ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON ENERGY AND COMMERCE

2125 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6115

MAJORITY (202) 225–2927
FACSIMILE (202) 225–2525
MINORITY (202) 225–3641

energycommerce.house.gov

February 20, 2009

Mr. Keith Whann
General Counsel,
National Independent Automobile'
Dealers Association
Whann and Associates
6300 Frantz Road
Dublin, OH 43017

Dear Mr. Whann:

I am writing to request your testimony at a hearing before the Subcommittee on Commerce, Trade, and Consumer Protection of the House Committee on Energy and Commerce on Thursday, March 5, 2009, at 10:00 a.m. in Room 2123, Rayburn House Office Building. The hearing is entitled "Consumer Protection in the Used and Subprime Car Market

An attachment to this letter provides additional information about testifying before the Committee. If you have any questions, please contact Anna Laitin, Christian Tamotsu Fjeld or Valerie Baron with the Committee on Energy and Commerce staff at (202) 226-2424.

Sincerely,

Bobby L. Rush

Bobby L. Rush, Chairman
Subcommittee on Commerce, Trade, and
Consumer Protection

Enclosure

cc: Henry A. Waxman
Chairman

Joe Barton
Ranking Minority Member

George Radanovich
Ranking Minority Member
Subcommittee on Commerce, Trade, and Consumer Protection

WHANN & ASSOCIATES, LLC
ATTORNEYS AT LAW

KEITH E. WHANN, ESQ.

JAY F. MCKIRAHAN, ESQ.
of Counsel

HAND DELIVERED

March 2, 2009

Congress of the United States
House of Representatives
Committee on Energy and Commerce
Attn: Earley Green, Chief Clerk
2125 Rayburn House Office Building
Washington, DC 20515-6115
Electronic address: earley.green@mail.house.gov

Re: Testimony before the Subcommittee on Commerce, Trade and Consumer Protection of the House Committee on Energy and Commerce
"Consumer Protection in the Used and Subprime Car Market"

Dear Committee Members:

INTRODUCTION

Mr. Chairman, members of the Subcommittee, my name is Keith Whann and it is my pleasure to offer testimony on behalf of myself and in my capacity as General Counsel for the National Independent Automobile Dealers Association (NIADA) regarding "Consumer Protection in the Used and Subprime Car Market."

My career in the motor vehicle industry has spanned the last 25 years, while NIADA has represented independent (non-franchised) motor vehicle dealers for over 60 years. The NIADA and its State Affiliate Associations represent more than 20,000 independent motor vehicle dealers located across the United States. Most of these dealers own and operate small businesses as defined by the Small Business Administration. NIADA and its members recognize the need for the accurate exchange of information about used motor vehicles to promote better understanding of a transaction for consumers and also to protect dealers, not only in acquiring used vehicles for inventory, but also in selling those vehicles to the public. There is also an urgent need for additional capital being made available to dealers for financing the acquisition of inventory (floor planning) and for the extension of credit to customers wanting to buy a vehicle. This includes the tax treatment of a transaction where the dealer itself finances a customer's purchase. The testimony offered today is intended to provide you with an overview of some of the legal and regulatory challenges faced by the independent (non-franchised) used motor vehicle dealer.

OVERVIEW OF THE USED MOTOR VEHICLE BUSINESS

The motor vehicle industry is one of the most heavily regulated and complicated industries in America today. A host of state and federal laws impact every motor vehicle transaction, including State Unfair and Deceptive Acts and Practices (UDAP) Statutes, State Titling and Retail Installment Sales Acts, the Uniform Commercial Code, the Magnuson Moss Warranty Act, the Fair Credit Reporting Act, the Truth in Lending and Leasing Acts, the FTC Used Car Rule and Federal Privacy Laws and implementing Regulations, to name a few. See Attachment A. Additionally, not only have these State and Federal Laws gone through major revisions in recent years, but numerous case decisions and regulatory interpretations addressing compliance with these Laws are rendered on an ongoing basis, e.g. current FTC solicitation and consideration of comments on proposed revisions to the Used Car Rule and pending Department of Justice action to complete implementation of NMVTIS.

Putting all of this together, achieving document compliance for a motor vehicle dealership and keeping current with legal, regulatory and legislative developments that impact the dealership's documents and processes can be extremely challenging. The large number of overlapping state and federal laws and regulatory requirements makes compliance extremely challenging for the typical motor vehicle dealership and is confusing for consumers. Contrary to much of modern commerce that is now conducted with the swipe of a card to transfer electronic information, motor vehicle dealers are still confronted with mandatory requirements of ink on paper and retention of hard copies of up to twenty (20) documents required to memorialize a transaction. See Attachment B.

Today we live in a rapidly changing and seemingly more difficult world. It used to be that when a motor vehicle dealership made a mistake, it had an opportunity to fix it. Now, the first mistake a dealer makes can cause financial ruin. Not surprisingly, paperwork compliance is one of the biggest challenges and the area that presents the greatest legal exposure for a motor vehicle dealership and is a great source of confusion for the customer.

Remember, each document in a transaction is not meant to stand alone, but rather is an integral part of the entire transaction. Moreover, what is disclosed on one document can have significant impact on another. Thus, complying with the large number of overlapping disclosure requirements and maintaining consistency throughout their documents becomes paramount. In addition, State UDAP Statutes typically require that every retail sale of a motor vehicle be preceded by a written contract that contains all of the agreements of the parties, including all material statements made prior to obtaining the customer's signature on the contract. If a dealership is to be in compliance with all of these State and Federal Laws, the dealership must ensure that the Retail Buyers Order, FTC Buyers Guide and, if used, any Limited Warranty Document contain the required disclosures and those disclosures must be consistent and properly integrated into the appropriate documents.

Given the scope of this hearing, I could comment on literally dozens and dozens of topics affecting consumer protection and the used motor vehicle industry. However, I have limited my presentation to a few of the most compelling issues facing dealers today: warranties, the FTC Used Car Rule, financing, and tax treatment of anticipated revenue.

WARRANTIES

While there are many legal aspects to a traditional motor vehicle sale, one area that continues to pose significant legal compliance problems for dealerships and confusion for dealers and customers is warranties. While the concepts in this area are relatively straightforward, the issue becomes complicated because of the various federal and state regulations that often have an overlapping effect. See Attachments A and B. Because dealers are required to warrant their compliance with all applicable laws in lender/dealer agreements, including subprime lender agreements, and often are requested to warrant that the vehicle, which is the subject of the transaction, is in good condition, this area of the law merits significant attention in order to ensure compliance.

A warranty is a promise by a manufacturer or seller to stand behind its product. There are two types of warranties that businesses give consumers with the sale of a product, implied warranties and express warranties. Implied warranties are a creation of state law and are based upon the common law principle of "fair value for money spent." There are two types of implied warranties for consumer goods such as motor vehicles, merchantability and fitness for a particular purpose. An implied warranty of merchantability is a dealership's standard obligation when it sells a product and, unless properly disclaimed in states permitting disclaimers, it is made automatically with every product sold. In essence, this implied warranty is a promise that the product is in proper condition for sale, that it will function as intended and that there is nothing significantly wrong with the product. An implied warranty of fitness for a particular purpose arises when a consumer relies on the dealership's advice that a product can be used for a particular purpose. Implied warranties do not cover problems caused by abuse, misuse, wear or other factors not relating to the product's condition at the time of sale.

Many states, but not all, allow motor vehicle dealerships to limit or disclaim implied warranties. State laws also vary with respect to which implied warranties can be disclaimed and the manner of such disclaimer.

Generally, disclaiming implied warranties is accomplished by including a statement on the motor vehicle sales contract stating the dealer's intention to disclaim the implied warranties and sell the vehicle "as is," "with all faults," or by using other language that, in common understanding, calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty. Some state statutes provide that there is no implied warranty for defects that ought to have been discovered by a consumer if, before entering into the contract, the consumer has examined the vehicle as fully as desired or has refused to examine the vehicle and an examination would have revealed the defects.

In states that do not allow dealerships to disclaim all implied warranties, dealerships may still be able to disclaim one or the other. To exclude or modify the implied warranty of merchantability, the disclaimer language must mention the word "merchantability" and, if in writing, must be clear and conspicuous. To exclude or modify an implied warranty of fitness for a particular purpose, the disclaimer must be in writing and conspicuous. In any event, the disclaimer should be contained on the front side of the sales contract. If it must appear on the reverse side of the sales contract, language on the front side of the contract should be included informing the consumer that the warranty disclaimer does appear on the reverse side.

Unlike implied warranties that are automatically provided to the consumer unless disclaimed, an express warranty is an affirmative fact or promise made by the dealership's representative orally or in writing that relates to the goods and becomes part of the basis of the bargain. Both state and federal law govern express warranties. Again, dealerships must refer to their state statutes to determine how express warranties are created and disclaimed in their jurisdiction. If, however, a dealership offers a written warranty, it must also comply with the federal Magnuson Moss Warranty Act.

The general goal of the Magnuson Moss Warranty Act is to ensure that consumers get complete information about warranty terms for products they purchase. The Act covers virtually any "consumer product" and only applies to written warranties. The term "written warranty" means any undertaking in writing in connection with the sale by a supplier of a consumer product to refund, repair, replace or take other remedial action with respect to such product in the event that such product fails to meet the specifications set forth in the undertaking. The written affirmation, promise or undertaking must become part of the basis of the bargain between a supplier and a buyer for purposes other than resale of such product. Only the supplier actually making a written warranty is liable under the Act. A supplier who does no more than distribute or sell a consumer product covered by a written warranty offered by another person is not liable for failure of the written warranty to comply with the Act unless the supplier is deemed to have adopted the warranty.

The Act provides that, if a written warranty is offered, only necessary information should be included in a warranty document. Any extraneous material in a warranty may confuse consumers about the purpose of the document and about what it really covers. It also requires some very detailed information to be included in any written warranty, which must be disclosed clearly and conspicuously in a single document, in simple and readily understood language.

Two types of written warranties, full and limited, are defined in the Act. All warranties have to be prominently labeled as one type or the other. Indicating "full" on a warranty means a defective product will be repaired or replaced for free, including removal and reinstallation when necessary, and that the warranty extends to anyone who owns the product during the warranty period. If a full written warranty is provided, implied warranties cannot be disclaimed or limited to the duration of the warranty. Placing "limited" on a warranty means the warranty gives the consumer less than full warranty protection. By giving a limited warranty, the dealership is representing to consumers that there are some costs or responsibilities that are not undertaken by the dealership. Implied warranties can be limited in duration to the term of an express limited warranty.

If the foregoing is not enough of a problem, confusion for dealers and consumers often arises concerning the difference between a written warranty and a service contract. The term "service contract" means a contract in writing to perform over a fixed period of time, or for a specified duration, services relating to the maintenance or repair or both of a consumer product. It is sold to the consumer as an additional after-market product. A written warranty, as previously stated, must be part of the "basis-of-the-bargain." This means that it must be conveyed at the time of the sale of the consumer product and the consumer does not give any consideration beyond the purchase price of the consumer product in order to benefit from the agreement. It should be noted that an agreement that would meet the definitions of a written warranty as set forth under Federal Warranty Law, but for its failure to satisfy the basis-of-the-bargain test, is a service contract.

USED CAR RULE

Even if the rocky shoals of warranty law are successfully negotiated, dealerships must also comply with the Federal Trade Commission's (FTC or Commission) Used Car Rule. The FTC enacted the Used Motor Vehicle Trade Regulation Rule, more commonly referred to by the motor vehicle industry as the "Used Car Rule", in 1985.[1] The Used Car Rule requires used motor vehicle dealers to disclose information about warranty coverage, if any, on used motor vehicles they offer for sale. To convey such information to consumers, dealers are to display a Buyers Guide (Guide) that, among other things, discloses information about warranty coverage on each used vehicle offered for sale. A vehicle is considered used under the Rule if it has been driven more miles than are necessary to deliver it to an ultimate purchaser.[2] The Buyer's Guide must be prominently and conspicuously displayed on or in the used vehicle so that both sides are readable. The layout for the Buyer's Guide is set forth in the Rule. The dealership must use the wording, type style, type sizes and the format specified in the Rule. Furthermore, the Guides must be printed in one hundred percent black ink on white paper cut to at least eleven inches by seven and one-quarter inches. Colored ink may be used to fill in the blanks on the Guide.

Dealerships must give the buyer of the used vehicle a copy of that vehicle's Buyer's Guide at the time of sale. A signature line may be included on the Guide and the buyer may be asked to sign to acknowledge that he or she has received the Guide. If a signature line is included on the Buyer's Guide, a disclosure must also be included near the signature line that says, "I hereby acknowledge receipt of the Buyer's Guide at the closing of this sale." Additionally, the signature line must appear in the space provided for the name of the individual to be contacted in the event of complaints after the sale.

As part of its regular review of regulations and guidelines, the FTC has invited comment on whether the Rule should be revised to permit use of a single, bilingual Buyer's Guide and the possible design of a bilingual Guide. The Commission has also requested comment on the efficacy of retaining the current pre-printed list of major systems and defects that must be disclosed on the Guide. Finally, comment has been requested on the utility of developing alternative Buyer's Guides to assist in disclosing a dealer's own warranty, unexpired manufacturer warranties, manufacturer's used car warranties, and used car warranties provided by third parties other than the manufacturer. NIADA is committed to assisting the FTC in developing cost-efficient and common sense modifications to the Rule to accommodate both consumers and dealers and has submitted comments to the FTC regarding the proposed changes.

There is a continuing need for this Rule that has been in place for almost twenty-five years. In that time, dealers have developed procedures for compliance with the Rule and have used it to communicate information to customers. Further, the Guide has become part of the car shopping/selling process. It is a mechanism that dealers use to impart information to customers

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[1] 49 Fed. Reg. 45,692 (November 19, 1984).

[2] This creates the possible anomaly that a vehicle that is still on a manufacturer's certificate of origin, but has been placed in demonstrator service, must, under state and federal law, be listed on a purchase contract as a "new," "used," "demonstrator."

and that customers have become accustomed to receiving. As the Commission knows, one of the main uses of the Guide is to advise potential customers of the availability of warranty coverage, what is covered by the warranty and the duration of any warranty on a used vehicle. We believe that the availability of such information is valuable for customers and often assists in completing transactions because potential purchasers have more information about the vehicle being considered. The purposes of the Rule are being achieved every day in thousands of transactions. To abandon or fundamentally alter the Rule or the Guides would lead to less accurate disclosures and increase confusion among dealers and consumers.

By providing consumers information on the Guide concerning a vehicle's warranty or the fact the vehicle is being sold "AS-IS," the Rule enables consumers to obtain standardized, understandable information that can be used to compare vehicles and to assist in making a decision whether to purchase a vehicle.

There is support for minor modifications to the Buyer's Guide to reflect current market practices and allow used motor vehicle dealers to more fully and accurately disclose the panoply of warranties available in today's used motor vehicle market. The examples of modified Buyer's Guides, attached to the FTC's rulemaking Notice as Appendices A and B, propose an improved disclosure method and, with certain limited revisions, NIADA supports their adoption.

Part of the impetus for change is the development of warranty programs that did not exist when the Rule was adopted, e.g. dealers now offer a variety of "Certified Pre-Owned" programs to their customers. These programs offer a range of warranty protections from a variety of sources outside the dealer. Most motor vehicle manufacturers now offer certified programs on used vehicles of that manufacturers' make and that are sold by that manufacturer's franchised dealers. Beginning in the early 1990's, after the enactment of the Rule, these programs and the sale of certified used motor vehicles has grown dramatically. The proposed revisions to the Buyer's Guide address deficiencies in the current documents.

Subsequent to the Rule's enactment, there has been an explosion of Internet advertising across the full spectrum of commerce. This applies to all dealers. Virtually every one has a computer and the ability to develop, at a minimum, a limited website for the purpose of advertising inventory or may use a third party website. NIADA believes it would be advantageous to dealers and consumers for the dealer to be able to post **examples** of its Buyer's Guides along with its Internet advertising, e.g. to highlight "AS-IS," dealer warranty, or certified programs. Having an example of what a Guide would look like for each category (not for each vehicle in inventory) would enable dealers to get valuable information to potential customers in preparation for a visit to the dealership. NIADA believes providing an example Guide in this fashion is similar to the Magnuson-Moss Warranty Act[3] pre-sale availability requirement where dealers must have a representative example of a warranty document available for customers to review prior to entering into a transaction to acquire a motor vehicle.

State Unfair and Deceptive Acts and Practices statues often incorporate by reference Federal laws, thus leading to confusion about how warranties are explained. Conflict may arise, for example, where states may limit implied warranties or require that a dealer offer a minimum express limited warranty. Additionally, a dealer may offer an implied warranty only on certain

[3] 15 U.S.C. §§ 2301-2312.

systems for a limited length of time. The Buyer's Guide is currently not capable of accommodating all of these variables.

I am aware of some consumer advocates' dissatisfaction with the current state of the Used Car Buyer's Guide and now seek a radical makeover of the document. Essentially, these advocates desire to make the document a catchall for all types of information that was never intended to be in the Guide.

For example, it has been suggested that a revised Guide include lemon law notices and buyback information, vehicle history and title brand data, and odometer readings. Such broad expansion of the Guide is unwarranted and will lead to substantially increased costs for motor vehicle dealers. It will also place them in an untenable situation regarding enforcement because all of the information suggested for inclusion is not necessarily available to dealers on a real time basis.

Further, any suggestion that such information is readily available through vehicle history sources and through title records is disingenuous as such statements do not address the limitations on vehicle history services, including proposals such as NMVTIS (National Motor Vehicle Title Information System), and the lag time of title information.

Through NIADA, we have urged the FTC to remember that the Buyer's Guide is a warranty disclosure document, not a "tell me everything you know and don't know about a vehicle" document. The Guide is to advise if a warranty is available or not, who provides any warranty and the duration of such warranty, what is covered by any warranty and the identity of someone at a selling dealership to whom a customer may inquire or complain about warranty problems. The logic of this limitation is best understood against the backdrop of the vast array of state and federal consumer protection legislation that addresses virtually all of the other types of information that is now suggested as being "necessary" for inclusion on the Guide.

States deal with lemon law and buyback notices and there are federal and state odometer disclosure laws. All of this legislation requires information to be disclosed prior to the conclusion of a sale or lease of a new or used motor vehicle. To now require such information to be disclosed in another document and to go through the cost of reprogramming the Guide to accommodate all the required new information is a cost that is unnecessary and should not be imposed on dealers, as it will only be passed on to consumers in the cost of the vehicle.

It has been suggested that the FTC follow the model created by Wisconsin. That is a slope far too slippery to travel. Wisconsin's document resulted from a request to the FTC to permit an "exception" based on a unique set of state laws. To suggest that now be the model for the remainder of the country is an unwarranted intrusion on virtually every other states' decisions on how best to protect its citizens and, once again, creates an inordinate cost to dealers that would, ultimately, be passed on to consumers in the document of higher prices for vehicles.

The Commission has been urged to leave the Used Car Rule essentially as it is and not morph this long-standing effort into something it was never intended to be.

Generally, states deal very effectively with disclosure of information that might be revealed through a vehicle history report. If a dealer misrepresents the history or condition of a new or used vehicle, then a state's UDAP statute provides meaningful remedies to customers, both through individual and class actions and permitting recovery of treble damages and attorney fees.

As to vehicle history reports, I urge Congress and the FTC to exercise caution in considering this type of information. First, there should be no real debate that history reports of any type are only as good as the information contained in them. If the vehicle history provider has not acquired existing information or has acquired it but not yet placed it in its database, then a report obtained one day may appear to be "false" when reviewed the next day or the next hour after the information is uploaded into the provider's system. This shortcoming exposes dealers to real harm when subjected to litigation due to the absence of information from a report. There is no "safe harbor" for a dealer who acquires such a report and provides it to a consumer.

The same is true for NMVTIS. The system went live on January 30, 2009. However, it remains incomplete and, thus, totally ineffective. Much of the responsibility for collection and reporting of data remains with the states. Currently, only thirty-seven (37) states are involved, even on a limited basis, with NMVTIS. Only thirteen (13) states participate fully, fourteen (14) provide data on a more limited basis and only an additional ten (10) are taking steps to provide date or participate more fully. As long as even one state remains out of the system or is unwilling to require or to acquire and report data in a timely fashion, NMVTIS cannot be effective.

While the goal of NMVTIS is a worthy one, it requires cooperation of many entities, both state and federal. Even if all states someday participate fully, some data gaps will remain, i.e. private sales (estimated at 40% of all used motor vehicle sales annually), rental car sales and sales by other fleet operators that privately insure their vehicles. The number of vehicles involved is so significant that a dealer will not be able to guarantee to a customer that a particular vehicle has not been rebuilt or involved in a flood. Until all of the information gaps are plugged, there is no "safe harbor" for a dealer who acquires a vehicle history report and supplies it to a consumer.

FINANCING

NIADA has also been involved in reviewing and critiquing proposed regulations concerning "Risk-Based Pricing". NIADA commended the FTC and Federal Reserve Board for their genuine effort to create a workable regulatory scheme within the confines of an exceedingly challenging statutory mandate. However, as discussed below, NIADA believes the agencies have created a regulatory scheme that impermissibly and imprudently applies the risk-based pricing notice requirements contained in Section 311[4] on persons, such as automobile and truck dealers involved in three-party financing, who do not engage in risk-based pricing.

If the agencies retain in the final rule a regulatory scheme that imposes the risk-based pricing requirements on dealers who do not engage in risk-based pricing, the agencies should retain the exception notices set forth in the proposed rule subject to the modifications and clarifications set forth below. The agencies also should retain, subject to the same modifications and clarifications, the exception notices for dealers involved in two-party financing transactions who do engage in risk-based pricing.

[4] Section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act)(73 Fed. Reg. 28,966-29,021 (May 19, 2008); 73 Fed. Reg. 30,814-30,818 (May 29, 2008).

As a threshold matter, it is important to understand the respective functions typically performed by dealers and finance sources in two party and three-party vehicle financing transactions.

Most consumers who take delivery of a vehicle from a franchised automobile dealer will finance the purchase of the vehicle or enter into a lease agreement with the dealer. When the consumer makes arrangements to obtain financing for the purchase directly from a finance source (such as a bank, finance company, or credit union), the transaction is commonly referred to as "two-party financing" as the finance contract involves two parties -- the consumer and the finance source. Similarly, when the consumer obtains financing from a dealer that serves as its own finance source (often referred to as "buy-here, pay-here financing"), the transaction also is referred to as two-party financing as the finance contract in this instance also involves only two-parties -- the consumer and the dealer.[5]

Most finance transactions involving dealers include three parties – the consumer, the dealer, and the assignee-finance source that may include subprime lenders -- and thus are commonly referred to as "three-party financing." In typical three-party financing transactions, the consumer enters into a finance contract with the dealer that is conditioned on a finance source's willingness to take assignment of the finance contract from the dealer. If the dealer cannot secure such an agreement from a finance source, then the finance contract is not consummated. This arrangement is necessary, as most dealers are not equipped to serve as their own finance source.

The typical three-party financing transaction begins with the consumer providing the dealer with a completed credit application that authorizes the dealer to (i) obtain a copy of the consumer's credit report, and (ii) submit the consumer's credit application to finance sources (with which the dealer has a contractual relationship) to determine which of them may be willing to take assignment of a credit contract between the dealer and the consumer. The dealer obtains the credit report to determine which of its finance sources to send the credit application based on the finance source's lending guidelines.[6]

The finance sources that receive the credit application then perform underwriting to determine the credit risk presented by the credit applicant. As part of this process, the finance sources typically obtain their own credit report, which may be from a credit-reporting agency different from the credit reporting agency used by the dealer. The finance sources' underwriting analyzes risk-based factors, such as loan-to-value and debt-to-income ratios, verification of employment, and routine entries on the applicant's credit report (e.g., credit score, number of delinquent accounts, bankruptcy filings, etc.). If a finance source agrees to buy a finance contract from the dealer, it will offer the dealer a wholesale buy rate that reflects the credit risk presented by the applicant.[7]

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[5] Albeit uncommon, another variety of two-party financing occurs when a dealer arranges financing directly between the consumer and the finance source. When this occurs, the finance source (and not the dealer) acts as the initial creditor.

[6] Although not typical, some franchised dealers do not obtain a credit report and some only have a contractual relationship with a single finance source.

[7] Other factors unrelated to risk also contribute to the buy rate such as the cost at which the finance source acquired the funds, the finance source's underwriting costs, and its profit.

The dealer does not repeat the costly underwriting process engaged in by the finance source, but rather negotiates with the consumer to determine the amount of its retail margin on the financing it provides (similar to the manner that it negotiates the amount of the retail margin on the vehicle it provides). The dealer thus does not establish its retail margin (which, in the vehicle financing context, is commonly referred to as "dealer participation" or "dealer reserve") according to a proprietary or other system or methodology to assess the risk of nonpayment by the consumer. On the contrary, the dealer determines its dealer participation based on factors such as the extent to which it can offer a competitive rate, its desire to sell a particular vehicle, its efforts to develop and maintain customer loyalty (each of which can result in no dealer participation at all), etc. Thus, whereas the finance source sets a buy rate that, in part, reflects the risk of non-payment by the consumer, the dealer sets dealer participation based on a variety of non-risk factors.[8]

TAX ISSUES

The last issue I want to discuss involves a plan to aid in reversing the motor vehicle industry's downward fiscal spiral. The President and this Subcommittee are searching for the right ingredients for an economic stimulus package to strengthen the economy. Although there has been a great deal of discussion about spending billions of dollars to accomplish this task, there is a viable partial solution that would cost taxpayers virtually nothing by being "revenue neutral," i.e. restoring the cash method of accounting for installment sales of used motor vehicles.

The motor vehicle industry has a significant impact on our economy. It impacts millions of jobs in America and even those Americans who do not work in the motor vehicle industry use a motor vehicle on a daily basis, most of them to get to work.

Congress has considered numerous programs to help the economically disadvantaged, but in all of these programs a single question remains unanswered: How do they get to work? Whenever individuals lose their jobs, regardless of whether it is due to corporate downsizing, health problems, or another reason beyond their control, it is typical for their credit to become impaired. The number of Americans with impaired credit that cannot obtain conventional financing is steadily growing. This fact, combined with the trend of various subprime lenders exiting the financing market for purchases of used vehicles, makes the situation even more disconcerting. It is becoming extremely difficult for individuals with impaired credit to find and obtain affordable transportation.

One of the few places credit impaired consumers have to turn is a motor vehicle dealership that is willing to finance the consumer's purchase itself. What is the dealership's reward for helping consumers get much needed transportation and providing financing when no one else will? They are obligated to pay tax in advance on anticipated revenue that has not been received and, in many cases, will never be received. Rather than being faced with such a huge disincentive, motor vehicle dealerships should be provided with an incentive to help individuals finance these transactions.

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[8] To be sure, in many dealer agreements with their finance sources, dealers are exposed to the risk of loss in the early stages of an assigned credit contract. However, dealers do not set or adjust dealer participation based on the risk of nonpayment by the consumer. As discussed above, this risk already is accounted for in the buy rate that is set by the finance source after the application of its underwriting process.

Allowing motor vehicle dealers to use the cash method of accounting or something similar would not only help provide a boost for our weak economy by aiding motor vehicle dealers, it would also give more economically disadvantaged individuals access to much needed transportation.

In the not too distant past, the Internal Revenue Service (IRS) released Revenue Procedure 2000-22, which allowed certain taxpayers with gross receipts of $1 million or less to use the cash method of accounting. In December of 2001, the IRS released a Notice of a Proposed Revenue Procedure, Notice 2001-76, in which it has proposed to exercise its discretion to allow certain business taxpayers with gross receipts of $10 million or less to use the cash method of accounting. Unfortunately, the IRS specifically excluded retail sellers that engage in installment sales, including motor vehicle dealers, from availing themselves of the benefits of the cash method of accounting. It is unclear why motor vehicle dealers are prohibited from utilizing this accounting method, when the IRS is making it available to other small businesses. At a minimum, a tax procedure equivalent to the cash method of accounting for installment sales of used motor vehicles that permits the taxing of income in the year it is earned should be restored to level the playing field.

In addition to the foregoing, there is another reason to permit the use of some form of an installment or cash method of accounting to spur the sale of used motor vehicles. By increasing the ability for dealers to sell vehicles at the lower end of the used vehicle price spectrum, dealerships will be able to create an outlet for the late model trade-ins. If we want to keep individuals employed manufacturing and selling new vehicles, we have to make sure they can sell the trade-in vehicles. If they are unable to do so, the number of new motor vehicles manufactured will decrease significantly causing a very negative ripple effect throughout the entire motor vehicle industry and on our nation's economy.[9]

Considering the overall positive impact that restoring the cash method of accounting for installment sales of used motor vehicles would have on the motor vehicle industry and our nation's economy, not to mention individual purchasers, the case for bringing it back is strong. More consumers would have access to affordable transportation and the means to finance the purchase of a used motor vehicle. Affordable transportation is a necessity, not a luxury, in today's world and ensuring everyone has access to transportation to get to and from work will certainly help improve the success rate of various federal programs.

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[9] Tax treatment of dealership revenue, the ability of dealers to finance their motor vehicle inventory and consumers' ability to finance their purchases are all critical elements of the motor vehicle industry. The system becomes disrupted in difficult times such as these due to the limited ability to obtain financing for inventory and for a used vehicle purchase. If, as NIADA believes, one of the goals of this hearing is to understand the relation of consumer protection and used motor vehicle financing, then it is imperative that the Sub-Committee understand the negative effect on motor vehicle sales caused by the lack of financing at both the wholesale and retail levels. If a dealer cannot obtain satisfactory floor plan financing, then it cannot stock the type of inventory that is appealing to customers. For example, if a dealer cannot obtain financing for its inventory, it will stock fewer vehicles and consumers will be left with more limited choices of vehicles to purchase. Additionally, if the customer cannot obtain financing for the purchase of a 7-10 year old vehicle, then there will be attrition in the market of what vehicles are available and who can purchase them, leaving many people with no viable transportation option to get to and from work. Making the foregoing types of transactions a possibility leads to the possible sale of later model vehicles also. Instead of backing up on dealer lots because the older vehicles are not selling, later models now become available because customers' trade-ins are worth more, permitting them to invest more equity toward the purchase of a more recent model year or new vehicle.

Due to our current financial crisis, most, if not all, Americans are having to make major adjustments in their daily lives. Many people believe that our Country will never be the same. Change can be a positive thing, however, if our Country grows stronger and becomes more unified in the process. Virtually everyone agrees- heads of industry, consumer groups, economists, Republicans and Democrats alike -that our economy needs to be rejuvenated. To date, the focus of the debate has been on how much money to spend and how to spend it. Recognizing that it is always important to spend taxpayers' dollars wisely, solutions that do not require large expenditures of tax dollars should be considered first. As a result, some version of the cash method of accounting for installment sales of used motor vehicles should be restored immediately.

Sincerely,

/s/ *Keith E. Whann*

Keith E. Whann, Esq.
Outside General Counsel for the
National Independent Automobile Dealers Association

Attachments: A (Laws Impacting Used Car Sales and financing Paperwork and Practices)
B (Documents Typically Found in a Used Motor Vehicle Transaction)