Dealer Details

For Executives of Automobile Dealerships

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Where is the LIFO Inventory Relief?

By Ryan McDonnell, CPA
Tax Manager

Many auto dealers use the last-in first-out (LIFO) accounting method for valuing new vehicle inventory. Under LIFO, dealers use the value of the most recently acquired inventory as an expense against income from vehicle sales. Ordinarily, when dealers can replace inventory as they sell it, this inventory method does not cause any issues. However, because of the COVID-induced global supply chain issues and semiconductor shortages, auto dealers have found it particularly difficult to replace new vehicle inventory in 2020 and 2021. The inability to replace inventory means that dealers have had to liquidate older low-cost LIFO layers and face large amounts of income which would have otherwise been deferred.

Internal Revenue Code Section 473 allows a taxpayer using LIFO to avoid picking up income in a liquidation year if an inventory liquidation is attributable to a qualified inventory interruption. Qualified inventory interruptions include major foreign trade interruptions that make it difficult or impossible to replace inventory – which, arguably, includes the global supply chain issues brought on by COVID. Taxpayers cannot utilize this code section unless the Secretary of Treasury publishes a notice in the Federal Register determining that a qualified inventory interruption has occurred. At the time of writing, the Treasury has yet to publish such a notice, which means that dealers have not been able to utilize Section 473 relief. Despite letters from both chambers of Congress, as well as NADA, Auto Innovators, the AICPA, and more requesting relief, Treasury has been reluctant to grant Section 473 relief, and instead it appears that authorization will have to be done via legislation.

Such legislation was introduced in April of 2022 – the bipartisan Supply

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The Importance of a Relevant Buy-Sell Agreement

By Chris Nadeau, CPA

In recent years, there has been a notable increase in the number of times I have been retained to consult on buy-outs of exiting shareholders. I have been on both sides of the equation, representing both the buying and the selling shareholders in these different cases. The most common problem I have encountered is either that there was no buy-sell agreement in place or the buy-sell agreement was so old and outdated it was no longer relevant and did not result in a fair and equitable transaction.

In some cases, parties were amicable and ready to negotiate, while in other cases parties proved to be more contentious which resulted in additional incurred expenses. In all cases, it dragged out longer than any party would have wanted it to. With proper planning and review of the company's buy-sell agreement, time, money, and much aggravation could have been saved.

The death or disability of an owner, a shareholder dispute, and other life changes can lead to the need for a company or its shareholders to purchase an exiting owner's share in the business. A proper buy-sell agreement should clearly stipulate the terms and process

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in which an exiting owner's share is valued and purchased by the company or remaining shareholders.

Buy-sell agreements typically exist in one of the following forms:

- **Cross-purchase agreement**
  The remaining shareholders agree to purchase the interest of the exiting shareholder.

- **Entity-purchase (stock redemption) agreement**
  The company agrees to purchase the interest of the exiting shareholder. The shares go into the company's treasury stock, which may be available for sale at a later date.

- **Hybrid agreement**
  The exiting shareholder offers his ownership interest to the remaining shareholders first. If the shareholders decline the purchase, then the company will redeem the shares.

Once owners have agreed on what type of plan to put into place, arguably the most important question becomes – how should the ownership interest be valued?

There are a few typical approaches to valuation in a buy-sell agreement:

Agreed-upon value (fixed price) agreement
An agreed-upon value agreement will stipulate the value of the company as of a certain date. While this may be very clear and simple, it is generally not practical as the valuation of a company is not static.

Book Value
The book value of a company is the historical cost of assets less liabilities as reported in its financial statements. The book value method does not consider asset appreciation or the goodwill of the company and therefore is likely to result in a value that is less than fair market value. For this reason, it is generally advised to avoid using the book value when valuing a profitable operating company.

Formula agreement
A formula agreement is typically based on an industry rule of thumb. For example, auto dealerships are often valued within the industry using the "Blue Sky Approach", a hybrid of the net asset and income approaches, which adds the estimated dealership goodwill (based on earnings) to the net asset value.

Rules of thumb will indicate generally accepted industry multiples of revenue and/or earnings to apply to the subject company. If using an industry rule of thumb, its often best to select an earnings multiple rather than a revenue multiple. Revenue multiples tend to be less reliable since they don't consider cost management, profitability, and cash flow available to shareholders. Two companies can have identical revenues, with very different bottom lines.

When applying a rule of thumb, it's important that the selected formula is well understood. It's not uncommon to have to adjust the value for working capital, interest-bearing debt, etc. When applying an earnings multiple, owners should consider whether there is a need to adjust the company's financials for discretionary expenses, or adjust expenses such as officers' compensation and related party rent to fair market value. Any adjustments needed should be clearly defined in the agreement and providing an example or illustration in such cases may be helpful.

Fair Market Value
The IRS defines "fair market value" as "the price at which property would exchange hands between a willing buyer and a willing

Where is the LIFO Inventory Relief? (continued)

Chain Disruptions Relief Act (H.R. 7382 in the House, and S.4105 Senate counterpart) which would allow new motor vehicle dealers to elect to wait until the end of 2025 to replace their inventory for purposes of determining income related to the sale of LIFO inventory during 2020 and 2021.

The bill would allow dealers to make a prospective change in accounting method by making a Section 481(a) adjustment in the first taxable year after the law is enacted instead of having to amend previously filed returns. However, since these bills were introduced, there has not been any movement to pass these bills standalone. It is difficult to predict whether these bills will end up as part of a larger legislative package or if efforts to receive Section 473 relief have been in vain – we will have to wait and see.

seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." Determining fair market value is difficult, and often engaging a valuation professional is necessary. While it may seem like the most expensive approach, the use of a business appraiser will result in an impartial conclusion of value and can save time and money if conflicts arise.

Whichever type of agreement is in place, it is advisable that business owners review their buy-sell agreements and the stipulations for determining value to verify that the agreement is still relevant and appropriate. If a company needs a buy-sell agreement or needs to update their agreement, hiring a business appraiser as a consultant can result in a relevant agreement that will mitigate cost, frustration, and wasted time in the future.

Three Critical Cyber Security Steps for Auto Dealerships

By Don Lander

Anyone working in the car dealership business knows that your employees are crucial to the success of your dealership. You also understand how important regular maintenance is for automobiles. Just as important, if not more important, is your Cyber Security strength.

Three critical Cyber Security steps that every automobile dealer should do are:

1. Educate your employees about Cyber Security
2. Maintenance of your technical infrastructure
3. Regularly repeat steps one and two

Employees are arguably the most valuable asset of any automobile dealership. Without employees, you don't have anyone to sell, finance, service automobiles or keep the operations running smoothly. Your employees have access to the customer's personal information which is needed to perform the job effectively.

Any good dealership spends time training their employees how to perform their individual roles that make your dealership successful. How much of that time is spent on Cyber Security?

Your employees have the keys to the kingdom. Would you trust just anyone to have these keys? Imagine if an employee were to inadvertently give these keys to a bad actor. If a bad actor had access to your entire network, what could they do? Wire money to their account? Sell your clients personal information on the dark web? These are very real threats and happen all the time. You need to take steps to protect your kingdom.

Well, if you aren't properly training your employees about Cyber Security, the risk of exposing your kingdom to nefarious actors greatly increases. Employee Cyber Security knowledge is critical to protecting the kingdom, and even basic training and awareness review helps considerably.

Three Critical Cyber Security Steps for Automobile Dealerships (continued)

By Don Lander

It starts with a Written Information Security Program (WISP), which is a document that outlines your Information Security process. A WISP will help you identify and resolve vulnerabilities that you might not have known existed. It is better that you find these issues yourself instead of a bad actor. In the state of Massachusetts, any company that handles customers personal information must have a WISP. Once implemented, all employees are required to review the company's WISP document on an annual basis.

An annual review of the company's WISP document is only a beginning. You should also conduct regular phishing campaigns. Phishing is an email sent by a bad actor trying to get your employees to reveal personal information or click on a link that will allow the bad actor access to your infrastructure. Once a bad actor has access to your infrastructure, they can shut your dealership down, send money to an offshore bank account or hold your business hostage for a ransom demand (via digital currency such as Bitcoin).

There are several low-cost phishing options available that will enforce the training from the WISP and learn how to recognize a phishing email. Some phishing email programs will provide feedback to the employee as well as the employer. Constant training and feedback are crucial for this step of your Cyber Security program.

Maintenance of your technical infrastructure is the second, and equally important step. Staying diligent with batch upgrades and software patches, as well as scanning your environment internally and externally are things that your technical support group should be doing on a regular basis. Requesting a third-party challenge of the infrastructure can confirm the strength of the network and identify any changes to be implanted.

If your response is "I have an IT person to handle Cyber Security," you are doing yourself a huge disservice. Do you know exactly what your IT person does? Do they do regular patching? Change default password servers, routers, etc.? When was the last time you had an internal and external vulnerability scan of your network? Can people on your public Wi-Fi access customer information?

These are just a few things that a regular vulnerability scan of your network can find. In addition to a vulnerability scan, you should also consider penetration testing (aka pen test). A pen test is an exercise that attempts to gain access to your network. Pen testers at OCD Tech are more likely than not to gain access to your environment. Would you rather that a friendly OCD Tech employee gain access to your network (with follow up suggestions for closing the access) or would you rather not know until it is too late?

Cyber Security must be part of your business operations. It is as important as sales, finance, maintenance and office support operations. I would argue that Cyber Security is the most important piece of your operation functions.

We are living in the digital world now and you need to take steps to protect your kingdom just like you do physically with locking the doors and windows. The big difference between the physical and digital environment is the digital environment is constantly changing and getting more resilient. Take Cyber Security very seriously and protect your kingdom.