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Personal Use of Company Vehicles – Tax Considerations

Providing company vehicles for employees and business owners to use either while at work or while away from work can be very beneficial to the employer as well as the employee and business owner. However, there are certain pitfalls to this arrangement if you are not aware of the tax consequences. Generally speaking, if the company vehicle is used entirely for company business, there are no consequences to the employee and business owner. The business is allowed a deduction for 100% of the vehicle's expenses. If the company allows the employees or business owners to drive the vehicle for personal business, there are a few complications. Because the employee or owner received a non-cash benefit from the company (i.e. – free use of a company car), he or she will be subject to taxes based upon the value of the benefit.

The first problem to be aware of is what is "personal use" and what is "business use" of a company vehicle. Business use of a company vehicle is using the vehicle to perform some aspect of your job required by your employer. It can be making deliveries, traveling, etc. On the other hand, personal use encompasses anything that is not business related**,** *including commuting*. IRS Publication 463 (Travel, Entertainment, Gift and Car Expenses) describes commuting as "driving a car between your home and your main or regular place of work." If you are using a company vehicle, you are required to keep written documentation to substantiate its business use. The documentation should include the date, mileage, business destination and business purpose for each trip (refer to IRS Publication 463). At the end of the year, you can determine what percentage of the mileage was for personal use and what percentage of the mileage was for business use. These percentages will be useful in determining the taxability of the personal use of the vehicle to the employee or business owner. If you did not maintain a complete log or similar record during the year, you may still be able to determine your business vs. personal use of a company vehicle by alternative means. *However, this approach is not advisable as it can be highly subjective and involves using estimates that may or may not be agreeable to the IRS***.** If you do not have written documentation and cannot determine your business vs. personal use through alternative means, it will be assumed by the IRS that you used the vehicle entirely for personal use. According to IRS Publication 15-B (Employer's Tax Guide to Fringe Benefits), "Any use of a company-provided vehicle that is not substantiated as business use is included in income."

The next problem that arises, once you are aware of business vs. personal use, is what is the value of the personal use of the company vehicle? As with all non-cash benefits, the IRS requires your employer to calculate the fair market value of the benefit. For vehicles, you are required to use one of three methods for the computation: Cents-Per-Mile Rule, Commuting Rule, and Lease Value Rule.

Under the cents-per-mile rule, you simply multiply the current 2012 mileage rate (55.5 cents per mile for business miles driven) times the personal use mileage. To use this method, you must, among other requirements, use the vehicle more than 10,000 miles per year, and the vehicle must be valued at less than the maximum permitted value when placed in service ($15,900 passenger automobiles, $16,700 truck or van for 2012) and meet the regular use* requirements.

> **Regular use in your trade or business*. A vehicle is regularly used in your trade or business if at least one of the following conditions is met:
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> - At least 50% of the vehicle's total annual mileage is for your trade or business.
> - You sponsor a commuting pool that generally uses the vehicle each workday to drive at least three employees to and from work.
> - The vehicle is regularly used in your trade or business on the basis of all of the facts and circumstances. Infrequent business use of the vehicle, such as for occasional trips to the airport or between your multiple business premises, is not regular use of the vehicle in your trade or business.

Valuation for the commuting rule is based on $1.50 per one-way commute (per employee or business owner). To qualify for this method you must:

1. provide the vehicle for bona fide business purposes and require the employee(s) or business owner(s) to commute in the vehicle;
2. establish a written policy under which you do not allow the vehicle to be used for personal purposes other than commuting; and,
3. if the vehicle is an automobile, it cannot be used by a control employee.

Most employees or business owners will qualify under the lease value rule based on the fair market value that is equal to what it would cost to lease a similar vehicle from a third party, known as the annual lease value. To make this calculation easy, the IRS provides an annual lease value for vehicles based on the vehicle's fair market value. The vehicle's fair market value can be determined from any number of websites or automobile appraisers such as Kelley Blue Book's website: www.kbb.com. Once you have the vehicle's fair market value, you can use the annual lease value table provided by the IRS in Publication 15-B. Once you have determined the personal usage percentage and the annual lease value, you multiply the two items together to determine the taxable value of the benefit.

After using one of the appropriate methods above to determine the taxable value of the benefit provided, that value must be included in the employee's or business owner's income. The taxable value of the benefit is subject to both income and payroll taxes. The value of the benefit must be increased to cover the payroll tax liabilities which can easily become a tedious calculation. This increased value must be reported on the employee's form W-2 at the end of the year, because the employee will be subject to the tax due on the value of the benefit. In order to avoid any last minute "surprises," the employee and employer should both be aware of the tax treatment of personal use of company vehicles far enough in advance so that if the employee needs to have additional income tax withholding taken out of his or her check, he or she will have enough time to do so.

If you are self-employed, there are some differences on the rules mentioned above. The IRS still requires the substantiation you would have provided to your employer, but you must report your business and personal mileage on schedule C of your tax return. Then, rather than determining the annual lease value of the vehicle and including it in your income, you must reduce the business deduction for your vehicle by the personal use percentage.

Enclosed is a copy of the Personal Use of Vehicle Worksheet, please. If you have any questions regarding this information, please call us at (252) 261-1040.

Hutchins Allen & Company, P.A.

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