THE SUV TAX LOOPHOLE: TODAY'S QUINTESSENTIAL SUBURBAN PASSENGER VEHICLE BECOMES SMALL BUSINESSES' QUINTESSENTIAL TAX BREAK

by
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Concededly, whether any given tax provision of the Internal Revenue Code ("the Code") is a "loophole" or an "opportunity" is a matter of perspective. Of late, section 280F(d)(5) of the Code has been both criticized and praised for the dual tax-evading and tax-saving qualities it possesses. Known as the "SUV tax loophole," this Code section is the mechanism that sets the wheels of tax incentives turning, producing great tax write-offs for those small businesses and self-employed individuals who buy heavy sport utility vehicles for business use. This Comment explains the development of the SUV tax loophole, and demonstrates, by way of illustrative hypotheticals, its persuasive influence on small businesses' vehicle choices. Also discussed are legislators' failed attempts to "close" the loophole at both the state and federal levels. Finally, this Comment argues for and suggests ways for Congress to close the SUV tax loophole at its source in section 280F(d)(5).

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I. INTRODUCTION

The law regarding business tax incentives is continually changing. What remains constant is the Sport Utility Vehicle ("SUV") tax loophole in section 280F(d)(5) of the Internal Revenue Code ("the Code"). Generally, section 280F operates to restrict the total amount businesses may write off each year as expensing and depreciation deductions for "passenger automobiles" purchased for business use. The definition of "passenger automobile" focuses on vehicle weight; therefore, certain behemoth SUVs fall outside the definition of passenger automobile and are not subject to the section 280F deduction limitations. This means that a business that purchases a heavy SUV instead of a lighter passenger automobile (such as a sedan) enjoys larger deductions and consequently greater tax savings in the year of the vehicle's purchase. Knowledge of the SUV tax loophole has become widespread, and it is now common practice for small business entities and self-employed individuals to buy heavy SUVs just for the tax breaks.

Of course, one tax critic's "loophole" is another taxpayer's "opportunity." What opens the SUV tax loophole to criticism is the way it interacts with section 179 expensing and section 168 depreciation deductions. These two business deductions have undergone several changes in recent years as Congress

has endeavored to stimulate the economy by encouraging business growth. Congress has designed these deductions to act as valuable tax incentives—in the form of bigger write-offs against gross income—to purchase new business assets, such as vehicles. So transformed, the expensing and depreciation deductions interact with section 280F to widen the SUV tax loophole and showcase its power to persuade a small business or self-employed individual[1] to choose a super-sized SUV over any other vehicle on the lot.

More specifically, Congress has enacted three tax acts in recent years to amend section 179 expensing and section 168 depreciation in ways that have resulted in the widening of the SUV tax loophole. The Job Creation and Worker Assistance Act of 2002[2] ("JCWAA"), enacted March 9, 2002, added subsection (k) to section 168 of the Code, providing for 30 percent bonus depreciation for certain depreciable property in addition to the regular depreciation deductions otherwise allowable under section 168. Then the Jobs and Growth Tax Relief Reconciliation Act of 2003[3] (JGTRRA), enacted May 28, 2003, extended the acquisition dates for property qualifying for bonus depreciation, and increased bonus depreciation to 50 percent. In addition, JGTRRA amended section 179 to increase the expensing amount from $25,000 to $100,000, and to increase the phase-out threshold from $200,000 to $400,000. Most recently, the American Jobs Creation Act of 2004,[4] enacted October 22, 2004, extended JGTRRA's increased expensing two more years, and added paragraph (6) to section 179(b) of the Code to limit SUV expensing to $25,000. Finally, bonus depreciation expired on January 1, 2005. Clearly, the law of business tax deductions is ever-changing, as Congress continues to manipulate deductions' operation as tax incentives for business investment and growth. But as the hypotheticals in this Comment will show, the expensing and depreciation deductions continue to interact with section 280F to widen the SUV tax loophole. Consequently, accountants and tax professionals across the country have the same tidbit of tax-saving advice for their small business clients: buy an SUV.[5] Of course, the advice is not merely to buy an SUV, but to buy a super-

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[1] The SUV tax loophole primarily benefits small businesses and self-employed individuals because they typically do not buy enough section 179 equipment in a given year to phase out their section 179 expensing deduction. Small and large businesses are put on the same playing field, however, when the expensing deduction is assumed to be used up, phased out, or waived, so that both entities may enjoy bonus depreciation and otherwise allowable regular depreciation.

[2] Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21 [hereinafter JCWAA].

[3] Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752 [hereinafter JGTRRA].

[4] American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 [hereinafter "the Jobs Act"].

[5] Jeffrey Ball & Karen Lundegaard, *Tax Breaks for the Merely Affluent: Quirk in Law Lets Some SUV Drivers Take Big Deduction*, WALL ST. J., Dec. 19, 2002, at D1 (Says one tax professional: "If a client is looking at purchasing a Navigator vs. another luxury vehicle for the same amount, [our accounting firm] would make sure [the client] understand[s] [she gets] a deduction quicker on the heavier vehicle." As far as a client's vehicle preferences go, "[a]lthough the deduction rarely persuades a luxury-car buyer to buy a truck instead, it some-

sized SUV in excess of 6,000 pounds gross vehicle weight, since this is the only way to reap the benefits of the SUV tax loophole.

The existence of the SUV tax loophole in section 280F runs contrary to the original purpose of that section: to crack down on abusive deduction practices by businesses buying expensive luxury vehicles just to enjoy bigger tax write-offs. In addition, with the environmental concerns inherent to the SUV, this tax incentive to choose a heavy SUV over other types of vehicles contradicts other provisions of the Code designed to reward businesses for buying more environmentally friendly vehicles such as electric cars. Finally, allowing businesses bigger first-year write-offs for SUV purchases costs both the federal and state governments millions of dollars in lost tax revenue each year. In fact, legislators in a few states in the throes of budget crises have pushed (unsuccessfully) for closure of the SUV tax loophole at the state level.

The SUV tax loophole is a loophole that developed by accident, as a product of changing consumer preferences for luxury vehicles. Congress needs to close the loophole in section 280F in order to restore the original purpose of that Code section, to be consistent with other Code provisions that reward more environmentally friendly vehicle purchases, and to alleviate budget crises by putting more tax revenues into federal and state coffers.

Part II will illustrate, by way of a two-part hypothetical, the SUV tax loophole and its power to persuade a self-employed individual to buy a heavy SUV instead of a sedan for business use. Part III explores the development of the SUV tax loophole, explaining the original purpose of section 280F and the changes in consumer preferences that revealed the loophole's value as a tax incentive. This part also discusses common environmental criticisms of SUVs, and compares the provision that rewards businesses for buying electric passenger automobiles to the SUV tax loophole. Part IV discusses responses at the state level to the federal tax incentives (increased expensing and bonus depreciation) and the SUV tax loophole. Finally, Part V exposes Congress's missed opportunities to close the SUV tax loophole directly at its source, the section 280F passenger automobile definition, and shows that Congress's remedies for the loophole thus far are quite inadequate.

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times persuades people to pick a big SUV instead of a smaller one."). *See also* UNION OF CONCERNED SCIENTISTS, TAX INCENTIVES: SUV LOOPHOLE WIDENS, CLEAN VEHICLE CREDITS FACE UNCERTAIN FUTURE, *at* http://www.ucsusa.org/clean_vehicles/cars_and_suvs/page.cfm?pageID=1280 (last visited Apr. 18, 2005) (noting that accountants and online tax management sites encourage small business owners to buy SUVs with advertisements such as "Write-Off 100% of Your New SUV? Yes, If It's Under $100,000!"); SELF EMPLOYED WEB, *at* http://www.selfemployedweb.com (last visited Apr. 13, 2005) (an online resource for small business owners and self-employed individuals, featuring links such as "SUV Tax Deduction" (links the reader to informative articles) and "SUV Tax Deduction List" (informs the reader which vehicles qualify for the generous first-year deductions)).

II. THE SUV TAX LOOPHOLE PERSUADES SMALL BUSINESSES TO BUY HEAVY SUVS: AN ILLUSTRATIVE HYPOTHETICAL

Meet Roger, a self-employed, independent Realtor who is willing to spend up to $50,000 on a new vehicle to use exclusively for his business. He wants a luxury vehicle to impress his clients when he drives them around to view homes and properties, and to give himself a professional appearance when he travels during work hours to meet other Realtors at open houses, closings, and other Realtor functions. For the purposes of this hypothetical, Roger will purchase the vehicle on September 1, 2004 (a date prior to the enactment of Jobs Act), Roger will put the vehicle in service in the same year, and the 2004 income associated with Roger's realty business is $150,000. Also, Roger is a taxpayer who wants to maximize his 2004 expensing and depreciation deductions because he prefers to defer as much tax as possible.[6] This hypothetical will apply the law as it existed prior to the enactment of the Jobs Act. Each scenario will consider increased section 179 expensing under JGTRRA, section 168(k) 50 percent bonus depreciation under JGTRRA, and regular MACRS double-declining balance method depreciation to determine and compare the maximum amounts Roger may deduct in the year of purchase for a luxury sedan and a heavy, luxury SUV. This will show that the SUV tax loophole creates a strong incentive for Roger to choose a heavy SUV.

A. Scenario 1: Purchasing a Luxury Sedan for Business Use

Roger is interested in purchasing a new 2005 Mercedes E320 sedan, a classic luxury car that fits into his budget at a price of $50,000. The sedan qualifies as "section 179 property,"[7] and because Roger plans to purchase it on a date that falls between the years 2002 and 2006,[8] the property is eligible for the increased section 179 expensing deduction. For 2004, small businesses and self-employed individuals are allowed to deduct up to $102,000 on the aggre-

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[6] Of course, if Roger is currently not in the highest income bracket, but anticipates that his profits will greatly increase next year, pushing him into a higher bracket, then he may prefer to plan the timing of his deductions more carefully so that he may enjoy greater tax savings when taxed at a higher rate.

[7] "Section 179 property" is, generally, depreciable tangible personal property that is acquired by purchase for use in the active conduct of a trade or business. I.R.C. § 179(d)(1) (RIA 2005). The sedan qualifies for section 179 expensing because automobiles are 5-year depreciable tangible personal property under I.R.C. § 168(e)(3)(B) (RIA 2004), and Roger plans to purchase this automobile for exclusive use in the conduct of his realty business.

[8] JGTRRA increased the dollar limitation for section 179 expensing from $25,000 to $100,000, but only for taxable years beginning after 2002 and before 2008. I.R.C. § 179(b)(1) (RIA 2005) (as amended by JGTRRA, *supra* note 3, at § 202(a)(1)). JGTRRA also increased the phase-out threshold from $200,000 to $400,000 for taxable years 2003, 2004, and 2005. I.R.C. § 179(b)(2) (RIA 2005) (as amended by JGTRRA, *supra* note 3, at § 202(b)). On October 22, 2004, the Jobs Act extended JGTRRA's increased expensing two years through the end of 2007. The Jobs Act, *supra* note 4. Assuming these increases are permitted to sunset as scheduled, on January 1, 2008, the dollar limitation will revert back to $25,000, and the phase-out threshold will revert back to $200,000.

gate cost of qualifying property.[9] It seems that Roger will be able to expense the full $50,000 cost of the new sedan, because the sedan is the only section 179 qualifying property purchased in 2004, meaning that the total amount spent on section 179 property falls well below the $410,000 phase-out threshold,[10] and his business income for the year exceeds the expensing deduction.[11] However, Roger cannot expense the full $50,000 cost in 2004 because the Mercedes E320 is a "passenger automobile,"[12] subject to section 280F limitations on deductions for luxury automobiles.[13] The maximum amount Roger may expense in the year of purchase is $10,610,[14] and because the expensing deduction would use up the amount section 280F allows him to claim as deductions for the passenger automobile in the first year, he is not allowed to take a depreciation deduction for 2004. Thus, taking a section 179 expensing deduction of $10,610 would leave him with an adjusted basis of $39,390[15] to depreciate over subsequent years using the MACRS double-declining balance method.

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[9] The $100,000 annual expensing limit, as well as the $400,000 phase-out threshold, are to be indexed for inflation for the taxable years 2004 and 2007. I.R.C. § 179(b)(5)(A) (RIA 2005) (as amended by JGTRRA, *supra* note 3, at § 202(d)). Indexed for inflation, the 2004 dollar limitation was $102,000.

[10] Indexed for inflation, the 2004 phase-out threshold is $410,000. The $102,000 expensing limit is reduced dollar for dollar by the amount by which the total cost of section 179 property exceeds $410,000. I.R.C. § 179(b)(2). Thus, by the time total purchases of qualifying property reach $512,000 for the taxable year, the expensing limit is completely phased out, and no section 179 expensing deduction is allowed for that taxable year. In effect, this means that only small businesses may take advantage of immediate expensing under section 179.

[11] After the potential section 179 deduction amount is determined by applying section 179(b)(1)–(2), the deduction is also subject to a limitation based on the taxpayer's business income: the deduction amount for the taxable year cannot exceed the aggregate amount of taxable income derived from the taxpayer's trade or business in the same taxable year. I.R.C. § 179(b)(3)(A) (RIA 2005). Any deduction amount in excess of the taxpayer's business income, however, is allowed to carryover to future taxable years. I.R.C. § 179(b)(3)(B) (RIA 2005).

[12] A "passenger automobile" is any four-wheeled vehicle which is manufactured primarily for use on public streets, roads, and highways, and weighs 6,000 pounds or less. I.R.C. § 280F(d)(5) (RIA 2005). The Mercedes E320 sedan is such a vehicle.

[13] I.R.C. § 280F(a)(1)(A) (RIA 2005) imposes limits on the amount that may be deducted as depreciation for passenger automobiles purchased for business use in each taxable year of the property's recovery period. This limitation applies to section 179 expensing deductions as well, "*in the same manner as if it were a depreciation deduction* allowable under section 168." I.R.C. § 280F(d)(1) (RIA 2005) (emphasis added). Thus, section 280F acts as one limitation on both kinds of deductions (expensing and depreciation) that may be taken on the cost of a passenger automobile.

[14] For passenger automobiles that qualify for the 50% bonus depreciation under section 168, the depreciation dollar limit for the first taxable year of the automobile's recovery period is increased by $7,650, from $2,560 to $10,210. I.R.C. § 168(k)(4)(D) (RIA 2004) (increasing the limitation amount under I.R.C. § 280F(a)(1)(A)(i) (RIA 2005)). Indexed for inflation, the cap on first-year depreciation deductions for passenger automobiles that qualify for bonus depreciation becomes $10,610. Rev. Proc. 04-20, 2004-1 C.B. 642. The $10,610 cap also applies to section 179 expensing deductions taken in the year of purchase for passenger automobiles. *See* I.R.C. § 280F(d)(1).

[15] $50,000 – 10,610 = $39,390.

This scenario will now assume that section 179 does not apply because Roger elected not to take an expensing deduction,[16] leaving Roger to see how much deduction he can get applying bonus depreciation[17] and regular MACRS depreciation rules. The sedan is eligible for 50 percent bonus depreciation because it is "qualified property"[18] that Roger plans to purchase on a date that falls after May 5, 2003 and before 2005.[19] Electing the 50 percent bonus depreciation would yield a first-year deduction of $25,000,[20] leaving Roger with an adjusted basis in the sedan of $25,000.[21] Additionally, his otherwise allowable depreciation deduction would be $5,000,[22] leaving Roger with a new adjusted basis of $20,000[23] to depreciate over the rest of the vehicle's five-year recovery period. Thus, Roger's total potential first-year depreciation deduction is $30,000.[24] Unfortunately, Roger cannot deduct the full $30,000 as depreciation in 2004, because section 280F applies to limit his deduction to $10,610.[25]

Thus, whether Roger chooses to claim a section 179 expensing deduction or depreciation deductions in the first year, section 280F acts to cut his deduction amount to $10,610 each time. Still, claiming a deduction of $10,610 saves[26] him $3,713.50 in tax dollars for this taxable year,[27] $2,677.50 more

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[16] Section 179 expensing deductions are optional. I.R.C. § 179(a) (RIA 2005).

[17] Bonus depreciation was allowed to expire at the end of 2004. It still applies in this hypothetical, however, because the hypothetical assumes the purchase occurred in September 2004, when JGTRRA 50% bonus depreciation was still in existence.

[18] The sedan is "qualified property" because it is five-year depreciable property under I.R.C. § 168(e)(3)(B) (RIA 2004). I.R.C. § 168(k)(2)(A)(i)(I) (RIA 2004); Temp. Treas. Reg. § 1.168(k)-1T (RIA 2004).

[19] In 2002, JCWAA added subsection (k) to section 168. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21, § 101(a). The new subsection allows for 30% bonus depreciation for the first taxable year in which the qualified property is placed in service, I.R.C. § 168(k)(1)(A) (RIA 2004), in addition to the depreciation deduction otherwise allowable for that taxable year, I.R.C. § 168(k)(1)(B) (RIA 2004), as long as the property is acquired by the taxpayer after September 10, 2001, and before September 11, 2004, I.R.C. § 168(k)(2)(A)(iii) (RIA 2004), and placed in service by the end of 2004. I.R.C. § 168(k)(2)(A)(iv) (RIA 2004). In 2003, JGTRRA amended section 168 to extend the acquisition period for 30% bonus depreciation through the end of 2004, and allow for new 50% bonus depreciation for qualified property purchased after May 5, 2003 and before 2005. I.R.C. § 168(k)(4)(B) (RIA 2004).

[20] $50,000(.50) = $25,000.

[21] $50,000 – 25,000 = $25,000.

[22] For five-year depreciable property like this sedan, the depreciation rate for the first year is 20% of the adjusted basis. Rev. Proc. 87-57, 1987-2 C.B. 687. Thus: $25,000(.20) = $5,000.

[23] $25,000 – 5,000 = $20,000.

[24] $25,000 + 5,000 = $30,000.

[25] I.R.C. § 280F(a)(1)(A)(i) (2005).

[26] Roger "saves" on taxes in the year of purchase simply because he is allowed to take a greater deduction against his business income. The actual effect is not tax avoidance, but tax deferral: when Roger is left with smaller amounts to deduct against income each year in the rest of the five-year recovery period, there will be less deduction to offset his income, leaving him with greater tax liability in subsequent years. But since this hypothetical assumes that Roger is a taxpayer who prefers to pay taxes later, he is nonetheless happy to have a smaller tax bill for 2004.

than if he had simply claimed a regular first-year depreciation deduction,[28] without also trying to claim JGTRRA increased expensing or 50 percent bonus depreciation deductions. Because Roger needs to continue depreciating the sedan over the rest of its five-year recover period, he will have to keep depreciation records.

B. Scenario 2: Purchasing a Sport Utility Vehicle for Business Use

When Roger went to the Mercedes dealership to view the E320 sedan in person, a salesperson there advised him to consider using the money he was planning to spend on a sedan to buy an SUV instead. Roger expressed disinterest in a larger vehicle, since he preferred the feel of driving a car, and he did not really need the extra passenger room since he usually carried only one or two clients with him at a time. Nonetheless, Roger remembered his tax advisor saying something to him about getting bigger write-offs for heavy SUVs, and he wondered whether buying the 2005 Mercedes ML500 Special Edition, a vehicle that also fit into his budget at $50,000, would yield a greater tax write-off for 2004. Intrigued, he called his tax advisor to request the following calculations.

Like the sedan, the SUV also qualifies as "section 179 property," eligible for a section 179 expensing deduction in the year of purchase. Unlike the sedan, however, if Roger elects to claim a section 179 deduction, the SUV's full $50,000 cost may be expensed in the first year. This is because the Mercedes ML500 is one of many SUVs that weighs more than 6,000 pounds gross vehicle weight, and therefore does not fit within the section 280F definition of passenger automobile.[29] Fully expensing the SUV means that Roger will not have to worry about keeping depreciation records. More significantly, deducting the full $50,000 cost from his taxable income yields a tax savings of $17,500,[30] a savings of $13,786.50 greater than the amount he would save if he were to maximize his expensing deduction for the sedan.[31] This illustrates the SUV tax loophole as it exists in section 280F: simply by weighing more than 6,000 pounds, an SUV (or other heavy vehicle such as a pick-up truck) is not subject

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[27] Assuming Roger is in the 35% bracket: $10,610(.35) = $3,713.50.

[28] $50,000(.20) = $10,000 regular depreciation deduction. When the taxpayer elects out of bonus depreciation, the first-year depreciation amount is subject to an even stricter section 280F limitation of $2,960. I.R.C. § 280F(a)(1)(A)(i) (providing that the first-year limit on depreciation deductions for passenger vehicles is $2,560); Rev. Proc. 04-20, 2004-1 C.B. 642 (adjusting the $2,560 for inflation, increasing it to $2,960). Thus, the $10,000 potential first-year depreciation deduction for the sedan would be cut back to $2,960. $2,960(.35) = $1,036 tax savings from claiming a regular depreciation deduction. $3,713.50 – 1,036 = $2,677.50 difference in tax savings.

[29] *See* I.R.C. § 280F(d)(5) (RIA 2005) (defining "passenger automobile"). For a list of SUVs that weigh more than 6,000 pounds and are not subject to section 280F limits on first-year expensing and depreciation deductions, *see* SELF EMPLOYED WEB, VEHICLES THAT QUALIFY FOR GENEROUS SUV TAX BREAK, *at* http://www.selfemployedweb.com/suv-tax-deduction-list.htm (last visited Apr. 14, 2005).

[30] $50,000(.35) = $17,500.

[31] $17,500 – 3,713.50 = $13,786.50.

to deduction limitations as would be a passenger automobile, even though the SUV may cost the same and serve the same purpose (*e.g.*, transporting passengers) as the passenger automobile.

If Roger elected not to claim a section 179 expensing deduction, or if he had already used up his deduction by claiming it for other section 179 property he purchased in 2004, then Roger would need to turn to section 168 to depreciate the cost of the SUV over the vehicle's five-year recovery period. Although a first-year depreciation deduction would not yield as great a benefit as fully expensing the cost in the first year under section 179, the SUV again far surpasses the sedan in tax savings. Again, like the sedan, the SUV is "qualified property" that is eligible for 50 percent bonus depreciation deduction in the first year. But because the SUV is not a passenger automobile, Roger would now be allowed to take the full $25,000 50 percent bonus depreciation deduction,[32] plus the $5,000 regular depreciation deduction.[33] This amounts to a $30,000 depreciation deduction for the first year,[34] $19,390 more than he would be allowed to deduct as first-year depreciation for the sedan.[35] Furthermore, Roger would save $10,500 in taxes,[36] $6,786.50 more than he would save if he maximized his depreciation deductions for the sedan;[37] and $9,464 more than if he had only claimed a regular first-year depreciation deduction.[38] Again, Roger would reap the benefits that come with the SUV tax loophole. Given that Roger would like to save as much in taxes as possible in 2004, preferring instead to defer his taxes to subsequent years, it is no small surprise that Roger ended up choosing the SUV over the sedan.

III. SECTION 280F AND THE UNINTENDED SUV TAX LOOPHOLE

With tax incentives like increased expensing and bonus depreciation, the SUV tax loophole is big enough to drive a Hummer through,[39] and businesses and self-employed individuals like Roger are gladly making the most of it. SUVs weighing more than 6,000 pounds gross vehicle weight fall outside the section 280F(d)(5) definition of "passenger automobile," meaning that heavy SUVs are not subject to the section 280F limitations on expensing and depreciation deductions. This is a loophole in a system that was originally intended

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[32] $50,000(.50) = $25,000.

[33] For five-year depreciable property like this SUV, the depreciation rate for the first year is 20% of the adjusted basis. Rev. Proc. 87-57, 1987-2 C.B. 687. Thus: $25,000(.20) = $5,000.

[34] $25,000 + 5,000 = $30,000.

[35] $30,000 – 10,610 = $19,390.

[36] $30,000(.35) = $10,500.

[37] $10,500 – 3,713.50 = $6,786.50.

[38] $10,500 – 1,036 = $9,464.

[39] SIERRA CLUB, PRESIDENT BUSH: NO HUMMER LEFT BEHIND, *at* http://www.sierraclubplus.org/hummerdinger/features/no_left.html (last visited Apr. 14, 2005) (a work of parody that scoffs at the SUV tax loophole, dubbing it "a tax 'loophole' so big, you could drive a Hummer H2 through it!").

to prevent "abusive tax deductions"[40] by businesses that purchased expensive, luxury cars in order to enjoy bigger business expense deductions against gross income. The weight classification included in section 280F(d)(5)(A)(ii) was intended to separate passenger automobiles from heavier vehicles typically used for farming, construction, and other hauling work (such as timber operations), so that businesses needing vehicles in the latter category would be entitled to uncapped expensing and depreciation deductions. But now that the SUV has become a trendy alternative to the traditional passenger automobile (without being classified as one), businesses that purchase expensive, luxury SUVs now find themselves in the same favorable position as self-employed farmers and construction workers.

A. The Original Purpose of Section 280F

Section 280F was added to the Code in 1984 to crack down on small business owners and self-employed individuals who were abusing the cost recovery system.[41] Such abuse took the form of businesses purchasing expensive luxury automobiles for the purpose of taking large depreciation deductions in the years of cost recovery, enabling businesses to enjoy an annual reduction in taxable income.[42] As was typically the case, the cost and luxury of the automobiles "far outweighed what was necessary for business use."[43] Moreover, provided that the business could spare the cash to buy a new car every few years, there was an incentive to purchase a replacement automobile at the end of each recovery period as a means of reducing taxable income every year.[44]

In response to such abusive practices, Congress imposed limits (expressly directed at "luxury automobiles")[45] on the amount that could be deducted each year as depreciation for passenger automobiles purchased for business use. These deduction limitations also apply to section 179 expensing.[46] The amount that could be deducted in a given year for depreciation was the same for all passenger automobiles,[47] regardless of cost, thus destroying the incentive to buy expensive Cadillacs and Mercedeses as part of a strategy to save on the annual tax bill.[48] While these deduction limitations for luxury automobiles demonstrate a policy choice by Congress not to subsidize the purchase of expensive

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[40] KEITH BRADSHER, HIGH AND MIGHTY: SUVS—THE WORLD'S MOST DANGEROUS VEHICLES AND HOW THEY GOT THAT WAY 73 (2002).

[41] *Id.*

[42] *Id.*

[43] Andrew D. Sharp, *Living Large: Fuel Guzzler Tax Deductions*, 51 OIL, GAS, & ENERGY Q. 771, 772 (2003).

[44] *See* BRADSHER, *supra* note 40, at 73 (explaining that the new limits on depreciation deductions resulted in many business customers no longer being able to afford to purchase the more expensive models, "nor could they replace their cars as often").

[45] I.R.C. § 280F (RIA 2005) is entitled "Limitation on depreciation for luxury automobiles."

[46] I.R.C. § 280F(d)(1) (RIA 2005).

[47] I.R.C. § 280F(a)(1)(A) (RIA 2005).

[48] BRADSHER, *supra* note 40, at 73; Sharp, *supra* note 43, at 772; Danny Hakim, *In Tax Twist, Big Vehicles Get the Bigger Deductions*, N.Y. TIMES, Dec. 20, 2002, at C1.

luxury cars for business use, the fact that vehicles weighing more than 6,000 pounds "unloaded gross vehicle weight" ("gross vehicle weight" in the case of trucks or vans, a category that includes SUVs) were excluded from the section 280F(d)(5) definition of passenger automobile[49] demonstrates Congress's other policy choice to allow businesses "to take big tax deductions on vehicles used for construction, farming, or hauling."[50] Thus, a self-employed Realtor who purchases a luxury sedan for transporting clients to and from open houses is limited in how much he may deduct each year for the vehicle's acquisition cost, while a construction worker who needs a large, heavy vehicle to transport his building materials is entitled to deductions unrestricted by section 280F.

B. The Advent of the SUV as a Trendy Luxury Vehicle Opens Up the SUV Tax Loophole

Classifying passenger automobiles by weight rather than by function is what leads to the SUV tax loophole as it exists in section 280F today.[51] Initially, the weight classification was sufficient to separate passenger automobiles from the heavier trucks and vans that workers in farming, construction, timber, and other hauling businesses relied on to do their work.[52] This achieved Congress's goal of denying big write-offs to those who abused the cost recovery system by purchasing expensive, luxury cars just to save on taxes, while allowing uncapped expensing and depreciation deductions to those who actually needed the more expensive, heftier vehicles to do their work. This system of discrimination, based on vehicle weight, fulfilled Congress's intent so long as the luxury vehicles businesspeople were interested in weighed less than 6,000 pounds. But the advent of the SUV as America's new luxury vehicle of choice changed businesses' purchasing incentives, quickly working to open up the SUV tax loophole in section 280F.[53]

In recent years, there has been an "explosion of SUV, pickup, and minivan sales"[54] in the United States, as consumers have increasingly preferred such vehicles as a trendy alternative to the traditional passenger car.[55] A few authors note that these vehicles, which the Code classifies as light trucks, now account

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[49] I.R.C. § 280F(d)(5)(A)(ii) (RIA 2005).

[50] Hakim, *supra* note 48, at C1. *See also* BRADSHER, *supra* note 40, at 74 (explaining that farmers benefited from the special treatment given to heavy vehicles in section 280F).

[51] SELF EMPLOYED WEB, SUV TAX DEDUCTION: A HUMMER OF A TAX BREAK, *at* http://www.selfemployedweb.com/suv-tax-deduction.htm (last visited Apr. 14, 2005).

[52] *Id.*

[53] *See* BRADSHER, *supra* note 40, at 74 (noting that "once Americans became accustomed to the idea of driving midsized SUVs instead of cars, the depreciation rules buried in the tax code would later prove a huge incentive for people to trade up into very large, luxury SUVs").

[54] UNION OF CONCERNED SCIENTISTS, *supra* note 5.

[55] MICHAEL L. BERGER, THE AUTOMOBILE IN AMERICAN HISTORY AND CULTURE: A REFERENCE GUIDE 164–65 (2001) (noting that by the late 1990s, SUVs had become "enormously popular with white-collar America" due to their roominess, versatility, and road-handling attributes. "In addition, for reasons that are always difficult to explain, they became very trendy, possibly because of their sporty and off-road images.").

for about half of the total U.S. new-vehicle market,[56] and the SUV—"today's quintessential suburban passenger vehicle"[57]—is now a common substitute for cars, "even luxury cars."[58] With the SUV's current prevalence and popularity in the American auto market (despite its poor gas mileage), businesses now have the opportunity to buy a trendy, luxury vehicle that falls outside the definition of passenger automobile, and therefore qualifies for uncapped deductions against gross income. Moreover, recent tax incentives for new business asset acquisition, including increased expensing and bonus depreciation, have widened the SUV tax loophole by enabling businesses to enjoy even greater uncapped write-offs.

C. The Fuss About SUVs: Environmental Concerns

Environmentalists' main concern with SUVs is their poor fuel efficiency. SUVs are far less fuel efficient than cars and minivans,[59] and according to author Keith Bradsher, "as millions of Americans [have] switched to SUVs, especially big ones, overall gas mileage [has] suffered" in this country, with the average efficiency of all vehicles sold in the United States in steady decline.[60] The SUV's thirst for fuel not only gouges drivers' wallets at the pump,[61] but also contributes significantly to three larger problems: dependency on foreign oil, air pollution, and global warming.[62] Naturally, there have been calls for higher standards for the SUV's fuel economy, and a push to encourage consumers to

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[56] CARL POPE & PAUL RAUBER, STRATEGIC IGNORANCE: WHY THE BUSH ADMINISTRATION IS RECKLESSLY DESTROYING A CENTURY OF ENVIRONMENTAL PROGRESS 72 (2004) (noting that "wildly popular" SUVs and pickup trucks "now constitute more than half of all vehicles sold in the United States").

[57] Ball & Lundegaard, *supra* note 5, at D1.

[58] BRADSHER, *supra* note 40, at 73.

[59] For instance, a large car such as a full-sized Chevrolet Impala gets 21 miles per gallon (m.p.g.) in the city and 32 m.p.g. on the highway, and a minivan such as the Honda Odyssey gets 18 m.p.g. in the city and 25 m.p.g. on the highway. *Id*. at 407. Although minivans are somewhat less efficient than large cars, both are still much better than SUVs. *Id*. For example, a Ford Explorer gets just 14 m.p.g. in the city, *id.* at 222, and a Hummer gets a mere 13 m.p.g. in a combination of *both* city and highway driving. *Id*. at 378.

[60] *Id*. at 241–42. The overall gas mileage of new vehicles purchased in the United States peaked in the 1987 and 1988 model years at 25.9 m.p.g, declining to an average of 24.5 m.p.g. by the 1997 model year, and to 23.9 m.p.g. by 2001. *Id*.

[61] For an economist's argument that an SUV's higher fuel consumption should not be considered a problem if the consumer is willing to pay for the extra fuel, *see* Frank S. Arnold, *Complaints About SUVs Don't Add Up*, ENVTL. F., Jan.-Feb. 2003, at 14.

[62] *See* POPE & RAUBER, *supra* note 55, at 228 (arguing automakers should be required to improve the fuel efficiency of vehicles in order to "reduce our dependence on Middle East oil, shrink our disproportionate 25% contribution to the global warming problem, and reduce our trade deficit, while enabling us to save money at the gas pump [and] clean up air pollution"). The SUV's poor fuel economy is related to global warming "because the fuel burned in an auto engine is a major source of carbon dioxide, believed to be one of the chief 'greenhouse gases' raising the Earth's temperature." Jeffrey Ball, *Road Rally: Global Auto Makers Are Racing to Inject Diesel into Mainstream*, WALL ST. J., Jul. 28, 2003, at A1. For more information on the SUV's harmful impact on the environment, see generally BRADSHER, *supra* note 40.

buy more fuel-efficient vehicles, including vehicles that do not rely entirely on gasoline as their energy source.[63]

Prior to the enactment of the Jobs Act, there was still a tax incentive for businesses to choose heavy SUVs over more environmentally friendly vehicles, despite the existence of a special provision in section 280F(a)(1)(C)[64] allowing tripled deduction limits for electric vehicles.[65] But under current law (explained in detail in Part V.B.), where expensing deductions for SUVs are limited to $25,000 and bonus depreciation no longer exists, a small business would get about the same write-off in the year of purchase for both the heavy SUV and the electric passenger automobile. Thus, for a business that is both environmentally conscious and in need of a passenger automobile, the SUV tax loophole is now less likely to lure the business into making an unnecessary SUV purchase just for the bigger write-off.

Of course, the write-off comparison and relative tax incentives of heavy SUVs versus electric passenger automobiles depend on the price of the hybrid vehicle that the business is considering buying. The write-offs are roughly equivalent only if the business is considering the most expensive hybrid vehicle on the market, assuming that the business has dual interests in helping the environment and maximizing its year-of-purchase write-off. If the business is truly primarily motivated by environmental concerns, then it would likely choose the lower-priced, more fuel-efficient model of hybrid vehicle, in which case the business would enjoy a full deduction for the price in the year of purchase, al-

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[63] For instance, hybrid vehicles such as the Honda Insight, Toyota Prius, and the Ford Escape (a new hybrid SUV) have garnered increased popularity in recent years. The Honda Insight far surpasses other vehicles in terms of gas mileage, achieving 61 m.p.g. in the city and 68 m.p.g. on the highway. HYBRIDCARS.COM, GAS MILEAGE, Apr. 14, 2005, *at* http://www.hybridcars.com (last visited Feb. 13, 2005). The Ford Escape SUV gets 36 m.p.g. in the city and 31 m.p.g. on the highway, *id.*, which is not as much as other hybrids, but about double the gas mileage that a conventional Ford SUV, such as the Ford Explorer, gets, as discussed in note 58, *supra*.

[64] I.R.C. § 280F(a)(1)(C) (RIA 2004) provides that "in the case of a purpose built passenger vehicle, . . . each of the annual limitations specified [for passenger automobiles] shall be tripled." A "purpose built passenger vehicle" is a passenger vehicle that was designed and manufactured to "be propelled primarily by electricity." I.R.C. § 4001(a)(2)(C)(ii) (RIA 2004). Thus, a taxpayer purchasing an electric passenger automobile for business use may deduct up to triple the amount otherwise allowed for a gasoline-burning passenger automobile.

[65] Prior to the enactment of the Jobs Act, there was no special limit on section 179 expensing for SUVs, and 50% bonus depreciation was still in effect under JGTRRA. Thus, under the old law, if Roger had purchased a heavy SUV, he would have been able to fully expense its cost in the year of purchase. Alternatively, if he had already used up his $102,000 section 179 expensing deduction on other section 179 property acquired in the same year, his total depreciation deduction for the year would have been $30,000. *See supra* note 24 for calculation. Roger represents self-employed individuals who buy very few business assets in a given year; therefore, assuming the vehicle is the only section 179 property that Roger purchased, his full expensing deduction for the SUV would be $18,170 greater than the maximum deduction allowed for electric cars. This means that even though section 280F rewards purchasers of electric passenger automobiles with tripled deduction limits, prior to the enactment of the Jobs Act, the SUV tax loophole undermined that tax incentive by offering even greater write-offs for environmentally unfriendly SUVs.

though less than what could have been deducted for a more expensive, heavy SUV. All this can be demonstrated by another hypothetical, broken into three scenarios: 1) Roger choosing between a $50,000 heavy SUV and a hypothetically priced $50,000 hybrid passenger automobile (to offer a straight comparison); 2) Roger choosing between a $50,000 heavy SUV and a $30,000 hybrid passenger automobile; and 3) Roger choosing between a $50,000 SUV and a $19,000 Honda Insight (the most fuel-efficient hybrid vehicle on the market).

1. Scenario 1: Choosing Between a Heavy SUV and a Comparatively Priced Hybrid Passenger Automobile

If Roger purchases a $50,000 heavy SUV, the most he may deduct in the year of purchase under current law for both section 179 expensing and regular depreciation is $30,000.[66] If Roger found a hybrid passenger automobile that also cost $50,000, Roger would be entitled to fully expense the purchase price under section 179,[67] but section 280F(a)(1)(C) would limit his deduction to $31,830,[68] which is three times the limit for conventional passenger automobiles. Thus, when doing a straight comparison, this scenario shows that there is a slight tax incentive to choose a like-priced hybrid over the heavy SUV, especially if Roger's environmental concerns weigh-in to tip the balance.

2. Scenario 2: Choosing Between a Heavy SUV and the Most Expensive Hybrid Passenger Automobile on the Market

No hybrid compact car or sedan currently on the market costs $50,000.[69] Assuming Roger wants to both help the environment and maximize his write-off, he could consider purchasing a Honda Accord Hybrid, which, at about $30,000,[70] is the most expensive hybrid passenger automobile on the market.[71] If Roger bought this hybrid passenger automobile, he could expense the full price of the vehicle in the year of purchase, leaving $1,830[72] of his section 280F(a)(1)(C) treble deduction limit unused. Thus, Roger could deduct $30,000 whichever vehicle he chooses, the heavy SUV[73] or the hybrid passenger automobile. If Roger truly only needed a vehicle to drive around his clients, and he preferred a vehicle that would get better gas mileage, he would choose the hybrid vehicle. But personal preferences aside, the special rule for electric passenger automobile deductions and the new rule that limits SUV expensing

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[66] The Jobs Act added paragraph (6) to section 179(b) to impose a $25,000 limit on section 179 deductions for heavy SUVs. The Jobs Act extended increased expensing two more years, through the end of 2007. The Jobs Act, *supra* note 4, at § 910(a). Thus: $50,000 – 25,000 expensing deduction = $25,000 adjusted basis. $25,000(.20) = $5,000 regular depreciation deduction. $25,000 + 5,000 = $30,000 total deduction for the year of purchase.

[67] The Jobs Act extended section 179 increased expensing two more years, through the end of 2007. Jobs Act, *supra* note 4, at § 201.

[68] Rev. Proc. 2004-20, *supra* note 14, at Table 6.

[69] HYBRIDCARS.COM, *supra* note 63.

[70] *Id.*

[71] *Id.*

[72] $31,830 − 30,000 = $1,830.

[73] See *supra* note 66 for calculation.

make it so that there is no tax incentive in favor of either vehicle for the year of purchase.

3. Scenario 3: Choosing Between a Heavy SUV and the Most Fuel Efficient Hybrid Passenger Automobile on the Market

Of course, if Roger were a true friend of the environment, he would consider purchasing the most fuel-efficient hybrid passenger automobile on the market, the Honda Insight. The Honda Insight gets about double the gas mileage that the Honda Accord Hybrid gets,[74] and it costs only $19,000.[75] Again, the generous section 280F(a)(1)(C) deduction limitation for electric passenger automobiles would allow Roger to fully expense the $19,000 price under section 179. Clearly, if Roger only needs a passenger automobile and cares about the environment, this is a great deal. But this scenario also shows how the tax incentives may shift in favor of the more expensive, heavy SUV (or even the more expensive, less fuel efficient hybrids) once the hybrid's price dips below $30,000. Assuming Roger is truly an environmentalist at heart, he would choose the hybrid and enjoy a full write-off of its price in the year of purchase.[76] But the opportunity to take a bigger write-off just by purchasing a different kind of vehicle might tempt Roger to choose the heavy SUV anyway, even though the larger vehicle is more than he needs for his business. This is how the SUV tax loophole facilitates abuse[77] of the cost recovery system.

IV. THE SUV TAX LOOPHOLE AT THE STATE LEVEL

A. State Response to the Federal Tax Incentives That Widen the SUV Tax Loophole

Nearly all state revenue codes are based on the federal system.[78] When JCWAA was passed in 2002, about half of the 46 states that based all or portions of their corporate tax codes on the Code had tax systems that "automati-

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[74] *See* HYBRIDCARS.COM, *supra* note 63 (showing that the Honda Insight gets 60 m.p.g. in the city and 65 m.p.g. on the highway, while the Honda Accord Hybrid gets 30 m.p.g. in the city and 37 m.p.g. on the highway, about half the gas mileage that the Honda Insight gets).

[75] *Id.*

[76] Although Roger may be happy to fully deduct the vehicle's cost against his business's gross income in the year of purchase, it must be remembered that the tax benefit is really just a matter of timing. Deducting the entire price in the year of purchase means there is no cost basis remaining to depreciate in later years, so that no amount of the vehicle's price will be spread out to reduce gross income in future years. The bottom line is that greater deductions allow greater tax deferment, which may be especially beneficial to a business taxpayer who expects to have more income this year than in later years.

[77] Certainly the businesses that are lured in by the bigger write-off would consider this "making the most of" the cost recovery system.

[78] Andrew Caffrey, *States Balk at Cuts in Federal Business Taxes*, WALL ST. J., Mar. 18, 2002, at A2; Federation of Tax Administrators, *Breaking Up is Hard to Do: States Respond to Federal Bonus Depreciation*, TAX ADMINS. NEWS, Apr. 2002, *available at* http://www.taxadmin.org/fta/rate/decoupling/tan_art.html.

cally" conformed to the changes made to the federal tax laws, unless the state legislatures took action to "decouple" (*i.e.*, deviate) from certain provisions in the Code.[79] Where state tax law does not automatically conform to changes in federal tax law, the legislatures periodically update their codes as of a certain date in the federal code.[80] Either way it is done, state conformity with the Code means that the SUV tax loophole and the federal tax incentives that widen that loophole apply at the state level as well. Thus, while section 179 expensing and section 168(k) bonus depreciation are costing the federal government billions in lost tax dollars and contributing to a massive federal budget deficit, states are losing out on tax revenues as well.[81] As one author noted, this comes at a time when "[s]tates face their worst financial crisis in 50 years."[82] Another author explains, "[w]hile the federal government can and almost always does run large deficits, that is not an option for states."[83] This is because nearly all states must maintain balanced budgets, as required by their state constitutions.[84]

Faced with the task of balancing their budgets, state legislatures must make a choice: conform their state tax systems to the Code and find other ways to meet their budget constraints, or decouple from the federal tax incentives, thereby protecting themselves from revenue loss, but disappointing business taxpayers in the process. Although the fundamental choice is between conformity and decoupling, actual state responses to the federal tax incentives fall along a varied spectrum. What follows is a general overview of state responses.

1. State Conformity with the Federal Tax Incentives

Prior to the enactment of the Jobs Act, only twelve states completely conformed with increased expensing and bonus depreciation as provided for under JCWAA and JGTRRA.[85] As of this writing, no data is available regarding how

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[79] Caffrey, *supra* note 77; Federation of Tax Administrators, *supra* note 77.

[80] Caffrey, *supra* note 77; Federation of Tax Administrators, *supra* note 77.

[81] Tim Catts, *Bush's Tax Cuts Take a Bite Out of States' Budgets*, 100 TAX NOTES 1098, 1098 (2003) (noting that because "state revenue codes are by and large based on the Internal Revenue Code, . . . changes wrought on Capitol Hill reverberate in state capitals across the country").

[82] Bob Kemper, *Bush Not Helping States, Experts Say: Underfunded Mandates Burden Tax-Shy Coffers*, CHI. TRIB., May 30, 2003, at C11. *See also* NATIONAL CONFERENCE OF STATE LEGISLATURES, STATE BUDGET & TAX ACTIONS 2004: PRELIMINARY REPORT 1 n.4, *available at* http://www.ncsl.org/print/fiscal/presbta04.pdf (last visited June 20, 2005) (noting that since fiscal year 2002, states have closed a cumulative budget gap exceeding $235 billion).

[83] Doug Sheppard, *NGA, NCSL: Federal Stimulus Will Cost States Billions*, 94 TAX NOTES 1414, 1414 (2002).

[84] Catts, *supra* note 80; Vivian Marino, *That Out-of-State Shopping Trip May Buy a Higher Tax Bill*, N.Y. TIMES, Feb. 15, 2004, at C11.

[85] States fully conforming to JCWAA and JGTRRA business growth incentives include: Alabama, Alaska, Colorado, Delaware, Kansas, Louisiana, Missouri, Montana, New Mexico, North Dakota, Oregon, and Utah. THOMSON RIA, UPDATE: STATE CONFORMITY WITH 2002 AND 2003 FEDERAL DEPRECIATION AND EXPENSING LEGISLATION (Article No. ta-042004-0036, Apr. 20, 2004), *available at* http://riacheckpoint.com. [hereinafter State Conformity Rules]. Missouri, however, disallows 30% bonus depreciation claimed under JCWAA on purchases made between July 1, 2002 and June 30, 2003. *Id.* at n.6.

many states conform with the Jobs Act changes to these tax incentives; however, it remains true that while some states automatically conformed to the Jobs Act changes on the date of its enactment, it remains to be seen whether other states will affirmatively adopt a post-enactment date to update their codes and adopt those changes. For example, after JCWAA and JGTRRA were enacted, a few states updated their codes by conforming them to the federal system as of specified post-enactment dates, thereby affirmatively adopting the increased expensing and bonus depreciation rules for their states.[86] Because the Jobs Act is still relatively new, it may take a while for states to decide how to respond to the new changes in federal law. The bottom line is, some states may already conform with the two-year extension for increased expensing and the expiration of bonus depreciation, while many states may still conform to pre-Jobs Act law that still allows both increased expensing and bonus depreciation.

State conformity with federal tax incentives means that small business owners and self-employed individuals enjoy faster write-offs for their purchases of qualifying property on both their federal and state tax returns. Although tax savings to businesses translates to less tax revenue and more budgetary restraints to states, those states that choose conformity have good reasons for it. Many states choose conformity for the sake of consistency between state and federal rules,[87] and to avoid the "logistical nightmare" of requiring business taxpayers to keep two sets of records to track the values of their depreciating assets.[88] Conformity also avoids disappointment to businesses that otherwise enjoy greater write-offs on their federal returns. Another reason to conform with the federal tax incentives, one *Tax Notes* author asserts, is to avoid the risk that the state will "miss[] out on [the] economic stimulus encouraged by the cuts."[89] According to an article in *The Tax Advisor*, "the federal-stimulus legislation [may] benefit states in the long run" if the tax incentives "generate a significant increase in employment and profits" for businesses.[90]

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[86] For example, on May 28, 2004, the Florida state legislature passed new legislation conforming Florida's tax code to the Internal Revenue Code as of January 1, 2004, thereby adopting increased section 179 expensing and 50% bonus depreciation as allowed under JGTRRA. State Conformity Rules, *supra* note 85 at n.2 (noting that the legislation to conform Florida's tax laws to JGTRRA was pending as of April 1, 2004); GRANT THORTON, STATE AND LOCAL TAX ALERT: UPDATE OF STATE ACCEPTANCE OF FEDERAL BONUS DEPRECIATION, *at* http://www.grantthornton.com/downloads/SALT_2-4-04_90621.pdf (last visited Aug. 13, 2004) (noting that legislation to conform Florida's tax laws to JGTRRA was signed into law on May 28, 2004). Prior to the recent enactment, the Florida system had already conformed to 30% bonus depreciation under JCWAA. State Conformity Rules, *supra* note 85.

[87] Catts, *supra* note 81, at 1099 (noting that in states that have chosen not to conform, "taxpayers must follow two different sets of rules when preparing their returns").

[88] Caffrey, *supra* note 78.

[89] Catts, *supra* note 81, at 1099 (noting that "[a]ny time you have reduced taxes on capital and wages, you'll see greater economic benefits overall").

[90] *See* Val Oveson et al., *States, Localities Respond to Federal Stimulus Legislation*, 33 TAX ADVISER 453, 453 (2002).

Of course, the fact remains that conformity comes at a cost: spending must be cut, and other taxes and fees must be raised, in order make ends meet.[91] According to the executive director of the National Governors' Association, "[e]ducation will clearly be the big loser as governors struggle to balance their budgets."[92] Although these are budget difficulties some conforming states chose to accept, others did not necessarily conform voluntarily. For example, the Colorado State Legislature is barred by its constitution from "retroactive decoupling,"[93] a move that could have spared the state from a projected $127 million loss in revenue through fiscal year 2005;[94] the Colorado constitution allows only prospective decoupling.[95] And some conforming states, such as Utah, are considering decoupling from the federal code in order to avoid further revenue loss.[96] Indeed, it was out of this concern for lost revenue dollars that the majority of states chose to decouple from the JCWAA and JGTRRA provisions for increased expensing and bonus depreciation.

2. State Decoupling from the Federal Tax Incentives

After the enactment of JCWAA and JGTRRA, most states chose to decouple, in whole or in part, from the federal provisions for increased expensing, bonus depreciation, or both.[97] Although there is currently no data regarding state decoupling in response to the Jobs Act, states must decide whether to decouple from the two-year extension of increased expensing, the expiration of bonus depreciation, or both. States interested in preserving tax revenues may choose to decouple from the two-year extension; states interested in keeping bonus depreciation on the books may decide to write an extension into their own tax codes.

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[91] Caffrey, *supra* note 78.

[92] Sheppard, *supra* note 83, at 1415 (according to the executive director of the National Governors' Association, "[l]ayoffs, larger class sizes, forgoing school repairs, tuition increases for higher education—these are the real-life, hard choices governors will have to make in light of the action Congress took").

[93] Catts, *supra* note 81, at 1098.

[94] *Id*. (noting that retroactive decoupling, if permitted by the Colorado constitution, could have spared the state from suffering revenue losses); NICHOLAS JOHNSON, CENTER ON BUDGET AND POLICY PRIORITIES, FEDERAL TAX CHANGES LIKELY TO COST STATES BILLIONS OF DOLLARS IN COMING YEARS, *available at* http://www.cbpp.org/6-3-03sfp.htm [hereinafter CBPP REPORT] (Rev. June 5, 2003) (projecting the total loss of revenue to Colorado through fiscal year 2005 that would result from the state's conformity with both increased expensing and bonus depreciation provisions). If Congress were to extend increased expensing and bonus depreciation, CBPP projects Colorado's total revenue loss to be $868 million through 2013. *Id*.

[95] Catts, *supra* note 81, at 1098.

[96] *Id.* (noting that the Utah legislature may consider decoupling to avoid further revenue loss); CBPP REPORT, *supra* note 94 (projecting that Utah's conformity with both increased expensing and bonus depreciation provisions will cost the state $64 million in lost revenue through fiscal year 2005).

[97] *See generally* State Conformity Rules, *supra* note 85 (using a chart to break down how each state treats the JCWAA and JGTRRA federal rules for bonus depreciation and increased expensing).

Generally, states chose one of two approaches when decoupling from the JCWAA and JGTRRA provisions for increased expensing and bonus depreciation. The first approach was to disallow one or both federal tax incentives entirely, retaining instead the depreciation or expensing rules as they existed prior to JCWAA or JGTRRA.[98] The second approach was to require an "add-back" of some or the entire amount that was deducted for expensing or depreciation on the federal return.[99] The states that choose to decouple from the two-year extension of increased expensing under the Jobs Act similarly may choose one of these two approaches. Either way, in decoupling states, businesses must contend with different expensing and depreciation rules, and will enjoy little or none of the big write-off they enjoy at the federal level.[100]

B. Legislative Effort to Close the SUV Tax Loophole at the State Level

To decide whether to conform with or decouple from the JCWAA and JGTRRA provisions for increased expensing and bonus depreciation, the state legislatures considered the overall impact that these tax incentives would have on their states' economies. Although the tax incentives could play a small part in stimulating an economic turnaround, they would certainly be costly for states as well. While legislatures dealt with the issue of whether to allow these tax incentives generally, some state legislators noticed how these tax incentives interacted with section 280F to enhance the SUV tax loophole. For various fiscal and policy reasons, legislators responded by proposing laws aimed directly at closing the SUV tax loophole at the state level. Although legislative efforts to close the SUV tax loophole in Maryland, California, and Oregon[101] have failed, these efforts demonstrate state level concern for the federal loophole's impact on revenue collections and the environment, and stand as examples for the kind of legislation Congress should pass to close the SUV tax loophole at the federal level.

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[98] Federation of Tax Administrators, *supra* note 78 (discussing the ways that states may decouple from federal bonus depreciation); CBPP REPORT, *supra* note 94 (discussing the ways that states may decouple from federal changes to section 179 expensing).

[99] Federation of Tax Administrators, *supra* note 78 (discussing the ways that states may decouple from federal bonus depreciation); CBPP REPORT, *supra* note 94 (discussing the ways that states may decouple from federal changes to section 179 expensing).

[100] For a detailed summary of how each state treats the JCWAA and JGTRRA federal rules for increased section 179 expensing and bonus depreciation, see State Conformity Rules, *supra* note 85. *See also* GRANT THORTON, *supra* note 86 (providing a chart summarizing each state's position and conformity with federal bonus depreciation under JCWAA and JGTRRA as of June 7, 2004); BNA SOFTWARE, STATE CONFORMITY WITH FEDERAL DEPRECIATION RULES, *at* http://www.bnasoftware.com/knowledgecenter/state%20 depreciation (last visited Apr. 18, 2005) (providing a pull-down menu for looking up each state's current position as to federal bonus depreciation, with links to each state's department of revenue website).

[101] *See generally* STATE ENVIRONMENTAL RESOURCE CENTER, ISSUE: BUSINESS SUV TAX BREAK, *at* http://www.serconline.org/suvTaxBreak.html (last updated Mar. 11, 2004) (listing Maryland, California, and Oregon as states to watch because they had all taken action to close the SUV tax loophole).

1. Maryland

In the interest of increasing state tax revenue,[102] Maryland Senate Bill 219,[103] entitled "Sport Utility Vehicle Business Tax Loophole Closure Act," was introduced on January 28, 2004,[104] to amend Maryland tax law so that "heavy duty SUVs" would also be subject to the section 280F limitations on expensing and depreciation deductions for passenger automobiles. To achieve this, the proposed law defines a "heavy duty SUV" as a vehicle with a gross vehicle weight between 6,001 and 14,000 pounds, which "would be a passenger automobile as defined in section 280F of the Code if it were rated at 6,000 pounds gross vehicle weight or less."[105] So defined, heavy duty SUVs would be subject to the same deduction limitations as are passenger automobiles. Thus, when business taxpayers compute their Maryland income taxes, they would be required to add back to their federal adjusted gross income any amount of expensing or depreciation deduction taken on the federal income tax return that exceeded the section 280F deduction limit.[106]

The bill is still pending, but the Maryland legislature has not taken any action on it since March 10, 2004.[107] To its credit, the bill would operate to prevent abusive deduction practices by businesses that buy heavy SUVs just for the tax breaks, resulting in increased tax revenues for Maryland. Maryland Senate Bill 219 proposes to do this by targeting heavy duty SUVs specifically; however, the definition may be broad enough to include all trucks and vans, despite the exclusive SUV label. As the definition is applied in section 280F, SUVs are a subset of trucks and vans, which are generally excluded from the passenger automobile definition for weighing too much. Thus, as Maryland's proposed heavy duty SUV definition is worded, it could apply to the entire trucks and vans category, creating uncertainty as to whether unlimited deductions are preserved for anyone, since the definition also fails to include any exceptions for certain industries or lines of work (*e.g.*, farming, construction, timber, and other hauling businesses).

The proposed law goes against the original intent of section 280F because it would deny tax breaks not only to those who abuse the cost recovery system, but also to those who were originally favored to reap a greater benefit from it.

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[102] The Comptroller's Office of the Maryland Department of Legislative Services estimated that the proposed changes to Maryland's tax laws would result in a $33.3 million net increase in state tax revenue for fiscal year 2005. DEP'T OF LEGIS. SERV., MD. GEN. ASSEMB., S.B. 219, FISCAL AND POLICY NOTE, 2004 Leg., 418th Sess., at 1 (2004), *available at* http://mlis.state.md.us/2004rs/billfile/SB0219.htm.

[103] S.B. 219, 2004 Leg., 418th Sess. (Md. 2004), *available at* http://mlis.state.md.us/2004rs/billfile/SB0219.htm.

[104] *Id.*

[105] *Id.* at § 1(a)(3) provides as follows: "Heavy Duty SUV" means a 4-wheeled vehicle that: is manufactured primarily for use on public streets, roads, and highways; is rated at more than 6,000 but not more than 14,000 pounds gross vehicle weight; and would be a passenger automobile as defined in section 280F of the Internal Revenue Code if it were rated at 6,000 pounds gross vehicle weight or less.

[106] *Id.* at § 1(b)(3).

[107] DEP'T OF LEGIS. SERV., MD. GEN. ASSEMB., S.B. 219: HISTORY BY LEGISLATIVE DATE, Reg. Sess. (2004), *available at* http://mlis.state.md.us/2004rs/billfile/SB0219.htm.

These observations may explain why there has been so little activity on the bill. In any event, Maryland Senate Bill 219 is an example of an approach Congress might take to include large SUVs expressly in the definition for passenger automobiles, although Congress should also take care to ensure that those who need the features of heavier vehicles to conduct their businesses are still exempt from the deduction limitations, in accordance with the original intent of section 280F.

2. California

The drafters of Maryland Senate Bill 219 were primarily concerned with ending the abusive deduction practices that were costing their state millions of dollars in lost tax revenues; accordingly, their proposed remedy to the SUV tax loophole was to amend the passenger automobile definition so that section 280F deduction limitations would also apply to heavy SUVs. The drafters of California Assembly Bill 848[108] took their remedy a step further: primarily motivated by concerns for the environment, California legislators proposed rewarding businesses that purchase "qualified reduced-emission" vehicles at the expense of businesses that purchase "large SUVs" unnecessary[109] to their line of work. The bill failed when put to a vote on the assembly floor on January 29, 2004.[110]

The drafters acknowledged that the "large vehicle provision" in section 280F, that was originally intended to "benefit farmers and businesses that use trucks or vans to carry out their work," had become an incentive for businesses to make unnecessary purchases of "environmentally unfriendly" "large[], less fuel-efficient SUVs" that also contribute to the deterioration of California's

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[108] Assemb. B. 848, 2003-04 Leg., Reg. Sess. (Cal. 2004).

[109] By "unnecessary," the author means that the vehicle purchased has features (*e.g.*, towing capacity, hauling space) that are not necessary to the business purchaser's line of work. Although the vehicle may be used in the taxpayer's business (*e.g.*, transporting clients or employees to and from meetings during work hours), the vehicle's size is essential only for tax, not work, purposes. For example, business professionals such as doctors, lawyers, and self-employed Realtors may choose a much larger vehicle than is necessary to fulfill their business travel needs just so that they have a vehicle for business use that qualifies for the large first-year deductions. *See, e.g.*, Jeffrey Ball & Karen Lundegaard, *Tax Breaks for the Merely Affluent: Quirk in Law Lets Some SUV Drivers Take Big Deduction*, WALL ST. J., Dec. 19, 2002, at D1 (Mark Sherrard, a doctor who lives in Monroe, Mich., bought a new Chevrolet Suburban at the prompting of his accountant, saying that he "wanted to get a new vehicle anyway," and with the accelerated tax breaks, his purchase "was a no-brainer."); Danny Hakim, *In Tax Twist, Big Vehicles Get the Bigger Deductions*, N.Y. TIMES, Dec. 20, 2002, at C1. (Additionally, accountant Jim Jenkins acknowledges that the SUVs that qualify for the tax breaks are "bigger than anything [he would] want," but admits that it is "tempting" to purchase one anyway just to get the larger first-year deduction.). *See also* Richard A. Westin, *The SUV Advantage*, 94 TAX NOTES 1360, 1361 (2002) (noting that most SUVs, pick-up trucks, and vans on the roads today "do the work of cars").

[110] LEG. COUNSEL OF CAL., ASSEMB. BILL 848: HISTORY, 2003-04 Leg., Reg. Sess. (2004), *available at* http://www.leginfo.ca.gov/bilinfo.html; LEG. COUNSEL OF CAL., ASSEMB. BILL 848: VOTE INFORMATION, 2003-04 Leg., Reg. Sess. (2004), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0801-0850/ab_vote_20040129_0214pm_asm_floor.html.

roads and highways.[111] California Assembly Bill 848 asserted that as a matter of public policy, "California should not allow these federal incentives for large SUVs."[112] Furthermore, the drafters asserted that "California should actively reward" purchases of qualified reduced-emission vehicles with a $1,000 credit against tax,[113] and effectively punish businesses that purchase large SUVs by completely denying them certain tax incentives for such vehicles, including all expensing and depreciation deductions.[114] Moreover, because the drafters' goal was to make the law "revenue neutral,"[115] they provided that the aggregate amount of credits granted to all taxpayers in a given year would be equal to the estimated increase in taxes paid for the same year attributable to the denied deductions related to large SUVs.[116] Essentially, the bill proposed that purchasers of large SUVs subsidize the purchases of lighter, more fuel-efficient vehicles.

In pertinent part, California Assembly Bill 848 defines "large sport utility vehicle" as a "four-wheeled vehicle . . . rated between 6,000 and 14,000 pounds gross vehicle weight."[117] Like Maryland Senate Bill 219, California Assembly Bill 848 includes an SUV definition that applies to all trucks and vans; however, it also expressly excludes from the definition such vehicles purchased for use in farming, construction, or timber businesses.[118] Doing this preserves uncapped expensing and depreciation deductions for certain businesses that need large vehicles to perform their work, keeping with the original intent of section 280F. Congress should take similar action.

Another feature that distinguishes the California bill from the Maryland bill is its proposal to punish businesses that make unnecessary purchases of large SUVs by denying them the tax-saving benefit of expensing and depreciation deductions.[119] Moreover, once businesses began paying taxes on the in-

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[111] The drafters acknowledged these legislative findings both within the language of the bill itself and in their comments to the bill. Cal. Assemb. B. 848 at § 1(b)–(d); LEG. COUNSEL OF CAL., ASSEMB. BILL 848: ANALYSIS, 2003-04 Leg., Reg. Sess. (2004), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0801-0850/ab_848_cfa_20040128_asm_floor.html.

[112] Cal. Assemb. B. 848 at § 1(e).

[113] *Id*. at § 2.5; Cal. Assemb. B. 848 Analysis, at 3–4.

[114] Cal. Assemb. B. 848 at § 3(a)(1)–(5); Cal. Assemb. B. 848 Analysis, *supra* note 110, at 4.

[115] Cal. Assemb. B. 848 Analysis at 3.

[116] Cal. Assemb. B. 848 at § 2.5(c); Cal. Assemb. B. 848 Analysis, at 3.

[117] Cal. Assemb. B. 848 at § 3(b) provides as follows: [T]he term "large sport utility vehicle" means a four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways if the vehicle meets all of the following requirements: (1) Is rated between 6,000 and 14,000 pounds gross vehicle weight. (2) Is designed to seat nine or fewer individuals. (3) Is not equipped with an open cargo area with an interior length of 72 or more inches or does not have a covered box with an interior length of 72 or more inches that is separate from the passenger compartment.

[118] *Id*. at § 3(c).

[119] *Id*. at § 3(a). Of course, although the business would not be permitted to recover the large SUV's cost by taking expensing and depreciation deductions against taxable income in the years the business owned the vehicle, the business would ultimately recover its cost (and save on taxes) when the SUV is sold, and the cost basis is applied against the amount realized for the asset. This, however, is cold comfort for a business that would much rather save

come used to buy their large SUVs, California would not be the beneficiary of the increased cash flow because the law proposes using that money to award tax credits to businesses that purchase lighter, more fuel-efficient vehicles.

Although California Assembly Bill 848 ultimately failed to pass, its provisions constitute a clear statement of the drafters' environmental policy, of which Congress should take note. But rather than create an affirmative disincentive to purchase a large SUV for business use (a proposal which met much criticism in the California assembly),[120] a more balanced approach would be to follow the Maryland drafters' example by simply removing the lucrative tax incentives for businesses to buy big, and treat large SUVs as subject to the same deduction limitations as passenger automobiles under section 280F.

3. Oregon

The endeavor to close the SUV tax loophole in Oregon has a longer and more complicated history than the legislative efforts made in Maryland and California. Although Oregon legislators came close to closing the SUV tax loophole in their state, like their counterparts in Maryland and California, their legislative effort ultimately failed as well.

The proposal to close the SUV tax loophole underwent many changes before the Oregon Legislature finalized and enacted its approach to closing the loophole. The proposal was originally introduced on February 25, 2003[121] as Oregon House Bill 2747,[122] and provided for an add-back-the-difference approach similar to what would later be proposed in Maryland Senate Bill 219. As originally drafted, Oregon House Bill 2747 provided that, for the purpose of determining Oregon income tax liability, taxpayers who purchased vehicles weighing more than 6,000 pounds[123] for business use must add back to their federal taxable income the amount of any difference between what was allowed as expensing or depreciation deductions on the federal return, and what would have been allowed as deductions on the federal return if the vehicle had been subject to section 280F deduction limitations.[124] This approach would have removed the incentive for businesses to choose heavy SUVs for the bigger write-

on taxes now than many years later when the SUV is finally sold.

[120] Cal. Assemb. B. 848 Analysis at 4. Opponents of the bill expressed concern that the bill would result in an increased tax burden for small businesses, possibly resulting in the inability to continue business operations. *Id*. Opponents also feared the bill would "depress vehicle sales in a difficult economic climate." *Id*. Finally, "opponents question[ed] why SUV purchasers should subsidize" purchases of qualified reduced-emission vehicles. *Id*.

[121] OR. LEG., H.B. 2747 MEASURE HISTORY, 72d Leg., Reg. Sess. (2003), *available at* http://www.leg.state.or.us/searchmeas.html (last visited Apr. 13, 2005).

[122] H.B. 2747, 72d Leg., Reg. Sess. (Or. 2003), *available at* http://www.leg.state.or.us/searchmeas.html.

[123] House Bill 2747, as originally introduced, specified that the modification to federal taxable income was required where expensing or depreciation deductions were taken on a "four-wheeled vehicle manufactured primarily for use on public streets, roads and highways . . . and [t]he vehicle [was one] rated at 6,000 pounds unloaded gross vehicle weight or more[, or] a truck or van . . . rated at 6,000 pounds gross vehicle weight or more." *Id.* at §§ 2(1), 5(1). SUVs fall into the latter category with trucks and vans.

[124] *Id*. at §§ 2(2)(a)–(b), 5(2)(a)–(b).

off. Then the House amended its approach to resemble the one proposed in California Assembly Bill 848, so that A-Engrossed Oregon House Bill 2747[125] provided that taxpayers must add back the "entire amount" of expensing and depreciation deductions allowed on the federal return for vehicles "rated between 6,000 and 14,000 pounds gross vehicle weight."[126] This approach would have created an affirmative disincentive to buy a heavy SUV for business purposes. The House changed its approach again when it transformed the disincentive into an expensive penalty, providing in B-Engrossed Oregon House Bill 2747[127] that taxpayers must add back "three times the amount" taken as deductions for such vehicles.[128] This third approach included exceptions for vehicles used in farming, construction, and timber businesses.[129] These progressively harsher approaches to closing the SUV tax loophole were driven by the House's concern that the SUV tax breaks ran contrary to the original intent of section 280F,[130] resulting in an unnecessary loss in tax revenue for the state.[131]

While the House was working out the details of its approach to closing the SUV tax loophole, the state legislature was also trying to alleviate Oregon's budget crisis with House Bill 2152,[132] which included many provisions for increasing tax revenues. Legislators added the substance of Oregon House Bill 2747 (the "entire amount" approach, along with the exceptions for farming, construction, and timber industries) as another revenue-raising provision of

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[125] A-Engrossed H.B. 2747, 72d Leg., Reg. Sess. (Or. 2003), *available at* http://www.leg.state.or.us/searchmeas.html.

[126] *Id*. at §§ 2(1), 5(1). It should be noted that this second version of House Bill 2747 has narrowed its definition of vehicles to which the provision would apply to those "rated between 6,000 and 14,000 pounds gross vehicle weight." *Id*. at §§ 2(1)(a), 5(1)(a). This focuses the provision on the category including heavy SUVs.

[127] B-Engrossed H.B. 2747, 72d Leg., Reg. Sess. (Or. 2003), *available at* http://www.leg.state.or.us/searchmeas.html.

[128] *Id*. at §§ 2(1), 5(1).

[129] *Id*. at §§ 2(3), 5(3).

[130] OR. LEG. HOUSE STAFF, A-ENGROSSED, H.B. 2747 MEASURE SUMMARY, 72d Leg., Reg. Sess. (2003), *available at* http://www.leg.state.or.us/searchmeas.html. (providing as background information the fact that "over twenty years ago," the vehicles that were eligible for the exclusion from deduction limitations were "mostly industrial vehicles, including cargo vans and light trucks." But today, "non-cargo vehicles" such as "heavier models of SUV[s], pickups, and 'hummers' . . . fit the category and are eligible for the tax benefit."); OR. LEG. HOUSE STAFF, B-ENGROSSED, H.B. 2747 MEASURE SUMMARY, 72d Leg., Reg. Sess. (2003), *available at* http://www.leg.state.or.us/searchmeas.html (noting that "some sport utility vehicles, currently being manufactured, exceed 6,000 pounds gross vehicle weight and would not be subject to the [section 280F] limitation." The House was concerned that the federal tax system was treating "four-wheeled vehicles with gross vehicle weight [over] 6,000 pounds" differently from passenger cars. The House's primary concern was with SUVs, "which do not qualify as passenger vehicles under the Internal Revenue Code because of gross vehicle weight but are used for the same purposes as passenger vehicles.").

[131] *See* OR. LEG. HOUSE STAFF, A-ENGROSSED H.B. 2747 REVENUE IMPACT OF PROPOSED LEGISLATION, 72d Leg., Reg. Sess. (2003), *available at* http://www.leg.state.or.us/searmeas.html (because the "federal cost of the 'light-truck tax break' is estimated between $840 million and $987 million annually," estimating that the tax break costs Oregon "a range between $1.9 million and $2.2 million annually").

[132] H.B. 2152, 72d Leg., Reg. Sess. (Or. 2003) (enacted).

House Bill 2152,[133] a decision that would doom to failure the proposal to close the SUV tax loophole. This is because about three months after the governor signed House Bill 2152 into law,[134] the secretary of state announced that a referendum petition had been completed, and that the referendum, numbered Measure 30, was to be placed on a special election ballot for approval or rejection by Oregon voters.[135] On February 3, 2004, tax-weary voters rejected Measure 30[136] 59 percent to 41 percent.[137] Thus the Oregon State Legislature came close—but failed—to close the SUV tax loophole at the state level.

Oregon's failed attempt to close the SUV tax loophole can be largely attributed to the provision's merger with House Bill 2152, which, with its provisions for increasing various taxes, proved to be an unpopular solution to the state's budget crisis.[138] It is uncertain whether the provision would have taken such a course to demise if it had been left alone in Oregon House Bill 2747.[139]

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[133] The Oregon House Bill 2747 provision for closure of the SUV tax loophole was included in the enacted version of House Bill 2152 under the subheading, "Deduction and Depreciation of Certain Vehicles." *Id*. at §§ 13–19. The approach the Oregon Legislature settled on was similar to the approach taken in California Assembly Bill 848: that the "entire amount" of any expensing or depreciation deduction taken on the federal return for business vehicles weighing between "6,001 and 14,000 pounds gross vehicle weight" was to be added back to the taxpayer's federal taxable income for the purpose of determining the taxpayer's Oregon income tax liability. *Id*. at §§ 14(1), 17(1). The final version of Oregon's approach excepted farming and construction businesses, and the timber or wood-products industry from the add-back requirement. *Id*. at §§ 14(3), 17(3).

[134] *See* OR. LEG. INFO. SYS., H.B. 2152 MEASURE HISTORY, 72d LEG., REG. SESS. (2003), *available at* http://www.leg.state.or.us/searchmeas.html. Oregon House Bill 2152 was a budget-balancing tax package that took Oregon lawmakers nearly eight months to pass in what turned out to be the longest legislative session in the state's history. James Mayer, *Oregon's Tax Increases: A Budget-Balancing Bill Includes a Variety of Temporary and Permanent Changes*, OREGONIAN, Sept. 25, 2003, at A10; Press Release, Ted Kulongoski, Governor of Oregon, Statement of Governor Kulongoski Upon Signing HB2152 (Aug. 27, 2003), *available at* http://governor.oregon.gov/Gov/press_082703.shtml.

[135] News Release, Bill Bradbury, Secretary of State, State of Oregon, Referendum Signature Verification Results (Dec. 3, 2003), *available at* http://www.sos.state.or.us/elections/feb032004/verify_results_nr.pdf.

[136] Oregon Ballot Measure 30 (2004).

[137] Of a total of 1,172,777 votes cast in the February 3, 2004, special election, 691,462 were against Measure 30. 691,462 / 1,172,777 = .589 = 59%. ELECTION DIVISION, OREGON SECRETARY OF STATE, OFFICIAL RESULTS: FEBRUARY 3, 2004, SPECIAL ELECTION (2004), *available at* http://www.sos.state.or.us/elections/feb032004/s04abstract.pdf.

[138] The special election received great public attention. Supporters of Measure 30 thought the tax increases were fair and necessary to help Oregon meet its budgetary needs without having to cut spending on schools, public safety, and other essential public services. Mayer, *supra* note 132. Tax-weary opponents disagreed, asserting that Oregon needs "fiscally responsible leaders," who will "enact greater efficiencies and do away with spending for low-priority programs." James Mayer & Dave Hogan, *Voters Trounce Measure 30*, OREGONIAN, Feb. 4, 2004, at A1; David Steves, *Measure 30: Oregon Slams Door on Tax-Raise Measure*, REGISTER-GUARD (Eugene, Or.), Feb. 4, 2004, at A1.

[139] Indeed, the SUV add-back provision had comprised only a small part of House Bill 2152's revenue raising plan. It was estimated that the SUV add-back provision would raise just $4.7 million of the $792 million that House Bill 2152 was expected to bring in additional tax revenue for the 2003-05 biennium. OR. LEG. ASSEMB., REVENUE IMPACT STATEMENT, H.B. 2152, 72d Leg., Reg. Sess. (2003), *available at* http://www.leg.state.or.us/

It is clear, however, that Oregon is yet another state where legislators pushed for the closure of a loophole that was costing the state millions in needed tax dollars, all because section 280F no longer operates true to its originally intended purpose.

Congress needs to take action to close the SUV tax loophole in section 280F. Congress must do this not only to restore the provision to its original purpose, thereby ending abusive deduction practices that are costing the federal and state governments millions in lost tax revenue, but also to address contemporary concerns regarding the heavy SUV's impact on the environment, infrastructure, and public safety. It is time for Congress to do what states thus far have been unable to do.

V. MISSED OPPORTUNITIES: CONGRESS'S FAILURE TO CLOSE THE SUV TAX LOOPHOLE IN SECTION 280F

State legislative efforts to close the SUV tax loophole have failed. Thus far, Congress has also failed to close the SUV tax loophole, although it has had a few opportunities to do so. First, Congress has ignored proposals to amend section 280F to close the SUV tax loophole directly at its source. And although recent congressional records clearly indicate Congress's disapproval of the SUV tax loophole, the recent changes to business tax incentives under the Jobs Act merely narrow the loophole, and do nothing to eliminate it. There has been much talk about closing the SUV tax loophole, but the fact remains that the loophole still exists, and until Congress finally closes it, the loophole will continue to award greater write-offs to those who unnecessarily choose heavy SUVs for business use.

A. Congress Has Failed to Close the SUV Tax Loophole Directly at Its Source

The source of the SUV tax loophole is the section 280F(d)(5)(A) definition of "passenger automobile," which excludes heavy SUVs from section 280F's deduction limitations. In early 2003, legislators introduced Senate Bill 265[140] and House Bill 727,[141] both entitled the "SUV Business Tax Loophole Closure Act." These bills proposed amending section 280F to include SUVs weighing between 6,000 and 14,000 pounds gross vehicle weight in the passenger automobile definition,[142] so that SUVs would also be subject to deduction limitations.[143] This would have eliminated the SUV tax loophole at its source. But these proposals essentially died in committee, because Congress has taken no

searchmeas.html. Therefore, it seems that the SUV add-back provision might have stood a better chance at becoming law if it had not been associated with a much larger, unpopular initiative to increase taxes.

[140] SUV Business Tax Loophole Closure Act, S. 265, 108th Cong. (2003).

[141] SUV Business Tax Loophole Closure Act, H.R. 727, 108th Cong. (2003).

[142] S. 265 at § 2(a); H.R. 727 at § 2(a).

[143] *Id*.

action on either of these bills since the dates of their introduction in early 2003.[144]

This was a missed opportunity to close the SUV tax loophole and restore section 280F to its original purpose. As explained by Senator Barbara Boxer, the sponsor of Senate Bill 265, "Congress never intended the SUV tax loophole to exist," [145] but now that it does, "people who do not need a large vehicle for business purposes are buying the largest Hummer SUVs, Mercedes SUVs, BMW SUVs, and other super-sized SUVs and deducting a significant portion of the cost from their taxes immediately."[146] This not only goes contrary to the original purpose of section 280F to limit the amount that small businesses may deduct for luxury vehicles, but also, as Senator Boxer observed, this "distorts the market, pushing up demand for the largest of all SUVs at a huge cost to the taxpayer."[147] For these reasons, Senator Boxer proposed restoring section 280F to its original purpose, by making heavy SUVs subject to the same deduction limitations as are cars, while also providing exceptions to ensure that businesses that do need larger vehicles to do their work will still get the larger write-offs. This is exactly what Congress needs to do; unfortunately, Congress failed to act on the 2003 bills, and currently there are no renewed efforts to push an amendment to section 280F through Congress.

B. Changes to Business Tax Incentives Narrow, But Do Not Eliminate, the SUV Tax Loophole

Expensing and depreciation deductions underwent more changes in 2004. The Jobs Act extended increased expensing two more years through the end of 2007,[148] bonus depreciation expired on January 1, 2005, and Congress added a new paragraph to section 179(b) to limit expensing deductions for heavy SUVs. These changes have narrowed the SUV tax loophole by lessening how much may be deducted for new purchases of heavy SUVs. Although this is some improvement, the fact remains that the SUV tax loophole still exists, and it continues to operate as a tax incentive to choose a heavy SUV over a passenger automobile for business use.

The Jobs Act amended section 179(b) to add a sixth limitation on the expensing election, to restrict expensing deductions to $25,000 per year for SUVs "not subject to section 280F" and weighing up to "14,000 pounds gross vehicle weight."[149] Essentially, rather than actually eliminating the loophole in section 280F by amending the definition of "passenger automobile" to include SUVs in

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[144] CONGRESSIONAL INFO. SERV. INC., 2003 BILL TRACKING, S.265 (2003); CONGRESSIONAL INFO. SERV. INC., 2003 BILL TRACKING, H.R. 727 (2003).

[145] 149 CONG. REC. S1828, S1829 (2003).

[146] *Id*.

[147] *Id*.

[148] Jobs Act, *supra* note 4, § 201.

[149] *Id*., *adding* paragraph (6) to section 179(b). Observe that the $25,000 restriction on expensing for heavy SUVs is equal to the pre-JGTRRA § 179(b)(1) dollar limitation on expensing, to which the Code will revert if the JGTRRA provisions for increased expensing deductions are allowed to expire at the end of 2007.

excess of 6,000 pounds, Congress left the loophole itself intact while reducing one of the loophole's manifestations as a tax incentive elsewhere in the Code. This is the only form of remedial action taken by Congress toward the SUV tax loophole. Clearly, it is quite inadequate. It is insufficient to merely lessen one of the negative effects of a problem if the core source of the problem—here, the outdated definition that allows heavy SUVs to elude the section 280F deduction limitations—continues to exist.

In explaining its decision to add the new paragraph to section 179(b), the Senate Committee on Finance identified the loophole and observed that it created an incentive for small businesses to buy heavy SUVs for the larger write-off, even though they were "not necessary for purposes of conducting the taxpayer's business."[150] Notably, the Senate Committee on Finance expressed its concern that such taxpayer behavior has produced "market distortions," and the Committee asserted that it "does not believe that the United States taxpayers should subsidize a portion of such purchase."[151] By failing to eliminate the source of the SUV tax loophole problem, Congress failed to follow through on its own concerns as expressed in the congressional record.

C. Roger Revisited: A Hypothetical That Shows the SUV Tax Loophole Still Exists, and It Still Persuades Small Businesses to Buy Heavy SUVs

Supposing Roger did not purchase a new business vehicle in September 2004, but delayed his purchase until some time after the October 22, 2004 enactment of the Jobs Act, he now faces different rules for expensing and depreciation deductions. The following two scenarios will show that although the tax incentive to buy a heavy SUV has been lessened, it still exists and is still strong enough to persuade Roger to buy the heavy SUV instead of the luxury sedan. In the first scenario, Roger purchases his new vehicle after the enactment of the Jobs Act, but before the end of 2004; in the second scenario, Roger makes his purchase in 2005.

1. Scenario 1: Purchasing a New Business Vehicle in 2004 After the Enactment of the Jobs Act

As far as expensing and depreciation deductions are concerned, if Roger chooses to buy a $50,000 sedan in 2004, it would make no difference whether he made his purchase before or after the enactment of the Jobs Act. This is because increased section 179 expensing and 50 percent bonus depreciation were still applicable to passenger automobiles through the end of 2004. Of course, nothing changes the fact that section 280F(a)(1)(A) limits expensing, bonus depreciation, and regular depreciation to a total first-year deduction of $10,610.[152] This is all Roger would be allowed to deduct in 2004, leaving $39,390 to depreciate over subsequent years using the MACRS double-declining balance method.[153]

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[150] S. REP. NO. 108-192, at IV.F.13 (2003).
[151] *Id*.
[152] Rev. Proc. 04-20, 2004-1 C.B. 642, at Table 2.
[153] $50,000 – 10,610 = $39,390.

Buying a $50,000 heavy SUV in the months following the enactment of the Jobs Act, however, would yield a different first-year deduction than if Roger had made his purchase earlier in 2004. After the Jobs Act, a new $25,000 expensing limit applied to heavy SUVs not subject to the section 280F deduction limitations.[154] Thus, although section 179 used to allow Roger an expensing deduction for the full $50,000 purchase price, under section 179(b)(6)(A), Roger may only deduct half that amount now. Roger may combine his $25,000 expensing deduction with a $12,500[155] 50 percent bonus depreciation deduction and a $2,500[156] regular depreciation deduction, for a total first-year deduction of $40,000.[157] Although not as great as fully expensing the SUV's price in the year of purchase, the law as it existed in the last few months of 2004 would still allow Roger to deduct 80 percent[158] of the $50,000 purchase price, whereas Roger could deduct only 21 percent[159] of the sedan's purchase price. Since Roger's preference is to take a greater deduction in the year of purchase, deferring as much tax to later years as possible, he would choose the heavy SUV over the sedan. This shows that despite the new limit on section 179 expensing for heavy SUVs, the SUV tax loophole still operated as a tax incentive to choose the heavy SUV in the last months of 2004.

2. Scenario 2: Purchasing a New Business Vehicle in 2005

Under current law, bonus depreciation no longer exists because Congress allowed it to expire on January 1, 2005. This changes the results for both passenger automobiles and heavy SUVs. Because bonus depreciation no longer applies, the most Roger may deduct for a passenger automobile is now only $2,960.[160] For a heavy SUV, Roger may combine a $25,000 expensing deduction with a $5,000[161] regular depreciation deduction, for a total first-year deduction of $30,000. Although less under current law, at $27,040,[162] the first-year deduction for the heavy SUV is still greater than the deduction for the sedan. Still persuaded that the heavy SUV is the better deal, Roger finally makes his purchase, and drives his new Mercedes SUV off the lot.

D. Recommendations for Congressional Action

Congress needs to take action to close the SUV tax loophole directly at its source: the section 280F(d)(5)(A) definition of passenger automobile. Closure of the loophole may be accomplished by expressly including SUVs weighing more than 6,000 pounds gross vehicle weight in the definition, as was proposed

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[154] I.R.C. § 179(d)(6) (RIA 2005).

[155] $50,000 – 25,000 expensing deduction = $25,000 adjusted basis. $25,000(.50) = $12,500 50% bonus depreciation deduction. $25,000 – 12,500 = $12,500 new adjusted basis.

[156] $12,500(.20) = $2,500 regular depreciation deduction.

[157] $25,000 + 12,500 + 2,500 = $40,000 total deduction for year of purchase.

[158] $40,000/50,000 = .80 = 80%.

[159] $10,610/50,000 = .2122 = 21%.

[160] Rev. Proc. 04-20, 2004-1 C.B. 642, at Table 1.

[161] $50,000 – 25,000 = $25,000 adjusted basis. $25,000(.20) = $5,000 regular depreciation deduction. $25,000 – 5,000 = $20,000 adjusted basis.

[162] $30,000 – 2,960 = $27,040.

in Senate Bill 265 and House Bill 727, so that heavy SUVs will be subject to the same deduction caps as are passenger automobiles. Taking this action will remove the incentive for small businesses and self-employed individuals to purchase heavy SUVs, the features of which are not necessary to carrying out their work, just for the bigger tax write-off.

Congress must also take care to preserve exceptions for farmers, construction workers, timber operators, and other businesses requiring large vehicles for their work, to accord with the original intent of section 280F that such businesses get the benefit of taking uncapped deductions for the expensive vehicles that they need. Language like that proposed in Senate Bill 265 and House Bill 727 may be used to provide this exception from the deduction limitations. Moreover, Congress should expressly state its intent that businesses legitimately needing large vehicles may enjoy uncapped deductions, while other businesses will be subject to the section 280F deduction limitations, no matter what kind of luxury vehicle they buy.

VI. CONCLUSION

Closing the SUV tax loophole would restore section 280F to its original purpose of preventing abuse of the cost recovery system by limiting how much businesses may deduct for expensive luxury vehicles. Closing the loophole would also be consistent with Congress's policy choice to encourage businesses to purchase environmentally friendly vehicles such as electric cars, as manifested in the Code in the form of tripled deduction limits for such vehicles. Additionally, closing the loophole would help alleviate budget crises by putting more tax dollars into federal and state coffers. Motivated by both fiscal and environmental concerns, a few state legislators have already pushed for closure of the SUV tax loophole at the state level. Although unsuccessful, these efforts nonetheless demonstrated the need for direct Congressional action. Thus, it is time for Congress to step forward to close the SUV tax loophole at its source, ending the abusive deduction practices made possible by an outdated definition and a change in consumer preferences for trendy, luxury vehicles.