



To: Whom it may concern

From: Donovan Thomas Billings, CPA on behalf of DTB Tax

Date: November 15, 2006

Re: General Information regarding federal tax deductions related to leasing of automobiles for employees

If you lease a vehicle for your business, you can generally use the actual cost method of computing your vehicle expenses (full cost of owning and maintaining the automobile... costs such as insurance, maintenance, car washes, gasoline, etc. would be included). Then, you can deduct each lease payment as a rental expense. However, when business use of a leased vehicle is less than 100 percent, the rental deduction is scaled down in proportion to the personal use.

If you use a leased car 75 percent for business, and 25 percent for personal purposes and commuting, you can deduct only 75 percent of the lease payments. The percentage of use for business is determined using your mileage records.

Moreover, if a vehicle with a fair market value in excess of approximately \$15,200 (for 2005) is leased, you must add back an additional amount (i.e., subtract it from your otherwise deductible amount) to offset a portion of the lease payments. This rule was enacted to prevent individuals from avoiding the luxury car depreciation limits that apply to purchased vehicles. The amounts that must be added into your income are called "inclusion amounts" and are taken from a price-based table issued annually by the IRS. These tables are published in IRS Publication 463, *Travel, Entertainment, Gifts, and Car Expenses*. (Please see the attachment P463 attached to this memo for full tables through TY 2005).

To use the table, find the value of your car on the first day of your lease term (or on the day you converted your personal car to business use) in the first column, and read across the line to the column that matches the year of your lease to find the dollar value to be included. Then prorate the dollar amount from the table for the number of days of the lease term included in your tax year, and multiply the prorated amount by your percentage of business use for the year (as calculated by using your mileage records).

EXAMPLE: Let's say that in April of 2004 you leased a new car valued at \$20,350 to use in your business. In 2000, your business usage was 75% and you had the car for the entire year. When computing your inclusion amount for 2000, you would use the table

for cars first leased in 1999, and the column marked "2nd" since this is the second year of your lease. Reading across the line for cars valued between \$20,000 and \$20,500, the dollar amount is \$43. Since you had the car for all of 2005, use 100% of the amount (otherwise you would multiply by a fraction, $x/365$, where x = the number of days you leased the car). Then multiply \$43 by 75%, your percentage of business use, to arrive at an inclusion amount of \$32. This amount should be subtracted from 75% of your total lease payments to arrive at the amount you can deduct.

Note that if you are leasing your car or truck, you can elect to use the standard mileage rate to compute your auto expenses, provided that you use this method for the entire period of the lease.

For more information, please contact Donovan Billings, CPA at:

▶ **DTB TAX**

92 Nashua Road
Pelham, NH 03076

p. 603.635.9308

f. 603.386.6394

www.DTBTax.com

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