

Providing Tax Advice for an Electric Car Environment

By Charles Goulding, Raymond Kumar and Taylor Goulding

Charles Goulding, Raymond Kumar and Taylor Goulding discuss the expected increase in the use of electric vehicles, the tax incentives associated with operating electric vehicles and the importance of tax advisors adequately preparing to best advise their clients on the use of electric vehicles.

The embryonic U.S. electric car vehicle (EV) market is supported by wide range of federal tax incentives. As with the beginning of all major technology changes, there is wide range of predictions about the rate of market acceptance. Tax advisors who understand the relevance of creative cities and objectively analyze the step-by-step developments in this market can provide strategic tax advice.

Electric Car Tax Credits

The Code Sec. 30D per-vehicle tax credit for purchasing an electric car weighing less than 8,500 pounds is capped at \$7,500. The credit is equal to the sum of \$2,500 with an additional \$417 for each kilowatt hour of battery capacity in excess of four kilowatt hours.¹

The credits presented above phase out beginning in the second calendar quarter following the manufacturer's sale of its 200,000th plug-in electric drive motor after 2009. Thereafter, there is a 50-percent credit reduction in the second and third quarters, a 75-percent credit reduction in the fourth and fifth quarters and zero

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Exhibit 1. Electric Vehicle Tax Credit Table

Battery Capacity (Kilowatts)	Tax Credit Available
Minimum Tax Credit (under 4 kw)	\$ 2,500
5 kw	\$ 2,917
6 kw	\$ 3,334
7 kw	\$ 3,751
8 kw	\$ 4,168
9 kw	\$ 4,585
10 kw	\$ 5,002
11 kw	\$ 5,419
12 kw	\$ 5,836
13 kw	\$ 6,253
14 kw	\$ 6,670
15 kw	\$ 7,087
16 kw	\$ 7,500

credit available for any additional quarters. It is important to note that the EV credit can be claimed against AMT, which is particularly important for the creative city target markets where there is a greater percentage of high-income taxpayers subject to AMT.

Marketing Strategies

Due to the impact of these large per-vehicle credits, EV manufacturer marketing departments are going to

need to carefully time their advertising campaigns to correlate EV tax credit phase-out. The advertising tax planning strategy should be to try to accurately predict the second calendar quarter commencing after the first quarter with model sales of 200,000 or more, and correlate budgets and advertising release dates. The concept would be to optimize the selling volumes during the full credit availability and phase-out period. The concern would be that, like the recent first-time home buyer tax credit, sales will stall once tax credits end.

Electric Car Charging Station Tax Credit Extended

The extension of the Bush-era tax incentives included a provision extending the 30-percent tax credit for the purchase and installation costs of charging equipment up to \$30,000 for businesses² and \$1,000 for individuals (for one year through December 31, 2011). Although these are lower amounts than the pre-extension \$50,000 credit limits for businesses and \$2,000 for individuals, a business will also be eligible for 100-percent bonus depreciation in 2011. The \$50,000 credit limits were effective for tax years beginning after December 31, 2008, and before January 2011.

Understanding Creative City Relevance

Richard Florida, the widely read college professor and book author,³ places a great emphasis on the importance of America's creative cities. Cities that are regularly identified as creative include Austin, Texas; Los Angeles, CA; New York City; San Francisco; Seattle, Washington; and Washington, D.C. It is no coincidence that the attributes that make these cities creative also make them the launch points for the major car brands electric car programs. Two of the creative cities are government capitals—Washington D.C. and Austin. It is expected that virtually all state government fleets will be converting to electric vehicles. In state capitals that also have major state universities—such as Albany, New York; Austin,

Texas; Ann Arbor, Michigan; Boise, Idaho; Columbus, Ohio; and Madison, Wisconsin—this could result in a large concentration of electric vehicles in these cities.

Consistent with the creative city framework, Hertz has announced that starting December 15, 2010, electric rental cars will be available in New York, Washington, D.C. and San Francisco.

On July 16, 2010, Edison, a major parking garage operator in New York City, announced the installation of the first of 100 New York City charging stations pursuant to a federal program.

BYD is a Chinese electric vehicle manufacturer that has agreed to locate its U.S. headquarters in Los Angeles and is being rewarded as the electric car supplier for Los Angeles municipal needs.⁴

Charging Station Initiatives

General Electric has embarked on a major marketing initiative to introduce its battery-charging product directly to consumers. Consistent with this initiative, GE has recently announced that it will be purchasing 25,000 electric cars for its corporate fleet by 2015.

Recognizing the underlying need for battery-charging systems, Nissan has endeavored to support its electric-car initiative with infrastructure support including the concurrent sale of chargers with its electric cars. eTec/ Ecotality in Michigan was granted \$8 million to wire five regions in the country and to supply 12,500 charging stations to support 5,000 Nissan Leaf EVs.

Understanding Electric Car Charging Ranges

Electric car battery mileage limits vary widely from 40/50 miles at the low end to Tesla car models that may achieve 200+ miles before requiring a recharge. It is important for commercial property owners and tax advisers to understand electric charging ranges from the creative cities to popular destinations. For example, hotels, restaurants, entertainment sites and shopping complexes that rely on the creative cities' need to consider creating the infrastructure to support electric cars. Examples would be San Francisco to Napa Valley, Washington to Baltimore Inner Harbor, New York City to the Woodbury Commons Shopping Complex, and Austin to San Antonio. The roundtrip mileage to these popular destinations is illustrated in Exhibit 3.

Exhibit 2. Common Creative City Electric Car Kick-offs

Chevy Volt	Nissan Leaf	Ford Focus	BYD E6
San Francisco	San Francisco	San Francisco	-
-	-	Los Angeles	Los Angeles
Washington DC	Washington DC	Washington DC	-
New York City	-	New York City	-

* Note that many of these brands are launching EV marketing initiatives in various other cities.

of individual strengths and spheres of expertise.

As a general matter, the Guidelines take the position that such CCAs take place when the arrangement involves the following:

- a group of companies have a common need for such particular services;
- this group decides to centralize activities or undertake these activities jointly; and
- the group of companies operates in way that minimizes costs and risks to the benefit of each participant.

Expectation of Mutual Benefit

The Guidelines, in examining the expectation of mutual benefit within the CCA provisions, address the mutuality in terms of contractual provisions.¹⁰ The Guidelines speak of offer and acceptance and of the “expectation of mutual benefit” that is “fundamental to acceptance by independent enterprises” of an arrangement for the “pooling or resources and skills,” engaging these resources and skills “without separate compensation.” The phraseology of the “expectation of mutual benefit” provision raises the issue whether the presence of compensation might invalidate the CCA.

The Guidelines presuppose that independent enterprises would in fact require that each participant’s share of the actual overall contributions to the arrangement be consistent with the participant’s proportionate share of the overall benefits the participant is to receive under the arrangement.

Mandatory CCA Arm’s-Length Requirements

The Guidelines apply three arm’s-length requirements to a CCA:

1. All parties to the CCA must demonstrate their expectation of benefits.
2. All parties to the CCA must calculate each participant’s relative contribution to the joint activity, whether in cash or in kind.
3. All parties to the CCA must determine whether the participants properly allocated the CCA computations, as adjusted for each participant’s balancing payments.

The Guidelines recognize that the preceding three CCA determinations might bear a degree of uncertainty. CCA participants can allocate contributions in a manner that results in an

overstatement of profits in some countries when participants apply the arm’s-length principle and might apply the understatement of taxable profits in other countries when participants apply the arm’s-length principle. The Guidelines recognize that overstatements or understatements can occur, and mandate that the taxpayer be prepared to substantiate the basis of their claim to the CCA under Section F of Chapter VIII.

Determining the Participants

The Guidelines view the “mutual benefit” concept as being fundamental to the CCA. This mutuality is paramount to the CCA concept. As a result, the Guidelines do not treat a party as a participant if the party does not demonstrate a “reasonable expectation” that the party will benefit from the CCA activity itself, and not just from performing part or all of that activity.¹¹

The Guidelines presuppose that a party or superior entity would be assigning beneficial interests in the property or the services of the CCA. Such party or superior entity would assign a beneficial interest to a participant, and the participant needs to demonstrate its reasonable expectation to exploit or use that assigned interest. This reasonable expectation can be direct or indirect, *e.g.*, through licensing arrangements or sales, whether this arrangement is to associated enterprises or to independent enterprises.

The “Expected Benefit” Rule

The Guidelines presuppose that the participant to a CCA requires an expected benefit from the activity. Nevertheless, the presence of an expected benefit does not impose a requirement on the CCA that the subject activity actually be successful.¹² The Guidelines provide an example of the expected benefits provisions. For example, research and development might fail to provide commercially valuable intangible property. That fact, standing alone, does not vitiate the expected benefit provisions.

The Guidelines caution that tax administrations might question whether parties to the CCA would continue their participation in the arrangement if they had been independent enterprises. For example, the activity might continue to fail to produce any actual benefit over a period in which the activity would normally be expected to produce benefits. See Chapter I, business strategies, particularly Guidelines §1.63, and see losses, particularly Guidelines §1.70-1.72.

The Separate Company Alternative

The participants in a CCA might decide to set up a separate entity. Such separate entity is not a participant under the standards of Guidelines §8.10. The separate entity can carry out all or part of the CCA's subject activity.¹³ The Guidelines implicitly allow participants to set up such a separate company alternative, and such activities could include contract research or could include manufacturing. The arm's-length charge, in the contract research situation or the manufacturing situation, might be appropriate to compensate the company for services the separate company provides to the CCA participants.

The Guidelines recognize that the separate company might be an affiliate of one of the CCA participants. For example, the participants might set up the separate company to secure limited liability exposure in the case of a high-risk research and development CCA activity. The participants would determine the arm's-length charge for the company under the general principles of Chapter I. The general principles of Chapter I include the considerations of functions performed, assets used and risks assumed. In addition, the participant is to include the special considerations affecting an arm's-length charge for services, as described in Chapter VII.¹⁴

Determining the Amount of Each Participant's Contribution

The Guidelines would have the tax administration determine whether the taxpayer's CCA satisfies the arm's-length principle.¹⁵ A CCA would potentially satisfy the arm's-length principle—*i.e.*, whether each participant's proportionate share of the overall limitations of the CCA is consistent with the participant's proportionate share of the overall expected benefits. It is necessary for the participant to measure the value or the amount of each participant's contributions to the arrangement.

Consistency in the Value of Each Participant's Contribution

The Guidelines require consistency in the value of each participant's contribution under the arm's-length principle. The value of each participant's contribution is to be "consistent with" the value that independent enterprises would have assigned to the contribution in comparable circumstances.¹⁶ The Guidelines require

the multinational enterprise and the tax administration to follow Chapter I through Chapter VII of the Guidelines in determining the value of contributions to a CCA.

The Guidelines provide the multinational enterprise and the tax administration with such an example of consistency: Chapter I of the Guidelines specify that the arm's-length principle would take into account, *inter alia*, the contractual terms and economic circumstances particular to the CCA. These particular contractual terms and economic circumstances are the sharing of risks and costs.

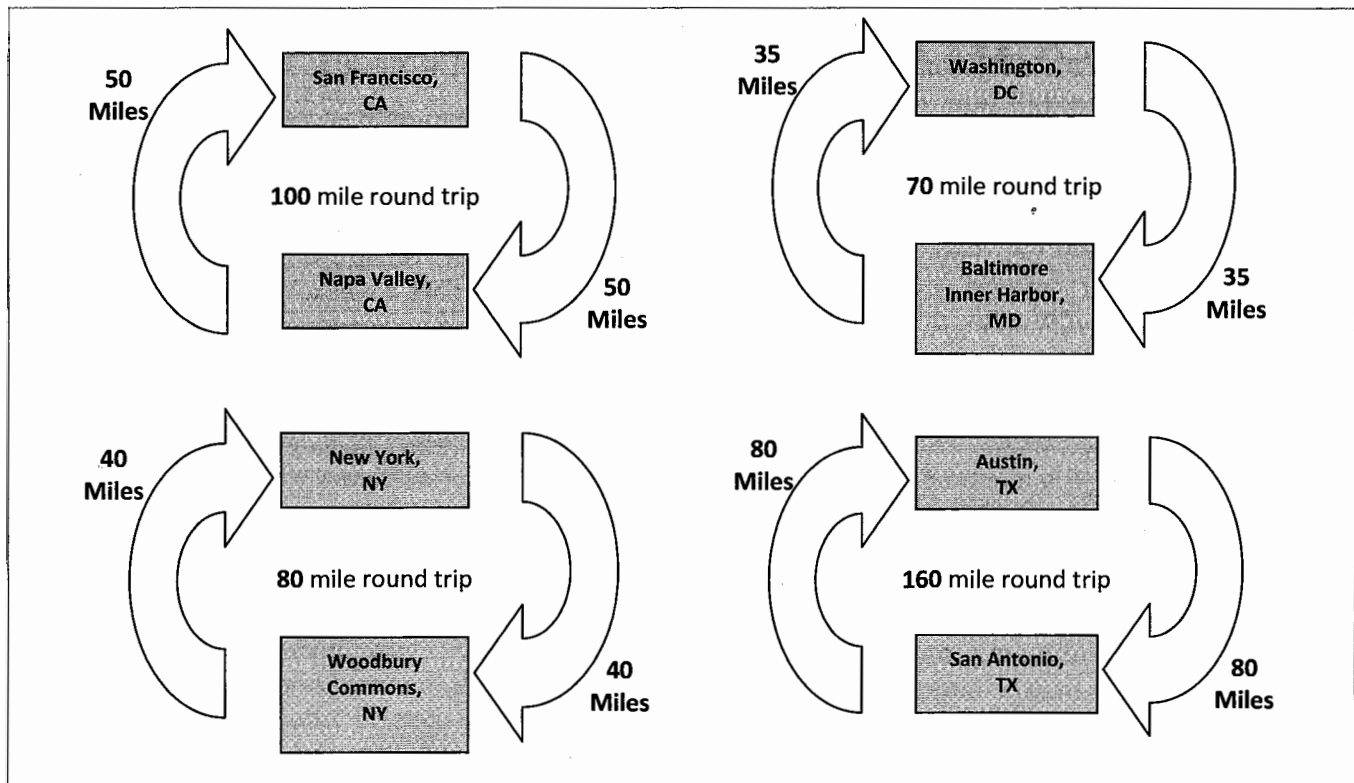
Costs and Market Prices as Valuing Contributions

The Guidelines caution that they cannot provide specific results for all situations in the cost contribution context.¹⁷ Instead, the multinational enterprise or the tax administration must resolve these cost contribution issues on a case-by-case basis. The multinational enterprise or the tax administration is to reach these issues consistent with the general operation of the arm's-length principle.

The Guidelines look to prior history on the part of tax administrations in determining costs or market prices in valuing contributions by a participant, noting that countries have experience both with the use of costs and with the use of market prices for purposes of measuring the value of contributions to arm's-length CCAs. The Guidelines caution that it is unlikely for the multinational enterprise or the tax administration to apply the relative value of each participant's contribution in a straightforward manner. The Guidelines provide one exception to the general rule: the multinational enterprise or the tax administration could apply the relative value of each participant's contribution in a straightforward manner when each participant makes its contributions wholly in cash. In this all-cash situation, for example, an external service provider can carry out the activity and the participants can jointly fund all of costs.

Distinguishing Business Categories

The Guidelines mandate that the multinational enterprise or the tax administration, in evaluating the cost contribution process, recognize all contributions that the participant makes to the arrangement.¹⁸ Such contributions include property or services the partici-

Exhibit 3.

California as an Electric Car Center

California is the national center of electric car developments. Virtually every major EV company is targeting California for its initial marketing launches. The California energy commission has provided a \$3.4-million grant to California-based Coulomb technologies to aid in wiring the state for EVs. California also has the "Cash for Clunkers" program, offering \$5,000 cash for clunker vehicles. This means that a California resident with a "clunker" could earn \$12,500 in combined cash equivalents (\$5,000 cash grant plus \$7,500 credit) when purchasing an electric car.

Electric Trucks

Some experts believe that trucks—particularly inner-city delivery trucks—could be an early adapter of electric vehicle technology. Inner-city delivery trucks by definition travel within the battery-charging ranges. Most impor-

tantly, initial data indicates that the cost per mile from switching from gasoline to electric would be much lower for inner-city delivery vehicles. Smith Electric Vehicles of Missouri—a company that converts delivery trucks to electric power—received two Department of Energy grants (\$10 million and \$22 million) to support developments in this area. Navistar, the large truck manufacturer, was also awarded \$39 million for its electric truck initiatives. If the post office and the major delivery companies such as Federal Express and UPS embrace this technology, it could quickly become a leading electric vehicle sector.

Conclusion

Massive investments have been made by the U.S. government, state governments, the global automotive industry and other industrial companies to prepare for electric-battery vehicles. The creative cities are the first beachheads. Tax advisers with impacted clients located in or dependent upon the creative cities should monitor these developments and be ready to provide relevant tax advice.

ENDNOTES

¹ Notice 2009-54, IRB 2009-26, 1124.

² Code Sec. 30C.

³ Richard Florida, *THE RISE OF THE CREATIVE CLASS*

(1st ed. 2002).

⁴ Charles Goulding, Raymond Kumar, and Taylor Goulding, *The G-2 U.S.-China Tax*

and Stimulus Focus on Solar and Electric Cars, CORP. BUS. TAX'N MONTHLY, Jun. 2009, at 11.