

THE Quarterly Dividend

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FAST TRACK



The 10000 Hour Rule

Here is something you'll never find in any business textbook or magazine column pertaining to the operation of a small business. Some may indicate that a good percentage of "start-ups" take awhile to get going before they show a profit for their owners and caution readers to have access to enough capital to maintain themselves and company operations for an

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The Taxation of the "Company Car"

The two most common questions asked by taxpayers conducting a business concern the manner in which they will be taxed on the money they withdraw from their companies and how they can write-off their automobiles for income tax purposes. The answer to the first question will have to wait. This article only addresses the second.

Before going too far, it is important to understand that the question does not even come up when the taxpayer conducts his business affairs through a sole proprietorship or a partnership. In both cases, the business is considered to be an extension of the taxpayer as a "person". The taxpayer typically calculates the percentage of his vehicle usage for business purposes and allocates this portion to his total automobile expenditures (including depreciation) for the year. The figure that he "comes up with" will be his allowable automobile expense for the year.

The carrying on of a business through a corporation complicates the picture. The shareholder/employee may choose to (a) have the corporation purchase the vehicle and "allow" him to use it for business purposes; (b) have the corporation lease the vehicle and "allow" him to use it for business purposes; or (c) have the shareholder/employee own or lease the vehicle in his own name and "charge" the corporation for the amount he uses the vehicle while conducting "its" business.

This article considers the above options and examines how each is treated for income tax purposes. You will note that under options (a) and (b) the Canada Revenue Agency (CRA) assumes that the shareholder/employee will be enjoying a "benefit" that will ultimately be added to his taxable income for the year. It divides the benefit into two components, termed a "reasonable standby charge" and an "operating expense benefit". The manner in which each is calculated determines the amount that will be included in income.

It also looks at situations where the shareholder/employee charges his company for use of his car. For the past few years the CRA's suggested charge has been \$.52 for the first 5000 kilometres and \$.46/kilometre thereafter.



Compliments of

Neamtan & Associates
Chartered Accountants

Audrey L. Neamtan, B.Comm., C.A. CFP

361 Willowdale Avenue
Toronto, Ontario M2N 5A5
Phone: (416) 590-9382
Fax: (416) 590-9636
Email: audrey@neamtan.ca



Taxable Benefits - Employer Owned Auto

- Scenario: (a) corporation buys automobile for \$26637 plus HST for a total of \$30100 on Jan 1/12;
 (b) corporation provides automobile to shareholder/employee for use throughout the year;
 (c) shareholder/employee drives 21000 km during year of which 5250 km is personal;
 (d) corporation pays shareholder/employee a salary of \$21000

Calculation of taxable benefit:

Reasonable Standby Charge

(a) cost of automobile x 2%	\$30100 x 2%	<u>\$602.00</u>
(b) determine number of 30 day periods that employee had use of auto 365/30		<u>12.1666</u>
First calculation	\$602 x 12.1666	<u>\$7,324.33 (A)</u>
(c) personal kilometres driven		<u>5,250</u>
(d) CRA determined factor (fixed) (b) x 1667		<u>20,281.83</u>
Second calculation	\$5250 divided by \$20281.83	<u>0.2588 (B)</u>
Final calculation	(A) x (B)	<u>\$1,895.92 (C)</u>

Note: Shareholder/employee can re-imburse corporation up to \$7324.33 to reduce the standby charge to as low as \$NIL

Operating Expense Benefit

Choose the lesser of the following, if circumstances permit:

(e) personal kilometres driven x \$0.24/km	5250 x \$0.24	<u>\$1,260 (D)</u>
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OR

If the shareholder/employee "informs the corporation in writing" that the automobile is being used more than 50% for business purposes

(f) 50% of the reasonable standby charge (C) above		<u>\$947.96 (E)</u>
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Note: Shareholder/employee can re-imburse corporation up to \$1260.00 (\$947.96) by Feb 14, 2013 to reduce the operating expense benefit to as low as \$NIL

Assuming no re-imbursements, the shareholder/employee will add the total of (C) and (E) or \$2843.88 to his \$21000 employment earnings on his T4 slip for 2012. The total \$23,843.88 will be eligible for contributions to the Canada Pension Plan and will be included in determining his "contribution room" for RRSP's.

The shareholder/employee will require the information calculated as (A) above to determine his taxable benefits in future years. This amount will be relevant for as long as the corporation owns the automobile that he drives.

One more point. The corporation providing the taxable benefit (\$2843.88 as calculated above) must pay HST on the income inclusion at the rate of two percentage points lower than the general HST rate. If the general HST rate is 13% the employer will be responsible to remit \$312.83 (\$2843.88 x 11%) to the Receiver General.

extended period of time without drawing a "pay-cheque" from the business.

But no one can ever go out on a limb and definitively say that if the owner/manager of a business has not "made a go" of it within a certain period of time then it would be better for all concerned to "throw in the towel" and concentrate his efforts elsewhere. There are just too many variables in any business to be able to predict "success" or lack of it across the board.

While this article does not purport to have the inside knowledge as to when any particular business owner should see the "writing on the wall" and outline certain tell-tale signs that inescapably point to where the owner, by persisting in the enterprise, would only be "throwing good money after bad", I can only offer "the 10000 Hour Rule" as a way of at least giving your start-up a fighting chance of survival beyond its infancy.

The 10000 Hour Rule suggests that to master any subject an individual must practice a particular skill for 10000 hours.



Taxable Benefits - Employer Leased Auto

- Scenario: (a) corporation leases automobile for monthly cost of \$1000 plus HST or \$1130;
 (b) corporation provides automobile to shareholder/employee for use throughout the year;
 (c) shareholder/employee drives 21000 km during year of which 5250 km is personal;
 (d) corporation pays shareholder/employee a salary of \$21000

Calculation of taxable benefit:

Reasonable Standby Charge

(a) monthly lease cost is defined to include HST, maintenance contracts, excess mileage costs and lease termination fees (excluding insurance) paid to the lessor under the lease agreement		
monthly lease cost	$2/3 \times \$1130.00$	<u>\$753.33</u>
(b) determine number of 30 day periods that employee had use of auto 365/30		
		<u>12.1666</u>
First calculation	$\$753.33 \times 12.1666$	<u>\$9,165.51 (A)</u>
(c) personal kilometres driven		
		<u>5,250</u>
(d) CRA determined factor (fixed) (b) x 1667		
		<u>20,281.83</u>
Second calculation	$\$5250 \text{ divided by } \20281.83	<u>0.2588 (B)</u>
Final calculation	$(A) \times (B)$	<u>\$2,372.03 (C)</u>

Note: Shareholder/employee can re-imburse corporation up to \$2372.03 to reduce the standby charge to as low as \$NIL

Operating Expense Benefit

Choose the lesser of the following, if circumstances permit:

(e) personal kilometres driven x \$0.24/km 5250 x \$0.24	<u>\$1,260 (D)</u>
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OR

If the shareholder/employee "informs the corporation in writing" before December 31, 2012 that the automobile is being used more than 50% for business purposes

(f) 50% of the reasonable standby charge (C) above	<u>\$1,186.02 (E)</u>
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Note: Shareholder/employee can re-imburse corporation up to \$1260.00 (\$1186.02) by Feb 14, 2013 to reduce the operating expense benefit to as low as \$NIL

Assuming no re-imbursements, the shareholder/employee will add the total of (C) and (E) or \$3558.05 to his \$21000 employment earnings on his T4 slip for 2012. The total \$24,558.05 will be eligible for contributions to the Canada Pension Plan and will be included in determining his "contribution room" for RRSP's.

The shareholder/employee will require the information calculated as (A) above to determine his taxable benefits in future years. This amount will be relevant for as long as the corporation owns the automobile that he drives

One more point. The corporation providing the taxable benefit (\$3558.05 as calculated above) must pay HST on the income inclusion at the rate of two percentage points lower than the general HST rate. If the general HST rate is 13% the employer will be responsible to remit \$391.39 ($\$3558.05 \times 11\%$) to the Receiver General.

This requirement applies to all skills and crafts. If you want to become a master golfer, for example, you will need 10000 hours to hone your swing. If you want to be a master salesman, mechanic, doctor or businessman, you had better be prepared to put in your 10000 hours if you want even a chance at "success".

Calculating the amount of time is easy. If the "average" owner/manager" of a start-up conservatively works seventy-five hours per week for a period of thirty-two months he will reach the ten thousand hour plateau.

What is not so easy is figuring out how to spend your time. In this area, try the following: (a) set aside time each day to concentrate on your business. Turn off the cell phone and tune the world out, except for emergencies; (b) during that time, focus your attention exclusively on your business. Put your individual stamp on the business and shape it until it is a reflection of you; (c) participation is next. This is your business and you have to be in charge of every aspect of it. Delegate areas of your



- Scenario: (a) corporation needs access to an automobile to operate
 (b) the corporation can purchase or lease the automobile in its "name"
 (c) alternatively, the shareholder/employee may purchase or lease vehicle in his name and "charge" corporation for use of automobile
 (d) if vehicle is owned or leased by the corporation, it provides shareholder/employee with automobile throughout the year
 (e) automobile is used by the shareholder/employee for business and personal purposes throughout the year

business to others when you lack the expertise, but make sure that you understand the suggestions they come up with and insist on the final say whenever major decisions are to be made; and finally, (d) repetition. Business is really doing much of the same thing over and over again. Before you can get into a routine you have to develop strategies to address different situations as they come along. Take this time to understand the distinct nuances pertaining to a problem and how they will be addressed.

Finally, once the 10000 hours have been completed, know one last point that all masters know so well: The first 10000 hours are just the beginning. It will take a lifetime of 10000 hours to get it right.

Thanks for Your Referrals

We very much appreciate your referrals. If you know of someone who can benefit from the services we provide or who would like to receive our publication, please let us know. We will send them a copy with your compliments.

Corporation Statement of Income

	Corp Leases Vehicle	Corp Owns Vehicle	Sh/Employ Owns Veh
Revenue	100,000.00	\$100,000.00	100,000.00
Expenses			
Management salary	21,000.00	21,000.00	21,000.00 (A)
Auto - lease costs	12,000.00		(B)
Auto - amortization @ 30%	7,990.00		(C)
Auto - interest charges		1,510.00	(D)
Auto - sh charges \$.50/km			7,875.00 (E)
Auto - operating costs	4,800.00	4,800.00	
	37,800.00	35,300.00	28,875.00
Income before income taxes	62,200.00	64,700.00	71,125.00
Corporate inc taxes @ 15%	9,330.00	9,705.00	10,669.00 (F)
Net income for year	52,870.00	54,995.00	60,456.00 (G)

Shareholder/Employee Tax Position

Management salary	21,000.00	21,000.00	21,000.00 (A)
Taxable benefit (see accompanying)	3,558.00	2,844.00	
Taxable income	24,558.00	23,844.00	21,000.00
Personal income taxes (20.05%)	4,924.00	4,780.00	4,210.00 (H)

Other Considerations

Total taxes paid (F) + (H)	14,254.00	14,485.00	14,879.00 (I)
Total cash inflow to corporation and shareholder/employee (G) + (E) + (A) - (H)	68,946.00	71,215.00	85,121.00

Finally

Total cash inflow to share/employ (lease)	68,946.00	71,215.00	85,121.00
Less: lease costs			- 13,560.00
	68,946.00	71,215.00	71,561.00 (J)
Total cash inflow to share/employ (purch)	68,946.00	71,215.00	85,121.00
Less: amortization			- 7,990.00 (C)
Less: interest costs			- 1,510.00 (D)
	68,946.00	71,215.00	75,621.00 (K)

Conclusion

The most important factor in any analysis is how much the shareholder/employee retains in his "pocket" at the end of the day. This analysis indicates that in both cases (J - for leased automobiles) and (K - for purchased automobiles) the shareholder/employee would be best off if he/she purchases or leases the automobile that is being used partially for business and personal use personally and "charges" the corporation for its usage. The difference is not large in the case where the corporation purchases is purchasing the automobile but becomes more significant where the corporation leases it.

The Quarterly Dividend highlights income tax and other financial matters in general terms. We recommend that no action be taken based solely on the basis of information contained in this letter. Specific professional advice should be obtained as individual circumstances must always be taken into account. This newsletter is copyright; its reproduction in whole or part by any means, without the written permission of the copyright holder, is forbidden.