August 10, 2022

VIA INTERNET

Dear Interested Party:

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

The Business Tax and Fee Division is proposing to revise AM Chapter 6, section 0614.25 which provides updated guidance on the application of tax to vehicles used by motor vehicle dealers for vehicle loan accommodation programs. Included in the Audit Manual section 0614.25, is clarification that standby time is not a taxable use of a loaner vehicle.

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. Your comments or suggestions must be received by the CDTFA no later than September 12, 2022 in order to be considered. Thank you for your consideration.

Sincerely,

Aimee Olhiser
Tax Policy Bureau Chief
Business Tax and Fee Division
Motor vehicle dealers loan vehicles (loaner vehicles) to 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 for use as a loaner vehicle for customers, while the dealer is servicing or repairing the customers’ customer-owned 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 the dealer is 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 maintain an inventory of vehicles for use exclusively as loaner vehicles, but obtains a vehicle for use as a loaner vehicle for some amount of time. 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 a dealer purchases a vehicle under a resale certificate, and otherwise holds a vehicle for resale, loans the vehicle to a customer who is awaiting delivery of a vehicle purchased or leased from the dealer, or awaiting the repair of their vehicle by the dealer, the dealer owes tax on that use (the loan), except as explained below. When tax applies, 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 a vehicle is loaned to a person who is not a customer, but is awaiting delivery of a vehicle purchased or leased from the dealer, or the return of a repaired vehicle by the dealer, tax would generally be measured by the purchase price. However, if such loan is for a very short period of time, combined 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 instead be based on fair rental value of the loan.

When the loan of a vehicle is not interspersed with frequent demonstration or display combined with frequent demonstration or display during the loan period 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. If
the lease is a continuing sale, and use tax is being collected and remitted on the regular
lease payments, no additional tax is due as a result of the loan.

**Special Courtesy Vehicle Loan Programs**

Many vehicle manufacturers offer incentives to dealers to participate in Special
Accommodation Programs (SAPs). SAPs require 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 their leased and/or owned vehicles to be repaired or serviced.
Generally, dealers purchase these courtesy loan vehicles under a resale certificate.
Distributors 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.
After that period, the dealers may 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. The dealer purchases vehicles from the distributor, immediately resells the
vehicles to the finance company, and leases them back. In most cases, the lease from
the finance company to the dealer is actually considered 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 In these situations, the loan is regarded as part of
the lease constituting a continuing sale and no further tax is due with respect to the
vehicle loan made to the person leasing the that 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 for the duration of each loan so made.

To support and document loan of courtesy vehicles to persons leasing in continuing sales, dealers Dealers should retain appropriate documentation to substantiate any claimed exclusion from measuring tax based on tax measured by 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 California Department of Tax and Fee Administration (CDTFA) establishes a deficiency, the burden is upon the taxpayer to explain the disparity between the discrepancy between its books and records and the results of the 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. Where an accommodation loan is made to a customer awaiting repair of a vehicle leased in a continuing sale from the dealer, another dealer who is part of the integrated manufacturer’s courtesy accommodation program, or a finance company related to such a dealer, no further tax will be due on an accommodation loan.

If a dealer does not offer a vehicle as a daily rental similar vehicles as a daily rental to customers not awaiting delivery of vehicles purchased or leased from the dealer or being repaired by the dealer, 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 monthly 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 method as outlined in Regulation 1669.5(b)(3)(A). The monthly fair rental value based on 1/40th of the purchase price of the vehicle may be prorated to determine a daily fair rental value when the dealer’s use of the vehicle as a loaner is for only a fraction of the month. Standby time in which the loaner vehicle is waiting to be loaned to customers is not considered a taxable use.

**Mandatory or Standard Manufacturer’s Warranty**

As part of a mandatory or standard manufacturer’s warranty, the manufacturer or warrantor may include a courtesy transportation program that provides the vehicle owner or lessee with a loaner vehicle while their vehicle is in for repair. When the loan
of the vehicle is in fulfillment of the contract requirements of a mandatory or standard manufacturer’s warranty upon which tax or tax reimbursement was paid at the time of sale, the loan of the vehicle is regarded as part of the original sales contract or lease agreement for the vehicle being repaired. The vehicle loans are not considered accommodation loans; they are considered part of the original sale contract.

When the vehicle being repaired is owned by the customer, tax does not apply to the use of the loaned vehicle. The loan of the vehicle is regarded as part of the original taxable sale or contract price of the vehicle being repaired for which the measure of tax included the warranty. Dealers may lease the vehicles from third parties ex-tax for resale or provide one of their own resale vehicles in fulfillment of the provisions of the original taxable sale.

Optional Warranty

When the warranty is optional, the dealer, obligated under the contract, is considered the consumer of the loaned vehicle. As the consumer, the dealer makes a taxable use of the loaned vehicle. Whether the loan of the vehicle is in fulfillment of the provisions of an optional warranty or an accommodation loan, tax is generally due on rentals payable (if the loaned vehicle is rented from another source) or fair rental value (if taken from resale inventory).

With respect to vehicles loaned to lessees of vehicles, it is irrelevant whether the lease contract requires the dealer and/or lessor to provide the lessee a loaner vehicle while the lease vehicle is being repaired. If the lease is a taxable continuing sale, the use of the loaned vehicle is regarded as part of the taxable continuing sale. Dealers/lessors may lease the vehicles from third parties ex-tax for resale or provide one of their own resale vehicles as part of the taxable continuing sale.

If the lease is not a taxable continuing sale (tax or tax reimbursement was paid on the purchase price of the vehicle), the dealer/lessor is not regarded as making a loan of the vehicle as part of the taxable continuing sale. Thus, the dealer/lessor is regarded as using any loaner vehicle provided to the customer whether that loan is required by the lease contract or not. The dealer/lessor may not lease the vehicle from a third-party ex-tax for resale. If the dealer/lessor makes a use of one of its own resale vehicles, tax is generally due on fair rental value.

**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 (SAP) (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 as a loaner vehicle (1) for their customer whose vehicle is being serviced or repaired under a mandatory or standard manufacturer’s warranty, or (2) for their customer whose leased vehicle is being serviced or repaired, or (3) for a customer who is awaiting delivery of their newly leased vehicle and the customer’s regular lease payments continue to accrue. 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, the 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 to the dealer. 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 taxable 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.