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Re: Planning 2012: Vehicle Depreciation and Deductions

In general, if you use your vehicle in pursuit of a trade or business, you are allowed to deduct the ordinary and necessary expenses incurred while operating the vehicle. However, any expenses associated with the personal use of the vehicle are not deductible. For purposes of these deductions, "car" includes a passenger vehicle, van, pickup or panel truck.

Personal vs. business miles. Business use of your car can include traveling from one work location to another work location within your tax home area; visiting customers; attending a business meeting away from the regular workplace; and traveling from home to a temporary workplace if you have one or more regular places of work. The costs of travel between home and a regular place of work, however, are nondeductible commuting expenses.

Standard mileage rate vs. actual cost method. In lieu of proving the actual costs of operating an automobile owned by them, employees and self-employed individuals may compute the deductible costs for their business use of an auto using a standard mileage rate. The 2012 standard mileage rate is 55.5 cents per mile. You may not depreciate your car or deduct lease payments if you use the standard mileage rate method. If you use the actual cost method, you may take deductions for depreciation, lease payments, registration fees, licenses, gas, insurance, oil, repairs, garage rent, tolls, tires and parking fees. Regardless of the method used, if the vehicle is driven for personal as well as business purposes, only expenses or mileage attributable to the percentage of business use are deductible. There are separate considerations involved in leasing a car for business.

Substantiation. If you are using your car for business purposes, whether owned or leased, proper recordkeeping is critical. The recordkeeping requirements vary depending upon which method you use. If you use the standard mileage rate, you should keep a daily log showing the miles traveled, destination and business purpose. Recordkeeping under the actual cost method is somewhat more onerous. You should also keep a mileage log if you use the actual cost method in order to establish business use percentage. In addition, you must keep receipts, invoices and other documentation to verify expenses. Finally, you must be able to prove the original cost of the vehicle and the date it was placed in service for business use in order to claim depreciation.

Vehicle fringe benefits. The fact that an employer allows an employee to use an employer-provided car for personal purposes generally does not deprive the employer of a vehicle expense deduction. An employer who provides a vehicle to an employee as a fringe benefit may use one of the special valuation rules, rather than the fair market value (FMV) of leasing a comparable car, to calculate the amount of the benefit that is attributable to the employee's personal use of the car. These special rules include the lease, cents-per-mile, commuting, and fleet-average valuation rules. An employer is not required to use the same valuation rule for all of the vehicles that are provided to employees. However, once a valuation method for a particular vehicle is elected, it must be used for income tax, employment tax, and reporting purposes for all employees who share the vehicle, as well as those who use it in subsequent periods.

Employers must report their employees' personal use of the car on their W-2, Wage and Tax Statement. They are not required to withhold income taxes on this income, although social security and railroad retirement taxes must be withheld. An election not to withhold income taxes may be made on an employee-by-employee basis. However, affected employees must be notified in writing by the later of January 31st of the applicable year, or 30 days after the day on which the employee receives a car.

An employee with an employer-provided car must substantiate the business use of the car with adequate records or evidence in order to claim a fringe benefit exclusion from income for personal use of the car. An employee who uses a personal car in the performance of services for his or her employer is entitled to deduct the car expenses if the car is used for the convenience of the employer, and is required as a condition of employment. Any unreimbursed employee expenses attributable to such use are deductible only to the extent that they exceed two percent of the employee's adjusted gross income (AGI).

Whether you are an employer, an employee, or a self-employed individual, we would like to evaluate the business use of your vehicle(s) in order to provide guidance in claiming and substantiating these expenses. Please call us at your earliest convenience to arrange an appointment.