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Special Rules on Vehicle Deductions and Credits

-by Neil E. Harl*

In an effort to provide economic incentives for individuals to shift to electrically-powered vehicles and vehicles using “clean fuels,” Congress has provided preferential income tax treatment for such vehicles. In general, the special tax provisions are available for both business vehicles and those used for personal driving.

Depreciation limits

In general, depreciation limits have been imposed on “passenger automobiles” for passenger automobiles placed in service after 1986. For 2004, the maximum depreciation claimable on passenger automobiles is $2,960 the year placed in service, $4,800 the second year, $2,850 the third year and $1,675 for each succeeding year. For vehicles placed in service in 2003 and later years, higher dollar limits are provided for vans and light trucks to reflect a higher rate of price inflation.

The term “passenger automobile” is defined as a vehicle rated at 6,000 pounds unloaded gross vehicle weight or less, gross vehicle weight for trucks and vans. Regulations published in 2003 exclude from the definition of passenger automobile any truck or van that is a “qualified nonpersonal use vehicle” which by its nature is not likely to be used more than a de minimis amount for personal purposes.

A 1998 amendment specifies that the maximum depreciation amounts that may be claimed for electric vehicles (“purpose built” vehicles) are tripled. That provision applies to vehicles placed in service after August 5, 1997, and before January 1, 2007. Thus, the dollar limits are $8,880 the first year (for vehicles placed in service in 2004), $14,400 the second year, $8,550 the third year and $5,025 for each succeeding year.

Credit for electric vehicles

Currently, taxpayers are allowed a non-refundable credit for 10 percent of the cost of any “qualified electric vehicle” (QEV) acquired for original use by the taxpayer. A QEV is any motor vehicle powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells or other portable sources of electric current. The vehicle must be manufactured for use by the taxpayer and not for resale. Eligible vehicles must be manufactured primarily for use on public streets, roads and highways (not including a vehicle operated exclusively on a rail or rails) and must have at least four wheels.

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The income tax basis of the vehicle must be reduced by the amount of the credit.\textsuperscript{19} If the vehicle ceases to be eligible for the credit, the amount of the credit is subject to recapture.\textsuperscript{20} No credit is allowed for property used outside the United States\textsuperscript{21} or for the portion of cost of a vehicle claimed as expense method depreciation.\textsuperscript{22} Also, no credit is allowed if the taxpayer elects not to have the rules for the credit apply to the vehicle.\textsuperscript{23}

The maximum credit is $4,000.\textsuperscript{24} The credit is scheduled to be reduced by 75 percent for vehicles placed in service after 2005.\textsuperscript{25} The credit is scheduled to terminate for vehicles placed in service after December 31, 2006.\textsuperscript{26}

**Deduction for clean-fuel vehicles**

A deduction is allowed for qualified “clean fuel” vehicles.\textsuperscript{27} Electric vehicles are not eligible.\textsuperscript{28} The motor vehicle, to be eligible, must meet applicable federal and state emissions standards with respect to each fuel propelling the vehicle and, for retrofitted vehicles, emissions-related certification, testing and warranty requirements.\textsuperscript{29}

The maximum amount of the deduction is limited to $50,000 for a truck or van with a GVW of more than 26,000 pounds; $5,000 for a truck or van with a GVW of more than 10,000 pounds but not more than 26,000 pounds; and $2,000 for all other vehicles.\textsuperscript{30} The deduction is scheduled to be reduced by 75 percent after 2005\textsuperscript{31} and to terminate for vehicles placed in service after December 31, 2006.\textsuperscript{32}

The following vehicles have been certified for the deduction:
- Toyota Prios, 2001-2005 model years
- Honda Insight, 2000-2005 model years
- Honda Civic Hybrid, 2003-2005 model years
- Ford Escape, 2005 model year\textsuperscript{33}
- Honda Accord Hybrid, 2005 model year\textsuperscript{34}

The deduction is claimed as an adjustment to gross income for a non-business deduction and on Schedules C or F under “other expenses” for a business deduction.

If claimed, the deduction reduces the vehicle’s basis\textsuperscript{35} and is subject to recapture.\textsuperscript{36}

**FOOTNOTES**

1 I.R.C. § 30.
2 I.R.C. § 179A.
5 The first year allowance has been increased by legislation authorizing 30 percent or 50 percent “bonus” depreciation for 2001-2004. See I.R.C. § 168(k)(4). The depreciation limit on passenger automobiles for the first year was increased by $4,600 under the 2002 law, providing for 30 percent bonus depreciation, and by $7,650 (to $10,710) for 50 percent bonus depreciation. See I.R.C. § 280F(a)(1)(A); Rev. Proc. 2003-75, I.R.B. 2003-43; Rev. Proc. 2004-20, I.R.B. 2004-13, 642, Table 2.
9 I.R.C. §§ 280F(a)(1), 280F(d)(5).
10 Temp. Treas. Reg. §§ 1.280F-6T(c)(3)(iii); 1.274-5T(k).
15 I.R.C. § 30.
16 I.R.C. § 30(c).
17 I.R.C. § 30(c)(1)(C).
18 I.R.C. § 30(c)(2).
19 I.R.C. § 30(d)(1).
20 I.R.C. § 30(d)(2).
22 I.R.C. §§ 30(d)(3), 179.
23 I.R.C. § 30(d)(4).
24 I.R.C. § 30(b)(1).
25 I.R.C. § 30(b)(2).
26 I.R.C. § 30(e).
27 I.R.C. § 179A.
28 I.R.C. § 179A(c)(3).
29 I.R.C. § 179A(c)(2).
30 I.R.C. § 179A(b).
32 I.R.C. § 179A(f).
33 IR 2004-147.
35 I.R.C. § 179A(e)(6).