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## 2005 REVIEW OF IRS ISSUES FOR AUTOMOTIVE DEALERS

As we begin a new year, it's important to review the IRS issues affecting automotive dealers. There are eight IRS examination issues car dealers should know about:

**Demos.** The IRS issued new rules three years ago that included the Simplified Method for Partial Exclusion of Demonstrator Automobiles as a safe-harbor method. According to a survey by NADA, many dealers have not implemented these new rules. Make sure you are using the best and proper methods for your dealership. Remember, if the IRS doesn't like your demo methods, it's you, the dealer that pays the additional tax,

interest and penalties—not the employees who are driving the cars. Generally, dealers will want to use the partial exclusion method for full-time salespeople and the full inclusion method for most other vehicles.

**Form 8300.** This year we have seen many IRS 8300 examinations with big penalties. It used to be that the IRS assessed the \$25,000 penalty on the first audit. Now, the IRS seems to have a policy that the \$25,000 penalty is assessed on every Form 8300 violation. The dealers hit in 2004 thought they were satisfactory until the IRS came in and took a closer look. Now is a good time to do a self-audit and schedule

employee training. Your computer system may be able to identify required filings for you, but make sure customer payments are being coded properly. Also, ensure that substitute employees who handle cash know what they are doing.

**PORCs.** The good news is that the IRS doesn't think that all producer owned reinsurance companies (PORCs) are bad anymore. You no longer have to tell the IRS about your PORC. But don't overlook the five abuses the IRS still looks for: over/under capitalization (e.g. using a PORC to shelter investment income); over

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## IRS ISSUES AUTOMOTIVE ALERT: ELECTRONIC RECORDS RETENTION REQUIREMENTS AFFECT DEALERSHIPS

On January 12, 2005, the IRS issued an *Automotive Alert* relating to Revenue Procedure (Rev. Proc.) 98-25, *Electronic Records Retention Requirements*. Rev. Proc. 98-25 is not specific to dealerships, but it applies to any taxpayer with at least \$10

million in assets.

Rev. Proc. 98-25 is not something new. In fact, it has been around since 1998. The Rev. Proc. was designed to require large taxpayers to maintain their records in an electronic format

that is capable of being processed; can be retrieved, manipulated and printed; and contains sufficient transaction level detail. The motive behind the Rev. Proc. was to make it easier for the IRS to perform audits of large companies.

In addition to the record maintenance, affected taxpayers must provide the necessary resources to process the records. This includes the hardware, software, terminal access, computer time, and personnel.

Historically, auto dealerships

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submits (i.e. diverting commission income to other entities); significant loans to related parties; non-performing related party loans; and ownership of personal use assets in the PORC. Also, new legislation in 2004 makes it harder for a PORC to qualify as tax-exempt.

**LIFO.** Dealers should be using the Alternative Method for new vehicles. While the new items can reduce the LIFO benefit, ensure that they are properly screened. In recent IRS exams, we convinced the IRS there were some vehicles they identified as *new items* that the IRS removed from their list after further consideration.

**Computerized records.** The IRS is focusing on computerized records that the dealer must maintain for an IRS examination. While the IRS has not assessed any financial penalties for non-compliance, they could issue an *inadequate records notice* that could be a problem for publicly held consolidators and dealers in the process of negotiating loans. It might be just one more thing that you won't want to have to explain to your lender. Be aware of the need to access old records

after you have upgraded your computer system or changed vendors. If necessary, have your records saved to a flat-ASCII file, which the IRS accepts.

**Extended service contracts.** Make sure your tax advisor knows what kind of contracts you are selling and is well versed in the required IRS treatment. It has been some time now since the rules came out, so a person new to dealership tax rules might not know how to apply them properly to dealer obligor or third party obligor contracts.

**Tool plans.** The IRS is going to issue a ruling in 2005 on tool plans, so be on the lookout for changes to how they can be used. In the meantime, it is very doubtful any existing tool plan will pass IRS scrutiny. This is because of the current IRS position on the *recharacterization rule*. Check out how this rule prevents dealers from getting the tax benefits they hope for before signing up for any plan.

**Fifth-wheel truck excise tax.** This is another tax trap for the unwary. The IRS position is that any truck configured with the primary purpose of towing a trailer is subject to the 12% Federal Excise Tax. What sense does it make to sell a

## TAX TIP

### WILL YOUR COST SEGREGATION STUDY HOLD UP?

Cost segregation studies are on the radar screen of the IRS. Because of this, it is absolutely necessary to be assured that your cost segregation study be performed by a qualified professional.

The IRS predicts that the use of cost segregation studies will continue to increase because of the significant tax benefits that can be derived from reclassifying costs to the personal property category from the building category. In response to that prediction, the IRS issued a 115-page *Cost Segregation Audit Guide* in April 2004. The purpose of the guide is to assist their examiners to develop an understanding of:

- *Why* cost segregation studies are performed for federal income tax purposes.
- *How* cost segregation studies are performed.
- *What* agents should look for in reviewing or examining a cost segregation study.

When examining a cost segregation study, the IRS says it is looking for a "quality" study. They define a quality study as one that is accurate and well documented. Clearly, the IRS will be looking at who performed the service as much as what the study accomplished.

Contact your Auto Team America member firm for an explanation of their approach to cost segregation studies to ensure IRS acceptance.

truck with a \$1,500 gross only to find out later that you owe \$6,000 excise tax that you were supposed to collect from the customer? This rule applies even if the truck is always used for pleasure, such as pulling a recreational vehicle or horse

trailer.

Auto Team America is committed to updating dealers with IRS and tax issues. For more information on any of these issues, contact your local Auto Team America firm.

## QUICK CHECK

Start out 2005 on the right foot. Randomly audit your Information Security Program for any risks of exposing confidential customer information.

Check the copier and fax areas, printers, trash cans, and desks. What types of customer information do you see?

Contact your local Auto Team America firm for assistance in implementing or auditing your dealership's Information Security Program.

*Records continued from page 1* have found it very difficult to comply with this Rev. Proc.—primarily because they are forced by the manufacturers to use computer systems that are compatible with the manufacturer's requirements. Consequently, the software programs were not designed with the concern of making an IRS audit easier. However, the IRS Computer Audit Specialists have been working with the major software vendors to make them aware of the requirements that you have for compliance.

Included in the alert was the

*Generic List of Computer Files Necessary for Most IRS Examinations.* The IRS suggests that you check with your software vendor to determine if they have updated their software sufficiently to be

considered in compliance should the IRS come calling.

If you have questions about Rev. Proc. 98-25, contact your Auto Team America member firm for more information.



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