You Own the Automobile, Lease Back to Your Company

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This might take a bit of getting used to so we will start with a similar situation. If you owned and operated a landscaping business, you might own the heavy equipment personally, and lease it back to the business. This is very common, and is considered a self-rental. Please refer to Chapter 3 (Three Types of Income) to refresh yourself on self-rentals and the handling of the income. As you know, self-rentals are perfectly fine as long as the lease rates being charged are considered market rates and cannot be considered remuneration of services provided (i.e., owner compensation).

The same thing can be accomplished with your automobile. You would lease a car that you own back to your company. This is **not** considered the same as the company leasing the car from a dealer. This is creating a self-rental arrangement between you and your business. And why would you want to do that?

The usual reason- it might prove to be a better tax position since you are reducing the income of your LLC which is subjected to self-employment taxes. Since we also use the ability to pay salaries as one of components in determining a reasonable salary for you as a shareholder in an S Corp, the leaseback option might influence a small reduction in your salary.

The income tax angle is a wash. A big table is coming up. First, let’s talk about some basic assumptions.

Keep in mind- this arrangement will benefit an LLC through the reduction of self-employment taxes much more than an S corporation. You might be asking why not just elect S corporation status to solve your SE tax troubles? Perhaps your LLC is not generating the $35,000 in net business income after expenses to warrant the S Corp election.

Every year, AAA publishes the annual cost of driving an automobile, and the costs are broken down by small sedan, medium sedan, large sedan, sport utility vehicle and a minivan. From there, costs are established for 10,000 miles, 15,000 miles and 20,000 miles.

Small sedans are Chevy Cruze, Ford Focus, Honda Civic, Hyundai Elantra and Toyota Corolla. Medium sedans are Chevy Impala, Ford Fusion, Honda Accord, Nissan Altima and Toyota Camry. No numbers for a Porsche 911. Sorry. We’re sure the operating costs aren’t too bad, and we’ve recently heard that 911s never depreciate and the service checks are free.

There are certain fixed costs such as insurance, registrations and financing. There are certain variable expenses such as gas, tires and maintenance. Then there are some quasi-variable expenses, namely depreciation. Depreciation accelerates as the mileage per year increases. Think about Kelly Blue Book, Edmund’s or lease rates- the reduction in value due to mileage gets more severe as the mileage exceeds 15,000. Sort of a curvilinear equation.

The lease rate needs some discussion too. If you have a newer, more expensive automobile, you might be able to fetch $600 per month. If you have an older car or a car that is more economical, a market lease rate might be $400. It a challenge to determine the market rate. Is it the rate a rental car agency would charge such as Hertz or Avis? Is it the rate a dealer would charge? Something in the middle? Don’t forget the **IRS Publication 15-B (Employer’s Tax Guide to Fringe Benefits)** where the lease value is determined by the IRS based on the value of the car. The benefit of ambiguity is the ability to pitch an argument on most numbers.

More tables. More numbers. Yes, tables are only meaningful to the table designer yet consider the following in a non S Corp situation-

Business Miles	**5,000**	**10,000**	**11,875**	**15,000**	**20,000**
Personal Miles	5,000	5,000	5,000	5,000	5,000
Total Miles	10,000	15,000	16,875	20,000	25,000
AAA 2014 Costs for Small Sedan	0.597	0.464	0.440	0.397	0.360
less Depreciation, Finance	0.288	0.204	0.181	0.161	0.106
Actual Operating Costs	0.309	0.260	0.259	0.236	0.254
Mileage Rate Method					
2015 IRS Mileage Rate	0.575	0.575	0.575	0.575	0.575

Mileage Deduction on Sched C	2,875	5,750	6,828	8,625	11,500
Savings of SE Tax	406	812	965	1,219	1,625
Savings of Income Tax @25% MFJ	719	1,438	1,707	2,156	2,875
Total Savings Using Mileage Reimbursement	1,125	2,250	2,672	3,375	4,500
Lease Method					
Annual Lease @ $400/month	4,800	4,800	4,800	4,800	4,800
less Depreciation ($3,160 Year 1)	-3,160	-3,160	-3,160	-3,160	-3,160
Biz Use Expenses Using Actual Costs	1,545	2,603	3,075	3,544	5,076
Savings of SE Tax	897	1,046	1,113	1,179	1,395
Savings of Income Tax @25% MFJ	1,586	1,851	1,969	2,086	2,469
Gain on Net Rental Income @25% MFJ	410	410	410	410	410
Total Savings Using Lease Back Option	2,073	2,487	2,672	2,855	3,454
Delta on Mileage Rate Method	**-948**	**-237**	**0**	**520**	**1,045**

Tilt!

We haven’t updated this for 2021 numbers. Out of our client base of 2,700, we only have one business doing this. Have some fun with this, but in the end the other scenarios won’t hurt the brain as much.

The first question is the break-even. That number is 11,875 miles for a small sedan. That means if you drive fewer miles, then a lease arrangement might be a good idea. Conversely, if you drive more miles than 11,875, then using the mileage rate deduction is better. Yes, this is a middle of the road number. Pun intended.

Second question is depreciation and finance. Since you are charging a lease to your business for the use of the automobile, you cannot also add depreciation and finance charges. Those figures make up a large part of AAA’s cost of ownership. You can only pass operational costs proportioned to business use. However, those expenses might be deducted on Schedule E of your individual tax returns, similar to rental properties.

How does the break-even move around? Good question. Frankly, AAA tends to be heavy-handed on the costs. So, if the average costs to operate an automobile go down or is less than what the AAA thinks, the break-even point decreases. If the market lease rate increases from the $400 used above, the break-even mileage increases.

In other words, as the mileage increases, you are amortizing the same fixed costs across more miles, whereas the IRS is giving you a flat rate of 57.5 cents for the 2015 tax year. Low miles? Lease arrangement might make sense since the mileage rate is lower than the actual costs. High miles? Your actual costs are being spread thinner, but the IRS still gives you 57.5 cents. Things to consider.

How does this arrangement reduce my self-employment taxes? Wow. Another good question- you are full of them. Leasing a car back to your business has the most benefit in the garden variety LLC or partnership where all the income is being subjected to self-employment taxes. As you know, an S Corp already sanitizes a bunch of income in the form of a K-1 which is not subjected to self-employment taxes.

So, to reduce your K-1 income in favor of non-passive self-rental income is basically moving money from your right pocket to your left pocket. Both income sources are only taxed at the income tax level. Net zero. But we’ve already discussed that reducing S corporation income through self-rentals might help reduce your reasonable salary. However, this is more apparent in self-rentals or lease arrangements that are not automobiles. The reimbursement allowances, depreciation limits and business use calculations on automobiles versus other self-rental items makes it less lucrative.

Conversely, in an LLC or partnership where self-employment tax is a concern, the automobile lease arrangement is a business expense and directly reduces the income, and therefore reduces self-employment taxes. This arrangement might be a good idea if you are unable to use an S Corp election (foreign investor) or if it doesn’t make sense to (below break-even income).

There is some danger with the lease back to your business option. The biggest challenge is estimating the actual costs to operate your automobile, and the second challenge is estimating your mileage. So, if you are close to the break-even point it might not make sense. And engaging in revisionist history is not an ideal situation either.

Some more commentary. The AAA rate is published each year by the American Automobile Association and takes into account fuel prices, average insurance, registrations, etc.

The previous table assumes a 25% marginal tax rate. This is not a huge consideration, but as marginal tax rates increase the break-even point decreases. For example, on a small sedan, a jump from 25% to 32% in marginal tax rate increases your savings by $400 annually for a person who drives 15,000 miles for business and elects to use the mileage deduction and not the lease arrangement.

Medium sedans. With a slight increase in operating costs and subsequent market lease rates, the break-even is about 13,000 miles. Again, that might be low to some business owners. Hassle versus reward.

What is the net-net?

- The lease arrangement seems like an OK idea with low business miles.
- It seems exotic. It seems like a cool thing to drop at a party as a genius idea. But in the end, it might not be all that. But looking smart can be better than being smart.
- With one vehicle, it only works well in an LLC or partnership where self-employment taxes are being applied to all income.
- With several vehicles (fleet) or machinery, lease-backs can prove to be smart tax planning.

To confirm, however, WCG can model your specific situation.

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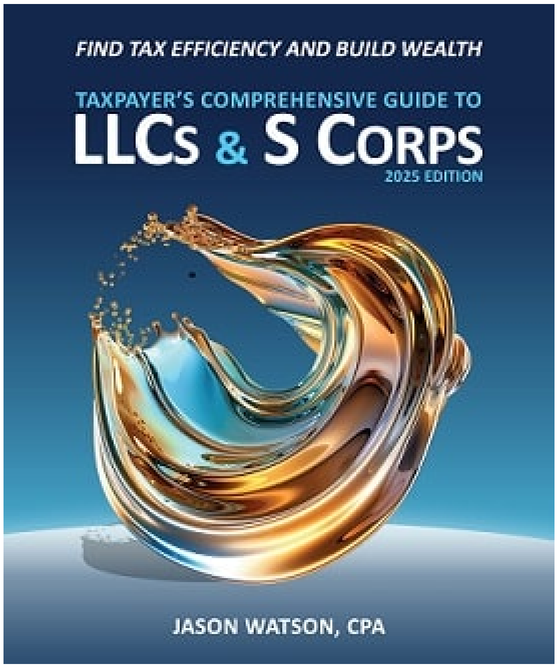

Taxpayer's Comprehensive Guide to LLCs and S Corps 2025 Edition

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