SEPTEMBER/OCTOBER 2013

DEALER INSIGHTS

Estate planning

In trusts, we often trust

Be an early bird
Prepare for your 2013 financial statements and tax strategies

4 tips for turning around factory mistakes

Dealer Digest

Estate planning

In trusts, we often trust

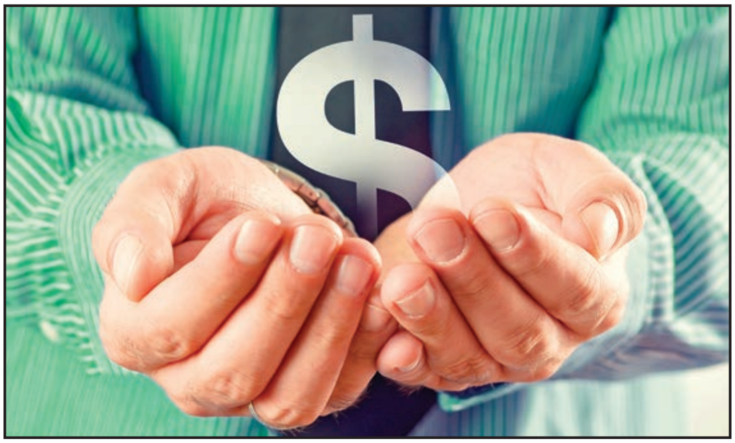
Dealership owners set up trusts to protect their assets from a variety of threats, transfer their wealth to their heirs and reduce tax liability. Different kinds of trusts serve different purposes.

To name just a few, there are simple/complex and grantor trusts; special trusts to hold S corporation stock; split-interest trusts (multiple parts); dynastic trusts; term certain trusts; and income vs. total return trusts. But all of these break down into two basic types: revocable, which can be revised, and irrevocable, which generally can't be revised.

Living with a revocable trust

The principal purpose of a revocable trust, also known as a *living trust*, is to avoid probate, a potentially lengthy, public and expensive process. A living trust allows you to:

- ❑ Manage your assets during your life as if you still owned them outright — you become the trust's trustee, and
- ❑ Select a trustee who will manage all trust assets immediately after your death until they're distributed.



The trustee can also manage your assets during your life should you become incapacitated and unable to do so. Your trustee can be an institution (a bank, for example) or an individual (such as a family member, close friend or trusted advisor). Special tax-saving clauses also can be drafted into your revocable trust, which becomes an irrevocable trust, and serves to dispose of your assets at death.

Saving taxes with an irrevocable trust

Trusts with the most tax advantages are typically irrevocable. They can provide significant tax savings while preserving *some* control over what happens to the transferred assets. There are many examples, including:

Credit shelter (or bypass) trusts. These can help minimize estate tax by taking advantage of both spouses' estate tax exemptions.

Qualified terminable interest property trusts. This trust type can benefit first a surviving spouse and then children from a previous marriage. Like the credit shelter trust, it can be set up during your lifetime or at death by your revocable trust or will.

Qualified personal residence trusts. These allow you to give your home to your children today. By doing so, you remove it from your taxable estate at a reduced tax cost (provided you survive the trust's term) while retaining the right to live in it for a certain period.

Grantor retained annuity trusts. A business owner can put assets in this trust and transfer the growth on those assets out of his or her estate tax-free.

Generation-skipping transfer (GST) or "dynasty" trusts. This trust type can help you leverage both your gift and GST tax exemptions and potentially lock in the currently high exemptions.

You can supercharge the benefits of many of these trusts by making them "grantor" trusts for income tax purposes. This increases the effectiveness of the trust benefits in transferring wealth to your heirs.

Giving to charity

If you want to benefit a charity while retaining an income stream yourself and diversifying your portfolio in a tax-advantaged way, consider a charitable remainder trust (CRT). You fund a CRT (also an irrevocable trust) with appreciated assets, which it can then sell tax-free and reinvest.

For a given term, the CRT pays an amount to you annually. You'll owe tax when you receive the payments. But because of a special income distribution mechanism that identifies the character of the income taxable in the payments to you, much of the liability on the capital gain will be deferred.

At the term's end, the CRT's remaining assets pass to one or more charities. When you fund the CRT, you receive an income tax charitable deduction for the present value of the amount that will go to charity, and the property is removed from your estate.

Another vehicle, a charitable lead trust (CLT), lets you benefit charity while transferring assets to loved ones at a reduced tax cost. You transfer assets to the CLT and, for a given term, the CLT pays an amount to one or more charities. At the term's end, the CLT's remaining assets pass to one or more of your "remainder beneficiaries."

When you fund the CLT, you make a taxable gift equal to the present value of the amount that will go to the remainder beneficiaries. As with the CRT, the property is removed from your estate.

Seeking advice

Trusts vary in their tax advantages and have other pros and cons. Ask your tax advisor which type would work best for you. ■

Look ahead with a spendthrift clause

When setting up a trust, you can take steps to protect your heirs from wasteful spending. A spendthrift clause sets up rules for distributing funds to the trust beneficiaries. For example, you could stipulate that each heir receive $5,000 per year until funds in the trust are depleted. Or you could arrange that your children receive $2,000 per year from the trust until they turn 30, and then get the balance of their trust money.

Spendthrift language also can protect your heirs from external threats, such as creditor claims, lawsuit settlements and life changes (such as divorce).

Be an early bird

Prepare for your 2013 financial statements and tax strategies

For dealerships on a calendar year, it's only a few months until year end financial statement and income tax planning will be here. Given the breadth of these documents and the complexity of changing tax laws, it's not too soon to start collecting the information you'll need and conferring with your CPA about strategies.

2013 tax considerations

Sizable tax incentives to buy fixed assets still exist in 2013. Under Section 179, you can immediately deduct up to $500,000 of new and used capital equipment purchases placed in service on or before Dec. 31, 2013. If you buy more than $2 million of equipment during the year, the Sec. 179 deduction begins to phase out dollar-for-dollar.

In 2013, bonus depreciation allows dealers to depreciate 50% of the cost of qualifying new assets placed in service before year end. There's no annual maximum or phaseout for bonus depreciation.

If you're thinking about replacing equipment or refreshing your signage, do it before Dec. 31 — as of this writing, the high 2013 Sec. 179 expensing limits and 50% bonus depreciation haven't been extended to 2014.

The fixed assets component

One of the most time-consuming parts of an audit or review is fixed assets. So, get your records together before your CPA arrives. Prepare a detailed listing of fixed asset purchases, new equipment loans, and retired or sold fixed assets. If old property will be replaced, consider a Section 1031 "like-kind" exchange to defer capital gains.

Establish a formal policy that considers the asset's value and useful life. You might, for instance, write off items that cost less than $100 or are likely to wear out within one year.

Look through the ledger for smaller items that were capitalized but could be expensed. For example, if you recorded a large order of tools as one combined fixed asset, consider reclassifying each individual item as a supply expense, not a fixed asset. Screwdrivers and wrenches aren't worth capitalizing.

Look for repairs that have been capitalized. Repairs should be expensed as long as they don't materially add value to a fixed asset, appreciably prolong an asset's life, or adapt an asset to a new or different use.

Last in, first out (LIFO) inventory method considerations

Book LIFO adjustments to cost of sales before year end, if possible. If you still have cars and trucks in separate LIFO pools, analyze whether it would be advantageous to combine them into one pool.

For inventory that's *not* on LIFO — parts, accessories and perhaps used cars — adjust to the lower of recorded cost or current wholesale value. Write off obsolete and damaged parts.

Donate or scrap write-offs before year end, if they can't be returned for credit.

Perform physical counts of miscellaneous inventory items, such as body shop materials, and adjust them to observed levels. Match work-in-process inventory to the amounts shown on your open repair orders and body shop tickets.

If owners or salespeople use demos, review IRS Revenue Procedure 2001-56 to determine the amount taxable to employees. There are a variety of methods you can use for demos. Ask your CPA which method is appropriate for your dealership.

The avoidance of adjustments

Adjusting journal entries (AJEs) muddy the waters when your CPA does his or her fieldwork. A long list of CPA-imposed changes could suggest that your CFO isn't doing his or her job — and cause owners, franchisors and lenders to wonder what else might have fallen through the cracks. Plus, the fewer discrepancies between your controller's year end statement and the CPA's audited (or reviewed) financial statement, the fewer questions your franchisors and lenders will ask.

Decide on the payments you want to make to owners before Dec. 31, such as salaries, bonuses, benefits and perks.

Review last year's list of AJEs and see which year end adjustments you can handle in-house. Consider making adjustments for bad debt write-offs; prepaid expenses; benefit plan contributions; and accruals for wages, commissions, interest and taxes. Generally, accruals should tie to the payments paid in the following month (January) or shortly thereafter.

Ask your CPA what book-to-tax adjustments were recorded last year. This will help you anticipate document requests and estimate probable tax adjustments. Book and tax income usually differ, sometimes quite markedly. So, don't make tax estimates based on pretax income shown on your income statement.

Owner transactions

Decide on the payments you want to make to owners before Dec. 31, such as salaries, bonuses, benefits and perks. Payments to owners, including interest on loans to S corporation shareholders or to C corporation shareholders (those owning more than 50% of the dealership's stock), will be deductible only if they're paid before year end. This includes expenses owed to related parties.

Also determine the appropriate tax treatment for retirement and insurance benefits paid to owners. S corporation, LLC and partnership owners may have to report these as taxable fringe benefits, rather than deduct them as an expense.

Under the wire

Year end comes quickly, but there's still time to take advantage of the tax incentives that remain in place for 2013. Weigh possible asset purchases against your income and anticipated year end profits. And don't fall behind by failing to pull together the information you'll need for your tax returns as well as your annual financial statement. ■

4 tips for turning around factory mistakes

When customers buy a new vehicle and discover a defect, they usually aren't happy campers. It doesn't matter if the flaw is the result of a mistake made at the factory — it's your doorstep that the customer will end up on, inconvenienced and possibly irate, expecting a satisfactory solution.

This is a pivotal point in the customer relationship. How you handle the situation might be the difference between saving — or even strengthening — the relationship and losing the customer for life. Here are four tips for turning around a bad situation to your advantage:

1. Be fast and reliable. Let your customer know that, though the problem isn't your dealership's fault, you'll do everything you can to resolve the difficulty quickly. If the matter is taking a while to resolve, keep the customer updated.

If a factory representative *must* handle the claim, become a facilitator. Set up the meeting between the customer and factory rep. Make sure that the customer has all the paperwork that's needed and knows what to expect from the process.

2. Be direct. Sometimes the problem will be the result of customer misuse or of not having followed manufacturer service recommendations. Be honest, but tactful, in letting customers know if the problem doesn't fall within warranty requirements.

While you want to satisfy your customer on all levels, you also represent the manufacturer. If you defend the factory in a reasonable manner, the customer may feel better informed about his or her vehicle and the situation at hand.

Let your customer know that you'll do everything you can to resolve the difficulty quickly.

3. Go the extra mile. Give the customer a ride home or arrange for a loaner if that would improve his or her experience. Also, if a pattern of factory mistakes emerges (for example, inside door handles on a particular model become loose after about six months), be proactive and have your service department check for such flaws when these vehicles are in the shop for routine checks. Spare your customers the inconvenience of coming in for a special visit.

4. Remember, it all matters. In years past, if a customer had a problem resolving a factory mistake, he or she might grumble about your dealership to family and a few friends. Today, online consumer reviews are so pervasive, and so easy to write, that word of your customer's misfortune might spread to thousands lickety-split. It's critical to handle all factory mistakes with care. ■

DEALER DIGEST

COSO issues new guidelines for strong internal controls

If you're looking to improve your dealership's internal controls to better guard against wrongdoing, check out new guidance finalized by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The guidance, issued May 14 after a two-and-a-half year COSO project, outlines 17 "principles" that COSO says companies need to follow for their internal controls to be effective. The updated *Internal Control — Integrated Framework* states that companies need to:

❏ Demonstrate commitment to integrity and ethical values,

❏ Identify and analyze risk,

❏ Exercise oversight responsibility, and

❏ Establish structure as well as authority and responsibility.

Your CPA can help you determine whether your internal controls need improvement and assist you in the project. ■

Movement to tax green car owners

A flurry of legislative activity is aimed at getting green car owners to pay annual taxes on their vehicles to support public highway maintenance. Supporters say such taxes will make up for the money states miss out on in taxes on gasoline when motorists drive fuel-efficient or electric cars. Gasoline taxes help fund the costs of road and bridge maintenance in many states.

One proposal is a bill introduced this year in Arizona that would impose a tax on electric cars of one cent per mile driven on the state's highways (estimated at about $130 annually per car). Other examples: In Washington state, electric car owners this year began paying a $100 annual fee. And in Virginia, a state senator recently proposed a $50 annual fee on electric and compressed natural-gas cars.

The question for dealers is whether such taxes could reduce demand for green vehicles. Keep an eye on any such legislation that could affect car buyers in your market. ■

Dealer charged in record identity theft case

A Missouri man faces 17 felony charges for his role in an alleged identity theft scam involving more than $1 million in fraudulent car loans and 44 victims. According to Missouri officials, a 25-year-old auto dealer used personal information he obtained from former and prospective customers at his car lot, and through online applications, to create fraudulent car loans. The man allegedly then sold the loans to automotive finance companies, who were unable to collect on the fake loans.

Although this instance involved a dealer, any dealership employee with access to customer data and loan application information could initiate a scam of this nature. Remember, customer information should be kept in a secured area with limited access. Review the Federal Trade Commission's "red flag" compliance guidelines to guard against identity theft. ■