

Use of An Automobile: Tax Consequences

January 2020

Expenses incurred for the use of an automobile for employment or business purposes present a business component that justifies their deductibility for tax purposes. The tax authorities are however concerned by the personal aspect related to the use of a vehicle by employees, shareholders and business managers. This is one reason why there are so many complex tax rules on the subject.

To help you understand these provisions, Raymond Chabot Grant Thornton prepared a summary of the rules for calculating taxable benefits, deducting automobile expenses and those pertaining to the allowances, refunds or advances paid to you by your employer.

This publication presents an overall view of the main rules applicable. Tax measures are constantly changing and their application should be assessed based on all facts and circumstances. We therefore recommend that you consult a professional before making any decisions.

We can help take you farther!



1. DEFINITIONS

For the purposes of this document, certain terms are defined as follows.

Automobile

An automobile is defined as:

- a motor vehicle designed to carry individuals (maximum of nine seats) other than:
 - an ambulance, taxi, bus, hearse;
 - a minivan with three seats or less that is being used primarily (more than 50% of the time) to transport merchandise;
 - a minivan the use of which is all or substantially all (90% or more of the time) for the transportation of goods or passengers, regardless the number of seats;
 - a pick-up truck that is used primarily for the transportation of goods, equipment or passengers in the course of earning or producing income in a location which is at least 30 kilometres outside the nearest point on the boundary of the nearest urban centre with a population of at least 40,000 people;
 - a clearly marked police car or fire emergency response vehicle, including vehicles used for emergency paramedic services. In Quebec, a written directive from the employer restricting the use of the vehicle for personal purposes and stating that the vehicle must be returned to the employer during extended absences is also required.

Cost of the Automobile

The cost of the automobile is the sum of the purchase price, including options, accessories, sales taxes, without taking account of the resale value and the amount (including sales taxes) of any additions after purchase. Any specialized equipment (for example, a radio transceiver, a cell phone, an electric winch) added to the automobile is not included in the cost of the automobile.

Operating Costs

Operating costs include gas and oil, maintenance and repair costs, license and insurance. These costs do not include interest, parking costs and highway or bridge tolls.

Leasing Costs

Leasing expenses include leasing costs as well as any associated costs paid to the lessor such as maintenance contracts, penalties for excess kilometres, terminal charges, including sales taxes. These costs do not include insurance to cover damages to the automobile or civil liability insurance premiums.

Personal Use

Personal use refers to any use of the automobile by an employee, or a person related to the employee, for purposes not related to his or her employment or business. This would include vacation trips, driving to conduct personal activities, and travel between home and work, even if the employee has to go back to work after hours to respond to an emergency, for example. However, it is generally not considered to be personal driving if the employer requires the employee to travel directly from home to a location other than the place of business to which the employee regularly reports.

2. EMPLOYEES

The automobile benefits that employees receive from their employer vary depending on whether the vehicle is leased or is owned by the employer or the employee. A benefit equal to the sum of the standby charge and operating costs has to be calculated when an employer makes an automobile available to an employee. If the vehicle belongs to the employee, the benefit will vary depending on whether the employee receives an allowance for the use of the automobile or is reimbursed for his or her expenses.

Automobile Made Available to an Employee

A taxable benefit must be calculated when employers make an automobile available to employees who have access to or control it, that is, the automobile is in their custody and available for their personal use. However, there is no taxable benefit if the automobile is used solely for business purposes **and** is not available to them for other uses.¹

The employee benefit for use of an employer's automobile includes a benefit for a standby charge **and** a benefit for operating costs.

Standby Charge

1) Employer-Owned Automobile:

$$\text{Automobile cost} \times 2\% \times \frac{\text{Number of days in year automobile is available to employee}}{30 \text{ days}}$$

¹ The Canada Revenue Agency (CRA) states that in this respect, the vehicle must be returned to the employer's premises at the end of the workday.

Automobile Salespersons

For automobile salespersons, the employer may use a 1.5% instead of a 2% rate if the following three conditions are met:

- The taxpayer is employed primarily in selling or leasing automobiles;
- An employer-owned automobile is made available to the taxpayer;
- The employer acquires at least one automobile in the year.

The cost of the automobile will be the greater of the average cost of all automobiles acquired by the employer for sale or rent during the year and the average cost of all new automobiles acquired by the employer for sale or rent during the year.

This calculation method using a reduced rate of 1.5% cannot be used to calculate the benefit for the stand-by charge in respect of an automobile made available to a shareholder (or related person) whose main activities are the sale or leasing of automobiles, unless it is reasonable to consider that the benefit is received in the shareholder's capacity as an employee. More specifically, it must be able to be shown that the benefit to the shareholder is comparable in nature and amount to the benefits generally offered to non-shareholder employees of a similar-sized corporation, in similar situations or if the benefit is offered to all of the corporation's employees.

2) Employer-Leased Automobile:

$$\text{Lease cost} \times \frac{2}{3} \times \frac{\text{Number of days in year the automobile is available to employee}}{30 \text{ days}}$$

Lump-sum Payment

If the employer makes a lump-sum payment at the beginning of the lease, this amount must be allocated over the term of the lease and added to the cost of the lease for the year. However, if this payment is made on termination of the lease, the employer may decide to either apply it to the final year of the lease or to allocate it over the term of the lease and amend the T4 / Relevé 1 forms of employees who used the vehicle. Lastly, if the lessor makes a payment to the employer, the employer may choose to either reduce the lease cost in the final year or to allocate it over the term of the lease and amend the T4 / Relevé 1 forms of the employees.

Reimbursement by Employee

The benefit is reduced by any amounts reimbursed by the employee in the year.

Reduction of Taxable Benefit

The benefit may be reduced if the following two conditions are met:

- The employee uses the automobile primarily (more than 50% of the time) for work-related purposes;
- The personal use is less than 1,667 kilometres per month.

The standby charge is calculated as follows:

$$\text{Standby charge previously calculated} \times \frac{\text{km for personal use}}{1,667 \text{ km}} \times \frac{\text{Number of days in year the automobile is available to employee}}{30}$$

Operating Cost Benefit

General Method

- For 2020, \$0.28 x number of personal-use kilometres; \$0.25 for employees employed primarily in selling or leasing automobiles;²
- Mandatory unless the employee chooses the optional method.

Optional Method

It is possible to use the optional method if the following conditions are met:

- The automobile is used primarily, i.e. more than 50% of the time, for office or employment purposes;
- The employee notifies the employer in writing before December 31 that this method will be used.

The operating costs benefit in this case is calculated as follows:

- Standby charge benefit (excluding any reimbursement by the employee) × 50%.

² Same rates as in 2019.

Reimbursement by Employees

No taxable benefits for operating costs will be calculated **if all the operating costs** actually incurred by the employer related to the personal use of the automobile by the employee are reimbursed to the employer or a related person within 45 days after year-end. If the employee reimburses the employer for part of the automobile's operating expenses in the year or no later than 45 days after the end of the year, the payment is deducted from the operating expense of the benefit otherwise calculated.

EXAMPLE³

In 2020, an employee was provided with an automobile. She drove 30,000 kilometres during the year, with 10,000 kilometres for personal use. The employer paid \$3,000 in costs associated with maintenance, licences, and insurance.

The portion of the operating expenses that relates to her personal use of the automobile is calculated as follows:

$$(10,000 \text{ km} \div 30,000 \text{ km}) \times \$3,000 = \$1,000$$

If she reimbursed her employer for the total amount of \$1,000 in the year, or no later than 45 days after the end of the year, no operating expense benefit will have to be included in her income.

However, if she reimbursed for only \$800 of the expenses in the year, or no later than 45 days after the end of the year, the operating expense benefit will amount to \$2,000, calculated as follows:

$$[10,000 \text{ km} \times 28¢/\text{km} = \$2,800] - \$800 = \$2,000$$

Benefit for electric automobiles

Although the operating costs of an electric automobile are lower than those for a car that uses gasoline, the tax authorities have confirmed that the operating costs benefit must be calculated in the same manner. However, the benefit amount calculated may be reduced by the amount of electricity costs paid personally by the employee for the personal use of the automobile.

Motor Vehicles Other Than Automobile

Personal use benefits⁴ must be calculated when an employee uses a motor vehicle not included in the definition of an automobile (e.g. minivans with three seats or less). The benefit is equal to the fair market value of the resulting benefit, for example the amount that the employee would normally pay for a similar transaction in an arm's length relation including the lease costs of a comparable vehicle as well as all the operating expenses. Alternatively, when an employee uses the vehicle solely to travel to and from work, the benefit may be based on an amount per kilometre for equivalent transportation.

Employee's Automobile

Automobile Allowance

An allowance is an amount paid by an employer to an employee to compensate expenses incurred in connection with the office or employment. There does not necessarily have to be a relation between the amount, the nature of the actual expenses incurred by the employee and the allowance received. An allowance is taxable, unless otherwise provided for in the fiscal laws. Reasonable car allowances are not taxable.

Allowance Based on Kilometres Driven

An allowance is considered reasonable if it is computed solely based on the number of kilometres driven in connection with the employment. Quebec's legislation specifically provides that the allowance must take account of the actual kilometres driven. Accordingly, it is essential for employees to keep a logbook of the actual number of kilometres driven to ensure the allowance will not be taxable. In addition, the tax authorities tend to indicate that an allowance will be reasonable if, for 2020, it is not more than \$0.59/km for the first 5,000 kilometres and \$0.53/km for any additional kilometres.⁵

If the allowance is not reasonable because it is insufficient to cover travelling costs, the employee may include the allowance in income and deduct the actual amount of the expenses if all the conditions are met. The employee must obtain the T2200 (federal) and TP-64.3 (Quebec) forms, duly signed by the employer.

If an employee receives both an allowance and a reimbursement of expenses, the total allowance is considered as exceeding a reasonable amount and must be included in income (the employee may claim expenses if the conditions are met). However, there is an exception for reimbursements of additional business insurance or parking as well as highway tolls or ferry costs, if such expenses were not taken into account in determining the allowance.

³ Example taken from the CRA Web site at <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/tmbl/bnfts/prtnng/rmbrsmnt-eng.html>.

⁴ This benefit is calculated on the basis of the actual personal use and not on the time the vehicle is available for use.

⁵ Respectively \$0.58 and \$0.52 in 2019. For the Yukon, Northwest Territories and Nunavut, the tax-exempt limit for 2020 is increased to \$0.63 for the first 5,000 kilometres driven and \$0.57 for each additional kilometre (respectively \$0.62 and \$0.56 in 2019).

Fixed or Lump-Sum Allowance (Fund Advance)

A fixed allowance is a predetermined amount paid out in advance periodically to the employee without taking into account the kilometres travelled. This allowance is taxable and the employee may deduct automobile expenses if the conditions are met. The employee must obtain the T2200 (federal) and TP-64.3 (Quebec) forms, duly signed by the employer.

However, employers sometimes prefer to pay lump-sum allowances (or fund advances) to their employees to reimburse travelling costs incurred as part of their employment. These advances are taxable since they are not based solely on the number of kilometres travelled and are considered not reasonable for tax purposes. In this particular case, the tax authorities provide an option that simplifies the procedure. The advance may be excluded from the employee's income if the following conditions are met:

- Both the rate per kilometre and the advance do not exceed a reasonable amount;
- The employer justifies the use of this method in the employee's file;
- No other provision exists for the inclusion of this advance in the employee income;
- The employee must reimburse the surplus amount if advances received exceed the allowance calculated based on the actual kilometres driven. The tax authorities do not accept the inclusion of the excess on the T4 / Relevé 1 forms. On the other hand, if the advances received are not sufficient, the employer must pay the amount to the employee.

The employee has to provide details to the employer on the number of business-purpose kilometres travelled as well as the advances received no later than the first of the following dates:

- The date of the termination of the employment;
- December 31.

Combined Allowance

When an employee receives both a per-kilometre allowance and a flat rate allowance that covers any of the same use on which the allowances are based, the combined allowance is considered not reasonable since it is not based solely on the number of kilometres for which the vehicle is used in connection with the duties of employment. Accordingly, the employee has to include the total allowance received in income and may deduct eligible automobile expenses once all the conditions are met. The employee must obtain the T2200 (federal) and TP-64.3 (Quebec) forms, duly signed by the employer.

Allowance for electric automobiles

At the date of publication, there are no specific policies on kilometrage allowances regarding electric automobiles. The general principles to determine if the allowance is reasonable in the circumstances must therefore be referred to (type of vehicle, road conditions, electricity rates, etc.).

Repayment by the employer of reasonable electricity costs paid by the employee for the use of an electric automobile for business purposes is not a taxable benefit.

Reimbursement or Advance for Travelling Expenses

Reimbursement for expenses relates to an amount that the employer pays the employee once the latter proves that expenses have clearly been incurred. There is an exact correspondence between the expenses incurred and the amount reimbursed. An advance is an amount paid to the employee to compensate him/her for the expenses to be incurred. The employee must however justify the use of the advance by providing supporting documents to the employer and remitting any unused portion of the advance. Such reimbursement or advance for expenses is not taxable, unless the expenses are of a personal nature or the Act specifies otherwise.

Expenses Incurred by Employee

An employee may claim expenses of a motor vehicle used in connection with his/her employment if the following conditions are met:

- The employee is usually required to work away from the employer's place of business;
- The employment contract requires him/her to pay his/her own automobile expenses;
- The employee has not received a non-taxable allowance for automobile expenses.

Eligible expenses include, among others, the lease costs, depreciation, interest as well as operating costs such as gas, oil, maintenance, repairs, insurance, license and registration. In addition, where the employees are in sales or negotiations of contracts for their employers, the expenses are also limited to the amount of commissions received during the year. However, this restriction does not apply to interest and depreciation expenses.

Employees must include the TP-64.3 form, duly signed by their employer, in their income tax return filed in Quebec. The federal form T2200 must also be signed by the employer but does not have to be filed with the return.

The tax authorities generally require employees to record the total number of kilometres travelled for business in a logbook, as well as the date, destination and purpose of the travels. The kilometres of the automobile at the beginning and end of the year should also be included.

Calculation of Deduction

$$\begin{aligned} & (\text{operating costs} + \text{depreciation} + \text{interest}) \times \frac{\text{employment km}}{\text{total km}} \\ \text{or} \\ & (\text{operating costs} + \text{leasing costs}) \times \frac{\text{employment km}}{\text{total km}} \end{aligned}$$

The maximum amounts eligible for depreciation, interest and leasing costs are as follows:

Capital Cost	Interest	Monthly Leasing Costs
\$30,000 + sales taxes on \$30,000 ⁶	\$10.00/day	The lesser of: <u>(Actual lease charges + sales taxes) x (\$30,000 + sales taxes on \$30,000)</u> 85% of the manufacturer's list price, tax-free (minimum \$35,294 ⁷ + sales taxes on \$35,294) or \$800 + sales taxes on \$800

Depreciation

The cost of the automobile determines its class for depreciation purposes, for vehicles other than zero-emission vehicles. Accordingly, the class will be different if the cost of the automobile is equal to or greater than the \$30,000 limit + tax (class 10.1) or lower than this amount (class 10).

Qualifying zero-emission vehicles⁸ acquired after March 18, 2019 are included in class 54. The depreciable value ceiling for vehicles in this class is \$55,000 + taxes on \$55,000.

The differences between each class are summarized in the following table:

Characteristics	Class 10	Class 10.1	Class 54
▪ Capital cost allowance (CCA rate)	30%	30%	30%
▪ Accelerated CCA in first year ⁹	45%	45%	100%
▪ Each vehicle is entered in a separate category	No ¹⁰	Yes	No
▪ A maximum capital cost	No	Yes	Yes
▪ 50% rule for net additions	No ¹¹	No ¹⁰	No
▪ Half-year rule for disposal	No	Yes	No
▪ Recapture at sale or trade in	Yes	No	Yes
▪ Terminal loss at sale or trade in	Yes	No	Yes

Parking and Repair Costs

Parking costs incurred for employment purposes are deductible, as are automobile repairs resulting from an accident that occurred during the performance of employment duties.

Electric vehicles: clarifications

Cost of electricity

When it is not possible in practice to provide supporting documents for the exact amount of electricity expenses incurred or made by a taxpayer for an electric vehicle, in the CRA's opinion, depending on the circumstances, other means to determine the expenses amount would be acceptable. For example, determining the average energy cost by kilometre driven could be a reasonable approach. In such a situation, the taxpayer must also take account of paid and free charging stations in determining costs.

⁶ Ceiling of \$55,000 + taxes on \$55,000 for qualifying zero-emission vehicles acquired after March 18, 2019.

⁷ That is, 85% of \$35,294 = \$30,000.

⁸ Qualifying zero-emission vehicles include hybrid rechargeable vehicles with a battery having a minimum capacity of 7 kWh and fully electric vehicles or fully hydrogen-powered vehicles.

⁹ Rate applicable for vehicles acquired after November 20, 2018 (after March 18, 2019 for class 54 vehicles) and available for use before 2024. Enhanced rates reduced after 2023.

¹⁰ An automobile used for both personal and employment purposes must be included in a separate class, even if it is a class 10.

¹¹ For vehicles acquired after November 20, 2018 and available for use before 2028 (rule applies to vehicles acquired before and after these dates).

“Drive Electric” program subsidy

The Quebec government “Drive Electric” program supports the acquisition of electric vehicles by providing financial assistance of up to \$8,000 on the purchase or lease of a qualifying vehicle. The CRA considers that the cost of the vehicle must not be reduced by the rebate received under this program when applying the \$30,000 ceiling for class 10.1. However, for CCA purposes, the vehicle cost must be reduced by the assistance received or receivable.

EXAMPLE¹²

An electric vehicle costing \$25,000 before the \$8,000 “Drive Electric” program rebate will be included in class 10 and an electric vehicle costing \$35,000 before the same rebate will be included in class 10.1. For purposes of the CCA, the cost amount will be \$17,000 and \$27,000 respectively for each vehicle.

Similarly, for calculating the standby benefit, the CRA considers that the amount of financial assistance received or receivable under the “Drive Electric” program does not affect the cost of the vehicle purchased by the employer. Accordingly, the taxable benefit must be calculated taking into account the cost before the rebate. If the vehicle is leased, the rebate may be considered as a lump-sum payment paid by the lessor to be prorated over the lease term.

Charging stations

The cost of a charging station for electric vehicles is a capital expenditure subject to CCA. The CRA is of the opinion that, generally, capital property installation costs are part of the capital cost of the property.

Electric vehicle charging stations set up to supply at least 90 kilowatts of continuous power are eligible for inclusion in class 43.2 (CCA rate of 50% on a declining balance basis) and those set up to supply more than 10 kilowatts but less than 90 kilowatts of continuous power are eligible for inclusion in class 43.1 (CCA rate of 30% on a declining balance basis). Charging stations included in classes 43.1 and 43.2 acquired after November 20, 2018 and available for use before 2028 give entitlement to accelerated CCA as of the first year at rates varying according to the date they become available for use.¹³ In other cases, charging stations are included in class 8 (CCA rate of 20% on a declining-balance basis).

When an employer provides an electric automobile to an employee and installs a charging station at the employee's home, the CRA considers that there is no taxable benefit provided the charging station is owned by the employer and the employer is the primary beneficiary thereof.

3. SELF-EMPLOYED INDIVIDUALS

Self-employed individuals may deduct expenses for automobile used in connection with earning business or professional income. These expenses include operating costs such as gas, oil, maintenance, repairs, insurance, license and registration as well as depreciation and interests if the individual owns the automobile or leasing costs if it is leased. These expenses are subject to the same rules and limitations as described above.

4. TRAVEL LOGBOOK

Whether you are an employee, an employer, a shareholder or a self-employed individual, there are many reasons for keeping a travel logbook. Be it for justifying an automobile expense deduction in your tax return or calculating the taxable benefit for the personal use of an automobile, keeping a travel logbook is essential.

In Quebec, any employee who benefits from an employer-provided automobile is **required** to keep a travel logbook and remit it to his or her employer no later than January 10 in the following year if the vehicle is available to the employee at year end or within 10 days of the end of the period that the vehicle was made available. Employees who do not comply with the requirement could be liable for a \$200 penalty.

Simplified Logbook

The tax authorities allow some businesses and self-employed individuals to keep a simplified travel logbook to calculate expenses relating to the business use of their vehicle. To do so, a full logbook covering a 12-month period must be maintained to determine the individual's business use of the vehicle for one base year. Once the information is gathered for this base year, a logbook for one continuous three-month period (the sample period) can be used in subsequent years to extrapolate the business use of the vehicle for these years.

Therefore, provided certain conditions are met, once the base year has been completed, self-employed individuals who choose to use the simplified logbook are permitted to maintain a full logbook relating to the business use of the vehicle for only one quarter in the year. The business use of the vehicle in the subsequent year will be calculated by multiplying business use as determined in the base year by the ratio of the sample period and base year period, as follows:

$$\frac{\text{Sample year period \%}}{\text{Base year period \%}} \times \text{Base year annual \%}$$

¹² Example taken from Question 5 of the federal tax roundtable at the October 7, 2016 APFF convention.

¹³ CCA equal to 100% of the cost in the first year until 2023, 75% in 2024 and 2025 and 55% in 2027.

EXAMPLE¹⁴

A self-employed 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 of April, May and June was 46%. The business use of the vehicle would be calculated as follows: $(51\% \div 46\%) \times 49\%$, with a business use result of 54% for the year in question.

Use of the sample period is only authorized if the distances travelled and business use of the vehicle during the three-month sample period are in the same range (10% more or less) as those of the base year and the business use in the subsequent year is in the same range as the base year. In the previous example, therefore, the 54% result is acceptable, because the calculated annual business use is within 10% of the annual business use in the base year (49%), that is, 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%, the base year is not an appropriate indicator of annual usage in that later year. In such a case, the sample period logbook would only be reliable for the three-month period it had been maintained and could not be used for the remainder of the year. In these circumstances, the taxpayer should consider establishing a new base year by maintaining a logbook for a new 12-month period.

Even though records and supporting documents are normally required to be kept for a period of six years from the end of the tax year to which they relate, the logbook for the 12-month period (base year) must be kept for a period of six years from the end of the tax year for which it is last used to establish business use.

¹⁴ Example taken from the CRA Web site at: <https://www.canada.ca/en/revenue-agency/services/what-s-new/documenting-use-a-vehicle.html>.