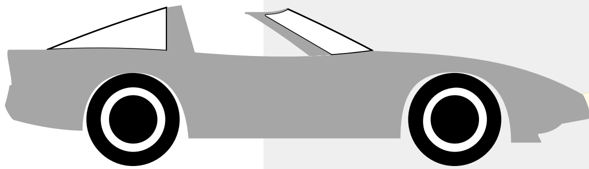

HEADLIGHTS

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PROPERLY CLASSIFYING WORKERS

The Governmental Accounting Office reports that approximately $20 billion annually is lost because employees are misclassified as independent contractors (ICs). And when the collection of taxes is at stake, the IRS is called in to find the perpetrators. But if you apply the following rules set forth by the IRS when determining whether to classify a worker as an IC or an employee, you may avoid having to pay back FICA and FUTA taxes.

Gerry Green, CPA
Green & Miller, P.C.

ICs are not required to follow any instructions provided by the company, nor are they supervised by the company's personnel. Furthermore, ICs do not receive any training from the company on how to perform the contracted work and their hours are not dictated to them. ICs are only responsible to the company for the end result of their work. Employees, however, are told by the company what to do, when and how to do it, and are required to follow company policies and procedures.

ICs are financially independent of the company for which they are providing services. They should be able to perform the assigned job by using their own tools, facilities and human resources. The ICs' investment in their trade or business then creates the risk that completion of their projects will result in profits or losses. Furthering the element of financial independence, ICs are not paid on an hourly or periodic basis, but rather by the job or based on the percentage of the job that is completed.

True employees, however, are financially reliant on the company, from reimbursement of business expenses to monthly salaries. More importantly, employees cannot realize a profit or suffer a loss when employed by a company.

An employer and IC relationship most likely exists when the four following conditions are present: (1) both parties sign a written contract or agreement,

please turn the page ☞

WINTER 2003

CUSTOMER RECEIVABLE CONTROL

WEALTH-TRANSFER PITFALL

A VERY IMPORTANT PHONE CALL

(2) work is temporary (worker does not provide services on a full-time basis), (3) contractor's services are available to the general public, and (4) company does not provide health or other employee benefits.

The IRS can help decide whether a worker is an IC or employee. To ensure compliance with employment and tax laws, also consult with your CPA and legal counsel for guidance.

CUSTOMER RECEIVABLE CONTROL

Ruxandra Barbulescu
Henry & Horne, P.L.C.

It is very easy to sacrifice the quality of a receivable just to make a sale. This practice, commonly found in dealerships, can have a negative effect on many areas—especially customer receivables. Adequate receivable control focuses on two aspects: prevention of bad receivables and collection.

There are a few things dealers can do to minimize losses. Credit reports are run for a reason and can offer valuable information about the customer. Collect accurate information, such as home and work addresses and phone numbers (try to avoid post office boxes).

Sign up with a guarantee check company. They usually charge a percentage of how much they collect for you, but they are a lot faster at getting your money back than doing the collections in-house. If you decide to go this route, make sure you train the people involved on all rules and procedures that apply to the guarantee company.

The other option is collecting the funds yourself. Timing, consistency and persuasive writing skills are key elements. Hire a process server and establish a good working relationship with the small claims court. Don't forget that as you get deeper into the collection process, certain laws apply—especially with regard to privacy issues and bankruptcy. Train your people about these laws or you can face expensive consequences.

The monitoring should not be limited to down payments. First payments to the bank made on behalf of the customer, license fee shortages or customer rebates are definitely worth paying attention to. However, all these can turn into customer-satisfaction concerns if they are not treated carefully.

In an efficient dealership, a contract should be approved and paid in less than 15 days. There are circumstances when the bank will take longer to approve the contract. In that case, the dealer will be required to make a payment even though the customer is driving the car. It is crucial that the dealer inform the customer about this as soon as possible and request reimbursement. If the customer does not know, it will be hard to make him or her understand a month or two down the road why he or she has to send another check to the dealership.

License fee shortages work the same way. License fees are estimated, which means the customer may overpay or underpay. If he or she overpays, the dealership should issue a refund. If he or she underpays, the dealership should inform the customer and ask for payment. The customer should be made aware that this might happen when signing the papers.

Rebates, on the other hand, should be treated differently. At times, salespeople get carried away and promise rebates that can be used as cash down or price reduction without making sure the customer qualifies. However, the factory can refuse payment, and calling the customer for the lost money can be detrimental for the business. Your personnel should be up-to-date on all rebate and incentive programs to avoid this situation.

The back end should not be forgotten, either. Don't let vehicles be picked up out of the body shop or service department without payment. Even though this is a common sense rule, it is amazing how many times it is ignored.

The collection process is not easy or fast, so some dealerships choose to write off receivables without any effort to recuperate the money. Keep your dealership's receivables under control or you will lose money and possibly damage your reputation.

WEALTH-TRANSFER PITFALL

Jeff Jensen, CPA
Jensen & Keddington, P.C.

Many dealers have used wealth-transfer tactics to transfer property out of their estate. A limited liability company (LLC) can be set up to house their real estate and each year, they can gift a percentage of that LLC to their children and/or grandchildren in the amount of the annual gift-tax exclusion using a valuation discount. Over time, they are able to get a large portion of their wealth out of their estate without using the unified credit.

Due to a recent court ruling, this planning method may no longer be allowed. In *Hackl v. Commissioner* (118 T.C. No. 14, 3/27/02), the Tax Court ruled that gifts of LLC membership units were not eligible for the annual gift-tax exclusion because the gifts had no present-interest component. The decision was based on prior rulings that require the gift of either the property interest or the income from that interest to provide a current substantial economic benefit to the donee. In the Hackl case, there is no present interest element, meaning there was no immediate use, possession or enjoyment of the gift.

The court concluded that restrictions in the LLC operating agreement disallowed the gift from being a present interest in the property based on the current income stream because the timing and amount of distributions were at the manager's discretion.

The LLC operating agreement indicated the following factors, making it difficult to show a present interest:

✔ The lack of ability for a member to withdraw capital from the company without the manager's consent.

✔ The lack of ability for a member to withdraw from the company without first offering units for sale to the company, with the manager having full authority to accept or reject the offer.

✔ The lack of ability for a member acting alone to dissolve the company.

✔ The lack of ability for a member to transfer units to third parties without the consent of the manager.

The court used a three-pronged test to analyze present-income interest: 1) that the company will receive income, 2) that income will flow steadily to the members, and 3) that the portion of the income flowing to the members is determinable. Because the Hackl entity generated losses in all years under review, it failed the first criterion. The court also indicated that even if it passed the first criterion, the LLC operating agreement provision that gives a manager full discretion to distribute income to the members would cause the second criterion to fail.

While this wealth transfer can still be a good method to use, you need to incorporate the above items to ensure that a valid gift has been made.

A VERY IMPORTANT PHONE CALL

Robert Deering, CPA
Pomares & Co.

I met with a dealer the other day to discuss ideas on generating the optimal CSI, QCP, etc. ratings from the respective factories. With the factory programs becoming a major priority (they generate a sizeable amount of dealer cash), this is very important for current, as well as future, franchises.

While I was there, the dealer got a phone call from another dealer who is a member of his franchise's dealer council. They let me listen in on their conversation. And what this dealer came up with was an idea I felt was worth passing on.

The dealer stated that the factories are only concerned with business that directly concerns them—the work performed in selling vehicles and selected warranty work in the service department. So, each night, a detailed list of every new vehicle sold that day and

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A VERY IMPORTANT PHONE CALL

(continued from page 3)

each warranty job completed is given to the dealer. The dealer then calls each of the customers on this list to find out if everything was performed to their satisfaction.

What is the benefit of these calls? First, the customer is impressed that the person who has his or her name on the franchise is interested enough to call for feedback. Second, if there is a problem, the dealer finds out that day and can take corrective measures before surveys are distributed. It is also a good way for dealers to find out what managers are not telling them.

While this may not be practical in a large metropolitan area, it is a very good idea for dealers in a smaller market area, where one to two hours a night could save a number of headaches and also help assure a dealer that factory cash keeps coming in.

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. It is recommended that you obtain professional advice with respect to any information that is covered in this newsletter.
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