



# HEADLIGHTS

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## CURBING: THE SILENT GROSS STEALER

Wayne Zimmerman  
Weinhold & Associates, LLC

**T**erry excitedly walked into the showroom in anticipation of the purchase of a new Mercedes-Benz E320. John, a car salesman, performed the usual sales process and inquired about her trade. He got excited when she told him she had a low-mileage Mercedes-Benz C280 that was garage-kept and maintained to the exact factory specifications.

Art, the used car manager, was just as overwhelmed by the condition of the vehicle. C280's were a particularly strong seller in the area and he knew that he would move it almost immediately. He wrote \$21,600 on the appraisal sheet, \$1,000 over book.

Instead, John told Terry the trade-in allowance was only \$19,000, so he offered a proposition to Terry. He suggested that he contact his friend Chris and see if he could get a little more for the vehicle trade-in. John came back saying Chris was on the way with a certified check in the amount of \$19,500.

Later that afternoon, Art ran into

Terry and wanted to apologize about his trade-in offer and explain that it was \$1,000 over book and it was difficult for him to step up much more than that. Terry was surprised when the \$21,600 amount was mentioned. It was then that she told him about John and his friend Chris buying the vehicle directly from her.

When confronted with the evidence, John admitted what he had done and that he had an ownership interest with his friend in a wholesale lot. He openly admitted he swindled the dealership of more than 100 cars during his five years of employment. Given an

average used vehicle gross of \$2,600, the gross loss to the dealership exceeded \$260,000.



*please turn the page* ➤

**REINSURANCE  
COMPANIES ARE  
ALIVE AND WELL**

**HOW MUCH  
IS THIS DEALERSHIP  
WORTH?**

alive and well, despite claims of an August 2004 article in *Automotive News* stating otherwise. This code section allows a small property and casualty insurance company (less than \$1,200,000 in annual premiums) to be taxed only on investment income. The author of the article concludes by

stating that, "I am not sure that a lot of dealers' accounting firms are aware of what's going on." Be assured that the members of the AutoCPA Group do know what's going on. We have an ongoing dialogue and relationship with experts like Andrew J. Weill to insure that we do. ☞

## HOW MUCH IS THIS DEALERSHIP WORTH?

Jacob J. Cohen, CPA, CVA, JD  
Walpert & Wolpoff, LLP

**M**any of our clients ask us every year to value their dealership as a measure of changes in their net worth. Some also request us to value a dealership they are targeting to acquire in order to decide how much they should pay for it. In either case, the principle of valuation that applies is the same, although the ultimate result may be different.

Comparable sales are useful in guiding the valuation analyst to a range of values; however, these comparables are hard to acquire. In most cases, they involve variations in franchise, location, management style and capabilities, as well as a host of other factors. In addition, for these comparables to be useful they have to constitute numerous transactions to demonstrate a trend rather than an isolated case, which may not be representative of market conditions.

Rather than describe the mechanics of valuing a dealership, which was the subject of past articles, I will concentrate on some key risk areas that have a material impact on the value of a given dealership.

**1.** There is no question that a Toyota, Lexus, BMW or Mercedes dealership will yield a different value than a KIA, Mitsubishi or Hyundai, even if the volume and net profit are the same. Keep in mind that the franchise value as an asset of the dealership is directly related to the factory long-term outlook, innovation, stability and available supply of products. Franchise value could also change drastically even in the short run. Improved product reliability and the introduction of a 10-year warranty, for example, had a material effect on some franchises almost overnight.

**2.** Location of the dealership is important, espe-



cially since a long-term facility lease and a franchise marketing area that does not allow easy relocation of the dealership bind most dealerships. A dealership property is a single-purpose use facility and, if the dealership vacates the property, the value of such property is expected to drop.

**3.** Economic conditions could have a material impact on dealership valuation. An increase in gasoline prices will affect the demand for certain cars and, therefore, the profitability as well as the market value of some dealerships. Economic conditions in some neighborhoods will also affect income per household as well as volume and profitability of certain dealerships and, ultimately, their value.

**4.** Franchise alignment continues to be a factor in manufacturers' long-term planning. For example, it is difficult to value a stand-alone Pontiac dealership, knowing that the factory may not approve an outside buyer unless the franchise is aligned with Buick and GMC. Valuing a single point in a zone also could be tricky since manufacturers grant a zone franchise such as Lexus and Saturn.

## HOW MUCH IS THIS DEALERSHIP WORTH?

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There are many other risk areas such as environmental issues, factory relationship, possible litigation, financing issues, income tax issues, industry outlook and a host of others.

Remember that the purpose of valuing a dealership is important. Such valuations could be prepared for estate- or gift-tax purposes, litigation support or in connection with a divorce, purchase or sale between partners or outsiders, and a host of other reasons. Finally, a valid valuation has to take all the risk factors into consideration in arriving at its final conclusion. ☞

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This case is a classic example of “curbing.” Curbing occurs when dealership personnel convince a client to sell a trade-in to someone besides the dealer, thus taking away the opportunity for the dealer to profit on the trade-in.

### How do you stop curbing?

**1** Take control of the deal process. Require a trade-in form to be prepared for every deal. If there is no trade, simply mark “no trade” on the trade-in form. Have the finance and insurance managers review the trade-in sheet with every client and ask why they did not trade their vehicle into the dealership or confirm that there was no trade-in as part of the deal. Make certain that the client reviews and clearly sees the appraised

value on the sheet. This provides deal control to the dealership and allows for constructive feedback from clients as to the adequacy of the trade-in process and the values presented by the used vehicle manager.

**2** Give the general manager a weekly summary of all appraisals prepared. On each appraisal, indicate whether or not the client purchased a vehicle and if so, whether or not the client accepted the value and traded in the vehicle to the dealership. The general manager could then periodically contact a client, whether or not they purchased, to find out if the trade-in offer had anything to do with the buying decision or if there is evidence of curbing. ✍

## REINSURANCE COMPANIES ARE ALIVE AND WELL

**John P. Bachle, CPA**  
**Sartain Fischbein & Co.**

**E**very auto dealer understands the profit potential in owning all or part of a reinsurance company to sell aftermarket financial products such as credit life insurance. Usually the dealership acts as an insurance agent for an unrelated insurance company and is paid a commission for the products it sells. The insurance company then reinsures these policies with a company owned by the dealer. This company is sometimes referred to as a Producer Owned Reinsurance Company (PORC), although technically a PORC is a subsidiary of the dealership corporation. A reinsurance company owned by the dealer should be referred to as an Affiliated Reinsurance Company (ARC).

Andrew J. Weill, an attorney with Benjamin, Weill & Mazer from San Francisco, spoke at a recent AutoCPA Group meeting. Mr. Weill is a leading authority on the tax consequences of reinsurance structures for the automotive industry. He discussed the recent activity at the IRS regarding PORCs.

Due to small casualty insurance companies avoiding tax on all or part of

their income, the IRS has seen some abuse in this area. Some of these companies with little premium income relative to their investment income have been labeled by the IRS as non-insurance companies. Since dealers have a profit motive and other business reasons (e.g., better service to customers) for forming an ARC and the majority of the income are premiums, one should be able to easily defend against an IRS attack.

According to the Pension Funding Equity Act of 2004, a non-life insurance company is now required to have more than half of its annual income from premiums. This will automatically prevent someone from trying to shelter significant investment income by forming an insurance company. However, the law will not allow tax-exempt status to any company if the gross receipts exceed \$600,000. This rule will include revenue from all companies under common ownership, which, in effect, now prevents all reinsurance companies from being tax exempt under Section 501(c)(15).

Reinsurance companies operating under IRC Section 831(b) are still

