DOWNEY & COMPANY, LLP

IRS Simplifies and Clarifies Recordkeeping for Demos

The IRS issued Revenue Procedure 2001-56, effective January 1, 2002, which provides dealers with additional optional simplified methods for determining the value of the use of demonstrator vehicles provided to employees. The previous methods continue to be acceptable and available for use by the dealer.

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) 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 limited the use of the vehicle as described above, however, 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. 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.

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 greater of $3 per day, or the pro rata portion of the amount specified in the annual lease table using the value of the demonstrator vehicle. If under the Average Look Back Method described in the previous paragraph the vehicle value is $25,000, $6,935 would have to be included in a non, or part-time salesperson's income per year. 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.

If you have any questions regarding this article or any dealership management issues, please contact Paul McGovern at PMcGovern@DowneyCoCPA.com or 800-849-6022.