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JULY 2009

LOOKING TO THE FUTURE

We are enjoying the services of three accounting interns whom we believe will be outstanding professionals. Joey Hinderberger came to us from Louisiana State University-Shreveport and started to work during the filing season. Joey is a graduate of Parkway High School and grew up in Bossier City. Louisiana Tech is the college home of our other interns. Tim Smith is a Loyola High School graduate

where he was a member of the golf team. David Watters is a graduate of Benton High School and is a student manager for the Louisiana Tech Bulldog basketball team.

All three of these young men have achieved outstanding academic success. We are grateful for the opportunity of getting to know them and having their services.

CHANGING VEHICLES

Two items concerning trade-ins on new cars and trucks come to mind. The first is a new idea – a government voucher for use in buying a new vehicle for which most of us will not qualify. The second is an old, but helpful, idea for those of us with tax deductible depreciation for the business use of a vehicle.

“Cash for Clunkers”

The purchaser of a new car or truck trading in an eligible vehicle between July 1 and November 1, 2009 might receive a voucher from the federal government of up to \$4,500, depending on the type of vehicle being traded in and the fuel efficiency of the vehicle being purchased. Only new cars and new trucks qualify. The trade-in must be in drivable condition, and the same owner must

show continuous insuring and registration of the trade-in vehicle for at least one year prior to the trade-in date. The trade-in vehicle must be less than 25 years old with a fuel efficiency of less than 18 miles per gallon. The new vehicle must have a “EPA window sticker mileage” rating of at least 22 miles per gallon for passenger automobiles. For light-duty passenger trucks, the old vehicles must be rated at 18 miles per gallon or less and the new light-duty truck or SUV must achieve fuel efficiency of at least two miles per gallon more to qualify for a voucher worth \$3,500 and must achieve five miles per gallon more to receive the full \$4,500 voucher.

Participating new car dealers (used cars are not eligible) will apply a credit reducing the price the purchaser pays at the time of

(Continued on reverse)

purchase or lease, providing the trade-in vehicle meets the program requirements. The dealer will then obtain reimbursement from the government. Only new vehicles with a manufacturer's suggested retail price of \$45,000 or less are eligible for the \$3,500 to \$4,500 credit.

The law requires that the trade-in vehicle be destroyed. Accordingly, the purchaser should not expect to get full value for the trade-in vehicle as the dealer can only realize the scrap value on the trade-in.

In summary, the program might be useful to those who want to buy a new vehicle with a manufacturer's suggested retail price below \$45,000 and who have owned the trade-in vehicle for more than one year prior to the trade-in date. The details of the program and some helpful questions and answers are at the government's website www.cars.gov.

The Trade-In Trap

Taxpayers who use a vehicle in a trade or business might find it better to occasionally sell the old business vehicle than to trade it in on a new business vehicle because of the "luxury car" depreciation limitations. Congress generally defines a "luxury car" in the Internal Revenue Code as one costing more than \$14,800 and imposes an annual limitation on tax deductible depreciation that is less than economic depreciation. A taxpayer who has successively traded in several business vehicles of relatively high initial acquisition cost will, because of the depreciation limitations, have a tax basis in the current vehicle that is probably greatly in excess of the vehicle's fair market value. For example, a taxpayer who has over a period of nine years purchased three cars, each originally costing \$40,000 and having a trade-in value of about \$18,000, will have a tax

basis of \$46,970 in the third car at the end of its third year of ownership. The third car in this example at trade-in would be three years old and might be expected to have a fair market value of about \$18,000, or \$28,970 less than its tax basis. Trading the car in would defer the recognition of this loss to the basis of the fourth car. Selling the car to an unrelated party (which can normally be arranged with the dealer) would trigger the current recognition of this loss and would result in an ordinary tax deduction that would save income taxes of \$11,588 for a 40 percent marginal bracket taxpayer.

This income tax savings is, however, partially offset by increased sales tax on the new vehicle equal to the sales tax rate times the value of the old vehicle. In other words, sales tax on a new vehicle with a trade-in is paid only on the cash difference. In the case of outright purchase of the new vehicle, sales tax is paid on the entire purchase price. In our example above, selling rather than trading the vehicle in would cause additional sales tax at 8.6 percent of approximately \$1,550, resulting in a net tax savings of about \$10,038.

In our example above, we have also assumed a business-use of 100 percent, which is the norm for corporate vehicles, but is very rare for vehicles owned by individuals. For vehicles with less than 100 percent business use and for lower-priced business vehicles, the tax savings on the sale will not be as dramatic. Regardless of a vehicle's cost or business use percentage, however, consideration of the income tax consequences of selling versus trading is usually worthwhile for every other vehicle acquisition.

We will be happy to discuss sale versus trade-in or any of your questions on business vehicle deductions.