16th ANNUAL CEO/CFO FORUM

NO SPEED LIMIT: THE PACE OF DEALERSHIP CHANGE

AutoTeam America (ATA) hosted its 16th annual forum event at the NADA Convention in Orlando, Florida this year and despite the weather problems in the Southeast that delayed and cancelled many flights, attendance at the event was as strong as ever. The timeliness of the topics coupled with the quality of the speakers continues to draw dealers and industry personnel to the event to discuss where we've been, where we are and the future of the automobile industry.

This year's event featured speakers including Dale Pollak, founder and chairman of vAuto and author of *Velocity: From the Front Line to the Bottom Line* and Erich Merkle, president of Autoconomy.com. Both speakers offered insights into the future of the dealership world in the new, post-recession economy we all find ourselves operating in today. The forum was proudly sponsored by Allstate® Dealer Services and Comerica Bank. ATA thanks both of our sponsors for helping to make this a complimentary event for participants this year.

Mr. Pollak spoke about the compression of margins occurring in the current economic environment indicating that it is an uphill battle to make average gross profits seen in the past with the prevalence of the internet and tighter lending limits on used cars, especially. Although some of the entire gross limits can be overcome with increasing volume (throughput velocity), that alone will not make up the gross profit many dealers need.

Furthermore, variable operations have become increasingly complex over the last few years. The sales manager of the past is just that – the past. Today's sales managers must perform many more tasks that are operationally intensive and must possess a more diverse set of skills to complete these tasks, manage the sales force, manage the deal process and sell cars. Unfortunately, most sales managers are ill-equipped to deal with this more intense sales environment that is more task oriented and less sales oriented.

Pollak discussed his dealership structure of the future – an evolution of the process. In the new dealership structure that is necessary to respond to today's more internet savvy customers, the new and used sales departments are no longer, can no longer, be separate departments. For one thing, it's financially not feasible – today's dealership can no longer afford the overhead necessary for separate sales managers, sales personnel, facilities, etc. The variable operations of today is not divided into new and used, but by function – sales (new & used combined), inventory and pricing and marketing departments.

Under the new combined variable operations division, documentation is the new negotiation, noted Pollak. Sales personnel must evolve into product specialists. Finding the right vehicle for the customer in today's sales environment is a collaborative effort between the product specialist and the customer – learning the customer's needs for a vehicle and finding the vehicle that fits those needs best. Moreover, the product specialist of today's dealership needs to be more productive than the sales person from yesterday. With margins squeezed, commissions are also under pressure.

Inventory and pricing department in the new dealership of today is not the domain of the old world used car manager – and it's not a new or used department. In fact, it's important that the managers collaborate when ordering new vehicles, taking used vehicles in on trade, and purchasing used vehicles at auction or from wholesalers. Pollak notes that the happenstance inventory/stocking methodology won't cut it for today's dealership. Inventory and stocking must be engineered to precise standards. Today's variable operations manager must be a student of the game – studying the market to discover what vehicles are selling, what trim levels are most demanded and what the price-point is that gets a car sold quickly.

Finally, marketing is key to getting customers in the door with a desire – and ability – to buy. Print and traditional electronic media are less important in marketing today's dealership and its vehicles. This department requires a more computer savvy leader with the ability to respond to changes in the market quickly and focus on various marketing tasks almost simultaneously – updating websites with new inventory and pricing, responding to customer inquiries and dispatching opportunities to the sales force.

Mr. Pollak answered questions from the audience for several minutes at the conclusion of his prepared remarks. Notable themes of his answers included:

- There is no rationale for pricing cars high or low generically; pricing is a function of supply and demand, not a fixed percentage.
- Forty-five (45) days is the new sixty (60). Turn of vehicles needs to be thirty (30) days.
- As the market becomes more efficient, margins will diminish, but it's not a race to the bottom. Differentiation is key.

Erich Merkle, president of Autoconomy.com spoke briefly on "The Future of Automotive". He predicts a rebound of new vehicles sales in the United States to 12.5 million units in 2010 and further indicated a desire not to return to the pre-recessionary levels at 17 million units annually. Mr. Merkle believes a 17 million market is too high citing easy credit and people feeling wealthy as causes for spending too much which contributed to the severity of the recent recession.

Mr. Merkle also commented about automakers generally, noting that manufacturers need to have the right product in place before the market arrives. Similarly to Mr. Pollak's comments about studying the market at the dealership level, Merkle notes that

***(Forum** cont. on page 2)*

(*Forum* cont. on page 2)

continued revelations from the mishandling of this situation. Also, he noted that Ford gained a point of market share in 2009 and he believes it will gain another point of market share in 2010. Chrysler, Merkle indicated, is losing share and he predicts it will continue to lose share in 2010 and for the foreseeable future.

Mr. Merkle concluded his remarks noting that the next two years will be much better.

The final portion of the forum event was the always popular Panel Speakers with Jay Ferriero, senior vice-president of Capital Automotive serving as moderator. Panelists this year included Christopher C. Hoffman, Esquire, managing partner with Fisher & Phillips, I. Bradley Hoffman, co-chairman of Hoffman Auto, David P. Kelleher, president of David Auto Group, Richard N. Sox, Jr., Esquire, with Bass Sox Mercer and Erik Day, chief financial officer of Warren Henry Automobiles, Inc.

The panelists spoke and commented on a number of industry issues including expectations for unit sales which most expected to be up for 2010 – killing 2009 as one panelist noted. Day noted that manufacturers are talking about increases of 20 – 25% in 2010.

Despite the talk of increased unit sales in 2010, there was much discussion about the compressed margins (as noted in Mr. Pollak's address). Day noted that the F&I departments in his organization were stable – which he referred to as the, "new manufacturers need to study the market more carefully and respond appropriately with products that the buying public need and want.

Further, he predicted that Toyota will lose market share over the massive recalls surrounding the unintended acceleration issues with several popular models and the continued revelations from the mishandling of this situation. Also, he noted that Ford gained a point of market share in 2009 and he believes it will gain another point of market share in 2010. Chrysler, Merkle indicated, is losing share and he predicts it will continue to lose share in 2010 and for the foreseeable future.

Mr. Merkle concluded his remarks noting that the next two years will be much better.

The final portion of the forum event was the always popular Panel Speakers with Jay Ferriero, senior vice-president of Capital Automotive serving as moderator. Panelists this year included Christopher C. Hoffman, Esquire, managing partner with Fisher & Phillips, I. Bradley Hoffman, co-chairman of Hoffman Auto, David P. Kelleher, president of David Auto Group, Richard N. Sox, Jr., Esquire, with Bass Sox Mercer and Erik Day, chief financial officer of Warren Henry Automobiles, Inc.

The panelists spoke and commented on a number of industry issues including expectations for unit sales which most expected to be up for 2010 – killing 2009 as one panelist noted. Day noted that manufacturers are talking about increases of 20 – 25% in 2010.

Despite the talk of increased unit sales in 2010, there was much discussion about the compressed margins (as noted in Mr. Pollak's address). Day noted that the F&I departments in his organization were stable – which he referred to as the, "new up." Generally, the panelists were cautiously optimistic about the future amid struggles at automakers like Chrysler to rebuild an image, Infiniti to become a tier one player, and Toyota and Lexus to overcome the taint of massive recalls that are threatening to tarnish the automaker's reputation for quality and safety.

Another topic of discussion was the Employee Free-choice Act which provides for secret ballot election elimination with respect to unionization of businesses. Panelists and business owners believe this will lead to an increase in unionization and suggest that dealers work harder to develop relationships with fixed operations employees as a measure against the peer-pressure that develops in non-secret ballot elections.

New franchise agreements were another hot topic for the panel and all dealers can expect new franchise agreements to be coming down the pike in the near future – re-contracting. Panelists and the audience alike believe the agreements will be more onerous with more exacting facility requirements, facility upgrades, and sales and customer satisfaction requirements.

The last topic of the forum was Chrysler's viability. Both attorneys indicated that many dealer clients are questioning the viability of Chrysler after the automaker shut down 789 stores in 2009. However, several panelists noted that Marchionne is a "smart guy" who could turn things around at Chrysler.

To hear the entire program, download the audio and handouts, at www.autoteamamerica.com.

IRS PROPOSED REGULATIONS PROVIDE POTENTIAL OPPORTUNITY TO INCREASE

The opportunity

Staying competitive requires substantial recurring capital outlays. Maintaining equipment, replacing worn-out fixtures, reconfiguring tenant spaces, maintaining and repairing roofs, and upgrading to a new franchise image are just a few examples of the costs that business owners incur. In the past, tax law did not provide clear direction on how to treat these costs. Since the costs relate to capital assets, most taxpayers conservatively considered them building components, typically depreciating them over 39 years. Proposed Regulation 1.263(a)-3 now provides guidance on how these costs should be treated for tax purposes. The guidance is generally favorable to taxpayers, because it may allow these items to be deducted currently as repairs and maintenance expenses, rather than depreciated over long periods.

Benefits

There are two benefits that result from the ability to currently expense costs that would otherwise be capitalized and depreciated. The obvious benefit is that a deduction that reduces taxable income today is worth more than a deduction in the future due to the time value of money. Currently deducting amounts that otherwise would be depreciated over 15 or 39 years can easily return up to $25 for each $100 spent. The less obvious benefit is that reclassifying these costs as repairs and maintenance allows you to avoid depreciation recapture when you eventually dispose of the property. By avoiding depreciation recapture, you can convert ordinary gains into capital gains, which are currently taxed at lower rates. This can provide another $5 to $10 of return for each $100 spent.

Solutions

The ability to deduct the types of costs discussed above will depend on your particular facts and circumstances, and will require proper analysis and documentation to meet the requirements of the proposed regulations. Analyzing your repairs and maintenance costs will:

- Provide you with the opportunity to structure current and future projects for maximum tax benefits.
- Allow you to review projects completed in prior years to consider if remaining depreciable basis can be deducted currently.

Please contact your local Auto Team America representative for further information.

TAX TIP — WHETHER SEVERANCE PAYMENTS ARE SUBJECT TO FICA

An employer who made severance payments to terminated employees or terminated employees who received severance payments should consider timely filing a claim for refund if FICA taxes were withheld and paid by the employer.

A recent district court decision, *U.S. Quality Stores, Inc., et al.*, February 23, 2010, concluded that any payment to an employee pursuant to a plan under which payments are made to an employee because of the employee's involuntary separation from employment (whether or not temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions while includible in gross income for purposes of the income tax are excludable from being considered "wages" subject to FICA or FUTA tax.

Recommended Action

While it is understood that this judgment will be appealed, we can file protective refund claims for FICA taxes paid on account of severance pay. While no refunds will be issued until the appeals process is exhausted, companies should file protective refund claims for FICA tax paid on severance pay, citing this decision. This is particularly true for businesses that had layoffs in 2006, because the statute of limitations for 2006 expires April 15, 2010, Claims may be submitted on Form 843 or Form 941X. Employees can file for their half of the FICA tax, or the employers can claim both halves. If claiming both, employers must first refund the workers' share or get their consent to claim for their portion. If successful, the employer agrees to refund the employees' share of FICA directly to them.

You should consult with your ATA representative to determine how and if the above provision applies to your situation.