Automobile Use By Employees

Employee-owned automobiles

Many businesses prefer to pay employees to use their own automobiles. If payments to the employee are based solely on the business kilometres driven, the payments will be deductible to the employer and considered a tax-free allowance if the payments do not exceed the prescribed rates set annually by the Canada Revenue Agency. For travel occurring in one of the provinces, the rates for 2015 are $0.55 per kilometre for the first 5,000 kilometres driven in the year (calculated on the calendar year and not the fiscal period of the employer) and $0.49 for each additional kilometre. (For travel occurring in one of the territories, the rates are $0.04 higher.)

If the employee is reimbursed for parking, toll or ferry charges, or supplementary insurance coverage that the employer requires, those payments will also be part of the tax-free allowance.

The prescribed rates are intended to reflect the main components of owning and operating an automobile, including deprecation, financing, insurance, fuel, maintenance and licensing. In some cases, the actual costs may be higher than the prescribed rates. This may be so when the employee’s automobile has higher than normal fuel consumption, or when the nature of the travel (high kilometres or significant off-road activity) affects the residual value of the automobile, resulting in higher than normal depreciation. In such cases, the employee may claim – and the employer may agree to pay – a higher rate. If the rate is reasonable in the circumstances, the payment to the employee will still be considered a tax-free allowance, but the employer will be limited to deducting the prescribed rate.

To simplify monthly record keeping, the CRA will permit payments based on a monthly estimate of kilometres to be driven with a year-end adjustment once the total distances for the year are known.

If the payment to the employee is not based solely on business kilometres driven (such as a flat monthly allowance), the payment will be deductible for the employer, but will be taxable to the employee and added to employment income for the year. The payments are considered pensionable earnings for the Canada Pension Plan (CPP) and insurable earnings for Employment Insurance (EI). The employer is required to make the necessary withholdings and remittances for income tax, CPP and EI.

If the payments to the employee are included in their employment income, the employee may be able to claim a deduction for the actual automobile expenses. The employee must obtain Form T2200 from the employer, acknowledging that the employee was required to use the automobile to perform employment duties. When preparing a tax return for the year, the employee may claim a deduction for the business portion of his or her total automobile expenses for the year (business-related kilometres divided by total kilometres). To support these expenses, the employee must maintain a log book detailing the business and personal travel in the year and copies of all expense receipts.

Employer-owned automobiles

Alternatively, the business may choose to be responsible for the ownership and operating costs of an automobile, which is then provided to the employee. The employer may deduct all of the expenses related to the ownership and operation of the automobile. (There may be restrictions on the capital cost allowance deductions or lease deduction of certain automobiles classified as passenger vehicles.) The automobile will be used by the employee in performing employment duties, but in many cases will also be used personally by the employee. At a minimum, the automobile will often be used for transportation between home and the workplace, which the CRA considers personal use. To ensure that employees do not receive a tax-free benefit in such cases, there is an extensive set of rules for calculating the benefit received by the employee and adding it to their employment income.

- **The standby charge** – If the automobile is owned, the charge is calculated as a percentage of the original cost of the automobile (2 per cent per month that the automobile is made available to the employee to a maximum of 24 per cent for the year). If the automobile is leased, the charge is calculated at 2/3 of the monthly lease cost for the months that the automobile is made available to the employee. If the personal use kilometres for the year are fewer than 20,004, a reduction in the standby charge may be claimed.
- **The operating cost benefit** – This charge is calculated as a per-kilometre charge on the personal kilometres driven in the year. For 2015, the rate has been set at $0.27 per kilometre. The employee may also elect to use 50 per cent of the standby charge if the personal use of the automobile is less than 50 per cent.
- If the employee reimburses the employer during the year for any of the costs related to their use of the automobile, the reimbursement will reduce the total of the standby charge and operating cost benefit to be included in the employee’s income. The employee is taxed on the total benefit at their marginal tax rate. As a result, the tax saved from the reimbursement will be less than the funds used for the reimbursement and there will be a net cost to the employee for the reimbursement.
- The total benefit from the use of the employer-provided automobile is considered pensionable earnings for CPP but not insurable earnings for EI purposes, and the employer will be required to make the necessary withholding and remittances for income tax and CPP.
- As with the personally owned automobile, the employee is required to maintain a log book detailing the business and personal travel in the year.

Reducing the tax consequences

Making the final decision on whether the employer or the employee should provide the automobile can be difficult. From a financial and tax perspective, the parties will seek to minimize the taxable benefit to the employee, minimize the total cost to the employer, and minimize record keeping requirements for both. General practice in the industry will be a relevant consideration so that the decision does not put the employer at a hiring disadvantage.

There are many strategies that can help to minimize the tax consequences.

Employer-owned automobiles

- Consider options to reduce the availability of the automobile, such as requiring that the automobile be left on the business premises during weekends and when the employee is away on business trips and vacation. A reduction in the available days will reduce the standby charge.
- If the employer is providing an automobile that is several years old, the standby charge is based on the original cost of the automobile. Consider a sale and leaseback arrangement to replace the higher original cost used in the standby charge with a lower lease cost based on the current value of the automobile. If the automobile has no debt, this may also provide a source of cash funds to the employer.
- For leased automobiles, consider longer lease terms to reduce the lease cost and the standby charge to the employee.
- Minimize personal driving by the employee. If the employee makes business visits on the way to or from work, they will convert what would otherwise be personal travel into business travel. If the employee has another automobile, the personally owned automobile should be used as much as possible for personal driving.

Employee-owned automobiles

- Maximize business driving by the employee. If the employee makes business visits on the way to or from work, they will convert what would otherwise be personal travel into business travel. If the employee has a second automobile, use the second automobile for personal purposes as much as possible to increase the business use of the other automobile as a percentage of its total use.
- If the employee purchases a new automobile, consider having the employer provide an interest-free or low-interest loan equal to the prescribed rate to help with the purchase of the automobile. The employee will be deemed to have received a taxable benefit on the loan equal to the difference between the prescribed rate (currently 1 per cent) and the rate charged on the loan. If the prescribed rate is less than the interest rate the employee would have paid on the financing they would otherwise have obtained, the employee will receive a tax-free benefit equal to this difference.
- If the employee is receiving a payment from the employer that will be taxable, and is able to claim a deduction for actual expenses, the employee should finance the automobile purchase. A portion of this debt will be deductible, whereas interest on other debt (such as a mortgage or a credit card) is not deductible.

Article by Bob Boser