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FOUR TAX STRATEGIES FOR 2004

Auto dealers constantly struggle with maximizing profit and minimizing taxes. With continuous changes and complex tax laws, it is becoming more difficult to keep up with the latest tax deferral opportunities. You may want to consider the following four concepts to reduce 2003 taxable income:

Cost segregation is the allocation of commercial building construction or additions to proper depreciation lives for tax purposes. Buildings are typically depreciated over 39 years. Many components of a building can be depreciated over a shorter period. This allows a quicker and higher write-off for tax purposes, thus reducing taxes.

The savings to a dealer include accelerated depreciation deductions. On a $1 million improvement to the dealership facility, the present value of the tax savings is typically $75,000 to $100,000. New bonus depreciation rules on buildings placed in service after September 11, 2001, will increase the tax savings.

The IRS has established strict rules and procedures to be eligible for shorter depreciation life. A cost segregation report needs to be prepared to support the allocation of cost for tax depreciation purposes in the year of construction. Cost segregation studies can also be made on pre-owned facilities as well as on facilities placed in service in prior tax years.

LIFO inventory valuation allows for a deduction that represents the increase in inflation in your inventory. This deduction is not recognized again as income until total inventory is liquidated upon sale of the dealership.

A typical LIFO deduction for new vehicle inventory of $2 million at an inflation rate of 2 percent would be $40,000. The benefit is compounded on an annual basis.

Interest credits received from the factory are typically recognized as income as soon as they are received. Interest credit payments are the same no matter how long a dealer holds a vehicle in inventory. These interest credits may represent payments for vehicles still in inventory at year-end. In essence, the dealer has overstated its taxable income for the year.

You can elect to defer the interest credits related to the vehicles remaining in inventory. For example, if your dealership averaged interest credits of $300 per vehicle and the dealership had 500 vehicles in ending inventory, the potential reduction of taxable income would be $150,000 for the year.

If you choose to reduce taxable income through cost segregation, LIFO inventory valuation, or interest credits received from the factory, the IRS automatically approves these changes. In order to take advantage of these tax deferrals, dealers still have to file with the IRS to change their method of accounting for these items on a timely filed tax return.

Advertising for new vehicles in the media may be paid by an auto dealer, the manufacturer, or an area advertising association. The manufacturers may establish a minimum assessment—e.g. 1% of the MSRP—that may be included in the base price of the vehicle or shown as a separate charge on the invoice. Because these advertising assessments are made on the vehicle invoice, many dealers include the assessments as a part of the inventory cost of the vehicle. The assessments are then

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deducted when the vehicle is sold. However, since the assessments are for advertising and not part of the cost of the vehicle, they may be treated as an expense. This applies to local and regional advertising only.

Dealers who have been treating these assessments as inventory cost may file a Form 3115 to obtain consent from the Commissioner to change the method of accounting to expense the assessments.

Each year, many auto dealers miss out on allowable deductions and end up paying too much in taxes. With some basic information about your dealership, an Auto Team America firm member will help you understand how much you can save by implementing these tax deferral concepts.

CUSTOMERS PURCHASING HYBRIDS TAKE ADVANTAGE OF TAX DEDUCTIONS

The original purchaser of a qualifying hybrid gas electric car may deduct $2,000 on their tax return for the year the vehicle is first used.

Under current law, the clean-burning fuel deduction will be reduced incrementally until it expires beginning in 2007. Purchasers of IRS-certified cars will be able to claim a deduction of $2,000 if the vehicle is placed in service on or before Dec. 31, 2003. The $2,000 maximum deduction will be reduced by 25 percent for vehicles placed into service in 2004, by 50 percent in 2005 and by 75 percent in 2006. No deduction will be allowed for vehicles placed in service after Dec. 31, 2006.

Individuals take this benefit as an adjustment to income on their Form 1040. They do not have to itemize deductions on their tax returns to claim it. To claim the deduction, write "clean fuel" on Line 33 of the 2003 Form 1040. Also, see the Instructions for Form 1040.

The IRS previously certified the Toyota Prius for model years 2001, 2002 and 2003; the Honda Insight for model years 2000, 2001 and 2002; and the Honda Civic Hybrid for model year 2003.

PLANNING OPPORTUNITY FOR CERTAIN C AND S CORPORATIONS

With the passage of the Jobs and Growth Tax Relief Reconciliation Act of 2003, planning opportunity exists for certain C Corporations and S Corporations that have accumulated earnings and profits (E&P) from their years while operating as a C Corporation.

C Corporations with E&P in excess of $250,000 are subject to a penalty where there is no valid reason for the accumulation of the E&P. The IRS effectively forces these corporations to pay out dividends to their shareholders.

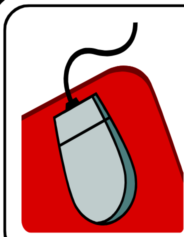
S Corporations with accumulated E&P face the danger of losing their S Corporation status (under certain conditions) or making taxable distributions as a result of tapping into this layer of corporate earnings.

Since dividends you receive in 2003 from a domestic corporation are taxed at 15%, this might be a good time to take a dividend distribution and eliminate your corporation's E&P.

DEDUCTING SUVs AS QUALIFIED PROPERTY

A current tax rule permits small business owners to deduct up to $100,000 in qualified property used in their trade or business. Qualifying property includes SUVs with a gross vehicle weight in excess of 6,000 pounds. Models such as Cadillac Escalade, Lincoln Navigator, Chevrolet Suburban, Dodge Durango and Ford Expedition would qualify for this favorable treatment.

While dealers are promoting this feature of the tax law as a way to sell the high priced SUVs, there is currently a bill in Congress trying to close this loophole. The bill submitted on February 12, 2003, and titled "SUV Business Tax Loophole Closure Act", will amend the Internal Revenue Code to include sport utility vehicles in the limitation on the depreciation of certain luxury automobiles. The new bill places a 14,000-pound weight limitation on SUVs before business owners will benefit from this special deduction.



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QUICK CHECK

Have a problem keeping insurance cards with drivers during dealer trades, demos, loaners and company vehicles?

Laminate a copy of your dealership's insurance card to the back of the dealer or registered license plate to make sure there is always one with the vehicle. This provides an easy solution to locating insurance information if the dealership vehicle is involved in an accident.

IRS CALLS PORCs TAX SHELTERS

In a surprise move, the IRS announced that producer owned reinsurance companies (PORCs) for credit-life insurance and extended service contracts are "listed transactions." This means they are subject to registration and tax reporting requirements and penalties on the promoters, participants and preparers.

After many years of allowing PORCs and other dealership related insurance companies, the IRS is now saying that arrangements with PORCs and "substantially similar transactions" may not qualify for the tax benefits previously approved by the IRS.

Right now there are more questions than answers. We hope the IRS will provide some guidance as to where it sees the abuse and which dealership companies should be making the required tax return disclosures. With the tax-filing season on us, more information is needed sooner rather than later.