

Tax Considerations of the Personal Use of Employer Provided Vehicles

Employer Provided vehicles for employees or 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. However, there are certain pitfalls to this arrangement if you are not aware of the tax consequences. Generally speaking, if the Employer Provided vehicle is used entirely for Employer Provided business, there are no consequences to the employee. The business is allowed a deduction for 100% of the vehicle's expenses. If the Employer Provided allows the employees or Employer Provided 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 Employer Provided (i.e. – free use of a Employer Provided 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 Employer Provided vehicle. Business use of a Employer Provided 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. If you are using a Employer Provided vehicle, you are required to keep a log to keep track of all trips taken in the car. The log should include the date, mileage of the trip and purpose of the trip. 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. If you did not complete a log during the year, you may still be able to determine your business vs. personal use of a Employer Provided 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 a completed vehicle log and can not 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, “Any use of a Employer Provided-

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 Employer Provided 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 mileage rate (\$.51 for January through June 2011; \$.555 for July through December 2011) 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 (\$15,300 autos, \$16,000 truck or van for 2010), and meet the regular use requirements.

Valuation for the commuting rule is based on \$1.50 per one-way commute (per employee). To qualify for this method you must (1) provide the vehicle for bona fide business purposes and require the employee(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, (3) if the vehicle is an automobile it cannot be used by a control employee.

Most employees 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. I like to use 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. 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 should be shown 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 Employer Provided 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.

The key thing to remember if you are an employee or employer in this situation is that good recordkeeping is essential to avoid understating or overstating your tax liability.

