Would a pickup truck by any name be as depreciable?

Moodys Tax
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On January 31, 2013, the Tax Court of Canada released *Myrdan Investments Inc. v. The Queen* and *Daniel Halyk v. The Queen*. These cases involve a business owner and the various business uses of his truck in the Alberta oil-patch. Automobile audits by the Canada Revenue Agency ("CRA") are very common. Accordingly, these cases should be of particular interest to business owners who use motor vehicles for work and to their tax advisors.

A bit of background on the statutory scheme behind these decisions is in order.

Many capital assets owned by a business will lose their value over time. The *Income Tax Act* (the "Act") permits a deduction from business income for the wear and tear on such depreciable property based on the capital cost allowance ("CCA") system.[1] A significant feature of the CCA system is that different types of assets are grouped together in prescribed classes with an assigned maximum rate for yearly depreciation. Most, but not all classes, are depreciated on a declining balance basis. In plain English, and overly simplified, a positive pool balance for a class is multiplied by the applicable class rate and the product is the CCA claim that may be made in the year.

Normally, the full amount of the capital cost of an acquisition of property in the year is added to the pool. If property is disposed of in the year, then the lesser of the amount of the original cost of the item and the disposal proceeds is applied against the pool balance to reduce it. If there are items remaining in the pool and the net pool balance is still positive, then there is no immediate taxable impact as a result of the disposition of the property. If, however, the disposed item was the last remaining item in the pool and the pool balance becomes negative, then such negative amount becomes "recaptured CCA" and is taxable. Where the net balance in these circumstances remains positive, it normally becomes a "terminal loss" and is deductible against business income.

Motor vehicles fall into one of two separate classes that, while applying the same CCA rate, treat a vehicle differently depending on its price. Class 10 includes various automotive equipment including cars and trucks. Class 10.1, on the other hand, includes property that would otherwise be included in Class 10 that is also a passenger vehicle with a capital cost in excess of $30,000.[2] Whereas items in Class 10 can be pooled together as described above, items in Class 10.1 must each be treated as a separate class.[3] Also, the Act prohibits the recapture of any undepreciated capital cost and terminal loss from being deducted from a taxpayer's income for Class 10.1 property.[4]

Back to the cases.

These appeals dealt with the 2006 and 2007 taxation years of the first appellant, Myrdan Investments Inc. ("Myrdan") and the 2007 taxation year of the second appellant, Mr. Halyk. At all relevant times, Mr. Halyk was:

- The sole shareholder of Myrdan, and

- The CEO of Total Energy Services Inc. (“Total Energy”), a public energy services company operating 30-35 branch locations in western Canada and the northwestern US.

Myrdan provided business consulting services, most notably to Total Energy, and invested in a number of businesses during the years in question.

In 2007, Myrdan traded in its old GMC Sierra pickup truck for a new one that cost $69,055, including GST. Both trucks were used for the same purpose and it is the use of these trucks that was in issue for both appellants.

The decisions in these cases hinged on whether the pickup truck was an “automobile” as that term is defined in subsection 248(1) of the Act:

“automobile” means

(a) a motor vehicle that is designed or adapted primarily to carry individuals on highways and streets and that has a seating capacity for not more than the driver and 8 passengers,

but does not include

. . .

(e) a motor vehicle

. . .

(ii) of a type commonly called a van or pick-up truck, or a similar vehicle, the use of which, in the taxation year in which it is acquired or leased, is all or substantially all for the transportation of goods, equipment or passengers in the course of gaining or producing income, or

(iii) of a type commonly called a pick-up truck that is used in the taxation year in which it is acquired or leased primarily for the transportation of goods, equipment or passengers in the course of earning or producing income at one or more locations in Canada that are

(A) described, in respect of any of the occupants of the vehicle, in subparagraph 6(6)(a)(i) or (ii), and

(B) at least 30 kilometres outside the nearest point on the boundary of the nearest urban area, as defined by the last census dictionary published by Statistics Canada before the year, that has a population of at least 40,000 individuals as determined in the last census published by Statistics Canada before the year. [Emphasis added]

Myrdan filed its corporate tax returns on the basis that the pickup trucks were Class 10 properties. Accordingly, when the old truck was traded in, Myrdan did not report any recaptured CCA since such amounts were netted against the acquisition of the new pickup truck. Myrdan was reassessed by the Minister of National Revenue (“Minister”) on the basis that both trucks were “automobiles” and therefore Class 10.1 capital property, which get separate class treatment. As a result, the disposition of the old truck resulted in the inclusion of recaptured depreciation in income (presumably since the Minister was statute barred from reclassifying the old truck); a denial of the claimed Class 10 deduction; and a recalculation of the CCA claim. Due to the Minister’s finding that the pickup trucks were automobiles, Mr. Halyk’s use of them was found to be taxable benefit.

A pickup truck will fall within the definition of an “automobile” unless it either “has a seating capacity for not more than the driver and two passengers”;[5] where the vehicle is used to transport goods, equipment, or passengers and either:

- “all or substantially all” of its use is for the purpose of gaining or producing income, or
- where it is “primarily” used in a remote work location that is far from any urban area and where the taxpayer could not reasonably be expected to establish and maintain a home.

Myrdan argued that its pickup trucks fell within the exclusions in the definition of “automobile” as highlighted above. The Crown argued that neither of the tests in subparagraphs (ii) or (iii) of paragraph (e) were satisfied when doing work for the different businesses because the truck was not being used to transport equipment for the purpose of gaining, earning or producing income for Myrdan.

Justice Hogan allowed both appeals based on his finding that the pickup trucks were not automobiles and that, although the trucks were used in several of Mr. Halyk’s businesses, these uses were still for the purpose of gaining, earning or producing income for Myrdan .

There must be an income producing purpose in moving or conveying goods or equipment in order for it to be said that they are “transported”.[6] The Court found that, at all times, Mr. Halyk carried equipment including personal safety gear and other tools for use in on-site visits to businesses Myrdan and Total Energy invested in and to remote locations. Despite the fact that the equipment and tools were always in the truck, they were still found to be “transported”. This case can be contrasted with *R. v. Myshak and R. v. 547931 Alberta Ltd.*[7] in which the taxpayers carried tools and other equipment and spare oil in their pickup trucks, respectively, at all times, but were found not to be transporting them for the purpose of producing income. Justice Hogan reasoned that all of the business activities above counted when determining the use of the vehicles. Notably, Justice Hogan found:

- Myrdan earned income, by various branch visits of Total Energy, through management fees charged to Total Energy which included an amount for his use of the truck;
- Portfolio companies invested in through a non-controlled subsidiary paid management fees, 50% of which flowed up to Myrdan; and
- Mr. Halyk’s travel to and from a controlled subsidiary’s work site was found to enhance that company’s ability to pay dividends to Myrdan, thus, it also had an income producing purpose.

Interestingly, while CRA administrative policy is that “all or substantially all” refers to 90% or more and “primarily” refers to at least 50%, this case and several cases cited within[8] emphasize the elasticity of these expressions. The Court took the view that it was entitled to flexibility in interpreting these terms and that a strict determination such as assigning a percentage or quantity (e.g. kilometres or time) to these terms was not warranted by the Act. Myrdan, therefore, satisfied the “*all or substantially all*” and “*used . . . primarily*” exclusion tests.

The determination of the use that applies for the exceptions in subparagraphs (ii) and (iii) is made in the year of acquisition. This requirement is dictated by the clear language of those sections and has lead to some curious results when taxpayers have acquired a vehicle late in a year but did not put it to its appropriate income producing use until the following year. In such circumstances, the above exceptions do not apply.

We would be remiss not to point out how the Court addressed the respondent’s arguments with respect to Mr. Halyk’s travel to remote locations. The Crown argued that where an “urban area” is driven through on the way to a remote location, the distance between that urban area and another should be

excluded when determining whether subparagraph (iii) applies. The Court focused on the ultimate destination recorded and determined that mere stop overs along the way to a remote location should not reduce the number of kilometers used for the “primarily” calculation in subparagraph (iii).

Mr. Halyk was found to have received a taxable benefit for the personal use he made of the truck, which was determined to be the travel between his home and the Total Energy office. Since the taxable benefits assessed by the CRA against Mr. Halyk from the use of the pickup truck only apply to “automobiles”, the Court was free to use other reasonable methods to determine the quantum of his taxable benefit as shareholder. The Court applied the statutory rate used to calculate employee benefits for the personal use of a passenger vehicle ($0.22/km) to the number of kilometres it found that Mr. Halyk used the pickup truck for personal use (4,320), which resulted in a shareholder benefit of $950.40. However, depending on what capacity he was visiting the Total Energy offices, it is debatable whether such travel was personal in nature.

As mentioned earlier, this case should be of interest to business owners that use their vehicles for business purposes. In the Alberta oil-patch, there is no shortage of businesses that use vehicles routinely. Dealing with CRA audits in this area can be very frustrating since the CRA will often take a hard line position when assessing business vs. personal use. The cases of *Myrdan* and *Halyk* are great examples of this. Accordingly, should you or your advisors experience a frustrating audit, one might look to the outcome of Myrdan and Halyk when disputing a negative assessment.

Of course, the outcome will depend on the particular facts and circumstances of a taxpayer, and, as the car ad reminds us, “Your mileage may vary”.

A few useful tips:

1. Keep great records of the vehicle’s use (e.g. kilometers driven, names of locations visited, etc.) especially where a vehicle has both business and personal uses. There is software and applications that can assist with this.
2. Minimize personal use of the vehicle as much as possible.
3. If feasible, use a GPS to plan more efficient routes, for an estimate of the distance and time between locations, and to track employees.
4. Keep in mind that, generally, the cost of parking at the employer’s office is considered a personal cost that is not deductible.

1. See paragraph 20(1)(a) of the Act.

2. This is a prescribed amount found in paragraph 13(7)(g) of the Act that can change over time.

3. Regulation 1101(1af) of the *Income Tax Regulation* (the “Regulations”).

4. See subsections 13(2) and 20(16.1) of the Act.
5. Subsection 248(1) “automobile” (e)(i) .

6. R. v. Myshak, [1998] CTC 2186 (TCC) at paragraph 18.

7. 2003 TCC 170 [*547931 Alberta*].

8. R. v. Pronovost, 2003 TCC 139; *547931 Alberta*, supra note 8; and *Ruhl v. Canada*, [1998] GSTC 4.