



# HEADLIGHTS

A PUBLICATION  
OF THE AutoCPA Group

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## LIFO RECORDS— A MUST

**T**he majority of new-car dealerships in this country use the last-in, first-out (LIFO) method of accounting for their new-vehicle inventories. For dealers who have utilized the LIFO method for over 20 years, we often see LIFO reserves in excess of \$3,000,000, which means that more than \$1,000,000 of federal tax has been deferred for each of these “high-LIFO” dealerships.

There are many requirements to meet if you wish to utilize the LIFO method, but one that sometimes gets overlooked is that of keeping complete records. Most dealerships on LIFO have elected the Alternative LIFO Method as described in Revenue Procedure 92-79, which was modified and superseded by Revenue Procedure 97-36. According to both of these IRS pronouncements, the “automobile dealer must maintain and retain complete records of the computations of the LIFO inventory under the Alternative LIFO Method, as well as copies of the actual purchase invoices for each

vehicle used in the computation.” This condition is interpreted by most LIFO experts to mean that you need to keep every new-vehicle invoice and the related LIFO computations for all year-end inventories going back to the first year the Alternative LIFO Method was adopted (usually 1992 for dealers on LIFO at that time).



**Jim Tanner,  
CPA  
Heider, Tanner &  
Dirks, Inc.**

If your dealership has been using the LIFO method for several years, it is important to know that your LIFO records are being permanently stored in a secure place with files from the date you adopted LIFO until the date you sell the dealership.

Inadequate records can create costly negotiations with the IRS, or can result in a potential buyer of

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### SPRING 2007

**COST SEGREGATION  
SERVICES**

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**NADA VEGAS STYLE**

your dealership asking you to reduce your price by the full amount of the LIFO taxes deferred. You may think that your CPA is storing your permanent records for you, but you should not make this assumption, especially if you have changed CPAs since you first adopted LIFO. It is a good procedure to have your CPA save all of your LIFO records even though your dealership maintains an identical set of records. This way a fire, flood or even a careless abandonment will not leave you at the mercy of the IRS.

Any business using LIFO should also be sure that its permanent tax files include copies of the IRS Form 970 originally filed to elect LIFO as well as any Forms 3115 to change your LIFO accounting methods.

The Auto**CPA**Group, which specializes in auto dealerships, considers your LIFO records to be some of your most valuable tax records. Don't be caught without them. ↵

## COST SEGREGATION SERVICES

**Ronald Weibley, MBA, CPA, CVA**  
**Boyer & Ritter, CPAs**

If you had the opportunity to turn a \$10,000 investment into a \$100,000 net present value, after-tax cash flow, would that be of interest to you? Incredible as it sounds, results such as these can be achieved by performing a Cost Segregation Study (CSS) for a taxpayer who is regularly in the maximum marginal tax bracket and who has constructed, renovated or purchased a commercial facility in the past five years.

A CSS is a combined comprehensive engineering and financial study applied to a commercial facility. It identifies asset costs that can be assigned shorter depreciable lives. Generally, an invest-



ment in real estate is depreciable over 39 years. A CSS allows some of these costs to be depreciated over 5, 7 or 15 years. This, in turn, accelerates depreciation expense and decreases taxable income. As a taxpayer, you pay less tax

during the early stages of a property's life, providing you with improved after-tax cash flow. Since money has a time value, a net present value analysis applied to the difference in the annual tax benefits will establish the net present value of these benefits.

You should work with seasoned engineering professionals skilled in all types of construction and experienced with the IRS rules as they apply to a CSS. This allows you to dig into the details to find cost savings that would otherwise be overlooked.

A properly documented CSS can help resolve IRS inquiries at the agent level, while improper documentation of cost and asset classification can lead to an unfavorable audit adjustment.

CSSs benefit a wide range of properties. Tax deferral opportunities exist when you

- ✓ build a new facility;
- ✓ acquire a new or existing facility; or
- ✓ renovate, remodel or expand.

Proper identification and allocation of construction-related costs to assets with short recovery periods is one of the most significant opportunities to reduce your income tax liabilities and improve cash flow from your real estate investments.

Contact your local Auto**CPA**Group member for more information and to get you on your way to improving cash flow. ↵

## DEALERSHIP PROPERTY

**A**re car dealers who own or control the real estate from which they operate only fooling themselves when they fail to charge market-value rent for the dealership property?

Assume the dealer signs a 15-year lease with his real estate holding company for a rent of \$300,000 a year when the going market rent for the dealership property is \$400,000. The dealer may think that, by increasing the dealership operating income by \$100,000 a year and failing to charge market rent, the goodwill value of the dealership will be increased by \$500,000 (assuming a goodwill multiple of 5 times earnings).

However, in this example, the dealer's holding company, which would be locked in under terms of a long-term 15-year lease, would see a prospective real estate buyer set the market value of the dealership real estate at \$3,000,000. This is assuming a capitalization rate of 10%, versus a market value of \$4,000,000 using the same capitalization rate if the dealer had charged fair-market value annual rent of \$400,000.

Here, the dealer has increased the value of dealership goodwill by \$500,000 but at a cost. The prop-



erty value of the dealership real estate is reduced to the holding company by \$1,000,000.

While every situation is different, and while goodwill multiples vary by location and by franchise, dealers who also own their dealership real estate should think twice before entering into long-term leases with their dealerships at below-market rent, as they may find they are significantly decreasing the value of their real estate holdings during the duration of the lease term. ☞

## NADA VEGAS STYLE

**T**he NADA convention held in sunny but not necessarily warm Las Vegas was a bit of a disappointment with attendance down from previous years. The state of the industry still brought many dealers and managers looking for ways to improve sales and their bottom line.

Retaining current customers is always cheaper than trying to obtain new ones. For this reason, customer retention programs were at the forefront for exhibitors on the floor. The techniques used ranged from telephone follow-up to drilling into your own computer system to retain your current customer base.

The seminars, as always, brought many new and old ideas to the dealers' attention and reminded

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them of old processes that may now work again to their advantage. Topics varied from selling menus for sales and service to the power of pay plans in helping to increase dealership profits.

Displayed on the floor of the convention were many new ideas along with some old designs to stimulate vehicle sales. One of the old ideas being reborn was the Dodge Challenger shown in the original design and most popular color—orange.

The exhibitors included many of the regulatory agencies, such as the IRS and the Federal Trade Commission. These agencies were there to remind dealers of their responsibilities for safeguarding

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## NADA VEGAS STYLE

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and retaining records as well as the other filing and disclosure requirements involved in running a dealership.

It was a pleasure to see all of the dealers and staff who stopped by our booth to talk about how the members of the **AutoCPAGroup** can help you maintain your share of the market. See you next year in San Francisco. 📍

For assistance, please call 1-800-4AUTOCPA or see our website at [www.autocpa.com](http://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) is 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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