

## **215.0000 DEMONSTRATION, DISPLAY AND USE OF PROPERTY HELD FOR RESALE—VEHICLES—Regulation 1669.5**

### **(a) GENERAL**

**215.0015 Accommodation Loan Car Programs.** Under these programs, distributors will sell vehicles to dealers under an agreement that the dealer use the vehicles exclusively for accommodation loan purposes for a certain period of time; thereafter, the dealers are free to sell the vehicles. In many cases, the transaction between the distributor and dealer involves a finance company (generally related to the distributor) in which the vehicles purchased by the dealer are immediately sold to the finance company which leases the vehicles back to the dealer. In most cases, the lease is actually a sale at inception based on the terms of the agreement. In exchange for agreeing to the restrictions on its use of the vehicle and its ability to sell the vehicle, the dealer's lease payments may be subsidized by the distributor so that the dealer effectively obtains the vehicle at a reduced price.

Regulation 1669.5 (b)(6) provides that when a dealer provides an accommodation loan to a customer who is awaiting the repair of a vehicle leased from that dealer, the dealer is regarded as leasing the accommodation loan vehicle to its customer as part of the lease of the vehicle being repaired. If the lease is a continuing sale, the accommodation loan is part of that continuing sale because it is regarded as coming under the original lease. In this context, a dealer would be entitled to purchase a vehicle for resale in the form of accommodation loans that constitute continuing sales. No further tax is due with respect to accommodation loans made to persons leasing vehicles in continuing sales leases.

Accordingly, the dealer may issue a resale certificate to a distributor for the purchase of vehicles to be used exclusively as accommodation loans to persons leasing vehicles in continuing sales. However, when the dealer loans these vehicles to customers who own vehicles (and to those whose leases are not continuing sales) which are under repair, the dealer is regarded as using the vehicles and owes use tax measured by the fair rental value of the vehicle. (Section 6094(b).)

Under these circumstances, the dealer must specifically substantiate by documentation the percentage of its accommodation loans to persons leasing vehicles in continuing sales. If the dealer does not maintain and/or provide substantial and detailed documentation, (e.g., repair invoices, lease agreements, schedules, etc.) for purposes of audit or reporting, the dealer owes tax or the fair rental value for all accommodation loans of vehicles made under these programs.

In some instances, vehicle dealers do not actually lease vehicles but rather a separate related finance company or arm of the dealership or distributor becomes the ultimate lessor. Also, the lease agreements may show the dealership as the original lessor, but the lease is later assigned to separate concern where all lease payments are remitted. Considering the unique circumstances of financing and leasing arrangements made in this industry, accommodation loans provided to customers awaiting repair of vehicles leased from a separate but related entity of

the dealer or distributor should be treated as one transaction for purposes of a continuing sale when the customer's lease originates through the dealer providing the accommodation loan. On the other hand, accommodation loans of vehicles made to customers awaiting repair of vehicles leased by an unrelated dealer, distributor, or franchise would be subject to tax measured by the fair rental value.

Under these specific accommodation loan programs, if the dealer does not offer a vehicle as a daily rental, then a reasonable fair rental value of the vehicle for each month will be obtained by using 1/40th of the purchase price of the vehicle as explained in Regulation 1669.5(b)(3)(A). 6/27/97.

215.0040 **Breaking in.** The breaking in of foreign cars by a dealer driving them for 500 miles for no other purpose, does not require payment of tax upon sale to dealer. Such breaking in of the car is nothing more than preparation of the car for delivery to the customer and is not sufficient in itself to subject the dealer to payment of use tax on the theory that the car was used prior to reselling it. 9/5/50.

215.0050 **Car Dealers "Holdback Allowance."** A vehicle manufacturer contends that the factory holdback allowance should be deducted in determining the "net dealer cost" for purposes of reporting use tax on vehicles, subject to the 1/40th or 1/60th fair rental value formula, which are used as company car demonstrators. The factory holdback allowance is a percentage of the factory invoice price, varying from 2 percent to 3 percent, which is shown on the dealer's sales invoice as a memorandum entry. It is annually credited to the car dealer against amounts they owe to the manufacturer.

The "net dealer price" is the manufacturer's selling price to its dealers, including optional extra cost equipment, before any discounts or rebates. It also includes the federal excise tax, but does not include destination, handling, and other charges." Therefore, for the limited purpose of determining the median cost (of the demonstrator) under Regulation 1669.5 (c)(2), the factory holdback allowance must be included in the "net dealer price." 11/30/90.

215.0080 **Company Car Inventory.** When a dealer transfers a car from its new car inventory to its company car inventory, the presumption is that the car is used for purposes other than, or in addition to, demonstration, and the dealer will owe use tax at time of transfer.

This presumption is rebuttable however, if, in fact, separate records are kept as to the vehicle and proper affidavit made that car has been used solely for demonstration purposes. 3/3/53.

215.0100 **Driving.** When a vehicle is driven from the factory to the dealer's place of business, use tax is not applicable if there is no other use except demonstration or display while holding the car for sale. 6/5/50.

215.0325 **Lessors—Fair Rental Value.** Since the definition of sale in section 6006 includes both the passage of title to tangible personal property and, generally, any lease of tangible personal property, lessors of automobiles are entitled to use the "fair rental value" schedule in Regulation 1669.5 to the same extent as automobile dealers. 9/15/75.

215.0400 **New Vehicles.** The following uses of new vehicles by dealers are held to constitute demonstration or display:

(1) Short term loan of passenger vehicles to prominent personalities while visiting California, when the loan is for the purpose of drawing attention to the vehicle.

(2) Assigning of vehicles to race tracks for display and use as an official car or pass car, when for the purpose of drawing attention to the vehicle.

(3) Assigning of cars to automotive editors of newspapers and magazines for purpose of writing articles about the cars.

(4) Assignment of cars to various divisions of the manufacturing corporation for demonstration to employees. The following uses are not within the meaning of demonstration or display:

(1) Assigning cars to recent purchasers of new cars for use while the cars they own are being repaired.

(2) Assigning of cars to motion picture and television studios for personal use of personnel of studios in addition to use in pictures.

(3) Assigning of cars to ski lodges for transportation of skiers.

(4) Assigning cars to professional and college sports teams used for transportation purposes. 8/23/66.

215.0401 **New Vehicles.** An importer and distributor of new automobiles purchases automobiles from the manufacturer for resale to independent new car dealers in the United States. The distributor makes no retail sales. In an effort to promote market awareness of the automobile it imports, the distributor will make demonstrator automobiles available for test drives by potential customers at their home or place of business. Several of these demonstrator automobiles will be temporarily based in California at the office of an independent company who will be responsible for coordinating the test drives by potential retail customers. All retail sales inquiries resulting from the test drives will be referred to a local independent dealership since the distributor makes no retail sales. These vehicles will be used for limited mileage (between 5,000 to 8,000 miles) and will be subsequently wholesaled by the distributor to automobile dealers. Cars generally will not be used in test drive programs for greater than six months. At all times, these cars will be available for sale, at the specific request of authorized dealers, while being used as demonstrator vehicles.

When a purchaser purchases tangible personal property for resale and uses the property solely for demonstration or display while holding it for sale in the regular course of business, the purchaser is not required to pay tax on such use. (Regulation 1669.5(a).) Under the facts stated above, the distributor is using the vehicles only for demonstration and display. Accordingly, if no other use is made of the vehicles purchased for resale by the distributor, no tax applies to its use of the vehicles for demonstration and display. 4/3/96.

215.0430 **Race Car.** When a distributor of a particular racing car enters a car in professional races in order to demonstrate its ability, the car is not being used solely for demonstration and display purposes. If the car is frequently

demonstrated and displayed and only used partly for racing, use tax is due measured by the fair rental value of the car for the period of such use. If the car, which is raced, is not frequently demonstrated or displayed while being held for sale, tax applies measured on cost. 11/19/91.

**215.0440 Racing.** Withdrawal of an automobile or boat from stock for the purpose of entry in an amateur race to demonstrate capabilities is nontaxable demonstration and display. Entry in a race for any purpose other than demonstration of capabilities, thus aiding the ultimate sale, cannot be regarded as a nontaxable use. 8/22/58.

**215.0460 Racing.** Where a sports car dealer obtained a car under a resale certificate and employed it extensively in both amateur and professional racing, there was a taxable use beyond the meaning of “demonstration or display” as contained in section 6094. 8/17/64.

**215.0470 Registration of Demonstrator Automobiles with DMV.** The fact that an automobile dealer registers a demonstrator with DMV will not prevent the dealer from claiming that the vehicle is used for demonstration and display, with tax due on fair rental value for other use. The burden of proof, however, remains on the dealer. 3/18/75.

**215.0510 Service Stations, Automobiles Displayed at.** The sales tax applies to sales of automobiles to service stations which display the vehicles as inducement to buy gasoline, and are either given away or sold by the station operator. Such a use of the vehicle does not fall within the “demonstration or display” language of section 6094, so that tax is due from the station operator who purchases the vehicles under a resale certificate, measured by the cost of the vehicles to him, even though he subsequently sells the vehicles and pays tax on the sales price. 10/27/55.

**215.0520 Shuttling and Deadheading Leased Vehicles.** The shuttling and deadheading of leased vehicles by the lessor for purposes of placing the vehicles in the appropriate inventory location represents retention of property for purposes of sale and is not subject to use tax. 7/12/76.

**215.0580 Use of Vehicles.** A company that is a wholly owned subsidiary of a major car manufacturer is engaged in the business of performing contracts for the manufacture of military hardware of surveillance equipment including satellite vehicles. It is not directly involved in the manufacture of components for motor vehicles but does perform considerable research and development work which could lead to improvements in motor vehicle components. Certain vehicles are acquired for resale without payment of sales tax reimbursement or use tax and are registered with the cooperation of local dealers. The employees are allowed the use of these vehicles for personal purposes for the payment of a monthly amount equivalent to 1.37% of the vehicle cost. The company declares and pays use tax on these amounts and also pays for repairs and maintenance, insurance, and all taxes and licenses. The employees are required to return these vehicles after they are used for 10,000 miles and complete a product evaluation form. Under terms of the agreement, a vehicle can be sold without notice or consent of the employee. Actual resale is made through local dealers. The company believes that the use of

the vehicles should be regarded as nontaxable demonstration and display in view of the product evaluation or that the vehicles were leased to the employees.

Nontaxable demonstration and display are limited to activities performed while the purchaser is holding the property for sale in the regular course of business. In legal contemplation, the company did not purchase and hold the vehicles for sale in the regular course of business even though a resale was to be made of each vehicle after it was used for 10,000 miles. In addition, the company does not qualify for the alternative reporting authorized by Regulation 1669.5 since the method is limited to manufacturers, distributors, or dealers.

It is also concluded that the transactions are not bona fide lease agreements. The employees receive the limited right of use of the vehicles for a monthly amount that is only approximately one-third of the market rental rate. While the preparation of a simple evaluation sheet has some value, it is not measured in terms of money and does not account for the great disparity. The amount of the monthly payment is not negotiated but is dictated by the company. It is only available to certain employees. The property may be sold by the company without notice to the employee. Finally, the employee does not bear the ordinary expense relating to its use during the period it is driven as is currently required of a lessee. In substance, the possession and use were given to the employees primarily as a fringe benefit. Tax is due on cost. The company's purchase of these vehicles "for resale" is contrary to law and should be discontinued. 8/12/92.

**(b) LOANS TO SCHOOLS, COLLEGES, AND VETERANS' INSTITUTIONS FOR EDUCATIONAL OR TRAINING PROGRAMS**

**215.0610 Cars Loaned to Drivers Training School.** A distributor buys new cars from the manufacturer for resale to dealers. The distributor registers a number of these cars in its own name and loans them to a private advanced driving school. The school offers specialized instruction on high-performance driving that bridges that gap between high-school drivers' education classes and the real world emergencies. Students are admitted to the school free, but by invitation only. Most invitations are issued by the dealers of the cars in question who sponsor the classes.

Since the taxpayer in this case is a distributor, the controlling authority is subdivision (c)(2) of Regulation 1669.5. Under that provision, the tax may be measured by fair rental value when vehicles are loaned to employees or other persons for periods not exceeding 12 months for frequent demonstration and display. The term "other persons" means "persons other than employees" and is further described in the regulation to include "TV studios, visiting dignitaries, etc." The driving school is an "other person" for purposes of the regulation.

Subdivision (c)(2) of Regulation 1669.5 expressly presumes that vehicles registered in the name of the distributor, as these vehicles are, are frequently demonstrated and displayed. Also, the evidence shows that the distributor's purpose in loaning vehicles to the school is to promote the sales of these makes of vehicles. Therefore, the tax on these vehicles may be measured by the 1/40th formula if the loan is measured for a period not exceeding 12 months. If the loan

is for a period of 12 months or more, the measure of tax is the purchase price of the vehicle to the distributor. 1/3/96.

**215.0620 Lessee, Loan by.** An automobile loaned to a school district by a lessee of the vehicle is not exempted from the use tax by section 6404. The lessee cannot be regarded merely as a conduit or agent for the lessor. 3/23/65.

**215.0635 Loan of Vehicle to a School District.** To be regarded as exempt, the loan of a vehicle to a school district must be for an educational program conducted by the district.

The following uses qualify:

- (1) Driver training for students or adults.
- (2) Hauling livestock and feed for the school district's farmer education program or to fairs when the hauling is part of the school district's program to encourage student entrance into fairs and exhibitions.
- (3) Student training in school automobile shops.
- (4) Transportation of teachers, students and/or administrators to educational programs sponsored or given by the school district such as music, special exhibits, etc., if students also are being transported.

The following uses do not qualify:

- (1) Transportation of teachers or school administrators on school business or transportation of special language teachers between schools.
- (2) Use in connection with maintenance of school land or buildings. In addition to the qualifying uses described above, if a loaned vehicle is used to travel to and from the home by an instructor or administrator charged with the responsibility for the vehicle, this incidental use would not disqualify the vehicle from exemption. 9/30/68.