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New Vehicle Tax Deduction

Watch your (GVW) weight and your AMT.

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The 2009 Federal Stimulus Package that was signed into law in February contains a favorable incentive for purchasers (but not lessees) of a new car, motorcycle, truck or SUV (sports utility vehicle) weighing less than 8,500 pounds (based on Gross Vehicle Weight (GVW)), which includes passenger and cargo capacities, as well as recreational vehicles (RVs) of any weight.

For example, Hummer models H1 and H2 are ineligible since they have GVWs exceeding the 8,500 threshold. However, Hummer H3 models are under the weight limit, therefore are eligible for the new sales/excise tax deduction.

To determine the GVW of the vehicles on your target list, visit <http://auto.howstuffworks.com/auto-parts/towing/towing-capacity/vehicle/gvwr.htm>.

Why the Shift in Gears?

The purpose of this tax provision was to jump-start the ailing auto industry — both manufacturers, as well as retailers. It might be a little too late, but auto dealers are certainly seeing people on their lots making reference to this tax break.

Months after enactment, there continues to be a fair amount of taxpayer confusion regarding the specifics of this new incentive. Since the legislation started off as a tax **credit**, but morphed into a tax **deduction** (which is only worth approximately one-third the value of a credit) in the Senate, most vehicle shoppers still think this is a tax credit.

The new federal tax deduction allows nonbusiness taxpayers to deduct the sales or excise tax attributable to the first \$49,500 of the new vehicle purchase. Taxpayers with Adjusted Gross Incomes (AGI) of less than \$250,000 (Joint Filers) or \$125,000 (Single) can claim the full benefit on both domestic and foreign vehicles purchased on or after February 17, 2009 and no later than December 31, 2009. Those making more than these thresholds will be subjected to phased-out benefits. Therefore, family members who might be over these limits should evaluate who will be using the vehicle and who should make the purchase in order to maximize the benefit.

Business taxpayers will generally not benefit under this provision since they are generally required to capitalize the sales or excise tax as part of the acquisition of the vehicle. The capitalized costs will then be eligible for Section 179, bonus or regular depreciation expense.

If a California based nonbusiness taxpayer would be entitled to a sales tax deduction of \$4,579 (\$49,500 limit times 9.25% sales tax rate) if s/he purchased a Cadillac Escalade (a 7,200-pound "lightweight" SUV) for \$75,000 in Los Angeles County. The \$4,579 deduction represents a federal tax savings of approximately \$1,511 (two percent of the purchase price or three percent of the \$49,500 maximum purchase price) for a taxpayer in the 33 percent tax bracket. This example presumes that the purchaser uses the vehicle solely for personal purposes. Sales tax associated with the business-use percentage of vehicle will generally reduce the Schedule A or "above the line" deduction and such amount must be capitalized and will impact the annual business depreciation deduction.

One tricky element associated with this new tax incentive may limit the tax savings to a very small number of taxpayers. If the taxpayer is subject to the federal Alternative Minimum Tax (AMT) for 2009, and the taxpayer claims this deduction on Schedule A, along with other allowable deductions, the sales/excise tax might yield no federal tax benefit since the AMT system will add this deduction back to AMT Taxable Income. Non-itemizers who are allowed to deduct this expense "above the line" (without the use of Schedule A), will be allowed to deduct the full amount for both regular and AMT purposes. However, from a practical perspective very few non-itemizers are subject to AMT anyway, so the exemption from AMT will be very limited.

While we are on the subject of vehicle deductions, it is worth noting that as part of the federal Stimulus Package, Congress also increased the first year auto depreciation limit for business vehicles by \$8,000 for a revised 2009 limit of \$10,160, and \$11,160 for light trucks and vans. These revised limits are the same as the temporary 2008 increase and will only apply to new and used vehicles placed in service during calendar 2009. Of course this presumes 100 percent business-use, the personal use will proportionately scale back these new limits.

A number of hybrid and alternative fuel vehicles also continue to be eligible for federal and state tax credits, but watch out for production limits and caps on the credits.

Conclusion

Earlier this month Congress narrowly passed the "Cash for Clunkers" legislation as part of a war funding bill, which will entitle individual taxpayers owning older gas-guzzling vehicles to receive an electronic voucher which can be used to purchase or lease (60 months or more) a new fuel efficient vehicle.

This program is scheduled to run from July 1st through September 1st with an estimated cost of approximately \$1 billion. The program may be extended, depending on results from this first phase.

The voucher amounts vary by the type of vehicle traded in. The credits range from:

- \$3,500 for autos traded in with average city and highway EPA estimated gas mileage (MPG) of less than 18 MPG in exchange for a new vehicle with a rating of at least 22 MPG. Owners of SUV's, light trucks and minivans can also obtain a \$3,500 voucher if they trade in a vehicle with less than 18 MPG for a new vehicle with at least two MPG improvement.
- \$4,500 vouchers can be obtained in those cases where the MPG on the new vehicle is 10 MPG or better than the sub-18 MPG auto traded in, or five MPG improvement in the case of an SUV, Light-Truck or Minivan.

The base MPG and the new vehicle MPG for purposes measuring the improvement spread is based on the EPA estimated city/highway MPG disclosed on the vehicle's window sticker and the vehicle traded in must be less than 25-years-old.

This program can be attractive to any taxpayer since there is no AGI limit and the voucher amount is nontaxable.

Additional information can be obtained at: www.cashforclunkersfacts.com.

Despite the turmoil in the auto industry, and potential limits on the new sales/use tax deduction, it is a good time to consider purchasing a new vehicle in order to save some federal taxes.

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