there is $100 in the pot, then you can be wrong 90% of the time and still break even. This is the essence of the pot odds: You're paying a fraction to win a larger sum, and the IRS is no different.

Here we go-

▲ Meals (shocker)

▲ Car and Truck Expenses, Mileage Logs (another shocker)

▲ Travel (abused regularly)

▲ Home Office (probably not as much anymore)

There are others, but these are the biggies. This should not have a chilling effect on you deducting these expenses. You should not be afraid of an audit. You should not be afraid of losing an audit. You should only be afraid of having an unreasonable or indefensible position. Sure, easy for us to say.

At the same time, if you have legitimate expenses and you can back them up with proof, then happily deduct them. Like Muhammad Ali once said, “It’s not bragging if you can back it up.” Well, the same can be said of small business tax deductions that are at higher risk of audit. If you can back it up then deduct it!

Automobiles and LLCs, S Corps

A question we entertain almost daily is “I want to save taxes. Should I have the business buy me a car?” Our auto-attendant replies with, “Do you need a car?” If you answer with “Yes” the auto-attendant replies with, “Hold please.” If your “Yes” is not quick or mumbled, or if there is any recognition of hesitation, the auto-attendant is unhappy.

We digress. There are only a few questions you need to ask yourself when considering a car purchase. Are you the type of person who buys new? How long do you typically keep your cars? Is the car 100% business use? How many miles do you plan to drive? There is a decision tree at the end of the automobile section.

Back up for a bit. Remember our previous discussions about tax deductions, and how only a fraction of the money you spend is returned to you? So, back to our auto-attendant, “Do you need a car?” If the answer is “Yes” because your bucket of bolts is getting exceedingly dangerous, then Yes, buy a much-needed car out of a sense of safety. If the answer is “Not really, but I want to save taxes,” then don’t.

Two rules to live by-

- ▲ Cash is King (keep it!)

- ▲ Depreciation is a tax deferral not a tax avoidance system (typically)

There might be some other external forces at play. For example, if you need a car next year but your income is ridiculously and unusually high in the current tax year, then reducing your income now makes sense. Again, tax modeling and planning is critical.

Ok, you've chatted with your car-loving buddies at the Watson CPA Group and we've determined that a car purchase should be in your near future, now what? There are all kinds of issues here, so, buckle up as we go through this stuff. There are four scenarios-

- ▲ Business Owned Automobile (mixed bag)

- ▲ You Own the Automobile, Get Reimbursed By The Mile (clean and elegant)

- ▲ You Own the Automobile, Take a Mileage Deduction (silly in an S Corp… oh and by the way, gone with the Tax Cuts and Jobs Act of 2017)

- ▲ You Own the Automobile, Lease it Back to Your Business (exotic)

We'll start with the crowd favorite- Business Owned Automobile. Everyone's default favorite. As we go through these, please excuse our interchange of vehicle, automobile and car. They all mean the same thing. And if you are being chastised by Tina Watson's sister for bringing food into her Toyota 4Runner then she would use the word "vehicle," with stark over-annunciation of each syllable like she was talking to someone who doesn't know English.

Business Owned Automobile

If the business truly owns the car, then it must be titled in the business's name. The IRS is cracking down on this, and it makes sense. If the business is the owner, then the business must be on the title. This might be a challenge with car loans and leases, but for the business to claim it as an asset and subsequent expenses the title needs to be in the LLC or S Corp's name.

If you buy the car yourself and then transfer it to the business, you might be on the hook for sales tax twice (technically) although recently Departments of Motor Vehicles are understanding that a transaction did not take place. Also, your title might have a lien on it making it challenging to change titling and names.

Another concern is higher insurance rates. It appears that most auto policies will charge a higher premium for cars owned by a business for business purposes. While the insurance businesses are regulated and must demonstrate the need for the premiums being charged, the higher amount appears to be a money grab.

Some insurance businesses will allow you to title in the business name and your name as joint tenants with rights of survivorship (JTWROS). This satisfies the IRS's need for titling, and it might allow you to insure the automobile with a personal insurance policy. Talk to your insurance agent.

Section 179 and Bonus Depreciation

Let's talk about the Hummer Loophole since that is where most taxpayer confusion comes from. Yes, at some point, long ago, in a galaxy far far away, businesses could buy heavy trucks and deduct them 100%. Was this a loophole of sorts? Yes. Does Congress and the IRS like loopholes? Not really, unless it benefits them. Did Congress and the Joint Committee on Taxation change the Hummer Loophole? Yes. What is the current state of affairs in 2018 and 2019 after the Tax Cuts and Jobs Act of 2017 (TCJA)? Good question, read on (sneak peek, we are back to 100% for heavy trucks… Hummers for everyone Oprah!).

Let's talk about which business automobiles are eligible for 100% Section 179 deduction under the current 2018 tax laws after the TCJA. The following trucks and business automobiles qualify for 100% deduction in Year 1-

▲ Automobiles that can seat nine-plus passengers behind the driver's seat (i.e.: Hotel / Airport shuttle vans, etc.).

▲ Automobiles with: (1) a fully-enclosed driver's compartment / cargo area, (2) no seating at all behind the driver's seat, and (3) no body section protruding more than 30 inches ahead of the leading edge of the windshield. In other words, a classic cargo van.

▲ Heavy construction equipment will qualify for the Section 179 deduction, as will forklifts and similar.

▲ Typical "over-the-road" Tractor Trailers will qualify.

This is straight from the Section179.org website who does a fantastic job of explaining this stuff. So what are the Section 179 deduction limits for passenger automobiles and heavy trucks that don't meet the list above? That is another really good question!

The following is directly from the IRS website speaking in reference to the TCJA-

> The new law changed depreciation limits for passenger vehicles placed in service after Dec. 31, 2017. If the taxpayer doesn't claim bonus depreciation, the greatest allowable depreciation deduction is:
>
> $10,000 for the first year,
> $16,000 for the second year,
> $9,600 for the third year, and
> $5,760 for each later taxable year in the recovery period.
>
> If a taxpayer claims 100 percent bonus depreciation, the greatest allowable depreciation deduction is:
>
> $18,000 for the first year,
> $16,000 for the second year,
> $9,600 for the third year, and
> $5,760 for each later taxable year in the recovery period.
>
> The new law also removes computer or peripheral equipment from the definition of listed property. This change applies to property placed in service after Dec. 31, 2017.

Where do some of these limits come from? The $10,000 for the first year comes from the Section 280F limitation. The $18,000 for the first year comes from the Section 280F limitation plus applying Section 168(k) bonus depreciation. There was a hiccup in the tax code that disallowed depreciation in subsequent years if accelerated depreciation was taken. But just like in 2011, the IRS released IRS Revenue Procedure 2018-25 which provided safe harbor for depreciation in subsequent years.

Again, these numbers are based on luxury passenger vehicles; in other words, vehicles that weigh 6,000 pounds or less. Why is this important… keep going!

You say, "so, my heavy SUV doesn't qualify for a 100% deprecation deduction under Section 179 because of the seating and configuration of the cargo hold, so now what?" Another really good question! Keep 'em coming! We have the answers.

The order of depreciation is Section 179 Deduction, then Bonus Depreciation and then regular depreciation. This means you apply limits, subtract the allowance and then apply subsequent laws to the remaining amounts. A truck or SUV that weighs more than 6,000 pounds is not considered a luxury automobile and therefore is not limited by Section 280F in the same way.

As such, the first year depreciation deduction for your heavy business automobile would be-

- ▲ $25,000 under Section 179, plus
- ▲ 100% Bonus Depreciation under Section 168(k)

So that $90,000 Ford F250 truck that comes in around 6,700 pounds would be fully deductible in Year 1. Wow! That is good news, right? Right! The Hummer Rule is back baby! Do I have to buy a new heavy truck to qualify for the bonus depreciation? No. The old rule was Yes, but the TCJA changed that too. Here is the blurb from the IRS website-

- ▲ The taxpayer didn't use the property at any time before acquiring it (read, new to you not "brand" new or never been used, emphasis emphatically added).
- ▲ The taxpayer didn't acquire the property from a related party.
- ▲ The taxpayer didn't acquire the property from a component member of a controlled group of corporations.
- ▲ The taxpayer's basis of the used property is not figured in whole or in part by reference to the adjusted basis of the property in the hands of the seller or transferor.
- ▲ The taxpayer's basis of the used property is not figured under the provision for deciding basis of property acquired from a decedent.

So there you go. The problem still remains with luxury passenger automobiles weighing under 6,000. Those limits are $18,000 for the first year under Section 280F and there are problems in subsequent years that we don't want to bore you with, but if you want to read IRS Rev. Proc. 2011-21 for nauseating examples, then go for it.

The bottom line is this- to maximize your Section 179 deduction for the business automobile purchase, buy an automobile that weighs over 6,000 pounds. Or… instead of driving Miss Daisy, drive a sumo wrestler to push you over 6,000 pounds (kidding!).

Leasing or Financing

If your business leases the automobile, the business portion of the lease amount is expensed. However, there are limits to how much can be expensed, especially for expensive or what the IRS would consider luxury automobiles. The disallowed lease payment is called a lease inclusion and is detailed in IRS Revenue Procedure 2016-23. The amount is added back into income and taxed, leaving only the IRS allowed portion as a deductible lease expense. So before you lease that brand new 911, call us. We'll determine a plan after the joint test-drive.

Also consider that leases are generally bad, especially on business automobiles over $80,000 for three really big reasons. First, the residual value offered on a 36 month lease will be about 60% or $48,000. This is essentially what the leasing business believes the automobile will be worth after 3 years. Yuck #1.

Second, they take the degradation in value ($80,000 minus $48,000) and apply a capitalization rate of 8% to 12%. This is essentially your interest rate. Yuck #2.

Third, they put ridiculous mileage limitations such as 10,000 miles per year with heavy penalties for going over the limit. 10,000 miles is laughable for most modern day business owners or families. Yuck #3.

Sure, if you lease a more economical automobile such as a Subaru Crosstrek for $30,000 then Yuck #1 goes away. But Yucks #2 and #3 remain. Also, automobile leases are generally not capitalized leases (they do not have a bargain purchase option) and therefore they cannot take advantage of the Section 179 deduction or Bonus Depreciation. Contrast that with your leased copier with a $1 buy-out option… this is considered "financing" or a capitalized lease, and the asset can be listed on your balance sheet, depreciated, painted purple, etc.

Liability

Another consideration- if you are driving the business car and get into an accident, the business might get into a liability rodeo just based on ownership. Proving that at the moment you were driving the car for personal reasons might not matter. We are not attorneys, but this scenario is not beyond possibility.

Personal Use

Lastly, and this is yet another big deal, any personal use must be considered taxable income as an employee of your S corporation. Don't laugh, it's true! How do you calculate the amount of imputed income? The easiest and most widely accepted way is to use the Annual Lease Value Table in IRS Publication 15-B Employer's Tax Guide to Fringe Benefits.

For 2018, the lease value of a $50,000 automobile is $13,250 annually. If you use the business-owned automobile for personal use 10% of the time, then $1,325 will be added to your W-2 and taxed as compensation (including Social Security and Medicare taxes, and all the taxes you would expect). Here is the link to IRS Publication 15-B-

www.wcgurl.com/5337

You can also use the mileage rate, but there are strong limitations such as the fair market value of the automobile must be below $27,300 (for 2018). That will preclude most automobiles. But let's run the math anyways.

For example, you drove 15,000 miles and 5,000 miles were personal. You would need to add 5,000 miles x 54.5 cents (for 2018) which equals $2,700 to W-2 income. And here's the personal use kicker- if you are operating your car for less than the standard mileage rate (and you usually do), you will artificially be inflating your income.

Having a mixed use (personal and business) automobile be owned by the business sounds like a lot of work. Everyone at the Watson CPA Group likes French fries, but we won't run a mile for just one. Let's make sure it's worth it. Will the tax benefit of depreciation in the first two years offset the additional imputed income? Perhaps.

Keep in mind that it is difficult to justify 100% business use of an automobile if it is the only automobile you own- perhaps in Manhattan, but not for most Americans. Even if you have another automobile at your disposal, it still might not make sense to have your business own it. The question boils down to how many miles you will drive versus your ability to accelerate your depreciation versus your marginal tax rate today and the following years. At the end of this section on automobiles is an overly simplified flowchart to help you decide (or confuse the situation more).

LLC Owned But Using Standard Mileage Rate

If you are operating an LLC without the S corporation election, you might be tempted to use the standard mileage rate. Typically this would be ill-advised- if you are using the standard mileage rate you are probably better off owning the automobile personally and be reimbursed by the LLC. However, there are situations where this might make sense.

Let's look at the myriad of rules where using the standard mileage rate method is not allowed.

According to IRS Publication 463, you cannot use the standard mileage rate when you-

- ▲ Use five or more cars at the same time (such as in fleet operations), or
- ▲ Claimed a depreciation deduction for the car using any method other than straight line (such as MACRS), or
- ▲ Claimed a section 179 deduction on the car, or
- ▲ Claimed the special (bonus) depreciation allowance on the car, or
- ▲ Claimed actual car expenses for a car you leased, or
- ▲ Did not use the standard mileage deduction during the first year of use.

This makes sense. The IRS does not want you to exploit the system by claiming huge amounts of depreciation in the first year, and then switch to the possibly more lucrative standard mileage rate deduction. Here is the link for the IRS Publication 463 (Travel, Entertainment, Gift, and Car Expenses)-

www.wcgurl.com/5330

Again, if your LLC owns the automobile but is using the standard mileage rate and your LLC elects S corporation status for taxation, this asset needs an adjusted cost basis for depreciation within the corporation. Why? As an S Corp where the business owns the automobile, the business can only use actual expenses and depreciation is a part of that.

The calculation for determining the basis of the automobile is quite simple since the IRS publishes the depreciation amount within the standard mileage rate. Here's the math from Notice 2018-03-

Purchase Price, 2016	50,000
2016 Depreciation @ $0.24 per Mile for 10,000 Miles	2,400
2017 Depreciation @ $0.24 per Mile for 10,000 Miles	2,400
2018 Depreciation @ $0.25 per Mile for 10,000 Miles	2,500
Adjusted Cost Basis on 12/31/2018	42,700

In this example, if the LLC elects S corporation status on January 1 2019, an asset would be created on the S corporation's balance sheet with an adjusted basis of $42,700. The depreciation schedule for an automobile is typically five years, but when you switch from standard mileage rate to actual expenses (e.g., LLC electing S Corp status) the IRS requires you to estimate the remaining useful life. This is another conundrum. In this example, somewhere between two years and five years would be reasonable.

We just went over a ton of stuff under the Business Owns the Automobile section. Please look at a quickie decision tree later in this chapter.

You Own the Automobile, Get Reimbursed By The Mile

This might be the best option, especially if Section 179 depreciation is not going to benefit you much and/or you use the automobile personally more than you use it professionally. As the owner of the automobile, you would submit expense reports in the form of mileage logs. If you are a smart automobile owner, you would also use a smartphone app to keep track of your miles for you. Keep in mind that the IRS wants corroborating evidence to support your mileage logs, so keep those Jiffy Lube receipts or other service records showing odometer readings near the beginning and end of the year (so extrapolation can occur). Just whippin' out a pretty color-coded spreadsheet during an IRS examination is not enough.

The business would reimburse you according to your mileage log submission. This can be a great option for a lot of reasons. First, you are reducing the net income of your business, and if you are an S Corp the lower business income could decrease the amount of reasonable salary you must take as a shareholder. Second, most automobiles generally operate for less than the Federal mileage rate.

Let's look at some numbers-

Business Miles	12,000
MPG	25
Gallon of Gas	$3.50
Cost of Gas	1,680
Maintenance, Biz Portion	3,000
Total Cost	4,680
Reimbursement at $0.545	6,540
Difference	**1,860**

So you just took home $1,860 tax-free. All legit. All legal. AAA might consider these operating costs to be too low, but then again this would be representative of an older or thrifty automobile. Why is that? In 2018, the IRS designated $0.25 of the $0.545 standard mileage rate to be depreciation of your automobile (almost half). Therefore, if you have a $5,000 POS which will be worth $5,000 ten years from now, you are getting reimbursed for depreciation that never happens. Cool! 10,000 miles would be $2,400 in your pocket free and clear.

Let's not forget that you took money out of the business tax-free and you reduced your business's overall taxable income through legitimate small business tax deductions. Therefore, if we are using net business income after expenses as one of the proxies for determining a reasonable S corporation salary, that salary starts off at a lower number and subsequently reduces Social Security and Medicare taxes (among others). Win win!

Time to pump the brakes a bit. There is some confusion out there about getting reimbursed for actual expenses. For example, a business owner will own the automobile personally but also wants to get reimbursed for actual expenses. This same business owner will use the business credit card for gas and oil changes. This is bad. If you want to get reimbursed for actual expenses, it must be a pro-rated amount. If you drive 18,000 miles and 12,000 are business miles, then the business should only reimburse 75% of all actual expenses.

If you have leased your automobile and you use the standard mileage rate for reimbursement, you must continue with that method for the entire lease term.

Your business must have an Accountable Plan to take advantage of the You Own the Automobile, Get Reimbursed scenario. As a general rule, any payment of an allowance or reimbursement of business expenses for which the employee does not provide an adequate accounting (i.e., substantiation with receipts or other records) is considered to have been provided under a non-Accountable Plan and is required to be treated as taxable wages for purposes of Federal, state, and local (if applicable) income tax withholding, Social Security and Medicare taxes, and Federal and state unemployment taxes. Yuck!

You Own the Automobile, Take Mileage Deduction

This is dead. Thanks to the Tax Cuts and Jobs Act of 2017 all miscellaneous deductions that were once subjected to 2% adjusted gross income limits and then deducted on Schedule A are gone. Obtaining a tax deduction through a mileage deduction on your individual tax return was always a bad idea anyway, and now it's just a memory.

You Own the Automobile, Lease It Back to Your Business

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 an earlier chapter 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 enumeration 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 business. This is not considered the same as the business 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 $30,000 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 can be 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**	**15,000**	**20,000**
Personal Miles	5,000	5,000	5,000	5,000
Total Miles	10,000	15,000	20,000	25,000
AAA 2014 Costs for Small Sedan	0.597	0.464	0.397	0.360
less Depreciation, Finance	0.288	0.204	0.161	0.106
Actual Operating Costs	0.309	0.260	0.236	0.254
Mileage Rate Method				
2015 IRS Mileage Rate	0.575	0.575	0.575	0.575
Mileage Deduction on Sched C	2,875	5,750	8,625	11,500
Savings of SE Tax	406	812	1,219	1,625
Savings of Income Tax @25% MFJ	719	1,438	2,156	2,875
Total Savings	1,125	2,250	3,375	4,500
Lease Method				
Annual Lease @ $400/month	4,800	4,800	4,800	4,800
less Depreciation ($3,160 Year 1)	-3,160	-3,160	-3,160	-3,160
Biz Use Expenses Using Actual Costs	1,545	2,603	3,544	5,076
Savings of SE Tax	897	1,046	1,179	1,395
Savings of Income Tax @25% MFJ	1,586	1,851	2,086	2,469
Gain on Net Rental Income @25% MFJ	410	410	410	410
Total Savings	2,073	2,487	2,855	3,454
Delta on Mileage Rate Method	**-948**	**-237**	**520**	**1,045**

Tilt!

We haven't updated this for 2019 numbers. Out of our client base of 2,000, 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 automobile, it only works well in an LLC or partnership where self-employment taxes are being applied to all income.

▲ With several automobiles (fleet) or machinery, lease-backs can prove to be smart tax planning.

To confirm, however, the Watson CPA Group can model your specific situation.

Automobile Decision Tree

In deciding whether to own the automobile personally or through your S corporation, here is a set of examples to help you make a decision. It is not a hard and fast set of rules, but will provide some guidance.

First, let’s establish the bookends. On one end is the $80,000 luxury auto that you barely drive, and you recycle automobiles every 2-3 years. This is clearly business owned.

On the other end is the $30,000 modest automobile that you drive a tone of miles, and you keep automobiles for at least 5 years. This is clearly individually owned and reimbursed.

Armed with that information, here we go-

Example 1
You like big fancy cars that cost $80,000 and you only drive 5,000 miles for the business. Degradation of value is a way of life simply based on time so this automobile will go down in value, and as such you might as well get a tax deduction for it. Ergo, have the business own it. In other words, if you have already budgeted for the degradation of automobile value you might as well get a tax deduction for it, right?

Example 2
You are frugal and therefore you like to buy used Subaru's costing around $20,000… and, you drive the wheels off the thing because you are a real estate agent. Degradation in value is not as severe as example 1, so in this example the small business owner should own the automobile personally and get a mileage reimbursement from the business.

Example 3
You like big heavy trucks that cost $80,000 and you drive 12,000 miles for the business. You would like to save some taxes this year as well (shocking). This is a great example of using Section 179 plus 100% Bonus Depreciation to deduct the full amount of the truck.

Example 4
Same as example 3, but you expect your income to dramatically increase next year versus this year. In this case, have some patience and purchase the truck next year to match the excellent tax deduction against the higher income. We know, patience stinks. Our job is to build your wealth, and save taxes over your lifetime… not just today.

Example 5
You buy a lightly used SUV that weighs over 6,000 pounds for $50,000 and you drive it 6,000 miles per year. Yuck. This is right in the middle of "no man's land" where the decision is not obvious. Yes, you can deduct the full amount of $50,000 since the Section 179 deduction is not based on a new automobile, just new to you. Same with 100% Bonus Depreciation with the new tax law.

But recall that depreciation is a tax deferral… if you sell your business automobile for $40,000 a few years later, you will have depreciation recapture on the $40,000 taxed at ordinary income tax rates (with some limits). And… Section 1031 Like-Kind Exchanges no longer apply to automobiles since the recent tax reform so you can't trade it in to kick this depreciation recapture can down the road.

It might behoove you then to own this automobile personally and get a mileage reimbursement from the business. Then again, if you have an unusually high income this year perhaps deducting it in full today makes sense. Again, "no man's land" since the decision now has a ton of variables and what-ifs.

Example 6
Same as example 5 but you keep the automobile for 10 years and drive 15,000 miles. This changes the narrative. Since you will be owning it for so long with so many miles, the mileage reimbursement option is the way to go. In other words, own it personally and get reimbursed for the business miles you drive.

We have a questionnaire that you can complete, and we can review together to find the best course of action. Here is the link-

www.wcgurl.com/8120

Paying Rent, Home Office

Should I have my LLC or S Corp pay me rent is another daily question. No. Technically this is old school. When you own 2% or more of an S Corp, the rules dramatically change when it comes to car ownership, paying rent for shareholder assets and home office deductions. These fringe benefits can be considered not so fringe, and therefore income.

What you might be asking is- Is there a way to have the business reimburse, compensate, or otherwise pay for my home office? Or, can I still take a home office deduction with an S corporation? Yes there is a way to claim a home office deduction with an S Corp.

Prior to the IRS making a recommendation to use the Accountable Plan and subsequent reimbursements to the employee (or shareholders), taxpayers would charge their corporation rent and declare the rent as income on Schedule E. Ok, but not elegant.

In the garden variety LLC world, the beauty of this was to take money out of the business as passive income. Since you were changing the color of money from earned income to passive income you were also sidestepping self-employment taxes. In the S corporation world, the beauty of this was to reduce the S Corp's overall income, and therefore reduce the reasonable salary thresholds for shareholders while still taking money out of the business as passive income (again reducing self-employment taxes).