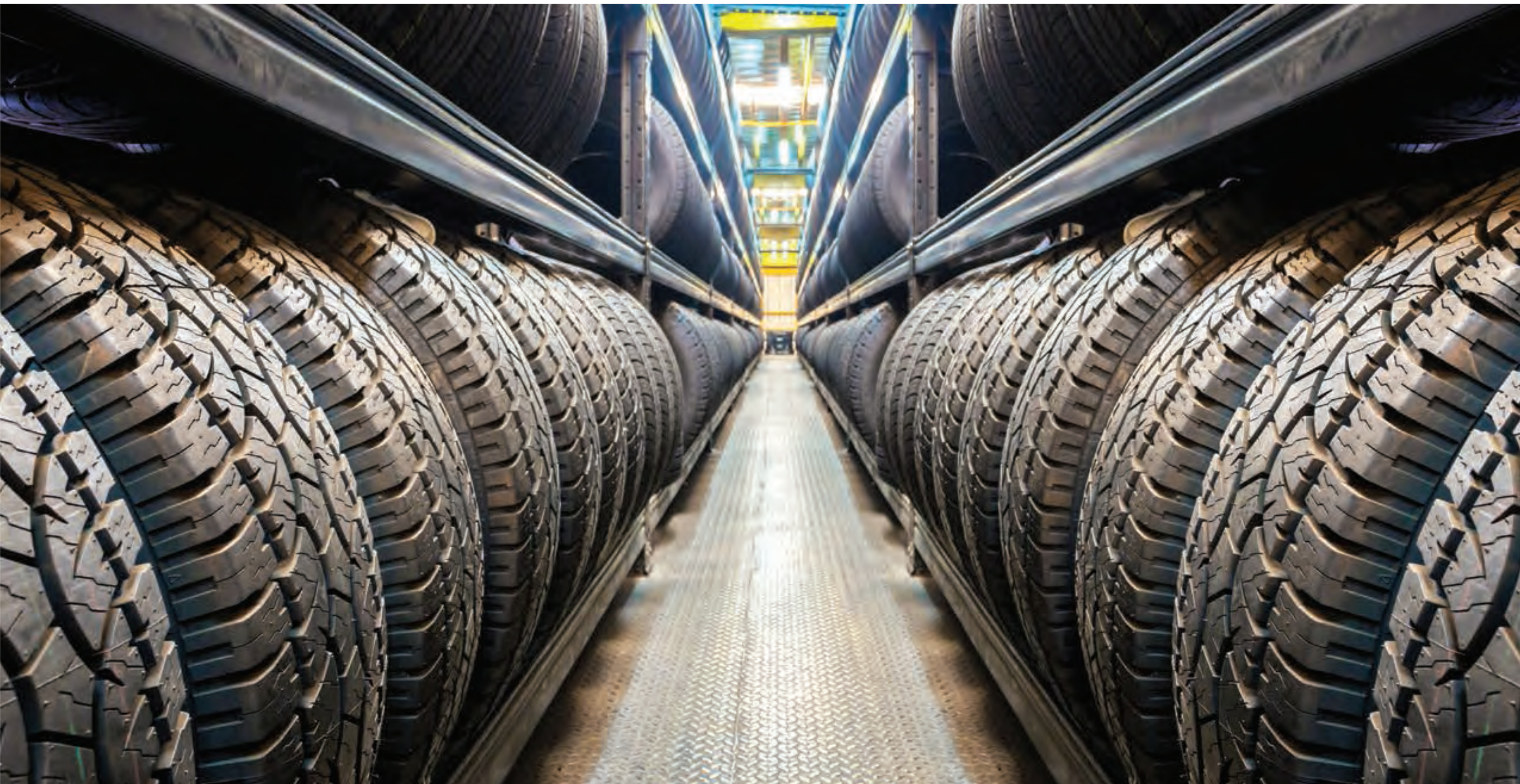
SEPTEMBER/OCTOBER 2016

Dealer Insights



Mind your P&Ps
Policies and procedures for Parts and Service

Saving tax dollars via cost segregation

Bad things happen
Take steps now to protect your dealership's assets

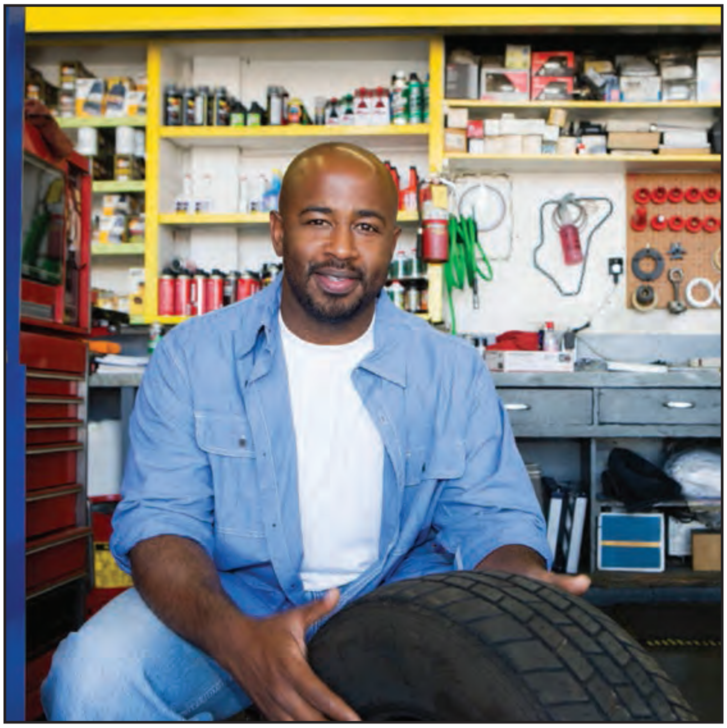
Valuable hiring tax credit extended through 2019

EISNERAMPER
ACCOUNTANTS & ADVISORS

Mind your P&Ps

Policies and procedures for Parts and Service

Successful businesses in any industry have standard policies and procedures (P&Ps) that formalize ways to perform certain tasks. Automobile dealerships are no exception.



Having established P&Ps is especially important in the Parts and Service department. Perhaps no other area of the dealership holds as much potential for high revenue and profits — or conversely, for waste, inefficiency and fraud.

Control your parts inventory

P&Ps are vital to reducing the opportunities for Parts and Service employees to commit fraud. In particular, policies and procedures that establish tight control over parts inventory are critical to helping prevent employee theft of parts and minimize shrinkage.

Create P&Ps for ordering, purchasing and receiving parts and entering them into your computer system. Then be sure to match purchase orders to the parts that are received. Also, assign different employees to order and receive parts and manage parts inventory so one employee can't manipulate the system in order to steal parts.

In addition, you should have an outside auditor conduct a parts inventory for you at least once a year. This inventory should count all the items on your parts shelves and compare this count to the data in your computer system.

Investigate any discrepancies that arise. And supplement your annual parts inventory with bin counts on at least a monthly basis, choosing bins randomly based on high-dollar or fast-moving parts categories.

Also set up procedures for closely monitoring open repair orders. Since parts go on repair orders, having numerous open repair orders raises the risk of employee theft. For example, a dishonest employee could create a fake repair order, place an expensive part (such as an alternator) on it and then walk away with the part. The only way to uncover this scheme is to periodically investigate open repair orders.

Finally, create policies designed to keep close tabs on obsolete parts in inventory — for example, by monitoring inventory aging and turnover and parts movement through your department. Consider returning some slow-moving parts to the manufacturer for credit or selling them wholesale.

Follow other tips

Here are some more policies and procedures that can help your Parts and Service department run more smoothly while reducing expenses and boosting profitability:

Promptly return and track core returns. Don't let core returns, whether they're small-ticket batteries or big-ticket transmissions, just sit around unaccounted for. Return them to the manufacturer in a timely manner and keep track of these returns in the general ledger.

Conduct an annual vendor expense review. At year end, review all of your vendor contracts, including pricing and terms. Contact each vendor and ask them for new quotes, letting them know you're looking at other options. And consider signing a long-term vendor contract in exchange for a lower price and better terms.

Check the credit of large corporate customers. If you perform service and repair work for corporate customers that maintain fleets of vehicles, run credit checks on them before extending credit and offering payment terms. Late payment (or nonpayment) by these customers could seriously jeopardize your cash flow.

Collect a deposit from customers for special orders. If you have to special order parts, consider collecting a deposit that's sufficient to pay the restocking fee you might be charged if the customer changes his or her mind about the repair and you have to return the part.

Is your service function running at peak efficiency?

Increasing productivity and efficiency is the key to boosting the profitability of your service function. Are there things you can do to streamline the workflow in your service area and make your technicians more efficient?

For example, some dealerships mount individual bins for each technician on the wall just inside the service area. Parts employees can then place repair orders and necessary parts in each technician's bin, reducing wait time at the back counter and preventing technicians from picking up the wrong repair order or part.

One industry benchmark is to strive for 92% technician productivity and 125% service and repair efficiency. In other words, technicians should spend at least 92% of their time on work that's billable to customers, and service and repair work should be completed in 75% of the allotted billable time. For example, a one-hour repair should be completed in 45 minutes.

Follow up with customers who decline repair orders. Sometimes customers have second thoughts about declining repair recommendations. Create a process for calling these customers within a day or two to ask them if they're sure they don't want to have the repair or service work performed.

Strategize your P&Ps

Your dealership could reap many benefits by establishing sound policies and procedures, such as deterring fraud, increasing efficiency and boosting profits. Meet with your managers to strategize which P&Ps make the most sense for your Parts and Service department.

Saving tax dollars via cost segregation

Early fall is a wise time to start planning year-end tax strategies for 2016. And one of the most effective tax-saving tactics for many dealerships is to perform a cost segregation study.

With cost segregation, the individual components in a facility are separated into different categories for depreciation purposes. Certain categories of assets have shorter depreciable lives and can thus be depreciated faster, lowering taxes.

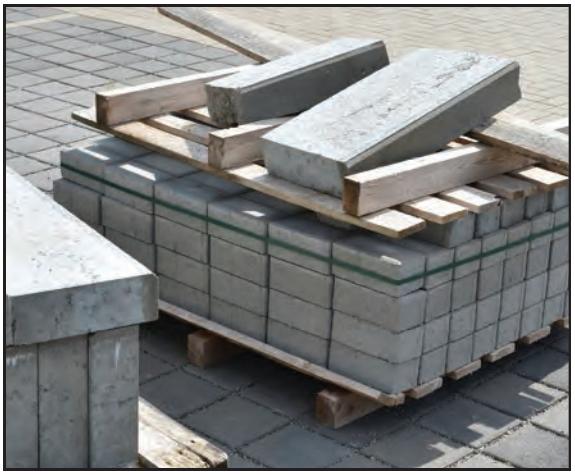
How does cost segregation work?

When calculating depreciation of commercial property, dealerships must use the correct method and cost recovery period for the type of property. Dealership property can be categorized as nonresidential income property, tangible personal property or land improvements.

Nonresidential income property must be depreciated on a straight-line basis over 39 years. But *tangible personal property* and *land improvements* can be depreciated over a shorter period: five or seven years (using double declining balance) for tangible personal property and 15 years (using 150% declining balance) for land improvements.

Unless a cost segregation study is performed, the different components in a facility are aggregated as nonresidential income property for depreciation purposes. In this scenario, the entire facility will have to be depreciated over 39 years.

A cost segregation study will provide a detailed analysis of the costs related to the construction, acquisition or remodeling of dealership facilities in order to reallocate some of them as tangible personal property or land improvements. These individual components can then be depreciated faster, resulting in larger tax deductions sooner — and this can improve cash flow and boost profitability.



There are a wide range of different components within a dealership that can usually be reallocated for depreciation purposes. Plumbing and electrical systems, carpeting, awnings and canopies, and parking lot paving are a few common examples of these types of components.

Where else can cost segregation be applied?

In addition to dealerships building, remodeling or purchasing new facilities, dealerships that own existing facilities also may be able to benefit from a cost segregation study.

Final tangible property regulations issued in 2013 permit certain repair and maintenance costs to be expensed and deducted immediately, while other costs must be capitalized and depreciated. A cost segregation study can identify which repair and maintenance expenditures may be expensed and deducted now, instead of being depreciated over a number of years.

The permanent extension of the increased Section 179 expensing limit of $500,000 and temporary extension of first-year bonus depreciation by the Protecting Americans from Tax Hikes (PATH) Act present another tax opportunity to use cost segregation.

Up to $500,000 of qualifying fixed-asset purchases, including some of the building components listed above, can now be expensed each year. You can also immediately expense and deduct 50% of the cost of certain types of new property purchased and placed in service in 2016 and 2017.

Performing a cost segregation study could enable you to maximize your bonus depreciation deduction this year. An example helps demonstrate how:

Suppose you are building a new facility at a total cost of $5 million and a cost segregation study reclassifies $1.5 million of this cost as tangible personal property that qualifies for accelerated depreciation. Claiming 50% bonus depreciation (or $750,000) on these expenses could save your dealership about $300,000.

Who should conduct the study?

A cost segregation study should be performed by an outside, independent firm. According to the IRS *Cost Segregation Audit Techniques Guide*, there are no prescribed qualifications for cost segregation preparers. The guide, however, states that a study conducted by a construction engineer would, all else being equal, be considered more reliable than one by someone without a construction background.

The guide further states that other important criteria include "experience in cost estimating and allocation, as well as knowledge of the applicable law." It adds: "A quality study identifies the preparer and always references his/her credentials, experience and expertise in the cost segregation area."

Is cost segregation right for you?

The details involved in cost segregation can be complex, so it's smart to obtain professional advice and assistance, including from a tax advisor. Your CPA firm can help you analyze the potential tax benefits of having a cost segregation study performed. The potential tax savings may be well worth the time and cost involved in the study.

Bad things happen

Take steps now to protect your dealership's assets

What would happen if your dealership were sued, or if your business failed and creditors chased after your assets? No one wants either scenario to materialize, but there are certain precautions you can take to protect your dealership's assets "just in case."

Set up an FLP

One asset-protecting vehicle worth exploring is a family limited partnership (FLP). In a typical scenario, you transfer assets to the FLP, and as its General Partner you have discretion over how the assets and income are distributed. You then gift or sell limited partnership interests to your children or other family members. A common application is to transfer assets such as marketable securities and/or the real estate on which your dealership is located to an FLP, although other assets also are appropriate.

The agreements are typically written with asset protection in mind, so the underlying assets are usually safe from creditors of the limited partners. Also, if the FLP is properly structured and administered, the assets gifted or sold will be removed from your taxable estate. And transfers of FLP interests might be eligible for minority interest and other discounts.

There are some drawbacks. Your franchise agreement may restrict transferring ownership interests in your dealership operations. Additionally, you'd need to be cautious when signing bank or creditor guarantees — they could undo the FLP's protective quality. Also, FLPs aren't the optimal choice for protecting your primary residence.

Create a Crummey trust

Another vehicle to consider is a trust — in particular, a Crummey trust. If you gift assets to someone else, such as your children or other family members, the assets will, generally, no longer be vulnerable to creditor claims. But you may not want to gift assets outright. Instead, you may want to transfer those assets to trusts for your family members. You can retain a degree of control over their access to the funds *and* provide a measure of protection against their creditors.

Normally, gifts to trusts aren't eligible for the $14,000 (per recipient) annual gift tax exclusion because transfers have to be of a "present interest" (generally meaning the recipient has immediate access to the funds) to qualify. But in a Crummey trust, after each gift to the trust is made the beneficiaries are allowed — for a limited time period — to withdraw the funds.

This withdrawal right allows the gift to qualify for the annual exclusion, so you don't have to use up any of your lifetime gift tax exemption (or pay gift taxes) on the transfers. Plus, the assets, along with any future appreciation on them, are removed from your taxable estate.

The downside: Once transferred, you'll no longer have access to the assets. And there's a risk that the beneficiary will take out the funds during the withdrawal period.

Establish an offshore trust

You can set up a trust in a foreign country with more favorable asset protection laws than in the United States. Cash or readily movable securities, rather than real estate, typically fund offshore trusts. Bear in mind that even if the assets are offshore you are liable for paying taxes on the trust's income. And the trust assets can still be subject to gift or estate taxes.

Offshore trusts offer protection from U.S. legal judgments and discourage litigation because of the expense and difficulty in pursuing a case under foreign jurisdiction.

But there are minuses: The costs to set up and administer offshore trusts can be high, making them a sensible choice only for individuals with sufficient net worth and risks of claims and lawsuits to warrant the expense. Because these trusts often face IRS challenges, get solid legal and tax advice.

Way to go

Whatever way you choose to guard your assets, the important thing is that you take that step. Talk with your CPA and attorney for guidance as to the best path for you.

Valuable hiring tax credit extended through 2019

For nearly 40 years, businesses have been able to claim a tax credit for hiring employees who are members of certain targeted groups.

During many of those years, though, the Work Opportunity Tax Credit (WOTC) expired and wasn't extended by Congress until year end, creating uncertainty for employers. But, thanks to the Protecting Americans from Tax Hikes (PATH) Act of 2015, the WOTC is now available through the end of 2019.

Targeted groups that qualify

There's a wide range of targeted groups of employees whose hiring may qualify your dealership to claim the WOTC. They include:

- Long-term family assistance recipients and recipients of Temporary Assistance for Needy Families,
- Recipients of Supplemental Nutrition Assistance Program and Supplemental Security Income benefits, and
- Qualified veterans and ex-felons.

Starting this year, the list of targeted groups has been expanded to include qualified recipients of long-term unemployment benefits (individuals who have received these benefits for at least 27 weeks).

To claim the WOTC for wages paid to an employee who's a member of a targeted group, the employee must work at least 120 hours for your dealership during the first year. In this scenario, the credit equals 25% of qualified wages, up to the applicable limit. If the employee works more than 400 hours during the first year, the percentage rises to 40%.

Money you can save

The credit generally applies to the first $6,000 in qualifying employees' wages, with some exceptions. The maximum credit per qualifying employee is generally $2,400, though the credit for a qualifying veteran can be as high as $9,600. There's no limit on the number of qualified individuals you can hire.

There are more details on the WOTC that you should investigate further before proceeding. Consult with your tax advisor about your dealership's specific situation.