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SECTION 1. PURPOSE AND SCOPE

Q-1. What is the purpose of this revenue procedure?

A-1. This revenue procedure provides optional simplified methods for determining the value of the use of demonstration automobiles provided to employees by automobile dealerships. The methods in this revenue procedure include —

- *Simplified Method for the Full Exclusion of Qualified Automobile Demonstration Use. (Simplified Out/In Method)* This is a simplified method for keeping records to support the full exclusion of the use of a demonstration automobile from the income of a full-time automobile salesperson. This method is discussed in section 4, Questions and Answers 11 through 25.
- *Partial Exclusion of Demonstration Automobile Use by Full-Time Salespeople.* This is a simplified method for

determining the excludible business use of a demonstration automobile provided to a full-time salesperson and the amount included in income if the full exclusion is not applicable. This method is discussed in section 5, Questions and Answers 26 through 39.

- *Inclusion of the Value of Demonstration Automobile Use When No Exclusion Applies.* This is a simplified method for determining the amount to be included in income of any employee provided the use of a demonstration automobile if neither the full nor partial exclusion for full-time salespeople is available. This method is discussed in section 6, Questions and Answers 40 through 47.
- *Application of General Rule When Methods in Revenue Procedure are Not Used.* Question 51 in section 7 provides that if the requirements of the simplified methods provided under this revenue procedure are not satisfied, generally the amount required to be included in an employee's income is the fair market value of the use of the demonstration automobile. Question 51 also provides that if errors are identified and corrected during the calendar year in which the vehicle is provided, an employer may continue to use the simplified methods under this revenue procedure.

This revenue procedure is designed to provide a comprehensive framework for addressing the tax treatment of demonstration automobiles provided by automobile dealers to employees. The simplified methods have been structured sequentially so that if the use by an employee does not qualify for treatment under one method, the use can nonetheless be taken into account under a subsequent method with no additional recordkeeping or change in determination period. For example, if the use of a demonstration automobile by a full-time salesperson fails to qualify for full exclusion under the simplified full exclusion method, the use may still be accounted for under the partial exclusion method based on records otherwise available or already maintained under the full exclusion method. At the same time, employers can choose to use the partial exclusion method immediately for all full-time salespeople without first attempting to satisfy the requirements of

the full exclusion method. Moreover, an employer can choose to apply the different optional methods on an employee by employee basis. Thus, if some employees are unwilling to maintain the records necessary to satisfy the full exclusion method, the employer can account for their use under the partial or full inclusion methods while still retaining the ability to use the full exclusion method for the other employees.

Q-2. Who may use the simplified methods in this revenue procedure?

A-2. The simplified methods provided in this revenue procedure are available to any automobile dealer engaged in the business of retail sales of new or used vehicles described in Question and Answer 3.

Q-3. What vehicles are demonstration automobiles that qualify for the simplified methods?

A-3. The application of the simplified methods provided in this revenue procedure for determining the tax-treatment of employer-provided vehicles is limited to demonstration automobiles as defined in Treas. Reg. § 1.132-5(o)(3). That regulation requires that the vehicle be currently in the inventory of the automobile dealership and be available for test drives by customers during the normal business hours of the employee provided its use. For purposes of this revenue procedure, demonstration automobiles can include passenger vans, sport utility vehicles, and light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2, or 3 trucks.

Q-4. For which employees can the simplified methods be used?

A-4. The application of the simplified methods provided in this revenue procedure for the full or partial exclusion of demonstration automobile use is limited to use by full-time salespeople as defined in Treas. Reg. § 1.132-5(o)(2). That regulation requires that the individual be employed by an automobile dealer, customarily spend at least half of a normal business day performing the functions of a floor salesperson or sales manager, directly engage in substantial promotion and negotiation of sales to customers, customarily work a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year),

and derive at least 25 percent of gross income from sales activities.

The simplified method for full inclusion may be applied with respect to the use of a demonstration automobile by any employee of an automobile dealer.

Q-5. Does this revenue procedure describe all of the methods for determining and substantiating the value of the use of demonstration vehicles provided to employees by automobile dealerships?

A-5. No. An automobile dealer is not required to use the optional simplified methods described in this revenue procedure. An automobile dealer may use any other applicable method that complies with the Internal Revenue Code and Treasury regulations to account for the use of demonstration automobiles by employees.

SECTION 2. BACKGROUND

Q-6. What provisions of the tax law may apply to a vehicle provided to an employee by an employer?

A-6. In general, section 61(a)(1) of the Internal Revenue Code (the Code) provides that gross income means all income, including compensation for services. Fringe benefits are specifically listed as an example of compensation for services. The examples of fringe benefits under Treas. Reg. § 1.61-2T(a)(1) include an employer-provided automobile.

However, section 132(a) of the Code permits certain fringe benefits, including working condition fringes, to be excluded from gross income. In certain circumstances, all or part of the value of the use of an employer-provided automobile may be a working condition fringe.

Q-7. When is the use of an employer-provided automobile a working condition fringe?

A-7. Section 132(d) of the Code generally defines a working condition fringe as any property or services provided to an employee by an employer to the extent that, if the employee paid for such property or services, the payment would be allowable as a business expense deduction. Thus, generally any business use of an employer-provided vehicle, including a demonstration automobile, by any employee is a working condition fringe.

In addition, section 132(j)(3) of the Code specifically provides that “qualified automobile demonstration use” by a full-

time automobile salesperson is treated as a working condition fringe.

However, regulations related to working condition fringe benefits at section 1.132-5(c)(1) generally provide that working condition fringe benefits may not be excluded unless the substantiation requirements of either section 274(d) or section 162 and corresponding regulations are satisfied. Thus, even if business use of an employer-provided vehicle is a working condition fringe, it may not be excluded from the employee’s gross income unless that business use is properly substantiated.

SECTION 3. FULL EXCLUSION FOR QUALIFIED AUTOMOBILE DEMONSTRATION USE

Q-8. What is the full exclusion for qualified automobile demonstration use?

A-8. As noted above, section 132(j)(3) specifically provides that “qualified automobile demonstration use” is treated as a working condition fringe. Generally, “qualified automobile demonstration use” is the use of a demonstration automobile by a full-time salesperson if the specific restrictions described in Question and Answer 9 are observed. If there is “qualified automobile demonstration use,” the value of the use of the demonstration automobile is excluded from the full-time salesperson’s wages. As a result, the salesperson will not owe income or FICA taxes on the value of use and the employer will not be required to withhold income taxes or pay FICA taxes with respect to the value of the use.

Q-9. What are the requirements for the full exclusion of automobile demonstration use by a full-time salesperson?

A-9. The requirements for the full exclusion of automobile demonstration use by a full-time salesperson contained in section 132(j)(3) of the Code are as follows:

a. The use must be in the sales area in which the automobile dealer’s sales office is located.

b. The use must be provided primarily to facilitate the salesperson’s performance of services for the employer.

c. There must be substantial restrictions on the personal use of the automobile by the salesperson.

Under Treas. Reg. § 1.132-5(o)(4), substantial restrictions on the personal use of a demonstration automobile exist when all of the following conditions are satisfied:

a. Use by individuals other than the full-time salesperson (e.g., the salesperson’s family) is prohibited;

b. Use for personal vacation trips is prohibited;

c. The storage of personal possessions in the automobile is prohibited; and

d. The total use by mileage of the automobile by the salesperson outside the salesperson’s normal working hours (“personal use”) is limited.

To use the simplified full and partial exclusion methods contained in this revenue procedure, the employer must also have a written policy limiting the use of the demonstration automobile. To use the full exclusion method, the employer must also determine that the personal use of the vehicle is limited to establish that the restrictions provided by the Code and regulations are satisfied.

Q-10. What is the treatment if the requirements for the full exclusion are not met?

A-10. If the use of the demonstration automobile by one or more employees does not satisfy the requirements for full exclusion, the employer must include some or all of the value of the use of the vehicle in the gross income of those employees using the methods for partial exclusion or full inclusion described in section 5 and 6, respectively, below.

SECTION 4. SIMPLIFIED METHOD FOR THE FULL EXCLUSION OF QUALIFIED AUTOMOBILE DEMONSTRATION USE

Q-11. What are the requirements under this revenue procedure for the Simplified Method for Full Exclusion of Qualified Automobile Demonstration use?

A-11. The requirements are as follows:

a. The employer must have a qualified written policy limiting the use of the demonstration automobile;

b. The employer must reasonably believe that the full-time automobile salesperson complies with the written policy; and

c. The employer must determine, no less often than monthly, that the personal use of the vehicle by the full-time salesperson was limited and maintain the records described in Answer 23 supporting the determination. (But see Question and Answer 51 regarding correcting errors identified during the calendar year.)

Q-12. What is a qualified written policy for purposes of the full exclusion?

A-12. A qualified written policy is in place if the employer establishes and communicates to each full-time automobile salesperson allowed the use of a demonstration automobile a written policy which —

(1) Prohibits use of the vehicle outside of normal business hours by individuals other than full-time salespeople.

(2) Prohibits use of the vehicle for personal vacation trips.

(3) Prohibits use outside of the sales area in which the employer's sales office is located.

(4) Prohibits storage of personal possessions in the vehicle.

(5) Limits the total use by mileage of the vehicle by the salesperson outside normal working hours to commuting between the salesperson's home and the dealer's sales office and to an additional average number of miles per day of 10 miles or less.

A model qualified written policy for purposes of the full exclusion is provided in Appendix A.

Q-13. When may the employer reasonably believe that the full-time automobile salesperson complies with the written policy?

A-13. Under the full exclusion method, the employer may reasonably believe that a salesperson complies with the written policy where the calculations of total mileage outside of normal working hours indicate that the limit on personal use was not exceeded and the employer has no actual knowledge that the other requirements of the policy are not satisfied. For example, if the employer had actual knowledge that a salesperson's family members used the demonstration automobile in violation of the policy, the use during the period does not qualify for the full exclusion even if the mileage records indicate that the lim-

its on mileage outside of normal working hours have not been exceeded during the period.

Q-14. What is the sales area of an automobile dealer?

A-14. Under Treas. Reg. § 1.132-5(o)(5)(i), sales area is generally defined as the geographic area surrounding the automobile dealer's sales office from which the office regularly derives customers. Paragraph (ii) under that regulation provides a safe harbor rule that, as a minimum, allows that an automobile dealer's sales area may be treated as the area within a radius of 75 miles of the sales office.

Q-15. When is the personal use of the demonstration automobile limited for purposes of the full exclusion?

A-15. For a full-time salesperson, personal use is considered limited as required under section 132(j)(3) if the total mileage a demonstration automobile is used outside normal working hours, less commuting mileage, does not exceed an average of 10 miles per day. For this purpose, the mileage on each demonstration automobile a salesperson uses for either commuting or personal purposes must be taken into account.

Q-16. How does an employer determine the total mileage that a demonstration automobile is used outside of normal working hours?

A-16. For purposes of this revenue procedure, an employer can determine the total mileage that a demonstration automobile is used outside of normal working hours under the Simplified Out/In Method. Under this method, the total miles that a demonstration automobile is used during normal working hours is not taken into account and only mileage outside of normal working hours is considered. To satisfy this method, the mileage on the automobile must be recorded under a reasonable system (1) at the end of the working hours of the salesperson using the automobile (out mileage) and (2) at the beginning of that salesperson's working hours on the next working day (in mileage).

Q-17. What is a reasonable system for recording out and in mileage?

A-17. Any reasonable system may be used for recording out and in mileage.

For example, an employee other than the salesperson could record the mileage on the demonstration automobiles at the arrival and departure of the vehicle at the sales office on each workday. A reasonable system would also include mileage entries for the vehicles by the full-time salespeople using the vehicle if there was random verification of the accuracy of the entries by an employee other than the salespeople at least once in every determination period, as described in Question and Answer 18.

Q-18. What is the applicable period for determining whether the average 10 miles per day is exceeded?

A-18. Under the simplified full exclusion method provided by this revenue procedure, the employer must determine whether the average 10 miles per day of personal use has been exceeded no less often than once each calendar month. If an employer chooses to make the determination every two weeks, the applicable period is two weeks, and the amount of personal use in addition to commuting allowed for the two weeks is 140 miles (14 days multiplied times 10 miles per day). If the employer chooses to make the determination monthly, the amount varies from month to month, depending on the number of days in the calendar month.

Q-19. What is commuting mileage?

A-19. Commuting mileage is the total number of miles a demonstration automobile is driven by a salesperson when commuting to and from the dealer's sales office during the period at issue. For this purpose, commuting mileage includes only one round trip to and from the sales office per workday. The employer should assume that the commuting distance is the same for every day the employee drives the automobile to work unless the employer has reason to believe that the employee has moved.

Q-20. How does an employer determine the commuting mileage for a full-time salesperson?

A-20. A full-time salesperson's commuting mileage can be determined by any reasonable method. Reasonable methods include employee mileage records of a single commute, computer research programs identifying distance between the

employee's home address and the dealer's sales office, or employee self-reporting that reasonably corresponds to the driving distance between the employee's home address and the dealer's sales office.

Q-21. Is commuting mileage limited to the most direct route between the employee's home and the sales office?

A-21. No. An employee can use any commuting route that is reasonable in time or mileage. However, an employee may not increase his or her reported commuting mileage to allow for additional personal use; the average 10 miles per day allowance is intended to provide limited personal use in addition to commuting.

Example 1. A salesperson employee lives in a subdivision on the opposite side of a significant urban area from the sales office. Although a direct route through the urban area is shorter, using a highway around the urban area generally takes less time, although the actual mileage is greater. In this case, the employer can use the longer commuting mileage reflecting the use of the highway for purposes of determining the employee's personal use mileage in excess of commuting.

Example 2. A salesperson belongs to a fitness club located eight miles outside of any reasonable commuting route between the sales office and the salesperson's home. Even if the salesperson regularly stops at the fitness club on the trip home, the employer cannot include the additional eight miles in the commuting mileage for purposes of determining the employee's personal use mileage in excess of commuting.

Q-22. How does an employer using the full exclusion method calculate personal use?

A-22. The following examples illustrate calculations of personal use and determinations of whether the requirement that personal use outside of working hours was limited in accordance with the qualified policy.

Example 1. The employer adopts the simplified out/in method and implements a written policy that satisfies the requirements of this revenue procedure. The employer chooses to determine personal use monthly. For a 30 day month, the total mileage for the automobiles used by full-time salesperson Y during the month is 1,450 miles. Based on the mileage recorded at arrival and departure during the month, 800 miles relate to use during normal working hours and is not taken into account. Salesperson Y's round trip commute is 15 miles and Y works 20 days during the month, for a total commuting mileage of 300 miles during the month. The total use outside of normal working hours is calculated by taking the

1,450 total miles and subtracting the use during working hours, resulting in 650 miles. Total use outside of normal working hours for the month, 650 miles, less commuting miles for the month, 300 miles, results in 350 miles. This is greater than 10 miles per day for 30 days (300 miles). Thus, use by salesperson Y is not considered to be limited during the month and salesperson Y does not qualify for the exclusion for the month. Nonetheless, salesperson Y may qualify for the partial exclusion under this revenue procedure if the requirements for that method are satisfied.

Example 2. The same facts as in Example 1, except that for a 31 day month, the total mileage for the automobiles used by full-time salesperson X for the month is 1,600 miles. Based on the mileage recorded at arrival and departure during the month, 720 miles relate to use during working hours. Salesperson X's round trip commute is 30 miles and X works 22 days during the month, for total commuting mileage of 660 miles during the month. The total use outside of normal working hours is calculated by taking the 1,600 total miles and subtracting 720 miles, the use during working hours, resulting in 880 miles. Total use outside of working hours for the month, 880 miles, less commuting miles for the month, 660 miles, results in 220 miles. This is less than 10 miles per day for 31 days (310 miles). Thus, use by X is considered to be limited during the month.

Q-23. What records must an employer maintain to satisfy the requirements for the full exclusion?

A-23. An employer must maintain the following records to satisfy the requirements for the full exclusion for any month —

a. A copy of the written policy on use and evidence that it was communicated to employees, such as a copy of a poster notifying employees of the policy, a copy of a letter or an electronic communication notifying the employee of the policy, or signed statements by the employees acknowledging receipt of the written policy.

b. Records establishing that the salesperson's personal use by mileage was calculated no less often than once each calendar month. This may include:

(i) Records identifying each demonstration automobile assigned to each salesperson during the period.

(ii) Records identifying the total mileage for each demonstration automobile assigned to a salesperson during the period.

(iii) Records supporting the total use outside of normal working hours under the Simplified Out/In Method described

in Question and Answer 16 and any verification of those records. In particular, the employer would maintain records of out and in mileage of the demonstration automobiles provided to full-time salespeople for each day the automobile is used.

(iv) Records identifying the round trip commuting mileage of each salesperson assigned a demonstration automobile from salesperson's home to the dealer's sales office during the period. See Questions and Answers 19, 20 and 21 regarding the determination of commuting mileage.

Q-24. What records must an employee maintain to satisfy the requirements for the full exclusion?

A-24. The employee is required to maintain no records except to the extent the employee is required to provide information to the employer to allow the employer to maintain the records as noted above.

Q-25. What are the tax consequences if one or more employees fail to satisfy the limited personal use requirement?

A-25. For each full-time salesperson whose personal use mileage exceeds the 10 miles per day average for the applicable determination period, the employer must include all or a portion of the value of the use of the demonstration automobile for the period in the income of that full-time salesperson. The employer may continue to use the full exclusion for all other full-time salespeople whose personal use mileage is limited.

The employer may implement the partial exclusion method by including amounts in income either in the current period or in the period immediately following the current period. Whichever method is chosen, the employer must implement the exclusion in a consistent manner. Thus, after determining that an employee does not qualify for the full exclusion for the month, the employer can include an amount in the employee's income for the current month. Alternatively, the employer can include an amount in the employee's income during the next month. In that case, the amount included in the next month under the partial or full inclusion method is determined by the number of days in the next month.

SECTION 5. SIMPLIFIED METHOD
FOR PARTIAL EXCLUSION OF
DEMONSTRATION AUTOMOBILE
USE BY FULL-TIME SALESPERSON

Q-26. What is the partial exclusion of demonstration automobile use?

A-26. Under the partial exclusion method, an amount is included in the full-time automobile salesperson's income and wages no less often than monthly. The amount reflects personal use of the demonstration automobile and is based on the value of the use of that vehicle as determined in Question and Answer 33 below. The remaining portion is deemed to represent business use that is excludable from income and wages as a working condition fringe.

Q-27. When can an employer use the partial exclusion method?

A-27. An employer choosing not to use the full exclusion method can use the partial exclusion method to account for the use of any demonstration automobile by a full-time salesperson if the requirements of this revenue procedure are satisfied. Moreover, the partial exclusion method is also available if a full-time salesperson employed by a dealer otherwise satisfying the requirements for the full exclusion exceeds the average 10 miles per day of personal use or does not provide records with respect to business use of a demonstration automobile. In such cases, the employer will generally be able to account for the use of the demonstration automobile by using the partial exclusion method rather than including the full value of the use of demonstration automobile in the income of the full-time salesperson.

Q-28. What are the requirements for the partial exclusion of demonstration automobile use by a full-time salesperson?

A-28. The requirements are as follows:

- a. The employer must have a qualified written policy limiting the use of the demonstration automobile;
- b. The employer must reasonably believe that the full-time automobile salesperson complies with the written policy; and
- c. The employer must account for the nondeductible personal use by any full-time automobile salesperson by including

in gross income and wages the amount specified in the table in Answer 35 no less often than monthly and maintain records specified in Answer 38, which are necessary to support that accounting.

Q-29. What is the treatment if the requirements for the partial exclusion are not met?

A-29. If the use of the demonstration automobile by a full-time salesperson does not satisfy the requirements for partial exclusion, the employer must include all of the value of the use of the vehicle in gross income of that employee using the method for full inclusion described in Answers 40-47 below. But see special rule regarding self-correction below in Question and Answer 51.

Q-30. What is a qualified written policy for purposes of the partial exclusion?

A-30. A qualified written policy is in place if the employer establishes and communicates to each full-time automobile salesperson allowed the use of a demonstration automobile a written policy which—

- (1) Prohibits use of the vehicle outside of normal business hours by individuals other than full-time salespeople.
- (2) Prohibits use of the vehicle for personal vacation trips.
- (3) Prohibits storage of personal possessions in the vehicle.

A model written policy for purposes of the partial exclusion is provided in Appendix B.

Q-31. May a qualified written policy under the full exclusion method be used for the partial exclusion method?

A-31. Yes.

Q-32. When may the employer reasonably believe that the full-time automobile salesperson complies with the written policy?

A-32. Under the partial exclusion method, the employer may reasonably believe that a salesperson complies with the written policy if the employer has no actual knowledge that the other requirements of the policy are not satisfied. For example, if the employer had actual knowledge that a salesperson's family members used the demonstration automobile, the use does not qualify for the partial exclusion.

Q-33. What method does the employer use to determine the value of

the demonstration automobile used by a full-time salesperson?

A-33. An employer may use any reasonable method to determine the value of the demonstration automobile used by a full-time salesperson. That value is used in applying the table in Answer 35. The following method is considered a reasonable method.

Annual Average Look Back Method. Under the annual average look back method, the value of the use of any new demonstration automobile is based on the average sales price of all vehicles sold in the prior year. The average sales price is calculated by taking the sum of the sales prices of all new car and truck sales in the prior calendar year and dividing that sum by the number of new vehicles sold in the prior year. The average sales price is used to determine the value of the demonstration automobile and the corresponding daily inclusion amount under the table in Answer 35. This amount is included in the employee's income and wages for each day the employee used a demonstration automobile. The amount must be included in income at least monthly. The average sales price must be determined in January of each year and must be applied no later than February of that year.

For used vehicles, the average sales price is calculated by taking the sum of the sales prices of all used vehicles for the prior year and dividing by the number of vehicles sold in the prior year. The value of a demonstration automobile may only be based on used cars for salespeople using only used cars as demonstration automobiles; the average sales price of used cars cannot be combined with the average sales price of new cars for purposes of determining the value of demonstration automobiles that are new. If a dealership sells both new and used vehicles, the employer may use the value based on new vehicles as the value of the demonstration automobiles used by all salespeople. Alternatively, the employer may calculate the value of the demonstration automobiles separately for salespeople using used vehicles and salespeople using new vehicles.

An employer using the annual average look back method must maintain evidence supporting the calculation of the annual average sales price.

Example 1. In 2001, an employer sold 948 new vehicles for total gross sales of \$23, 226,000 (as

shown on the year-end standard financial statement that the dealer provided to the manufacturer). In January 2002, the employer calculates the average sales price by dividing \$23,226,000 by 948 vehicles, resulting in \$24,500. For each month ending on or after February 1, 2002, to January 31, 2003, of the next year, for each full-time salesperson provided the use of a demonstration automobile, the employer includes in the salesperson's gross income \$6, the amount from the table in Answer 35 based on that value, for each day in the month. This treatment is proper even if one full-time salesperson was provided only used demonstration automobiles. In addition, the employer keeps a copy of the factory statement that provided the amount of the 2001 sales and the number of vehicles sold as a record of his calculation.

Example 2. The same facts as in Example 1, except in addition to the new cars, the employer sold 233 used vehicles in 2001 for a total sales price of \$2,903,248. Thus, the average sales price for the used vehicles is \$12,456. While all the full-time salespeople sell used vehicles, only two full-time salespeople are provided used vehicles as demonstration automobiles. In this example, the value of the demonstration automobiles for the salespeople provided new cars as demonstration automobiles may not be based on the used cars sold in 2001. However, the employer may use \$12,456 to determine the amount included in the income of the two full-time salespeople provided used cars as demonstration automobiles.

Q-34. How does an employer determine the annual average sales price if more than one franchise is operated at or from a single location?

A-34. The employer must use a consistent method for calculating the value of the demonstration automobiles. If more than one franchise is operated at a single physical location ("store"), the annual average sales price for all salespeople may be based on the combined sales of

all franchises operating at the store. The value of a demonstration automobile may only be based on used cars for salespeople provided used cars as demonstration automobiles; the average sales price of used cars cannot be combined with the average sales price of new cars for purposes of determining the value of the use of demonstration automobiles that are new.

However, if a salesperson is only provided demonstration automobiles from a single franchise operating out of the store, the employer may base the annual calculation of value for that salesperson on the sales of the specific franchise. In that case, the value for all salespeople in the store must also be based on specific franchises.

Similarly, if some salespeople receive demonstration automobiles exclusively from the store's used car inventory and other salespeople received demonstration automobiles exclusively from the store's new car inventory, the value must generally be calculated separately for each group of salespeople. However, as noted in Question and Answer 33, if the store sells both new and used vehicles, the employer may also use the value based on sales of new vehicles as the value of the demonstration automobiles for all salespeople.

A special consistency rule is available if some salespeople sell automobiles and provide demonstration automobiles from more than one franchise operating out of the store; in that case, the value must be

calculated consistently within groups of salespeople. For example, all salespeople assigned demonstration automobiles from a single franchise may have the value based on the specific franchise, and all salespeople assigned demonstration automobiles from more than one franchise may have the value based on the combined inventories of the franchises.

However, if two franchises operate out of a store, the employer could not base the value for salespeople of the less expensive franchise on the less expensive franchise while basing the value for salespeople of the more expensive franchise on the combined inventory. In that case, either the value for all salespeople must be based on the combined sales or the value for the two groups of salespeople must be based on the respective franchise sales.

Q-35. What is the amount included in the full-time salesperson's income and wages for use of the demonstration automobile under the partial exclusion method?

A-35. For each day (including non-workdays) a full-time salesperson is provided the use of a demonstration automobile, the appropriate amount from the table below, based on the value of the demonstration automobile as determined under a reasonable method as described in Question and Answer 33, must be included in the full-time salesperson's income and wages no less often than monthly.

Value of the Demonstration Automobile	Daily Inclusion Amount
0 — \$14,999	\$3
\$15,000 — \$29,999	\$6
\$30,000 — \$44,999	\$9
\$45,000 — \$59,999	\$13
\$60,000 — \$74,999	\$17
\$75,000 and above	\$21

Q-36. How does an employer determine the number of days that a salesperson has the use of a demonstration automobile?

A-36. Absent evidence to the contrary, full-time salespeople are assumed to have

the use of a demonstration automobile for every day of the period under consideration. Salespeople hired during the period are assumed to have use for every day from the date of hire to the end of the period. Salespeople that separate from

service are assumed to have the use of an automobile from the first day of the period to the date of separation.

Q-37. May an employer elect under section 3402(s) of the Code not to withhold income taxes from the portion of the vehicle fringe benefit required to be included under the partial exclusion method provided under this revenue procedure?

A-37. No. Under this revenue procedure, the periodic inclusion inherent in the requirement to include amounts in income not less often than monthly is intended to substitute for more specific recordkeeping requirements for substantiating the use of the demonstration automobile. Annual inclusion and withholding of other employment taxes with respect to noncash fringe benefits allowed under Announcement 85-113 (1985-31 I.R.B. 31) is unavailable under the methods provided by this revenue procedure.

Q-38. What records must an employer maintain to satisfy the requirements for the partial exclusion?

A-38. An employer must maintain the following records to satisfy the requirements for the partial exclusion—

a. Records supporting the determination of the value of the use of demonstration automobiles. For these purposes, records identified above in the description of annual average look back method for determining value in Question and Answer 33 will be considered adequate.

b. Evidence that the amount was timely included in the employee's income and wages. For example, copies of wage statements showing inclusion of the amounts no less often than monthly.

c. A copy of the written policy on use and evidence that it was communicated to employees, such as a copy of a poster notifying employees of the policy, a copy of a letter or an electronic communication notifying the employee of the policy, or signed statements by the employees acknowledging receipt of the written policy.

Q-39. What records must an employee maintain to satisfy the requirements for the partial exclusion?

A-39. The employee is required to maintain no records.

SECTION 6. SIMPLIFIED METHOD FOR INCLUSION OF THE VALUE OF DEMONSTRATION AUTOMOBILE IF NEITHER FULL NOR PARTIAL EXCLUSION APPLIES

Q-40. What method does an employer use to account for the use of demonstration automobiles provided to employees who are not full-time salespeople?

A-40. If the employee provided the use of a demonstration automobile is not a full-time salesperson, the full exclusion and the partial exclusion in this revenue procedure do not apply. To reduce recordkeeping with respect to use of a demonstration automobile by an employee who is not a full-time salesperson, the employer may include in the employee's income and wages each month the full value of the demonstration automobile determined with no reduction to take into account business use (the "full inclusion method"). See Questions and Answers 43 through 45 below which discuss the use of the annual lease value table to determine the amount included under this method.

Of course, other methods for excluding from an employee's income a portion of the value of the use of an employer-provided automobile remain available for those employees that are not full-time salespeople. Specifically, see Questions and Answers 48 through 50 below regarding the application of Treas. Reg. § 1.274-6T. Section 1.274-6T generally allows an employer implementing certain written policies restricting personal use to account for commuting and *de minimis* personal use by any employee by including the \$1.50 per one-way commute provided under Treas. Reg. § 1.61-21(f)(3) in the employee's income and providing other evidence allowing a determination that use was actually limited.

Q-41. What method is used to account for the use of a demonstration automobile by a full-time salesperson who does not qualify for the full exclusion or partial exclusion?

A-41. If use of a demonstration automobile by a full-time salesperson does not qualify for the full exclusion or the partial exclusion, an amount is included in the full-time salesperson's income and wages no less often than monthly that reflects the full value of the demonstration automobile, with no reduction to take into account business use. See Questions and Answers 42 through 44 below which discuss the use of the annual lease value table to determine the amount included under this method.

Q-42. What are the requirements for using the full inclusion method for demonstration automobiles used by employees who are not full-time salespeople or who are full-time salespeople?

A-42. The employer must account for the use by an employee who is not a full-time salesperson by including in gross income and wages for each day in each period (no less often than monthly) the greater of \$3 per day or the *pro rata* portion of the amount specified in the annual lease value table at Treas. Reg. § 1.61-21(d)(2)(iii) using the value of the demonstration automobile.

Q-43. Under the full inclusion method, how does an employer determine the value of the demonstration automobiles provided to employees?

A-43. An employer may use any reasonable method to determine the value of the demonstration automobile provided to the employee. For this purpose, a reasonable method includes the annual average look back method listed as a reasonable method for determining the value of a demonstration automobile under the partial exclusion method in Answer 33 above.

Q-44. How is the *pro rata* portion of the annual lease value amount included in income calculated?

A-44. The *pro rata* portion of the annual lease value amount is the amount specified in annual lease value table at Treas. Reg. § 1.61-21(d)(2)(iii) using the full value of the demonstration automobile, divided by 365, rounding to nearest dollar amounts.

For ease of reference, the following table provides the daily inclusion amount under the annual lease value table.

Value of Demonstration Automobile	Daily Inclusion Amount
\$0–2,999	\$3
3,000–4,999	4
5,000–5,999	5
6,000–7,999	6
8,000–8,999	7
9,000–10,999	8
10,000–11,999	9
12,000–12,999	10
13,000–14,999	11
15,000–15,999	12
16,000–17,999	13
18,000–18,999	14
19,000–20,999	15
21,000–21,999	16
22,000–23,999	17
24,000–24,999	18
25,000–25,999	19
26,000–27,999	20
28,000–29,999	21
30,000–31,999	23
32,000–33,999	24
34,000–35,999	25
36,000–37,999	27
38,000–39,999	28
40,000–41,999	29
42,000–43,999	31
44,000–45,999	32
46,000–47,999	34
48,000–49,999	35
50,000–51,999	36
52,000–53,999	38
54,000–55,999	39
56,000–57,999	40
58,000–59,999	42

For vehicles with value in excess of \$59,999, the dollar inclusion amount is $(.25 \times \text{value}) + \500 , divided by 365, rounded to nearest dollar amount.

Q-45. Under the full inclusion method, how does an employer determine the number of days that an employee has the use of a demonstration automobile?

A-45. Absent evidence to the contrary, employees provided the use of a demonstration automobile are assumed to have the use of the automobile for every day (including non-workdays) of the period under consideration.

Q-46. What records must an employer maintain to satisfy the requirements for the full inclusion method?

A-46. An employer must maintain the following records to satisfy the requirements for the full inclusion method—

a. Adequate records supporting the determination of the value of the demonstration automobile provided to the employee. For these purposes, records identified above in the description of the deemed reasonable method for determining value will be considered adequate.

b. Evidence that the amount was timely included in the employee's income and wages. For example, copies of wage statements showing inclusion of the amounts no less often than monthly.

Q-47. What records must an employer maintain to satisfy the requirements for the full inclusion method?

A-47. No records must be maintained by an employee under the full inclusion method.

SECTION 7. APPLICATION OF GENERAL RULE WHEN METHODS IN REVENUE PROCEDURE ARE NOT USED

Q-48. What is the interaction of the method under Treas. Reg. § 1.274-6T for an employer implementing a policy of no personal use except commuting through a written policy with the full exclusion or partial exclusion methods?

A-48. Under Treas. Reg. § 1.274-6T, certain types of written policy statements can be used to implement a policy of no personal use, or no personal use except commuting, of a vehicle provided by an employer. Under the regulation, the employee is not required to keep a separate set of records for purposes of the employer's substantiation requirements under section 274(d) of the Code with respect to the use of a vehicle satisfying the written policy statement rules. Among the requirements under Treas. Reg. § 1.274-6T for a policy of no personal use except commuting is that the employer reasonably believe there is no personal use except for *de minimis* personal use in addition to commuting and that the employee does not use the vehicle for any personal use except for *de minimis* personal use in addition to commuting. Also among the requirements is that there be evidence that would enable the Commissioner to determine whether the use of the vehicle met the requirements.

Generally, in the case of a full-time salesperson, satisfying the requirements of Treas. Reg. § 1.274-6T would satisfy the requirements for the full exclusion under this revenue procedure. Moreover, in the case of a full-time salesperson, the employer would not be required to include an amount in the income of the salesperson representing the value of commuting.

Q-49. What amount of personal use mileage in addition to commuting would satisfy the *de minimis* personal use in addition to commuting under Treas. Reg. § 1.274-6T ?

A-49. For purposes of Treas. Reg. § 1.274-6T and this revenue procedure, *de minimis* personal use means personal use during the employee's commute and in conjunction with business use. In con-

trast, the limited personal use permitted under section 132(j)(3) and the full exclusion in this revenue procedure allow the employee to use the vehicle for personal purposes, even if that use involves a departure from the commuting route. Thus, if the employee stops on the commuting route for a personal purpose, that use constitutes *de minimis* personal use. However, if the employee travels to a location that is five miles away from the commuting route for a personal purpose, that use exceeds *de minimis* personal use even though it may be permitted under the full exclusion method described in this revenue procedure.

Q-50. What evidence would satisfy the requirement under Treas. Reg. § 1.274-6T that the employer must maintain evidence that would enable a determination whether the use of the vehicle met the requirements?

A-50. Evidence establishing that each salesperson's personal use by mileage was calculated no less often than monthly would support an employer's reasonable belief that the vehicle was not used for any personal purpose other than *de minimis* personal use in addition to commuting. For that purpose, the out and in records under the simplified full exclusion method described in section 4 would constitute evidence that would enable a determination that the use of the vehicle met the requirements. Of course, as noted in Question and Answer 49, the additional average 10 miles per day would not be permitted as *de minimis* use.

Q-51. What amount is included in the income of an employee if the use was not taken into account and included in income for the month in which the use of a demonstration automobile was provided?

A-51. If the error is identified and corrected during the calendar year the demonstration automobile was provided, the amount included may be determined under this revenue procedure. If the error is not corrected during the calendar year in which the demonstration automobile is provided, the amount included is determined under general valuation and substantiation rules.

Example 1. In August, the employer determines that three employees provided the use of demonstration automobiles without limitations on personal mileage (and for whom amounts were included in income and wages under the partial exclusion

method) did not qualify as full-time salespeople since June of that year. Beginning in August, the employer accounts for the use of demonstration automobiles by these three employees using the full inclusion method. In addition, no later than December 31, the employer includes an amount in the three employees' income that is the difference between the amount that should have been included in their incomes under the full inclusion method for June and July and the amount actually included under the partial exclusion method. With respect to these employees, the employer satisfies the requirements of Question and Answer 51 of this revenue procedure.

Example 2. Two years after a demonstration automobile was provided to an employee, it is determined that the employee was not a full-time salesperson qualifying for the full exclusion or the partial exclusion. The employer did not include any amount in the employee's income with respect to the demonstration automobile. The amount required to be included in income and wages for the year the vehicle was provided is the full fair market value of the demonstration automobile. If there are not records substantiating the business use of the demonstration automobile, the full fair market value is included without reduction.

SECTION 8. INTENT TO REVISE REGULATIONS TO EXTENT NECESSARY

The Service intends to issue regulations modifying existing regulations to the extent required to authorize the procedures set out in this revenue procedure.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning on or after January 1, 2002.

SECTION 10. REQUEST FOR COMMENTS

We welcome comments regarding this revenue procedure. We specifically request comments concerning two issues:

Question and Answer 32 of this revenue procedure describes one reasonable method for determining the value of demonstration automobiles, an annual look back at the average sales price of all vehicles sold in the prior calendar year, for purposes of applying the daily inclusion value table under the partial exclusion method. Comments are specifically requested regarding the usefulness of specifying additional reasonable methods, including:

- A method basing the daily inclusion amount on an annual look back at the average sales price of only those vehicles used as demonstration automobiles in the prior year. For example, an employer has a full-time sales staff of six employees. During January, the employer reviews the permanent records of all vehicles sold during the prior year. This review identifies 38 vehicles that were sold as new vehicles with over 1,000 miles on the odometer at the time of sale. Totaling the price for which the 38 vehicles sold and dividing by 38 results in an average value of \$26,980. For each month from February 1 of the present year to January 31 of the next year, the employer includes in each of the 38 full-time salesperson's gross income the amount from the table based on that value for each day in the month.

- A method basing the daily inclusion amount for each employee on the value of the specific demonstration automobiles provided to the employees for the month; in particular where records identifying which salesperson is provided which vehicle are already maintained pursuant to the simplified out/in method under the full exclusion.

Question and Answer 51 allows employers to correct errors identified in the calendar year during the calendar year. Comments are also specifically requested regarding the need for more detailed correction procedures where errors are identified preventing the employer from satisfying the requirements for the simplified methods under this revenue procedure.

Comments regarding this revenue procedure should be sent by March 1, 2002, in writing, and should reference Rev. Proc. 2001-56. Comments can be addressed to:

CC:ITA:RU (Rev. Proc. 2001-56),
room 5226
Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Comments also may be hand delivered between the hours of 8 a.m. and 5 p.m. to:

CC:ITA:RU (Rev. Proc. 2001-56)
Courier's Desk

Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC.

Alternatively, taxpayers may transmit comments electronically via the following email address:

Notice.Comments@m1.irs.counsel.treas.gov

SECTION 11. DRAFTING INFORMATION

The principal author of this revenue procedure is Neil D. Shepherd of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue procedure, call (202) 622-6040 (not a toll-free number.)

SECTION 12. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1756.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 4, 5, and 6. This information is required to comply with the optional simplified methods for determining the value of the use of demonstration automobiles provided to employees by automobile dealerships. This information will be used to satisfy the substantiation requirements of section 274(d) and the regulations thereunder and is required to obtain a benefit under the optional simplified methods. The likely respondents are business or other for-profit institutions.

The estimated total annual recordkeeping burden is 100,000 hours.

The estimated annual burden per recordkeeper varies from 2.5 hours to 7.5 hours, depending on individual circum-

stances, with an estimated average of 5 hours. The estimated number of recordkeepers is 20,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

APPENDIX A

MODEL QUALIFIED WRITTEN POLICY FOR FULL EXCLUSION

[INSERT NAME OF DEALERSHIP]

DEMONSTRATOR VEHICLE POLICY

This policy statement is designed for use by dealers that wish to adopt the out/in or partial exclusion methods of accounting for use of demonstrator vehicles provided to full-time automobile salespeople. It may also be used to explain the full inclusion method for vehicles provided to employees other than full-time automobile salespeople.

*Material in italics explains how to use the policy and should be deleted from the policy provided to employees and maintained by the dealership. Material in **bold** is optional and should be included only if it reflects the choices made by the dealership. Material **IN CAPITALS** is information that is specific to the dealership—the dealership should insert the appropriate information.*

Because the optional language in this model provides for specifying the amount included in employee income, any dealer adopting that language should review the model annually to determine if inclusion amounts have changed; if the inclusion amounts have changed, the dealer should modify the policy to reflect the change and reissue it to employees provided demonstration automobiles.

Full-time automobile salespeople at [INSERT NAME OF DEALERSHIP] **and certain other employees** may be provided with the use of a demonstration vehicle. We want you to understand the restrictions on use of demonstration vehicles and how employees who use demonstration vehicles will be taxed on that use.

Restrictions on Use of Demonstration Vehicles

- The demonstration vehicle must be available for test drives by customers during the normal working hours of the employee to whom the vehicle is assigned. Personal possessions may not be stored in the vehicle. Any personal possessions must be removed by the beginning of normal working hours.
- The demonstrator vehicle is provided so that employees can become familiar with the features of the vehicles we sell. Only the employee to whom the vehicle is assigned may use the vehicle outside of normal working hours. It may not be used by family, friends, or neighbors.
- The demonstrator vehicle is part of our inventory and must be available for sale to customers. It may not be used outside the dealership's sales area or for vacation travel.
- *Insert any other restrictions the dealership has concerning use or maintenance of the vehicle.*

Insert the following two paragraphs only if the "out/in" method will be used for full-time automobile salespeople.

- **The demonstration vehicle may be used only for tests drives by customers or other dealer business, for a daily commute between the employee's home and the dealership, and for other limited personal use. Personal use is limited to [INSERT NUMBER NO GREATER THAN 10 MULTIPLIED BY THE NUMBER OF DAYS IN THE DETERMINATION PERIOD] miles during each [INSERT LENGTH OF A DETERMINATION PERIOD WHICH IS NOT MORE THAN ONE MONTH]. In order to minimize recordkeeping, all use during the employee's normal working hours will be treated as business use, and all use outside the employee's normal working hours will be treated as commuting or personal use.**
- **The employee must ensure that mileage on the vehicle at the end of each working day, and at the beginning of the next working day, is properly [recorded] OR [verified] by [INSERT NAME, TITLE, OR JOB DESCRIPTION OF THE PERSON**

OR PEOPLE RESPONSIBLE FOR RECORDING OR VERIFYING MILEAGE].

Tax Treatment of Use of Demonstrator Vehicles

Insert the next paragraph only if the "out/in" method is being used.

- **Any full-time automobile salesperson who meets all of the above requirements, including limiting personal use to [INSERT NUMBER NO GREATER THAN 10 MULTIPLIED BY THE NUMBER OF DAYS IN THE DETERMINATION PERIOD] miles during each [INSERT LENGTH OF A DETERMINATION PERIOD WHICH IS NOT MORE THAN ONE MONTH] will not owe any federal [INSERT STATE OR LOCAL, IF APPROPRIATE] income tax or any Social Security or Medicare tax on the use of the demonstrator vehicle.**
- Any full-time automobile salesperson who meets all of the above requirements *[insert this material only if the "out/in" method is used except for limiting personal use or ensuring that mileage is recorded and verified]* will have [INSERT APPROPRIATE NUMBER FROM TABLE IN ANSWER 35] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. **Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.**
- Any full-time salesperson who is provided with the use of a demonstration vehicle but does not comply with the restrictions on storage of personal possessions, use by people other than the employee, use outside the sales area, and vacation travel during a pay period will have the full value of the use of the demonstrator automobile included in wages for the pay period, resulting in [INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE UNDER ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. **Income tax, Social Security tax, and**

Medicare tax on this amount will be withheld from other wages owed to the salesperson.

Insert the following bullet only if demonstration vehicles are provided to employees other than full-time salespeople.

- **Any other employee who is provided with use of a demonstration vehicle and meets all of the above requirements [insert this material only if the "out/in" method is used except for limiting personal use or ensuring that mileage is recorded and verified] will have:** [INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE AT QUESTION AND ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. **Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.**

APPENDIX B

MODEL QUALIFIED WRITTEN POLICY FOR PARTIAL EXCLUSION

[INSERT NAME OF DEALERSHIP]

DEMONSTRATOR VEHICLE POLICY

This policy statement is designed for use by dealers that wish to adopt the partial exclusion methods of accounting for use of demonstrator vehicles provided to full-time automobile salespeople.

*Material in italics explains how to use the policy and should be deleted from the policy provided to employees and maintained by the dealership. Material in **bold** is optional and should be included only if it reflects the choices made by the dealership. Material **IN CAPITALS** is information that is specific to the dealership—the dealership should insert the appropriate information.*

Because the language in this model provides for specifying the amount included in employee income, any dealer adopting that language should review the model annually to determine if inclusion amounts have changed; if the inclusion amounts have changed, the dealer should modify the policy to reflect the change

and reissue it to employees provided demonstration automobiles.

Full-time automobile salespeople at [INSERT NAME OF DEALERSHIP] may be provided with the use of a demonstration vehicle. We want you to understand the restrictions on use of demonstration vehicles and how full-time salespeople who use demonstration vehicles will be taxed on that use.

Restrictions on Use of Demonstration Vehicles

- The demonstration vehicle must be available for test drives by customers during the normal working hours of the employee to whom the vehicle is assigned. Personal possessions may not be stored in the vehicle. Any personal possessions must be removed by the beginning of normal working hours.
- The demonstrator vehicle is provided so that employees can become familiar with the features of the vehicles we sell. Only the employee to whom the vehicle is assigned may use the vehicle outside of normal working hours. It may not be used by family, friends, or neighbors.
- The demonstrator vehicle is part of our inventory and must be available for sale to customers. It may not be used for vacation travel.
- *Insert any other restrictions the dealership has concerning use or maintenance of the vehicle.*

Tax Treatment of Use of Demonstrator Vehicles

- Any full-time automobile salesperson who meets all of the above requirements will have [INSERT APPROPRIATE NUMBER FROM TABLE IN ANSWER 35] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.
- Any full-time salesperson who is provided with the use of a demonstration vehicle but does not comply with the

restrictions on storage of personal possessions, use by people other than the employee, and vacation travel during a pay period will have the full value of the use of the demonstrator automobile included in wages for the pay period, resulting in [INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE UNDER ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.