Willard J. De Filipps, CPA, PC
www.defilipps.com

DEALER TAX WATCH

A Quarterly Update of Essential Tax Information

Volume 8, Number 4 | Publisher: Willard J. De Filipps, C.P.A. | March 2002

DEALER TAX WATCH *OUT*

If you had called me personally to ask, "What's happening lately with IRS audits of dealers and dealerships that I need to know about?"... Here's what I'd say:

#1. IRS GUIDANCE ON VALUING EMPLOYEE USE OF DEMOS. The guidance the IRS recently provided in Revenue Procedure 2001-56 has been favorably received by the majority of practitioners who have taken the time to share their opinions with us. In a follow-up conversation, Terri Harris indicated that the Service has received few questions on these new rules since they came out.

The Service seems to be very pleased with the results of its Industry Issue Resolution Program, which, in part, accounted for these new guidelines. The Service now says that it will make the Industry Issue Resolution Program a permanent program for this year. If you have any suggestions for other issues that you think the Service ought to consider, contact Terri Harris directly at (616) 235-1655.

#2. IRS DOES AN ABOUT-FACE: DEALERS CAN USE REPLACEMENT COST FOR VALUING PARTS INVENTORIES. In Revenue Procedure 2002-17, the IRS announced that it will allow auto dealers ... and truck dealers ... to value their parts inventories using a replacement cost method grounded in their manufacturers' standard price lists.

In announcing its 100% reversal of position on this important issue, the Service said that it has given careful consideration to the "unique circumstances surrounding the use of replacement cost by automobile dealers." It said that it was now willing to provide auto and truck dealers with a safe-harbor method of accounting to determine the cost for parts using replacement cost to approximate actual cost.

If dealers are currently under IRS audit exam and the use of replacement cost is in question, the IRS will drop the issue.

In effect, the IRS is forfeiting the Tax Court victory it achieved in *Mountain State Ford Truck Sales.* The IRS Motor Vehicle Technical Advisor, released an *Automotive Alert!* discussing the safe harbor Revenue Procedure and this was reproduced in the March 2002 issue of the *LIFO Lookout.* Further analysis and commentary on Rev. Proc. 2002-17 will appear in the June issue of the *LIFO Lookout.*

#3. IRS PRIVATE LETTER RULING PROVIDES RELIEF FOR OLDS DEALER BOUGHT OUT BY GM. In December of 2000, GM took its dealership network–and the industry–by surprise when it announced that it would discontinue its Oldsmobile line. Among the many concerns facing dealers is how they will be taxed on the payments they negotiate from GM in return for giving up their franchises.

WATCHING OUT FOR

see **DEALER TAX WATCH OUT**, page 2

(Continued from page 2)

NADA proudly announced that after an intensive 6-month campaign, it finally succeeded in getting the IRS to rule favorably in one hand-picked dealership situation.

The IRS has held that the payments received from GM could be treated as payments received in exchange for the cancellation of the distributor agreement under Code Section 1241. In addition, the Service allowed characterization of the payments as long-term capital gain, and it allowed the use of the installment method since these payments were going to be spread into at least two years.

Our discussion of this Letter Ruling begins on page 12. However, before jumping to the conclusion that "everything's cool," be forewarned: The facts are very basic...and CPAs may encounter unexpected complications when they get around to reporting these payments in the various tax returns where they belong.

#4. CONSTRUCTIVE DIVIDENDS & DEMO ISSUES FOR DEALER INVOLVED IN *BURIEN NISSAN*. One of the dealer principals involved in a buy-out situation received some bad news from the Tax Court recently in connection with his personal tax return. In *Herbert L. Whitehead v. Comm.*, the Tax Court said that the payments that the dealership corporation had made directly to the seller were constructive dividends which Mr. Whitehead should have reported as income in his personal tax returns.

There were also demo issues. In an unusual twist, the Court analyzed the *character* of the income that had been reported in connection with the dealer's wife's use of demonstrator vehicles and found that this income should have been reported as wages earned by the dealer ... not as self-employment income earned by his spouse.

Finally, the Court upheld accuracy-related penalties. See page 9 for more details.

#5. TAX RELIEF IN 9-11 LEGISLATION MAY MEAN YOU'VE GOT TO FILE AMENDED RETURNS. If you've been swamped filing tax returns for your dealership clients, maybe you didn't notice that some tax changes in the recently passed Job Creation and Worker Assistance Act require rethinking the way you did things on those tax returns.

If you've already filed 2001 returns unaware of these changes, now is the time to take a closer look. The most important change is that for current net operating losses the carryback period was lengthened to 5 years (from 2 years), unless an election is made by the taxpayer to not carryback 5 years.

Also, 30% additional first-year depreciation is mandatory for qualifying fixed asset additions ... unless, again, an election is made not to take the benefit allowed. Either or both of these may be beneficial–or they may be undesirable–depending on the specific tax fact pattern.

These changes discussed on page 4 are not unique or of special interest only to auto dealerships. But, they are worth some attention ... just in case you're catching up now.

#6. USED CAR DEALERS LOBBYING TO GET IRS TO ALLOW CASH BASIS METHOD. The National Independent Automobile Dealers Association is working very hard trying to persuade the IRS to allow the use of the cash method by buy-here, pay-here dealers in the $1 to $10 million average gross receipts range. It is also lobbying strenuously to get the IRS to allow them to use the "installment method." For more on this, see page 6.

#7. IRS REVISES FORM 8300. Form 8300 for reporting cash payments in excess of $10,000 was revised recently. The new Form has a revision date of December 2001 and it should be used for reporting all transactions immediately.

#8. WHAT ARE AUTO DEALERS' CONCERNS? After attending the NADA Convention in New Orleans, we've again reported the issues dealers mentioned at various make meetings as their biggest concerns. These lists appear on pages 22-23.

P.S. If you really want to keep up with this fast-paced industry, you shouldn't miss the monthly updates in *Dealer Magazine* in Jim Ziegler's "Dealer Advocate" column and in Dan Myers' column on dealer-Factory issues and litigation.

#9. IRS PLANS NEW TAXPAYER COMPLIANCE MEASUREMENT SURVEY. The IRS is ramping up its plans to conduct a taxpayer compliance survey in the near future. After careful consideration, this new initiative has been named *The National Research Program.*

For those with short memories, these information-collecting forays in the past were called by the IRS "TCMP" or "Taxpayer Compliance Measurement Programs." By taxpayers selected for the process, these were known as "the audits from hell." Undoubtedly, we'll be hearing more about these in the future. Right now, the Commissioner is treading lightly in briefing Congress on this new initiative.

The last time the IRS performed TCMP audits was on 1988 income tax returns, and the results were factored into the DIF (that's Discriminate Function) scores set up in 1993. As a result, changes in the tax laws over more than the last decade, not to mention

→

the plethora of newer tax schemes and scams, have not been factored into this IRS selection intelligence.

Another consideration could be that in recent years, the IRS has ended up with more "no-change" audits. The result of these is to leave some taxpayers annoyed (although you'd think relief would be the overwhelming reaction) at having been chosen for audit and then having their "time wasted." By updating its DIF model with more current information, presumably the IRS will be less likely to start audits that ultimately result in no-change letters.

#10. ALL TYPES OF CHANGES IN ACCOUNTING METHOD RECEIVE IRS ATTENTION. Generally speaking , there are three types of changes in accounting methods

- Changes taxpayers cannot make unless they receive IRS permission in advance to make the change (i.e., ***non-automatic*** changes),
- Changes taxpayers are permitted to make without first receiving IRS permission ... although they are required to ***notify*** the IRS that the change has been made (i.e., ***automatic*** changes), and
- Changes taxpayers are required to make because the IRS says their present method of accounting does not clearly reflect income. These are changes resulting from IRS audit examinations (i.e., ***involuntary*** or ***IRS-imposed*** method changes).

The IRS has recently reconsidered each type of change in a separate Revenue Procedure, setting forth new guidelines and requirements.

- ***Non-automatic*** changes ... Rev. Proc. 2002-19
- ***Automatic*** changes ... Rev. Proc. 2002-9
- ***Involuntary*** or ***IRS-imposed*** changes ... Rev. Proc. 2002-18

In Rev. Proc. 2002-9, the IRS increased the number of accounting method changes that taxpayers would be permitted to make as "automatic" changes. The IRS list of now-automatic changes has been expanded ... and liberalized ... to include, among others, (1) the termination of used vehicle LIFO while retaining new vehicle LIFO and (2) certain changes relating to the treatment of "qualified volume-related trade discounts." These Revenue Procedures are discussed in detail in the *LIFO Lookout.*

WANT MORE BILLABLE TIME THIS SUMMER? GET GREAT IDEAS AT OUR SUMMER TAX SEMINARS FOR DEALER CPAs.

For the last 4 years, we have presented a 2½ day conference bringing in speakers of national reputation for our Auto Dealer Niche Conferences. We had originally planned another Conference for this summer. However, given many recent developments, including the issuance by the IRS of several significant Revenue Procedures and Rulings affecting auto dealers, this year, we are altering our CPE training format.

This year, we will be presenting more dealer-tax intensive materials over the course of two consecutive full-day seminars. One of the benefits of offering these seminars over the summer and fall is that some of these new developments will require a little time and interaction with the IRS in order to clarify underlying issues and see how these developments can practically and effectively be translated in our daily practices.

The first of these two day seminars will be held on June 20th and 21st at the Schaumburg Radisson (Schaumburg is a northwest suburb of Chicago).

Mr. De Filipps will personally teach both days.

These seminars will include updates on developments involving demonstrator vehicles, taxation of GM-Olds and other transition payments, the use of replacement cost for parts inventories (*Mountain State Ford Truck Sales*), the more recent liberalizations for changes in accounting methods, and other subjects.

More specifics will be available very soon, and they also will be posted on our web site (www.defilipps.com).

These seminars can also be tailored to your Firm's needs and presented in-house.

The June 20 seminar is ***DEALER IRS TAX ISSUES & PLANNING OPPORTUNITIES.***

The June 21 seminar is ***DEALER LIFO INVENTORIES ... BASICS & PLANNING OPPORTUNITIES.***

Cost is only $225 per day.

RECENT TAX RELIEF MAY REQUIRE AMENDED DEALERSHIP RETURNS

1139
1120-X

In early March, Congress enacted the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147). The legislation includes a few tax breaks, effective immediately, that may benefit dealers in year 2001 tax returns that are currently being prepared or that already may have been filed. The JCWAA also includes many other business "economic stimulus" provisions and a long list of special provisions whose expired or about-to-expire status has been extended.

If tax returns have already been filed with no attention given to the changes discussed below, taxpayers...including dealers...could find themselves required to apply the new provisions even though that might not be to their advantage.

EXTENDED CARRYBACK PERIOD FOR NET OPERATING LOSSES

Effective for taxable years ending in 2001 or 2002, the number of years to which a taxpayer may carryback a net operating loss has been increased from two years to five years.

A net operating loss is generally the amount by which a taxpayer's allowable deductions exceed gross income. A carryback of a net operating loss results in the refund of Federal income tax that was paid in the carryback year. To carryback their net operating losses and obtain their tax refunds, corporations file Forms 1139 or amended corporate returns Forms 1120-X; individuals file Forms 1045 or amended individual returns Forms 1040-X.

In all cases, each of the prior five taxable years will reflect different amounts of taxable income or loss. Therefore, different amounts of tax would have been paid in each year. One has to analyze the entire five-year history to decide whether or not carrying back the net operating loss five years is more advantageous than carrying that net operating loss back only two years. Part of the difference in result between a five-year vs. a two-year carryback will be due to the different corporate (or individual) tax rates that applied to the taxable income reported in each carryback year.

OPTION TO "ELECT OUT"

The law provides that any taxpayer entitled to a five-year carryback of a net operating loss from any loss year may elect to have that carryback period "with respect to such loss year" determined without regard to the new provision.

In other words, a taxpayer can elect out of the five-year carryback result and use the two-year carryback rule. If the taxpayer does not elect out of the five-year carryback, the NOL carryback to the fifth preceding year will be required ... unless the taxpayer had previously elected in the tax return filed to forego any net operating loss carryback and instead to carry forward the net operating losses.

The law provides that the election to forego the five-year carryback period shall be made in such manner as may be prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

If a taxpayer has already filed Form 1139 to carryback a year 2001 net operating loss to the years 1999 and 2000, will the IRS return the Form with a "Are-you-sure-you-want-to-do-this?" letter? Will taxpayers be left to devise their own Form 1139? If a taxpayer elected to forego the carryback period because at the time of filing the return for the loss year it could not reach the prior third, fourth and fifth year, will it be permitted to change its mind as a result of the change in the law?

Observation #1: Although a taxpayer is permitted to elect not to use the five-year carryback period for a net operating loss incurred in 2001, making that election for a 2001 NOL would not prevent the taxpayer from electing to use the five-year carryback period for a net operating loss incurred in 2002. Obviously, this decision would depend on the tax paid in the preceding years and the anticipated level(s) of taxable income projected for the next few years. There's a lot of flexibility and, therefore, a lot of planning involved in these situations.

You'll either need to modify the current Form 1139 or wait for the new Form and Instructions in order to carry back net operating losses. For whatever reason, there was no change in the three-year carryback period available for net capital losses incurred by corporations.

Observation #2: The extended carryback period is a temporary measure. The extended carryback period is only for losses in the years ending in 2001 or 2002. For years ending in 2002, if there are discretionary deductions that can be switched between either 2002 or 2003, part of the overall planning strategy should consider that net operating losses in 2002 can go back 5 years, but losses in 2003 can only be carried back 2 years.

→

ADDITIONAL 30% FIRST-YEAR DEPRECIATION DEDUCTION

Depreciation Deductions - Present Law. In most cases, depreciation is determined under the modified accelerated cost recovery system ("MACRS"). The depreciation methods generally applicable to tangible personal property are the 200% and 150% declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment generally may elect to deduct up to $24,000 (for taxable years beginning in 2001 or 2002) of the cost of qualifying property placed in service for the taxable year (Sec. 179). This amount is increased to $25,000 for taxable years beginning in 2003 and thereafter. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which Section 197 applies, are recovered ratably over 36 months.

Additional First-Year Depreciation Deduction. The new law allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified property. The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.

The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements.

- *First,* the property must be property to which the general rules of MACRS apply with (1) an applicable recovery period of 20 years or less, (2) qualified leasehold improvement property or (3) computer software other than computer software covered by section 197.
- *Second,* the original use of the property must commence with the taxpayer ***on or after September 11, 2001.*** In other words, the purchase of used property does not qualify.
- *Third,* the property must be placed in service before January 1, 2005.
- *Finally,* the taxpayer must purchase the property within the ***applicable time period.*** The ***applicable time period*** for acquired property is (1) after September 10, 2001 and before September 11, 2004, and no binding written contract for the acquisition is in effect before September 11, 2001 or (2) pursuant to a binding written contract which was entered into after September 10, 2001, and before September 11, 2004.

There are other special requirements for property that is manufactured, constructed, or produced by the taxpayer for its own use.

Here are two examples of how the 30% provision works.

Example 1. Assume that on March 1, 2002, a taxpayer acquires and places in service qualified property that costs $1 million. The taxpayer is allowed an additional first-year depreciation deduction of $300,000. The remaining $700,000 of adjusted basis is recovered in 2002 and subsequent years pursuant to the depreciation rules of present law.

Example 2. Assume that on March 1, 2002, a calendar year taxpayer acquires and places in service qualified property that costs $50,000. In addition, assume that the property qualifies for the expensing election under Section 179. The taxpayer is first allowed a $24,000 deduction under Section 179. The taxpayer then is allowed an additional first year depreciation deduction of $7,800 based on $26,000 ($50,000 original cost less the Section 179 deduction of $24,000) of adjusted basis. Finally, the remaining adjusted basis of $18,200 ($26,000 adjusted basis less $7,800 additional first-year depreciation) is to be recovered in 2002 and subsequent years pursuant to the depreciation recovery schedule under present law.

If returns were filed for the year 2001 without an awareness of this change in the law, the depreciation computed on "qualified property" will be incorrect because that additional 30% depreciation should have been claimed. Furthermore, in this case, the basis of the property will be reduced under the "allowed or allowable" requirement.

Election Out. A taxpayer is allowed to elect out of the additional first-year depreciation deduction for any class of property for any taxable year. Thus, a taxpayer may elect out of the 30% first-year depreciation result for one year, but elect to have the additional 30% allowance apply in a later year.

If the tax returns for 2001 have already been filed, the depreciation deductions claimed for assets placed in service after September 11, 2001 should be reviewed in light of this new provision. The IRS already has revised Form 4562, *Depreciation and Amortization*, adding a new Part II to Page 1 to reflect this change in the law.

IRS PONDERS ALLOWING BHPH DEALERS TO USE THE CASH METHOD

ACCRUAL OR CASH?

In working with auto dealerships, whether they are franchised new or independent used vehicle dealerships, most CPAs understand that because inventories are involved, dealers are required to use the accrual method. That prevents the dealer from being able to use the cash receipts and disbursements (i.e., cash-basis) method.

In other business situations, the IRS has generally been resistant to allowing other small taxpayers to use the cash method. However, more recently, some of this resistance has softened either because of court decisions which the IRS has lost or the IRS has "voluntarily" conceded ground to taxpayers on this issue. These concessions have come in the form of recent Revenue Procedures.

The Commissioner has the authority to permit any taxpayer to use a method of accounting that clearly reflects income, even if that method is not specifically authorized by the Regulations. In Revenue Procedure 2001-10, the IRS allowed taxpayers who previously used the accrual method to change to the cash-basis method if their average annual gross receipts for the three years prior to the year of change was not more than $1 million.

NOTICE 2001-76

In Notice 2001-76 (2001-52 I.R.B. 613), the IRS proposed a Revenue Procedure that would allow more ***qualifying*** small businesses with gross receipts of less than $10 million to use the cash receipts and disbursements method for ***eligible*** trades or businesses.

According to the preamble, "This proposed revenue procedure is intended to reduce the administrative and tax compliance burdens on certain small business taxpayers and to minimize disputes between the IRS and these taxpayers regarding the requirement to use an accrual method of accounting under Section 446 ... because of the requirement to account for inventories under Section 471."

Although Notice 2001-76 contains the Revenue Procedure in its proposed form, taxpayers who qualify under it may rely on it for taxable years ending on or after December 31, 2001.

In effect, the $1 million maximum average annual gross receipts ceiling is raised to $10 million, but only for taxpayers who are within the scope of the proposed Revenue Procedure. Section 4 indicates that a ***qualifying*** small business taxpayer is one that reasonably determines that its principal business activity (i.e., the activity from which it derived the largest percentage of its gross receipts) for its prior taxable year is described in the North American Industry Classification System (NAICS) code other than one of the five ineligible code categories.

The ineligible NAICS codes include ... "retail trade within the meaning of NAICS codes 44-45." These codes include new car dealers, used car dealers and all other motor vehicle dealers, among others.

NIADA COMMENTS

In Notice 2001-76, the IRS requested comments on additional relief that should be considered for taxpayers with gross receipts of $10 million or less. In response, the National Independent Automobile Dealers Association (NIADA) said that allowing used motor vehicle dealers to use the cash method of accounting would reduce administrative and tax compliance burdens on these small businesses. It would also help stimulate the weak economy and provide more economically-disadvantaged individuals access to much-needed affordable transportation and financing for their transactions. Finally, it would allow these dealers to avoid the hardship (i.e. adverse cash flow) they otherwise face under current law.

NIADA's submission closes with the request that the Service reconsider its position with respect to the small businesses it has listed as ineligible to use the cash method of accounting. NIADA specifically asked the Service to further exercise its discretion to permit used motor vehicle dealers with gross receipts of less than $10 million annually to use the cash method of accounting.

INVENTORY ISSUES

As a matter of clarification, some CPAs have mistakenly jumped to the conclusion that if a used car/BHPH dealer weren't required to use the accrual method, the dealer would also be relieved of the need to maintain inventories. That would not be the case.

Section 4.03 of the proposed Revenue Procedure provides that when an item is purchased for resale, it must be accounted for as a *non-incidental material and supply.* As such, these items would be deductible only in the year in which they are actually used and consumed in the taxpayer's business.

Section 4.04 provides that "for purposes of this revenue procedure, inventoriable items that are treated as materials and supplies that are not incidental are

→

consumed and used in the year the (qualifying small business) taxpayer sells the items to a customer. Thus, under the cash method as described in this revenue procedure, the cost of such inventoriable items are (is) deductible only in that year (i.e. the year of sale), or in the year in which the taxpayer actually pays for the goods, ***whichever is later.***"

This "whichever or later" language could be harmful if, by some contorted logic, the position could be sustained that used vehicles purchased for resale were not "inventoriable items," but rather were "materials and supplies that are not incidental under Reg. Sec. 1.162-3." According to this language, if the dealer bought and sold the same used vehicle in December, but the dealer did not pay for that vehicle until after year-end, the deduction for the cost of that vehicle would be postponed until the year following the sale, since that is the later year.

OTHER RESOLUTION POSSIBILITIES IF THE IRS DOESN'T AGREE WITH NIADA

Apparently NIADA hopes that on the basis of its arguments and statistics, the IRS will allow (under-$10-million) used car dealers *en masse* to use the cash method. But, what if the IRS doesn't agree? There appear to be several other approaches or arguments that could be raised to help buy-here, pay-here dealers out of their tax predicament.

SEPARATE TRADE OR BUSINESS TREATMENT

For example, Section 4.01(1) of the Notice contains the listing of five NAICS code groups that are ineligible. It simply provides that if the taxpayer determines that its ***principal*** business activity is not one that is described by those codes, it may use the cash method ... "for ***all*** of its trades or businesses."

Several articles in prior issues of the *Dealer Tax Watch* have analyzed in some detail previous Letter Rulings and/or TAMs involving buy-here, pay-here dealers. In some of these, the position has been argued that the buy-here, pay-here dealer really is involved in at least two separate and distinct trades or businesses. One trade or business is the purchase and resale of used vehicles. The second trade or business is the financing of customer installment notes.

Section 4.01(4) of Notice 2001-76 (i.e., the proposed revenue procedure) states: "Notwithstanding the taxpayer's principal business activity, a qualifying small business taxpayer may use the cash method as described in this revenue procedure with respect to ***any separate and distinct trade or business whose principal business activity is not described in an ineligible NAICS code*** in Section 4.01(a) through (e)...."

Why not argue that the financing of customer notes is a separate trade or business that falls into one of the permitted "finance and insurance" NAICS codes? Specifically #522291 *Consumer Lending (Nondepository Credit Intermediation)* or the catch-all #522298 *All Other Nondepository Credit Intermediation* would seem to be relevant here.

Separating the financing activities of a buy-here, pay-here dealer into a separate component should

see **IRS PONDERS ALLOWING BHPH DEALERS TO USE THE CASH METHOD**, page 8

NIADA's COMMENTS ON NOTICE 2001-76

"Clearly the used vehicle industry has a significant impact on our country's economy. The used motor vehicle industry impacts millions of jobs in America, as well as most Americans being dependent on motor vehicles to get to and from work on a daily basis.

"Congress has considered numerous welfare-to-work and other incentive programs to help the economically-disadvantaged, but in all of these programs, a single question remains unanswered: ***How do they get to work?***

"Whenever individuals lose their jobs, ... it is typical for their credit to become impaired. Unfortunately, the number of Americans with impaired credit that cannot obtain conventional financing is steadily growing.

"One of the few places credit-impaired consumers have to turn is a motor vehicle dealership that is willing to finance the consumer's purchase itself. Under the current law, the dealership's reward for helping consumers get much-needed transportation, and providing financing when no one else will is to pay tax on the entire profit from the sale in advance, even though it has not been received and, in many cases, will never be received.

"One would think that motor vehicle dealerships would be provided with an incentive to help individuals finance these transactions, not a huge disincentive. Instead, the current tax law (i.e., that all anticipated revenue be declared as income at the time of sale and a deduction be taken if and when a charge-off occurs) results in an enormous tax liability to the dealership. The added tax imposed on a dealership can exceed the dealership's total net income for the year. If this tax structure continues to exist without modification, it will likely force a number of dealerships that currently offer their own financing out of business."

 (Continued from page 7)

entitle that component *trade or business* to be eligible for cash basis treatment. There are two advantages to this approach. First, the timing-of-the-deduction-for-inventory-purchases issue mentioned previously is avoided since the inventory is in a separate business component.

More importantly, this approach directly addresses the ***real*** problem. As NIADA expressed it: Dealers are required "to pay tax on the entire profit from the sale in advance, even though it has not been received and, in many cases, will never be received."

Notice 2001-76 states that no trade or business will be considered separate and distinct unless a complete and separable set of books and records is kept for such trade or business. This requirement should pose no real difficulty because of the extensive separate accounting and controls for all customer notes that exist in any well-run BHPH operation.

Furthermore, although Section 4.02 addresses the treatment of open accounts receivable (i.e., receivables due in 120 days or less), the dealers' secured customer notes should be distinguishable.

IMPUTE SOME INCOME & PAY A SMALL AMOUNT OF TAX

Another resolution alternative: If the case can't be made for separate and distinct trade or business treatment of the financing activity, why not try to work out with the IRS an approach whereby dealers would pay a small additional amount of tax for the privilege of not having to report up front all of the income on an installment note sale?

There is recent significant precedent for trying to work out this kind of resolution. In fact, that's exactly what the Revenue Procedure for the Service Warranty Income Method (SWIM) is all about.

For another example, consider the Revenue Procedure by which the IRS worked out an industry-wide settlement with dealers using the LIFO method who had problems with the LIFO financial statement conformity requirement for prior years. That was Revenue Procedure 97-44. Again, in this case, a large number of taxpayers agreed to pay a separate fee for the privilege of departing from the customary requirements. To everyone involved, this seemed to be a reasonable alternative, for a modest cost. And, in each case, taxpayers and the IRS felt they had a win-win situation.

Under this approach, a smaller amount of tax would most likely be paid if–as NIADA and dealers assert–it is really true that many times dealers do not collect a large percentage of their BHPH customer notes. And, apparently, the more risky the customer's credit situation, the more likely it is that a larger percentage of the income/principal will not be collected. The industry should be flush with statistics to support all of this.

A THIRD, MORE COMPLEX, POSSIBILITY

There might be still another resolution for the adverse cash flow problems faced by buy-here, pay-here dealers. This might involve some combination of (1) allowing the dealers to use the cash basis for customer notes, (2) requiring dealers to pay a higher rate of tax on installment note collections after some future date, and (3) extending the statute of limitations so that computations in the year of sale based on anticipated future collections can be matched with real experience in those later years.

Here again, there should be ample industry statistics available which could provide realistic, experience-based collection assumptions in the year of sale.

CONCLUSION

At this point, it's worth recalling comments of the IRS Motor Vehicle Industry Specialist (Mary Baker) that were included in the December 1999 *Dealer Tax Watch.* Here's what she said:

"When you have sub-prime customers, you don't know **if** you're going to collect...you don't know **when** you're going to collect...and you don't know **how much** you're going to collect. So, this a very complex problem. ***We recognize that we have a technical answer, but we probably don't have a practical answer to the problem.*** We're hoping that we can try to get some sort of guidance out there–whether it's through a Revenue Ruling, Revenue Procedure, Coordinated Issue Paper. We've discussed all sorts of alternatives to try to approach this, to try to give some practical guidance."

These comments were made in the context of grappling with sales of sub-prime notes to unrelated parties. They appear to be equally relevant to the deliberations of whether or not buy-here, pay-here dealers who hold their own paper should be permitted to use the cash method for their financing activities.

Even if the procedures and computations may have to become a little more complicated in order to reach this goal, the improving level of professional services and institutional assistance available to these BHPH dealers surely would rise to any new challenges. The additional complexity should be a reasonable tradeoff against the dealer's present burden of paying tax on phantom income.

It will be interesting to see how the IRS responds to NIADA's arguments. If more action or new proposals will be necessary to help BHPH dealers, maybe some of these ideas are worth further consideration.

TAX COURT FINDS BUY-SELL PAYMENTS WERE CONSTRUCTIVE DIVIDENDS & REVERSES SELF-SERVING DEMO POSITIONS

WHITEHEAD vs. COMM

Over the years, articles in this publication have discussed cases where dealers have been hit with constructive dividend-ordinary income treatment where payments were made on their behalf by their corporations. For examples, consider our discussions of *Yarborough Olds Cadillac* (*DTW*, December 1995) and *The IRS Audit Guide on Shareholder Loans vs. Constructive Dividends* (*DTW*, June 2001).

Then there's always our *Practice Guide Checklist* on identifying problem areas for disguised dividends lurking in related party transactions (*DTW* June 2001, pages 20-21). Some exposure is more direct, other exposure to a constructive dividend attack may be "beneath the surface and beyond the obvious."

One *Checklist* Question asks ... "How has the dealer secured financing for any additional franchise purchases or expansion activities?" The next asks whether the risk of recharacterization of activities or transactions by the IRS has been considered and discussed with the dealer. Yet another question asks: If potential exposure exists, have accuracy-related penalties and preparer penalties been considered and discussed?

As one recent tax case makes evident, these aren't hypothetical questions. In *Herbert L. Whitehead v. Comm.* (T.C. Memo 2001-317), the Tax Court recently hit the president of Burien Nissan with constructive dividends and accuracy-related penalties in connection with some buy-out payments he was involved with.

The name *Burien Nissan* may ring a bell with some readers. This dealership was one of two discussed in the June 2001 article entitled "Two More Dealerships Non-Compete Agreements Trapped by Section 197." In that article, the focus was on the application of Section 197 to payments made for non-compete agreements. As far as *Burien Nissan, Inc.* was concerned, the largest dollar issue involved the personal tax returns of the dealer who had sold his stock in the dealership and failed to report payments he received under non-compete agreements that he had executed.

In *Burien Nissan, Inc. et Al. v. Comm.* (T.C. Memo 2001-116), Mr. Whitehead was a minor figure. However, afterward when he had his own day in the U.S. Tax Court (T.C. Memo 2001-317), he was the principal figure on center stage.

In our June 2001 article, with respect to the *Burien Nissan* case, we said: "The facts in this case (TCM 2001-116) are somewhat of a jumble. There was considerable confusion due to ... transactions that were supposed to take place, but, in fact, never did." The same can be said about the facts and circumstances surrounding the shareholder purchase agreements and employment agreements in which Mr. Whitehead and several others were involved.

BUY-SELL FACTS

There is little benefit in detailing all of the purported facts, arguments by the taxpayer and comment of the Tax Court as to why it did not accept much of what the taxpayer asserted were "the facts."

The essence is that the dealership, Burien Nissan, experienced financial difficulties during 1990 and early 1991. Sometime during 1991, Mr. Stanford–who owned 75% (35,280 shares) of Burien Nissan–accepted an offer to manage a large automobile dealership in Hawaii. On September 13, 1991, Mr. Whitehead and Mr. Stanford entered into a stock purchase agreement. Pursuant to this agreement, Mr. Whitehead, who owned 25%, purchased all of Mr. Stanford's shares in Burien Nissan, Inc. for $178,000. This purchase price was paid for by Mr. Whitehead delivering a non-negotiable promissory note to Mr. Stanford. This promissory note contained a number of restrictions and provisos by which the timing of principal payments was related to prior transactions and options.

On April 11, 1995, Burien Nissan, Inc. began making payments to Mr. Stanford in the amount of $2,000 per month. These payments continued until at least September 1999. On October 15, 1995, Burien Nissan cancelled the 35,280 shares of Mr. Whitehead's stock that he had purchased from Mr. Stanford on September 13, 1991. Thereafter, Mr. Whitehead held 11,760 shares of Burien Nissan stock which was 100% of all of the issued and outstanding stock of the Corporation after the share acquired from Mr. Stanford were cancelled.

At no time did Mr. Whitehead individually make any payments directly to Mr. Stanford on the promissory note that he had signed on September 13, 1991 in exchange for Mr. Stanford's stock. As indicated above, Burien Nissan made monthly payments to Mr. Stanford from April 1995 until at least September

see **BUY-SELL CONSTRUCTIVE DIVIDEND**, page 10

(Continued from page 9)

1999. It is stated as a fact that "neither Mr. Whitehead nor Burien Nissan expected Mr. Whitehead to repay those amounts to Burien Nissan."

Related to this, there was an Adjusting Journal Entry for the Period Ended December 31, 1995. This AJE indicated a *debit* to the *Retained Earnings* account in the amount of $178,000 and a *credit* to a *Note Payable - Ken Stanford* account in the amount of $178,000. This entry was followed by the description: "To record note payable on capital stock redeemed."

THE IRS & THE TAX COURT

The years involved in this case were the calendar years 1996 and 1997. In auditing Mr. Whitehead's income tax returns, the IRS took the position that Mr. Whitehead had received constructive dividends of $24,000 for each year. These were the monthly payments made directly to Mr. Stanford by the dealership corporation 100% owned by Mr. Whitehead.

In discussing its evaluation of the evidence in the record, the Court stated that it found Mr. Whitehead not to be a credible witness. The Court said that it found his testimony "to be conclusory and/or uncorroborated by reliable evidence in certain material aspects."

In discussing the documentary evidence with respect to the constructive dividend issue, the Court found no shortage of inconsistencies and incomplete and questionable information, going so far as to refer to some of them as "significant irregularities."

The Court emphasized the inconsistency in the alleged facts, the poor execution and poor documentation of legal instruments and the fact that the record, almost more often than not, contained nothing in support of Mr. Whitehead's allegations of fact.

Referring to the adjusting journal entry above, the Court said: "We are not persuaded by the AJE 15 entries that Burien Nissan redeemed Mr. Stanford's stock in 1995, or at any other time. We have found that Mr. Whitehead purchased all of Mr. Stanford's Burien Nissan stock on September 13, 1991, pursuant to the September 13, 1991 Whitehead/Stanford Stock Purchase Agreement. We find on the record before us, that Mr. Stanford owned no Burien Nissan stock after September 13, 1991 and Burien Nissan could not have redeemed any stock from Mr. Stanford in 1995. We shall not rely on the AJE 15 entries to support Petitioners' position that Burien Nissan redeemed Mr. Stanford's Burien Nissan stock in 1995."

The Tax Court agreed with the IRS determinations that the $24,000 paid by Burien Nissan during each of the two years in issue should be treated as constructive dividends. Citing such cases as *Yelencsics v. Commissioner* (74 T.C. 1513 (1980)), the Court said that by making those payments, Burien Nissan relieved Mr. Whitehead of his obligations under the promissory note that he had issued to Mr. Stanford on September 13, 1991.

Mr. Whitehead had argued that his September 13, 1991 stock purchase agreement with Mr. Stanford was void or voidable because of certain restrictions that had been placed on the transfer of such stock pursuant to a shareholder's agreement that had been in effect since a date almost one year earlier (September 1, 1990). Consequently, Mr. Whitehead had argued that he had not purchased Mr. Stanford's stock in Burien Nissan and that it was the Company's payments to Mr. Stanford during those years that were payments made "in redemption of" his Burien Nissan stock.

As stated previously, the facts in the case were a jumble. The Court said that based on the record before it, the taxpayer failed to bear the burden of supporting its arguments that the September 13, 1991 stock purchase agreement was void or voidable.

One lesson from all of this is clear. A taxpayer should not expect ambiguous and inconsistent facts and arguments to prevail in the Tax Court. Better off trying to settle with the IRS sooner, than spending a lot of money trying to achieve the impossible. On top of that, the Court sustained the assessment of accuracy-related penalties under Section 6662 in amounts of 20% of the tax deficiencies.

USE OF DEMONSTRATOR VEHICLES: REVERSAL OF DEALER'S SELF-SERVING DEMO POSITIONS

Another issue in this case related to who should report income from the use of a demonstrator vehicle and in what amount. During the years in issue, neither Mr. Whitehead nor Mrs. Whitehead owned an automobile. However, they did have the use of demonstrators owned by Burien Nissan, and they did not pay the Company for their uses of their respective vehicles.

The demos they drove varied throughout the years. Neither the Whiteheads nor the Company maintained records showing which vehicles were used. Mr. Whitehead selected the specific vehicles that he and his wife drove. The average value of the vehicles that he used during 1996 was $18,000 and the average value of the vehicles that she drove during 1996 was $24,000.

Mr. and Mrs. Whitehead did report a certain amount of income in their 1996 and 1997 individual income tax returns as attributable to the use of these vehicles. The real issue, however, was not the

→

amount of income that each one reported. The issue was who should report the income and how it should be characterized.

Mrs. Whitehead had reported the value claimed for her use of the vehicle as self-employment income. The IRS took the position that the value of her use of the vehicle should be taxable to Mr. Whitehead as part of his employment-related compensation. Why? Simply because this treatment meant that Mrs. Whitehead could not take a deduction for a contribution she had made to her IRA account!

With surgical precision, the Tax Court opinion discusses the consequences of the lack of documentation and a number of alternative positions. One of these was whether the taxpayers might have met the requirements of the "sampling method" of substantiation. The Court held "that the fair market value of Ms. Whitehead's use of certain Burien Nissan automobiles during the years at issue constitutes a fringe benefit provided by Burien Nissan ***to Mr. Whitehead***, and is includable in petitioners' income ... as wages to Mr. Whitehead."

The Tax Courtfound that the petitioners failed to show that Mrs. Whitehead performed any services for Burien Nissan during the years at issue. The taxpayers had contended that Mrs. Whitehead performed services for Burien Nissan. These services included (1) performing administrative tasks, (2) functioning as corporate Secretary, (3) assisting with the transporting of vehicles when sales promotions were conducted away from the dealership site and (4) coordinating employee functions at two or more major events during the year.

At the trial in the Tax Court, both Mr. and Mrs. Whitehead testified. However, the Court did not rely on their testimony as being credible.

The Court looked very closely at the assertion that Mrs. Whitehead had performed services with respect to alleged employee functions. In that regard, it said, "We infer from petitioners' failure to proffer any such credible corroborating evidence that any such evidence does not exist and that, if any such evidence does exist, it would not have substantiated petitioners' position with respect to the alleged services provided to Burien Nissan by Ms. Whitehead during the years in issue."

The Judge even looked at the tax return the company filed and said, " ... in this connection, we note that in Form 1120 (i.e., the Corporate Federal Income Tax Return) that Burien Nissan filed for each of the years at issue, it did not claim deductions in amounts large enough to cover the several thousand dollars that Ms. Whitehead testified it spent each year on the alleged employee functions."

There's more, but you probably get the point!

The Tax Court found that both petitioners failed to show that any portion of their use of the automobiles during the years in issue constituted a business use of the vehicles. It sustained the IRS determination that $15,000 per year was the proper amount that should have been reported each year by Mr. Whitehead in connection with the use of the vehicles.

The portion of this decision involving the use of employer-provided vehicles contains an excellent analysis of the documentation and substantiation requirements and the consequences when taxpayers fail to meet them. This is an area we have covered many times in previous articles.

IRS RULES FAVORABLY FOR SOME OLDS DEALERS ... BUT BE CAREFUL IF YOU'RE GOING TO RELY ON THIS RULING

GM OLDS IRS

On December 12, 2000, General Motors abruptly announced that it was going to phase-out its Oldsmobile dealer network. Ever since, dealers and their advisors have been scrambling to "make deals" with GM...or is it the other way around? At the same time, some have been wondering how badly they would be hit by the tax consequences of all of this.

One affected area that has already received much attention is the impact that the drop in inventory levels at year-end would have on the repayment of LIFO reserves for dealers using the Last-In, First-Out method. But this is only one of the many tax ramifications.

NADA recently announced its success in obtaining a "favorable" ruling from the Internal Revenue Service on behalf of an Oldsmobile dealer receiving payments under a GM Transition and Release Agreement (TRA). The text of this Ruling is available to dealers on the NADA web site, even though it has not yet been made public under the Freedom of Information Act.

In addition to discussing the Ruling, this article suggests areas where dealers and their advisors will have to be careful because these favorable results may not be without significant side effects or other tax risks and complications.

THE NADA - OLDS RULING

Holdings. Based on the facts submitted by the Oldsmobile dealership, the IRS ruled:

1. ***The transition payments received by the dealer are considered amounts received in exchange for the cancellation of its Distributor Agreement pursuant to Section 1241.*** The Service is very careful to use the term *distributor agreement*, and not "*franchise*," in any of its discussions.

2. ***The gain calculated upon the exchange will be considered as long-term capital gain to the taxpayer within the meaning of Sections 1221 or 1231.*** The Service accepted the fact that the Distributor Agreement was an asset used in the taxpayer's trade or business that does not fall within any of the listed exceptions to capital gain treatment in Sections 1221 or 1231. Therefore, it said that it did not need to decide whether the Distributor Agreement was a capital asset or a Section 1231 asset because, in either case, gain from the sale of such an asset would be capital gain for the taxpayer.

3. ***The taxpayer is eligible to report the gain from the exchange on the installment method pursuant to Section 453***, because at least one transition payment will be received by the taxpayer after the year of disposition.

Background. In general, individual taxpayers benefit if they can report taxable payments as long-term capital gain, instead of as ordinary income, because the maximum tax rate on long-term capital gains is usually 20%. This is also important for S corporations (and other flow-through entities, such as partnerships and LLCs) who are able to flow the long-term capital gain characterization of taxable payments through to their respective owners.

This generally favorable result, however, is subject to at least two qualifications. First, for individuals, significant amounts of long-term capital gain taxed at a 20% rate may create or further increase an individual's tax liability for the Alternative Minimum Tax. Second, for regular taxable corporations (i.e., C corporations filing Form 1120, rather than S corporations filing Form 1120-S), the characterization as long-term capital gain produces less benefit since the 20% maximum rate is inapplicable.

In July of 2001, the dealership initially requested three rulings concerning the tax treatment of certain payments "received by the Taxpayer from Corporation." Presumably, "Corporation" refers to the Oldsmobile division of General Motors. The taxpayer is an auto dealership operating in corporate form which has made an election to be taxed as an S corporation. The Ruling states that the taxpayer is "engaged in the business of selling and servicing Product A and Product B." Let's assume that A is the Oldsmobile franchise and that B is a Chevrolet or some other GM franchise. The facts in the Ruling Request are on the facing page.

The taxpayer's letter to the IRS specifically requested rulings involving only Sections 1221, 1241 and 453 of the Internal Revenue Code. And these are the only ones that the IRS looked at.

The Application of Sec. 1241. The Service's analysis begins with whether Section 1241 applies to the Transition & Release Agreement between the dealership and GM so that the cancellation of the Distributor Agreement will be considered an ***exchange.***

see **IRS RULES FAVORABLY FOR SOME OLDS DEALERS** page 14

FACTS IN OLDSMOBILE DEALER'S RULING

"The Taxpayer is an S corporation engaged in the business of selling and servicing Product A and Product B. The Taxpayer's annual accounting period is the calendar year and it reports income and expenses using the accrual method of accounting.

"The Taxpayer and Corporation entered into a distributorship's agreement that provided that the Taxpayer with the right to sell and market Product A within a prescribed geographic area (Distributor Agreement). The Distributor Agreement provides that it may not be assigned to a third party. If a distributor sells its business (assets or stock), the selling distributor voluntarily terminates its distributor agreement with Corporation and Corporation subsequently approves the buyer under a new distributor agreement. The Taxpayer had the right to continually renew the Distributor Agreement as long as the Taxpayer performed according to the terms of the Distributor Agreement. In addition to being part of the Distributor Agreement, the renewal right was provided to the Taxpayer pursuant to State (of ___) law. The Taxpayer and Corporation last extended the Distributor Agreement on _____ (date deleted).

"Under the Distributor Agreement, the Taxpayer is obligated to maintain at least $_____ of net working capital at all times for the Product A and the Product B lines during its business operation and maintain the Image of Corporation consistently with other distributors of Product A. The Distributor Agreement requires the Taxpayer to maintain and manage its distributorship so that it can effectively sell and service Product A. To do so, the Taxpayer is required to purchase and use Corporation designed equipment as necessary. The Taxpayer must service customers and maintain customer satisfaction. In addition, the Distributor Agreement requires that the Taxpayer must maintain a sufficient level of inventory to allow customers a variety of Product A. The Taxpayer's sales performance is monitored at least yearly and Corporation has the right to terminate the Distributor Agreement with the Taxpayer if it determines that the Taxpayer's sales performance is inadequate.

"In _____ (date deleted), Corporation notified the Taxpayer and other Product A distributors of its intention to discontinue the Product A line. As part of this announcement, Corporation offered to provide transition payments to distributors who agreed to cancel their distributor agreements with Corporation. The calculations of the transition payments are based upon a number of factors including the number of Product A sold by the distributor over a three-year period and the percentage of Product A sold out of total sales by the distributor. The cancellation would also entail a release of Corporation from any future claim brought under a distributor agreement.

"On _____ (date deleted), the Taxpayer and Corporation agreed to cancel the Distributor Agreement and executed a Transition and Release Agreement (TRA) setting forth the terms of the cancellation. The TRA provided for ___ percent of the transition payment amount of $_____ (amount deleted) to be paid to the Taxpayer upon the execution of the TRA and the remaining amount upon the earliest of three dates;

(1) _____ number of days after the Taxpayer provides notice to Corporation of its intention to no longer sell and market Product A;

(2) _____ number of months after Corporation provides notice to the Taxpayer of its intention to eliminate the Taxpayer's ability to sell, market and service Product A; or

(3) _____ (specific date, date deleted).

"Under the terms of the TRA, the Taxpayer may continue to sell and market Product A until the earliest of the three dates. One or more of the transition payments will be received by the Taxpayer after the close of the taxable year in which the disposition occurs. As of _____ (date deleted), the Taxpayer had an inventory of approximately $_____ (amount deleted) relating to the Product A line and gross revenue in _____ (year deleted) of approximately $_____ (amount deleted) relating to the Product A line."

From NADA / IRS Oldsmobile Ruling to be released as LTR 2002_ _ _ _

(Continued from page 12)

The Service said that in order for Section 1241 to apply, three requirements had to be met.

1. The distributor must be a distributor of goods,

2. The transition payments received by the taxpayer must be for the cancellation of a distributor's agreement, and

3. The taxpayer must have a substantial capital investment in the distributorship.

According to the IRS, "The Distributor Agreement provides that the Taxpayer may sell Product A, which is not an intangible or a personal service, within a certain defined geographic area and the Taxpayer has made a substantial investment of capital in the distributorship as evidenced by the inventory value of approximately $_____(amount deleted) as of_____ (date deleted).

"Under Reg. Sec. 1.1241-1(b), a cancellation of a distributor's agreement means a termination of all contractual rights of a distributor for a particular distributorship. The TRA terminates all of the Taxpayer's contractual rights over time (no later than [____specific date deleted]) to sell new Product A. Therefore, the transition payments received by the Taxpayer from Corporation under the TRA are considered amounts received in exchange for a distributor's agreement under Section 1241."

Note how little discussion ... if it can even be called that ... there is of the Transition & Release Agreement.

Eligibility for Long-Term Capital Gain Treatment. In discussing whether the exchange of the Distributor Agreement would be considered long-term capital gain to the taxpayer, the IRS said three tests had to be satisfied. ***First,*** the asset must be a capital asset as defined by Section 1221. ***Second,*** the disposition must be a "sale or exchange." ***Finally,*** the asset must have been held for more than one year, as required by Section 1222.

The Service observed that under Section 1231, capital gain treatment also may result from the sale or exchange of real or depreciable property used in the taxpayer's trade or business and held for more than one year, if the taxpayer's Section 1231 gains exceed its Section 1231 losses for the year.

The Service concluded that gain on the exchange could be considered as long-term capital gain within the meaning of Sections 1221 or 1231. The Service's entire discussion of this area, appears on page 19. What is interesting is that although the ruling mentions a few cases in a footnote, it omits any reference to one seemingly relevant case: *W. R. Matthews v. U.S.* This case is discussed separately below.

Eligibility for Installment Reporting. The third issue in the Ruling involved whether the taxpayer's income from the cancellation of its Distributor Agreement could be taken into account under the installment sales method provided in Section 453. An installment sale is a disposition of property if at least one payment is to be received after the close of the taxable year in which the disposition occurs.

The Ruling cites Revenue Ruling 55-374 which held, in part, that a taxpayer's sale to a third party of his rights in a distributor agreement was a sale of property which could be reported on the installment basis. The Service also cited the Tax Court's holding in *Fox v. Commissioner* (84 T.C. 50) that the proceeds received from the sale of a janitorial and building maintenance franchise network qualified under Section 453 for installment reporting.

The Service held that the payments received by the Oldsmobile dealership corporation for the cancellation of the distributor agreement under GM's Transition & Release Agreement are considered amounts received in exchange for such agreement, and accordingly, the cancellation would qualify as a disposition for purposes of Section 453. The Ruling adds only the following: "The distributor agreement constitutes property within the meaning of Section 453. Thus, the Taxpayer's income from the cancellation may be taken into account under the installment method of Section 453."

IRS Caveats. The IRS Ruling closes with two cautions. First, it says that no opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. It closes with the warning that this Private Letter Ruling does not address many other situations or aspects that Olds dealers may be involved with.

In connection with this ruling, the NADA website says, "While the rulings were issued to a specific dealer, as a practical matter, all Olds dealers in a ***similar*** situation can use these rulings as non-binding guidance." More experienced practitioners will recognize the peril if they fail to appreciate the importance of the ***"similar"*** qualification wording, and the IRS reminder that its holdings are limited to the (almost negligible) facts presented in the case.

W. R. MATTHEWS: PAYMENTS FOR ASSISTANCE IN TERMINATING FRANCHISE

First, let's consider whether an older case ... not cited in the IRS Ruling ... might shed any further light in the current Olds dealer situations. *W. R. Matthews v. U.S.* (36 AFTR 2d 75-5974, 75-2 USTC Para. 9738) is a case decided in 1975 by the U.S. District Court, District of South Carolina, Columbia Div.

→

In this case, the Court ruled that amounts paid directly to an individual dealer who had assisted another unrelated dealership in securing the Pontiac franchise that his own dealership previously held were payments that should be taxable to him in his personal return as ordinary income ... and not as long-term capital gain under Section 1241.

Matthews also contains some interesting language that bears out the application of Section 1241, emphasizing that the dealership corporation (controlled by the dealer) owned/***held*** the Distributor Agreement ... and that the individual dealer did not. The Court said that "a shareholder is not the owner of his corporation's assets; the corporation's separate legal status–including ownership of assets–must be respected for tax purposes barring sham or the like." (Citing *Moline Properties v. Comm.*)

It is our understanding that the current GM payments to terminating Olds dealers for "transitional assistance" are being made directly to the dealership corporations–and not directly to the individual dealers (even though it is the dealers who are individually named on Paragraph Third). Accordingly, the language in *Matthews* is consistent with the conclusion in the current Ruling relative to the dealership corporation–and not the dealer individually–as being the owner of the distributorship agreement.

This is significant because it emphasizes the need to distinguish between dealership corporations that have made S elections for tax purposes, and those that have not. In distinguishing between S corporations and C corporations, there may be issues involving the separate tax at the Corporate level for S corps in connection with built-in gains under Section 1374.

On the other hand, C corps and their shareholders now face the inevitable burden of double taxation.

W. R. Matthews is all the more interesting because of the related earlier (1969) decision in the same district, *Hampton Pontiac, Inc. v. U.S.* The *Hampton* case held that the payments made to Mr. W. R. Matthews were not deductible by Hampton Pontiac, Inc., the payor. The *Hampton* case also contains language discussing what to some is the conflicting language on Paragraph Third regarding the "personal service contract" nature involving the individual dealer and the separate ownership of the distributorship agreement by the corporation.

W. R. Matthews and *Hampton Pontiac, Inc.*, read together, illustrate just one of the rich fact patterns and possibilities likely to be encountered in franchise termination scenarios. For more about the *Matthews* case, see pages 16-17.

REAL WORLD VARIATIONS & SCENARIOS

Many of the different fact patterns and "special circumstances" giving rise to termination payments by GM for its Oldsmobile distributor agreements may not be covered by the NADA/Olds Ruling.

In a situation where the Oldsmobile dealer is losing his franchise and completely exiting the business, long-term capital gain treatment of the proceeds would seem to be more consistent with generally established case law. However, where the Oldsmobile dealer is receiving payments in the context of the termination of the Oldsmobile franchise, but the economic activity of selling vehicles will continue–just in a different form or with a different/replacement franchise–can it be said that the payments are really eligible for tax-favored treatment?

Or is it a matter of semantics? The Olds Ruling does not provide any specifics as to how the payments in question were computed, nor as to what they may have been called. In discussions with GM, and in closing documents, the "transition payments" usually can be divided into payments made for acquisition assistance, facilities assistance, termination assistance and/or the repurchase of inventory parts, etc. The Olds ruling discloses only one overall simplified set of facts and end result. We have no way of knowing just how much consideration the IRS might have given to any of these other factors, if–in fact–they were present or presented to the IRS.

Semantics, Terminology, Rent Equivalents. Some of the General Motors documentation makes it clear that GM is willing to determine a portion of its Transition Assistance Payments by looking at the nationwide average rent and rent equivalent for all GM dealers. Can it be said that this portion of its Transition Assistance Payment (i.e., "facilities assistance") meets the strict tests of Section 1241?

In other instances, there may be other specific obligations under the dealer agreement, or arising from prior transactions with General Motors, that the "Transition Assistance Payments" are intended to satisfy. Here again, the question is: Can it be said that amounts paid under these circumstances satisfy the strict requirements for the application of Section 1241?

Replacement Franchises. What if the cancellation of the Oldsmobile franchise is followed by GM's issuing another franchise, with the dealer obviously staying in business? In some instances, payments by General Motors may take the form of special assistance to a dealer who very recently acquired and invested heavily in their Oldsmobile franchise. The dealer is now receiving "transition assistance" from

see **IRS RULES FAVORABLY FOR SOME OLDS DEALERS** page 20

W. R. MATTHEWS: PAYMENTS TO DEALER FOR HIS ASSISTANCE IN GETTING GM TO TERMINATE PONTIAC FRANCHISE

The facts in *W. R. Matthews**, although interesting, are somewhat different from those likely to be found in connection with the current GM Olds franchise termination situations. What is interesting is the Court's discussion of the application of Sections 1221, 1222 and 1241 to the facts.

Hampton Pontiac, Inc. became interested in securing a Pontiac franchise in Columbia, SC. It was advised that so long as an existing franchise for that area was already held by King Pontiac, Inc., General Motors would not consider its request for another Pontiac franchise in that area. W. R. Matthews was the dealer in control of King Pontiac, Inc., and he eventually acquired 100% of its stock.

It was plain to Hampton Pontiac, Inc. that an immediate Pontiac franchise in Columbia could only be secured by inducing the current holder of the Pontiac franchise, King Pontiac, Inc., to voluntarily surrender its existing Pontiac franchise.

Hampton Pontiac, Inc. approached Mr. Matthews in an effort to negotiate with him for the surrender of the Pontiac franchise. "...Whether such approach had been suggested by Pontiac is not clear, but seems fairly inferable from the conduct of the parties."

Hampton Pontiac, Inc. agreed to pay $15,000 over a period of three years to King Pontiac, Inc. It also agreed to pay Mr. Matthews personally a percentage of its profits before taxes for 5 years. In *Hampton Pontiac, Inc.***, the Court agreed with the IRS that the payments made to Mr. Matthews could not be deducted as salary expense.

We now shift the focus to the treatment of these payments by Mr. Matthews in his individual income tax return. Ultimately, he contended that the payments should be taxable as long-term capital gain and not as ordinary income. The text below is from the *W. R. Matthews* case.

> "First, he (i.e., W. R. Matthews) contends that this transaction meets the definitional requirements of Section 1222, which defines a long-term capital gain as the gain or loss from the 'sale or exchange of a capital asset held more than six months.' ...
>
> "The defendant denies that the plaintiff is entitled to capital gains treatment on any of the payments in question. Instead he contends, and the Court agrees, they are taxable as ordinary income. With respect to plaintiff's contentions that the payments were received as the result of the 'sale or exchange of a capital asset,' the defendant asserts that ***the facts clearly establish that King Pontiac, Inc., a separate and distinct legal entity, and not the plaintiff own the Pontiac Motor Division franchise*** (hereinafter referred to as the franchise). This, according to the defendant, defeats plaintiff's claim under Section 1222 because when Section 1221(3), (which defines 'capital asset' as 'property *held* by the taxpayer' with certain exceptions not here relevant), is read in connection with Section 1222(3) it is clear that the plaintiff cannot qualify for capital gains treatment since he did not own the 'capital asset in question.' (Emphasis added.)
>
> "Plaintiff, however, asserts that the correct interpretation of the dealership agreement between King Pontiac, Inc. and Pontiac Motor Division is that the plaintiff and not King Pontiac, Inc. should be considered the owner of the franchise. Plaintiff's argument in this regard is predicated

(Continued)

upon the fact that the dealership agreement provided that Pontiac Motor Division [pg. 75-5977] could terminate the franchise upon the *removal, resignation, withdrawal or elimination from dealer for any reason of any person named in Paragraph Third.* This, according to the plaintiff, demonstrates that the agreement runs with the individual named in the third paragraph rather than the corporate entity designated as *dealer* in the first paragraph.

"The plaintiff's argument, however, asks the Court to read ambiguity into a manifestly clear and straightforward agreement. Under the facts as stipulated by the parties the first paragraph of the agreement between King Pontiac, Inc. and Pontiac Motor Division provided in pertinent part that it was an, 'Agreement ... by and between Pontiac Motor Division - General Motors Division ... and King Pontiac, Inc., a corporation of Columbia ... South Carolina hereinafter called dealer.' This paragraph as well as the remainder of the agreement support only one conclusion - ***King Pontiac, Inc., and not the plaintiff was the owner of any rights conveyed under the dealership agreement.*** It is also clear from correspondence introduced by the parties that the officials of Pontiac Motor Division treated King Pontiac, Inc. as the owner of the dealership agreement. (Emphasis added.)

"Nor can it be argued that plaintiff had a property interest in the franchise by reason of his ownership of all outstanding stock in King Pontiac, Inc. For as the defendant correctly asserts, a shareholder is not the owner of his corporation's assets; the corporation's separate legal status - including ownership of assets - must be respected for tax purposes barring sham or the like. *Moline Properties v. Commissioner*, 319 U.S. 436 [30 AFTR 1291] (1943).

"The foregoing reasoning applies with equal force to plaintiff's contentions that he was a *distributor* within the meaning of Section 1241, which provides in pertinent part:

> 'Amounts received ... by a distributor of goods for the cancellation of a distributor's agreement (if the distributor has a substantial capital investment in the distributorship, shall be considered as amounts received in exchange for such ... agreement.'

"Since, as the facts clearly establish, King Pontiac, Inc. not the plaintiff, was the owner of the franchise, it follows that it and not the plaintiff would be considered the *distributor* for the purposes of this section. It should also be noted that qualification under this section confers only the *exchange* requirement of Section 1222 upon the transaction, leaving unfulfilled the requirement of Section 1221 i.e. that 'the property be *held* by the tax payer.' (emphasis added)."

Portions of the opinion not included above relate to the Mr. Matthews' alternative argument (rejected by the Court) that the payments he received were constructively received ("as a result of" from the liquidation of his dealership corporation, King Pontiac, Inc.) In rejecting Mr. Matthews' alternative position, the Court includes some very interesting language on "form over substance" and how the transaction could have been structured so that Mr. Matthews would have ultimately received them as a liquidating distribution eligible for capital gain treatment under Section 331, which at that time, was in effect.

Citations

* *W.R. Matthews v. U.S.*, U.S. District Court, District of South Carolina, Columbia Div. (36 AFTR 2d 75-5974, 75-2 USTC Para. 9738)

** *Hampton Pontiac, Inc. v. The United States*, 294 F.Supp. 1073 [23 AFTR 2d 69-624] (D.C.S.C. 1969)

IRS ANALYSIS OF SECTION 1241 IN OLDS DEALER'S RULING

"Section 1241 provides that amounts received by a lessee for the cancellation of a lease, or by a distributor of goods for the cancellation of a distributor's agreement (if the distributor has a substantial capital investment in the distributorship), shall be considered as amounts received in exchange for such lease or agreement.

"Reg. Sec. 1.1241-1(a) provides, in general, that proceeds received by lessees or distributors from the cancellation of leases or of certain distributorship agreements are considered as amounts received in exchange therefore. Section 1241 has no application in determining whether or not a cancellation not qualifying under that Section is a sale or exchange. Further, Section 1241 has no application in determining whether or not a lease or a distributorship agreement is a capital asset, even though its cancellation qualifies as an exchange under Section 1241.

"Reg. Sec. 1.1241-1(b) defines "cancellation" of a lease or a distributor's agreement, as used in Section 1241, to mean a termination of all the contractual rights of a lessee or distributor with respect to particular premises or a particular distributorship, other than by the expiration of the lease or agreement in accordance with its terms. A payment made in good faith for a partial cancellation of a lease or a distributorship agreement is recognized as an amount received for cancellation under Section 1241 if the cancellation relates to a severable economic unit, such as a portion of the premises covered by a lease, a reduction in the unexpired term of a lease or distributorship agreement or a distributorship in one of several areas or of one of several products. Payments made for other modifications of leases or distributorship agreements, however, are not recognized as amounts received for cancellation under Section 1241.

"Reg. Sec. 1.1241-1(c) provides that Section 1241 applies to distributorship agreements only if they are for marketing or marketing and servicing of goods. It does not apply to agreements for selling intangible property or for rendering personal services as, for example, agreements establishing insurance agencies or agencies for the brokerage of securities. Further, it applies to a distributorship agreement only if the distributor has made a substantial investment of capital in the distributorship. The substantial capital investment must be reflected in physical assets such as inventories of tangible goods, equipment, machinery, storage facilities or similar property.

"An investment is not considered substantial for purposes of Section 1241 unless it consists of a significant fraction or more of the facilities for storing, transporting, processing, or otherwise dealing with the goods distributed, or consists of a substantial inventory of such goods. The investment required in the maintenance of an office merely for clerical operations is not considered substantial for purposes of the Section.

"Furthermore, Section 1241 does not apply unless a substantial amount of the capital or assets needed for carrying on the operations of a distributorship are acquired by the distributor and actually used in carrying on the distributorship at some time before the cancellation of the distributorship agreement. It is immaterial for the purposes of Section 1241 whether the distributor acquired the assets used in performing the functions of the distributorship before or after beginning his operations under the distributorship agreement. It is also immaterial whether the distributor is a retailer, wholesaler, jobber, or other type of distributor."

From NADA / IRS Oldsmobile Ruling to be released as LTR 2002_____

IRS ANALYSES OF SECTIONS 1221-1231 IN OLDS DEALER'S RULING

"In order for proceeds from the disposition of an asset to qualify as long-term capital gain, the asset must be a capital asset as defined by Section 1221, the disposition must be a "sale or exchange," and the asset must have been held for more than one year. [Section 1222] Under Section 1231, capital gain treatment also may result from the sale or exchange of real or depreciable property used in the taxpayer's trade or business and held for more than one year, if the taxpayer's Section 1231 gains exceed its Section 1231 losses for the year.

"Thus, in order for the Taxpayer to get capital gains treatment for gain it realizes upon the cancellation of its distributorship, three requirements must be met:

(1) the Taxpayer must have held the distributorship for more than one year;

(2) there must be a sale or exchange upon cancellation of the distributorship; and

(3) the Distributor Agreement must be an asset that qualifies for capital gain treatment under either Section 1221 or Section 1231.

"In this case, the ***first requirement*** has been met because the Taxpayer has held the distributorship for more than one year. The ***second requirement*** that there be a sale or exchange upon the cancellation of taxpayer's distributorship agreement has been satisfied because, under Section 1241, amounts received by a distributor of goods for the cancellation of a distributor's agreement (if the distributor has a substantial capital investment in the distributorship), shall be considered as amounts received in exchange for such agreement."

[Note: The following is a footnote to the preceding paragraph ... "Over the years, Congress has enacted numerous "statutory sale or exchange" provisions that provide for capital gain or loss in many situations, including Section 1241 with respect to cancellation of leases and certain distributorship agreements. See e.g. Sections 165(g), 166(d)(1)(B) (worthless securities); 1038 (foreclosures); 1231(a)(3) (involuntary conversions; overruling *Helvering v. William Flaccus Oak Leather Co.*, 313 U.S. 247 (1941)); 1233 (short sales); 1234 (option expirations); 1234A (certain contract cancellations); 1271 (debt retirements)."]

"We look, then, to the ***third requirement***, that the distributorship must be an asset that qualifies for capital gain treatment under either Section 1221 or Section 1231. Section 1221 defines the term "capital asset" as property held by the taxpayer, regardless of whether it is connected with the taxpayer's trade or business, unless the property meets one of five listed exceptions: (1) inventory; (2) property of a character which is subject to the allowance for depreciation provided in Section 167 or real property used in a trade or business; (3) certain intangible property; (4) accounts receivable acquired in the ordinary course of a trade or business; and (5) certain publications of a United States Government.

"The term "Section 1231 gain" includes gain from the sale or exchange of property used in a taxpayer's trade or business, of a character which is subject to the allowance for depreciation under Section 167, and that does not fall within certain exceptions generally equivalent to the exceptions in Section 1221.

"In this case, the Distributor Agreement is an asset used in the Taxpayer's trade or business that does not fall within any of the listed exceptions to capital gain treatment in Section 1221 or Section 1231. We need not decide whether it is a capital asset or a Section 1231 asset because, in either case, gain from the sale or exchange of such an asset would be capital gain for Taxpayer. We conclude that the gain calculated upon the exchange will be considered long-term capital gain to the taxpayer within the meaning of Sections 1221 or 1231."

From NADA / IRS Oldsmobile Ruling to be released as LTR 2002_____

(Continued from page 15)

GM in connection with helping the dealer acquire a replacement franchise.

In this case, what is the correct tax characterization of the transition payment received? Will all amounts General Motors pays automatically be favorably treated in circumstances where the payments have been adjusted to reflect these circumstances?

Multiple Franchises. Some dealership groups hold many different franchises. In fact, they may hold so many that in the past, it may have been to their advantage to take the position that they are in the "trade or business" of holding and acquiring franchises ... and the underlying distributor agreements. One area where this position has been very helpful to multi-franchise dealerships involves (Last-In, First-Out) inventory liquidations and replacements. In these situations, the pro-taxpayer argument is that the disposition of a particular franchise occurs within the ordinary course of the taxpayer's trade or business.

In these multi-franchise dealership situations is the disposition of a single franchise/distributor agreement eligible to be treated as the disposition of a capital asset? Where does one draw the line?

Valid Agreements. The facts in the IRS Ruling presuppose a valid distributor agreement. What if, for any reason, the franchise agreement is ***not*** valid?

What if the dealer failed to notify the Factory of changes in ownership or the occurrence of other circumstances which it is obligated to bring to the Factory's attention? Technically, the dealer would be in violation of the distributorship agreement. What if the dealer is *out of trust?*

Any consequences?

In these situations, even if other particulars are respected from a tax standpoint, can it be said that the payments received by the dealership corporation from GM were payments made in exchange for a ***valid*** distributorship agreement? Does Section 1241 require that a valid distributor agreement be in effect in order for there to be ***exchange*** treatment?

S Corporation Elections & Structures. This C vs. S booby trap has already been mentioned. The difference between C corp. and S corp. structuring could produce different results, depending on whether the Section 1374 tax on built-in gains might apply.

Where S corporations are involved, there are different levels of exposure to the corporate level tax on "built-in gains." This depends on whether an S election was made (1) at the inception of the corporation or at some later date before the corporation had accumulated earnings and profits, (2) before 1987, (3) during 1987 or 1988, (4) after 1988, or (5) more than 10 years from the date when the payments in question are received.

Note that Reg. Sec. 1.1374-4(a)(1) provides that Section 1374(d)(3) or 1374(d)(4) applies to any gain or loss recognized during the recognition period in a transaction treated as a sale or ***exchange*** for Federal income tax purposes.

Section 1374 provides for a tax on built-in gains that applies to certain corporations that made their S elections after 1986 and certain transitional relief was provided for elections made in 1987 and 1988. Where the Olds dealers who received payments from GM operated their businesses as S corporations for tax purposes, what value was placed on the distributorship agreement as an asset with a potential built-in gain on the date when the S election was made?

For a quick refresher, review the S corporation's Form 1120S, Page 2, Schedule B, Question 7 and the corresponding information in the instructions.

C Corporations. Most emphatically, if the dealership corporation is a C corporation, payments it receives from GM will have no way of avoiding the so-called double-taxation impact, regardless of whether or not the corporation liquidates. The possibility of avoiding tax at the corporate level went away in 1986 with the repeal of the *General Utilities* doctrine and (the repeal of) Section 337.

Other Areas Not Covered. It should be noted that the IRS Oldsmobile dealer ruling specifically does not address the following:

1. Payments made in connection with the repurchase of vehicles, parts and accessories, special tools, signage, etc.,

2. Special considerations relative to the recapture of LIFO inventory reserves that may be associated with vehicle and/or parts inventories on the LIFO method,

3. Payments related to the cancellation of leases (although certain lease termination payments may qualify for Section 1241 treatment),

4. Payments intended to compensate dealers for giving up considerations other than those in the Private Letter Ruling, a few of which have been mentioned.

Finally, note that in some situations, there may be exposure to the Service taking the position that the dealer was in receipt of a constructive dividend if the facts so warrant when the IRS follows the money. Similar exposure exists if all of the agreements are not carefully thought out and properly documented. For a reminder of this possibility, what could be more timely than the *Whitehead* case, analyzed on page 9?

→

FINAL WARNINGS

On the surface, it looks like the IRS has given Oldsmobile dealers the benefit of the doubt in interpreting the characterization of GM transition payments. However, the Ruling seems to be of little help where GM Transition Assistance Payments may consist of several components.

Also, especially where GM is trying to unwind a deal where the dealer recently acquired the Olds franchise, there is great likelihood that transition payments more clearly relate to helping the dealer acquire an asset (i.e., the new franchise to be acquired as a substitute for the old Olds franchise) within the same corporate solution. This seems to fly in the face of most Subchapter C case law and *Bittker & Eustice.*

In distinguishing between the simplified facts in the Ruling and more likely fact patterns of greater complexity, on a case-by-case basis, it may appear that (long-term) capital gain characterization of some payments may be incorrect or at least debatable.

In these situations, practitioners should consider advising their dealers to secure their own Letter Rulings from the Service based on their own specific facts.

In situations where the dealer is not completely exiting from the business and retiring, it would seem less tenuous and more logical to attempt to recognize the receipt of any transition payments in a manner consistent with that afforded by Section 1033 for involuntary conversions.

This is the intention of one bill in the House of Representatives, H.R. 2374, introduced in June 2001. It would be unfortunate if this bill is not enacted based on the incorrect assumption that the IRS has already addressed and resolved ***all issues*** that might come up in connection with GM's payments to its fast-fading Oldsmobile dealer network.

TAX RELIEF FOR OLDSMOBILE DEALERS PROPOSED AMENDMENT TO SECTION 1033 H.R. 2374 ... 107th CONGRESS ... 1st Session

To amend the Internal Revenue Code of 1986 to treat certain motor vehicle dealer transitional assistance as an involuntary conversion, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

June 28, 2001

Mr. CAMP introduced the following bill; which was referred to the Committee on Ways and Means.

A BILL

To amend the Internal Revenue Code of 1986 to treat certain motor vehicle dealer transitional assistance as an involuntary conversion, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. MOTOR VEHICLE DEALER TRANSITIONAL ASSISTANCE TREATED AS AN INVOLUNTARY CONVERSION.

(a) IN GENERAL - For purposes of subtitle A of the Internal Revenue Code of 1986, in the case of a taxpayer who was a party to a motor vehicle sales and service agreement with a motor vehicle manufacturer who announced in December 2000 that it would phase-out the motor vehicle brand to which such agreement relates -

(1) amounts received by such taxpayer from such manufacturer on account of the termination of such agreement shall be treated as received in an involuntary conversion to which section 1033 of such Code applies, and

(2) the period described in section 1033(a)(2)(B) of such Code shall begin on December 12, 2000.

(b) CHARACTER OF CONVERTED PROPERTY - In applying section 1033 of such Code for purposes of this section, the property involuntarily converted shall be treated as being property used in the trade or business of a motor vehicle retail sales and service dealership.

(c) DEDUCTION FOR INTEREST ON DEFICIENCIES - In the case of a taxpayer who makes an election under subparagraph (A) of section 1033(a)(2) of such Code pursuant to this section, any interest attributable to a deficiency referred to in subparagraph (C) of such section shall be allowable as a deduction under subtitle A of such Code notwithstanding any law or rule of law.

(d) EXCEPTION FROM TAX ON CERTAIN BUILT-IN GAINS OF S CORPORATIONS - Solely for purposes of section 1374 of such Code, in the case of a corporation which elects before June 28, 2001, to be an S corporation (as defined in section 1361 of such Code), payments referred to in subsection (a) (whether or not an election under section 1033 of such Code is made pursuant to this section) shall not be taken into account in computing net recognized built-in gain of such corporation.

(e) INSTALLMENT SALES TREATMENT - Amounts referred to in subsection (a)(1) with respect to which the taxpayer does not make an election under subparagraph (A) of section 1033(a)(2) of such Code shall be treated for purposes of such Code as received from an installment sale to which section 453 applies.

(f) EFFECTIVE DATE - This section shall apply to amounts received after December 12, 2000, in taxable years ending after such date.

TOP ISSUES & DEALER CONCERNS FROM DEALER MAKE MEETINGS AT NADA CONVENTION - NEW ORLEANS - JANUARY, 2002

ACURA	1. Get new and fresh product. 2. Get tools to be the best in industry customer satisfaction. 3. Be aggressive with products.
AUDI	1. Maintain market share. 2. Support parts, service and sales. 3. Maintain momentum of last 2 years.
BMW	1. 7-Series launch. 2. Dealer profits. 3. Higher volume.
BUICK	1. Communication. 2. Product. 3. The right incentives: "Our programs need to be more flexible for the customer."
CADILLAC	1. Successful launch of new-look Cadillacs, beginning with the CTS. 2. Competitive incentives, lease rates. 3. Preserve Cadillac's identity in GM's "vanilla" culture.
CHEVROLET	1. Speed up introduction of Cavalier replacement. 2. Promote inventory pooling to serve Internet shoppers. 3. Gain truck-sales leadership.
CHRYSLER-JEEP	1. Return the Chrysler Group to profitability. 2. Get new products. 3. Increase dealer margins.
DODGE	1. Dodge is losing market share because of weak car sales. 2. Dealers want their $500 in monthly floorplanning payments returned. 3. Dealer martins have been cut too drastically.
FORD	1. Relationship with Ford. 2. Product quality. 3. Product cycle plan.
HONDA	1. Update the Honda and Acura dealer sales and service agreement. 2. Encourage Honda to build a pickup truck. 3. Promote Honda's Excell initiative to improve processes within the dealerships that affect the customer.
HUMMER	1. Successful launch of the H2. 2. Ditto. 3. See above.
HYUNDAI	1. Have enough product to meet consumer demand. 2. Urge the company to increase its ad budget. 3. Make sure the retail network does not have too many dealers.
INFINITI	1. Profitability. 2. Vehicle volume. 3. Brand image.
ISUZU	1. Clarify the future of the franchise. 2. Introduce products. 3. Improve positioning of the Axiom.
JAGUAR	1. Dealer profits. 2. Higher volume. 3. Turnover in Jaguar management.
KIA	1. Improve Sedona availability. 2. Stay aggressive with incentives. 3. Improve Initial Quality Survey and Customer Satisfaction Index scores..

TOP ISSUES & DEALER CONCERNS FROM DEALER MAKE MEETINGS AT NADA CONVENTION - NEW ORLEANS - JANUARY, 2002

LAND ROVER	1. Product 2. The economy. 3. Partnership-style working relationship between dealers and manufacturer.
LEXUS	1. Product. 2. Profit margins. 3. Branding project.
LINCOLN MERCURY	1. Get new products. 2. Dispel the suspicion Mercury will be killed. 3. Provide a high-volume vehicle for Mercury.
MAZDA	1. Dealer profitability. 2. Product. 3. Brand image.
MERCEDES-BENZ	1. Dealer profitability. 2. Product quality. 3. Certified used cars and service loaner cars.
MITSUBISHI	1. Continually refreshing marketing. 2. Introducing new products. 3. Improving customers retention.
NISSAN	1. Discuss cost shifting from the manufacturer to the dealer body. 2. Pick an objective for return on sales. 3. Stay competitive with every product.
OLDSMOBILE	• None provided.
PONTIAC-GMC	1. Launch the Pontiac Vibe successfully. 2. Change GMC "professional grade" advertising. 3. Move brand management away from emphasis on individual models.
PORSCHE	1. Maintain dealer margins on specialty cars. 2. Price Cayenne sport-utility fairly. 3. Continue building exclusive franchises.
SAAB	1. Product. 2. Product support. 3. Advertising.
SATURN	1. Roll out a new product portfolio. 2. Select a new ad agency and campaign. 3. Restore dealer enthusiasm.
SUBARU	1. Make dealers understand the importance of the council. 2. Get a national health care plan for Subaru corporate and dealership employees. 3. Determine how selling vehicles shared with GM will affect Subaru dealers.
SUZUKI	1. Product. 2. Advertising. 3. Marketing.
TOYOTA	1. Internet communications.
VOLKSWAGEN	1. Implement dealer-based ordering system. 2. Get the Microbus. 3. Maintain quality to stay competitive.
VOLVO	1. Discourage the Factory from trying to micromanage the dealers' business. 2. Advocate advertising that showcases the product and features. 3. Let the Factory know what dealers need to be competitive.

The *De Filipps' Dealer Tax Watch* newsletter is a quarterly publication of essential tax information by Willard J. De Filipps, CPA, P.C., 317 West Prospect Avenue, Mt. Prospect, IL 60056. It is intended to provide accurate, general information on tax matters and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Readers should consult their certified public accountant, attorney and/or other competent advisors to discuss their own situations and specific income, gift and estate tax questions. Mechanical or electronic reproduction or photocopying is prohibited without permission of the publisher. Annual subscription: $395. Back issues available for $70 each. Not assignable without consent. Any quoted material must be attributed to *De Filipps' Dealer Tax Watch* published by Willard J. De Filipps, CPA, P.C. Editorial comments and article suggestions are welcome and should be directed to Willard J. De Filipps at cpawjd@aol.com. Phone: (847) 577-3977; FAX (847) 577-1073. **INTERNET**: http://www.defilipps.com. *De Filipps' Dealer Tax Watch* format designed by *Publish or Perish, Inc.* (630) 627-7227.

De Filipps' DEALER TAX WATCH **First-class**
Willard J. De Filipps, C.P.A., P.C.
317 West Prospect Avenue
Mt. Prospect, IL 60056