



CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

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EDMUND G. BROWN JR.  
Governor

MARYBEL BATJER  
Secretary, Government Operations Agency

NICOLAS MADUROS  
Director

January 9, 2018

VIA INTERNET

Dear Interested Party:

The Audit Manual (AM) is a guide for the California Department of Tax and Fee Administration (CDTFA) staff in administering tax and fee programs. It is available to the public and can be accessed from the CDTFA web page at <http://www.cdtfa.ca.gov/taxes-and-fees/staxmanuals.htm>.

The Business Tax and Fee Division is proposing to revise AM Chapter 1, *General Information* and AM Chapter 6, *Vehicle, Vessel, and Aircraft Dealers*. The revision material is provided on the following pages for the convenience of interested parties who may wish to submit comments or suggestions. Please feel free to publish this information on your website or otherwise distribute it to your association/members.

If you have any comments or suggestions related to the proposed AM revisions, you may contact the CDTFA at [BTFD-BTCT-AM.RevisionSuggestions@cdtfa.ca.gov](mailto:BTFD-BTCT-AM.RevisionSuggestions@cdtfa.ca.gov). Your comments or suggestions must be received by the CDTFA no later than **March 9, 2018**, in order to be considered by staff.

Thank you for your consideration.

Sincerely,

Trista Gonzalez, Chief  
Tax Policy Bureau  
Business Tax and Fee Division

# AUDIT MANUAL, CHAPTER 1 GENERAL INFORMATION

<b>GENERAL INFORMATION</b>	<b>0100.00</b>
<b>INTRODUCTION</b>	<b>0101.00</b>

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## **PURPOSE OF AUDIT MANUAL** **0101.05**

The Audit Manual (AM) is a guide to conducting the CDTFA audits. It incorporates procedures and techniques that have evolved over a period of years and have proved to be sound and practical. Auditors should carefully study this manual to conduct audits and prepare reports in a uniform manner consistent with approved ~~tax~~ auditing practices.

This manual, however, is not a substitute for experience, training in accounting and auditing, good judgment and active supervision. The procedures outlined in this manual are not inflexible. *However, all sections of Chapter 2, Field Audit Reports, and the italicized portions of the other chapters are to be followed exactly. The audit supervisor must approve any deviation from these instructions.*

## **AUDIT MANUAL REVISIONS** **0101.10**

Procedures have been developed to ~~afford the Board Members (Board) the opportunity to review proposed changes to this manual and to~~ ensure that tax/~~fee~~ payers, ~~taxpayers' their~~ representatives and other interested parties are notified of changes in ~~BOE the CDTFA's~~ policies and procedures that may affect tax/feepayers. AM revisions are generally made to incorporate existing guidance to staff from management, to enhance clarity or to correct errors. All revisions undergo a clearance process. ~~Board approval is obtained via the Business Taxes Committee (BTC) process or via the Board's Administrative Agenda.~~

### **Clearance Process**

Drafts of suggested revisions to AM chapters will complete a two-step clearance process, consisting of a preliminary review by all affected CDTFA ~~units divisions and a selection of field offices,~~ and a final review by Business Tax and Fee Division (BTFD) and Field Operations Division (FOD) management. ~~At least one field office from each Equalization District will participate in the preliminary clearance process.~~

### **Board Approval — Business Taxes Committee (BTC) Process**

If the proposed AM revisions involve policy or procedure modifications that ~~would~~ significantly impact the public, ~~a recommendation will be made to the BTC Chair to place~~ the matter may be handled through the BTC process ~~on the BTC agenda as a separate topic in order~~ to ensure participation by interested parties in discussing the change. This process will include the customary discussion and issue papers and interested parties meetings.

**~~Board Approval Process—Administrative Agenda~~**

AM revisions that do not involve policy or procedure modifications ~~that~~ which are handled through the BTC process ~~would significantly impact the public will be provided to Board Member staff and~~ are posted ~~for two months to~~ on the BOE's CDTFA's ~~Internet~~ website located at <http://www.cdtfa.ca.gov/taxes-and-fees/staxmanuals.htm>. ~~A “pending approval” icon on the website manuals page will identify chapters with~~ Pending revisions are listed under the specific manual chapter to which they pertain, ~~and~~ a A cover letter attached to the proposed revisions ~~will~~ explains the origin and need for the revisions and invites public comment on these revisions only. Staff will acknowledge and address all comments, and once the final revisions are approved by management, the approved revisions are incorporated into the AM. ~~will then schedule the revisions for approval on the Board's Administrative Agenda. The materials provided to the Board Members will include a summary of the comments received and actions taken in response to the comments.~~

## AUDIT MANUAL, CHAPTER 6 VEHICLE, VESSEL AND AIRCRAFT DEALERS

### COURTESY VEHICLE LOANS

0614.25

#### ~~In~~ GENERAL —

Motor vehicle dealers loan their customers vehicles (loaner vehicles) under various situations. The application of sales or use tax depends upon how the dealer obtains the vehicle and under what circumstances the vehicle is loaned to the dealer's customer. For information on how the California Tire Recycling Fees apply to courtesy vehicle loans, see AM section 0612.45, *Tire Recycling Fee*.

When a dealer buys a vehicle to be used exclusively as a loaner vehicle for customers while the dealer is servicing or repairing the customers' vehicles, it is considered a company vehicle and the dealer cannot issue a resale certificate when purchasing the loaner vehicle. Sales tax applies to the sale of the vehicle to the dealer, or if they purchase the vehicle without paying tax, the dealer owes use tax based on the purchase price of the vehicle. If the dealer later resells the vehicle, they are responsible for the tax, based on the selling price of the vehicle, since the sale is a separate sales transaction.

However, there may be instances in which a dealer does not buy a vehicle to be used exclusively as a loaner vehicle but the vehicle they buy or lease is used as a loaner vehicle. Typically, the dealer would obtain the vehicle from one of the following:

- Resale or lease inventory, or
- Purchased or leased under a special accommodation program, or
- Leased from a third-party lessor (i.e., car rental agency).

#### VEHICLES PURCHASED UNDER A RESALE CERTIFICATE

When vehicles purchased under a resale certificate are loaned to customers who are awaiting delivery of vehicles purchased or leased from the dealer, or while the customers' vehicles are being repaired by the dealer, the measure of tax is the fair rental value of the loaned vehicle for the duration of each loan so made. If a specific charge is made for use of the vehicle, such charge shall be considered the fair rental value. If the dealer has previously reported tax on the cost of the loaned vehicle, no additional tax is due.

When vehicles are loaned to persons who are not customers awaiting delivery of a vehicle purchased or leased from the dealer, or the return of a repaired vehicle, there is generally no provision to measure use tax liability by other than the purchase price. However, if such loans are for very short periods of time, interspersed with frequent demonstration or display while holding the vehicle for sale in the regular course of business, the tax liability may be based on the fair rental value.

When the loan of a vehicle is not interspersed with frequent demonstration or display, but is loaned for a period of 30 days or less to a person other than a customer

awaiting delivery of a vehicle or return of a repaired vehicle, tax is due on the fair rental value, provided the loaned vehicle was frequently demonstrated or displayed prior to being loaned and continues to be demonstrated or displayed following its loan. However, if the loan period does not constitute an incidental use (30 days or less) or the loaned vehicle is not frequently demonstrated and displayed during the period of loan, tax is measured by the purchase price of the loaned vehicle.

When a lessor loans a vehicle to a lessee who is awaiting delivery or return of a leased vehicle, and the regular lease payments continue to accrue during the period of the loan, the regular lease payments will be considered to cover the use of the loaned vehicle.

### **SPECIAL COURTESY VEHICLE LOAN PROGRAMS**

Many vehicle manufacturers offer incentives to dealers to participate in Special Accommodation Programs (SAPs). ~~Special Accommodation Programs~~ SAPs exist between vehicle manufacturers and dealers that require the dealers to maintain an inventory of a certain number of vehicles for the specific purpose of loaning the vehicles to customers who are waiting for ~~awaiting repairs to~~ their leased and/or owned vehicles to be repaired or serviced. Generally, dealers purchase these courtesy loan vehicles under a resale certificate. Distributors ~~will~~ sell the vehicles to dealers with the understanding that the dealers will use the vehicles exclusively for accommodation loan purposes for a certain period of time; ~~thereafter~~ After that period, the dealers ~~are free~~ may ~~to~~ sell the vehicles and collect tax reimbursement from their customer.

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 from the finance company to the dealer is actually a sale at inception. In exchange for agreeing to the restrictions on use of the vehicle and ability to sell the vehicle, the dealer's lease payments may be subsidized.

### **Taxable Measure Under These Programs**

If a dealer provides a courtesy accommodation loan to a customer who is awaiting the repair of a vehicle leased from that dealer or another dealer who is part of the integrated manufacturer's courtesy accommodation program, and the lease is a continuing sale, the vehicle loan is part of that continuing sale. In this case, the dealer is entitled to purchase the vehicle for resale and no further tax is due with respect to the vehicle loan made to the person leasing the vehicle.

Accordingly, dealers participating in the manufacturers' courtesy loan program may issue resale certificates to distributors for purchases of vehicles used exclusively as accommodation loans to persons leasing vehicles in continuing sales. However, except as discussed below, when dealers loan these vehicles to customers who own their vehicles (and to those whose leases are not continuing sales), the dealers are regarded as using the vehicles and owe use tax measured by the fair rental value of the vehicles loaned.

To support and document loan of courtesy vehicles to persons leasing in continuing sales, dealers should retain appropriate documentation to substantiate any claimed exclusion from measuring tax based on the fair rental value. Dealers should maintain documentation such as repair invoices, lease agreements, service or maintenance retention schedules, and other pertinent documents that support amounts claimed by the dealer. Sufficient documentation to distinguish between vehicle loans made to customers who own their vehicles and those leasing under a continuing sale must be retained by the dealers. If the dealer does not maintain the required documentation, the dealer owes tax on the fair rental value for all courtesy accommodation loans of these vehicles. Where the ~~BOE-CDTFA~~ establishes a deficiency, the burden is upon the taxpayer to explain the disparity between the books and records and the results of the ~~BOE's-CDTFA's~~ audit.

In some instances, vehicle dealers do not actually lease vehicles. 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 a separate business where all lease payments are remitted. Under these circumstances, accommodation loans provided to customers awaiting repair of vehicles leased should be treated as one transaction for purposes of a continuing sale whether the customer's lease originates through the dealer providing the accommodation loan or another dealer participating in the manufacturers' courtesy loan program.

If a dealer does not offer a vehicle as a daily rental, then the fair rental value is the amount for which other dealers in the area rent similar vehicles for similar periods to persons who are not customers awaiting delivery of vehicles purchased or leased or repaired by the dealer. (Regulation 1669.5(b)(6)) If a similar vehicle is not leased (e.g. Lexus and Infiniti dealerships do not generally rent their vehicles), then a reasonable fair rental value of the accommodation loan vehicle for each month will be obtained by using 1/40th of the purchase price of the vehicle as outlined in Regulation 1669.5(b)(3)(A).

## **LOANER VEHICLES FROM THIRD-PARTY LESSORS**

Dealers may lease vehicles from third-party lessors to use as loaner vehicles to their customers. Third-party leases include those from car rental agencies or vehicles leased under a Special Accommodation Program (as explained above) to use as loaner vehicles. Generally, a dealer may issue a timely resale certificate to the third-party lessor when the leased vehicle will be used in a nontaxable manner. However, in some instances, the dealer may lease a vehicle and pay tax to the lessor measured by the lease receipts. The following explains how tax applies to three different types of courtesy loans when dealers obtain loaner vehicles from third-party lessors and pay tax on their lease receipts.

### 1. Customer is provided a loaner vehicle as a courtesy

When a dealer loans a vehicle to their customer free of charge solely as a courtesy (for example, their customer's vehicle is being repaired or serviced under an optional warranty or their customer is awaiting delivery of their new vehicle), the dealer makes a use of the vehicle and the tax applies to the lease of the vehicle. In this instance, the dealer may not claim a tax-paid purchases resold credit or

file a claim for refund for the tax paid to the third-party lessor on the lease payments.

2. Customer's vehicle is being serviced or repaired under a mandatory or standard manufacturer's warranty

When a dealer loans a vehicle to their customer whose vehicle is being serviced or repaired under a mandatory or standard manufacturer's warranty, the loan of the vehicle is considered to be part of the original sales contract and no additional tax is due. In this situation, the dealer may claim a tax-paid purchases resold credit on their sales and use tax return or file a claim for refund for the tax paid to the third-party lessor on those lease payments that are for the period(s) of nontaxable use.

3. Customer's leased vehicle is being serviced or repaired or customer is awaiting delivery of their newly leased vehicle

When a dealer loans a vehicle to their customer whose leased vehicle is being serviced or repaired or to a customer who is awaiting delivery of their newly leased vehicle and the customer's regular lease payments continue to accrue, no further tax is due. The dealer may claim a tax-paid purchases resold credit on their sales and use tax return or file a claim for refund for the tax paid to the third-party lessor on those lease payments that are for the period(s) of nontaxable use.