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# New CATA $1 million advertising campaign promotes vehicle leasing

The advantages of leasing from the area's new-car dealers is the message of an ambitious ad campaign that began several weeks ago and extends through October.

The "Lease for Less" campaign launched March 13 on several area television stations and online. Radio spots join the mix beginning May 1.

Leasing activity in Illinois lagged much of the nation until the state's revenue department changed the taxation method effective Jan. 1, 2015. Lease penetration increased immediately. Secretary of State registrations show the percentage grew again in 2016, to about 26 percent of vehicle transactions in the Chicago market. And if the city of Chicago is exempted from the equation, lease penetration jumps to 35 percent.

CATA officials have had numerous discussions with Chicago about eliminating its 9 percent use tax on leased cars, which causes the drag, but the discussions have not yet been fruitful.

The CATA expenditure on the campaign is $1 million, but bonus placements will deliver an exposure to the ads worth roughly $2 million. The radio ads will air on both general market and Hispanic stations.

"The success of our previous campaign in 2015 was helped significantly by the excellent cooperation we received from the manufacturer lease incentives that primed the market throughout the year. It's with that cooperative spirit in mind that we asked manufacturer regional offices to consider another aggressive round of lease incentives to coincide with our campaign," said CATA President Dave Sloan.

The style of the ads on TV and online resembles what viewers have seen since 2015: whiteboard digital animation. The background now features a highway and road signs, to impart the feeling of being behind the wheel.

# Contact senators over bill to revamp Franchise Act, Senate Bill 1687

The legislative clock is winding down on most of the bills before the Illinois General Assembly this session that would impact the state's dealerships.

Legislators face an April 28 deadline to move bills out of the chamber in which they originated, and the lawmakers are scheduled to meet just five more days until then. Of the 13 bills from this session considered to impactful for dealers, only one has moved to the second chamber. House Bill 733, now before the Senate, would prohibit test drives when the driver's view is obstructed by signs or other paperwork on the windows.

Among the notable bills to watch, Senate Bill 1687 would amend the Illinois Motor Vehicle Franchise Act in several ways: It would strengthen the direct sales language, which lobbyists for Tesla are trying to dismantle; and it would prohibit manufacturers from requiring their dealers to remodel their facilities twice within 10 years. It also would halt the manufacturer from exercising a right to buy the franchise from a selling dealer unless several steps are taken.

Other bills include Sen. Jim Oberweis's perennial attempt to open dealerships to Sunday sales and another regarding test drives. This marks the fourth time since he became an Illinois state senator in 2013 that Oberweis, R-Sugar Grove, is attempting to tinker with dealership operating days.

The latest legislation, Senate Bill 2037, would permit a licensed dealer to

See Legislation, Page 2

# Deutsche Bank: U.S. auto industry faces 2004-style triple threat

This month's report about a shock stagnation in U.S. vehicle sales may be a sign that the auto industry is about to head back down the mountain at a rapid pace after a peak last year.

Deutsche Bank AG said March's weak sales, coming as they did amid rising interest rates and a slide in used-vehicle prices, make for a potentially slippery outlook. Industrywide deliveries last month slowed to a seasonally adjusted annual pace of 16.6 million vehicles, confounding analyst expectations that the rate would accelerate to 17.2 million. Automakers set a record in the U.S. last year, with 17.6 million vehicles sold.

"Somewhat ominously, today's market increasingly resembles one we described in 'A Triple Threat' (Feb. 20, 2004)," Deutsche Bank analysts Rod Lache, Mike Levine and Robert Salmon wrote in a note on Tuesday. "In that report we highlighted the risks to the industry from rising rates, rising negative equity in vehicle loans and used vehicle-price deflation. This could lead to deteriorating affordability, delayed trade-in cycles, consumer shifts from new to used, diminishing credit availability and deteriorating mix/pricing."

A key concern is that fewer cars are being taken off the road — scrappage has declined to about 11 million a year from about 13 million to 14 million a decade ago. While net new drivers jumped to 4 million in 2015, that may not be enough. Total vehicles in the U.S. have increased to 270 million, from 249 million at the end of 2012.

"This has led us to question whether the U.S. is broadly oversupplied, and whether trend demand in the 17 million range is fundamentally supported," the analysts wrote. "If it is not, the oversupply should be self-correcting — the U.S. market will experience declining used-vehicle prices, pressuring new vehicle sales."

Bonds comprised of subprime auto loans were a bright spot for the securitization industry following the housing bust. In recent weeks, however, analysts and investors have been debating what impact rising delinquencies may have on the sector.

"Credit performance for both prime and subprime auto loan ABS is expected to continue to deteriorate, although at a moderate pace," analysts at Bank of America Merrill Lynch said in a report in late March.

Deutsche Bank also noted the following:

- Used-vehicle price declines accelerated to 7.7 percent in February, from an average fall of 3.5 percent in the first nine months of 2016.
- Sales have bifurcated, with significant declines for passenger cars, while trucks hold at a 10-to-11 million a year pace.
- Ford Motor Co. and General Motors Co. may need to cut their car production again in 2Q and add additional incentives to keep inventories manageable.
- Deutsche Bank maintains a more positive view on a few select market segments, with pickup truck demand up 6 percent so far this year, and the analysts view American Axle & Manufacturing Holdings Inc. and Dana Inc. as "compelling" thanks to their exposure to the market segment.

# Legislation

Continued from Page 1

operate any six days of the week of his choosing. None of the bills Oberweis crafted to permit Sunday operations have been voted upon; they received subject matter hearings only.

The Illinois blue law, which took effect in 1984, prohibits new- and used-vehicle sales on Sundays, and few dealers support changing the law. Instead, they favor giving employees that day off, especially since banks are not able to finance vehicles on Sundays. Lifting the ban on Sunday sales also would increase dealership costs without increasing sales, which could lead to higher prices for consumers.

Senate Bill 1755 provides that dealers make a record of test drives. Any moving violations, tickets and accidents would be the fault of the permitted user driving a dealer's vehicle.

# Marketplace

**Service Writer/Foreman** Background as Technician, Foreman, Service team leader. Recent history as technical support and trainer for manufacturers. Dale Carnegie Management Training, all ASE certifications for Automotive, including L1. John Ragauskis, (708) 770-7495.

Résumé on file at the CATA.



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# Potential pitfalls for dealers in captive or reinsurance programs

**By Andy Weill**

The Internal Revenue Service has been quite active with regard to perceived abuses in the area of micro captive insurance. In particular, the IRS promulgated Notice 2016-66 in November 2016, designating certain micro captive transactions to be "transactions of interest," mandating certain reporting requirements. Counsel who know that their clients participate in captive or reinsurance programs should be mindful of this new development and advise clients accordingly.

What is a micro captive? "Captive" insurance is an insurance relationship between an insurer that accepts the risk of its owner or related party. Captive insurance does not properly refer to arrangements where the underlying risk derives only from unrelated third parties. The use of the prefix "micro" refers to the size of the company, and primarily whether the captive makes an election under 831(b) of the Internal Revenue Code. This election is only available for property and casualty companies. It is irrevocable once made, and it permits the insurance company to be taxed only on its investment income, not its premium income. To qualify, the company must not have more than $1.2 million in annual premium ($2.2 million as of 2017).

The IRS has identified situations where it considers section 831(b) has been abused. On Feb. 3, 2015, the IRS published its "Dirty Dozen" list of questionable tax transactions. (Notice IR-2015-19.) The IRS notes: "In the abusive structure, unscrupulous promoters persuade closely held entities to participate in this scheme by assisting entities to create captive insurance companies onshore or offshore, drafting organizational documents and preparing initial filings to state insurance authorities and the IRS."

This language was directed to two separate concerns: (1) coverages that move risks from traditional insurers to captives, especially if this results in a higher premium than would be paid in the regular market; and (2) "esoteric, implausible risks." One story involves an arrangement wherein a Midwest taxpayer took a $1 million deduction by paying a micro captive for tsunami insurance. The Dirty Dozen listing also noted: "Total amounts of annual premiums often equal the amount of deductions business entities need to reduce income for the year; or, for a wealthy entity, total premiums amount to $1.2 million annually to take full advantage of the Code provision."

The IRS escalated its attention to the issue in Notice 2016-66. In Section 1 of the Notice, the IRS describes in greater detail the same abusive captive insurance practices described in the Dirty Dozen announcement. The Service indicated its intention to raise questions about:

1. Legitimacy of the risks being insured;
2. Pricing of the premiums;
3. Risk sharing mechanism; and
4. Proper capitalization.

In Section 2 of the Notice, the Service listed the factors that would trigger a requirement to report participation as a "transaction of interest," requiring the submission of Form 8886 by participants. TOI status is determined by a three-part test:

1. The insurance company has made an election under IRC § 831(b) (Captive);
2. There is a 20 percent (or greater) owner of the Captive who is also an owner of a company (Insured) which transfers risks to the Captive, directly or through an Intermediary; and
3. The Captive has a loss ratio of less than 70 percent and/or has loaned any portion of the payments under insurance policies or reinsurance agreements to the Insured or a related party.

Although typical automotive F&I programs are well outside the extreme and obviously abusive examples described in Section 1 of the Notice, that provides little comfort to tax practitioners. Section 2 sets out the Transaction of Interest test and designation and expressly states that it applies even if the transaction is not as described in Section 1.

In other words, just because your client is not a Section 1 company does not mean it is not within Section 2. The Service has amplified that participants in F&I reinsurance programs will be considered within the Notice if the dealership and reinsurance company have common ownership and if the dealership is an obligor or otherwise can be considered "insured" under the program structure.

This will create a significant filing requirement (filings and annual returns, along with a "catch-up" filing with the Office of Tax Shelters Analysis due by May 1, 2017), because certain components of the F&I product mix have the dealership on risk, even if briefly. A primary example will be GAP debt waiver protection. The IRS considers this product to be insurance. Even though the debt waiver obligation invariably is assigned to a financing institution, the initial contract is between the consumer and the dealership. According to the IRS, this highly transitory relationship is sufficient to bring a reinsurance program with GAP products into the ambit of Notice 2016-66.

Multiple efforts to educate the Service on this issue and dissuade them from this position have been unsuccessful to date. However, the Service has stated that it is merely in information-gathering mode and that after review, it will eventually consider the industry's arguments as to whether GAP and other F&I products merit continued treatment as TOIs.

*The author is a Principal with Benjamin, Weill & Mazer, in San Francisco.*

# FTC finalizes 3 consent orders with dealers over used-car ads

The Federal Trade Commission has approved three proposed consent orders with auto dealer groups to resolve allegations that they advertised "how rigorously they inspect their used cars" without disclosing that some of the vehicles were subject to open safety recalls.

Among other provisions, the consent orders prohibit the dealers from representing — either expressly or by implication — when marketing, advertising, offering for sale, or selling used motor vehicles to consumers that the vehicles are safe, have been repaired for safety issues, or have been subject to a rigorous inspection, unless:

1. The vehicles are not subject to any open safety recalls, or

2. The dealer discloses, in close proximity to such representation, any material qualifying information related to open recalls, including but not limited to:

• the fact that its used motor vehicles may be subject to recalls for safety issues that have not been repaired, and

• how consumers can determine whether an individual used motor vehicle is subject to an open recall for safety issues that has not been repaired.

In addition, if the dealer receives a written notice from a manufacturer that a motor vehicle is subject to an open safety recall, the dealer must provide to a consumer — prior to the consummation of the sale of the vehicle — the manufacturer notice or a document that conveys the same information using a substantially similar format.

As an alternative to providing the manufacturer notice, two of the three consent orders permit the dealers to provide to consumers — prior to the consummation of the sale of a used motor vehicle — a written notice that conveys that the vehicle is subject to an open recall that is unrepaired and the safety risks associated with the recall that is made available by the National Highway Traffic Safety Administration (see safercar.gov) or a commercial provider of recall information.

All of these disclosures and notices must be clear and conspicuous and not otherwise misleading.

These three finalized consent orders follow separate FTC consent orders with similar terms involving General Motors and two dealer groups that were finalized in December 2016. Dealers are advised to review with legal counsel the full terms of these consent orders along with any applicable state law requirements to help assess the legal sufficiency of their used vehicle advertisements.

# FTC issues new response guide for businesses with data breaches

The Federal Trade Commission recently released a Data Breach Response Guide to assist small businesses with what to do and whom to contact if they suspect their business's data has been breached.

Dealerships must move quickly to secure their systems if they experience a data breach. Some immediate steps to take include:

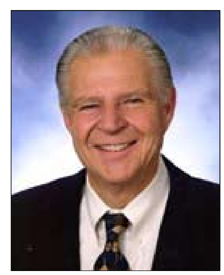
• Secure physical areas potentially related to the breach. Lock them and change codes, if needed.

• Stop additional data loss. Take all affected equipment offline right away, but be careful not to destroy evidence. Monitor all access points to your system. If a hacker stole credentials, the dealership will need to change those credentials, too, even if the hacker's tools have been removed.

• Remove improperly posted information from the internet. After the dealership cleans up its web presence, conduct a search to make sure others sites haven't posted the information. If they have, ask them to remove it.

For additional information on data breach response, view and download the FTC's Data Breach Response Guide.

## In Memoriam



**Edward P. Schoenthaler**, who retired in 2009 as co-owner of Crossroads Chevrolet-Buick in West Chicago, died April 1 at age 75.

Popularly known as "Mr. Ed," Mr. Schoenthaler began his career as a salesman at Brigance Chevrolet in Oak Park. He went on to own several Chicago area dealerships, concluding with Crossroads, which he owned with his brother, Bob.

Mr. Schoenthaler was a longtime Rotarian and an active member of Butterfield Country Club, in Oak Brook, and he served on the board of several local banks. He was also a longtime Trustee of the Auburn Cord Duesenberg Museum in Auburn, Ind.

In addition to his brother, survivors include a fiancé, Kimberly Roberts; daughters Lori Anne and Kristin Lynne; and four grandchildren.

Memorials appreciated to the Auburn Cord Duesenberg Museum, P.O. Box 271, Auburn, IN 46706.

**Save the date!**

Set aside **Tuesday, June 13** to take part in the CATA's annual member golf outing at Cog Hill Golf & Country Club in Lemont. Full details in the April 24 edition of this newsletter.