12th Annual CFO/CEO Forum

12th ANNUAL AUTO TEAM AMERICA CFO/CEO FORUM A WINNER

Auto Team America held their 12th annual CFO/CEO forum on Friday, February 10, 2006, in Orlando, Florida, just prior to the beginning of the NADA convention. The forum was a major success as several hundred attendees enjoyed the interesting, candid and heartfelt words of this year's speakers. Attendees included dealers, managers, controllers and related industry associates involved in dealership business management.

The featured speakers were **Malcolm Bricklin**, **Michael Bruynesteyn**, and **Lou Holtz**.

Malcolm Bricklin, Visionary Vehicles, offered a tremendous presentation about his past and current involvement in bringing the Chery Motors automobile from China to the USA. Mr. Bricklin has enthusiastically come back from China with a new automotive vision. Malcolm Bricklin's Visionary Vehicles intends to pioneer the Chinese auto-import industry through a deal with Chery Motors and hopes to have vehicles on the roads of America in the next few years.

Michael Bruynesteyn, Senior Vice President and Senior Autos & Auto Parts Analyst at Prudential Equity Group, provided a remarkable amount of current, valuable information to the dealership community on the automotive industry. Michael kept everyone on the edge of their seats with his forecasts regarding the various manufacturers and relationships between the economy, demographics and the factories.

Lou Holtz is currently an ESPN Analyst for the network's college football coverage. Coach Holtz was phenomenal and inspiring. He had a number of basic ideas that can be used by businesses to help them succeed. He views professional success as the driver to one's character and integrity. These are just a few thoughts and questions that Coach shared with us:

- Are individuals all willing to sacrifice for the good of the team?
- You need to stay focused on the team's mission and vision.
- It is important not to *maintain*. You should always try to improve and move forward.
- You need to concentrate on the teamwork needed to succeed and have quality players on the team who possess character and integrity.

Auto Team America was pleased with the content and astounding turnout at the 12th annual CFO/CEO forum, as well as the positive feedback from this year's attendees. If you have any questions about any of the topics discussed at the forum, contact your local ATA firm.

THE END OF REBATES: HOW YOUR DEALERSHIP MIGHT BE AFFECTED

2006 may be shaping up to be a disastrous year for new car dealers on LIFO. Ford and GM have announced plans to drop rebate programs and lower the base price of their vehicles accordingly.

In theory, consumers won't see a change in their bottom-line cost, so the effects of such a move aren't getting much press. Some sales professionals think it will be psychologically harder to sell a cheaper car with no rebate than a higher-priced car with a rebate that brings the consumer cost back to the same point.

The real difference comes for the dealer using LIFO, the last-in, first-out method of inventory valuation that has historically saved dealers hundreds of thousands of tax dollars.

Dealers normally use a unit-identification costing method when preparing their factory financial statements. Under this

*(see **LIFO** on page 2)*

(*LIFO continued from page 1*)
method, the dealer's actual cost of the specific vehicle sold is matched to the selling price to determine gross profit and net income for the month. Dealers on LIFO convert this costing method to a theoretical last-in, first-out costing model by recording *LIFO Expense* on their December income statement and a *LIFO Reserve* on the balance sheet. Under the LIFO costing model, the most recent inventory purchases (2006 model year vehicles at 12/31/05) are used to calculate cost of goods sold on the tax return, leaving the earliest purchases for the year in inventory. After several years on LIFO, the effect is a series of inventory layers, with the oldest layers representing the cost of inventory a decade or more ago. The LIFO model is effective at saving tax dollars only when the cost of inventory is increasing.

The plans to cut rebates and prices cut to the heart of LIFO. When prices are decreasing, the LIFO model matches the new cheap inventory costs to sales, increasing gross profits and net income, and pushing the older, more expensive inventory costs to inventory still on hand. This causes a recapture of those prior year LIFO benefits and in some circumstances can actually result in the recapture of more benefit than was originally received. After a couple of years of weak profits, this artificial boosting of reported profits can be a cash-flow disaster.

It's a fact of LIFO that if prices go down, you will have some amount of income from the LIFO adjustment. However, the recapture that could be generated from the price cuts that would offset all the recent rebate programs is monstrous. Any dealer using LIFO on their new vehicle inventory needs to be concerned and needs to optimize his inventory level to minimize the recapture. Dealers with sizable amounts in recent inventory layers (representing a real growth in inventory on hand or a recent LIFO election) are more at risk than dealers with stable or declining inventories, but both will experience LIFO income.

So how big is big? Estimates run on four different dealerships yielded recapture of as little as 25% of the LIFO reserve to as much as 23 times the previous LIFO benefit. The key for a given dealer is how much the manufacturer actually reduces the base price for all the various rebate programs.

Saturn dealers need to be concerned with this right now, since GM started the price-cutting in earnest with the Saturn lineup in 2005. There have been some cuts made in other lines by several manufacturers, but not to the extent anticipated with the Ford and GM announcements.

There is a relief option for a dealer that would be required to pick up as much or more LIFO income than he has received in prior deductions. He can file an election to terminate his prior LIFO election and go back to the unit identification method. The election is automatic and has no user fee. It is filed with the original return for the year of election, as long as that return is filed by its due date (including extensions). The resulting income from termination of the election is taken into taxable income over four years. The disadvantage to terminating the LIFO election is that the dealer cannot re-elect LIFO for five years, including the year of change.

As mentioned above, the dealer with large recent layers in their LIFO inventory will get hurt the worst, because their reserve balance from those layers is the smallest. A dealer with an inventory that does not decrease in 2006 can expect to recapture the deflation percentage times his prior year inventory. For example a dealer with a $5,000,000 inventory that has 5% deflation can expect a recapture of $250,000. If his reserve is only $150,000, he's lost all his benefit plus he's picked up an additional $100,000 of excess LIFO income.

If you have questions regarding the impact these changes may have on your dealership, please contact your local ATA firm.

TAX TIP

WILL YOUR DISABILITY INSURANCE BENEFITS BE TAX-FREE?

Pre-tax vs. after-tax contributions. If disability insurance is provided to an employee under an employer benefit plan and is funded by after-tax contributions (premiums are included in the employee's Form W-2 as taxable income), then any disability benefits received under the plan are excludable from the employee's gross income. However, if the plan is funded by pre-tax contributions, then any disability benefits received under the plan are includable in the employee's gross income.

Both employee and employer contributions. The calculations get complicated when both employer and employee after-tax contributions are made. They vary based on whether the disability plan is self-insured or insured under a group or individual policies.

For individual policies purchased with both employer and employee contributions, the taxable portion of benefits is determined by the ratio of premiums paid by the employer to total premiums for the current policy year.

For group policies purchased with both employer and employee contributions, the taxable portion of benefits for the calendar year is determined by the ratio of premiums paid by the employer to total net premiums for the three most recent years for which net premiums are known at the beginning of the year. This *lookback rule* can cause benefits to be taxable if the employer has paid premiums in the past, even if the employee paid all premiums in the year benefits are received.

Plans that allow employees to annually elect whether disability insurance is paid with employer funds are not subject to the lookback rule. If an employee becomes disabled in a year when he has elected to have the coverage paid with his funds, any resulting benefits are tax-free. Any benefits attributable to a disability that occurs in a year the employee has elected to have the coverage paid by the employer are fully taxable.

Strategy. Following two simple rules will ensure that disability insurance benefit payments are received tax-free. First, have the covered individual make the premium payments themselves with after-tax dollars. Second, if the employer has paid all or a portion of the group policy premiums in the past and an existing plan is modified, make sure the lookback rule is avoided by obtaining coverage under an individual policy. If that's not possible, have the covered employee irrevocably elect to pay 100% of the premiums before the start of the year. The downside to these strategies; they require premiums to be paid with after-tax dollars. If you would like more information regarding disability benefit taxation, please contact your local ATA firm.