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Qualified Electric Car Credit

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THE QUALIFIED ELECTRIC CAR CREDIT

legislated in 1992 was scheduled to be phased out between 2002 and 2004, but the Job Creation and Worker Assistance Act of 2002 (JCWAA) amended the tax provision by deferring the phaseout credit for two years. More recently, the Working Families Tax Act of 2004 (WFTA) eliminated the phaseout for 2004 and 2005. Consequently, taxpayers are permitted to take the full credit in 2002 through 2005, with the phaseout shifted to 2006 and 2007.

Section 30 of the Internal Revenue Code states that a taxpayer who buys and uses any qualified electric car will be allowed a tax credit equal to 10% of the car's cost in that tax year. The credit is limited to \$4,000 per vehicle. In order to qualify for the electric car credit, the car must be a motor vehicle, defined in IRC §30(c)(2) as any vehicle with at least four wheels that's manufactured for use on public streets, roads, and highways. In addition, the electric car must satisfy three requirements: (1) It must be powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current; (2) the taxpayer is the car's first owner; and (3) the car is acquired for use by

the taxpayer and not for resale [IRC §30(c)]. Gasoline/hybrid vehicles do *not* qualify for the credit, however, because they aren't powered primarily by an electric motor.

As an added bonus, the qualified car can be used for either business or personal purposes. The credit, however, isn't allowed for property used outside the United States or that is owned or leased by governmental units or certain tax-exempt organizations. Furthermore, vehicles that have been converted to electric power aren't eligible for the credit.

There is a limitation on the amount of credit for tax years ending after June 30, 1996. The credit can't exceed the excess of regular tax for the year reduced by the sum of nonrefundable personal credits, the taxes of foreign countries and possessions of the U.S., possessions tax credit, and the credit for producing fuel from a nonconventional source

credit, over the tentative minimum tax for the tax year [IRC §30(b)(3)]. For any qualified electric car placed in service after December 31, 2005, the credit will be phased out as amended by the JCWAA. Per §30(b)(2), the allowable credit is reduced to \$1,000 in 2006 and eliminated thereafter [IRC §30(e)].

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According to §30(d)(2), if the vehicle no longer fits the definition of a qualified electric vehicle within three years of when it was placed in service, the credit must be recaptured. Regulation §1.30-1(2) states that a vehicle ceases to be a qualified vehicle if: (1) It's modified so that it isn't powered by electricity, (2) it is used in a manner as described in §50(b), or (3) the taxpayer who claimed the credit sells or disposes of the vehicle while knowing—or having reason to know—that it will be modified or used as described in (1) or (2). Section 50(b) refers to situations when the vehicle is used predominantly outside the U.S., for lodging, or sold or disposed of when the person who claimed the credit knows or has reason to know that it will be modified or have its use changed in any manner. Sales or dispositions, accidents, and casualties involving the vehicle are not treated as recapture events [Reg. §1.30-1(2)(ii)]. The recapture date is the date that the vehicle no longer qualified as an electric vehicle.

The recapture amount must be added to the tax owed for the year in which the vehicle no longer qualifies for the credit. The amount, however, isn't treated as income tax for computing the AMT or for determining the amount of other allowable credits. If a recapture is triggered for a credit partially disallowed under §30(b)(3)(B) and added to the taxpayer's minimum tax credit carryover, then the taxpayer must reduce the minimum tax credit carryover by an amount equal to the portion of any minimum tax credit carryover attributable to the disallowed §30 credit multiplied by the recapture percentage for the tax-

able year of recapture. The taxpayer must also reduce any other credit carryover amounts by the portion of carryover attributable to §30, multiplied by the recapture percentage [Reg. §1.30-1(b)(ii)].

The amount of recapture is equal to the applicable recapture percentage times the amount of the credit claimed for that vehicle. The applicable percentage rates are:

- 100% if the recapture date is within the first full year of placing the vehicle into service,
- 66.67% if the recapture date is within the second full year of placing the vehicle into service, and
- 33.33% if the recapture date is within the third full year of placing the vehicle into service.

Example: Judith purchases a qualified electric car for personal use on July 4, 2003, for \$20,000. As a result, Judith was able to claim a \$2,000 (10% of \$20,000, limited to \$4,000) electric vehicle tax credit on her 2003 tax return. If, however, Judith modifies the vehicle in August 2005 so that it's no longer electric powered, she must recapture \$667 ($\$2,000 \times 33.33\%$) of the credit claimed on her 2003 return.

The recapture rules also affect the basis of the vehicle. For example, the basis of the electric vehicle is increased by the amount of carryover reductions and the recapture amount. When the vehicle is depreciable, the increased basis from the recapture may be deducted under the cost recovery rules (i.e., depreciation) over the remainder of the recovery period for the vehicle beginning as of the first day of the tax year of the recapture [Reg. §1.30-1(b)(6)].

For purposes of §1245, the amount of the credit taken under

§30(a) is treated as a deduction allowed for depreciation under §167. Under sale or other disposition of a depreciable qualified electric vehicle, therefore, the recapture provisions of §1245 will apply to any gain recognized to the extent the basis of the depreciable vehicle was reduced under §30(d)(1) net of any basis increase [Reg. §1.30-1(b)(7)]. For example, a business that purchases a qualified vehicle in 2005 for \$34,000 has a tax credit for \$3,400 (10% of \$34,000, with a limit of \$4,000) and a depreciation expense of \$3,600. The adjusted basis of the vehicle is \$27,000. If the vehicle is sold in 2006 for \$32,000, the company has a §1245 recapture of \$5,000, which is the depreciation allowance of \$3,000 plus the tax credit of \$2,000.

The moral is simple. First, time still remains for a person or a business to take advantage of the electric vehicle tax credit in 2004 and 2005 before 75% of the credit evaporates as the ball drops on Times Square for the start of the 2006 New Year. Second, once the electric car credit is taken, keep the car electric powered for at least three years to avoid the messy recapture and subsequent depreciation rules. Third, have a happy holiday season! ■

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