Module 3.3: Standard Mileage vs Actual Expenses Deductions

One of the best deductions that you can take for your small business if you have vehicle expenses is the mileage deduction. There are two ways that you can deduct mileage. The actual expense method is to take the business use percentage of all the money you spend on the vehicle during the year. This can include gas, oil repairs, tires, insurance, registration fees, licenses, lease payments, depreciation, and so forth.

The standard mileage method involves multiplying the number of business miles driven against the standard mileage rate for the year. Each year, the IRS issues what the mileage rates will be for the following year.

The standard mileage rate was created to take reduce the amount of paperwork it takes to claim this deduction. The standard mileage rate includes: fuel, maintenance, insurance, repairs, depreciation, etc. It covers everything except tolls, parking, and the business usage percentage of interest on a vehicle loan. So, you can add the tolls, parking and interest to the mileage rate, providing you document them.

The mileage rate tends to be very generous as it needs to account for those areas of the country that are more expensive to live in. So, you usually end up deducting more than you actually spend, unless you have to replace a motor or transmission or some other huge expense.

Documentation

Both of these methods require that you keep track of the mileage. If the vehicle is used 100% for business, then you only need to record what the odometer setting are on January 1st and December 31st of the year to get the total miles for the year.

If you use the vehicle for both business and personal, then you must keep a daily log of your business activities. The log must contain the following: the date, the business purpose (client name, trip to office supply or post office, etc.) and the number of miles driven to and/or from. *If you are audited and don't have this level of detail, they can disallow the entire deduction.*

You can keep this log on paper in a simple notebook or use one of the many mileage software apps available, where you just hit the start and stop buttons and it will figure the mileage for you. All you have to do is add the business purpose and then print out the report at the end of the year. You will also need year beginning and ending odometer readings to go with your log.

Restrictions on Standard Mileage Deduction

Because the standard mileage rate is such a popular deduction, the IRS has put some restrictions on who and how you can use it. If you want to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then, in later years, you can choose to use either the standard mileage rate or actual expenses.

This also means that if you pick actual expenses the year you start using the vehicle for business, you have to continue to use actual expenses for that vehicle forever. A lot of people miss this little rule.

If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.

You must make the choice to use the standard mileage rate by the due date (including extensions) of your return. You can't change this choice. However, in later years, you can switch from the standard mileage rate to the actual expenses method. If you change to the actual expenses method in a later year, but before your car is fully depreciated, you have to estimate the remaining useful life of the car and use straight line depreciation. This is something your tax preparer should be able to help you figure.

There are also some situations where the standard mileage rate is simply not allowed. You can't use the standard mileage rate if you:

- Use five or more cars at the same time (such as in fleet operations like a taxi or limousine service);
- Used actual expenses and claimed a depreciation deduction for the car using any method other than straight line, for example, MACRS; or
- Claimed a section 179 deduction on the car; or
- Claimed the special depreciation allowance (which are all discussed in module 3.6) on the car.

Figuring the Mileage

The standard mileage rate for business use is based on an annual study of the fixed and variable costs of operating an automobile. For instance,

- The standard business mileage rate for 2020 is 57.5 cents per mile
- The standard business mileage rate for 2021 is 56 cents per mile

Your vehicle expense deduction is calculated by taking the number of miles driven times the appropriate standard mileage rate. You then add to it the tolls, parking and interest percentage to obtain your final mileage deduction.

Business owners deduct the standard mileage rate for business miles in the same manner as you deduct any other business expense.

Actual Expenses

The rules for deducting actual expenses are basically the same as the standard deduction. You still must keep a mileage log if not used 100% for business and always write down the beginning and ending odometer readings.

You must keep the receipts for all of your vehicle expenses for the year and total them by category such as gas, oil, maintenance, repairs, toll, parking, etc.

If you use the vehicle 100% for business use, then the totals of all receipts is your deduction. If you use a vehicle for personal and business, then you need to figure the business use percentage. This is simple done by dividing the business miles you get from your log by the total miles for the year, which you get from our odometer readings.

This business use percentage is then multiplied against the total receipts for the year to get your deduction.

Bottom Line

While most small businesses use the standard mileage deduction because of its reduced amount of paperwork, it is still best practice to compare both methods each year (providing you used the standard mileage deduction the first year). There could be some years that you had large repair expenses that could save you some money, but the tradeoff is having to keep your receipts for all vehicle expenses for the entire year just in case.

Also, since the standard mileage rate is figured a year in advance, it doesn't take into account rising gas prices and other inflation pressures that could raise actual expenses, especially if you live in one of the more expensive parts of the country. I just want to make sure you know all of your basic options.