

## Contemplating On Buying Or Leasing An Auto?



■ By **BLAKE CHRISTIAN**

**S**ettling on purchasing or leasing a vehicle is a complex decision. One must weigh emotional and economic factors, as well as the tax implications if the vehicle will be used for business.

A few Web sites which allow you to compare a lease to a purchase include bloomberg.com, leaseguide.com and autos.yahoo.com.

On average, 30 to 50 percent of a vehicle's value evaporates during the first three years. Another 25 to 30 percent of value disappears during years four and five. This estimated market decrease, or "depreciation," is built into each monthly payment on a lease. However, when purchasing, the buyer bears the entire risk of value decrease when he or she sells the car.

Generally, leases make the most sense for higher-priced vehicles that may be held for relatively short periods (three to four years), as well as for new models without long track records. Leases allow consumers to return vehicles after a specified lease period. Even with some additional costs inherent in leases, less money is generally tied up in a leased vehicle.

Other reasons to lease a vehicle include minimizing the risk of changes in the economy, color/body style changes or gas-price fluctuations, which could reduce resale values. You would look pretty smart today if you leased (rather than bought) a Hummer in 2003 when gas prices were cheaper.

### Tax Aspects Of Purchase Versus Lease

To claim any tax benefit (other than DMV fees or possibly sales tax), vehicles must have some business or charitable use. Owners of purchased vehicles claim deductions in the form of depreciation based on IRS tables. Lessees claim tax deductions based on the business percentage of each lease payment.

The maximum first-year depreciation deduction for a vehicle purchased in 2006 is only \$2,960, with varying amounts in later years. That stretches the tax recovery period to over 20 years on a \$50,000 car. Depreciation can be accelerated through "Section 179 expensing" for vehicles weighing more than 6,000 pounds.

The government also requires an "auto lease inclusion" tax add-back when a leased vehicle's value exceeds \$15,200. This inclusion has less impact than the aforementioned depreciation limits. For example, a \$50,000 passenger automobile (36-month lease) acquired in 2006, resulting in annual lease payments of \$10,992, would add-back only \$233 in 2006, for a net tax deduction of \$10,759 for a vehicle used 100 percent for business (a rarity).

In summary, generally consider purchasing if:

- You are buying a vehicle weighing more than 6,000 pounds.
- You are buying a vehicle under \$30,000.
- You use the vehicle for less than 25 percent business use.
- You have plenty of cash or have easy access to low-interest loans.
- You are inclined to keep your vehicle for five years or more, or average more than 15,000 miles per year.

And consider leasing if:

- You prefer luxury cars.
- You tend to want a new car every three to four years.
- You want to minimize monthly payments and up-front investment.
- You use the car for business and want to maximize deductions.
- You don't like the hassle of selling your old car.
- You are buying a "unibody" car, a new design or a wild color.

### Tax Implications Of Purchase Versus Lease

#### 1. Can I take a tax deduction?

**Purchase:** Only on the portion used for business (personal use is a nondeductible expenditure).

**Lease:** Only on the portion used for business (personal use is a nondeductible expenditure).

#### 2. How is the tax deduction determined?

**Purchase:** The original cost of the vehicle is depreciated over a number of years, which depends on the price and weight of the vehicle.

**Lease:** The lease payments are deductible in the year payments are actually made.

#### 3. Are there limitations to the amount of the tax deduction?

**Purchase:** If the vehicle is 6,000 pounds or less, the luxury auto limitations restrict the amount of the depreciation deduction taken in a given year and lengthens the time in which the benefits of a tax deduction are realized, depending on the purchase price of the vehicle.

**Lease:** The auto lease inclusion is netted against the amount of the lease payment deductions (No. 2 above). Since the lease payment includes sales tax, depreciation and other costs, the tax-deductible amount under a lease is typically higher than a purchase.

#### 4. On what types of vehicles do the above limitations apply?

**Purchase:** Vehicles with a "gross vehicle weight" of 6,000 pounds or less. Sample vehicles that would not be subject to the limitations range from the Ford Expedition and Dodge Durango to the Hummer H2.

**Lease:** Vehicles with a "gross vehicle weight" of 6,000 pounds or less. Sample vehicles that would not be subject to the limitations range from the Ford Expedition and Dodge Durango to the Hummer H2.

#### 5. At what fair market value (FMV) of the vehicle do the limitations begin to apply?

**Purchase:** For 2006, FMV approximately in excess of \$14,800 for "passenger autos"; FMV in excess of \$16,300 for "trucks and vans"; and FMV in excess of \$44,900 for "electric vehicles."

**Lease:** For 2006, FMV in excess of \$15,200 for "passenger autos"; FMV in excess of \$16,700 for "trucks and vans"; and FMV in excess of \$45,000 for "electric vehicles."

#### 6. Is the interest expense deductible?

**Purchase:** The interest expense incurred on the financing of the vehicle is deductible (not subject to limitations in No. 5 above), to the extent that the vehicle is used for business.

**Lease:** With leases, the term for interest is called the "money factor." The "money factor" is built into the lease payments, and therefore, there is an indirect minor limitation through the "auto lease inclusion" rules.

#### 7. Can I take a Section 179 deduction in the year of acquisition?

**Purchase:** For vehicles 6,000 pounds or less, due to the "luxury auto limitations," a Section 179 expense is not allowed. However, for vehicles over 6,000 pounds and up to 14,000 pounds, the maximum Section 179 deduction for 2006 is \$25,000 for both federal and California. For vehicles more than 14,000 pounds, the maximum Section 179 deductions for 2006 are \$108,000 and \$25,000 for federal and California, respectively.

**Lease:** Section 179 deduction is not allowed for a true lease.

*Note: All of the above rules only apply on the business-use portion of the vehicle.*

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