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IRS Simplifies and Clarifies Recordkeeping for Demos

The IRS issued Revenue Procedure 2001-56, effective January 1, 2002, which provides dealers with simplified methods for determining the value of the use of demonstrator vehicles provided to employees.

Two methods are available for full-time salespersons: the Full Exclusion Method and the Partial Exclusion Method. The Full Inclusion Method is available for part-time and non-salespersons. We recommend that dealers abandon previous methods and use the Partial Exclusion Method for full time salespersons and use the Full Inclusion Method for all other employees.

Full Exclusion Method - Under this method, the dealer is required to have a qualified written policy limiting the use of the vehicle. This means that only the full-time salesperson (no family members or friends) may use the vehicle, no personal vacation trips allowed, no storage of personal possessions in the vehicle, and mileage outside of normal business hours is limited. Further, the dealer must reasonably believe the salesperson is in compliance with such policy and must determine, no less often than monthly, that the personal use of the vehicle did not exceed an average of ten miles per day each calendar month. This method requires mileage record keeping. Also, if the personal use exceeds the average of ten miles per day, use of the Full Exclusion Method is not allowed. Monthly records are required to be maintained for each vehicle. Downey & Co. feels that this method is generally not practical due to the strict record keeping requirement and recommends the Partial Exclusion method.

Partial Exclusion Method - Under this method, the dealer is required to have a qualified written policy limiting the use of the vehicle. This means that only the full-time salesperson (no family or friends) may use the vehicle, no personal vacation trips allowed, no storage of personal possessions in the vehicle. The mileage outside of normal business hours is not limited. Further, the dealer must reasonably believe the salesperson is in compliance with such policy and, lastly, must include in gross income, no less often than monthly, an amount specified in the inclusion table provided by the IRS. Key features to this method, aside from its simplicity, is that the inclusion amount is substantially less than those under the annual lease value table and no mileage record keeping is required. The IRS offers the Annual Average Look Back Method to simplify the calculation of the value of the demonstrator vehicle. This calculation must be done in January of each year and applied no later than February of that year. This calculation calculates the value of the demonstration automobile based on the average sales price of all vehicles sold in the prior year. If you have new and used demonstrator vehicles the calculation should be made for each category. For example, under this scenario, a vehicle value between \$15,000 and \$29,000 would generate \$2,190, or \$6 per day, to be included in a salesperson's income per year. Downey & Co. feels that this method produces the most desirable result in that the record keeping requirements are at a minimum, and a minimum compensation amount is included in the salesperson's income. We have made available an example of an agreement that should be signed annually by fulltime sales persons with demo vehicles. This can be found at our website at www.downeycocpa.com. Each dealership will have additional restrictions and or requirements for employees with demonstrators and those conditions should be included in a separate document.

Full Inclusion Method - Under this method, the dealer is required to include in non, or part-time salespeople's gross income (no less than monthly) the daily inclusion amount specified in the annual lease table using the value of the demonstrator vehicle (see our web site for a copy of this table). If under the Average Look Back Method described in the previous paragraph the vehicle value is \$25,000, \$6,935 annually or \$19 per day, should be included in a non, or part-time salesperson's income. Under the full inclusion method, the only documentation to be maintained is the back up for the average look back calculation and the evidence that the amount is included the employee's income, no less than monthly. The IRS does not require an employee that is taxed under the full inclusion method to sign a demonstrator agreement.

If you would like more information regarding these methods, please e-mail Paul McGovern at pmcgovern@downeycocpa.com or call 781.849.3100.

Visit our web site at www.downeycocpa.com

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