

DEMONSTRATOR USE

[The following was received via facsimile from Paul D. Metrey, NADA Legal & Regulatory Group, August 26, 2002 to be used as a brief article for State and Metro Auto Trade Association Executives' publications that announces NADA's release of A Dealer Guide to the Federal Tax Treatment of Demos.]

NADA Releases Publication Explaining New IRS Demo Rules

NADA recently sent to its members a comprehensive revision of its Management Education publication entitled A Dealer Guide to the Federal Tax Treatment of Demos (L.17). The re-write was prompted by IRS Revenue Procedure 2001-56, which created for tax years beginning January 1, 2002 several optional simplified methods for valuing the use of demonstration vehicles by full-time salespersons and other dealership employees. The IRS developed the revenue procedure after NADA and two dealer accounting firms argued for more streamlined procedures that would reduce the audit exposure of dealers who make demos available to their employees.

Among the optional methods created by Revenue Procedure 2001-56 are: (i) a simplified full exclusion from income method for qualified demo use by full-time salespersons (which defines "limited personal use" as commuting distance plus an average of 10 miles per calendar day, specifies the mileage substantiation requirement and requires dealers to verify that the salesperson's personal use is within the prescribed mileage limits on at least a monthly basis); (ii) a simplified partial exclusion from income method for qualified demo use by full-time salespersons (which removes the mileage limitation on personal use and the need to substantiate the personal miles driven by the salesperson provided the dealer adds to the salesperson's income on at least a monthly basis an amount for "non-deductible personal use"; and (iii) a simplified full inclusion of income method for demo use by any employee (which permits dealers to use the average selling price of vehicles from the previous calendar year to determine the demo value that is plugged into the Annual Lease Value Table (regardless of the value of the demo actually driven by the employee) – mileage records are not required, deductions for business use are not permitted and the value of the demo use must be added to the employee's income on a least a monthly basis). The NADA publication describes the new methods in detail and compares them to the other existing methods for valuing demo use that are authorized in the Internal Revenue Code and its implementing regulations.

A particularly noteworthy feature of Revenue Procedure 2001-56 is that it permits dealers to correct error that occurred under the simplified methods provided the correction occurs in the same year as the error(s). This is only available for the simplified full and simplified partial exclusion methods if the dealer had in place and communicated to its salespersons at the time the error occurred the written demo policy that is required by these methods (this restriction does not apply to the simplified full inclusion method since that method does not require a written demo policy). Dealers therefore should review the requirements of these methods and make the appropriate corrections prior to the end of each calendar year.

Additional copies of the publication may be ordered from the NADA Management Education office by calling (800) 252-NADA, ext. 2, or (703) 821-7227.