



Taxability and Tax Deductibility of Insurance Payments



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This proprietary program allows business owners to "have their cake and eat it too" by properly adding a business vehicle to a personal automobile policy.

Saving on Auto Insurance...Properly

Recently, we have become aware of a new automobile insurance program that helps small business owners save money and reduce risk. Offered by the Friedlander Group, this program allows business owners to properly title and insure their business automobiles.

In this program, a business (with certain restrictions) may be a named additional insured on a personal automobile policy. This means that the insurance carrier will allow (again with restrictions) business-owned vehicles to be insured on the cheaper personal policy. This immediately saves the cost of the commercial insurance premium over the personal premium, as well as making it tax deductible for the business portion of use. In essence your client has the best of both worlds. He has the most inexpensive (in relative terms) business automobile coverage, and the titling of the assets that matches the economic reality, while the risk of the carrier denying the claim (since the coverage does not match the risk) is avoided completely.

Not all carriers offer this program. The reality is, most don't. In fact, this program is just being rolled out in fall of 2006. We must stress that full disclosure to the agent and the carrier is necessary to make sure that the coverage is

done properly. Also the tax deductions available are for the business use only, and proper documentation is necessary.

Background

Many of you have clients whose first question is, "Can I write my car off on the business?"

We all know that in general the Internal Revenue Code allows a deduction for all reasonable and necessary costs and expenses incurred in the production of income. The key is the proper documentation for such expenses. Without proper substantiation, there is a risk that upon audit these expenses will be disallowed by the IRS.

For this article, we will be limiting our discussion to automobile insurance. In the past, it was not uncommon for a business owner to pay for a vehicle using their business, record it as an asset of the corporation and take depreciation deductions as appropriate for the business portion of the use of that vehicle. The corporation would pay for the insurance and appropriately deduct that expenditure as well. Since the vehicle was owned by a commercial enterprise, the appropriate insurance policy would be a commercial policy. There is nothing wrong or incorrect about this arrangement.

Saving on Auto Insurance . . .

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If a claim is denied, the savings realized by using personal insurance for a commercial policy do not seem like much of a bargain after all.

The problem that arises concerns commercial automobile insurance, which is almost universally much more expensive than private personal automobile insurance. A price difference of 50% is not uncommon. Thus, while there may be a benefit (real or perceived) to having the corporation take out and pay for the policy, the economics make that policy more expensive, thus negating the tax benefit.

Some small businesses have the company pay for the vehicle while having the title remain with the owner as an individual. The accountant may not be aware of this arrangement since rarely do accountants review the titles to the fixed assets, as analysis of the underlying documents is not required by the preparer.

At this point, the business owner insures the vehicle as part of his or her personal automobile insurance policies to enjoy the lower rates than a comparable commercial policy. The owner then has the corporation pay for the insurance. In practical terms, this arrangement has the business recording an asset and taking deductions for an asset that it does not own. Depending on the outcome of an audit, the business may still receive some deductions, but more likely the individual may recognize income since they are in effect renting the car to the business. This income might also be subject to self employment taxes, and since we are talking audit here—there are always penalties and interest. Even if the final economics do not result in significant tax issues assuming the business use rules are followed, there is the ex-

pense of the audit and the unpleasantness of the entire process. Your fees may be paid, but just how happy is your client going to be?

The problem begins when there is a claim. Despite the fact that the premiums were paid, coverage may be denied since the carrier was insuring a commercial vehicle risk on a personal automobile policy. If the vehicle was titled in the business name, yet insured as a personal policy, perhaps no insurable interest existed so that no coverage is in effect. At this point the \$1000 per year savings by using personal insurance for a commercial policy seems like not so much a bargain.

While it is not your responsibility to aggressively review or even look at underlying receipts and other client records when preparing tax returns and compilations, sitting with your client and advising them of risks and helping them correct adverse titling of assets should be a billable matter.

Further, pointing out solutions where your client can legitimately save money without risk will make you a hero. This unique policy may save your clients a thousand dollars or more, while keeping risks to a minimum.