Warranty Matters

General Motors Edition

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Taxing Goodwill Revisited

In the January issue of *Warranty Matters*, we published an article titled, “Tax on Goodwill?” with focus on how most state tax revenue offices view goodwill repairs, or other goodwill offerings, as taxable events.

Several weeks before the article ran, we requested a response from General Motors in this regard and promised a follow-up when an official clarification became available. Since then, many dealers, state dealer associations, NADA and various tax revenue offices have contacted us to offer comments and/or request for updated information.

Although *Warranty Matters* has maintained a good working relationship with GM’s media and warranty department over the years, when it came to this issue, we’ve basically been stonewalled. Understand, we have not tried to influence their decision in either way, but have only requested information to pass along to our clients and readers.

Although the lack of response has been somewhat disappointing, when you consider the potential expense and legal ramifications involved, perhaps it’s not too surprising. For GM to respond either way would simply open a can of worms. Nonetheless, we have come across some new information and wanted to share what we can with readers.

First, at the time of our initial publication, some states had not responded by our press deadline as to whether they viewed goodwill as a taxable event. Since then, California and New York have replied with multi-page answers, obviously drafted by attorneys. Revenue offices for both states have confirmed they, like the vast majority, view goodwill or after-warranty adjustments as taxable.

Several of our readers and clients have also contacted various GM regional offices to seek an “official” ruling. As we have been told by you, GM is standing by their assessment that the potential cost of goodwill is calculated into the price of the vehicle and any due taxes are paid upon the sale of the vehicle. As we noted in the earlier issue, that argument has been successful in a limited number of states (three we are aware of), but fallen on deaf ears in most others.

We also had a contact from a claim processing company in the mid-west since our original article that would seem to raise questions about this position. In this case, a dealership in the northeast was the subject of a state sales tax audit that focused on goodwill tax liability and suffered a significant chargeback as a result. According to our contact, the dealer appealed to GM for assistance and was allowed to submit “add credit” claims for goodwill taxes.

While we were unable to confirm this through an examination of paperwork, the president of this company assures us it did happen—as they filed the additional credit claims for the dealership. Whether or not this was a one-time situation, we simply don’t know. It would, however, seem to fit a common GM practice of dealing with such issues on a case-by-case basis.

We’ve also since learned of several sales tax audits in the state of Illinois (some dating back to 1991) that have specifically targeted dealerships, with focus on goodwill taxes. In a more recent tax audit (within the last six months), our con-

(Continued on page 2)

IN THIS ISSUE

- *GM is apparently standing by its view that goodwill is calculated into the price of a new vehicle and therefore not taxable*
- *The state of Illinois has been assessing goodwill tax in audits since at least 1991 and seems to be targeting dealerships heavily during the past year*
- *Some of you are taking a wait-and-see attitude while others are charging goodwill tax to the customer*

(Continued from page 1)

tact described the goodwill tax chargeback as "sizeable" and said, "I can't speak for other states, but in Illinois, they are well aware of the potential revenue and are pursuing it hard." At least one dealer has tried to appeal by using GM's argument that goodwill is calculated into the price of the vehicle. His appeal was rejected and taxes were assessed.

Given the information available, some you have taken a wait-and-see attitude, while others have begun charging goodwill taxes to the customer. Of course, there are prospective problems no matter what you choose to do.

If you sit back and wait on a tax audit, it's like sitting back and waiting on a warranty audit and just taking what hand you are dealt, rather than taking a proactive approach to avoid problems. If you decide to charge the customer with any goodwill taxes, haven't you really defeated the intent of goodwill in the first place?

Although we wish there was a clear-cut answer to this dilemma, if there is one we don't know what it is. At this point, we can only assure readers of two certain things in this world: death and taxes.

Audits & Appeals

Setting acceptable standards for audits and appeals has been overlooked by most state legislatures, thereby allowing manufacturers to seemingly set their own rules. The existing laws are generally vaguely worded, outdated, rarely enforced and sometimes ignored altogether by manufacturers.

We had a call from a Volkswagen store out west last month who'd suffered a sizeable warranty audit and the dealer principal wanted to file an appeal of debits. The only problem was that the auditor told them point blank: "There is no appeal process. You owe us this money."

Well, that's not the first time we've had an auditor say something so ignorant, and we suspect it won't be the last.

Several years ago, a Mitsubishi auditor told us the same thing during a closing meeting in New York—and we made a few phone calls shortly thereafter. Before his plane landed back in California, Mitsubishi had agreed to hear the dealer's appeal. Partially playing on the auditor's arrogance before, during and after the audit, we successfully negated some $30,000 in debits.

With this in mind, DaimlerChrysler and Ford Motor Company have very specific guidelines, identified in their P&P manuals, or upon request at the conclusion of an audit, on how a dealership should go about filing an appeal.

In Ford's case, an official appeal begins with the Regional office and possibly escalates to their Dealer Policy Board. With DaimlerChrysler, it starts with a zone level appeal and continues from there, sometimes taking a year, or more, to resolve.

The problem with most manufacturers' appeal process is that you are ultimately appealing to the same entity who audited you in the first place! Nonetheless, our experience has shown a surprising level of objectivity in most cases. Still though, the process skewed towards them and is more arbitration than mediation.

In the normal flow of an audit however, the first level of appeal really begins with the auditor, either during the audit process, or during the closing meeting. This is commonly called a verbal appeal. Success here hinges on the auditor and the validity of any arguments presented, but is usually small.

In the distant past, GM did have an appeal process through an appeal board. Since their 1999 reorganization, their official policy remains unpublished and unclear. But, as with Ford and DaimlerChrysler, there are opportunities for appeal through the zone, regional or national level.

Even though an auditor and/or manufacturer may insist their appeal process (if they have one at all) is final, it really depends on how far a dealer would want to go.

If your state maintains a Motor Vehicle Commission, appeal hearings can sometimes be filed here too. These commissions have oversight into how the manufacturers conduct business and adhere to state franchise laws. Since the commissioners are usually dealers themselves, you at least are allowed to present your case to a group of peers.

The last alternative involves litigation and is, of course, the most costly option. Because of the cost, audit litigation usually involves chargeback amounts in excess of $100,000. As a side note, very few attorneys are familiar with the complex nature of warranty compliance. If your attorney doesn't insist on hiring a professional in this field, find another attorney.

Back to the auditor who insists there is no appeal process. Well, most likely s/he just doesn't want their work questioned, but just like the rest of us, everybody has a boss somewhere. Don't take their word for it, pick up the phone and make some calls. You might be surprised how quickly someone would agree to hear your appeal.

Aftermarket Parts

Last month while conducting a compliance review, I made a pass through the defective parts retention area with the service manager. Sitting on the shelves, tagged along with everything else, you couldn't help but notice the aftermarket part boxes.

When questioned about the discrepancy, he simply said, "Our parts manager does this all the time and bills them out under GM part numbers." In this particular case, the service manager seemed to have little to no say about the parts manager's purchasing habits. Oh boy…

We'd like to make it very clear that this practice is viewed as fraud by *every* manufacturer and sanctions are always severe, possibly including franchise termination proceedings.

Unfortunately, some parts managers believe they'll never get caught doing this and obviously some of them haven't yet. Rest assured, if they are caught the temporary small profit gain will be offset with the ensuing chargeback.

Besides making a simple walk-through as mentioned above, where the evidence is staring you in the face, GM and other manufacturers have the ability to compare parts purchases verses labor operation usage. While they understand some parts are legitimately purchased from other authorized facilities, it is fairly easy to detect a trend.

In addition, something as simple as "abnormal" warranty part gross profit margins or "inventory adjustments" reported on the monthly financial statement can be an indicator for the factory to dig deeper. It's so much simpler to just do the right thing.

Core Returns

Just wanted to remind readers of GM policy regarding the returning of core parts when used on a warranty claim, as we still occasionally see unnecessary debits resulting from improper handling.

As you know, core charges vary widely depending on the actual part. In some cases, cores can run several hundred to even thousands of dollars (Allison transmission, for example).

Because of this, parts managers are anxious to get cores returned quickly as possible so they can receive the core credit and apply it back to their inventory.

While we agree with this strategy, when a warranty claim is involved, <u>you must not return the core until the claim is paid</u>. This change came about several years ago with the implementation of the Warranty Parts Center (WPC). Prior to that, dealers could return cores "*immediately upon completion of the repair*."

Now, dealers are notified by the WPC if the part should be returned to them along with the corresponding credit memo. If requested and returned, dealers are to claim the core credit via Claim Type F, using Z7200, with the core allowance submitted as a net item.

Some AVMs have provided dealers with assistance if the core was returned through regular core return procedures prior to claim payment, but later debited by the WPC for failure to return within 28 days.

However, they are under no obligation to do so and even if they do, it will adversely affect your DA report, as you are once again submitting a claim attached to a specific VIN.

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The Money Game

Even though they remained the world's #1 automaker by total unit sales, GM reported a $10.6 billion loss in 2005. Ford Motor Company is in a similar situation. Both companies have announced impending cuts, primarily in their respective production plants. GM's buyout proposal of some 125,000 employees made big news last month.

In Ford's case, those job reductions are also affecting regional office staffing and as we understand, they are eliminating the regional warranty manager positions nationwide—viewing them as expendable. Although those jobs are being eliminated, it has been rumored that Ford has realigned their resources to put as many as 100 warranty and sales auditors in the field, viewing these positions as potentially worthwhile.

It would stand to reason, that a reduction in vehicle production would also equate to a reduction in dealer numbers. It's the only logical solution and Ford has admitted so, although they haven't fully disclosed how they plan to do it. They have acknowledged that normal attrition will play a roll. Let's see though, 100 new auditors combined with the need to reduce dealer numbers. Hummm…

Although franchise terminations related to warranty/sales misrepresentation are considered rare in the industry, they are not altogether unheard of, particularly when it comes to Ford Motor Company. In fact, we have represented two Ford dealerships that were targeted for termination—both in the same year.

And while we are not automatically assuming that GM would make such a move, at this point in time it'd be a safe guess that any reasonable cost-reduction measure would be on the table and sure to filter down through the dealer network.

Consider this: If you were in GM's shoes, where would be one of the easiest places to recoup revenue? Warranty and sales incentive audits seem like viable targets to us. After all, desperate times require desperate measures and $10.6 billion sounds like a pretty desperate number.

The Back Page

In February we alerted our readers to the impending audit inspections of your dealership's GM Certified Used Vehicle Program by Carcannon Corporation.

As of early March, Carcannon had completed visits of about 200 GM Certified dealers and will have visited all 3,650 by year's end.

All Carcannon consultants conducting these dealer visits are ASE or Master certified and will inspect a minimum of 4 vehicles at each dealer to insure quality inspection and reconditioning guidelines.

Dealers, and General Motors, will be provided with a "Consultation Worksheet," which will include a contact score, basically ranking your store's performance.

Some of our readers were quick to point out that they hope the consultants will be looking at the FrontLine Ready vehicles as well.

According to the website gmonlineauctions.com, "*FrontLine Ready vehicles are select vehicles...that have undergone a 110+ point mechanical/body inspection and reconditioning process. GM FrontLine Ready vehicles already meet their respective certification requirements.*" But, do they really?

Not according to many of you. Since these vehicles are "pre-inspected," most are not seen in the service department until after they are sold and return to the dealer for service.

Stories have been coming in for some time about worn out brakes, worn tires, dirty air filters, low fluids, rusted rotors and even body damage on these so-called FrontLine Ready vehicles.

This made us wonder who is actually doing the inspections of these vehicles, trunk monkeys? Well, the truth is, we really can't seem to find out who inspects them.

According to one of our GM contacts, he was told inspections and reconditioning is performed "by the auction house."

It doesn't take a genius to figure out the auction house is a for-profit business too and wouldn't be too much of a stretch to imagine that they would cut corners wherever they could—sorta like the used car manager, huh?