Brake for Auto-Related Tax Breaks

Abstract: Many taxpayers don't understand all the ways their cars, crossovers, SUVs or pickup trucks can also be tax-reduction vehicles. This article provides an overview of vehicle-related tax breaks, including what vehicle-related expenses are deductible, and the actual-cost method and the mileage-rate method for calculating deductible expenses.

Don't pass by your opportunity to save

You couldn't live without your car, crossover, SUV or pickup truck — but do you really understand how it can be a tax-reduction vehicle? Tax breaks aren't limited to hybrids and electric vehicles.

For example, do you know that the amount of vehicle-related expenses you can write off depends not only on operating costs, but also on how much you use your vehicle and where you drive? So slow down to understand the rules and avoid passing by a significant tax-saving opportunity.

What expenses are deductible

You may deduct expenses for any business use of your vehicle or if it's used in connection with an income-producing activity, such as an investment or rental activity. You cannot deduct the portion attributable to personal use, however.

Most of the time, commuting to and from a regular job doesn't count as business use. But if your home office is your primary place of business, or you're going to a temporary job site or the second business location of the day, you may escape the commuting label.

To compute your deduction for vehicle expenses, you have two options: the actual-cost method and the mileage-rate method.

Actual-cost method

The deduction can be computed under the actual-cost method simply by multiplying the total amount of your actual expenses by the business use percentage. So, if you have $8,000 of expenses in 2010 for things like lease payments, gas, oil, repairs, insurance and tires, and you drive the vehicle 80% of the time for business purposes, you could deduct $6,400 as business vehicle expenses in 2010.

Things get a little complicated if you own the vehicle, because you can't just deduct any monthly payments you're making; you must depreciate the purchase cost. To claim accelerated depreciation, you must have more than 50% business use. And the "luxury" vehicle rules limit annual depreciation to an amount specified by the IRS. Keep in mind that the term "luxury" is a misnomer because these limits are primarily based on the vehicle's weight.

For vehicles purchased in 2010 and used 100% for business, depreciation is limited under these rules to $3,060 in this first year ($3,160 for vans and light trucks; $25,000 for an SUV or truck that weighs more than 6,000 pounds but no more than 14,000 pounds). The normal Sec. 179 expensing limits generally apply to vehicles weighing more than 14,000 pounds.

Mileage-rate method

To compute the allowable deduction under the second method — called the “optional” or “standard” mileage-rate method — you multiply the number of business miles driven by the standard mileage rate.

For 2010, the mileage rate is 50 cents per mile (*down* from 55 cents per mile for 2009) for business miles. So if you drove 11,000 business miles in 2010, your deduction would be $5,500. The mileage rate is in lieu of operating and fixed costs, including depreciation, repairs, tires, gas, oil and insurance. You may, however, deduct parking fees and tolls in addition to mileage.

Leased vehicles have even more restrictions. If you use the mileage-rate method, you must use it for the *entire lease period* (including renewals).

The standard mileage-rate method may not be used in certain situations, such as when:

- An accelerated depreciation method was used on the vehicle in any prior year,
- A business is operating a fleet of vehicles at the same time, or
- The vehicle is for hire (such as a cab or limousine).

Moreover, if you use the mileage-rate method in the first year of business use, you can use only straight-line depreciation if you switch to the actual-cost method in a later year. And, before calculating that depreciation, you must reduce the basis by the depreciation component of the standard mileage rate, which is 23 cents for miles claimed for 2010.

More speed bumps

Other rules also conspire to limit your vehicle-related deductions. For example, employees usually must deduct unreimbursed vehicle expenses as miscellaneous itemized deductions, which are subject to the 2% limit. Employees who are reimbursed for vehicle expenses by their employers may or may not see a tax impact on their tax return, depending on the type of business expense reimbursement plan established by the company.

Determining whether you’re eligible and the amount you can deduct is complicated and can’t be done at high speed. But these tax breaks are worth braking for.

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