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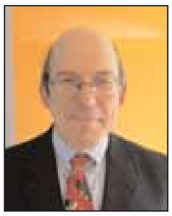
The NADC Newsletter



Andrew J. Weill

Patricia Covington

Buying A Dealership? Recent Tax Decision Raises New Issues

Andrew J. Weill, Esq. and Alexis E. Emmel, Esq.

Recent Tax Court ruling impacts the real cost of legal transaction fees and could cost dealers big money in disqualified write-downs.

We are living through a time when the sale of a dealerships is becoming an increasingly familiar activity. There is no shortage of issues confronting the attorney trying to put together sales documentation that satisfies all relevant concerns. Probably the last thing you want to hear is that the IRS has made your life even more difficult, but no such luck. A recent Tax Court opinion has just complicated two issues: 1) write-downs on acquired inventory and 2) the extent to which legal fees can be expensed.

If your client is the buyer, there are important things to advise them before they close to avoid some of the more painful and expensive aspects of the new ruling.

First, let's talk about how legal fees are now viewed by the Tax Court as part of the transaction. A taxpayer always wants to maximize the amount of legal fees that are

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GLBA Privacy Notices Finallly Get Revamped

Patricia Covington, Esq.

On November 17, 2009, the Federal Trade Commission, along with other federal regulators (Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, Commodity Futures Trading Commission and Securities and Exchange Commission, collectively "Agencies") adopted final model privacy notice forms ("Model Privacy Notice") for compliance with the Gramm-Leach-Bliley Act ("GLBA") and its implementing regulation, the Federal Trade Commission's ("FTC") Financial Privacy Rule ("Privacy Rule"). The Model Privacy Notice replaces the Sample Clauses, which appear in Appendix B to the Privacy Rule, and as such, now provide the safe harbor for compliance.

The Model Privacy Notice is the product of a six-year quest to make GLBA privacy notices more understandable and readable. In addition, the FTC and Agencies aimed for a form that allowed consumers to more easily compare the privacy practices of one financial institution with those of another—something akin to nutrition labels. What resulted is a standardized template that must be completed in strict compliance with the accompanying Instructions.

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From the Editor: Nothing Lasts Forever

Michael G. Charapp

As a young lawyer, I worked for a law firm that specialized in, among other things, white collar criminal defense and representation of witnesses before Congress. I learned that the only thing worse than having a prosecutor get his or her teeth into a client is having a Congressional committee get a client in front of TV cameras. After all, a white collar criminal defendant can reduce prosecution pressure by negotiating a stretch in a country club prison. One can never truly hide from Congressional pressure as long as there are votes to be had.

Toyota is learning that painful lesson. The opportunity to kick around one of the largest foreign companies successfully doing business in the U. S. is a treat that Congress cannot resist. This is not to suggest that Toyota's troubles will destroy it. It is a successful company that will get through this.

These events will, nevertheless, wound the company. Already, customers are threatening to park their Toyotas, demanding that dealers do something to fix the problems. Every front-end collision involving a Toyota for the next decade will be the result of unintended acceleration. Even the late night comics are making fun of Toyota's engineering prowess. There is no surer predictor of the decline of a public figure's reputation than derision by late night comics.

Toyota may be willing to admit errors, but Toyota has left many dealers with little room for error. Many dealers have built palaces at Toyota's insistence, and they must sell and service a lot of Toyotas to pay for them. When Toyota catches cold, these dealers are faced with a life-threatening pulmonary crisis.

This is the latest instance of a sad lesson that too many dealers learned in 2009: nothing lasts forever. At one time, General Motors was king of the automotive world. My late father was a Dodge dealer. More than anything, he wanted to be a Chevrolet dealer. In the last three decades Toyota has been one of the crown jewel franchises. Instead of Chevrolet, dealers aspire to be franchisees of Toyota. I expect, and I hope, that will continue to be so.

However, we lawyers must always counsel caution for our clients who are willing to do anything, pay anything, and personally guaranty anything for a chance at one of today's hot franchises. We must always be mindful of the potential for a manufacturer's unintended deceleration. We must counsel clients about the ways to insulate themselves in the event plans don't work out even with today's sure-thing franchises. After all, nothing lasts forever.

Michael G. Charapp is a lawyer in the Washington, D.C. metro area who represents car dealers and dealer associations. He is editor of the Defender. He encourages submissions for publication, and he can be reached at mike.charapp@cwattorneys.com.

NADC
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Plan to attend!

6th Annual Member Conference

April 11-13, 2010

Dallas

See page 4 for more information. For updates to the program, go to:

http://dealercounsel.com/events.php

Buying A Dealership?
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currently deductible. The IRS wants to characterize the fees as associated with the acquisition of a capital asset, and therefore amortize the deduction over a period of years.

In *West Covina Motors, Inc. v. Commissioner of Internal Revenue*, T.C. Memo. 2008-237 ("*West Covina* I"), buyer and taxpayer Zaid Alhassen purchased a dealership for approximately $6 million and argued that most of the legal fees associated with acquiring the dealership were for inventory that would be sold in 90 to 150 days. Alhassen incurred about $140,000 in legal fees in the acquisition, and he claimed all the fees were attributable to inventory and, therefore, deductible in that year.

Unfortunately for Alhassen, the IRS didn't agree with him, and neither did the Tax Court. The court supported the position of the IRS that because those legal expenses were incurred with the purchase of a capital asset, they were a capital expenditure and needed to be amortized over a prescribed number of years - not, as Alhassen had hoped, deductible as an expense.

The buyer's bare testimony that some or all of those fees were tied to inventory did not satisfy the court's need for evidence. However, luckily for the buyer, the court subsequently allowed further evidence that proved which legal fees were related to inventory and which were not. *See West Covina Motors, Inc. v. Commissioner*, T.C. Memo. 2009-291 ("*West Covina* II"). Although Alhassen could not deduct the entire $140,000, he showed that almost $20,000 of those fees were directly tied to inventory and was able to get part of what he wanted.

In *West Covina* I, the IRS initially wanted the remaining $120,000 in legal fees characterized as section 197 intangibles, essentially requiring the buyer to amortize the rest of his legal fees over 15 years. However, in the end, the West Covina II court recognized that those remaining legal fees could be matched up with the pricing of the assets in the buy-sell agreement — allowing the taxpayer to amortize almost half of the remaining legal fees over 7 years instead of 15. Based specifically on this part of the ruling, the asset allocation schedule is a must in the agreement between the buyer and seller, otherwise the client is at the mercy of section 197 and a needlessly long amortization schedule.

Bottom line, only legal costs directly tied to inventory can be expensed - all other legal fees must be amortized pro rata based on all other non-inventory asset classes. The decision highlights how critical it is to explicitly state asset allocation in the arms-length agreement between the buyer and

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6th Annual NADC Member Conference

April 11 to 13, 2010

Four Seasons Dallas at Las Colinas

Make your plans now to attend the sixth annual meeting of NADC members in Dallas. Sessions are being developed to reflect the special interests of members and the realities of today's auto industry. The meeting opens with a reception Sunday evening, April 11, and will conclude by 1:00 pm on Tuesday, April 13. Register now on the events page at **www.dealercounsel.com**.

The conference is open to NADC members only. Registration is $495 per person and includes receptions, breakfasts, lunch and breaks. The receptions, lunch and breaks provide time for members to get to know each other. CLE credit will be available.

Reserve your hotel room by March 18, 2010 for conference rates: Superior $235; Deluxe $260; Villa $285. All room rates are plus tax and, subject to availability. Contact the hotel by calling 972-717-2499 and referencing NADC.

Brief Agenda

Sunday, April 11 - There will be a meeting of the Board of Directors in the afternoon and the Opening Reception in the early evening.

Monday, April 12 - The day will begin with a continental breakfast followed by a day full of educational sessions punctuated by morning and afternoon breaks and a lunch. There will be ample time for questions and answers in all sessions. A cocktail reception caps off the day's events.

Tuesday, April 13 - A continental breakfast will be followed by the final sessions and will end by 1:00 pm.

Registration fee includes receptions, breakfasts, breaks and Monday's lunch.

Topics Will Include:

- NADA Update
- NHTSA Compliance/Factory Recalls
- Product Liability Issues for Dealers/Class Action Defense
- Rejected Dealer Arbitration
- Regulatory Update
  - Risk Based Pricing Notices
  - Privacy Notices
- A Lawyer's Guide to Understanding Dealer Financial Statements/UNICAP
- Buyer's Orders & Retail Installment Sale Contracts: Can They Play Nice Together?
- Labor & Employment
- Business Software Alliance (BSA)/Payment Card Industry (PCI) Compliance
- Bankruptcy Revisited
- Selling a Car on the Internet

Program updates are posted at www.dealercounsel.com as they become available.

Buying A Dealership?
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seller. In many cases, the allocation of assets may not even be part of the negotiation between the parties, so your input prior to closing could really help your client post-closing when it comes time to expense the legal fees associated with the acquisition.

Now, let's move on to the second aspect of the "*West Covina I*" decision – write-downs. The court found fault with two things the taxpayer did: 1) the inventory write-downs claimed were not adequately substantiated and 2) instead of using the write-down calculation, the taxpayer substituted a reserve amount, violating the IRC regulations.

The taxpayer's CPA determined market value for write-down purposes was the wholesale Kelley Blue Book value based on the assumption that the cars were in average condition. However, his CPA testified that it is necessary to know the make, model and year of each car, as well as the condition, mileage, and equipment options to determine Kelley Blue Book value. The taxpayer's write-down records did not include all of this information. The records lacked make, model, and year for some cars and did not include mileage, condition, or equipment options for any of the cars. The buyer argued that the method used was the industry standard, and that a more detailed analysis would have made little difference in the amount of the deduction. The court was not persuaded by the taxpayer's argument and found that there were incomplete write-down records and a lack of corroborating evidence to support the estimated Kelley Blue Book values.

The buyer's calculations showed inventory write-downs should have been $309,172 for 1999 and $344,207 for 2000. Although the taxpayer recorded the inventory write-down adjustments for these years, the documents showed that he used a reserve offset of $340,181 for each of these years instead of the actual write-down amounts from his records. Substituting a reserve amount in place of the actual write-down violates section 471 regulations.

Taxpayer Alhassen's use of Kelley Blue Book average prices combined with write-downs against a reserve rather than of actual amounts from an itemized schedule had pretty drastic results. The court backed the IRS and disallowed almost half of the write-down deductions because they weren't properly substantiated. This move cost Alhassen $306,000 in write-downs that he had hoped to take over 1999 and 2000.

You may be wondering: how a buyer can actually comply with this ruling? The solution, as with so many tax issues, is to have the documentation, especially if your client intends to be aggressive in taking deductions. There may be some less onerous methods that the IRS will accept if the claimed deduction is more modest than what the taxpayer was trying to achieve in *West Covina*.

The two key takeaways from this case:

1) Legal fees tied directly to inventory can be deducted, *but* the dealer needs to show proof. If the dealer intends to deduct fees associated with inventory, then the dealer needs to maintain clear, supporting records. The remaining legal fees can be amortized based on the buyer-seller agreement showing allocation of the assets – as long as there is an asset allocation schedule in the agreement. If there is no asset schedule, section 197 kicks in and the dealer is stuck amortizing the legal fees over 15 years.

2) If the dealer's goal is to maximize full write-down deductions, keep details for each car, such as make, model, year, mileage, condition, and equipment options. Without proper records, your client could get a nasty surprise when the IRS challenges those unsupported deductions.

Andrew J. Weill is a Principal of Benjamin, Weill & Mazer, APC, in San Francisco. His practice includes complex business, tax and estate disputes across the nation. He is Secretary of the NADC board of directors.

Alexis E. Emmel, also of Benjamin, Weill & Mazer, APC, co-authored the article.

GBLA Privacy …
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There are three Model Privacy Notice forms. The first does not provide an opt-out. The second provides an opt-out by telephone and Internet, and the third provides an opt-out with a mail-in form.

Each Model Privacy Notice form consists of two pages, and may be printed either on two separate sheets of paper or on both sides of a single sheet. The notice may extend to a third page if there is a long list of affiliates or additional information that must be disclosed and exceeds the space available on page two.

There are five parts to the first page: (i) the title; (ii) an introductory section called the "key frame," which provides context; (iii) a disclosure table that describes the types of sharing used by dealers, which of those types of sharing the dealer actually does, and whether the consumer can limit or opt-out of any of the dealer's sharing; (iv) a box titled "To limit our sharing" (if the dealer offers an opt-out) and (v) the dealer's customer service contact information. The dealer will also identify on the first page the last date the notice was revised. If an opt-out is offered, the opt-out form is included on the first page.

Page two consists of (i) a heading; (ii) certain frequently asked questions ("Who we are" and "What we do"); (iii) key definitions; and (iv) a section entitled "Other Important Information" where required state disclosures or an optional acknowledgment of receipt form can be provided..

The Model Privacy Notice must be printed in an easily readable type font, and except where specifically provided, it must be in at least 10 point type. Dealers may include their logo on any of the pages so long as it does not interfere with the readability of the notice or the space constraints of each page.

Dealers are not required to use the Model Privacy Notice; it's purely voluntary. If they elect not to use the Model Privacy Notice, they must ensure their notices comply with all of the requirements of GLBA and the Privacy Rule. The benefit of the Model Privacy Notice is that if completed as required by the Instructions and delivered properly, it provides a safe harbor for compliance. Completing the notice precisely as required is vital. If the Model Privacy Notice is not completed *precisely* as set forth in the Instructions, the dealer loses the safe harbor.

The FTC and Agencies have granted a transition period to phase out the Sample Clauses. Until December 31, 2010, notices using the new Model Privacy Notice or Sample Clauses enjoy safe harbor protection. And any compliant privacy notice delivered or posted online during this transition period has a one-year safe harbor from the date of delivery or posting. After January 1, 2011, privacy notices, whether delivered or posted online, must adopt the new Model Privacy Notice to be entitled to the safe harbor.

Dealers must give their privacy notices to customers at the time they establish their customer relationship with the customer. There is also an annual notice requirement for dealers that maintain a continuing relationship with customers. Generally, if a dealer assigns its installment contract to finance companies, it does not maintain a customer relationship with its customers.

The Model Privacy Notice should make drafting and giving privacy notices much easier for dealers. But, attention to detail is critical.

Patricia Covington is a Partner in the Maryland office of Hudson Cook, LLP. Her practice focuses on consumer finance, privacy, security and information management, electronic commerce, and marketing. She is 1st Vice President of NADC's board of directors.

We are always looking for submissions to publish in the Defender. Please send your contributions or proposals for articles to mike.charapp@cwattorneys.com

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