TAX TALK

Three decisions to make when you shop for a truck

Spec' the truck with the salesman. Spec' the money with your accountant.

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Shopping for a truck involves three separate decisions. There's the vehicle itself, the money to pay for it, and the taxes. Like legs on a stool, all three need to bear weight if that truck is going to help you make a good living.

I sat down with a client recently who had part one nailed down and wanted to talk about part two, the financing. We had a great discussion about leases versus loans, and as it turned out, the pros and cons for this owner/operator were about equal.

Except for one thing: taxes.

My client purchased his current truck many years ago, so its value on his capital cost allowance (CCA) schedule is very low. Indeed, when the dealer agreed to take the vehicle on a trade for $20,000 higher than the book value, it seemed like a sweet deal.

But it has tax consequences.

If my client purchases the new truck, any gain on the sale of the old one would be rolled into the new truck's CCA balance and reduce his annual CCA claim for years to come. Score one for the "con" column.

However, my client would benefit from Canada Revenue Agency's (CRA) policy that allows a 20% depreciation expense during a truck's first year. Because he'd be buying the truck in the last few months of the year, he'd probably write off far more than he actually paid out during the short time he would have owned it.

Score one for the "pro" side of purchasing, at least in the short term.

Leasing a new vehicle close to year's end doesn't offer the same tax-related benefit. In fact, if you lease, it may be better to add the vehicle at the beginning of your business year.

CRA considers that big initial lease payment a pre-paid deposit that you write off over time. You divide the down-stroke by the number of months in your contract and expense the amount each month in addition to your regular lease payments.

If you put $20,000 in cash and/or trade on a five-year lease, you need to expense an extra $333.34 over the next 60 months on top of your monthly payment.

If you end the lease early for any reason, you need to write off the remaining balance of the down payment at that time.

So if you trade in your leased vehicle after 48 months instead of carrying it to the full-term 60 months, you still have 12 months times $333.34 (equaling roughly $4,000 of value) to expense.

If my client leases the new truck, he'll have to report that $20,000 gain from the trade as income. It's a short-term consequence that could result in several thousand dollars in tax liability this year. He put a tick in the "con" column and decided a purchase made more sense for him.

Put your accountant to work

If you're thinking of adding equipment, your accountant should be able to walk you through the tax implications of purchasing and leasing. Before you make your own list of pros and cons, keep three things in mind:

1. "Buying" and "leasing" are not interchangeable terms. If your accountant advises you to "buy" a new truck, don't go out and negotiate a lease. Purchasing and leasing have totally different effects on your accounting and tax planning.

2. When you compare write-offs on leases and purchases, you're really talking about tax deferral, not tax elimination. If you spend $130,000 on a commercial truck, then you have $130,000 to expense. The difference between purchasing and leasing is just the timing of the expense.

3. Spec' the truck with the salesman, spec' the money with your accountant. Do you think the guy at the dealership is going to help you evaluate the potential short-term tax hit of taking $20,000 above book value on a trade? Of course not. He doesn't care about anything but making the sale. (No offence, salespeople.)

Once you have your truck spec'd, take a breath, call your accountant, and begin to explore which financing option is best for you. It's a big step for your business when you drop Ol' Betsy at the truck lot and ride off in a shiny new model. You don't want any lingering doubts about a tax bill down the road. □

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