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ACCOUNTANTS & ADVISORS

Is your dealership vulnerable to cybercrime?

Cybercrime has become an ever-growing threat to U.S. businesses, with recent news headlines trumpeting a long list of major corporations that have been victimized by high-profile attacks.

Dealerships aren't immune to the risk of cybercrime — in fact, you're a prime target. Why? Because your network holds a vast amount of personal data, thanks to the growing use of e-contracting, paperless deal jackets and customer relationship management software. All of this and more make it critical to take steps that will help protect your dealership and its customers from the potentially devastating effects of a cyberattack.

Looking for a sweet spot

Unfortunately, many dealers think that hackers are more focused on the networks of large Fortune 500 companies than those of smaller businesses. But this isn't the case. Many of today's cybercrimes originate from highly sophisticated overseas criminals looking specifically for small to midsize U.S. businesses in the cybercrime "sweet spot." These are companies — including dealerships — big enough to have significant bank accounts, but often not sophisticated enough to deploy the most current network defenses.

In other cases, the cyberattacks aren't targeted at any specific size of company or industry. Instead, they're random attempts (phishing emails, for example) to get employees to click on attachments or links that will download malware or compromise sensitive customer and corporate data in some other way.

Although the hacking of customers' credit card information gets most of the headlines, there has been a marked increase in the theft of sensitive and confidential noncard data. This includes employees' internal network and online banking login credentials; confidential corporate communications; and various other types of records with sensitive customer information, such as Social Security, bank account and driver's license numbers.

For instance, cyberthieves may launch Man-in-the-Browser (also known as MitB) attacks that infect a dealership's computers with malware used to capture employees' online banking login credentials. The thieves then use this information to steal money from the dealership's bank accounts.

Pinpointing your vulnerability

For any type of organization, the first step in guarding against a cyberattack is to figure out where the operation is the most vulnerable. For dealerships, the greatest vulnerability typically lies in your customers' sensitive personal information.

Next, determine the biggest *specific* threats to your dealership and what you can do to minimize them. For example, "phishing" scams remain one of the most commonly used ways cybercriminals attack businesses, including dealerships.

The challenge of compliance

The cybercrime issue has a regulatory component. Dealerships are considered financial institutions by the Federal Trade Commission, which means they're governed by the Gramm-Leach-Bliley Act. This law contains certain preventive measures dealerships should implement to protect their customers' personal information from theft by cybercriminals. These measures are detailed in *A Dealer Guide to Safeguarding Customer Information*, produced by the National Automobile Dealers Association (NADA). Contact NADA for further information.

"Dealerships face very specific issues from a regulatory and compliance perspective when it comes to safeguarding the personal information they collect and store from customers," said a NADA spokesman. "Even among financial institutions, dealerships have a uniquely difficult task due to the nature of their business."

In a typical phishing expedition, cyberthieves will send emails supposedly from a bank to employees stating that the dealership's bank accounts have been compromised or frozen because of fraudulent activity. Then they instruct employees to provide sensitive account information such as user names and passwords so they can supposedly resolve the problem. Once they have access to a dealership's bank accounts, thieves can initiate unauthorized wire transfers to easily steal the money therein.

You can go a long way toward reducing the threat of cybercrime at your dealership by educating employees about phishing and other similar threats. For instance, make sure your staff knows to never reply to suspicious emails with sensitive account information, nor should they ever click on links within these emails.

Taking the right steps

The National Institute of Standards and Technology offers some guidelines for defending your dealership against cybercrime and responding if attacked. (Go to nist.gov and click on "Cybersecurity Framework" in the "NIST Most Popular" menu.) For example, it recommends that you protect your most critical pieces of infrastructure first, respond appropriately to any detected cyberattack, and recover and restore any capabilities that have been impaired by a cyberattack as quickly as possible.

Here are a few additional steps you can take to help prevent a cyberattack:

- ❏ Make sure employees are using strong passwords and that they change them regularly.
- ❏ Enhance the security of your wireless network by providing a separate Wi-Fi network for customers.
- ❏ Implement and enforce strict policies on the downloading of software and use of flash drives by employees.
- ❏ Control and monitor employees' Internet usage.

In addition to these safeguards, make sure to use antivirus and antimalware software on all of your computers, and keep the software up to date.

Going on the offensive

In the current environment, dealerships can't afford to take cybersecurity lightly. Go on the offensive by discussing network security with a qualified technology consultant and strengthen your defenses now — before a hacker finds a way in. ■

A good time to grow

Target the right kind of loan for your dealership

With the industry on track for the strongest sales year in a decade, it's "the best of times" for dealers right now. Indeed, sales are projected by analysts to top 17 million this year, surpassing the 16.94 million vehicles sold in 2005. As a result, many dealerships will be looking to expand their operations to take advantage of new growth opportunities.

However, it takes capital to grow and expand a business. Dealerships can sometimes fund growth using earnings retained from the business. But, more often, they must turn to an outside financing source for growth capital.

Bank expansion loans

The first place many dealerships look for growth financing is their bank. Commercial banks offer a wide range of loans that can help dealerships fund their growth plans, including:

Term loans. These are amortizing fixed-rate loans typically used to finance the purchase of fixed assets such as furniture, fixtures and equipment. They also are sometimes used to finance smaller reimaging projects. The loan's term should be structured to match the depreciable or useful life of the asset being purchased.

Commercial mortgage or construction loans. These are generally used to finance the construction or purchase of new or existing buildings (including a new showroom) or the purchase of commercial real estate. They also are used to finance larger, significant reimaging or remodeling projects. They're typically amortized for a period of up to 15 or 20 years.

Other financing avenues

If a bank loan doesn't look inviting or doable, here are some other financing options to explore:

SBA loans. The Small Business Administration (SBA) offers several types of loans designed for dealerships that meet the SBA's definition of a small business. For example, SBA 504 loans can be used to finance the purchase of equipment, buildings and commercial real estate. The SBA guarantees a portion of the loan, which gives banks more lending flexibility.

Manufacturer financing. Bank loans usually include strict conditions, such as minimum monthly payment amounts and covenants that require borrowers to meet certain performance levels and that restrict their business activities. Banks also typically require borrowers to submit detailed financial information along with their loan request, and they might require owners to pledge personal assets as collateral — including a personal residence. Manufacturers usually don't demand any of these things.

For this reason, many dealerships consider automobile manufacturers' financing arms for loans to finance expansion. In addition to providing consumer credit, manufacturers' financing arms like Ford Credit, BMW Financial Services and Ally Corporate Finance also can provide business loans to help dealers finance their growth and expansion plans.

Another plus: Manufacturers already have a relationship with dealerships and know their financial conditions. Thus, dealerships may have to jump through fewer hoops to obtain financing than if they were trying to obtain a bank loan. On the down side, financing through the manufacturer will typically involve a higher finance charge or interest rate.

Be prepared

Regardless of whether you're seeking expansion financing from a bank, an auto manufacturer's financing arm or somewhere else, be prepared to demonstrate how you'll repay the loan. Also show the lender exactly how the loan will be used to grow your sales and revenue.

With sales strong and future prospects generally bright, now could be a good time to expand your dealership. So, take the time to plan for how you'll finance your growth initiatives. ■

Ownership compensation

Beware of IRS scrutiny

Pinpointing how much a dealership should pay its owners is never easy. You've got to consider a variety of factors, including just what form (salaries, benefits, stock) that compensation will take. You also need to ensure your approach will hold up under IRS scrutiny.

Balancing act

Let's start with the basics. Compensation is affected by the amount of cash in your dealership's bank account. But just because your financial statements report a profit doesn't necessarily mean you'll have cash available to pay owners a salary or make annual distributions. Net income and cash on hand aren't synonymous.

Other business objectives — for example, buying new equipment, repaying debt and sprucing up your showroom — will demand dollars as well. So, it's a balancing act between owners' compensation and dividends on the one hand, and capital expenditures, expansion plans and financing goals on the other.

Dividend double-taxation

If you operate as a C corporation, your dealership is taxed twice. First, business income is taxed at the corporate level. Then it's taxed again at the personal level as you draw dividends — an obvious disadvantage to those owning C corporations.

C corporation owners might be tempted to classify all the money they take out as salaries or bonuses to avoid being double-taxed on dividends. But the IRS is wise to this strategy. It's on the lookout for excessive compensation to owners and will reclassify above-market compensation as dividends, potentially resulting in additional income tax as well as interest and penalties.

Above- or below-market compensation raises a red flag with the IRS.

The IRS also monitors a C corporation's accumulated earnings. Generally similar to retained earnings on your balance sheet, accumulated earnings measure the buildup of undistributed earnings. If these earnings get too high and can't be justified as needed for such things as a planned expansion, the IRS will assess a tax on them.

Other business structures

Perhaps your dealership is structured as an S corporation, limited liability company or partnership. These are all examples of flow-through entities that aren't taxed at the entity level. Instead, income flows through to the owners' personal tax returns, where it's taxed at the individual level.

Dividends (typically called "distributions" for flow-through entities) are tax-free to the extent that an owner has tax basis in the business. Simply put, basis is a function of capital contributions, net income and owners' distributions.

So, the IRS has the opposite concern with flow-through entities: Agents are watchful of dealer-owners who *under*pay themselves to avoid payroll taxes on owners' compensation. If the IRS thinks you're downplaying compensation in favor of payroll-tax-free distributions, it'll reclassify some of your distributions as salaries. In turn, while your income taxes won't change, you'll owe more in payroll taxes than planned — plus, potentially, interest and penalties.

Red flags, higher taxes

Above- or below-market compensation raises a red flag with the IRS — and that's definitely undesirable. Not only will the agency evaluate your compensation expense — possibly imposing extra taxes, penalties and interest — but a zealous IRS agent might turn up other challenges in your records, such as nonsalary compensation or benefits.

What's more, it might cause a domino effect, drawing attention in the states where you do business. Many state and local governments face budget shortages and are hot on the trail of the owners' compensation issue and will follow federal audits to assess additional taxes when possible.

Other interested parties

Other parties also might have a vested interest in how much you're getting paid. Lenders, franchisors and minority shareholders, for instance, could think you're impairing future growth by paying yourself too much.

Plus, if you or your dealership is involved in a lawsuit, the courts might impute reasonable (or replacement) compensation expense. This is common in divorces and minority shareholder disputes. In these situations, you'd be wise to consult an attorney early in the compensation decision-making process.

Best practice

The best practice in owners' compensation is to see to it that you're being fairly compensated — and that you're in line with industry figures. Avoid red flags, and your decisions should be able to withstand outside scrutiny. ■

DEALER DIGEST

More Americans are leasing vehicles

The number of Americans leasing instead of buying vehicles reached an all-time high of 31% during the first quarter of this year, according to data provider Experian Automotive. This is up from 24% five years ago.

One of the main factors behind this shift is the high cost of new vehicles: Monthly auto lease payments are lower on average than monthly auto loan payments. Experian reports that the average new vehicle monthly lease payment is $405, down by $7 a month over the past year. In comparison, the average new vehicle monthly loan payment is $488, up by $14 a month over the past year. ■

Is your dealership benefiting from charitable work?

Many dealerships perform charitable work in their communities. Doing so can result in many benefits for both the business and nearby residents.

Obviously, communities gain from the volunteer time and effort that dealerships donate to charitable causes. Dealerships, meanwhile, may enjoy positive exposure and increased goodwill in their local markets. In fact, some dealers integrate charitable work into their corporate philosophies and strategic marketing plans.

One way your dealership might be able to help your community is to arrange for a bloodmobile to spend a day parked in front of your dealership. This will enable customers to stop in and donate blood before or after they visit your showroom and employees to do so during the workday.

Another idea is to organize a car wash at your dealership with detailing available. Ask employees about their preferences regarding which organization should receive part or all of the proceeds.

You can conduct a fundraising campaign for any local charity that you and your employees would like to support. Contributions made by your staff, customers and dealership could be tax-deductible, if the campaign is held for a "501(c)(3)" organization — that is, one that's an approved charitable organization in the eyes of the IRS. ■

2016 HSA and HDHP figures released

The IRS has announced the new inflation-adjusted annual limits on contributions to Health Savings Accounts (HSAs) for 2016. In addition, it also has announced new inflation-adjusted minimum deductibles and out-of-pocket maximums for high-deductible health plans (HDHPs). The new numbers are as follows:

- ❏ HSA contribution limits (combined employer and employee) will be $3,350 for individuals (or $4,350 for those age 55 or over) and $6,750 for families (or $7,750 for those age 55 or over).
- ❏ HDHP minimum deductibles will be $1,300 for individuals and $2,600 for families.
- ❏ HDHP out-of-pocket maximums will be $6,550 for individuals and $13,100 for families. ■