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Generations Fall 2022 - The Daunting Mix of Taxes and a Passion for Collectible Cars

The world of collectible cars inspires a passionate following, leading collectors to seek out vehicles and experiences far and wide. The most devoted followers scour auctions and car shows and work closely with dealers to acquire the rarest vehicles and, at the same time, attend or participate in rallies around the globe. With collections ranging from vintage and novelty cars to the newest limited-edition models available to a few preselected buyers, each owner has a collection that reflects his or her personality.

Whatever the personal preference or motivation of a collector might be, a few common issues unite the car collecting experience. For collectors with multiple residences across state lines, tax issues arise from state and local sales and use taxes triggered by the acquisition, use, storage, trade or sale of the vehicles, in addition to federal and state income taxes triggered by the sale or transfer of a vehicle.

General Issues

A few initial issues surround the acquisition process. An owner of a collectible vehicle must decide where to register the car (and thus which license plates the car will display) as well as where the car will be stored or used and under what conditions.

Unlike other collectibles, such as artwork or watches that are not registered with the state, the owner will generally register the vehicle with the appropriate state department of motor vehicles. Any change in ownership will generally require a new registration, and tax consequences will follow depending on the type of transfer involved, such as a gift, a sale to a third party, or a sale to a related party or family member.

The collector must also decide how to hold title to the vehicle and determine how, when and where title passes as well as the location of the sale or point of delivery—any of which can affect the application of federal or state taxes. A collector also needs to consider whether to own the vehicle outright or through an entity, such as a limited liability company.

Sales and Use Taxes

A state may impose sales tax on the purchase of property at the point of sale. Forty-five states impose sales tax. If a collector operates as a dealer, purchasing the car with the intent to resell it, he or she may purchase the car with a resale certificate from his or her state. This certificate will allow the collector to purchase the car without paying sales tax.

If a collector purchases a car in one state but intends to use it in another state, the state where the car is stored may impose a use tax, the counterpart to sales tax. A state may impose a use tax on tangible property brought in from another state for use (which usually includes storage) in that state, with a credit given for any sales tax paid on the purchase of the car.

Income Tax

On the sale of a car, federal, state and local income taxes may apply. The owner's treatment of his or her collection will determine the character of the tax due as capital gain or ordinary income, as well as the deductions allowed.

If a collector holds the car for investment purposes, deductions that were historically available for expenses incurred for investment or for the production of income were eliminated by the Tax Cuts and Jobs Act passed in 2017, at least through

January 1, 2026. Any gain on the sale of a car held for investment would be taxed as capital gain. It should be noted, though, that a special 28 percent rate applies to gain on the sale of "collectibles." Although automobiles are not currently specified in applicable regulations defining collectibles, the IRS has been given broad authority to identify categories of tangible property that can be considered collectibles.

If a collector holds cars for personal enjoyment, the hobby loss rules may apply, limiting any deductions claimed to the amount of revenue generated by the activity.

Finally, if an owner is deemed to be a dealer, the car will be treated as inventory. A dealer can claim business losses for cars sold at a loss and deductions for "ordinary and necessary" business expenses, but a collector acting as a dealer would also recognize ordinary income on any sale of a car for profit.

Personal Property Tax

In addition to these taxes, personal property taxes may apply in a number of states, such as Connecticut.

Strategies for Holding Collectible Vehicles

As discussed above, the purchase of a car for resale is not subject to sales or use tax on the purchase. For this reason, some collectible car owners may hold themselves out as dealers or even establish a dealership. Tax authorities may challenge this status, depending on the frequency and regularity of sales. Moreover, dealership status will subject gain on any sale of the vehicle to ordinary income tax, as described above.

Conclusion

Collectible car owners face a range of considerations when purchasing, holding and disposing of a vehicle. These considerations will differ depending on the motivations of the owner and the state in which he or she lives. In all cases, collectible car owners should be aware of the various applicable taxes and the strategies for mitigation of these taxes.

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