CLAIMING AUTOMOBILE EXPENSES

Most Canadian businesses, especially small local businesses, still need to have and use a car or other vehicle for business-related purposes on a regular basis. Consequently, the significant costs of acquiring and operating a vehicle represent a non-discretionary expense for most businesses.

The general rule for businesses, whether sole proprietorships, partnerships or corporations, is that expenses incurred for the purpose of earning income from that business are deductible from business income. The amount of those expenses is subject to an overall "reasonableness" limit and, in some cases, more detailed rules limit the amount which may be claimed, or the circumstances in which a claim for expenses can be made at all.

MARIO SGRO CHARTERED ACCOUNTANT
PROFESSIONAL CORPORATION

The rules governing the deduction of automobile-related expenses have a well deserved reputation for being complex, excessively detailed and subject to frequent revision. Nonetheless, due to the fact that almost every business, small or large, must incur automobile-related expenses in the course of carrying on that business, a basic understanding of those rules is something of a necessity.

What follows is a general outline of the rules governing the deduction of automobile-related expenses for businesses. However, the complexity of the rules is such that any business which incurs a significant amount of motor vehicle expenses is well-advised to seek advice from a tax professional that is familiar with both those rules and the particular business, in order to ensure that the best possible tax result is obtained.

What's deductible?

The list of motor vehicle expenses which are deductible from business income is quite straightforward; it is the rules which limit or circumscribe the amount of such deductions, depending on the kind of vehicle involved, which can create confusion.

Generally, the following motor vehicle expenses are deductible in the computation of income from a business:

- licence and registration fees:
- the cost of fuel and oil;
- maintenance and repair charges;
- insurance;
- interest on money borrowed to buy a motor vehicle;
- leasing costs; and
- capital cost allowance.

To be deducted on the annual return, motor vehicle expenses claimed by a business must be "reasonable" and must be supported by receipts. As well, it's necessary for the business owner to keep track of the total kilometers driven and the number of kilometers driven to earn business income. Specifically, the CRA requires business owners to record, for each business trip, the date, destination, purpose and number of kilometers driven (as shown on the vehicle odometer). At one time, keeping such records meant maintaining a written vehicle logbook, but technology has made such record-keeping less onerous, through the use of any one of a number of smartphone apps or software programs.

Keeping such logs means a lot of record-keeping, even with the assistance of technology. The CRA, as part of its efforts to reduce the administrative burden placed on small businesses, provides business owners with the option of using simplified logbook rules. A change made starting in 2009 allows small businesses the choice of keeping a detailed logbook for one complete year, in order to establish a base year. In future years, the business can use a three-month sample logbook in order to predict business use of the vehicle for the entire year, as long as the usage is within 10% of the results of the base year.

While the formula used to determine that usage is complex, it's easier to understand when applied to a specific fact situation, as in the following example taken from the CRA website.

Example

An individual has completed a logbook for a full 12-month period, which showed a business use percentage in each quarter of 52/46/39/67 and an annual business use of the vehicle as 49%. In a subsequent year, a logbook was maintained for a three-month sample period during April, May and June, which showed the business use as 51%. In the base year, the percentage of business use of the vehicle for the months April, May and June was 46%. The business use of the vehicle would be calculated as follows:

$$(51\% \div 46\%) \times 49\% = 54\%$$

In this case, the CRA would accept, in the absence of contradictory evidence, the calculated annual business use of the vehicle for the subsequent year as 54%. (I.e., the calculated annual business use is within 10% of the annual business use in the base year - it is not lower than 39% or higher than 59%.)

Where the calculated annual business use in a later year goes up or down by more than 10% from the base year, that base year is no longer a reliable indicator of annual usage in the later year. Where that happens, the sample period logbook can be used only for the three-month period during which it was maintained. For the remainder of the year, the business owner will be required to determine the business-related use of the vehicle based on an actual record of travel (i.e. a logbook). The

CRA recommends that in those circumstances, the business owner consider establishing a new base year by maintaining a logbook for a new 12-month period.

Using one's own car for business purposes

It's often the case that small business owners – especially those who are just starting up – aren't in a financial position to purchase or lease a vehicle solely for use in the business. More often, such business owners use their current vehicle for both personal and business activities. Where that's the case, the same costs involved in maintaining and running the vehicle remain deductible, to the extent of the business use.

What that means, in practical terms, is that the business owner must keep a record of the number of kilometers driven during the year to earn business income. The ratio of that number to the total number of kilometers driven during the year will determine the percentage of most vehicle expenses which can be deducted from business income, as shown in the following example:

Brenda owns a home renovation business and has a van which she uses in the business, to pick up supplies and drive to work sites. She recorded the following information for the 2016 tax year:

Kilometres driven to earn business income.......18,000

Total kilometers driven during the year..... 24,000

Motor vehicle expenses incurred

Fuel and oil..$2,400

Licence and registration fees......................................$150

Maintenance and repairs...$450

Interest charges on car loan.......................................$600

Total motor vehicle expenses................$3,600

Of the total of 24,000 kilometers driven during the year, 18,000 or 75% of those were for business purposes. Consequently, Brenda can deduct, from business income earned during 2016, 75% of her motor vehicle expenses, or $2,700 ($3,600 × 0.75).

There are also two types of motor vehicle related costs which can be deducted in their entirety, without the need for pro-ration. The full amount of any parking fees related to business activities is deductible from business income. As well, business owners who use a personal vehicle in their business may need to obtain supplementary business insurance for the vehicle. The full cost of that supplementary business insurance is similarly deductible from business income.

Calculating the available deductions

The first three items on the listing of deductible motor vehicle expenses are relatively straightforward. Nonetheless, the CRA does provide additional information and examples to illustrate the kinds of costs that fall into each category, as follows.

Licence and registration costs

Costs incurred under this category would include fees paid for the issuance or renewal of a driver's licence, fees paid for the issuance or renewal of licence plates and for vehicle registration with the particular provincial authority.

Fuel costs

The cost of fuel purchased to operate the vehicle is deductible.

Maintenance and repairs

Usual and ordinary costs for vehicle maintenance, like the cost of oil changes, car washes, cleaning and detailing are all deductible to the business owner. Similarly, repairs needed for parts that wear out or break in the course of use of the vehicle are deductible.

Repairs needed where the vehicle has been in an accident are treated slightly differently. Such repair expenses, whether incurred to repair damages resulting from the accident to a vehicle driven by the individual or to the property of others, are deductible in full if the vehicle was being used for business purposes at the time of the accident. Any amount deductible is net after recoveries through insurance or damage claims.

Insurance

Insurance purchased by a business owner for vehicles owned by the business will be deductible in full from business income. As outlined above, where a business owner uses his or her own vehicle for business purposes and must therefore purchase supplemental business insurance, the cost of that supplemental insurance is also fully deductible when calculating business income for the year.

The rules governing the tax treatment of the next three items in the list of possible deductions – interest, leasing costs, and capital cost allowance – are the source of most of the confusion which arises with respect to these rules. All such costs are deductible, but the restrictions on those deductions and the required calculation of the amount which can be deducted can be complex.

The amount of any interest or lease cost deduction depends in the first instance on the kind of vehicle involved. While it may seem that it should be the use to which the vehicle is put (rather than the kind of vehicle) that determines the availability and amount of any deduction that's not, at least in the first instance, the case. Vehicles are classified as being either passenger vehicles or motor vehicles, and there are significant differences in the tax treatment of each. Generally, where the vehicle in question is a motor vehicle, costs arising from the business-related use of the vehicle are fully deductible. Where, however, the vehicle used is a passenger vehicle, there are usually limits and limitations placed on the amounts which can be deducted for interest, lease costs and capital cost allowance.

The CRA provides the following general description of what constitutes a motor vehicle or a passenger vehicle, for purposes of the limitations imposes on the deduction of interest, lease costs and capital cost allowance.

Motor vehicle – an automotive vehicle designed or adapted for use on highways and streets. A motor vehicle does not include a trolley bus or a vehicle designed or adapted to be operated only on rails.

Passenger vehicle – a motor vehicle designed or adapted primarily to carry people on highways and streets. It seats a driver and no more than eight passengers. Most cars, station wagons, vans, and some pick-up trucks are passenger vehicles. A passenger vehicle does not include:

- an ambulance;
- a clearly marked police or fire emergency response vehicle;
- a motor vehicle bought to use more than 50% as a taxi, a bus used in the business of transporting passengers, or a hearse used in a funeral business;
- a motor vehicle bought to sell, rent, or lease in a motor vehicle sales, rental, or leasing business;
- a motor vehicle (except a hearse) bought to use in a funeral business to transport passengers;
- a van, pick-up truck, or similar vehicle that seats no more than the driver and two passengers and that, in the tax year it was bought or

leased, was used more than 50% to transport goods and equipment to earn income;

- a van, pick-up truck, or similar vehicle that, in the tax year it was bought or leased, was used 90% or more to transport goods, equipment, or passengers to earn income;
- a pick-up truck that, in the tax year it was bought or leased, was used more than 50% to transport goods, equipment, or passengers to earn or produce income at a remote work location or at a special work site that is at least 30 kilometres from the nearest community with a population of at least 40,000; and
- a clearly marked emergency medical service vehicle used to carry paramedics and their emergency medical equipment.

To assist taxpayers in determining what kind of vehicle they own, and what tax treatment it will receive, the CRA also provides a more user-friendly summary chart on its website and in its publications. That chart identifies the kinds of vehicles frequently purchased and used by individuals and businesses, in the terms normally understood by public, outlines the percentage of business use required in each case and the resulting characterization of the vehicle for tax purposes, as follows.

Vehicle definitions

VEHICLE TYPE: Coupe, sedan, station wagon, sports car, or luxury car

SEATS (INCLUDING DRIVER): 1 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Pickup truck used to transport goods or equipment

SEATS (INCLUDING DRIVER): 1 to 3

BUSINESS USE IN YEAR BOUGHT OR LEASED: more than 50%

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Pickup truck (other than above)

SEATS (INCLUDING DRIVER): 1 to 3

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Pickup truck with extended cab used to transport goods, equipment, or passengers

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 90% or more

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Pickup truck with extended cab (other than above)

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: SUV used to transport goods, equipment, or passengers

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 90% or more

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: SUV (other than above)

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Van or minivan used to transport goods or equipment

SEATS (INCLUDING DRIVER): 1 to 3

BUSINESS USE IN YEAR BOUGHT OR LEASED: more than 50%

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Van or minivan (other than above)

SEATS (INCLUDING DRIVER): 1 to 3

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Van or minivan used to transport goods, equipment, or passengers

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 90% or more

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Van or minivan (other than above)

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

Interest on money borrowed to buy a motor or passenger vehicle

Almost no one, individual or small business, has the financial wherewithal to purchase a vehicle for cash. As well, in the current low-interest environment, vehicle manufacturers or dealers are often willing to provide financing at extremely low rates. In such circumstances, both individuals and businesses are often better off putting any "spare" cash which may be available to use in the business or investing it, and taking advantage of attractive financing options, especially where any interest paid is deductible.

Where the interest is paid in respect of a purchase of a vehicle which is classified as a motor vehicle and that motor vehicle is used to earn business income, all interest paid is deductible from business income earned.

Where, on the other hand, the vehicle is classified as a passenger vehicle, the amount of interest paid which may be deducted by the business owner is restricted. In such a case, the maximum available deduction is the lesser of the following two amounts:

- total interest paid for the year; or
- $10 times the number of days for which interest is paid.

Obviously, where the business owner has owned (and paid interest on) the passenger vehicle throughout the entire calendar year, the maximum deduction which can be claimed for interest payments made is $10 times 365 days, or $3,650. If the actual interest paid is less than $3,650, it is the actual amount of interest payments that is deductible from business income earned in the year.

Leasing costs for a vehicle

Here again, the deductibility of lease costs incurred will differ for motor vehicles and passenger vehicles. Where the business leases a motor vehicle and uses that vehicle for business purposes, it can deduct leasing costs incurred from business income, without limit.

Where, however, the leased vehicle is classified as a passenger vehicle, the amount of lease costs which are deductible is restricted. As well, the actual computation of such costs is extremely complex, involving as it does a formula which includes the suggested manufacturers' list price for the vehicle, the leasing charges and cumulative payments made, as well as the prescribed limit set by the CRA. In almost all cases, a business owner who wishes to lease a passenger vehicle and use it for business purposes should consult a professional tax advisor to determine the extent to which any lease costs incurred will be deductible from business income.

Capital cost allowance claims

As everyone knows, the value of a new vehicle drops rapidly after it is purchased. The owner of a vehicle used for business purposes is entitled (in addition to any claims for interest charges) to claim and deduct depreciation on that vehicle. In tax terms, that depreciation claim is known as capital cost allowance. As is the case with interest costs and lease costs, the availability of capital cost allowance claims will differ, depending on the kind of vehicle involved. As well, where the vehicle owned is a passenger vehicle, the CRA imposes a limit of $30,000 as the starting point of any CCA claim. In other words, even if the cost of a passenger vehicle which is used for business purposes is more than $30,000, it must be treated, for CCA purposes as having a cost of $30,000.

Any asset on which a taxpayer seeks to claim CCA must be put in to a prescribed CCA class, and that placement will determine the percentage amount of CCA which can be claimed and deducted each year. There are two classes into which vehicles used for business purposes can be allocated, depending on the kind of vehicle and its cost.

In all cases, the cost of the vehicle for capital cost allowance purposes is calculated as the cost after applicable taxes, less any GST or HST input tax credits claimed. Passenger vehicles which cost less than $30,000 are allocated to CCA class 10 and depreciated at a rate of 30%. The cost (without limitation) of a motor vehicle which is used for business purposes is also included in Class 10 and also depreciated at an annual rate of 30%.

Where the cost of a passenger vehicle exceeds $30,000, it is placed in CCA class 10.1, assigned a value of $30,000, and also depreciated at a rate of 30%.

While everyone likes to complain about the cost of buying, maintaining, insuring and operating a motor vehicle, very few of us want to live without one. For many small businesses, vehicle ownership is simply a necessity, and for many the cost of purchasing and operating that vehicle is a significant business expense. Given the sometimes complex rules which govern the deductibility of motor vehicle expenses from business income, a business owner who is considering making such an acquisition should consider obtaining professional tax advice, in order to structure the lease or purchase in the most tax-advantageous way possible.