

# Memorandum

215.0015

To : Mr. Robert Nunes  
Chief, Annotations Project

Date: June 27, 1997

From : David H. Levine  
Supervising Tax Counsel

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Subject: Accommodation Loans

Certain automobile manufacturers and distributors offer accommodation loan programs to their dealers. We have considered the application of tax to the programs. After several memoranda were written by Legal and several meetings were held between Legal and the Department, we eventually determined the correct application of tax. Analysis and conclusions from these memoranda and meetings were compiled in a memorandum dated August 16, 1996 from Program Planning Manager Dennis Fox to the District Administrators, a copy of which is attached. I have reviewed the memorandum and confirm that it is correct and incorporate it herein by reference. I note that in a later memorandum to the District Administrators, Mr. Fox provided the following additional guidance regarding the determination of fair rental value:

“In the [August 16, 1996] memo, I recommended that staff may prorate the *normal* monthly lease rate of the loan vehicles for purposes of determining the daily fair rental value in cases where dealerships (and other area dealers) do not provide daily rental of types of vehicles loaned under these programs. Under these specific accommodation loan programs, if a dealer does not offer a vehicle as a daily rental, then we believe 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).

“Although a greater value may be established by looking at third party car rental companies in the same area, we do not believe the additional measure warrants the time and expense which would be needed to document the increase in measure.”

It seems that an annotation on this subject would require most of the language in the attached memorandum to capture the essence of our conclusions and to ensure that readers understand the limited circumstances to which these conclusions apply.

DHL/cmm  
Attachment

**M e m o r a n d u m****215.0015**

To : District Administrators

Date: August 16, 1996

From : Dennis Fox  
Program Planning ManagerSubject : **Accomodation Loan Car Programs**

This is to provide you with guidance concerning the handling of certain specialized accommodation loan programs currently conducted by a number of L--- and I--- dealerships and other vehicle dealers throughout the state. 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, we have found that 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.

In previously considering this matter, we concluded that a distributor's sale of a vehicle to a dealer solely for purposes of accommodation loan is a retail sale subject to tax. In such case, a resale certificate should not be issued by the dealer since the vehicles are not held for resale in the regular course of business<sup>1</sup>. After further consideration and consulting with Legal, we have now concluded that depending on the facts of the transaction, a dealer can be regarded as acquiring the vehicles for resale if the actual accommodation loans constitute sales. The following will serve to clarify:

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

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<sup>1</sup> Generally, a person cannot purchase property for resale in a sale and leaseback transaction qualifying under Regulation 1660 or Section 6010.5 because a sale and leaseback qualifying for nontaxable treatment under either of these provisions is not regarded as a "sale" or "purchase" for purposes of the Sales and Use Tax Law. However, when a person enters into a sale and leaseback prior to functionally using the property, that person often has a choice of purchasing the property for resale, with tax applying to the sale or to the leaseback, or alternatively paying tax on the original purchase price with neither the sale nor the leaseback subject to tax. If the tax is paid on the original purchase price, or on the subsequent sale and leaseback with respect to these particular accommodation loan programs, no further tax is due on the fair rental value of vehicles loaned for accommodation purposes. In addition, no consideration for refund of the tax paid (or any portion thereof) would be applicable under circumstances where accommodation loans are provided to customers awaiting repair of vehicles leased from the dealer. The subsequent sale of the vehicles by the dealer would of course be subject to sales tax unless otherwise exempt by statute or excluded by type of transaction.

accommodation loan vehicle to its lessee 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. (Further reference to the term "lease" hereafter means a continuing sale lease unless otherwise specified.) 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 sale leases.

Accordingly, if a dealership leases vehicles, the dealer may issue a resale certificate to a distributor for the purchase of vehicles to be used exclusively as accommodation loans. 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 by the dealer, the dealer is regarded as using the vehicles and owes use tax measured by fair rental value of the vehicle [Section 6094(b)].

Upon review of these programs, we have concluded that generally a number of these vehicles are often loaned to some persons leasing in continuing sales. Under these circumstances, the dealers may purchase the vehicles for resale. However, in order for these type of accommodation loans to be regarded as part of the lease of vehicles being repaired, the dealer will be required to fully document each individual occurrence if they wish to exclude the fair rental value from the measure of tax. That is, the dealers must specifically substantiate their deduction from fair rental value for each vehicle and on each occasion the vehicle is loaned to persons leasing 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 on the fair rental value for all accommodation loans of vehicles made under these programs.

We are aware that in many instances vehicle dealerships do not actually lease vehicles, but rather a separate related financing company or arm of the dealership or distributor becomes the ultimate lessor. Also, in some cases, the lease agreements may show the dealership as the original lessor, but the lease is later assigned to a separate concern where all lease payments are remitted. Notwithstanding, upon review of these programs, and considering the unique circumstances of financing and leasing arrangements made within this industry, we have concluded that 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. That is, under the above discussed programs, when an accommodation loan vehicle is provided by a dealership to a customer who is awaiting repair of the vehicle leased by the financing arm or a separate legal relative of the dealership, franchise, or distributor, the regular lease payments will be considered to cover the use of the substitute loan vehicle and no additional tax will be due provided the lease payments continue to accrue during the period of the loan and the customer originally arranged for the lease through the dealership providing the accommodation vehicle<sup>2</sup>. Accommodation loans of vehicles made to

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<sup>2</sup> As an example, if L--- F--- S--- (LFS) leases 1,000 vehicles and 50 of the vehicle leases originated through XYZ L--- Dealership, the XYZ dealership could only claim deduction from fair rental value on accommodation loans of vehicles made to the same 50 customers who had originally arranged through XYZ to lease vehicles from LFS and are awaiting repair of the vehicles from XYZ. The 50 vehicle leases may have originally been assigned by ZYZ to LFS or the customer may have contracted directly with LFS through facilities or personnel provided by or in physical association with XYZ L--- dealership.

customers awaiting repair of vehicles leased by an unrelated dealer, distributor or franchise would be subject to tax measured by fair rental value.

This analysis applies *only* with respect to these particular accommodation loan programs. Again, the dealer must fully document these transactions or the dealer will be required to pay tax on the fair rental value of the vehicles so loaned. I suspect few dealers will wish to document a partial exemption and will therefore report tax on the fair rental value of all loans.

In final note, Regulation 1669.5(b)(6) provides that “*if the dealer does not rent vehicles...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 from the other dealers or being repaired by the other dealers.*” We understand that in many instances, L--- and I--- dealerships (and other area dealers) do not generally rent the type of vehicles provided under these accommodation loan programs (i.e., provide daily rentals). Under these circumstances, district staff are advised to prorate the normal monthly lease rate on these types of vehicles for purposes of determining the daily fair rental value for vehicles loaned under these specific accommodation loan programs.

If you have any questions, please let me know.

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Cc: Mr. Glenn Bystrom  
Mr. Gary Jugum  
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