

## Deduction for buying a hybrid automobile

A hybrid passenger automobile is defined as; a passenger automobile that is propelled by both a gasoline engine and an electric motor that is recharged as the motor vehicle operates.

Buying a hybrid passenger automobile (referred to below as a 'hybrid') has one tax advantage -- a deduction, in the year of purchase, of up to \$2,000 of the portion of the cost of the hybrid that is attributable to its ability to use electricity as a power source (the 'incremental cost'). Discussed below are the main points to keep in mind about the deduction.

- The maximum deduction is increased to \$3,000 for hybrids bought after Dec. 31, 2005. (new tax regulations passed in 2005)
- The deduction is available whether use of the hybrid is personal or for business.
- The deduction is applied directly against gross income. Thus, the deduction reduces your taxable income whether or not you itemize deductions, and without regard to limits on itemized deductions that might otherwise apply.
- The deduction is allowed in full before the calculation of any depreciation deduction (or 'expensing' deduction claimed in lieu of depreciation), but reduces the total cost of the hybrid for purposes of calculating the depreciation deduction (or expensing deduction).

Thus, if, in 2005, you buy a hybrid for business use at a cost to you of \$27,000, and the \$27,000 includes at least \$2,000 that is attributable to the ability of the hybrid to use electricity as a power source, you are allowed (1) a \$2,000 deduction, plus (2) whatever depreciation deduction (or expensing deduction) is available for a passenger automobile purchased for \$25,000.

- The deduction isn't allowed if you buy the hybrid for resale.
- The deduction isn't allowed if you use the car predominantly outside of the U.S. or enter into certain leasing arrangements.
- If certain events occur within 3 years of purchase, the deduction must be 'recaptured.' That is, you must include in income an amount equal to all of the deduction, one-third of the deduction or two-thirds of the deduction (depending on when the recapture event occurs).

The events that trigger a recapture are (1) a modification of the car so that it is no longer a hybrid, (2) predominant use of the car outside of the U.S., (3) entry into certain leasing arrangements or (4) your sale of the car with reason to know that an event described in (1), (2) or (3) will occur.

- The deduction is available for a portion of the cost of buying new cars only. It isn't available for any portion of the cost of buying a used car. (However, under rules similar to, but not exactly the same as, the rules that apply to buying a new car, a hybrid deduction is also available for certain costs of converting a non-hybrid car to a hybrid.)
- IRS, from time to time, announces the make, model and year of automobiles that it has certified as hybrids. Additionally, the dealer who sells you the car should make available to you a certification by the manufacturer (or, for a foreign car, the domestic

distributor) of the 'incremental cost' (see above) of the car. Accompanying the certification should be a letter of acknowledgement by IRS that the certification can be relied upon.

We expect Congress will address this tax regulation and perhaps provide additional incentives. Please contact us if you would like us to evaluate your tax impact of buying a hybrid.