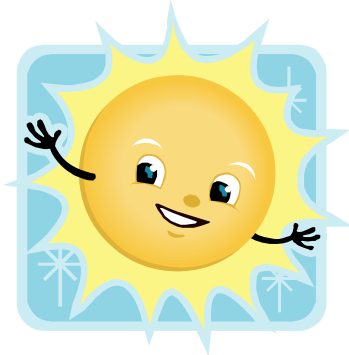




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# Client Update

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## Hybrid Vehicle Credit Starting in 2006

The \$2,000 deduction allowed for the 2005 purchase of a new 2005/2006 model year Toyota Prius or other certified hybrid vehicle does not apply to a hybrid bought in 2006. For hybrid vehicles purchased on or after January 1, 2006, the deduction is replaced with a potentially more valuable tax credit, which will require a different certification.

There has been no official announcement of the credit amounts for 2006 hybrid models, which depend of fuel efficiency comparisons. In Notice 2006-9, the IRS has provided guidelines for manufacturers to use in preparing a certification of the credit amount that purchasers of eligible vehicles may rely on.

The maximum credit under the law could be as much as \$3,400, but the estimated credit for the Toyota Prius (from Internet publications) is \$3,150, more than for any other hybrid vehicle.

However, unless the law is changed, taxpayers subject to the AMT will be unable to claim the hybrid credit for a personal-use vehicle, and even for taxpayers not subject to AMT, the benefit of the credit will be limited to the excess of the regular tax (after reduction by other personl credits) over the tentative AMT figured on Form 6251.

Also note that the credit for popular models such as the Prius may begin to phase out sometime this year. Under Code Section 30B(f), the full amount of the credit is available only up to the end of the first calendar quarter in which the manufacturer records its 60,000<sup>th</sup> sale after 2005 of any hybrid vehicle in the U.S. This limit applies per manufacturer, not per model. For Toyota, the manufacturer of the 2006 Highlander Hybrid and Lexus

RX 400h as well as the Prius, the 60,000<sup>th</sup> sale may take place by the middle of 2006. under the phaseout formula, the full amount of the credit begins to phase out in the second calendar quarter after the quarter in which the 60,000<sup>th</sup> sale occurs. For example, if the 60,000 vehicle limit is exceeded by Toyota during the second quarter for 2006 (April – June), the full credit for a Toyota hybrid would be allowed for purchases in that quarter and in the next quarter (July – September). Only 50% of the full credit would be allowed for purchases in the next two quarters (October 2006 – March 2007) and 25% for purchases in the next two quarters (April – September 2007), after which no credit would be allowed.

*J.K.Lasser's Monthly Tax Letter March 2005*

## No Charitable Deduction for Religious Education

For the third time, a couple's attempt to deduct part of their payments for their children's religious education has been rebuffed by a court. The Sklars tried to deduct 55% of the tuition and fees paid in 1994 to Jewish day schools for their children as a charitable contribution. The Tax Court upheld the IRS's disallowance of the deduction and the Ninth Circuit Court of Appeals affirmed the disallowance on the grounds that the Sklars had not shown that their payments exceeded the value of the education benefits received.

Now the Tax Court had denied a deduction for 2005. the Sklars deducted \$15,000 paid to two Orthodox Jewish day schools for their five children. The \$15,000 amount was 55% of the total tuition and fees (\$27,283) they paid in 2005. they deducted 55% because that was the portion of

the payments that the schools estimated was devoted to religious studies.

After the IRS disallowed the deductions, the Sklars went back to Tax Court, where they made a statutory argument and a constitutional argument in an attempt to avoid the long line of court decisions holding that tuition paid to religious schools is not deductible. First, they claimed that when Congress enacted new substantiation/disclosure requirements for charitable contributions in 1993, an exception for “intangible religious benefits” was created that has the effect of making tuition for religious education deductible. Second, they claimed that the IRS violated the Establishment Clause of the First Amendment by disallowing their deduction for tuition and fees while allowing members of the church of Scientology to deduct payments for Church “auditing and training” courses as charitable contributions.

The Tax Court rejected both arguments. It is true that in meeting the written acknowledgement requirement of Code Section 170(f)(8) for donations over \$250, a religious charity can disregard the value of “intangible religious benefits” when providing an estimate of the value of any benefits provided to the donor, provided such intangible benefits are the sole benefits provided. Similarly, in meeting its obligation under Section 6115 to inform donors of more than \$75 that a deduction is limited to the excess of the contribution over the value of benefits received, religious charities do not have to assign a value to “intangible religious benefits” if those are the sole benefits provided.

However, there is no indication that when it enacted these statutes in 1993, Congress intended to expand the types of deductible payments or to overturn decades of case law disallowing charitable deductions for tuition payments to schools providing a religious and secular education. The exception to the substantiation and disclosure requirements of Sections 170(f)(8) and 6115 for intangible religious benefits applies only if the organization is organized exclusively for religious purposes. That was not the case here. The Jewish day schools attended by the Sklars’ children provided both a secular and a religious education,

and the IRS granted the schools an exemption from tax as educational, not religious, organizations.

The Sklars’ First Amendment claim was also rejected. Although the IRS has allowed members of the Church of Scientology to deduct payments for “auditing and training” under a 1993 closing agreement, this does not affect the result here because the Sklars’ payments were partly for secular education.

What does control here is the “dual payment test” provided by the Supreme Court in its 1986 *American Bar Endowment* decision (477 U.S. 105). Under this test, there is no charitable intent if the payment does not exceed the value of benefits received. The tuition paid by the Sklars may have exceeded the usual tuition charged by Catholic schools in their Los Angeles area, but it was less than the tuition charged by some other Jewish day schools and some wholly secular private schools. There is no evidence that the Sklars’ payments exceeded the value of the education provided to their children, and so they made no charitable contribution.

One bright now for the Sklars: the Court held that they were not liable for a \$2,040 accuracy-related penalty. When they filed their 1995 return claiming a deduction for tuition payments, they believed in good faith that the deductions were allowable. Although they knew that their 1994 return claiming similar deductions was being audited, they did not know that they would ultimately lose on this issue.

*J.K.Lasser’s Monthly Tax Letter February 2006*

## **Donating Cars to Charity**

Need help understanding the new rules for deducting car donations? The IRS comes to the rescue with a new publication, *A Donor’s Guide to Car Donations*, that explains what is allowed. It details four exceptions to the general rule that the donor’s write-off for a vehicle that is sold by the charity cannot be more than the sales price. It also lays out the circumstances when Form 8283 must be filed and when an appraisal is required.