

# CRS Report for Congress

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## Luxury Excise Tax on Passenger Vehicles

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### Summary

There is a long history of federal taxes on automobiles. The current luxury tax on passenger vehicles was reintroduced with passage of the *Omnibus Revenue Reconciliation Act of 1990*. At the time of its reintroduction, its purpose was to increase revenues to help reduce large projected federal budget deficits. Other luxury taxes were also introduced at the same time (boats, aircraft, jewelry, and furs) but have since been repealed. All of the luxury taxes were based on a sales price exceeding statutory amounts so as to shift the tax to upper-income individuals. Since passage of the 1990 act, the tax has been extended but at reduced rates, the statutory sales price has been inflation adjusted, and the subsequent installation of small dollar value parts and accessories are exempted from the tax. The tax rate is 3% for tax year 2002. The tax expires next year. The tax rate is applied to that portion of the sales price which exceeds \$40,000. Revenues from luxury auto taxes exceeded \$400 million in fiscal years 1999 and 2000. There are no plans to update this report.

### Background

Federal taxes on automobiles can be found as early as 1917. Not only were taxes applied to automobiles but also to auto trailers, trucks, trailers, buses, road tractors, motorcycles, tires, tubes, tread rubber, as well as parts and accessories. Over the course of many years, federal excise tax rates varied between 2% and 10%. These taxes were instituted to increase general revenues. It was argued that since federal expenditures for highways promoted development of the automobile as a means of national transportation, the industry and consumers should help in the support of the federal government through increased tax revenues. Several arguments were advanced against these taxes on autos. The primary arguments against this tax were that there were already a host of other taxes on autos (federal, state, and sometimes local gasoline taxes, as well as state and local property taxes, sales taxes, registration fees, etc.), that the tax could be seen as regressive for those with lower incomes, that it discriminated against those living in a rural environment, and that automobiles should no longer be considered an item of luxury but

rather a necessity of modern living. The excise tax on passenger automobiles was repealed effective August 16, 1971.

## History of the Current Luxury Excise Tax

To increase revenues, the current luxury excise tax on automobiles was reintroduced with the passage of the *Omnibus Revenue Reconciliation Act of 1990* (H.R. 5835, P.L. 101-508). Several other luxury excise taxes were revisited in this law, with excise taxes imposed on boats, aircraft, jewelry, and furs.<sup>1</sup> The excise tax on jewelry and furs was 10% of the sales price over \$10,000. A 10% excise tax was also imposed on the sales price of a passenger automobile over \$30,000<sup>2</sup>, the sales price of a boat over \$100,000, and the sales price of an aircraft over \$250,000. The tax was not imposed if the vehicle was used in a trade or business or if it was used by the federal government or a state or local government for police, fire fighting, emergency medical services, search and rescue, public safety, or public works activity. The luxury taxes were set to expire on January 1, 2000. Under this tax law, luxury excise taxes were expected to generate \$1.479 billion over the FY1991-FY1995 period.

The luxury excise taxes enacted in 1990 were all based on sales prices exceeding statutory amounts, suggesting congressional desire to shift some or part of the overall tax increase to upper-income individuals. Opponents argued, however, that the taxes depressed sales and employment in the affected industries and this actually burdened lower-income workers. Congress accepted this argument in 1993, repealing all the taxes except that on automobiles in the *Omnibus Budget Reconciliation Act of 1993* (H.R. 2264, P.L. 103-66). While not repealing the tax on luxury automobiles, Congress did provide an inflation adjustment to the statutory sales price. Perhaps the reason why the tax on automobiles was retained was that it was the only one raising significant amounts of federal revenue.

With passage of the *Small Business Job Protection Act of 1996* (H.R. 3448, P.L. 104-188), the tax on expensive automobiles was extended but at reduced tax rates. Under that law, the tax for sales after August 28, 1996, was decreased from 10% to 9%. Thereafter, the tax was to be reduced 1% per year through the year 2002 – at which point it expires from federal tax law. The rationale given for this change was that if the tax expired as scheduled on January 1, 2000, it “would create an unacceptable disruption of the automobile market. Congress believed a more gradual phase-out of the tax would be

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<sup>1</sup> For a discussion of the economic issues associated with luxury excise taxes see CRS Report RL30049, *Excise Taxation of Luxury Goods: A History and Economic Assessment*, by Louis Alan Talley.

<sup>2</sup> Under the original law, taxpayers were expected to pay the luxury tax on parts and accessories added at a latter date to the vehicle. Current law provides that the tax attaches when the cost of accessories exceeds \$1,000. An exemption is provided for any part or accessory installed to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle.

less disruptive to the market and believed it is appropriate to commence the phase-out in 1996.”<sup>3</sup>

A provision included in the *Taxpayer Relief Act of 1997* (H.R. 2014, P.L. 105-34) provides that the luxury tax on passenger vehicles does not extend to the subsequent installation of parts and accessories with an aggregate price that does not exceed \$1,000. This provision became effective as of January 1, 1998. Congress indicated that in the case of a later installation “the owner or operator of the vehicle is responsible for paying the tax attributable to the installation and the installer is secondarily liable. Increasing the de minimis amount should significantly reduce the number of return filers and relieve many persons from the administrative burden of filing an excise tax return reporting a very small amount of tax.”<sup>4</sup>

Under current tax law, luxury automobiles are taxed when the price exceeds \$40,000. Cars that sell for less are not subject to the luxury tax. The tax is applied only to the portion of the sales price that exceeds \$40,000.<sup>5</sup> The tax rate fell to 3% for tax year 2002. The tax expires after this year.

## Revenues

We have gathered information on revenue collections from the luxury excise tax on automobiles. This excise tax first became effective on January 1, 1991. As of the end of fiscal year 2000, over \$3.94 billion has been collected. **Table 1** provides a breakdown of revenues by year. As can be seen, the high point in collections was in fiscal year 1996. With the tax rate declining by one percentage point each year and with the base amount inflation adjusted, it can be expected that revenues will most likely fall this year from current collection amounts.

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<sup>3</sup> U.S. Congress. Joint Committee on Taxation. *General Explanation of Tax Legislation Enacted in the 104<sup>th</sup> Congress*, (Washington, U.S. Govt. Print. Off., Dec. 18, 1996.), p. 225.

<sup>4</sup> U.S. Congress. Joint Committee on Taxation. *General Explanation of Tax Legislation Enacted in 1997*, (Washington, U.S. Govt. Print. Off., Dec. 17, 1997), p. 413.

<sup>5</sup> Today's tax threshold amount represents the 1993-enacted base threshold of \$30,000 inflation adjusted in rounded \$2,000 increments. The adjustment was \$110 short of being rounded to \$40,000 for calendar year 2001 but achieved that amount for tax year 2002.

**Table 1. Luxury Automobile Excise Tax Collections**  
(in thousands of dollars)

<b>Fiscal Year</b>	<b>Collections</b>
1991	88,000
1992	276,100
1993	379,530
1994	475,177
1995	519,142
1996	532,180
1997	440,347
1998	428,471
1999	401,535
2000	407,222

**Source:** Information taken from the Internal Revenue Service's *Statistics of Income Bulletin*, Spring 2001, Washington, U.S. Govt. Print. Off., 2001, Table 21. pp. 305-306.