Supplying Employees with a Company Car

Buying or leasing an auto for the use of your employees ought to be an uncomplicated transaction from the tax viewpoint, but it's not. The plain fact is that the company auto creates more tax complications than almost any other type of business asset. That's why it's imperative for you to formulate an overall strategy with our experts, one that yields the maximum in tax savings, while keeping your paperwork and administrative burden at a minimum. This strategy will take into account the special rules that apply to your deductions for the company auto, the tax consequences of an employee's personal use of a company auto, and the payroll implications of such personal usage.

As a general rule, your company can claim depreciation deductions for the full cost of a purchased company auto, or fully deduct its lease cost if it rents the car, as long as the value of the employee's personal use of the car is treated as fringe benefit compensation income. However, there are extra complications if the car is what the tax law considers to be a luxury auto. For cars bought or leases commencing in 2002, for example, this means a car valued at approximately $15,300. Depreciation deductions are artificially low for purchased company autos that fall in the "luxury" class, which means it will take longer to recover your cost. And if your company leases a "luxury" company auto, it will wind up with a special add-back to income (called the lease inclusion amount) that varies with the value of the car and the year of the lease.

The employee's personal use of the company auto creates a separate category of tax complications. That's because the value of the employee's personal mileage must be treated as noncash fringe benefit income that is taxable to the employee, but not deductible by the company (its deductions consist of depreciation or lease deductions and operating costs). There are four separate ways to value employee personal mileage, and each of them carries its own rules and conditions. Three of the four methods require detailed record keeping of business and personal usage.

The fringe benefit value of personal use of the company auto generally is subject to federal income tax withholding and FICA tax. However, your company can elect not to withhold federal income tax if it properly notifies affected employees of this choice. In addition, your company can choose to treat the company car as having been used entirely for personal travel. This option will greatly simplify the company's record keeping burden, but usually will create extra taxable income for your employees.

Although the rules for company autos are complex, we can show you how to minimize their impact on your bottom line, on your payroll department, and on your employees. Please do not hesitate to call at your convenience for an appointment.