The tax-smart way to replace a business vehicle

Although a vehicle's value typically drops fairly rapidly, the tax rules limit the amount of annual depreciation that can be claimed on most cars and light trucks. Thus, when it's time to replace a vehicle used in business, it's not unusual for its tax basis to be higher than its value. This can be costly tax-wise, depending on how you dispose of the vehicle:

Trade-in. If you trade a vehicle in on a new one, the undepreciated basis of the old vehicle simply tacks onto the basis of the new one — even though this extra basis generally doesn't generate any additional current depreciation because of the annual depreciation limits.

Sale. If you sell the old vehicle rather than trading it in, any excess of basis over the vehicle's value can be claimed as a deductible loss to the extent of your business use of the vehicle.

For example, if you sell a vehicle you've used 100% for business and it has an adjusted basis of $20,000 for $12,000, you'll get an immediate write-off of $8,000 ($20,000 – $12,000). If you trade in the vehicle rather than selling it, the $20,000 adjusted basis is added to the new vehicle's depreciable basis and, thanks to the annual depreciation limits, it may be years before any tax deductions are realized.

Please contact Ceschini, CPAs at (631) 474-9400 for more information about this topic and other tax and business developments – such as new IRS regulations and court decisions.