HOW TO DETERMINE IF THERE IS FRAUD IN YOUR DEALERSHIP

The "F" word that no business owner likes to think about is fraud. Can we say with certainty that it is happening at your dealership? Not with certainty, but we can say it with a high probability. The simple truth is that employee dishonesty is happening with greater frequency throughout the country.

Fraud, in particular identity theft, has reached an almost epidemic level in the United States. It is so rampant that the government has put regulations in place to attempt to safeguard customer information. By now you have all put your Safeguarding policy in place, have tested it, and are making corrections and adjustments as necessary to ensure your compliance with the Gramm-Leach-Bliley Act, right? If you haven't, you need to, and sooner rather than later.

Over and above safeguarding customer information, dealerships are at tremendous risk for fraud being perpetrated against them. You have millions of dollars of inventory that is designed to be driven away from your dealership. You have hundreds of thousands of dollars worth of parts inventory that can find its way out the back door. You deal in thousands of dollars of cash on a daily basis that from time to time can be diverted into an account or a pocket other than yours. You have thousands of dollars worth of computer equipment in your dealerships.

*(See **Fraud** on page 2)*

HOW CAN AN ESOP BENEFIT YOU & YOUR BUSINESS?

WHAT IS AN ESOP?

An employee stock ownership plan (ESOP) is a defined contribution plan and is subject to the general rules of ERISA that govern all qualified plans (like profit sharing and 401(k) plans). ESOPs are unique because they are designed to invest primarily in employer stock and they offer special tax advantages.

A *leveraged ESOP* is an ESOP that borrows money to acquire employer stock. A simple leveraged ESOP transaction works as follows:

- ABC Company establishes an ESOP.
- The ESOP agrees to buy company stock paying *no more* than its fair market value.
- ABC borrows money from a third-party lender and, in turn, loans the money to the ESOP. The ESOP uses the proceeds to purchase the stock.
- Annually, ABC makes tax-deductible contributions to the ESOP. The ESOP pays the contributions back to ABC in the form of a loan repayment. When ABC receives these loan payments, it repays the third-party lender.
- As the debt is amortized, the stock in the ESOP is allocated to individual employees' accounts.

***Benefits to the Owner*:**
A key advantage of an ESOP is flexibility. The owner can sell as much or as little of the stock as they desire. The benefits to the owner can generally be classified into four areas:

- Tax savings
- Control of the business
- Confidentiality
- Price

Tax Savings: By selling to an ESOP, the owner can receive the sale proceeds on a tax-deferred or tax-free basis, provided that the ESOP holds at least 30% of the company's stock after the sale. Taxes are not assessed on the sale proceeds as long as they are reinvested in qualified

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The list of assets that you own that are susceptible to theft goes on and on.

What have you done to protect them? Do you require background checks on all new employees? Are your employees that handle cash bonded? Do employees other than those responsible for selling your inventory verify its existence at least monthly? Does someone other than an authorized check signer reconcile your cash accounts? Have you password protected all of your computer files, and limited access only to those with a *need to know*?

In short, are your internal controls adequate to ensure the safekeeping of your assets? Regardless of how good you think they are there is probably room for improvement. At the very least, you should be reviewing and testing your internal controls on a regular basis.

If you have concerns that your controls are not as good as you would like them to be, or if you would just like to have additional information concerning this topic, please talk to your Auto Team America representative to find out how we can help.

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replacement securities (certain domestic stocks and bonds). The owner is taxed only upon the subsequent sale of the qualified replacement property. If the securities are held until the seller's death, there is no tax, since the heirs will benefit from a step up in basis. A strategy exists that will allow the owner to invest the sale proceeds in assets other than qualified replacement securities while permanently avoiding taxes on the sale proceeds.

In order to receive this special tax deferred treatment, the company must be a C corporation at the time of the sale. Since many dealerships are S corporations, the company will want to change to C corporation status prior to the transaction.

Finally, ESOPs can also be used to supplement charitable and other gifts strategies, while reducing gift and estate taxes.

Business Control: Generally, the ESOP trustee, not the ESOP participants, votes the ESOP shares. If an ESOP is properly structured, the owner can remain active in the business as long as the owner desires, while retaining effective control of the business -- even if the ESOP owns more than 50% of the stock.

Confidentiality: As compared with Initial Public Offerings (IPO), and sales of stock or assets to an outside buyer, a leveraged ESOP transaction is an *internal* transaction that can be accomplished confidentially during the investigation and implementation phases.

Price: Depending on location and type of franchises owned, it might be difficult for a dealership owner to find a buyer. In those cases, an ESOP may be the only buyer willing to pay fair market value. The ESOP must pay *no more* than fair market value for the company stock.

Benefits to the Company: Dollars contributed to the ESOP that are used to repay the loan to an ESOP generate a tax deduction equal to the interest *and* principal paid on the loan. Because both interest *and* principal are deductible in a leveraged ESOP transaction, ESOPs may be used to raise purchase capital on a more cost-efficient basis.

If the company elects S corporation status, the earnings on the shares held by the ESOP are tax-free for federal income tax purpose, since the ESOP is a tax-exempt entity.

Finally, one intangible benefit of an ESOP is that, according to research, ESOP companies are more profitable than comparable non-ESOP companies.

Benefits to Employees: ESOPs provide a means for rewarding employees who have promoted the employer's success, resulting in employees having substantially increased retirement plan benefits through the ESOP. ESOPs can also be used as one component of a management buyout strategy.

In summary, dealers have unique concerns that must be carefully considered when contemplating an ESOP transaction. For example, many dealerships are S corporations and would need to become C corporations before the transaction. Additionally, dealers must obtain the approval of manufacturers to complete the transaction.

If you have any more questions regarding ESOPs and how they can be beneficial to your business or dealership, please contact your local ATA member firm.

TAX TIP

APPLYING FOR MEDICARE BENEFITS

Medicare is a national health insurance program for persons age 65 and older, certain disabled persons and persons of any age with permanent kidney failure.

Medicare consists of two programs:

Part A – Hospital Insurance. For most Medicare beneficiaries, there are no premiums for Medicare Part A.

Part B – Medical Insurance. Monthly premium of $88.50 for 2006.

The sign-up period for Medicare Part B lasts seven months. It begins three months before the 65th birthday, includes the birthday month and ends three months after the 65th birthday. If not enrolled during initial enrollment, another opportunity is given each year from January 1st through March 31st, with coverage beginning the following July 31st. Anyone not enrolling in Medicare Part B when eligible will pay a penalty to enroll later. The penalty is an increase in premiums of 10% for each year eligible and not enrolled.

Medicare Drug Options:

Medicare Part D is a new federal outpatient prescription-drug-benefit insurance program that became available Jan 1, 2006. It is a voluntary benefit offered through private companies only to people with Medicare coverage. Part D is available to anyone with Medicare who is entitled to Part A (hospitalization) or is enrolled in Part B (medical insurance) and lives in the service area of the plan.

For those who wanted coverage to begin on Jan.1, 2006, enrollment opened Nov. 15, 2005, and closed Dec. 31, 2005. Enrollment re-opened on Jan. 1, and will close again on May 15, 2006. If elected during this open enrollment, period coverage will begin on the first of the month following enrollment.

The strategy is to join when one first becomes eligible in order to pay the lowest monthly premium. A penalty of 1% per month for every month a participant waits to join will be accumulated and will apply indefinitely, i.e. wait 7 months to enroll, add 7% to your premium – for life!

Premiums will average $32 per month in 2006.