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President's Message

Rob Cohen, Esq.
NADC President

Point of Sale Insurance Tips and Tricks

The NADC list serve recently contained some questions and comments regarding confirming insurance coverage at the point of sale. This is a common problem for dealers and one of the many risks associated with spot delivery. Nevertheless, there are various things dealership personnel can do to significantly limit this risk.

Here are some suggestions I provide to my clients:

1. First and foremost, develop a written policy regarding the duties and responsibilities of dealership personnel with respect to customer insurance confirmation.

2. Make sure, from a policy perspective, a distinction is drawn between confirming liability coverage and comprehensive/collision insurance. Confirming liability coverage may be required by state law (and on leases by leasing companies) whereas comp/collision coverage is typically only required by lenders/lessors (but is also necessary to protect the dealer's collateral prior to funding).

3. Make sure dealership personnel understand that having a customer sign an "Agreement to Furnish Insurance" only provides the dealership with legal recourse in the event the customer does not actually have insurance. Explain to sales and finance personnel that if a vehicle is wrecked prior to funding and the customer and/or vehicle is uninsured, the dealership may have to absorb the loss (particularly if the customer is "judgment-proof").

4. Impress upon dealer personnel the importance of insurance confirmation. In states where dealers must confirm liability coverage prior to delivery, this obviously must occur 100% of the time.

As an interesting aside, many may be surprised to learn that under California law, dealers are not required to confirm liability insurance prior to delivery of a sold vehicle. This is true notwithstanding the fact that every driver in California must have public liability insurance.

5. On cash deals, unless state law requires otherwise, dealership personnel may not need to confirm insurance. But keep in mind, when I say "cash deals," I am referring to green money or wire transfer deals. Anytime a dealer accepts a check (even a cashier's check), I recommend treating the deal as a "one-pay" or "single

President's Message

Continued from page 1.

installment sale." And, therefore, comp/collision insurance should be required in order to protect the dealer's collateral while waiting for the check to clear.

6. On finance and lease deals, always attempt to confirm comp/collision insurance coverage prior to delivery. When delivery occurs after hours or on weekends, attempt to confirm insurance through a carrier's claim line. Many carriers have 24/7 claim "hotlines," and sometimes (with a little cajoling) you can confirm coverage through these channels.

7. On lease deals, always attempt to confirm liability and comp/collision coverage prior to delivery. Unlike on retail deals, the lessor is the registered owner of the vehicle and, therefore, maintains liability for permissive use of the vehicle (state law differs widely as to the extent of such liability). As such, the lessors with which dealers typically do business will likely require that dealers confirm liability coverage as well as comp/collision (often at a higher minimum coverage amount than what state law requires). Also, on most dealership-initiated leases, the dealer is the initial lessor. Therefore, the dealer may be exposed to permissive use liability prior to funding.

8. Make sure sales personnel know which carriers have acquired vehicle coverage and which do not. From my experience here in California, most of the reputable carriers automatically cover vehicles acquired by an insured for a period of 30 days. But, many of the lesser-known carriers (and "higher risk pool"-type carriers) do not have acquired vehicle coverage. In the latter case, even if current insurance is confirmed, sales personnel may still be delivering an uninsured vehicle. In addition, one trap I have seen dealers fall into involves a customer who has only liability coverage. The dealership confirms "insurance" and delivers the vehicle assuming there is acquired vehicle coverage for 30 days. The carrier may offer acquired vehicle coverage but only to the extent of the coverage in place at the time the vehicle is acquired. In other words, the customer may have liability coverage but the newly acquired vehicle itself is not covered.

9. Make sure the dealership adopts policies regarding point of sale (POS) insurance (a/k/a, "binders"). Perhaps the most common POS auto insurance company I know is Insure Express (www.insureexpress.com). Disclaimer: I do not vouch for nor recommend Insure Express.

Polices must be developed that establish when binders can be sold to customers or when they can be purchased by the dealership. Some POS insurance companies will allow dealers to purchase a binder that insures the collateral (without the involvement of the consumer). This is basically vendor's single interest (VSI) insurance. Dealers will want to purchase these types of policies when, for example, a customer takes delivery of a vehicle but dealership personnel are subsequently unable to confirm insurance (or insurance is canceled after delivery but before funding).

To avoid problems associated with selling binders, some dealers simply absorb the cost of the binder (i.e., "take it out of the gross of the deal"). This is generally fine so long as the cost is truly absorbed. Any evidence of an increased selling price or other disguised charge can result in a Truth in Lending Act (TILA) and/or state law violation.

10. In many states the dealership and/or dealership personnel are required to have property and casualty insurance licenses in order to sell auto insurance.

It is important to note that some "binders" merely offer comp/collision coverage and not liability coverage. These types of binders can be problematic due to the fact that consumers do not always understand the difference between coverage types and may claim that they were misled by dealership personnel.

11. Assuming proper licenses are obtained and the dealer sells insurance to consumers (and further assuming the transaction is subject to TILA), Regulation Z requires any such charges to be separately itemized and labeled as, for example, "amounts paid to insurance companies." (12 CFR 226.18(c)(1)(iii), footnote 41) Some states (such as California) also require separate itemization and/or disclosure of insurance charges on retail installment sale contracts and lease agreements.

12. Lastly, as with all F&I products, always work with reputable vendors, agents, and/or insurance companies. Always check dealer references, ask for legal clearance letters, and seek indemnification for claims related to non-compliance whenever possible. ■

Rob Cohen, Esq., President of Auto Advisory Services, Inc., Tustin, CA, is President of NADC.

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Feature Article

Buying Dealerships in Tough Times Protecting Your Clients' Interests

Part 1: Personal Property Lien Protection

By Erin Tenner, TennerJohnson LLP

Buying a dealership when times are tough is full of potential pitfalls. Making sure your client does not end up paying the seller's taxes, losing the assets to tax liens or losing the property because the landowner did not pay the mortgage are just a few of the things you need to be thinking about to protect your client.

This article is Part I of a three part series that will appear in the Defender on protecting your client in dealership acquisitions (see March and April 2011 issues for Parts II and III). Part I focuses on issues particular to protecting your client against secured and unsecured creditors and tax issues affecting personal property. Part II will focus on real estate issues in dealership acquisitions. Part III will focus on how to avoid litigation over conditions to closing and warranties and representations. Here are some specifics on how you can provide your client with the protection they need in these trying times.

I. Protecting Against Seller's Obligations to Creditors

A. Buying Assets Provides More Protection than Buying Capital Stock. In times like these buying assets instead of buying capital stock is the best practice. In rare cases a stock purchase may be warranted or even the only option. For example, if a seller has net operating losses that it can't use, but that the buyer can use, or if pension plan liability would vest if assets were sold, selling stock might be the better option. However, an asset purchase is usually preferable because your client can pick and choose which liabilities they want to assume and avoid liability for the rest. In a stock purchase the buyer is getting all the assets and all the liabilities. Although an asset purchase is much more complicated, it is the best way to protect your client against liability he or she does not want.

B. Bulk Sales Law Compliance. Compliance with the Bulk Sales Laws for the state in which the transaction is taking place is critical. Failure to comply will expose the buyer to all of the seller's liability to unsecured creditors. Compliance with the bulk sales laws cuts off the rights of unsecured creditors against a buyer. Some states require giving notice to each creditor while others require only publishing a notice in compliance with the Code. Check the Commercial Code provisions for the state in which the sale will take place and make sure you comply. With purchase prices for auto dealerships relatively low, more and more transactions are subject to the notice requirements of the Uniform Commercial Code's bulk sales laws.

C. UCC Search and Tax Lien Searches. In every state, liens can be filed against personal property. Conducting a UCC lien search including tax lien search in the state of the seller's incorporation and in the state in which the property being sold is located is a must in every transaction. Any lien against assets being purchased that is not released prior to closing an asset purchase will follow the assets and become the buyer's problem. If less than all of the assets covered by a lien are being purchased, a partial release can usually be negotiated. Lien releases should not be left for after closing. Making sure all liens are released simultaneously with closing is essential to clear title.

II. Protecting Against Seller Tax Liability.

Knowing how tax laws affect your client is critical if you want to save your client money and headaches.

A. Sales and Employment Taxes. Whether your client is buying or selling a dealership, you need to pay particular attention to sales and employment taxes. If they are not paid in full as of Closing, at least in some states, the buyer and seller can both be held personally liable for payment. A holdback at Closing is the only practical way to fully protect a buyer. If a buyer does not hold back enough to pay all unpaid taxes, interest and penalties, the assets purchased could be confiscated to pay the tax, and in some states, like California where I practice, the buyer could be held personally liable for the taxes. Tax clearance certificates will provide ideal protection, but they cannot always be obtained prior to Closing. Check the statutes in your state to make sure you follow the procedures set out to avoid liability for the seller's unpaid sales, employment and franchise taxes. If you do provide for a holdback account in your transaction documents, make sure it provides for enough money to cover any unpaid taxes that may be discovered during an audit. Audits are frequently triggered by an asset sale. I usually ask for a holdback of cash in escrow equal to the full amount of any unpaid taxes plus one and half times the last month's taxes.

B. Sales Tax on Fixed Assets. Whether or not a dealership collects sales tax from the buyer when it sells a car, it has to pay the sales tax on the vehicle to the state. The same applies when a dealership sells substantially all of its assets. The seller is responsible for collecting and paying sales tax on all fixed assets sold.

Furniture, fixtures, equipment and special tools are all subject to sales tax. If you don't negotiate who will pay sales tax, the seller will be stuck paying the tax whether or not he or she is able to collect it from the buyer. If the Seller is unable to pay, state law may permit the assets to be confiscated from the buyer and sold to pay the tax.

C. Recapture of Depreciation. Often first time sellers don't realize that after selling the assets of the dealership the corporation is going to have to recapture some or all of the depreciation it took and pay taxes on it. Just like a 1031 exchange, depreciation is just a tax deferral method. Unless the value of the asset actually declines, depreciation does not reduce or eliminate taxes permanently. Make sure your client discusses this with his or her accountant to make sure they know what the tax liability will be upon sale of fixed assets.

D. Income Tax or Capital Gains Tax on Assets. The most obvious tax is the income or capital gains tax your client will have to pay on sale of the dealership. Remind your client to discuss this with their accountant to make sure they take it into consideration when deciding to sell. If your client has a lot of fixed assets, a stock sale could save a lot of money, not only in sales tax, but also in income tax. Your client will pay income tax on the difference between the book value of the fixed assets and the sale price up to the original cost of the fixed assets. In addition, if you can negotiate a stock sale, your client will not have to incur the cost of winding down the business.

E. Tax Liens. Another thing to think about is whether a buyer could have liability for any of the seller's unpaid income taxes. Income tax liens can attach to assets. The good news these days is that most auto dealerships are Subchapter S corporations or limited liability companies. Income taxes on S corporations and LLC's are assessed on the person who owns the stock or membership interest rather than on the corporation or LLC. If a lien attaches, it will attach to the capital stock ownership interest or membership rather than to the assets of the business. Nonetheless, a tax lien search should always be part of due diligence.

III. Summary.

There are many other tools to protect your client and save them money including warranties and representations, indemnity agreements, deeds of trust, security agreements and even accounting tools like cost segregations analysis, but the above are at least a few to get you going in the right direction. Due diligence is essential when representing the buyer of an auto dealership. If you are representing the buyer, buying assets will usually be the best way to protect your client. If you are representing the seller, a stock sale will usually be preferable, but most buyers will not agree to buy stock. Whether you are representing a buyer on a stock purchase or an asset purchase, make sure you know what liabilities are out there. Always conduct a UCC search in the state of incorporation and in the state in which the seller is doing business. Include all names used by the seller to conduct business. Even if no tax liens show up, order tax clearance certificates from the state agency that collects sales, employment and franchise taxes for the state in which the business is conducted. If they cannot be obtained prior to closing, hold back money in escrow sufficient to cover unpaid taxes, interest and penalties. Failure to do so could expose both you and your client to unnecessary liability. ■

Erin Tenner is a partner at TennerJohnson LLP and a member of NADC. She has handled hundreds of buy/sell transactions for auto dealers. In addition to her transactional practice she is also available as a private mediator and expert witness. She can be reached at 818-707-8410 or toll free at 888-501-0040.

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Robert T. Bowsher

Lance J. Kinchen

Tax Relief, Umemployment Insurance Reauthorization and Job Creation Act of 2010

Feature Article

By Robert T. Bowsher and Lance J. Kinchen, Breazeale, Sachse & Wilson, L.L.P.

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("Act"). The Act temporarily extends tax cuts that were set to expire at the end of 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and the Job and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA"). The following is a brief summary of some of the Act's main provisions.

Individual Income Tax Rates. One of the biggest benefits resulting from the new Act is that the individual income tax rates or brackets will remain unchanged through the end of 2012. Prior to the new Act, the 25%, 28%, 33% and 35% individual income tax brackets were set to expire at the end of 2010. Without the Act, the individual income tax brackets would have been 28%, 31%, 36% and 39.6% in 2011. The Act extends the 25%, 28%, 33% and 35% individual income tax brackets for an additional two (2) years, through 2012. The Act also maintains the 10% bracket for low income taxpayers for an additional two (2) years, through 2012.

Capital Gains and Dividends. The Act extends for those taxpayers in the 25% individual income tax bracket and above, the long-term capital gains and dividend tax rates at 15%. Without the new Act, the rates for long-term capital gains would have increased to a maximum of 20% and dividends would have been subject to the ordinary income tax rates. The new Act also retains the long-term capital gains and dividend rates for taxpayers below the 25% bracket at 0%.

Itemized Deduction Limitation. For the past several years, the amount of itemized deductions that a taxpayer may claim has been reduced to the extent that the taxpayer's adjusted gross income is above a certain amount. The first year in which there were no limitations on itemized deduction in 2010. The Act extends the repeal of the itemized deduction limitation for an additional two (2) years, through 2012.

AMT Relief. The Act increases the AMT exemption amount for 2010 from $33,750 to $47,450 for non-married individuals and from $45,000 to $72,450 for married individuals filing jointly. The Act increases the AMT exemption amount for 2011 to $48,450 for non-married individuals and $74,450 for married individuals filing jointly.

Temporary Extension of Estate Tax Relief. After December 31, 2010, the Bush era estate tax reduction was scheduled to expire and return to the exemption amounts and the rates in effect in 2001. This result was apparently not acceptable to anyone and the resulting tax relief Act makes significant changes to the estate tax provisions of the Internal Revenue Code, which will now be in effect until January 1, 2013.

(a) The applicable credit amount, which is the amount an individual can pass free of estate tax to his heirs, which was scheduled to be $1.0 million in 2011 with a maximum tax rate of 55% was changed for decedents dying after December 31, 2009 to be $5.0 million with a maximum tax rate of 35%.

(b) After December 31, 2010, the gift tax exclusion amount for an individual's lifetime gifts will be raised from $1.0 million to $5.0 million. Additionally, the applicable credit for estate tax purposes and the exclusion amount for gift tax purposes will again become a unified credit for taxable transfers both during an individual's lifetime and also at death.

(c) The Act did away with, in general, the carryover basis for heirs of decedent's dying in 2010, providing a return to a step up in basis to the fair market value of the decedent's property at the date of death.

(d) For decedents dying in 2010, the executor of such estates may elect out of the new estate tax and stepped up basis provisions and have the old provisions apply. For estates having net assets in excess of $5.0 million, the executor may want to elect out of the new tax provisions to avoid paying estate taxes but then the assets of the estate will have a carryover basis to the heirs, not a stepped up basis. Under rules to be issued by the Treasury, the executors of such estates will have nine (9) months from enactment of the Act to elect out.

(e) The Act introduces a new benefit for married decedents dying after December 31, 2010. In situations where the first spouse to die does not use all of the deceased spouse's applicable credit amount of $5.0 million, the unused portion is available for use by the surviving spouse as an addition to such surviving spouse's own applicable exclusion amount of $5.0 million. For example, if the first spouse to die only has a taxable estate of $3.0 million, the surviving spouse may use the predeceased spouse's carryover amount of $2.0 million with such surviving spouse's own $5.0 million exclusion for taxable transfers of $7.0 million made during life or at death.

These provisions are only a temporary fix to the estate and gift tax issues and all of these provisions sunset after December 31, 2012, when the old law of 2001 once again is scheduled to come back into effect at an applicable credit amount of $1.0 million and a maximum tax rate of 55%

Payroll Tax Cut. The Act reduces only the *employee portion* of the social security tax from 6.2% to 4.2% for 2011. Under current law, employees pay 6.2% in social security tax in all wages earned up to $106,800 (in 2011). Self-employed individuals pay 12.4% social security self-employment taxes on all of their self-employment income up to the same threshold. The Act provides that self-employed individuals will only pay 10.4% on self-employed income up to the threshold amount for 2011.

100% Bonus Depreciation. Businesses are allowed to recover the cost of capital expenditures over time according to a depreciation schedule. Congress allowed businesses, beginning January 1, 2008 through December 31, 2009, to take an additional depreciation deduction allowance equal to 50% of the cost of the depreciable property placed in service in those years. Under the Small Business Jobs Act of 2010, this temporary increase in the depreciation deduction allowance was extended through December 31, 2010. The Act now extends and temporarily increases this bonus depreciation provision for investments in new business equipment. For qualified property acquired after September 8, 2010 and before January 1, 2012, and which is placed in service by the taxpayer before January 1, 2012 (before January 1, 2013 for certain longer-lived and transportation property), the Act provides for 100% bonus depreciation. For qualified property placed in service after December 31, 2011 and through December 31, 2012 (before January 1, 2013 for certain longer-lived and transportation property), the Act provides for 50% bonus depreciation.

Section 179 Deduction. Under current law, a taxpayer may elect to deduct the cost of certain property placed in service for the year rather than depreciate those costs over time. The 2003 tax cuts temporarily increased the maximum dollar amount that may be deducted from $25,000 to $100,000. The tax cuts also increased the phase-out amount from $200,000 to $400,000. In 2007, the tax cuts temporarily increased these thresholds to $125,000 and $500,000, respectively, indexed for inflation. These amounts have been further increased and extended several times on a temporary basis, including most recently as part of the Small Business Jobs Act which increased the thresholds to $500,000, with the $500,000 amount reduced by the amount by which the cost of the qualifying property placed into service in that year exceeds 2,000,000 for the taxable years beginning in 2010 and 2011. The Act extends the 2007 maximum amount for taxable years beginning in 2012, to $125,000 and phase-out thresholds to $500,000, respectively, indexed for inflation.

Conclusion. The Act contains numerous other provisions that may apply to your specific situation. We recommend that you consult your individual tax advisor to determine what provisions of the Act may affect your individual or business tax returns. Pursuant to IRS Circular 230 and IRS regulations, we inform you that, unless specifically indicated otherwise, any tax advice contained in this communication, including attachments, was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any tax-related matter addressed herein. ■

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Please send your contributions or proposals for articles to:

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