

FACTS: During 1988, Honest John's Auto Sales, a dealer in new and used cars, sold some new cars, some used cars, some company cars (used in the business to run errands, etc.), and some demonstrators.

ISSUES: To establish the proper treatment for the gain on the sales of autos made by Honest John's Auto Sales we must determine whether profits and losses from the sale of these automobiles occurred from the everyday operation of Honest John's Auto Sales or from gain on Section 1231 trade or business assets. In order to do this we must answer the following questions.

- Good*
- 1). What is the inventory treatment of the property in question?
 - 2). What is the taxpayer's trade or business?
 - 3). Is the property acquired with the primary intention that it be sold?
 - 4). How long is the property held before disposition?

ANALYSIS:

During 1988 Honest John's Auto Sales sold:

- 1). New cars,
- 2). Used cars,
- 3). Company cars used to run errands, and
- 4). Cars used as demonstrators.

The client would like to know if any of these sales can be considered as sales of Section 1231 assets?

Long and awkward

Section 1231 ^{1231(a)(1)} (b)(1) of the Internal Revenue Code states that property used in ^{or} trade or business is depreciable property used in a trade or business that is held for more than 6 months (12 months in 1988) if it is not of a kind of property properly includable in inventory if it is on hand at the end of a taxable year and if it is not property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business.

Rev.Rul. 75-538, 1975-2 C.B. 34 says "A motor vehicle dealer is presumed to hold all vehicles, including those temporarily withdrawn from inventory for business use or for demonstrations, primarily for sale to customers unless it is clearly shown that the vehicles were actually devoted to use in the dealer's business and that the dealer looks to such use to recover their cost."

The client is a dealer in new and used cars and sells these cars in the course of his trade or business. Clearly, Section 1231 treatment is denied to him or any other automobile dealer where new and used cars held for resale are concerned.

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This leaves us with the automobiles used as demonstrators and the cars used in the business to run errands. In order to deal with them we must answer several questions. These are:

- 1). What is the primary purpose for which the automobile is used?
 - a). Is it to further the sale of the client's other automobiles?
 - b). Is the automobile in question itself for sale?
- 2). Is the automobile in question being used in such a way that it decreases its value significantly or that the cost has to be recovered by its use rather than by its sale?

Why?
As to the demonstrators, in Duval Motor Co., 28 T.C. 42, aff'd (5 cir; 1959) 3 AFTR2d 799, 264 F.2d 548, Section 1231 treatment was denied for cars assigned to company personnel for personal use and display, demonstration, parades and loans during repairs. Cars were sold on the introduction of new models or when the mileage had reached 15 thousand miles. However, in that same case, Section 1231 treatment was allowed for cars used for deliveries and for parts and service departments that were sold after two and a half to five years.

In Luhring Motor Co., Inc., 42 T.C. 732 dis (4 Cir:4/5/65) the court found that cars temporarily assigned for company use were being held for sale. They were available for sale while assigned. The cars were generally used for less than one year before they were sold and were sold at a price exceeding the dealers original cost. Here again, Section 1231 treatment was denied.

Section 1231 treatment was also denied in W.R. Stephens & Co., 51,231 P-H Memo TC, aff'd (8 Cir;1952) 199 F.2d 665, 42 AFTR 752, where the court said that a car acquired by a dealer for resale does not become property used in a trade or business when it is merely used for a temporary period as a demonstrator.

In R.E. Moorhead & Son, Inc., Dec 26,210, 40 T.C. 704, The Tax Court denied Section 1231 treatment saying that while many of the cars were used in business, they were demonstrators held primarily for sale.

In Fields v. Granquist, (D.C. Ore; 1955), 134 F.Supp.624, 48 AFTR 186, while 1231 treatment was allowed on some cars, any that had been listed as demonstrators were denied 1231 treatment. These cars were considered by the court to have been held for sale to customers.

The above mentioned court cases clearly indicate that a demonstrator automobile is also ineligible for treatment under Section 1231.

Finally, we must deal with the status of the company automobiles used by the business to run errands, and in this instance, Section 1231 treatment is more attainable. Contrary to the client's situation with the new, used, and demonstrator automobiles, merely being a car dealer does not deprive him of Section 1231 treatment with regard to these cars so long as he commits them over a reasonable useful life to the purpose of his business.

Rev.Rul. 75-538, 1975-2 C.B. 34 says that it must be clearly shown that the motor vehicle was actually devoted to use in the business of the dealer and that the dealer looks to consumption through use of the vehicle in the ordinary course business operation to recover the dealer's cost.

In Massey Motors, Inc. v. U.S., (D.C. Fla.; 1957), 156 F.Supp. 516, 52 AFTR 933, aff'd (5 Cir;1959), 3 AFTR 787, 264 F.2d 1780, 364 U.S. 92, 4 L.Ed.2d 1592, 80 Sct. 1411, Section 1231 treatment was allowed on the sale of cars used in business by officials of the dealer's wholly owned subsidiary. The dealer had insured the cars for his exclusive benefit and had purchased regular license plates. The cars were used by the dealer in his everyday business.

In John P. Wagner, et al., 58,112 P-H TC Memo, Section 1231 treatment was allowed in the sale of automobiles that had been used to carry spare parts and for other business purposes. The taxpayers business was selling new busses and automobiles. (date)

In Latimer-Looney Chevrolet, Inc., 19 T.C. 120, dis (6 Cir;5/7/53) Section 1231 treatment was allowed even though the manufacturer's accounting system required the dealer to enter all new cars in his books as "New cars available for sale." Shortly after their acquisition, the dealer paid cash for the cars, insured them and purchased license tags. The cars were sold after between eight and twelve thousand miles.

In Duval Motor Co., 28 T.C. 42, mentioned earlier, while Section 1231 treatment was denied the dealer on many of his automobiles, it was allowed on cars used for deliveries and by the parts and service departments. These cars were kept by the dealer for between two and one half and four years.

In W.R. Stephens Co. v. Kelm, (DC Minn;1956), 140 F.Supp. 12,49 AFTR 1038, Section 1231 treatment was allowed the taxpayer on new cars he assigned to employees for business use and later sold at new car prices. The cars sold were used for between eight and thirteen months and had an average of seven thousand miles on them at the time of sale. The cars were not all current models.

Clearly Section 1231 treatment is appropriate for company automobiles used to run errands in the course of the day to day business of the client so long as that is the purpose to which these automobiles are dedicated and the use is not incidental to the automobiles being held for resale.

CONCLUSION:

Honest John's Auto Sales is not eligible for Section 1231 treatment on its new cars, used cars or demonstrators. They can however claim Section 1231 treatment for automobiles used to run errands in the course of their daily business so long as these cars are dedicated to this use and expected to justify their cost in service rather than at the time of sale. It is not necessary that these cars be sold at an actual loss but profit or loss at the time of sale must be incidental to their use in the trade or business.

(10) Excellent -
But, need have focused on the
differences between some similar
overlapping cases, but in consistent
cases.

RESEARCH TRAIL:

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