

2010 TAX PLANNING WITH AUTOMOBILES

The following is a summary of the various income tax considerations relevant in using an automobile for business purposes. Prescribed Canada Revenue Agency rates are those in effect at December 1, 2010.

EFFECT ON EMPLOYEES – EMPLOYEE SUPPLIED VEHICLES

1. Allowances paid to employees for the use of a motor vehicle are taxable in the employee's hands unless:
 - (a) the payment of the allowance is based solely on the number of kilometres travelled for employment purposes; and,
 - (b) the employee is not reimbursed in whole or in part for expenses in respect of the same use.
2. If an employee receives an allowance which is taxable because it does not meet the requirements in (1) above, he may deduct actual expenses incurred on his tax return as long as he was both ordinarily required to carry on his duties of employment away from his employer's place of business and was required under his contract of employment to pay the travelling expenses incurred. This would necessitate the employee keeping detailed records of expenses incurred and filing form T2200 with his tax return.

Tax Tips

If an employee expects his actual expenses to exceed his car allowance, he should consider including the otherwise non-taxable allowance in his income and deducting the related expenses.

In other circumstances, a per kilometre allowance should be paid. Such an allowance should be a reasonable one based on anticipated operating costs, depreciation and interest. Canada Revenue Agency generally accepts their non-taxable reimbursement limits (described below) as being reasonable; however, higher reimbursements may be paid if they can be justified in the circumstances. Any excess over the prescribed Canada Revenue Agency rates is non-deductible to the employer.

All employees should retain records of business mileage driven, either to support per kilometre reimbursements described in (1) above or to support the proration of deductible auto expenses described in (2) above.

Employees may claim a credit on their personal income tax returns for Harmonized Sales Tax paid on unreimbursed automobile expenses which are deductible for income tax purposes, but not if you received a non-taxable (i.e. not included in your T4) automobile allowance from your employer.

EFFECT ON EMPLOYERS – EMPLOYEE SUPPLIED VEHICLES

1. Non-taxable (i.e., per kilometre) allowances are deductible by the employer up to the following maximums:

- (a) First 5,000 kms driven by an employee for business purposes in the employer's taxation year may be reimbursed at a rate of 52¢/km.
- (b) Kilometers driven in excess of 5,000 in a year may be reimbursed at a rate of 46¢/km.

Higher rates apply for driving in the Northwest or Yukon Territories.

- 2. Allowances, which are taxable in the hands of employees, will be deductible as long as they are reasonable in the circumstances.
- 3. If the employer is registered for Harmonized Sales Tax purposes, an employer in British Columbia may obtain a Harmonized Sales Tax credit of 12/112ths of non-taxable allowances paid.

EFFECT ON EMPLOYEES – EMPLOYER SUPPLIED VEHICLES

To the extent that an employee derives a benefit from an employer supplied vehicle, the employee is taxed on the value of that benefit. For tax purposes there is a benefit whenever the auto is "available for use" regardless of whether or not it is actually used by the employee.

There are two components to the taxable benefit of an employer supplied automobile:

1. Standby Charge

This is a means of taxing an individual for the capital cost of an automobile provided to him. The calculation differs depending on whether the employer leases or owns the vehicle.

Employer Owned Vehicle

Standby Charge formula:

2% x cost of auto to employer multiplied by (number of days in year auto available divided by 30)

* including H.S.T.

For example, if an employee were provided with a \$15,000 vehicle for the entire year, the standby charge would be:

$2\% \times \$15,000 \times 365/30$ (rounded to 12 months) = \$3,600

Employer Leased Vehicle

Standby Charge is equal to $2/3 \times$ lease payment*

* while auto is available to employee; including H.S.T.

For example, if an employee is provided with an auto on July 1, 2010 and the monthly lease payment (including HST) is \$400, the standby charge would be:

$2/3 \times (7 \text{ months} \times \$400) = \$1,867$

Furthermore, a reduced standby charge may apply if the vehicle's use is primarily (more than 50%) employment related. (Travel to and from an employer's place of business is generally considered to constitute personal use.) The standby charge on owned or leased vehicles as calculated above is reduced to the extent that the average monthly personal kilometres driven are less than 1,667. This is represented by the following formula:

lesser of: (a) total personal km, and

(b) number of months available x 1667

divided by the number of months available x 1667

Thus, in the above case for 2010 if the employee's personal use kilometres were 8,000 of 24,000 total kilometres driven, the standby charge would be calculated as follows:

$$\$1,867 \times \frac{8,000 \text{ km}^*}{7^{**} \times 1,667 \text{ km}} = \$1280$$

* lesser of (a) total personal km, and (b) number of months available X 1.667

** number of months automobile is available

Had the employee's personal use (in the above example) exceeded 1,667 km per month, no reduction would have been available.

Tax Tips

In an owner-manager situation, it may be beneficial to transfer a heavily depreciated vehicle from the company to the shareholders (and pay a non-taxable allowance) rather than continue to have the shareholder pay a high standby charge for use of the vehicle.

The standby charge is calculated on the original cost of a vehicle. It may be possible to reduce this charge if a vehicle has depreciated in value via a transfer within a corporate group. For example, a vehicle with an original capital cost of \$20,000 which is now worth \$10,000 could be transferred to a related company at fair market value. The standby charge would be calculated on the \$10,000 value (the capital cost to the transferee company) thereby cutting the standby charge in half.

A standby charge will also be applicable when a partnership makes an automobile available to a partner. Since the standby charge will invariably exceed the capital cost allowance that the partnership may claim on the vehicle, there is a tax cost to the partnership owning the vehicle. Partners should therefore consider transferring the ownership of automobiles from the partnership to themselves personally.

If possible, ensure that the reduced standby charge is available by minimizing the personal use of an employer provided vehicle.

2. Operating Benefit

Where an employer pays the operating expenses of a vehicle, the employee derives a benefit to the extent that the expenses relate to personal use. The computation of this benefit is based on a fixed

rate of 24¢/km of personal use. In the case of taxpayers employed principally in selling or leasing automobiles, the rate is .21¢/km.

A special election is available if the business use of a vehicle is over 50%. This election deems the operating benefit to equal one-half of the standby charge. This election might be beneficial where the capital cost of the vehicle is low and so the standby charge is correspondingly low.

Note that any reimbursement by an employee to the employer will reduce the amount of the above benefits, but reimbursement must be made within 45 days after the end of the year.

Tax Tip

Operating expenses paid personally by the employee are not considered reimbursements for purposes of reducing the taxable benefit. Either all operating costs should be paid by the employee (to avoid the 24¢/km benefit), or all costs should be paid by the employer with an appropriate employee reimbursement.

3. Harmonized Sales Tax¹

If the employer is a HST registrant, the employer may be considered to have collected HST on the automobile benefits, in which case the HST must be remitted by the employer for the reporting period that includes the last day of February of the following year.

The employer is not considered to have collected HST if:

- a) The employer is an individual or partnership and owns the vehicle, which is used less than 90% in the commercial activities of the business.
- b) The employer is not an individual or partnership (or financial institution) and owns the vehicle, which is used 50% or less in the commercial activities of the business.
- c) The vehicle is leased, is used 50% or more in non-commercial activities in the business, or the employer is a financial institution and has elected to treat it as being used 90% or more in non-commercial activities.

The amount of HST considered to have been collected in 2010:

- a) 11/111 of the sum of the standby charge reported on the T4 or T4A and any reimbursement received from the employee.
- b) 4/104 of the sum of the standby charge reported on the T4 or T4A and any reimbursement received from the employee if the employer is considered to be a large business and subject to the Temporary Recapture of Input Tax Credits for motor vehicles in BC.
- c) 4% of the sum of the operating benefit reported on the T4 or T4A and any reimbursement received from the employee.

¹ The HST commentary is specific to a person operating exclusively in BC

“LUXURY” VEHICLES

1. Vehicles Costing Over \$30,000

- (a) To the extent that a taxpayer purchases a vehicle with a cost (exclusive of Harmonized Sales Tax) exceeding \$30,000, the base for computing capital cost allowance is limited to \$30,000 plus unrefunded Harmonized Sales Tax. (Note however that if such a vehicle is provided by an employer to an employee, the standby charge is still based on the original cost to the employer.) A separate CCA class (Class 10.1) must be set up for each such vehicle.
- (b) There will be no recapture or terminal loss on vehicles described above, although 50% of CCA otherwise calculated may be claimed in the year of disposal.
- (c) When a GST/HST registrant acquires a passenger vehicle in excess of \$30,000, an input tax credit is denied on the excess amount. However, when the registrant subsequently sells the passenger vehicle, an opportunity exists to recover some of the excess input tax credit initially denied.

Example:

A GST/HST registered corporation² acquires an automobile in BC in July 2010 for \$50,000 (excluding taxes) for use primarily in its commercial activities, and sells the vehicle in December 2011 for \$40,000. The registrant pays \$6,000 HST on the purchase and is entitled to claim an ITC of up to \$3,600 (12 % of \$30,000) in the reporting period in which the vehicle was acquired. On the sale in December, the registrant will be required to collect tax of \$4,800 (12% of the \$40,000 sale price) and will be entitled to claim a further ITC determined by the following formula:

For purposes of the formula “basic tax content” of the automobile (assuming no improvements) is \$4,800 [$\$6,000 \times (\$40,000/\$50,000)$]

$$\$4,800 \times (\$6,000 - \$3,600) / \$6,000 = \$1,920$$

The total ITCs available will thus be \$5,520 (\$3,600 when purchased, plus \$1,920 on resale). The \$480, which is denied as an ITC to the registrant, represents tax paid on the purchase price of the vehicle in excess of the ceiling, to the extent the registrant has “consumed” that value of the vehicle.

These “luxury” vehicle rules only apply to passenger vehicles as defined by the Income Tax Act. A passenger vehicle includes automobiles acquired after June 17, 1987, but excluded from this definition are vans, pick-up trucks or similar vehicles which seat less than four people and are used (in the year of acquisition) primarily to transport goods and equipment for income earning purposes. Also excluded are vans or pick-up trucks which may seat more than three people if at least 90% of the use of the vehicle in the year of acquisition is to transport goods, equipment or passengers for income earning purposes.

² Not a “large business” for purposes of the temporary recapture of input tax credits

2. Interest Expense

Tax deductions for interest expense are restricted to \$300 per 30 day period per passenger vehicle.

3. Leased Vehicles

Rules are in place to restrict tax deductions for leased vehicles. They are intended to mirror the above rules such that a taxpayer cannot avoid the effect of the rules described in (1) and (2) above by leasing rather than purchasing a vehicle. Generally speaking, the maximum monthly lease payment, which may be deducted for income tax purposes, is \$800 plus H.S.T.

PARKING BENEFITS

Where employees are provided with free parking and the fair market value of the parking can be determined, Canada Revenue Agency's position is that the value of the parking constitutes a taxable benefit. Where the number of spaces provided is less than the number of employees, generally no taxable benefit will be assessed.

THE INFORMATION PROVIDED IN THIS PUBLICATION IS INTENDED FOR GENERAL PURPOSES ONLY. CARE HAS BEEN TAKEN TO ENSURE THE INFORMATION HEREIN IS ACCURATE; HOWEVER, NO REPRESENTATION IS MADE AS TO THE ACCURACY THEREOF. THE INFORMATION SHOULD NOT BE RELIED UPON TO REPLACE SPECIFIC PROFESSIONAL ADVICE.

Revised 12/10