

VOLUME OR GROSS ??

We review quite a few financial statements on a regular basis. All the franchises' financial statements are quite different in format and how the financial data is displayed for your review. Each franchise seems to think its format is the best to inform you as the dealer how your business is performing.

Well, they are very different, but the basics remain. There is a balance sheet and an income statement. The income statement is broken up into many departments; new, used, F&I, service, parts, body shop, rental, quick lube, etc. Some statements show some of the variable expenses under the sales and gross profit area and others show the gross and all expenses separately.

It doesn't really make much difference, as most dealers look at the bottom line on the front page and then turn to the second page to see the summary of all gross and expenses. Some even turn to the sales and gross profit pages to see if the counts seem right and the grosses appear to be reasonable based on what type of month they think they had.

Are you a volume unit dealer with low to average grosses or are you a large grosser with a lot less units? You could sell 100 units at an average of

\$1,000 gross profit on the front end or you could sell 65 units at an average of \$1,550 gross profit. Either way you get to \$100,000 in gross for the month. Which way is better? Well there are quite a few factors to take into consideration.

One is how much inventory you are carrying and how fast you can replace it. If you want to sell 100 units per month you had better get busy and visit the factory order bank frequently, the on-line auctions and even physically visit auctions to purchase enough units to keep up the sales pace you have created.

Another factor to consider is the number of employees you are going to need to sell 50% more vehicles than normal each month. Can you find enough qualified individuals to staff all the positions such as F&I, sales, technicians, detail, etc.? You probably can do this over time as you build up to the increased unit volume.

You will also need to increase your variable expenses considerably to fund the growth in units, such as advertising, interest, commissions, drivers, etc. to handle the volume of increased dealer trades and picking up cars at the auctions. What you have to make sure of is these expenses don't increase

disproportionately to the gross generated. Remember to make the same net bottom line income you can't increase your expenses very much over what you are already incurring.

Another factor to consider is your geographic area and the population around you. Can it provide enough customers in your market area to supply the sales volume you want to achieve? More and more dealers are finally understanding the power of the internet and driving traffic to their store with a lower cost than the older more conventional ways of newsprint, cable, TV and mailers. It is not that these methods of advertising don't work, it is just they may not work as well as they have in the past.

For example, I don't know very many people under the age of 40 to 45 who read a newspaper. The more preferable method is to view everything online. More and more people are spending their time either in front of a computer, a TV or listening to the radio while driving. With the increased use and decreasing cost of smart phones, the computer has become very portable. As I travel around the country in and out of airports, hotels, conventions, etc. it seems the

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business to go into is neck massages. This has to be a growing field as all I see are people looking down at their phones, Kindles or iPads. Sooner or later our necks are going to give out.

One of the problems with volume is when you build up to be a volume dealership and suddenly the economy and car sales dive, you are most likely be left with a higher than normal overhead structure which can totally destroy your bottom line. It can be very hard to shrink down to a workable overhead factor quickly enough, as many dealers have found out. Now everyone hopes this never happens, but it has in the past and will again in the future. You might want to consult your crystal ball to give you enough advance notice (mine is still on back order).

Does it make sense to work almost twice as hard to generate the same gross profit? There are many ways to make money in this business and it seems there is not a "one for all" method of doing so. If you want to increase your unit sales, then start researching dealers you know who have increased their volume considerably and document their advertising, what inventory they are carrying, how many units, how many conventional versus internet sales they have, how far away are customers driving, how many employees do they need to accomplish this, etc.

Remember, you need to not only plan on how to ramp up the volume, but also plan on how you can decrease your overhead expense and become more efficient so if the economy does tank on you, you have a plan in place already. Make sure you don't increase your fixed expenses very much and keep your variable expenses in proportion to the gross you are generating. Complete a projection of what your grosses and financial statements will look like as your unit volume increases at various stages.

Predictions are for vehicle sales to increase as we plod along in this economy. Hopefully the worst is behind us, but we don't want to forget the past and drop into our old ways of management style and not be aware of what is happening around us. We need to constantly keep accepting change in our dealerships and moving forward to ensure we are never at the end of the race but are actually in the race for better profits and a better life.

The final regulations for Net Investment Income Tax include the following "special rules" applicable to many clients:

Self-charged interest. When an individual makes a loan to a pass-through entity conducting a trade or business in which the individual materially participates, the interest income paid by the entity to the individual would be included in net investment income, but the individual's allocable share of the interest expense deduction of the pass-through entity would not be permitted to reduce his net investment income because the expense was generated in a trade or business that was not passive to the individual. To prevent this result, the final regulations provide that in the case of self-charged interest received from a non passive entity, the individual may exclude from net investment income an amount equal to the individual's allocable share of the flow-through entity's deduction. Note that the "special rule" will not apply to a situation where the interest deduction is taken into account in determining self-employment income subject to SE tax.

Example: A loans \$100,000 to X, an S corporation in which A owns a 30% interest. X is not a passive activity to A. X, which conducts a trade or business, pays \$8,000 of interest to A during 2013. Barring a rule to the contrary, the \$8,000 of interest income recognized by A would be included in net investment income. The \$2,400 of interest expense deducted by X and allocable to A, however, would not be included in the computation of A's net investment income because X conducts a trade or business that is non passive to A. Under the final regulations, A may exclude \$2,400 (A's 30% share of X's \$8,000 interest expense deduction) of the \$8,000 interest he receives from X from the computation of net investment income. The remaining \$5,600 of interest income must be included in A's net investment income

Self-charged rent. Under passive activity rules (Section 469), rental activities are treated as passive, regardless of the owner's level of participation. However, when an individual rents property to an activity in which the individual materially participates, any net rental income generated by the property is re-characterized as non-passive income. The final NII regulations provide that if rental income is re-characterized as non-passive by the self-rental rules – or if the rental property is properly grouped with a trade or business under Reg. Section 1.469-4(d)(1) – the rental income is deemed to be derived in the ordinary course of a trade or business. As a result, the income will be excluded from net investment income.

Example: A and B each own 50% of an LLC that rents a building to S Co., an operating S corporation that is also owned 50/50 by A and B. The LLC generates \$20,000 of rental income. For taxable income purposes, the income is re-characterized as non-passive. Under the final NII regulations, the rental income will be treated as having been earned in the ordinary course of a trade or business. As a result, A and B can exclude from net investment income their \$10,000 share of the LLC's rental income.

If you are subject to the Net Investment Income Tax and any of the above situations affect you, you should discuss its impact in calculating NII with your ATA professional.