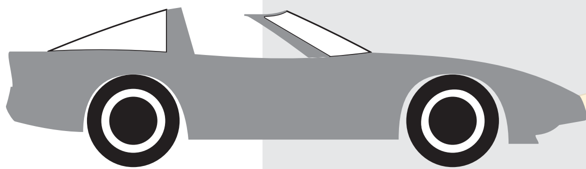

HEADLIGHTS

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SUING DEALERS: A BOOMING BUSINESS

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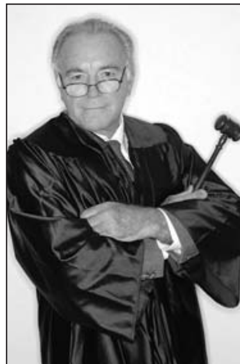
The last five years have witnessed a significant increase in litigation involving dealerships. This is due to several factors:



✔ Trial attorneys' cases against asbestos and cigarette manufacturers are more difficult to win.

✔ As gross profits from new vehicles decline, dealers have turned to finance and insurance products to become bigger profit centers. Lawyers realize that cases based on these profit centers are more lucrative because they are class-action certifiable. Frequently, they involve patterns of conduct rather than problems with individual vehicles.

✔ Many dealers loathe to have cases tried before a jury. They fear bad publicity and jury members who may be prejudiced if they have had a prior poor experience in purchasing a vehicle. Thus, some dealers quietly settle, even if they feel that from a technical and legal standpoint they are right.

The following examples are cases that dealers throughout the country have faced.

1 Eliot Spitzer, former New York Attorney General, settled with twelve Long Island dealers who were accused of misleading and deceptive sales practices. A specific complaint was that dealers did not make the necessary disclosures about qualifying for 0% financing with a minimum credit or Beacon score.

2 Connecticut Attorney General Richard Blumenthal, in conjunction with 22 state attorneys general, halted advertisements proclaiming "no money down." In reality customers were required to pay pre-delivery taxes and fees that often exceeded $1,000.

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UNCLAIMED PROPERTY

USED-VEHICLE WRITEDOWN

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3 Multiple suits in Florida, Minnesota and Oregon have been brought against dealers involving the pricing and marketing of finance and insurance products. Supplementary products such as gap insurance, extended service contracts and vehicle "etch" fees have invited litigation.

Dealerships are increasingly being sued over the payout of coupons for future vehicle purchases (rather than cash) to clients. In several New Jersey cases, customers were awarded coupons in the $200–$300 range, and the defendants (dealers) were forced to pay plaintiffs' high legal fees and court costs. Many dealers find this outcome preferable as it lowers their costs and lessens the opportunity of a long, drawn-out court case.

Dealers can avoid the potential for litigation by taking a proactive position. Proper training of employees, mandatory arbitration clauses as part of sales contracts and a legal audit of existing procedures are several ways to prevent lawsuits. However, acting in an honest and ethical manner is always the best defense.

Automobile dealers, given their expensive, complicated product, find it challenging to avoid the legal system in today's litigious society. By having the appropriate safeguards in place, dealers can spend more time in the showroom and less in the courtroom. ✍

UNCLAIMED PROPERTY

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Pomares & Co., LLP

Unclaimed property is becoming the new buzz phrase across the country. Funds, deposits, accounts and other types of property that have been dormant for a period of time are, in most states, required to be turned over or escheated to your state for safe keeping. State laws allow the state to take these funds or property so that the "rightful" owner may be found and the funds or property returned.

However, while states are becoming more aggressive in sending these funds to the state treasury, there is some question whether they are being diligent in trying to find the rightful owners. In California, more than $5 billion has been escheated to the state treasury where the rightful owners have not been found. The state requires that these monies be held in trust, but only approximately $200 million is being held for claims to be paid. The remainder has been put into the general fund.

What does this have to do with automobile dealers? There are many types of property that have not been claimed by customers or creditors. These might include checks that have not been cashed, deposits not returned or title fees not refunded. The list can go on and on. Under most state laws, this type of property is considered unclaimed property. If not sent to the respective state treasury within the time frame required by each state's law, penalties will normally be assessed.

Many dealers over the years have ignored the laws, probably because of the lack of audits on these funds by the states. This has now changed, and it is paramount that the dealer take these laws seriously. There have been a number of audits in California, where there does not appear to be a statute of limitations, and assessments and penalties have gone well into six figures.

What should dealers do? The first thing is to become familiar with their applicable state laws and the time prescribed to escheat funds to the appropriate authority. Research any property that could be considered unclaimed property and make

another attempt to return it to the rightful owner. If the period prescribed by state law has passed, file the appropriate remittance, being ever mindful of meeting whatever filing deadline is required.

In the past, many assumed that states were lax in enforcing these laws. With most states in a budget crunch, they are finding that this is a way to generate additional revenue, even if only temporary, and are creating audit teams to generate these funds. If there are any questions as to your state law and what should be done, call your AutoCPAGroup member for details that affect you. ✍

USED-VEHICLE WRITEDOWN

Carl Woodward, CPA
Woodward & Associates

Most new-vehicle dealers write down their used-vehicle inventory at the end of the year for income-tax purposes. The purpose of the writedown is to minimize and accurately reflect their taxable income. The IRS allows dealers to value their used-vehicle inventory at the "lower of cost or market value." This means that if the wholesale value of the vehicle is "worth" less than what you have in it, you are allowed to adjust its value to current wholesale market value.

However, the accounting of the writedown should be dealt with in a certain way. After these vehicles have been written down, they are usually sold between January and March of the following year. Often a larger than average gross profit is shown when these vehicles are sold, and the dealership shows large "false" net profits on the monthly dealership financial statement due to the recapture of these writedowns. This is not good for the following reasons.

1. It distorts the real net-profit picture of the dealership.
2. It distorts the gross-profit margins on used vehicles.
3. Proper compensation for sales managers and other workers must be considered.
4. When you look at your financial statement later in the year, you "feel" better about your net profits than you should because the writedown (false) profits are in the year-to-date profits.

Case in point: A client showed a $150,000 net profit through August. He felt he was doing "okay." After seeing that his prior year's used-vehicle writedown was $175,000, he realized he was losing money

and stopped showing the recapture of the writedowns when he sold these vehicles. In other words, he thought his dealership was profitable, when in fact he had lost $25,000 for the year.

A used-vehicle writedown is not a complicated process. You need to have your staff or CPA firm "Black Book" each used vehicle at the end of the year. You should compare the value of the vehicle with the average Black Book value for that vehicle. If the Black Book amount is less than your value, then the difference between these two values is the amount of writedown for that vehicle. You need to do this for all of your used vehicles and then add up the total amount of the writedown.

If you want to individually determine whether the vehicle is "rough," "average," "clean" or "extra clean," that is up to you. But, it is often preferable to use the "average" value for all vehicles. After you have the total of the writedowns, you will make one entry to charge the cost of sales-used vehicles

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USED-VEHICLE WRITEDOWN

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and either credit your used LIFO (last-in, first-out) reserve account (even if you are not on used LIFO), or credit a used vehicle with a dummy stock number. You do not apply the writedown credit to each individual used vehicle; this credit remains on your books all year.

To summarize the above, make sure you write down your used vehicles for income tax purposes, but do not apply this writedown to individual vehicles. Instead, put the total amount of the writedown in used-vehicle inventory as a negative vehicle, or put it in the LIFO reserve. In future years, you then will adjust this writedown reserve amount to what it should be for that year end. ✍

For assistance, please call 1-800-4AUTOCPA or see our website at www.autocpa.com. Headlights is prepared by the **AutoCPAGroup** for the clients of its members. We are required by IRS Circular 230 to inform you that the advice contained herein (including all attachments) was not intended or written to be used for the purpose of avoiding any penalties that may be imposed under Federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. © 2007 Headlights

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