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Profitable Ideas for Automobile Dealers

Tax Considerations for Buying or Selling a Dealership

5 Commonly Asked Questions About Buying-In to a Dealership

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Many dealers are considering buy-ins as part of their exit strategy. For anyone considering a buy-in, we are continuing our buy/sell series with the 5 most frequently asked questions about buying into a dealership. We will first address the tax considerations and then expand to more general considerations.

Tax Considerations

Q: Who pays the income tax?

A: A C corporation pays tax on its taxable income. For S corporations, partnerships and, typically, LLCs (flow through entities), income tax is paid by the equity owner. Even if the company makes a distribution from a flow through entity, the equity owner is responsible for income taxes. K-1 forms are a tax form that communicates how individuals report the entity's information on their income tax returns.

Depending on the entity type (partnerships and LLCs), you cease to be an employee for tax purpose. You will be required to make estimated payments and incur self-employment taxes.

Q: What is LIFO?

A: For simplicity, we will leave this discussion to a simple statement: it is a deferral of taxable income. However, there will probably be a future income tax liability on the accumulated reserves that exist at the date of your buy-in and on the annual changes after the buy-in.

Q: Why is there a difference between a book income and taxable income?

A: Be prepared for a difference between operating income and taxable income. Accelerated depreciation on equipment, furniture, LIFO, changes in estimated reserves and meals limitations are just some of the items that create the differences between the dealer statement and the tax returns.

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Q: How are distributions taxed?
A: C Corporation distributions are taxable to the shareholder when paid. Flow-through entity distributions are typically not taxable.

Q: Are you purchasing equity or is it part of your compensation?
A: If you are paid/given ownership as a reward for improving a store, for a percentage of the profits or such, the fair market value of the equity is taxable income in the year received. It is also subject to self-employment (FICA and Medicare) tax.

General Considerations
Do not let the excitement of becoming an owner overshadow sound business judgement. You will be entering a "marriage" that is much easier to get in than to get out. You will be putting most if not all of your net worth at risk and only owning a minority position in the business. Even more important is to know that you will not have voting control.

Understanding what happens if the store is successful, maintains status quo or is not successful is most important BEFORE signing an agreement. Congratulations on your opportunity, but go into this transaction with your eyes open.

When buying into a dealership, make sure you understand what you are purchasing and how the business operates. This will help minimize conflicts after becoming the new owner. Below are the top items you should understand or address before the buy-in.

- Obtain a full understanding of the assets and liabilities and their effect on future cash flow.
- Agree to the timing and determination of distributions.
- Agree to compensation and benefits for yourself, the current equity owners and family members.
- Agree to facility rental terms and how future major renovations or factory required upgrades are to be handled.
- Obtain an understanding of related company transactions and loan guarantees.
- Address future expansion that affects the current company or your involvement with new stores.
- Determine what "toys" are owned and how costs are allocated.
- Agree to F&I product pricing and who receives over-remits.
- Agree to reinsurance company ownership.
- Address lawsuits resulting from pre buy-in actions.
- This transaction requires factory approval before being completed. Determine what your status will be with the manufacturer.

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- Obtain an understanding of how income will be distributed.
- Obtain an understanding of how losses will be treated and how recapitalization will be made.
- Agree to the terms if you cannot get along. Will your ownership be repurchased and at what price?
- Agree to an annual determination of value.
- Address the situation in the event of death, disability or divorce.
- Obtain an understanding in the event of a sale of the store's assets on your portion of proceeds allocated to personal goodwill, non-compete or other off-book items.

While this is a long list of items to consider, it is not all encompassing. Rather, it will start the discussion to help avoid future problems. It is highly probable you are entering into a business transaction with an honest and fair individual. But sometimes things do not go as planned. These suggestions are to help protect you.

The final article in this series will address considerations for the seller during a buy-in transaction. There are a few quirky tax issues that need to be understood before you sell a portion of your company. If you are actively selling today and cannot wait for the final article, contact us today.

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