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Volume 42
Issue 15
September 2019

Questions? Contact the Compliance Hotline!

Monday-Friday, 9 a.m.-5 p.m. (PT)

Phone: (800) 785-2880, Select Option 4 | Email: questions@autoadvisory.com

How Are We Doing?

We are always looking for ways to improve. Please take a minute or two to tell us what we can do to make KPA Transmission a better resource for you.

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Downpayments from Third Parties

by Robert Ebin

For me as a kid, September signified the beginning of the new school year. I vividly remember driving to college with my parents in an SUV packed full of my things ready to be moved into my dorm room. I remember one of my roommates mentioning that his parents had helped him put a downpayment on his new car as a going-away present. This story (along with some recent Hotline calls) provides a good opportunity to discuss the potential pitfalls of accepting third-party downpayments.

What is a “Downpayment”?

Regulation Z defines a downpayment in pertinent part as “an amount, including the value of property used as a trade-in, paid to the seller to reduce the cash price of goods or services purchased in a credit sale transaction.” [12 CFR § 226.2(a)(18)]. California law, however, has a slightly more specific definition: “Downpayment means a payment that the buyer pays or agrees to pay to the seller in cash or property value or money’s worth at or prior to delivery by the seller to the buyer. . .” [Civil Code § 2981(f)]. The major difference between the two definitions is that California law specifies that the downpayment is to be paid by the “buyer,” whereas Regulation Z does not specify where the downpayment comes from.

So, does this mean that a downpayment in California must come from the buyer? This issue has never been officially opined on, and likely this would not be the case. Everyone in the auto industry probably remembers at least one deal where a downpayment was tendered by a third-party not on the contract. Statutory issues aside, there are many other reasons why we recommend against accepting a downpayment directly from a third-party.

Potential Pitfalls

Lender Agreements

Most lender agreements require that the dealer ensure that the downpayment was received from the buyer. Accordingly, if there is such a provision in your master lender agreement, accepting a downpayment from a third-party likely breaches the agreement. As we are all aware, a breach of the agreement can, and many times does, result in a demand from the lender to repurchase the contract.

Regulatory Compliance Issues

Third-party downpayments also spawn a variety of potential compliance problems. Two of the more common ones I have seen are failing to run an OFAC check for the third-party and failing to complete Form 8300.

Remember, that you must run an OFAC check for each party involved in each transaction. Many dealers now run OFAC checks as part of their credit checking process. While this is an excellent procedure to follow, an issue lies where no credit check is run for a customer, and ergo no OFAC check either. In the case of a third-party downpayment, many dealers erroneously fail to run an OFAC check on the third-party for this very reason.

Dealers also forget to fill out (or improperly fill out) an IRS Form 8300 when receiving a cash downpayment from a third-party over \$10,000. Some dealers may incorrectly believe that Form 8300 wasn’t necessary for these situations because the third-party was not the contracting customer. I have also heard that some dealers neglect to put either the third-party or the contracting customer on Form 8300. Recall that Part I of the form requires the dealer to fill out information on the identity of the individual from whom the cash was received, and Part II requires information on whose behalf the transaction was conducted.

Ownership Issues

Another reason why accepting third-party downpayments is not advisable is because it further complicates financial transactions when something goes wrong. Perhaps the best way to illustrate this is with a few scenarios:

Scenario 1

A Boyfriend and Girlfriend come into the store and want to buy a vehicle for Girlfriend, who is going back to college after summer break. As a symbol of his undying love, Boyfriend insists on paying the \$2,500 downpayment on the vehicle and hands the green cash directly to the salesman. However, only the Girlfriend is named as the buyer on the sale contract.

Over the next holiday break, Girlfriend returns from college to surprise Boyfriend. However, she sees Boyfriend out with another girl and breaks up with Boyfriend. Boyfriend

demands that Girlfriend give him his “half of the vehicle,” but Girlfriend refuses and drives the vehicle back to her college. Boyfriend then runs back to the dealer and demands the return of “his” downpayment. The dealer politely refuses, which infuriates Boyfriend, who then seeks out a local consumer attorney. Boyfriend swears that he thought he was part owner of the vehicle and that he would be included on the vehicle’s registration. After receiving a nasty demand letter from the attorney, the dealer interviews the salesman involved in the transaction who does not remember it at all, since it was during the hustle and bustle of the long Labor Day weekend.

Scenario 2

Son (an adult) and Father go into the dealer to buy a vehicle for Son. Father wants to put the \$2,500 down payment on the vehicle for Son and writes a check to the dealer. Father and Son do not want Father to be on contract because Son wants to be “responsible” for the vehicle. Dealer spot delivers the vehicle to Son, but a few days later, the dealer sends out a 10-day letter because Son has not been so “responsible” in the past with his finances and no lender would purchase the contract. Son agrees to bring the vehicle back but insists that the refunded downpayment be given directly to him and not to Father. Father, who had a falling out with Son after finding out how irresponsible Son was with his finances, demands that the downpayment be returned to him since he was the one who wrote the check.

Types of Downpayments

Cash or Cash Equivalent

If a third-party is making a cash downpayment for the contracting party, rather than accepting funds directly from the third party, the third-party should hand the cash first to the contracting party. The contracting party should then hand the cash over to the dealer. The dealer should issue a receipt in the contracting party’s name only. In Scenario 1 above, Boyfriend should have first given the cash to Girlfriend; the dealer should have accepted the cash from Girlfriend (the contracting party) and issued a receipt only to Girlfriend. These steps would make any potential claim to the downpayment by Boyfriend very weak.

What about situations where a check or credit card is used by the third-party? Rather than having the third-party issue the check to the dealer or swipe the credit card, the third-party should send funds directly to the contracting party first, and then the contracting party should issue payment to the dealer. In today’s world, the third-party could utilize electronic payment transfers, such as PayPal, Venmo, or Zelle. The contracting party then would pay the dealer via cash, check, credit card, etc. The dealer here should also issue a receipt in the contracting party’s name only.

Third-Party Trade-In

The same general logic should be applied here as above. The dealer should avoid accepting a trade-in vehicle from anyone other than a party on the contract. In this situation, the dealer should consider doing a “multiple transfer,” which ensures that the trade-in is first transferred to the contracting party before being transferred to the dealership.

In addition to the basic transfer requirements in the [DMV Vehicle Industry Registration Procedures Manual Chapter 11.015](#)], the dealer must follow the procedures for a multiple transfer in the [DMV Vehicle Industry Registration Procedures Manual Chapter 11.115](#).

Note: We strongly recommend not doing a multiple transfer of a trade-in vehicle where there is a lienholder and/or payoff remaining on the vehicle. These transactions can get extremely messy and complicated should there be an unwind. In addition, when there is negative equity involved, including a lien balanced owed by an unrelated party in the amount financed could be considered a misrepresentation to the current lender.

Best Practices

- Make it a policy not to accept downpayments from someone who is not on the

contract. If possible, consider adding the third-party as a co-buyer on the contract if that party is tendering the downpayment. If this is not possible, have the third-party give the funds to the contracting party, and then accept the downpayment directly from the contracting party.

- Do not accept a trade-in from a third-party. Either add that third-party to the contract or perform a multiple transfer. Do not perform a multiple transfer where there is a lienholder on the trade-in vehicle.
- Avoid straw purchases (does not apply to all-cash deals). For more on this, please refer to the other article in this month's newsletter called "Buying a Vehicle for Others."
- If "kicking off" someone from a deal because of bad credit, consider obtaining a statement of facts from the person acknowledging that s/he is not purchasing the vehicle and will not be on the registration or title of the vehicle. Also, don't forget the adverse action notice.

Questions?

If you have any questions regarding this issue or any other situation that may arise in your sales or service departments, hotline clients are invited to contact us at [\(800\) 785-2880](tel:8007852880) (then press "4" for hotline) or hotline@autoadvisory.com.

Buying a Vehicle for Others by Hao Nguyen

Oh September. Some remember dancing in September (Earth, Wind & Fire), some can't wait for September to end (Green Day), and some see it as a brief reprieve from their children as they begin school again (almost all parents out there). Ever thought buying a new vehicle would be part of the "back to school" list? It happens more often than you would think and most dealers are unsure of what to do when a parent wants to purchase a vehicle for their child (and even more so when the parent does not want to be on the registration). With this edition's lesson plan on third-party transactions set, please take your seats, class is now in session.

Third-Party Purchasers

A father and his son come into your dealership. The father wants to purchase a vehicle for his son as he starts his senior year in high school. However, partly to teach his son about responsibility (and partly to save some money on a vehicle that would undoubtedly get beaten up), the father said that he would only purchase his son a used vehicle. There are three possible routes that this transaction could take. We will discuss them below.

Father Purchases the Vehicle in All Cash

There is nothing that prevents the father from purchasing the vehicle for his son in a true all-cash deal. There is no lender or financing company to worry about in these situations, nor has anyone applied for credit.

However, questions could potentially arise about the registration. If the father does not want to be on the registration, the dealership should take extra steps to protect itself from potential headaches. Without documentation of the father's request, nothing stops either the father or the son from claiming that the dealership improperly left the father's name off the registration. Therefore, we recommend that the buyer (father) and future registered owner (son) document this arrangement and registration instructions on a DMV Form REG 256 (Statement of Facts). Keeping a copy of this in the deal jacket would ensure that neither of the parties will claim that the dealership's actions were improper in the future. Here is some sample language:

"I, [Father] am purchasing this vehicle for [Son], and I have instructed the dealership employees to register and title the vehicle solely in [Son]'s name. I understand that I will have no ownership rights in this vehicle."

[Signature block for both people]

Another avenue for the registration to be solely in the son's name, would be for the father to transfer the vehicle over to the son once the vehicle was purchased by and registered to the father. For the transfer to be exempt from use tax, the DMV requires that the application for transfer include a REG 256 to show the relationship between the two parties.

Father Purchases the Vehicle on a One Pay Deal

If the transaction is done through a method other than green cash, wire transfer, or ACH for the full purchase of the vehicle (i.e., a personal check) and the deal will be a one pay deal, proceed with caution. A story here would help. Known loosely as the "Elvis Principle," Elvis Presley was known to be an avid fan of Cadillacs. Legend has it that Elvis purchased as many as 100 new Cadillacs over his career as gifts for employees, relatives, and close friends (and even his karate instructor!). What if an Elvis impersonator, bent on recreating the magic of the King of Rock and Roll, came to your dealership with a personal check for a new Cadillac for his dog walker? The dealership will want to protect its contractual right to repossess the vehicle if the check bounces. If the dog walker is the registered owner but does not appear anywhere on the contract, then, arguably, the dealership may not be entitled to repossess the vehicle in the event of a default.

Going back to the father-son scenario, to prevent this situation from ever happening, the father should complete the contract as usual. Additionally, the son (who is the registered owner) should sign the contract as a co-buyer or "other owner" of the vehicle. The "other owner" signature line is towards the bottom of the LAW 553-CA-ARB form above the Guaranty box. The son's signature here gives the dealership security interest in the vehicle and a contractual right to repossess the vehicle if the father's payment is dishonored.

Father Finances the Purchase of the Vehicle

Nope, can't do it. The dealer will not be able to register the vehicle in the name of a third party without violating its agreement with the finance company. This is true even for leases. It's a "straw purchaser" issue as lenders generally require dealers to warrant that the purchaser identified on the contract is the intended driver of the vehicle. If lenders find out the transaction was a straw purchase, and that another party is driving the vehicle, the lender may require the dealer to buy back the contract. It also may be seen as the customer submitting a false credit application, which is a felony, and a situation in which the dealership does not want to be involved. Federal law states that whoever knowingly makes any false statement or report, or willfully overvalues property or security, for the purpose of influencing in any way the action of a Federal Reserve bank, a federal credit union, an insured state-chartered credit union, or any institution the accounts of which are insured by the Federal Deposit Insurance Corporation upon any application, purchase agreement, commitment, or loan shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both. [[18 USC § 1014](#)]. Save yourself the headache (and potential jail time) and pass on any of these situations.

For the father to finance a purchase of the vehicle for his son, the son must be a part of the transaction and named on the contract as a co-buyer.

What if the Father Secured a Loan Through a Credit Union?

The same situation regarding false credit applications may apply, and additional risks involving bank fraud may arise. Federal law states that whoever knowingly executes, or attempts to execute, a scheme to defraud a financial institution, or obtain any of the moneys, funds, credits, assets, securities, or other property own by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses shall be fined no more than \$1,000,000 or imprisoned not more than 30 years, or both. [[18 USC § 1344](#)]. Even if the customer tells you that the credit union knows about this arrangement, it is best to not be involved.

Questions?

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