

First of all, note that a separate depreciation allowance for a car only comes into play if you choose to determine the cost of its business use by the "actual expense" method. If, instead, you use the standard mileage rate (for 2008, 50.5 cents per business mile driven through June, and 58.5 cents per business mile driven thereafter; for 2007, 48.5 cents per business mile driven), a depreciation allowance is built in as part of the rate.

If you are using the actual expense method in calculating the depreciation allowance, an automobile is treated as an asset with a 5-year recovery period. Under the regular depreciation tables, the cost of an automobile is actually depreciated over a 6-year span according to the following percentages: Year 1, 20%; Year 2, 32%, Year 3, 19.2%, Years 4 and 5, 11.52%, and Year 6, 5.76%. Six years are involved because depreciation is deemed to start in the middle of Year 1 and end in the middle of Year 6. (These percentages are not available for cars used 50% or less for business purposes. For these, straight-line depreciation is required.) (For qualified property (including automobiles) placed in service in 2008, a first-year bonus depreciation deduction of 50% applies unless the taxpayer elects out of taking the deduction; the basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.)

However, under additional limitations applicable to cars, you are limited to specified depreciation ceilings, under "luxury automobile" rules. These ceilings, which are indexed for inflation, operate to extend depreciation beyond the sixth year for cars costing more than what the total depreciation allowance would be over the six years. For cars first put in service in 2008 that are not eligible for 50% bonus depreciation, the ceiling is \$2,960 for that year; the annual ceiling amounts for later years are \$4,800 for the second year, \$2,850 for the third year, and \$1,775 for all later years. For passenger automobiles that are "qualified property" under the 50% bonus depreciation rules applicable to property placed in service in 2008, the first-year limit on depreciation is increased by \$8,000. Thus, for vehicles qualifying for the 50% bonus depreciation, the ceiling is \$10,960 for the first year, \$4,800 for the second year, \$2,850 for the third year, and \$1,775 for all later years. Higher ceiling amounts apply for certain trucks and vans (passenger autos built on a truck chassis, including SUVs and minivans) placed in service in 2008.

You cannot avoid these limitations via an election to "expense" the car (a Section 179 election). With the limitations applying, it may take longer than the regular 6 years to depreciate the entire cost of the car, if it is not disposed of sooner.

If the car is used partly for business purposes and partly for personal purposes, the limits are reduced to the business percentage. For example, the maximum depreciation deduction for a car placed in service in 2008 that is eligible for bonus depreciation and used 75% for business is \$8,220 (75% of \$10,960) for the first year. The "personal" 25% portion (\$2,740) is disallowed. If the vehicle is used 75% for business but is not eligible for bonus depreciation, the maximum depreciation deduction for the first year is \$2,220 (75% of \$2,960).

What is the impact of these limitations from the standpoint of the business decisions you must make? They raise the "after-tax" cost of automobiles used in your business. That is, the true cost of regular equipment used in the business will be its actual cost reduced by the tax benefits enjoyed via depreciation deductions. To the extent these deductions are reduced (deferred to future years actually), the tax benefits are less and the true cost is higher. It may be advisable to consider this factor in deciding how much to spend on automobiles used in your business.

Please note that these limitations cannot be avoided by leasing a "luxury" car instead of buying it. Although the mechanics of the tax rules are different with leases, essentially your taxable income is increased to mirror the tax savings you would have lost had you bought the car. (These rules do not apply to car rentals for less than 30 days.)