

Your Business: Buying vs. Leasing Your Vehicle

Filing Guide

Deduct car and truck expenses on [Schedule C, Form 1065](#), or [Form 1120](#).

Use [Form 4562](#) to report depreciation and first-year expensing.

IRS Publication 463:
[Travel, Entertainment, Gift, and Car Expenses](#)

Tax Savers

Trucks and truck-based SUVs with gross vehicle weight ratings of more than 6,000 pounds aren't subject to the depreciation limits that apply to passenger cars. Code Section 179 lets you deduct up to \$25,000 of the purchase price for those types of vehicles in the first year.⁵

- You can use first-year expensing for a vehicle you buy as late as December 31.
- You can expense a new or used vehicle.
- BUP must be above 50%.
- If BUP later drops below 50%, you'll have to recapture the difference between your actual deduction and what you could have depreciated using the straight-line method.

First-year expensing doesn't let you deduct more than you could otherwise depreciate. You just get to deduct it faster. And you're still responsible for financing, maintaining, and insuring the vehicle. So don't buy an SUV just for the tax breaks. But don't miss the savings if it's what you really want.

Sources

¹Rev. Proc. 2005-13.

²IRC §1231(a).

³Rev. Proc. 2005-13.

⁴IRS Pub. 463, page 23 (2005).

⁵IRC §179.

Choosing whether to buy or lease your vehicle is a common dilemma. Buying — especially full-size trucks, vans, or SUVs weighing over 6,000 pounds — yields bigger up-front deductions, and possible gain or loss when you sell. Leasing yields steadier deductions as you go along. Most authorities agree that leasing costs more — but gets you more car for the money in the short run.

If you *buy* your vehicle, you'll depreciate it over five or more years. Your actual deduction depends on your business use percentage (“BUP”).¹

- If BUP is more than 50%, use “accelerated” depreciation: 20% in Year 1 (or 5% if you buy after September 30), 32% in Year 2, 19.2% in Year 3, 11.52% in Years 4 and 5, and 5.76% in Year 6.
- If BUP is 50% or less or you're subject to the Alternative Minimum Tax, use straight-line depreciation: 10% in Year 1, 20% in Years 2-5, and 10% in Year 6.
- Special dollar limits cap deductions for passenger vehicles with gross vehicle weights under 6,000 pounds. Those limits are \$3,060 in Year 1; \$4,900 in Year 2; \$2,850 in Year 3; and \$1,775 thereafter. For 2008 only, you can claim up to \$8,000 in “bonus depreciation” for qualifying new (not used) passenger cars.
- Your actual deduction equals your BUP times the annual percentage limit — but not more than the annual dollar limit.
- Selling your vehicle may produce a taxable gain or loss. Start with your basis when you place the vehicle in service (actual cost if placed in service new, or fair market value if used). Subtract any depreciation taken to calculate your adjusted basis, then subtract your sale price to calculate gain or loss. If your sale price is *more* than your adjusted basis, you'll “recapture” any gain attributable to business use. This is ordinary income, but not subject to self-employment tax.² If your sale price is *less* than your adjusted basis, you can deduct any loss attributable to business use.
- If selling the vehicle outright will result in a taxable gain, you can trade it in instead, treat it as a 1031 exchange, and roll the gain into the replacement vehicle.

If you *lease* your vehicle, you'll deduct the BUP of your lease payment — along with these twists:

- If the vehicle's value when you place it in service tops \$15,500 (\$16,400 for trucks and vans), you'll add back a small “exclusion” amount intended to limit your deduction to what you could have depreciated had you *bought* the vehicle.³
- If you make advanced rent or capitalized cost reduction payments, you can deduct them over the course of the lease.⁴