

Stimulus Offers Modest Auto Savings

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Taxpayers who buy a new car in 2009 may be able to save up to \$600 on their taxes.

However, some experts warn the new tax incentive will not single-handedly turn around flagging auto sales.

"This tax incentive is not going to be the tipping point for sales," says Phil Villegas, head of dealership consultancy at Morrison, Brown,

The Auto Ownership Tax Assistance Amendment, introduced by Sen. Barbara Mikulski, D-Md., is part of the stimulus legislation known as the 2009 American Recovery and Reinvestment Act.

The new tax incentive allows car buyers to deduct from their federal taxes the state and local sales and excise taxes levied on purchased vehicles.

The tax break will only apply to up to \$49,500 of the price a car. The amount buyers can deduct will depend on the price of the car and the amount of sales tax charged by their state.

Mikulski's office calculates families will be able to save between \$300 and \$600 on their taxes. To be eligible for the deduction, individual taxpayers must make less than \$125,000. Joint filers must make less than \$250,000.

The deduction is above the line, which means that it can be taken by itemizers and nonitemizers alike. Above-the-line deductions are subtracted from the taxpayer's total income to get the adjusted gross income amount.

The end result is less taxable income and, therefore, less money shelled out to Uncle Sam.

For example, a car buyer in a state with 6% sales tax who drives off the lot in a new \$35,000 car could be looking at reducing her taxable income by \$2,100. The actual amount saved on taxes by the deduction will depend on her income and tax bracket.

Trade-in penalty

Bringing a trade-in to the table will reduce the amount of the deduction, however.

In some states, buyers who trade in a vehicle will get a sales tax credit against the appraised value of their old vehicle that can be applied to the sales tax charged on the new car.

"The sales tax on the new car is reduced by the credit. And the net sales tax that you're paying is reduced," says Sarah Marks, automotive writer and owner of Mycarlady.com, a car shopping Web site.

For new car buyers this year who do trade in a vehicle, the deduction amount will equal the amount of sales tax they paid on the sale.

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Will the deduction help?

According to a prediction from analysts at R.L. Polk & Co., an automotive consulting firm, the tax deduction will give car buyers an average rebate of \$330.

However, the analysts do not believe the new deduction will cause a surge in car sales. They predict the tax incentive will increase light vehicle sales by 94,000 units this year.

For some perspective, consider that the number of light vehicles sold in the U.S. for the month of January this year was 656,976, according to Auto Data's Motor Intelligence Web site.

The previous version of the bill passed in the Senate -- but not included in the House of Representatives bill -- would have expanded the tax deduction to include the interest paid on a car loan in 2009.

The original auto ownership tax assistance amendment would have cost taxpayers \$11.5 billion, but would have provided a much larger tax deduction to car buyers. The version that passed will cost about \$2 billion.

Eliminating the deduction for loan interest dramatically reduces the amount of money car buyers can save, says Chas Roy-Chowdhury, head of taxation for the Association of Chartered Certified Accountants.

"Compared to tax savings of \$1,500 or \$2,500, it's just a drop in the bucket," he says. "I don't know if they really thought through leaving it in there, because it's going to be very minimal and yet it's going to cost \$2 billion."

Stephen Spivey, senior automotive and transportation industry analyst with the research and consulting firm Frost and Sullivan, also questions whether the tax incentive will be enough to drive sales higher.

Spivey believes tight credit conditions and pervasive fears over the state of the economy may continue to keep buyers on the sidelines.

"Manufacturers are spending thousands on incentives for each car that they sell and states are going to lose money with this deduction that is not going to drive dealer traffic in a substantive way," he says.

However, not everyone is pessimistic about the new tax break. Peter Kitmiller, president of the Maryland Automobile Dealers Association, is hopeful the sales tax deduction will be enough to get people in showrooms.

"I think the ability to deduct the sales tax upfront is going to be a good incentive for people to take a look at buying a new car," he says. "Depending on what kind of car you buy and the tax rate in your state, it can be a pretty significant deduction."

Kitmiller hopes the new deduction will provide just enough incentive to bring wavering shoppers off the fence and into the showroom.

"There are unbelievable discounts and rebates right now, but we've just had a hard time getting people to come into the show room," he says. "So hopefully this nudge will get them to come in."

Extra credits

The stimulus legislation also includes a tax credit of up to \$2,500 available through 2011 for the purchase of any neighborhood electric vehicle such as the Chrysler GEM.

Neighborhood electric vehicles are plug-ins that travel a maximum of 25 miles per hour and have a battery capacity of at least 4 kilowatt hours, or 2.5 kilowatt hours in the case of 2- or 3-wheeled vehicles.

In 2010, highway-speed plug-in vehicles will be eligible for a tax credit of up to \$7,500. The tax credit will be a base amount of \$2,500 and then will increase \$417 for each kilowatt hour of capacity the battery has over 5 kilowatt hours, with a cap of \$5,000.

This tax credit will begin to phase out for each manufacturer after a certain number of vehicles have been sold.

"When a manufacturer has sold 200,000 vehicles, the phaseout will start," says Mark Luscombe, principal federal tax analyst at CCH, a provider of tax, accounting and audit information, software and services.

There is also a credit for converting a traditional hybrid vehicle to a plug-in. The credit covers up to 10% of the cost, with a limit of \$40,000.