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HEADLIGHTS

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MORE GOVERNMENT STIMULUS ... WHAT'S IN IT FOR YOUR DEALERSHIP?

The extension of the Paycheck Protection Program (PPP) was a welcome surprise at the end of 2020. We breathed a collective sigh of relief that expenses paid with forgiven PPP funds are deductible. Now, if states would get on board! The new legislation included a PPP2 program, which is exciting for many that benefited from PPP1. The PPP2 program comes with a caution that could eliminate some dealers from participating.

Bart Haag
Albin, Randall & Bennett, CPAs

To qualify for PPP2, businesses must demonstrate a 25% decline in sales in any quarter of 2020 compared with the same quarter in 2019, and it must have fewer than 300 employees. This is a change from PPP1, where there wasn't a requirement that sales had slipped and the head count figure was 500, not 300. Franchise indicator code exceptions and other requirements carry over from the original PPP.

PPP2 requires businesses to certify that loans are needed due to economic uncertainties threatening the business's continuation and ability to keep people employed. At first glance, this certification didn't appear to be as easy as it was for PPP1. The Small Business Administration (SBA) issued an FAQ on March 3, 2021, that, among other things, appears to have made the certification process for PPP2 infinitely easier. Now businesses are deemed to have met the certification requirement by substantiating a decline in revenues of 25% or more.

Significant changes relate to the employee retention credit (ERC). Initial legislation indicated that if you received a PPP loan, then you didn't qualify for the ERC. Now, if you received a PPP loan, you also potentially qualify for the ERC. Unfortunately, it's MUCH more complicated, but

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the credit can be significant. The ERC is up to $5,000 per employee for 2020, and it has been expanded to the first two quarters of 2021 and increased to a maximum of $7,000 per employee per quarter. That means you could receive up to $14,000 per employee for 2021. You claim the credit through the payroll tax system, along with the following:

✔ Employers with more than 100 full-time employees get a credit in 2020 for only those employees they paid NOT to work. Qualifying employers with fewer than 100 full-time employees receive the credit for up to 50% of any wages paid to the employees.

✔ Similar to determining whether you qualified for a PPP loan, count employees and not full-time equivalents (FTEs) when determining employees for purposes of the 100 full-time employee qualification. An employee working more than 30 hours/week counts as one employee.

✔ The amount of the credit received is not included in your deductible wages.

✔ The credit is claimed on your payroll tax returns, not your income tax return.

✔ You can receive the credit in 2020 for as long as you had a partial or full government shutdown OR for any quarter beginning with the first calendar quarter in 2020 where your gross receipts declined 50% compared with the same quarter in 2019 until the end of the quarter where gross receipts compared with the same quarter in 2019 declined less than 20%.

✔ Franchise indicator codes don't apply. Dealers with multiple businesses use aggregation rules the IRS uses for other consolidating purposes.

For 2021, the credit is based on a decrease in gross receipts of 20% instead of 50% as required for 2020. The number of full-time employees increases to 500 to determine qualifying wages.

✔ Payroll used for PPP forgiveness cannot be used for the ERC.

One of the reasons the ERC is such a big deal is because if you qualify, there is no need to certify that you need the credit. If you would like to discuss this further, please contact your AutoCPAGroup member. ✍

BANKING (LENDER) RELATIONSHIPS

Carl Woodward
Woodward & Associates, Inc.

Almost all dealers have a lending relationship with banks and factory finance companies. All these lenders have many business and legal documents they require of their dealer borrowers. Most of the documents are needed from a legal perspective. However, I am concerned about the terms of some of these documents and the consequences of those documents. Some of the terms I want to alert the reader to consider is whether or not to include the following:

Do you have the written approval of the new lender that does not allow you to possibly have a borrowing relationship with other lenders? Do not agree to this.

How much notice in days will the new lender give you if they decide they do not want to continue the lending relationship? This needs to be reasonable.

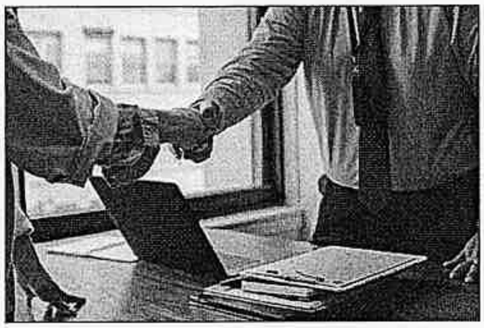
Are you required to have all your checking accounts with the new lender?

The agreement may allow the lender to change any of its wording at its discretion with minimal notice. Insist on restrictive language to protect yourself.

The lender may require you to obtain its approval to buy any new business. Do you want to allow the lender to run your business?

The lender may require you to have an annual CPA-prepared financial statement. This will result in additional cost to the dealer.

Upon the death of the dealer the lender can call the loan within 30 days. This would put a huge burden on your family. If a lender is asked about this, their response is usually, "Don't you trust us?"



Lender should supply an itemization of expected fees and charges to change lenders.

Many lenders require that the dealer-supplied financial statements be prepared in accordance with GAAP (generally accepted accounting principles) consistently applied. Very few dealers meet this GAAP requirement. You need to delete this GAAP language or, with the assistance of your CPA, modify this language.

Many lenders have a debt-to-equity ratio requirement. Have your lender compute this ratio so that you can understand and meet this ratio with some flexibility. Also, obtain wording, in writing, from the lender, regarding the consequences of not meeting this ratio.

Many lenders have a cash flow ratio requirement. You need to have your lender compute your ratio to make sure you meet this requirement. If your working capital exceeds the requirement, you might ask the lender to waive this requirement.

Many lenders will not allow payment of dividends or distributions above income tax needs without their approval. This is silly if the dealership substantially exceeds factory working capital guidelines. Do you want to have to ask your lender if you want to take a distribution for personal needs or to buy a larger house?

In summary, you need your **AutoCPAGroup** member and/or auto attorney to review all the lenders' documents to make sure they are reasonable and that you understand what you are agreeing to.

DEALERSHIP FIXED OPERATIONS ABSORPTION

Scott Lewis, CPA
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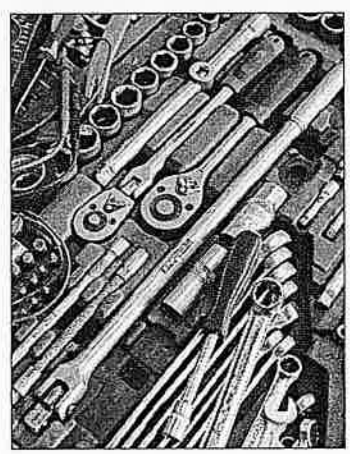
Although some states continue to experience high levels of COVID-19 and/or other pandemic-related limited shutdowns, dealerships are still considered essential businesses, especially in the operations of the service drives. A major item to analyze is the financial health of the parts and service departments, which can be measured by a fixed absorption formula.

Some equations calculate this as the sum of all fixed operations' gross profits divided by the sum of the total dealership fixed expenses, dealer salary and all sales expenses in parts and service. Others also include used-vehicle gross in the mix. No matter the detailed nuances and adjustments in the formulas, fixed operations should never be considered as a second thought in the profit centers of a dealership. Although they generally contribute only about 12% to 15% of overall sales, they provide over 50% of overall dealership gross. This back-end profit should be covering (according to many of the factories) between



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85% to 100% of total fixed overhead expenses for the entire dealership, although NADA averages are closer to 60%.

As vehicle sales slow down due to reduced factory production, with fewer used vehicles in the overall inventory sales pipeline, now is the time to review and fine-tune fixed operations, as these are the true profit centers of the dealership. Some top-line items to consider are increasing parts and service sales and gross.

A dealership should pinpoint and follow up with lost souls from the customer relationship management (CRM). These are customers who have visited the service department but have not returned in 15 months or more. Offer them coupons or other incentives to come in. Ensure that you promote the cleanliness of the customer-service lounge or offer home pickup and drop-off if needed. Additionally, shift advertising expenditures around, if needed, from vehicle sales to fixed operations. In certain areas, the new vehicle market is still strong, and inventory on the ground is still low, so why spend dollars to promote vehicles that are basically being "pre-sold"?

Consider factory rental programs or partnering with one of the national rentals, if not doing so already. This will provide another avenue of convenience for customers to get them in and out of the service drive and ideally raise traffic counts.

Ensure that the exercises to receive customer pay rate in warranty reimbursements on labor and parts are up to date. An increase of a dollar or two per hour from warranty payments adds a significant amount to gross profit and the bottom line.

Run and evaluate technician efficiency reports. Note that A-level technicians are not doing D-level service work, which is not translating into the highest gross profit. This decreases the real effective labor rate, which has a negative impact on departmental gross.

On the expense side, this is a great time to go through vendor contracts and compare them with actual bills being paid. See whether agreements can be restructured and/or eliminate any duplications on products and services being provided to the dealership.

As the economy gets back to some level of normalcy and quarantines are alleviated, more vehicles will be back on the roads and more miles will be driven. These vehicles will need to be serviced, and dealerships' service drives should be ready to capitalize.

Please contact a member of the **AutoCPAGroup** to discuss this further. ✍