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"A CPA firm that understands dealership management, accounting, and tax issues"

How a Typical Dealership Sale is Structured

Acquiring or selling a dealership is likely to be one of the more complex transactions that you undertake over the course of your career. Understanding how these transactions are structured and their tax effects can certainly give you an advantage at the negotiating table. Additionally, the tax aspects of acquiring or selling a dealership can have a significant impact on the owner's returns and should be thoroughly considered prior to entering any transaction. The following outline is intended to explain some of the important aspects of merger and acquisition transactions for both the acquiring dealer and the selling dealer.

Nearly every dealership transaction is structured as an "asset sale" as opposed to a "stock sale." In an asset sale, the acquiring dealer will purchase certain assets of the selling dealership. Those assets include the following:

New vehicle inventory - The acquiring dealer will purchase the selling dealer's new vehicle inventory at his cost. The acquiring dealer will pay off the selling dealer's floor plan at the closing and finance the units with his/her bank. The floor plan payoff will be higher than the inventory cost, since the floor plan amount includes the holdback and other incentives. The acquiring dealer receives a credit at the closing for the amount that the floor plan exceeds the true inventory cost. Demo units and prior year models are often discounted. Most dealerships use LIFO to value their new vehicle inventory. The selling dealer will record a gain on the sale of the new vehicles to the extent of the LIFO reserve.

Used vehicles - The acquiring dealer negotiates a purchase price on used units that he/she desires. Some or all of the used vehicles will be retained by the seller and auctioned or transferred to other stores in a dealer group.

Parts – A physical inventory is performed by an independent third party to establish the quantities and price. The cost of performing the inventory is typically split by the parties.

Machinery and shop, parts, furniture, computers, small tools, etc. – The parties negotiate the price for these items, generally $100,000 to $400,000.

Franchise Value/ Blue Sky/Goodwill – The parties negotiate the purchase price. The factors involved are the franchise, number of units sold, location, and profitability.

Asset sales are the preferred structure for two reasons. First, the acquiring dealership receives a "step up in basis" for the assets acquired. This means that the acquirer will record them on the books at the cost he / she paid for them. Based on these values, the assets will then be depreciated / amortized over their proper lives. Secondly, in an asset sale the acquiring dealer does not assume any of the legal liabilities of the selling dealership corporation. (There may be liabilities that are undisclosed and may not surface for several years, i.e. warranties given, etc. All liabilities in an asset sale will remain with the predecessor corporation.)

A stock sale is the other way to structure an acquisition. As noted previously, this is rarely used in acquisitions of dealerships. Under a stock sale, the acquiring dealer will retain the seller's basis in the assets purchased and the legal entity survives the transaction. These assets will continue to be depreciated over their remaining lives. The seller transfers his shares/interest in the entity to the purchaser, and realizes a capital gain, with a current maximum rate of 15%.

When negotiating the purchase price, a dealer must be conscious of the allocation to the various assets under an asset sale. This will dramatically affect the taxation of the transaction. We have developed checklists, "The Tax Aspects of Dealership Asset Sales" and "The Tax Aspects of Dealership Asset Purchases" to assist you in understanding the implications of the allocations. Please use them if you are considering a transaction. If you would like copies of these checklists, please email Paul McGovern at pmcgovern@downeycocpa.com or you can obtain them from our website at www.downeycocpa.com and follow the link to auto dealer services and newsletters.

P.S. We are now distributing this newsletter via email. If you prefer to receive it electronically, please subscribe directly on our website or email Paul McGovern at pmcgovern@downeycocpa.com.