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ADVANTAGES/DISADVANTAGES OF USING STANDARD MILEAGE RATE FOR BUSINESS AUTO USE IN 2003

The IRS has announced the optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) will be 36 cents for business travel after 2002. That's a half-cent drop from the 36.5 cents allowance for 2002 business travel. The primary reason for the decrease, is the decline in gas prices during the twelve-month period ending on June 30, 2002.

After going up two years in a row by 2 cents a mile, the standard mileage rate has reversed course and dropped. The lower rate may make it more worthwhile for business-auto owners to deduct actual expenses plus depreciation instead of using the mileage rate.

Even taxpayers who are eligible to use the mileage allowance in 2002 may be better off forgoing it and deducting actual expenses plus depreciation if they bought a new auto this year and use it more than 50% for business use. Under the special first-year depreciation allowance rules applicable to business autos, first-year depreciation on the auto can be as high as $7,660, or $4,600 more than the generally applicable $3,060 first year depreciation dollar cap on autos first placed in service in 2002.

SIMPLIFIED DEDUCTION METHOD

The mileage allowance deduction replaces separate deductions for lease payments (or depreciation if the car is purchased), maintenance, repairs, tires, gas, oil, insurance, license and registration fees. The taxpayer may, however, claim separate deductions for parking fees and tolls connected to business driving.

The standard mileage rate can be used for a purchased auto only if:

- the auto was previously depreciated using straight-line only for its estimated useful life;
- a Code Sec. 179 expensing deduction was not claimed for the auto;
- the taxpayer did not depreciate the auto using MACRS under Code Sec. 168;
- the vehicle is not used for hire, such as a taxicab;
- two or more autos are not used simultaneously, such as in fleet operations. However, a taxpayer isn't considered to be using two or more cars at the same time if he alternates using the cars for business.

Rural mail carriers who receive qualified reimbursements also can't use the mileage rate.

A taxpayer who uses the mileage allowance method for an auto he owns may switch in a later year to deducting the business connected portion of actual expenses, so long as he depreciates it from that point on using straight line depreciation over the auto's remaining life. The depreciation deductions would still

be subject to the dollar caps.

A taxpayer may use the mileage allowance method for a leased auto only if he uses that method (or a FAVR allowance method) for the entire lease period including renewals. If the lease period began before 1998, this rule applies only for the post-1997 portion of the lease period including renewals.

OTHER BUSINESS MILEAGE RATE RULES

For 2003, the depreciation component of the mileage rate increases to 16 cents a mile (it was 15 cents for 2002 and 2001, 14 cents for 2000, and 12 cents for 1997 through 1999), which reduces the basis of the auto for gain or loss purposes.

ADVANTAGES OF USING STANDARD MILEAGE RATE

For those taxpayers eligible to use it, the standard mileage rate offers the following advantages:

- Mileage rate users need not keep a record of actual expenses, or retain receipts where required. A record of the time, place, business purpose and number of miles traveled suffices.
- If an auto's business expenses are deducted via the mileage rate, it is not subject to the dollar caps, or the special rules that apply if qualified business use does not exceed 50% of total use.
- The mileage rate method may yield bigger deductions than the actual expense method, if the driver's business mileage is high, his auto is not eligible for the special first-year depreciation allowance (e.g., he bought it used) and it is a thrifty, high-mileage model.

DISADVANTAGES OF MILEAGE RATE METHOD

The mileage rate method may produce a smaller deduction than would be obtained by claiming actual business-connected operating expenses plus depreciation (or lease payments). That's particularly true if the auto is eligible for a larger first-year depreciation allowance. Also, use of the mileage rate method prevents the taxpayer from claiming regular MACRS deductions (subject to the luxury auto dollar caps) for the auto in later years.

OTHER APPLICATIONS OF MILEAGE ALLOWANCE METHOD

Employers that require employees to supply their own autos may reimburse them at 36 cents a mile for employment-connected business mileage during 2003, whether the autos are owned or leased. The reimbursement will be treated as a tax-free accountable-plan reimbursement if the employee substantiates the time, place, business purpose and mileage of each trip. Additionally, an employee's personal use of lower-priced company autos during 2003 may be valued at 36 cents per mile if certain conditions are met.

OTHER MILEAGE RULES FOR 2003

Employers may use a fixed and variable rate (FAVR) method to reimburse employees

who supply their own cars for business (whether the cars are leased or owned). For 2003, the standard auto cost used to compute the FAVR cannot exceed $26,900, which is $200 lower than the $27,100 standard-auto cost that applies under the FAVR method for 2002. In addition, for 2003, the rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction is 12 cents a mile (it was 13 cents a mile for 2002). The mileage rate for driving an auto for charitable use during 2003 will remain unchanged at 14 cents a mile (an unindexed statutory rate).

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