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THE PHASE-OUT OF OLDSMOBILE - DEALERS FACE TAXING ISSUES

Oldsmobile dealers will soon be reaching an agreement with General Motors (GM) regarding the dollar amount they will receive from GM as consideration for the phase-out of the Oldsmobile franchise.

Now is the time to consider the phase-out's tax impact on dealers. Dealers will be receiving payments for what GM has called the "Transition Financial Assistance Package" or "TFAP". The phase-out will also have a significant impact on a dealer's LIFO reserves. The goal for the dealer and its advisors will be to minimize the tax consequences of the phase-out.

LIFO Recapture

For single-point dealers, the answer is simple, but painful. As your inventories diminish, so does your LIFO reserve. You will likely pay taxes of over 40% on your reserve. If you elect to defer your



Tax Tip



SALES TAX AUDITS ARE HEATING UP

As states search to find more revenue from local sources, look for sales tax audit activity to increase. When was the last time you reviewed your internal controls to make sure you are collecting the appropriate amount of sales tax on every transaction at the time of sale? Also, are you paying sales/use tax on purchases where applicable? Most states have statutes of limitations ranging up to four years. That means, if you have a \$25,000 exposure in one year, multiply it by four and you are looking at a \$100,000 assessment. There are also hefty penalties if the tax is not paid in a timely manner.

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termination of the franchise, then the LIFO recapture will occur gradually as your inventory levels decrease.

For multi-franchise dealers, the LIFO impact may be less severe. You will see a partial recapture of your LIFO reserve, since all inventories will remain except Oldsmobile. The effects of this will vary among dealers, therefore, we encourage you to have your CPA begin projecting the tax impact as soon as possible.

An option for dealers who own a group of dealerships would be to merge dealerships, into a single taxable entity, thus combining

your new vehicle inventories. The purpose would be to minimize or eliminate LIFO recapture.

The Transition Financial Assistance Package (TFAP)

Under the TFAP, dealers will receive two payments. One section of the agreement addresses the payment for the "repurchase" of dealers' new vehicle and parts inventories, essential tools, and signs. There will also be a second payment called the "TFA Amount". The TFA Amount is based on a form-

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ula established by GM that will uniformly apply to all dealers. Under this formula, most dealers will receive between \$1,695 and \$3,100 for each new Oldsmobile retailed within the dealership's best year of a three-year period from 1998-2000. The tax treatment of the TFA payment is the primary issue that dealers and their advisors must address.

The question to be answered is whether it is ordinary income or capital gains income. At the federal level the rate changes from 20% to 40%.

There are some fundamental differences that can arise for CPA's as they analyze this payment. Should they analyze each component of the formula separately or should they consider addressing the entire payment as one single item? The GM formula has several components including such items as transition assistance, facilities assistance and special circumstances allowances. Whether to look at each of these components individually or collectively is a debatable issue among CPAs.

Considered separately, there can be different tax results for each component. The difficulty with this approach is that each of the components are merely theoretical in nature and do not relate to any specific asset. This may result in classifying the items as ordinary income giving some flexibility to treat facilities assistance as a reduction in

Quick Check

IS IT FINALLY TIME TO CONTROL YOUR ADVERTISING BUDGET?

Controlling expense during 2001 will be one of the key factors in maintaining profitability. A major expense that never seems to get a hard look is advertising. Maybe now is the time to budget advertising, limiting it to a percentage of gross profit. Advertising dollars spent above the saturation point are dollars wasted. Save these excess dollars and they will fall to the bottom line.

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the basis of leasehold improvements. This component analysis may be rather ambiguous and provide fewer options for minimizing your taxes.

If you treat this payment as a single item, here are a few IRS code sections that may be appropriate to apply to this transaction. *(Remember, each dealer's facts and circumstances may vary, so these strategies will not apply to everyone).*

IRS regulations in code Section 1241 state that amounts received for the cancellation of a distributor's agreement will be considered a capital gain. Some practitioners cautiously apply this code section since it has

only been applied in a very limited number of situations. It has been, however, referred to in a case involving a GM franchise in the past, but as usual, there are minor variations in the fact patterns.

IRS code Section 1253 may also be applicable to the TFA payments. This code section states that a transfer of a franchise may qualify as a sale or exchange, so long as the dealer relinquishes all significant power, rights and continuing interest with respect to the franchise. It is possible that the IRS will attempt to challenge the idea that there has been a "transfer" of the franchise. This strategy could be challenged by the IRS on the grounds that the franchise ceased to exist and a "transfer" did not take place.

If either of these regulations can be successfully applied to the tax characterization of the TFA amount, then dealers will be able to benefit from the favorable capital gain tax rates.

The "Blue" Sky is Falling

If your company is carrying goodwill as an asset on the books, perhaps the best solution is to treat this in two steps. First, write-off the full amount of goodwill remaining on the books, and claim an ordinary tax deduction at the highest tax rates. Secondly, using one of the strategies discussed earlier, report the TFA payment as a capital gain taxed at only 20%.

If you have goodwill on your

books resulting from a multi-franchise purchase that included Oldsmobile as only a part of the whole deal, then the answer is less clear. The regulations indicate that separating out an amount of goodwill as being allocable to Oldsmobile will not be permissible unless it was identified as a component of your acquisition in the purchase agreement. The regulations disallow any losses in this circumstance.

C-Corporations

Dealers in a C-Corporation should examine the possibility of receiving the payment personally to escape double taxation at the corporate level. The GM agreement has included the option for the dealers to receive the TFA directly if they so choose. If you opt this treatment, the payment will not go through the company and may avoid being taxed twice.

Determining the tax treatment of the TFA payments will be a complex issue. Dealers and their advisors should begin forming a strategy that can minimize taxes. Starting now is the best advice of all.

For a complete analysis of your particular facts and circumstances, contact your local Auto Team America representative.

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