



# HEADLIGHTS

A PUBLICATION  
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## FEDERAL TAX INCENTIVES FOR ALTERNATIVE MOTOR VEHICLES

**O**n April 7, 2006, the IRS announced the certification of certain models for the new energy tax credit. Four different types of fuel-efficient vehicles are covered by the new IRS announcement.

**Background:** The Energy Policy Act of 2005 provides a tax credit for certain fuel-efficient vehicles. The credit is available for vehicles purchased after January 1, 2006. Qualifying vehicles include each of the following defined categories:

**1** “Hybrid”—Draws propulsion energy from both an internal combustion engine and a rechargeable energy system, and meets certain power and emissions standards.

**2** “Advanced Lean Burn Technology”—Certain diesel engines that meet prescribed fuel economy and emissions standards.

**3** “Fuel Cell”—Power is derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel.

**4** “Clean Fuel”—Capable only of operating on an alternative fuel—compressed or liquefied natural gas, liquefied petroleum gas, hydrogen or methanol (at least 85% by volume).

A credit is more favorable than a deduction because tax liability is reduced dollar-for-dollar by a credit. A deduction, however, only reduces taxable income.

The credit amount, which may be up to \$3,400, depends on the fuel efficiency of the vehicle. Calculating the exact amount of the credit is a technical issue. As defined by the 2005 law, the credit amount is generally determined by the weight of the vehicle

and its fuel economy.

### Other important things to know about the credit:

✓ Generally, the credit is available when the original

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use of the vehicle commences with the taxpayer and the vehicle is acquired or leased for his or her use.

- ✓ For vehicles sold to tax-exempt entities, the seller of the vehicle qualifies for the credit provided the amount of the credit is clearly disclosed to the user.
- ✓ The credit is allowed in the year the vehicle is placed in service.
- ✓ The vehicle must be used predominantly in the United States to qualify; vehicles bought for resale are not eligible.
- ✓ The amount of the credit is limited if any portion of the vehicle is depreciated or expensed using Code Section 179, the expensing election provision.
- ✓ The credit is not allowed against the alternative minimum tax (AMT).

On January 13, 2006, the IRS provided guidance to the vehicle manufacturers (or, in the case of foreign vehicle manufacturers, their domestic distributors) with the issuance of Notice 2006-9. This IRS publication instructs manufacturers on how to obtain the necessary certification of qualifying vehicles, which will determine the amount and availability of the credit for the vehicle. This guidance covers only the first two of the categories listed: hybrid and advanced lean burn technology vehicles.

Future notices will be issued to address the other vehicles. Additionally, future notices will address

rules for which lessors may claim the credit, as well as the rules that the credit may not be used to reduce the AMT or may be recaptured.

The credit is set to expire at the end of 2010, but for many models the incentive will end much sooner because the law limits the credits to 60,000 vehicles from each automaker. Once a manufacturer has sold 60,000 hybrid and advanced lean burn vehicles, the tax credit for that manufacturer's vehicles is reduced over the next five consecutive quarters, eventually dropping to zero.

For manufacturers who are currently offering popular models, the tax credit could begin to be reduced as soon as the third quarter of 2006. For other manufacturers, their cars will have the full tax credit for a longer period.

### What action can you take now?

Contact the factory to find out more about their plans for certifying vehicles for the credit and the best way to use this information as a selling feature for your product. **Note:** According to published reports, factories expected to have qualifying vehicles include Honda, Chevrolet, GMC, Saturn, Jeep, Mercedes-Benz, Volkswagen and Nissan.

Any questions on the tax treatment for alternative motor vehicles can be directed to your local AutoCPA Group member. ✉

## SPEED UP COLLECTION OF WARRANTY RECEIVABLES



**W**arranty receivables that are owed to your dealership by the factory should be some of the easiest receivables for your dealership to collect. Yet we still find some dealerships that allow warranty receivables to become old.

This leads to the distinct possibility that these old balances may not be collected.

With the availability of direct dealer communications with the factory, most of these receivables should be collected within 30 days of the invoice date, if not sooner. Where do the slowdowns occur in your dealership and how can you prevent them?

The most common problem arises when all or part of the warranty is rejected by the factory. Your

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warranty clerk needs to immediately determine why the factory has rejected the claim and resubmit the appropriate corrected information. In many cases this will require a discussion with a service advisor or technician at your dealership. Their prompt attention can greatly speed up the correction of the problem.

The most effective way to determine if your warranty receivables are being collected in a timely manner is to briefly review the month-end warranty schedule produced by your computer system. Specifically, you should look at the aging of the balances not collected by month-end. Most should be zero to 30 days old. Any balance older than

30 days should be investigated to determine what the problem is and how it is being corrected. A large number of uncollected amounts over 30 days old indicates a problem that needs your immediate attention.

**Check and double-check:** Your office manager should be reviewing your computer schedules on a regular basis and following up with the service manager and/or warranty clerk on any problems. Additionally, if you can take just a few minutes to do a quick review of this schedule, you can help reassure yourself that your warranty receivables are being collected in full and in a timely manner. ↵

## DEALERSHIP RENT EXPENSE

**M**any dealers have or are in the process of expanding, remodeling or building new facilities. Also, as we know, some factories are “pressing” dealers to build new facilities or to materially remodel their current facilities. I am concerned from a cost-perspective view that dealers keep their budget under control for these new incremental facility costs. As I regularly tell dealers, you are in the “profit” business, not the real estate business.

The National Automobile Dealers Association (NADA) reports that rent, property taxes, amortization of leasehold improvements, maintenance and repairs for its average dealer in 2005 were 0.98% of total dollar sales. This is the equivalent of \$504 per new vehicle sold and 7.4% of gross profit.

Some dealers plan new facilities for what their factory wants and what they believe is nice. How many factory employees understand building costs and expenses? Some of these dealers do not budget the new buildings or improvements to see if the new higher rent factor is a reasonable percentage of total dealership gross profit. If the average dealer retains only 15% of its gross profit as net profit with its current rent factor being 8% of its gross profit, what is going to happen if the new increased rent factor is 12% of its gross profit? Losing this 4% of gross profit to the additional

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rent factor will reduce the dealer's net profit more than 25%. Some dealers' new rent factors will be even higher. How can you justify this?

The basic “rule of thumb” for annual rent, excluding other rent factor costs, is 10%–12% per year of the value of the land and building. Is this percentage reasonable when compared with 8% of total gross profit of the dealership? If this puts you well over the 8% of gross profit guideline, can you expect your gross profits to increase enough at the new facility to justify this higher rent? Do you realize how much your profits will be reduced if the rent factor is too high? Do you realize that if the

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## DEALERSHIP RENT EXPENSE

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rent factor is too high, it will limit what you can sell the real estate for in the future because the amount a property can be rented for determines its value more than the appraised value? Do you realize that if the price of the property is too high or if the rent is too high, then the amount you will receive for “Blue Sky” in the future might be materially reduced?

In summary, make sure the amount you spend on new or updated facilities will keep the rent factor reasonable so you do not have reduced profits now and reduced Blue Sky in the future. ✍

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