**Internal Revenue**
# bulletin

**Bulletin No. 2001–51**
**December 17, 2001**

## HIGHLIGHTS OF THIS ISSUE

**These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.**

## INCOME TAX

**Rev. Rul. 2001–59, page 585.**
**Bank bad debts; clarification of the conformity method.** This ruling provides guidance to banks using the conformity election as to what steps are necessary to assign a loan as a loss asset. Also, the conclusive presumption of worthlessness will apply to loans erroneously charged off if the charge-offs are not substantially in excess of those warranted by reasonable business judgment.

**Rev. Rul. 2001–60, page 587.**
**Golf course greens land preparation costs.** The costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of push-up or natural soil golf course greens are not depreciable. However, the costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern golf course greens that is so closely associated with depreciable assets, such as a network of underground drainage tiles or pipes, that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are depreciable. Rev. Rul. 55–290 modified and superseded. Rev. Proc. 99–49 modified and amplified.

**Rev. Proc. 2001–56, page 590.**
This procedure provides optional methods for determining the value of the use of demonstration automobiles provided to employees by automobile dealerships. The optional methods include (1) a simplified method for the full exclusion of qualified automobile demonstration use, (2) a simplified method for the partial exclusion of nonqualified demonstration automobile use, and (3) a simplified method for the full inclusion of nonqualified demonstration automobile use.

## EMPLOYEE PLANS

**Announcement 2001–122, page 604.**
**Extension of time for filing forms described in Announcement 2001–77.** This announcement extends through March 31, 2002, the cut-off date for the use of the prior revision of certain forms used to apply for determination letters on the tax-qualified status of employee benefit plans described in section I.G. of Announcement 2001–77 (2001–30 I.R.B. 83).

## EMPLOYMENT TAX

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**Page 603.**
**2002 social security contribution and benefit base; domestic employee coverage threshold.** The Commissioner of the Social Security Administration has announced (1) the OASDI contribution and benefit base for remuneration paid in 2002 and self-employment income earned in taxable years beginning in 2002, and (2) the domestic employee coverage threshold amount for 2002.

**(Continued on the next page)**

**Actions Relating to Court Decisions is on the page following the Introduction.**
**Announcement of Declaratory Judgment Proceedings Under Section 7428 begins on page 604.**
**Finding Lists begin on page ii.**

Department of the Treasury
Internal Revenue Service

# ADMINISTRATIVE

**Notice 2001–75, page 590.**

**Equity investment prior to new markets tax credit allocation.** An equity investment in an entity will be eligible to be designated as a qualified equity investment under section 45D(b)(1) of the Code if (1) the equity investment is made on or after April 20, 2001, (2) the entity in which the equity investment is made is certified by Treasury's Community Development Financial Institutions Fund (CDFI Fund) as a qualified community development entity under section 45D(c)(1) before January 1, 2003, (3) the entity in which the equity investment is made receives notification of a credit allocation (with the actual receipt of such credit allocation contingent upon subsequently entering into an allocation agreement) from the CDFI Fund before January 1, 2003, and (4) the equity investment otherwise satisfies the requirements of section 45D.

# The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

### Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

### Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

### Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

# Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decision:

**Robert L. Beck v. Commissioner,**[1]
T.C. Memo. 2001–198 (filed July 30, 2001)
Dkt. Nos. 14577–98 and 14578–98

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[1] Acquiescence relating to whether the Tax Court has jurisdiction to review the Service's determination that a spouse is not entitled to equitable relief under I.R.C. section 66(c).

# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 166.—Bad Debts

*26 CFR 1.166–2: Evidence of worthlessness.*

**Bank bad debts; clarification of the conformity method.** A bank has classified loans as loss assets under the conformity election if the loans are charged off pursuant to a board of director's resolution authorizing the charge-offs only if required under regulatory standards. Also, the conclusive presumption of worthlessness under the conformity election applies to loans erroneously charged off for regulatory purposes, if the bank's charge-offs are not substantially in excess of those warranted by reasonable business judgment.

## Rev. Rul. 2001–59

ISSUES

1. What steps are necessary to record or memorialize the assignment of a loan (or loan portion) as a "loss asset" for purposes of the conformity method of accounting for worthless bad debts?

2. Does the conclusive presumption of worthlessness under the conformity method apply to loans erroneously classified as loss assets?

FACTS

*ABC* corporation is a "bank" (as defined in § 1.166–2(d)(4)(i) of the Income Tax Regulations) and is subject to supervision by Federal authorities. *ABC* has elected under § 1.166–2(d)(3) to use the conformity method of accounting to determine when debts owed to *ABC* become worthless bad debts.

Under a resolution adopted by *ABC's* board of directors, *ABC's* officers and employees are authorized to charge off loans (or portions of loans) only when the charge-off is required under the loan loss classification standards issued by the bank's supervisory authority. Thus, when *ABC's* officers and employees charge off a loan for regulatory purposes, they do not take any additional steps to record or memorialize whether, in their judgment, the charge-off is required by the loan loss standards that have been issued by *ABC's* supervisory authority.

The loan loss standards require *ABC* to charge off "loss assets." Loss assets are loans (or portions of loans) determined to be uncollectible and of such little value that their continuance as bankable assets is not warranted. In the case of a consumer loan or credit card debt, regardless whether there is specific adverse information about the borrower, *ABC* is required to charge off the asset when its delinquency exceeds certain established thresholds. Thus, *ABC* must charge off installment loans that are 120 days, or five payments, past due and credit card debts that are 180 days past due after seven zero billings. In addition, if *ABC* receives specific adverse borrower information (for example, the borrower's death or bankruptcy) confirming a loss before the applicable 120 day or 180 day threshold date has passed, then an immediate charge-off is required. *See* Comptroller of the Currency, "Allowance for Loan and Lease Losses," *Comptroller's Handbook* 10, 19 (June 1996); "Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks," Attachment to Comptroller of the Currency Banking Circular No. 127, Rev. 4–26–91.

*ABC's* supervisory authority, in connection with its most recent examination of the bank's loan review process, made an express determination that *ABC* maintains and applies loan loss standards that are consistent with the regulatory standards issued by the Comptroller of the Currency.

During the taxable year ending on December 31, 2000, *ABC* charged off for regulatory purposes certain credit card debts that were not required to be charged off under applicable regulatory loan loss standards. Except for the erroneously charged off credit card debts, *ABC* charged off only loans required to be charged off under the loan loss standards.

On its Federal income tax return for 2000, *ABC* deducted as wholly worthless debts all assets that it had charged off for regulatory purposes, including the debts that had been erroneously charged off despite the absence of an applicable regulatory requirement. Even so, the total amount of worthless bad debts claimed on the return was not substantially in excess of the amount that would be warranted by the exercise of reasonable business judgment in applying the loan loss standards of *ABC's* supervisory authority.

LAW AND ANALYSIS

Section 166(a)(1) of the Internal Revenue Code allows a deduction for a debt that becomes worthless during the taxable year. In addition, § 166(a)(2) permits a deduction for "partially worthless debts" if the taxpayer charges off an appropriate amount on the taxpayer's books and records and the Internal Revenue Service is satisfied that the debt is recoverable only in part.

No precise test exists for determining whether a debt is worthless. In many situations, no single factor or identifiable event clearly demonstrates whether a debt has become worthless. Instead, a series of factors or events in the aggregate establishes whether the debt is worthless. Among the factors indicating worthlessness are: a debtor's serious financial reverses, insolvency, lack of assets, continued refusal to respond to demands for payment, ill health, death, disappearance, abandonment of business, and bankruptcy. Additionally, a debt's unsecured or subordinated status and expiration of the statute of limitations can provide an indication that the debt is worthless. Conversely, availability of collateral or third party guarantees, a debtor's earning capacity, payment of interest, a creditor's failure to press for payment, and a creditor's willingness to make further advances are factors suggesting that the debt is not worthless. Accordingly, § 1.166–2 of the regulations requires consideration of all pertinent evidence and provides that a deduction is warranted if the surrounding circumstances indicate that the debt is uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment.

In the case of a "bank" (as defined in § 1.166–2(d)(4)(i) of the regulations) or other corporation subject to supervision by Federal authorities, or by State authorities maintaining substantially

equivalent standards, § 1.166–2(d)(1) provides administrative simplicity by creating a conclusive presumption of worthlessness for loans charged off in whole or in part in obedience to specific orders or in accordance with the established policies of those authorities.

Additional simplification is provided by § 1.166–2(d)(3) of the regulations for tax years ending on or after December 31, 1991. Under the regulation, a bank subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, may elect to use the conformity method of accounting to determine when a debt becomes worthless. Under the conformity method, a conclusive presumption of worthlessness applies to loans charged off, in whole or in part, for regulatory purposes if the charge-offs correspond to the bank's classification of the loans, in whole or in part, as loss assets under applicable regulatory standards. Section 1.166–2(d)(3)(ii)(A)(2) provides that a bad debt deduction is allowed for the taxable year in which a debt is conclusively presumed to have become worthless.

For the conclusive presumption of worthlessness to arise, a bank must satisfy the express determination requirement of § 1.166–2(d)(3)(iii)(D) of the regulations and must classify the loan, in whole or in part, as a loss asset as described in § 1.166–2(d)(3)(ii)(C). The express determination requirement is satisfied if the bank's supervisory authority, in connection with its most recent examination of the bank's loan review process, has made an express determination that the bank maintains and applies loan loss classification standards that are consistent with the authority's regulatory standards. *See* Rev. Proc. 92–84 (1992–2 C.B. 489) (providing the form for the determination letter). Section 1.166–2(d)(3)(ii)(C) defines the term "loss asset" as a debt that the bank has assigned to a class that corresponds to a loss asset classification under the standards set forth in the "Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks" or similar guidance issued by the bank's supervisory authority.

Various procedures can be used by a bank to classify loans (or loan portions) as loss assets. For example, an officer or employee may record or memorialize on a form the determination that a loan (or loan portion) is a loss asset. Loan or credit committee reports or internal credit rating reports also can demonstrate that a loan has been classified as a loss asset. Additionally, if officers and employees are authorized to charge off loans (or loan portions) only if the loans (or loan portions) are loss assets, then the charge-offs of the loans (or loan portions) demonstrate that the loans (or loan portions) have been classified as loss assets.

*ABC* has made the conformity election under § 1.166–2(d)(3) of the regulations and has satisfied the express determination requirement described in § 1.166–2(d)(3)(iii)(D). Additionally, under the resolution adopted by *ABC's* board of directors, *ABC's* officers and employees are authorized to charge off loans (or portions of thereof) only if the charge-offs are required under applicable loan loss standards issued by *ABC's* supervisory authority. Under these circumstances, *ABC's* charge-offs of certain loans (or loan portions) are sufficient to demonstrate classification of those loans (or loan portions) as loss assets under standards issued by *ABC's* supervisory authority.

Under § 1.166–2(d)(3)(ii) of the regulations, the conclusive presumption of worthlessness applies to loans charged off, in whole or in part, for regulatory purposes if the charge-off corresponds to the bank's classification of the loans, in whole or in part, as loss assets under applicable regulatory standards. Although the applicable loan loss regulatory standards did not require *ABC* to charge off certain credit card debts, the conclusive presumption of worthlessness attached to those debts when *ABC* erroneously charged off the debts for regulatory purposes.

Under § 1.166–2(d)(3)(iv)(D) of the regulations, if an electing bank fails to follow the conformity method of accounting to determine when debts become worthless, or if the bank's charge-offs are substantially in excess of those warranted by reasonable business judgment in applying the regulatory standards of the bank's supervisory authority, then the Commissioner may revoke the bank's election to use the conformity method. Under the facts described above, however, except for the erroneously charged off credit card debts, *ABC* properly used regulatory loan loss standards to determine its worthless bad debts and did not claim a deduction on its return for bad debts substantially in excess of the amount warranted by reasonable business judgment under the applicable regulatory standards. If the deduction claimed had been substantially in excess of that amount, the Commissioner could have revoked the conformity election.

## HOLDINGS

1. *ABC's* charge-offs of certain loans (or portions thereof), pursuant to a board of directors' resolution authorizing the charge-off of a loan (or portion thereof) only if the charge-off is required under applicable regulatory standards issued by the bank's supervisory authority, are sufficient to demonstrate classification of the loans (or loan portions) as loss assets for purposes of § 1.166–2(d)(3) of the regulations.

2. The conclusive presumption of worthlessness applies to the credit card debts that *ABC* erroneously charged off for regulatory purposes during the taxable year ending on December 31, 2000. *ABC*, on its 2000 income tax return, properly deducted the credit card debts as worthless bad debts.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Craig Wojay of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Wojay at (202) 622–3920 (not a toll-free call).

## Section 167.—Depreciation

*26 CFR 1.167(a)–2: Tangible property.*
*(Also § 168.)*

**Golf course greens land preparation costs.** The costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of push-up or natural soil golf course greens are not depreciable, but the costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern golf course greens that is so closely associated with depreciable assets, such as a network of underground drainage tiles or pipes, that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are depreciable.

## Rev. Rul. 2001–60

ISSUE

Are land preparation costs incurred by a taxpayer in the original construction or reconstruction of golf course greens subject to an allowance for depreciation under § 167 of the Internal Revenue Code?

FACTS

Two types of golf course greens that are currently in use are "push-up" or natural soil greens and "modern" greens. Push-up or natural soil greens are essentially landscaping that involves some reshaping or regrading of the land. The soil is pushed up or reshaped to form the green. While push-up or natural soil greens may have limited irrigation systems (such as hoses and sprinklers adjacent to the greens), a subsurface drainage system is not utilized.

Modern greens make use of technological changes in green design and construction and contain sophisticated integrated drainage systems. The construction of the modern green occurs after the general earthmoving, grading, and initial shaping of the area surrounding and underneath the green. These greens are constructed with a network of subsurface drainage tiles or interconnected pipes, one or more layers of gravel and/or sand particles, a rootzone layer, and a variety of turfgrass. Over time, the modern green loses its effectiveness as a drainage system due to tile or pipe deterioration, or sediment blockage. Replacement of the subsurface drainage tiles or pipes requires excavation and replacement of the gravel layer, rootzone layer, and turfgrass above the tiles or pipes. The subsurface drainage tiles or pipes typically are replaced within 20 years.

LAW AND ANALYSIS

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion and wear and tear of property used in a trade or business or held for the production of income.

Section 1.167(a)–2 of the Income Tax Regulations provides that in the case of tangible property, the depreciation allowance applies only to that part of the property that is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to land apart from the improvements or physical development added to it.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances: (1) the general depreciation system in § 168(a); and (2) the alternative depreciation system in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

The applicable recovery period for purposes of § 168(a) or § 168(g) is determined by reference to class life. Section 168(i)(1) provides that the term "class life" means the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under former § 167(m) as if it were in effect and the taxpayer had elected under that section. Prior to its revocation, § 167(m) provided that in the case of a taxpayer who elected the asset depreciation range system of depreciation, the depreciation deduction would be computed based on the class life prescribed by the Secretary that reasonably reflects the anticipated useful life of that class of property to the industry or other group.

Rev. Proc. 87–56 (1987–2 C.B. 674) sets forth the class lives of property that are necessary to compute the depreciation allowance under § 168. This revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business activities.

Asset class 00.3, Land Improvements, of Rev. Proc. 87–56 includes improvements directly to or added to land, whether the improvements are § 1245 or § 1250 property, provided the improvements are depreciable. Examples of these assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers, wharves and docks, bridges, fences, landscaping, shrubbery, or radio and television transmitting towers. Assets included in asset class 00.3 have a recovery period of 15 years for purposes of § 168(a) and 20 years for purposes of § 168(g).

Rev. Rul. 55–290 (1955–1 C.B. 320) concludes that expenditures incurred by a taxpayer in the original construction of golf course greens are capital expenditures that are added to the original cost of the land and are not subject to an allowance for depreciation. The revenue ruling also concludes that subsequent operating expenses for sod, seed, soil, and other sundry maintenance are ordinary and necessary business expenses that are deductible from gross income for federal income tax purposes.

In *Edinboro Company v. United States*, 224 F. Supp. 301 (W.D.Pa. 1963), the court held that golf course improvements, such as greens, tees, fairways, and traps, were not depreciable under § 167(a) because they are not distinguishable from the land, which is molded and reshaped to form them, and, like the land, they have an unlimited useful life. The court concluded that "[a] golf course is primarily a landscaping proposition[, although] [o]ccasionally a green or a trap or bunker is altered or rebuilt." The taxpayer in *Edinboro* failed to demonstrate a determinable useful life of the golf course improvements, or that the improvements were subject to wear and tear, exhaustion,

or obsolescence that could not be fully reversed by annual maintenance.

Although the depreciation allowance generally does not apply to land because land has no determinable useful life, land preparation may be depreciable if it is closely associated with depreciable assets so that it is possible to establish a determinable period over which the land preparation will be useful in a particular trade or business. A useful life for land preparation is established if it will be replaced contemporaneously with a related depreciable asset. Whether land preparation will be replaced contemporaneously with a related depreciable asset is a question of fact, but if the replacement of the asset will require the physical destruction of the land preparation, this test will be considered satisfied. Rev. Rul. 68–193 (1968–1 C.B. 79) clarifying Rev. Rul. 65–265 (1965–2 C.B. 52) (costs for a roadway grading that would be retired contemporaneously with a building are depreciable); Rev. Rul. 72–96 (1972–1 C.B. 66) (land preparation costs for a reservoir that would be retired contemporaneously with an electric generating plant are depreciable); Rev. Rul. 74–265 (1974–1 C.B. 56) (the cost of shrubbery immediately adjacent to apartment buildings is depreciable because the shrubbery would be retired contemporaneously with the buildings); Rev. Rul. 80–93 (1980–1 C.B. 50) (costs for excavation and backfilling that would be retired contemporaneously with laundry facilities and a storm sewer system are depreciable).

While § 168 determines the amount of the depreciation allowance provided by § 167(a) for tangible property placed in service generally after 1986, § 167 determines whether the tangible property is depreciable property. Under § 167 and the regulations thereunder, land is not depreciable. Similarly, the costs of general grading or shaping of land are not depreciable because the land preparation is inextricably associated with the land. However, if the land preparation is so closely associated with depreciable assets that it will be retired, abandoned, or replaced contemporaneously with those assets, a useful life for land preparation is established and, therefore, the cost of the land preparation is depreciable.

Push-up or natural soil greens are representative of the type of green commonly in use when Rev. Rul. 55–290 was issued and *Edinboro* was decided. Push-up or natural soil greens are essentially landscaping that involves some reshaping or regrading of the land. Accordingly, the Service will continue to follow the holdings in Rev. Rul. 55–290 and *Edinboro* with respect to push-up or natural soil greens.

Unlike push-up or natural soil greens, the modern green is a sophisticated improvement to the land carefully designed to facilitate drainage. Essential components of the modern green are the underground drainage tiles or interconnected pipes. Because these tiles or pipes deteriorate over time, they have a determinable useful life and, therefore, are depreciable. Asset class 00.3, Land Improvements, of Rev. Proc. 87–56, includes drainage facilities. The gravel layer, rootzone layer, and turfgrass above the network of underground drainage tiles or interconnected pipes are so closely associated with these tiles or pipes that replacement of the tiles or pipes will require the contemporaneous physical destruction of that land preparation. Thus, it is possible to establish a determinable useful life for the land preparation above the underground tiles and pipes.

## HOLDINGS

Land preparation undertaken by a taxpayer in the original construction or reconstruction of push-up or natural soil greens is inextricably associated with the land and, therefore, the costs attributable to this land preparation are added to the taxpayer's cost basis in the land and are not depreciable.

The costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern greens that is so closely associated with depreciable assets, such as a network of underground drainage tiles or pipes, that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are to be capitalized and depreciated over the recovery period of the depreciable assets with which the land preparation is associated. For purposes of § 168, the modern green described above is includible in asset class 00.3, Land Improvements, of Rev. Proc. 87–56. However, the general earthmoving, grading, and initial shaping of the area surrounding and underneath the modern green that occur before the construction are inextricably associated with the land and, therefore, the costs attributable to this land preparation are added to the taxpayer's cost basis in the land and are not depreciable.

Subsequent operating expenses for sod, seed, soil, and other sundry maintenance are ordinary and necessary business expenses that are deductible from gross income for federal income tax purposes.

## CHANGE IN METHOD OF ACCOUNTING

Any change in a taxpayer's treatment of the cost of modern greens to conform with this revenue ruling is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer wanting to change the method of accounting for the cost of modern greens owned by the taxpayer at the beginning of the year of change to conform with this revenue ruling must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49 (1999–2 C.B. 725) (or its successor), unless the scope limitations in section 4.02 of Rev. Proc. 99–49 apply.

## EFFECT ON OTHER DOCUMENTS

Rev. Rul. 55–290 is modified and superseded. Rev. Proc. 99–49 is modified and amplified to include this accounting method change in the APPENDIX.

## PROSPECTIVE APPLICATION

A taxpayer may continue to use its present method of treating the cost of modern greens placed in service during any taxable year beginning before November 29, 2001, as a nondepreciable capital expenditure.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Mark Pitzer of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mark Pitzer at (202) 622–3110 (not a toll-free call).

## Section 168.—Accelerated Cost Recovery System

If the costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern golf course greens are depreciable, what is the classification of these costs under § 168(e)(1) of the Internal Revenue Code? See Rev. Rul. 2001–60, page 587.

# Part III. Administrative, Procedural, and Miscellaneous

## Section 45D.—New Markets Tax Credit

## Notice 2001–75

PURPOSE

This notice clarifies that certain equity investments may be eligible for the new markets tax credit under § 45D of the Internal Revenue Code, notwithstanding that they are made before the receipt of a credit allocation from the Secretary of the Treasury under § 45D(f)(2).

BACKGROUND

Section 45D(a)(1) provides a new markets tax credit on certain credit allowance dates described in § 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity (CDE).

Section 45D(b)(1) provides that an investment in a CDE is a qualified equity investment only if, among other things, the CDE designates the investment as a qualified equity investment.

Section 45D(c)(1) provides that an entity is a CDE only if, among other things, the entity is certified by the Secretary as a CDE.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments may not exceed the portion of the new markets tax credit limitation set forth in § 45D(f) that is allocated to the CDE by the Secretary under § 45D(f)(2).

The Secretary has delegated certain administrative functions relating to the new markets tax credit program to the Under Secretary (Domestic Finance), who in turn has delegated those functions to the Community Development Financial Institutions Fund (CDFI Fund). In accordance with procedures to be issued by the CDFI Fund in the future, the CDFI Fund will request and evaluate applications for CDE certification and for new markets tax credit allocations. Under those procedures, if a CDE is selected to receive a credit allocation, the CDFI Fund will provide to the CDE a notification of credit allocation. However, the CDE's actual receipt of a credit allocation under § 45D(f)(2) will be contingent upon the CDE subsequently entering into an allocation agreement with the CDFI Fund.

DISCUSSION

Questions have arisen as to whether an equity investment in an entity may be eligible to be designated as a qualified equity investment if it is made before the entity is certified by the CDFI Fund as a CDE under § 45D(c)(1) and before the entity enters into an allocation agreement with the CDFI Fund. In such a situation, an equity investment in an entity will be eligible to be designated as a qualified equity investment under § 45D(b)(1) if:

1. The equity investment is made on or after April 20, 2001;

2. The entity in which the equity investment is made is certified by the CDFI Fund as a CDE under § 45D(c)(1) before January 1, 2003;

3. The entity in which the equity investment is made receives notification of a credit allocation (with the actual receipt of such credit allocation contingent upon subsequently entering into an allocation agreement) from the CDFI Fund before January 1, 2003; and

4. The equity investment otherwise satisfies the requirements of § 45D.

In the case of an equity investment that is designated as a qualified equity investment in accordance with this notice, the first credit allowance date under § 45D(a)(3)(A) will be the effective date of the allocation agreement between the CDE and the CDFI Fund.

Regulations to be issued in the near future will incorporate the guidance set forth in this notice. Taxpayers may rely on this notice until those regulations are issued.

DRAFTING INFORMATION

The principal author of this notice is Paul Handleman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Handleman at (202) 622–3040 (not a toll-free call).

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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 limits 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 SALESPEOPLE

***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 nonworkdays) 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 record keeping 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 x 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 employee 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 contrast, 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.irscounsel.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 circumstances, 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.

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## Social Security Contribution and Benefit Base for 2002

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (66 F.R. 54047, dated October 25, 2001) that the contribution and benefit base for remuneration paid in 2002, and self-employment income earned in taxable years beginning in 2002 is $84,900.

**"Old-Law" Contribution and Benefit Base**

*General*

The "old-law" contribution and benefit base for 2002 is $63,000. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. The base is computed under section 230(b) of the Act as it read prior to the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) The Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

**Domestic Employee Coverage Threshold**

*General*

The minimum amount a domestic worker must earn so that such earnings are covered under Social Security or Medicare is the domestic employee coverage threshold. For 2002, this threshold is $1,300. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

*Computation*

Under the formula, the domestic employee coverage threshold amount for 2002 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 2000 to that for 1993. If the resulting amount is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

*Domestic Employee Coverage Threshold Amount*

Multiplying the 1995 domestic employee coverage threshold amount ($1,000) by the ratio of the national average wage index for 2000 ($32,154.82) to that for 1993 ($23,132.67) produces the amount of $1,390.02. We then round this amount to $1,300. Accordingly, the domestic employee coverage threshold amount is $1,300 for 2002.

(Filed by the Office of the Federal Register on October 24, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 25, 2001, 66 F.R. 54047)

# Part IV. Items of General Interest

## Extension of Cut-Off Date for Use of Prior Revision of Determination Letter Application Forms

## Announcement 2001–122

The Service is extending the cut-off date for use of the prior revision of certain forms used to apply for determination letters on the tax-qualified status of employee benefit plans. This extension will allow determination letter applicants to use the prior revision of the forms in accordance with the transition rules described in section I.G. of Announcement 2001–77 (2001–30 I.R.B. 83) through March 31, 2002.

Announcement 2001–77 described changes that the Service has made to simplify its application procedures for determination letters on the qualification of pension, profit-sharing, stock bonus and annuity plans under §§ 401(a) and 403(a) of the Internal Revenue Code. Announcement 2001–77 noted that the Service was revising the determination letter application forms. Section I.G. of Announcement 2001–77 required determination letter applications filed after December 31, 2001, to be submitted on the revised application forms. For determination letter applications filed on or before December 31, 2001, section I.G. provided transition rules that allowed the prior revision of the application forms to be used.

Announcement 2001–109 (2001–45 I.R.B. 485) announced the availability of several of the revised application forms. Rev. Proc. 2001–55 (2001–49 I.R.B. 552) extended the remedial amendment period for amending plans for GUST[1] until February 28, 2002.

The availability of the transition rules in section I.G. of Announcement 2001–77 is extended through March 31, 2002. Thus, the Service will accept applications that are filed on the July, 1998 revision of the following forms in accordance with the procedures in section I.G. through March 31, 2002: Form 5300, Schedule Q (Form 5300), Form 5307, and Form 6406. Of course, applicants may instead use the 2001 revision of these forms. In addition, Form 5303 (Rev. 7/98), which is being discontinued, and the September, 1999 revision of Form 5309 may be used through March 31, 2002. Applications for determination letters on plan termination should be filed on the June, 1997 revision of Form 5310 and, if applicable, Form 6088 (Rev. 6/97) until further notice. Also, notices of plan merger, etc., and qualified separate lines of business, should be filed on the June, 1997 revision of Form 5310–A until further notice.

DRAFTING INFORMATION

The principal author of this announcement is James Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Flannery may be reached at (202) 283–9888 (not a toll-free number).

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## Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

This announcement serves notice to donors that on July 26, 1999, the Court of Appeals for the Eleventh Circuit affirmed the decision of the United States Tax Court which was entered on August 28, 1998. The Courts agreed with the Service that the organization listed below is not an organization recognized as tax exempt under section 501(a) of the Internal Revenue Code and is not described in section 501(c)(3) effective October 1, 1982.

Anclote Psychiatric Center, Inc.
Tarpon Springs, FL

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[1] "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

# Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

# Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

*A*—Individual.
*Acq.*—Acquiescence.
*B*—Individual.
*BE*—Beneficiary.
*BK*—Bank.
*B.T.A.*—Board of Tax Appeals.
*C*—Individual.
*C.B.*—Cumulative Bulletin.
*CFR*—Code of Federal Regulations.
*CI*—City.
*COOP*—Cooperative.
*Ct.D.*—Court Decision.
*CY*—County.
*D*—Decedent.
*DC*—Dummy Corporation.
*DE*—Donee.
*Del. Order*—Delegation Order.
*DISC*—Domestic International Sales Corporation.
*DR*—Donor.
*E*—Estate.
*EE*—Employee.
*E.O.*—Executive Order.
*ER*—Employer.
*ERISA*—Employee Retirement Income Security Act.
*EX*—Executor.
*F*—Fiduciary.
*FC*—Foreign Country.
*FICA*—Federal Insurance Contributions Act.
*FISC*—Foreign International Sales Company.
*FPH*—Foreign Personal Holding Company.
*F.R.*—Federal Register.
*FUTA*—Federal Unemployment Tax Act.
*FX*—Foreign Corporation.
*G.C.M.*—Chief Counsel's Memorandum.
*GE*—Grantee.
*GP*—General Partner.
*GR*—Grantor.
*IC*—Insurance Company.
*I.R.B.*—Intemal Revenue Bulletin.
*LE*—Lessee.
*LP*—Limited Partner.
*LR*—Lessor.
*M*—Minor.
*Nonacq.*—Nonacquiescence.
*O*—Organization.
*P*—Parent Corporation.
*PHC*—Personal Holding Company.
*PO*—Possession of the U.S.
*PR*—Partner.
*PRS*—Partnership.
*PTE*—Prohibited Transaction Exemption.
*Pub. L.*—Public Law.
*REIT*—Real Estate Investment Trust.
*Rev. Proc*—Revenue Procedure.
*Rev. Rul.*—Revenue Ruling.
*S*—Subsidiary.
*S.P.R.*—Statements of Procedural Rules.
*Stat.*—Statutes at Large.
*T*—Target Corporation.
*T.C.*—Tax Court.
*T.D.*—Treasury Decision.
*TFE*—Transferee.
*TFR*—Transferor.
*T.I.R.*—Technical Information Release.
*TP*—Taxpayer.
*TR*—Trust.
*TT*—Trustee.
*U.S.C.*—United States Code.
*X*—Corporation.
*Y*—Corporation.
*Z*—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001–1 through 2001–26 is in Internal Revenue Bulletin 2001–27, dated July 2, 2001.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–1 through 2001–26 is in Internal Revenue Bulletin 2001–27, dated July 2, 2001.