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NEWS RELEASE

FOR IMMEDIATE RELEASE

Planning Nuances and Unanswered Questions Complicate the New Deduction for Motor Vehicle Taxes

New York, NY, March 2, 2009 – The recently enacted Stimulus Plan includes a new income tax deduction for state or local sales or excise tax paid on qualifying 2009 motor vehicle purchases. It sounds pretty straightforward but William E. Massey, a Senior Tax Analyst at Thomson Reuters notes that “planning nuances and unanswered questions” can cause complications for some taxpayers. These planning nuances arise from how the new deduction interacts with other tax rules, as Massey explains below in setting out the details of the new deduction.

New temporary deduction. For purchases on or after Feb. 17, 2009 and before Jan. 1, 2010, the Stimulus Plan expands the definition of taxes allowed as a deduction to include “qualified motor vehicle taxes” paid or accrued within the tax year. The deduction generally is allowed to itemizers, but also is allowed to those claiming the standard deduction as an addition to that deduction.

Covered taxes and vehicles. Qualified motor vehicle taxes are state or local sales or excise taxes imposed on the purchase of a brand new (1) passenger automobile, light truck or motorcycle the vehicle gross weight rating of which is not more than 8,500 pounds, or (2) motor home.

Limitation based on vehicle’s purchase price. Only taxes on the motor vehicle’s purchase price up to \$49,500 may be deducted. This is one area where there are unanswered questions. For example, it is not clear whether an individual can claim a deduction for more than one vehicle if the amount claimed for each vehicle is under \$49,500 or whether, in the case of a married couple, each spouse can claim the deduction. The IRS presumably will be addressing these issues in forthcoming guidance.

Income limitation. The amount of sales or excise taxes that may be treated as qualified motor vehicle taxes is phased out ratably for a taxpayer with modified AGI (MAGI) between \$125,000 and \$135,000 (\$250,000 and \$260,000 on a joint return). MAGI is adjusted gross income computed in a special way.



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Interplay with pre-2010 optional sales tax deduction for itemizers. The deduction for qualified motor vehicle taxes is not available to a taxpayer who elects to deduct state and local sales and use taxes in lieu of income taxes as an itemized deduction. This means that, for those who itemize and choose to deduct state sales taxes in lieu of state income taxes, the new deduction is not allowed. That's because, such individuals can already deduct the sales tax on a car purchase. The prohibition prevents a double deduction for the same item.

Massey notes, however, that there are a few caveats here. For purposes of the optional sales tax deduction, (1) if the rate of tax on motor vehicles exceeds the general sales tax rate, the deduction is limited to the general rate; and (2) there is no purchase price limitation or separate income limitation. The rule in (1) could limit the optional sales tax deduction where the sales tax rate on an automobile purchase is higher than the general sales tax rate, especially where the car is modestly priced. If the car's cost is well in excess of \$49,500, that difference would probably become immaterial and it would be better to take the unlimited optional sales tax deduction than the Stimulus Plan's new deduction for those who have a choice. In states where there is an income tax, the optional deduction will usually only be taken if there is a purchase of some major item such as an automobile. Thus, in those states the election will be less likely to be made now since the new deduction for qualified motor vehicle taxes can be taken in addition to income taxes that are taken as an itemized deduction.

Interplay with AMT. The new deduction for qualified motor vehicle taxes is allowed in computing the AMT but the preexisting optional sales tax deduction is not. Thus, Massey observes that if "a taxpayer would be subject to the AMT before taking a deduction for state or local taxes into account, the taxpayer would never benefit by electing to deduct state or local sales or use taxes instead of income taxes since such a deduction would not be allowed in computing the AMT, and the taxpayer would lose the new deduction for sales or excise taxes paid on a qualified motor vehicle."

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