

HEADLIGHTS

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THE RISKS AND BENEFITS OF MAXIMIZING PROFITS USING PORCS

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Dealers are tapping additional profits in the Finance and Insurance (F&I) department with Producer Owned Reinsurance Companies, or simply, "PORCs." These profits are realized from insurance and investment income earned by the PORC. They can also provide tax advantages to the owner, who should also be aware that these advantages draw IRS interest.

The IRS has a special interest in PORCs because they have the potential to be construed as abusive tax shelters. PORC is an unfortunate acronym, but it does help to remind everyone of the old saw that "pigs make money, but hogs will get slaughtered." Which farm animal does your PORC resemble? To learn if your PORC steps over the line, the following overview on what to look for can help, starting with a cast of four parties common to many reinsurance arrangements.

- ✓ The dealer owner (dealer O);
- ✓ The dealership (dealership A);
- ✓ The insurance company (InsurCo) that is independent and unrelated; and
- ✓ The PORC.



For example, dealership A sells a vehicle service contract to a customer and remits the insurance premium to InsurCo (also known as a direct writer licensed to sell insurance). In turn, dealership A retains a portion of the premium as commission income. Dealer O sets up and owns a PORC, a separate legal entity created to reinsure the policies written by InsurCo, which pays claims from amounts it receives from dealership A. InsurCo also remits a portion of the pre-

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mium to the PORC, which will reinsure the risk assumed by InsurCo. Any reinsurance premiums held by the PORC can earn investment income. The accumulated funds held inside the PORC, comprised of both underwriting profits and investment income, are allowed to grow with little or no income tax. Dividends to dealer O of the PORC are later taxed at favorable tax rates.

There are some things to consider if you want to lower the risk profile of your PORC.

1 Make sure that premiums are established at reasonable, fair-market levels. It is a problem if dealership A instructs InsurCo to reduce its normal \$500 commission to \$250 with the proviso that the other \$250 be remitted to the PORC, owned separately by dealer O. The IRS will take a dim view of effectively moving \$250 out of taxable income at the corporate level.

2 The PORC's income should be from insurance, not investment income. Owners of PORCs should verify, at a minimum, that investment income of the PORC does not exceed income from insurance premiums.

3 Watch out for loans between the PORC and the shareholder. Because shareholder loans are such a magnet for IRS scrutiny, dealers have been advised by some to avoid such loans altogether. If shareholder loans exist, extra care should be taken to ensure that

- ✓ the loan is properly documented;
- ✓ the loan is interest bearing at adequate rates;
- ✓ the loan is being repaid according to the terms of the note; and
- ✓ the loan amount should not adversely affect the capitalization of the PORC.

Again, all participants in PORCs should be knowledgeable on how it operates and ask questions of the promoter to learn of any conditions noted above that can jeopardize the reinsurance arrangement. If the IRS discovers that the PORC is operating outside of what is acceptable, taxes, interest and penalties await the unsuspecting. Despite the current visibility of PORCs at the IRS, they can, nonetheless, be an effective way to maximize your return from the sale of F&I products when the rules are followed. ⚡

CAN GM BE RESCUED?

At our most recent meeting, the AutoCPA Group opened the floor to discussion about General Motors (GM), as it has been the topic of numerous recent articles in business and automotive news. Each of us assumed it would survive if these questions are addressed: Will GM be required to maintain its staggering legacy costs? Will GM learn from all other automotive manufacturers the importance of design? Will GM learn that the entire world is demanding hybrid vehicles now? Will GM learn that you cannot save your way to earnings? Will GM learn to make every division profitable? This, of course, is not a complete list, but rather some that beg for answers.

Legacy costs are defined as the



pension and health care costs for employees. GM maintains a very tolerable unfunded pension liability (unlike United), but its union concessions has it bearing a larger percentage of each employee's health care costs than most major companies and many small and privately held companies—this must be brought down. The casual observer can tell us that the Pontiac Motor division has been shortchanged by the design studios in relation to Cadillac and Chevrolet. Hybrid vehicles are a part of every other major automotive manufacturers' line of cars, and yet they have been ignored by GM and are not currently offered by them nor are they mentioned in its future projections. Just because GM has a lot of cash, we cannot assume it will survive and be profitable—it must spend money in the right areas on research and development (R&D) costs to ensure its

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market share. It is estimated that if GM sinks to a market share of 25%, the cash will quickly evaporate. How can GM justify to Pontiac dealers that they must suffer to allow the ego-driven Saturn division to lose money perpetually?

Whether economists want to admit it or not, America needs GM to prosper and reshape itself

FIXED OPERATIONS PROFITABILITY

Larry Edwards, who is president of a consulting firm that specializes in improving profitability for dealership fixed operations, recently spoke to the AutoCPA Group. The following are some relevant comments that Larry shared with us.

One of the most important ways to increase fixed operations profitability is to increase your service customer retention rate. The National Automobile Dealers Association (NADA) average dealer retention rate is only 28%. You can calculate your dealership's service customer retention rate by using the following formula: number of customer-pay repair orders written last year, divided by new units sold in the last seven years, times projected repair orders per year. How do you compare with the NADA average?

Three key items to increase the service customer retention rate are:

1. Proper staffing to handle all potential business.
2. An effective service marketing program.
3. An effective service merchandising program.

Edwards believes that an effective dealership must have one service advisor for each 15 repair orders per day. Low staffing levels result in telephone calls not being promptly answered, appointments being difficult to obtain or having no real relevance, and customers not being greeted promptly and not kept informed during the repair process. Customers conclude that if you cannot take care of them, you probably cannot take care of their vehicles either.



into a lean, mean profit machine. We addressed some of the business challenges that GM and its board of directors must confront head-on now. If they don't, we might see a foreign purchase or bailout and, at a minimum, an increase in the carrying costs (interest) of its bonds, which now enjoy "junk" status. ✍

J. Michael Vaughn, CPA
Lattimore Black Morgan & Cain, P.C.

Appointments are necessary for two reasons—they are convenient for your customer, and the flow of work in the service department is smoother if the work is expected. An appointment coordinator is a necessity if you want to improve customer retention. Management,

not the service advisor, must control the number of appointments coming into service each day.

With 15 repair orders written each day, a service advisor should be selling more than \$90,000 of parts and labor each month if your labor rate is \$80 per hour. The average hours per repair order should be two or a total of 30 labor hours sold times \$80, or \$2,400 per day plus parts at 80% of labor, or \$1,920 for a total of \$4,320 per day. With most months having 21 selling days, that would be a total of \$90,720.

How do your service advisors compare with these standards? If you are not at these levels, you may want to consider improving your service marketing program. No new vehicle should ever be delivered without an introduction to a service advisor.

Marketing convinces customers to visit your service department. Several marketing tactics to retain your new-vehicle customers as service customers are:

- ✓ New-owner clinics;
- ✓ Customer reminder letters;
- ✓ Coupon mailings;
- ✓ Factory mailings; and
- ✓ Advertisements.

FIXED OPERATIONS PROFITABILITY

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A merchandising strategy consists of the things you do to convince customers to buy from your service department once they have arrived. The following are recommended merchandising tactics.

- ✓ Accessory displays;
- ✓ Worn parts displays;
- ✓ Competitive pricing board;
- ✓ Service manager's daily specials display; and
- ✓ Electronic service menus.

Customer retention is the key to making your fixed operations more profitable. It should be your top priority to run your fixed operations at their maximum levels. ↵

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