

# AUTO FOCUS

Summer 2010



**Demystifying health care reform**

**Go green, create some green**  
*7 ways to help the environment and your bottom line*

*Cost segregation*  
**Is it time to study?**

**Leasing strikes back**



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# Demystifying health care reform

**R**ising health care costs pose a big challenge for dealers today — and recent health care legislation has only complicated matters. The Patient Protection and Affordable Care Act and its sidecar legislation, the Health Care and Education Reconciliation Act, seek to contain health care costs and prevent insurance companies from dropping or denying coverage for people with medical problems.

There's a lot of confusion about how — and when — the new legislation affects small businesses. Here we address how health care reform will affect dealers over the next few years.

## Small business tax credits

Many dealers are counting on small business tax credits equal to 35% of health insurance premiums paid in 2010 through 2013. But the law's fine print significantly limits how many dealers will qualify for the full credit.

The credit only applies to small businesses that pay at least 50% of employees' health benefits, have fewer than 26 "full-time equivalent" employees (FTEs) and pay average annual wages of less than \$50,000. Excluded from the head count are seasonal workers, self-employed contractors, and most small business owners and their dependents.

The tax credit is gradually phased out for businesses with 10 to 25 employees or that pay average annual wages of \$26,000 to \$50,000. And the credit may be limited if the average small-group premium in your state — yet to be determined — is less than you pay.

If your dealership qualifies for the small business credit, there's good news: The credit can jump to 50% of the cost of premiums paid through a state-run insurance exchange in 2014.



## Required coverage

Starting in 2014, individuals without Medicare or Medicaid coverage must secure health insurance coverage or face penalties. Low- and some middle-income individuals may be eligible for tax credits to subsidize the cost of insurance.

Likewise, in 2014 employers must provide health benefits to employees who work at least 30 hours per week or face paying a \$2,000 penalty per employee. (The first 30 employees aren't counted in the fine, however.)

Small businesses with fewer than 50 employees are exempt from the insurance mandate. Some dealers near this threshold may be unable to offer health care to all their employees. To stay below the 50-employee limit, cash-strapped dealers might, for example, break up operations into separate companies or hire more part-timers. Some owners also speculate that it may be cheaper to pay penalties than to offer health insurance coverage.

## Upcharges on high-income individuals

One way the government plans to fund health care reform is through tax hikes for high-income individuals, including many dealer-owners.

Beginning in 2013, taxpayers with earned income in excess of \$200,000 (\$250,000 for joint filers) will be charged an extra 0.9% Medicare Hospital Insurance Tax.

This change increases the individual's Medicare payroll tax deduction rate from 1.45% to 2.35%. The tax hike only applies to wage earners and self-employed individuals; employers will pay no additional payroll tax.

Wealthy individuals also face a 3.8% Medicare "contribution" tax on unearned income. Interest, dividends, capital gains, annuities, royalties, rents and income from passive activities are fair game. But tax-exempt interest and retirement plan distributions are exempt from the 3.8% surcharge.

### Reporting changes

Health insurance reform also changes IRS reporting requirements. Dealers must report the value of each employee's health insurance coverage on Forms W-2 issued after Jan. 1, 2011. Note that the amount isn't taxable to the employee; it merely must be reported.

Then, starting in January 2012, you must file a record of payments in excess of \$600 made to corporations (not just individuals). The paper trail is intended to improve the IRS's collection rate and help fund health care reform. The Congressional Budget Office hopes the provision will raise \$17 billion over 10 years.

### A moving target

Health care reform is complex and evolving. Most industry authorities remain uncertain about how the legislation will specifically affect automakers, suppliers and dealers. The bulk of its provisions aren't effective until after 2013, and the government promises to publish additional clarification as different aspects unfold.

Insurance and tax professionals can help you stay atop the latest updates and changes. They can ensure your health care coverage is both cost-effective and compliant with the new rules. ■

## Lower health care costs *now*

Health care reform aims to gradually lower insurance costs by 2018. But there are ways to immediately reduce the cost of employee benefits:

**Reduce coverage.** One way to lower insurance costs is to downgrade coverage. Find a plan that has higher deductibles and co-pays, for example. Or, instead of providing 100% coverage, you might require employees to foot a percentage of the premiums, or an increasing percentage if they already pay a portion. Another solution would be to lengthen the waiting period for benefits for new hires.

**Offer a cafeteria plan.** Give employees a list of benefits; then let them customize a package that fits their individual needs. The more options an employee wants, the more money that's withheld from his or her paycheck.

**Shop around.** Nobody likes change, but employees may be more accepting if they know you're working as hard as you can to keep their costs low and benefits high. Trade associations might offer lower rates, because you'd belong to a large insurance pool.

Plus, changing providers lets you reduce premiums by swapping insurance policy terms. For example, your new provider might offer lower co-pays but higher deductibles.



# Go green, create some green

## 7 ways to help the environment and your bottom line

**A**dopting sustainable business practices isn't only the right thing to do — it also makes financial sense. You can reduce your dealership's operating costs with simple facility upgrades and everyday changes. Here are seven ways to do just that:

**1. Do a cosmetic makeover.** Going green can be as easy as putting blinds on westward-facing windows to lower air conditioning bills and reducing water consumption with toilet inserts, low-flow aerators on faucets, or pressure-reducing valves near the water meter.

**2. Invest in upgrades.** Replace drafty windows and install solar panels to help lower heating and air conditioning bills. Ask your CPA about the availability of federal stimulus money or tax credits for energy-conservation projects initiated in 2010.

**3. Adopt green habits.** Ask your employees to help brainstorm changes to old habits. Some ideas: Set energy-saver modes on computers, install motion detectors on lights, turn off equipment at day's end, and file titles and liens electronically.

*Ask your employees to help brainstorm changes to old habits.*

**4. Bring it outside.** Improve water retention by mulching flower beds. Lower sprinkler consumption by as much as 10% with soil moisture sensors.



**5. Get an energy audit.** Most utility companies offer an energy consumption audit for a small fee. They evaluate where you spend the most money — and what the expected financial payback will be for upgrades. Your gas or electric company also may offer rebates or low-interest loans for improvements.

**6. Check with your manufacturer.** Ford launched a voluntary "Go Green" program to help dealers reduce energy consumption. For a small fee, it assesses a dealer's energy use and recommends ways to improve efficiency. Your factory may have a similar initiative.

**7. Keep it up.** Once you turn over a new (green) leaf, make sure you maintain it. Track your progress by comparing utility bills year to year, and make note of the savings, which mount up fast. ■

## Cost segregation

# Is it time to study?

**W**ith the current down economy now hovering at the two- to three-year mark, you may have run out of ways to cut back on expenses at your auto dealership. But don't despair: Some funds — in the form of tax savings — may be literally in front of your nose and on your walls, floors and ceilings.

How? With a cost segregation study.

### What is it?

A cost segregation study allows businesses that have constructed, bought, expanded or remodeled real estate to speed up depreciation-related tax deductions. To do so, the study identifies and segregates *property costs* depreciated over the standard 39-year period that can be reclassified to shorter depreciable periods.

A cost segregation study is generally a wise move when you're building a new facility. But it also can be used if you purchase an existing building — or improve, renovate or expand an existing building you own. A study also is often worthwhile when you spend your own funds for substantial improvements on a building you lease.

The optimal time to perform a cost segregation study is during construction or remodeling while the contractor can more easily help identify costs. But the analysis can be performed at any time.

### How does it work?

If you're purchasing an existing building, a cost segregation study will determine how to allocate the purchase price between various categories for depreciation purposes, rather than depreciating the entire building over a painstaking 39 years.

The study (and report) should classify assets into property classes such as land, land improvements (parking lots, sidewalks, landscaping), and building and personal property (decorative fixtures, cabinets, security systems). It also should explain the rationale (including legal citations) for the classifications. Finally, the study should substantiate the cost basis of each asset and reconcile total allocated costs to total actual costs.

And that's not the only opportunity for tax savings. By categorizing items as other than buildings, you also may qualify them for expensing under Section 179. This allows you to deduct the entire cost of an item in the first year. But be mindful: There are overall limitations on this deduction, and you can't use it to create or add to a net loss for the business.

### Who conducts the study?

A cost segregation study calls for a team of experts well versed in tax laws and regulations, as well as engineering and construction principles. Preparation requires knowledge of both



the construction process and the tax law governing property classifications for depreciation purposes. Experience in cost estimating and allocation also is important.

Your CPA can play a starring role, quantifying building components and estimating the costs of those components under IRS guidelines. For larger projects, the team also may include a contractor, engineer and architect.

The team will examine your dealership's walls, floors, ceilings and plumbing, as well as its electrical lighting, telecommunications, and heating and cooling systems. Its aim will be to identify the components that qualify for accelerated write-off periods.

For new construction and remodeling, team members will analyze detailed working drawings, mechanical and electrical plans, and blueprints to segregate the structural, electrical and mechanical components from those linked to personal property. The study also will allocate "soft costs," such as architect and engineering fees, to all components.

### How much tax savings can you expect?

Tax savings can be significant for property with a shorter "useful life" for tax purposes. For example, you might be able to classify:

- Your parking lot and landscaping and shrubbery as 15-year property for a net present-value tax savings of about 8 cents per dollar,
- Your ventilation system or computer-capable wiring and flooring as 5-year property for a savings of about 21 cents per dollar, and
- Furniture and fixtures as 7-year property for a savings of about 18 cents per dollar.

Beware: Tax rates are scheduled, and expected, to rise in the future. This can have an impact on projected present-value savings, reducing the benefits of a faster write-off.

### Start from the beginning

To get an idea of how a cost segregation study can benefit your dealership, contact your financial advisor. He or she can help you evaluate whether it would be worthwhile to conduct a study. ■

## Leasing strikes back

**A** long time ago at a dealership far, far away, leasing was a profitable way to get car enthusiasts into vehicles they couldn't otherwise afford. But when residual values unexpectedly nose-dived and gasoline prices skyrocketed, finance companies slammed the brakes on leasing contracts.

Leasing bottomed out in the third quarter of 2009, accounting for just 15% of financed deals, according to the Power Information Network (PIN), a division of J.D. Power and Associates. Now, according to many industry sources, leasing is making a slow comeback. According

to PIN, for example, leasing accounted for 25% of financed transactions in the first quarter of this year.

### Structuring profitability

Ensuring that lease agreements are profitable is paramount. Thus, you need to make sure that lease payments cover interest costs *and* the spread between the vehicle's capitalized cost and its residual value.

*Capitalized cost* is a lease transaction's equivalent of a selling price; this is the key negotiating point between customers and dealers — although some lessors don't realize that cap cost is negotiable.



You can boost profits by keeping the capitalized cost as close to the MSRP as possible. This expands the gap between the cap cost and residual value.

At the end of the lease term, a leased vehicle often goes back into your inventory, which gives you an opportunity to clean it, certify it and resell it. Think: more profits. Pay close attention to the vehicle's condition upon return. Money spent getting a vehicle sale-ready only eats away at your bottom line. It's OK to charge for excessive wear and tear, such as scratched bumpers, cracked windshields or stained interior carpeting.

*Residual value* is how much the finance company thinks the car will be worth at the end of the lease term. Higher expected residual values mean lower lease payments, because the difference between the capitalized costs and residual value is smaller.

The *expected* residual value is an educated guess based on historic residual values. A car's *actual* residual value at the end of the lease term may be higher or lower.

### **Riding the resurgence**

Many of the same factors that have increased used car prices are helping leasing companies slowly recover. Consumers are keeping their cars longer and factories have cut back production. A lower supply of 2- to 4-year-old vehicles translates into higher used car (and residual) values.

Higher actual residual values are making leases more affordable. And automakers — desperate to “move metal” — are luring gun-shy consumers with special lease incentives. For example, some

offer inflated residual values or they may buy down the customer's interest rate.

### **Training staff**

Leasing has fallen by the wayside; so, your sales and F&I staff may be rusty. Now is the time to reacquaint them with leasing fundamentals. They should be able to explain the pros and cons of leasing to customers. That includes excessive mileage, early return, and wear-and-tear charges, as well as the importance of having gap insurance coverage, a lucrative — but prudent — F&I product that protects the lessee if the car is wrecked early in the lease term and insurance proceeds don't cover the lease contract's balance.

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Leasing isn't for everyone — it's a matter of personal preference and driving habits. The best leasing candidates want a new car every four years (or less), drive less than 12,000 miles per year (the typical annual mileage allowed under most leases), and stay atop maintenance. Leases also are more popular for luxury cars that retain their value and appeal to executives with auto spending allowances. Never push a customer into a lease they'll regret or can't afford.

Also educate your staff about the latest subvented leases, where the manufacturer provides special lease incentives to promote certain product lines. These deals can be a win-win situation, and they build customer loyalty.

### **May the force be with you**

If you've turned your back on the lease market, you might want to reconsider. Don't miss out on sales and F&I opportunities. Your CPA can review the structure of your leasing agreements and help you bring leasing activities rocketing back to profitability. ■

# Service that moves your dealership ahead

**A**utomobile and truck dealers face special challenges. To meet them, you need the assistance of professionals who know the automotive industry and have the specialized expertise it takes to help dealerships and their owners increase their financial success.

This is where we come in. The principals at Johnson Jacobson Wilcox have been serving dealerships in Nevada, Utah, Idaho and Arizona since 1981. We combine a commitment to providing services of the highest quality and integrity with a belief in the value of business relationships built on trust and understanding.

To keep abreast of developments in the industry, we are a member of the CPA Auto Dealer Consultants Association (CADCA), a nationwide group of CPA firms specifically

selected for their experience in and dedication to serving automobile dealers.

## We are ready to help in these and other areas:

- Acquisitions and divestitures
- Estate and financial planning
- Business valuation and succession
- Fraud prevention and detection
- Employee benefit plans
- Litigation support
- Benchmarking and performance measurement
- Management and technology consulting



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We would be glad to answer any questions you may have about the topics discussed in this issue or about others related to running a profitable dealership. Please call us at 702-304-0404 and let us know how we can be of service.



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