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A Quarterly Update of Essential Tax Information

DEALER TAX WATCH

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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. OLDSMOBILE DEALERS & OTHERS IN TRANSITION ... SOME POSSIBLE TAX RELIEF? During the year, several CPAs have called to discuss how they should, or might, handle reporting payments received by Olds dealers from GM in connection with their franchise termination settlements. Some callers were interested in discussing the possibility of allocating a part of the amount received for dealership goodwill between the (separate) corporate entity in its tax return, and the individual dealer in his personal Form 1040. For some comments on these conversations, see page 5.

Possible Relief? There are more pending bills in the House and in the Senate that might give tax relief to Oldsmobile dealers who've gone through the transition process with GM.

The effective dates of these bills would make favorable tax treatment (i.e., deferral of tax under Section 1031) retroactive to amounts received after December 12, 2000. See pages 6-7 for more on this.

What have you got to lose? A caller recently told me something very interesting. A dealer client of his had received termination payments from Olds and these payments were treated as fully taxable in the 2001 dealership income tax return. Subsequently, the CPA filed an amended return for year, requesting a refund of the entire amount of tax paid by the dealership that was attributable to including those payments in taxable income.

The CPA said that he explained that the basis for the refund claim was, simply, "H.R. 2374." See page 21 of the March, 2002 *DTW* for the text of this Bill.

H.R. 2374 would provide ***Section 1033*** tax deferral for ***involuntary conversions***, and this relief should not be confused with the more-recent Bills that would provide like-kind property (tax-free) exchange treatment under ***Section 1031.***

WATCHING OUT FOR

Guess what? The IRS issued the dealership a refund in full. So, if you've previously treated GM-Olds payments as fully taxable or recognized gain on property settlements, do you really have anything to lose by filing an amended return and asking for a refund?

#2. PORC UPDATE ... STILL NO GUIDANCE OR CLARIFICATION FROM THE IRS, *even though it's time again for you to deal with tax return reporting disclosures.* Our 4th Quarter issue last year was devoted entirely to IRS Notice 2002-70, which suprised and shocked many dealership CPAs with the myriad of tax questions it raised in connection with dealership PORC activities.

During 2003, our brief *DTW* updates on this always had the same message: The IRS hasn't said anything new, yet. That's the same bottom line again

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at year-end. So, that leaves CPAs in about the same uncertain situation that they were in last year.

A year ago (in Update #2), I said basically that I'd put a statement in each tax return filed. This would be a ***protective*** disclosure so that if disclosure were technically required (let the more astute technician mentally wrestle with this), at least some disclosure would already be in the return and there would be compliance.

What do I think, or what would I do, this year? That's easy ... I'd do the same thing. I haven't changed my opinion at all that disclosures should be made in ***all*** PORC-related tax returns. And that still holds even though we expect these Form 8886 disclosures to be reviewed carefully by the IRS.

Since last year, the IRS has issued Form 8886 (*Reportable Transaction Disclosure Statement*). So, I use would that Form.

The instructions to Form 8886 don't give any "magic answers." But they do make it clear that "If you are uncertain whether a transaction is a reportable transaction ... you may indicate that you are filing on a protective basis by writing ***'Protective Disclosure'*** at the top of the form." Note: that is exactly what I suggested you do last year.

There are several other zingers to be aware of, including a requirement to file a duplicate copy of Form 8886 with another IRS office for review.

Some readers may not have any dealers involved with PORCs and therefore this all may be irrelevant. If so, you can skip all of the PORC discussions which begin on page 14.

#3. IRS & TAX ISSUES ... OTHER THAN PORCs. For a year-end status report on several IRS activies and tax issues other than PORCs, see the article beginning on page 9. This includes remarks made by the IRS Motor Vehicle Technical Advisor, Terri Harris, at the AICPA National Auto Dealership Conference in October.

During the year, various IRS employees, in general, have suggested that there is more IRS audit activity going on and that in some cases it is being conducted in newly fashioned ways. However, other media coverage (especially in the *New York Times* July 6, 2003 and October 20, 2003) and our conversations with many automotive CPAs give us a different impression.

Here's a thumbnail sketch of the picture of the IRS that we're seeing ... It's over-reorganized, understaffed, under-resourced, committee-driven and moving very slowly. However, that slow movement should not necessarily be interpreted as a sign of confusion, ineptness, or lack of resolve. Rather, the Service is expending a large portion of what limited resources it has in fighting slow, costly battles on several fronts against abusive tax shelters marketed by ethics-impaired CPAs and lawyers. And each successful IRS revelation becomes more shocking and upsetting to honest taxpayers and CPAs.

In the meantime, until the IRS can really get a handle on all the facts and determine its technical positions accordingly, it is trying valiantly to mount a few limited focus audits, especially in the cash reporting and the anti-money laundering areas.

#4. IRS SUMMARIZES DEMO RULES FOR 2003 TAX RETURN REPORTING. In case you missed it, the IRS recently issued a good summary of the demonstrator vehicle rules and what amounts should be included on Forms W-2 for dealership employees who are driving demos. Publication 4230 is on pages 12-13.

#5. FORM 709 ALERT IF YOU'RE PREPARING GIFT TAX RETURNS FOR 2003. In the December 1996 *Dealer Tax Watch*, we discussed in some detail the subject of entity choices for dealerships. See *C, S, LLP or LLC ... Which Should Your Dealership Be?*

The conclusion still is that limited liability companies (LLCs) continue to be the "vehicle of choice" for new automobile dealerships, as well as for many other new business activities. Basically, the reason is that LLCs combine for their owners the benefits of significant flexibility, limited liability and the flow-through of the taxable results so that there is only one level of Federal income taxation.

In the March 2003 issue of the *DTW*, we reported that inadequate disclosure of an LLC interest in a gift tax return (Form 709) could prevent the start of the statute of limitations in connection with that return.

Another tax case involving LLCs and gift tax returns hit the news. Recently, the U.S. Court of Appeals for the 7th Circuit affirmed a Tax Court decision holding that an outright gift of units in an LLC ***did not*** qualify as a gift of a present interest under Section 2503(b). Therefore, that gift was not eligible for the annual gift tax exclusion, which is currently $11,000 per donee.

The Tax Court case is *Hackl*, 118 T.C. 279 (2002), and it may be more or less applicable to auto dealership situations because of its specific facts and circumstances. However, if you have dealers operating their dealerships as LLCs ... and if during 2003, they made any gifts of their LLC interests to family members as part of their business succession or

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estate planning strategies, you will need to consider the implications of the *Hackl* decision as you prepare Form 709 this year.

#6. BURIEN NISSAN LOSES ON APPEAL. In the June 2001 *Dealer Tax Watch*, we discussed two Tax Court decisions in which the IRS successfully required dealerships to stretch out their deductions for payments for their non-compete agreements. In both cases, the dealerships had tried to write-off the non-compete payments over the shorter 5-year terms of the agreements. The IRS and the Tax Court said that these payments had to be amortized by a 15-year write-off.

One of these cases was *Frontier Chevrolet Co.* In this case, the question for the Tax Court was whether a non-compete agreement that had been given as part of a broader corporate stock redemption agreement should be treated as an ***indirect*** acquisition of stock which was subject to the Section 197 write-off rules. The Court held that it was and that the payments for the agreement should be written-off over 15 years.

In the other case, *Burien Nissan, Inc., et Al. v. Comm.*, the auto dealer involved also ran into trouble with the IRS over how he had handled the tax treatment in his personal Form 1040 tax return of the gain on the sale of his dealership stock and the non-compete payments he received for his agreement. In addition to substantial tax deficiencies, the IRS also imposed accuracy-related penalties against the dealer and against the dealership. See *Dealer Tax Watch*, June 2001, page 8 for a discussion of these issues.

Although Frontier Chevrolet did not dispute the Tax Court's conclusion, the auto dealer and the dealership in *Burien Nissan* did. On September 16, 2003, the U. S. Court of Appeals for the 9th Circuit, in a very brief opinion, upheld the Tax Court against the taxpayers in all respects.

#7. 2003 AICPA NATIONAL AUTO DEALERSHIP CONFERENCE. This AICPA Conference was held on October 23-24, 2003 at the Marriott Rivercenter in San Antonio, Tex. I did take the opportunity to walk over to the Alamo and, saw for myself that "There's no basement at the Alamo!"

A large audience of CPAs, advisors, controllers and allied industry professionals heard presentations (see page 4) covering dealership tax, accounting and management issues, against a backdrop of general industry condition updates. Many sessions were presented concurrently, and all but two were taped. Therefore, if you missed the Conference, but have a special interest in any of the sessions, you can always purchase a tape of that session.

Out of the two dozen sessions, only four, at most five, were tax-related. In addition to the *Tax and Regulatory Developments Panel*, I found four sessions particularly informative: (1) Jim Ziegler' *Irreverent Look at the Retail Automobile Industry*, (2) Michael Charapp's *Challenge of Compliance in a Highly Regulated Industry*, (3) the joint presentation on *Maximizing the Tax Benefits from your Real Estate - A New Look at Cost Segregation Studies*, and (4) the *Dealer Owned Reinsurance Update* presented by Gregory Petrowski (whose session, unfortunately, was not taped).

The outline for the presentation I gave on *LIFO at 30: Looking Back, Sideways and Forward* was included in the December 2003 *LIFO Lookout* (pages 5-10). If you missed it there, copies of my outline are available by contacting us. A portion of that presentation discussed changes in accounting methods for trade discounts, floorplan assistance payments and certain advertising fees and expenses. This outline was reprinted in the September 2003 *Dealer Tax Watch* (pages 10-14). As a reader of this publication, you're well aware that over the last year or so, we've devoted a lot of attention in the *DTW* to these changes.

One interesting bit of information that I picked up at the Conference (from Jim Ziegler's talk) was the startling statistic that approximately 25% of the vehicles purchased are now being financed by the buyers over 72 months. Think about some of the implications of that!

The Conference Manual of speaker presentations includes some outlines that are very useful (such as *Valuation Issues: What You Need to Know* and Petrowski's *Dealer Owned Reinsurance Update*). Others are far too general to be of any real value. The dealership valuation issues presentation includes a detailed case study, but that case study is of a Lexus dealership valuation that occurred so many years ago that it may be somewhat outdated, but maybe the methodology is what's important.

What seems to be popular in Conference Manuals these days is the inclusion of PowerPoint® slides rather than more detailed outlines or narrative text. These PowerPoint® substitutes are usually bland at best and adhere to the "keep it simple, stupid" principle of showing not more than two or three bullet points, with each having not more than four or five words per line. Consequently, you may find some of the "presentation outlines or materials" included in the Manual to be extremely useful, while others may be of little use.

Given the relatively high cost of the Conference, one might hope for an overall higher caliber of take-

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home reference materials. Some conferences provide only a CD-ROM with all of the presentation materials (in .pdf format) in advance of on-site registration. With this, attendees can better prepare themselves before going to the conference. This format allows attendees to know ahead of time what is expected to be covered in each session so that they can focus only on the areas which are important to them and maximize the use of their time at the conference.

Because it tries to appeal to several very distinct and different interest groups, the AICPA National Auto Dealership Conference might benefit from trying this approach.

#8. NADA CONVENTION. The National Automobile Dealers Association Convention will be January 31 through February 3, 2004 in Las Vegas. There's no better way to bond with your dealer clients than to tell them you've just come back from the NADA Convention with some great ideas to discuss with them. Chances are you may even see some of your clients there while you meet new prospects and get a whole lot of new ideas.

AICPA NATIONAL AUTO DEALERSHIP CONFERENCE - 2003

TOPICS & SPEAKERS

San Antonio, Texas • October 23-24, 2003

- *Keynote Address: Putting the Future into Perspective* ... Edie Weiner
- *Tax and Regulatory Developments* - Panel ... Terri Harris (IRS), Paul Metrey (NADA) and John Hayes
- *Controller's Workshop* ... Moderated panel discussion
- *Fraud - Is the Wolf inside or outside the "Hen House?"* ... Wayne Fortier
- *Valuation Issues - What You Need to Know* ... Gary Trugman
- *Profit Enhancement for the Automobile Dealership* ... Tony Noland
- *Accounting & Auditing Update* ... Randy Lund
- *Customer Retention Systems - Do You Need One?* ... Sandi Jerome
- *Pay Plans that Motivate and Produce a Better Bottom Line* ... Dennis Puskaric
- *LIFO at 30: Looking Back, Sideways and Forward* ... Willard De Filipps
- *Captive Insurance Options* ... R. Peter Urquhart
- *Fire & Rain - A Look at the Retail Automobile Industry from and Irreverent Point of View* ... James Ziegler
- *Automotive Retailing, the Economy - A Look in the Crystal Ball* ... Paul Taylor
- *The Challenge of Compliance in a Highly Regulated Industry* ... Michael Charapp
- *What Should a Dealer Expect from its Outside Accounting/Auditing Firm* ... Alex McAllister
- *Alternative Financing Technique - Blue Sky: High Octane Growth Fuel* ... Jay Ferriero & Ralph Miller
- *How to Beat the Odds Against Succession Failure - Would Your Client's Dealerships Qualify to Be Succession Certified?* ... Hugh Roberts
- *Selling Used Cars Online* ... Sean St. Clair
- *Mind over Data: Aligning Culture-Designing Processes for Retention and Growth* ... Joe Jankowski & John Mlinarcik
- *Maximize the Tax Benefits from Your Real Estate - A New Look at Cost Segregation* ... Gary Fleming & Michael Morris
- *From the Back to the Front: A Walk through the Dealership from a Consultation, Profit Enhancement and Compliance Perspective* ... Rex A. Collins
- *Effectively Planning and Buying Auto Dealer Advertising* ... Steve Diebold
- *Thawing Frozen Capital* ... Fred Samuelson
- *Dealer Owned Reinsurance Update* ... Gregory Petrowski

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OLDS DEALERS & OTHERS IN TRANSITION ... AN UPDATE, INCLUDING SOME POSSIBLE TAX RELIEF?

During the year, GM has been producing limited quantities of its *Oldsmobile Collector's Edition Series* ... "Final Editions" of the end-of-the-line *Silhouettes*, *Bravadas* and *Aleros*. At the same time, it has been reported that many dealers have filed lawsuits contesting the amounts GM is proposing to pay them for terminating their franchises.

Automotive News (August 11, 2003) reported that under GM's current plan, dealers were to receive anywhere from $1,675 to $3,100 per new Oldsmobile sold, using as the reference point their best sales year from 1998 to 2000. The higher per-vehicle amounts would be paid to exclusive Oldsmobile dealerships. At last report, owners of approximately 175 dealerships have yet to reach a settlement with GM, and this excludes dealers who have filed lawsuits against GM.

In the March 2002 *DTW*, we analyzed the Private Letter Ruling (LTR 200218034) that NADA obtained from the IRS for an Oldsmobile dealer regarding the tax treatment of payments received from General Motors. (See *IRS Rules Favorably for Some Olds Dealers ...But Be Careful if You're Going to Rely on this Ruling.*) We observed in that article that this LTR is based on an oversimplified fact pattern and it leaves many questions unanswered.

CORPORATE vs. INDIVIDUAL GOODWILL

During the year, some CPAs finally have had to reckon with how to report the payments their Oldsmobile clients received on their corporate and/or individual income tax returns. Over the past several months, I've received several calls from CPAs who want to discuss whether it is possible to break down amounts paid for dealership goodwill into two elements. These elements are (1) the goodwill attributable to the dealership/business entity ... and (2) the goodwill attributable to the individual dealer/business owner. Splitting (or trying to split) the payments into two different tax returns will obviously save some tax dollars.

An added reason for interest in making this allocation is the individual income tax rate reductions and other changes enacted by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA.)

It goes without saying (but we'll say it anyway) that it would have been nice to have an allocation of this nature spelled out in the formal agreements and/or documents. However, it seems that the Factory simply refuses to do this.

Martin Ice Cream Company v. Comm. (110 T.C. 189, 1998) is the case that many CPAs have mentioned in their discussions as providing support ... or shall we say encouragement ... for splitting goodwill payments into two elements in order to avoid the double taxation in a C corporation setting. However, this case should be read and studied carefully before getting too excited and jumping on the bandwagon (see page 6.)

In several instances, I referred callers to a thought-provoking article on this subject in the June 2003 *Tax Adviser*. This article, entitled *Separating Personal and Business Goodwill*, analyzes *Martin Ice Cream Company* and a few other relevant court decisions ... *D. K. MacDonald*, *Stanton H. Bryden* and *Frank J. Longo*.

The article also includes several useful illustrations and exhibits. The authors conclude that "...tax savings are available in a variety of transactions if goodwill can be shifted away from the business entity. Although the Tax Court has followed a well-reasoned and consistent approach to this issue for more than 50 years, ***the classification of goodwill depends on the facts and circumstances*** (emphasis added.) Knowledge of the judicial factors and appraisal methods can assist taxpayers in supporting a case for an allocation to personal goodwill."

As a tax return preparer, this article will not lead you to an exact dollar amount that you should report. Nor will it lead you to a precise quantification of the degree of risk you might be taking in reporting a goodwill allocation for tax purposes on different tax returns. Nevertheless, the article does contain many useful ideas, and if you're wrestling with the personal (shareholder) vs. business goodwill problem, you should definitely read it carefully.

Another article in *The CPA Journal*, August 2002, *(Allocating the Sale of a Business to Personal Goodwill)* analyzes both *Martin Ice Cream Company.* and an earlier case, *Norwalk v. Commissioner* (T.C. Memo 1998-279). In commenting on both of these cases, the author states... "The Tax Court held that a shareholder can own goodwill separate from the corporation where the customers of the business view the owner as the center of their commercial relationship. This goodwill engendered by the commercial relationship is personal goodwill that can be sold outside of the corporation.... ***Personal goodwill can exist only if there is no noncompete or employment***

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agreement between the shareholder and the corporation (emphasis added.) Otherwise, the shareholder would be treated as having transferred ownership of the goodwill to the corporation. In order to establish intent, it is critical that the corporate minutes document that the shareholder owns the goodwill separate from the corporation."

Several other authors agree that the presence or absence of noncompete agreements and/or employment agreements are critical factors in determining whether a separation of goodwill between the parties will be successful.

Two observations on this... ***First***, most dealers are likely to have employment agreements with their corporations, so the concern over these agreements is very relevant. ***Second,*** in some dealership situations, the dealer owner may be personally involved with many vehicle sales to customers he or she knows very well. For examples, think smaller, or rural, dealerships. In those circumstances, a stronger argument may be made for the "commercial relationship" aspect being more personal to the dealer than to his/her corporate entity.

Payments determined by litigation. For dealers who may be involved in litigation with General Motors over (Oldsmobile) transition payments, another recent article may provide some ideas on how, if the litigation is successful, to report the payments awarded to the dealer. This article is *Tax Treatment of Business Litigation Recoveries - Capital Gains vs. Ordinary Income* by Robert W. Wood appearing in the July 2003 *Journal of Taxation.*

Mr. Wood observes ... "In business litigation ... taxpayers should endeavor whenever possible to include express allocation language (including tax reporting, if any) in settlement agreements. Although some may dismiss such devices as self-serving window dressing, express tax treatment, whether or not the parties are not truly adverse on these issues, is always better than nothing. Where the parties are adverse and they bargain over such language in the settlement agreement, the degree of helpfulness of the document in later dealing with the Service should not be underestimated." We strongly agree.

LIKE-KIND EXCHANGE TREATMENT?

In other discussions on this subject, one question that has come up is whether a dealer in transition who obtains another franchise and other property as part of a settlement may secure tax-free (or, more accurately, tax deferral) treatment under Section 1031 where one franchise has been given up in exchange for another.

Technically, Section 1031 allows tax deferral by requiring adjustments to the tax basis of the replacement property acquired. Also, there are special rules

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MARTIN ICE CREAM COMPANY ... WHAT THE TAX COURT SAID

Note: In this case, the Court held that it was the individual owner, and not the corporation, whose goodwill was sold. Therefore, the Court held that the corporation, Martin Ice Cream Company, was not taxable on the gain from that sale transaction. The comments below indicate how the absence or presence of an employment contract or a non-compete agreement will bear on the matter.

"Ownership of these intangible assets cannot be attributed to petitioner (i.e., to Martin Ice Cream Company) because Arnold never entered into a covenant not to compete with petitioner at any other agreement–not even an employment agreement–by which any of Arnold's distribution agreements with Mr. Mettus, Arnold's relationship with the supermarket, and Arnold's ice cream distribution expertise became the property of petitioner ...

"This Court has long recognized that ***personal relationships of a shareholder-employee are not corporate assets when the employee has no employment contract with the corporation.*** Those personal assets are entirely distinct from the intangible corporate asset of corporate goodwill. (Citations omitted)

"... We find no authority which holds that an individual's personal ability is part of the assets of a corporation by which he is employed where ... the corporation does not have a right by contract or otherwise to the future services of that individual.

"In the case at hand ... petitioner never obtained exclusive rights to either Arnold's future services or a continuing call on the business generated by Arnold's personal relationships ...; petitioner never had an agreement with Arnold that would have caused those relationships and rights to become petitioner's property."

"...Even if there had been such an agreement, and the record shows that there was none, the value of those relationships and rights would not have become petitioner's property ***in toto***."

TAX RELIEF FOR OLDSMOBILE DEALERS

108th CONGRESS ... 1st SESSION ... JUNE 20, 2003

IN THE SENATE OF THE U.S. ... S. 1305

To amend the Internal Revenue Code of 1986 to provide for the treatment of certain motor vehicle dealers transactional assistance.

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

(a) ***IN GENERAL.*** -- For purposes of subtitle A of the Internal Revenue Code of 1986, in the case of a taxpayer who elects the application of this section and 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 (hereafter I this section referred opt as "termination payment") are considered to be received for property used in the trade or business of a motor vehicle retail sales and service dealership, and

(2) to the extent such termination payment is reinvested in property used in a motor vehicle retail sales and service dealership located within the Untied States, such property shall qualify as like-kind replacement property to which section 1031 of the Internal Revenue Code of 1986 shall apply with the following modifications:

(A) Such selection shall be applied without regard to subparagraphs (A) and (B)(ii) of subsection (a)(3).

(B) The period described in section 1031(a)(3)(B) of such Code shall be applied by substituting "2 years" for "180 days."

(b) ***RULES FOR ELECTION.*** --

(1) ***Form of Election.*** -- The taxpayer shall make an election under this section in such form and manner as the Secretary of the Treasury may prescribe and shall include in such election the amount of the termination payment received, the identification of the replacement property purchased, and such other information as the Secretary may prescribe.

(2) ***Election on Amended Return.*** -- The Secretary of the Treasury shall permit an election under this section on an amended tax return for taxable years beginning before the date of the enactment of this Act.

(c) ***STATUTE OF LIMITATIONS.*** -- Notwithstanding the provisions of any other law or rule of law, the statutory period for the assessment for any deficiency attributable to any termination payment gain shall be extended until 3 years after the date the Secretary of the Treasury is notified by the taxpayer of the like-kind replacement property or an intention not to replace.

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

Mr. Baucus' Comments ... Introductory Remarks on Measure ... June 20, 2003

Mr. President, I am proud to support Senator Bingaman's legislation to ensure equitable tax treatment for Oldsmobile dealers impacted by General Motors' sudden decision to eliminate the Oldsmobile from its product line. General Motors did agree to partially compensate Oldsmobile dealers for their loss.

Senator Bingaman's bill endures that like-kind exchange treatment, which defers the gain on the exchange of business or investment property until it is ultimately sold, is also available for motor vehicle dealers who receive payments when the brand of automobile they carry is eliminated by the manufacturer. The proposal allows such reinvested payments to be treated as a like-king exchange of property if exchanged within 2 years from receipt of the payments, thus deferring the tax consequences. As such, the proposal encourages capital investment by recognizing that a longer period of time is required for dealers to obtain a new franchise or establish a new car sales business.

The manufacturer, not the automobile dealer, makes the unilateral decision to eliminate vehicle brands. Nonetheless, the dealer is the one who invests years of hard work in bringing a particular brand to his or her local community. When a manufacturer decides to eliminate a brand, many family-owned dealerships face a complete loss of business as well as an increased thereat to the viability of other brands located in the same facility.

Approximately one-third of the 2,801 Oldsmobile dealers across the country are expected to reinvest the GM payments into another franchise or other retail motor vehicle sales business. Many of the 27 Oldsmobile dealers in Montana have expressed their interest in reinvesting the GM payments they received, if this legislation becomes law. These Montanans have been stripped of a source of income at a time when the economy is not too forgiving.

I urge my colleagues to support this important legislation.

Read Twice and Referred to the Committee on Finance ... June 20, 2003

Identical Bill Introduced as H.R. 870 on Feb. 25, 2003 & Referred to the Committee on Ways and Means

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depending on whether "boot" is paid or received in connection with like-kind exchanges. In general, if boot is received in a like-kind exchange, Section 1031(d) provides that the basis of the assets received in the exchange will be equal to the adjusted tax basis of the assets given up in the exchange, reduced by the "boot" received and increased by the gain recognized.

Some CPAs may be intrigued by the possibility of using Section 1031 as part of their overall tax reporting strategy. An excellent reference in this regard is Richard M. Lipton's article on *The "State of the Art" in Like-Kind Exchanges, Revisited*, in the June 2003 *Journal of Taxation*.

PENDING TAX RELIEF BILLS

In our coverage of the IRS Private Letter Ruling for Olds dealers in the March 2002 *DTW*, we included reference to one Bill proposing relief for (Olds) dealers. This was H.R. 2374 which was introduced into the House of Representatives on June 28, 2001. This Bill would amend Code Section 1033, which provides tax-free/deferred treatment for property received in involuntary conversions.

During 2003, identical new Bills were introduced in the House and in the Senate that would provide relief for Olds dealers under IRC Section 1031. This Section deals with tax-deferred exchanges involving the receipt of like-kind replacement property. The Bill in the House (H.R. 870) was introduced on February 25, 2003 and an identical counterpart was introduced in the Senate as S. 1305 on June 20, 2003 (see page 7).

In contrast to H.R. 2374, these Bills introduced in 2003 would provide more flexible relief in the form of the opportunity to make an election with respect to amounts received after December 12, 2000.

SHOULD YOU FILE AMENDED RETURNS?

As mentioned in Update #1 of this *DTW* issue, a CPA recently told me that a dealer client of his had received termination payments from Olds and these payments had been treated as fully taxable in the 2001 dealership income tax return.

Subsequently, the CPA amended that tax return by filing Form 1120-X, requesting the IRS to refund the amount of tax paid that was attributable to including those payments in income. The CPA said that he explained that the basis for the refund claim was, simply, "H.R. 2374," which provides Section 1033 tax deferral for ***involuntary conversions***. (This should not be confused with the Senate Bill, S. 1305, mentioned above that would provide like-kind property (tax-free) exchange treatment under Section 1031.)

Guess what? The IRS issued the dealership a refund in full. If you've previously treated these payments as fully taxable in a return that you've already filed, what have you got to lose by filing a claim for refund?

SUGGESTED FURTHER READINGS

- Arne, Darrell V. and James R. Hamill. *"Separating Personal and Business Goodwill. The Tax Adviser."* June 2003, pgs. 346-353.
- Bulua, Stanley E. *"Allocating the Sale of a Business to Personal Goodwill." The CPA Journal.* August 2002, pg. 66.
- Grimes, Scott E., Timothy T. McDaniel and Marilyn K. Wiggam.
  "Personal Goodwill Cuts Tax on Corporate Sale or Liquidation." Practical Tax Strategies. December 1998, pgs. 324-329.
  "Tangible Tax Savings from Shareholder Owning Intangibles." Practical Tax Strategies. November 1998, pgs. 260-268.
- Lipton, Richard M.
  "The 'State of the Art' in Like-Kind Exchanges, Revisited." Journal of Taxation. June 2003, pgs. 334-357.
  "The 'State of the Art' in Like-Kind Exchanges." Journal of Taxation. August 1999, pgs. 78-84.
- Raby, Burgess J.W. and William L. Raby. *"Whose 'Goodwill' Is It Anyway?" Tax Notes.* April 13, 2998, pgs. 219-221.
- Schnee, Edward J. *"Contract Cancellation Payments Raise Income and Deduction Issues." Practical Tax Strategies.* October 2003, pgs. 226-231.
- Wood, Robert W. *"Tax Treatment of Business Litigation Recoveries - Capital Gain vs. Ordinary Income." Journal of Taxation.* July 2003, pgs. 27-33.
- Zimmerman, John C. *"When Service Corps. Liquidate as Part of a Change in Form of Entity - The Problem of Goodwill." Journal of Taxation.* August 2001, pgs. 110-115.

IRS & TAX ISSUES & ACTIVITIES... EVERYTHING OTHER THAN PORCs

YEAR-END UPDATE

This year-end status report covers six subjects with information drawn from a number of sources and our own observations. At the AICPA 2003 Auto Dealership Conference, Terri Harris, the IRS Motor Vehicle Technical Advisor was one of three participants in a panel presentation. Most of her comments were devoted to how the IRS is currently dealing with PORCs under Notice 2002-70. All PORC-related issues are covered in the separate article beginning on page 14.

IRS AUDIT ACTIVITIES

Ms. Harris indicated that as a direct result of the Patriot Act, the personnel in the Anti-Money Laundering Division (AMLD) of the IRS has been increased. In addition to having more auditors and a sharper focus, it seems that the AMLD is taking its responsibilities a little more seriously than it may have before 9/11.

Currently, the Service has two divisions: the Exam Enforcement Division and the TEC (Taxpayer Education and Compliance) Division. The IRS TEC Division is taking very seriously its mission to help CPAs and dealers know what their Form 8300 filing responsibilities are.

The *Automotive News* (October 6, 2003) recently reported that the IRS has sharply increased the audits of car dealers. This was based on IRS Fact Sheet 2003-16 (See *Dealer Tax Watch*, September 2003).

EXAM FOCUS

- Potential money laundering activities
- Form 8300 reporting compliance
- Producer-Owned Reinsurance Company issues
- Other typical exam issues

Interestingly, Ms. Harris indicated two general situations where the Service has been successful in obtaining convictions and severe sanctions on dealers who have failed their Form 8300 responsibilities. The first situation is where an undercover IRS agent posed as a customer and was able to persuade dealership employees to structure a transaction in violation of the Form 8300 cash reporting rules.

The second situation, basically, involved one dealership informing on a competing dealership. In other words, Dealership A had turned away a potential customer (who had wanted Dealership A to engage in an illegal structuring.) That potential customer then went to "the dealership next door"–Dealership B. At Dealership B, the customer bought a vehicle because Dealership B (either intentionally or out of ignorance) allowed the transaction to be processed illegally. Then, Dealership A–not happy about losing a sale?–called the IRS and informed on Dealership B.

Ms. Harris indicated that one questions she gets very often is, "Does the dealership (or a salesperson) have to forego the sale to a customer if that customer won't provide all of the required information or go along with the Form 8300 rules?"

Her answer is, simply, yes... that the dealership probably should forego the sale. And, that makes a lot of sense. After all, what's the gross profit, let alone the net profit, on a "lost" $20,000 sale when measured against the fact that, if caught and convicted, the non-deductible fine could be $20,000 ***and/or*** time in jail? Not to mention the risk of loss of other assets being seized. This seems like a no-brainer.

Another speaker at the Conference indicated that if a dealer were caught structuring a deal or actually working with a customer to avoid reporting a transaction, and if the IRS agent had already been in the dealership once on a compliance audit, then the second time the IRS came in, any violation it found then would be a "knowing" or intentional violation. Generally, first time violations that are not intentional result in smaller, per transaction penalties. But the second time a dealer is caught, the penalty could rise to $25,000 per transaction. And it could be even worse, depending on the circumstances.

While cash reporting Form 8300 compliance exams are increasing, they are not being conducted by "typical" IRS agents as part of regular IRS audits. Instead, these exams are being conducted by special agents with this limited exam focus. In addition, at the same time these agents are in the dealership, they are also looking at anti-money laundering practices to see if any exist in the dealership.

The *Automotive News* (December 1, 2003) included an article entitled *Battle Against Terrorism Catches Auto Dealers Off Guard.* This article focused on yet another problem area for dealers. This is the risk that dealers might unintentionally be doing business with an individual or entity whose name is on the OFAC (Office of Foreign Assets Control) List of Specially Designated Nationals. Under legislation entirely separate from the Patriot Act, every entity and person in the United States is prohibited from doing

see **IRS & TAX ISSUES UPDATE**, page 10

(Continued from page 9)

business with anyone or with any entity whose name appears on the SDN or Specially Designated Nationals list.

It seems that the IRS has little time any more for some of the old-fashioned "bread-and-butter" exam issues: Shareholder loan and constructive dividends, travel and entertainment expense abuses, compensation arrangements, dealership restructuring activities, LIFO inventory calculations, and the like. For some, this may be a really fortuitous circumstance.

ELECTRONIC RECORDKEEPING REQUIREMENTS

Apparently, IRS Computer Audit Specialists are continuing to report that auto dealerships comprise one of the few industries that still is not complying with the ***electronic recordkeeping requirements*** for taxpayers.

These requirements are found in Revenue Procedure 98-25 and we have repeatedly discussed them. In Update Item #4 in the June 2000 *DTW* (*"IRS Is Zeroing in on Electronic Recordkeeping Requirements,"* page 2), we reported that the previous Motor Vehicle Technical Advisor indicated 4 years ago that this was a problem getting national attention at that time. For specifics on this, see *"Warning: "Dealership Software Programs Must Save All the Detail Required by Rev. Proc. 98-25,"* June 2000 *DTW*, page 3. This just shows how slowly some things move along at the IRS.

All we'll do here is repeat three key points. ***First,*** whenever a dealer changes computer vendors and/or systems, continuing compliance with Rev. Proc. 98-25 and with Rev. Rul. 71-20 should be an important element on the CPA's or computer consultant's due diligence checklist.

Second, any time a dealer's computer system crashes and all, or much, of the accounting data is lost or compromised, compliance with Rev. Proc. 98-25 and Rev. Rul. 71-20 should be ascertained. Then appropriate and reasonable steps should be taken to comply. ***Third,*** if a dealer is audited by the IRS and found to be significantly at risk due to non-compliance with these electronic recordkeeping requirements, could the CPA have expanded liability for failing to advise the dealer of this non-compliance? In short, the engagement letter should be reviewed to see what, if anything, it says about this either affirmatively or negatively.

Ms. Harris indicated that the IRS is aware that there are some problems and that it is working with some of the vendors who provide software for dealerships in trying to get them (i.e., the vendors) to understand what the IRS really needs from them. She said that she also hoped CPAs would be instrumental in bringing these requirements to the attention of their dealer clients.

COST SEGREGATION STUDIES

In discussing cost segregation studies, Ms. Harris said that this was another area where the IRS is looking for help from dealer-CPAs.

As a result of cost segregation studies, every dollar reclassified or segregated from 39-year property to 15-year property achieves a significant payback benefit. Similarly, every dollar reclassified to the 5-year property category achieves an even greater payback benefit. These benefits are further enhanced as a result of recent changes, including the special 30%-50% depreciation provisions that are part of 9/11 relief legislation.

If your dealer clients–or any other clients for that matter–have constructed, renovated, purchased or inherited real estate in the current year or even in a recent year, a cost segregation study could accelerate hundreds of thousands of dollars of depreciation deductions. For more on cost segregation studies and benefits, see *DTW*, Update #4, June 2002 (page 2) and September 2000 (page 14).

Ms. Harris indicated that there is another team within the IRS that is giving attention to cost segregation studies because the tax issues cross over many industries and other divisional lines of IRS responsibility. The IRS team is currently working on an Audit Technique Guide. When eventually published, this Guide will become public information under the Freedom of Information Act.

Ms. Harris said, "I'm not here to tell you that they (i.e., cost segregation studies) can't be done, but I am here to tell you that (they) need to be done ***right.***" She said that the Service is interested in knowing whether automobile dealership cost segregation studies might be so unique that they require a separate Audit Technique Guide specific to their own industry. She added that there was interest within the IRS in putting together a small group from the industry for more discussion and interaction on these issues ... Any volunteers out there?

SECTION 62(c) ACCOUNTABLE PLAN REIMBURSEMENT RULES FOR TECHNICIANS' TOOLS

This used to be a very hot topic until the IRS issued a Coordinated Issue Paper in July of 2000 which broadly lumped together all technician tool rental and reimbursement programs. See Update #3 in *DTW* June 2003 and pages 6-7 of that *DTW* issue

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for a recent submission to the IRS requesting clarification of the tax treatment for Section 62(c) accountable plans.

Although the Service, to date, has declined to consider this matter within its Industry Issue Resolution (IIR) Program, one provider (Pro-Check National, Inc.) is still actively attempting to engage the Service to obtain technical clarifications. For more information, you can call Tom Lower at (877)385-4227 or visit Pro-check's web site *prochecknational.com.*

During the Question & Answer session following the formal panel presentation at the AICPA 2003 Conference, the following question was asked ... ***"Is there anything new on Service Tech Tools?"***

In reply, Ms. Harris answered, "... They were submitted under that Industry Issue Resolution Program ... At this point, there is no work on one, it has not been accepted into that (Program). ...It is a Coordinated Issue in the Motor Vehicle Program which means that our Agents must raise it (the issue) and cannot deviate from the Service's position without permission of the Motor Vehicle Technical Advisor Program...."

Ms. Harris added: "...There was a perception out there that we said that service technician tool reimbursement plans could not be done correctly ... ***and that is not right; they can be done correctly.*** So, there is minimal activity on them, and they are still out there ... ***and we are looking to get you additional guidance.***" Note that Ms. Harris referred to reimbursement plans, not to "rental" plans.

We are hopeful that in 2004, additional guidance will be forthcoming from the IRS on this subject, especially if the IRS will discuss Section 62(c) accountable plan issues separate from the more problematic "rental plans" which warrant separate and distinct attention.

CHANGES IN ACCOUNTING METHODS TO REMOVE TRADE DISCOUNTS AND CERTAIN ADVERTISING EXPENSES FROM INVENTORY COSTS

Throughout the year, the *Dealer Tax Watch* has emphasized the importance and advantages of making these changes in methods in order to comply with the law to reduce inventory costs by trade discounts and floorplan assistance payments. In addition, certain local and regional advertising charges may also be eliminated from inventory cost. This still holds true at year-end 2003.

This topic received an extraordinary amount of attention a year ago at the 2002 AICPA National Auto Dealership Conference. However, at this year's conference, no mention was made of this topic except during the LIFO presentation (the outline for which was reprinted in the September 2003 *DTW*, pages 10-15).

Assistance and incentive programs vary by manufacturer and, in some cases, by year. If the inventory is on LIFO, all prior year LIFO layers need to be recomputed. Since these changes cannot be made using the cut-off method, Section 481(a) adjustments are required. These adjustments have been discussed thoroughly elsewhere.

For emphasis, we'll only repeat that for dealers on LIFO, the largest part of the benefit is 100% deductible in the year of change and it does not reverse in later years. Then, although comparable monitoring at subsequent years-end is required, the net changes in later years are usually not too significant.

For the CPA or the controller trying to contend with all the detail alone, the work can be both tedious and overwhelming. Not only do year-end invoices for several years have to be analyzed, but other dealership information including floorplan and other reports must be reviewed.

Here's what we did this year with all of our clients concerning this matter. Some clients were not aware that *these overall changes in accounting methods can be made on a cost effective, turn-key basis.* Late in the year we contacted every LIFO client that we handle (if they had not previously made the changes) to apprise them of the benefits. We also informed them of the risks associated with continuing to use a method of accounting that is not authorized by the Regulations.

As a result, many dealers decided to make the changes effective for 2003. Many others decided to make the changes effective for 2004. Others, as you might expect, turned our letter over to their CPAs and they just ignored us.

DEMONSTRATOR VEHICLES

The use of demonstrator vehicles and related reporting requirements under Revenue Procedure 2001-56 were not discussed at the AICPA Conference. However, the IRS recently issued *Publication 4230 (10-2003)* entitled *Auto Dealership Demonstrator Vehicles: Federal Income Tax Guidelines.* This 2-page brochure (see page 12-13) is available on the IRS web site (www.irs.gov), and it summarizes the Simplified Accounting Methods to Value Demonstrator Vehicles.

You might want to give a copy of this to your dealership controllers. ✻

A Quarterly Update of Essential Tax Information for Dealers and Their CPAs

De Filipps' DEALER TAX WATCH, Vol. 10, No. 3

Simplified Full Inclusion Method
Annual Lease Value -Daily Inclusion Amount Table (Rev. Proc. Question 44)

If the employee provided the use of a demonstration automobile is not a full-time salesperson, the full exclusion and the partial exclusion in this revenue procedure do not apply. The employer must include in the employee's income and wages each month the full value of the demonstration automobile using the following table.

Value of Demonstrator Provided	Daily Inclusion Amount
3,000 - 4,999	4
6,000 - 7,999	6
9,000 - 10,999	8
12,000 - 12,999	10
15,000 - 15,999	12
18,000 - 18,999	14
21,000 - 21,999	16
24,000 - 24,999	18
26,000 - 27,999	20
30,000 - 31,999	23
34,000 - 35,999	25
38,000 - 39,999	28
42,000 - 43,999	31
46,000 - 47,999	34
50,000 - 51,999	36
54,000 - 55,999	39

For vehicles with value in excess of $59,999, the dollar inclusion amount is (.25 x value) + $500, divided by 365, rounded to nearest dollar amount

Simplified Partial Exclusion Method
Inclusion Amount Table
(Rev. Proc. Question 35)

For full-time salespersons covered under the Simplified Method for Partial Inclusion (Section 5 of R.P. 2001-56) dealers should include an amount based on the following table in the salesperson's income at least monthly. *(Note: The daily inclusion amount must be applied based on a 7-day week.)*

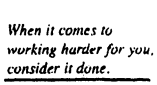
Value of Demonstrator Provided	Daily Inclusion Amount
$15,000 - $29,999	$6
$45,000 - $59,999	$13
$75,000 and above	$21

Definition of a Qualified Salesperson

- Employed full-time by an automobile dealer
- Spends at least half of a normal business day performing functions of a floor salesperson or sales manager
- Directly engages in substantial promotion and negotiation of sales to customers
- Derives at least 25% of his or her gross income directly as a result of sales activity

Full Text of Revenue Procedure 2001-56 and other employment tax information can be found at
www.irs.gov/smallbiz
Toll Free Assistance: 1-800-829-4933

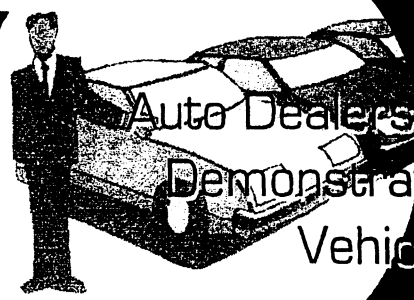
When it comes to working harder for you, consider it done.



Department of the Treasury
Internal Revenue Service

www.irs.gov

Publication 4230 (10-2003)
Catalog Number 37240S



Auto Dealership Demonstrator Vehicles

Federal Income Tax

Revenue Procedure 2001-

Accounting Period

Internal Revenue Service

Small Business/Self-Employed

[illegible] provide [illegible] dealership [illegible] order to [illegible] value of the salesperson's demo from [illegible] income significant record keeping by [illegible] required.

[illegible] provides simplified [illegible] the value of the [illegible] and clarifies the [illegible] by salespersons.

[illegible] are available to any [illegible] engaged in the sale of new or [illegible] duty trucks. Light duty [illegible] a gross vehicle weight of [illegible] or less.

[illegible] include:

[illegible] method for the full exclusion [illegible] qualified demo use (Simplified [illegible]

[illegible] method that allows [illegible] include in the salesperson's [illegible] the personal use of the

[illegible] include the full value of [illegible] employee's income when [illegible]

[illegible] when the [illegible] are not

Simplified Method for Full Exclusion Out/In Method (Rev. Proc. Questions 11-25)

- Available only to qualified salespersons
- Requires a qualified written policy and reasonable belief that it is followed
- Limits personal use outside of normal working hours
  - o Commuting plus an average of 10 miles per day
- Required Records include:
  - o Record of round trip commuting mileage for each salesperson
  - o Records supporting total use outside of working hours

Simplified Partial Exclusion Method (Rev. Proc. Questions 26-39)

- Available only to qualified salespersons
- Requires a qualified written policy and reasonable belief that it is followed
- Requires that an amount be included in salesperson's income at least monthly
  - o Table of amounts included
- Required Records include:
  - o Written Policy
  - o Verification of value of demo
  - o Evidence that the amount was timely included in salesperson's income

Simplified Full Inclusion Method (Rev. Proc. Questions 40-47)

- Available to any employee
- Requires that the value of the use of the vehicle be included in the employee's income at least monthly
  - o Amount based on Annual Lease Value Tables
- Required Records Include:
  - o Verification of value of demo
  - o Evidence that the amount was timely included in employee's income

Application of the General Rule When Revenue Procedure Methods Are Not Used (Rev. Proc. Questions 1, 48-51)

- Available to any employee
- Requires that the full fair market value of the use of the demo be included in the employee's income at least monthly

Determination of the Value of Demos Provided (Rev. Proc. Questions 33-34)

- Annual Average Look Back Method
  - o May be used under the Partial Exclusion or Full Inclusion Method
  - o Based on average sales price and number of all vehicles sold in the prior year
  - o Method is optional

PORC ACTIVITIES & 2003 TAX RETURN REPORTING-DISCLOSURE ISSUES

YEAR-END UPDATE

This article focuses only on Producer-Owned Reinsurance Company (PORC) related issues. These are divided into two major discussion areas: (1) how the IRS is currently dealing with Notice 2002-70, including its PORC audit activies and (2) year-end 2003 income tax return reporting and disclosure issues.

HOW THE IRS IS CURRENTLY DEALING WITH NOTICE 2002-70

During the year, we've commented on the absence of any new guidance coming out of the IRS as it relates to PORCs and auto dealerships. However, Ms. Harris indicted at the 2003 AICPA Conference that there has been a lot of activity going on at the IRS "behind the scenes" that has not been publicized. She jokingly said that PORCs should become the IRS poster child for "coordination," because PORC issues cross so many divisional and industry lines within the IRS.

Let's see, for starters there's LMSB, SBSE, TEGE, CID, Excise, and International ... not to mention retailer, service provider, lender and auto dealer industry concentrations. Almost every department of the IRS has an interest in PORCs, and after an initial meeting involving almost 50 people, the IRS narrowed the crowd down to an *Executive Steering Committee* and three *Issue Champions.* In addition to coordination problems in general, Ms. Harris indicated that one of the Issue Champions was retiring at the end of December. That too may slow down the *rate of movement* or progress on decisions coming out of the IRS.

Ms. Harris said she could not help but observe an initial sense of denial by many dealers and their CPAs over the question of whether Notice 2002-70 "was really meant to apply to them." She emphasized that although a word-by-word literal reading of much of the Notice might, at first, lull one into this misbelief, the critical language has been carefully placed within the Notice by its drafters. The Notice states that transactions that are the same as, ***or substantially similar to,*** the transactions described in this Notice... are identified as "listed transactions." It is the "substantially similar to" language that brings auto dealership PORC activities into the fold.

Ms. Harris said that Notice 2002-70 was written broadly because there is *a potential for* abuse out there. That does not necessarily mean, per se, that all PORCs are abusive ... but only that they have *the potential to become so.* To date, the IRS has seen some egregious situations involving PORCs where there has been unbridled use of funds, unrepaid shareholder loans and other abusive results. The Service is trying to find out if there are any more abusive situations out there.

Accordingly, one of the goals of the IRS' PORC Task Force is to try to understand what is going on out in the real world. In pursuit of this goal, on August 19, 2003, members of the Task Force had a meeting with various stakeholders including retail auto dealers, lending associations and IIR submitters. During this meeting, the IRS listened to various positions and solicited additional information from the attendees.

Ms. Harris emphasized that (1) to date, the Service has received no additional information as a result of its request, and (2) the IRS is not in the process of "negotiating" anything with anyone to resolve PORC issues. Also, because of the significant overlapping of divisional levels and responsibilities relating to PORCs, the IRS has decided to not accept PORC issues into its formal IIR Program structure.

So, currently, the Service is dealing with PORCs outside of its IIR Program, and it is gathering facts, evaluating the industry/industries, developing issues and seeking technical guidance or advice on these issues, where appropriate. All of this takes time and is being done slowly but surely.

As is evident from Ms. Harris's comments, as well as from others, the Service is currently at a disadvantage in not knowing more of the facts. What means does the IRS have at its disposal for gathering more information? The Service is doing this by conducting audits–some on auto dealerships, some on other non-dealership businesses. In addition, the Service is conducting promoter investigations and, where it deems appropriate, issuing subpoenas to various promoters to gain access to their files. Finally, the IRS has been reviewing the PORC related disclosures that were made in 2002 income tax returns filed for last year.

Subpoenas and summons activities. On this subject, the BNA (Bureau of National Affairs) *Daily Tax Report* for October 28, 2003, page G-7, reported that on October 16, the IRS asked a Federal District Court for approval to serve a "John Doe" summons seeking the names of U.S. businesses that were using off-shore reinsurance companies. One company served was American Bankers Insurance Group

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(ABIG), based in Miami, that apparently has helped some 300 companies set up PORCs.

The summons asked ABIG to provide

1. The names of U.S. taxpayers who sold credit insurance as agents for U.S. subsidiaries of that company during the 78-month period from January 1, 1997 through July 1, 2003, and who reinsured those policies with entities in the Turks and Caicos Islands,

2. Detailed information on the insurance and reinsurance entities,

3. Detailed information on the insurance agency and commission agreements, and

4. Detailed information on the calculation of commissions and reinsurance payments.

According to an IRS spokesperson for the IRS Large and Mid-Size Business Division, only two promoters who registered tax shelters under Section 6111 have registered off-shore reinsurance transactions, and neither was an ABIG entity. Also, out of 1,653 disclosures under Section 6011 from taxpayers participating in off-shore reinsurance transactions, only one taxpayer potentially identified an ABIG subsidiary as the promoter.

IRS PORC-RELATED AUDIT ACTIVITIES

According to the BNA article, the IRS has described what it is seeing and views as a potentially abusive tax shelter PORC arrangement in terms of six elements (see below).

At the AICPA Conference, Ms. Harris identified at least three possible tax issues that an agent may raise in connection with PORCs:

1. Whether the *reinsurance* is actually *insurance*,
2. Whether the PORC arrangement is a sham, and
3. Whether the reinsurance arrangement is correctly priced.

The Service is clearly now intent on guarding all three of the possible gates through which PORCs might otherwise pass on the way to becoming abusive tax shelters. The addresses of these Code Section gates are ... 501(c)(15) *tax exempt entities*– who pay no U.S. tax ... 806 *the deduction for a small life insurance company*–which produces a 13.6% (instead of a 34%) tax rate ... and 831(b) *treatment as a small property and casualty insurance company* - which avoids tax on underwriting profit and pays tax only on investment income.

During 2003, the IRS issued Notices 2003-34 and 2003-35 to especially warn taxpayers about its protective attitude toward possible misuse of these benefits.

Turning again to BNA as our source, the IRS reportedly has identified two potential abuses from PORCs as follows. ***First,*** "Insurance commission income, which can be an initial 40% of the premium plus a 'retro' or subsequent amount, escapes U.S. tax by having the unrelated insurer pay a substantial portion of the commission to the PORC, which is tax-exempt or tax 'advantaged.'" ***Second,*** "The money received by the PORC is returned to the United States, possibly as tax-free dividends from an off-shore subsidiary to a corporation, or as purported loans (to shareholders)."

BNA reported that IRS agents who audited three such arrangements found that virtually all of the funds received by the PORCs were returned to the U.S.

RECIPE FOR BAD PORC STEW

1. In a typical transaction, a U.S. company such as a car dealer or a lender offers credit insurance in connection with a product or service it sells,
2. The company acts as an agent for an unrelated insurance company, collects premiums from its customers and sends them (i.e., the premiums), minus a commission, to the insurer,
3. The company, or its owners, form an offshore company that reinsures the policies sold by the company. The offshore company (being a foreign corporation) elects domestic tax treatment under Section 953(d) and claims beneficial U.S. tax-exempt status under Section 501(c)(15) or it may elect the benefits available under Sections 806 or 831(b),
4. The PORC often is located in the Turks and Caicos Islands, which provide privacy for their companies and emphasize the low capitalization and minimal requirements for establishing a reinsurance corporation,
5. The unrelated insurer pays claims and other expenses from the insurance policies and retains its profit margin, and
6. The insurer transfers the balance of the premiums to the offshore PORC.

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(Continued from page 15)

businesses as dividends or as unrepaid or non-performing loans. According to one agent, one retail rent-to-own business used offshore reinsurance transactions to underreport its income by $325,000 for 1994; $629,000 for 1995 and $604,000 for 1996. This business conceded the IRS audit unreported income assessments in full.

According to Terri Harris, in addition to using document information requests and questionnaires (see pages 17-18), IRS agents are given the following instructions when they are examining PORC arrangements:

GO GET 'EM

1. Follow the flow of funds,
2. Follow the flow of the documents,
3. Make sure you know exactly what is happening (because there are many different service contract and credit life programs in the marketplace,
4. Find out which dealership employee or employees are responsible for understanding the PORC program, and
5. Interview those responsible people and get the facts.

As many of us know, often no one in the dealership really understands what is really going on in connection with the PORC programs. They just see dollar signs. Apparently, IRS agents are fed up with wasting time in talking to the monkeys and have been instructed instead to talk to the organ grinders. Often, this means eventually talking to–or prying information out of–the promoters.

Ms. Harris has told dealership controllers that if it's not their job to know how their PORC program is working, they better find out who is responsible for knowing that. She has further advised them to be sure to explain how the PORC program is working to their CPAs, because often their CPAs don't know how the program is supposed to work. To this, we add ... if a CPA does not know how a dealer's PORC program is supposed to work (and how, in practice, it is actually working), how can the CPA prepare accurate tax returns and/or evaluate their implications for PORC participants?

We are aware of at least two meetings that the IRS has had with industry representatives concerning Notice 2002-70 and its specific implications for auto dealers. The first meeting was in November of 2002 and the more recent meeting, August 19, 2003, mentioned previously. During the year, we also pointed out that the AICPA had submitted some of its views to the IRS. But, one piece is still missing from the puzzle ... ***Where's NADA*** in all of this?

In a recent conversation, I was reliably informed that during 2003, NADA has not received any calls from dealers (or their CPAs) expressing any kind of concern over 2002-70. Notwithstanding Ms. Harris' observation about a "significant sense of denial" evidenced by many dealers, the absence of any concerns being addressed to NADA is strange. Or is it?

There are significant controversies over potential PORC tax issues. At what point might tax sham PORCs enter the dark region of abusive tax shelters? Could it be that, as Kevin Woodruff suggested in the March 2003 *DTW*, ultimately, it may be the ***promoters***–who have been playing "fast and loose" with dealers' reinsurance programs–who may be more on the hook than dealers? Even if it is, it will be the dealers, and their CPAs, who will probably get hit by the crossfire. It seems that for now, all is calm before the storm, and before too long, that gathering storm will surely hit the mainland.

Despite all the seemingly negative vibes PORCs are getting, one recent development might actually encourage the formation of more PORCs. *Automotive News* (November 24, 2003) indicated that "National Warranty's downfall harmed countless dealers, but the lure of plump commissions still draws many to independent insurers." In this article, it was suggested that as a result of National Warranty's collapse, "More dealers are likely to set up their own reinsurance companies to provide backup insurance if an administrator or insurance company goes bust ... Dealers who had their own reinsurance (companies) had some money available to pay claims, while others with no back-up funding, generally have to eat the cost of (those) claims." The collapse of National Warranty suggests that, properly structured, there are legitimate, non-tax, reasons for setting up PORCs.

SPECIALIZED AUDITS FOR PORCS WITH SEC. 953(d) ELECTIONS

Recall that our December 2003 *DTW* included a *Practice Guide*: "Checklist for Evaluating Exposure to IRS Attack on PORCs." Item #3 of the "Factors to Consider" reads: "Has the reinsurance company made an election under Section 953(d) to be taxed as a U.S. corporation for Federal income tax purposes? ... If 'Yes,' has IRS acknowledged acceptance of the election? ... What country is the domicile of the reinsurance company?"

Notice 2002-70 applies equally to corporations domiciled in the U.S. and to those domiciled outside the U.S. (i.e., "foreign" corporations).

Section 953(d) permits a foreign corporation that would otherwise qualify under the U.S. income taxation provisions for insurance companies, to make an

see **PORC ACTIVITIES & REPORTING UPDATE**, page 19

PORC Audit Letter ... From IRS Small Business / Self-Employment Division

... (Heading omitted)

Dear Mr./Ms. _____

Internal Revenue Code Section 4371 refers to Federal excise tax on reinsurance.
In order to review this no liability audit, I would like to meet with you at the date and place noted above.

In order to keep the visitation as brief as possible, please have the following information available for the scheduled appointment.

Information Document Request for the periods October 2001 to December 2002:

1. List all foreign insurers or reinsurers along with their country of domicile.
2. Insurance contracts, quarterly bordereaux/settlement statements.
3. NAIC Annual Statements (Schedule S - Life) (Schedule F - P/C)
4. Please provide ceded premiums accounts.
5. Any 953(d) elections
6. Closing agreement.
7. Certificate of residency.

Please call to confirm appointment. If you have any questions, please contact me at the telephone number listed above.

Thank you for your cooperation.

Sincerely yours,

Revenue Agent

IRS Form 4564 ... Information Document Request ... re: Form 720

... (Heading omitted)

Returns: 720 Tax Periods: _____

The information being requested is in relation to foreign insurance or reinsurance under Internal Revenue Code Section 4371, 4373 and 953 election.

1. Brochure of the company.
2. Form 990 for the years 2000, 2001 and 2002. *(Filed for Sec. 501(c)(15) exempt organization)*
3. Complete Section 953(d) questionnaire.
4. How is *(name omitted)*_____ related to *(name omitted)*_____? Please provide address and EIN of *(name omitted)*_____.
5. Please provide the original Life NAIC Statement for the year 2002.
6. Has the company's Form 990 been audited? If yes, please provide the audit result and the agent's name and phone number.

Please provide information in two weeks on or before _____.

Thanks for your cooperation

From: | Name and Title of Requester

Address: | Internal Revenue Service

Date _____

PORC IRS Audit Letter ... Section 953(d) Election Questionnaire

Entity Name: _____ Contact Person: _____

Address: Title: _____

Telephone Number: _____

EIN: _____

Address of Books and Records:

---

1. Is the U.S. address on the information provided a related entity, a preparer, a broker or other (explain)?
   _____
   _____
2. Date of Incorporation: _____
3. Date the entity is treating the election as valid: _____
4. Does this match the information contained in the acceptance letter from the IRS? _____
5. Business purpose for election: _____
6. Is the electing entity currently active? _____
7. Organization structure: _____
8. How was the insurance structured before the election? _____
   _____
9. What were the changes to the insurance structure after the election? _____
   _____
10. Was a Form 720 filed before the election by the U.S. entity paying premiums? If so, by whom? _____
    _____
11. Was a Form 720 filed before the election by the entity making the Section 953(d) election? _____
12. Was a Form 720 filed after the election? By whom? _____
13. Has the company making the election reinsured premiums with other foreign insurers? _____
    _____
14. After the election was made, what U.S. income tax returns are being filed? _____
    _____
15. Provide copies of the income tax return(s).
16. Does the entity utilize a broker? (If so, and the entity states that the broker is paying the tax, obtain verification from the broker that the tax was paid along with the amount.) _____
17. If excise tax is paid, are gross premiums taxed, or are premiums net of commissions and other offsets taxed?
    _____
18. Sources of all Premium Income:

Type of Insurance	*Related or Unrelated Premiums?*	*If Related: Insured Name & Relationship*

 (Continued from page 16)

election to be treated for tax purposes as a U.S. domestic corporation. In making this election to be taxed as a U.S. domestic corporation, the foreign corporation simply waives all benefits to which it might be entitled under any U.S. treaty with that foreign country of domicile. Usually, in agreeing to this waiver, the foreign corporation is not giving up very much in return for far more beneficial U.S. tax treatment.

Previous discussions have referred to the ongoing IRS audit activity to obtain more information on PORCs. On pages 17-18, you can see what the IRS *Information Document Request* and related *Questionnaire* look like for a foreign corporation making an election under Section 953(d) to be taxed as a U.S. corporation.

YEAR-END 2003 TAX RETURN REPORTING & DISCLOSURE ISSUES

Last year, and again this year (see Update #2 on page 2), we believe the proper and prudent course of action is to include appropriate disclosures on Form 8886 with respect to any dealer producer-owned reinsurance company activity. Form 8886 is on pages 21-22.

As you can see, the reverse side of Form 8886 (i.e., page 2) is divided into three sections: ***#7 Facts*** ... ***#8 Expected Tax Benefits*** ... and ***#9 Estimated Tax Benefits***. Each section calls for various detailed descriptions of facts, anticipated benefits, etc.

The Form 8886 instructions are printed on three pages. However, the portions that are relevant to dealership/dealer CPAs require only about one page. (See page 20.) The reason for this is that although there are six possible reportable transactions, dealership/dealer PORC-related transactions fall within the specific category of "listed transactions" for which published guidance has been provided in IRS Notice 2002-70 (2002-44 IRB 765). The other five types of reportable transactions, in general, are not likely to be encountered in the typical dealership situation.

Warning: CPAs and other tax return preparers should not overlook an additional special filing requirement. For only the first time when a reportable transaction is disclosed, a ***copy*** of Form 8886 is also required to be filed with the IRS Large and Mid-Size Business Division in Washington, D.C.

For whatever comfort it may provide, the instructions state that the fact that a transaction must be reported on Form 8886 does not mean the tax benefits from the transaction will be disallowed.

What is not so clear is the degree, or extent, of the disclosures that are required. CPAs, industry consultants and (reinsurance) specialists differ in their interpretations of what should, or what needs to be, disclosed and by whom these disclosures should be made.

In some pro forma disclosures that we have seen, the description suggested for a PORC in response to the "Expected or Principal Tax Benefits" section would be along the following lines. ... "The potential tax benefit is the amount of the difference between what the PORC taxpayer would have paid had its tax liability been based upon the taxable income computed under Section 831(a) or Section 801, whichever is applicable, or the actual taxable income as determined by the provisions of Sections 831(b), 806 or 501(c)(15), whichever is applicable."

Following the response for estimated tax benefits would be a three-line schedule showing the reduction in tax liability by year as follows: (1) Actual tax paid, (2) Actual tax without Section 806 and (3) Difference.

There was one other PORC presentation at the AICPADealership Conference–Session #24, "Dealer Owned Reinsurance Update" by Gregory L. Petrowski, CPA. Mr. Petrowski is Secretary/Treasury of GPW and Associates, Inc., an actuarial and consulting firm in Phoenix, AZ. Unfortunately, Mr. Petrowski's presentation at the Conference was not taped, but his Conference Manual materials are very good and he can be reached at gpetrowski@gpwa.com.

According to Mr. Petrowski, there is a ***"grandfather" position*** or interpretation which concludes that if the Producer-Owned Reinsurance Company filed a tax return before February 28, 2000, the disclosure filing requirements ***do not*** apply... Technically, the taxpayer falls under the Notice, it just is not required to file anything. As a practical matter, this interpretation would mean that reinsurance companies with a formation date in 1998 or before would probably be exempt. A reinsurance company that was formed in 1999, however, probably would not have filed its income tax return for 1999 before the cutoff date of February 28, 2000, and, if so, it would not be exempt from the disclosure requirement.

At least one other promoter has gone on record as agreeing with this interpretation. However, it appeared that Ms. Harris of the IRS was not certain that this was a correct position.

For CPAs and/or dealers who may consider relying on this interpretation to avoid penalties for non-disclosure/non-reporting, here's one ***caution.*** If the PORC arrangement reflected in tax returns filed on or before February 28, 2000 has been substantially modified or changed since then, the "grandfather exception" (in support of not having to file a

see **PORC ACTIVITIES & REPORTING UPDATE**, page 23

Instructions for Form 8886

Department of the Treasury
Internal Revenue Service

Form 8886 (Rev. March 2003)	***REPORTABLE TRANSACTION DISCLOSURE STATEMENT***
Form 8886 Applies to ...	• Form 8886 applies to transactions entered into after December 31, 2002. • However, these instructions are based on Reg. Sec. 1.6011-4, which applies to transactions entered into after February 27, 2003. • For transactions entered into after December 31, 2002, and before February 28, 2003, you may either follow these instructions or the rules of Temp. Reg. Sec. 1.6011-4T. • For transactions entered into prior to January 1, 2003, see your tax return instructions for the disclosure requirements. ♦ Note that the instructions for Form 1120 for 2003 corporate returns only say that... "Form 8886 must be filed for each tax year that the Federal income tax liability of the corporation is affected by its participation in the (reportable) transaction." • Generally, you must file a separate Form 8886 for each reportable transaction. You may report more than one transaction on one Form 8886 if the transactions are the same or *substantially similar*. See the definition of *"substantially similar transaction"* below. • The fact that a transaction must be reported on this form does not mean the tax benefits from the transaction will be disallowed.
Who Must File	• Any taxpayer, including an individual, trust, estate, partnership, S corporation, or other corporation, that participates in a reportable transaction and is required to file a Federal income tax return or information return must file Form 8886.
Definitions	• ***Transaction:*** A transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan or arrangement, ***and it includes any series of steps carried out as part of a plan.*** • ***Substantially Similar:*** A transaction is ***substantially similar*** to another transaction if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy. ♦ Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as, or *substantially similar* to, another transaction. ♦ The term *substantially similar* must be broadly construed in favor of disclosure. See Reg. Sec. 1.6011-4(c)(4) for examples.
Reportable Transactions (6 Categories)	• ***Listed Transactions*** ***... Dealer PORCs fall in here, under guidance issued in Notice 2002-70, 2002-44 IRB 765.*** • Confidential Transactions • Transactions with Contractual Protection • Loss Transactions • Transactions with a Significant Book-Tax Difference • Transactions with a Brief Asset Holding Period
Participation	• ***You have participated in a listed transaction if ...*** ♦ Your tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction or if you know, or ♦ You have reason to know that tax benefits reflected on your tax return are derived directly or indirectly from such tax consequences or tax strategy.
Records	• You must keep a copy of all documents and other records related to a reportable transaction. • See Reg. Sec. 1.6011-4(g) for more details.
When & How To File	• Attach Form 8886 to your income tax return or information return (including a partnership, S corporation or trust return) for each tax year in which you participated in a reportable transaction. • Special rules apply to reporting events occurring after the time for filing the tax return.
Special Filing Required	• For ***only*** the ***first time*** you disclose the reportable transaction, • ***You must file a copy of Form 8886 separately*** with the: Internal Revenue Service LM:PFTG:OTSA Large & Mid-Size Business Division 1111 Constitution Ave., NW Washington, DC 20224
Protective Disclosure	• You may indicate that you are filing Form 8886 on a ***protective basis.*** • This is done by writing ***"Protective Disclosure"*** at the top of Form 8886. • Do this if you are uncertain whether a transaction is a *reportable transaction* under Reg. Sec. 1.6011-4.

Form **8886** (March 2003)
Department of the Treasury Internal Revenue Service

Reportable Transaction Disclosure Statement

▶ Attach to your tax return.
▶ See separate instructions.

OMB No. 1545-1800
Attachment Sequence No. 137

Name(s) shown on return | Identifying number

Number, street, and room or suite no.

City or town, state, and ZIP code

1a Name of reportable transaction | 1b Tax shelter registration number (11-digits) (if any)

2 Identify the type of reportable transaction. Check the box(es) that apply. (see instructions)

a ☒ Listed transaction
b ☐ Confidential transaction
c ☐ Transaction with contractual protection
d ☐ Loss transaction
e ☐ Transaction with significant book-tax difference
f ☐ Transaction with brief asset holding period

3 If the transaction is a "listed transaction" or substantially similar to a listed transaction, identify the listed transaction (see instructions) ▶ NOTICE 2002-70

4 Enter the number of transactions reported on this form . . . . . ▶

5 If you invested in the transaction through another entity, such as a partnership, an S corporation, or a foreign corporation, identify the name and employer identification number (EIN) (if any) of that entity . . . . . ▶

6 Enter in **columns (a) and (b)** below, the name and address of each person to whom you paid a fee with regard to the transaction if that person promoted, solicited, or recommended your participation in the transaction, or provided tax advice related to the transaction.

(a) Name	(b) Address

Cat. No. 34654G Form **8886** (3-2003)

Producer-Owned Reinsurance Company (PORC) Tax Return
... File Form 8886 as a disclosure statement

Auto Dealership Tax Return ... whether C corp. or S corp.
... File Form 8886 as a ***PROTECTIVE DISCLOSURE*** attachment
... The words "Protective Disclosure" to be written at the top of Form 8886.

Dealer / Shareholder Individual Tax Return ... whether majority or minority % ownership
... File Form 8886 as a ***PROTECTIVE DISCLOSURE*** attachment
... The words "Protective Disclosure" to be written at the top of Form 8886.

Form **8886** (March 2003) Department of the Treasury Internal Revenue Service

Reportable Transaction Disclosure Statement

► Attach to your tax return.
► See separate instructions.

OMB No. 1545-1800

Attachment Sequence No. **137**

Name(s) shown on return | Identifying number

7 Facts. Describe the facts of the transaction that relate to the expected tax benefits, including your participation in the transaction.

Producer-Owned Reinsurance Company (PORC) Return ... Reinsurance of certain insurance products sold through an affiliated automobile dealership (or dealership group). These reinsurance arrangements may be interpreted as transactions substantially similar to those described in Notice 2002-70.

Auto Dealership Return ... Same as above.

Dealer / Shareholder Individual Return ... Same as above.

8 Expected tax benefits. Describe the expected tax benefits, including deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, etc. See instructions for more details.

Producer-Owned Reinsurance Company (PORC) Return ... The potential or principal expected tax benefits would be the amount of the difference between (1) what the taxpayer would have paid had its tax liability been based upon the taxable income computed under Section 831(a) or Section 801 (whichever is applicable), or (2) the actual taxable income as determined by the provisions of Sections 831(b), 806 or 501(c)(15) (whichever is applicable).

Auto Dealership Return ... Form 8886 is being filed on a protective basis and Taxpayer contends that there are no potential or principal expected tax benefits arising out of its reinsurance arrangements.

Dealer / Shareholder Individual Return ... Form 8886 is being filed on a protective basis and Taxpayer contends that there are no potential or principal expected tax benefits arising out of its reinsurance arrangements.

9 Estimated tax benefits. Provide a separate estimate of the amount of each of the expected tax benefits described above for each affected tax year (including prior and future years).

Producer-Owned Reinsurance Company (PORC) Return ... Three-line schedule showing:

Line 1 - Actual tax paid
Line 2 - Actual tax without Section 806, etc.
Line 3 - Difference (Line 1 minus Line 2)

Auto Dealership Return ... Consistent with this Form 8886 being filed on an protective basis, Taxpayer estimates there will be no tax benefits or reduction of its Federal income and tax liability for the year.

Dealer / Shareholder Individual Return ... Consistent with this Form 8886 being filed on an protective basis, Taxpayer estimates there will be no tax benefits or reduction of its Federal income and tax liability for the year.

 (Continued from page 19)

disclosure statement) may not apply. Material changes in the business could include any number of events, such as adding new lines of coverage, adding new products, changing carriers and last–but not least–changing accounting methods for income and/or expense reporting in these returns over the years.
P.S. – does it make any difference that the year 2000 was a leap year?

The instructions for Form 8886 do not address the question of whether certain prior year activities might fall under a "grandfather exception" and therefore might not have to be reported. The only break in a timeline that the instructions refer to involve pre- and post-December 31, 2002 transactions, and this only relates to which set of Regulations should be consulted for further disclosure requirements.

Accordingly, this is an issue or question that definitely requires clarification by the IRS ... and, hopefully, sooner rather than later. In the meantime, we repeat our advice that all PORCs and related entities and individuals should be filing Forms 8886 ... without exception.

At A Glance

PORCs ... PIGS will get fat ... HOGS will get slaughtered

1. The IRS has provided absolutely no new guidance or clarification over the past 15 months.
2. The Service is working slowly, outside of its Industry Issue Resolution structure, to learn more about the industry and to think through a variety of technical issues involving potential tax abuses.
3. The Service has said that Notice 2002-70 is not specifically aimed at auto dealerships and it has said that many reinsurance programs will be all right if they are legitimately structured and properly administered.
4. ***As potentially abusive tax shelters, PORCs right now seem to be in the category of "guilty, until proven innocent."*** For whatever reason(s), taxpayers have not voluntarily provided any extra or additional information to the IRS to help it better understand the industry. As a result, the IRS is undertaking broad, comprehensive and time-consuming activities in an effort to understand the magnitude of PORC-related issues.
5. In terms of year 2003 income tax return reporting and disclosures, CPAs are again pretty much on their own in terms of whether to and/or how to fill out Form 8886. Industry consultants and specialists differ in their interpretations of what should, or what needs to be, disclosed and by whom these disclosures should be made. About the only "good" news is that at least Form 8886 has finally been published by the IRS.
6. Our admittedly conservative suggestions are that
   - All producer-owned reinsurance corporations should file Form 8886 disclosures with their income tax returns.
   - All PORC-related dealerships and dealership owners and shareholders - whether majority % or minority % shareholders - and whether the dealerships are C corporations or S corporations - should file protective disclosure attachments (Forms 8886) with each income tax return filed until the IRS officially says otherwise.
7. ***Our prediction...*** Although the IRS seems to be moving very slowly, and despite its assurances that many reinsurance arrangements should be all right if properly structured and operated, ***eventually the IRS will finally reach the point where it will publish its conclusions.*** When it does, we expect that there will be some dealerships who will be found to typify the proverbial pigs who get (and deserve to be) slaughtered.
   - If a CPA/advisor has signed the income tax returns for these greedy entities, the consequences for them may be as severe as the consequences for the PORC and its related entities. We are now in a environment where abusive tax shelters have become the lightening rods for many unpleasant repercussions.
8. Remember: If they are properly structured and administered, PORCs can basically provide excellent tax planning opportunities and can be a very effective part of a dealer's overall tax reduction and estate planning strategies.

What can we say about IRS Notice 2002 and how if affects dealerships at the end of 2003?

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. © Copyright 2004 Willard J. De Filipps. *De Filipps' Dealer Tax Watch* format designed by *Publish or Perish, Inc.* (630) 627-7227.

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