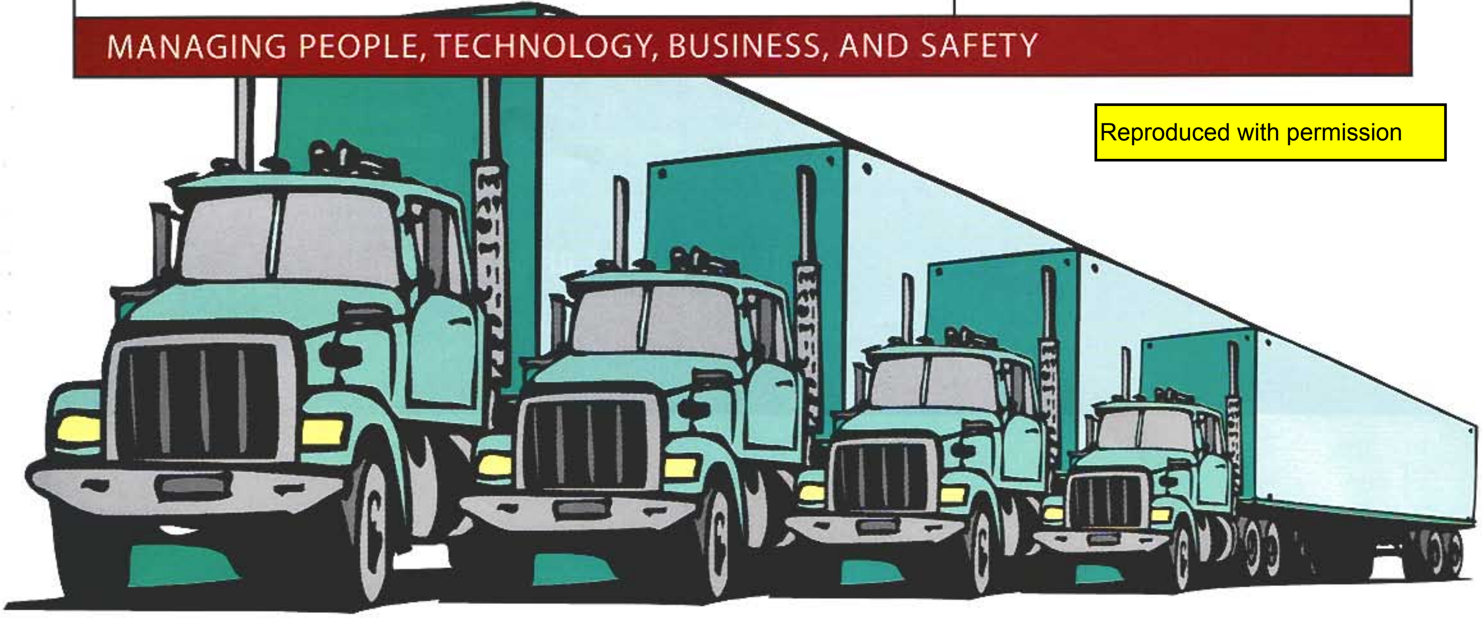

You're Allowed

depreciation *Before you get pumped up about buying your next truck, talk to your accountant about its gradual decline.*
By Stephen Petit

It's one of the bitter realities of truck ownership: from the moment you drive out of the dealer's lot, for every day that passes, for every mile you turn, your brand-new tractor will drop in value.

Accountants have a way of measuring that loss: it's called depreciation, where you deduct the value of an asset bit by bit over time rather than the entire amount in the year of purchase. Take a gander at your business and you'll see all kinds of depreciable assets: furniture, tools, machinery — generally anything you own that will wear out as it's used over the years. Highway tractors, trucks, trailers, and other vehicles are no exception.

For tax purposes, the Canada Revenue Agency (CRA) has its own ideas about the amount of time various assets should last and the rate at which they lose value. This is called Capital Cost Allowance, or CCA. Where depreciation is an accounting principle, CCA is a tax term that describes the annual maximum write-off you're allowed to apply against your business income for tax purposes as the worth of your asset declines.

Sounds straightforward enough. The trouble is, a lot of people use the terms depreciation and CCA interchangeably. They're not the same thing.

For accounting purposes, you can depreciate items in a way that makes sense for your balance sheet. For some assets, it makes sense to depreciate the value equally over the years in what's called 'straight line' depreciation. You take the purchase price of an asset, subtract what you think it'll be worth when you're through with it, and divide by the number of years the asset will have a useful life.

For other assets, a 'declining balance' method works best. The asset depreciates the most when it's newer, and progressively less in the third, fourth, and fifth years. By recording large depreciation expenses in the early years, you can reduce your tax bills. But there may be financial and tax consequences later on.

Consider a $3,000 computer. Accounting rules allow a useful life of five years for a computer; you upgrade every three years and then sell it for parts. Using straight-line depreciation, the $3,000 purchase price minus $300 approximate salvage value divided by three years is $900. That's the depreciation expense you'd report on your income statement at the end of each year.

CCA, on the other hand, is set by the government. On that $3,000 computer, CRA allows you to deduct 15 per cent the first year and 30 per cent every year thereafter. That means in your first year your maximum write-off is $450. In year two you can write off $765 but only $500 the third year. Taking the maximum CCA, after three years you'll have $1,250 on the books. A far cry from $300.

Sit down with your accountant to map out a depreciation and CCA strategy before you buy your next truck. When you do, here are five points to consider:

1 CCA RATES ARE MAXIMUMS. CRA allows high rates of CCA — higher, in fact, than the normal loss in value of the asset. The CCA on a highway tractor is 40 per cent. "Say you're a brand new owner-operator with a $133,000 truck and you take the full 40 per-cent CCA," says Scott Taylor of TFS Group, a Waterloo, Ont., accounting firm that specializes in trucking clients. "In the first two years, you're going to write off more than $67,000 for income tax purposes. Well, you didn't make $67,000 worth of payments on it. On your income statement, you end up deducting more than you've actually paid out, so therefore you're showing a net income that's less than what you really made."

Jump ahead to years three, four, and maybe five. Your CCA is used up, but your truck payment is the same. So now you're showing CRA that you're writing off less than what you really paid. Your income is artificially high, and you may be paying more tax than you should.

"It may be more advantageous for you to take 30 per cent one year, 22 per cent the next," Taylor says. "Plan ahead. You don't have to take the maximum."

2 ALIGN DEPRECIATION WITH REAL LIFE. Your financial statements should reflect the value of your assets. Overzealous depreciation rates can mislead anyone who looks at your books, especially potential lenders.

"We see companies go into a bank and the bank looks at their assets versus their liabilities and doesn't want to touch them because on the balance sheet the value of their truck is less than the loan they're paying," says Taylor. "They have to go to the time and expense to go get their truck appraised, at market value, and go back to the bank to show that they're not upside down."

3 ACCOUNT FOR IMPROVEMENTS. If you improve an asset — spend $15,000 on a new engine, for example — it may need to be added to the CCA schedule. "You get into a grey area as to whether the cost should be expensed one time, or added to the cost of the vehicle," Taylor says.

4 INCOME ON YOUR TRADE-IN. Recapture from the sale of an asset is considered income. Say you depreciate that $133,000 truck down over three years and it's on your balance sheet for $37,000 at the beginning of your fourth year. You buy a new truck and the dealer pays you $50,000 for your trade-in. You have $13,000 left over.

For tax purposes, you can roll that $13,000 into the new vehicle as long as it falls into the same CCA class as the truck you're trading in. Now, instead of the new rig coming on your books at $133,000, it can go on for $120,000. But if you go out of business, retire, or you go buy a small straight truck or something outside the CCA class for a highway tractor, then that $13,000 is taxable income.

You may also face this recapture situation if you decide to lease your next truck. "Salesmen don't talk about that," Taylor says. "Yes, under a lease you can write off what you're paying. But don't forget, you'll have to cough up tax on any income from the trade if you're taking a truck you own off the CCA schedule by converting your financing to a lease."

5 LEASE OR PURCHASE? From an overall tax deduction standpoint (CCA and interest), there was virtually no difference between a purchase scenario and a capital lease. That changed when CRA effectively revoked the capital lease option. Since then, the agency has provided little guidance about the tax implications of switching from an existing capital lease to a conventional one.

"When you trade a leased truck for another leased truck, the dealership will assess a value in comparison to the payout on the lease. Typically, you'd apply that differential to the new lease," Taylor says. "You're not receiving cash, but you are benefiting from reduced payments. CRA may see that as a taxable gain or income.

"It's hard to tell, because there's no audit history on this. But if you've had trucks on capital leases, you need to talk to your accountant about the tax implications of your next trade. Otherwise, you might find yourself with penalties and interest on top of the tax you owe." ▲

Useful Link: Canada Revenue Agency, www.cra-arc.gc.ca.

Today's Trucking

CONTACT THE EDITORS

Letters to the editors of *Today's Trucking* should include your name, address, and phone number. You can reach us at our **new mailing address:** *Today's Trucking*, 451 Attwell Dr., Etobicoke, ON M9W 5C4. By fax: 416/ 614-8861. By e-mail: *editors@todaystrucking.com.*

SUBSCRIPTION INFO

Update your subscription information online. Go to www.todaystrucking.com/subscribe and follow the links to renew your subscription or change your address. Or please mail changes to: *Today's Trucking* Circulation Dept., P.O. Box 370, Station B, Toronto, ON M9W 5L3, and enclose a copy of your mailing label.

To reach our circulation department by phone, call 416/614-2200. Have your mailing label handy so we'll be able to help you more quickly.

PROMOTE YOUR PRODUCTS

For information about how to advertise in *Today's Trucking*, either online or in the magazine, contact Jack Meli at 416/614-5824 or *jack@todaystrucking.com*. Check our web site for a full media kit.

SEE US ON THE WEB

For the latest industry news, weekly features, daily management tips, truck sales stats, product news, and more, go to www.todaystrucking.com.