
FineAnswers

Answers to questions on tax and finance

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TAVANA & CO *Chartered Accountants* Tel: 416-229-2221 Fax: 416-229-2234
email: Tavana@tavana.ca web: <http://www.tavana.ca>

SHOULD YOU LEASE OR BUY THE CAR?

1) What are the factors that determine a car lease?

There are normally six factors that affect a car lease. They are the following:

- The cash price of the car.
- The term of the lease, 36 months, 48 months etc.
- The interest rate.
- The down payment.
- The residual value or the end of the lease purchase price.
- Monthly lease payments.

If you know five out of the above the sixth can be calculated.

2) How is a Capital Lease (lease to own) different from an Operating Lease?

In an operating lease the lessee has option to buy the car at the end of the term of the lease. The price of the option is determined on the estimated undepreciated value of the car. In a capital lease you are forced to buy the car or the option price is so low – usually equal to the last monthly lease payment- that effectively you own the car at the end of the lease. This kind of arrangement is like financing the purchase of the car and should therefore be treated as such.

3) Would financing the purchase of a car be better or buying it cash; ignoring the effect of taxation?

The answer lies in how much your cash is earning for you AFTER TAX. If it is lower than that charged by the lender or the bank then it makes sense to buy cash. Of course if you can deduct all of your loan interest then you should compare the BEFORE TAX amount your money is earning to the loan interest you will be saving by paying cash for the car.

4) Would leasing a car be better than financing; ignoring the effect of taxation?

Cash flow and the interest rates are the main factors that should affect your decision. If your lessor is charging you a higher interest rate, then financing is better. If monthly loan installments are too high for you then leasing would be the answer.

5) How can I figure out how much interest I am being charged by the lessor?

You can use a financial calculator to figure out the interest rate or ask your accountant.

6) How would my taxes be affected if I use my car 100% for business?

Other than running costs you can deduct your lease payments or, if you own the car, you can deduct loan interest and depreciation of your car. Also, if your business is registered for GST you may get refunded the GST you pay. (GST input credit)

7) If I use my car 100% for business can I deduct –for tax purposes - all my car expenses from business income?

No. The Income Tax Act imposes limitations on some auto expenses. The limitations are intended to curb excessive deductions relating to expensive luxury cars. These limits relate to the cost of the car and therefore the depreciation or lease expenses you are allowed to deduct. Also, the interest you are allowed to deduct is limited.

8) What are the deductible limits on depreciation and interest imposed by the Income Tax Act?

The maximum rate of depreciation per year is 15% for the first year and 30% on the undepreciated balance for the years thereafter. The maximum amount on which depreciation is allowed is \$30,000 plus Provincial Sales Tax (PST). If you are exempt from GST, \$30,000 plus PST & GST. The limit on interest deduction is \$300 per month. (these limits apply for the year 2001)

9) How are lease payments limited for tax deduction?

Similar to buying a luxury car, if you lease one your deductions are limited. There are two limitations on lease payments. The first one prorates the lease payments down by the ratio of \$30,000 (plus GST & PST) to 85% of the Manufacturers Selling Retail Price (MSRP). MSRP is usually higher than the purchase price. This lower amount cannot exceed \$800 (for year 2001) per month.

10) How would my claim for a GST input credit (refund) be affected if I use my car 100% for business?

If you have a GST registered business and not an exempt business like healthcare or childcare you can claim the GST you pay on purchasing or leasing a car. However, the GST can only be claimed on the deductible amount of the lease and on the purchase price subject to it not exceeding \$30,000-as described in paragraph 8 above.

11) How would my deductions be affected if I used my car less than 100% for business?

If you are the owner or the lessee and YOU are using the car in your business the deductions will be prorated down in the ratio of business usage (kilometers) to total usage (kilometers). If your employee uses the car you get to deduct all the interest, depreciation or lease (if the car is leased) subject to the limitations discussed above.

12) How would my GST input credit be affected if I use my car less than 100% for business?

Your GST claim can be limited or denied depending on whether the owner or lessee uses the car or the employee of the owner or lessee uses the car.

Assuming the OWNER or LESSEE is the user:

- the car must be used 90% or more for business in order to claim 100% of the GST paid.
- if the OWNER uses the car less than 90%; but uses it 10% or more for business you can claim the GST on the deductible depreciation (CCA as referred to by tax people) – prorated between business and total use. GST is totally denied if the car is used less than 10% for business.
- GST on lease payments are denied if the car is NOT used more than 50% for business.
- GST paid on the lease of a car which is used 50% or more; but less than 90% for business is refunded but prorated down in the ratio of business usage to total usage.

13) If I had to provide my employees with a car what are the ways I can structure it?

Other than just giving your employee a car; you can do any of the following:

- Give your employee a large enough raise to enable him to use the after tax increase in salary to pay for a car lease. If the employee uses the car in your business the after tax amount may be larger; as the employee may be able to deduct some of the car expenses.
- Lease a car and let your employee use it. Top up this with a salary increase large enough to generate sufficient after tax cash

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to pay for the tax assessed on the benefit of having a company car.

- Buy the car using the excess cash in your business and let your employee use it and top up his salary so that his after tax increase in salary will pay for the tax on the benefit.
- Buy the car by taking a car loan and let your employee use it and top up your employees salary so that after tax increase in salary will pay for the tax on the benefit.

14) How would I select the best way to provide my employees with a car?

This is not a simple calculation and depends on many factors; including the monthly lease, purchase cost, interest charges, Stand-by Charges (taxable benefit of the employee having a car available for use), GST input credit and the marginal tax rates of the employer and employee.

15) What is a form T2200 and when would an employer give me one?

If an employee uses, a vehicle he owns or leases, in the employer's business and certain conditions are satisfied the employer can issue a certificate stating that those conditions are met. This certificate is called *T2200* and permits the employee to claim deductible car expenses.

16) If an employee owned or leased his car what kind of deductions would the employee have and how would they be different from someone who uses the car in his or her own business?

If an employee receives a *T2200* he can deduct auto expenses based on similar principals, which allows a self-employed individual claim auto expenses.

17) What is a Stand-by Charge?

A car provided by an employer to an employee, which is not, used 100% in the business of employer gives rise to a taxable benefit to the employee. This benefit is referred to in the Income Tax Act as a Stand-by Charge. The Stand-by Charge is calculated at the rate of 2% of the cost of the car per month where the car is owned by the employer and 2/3 of the monthly lease if it is leased by the employer. The benefit

for exactly the same car if leased or owned is not usually the same.

18) Are Stand-by Charges limited to the same deductible ceilings? i.e. \$30,000 maximum for the purchase of a car and \$800 per month maximum for the lease?

No. It applies to the actual cost regardless of whether it exceeds \$30,000 or \$800 per month.

19) Do Stand-by Charges get prorated if the employee uses the car partially in the employer's business?

Not unless the car is used more than 90% in the employer's business. In which case the Stand-by Charge is prorated down in the ratio of Personal kilometers driven to 1000 (times) number of months the car is made available to the employee.

20) Can I deduct my car expenses if my employees did not use the car for business?

Yes; but the employee would be subject to a Stand-by Charge.

21) How would my ability to claim GST input credit be affected if my employee did not use the car 100% for business?

100% of the GST paid subject to limitations discussed above (**8 & 9**) can be claimed if the car is used principally for personal use that is 90% or more.

22) How can I negotiate a lease, which offers the best tax deduction?

Depending on the (**paragraph 1 above**) six parameters of your lease you should calculate the cost of each alternative minus the tax savings and GST input credit. The calculation is complicated. Generally the longer the lease and the lower the down payment the larger the benefit. .

23) How can I negotiate with my bank to get a loan that affords me the best deductions?

As mentioned above only a maximum of \$300 per month can be deducted as interest on a car loan. If your monthly interest exceeds \$300; other than lowering the interest rate or the amount borrowed there is little you can do. Generally if the term of the loan is increased a greater amount of interest can be deducted. This is because the principal gradually falls and therefore the interest calculated on the smaller principal drops. As a result, a larger portion of the interest - because of the \$300 per month ceiling - can be deducted over a longer period of time.

24) My son is over 18 years of age and is a student at University. He works for me part time. Is there an advantage in providing him with a company car rather than a larger salary?

As a shareholder, a company car confers a benefit on you or someone related to you and that benefit is calculated as a Stand-by Charge. As an employee, your son would also be subject to the same Stand-by Charge, which is calculated at 2/3 of the lease cost. The deduction allowed is 100% of the lease; subject to the car not being priced over \$30,000 and the lease not to exceed \$800 a month. As the taxable benefit is 2/3 rd. of the lease and 100% of the lease is deductible; there could be an advantage in providing your son with a leased car rather than a large salary

25) In situations where lease payments exceed the limit can one make one large upfront or terminal payment in order to reduce the monthly lease costs and therefore affect the standby-charge?

No. Such payments must be averaged and added to the lease cost.

26) In situations where lease payments exceed the limit can a large refundable deposit be placed so that the lessor can

charge a lower lease and therefore a lower amount being disallowed?

Yes; but if this deposit exceeds \$1,000 a notional interest income is imputed to the lessee at the prescribed rates advertised by Canada Customs and Revenue Agency on its website. The effect of this would be to reduce your deductible lease expenses.

Please consult with your professional tax advisor before taking any action.

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