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EVs from Tesla and GM may start losing their tax credits

By: David Welch, November 2, 2017

Electric vehicles have caught the eye of many American consumers. But it’s not only the cars’ green cred that seals the deal. Another big lure: a federal tax credit of up to $7,500 per vehicle. Now that lucrative incentive may be fading away for two reasons. First, buyers of vehicles from leading EV makers such as Tesla Inc. and General Motors Co. could soon use up the maximum value of tax credits for their brands. (They’re capped for each manufacturer.) But worse for the entire industry, all EV credit provisions in the U.S. tax code are at risk of being eliminated as part of the horse trading under way over a tax cut bill.

To understand what could happen to electric car sales if Republicans phase out federal EV incentives, look at what happened in Georgia. Electric car sales there were growing briskly until the state cut its $5,000 electric vehicle tax credit in June 2015. Sales crashed from as many as 1,400 electric cars a month statewide to fewer than 100 the month after the incentive was axed.

Automakers fear a similar sales plunge if the federal tax credit goes away. Losing the credit would crush sales of electric cars just as most major automakers are beefing up to sell a slew of EVs over the next five years. “The credits matter a lot,” says Eric Noble, president of the CarLab, a consulting company in Orange, Calif. “In states without EV mandates or incentives, you’ll see sales crater.”

Electric cars have always been a tough sell to Americans, who are hooked on big SUVs and cheap gasoline. But the tax credits have helped juice sales, especially for lower-priced EVs and plug-in hybrids, Noble says. Even if Congress doesn’t do away with the credits, each manufacturer—under the existing IRS program—would see the incentive start to phase out once it sells 200,000 EVs or plug-in hybrids. Tesla, Nissan Motor Co., and GM would be the first to see their credits dwindle, because they’ve sold the most EVs.

If the government keeps the system in place but lets it run its course, Tesla will probably reach the limit first. The company had sold 127,000 of the Model S sedan and Model X SUV through August, according to researcher IHS Markit. With plans to produce as many as 10,000 a week of its smaller, $35,000 Model 3 sedans at some point next year, Tesla could max out sometime in 2018.

GM would probably be next. The carmaker had sold 126,000 of its Chevrolet Volt plug-in hybrids through August, along with 12,000 of the Chevy Bolt EV and 7,000 of the tiny Chevy Spark EV, according to IHS. Those various models count as a single car under the tax credit system. Nissan had sold 112,000 of its all-electric Leaf.

The program doesn’t end abruptly when a carmaker reaches 200,000 in sales. Once a manufacturer gets to that number, new buyers receive ever-diminishing credits over the next five quarters, at which point the subsidy is completely gone.

Brands with reduced or used-up credits would be at a financial disadvantage against competitors that are coming out with models eligible for the full incentive. Between now and 2022, global carmakers plan to sell 50 new electric car models, with many of them headed for dealer lots in the U.S. GM alone has 20 coming by 2023.

The industry lacks the flexibility simply to pull back from making alternative-fuel cars because California—the biggest automobile market in the U.S.—mandates that a certain share of all automakers' sales in the state must be zero-emission vehicles. If they don't reach that percentage, they must buy credits from companies with bigger green footprints (and thus extra emission credits), such as Nissan and Tesla, to make up their numbers.

There are big financial implications. If states continue mandating EV sales but the tax incentives disappear, carmakers will have to lower prices to get the sales volume required by state governments, Noble says. "Right now the EV market isn't driven by natural demand," he says. "If you remove the tax credit, then either the manufacturer eats it or sells fewer vehicles."

Electric cars are already big producers of red ink. GM loses $9,000 on every Bolt it sells, people familiar with the matter told Bloomberg earlier this year. And Tesla has burned through $10 billion en route to becoming a leader in electric car sales. Analysts don't expect it to turn a profit for years.

For now, states are helping to bolster manufacturers' sales by providing tax breaks for green-car buyers. Eleven states have some kind of alternative-fuel-vehicle incentive, and more are considering following suit. The tax breaks typically range from $1,000 to $5,000. New York started a $2,000 tax credit in April, and Texas began its $2,500 credit in July.

For next year, Tesla should be just fine. Both the carmaker's Model S sedan and its Model X SUV can easily cost more than $100,000 when equipped with a longer-range battery and luxury options. Some affluent buyers of those models don't even bother to cash in the tax credit, and most of them don't need it to buy the car, says Rebecca Lindland, an analyst with Kelley Blue Book, an auto pricing website. But buyers of the much cheaper Model 3, Tesla's attempt to offer a mass-market ride, may be more price-conscious, she says.

Tesla Chief Executive Officer Elon Musk said in August that, given the more than 400,000 deposits customers have put down for the recently introduced Model 3, his first year of production will likely be sold out. After that, he could have a tougher time, Lindland says.

Fears of a negative response from buyers could explain why GM and other carmakers are spending more lobbying time trying to make sure the tax credit is renewed and making the case that the industry has truly committed to electric cars, thanks to federal incentives and sales mandates in both California and China, say two people familiar with the matter.

GM spokesman Pat Morrissey says the credits "are still necessary to help grow the EV market," adding that the company is working with the Trump administration and Congress.

Detroit and its rivals should have an unusual ally in the green lobby as they fight to keep the incentives alive. But with President Trump threatening to water down fuel economy standards for conventional cars, EV credits aren't a top priority for some environmentalists, who instead are focusing on improving the gasoline-powered cars still purchased by 99 percent of buyers.

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