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Primer on Contractor Tax Deductions for Car & Truck Expenses

Since contractors invest in and use many types of vehicles, including cars and trucks, maximizing tax deductions and maintaining proper documentation is a concern for all CFMs. Navigating the rules and regulations can be daunting – mileage deductions, listed property rules, whether or not to include vehicle allowances in employee wages, and determining depreciation are just some of the issues that must be addressed.

Overview & Structure

First, the car or truck's (the asset's) usage is split between business and personal. Generally, the personal portion is not tax deductible by the business unless it is included in employee compensation. Next, determine how the business portion is to be deducted, which starts with splitting the vehicles into two asset categories: *listed property* and *full business*.

Let's start by looking at the definition of what the IRS calls listed property.

Listed Property

In general terms, listed property can be thought of as any company asset that lends itself to actual or potential mixed use for both personal and business purposes. Listed property has specific rules that limit depreciation deductions and expensing elections.

IRC §280F(d)(4)(A) defines listed property as any passenger automobile, any property used as a means of transportation, and any property generally used for purposes of entertainment, recreation, or amusement. IRC §280F(d)(5)(A) further clarifies that passenger automobiles are "any four-wheeled vehicle which is manufactured primarily for use on public streets, roads, and highways, and which is rated at 6,000 pounds" or less unloaded gross vehicle weight (GVW). It also confirms that passenger automobiles do not include specialized vehicles such as ambulances, hearses, vehicles used in the business of transporting persons or property for hire, and any other trucks or vans.

Generally, sizable trucks or vans are not classified as listed property, and therefore, are not subject to the depreciation

limits. Moreover, certain vehicles that are not likely to be used more than a *de minimis* amount for personal purposes are also not considered listed property.¹ For example, this includes bucket trucks, flatbed trucks, school buses, cement mixers, and other vehicles designed to carry cargo with a loaded GVW over 14,000 pounds.²

Let's revisit that 6,000-pound GVW threshold. Notwithstanding the potential for personal usage, trucks and vans over 6,000 pounds are full business assets that may take advantage of elevated depreciation and expensing treatment. Trucks and vans under the 6,000-pound weight threshold are classified as listed property passenger automobiles, which are generally the typical factory vehicles, such as a Jeep Cherokee. These vehicles will be subject to the listed property/passenger automobile depreciation limits under §280F.

So, what are the §280F limits for listed property?

Passenger/Luxury Automobile Depreciation Limits

If a passenger automobile is listed property *and* is used more than 50% of the time for business purposes, then IRC §280F depreciation limits apply to the depreciation deduction. If business usage is under 50%, then the more stringent alternative depreciation system applies to passenger automobiles³ (i.e., even more limitations delaying tax depreciation deductions).

According to §280F(a)(1)(A), for 2019, the listed property depreciation limits for passenger vehicles with business usage over 50% are:

- \$10,100 for the first taxable year in the recovery period (\$10,000 for 2018)
- \$16,100 for the second taxable year in the recovery period (\$16,000 for 2018)
- \$9,700 for the third taxable year in the recovery period (\$9,600 for 2018)
- \$5,760 for each succeeding taxable year in the recovery period⁴ (\$5,760 for 2018)



The *Tax Cuts and Jobs Act of 2017* (TCJA) also allows an increase of \$8,000 in depreciation deduction limit for the first taxable year in the recovery period. This increase is in addition to the limit for qualified property passenger vehicles⁵ acquired and placed in service after September 27, 2017, and before January 1, 2027.⁶ Therefore, the potential first-year depreciation deduction could be \$18,100 for 2019, which is the §280F \$10,100 limit plus the \$8,000 bonus.

The depreciation limits in §280F(d)(1) encompass all types of tax depreciation for the asset including §179 depreciation and bonus/special depreciation. The intent of the threshold is to limit immediate depreciation deductions for more expensive autos, which are those above the current year's IRS threshold.

Notice that the regular deductions in the §280F schedule totals \$47,420 after the fifth year. With the initial year \$8,000 bonus, that's a total of \$55,420 after five years. Unlike typical five-year assets, depreciation continues after the fifth and sixth years until the entire business portion of the asset is fully depreciated or disposed. So, for luxury vehicles or other high-priced autos, depreciation can continue into the seventh and later years if the auto is held that long.

Full Business Assets

Full business assets are treated the same as any depreciable assets, which do not have nonbusiness (personal) usage.

Regular tax depreciation, §179 expensing, and special bonus depreciation are all available within normal limitations for vehicles not categorized as listed property. This is mostly for vehicles that weigh more than 6,000 pounds GVW and are qualified nonpersonal use vehicles. Therefore, vehicles that are not listed property can be fully deducted in the initial year by way of the current permissible 100% bonus depreciation. Once the current bonus depreciation rules phase-out after 2026,⁷ these assets can also be expensed under §179 during the initial year the asset is placed in service within the limits of that section (must have income, limits on total assets placed in service during the year, etc.).

While treated more favorably than listed property, total deductions for full business assets must still be addressed if there is, in fact, personal usage.

To recap, first determine if the vehicle is listed property or a full business asset. If it's listed property, then apply the applicable limits and deduct permissible depreciation. Based on current laws, if the vehicle is not listed property, then

the contractor is generally entitled to a first-year full write off of the cost. In other words, for an asset that is not listed property, bonus depreciation can be taken, and the full cost is written off in the initial year the asset is placed in service. That's a significant timing and tax difference when compared to the approximate \$55,000 deduction over five years that is permitted for listed property vehicles.

Trade-ins

Prior to 2018, there was no gain or loss for trade-ins because the transaction was treated as a like-kind exchange. Basis in the vehicle (cost less depreciation taken to date) is carried over and the gain, if any, was deferred until the replacement vehicle was disposed of or sold. The TCJA changed the law so that the §1031 like-kind exchange treatment no longer applied to tangible personal property.⁸ Thus, after 2017, a traded in vehicle is treated as an exchange transaction. Gain or loss is recognized on any realized gains and depreciation recapture likely applies, so the recognized gain will likely be taxed at ordinary rates rather than at capital gain rates. The first-year write off of the new/replacement vehicle offsets this ordinary income.

Leases

The rules differ for leased passenger vehicles that are listed property. As stated in §280F(c)(2), for vehicles that are leased for 30 days or more, only the allowable percentage of lease payments shall be considered. The IRS publishes what is referred to as *income inclusion tables* for listed property vehicle leases. The deductible portion (i.e., business percentage) of the lease payment is reduced by the amounts in these tables.

Theoretically, this accomplishes the same concept as the §280F limitations (i.e., delayed deduction for higher cost luxury vehicles that have actual or potential personal use) through different mechanics. For the 2019 tax year, the income inclusion tables apply to leased passenger automobiles with fair market values of at least \$50,000.⁹

Mileage vs. Actual Expenses

Depreciation deductions for the cost of the vehicle is part of all of the vehicle's carrying costs. In lieu of taking depreciation (plus other actual costs), a deduction based on mileage is permissible.

The IRS gives taxpayers the option to use the actual expense method or standard mileage method for deducting costs of vehicles for those who are self-employed or an employee.¹⁰ The business mileage rates are posted every year in IRS

Publication 463. The standard mileage rate for tax year 2019 is 58 cents per mile for business (not personal) miles.¹¹ The standard mileage rate cannot be used if a taxpayer:

- Uses five or more vehicles at the same time¹² (i.e., fleet operations);
- Claimed a depreciation deduction for the vehicle using any method other than straight line (i.e., MACRS);
- Claimed a §179 expensing deduction on the vehicle; or
- Claimed the special bonus depreciation allowance on the vehicle.

The mileage method is elected by using it in the first year the vehicle is placed in service,¹³ although a taxpayer can change to actual expenses in a future year for that particular vehicle.

However, this doesn't work both ways; if the actual expense method is initially used in the first year, then it can't be changed to the mileage method in the future. In addition to the mileage rate, parking fees and tolls attributable to vehicle use for business purposes should be deducted. Moreover, the taxpayer deducts interest expense related to the purchase of the automobile as well as state and local personal property taxes.¹⁴ Of course, only the business use percentage can be used when calculating these actual costs. So, for example, if the vehicle is used 75% of the year for business purposes, then 75% of the corresponding actual costs are deductible, and the remaining 25% are not.

Actual expenses based on business use percentage, generally include these types of costs:¹⁵

- Depreciation (for purchased vehicles)
- Licenses
- Lease payments (as previously covered)
- Registration fees
- Gas
- Insurance
- Repairs
- Oil
- Garage rent
- Tires
- Tolls
- Parking fees

As discussed earlier, when deducting actual expenses, remember that the §280F listed property limits apply to the largest of these expenses: namely, depreciation.

Reporting

When employees use company vehicles, employers generally include the value of the personal portion of usage in the employees' compensation, which is subjected to withholding

taxes. There is a safe harbor methodology for vehicles that have limited personal use.

In cases where employees are using their own vehicles and the employer reimburses the employee for the use of their vehicles, employers can avoid adding to W-2 income by establishing an "accountable plan" for expense reimbursement.

Under this type of plan, the employee must report all business usage details and is reimbursed based on the documentation supplied. The employer then takes the tax deduction for the expenditures documented by the employee under the accountable plan.

If the employee is paid an allowance to cover their vehicle expenses and therefore no accountable plan is in place, then the allowance is treated as additional W-2 compensation and all withholding taxes apply. Temporary changes in how the employee handles the business-related expenses are addressed on the last page.

Special Rule for Employee Commuting Costs

Employees who are provided vehicles that they take home receive a benefit that is not tax deductible; this is the value of using the vehicle for commuting to and from work. Commuting is determined based on the *first contact* rule, which is from home until an employee's first contact with a work location (i.e., jobsite, office, customer's office, etc.) during their commute. The same applies at the end of the day.

The IRS provides a commuting safe harbor rate of \$1.50 each way that the employer can add to the employee's compensation.¹⁶ So, the value of the vehicle provided to an employee for commuting use is pre-set and no complicated valuation or computations need to be maintained other than commuting days.

If more than one employee commutes in the same vehicle, then the value of \$1.50 each way applies to each employee. To qualify to use this method, all of the following are required:

- The employee is provided the vehicle for use in the trade or business, and the employer requires the employee to commute in the vehicle.
- The company establishes written policies stating that employees are not permitted to use the company vehicle for personal purposes other than for commuting or *de minimis* personal use.
- The employee does not actually use the vehicle for personal purposes other than commuting and *de minimis* personal use.



- The employee who uses the vehicle for commuting is not a “control employee” such as an owner of the business.¹⁷

Documentation/Substantiation Requirements

This documentation generally starts with a mileage log. The regulations are clear that some type of written diary or log is necessary.¹⁸ The business use portion of a vehicle is the percentage of miles driven for business purposes compared to total miles. The regulations actually require approval from the IRS to compute business use of an automobile on a measurement other than mileage.¹⁹

As previously noted, for both the actual method or the standard mileage method, business and total mileage must be documented.

For every expenditure related to listed property, the following documentation is needed:

- The amount for the use of the listed property, which for autos starts with the mileage traveled;
- Date(s);
- Destination; and
- Business purpose for each expenditure, or the business benefit expected to be gained.

There are many court cases regarding these documentation requirements. For example, the submission of a calendar was deemed inconclusive because of weak descriptions of the nature of the business transacted and the actual miles driven to or from the destinations.²⁰

In another case, instead of using odometer readings on a contemporaneous basis, mileage was recorded based on a computer atlas database (i.e., Google Maps). Here, the IRS was successful in arguing insufficient documentation.²¹

CFMs should be mindful that IRS auditors have taken very stringent positions regarding this type of documentation.

Business Expenses – From the Employee’s Perspective

Prior to 2018, employees who received allowances for expenses that were *not* paid through an accountable plan could deduct their travel costs as part of the “miscellaneous” expense on Schedule A of their Form 1040. That is, the portion greater than 2% of their adjusted gross income was deducted. However, as a part of the TCJA for the years 2018 through 2025, miscellaneous expenses are no longer

deductible on Schedule A.²² The options for the employee are two-fold:

- 1) Ask for the amounts received to be grossed up so that there are sufficient amounts received to pay the tax on the additional income, or
- 2) Report the business expenses to the employer under an accountable plan so that the employer has sufficient documentation to deduct the expenses and the reimbursement of the actual amounts that are then excluded from income.

Sample Calculations

Example 1

In early 2019, Jones Construction Company purchases two assets: A backhoe for \$70,000 and a new \$60,000 auto for a key executive. Each asset is used 100% in the business. The backhoe, whether new or used, is entirely written off under the 100% bonus depreciation rules. The auto is listed property and used 100% for business, so depreciation is computed as follows:

- 1) First-year luxury auto cap of \$10,100 plus \$8,000 bonus for a total of \$18,100.
- 2) The \$18,100 is then multiplied by business usage of 100% for a first-year deduction of \$18,100.
- 3) The company has a written policy in place discussing the usage of company vehicles for commuting and will include \$3.00 per day in the executive’s annual W-2 compensation.
- 4) Depreciation for the auto in future years will be: \$16,100 for 2020; \$9,700 for 2021; and \$5,760 for 2022 and 2023 taxable years, respectively, with the balance for the \$60,000 vehicle in the sixth taxable year (2024).

Example 2

In early 2019, ABC Construction Company purchases a \$75,000 SUV for a key executive who, based on mileage, uses the vehicle 100% for business purposes notwithstanding a nominal amount of mileage for commuting.

The SUV’s GVW exceeds 6,000 pounds and therefore is not subject to the listed property/luxury auto dollar caps. First-year depreciation is \$75,000 because 100% bonus depreciation is elected for this qualified property placed in service after September 27, 2017, and before January 1, 2023. Also, in the executive’s annual W-2 compensation, the company includes an amount for personal use and commuting in accordance with the company’s written policies.

Example 3A

In late 2017, Bill's Construction Company purchases a new \$55,000 vehicle for a key executive. Bill's Construction Company traded in an SUV with \$2,500 of remaining, undepreciated tax basis. The SUV's fair value was \$12,500 and accordingly reduced the purchase cost of the new vehicle from \$55,000 to \$42,500 (not including sales taxes and other costs).

While there is a \$10,000 gain realized on the disposition of the SUV (\$12,500 fair value less \$2,500 basis), the gain is deferred for tax purposes. The new vehicle's tax basis for depreciation purposes is \$45,000; that is \$55,000 reduced by the deferred gain of \$10,000.

Example 3B

The facts are the same as Example 3A, but the transaction took place in early 2018. Because of the change under the TCJA, the tax basis for depreciation purposes of the new vehicle (\$55,000) is *not* reduced by the deferred gain of \$10,000.

The \$10,000 gain is recognized by Bill's Construction Company, and it is likely that all depreciation recapture is taxed as ordinary income. The new \$55,000 auto is listed property that faces the luxury auto caps for depreciation purposes.

Summary

As you can see, the CFM must establish policies and systems to ensure that company vehicle expenditures are properly recorded and documented. CFMs should also consult with their tax advisor to ensure that their company is maximizing vehicle-related tax deductions. ■

Endnotes

1. Treas. Reg. §1.274-5(k)(2)(i).
2. Treas. Reg. §1.274-5(k)(2)(ii).
3. IRC §280F(b)(1).
4. Rev. Proc. 2019-26.

5. IRC §168(k)(2)(B)(i).
6. IRC §168(k)(2)(F)(i).
7. IRC §168(k)(2)(A)(iii) and §168(k)(2)(F)(i).
8. Section 13303(a) of TCJA limited Section 1031 exchanges to real property.
9. Rev. Proc. 2019-26; the threshold is unchanged from 2018 found in IRS 2018 Publication 463.
10. IRS Publication 463 (2018) Cat. No. 11081L; Rev. Proc. 2010-51 (4)(.01), (7)(.07); Rev. Proc. 2010-51 (7)(.08).
11. IRS Notice 2019-02 Section 3.
12. IRS Notice 2019-02 Section 3.
13. IRS Publication 463 (2018) Cat. No. 11081L.
14. Rev. Proc. 2010-51 (4)(.03); §163; §164.
15. IRS Publication 463 (2018) Cat. No. 11081L.
16. Treas. Reg. §1.61-21(f)(3).
17. Treas. Reg. §1.61-21(f)(1).
18. Treas. Reg. §1.274-5T(e)(2)(i).
19. Treas. Reg. §1.274-5T(b)(6)(1)(B).
20. Iraj Mahdavi v. Commissioner (Tax Ct. 2010). T.C. Summary Opinion 2010-178.
21. Olsen v. Commissioner (83. T.C.M. 1236) (2002). T.C. Memo. 2002-42.
22. IRC §67(g).

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