Are travel allowances still beneficial when compared to company cars?

During his 2004 Budget speech the Minister of Finance said the following: 'I am concerned about the tax loss associated with travel allowances. In the coming year, we plan to review the taxation of the motor vehicle allowances and the ad valorem duty structure on motor vehicles."

A year or two later, during his 2005 and 2006 Budget speeches, far-reaching amendments to the taxing provisions of company vehicles and travel allowances were suggested. The bulk of the changes to the taxing provisions of travel allowances were dealt with in the Taxation Laws Amendment Act 9 of 2005 that was promulgated on 19 July 2005. The Revenues Laws Amendment Act 31 of 2005 was promulgated on 1 February 2006 and contained the rest of the amendments with regards to travel allowances and company cars. A brief overview of these latest changes will firstly be provided before the comparison between the different benefits will be discussed.

Section 11(e)

It has always been the practice that a taxpayer may claim wear and tear on a qualifying asset, even if he is not the owner of it. This was based on the argument that s 11(e) refers to the value of an asset used in a taxpayer's trade and not to its cost. This argument is inconsistent with the generally accepted and long-standing interpretation by the Commissioner. The Act is now amended to place beyond doubt the fact that a taxpayer claiming the depreciation allowance must be the owner of the asset.

As it was always clear that an employee could enjoy a travel allowance for using a vehicle for business purposes even though he is not the owner of it, this change will now exclude any wear and tear on the fixed costs in calculating the actual costs expended by such an employee. It might be that because s 8(1)(b)(ii) refers to the 'portion of the allowance expended", that an employee using someone else"s vehicle (even the vehicle of a spouse if they are married out of community of property) for business purposes was not entitled to the wear and tear on the fixed cost as it was not expended by him. He should therefore make use of the deemed cost scales.

The changes to s 11(e) are to come in operation as from the commencement of years of assessment ending on or after 1 January 2006. Thus, for individuals as from 1 March 2005. (Section 11(e) still refers to value and not to the cost).

Company vehicles

To pre-empt a switch to 'company vehicles" over the short to medium term, the deemed value of a company vehicle will be increased from 1,8% a month to 2,5% a month. The effective date for this amendment is 1 March 2006. The deemed value of the second company vehicle (or any other additional number of company vehicles for that matter) remains at 4% a month.

To avoid the unfair taxation when an employee actually bears a portion of the costs for the private use of his employer's vehicle, the previous version of para 7(4)(a) provisos (i) and (ii) allowed the taxable benefit of 1,8% to be reduced as follows:

- By R120 a month when the employee bears the cost of all fuel for the purposes of private use of the vehicle;
- By R85 a month when the employee bears the full concessions of maintaining the vehicle, including, for example, the cost of its repairs and servicing it. The monetary values of these concessions were deleted and the percentage of the value of the vehicle that is taxed as a fringe benefit should now be adjusted. The 2,5% should be reduced;
- By 0,22% when the employee bears the cost of all fuel for the purposes of private use of the vehicle; and by 0,18% when the employee bears the full cost of maintaining the vehicle.

These deductions should also only be granted if the employee does not enjoy a travel allowance for the same vehicle. There was previously a possibility of a double deduction when an employee reduced the taxable portion of the travel allowance by claiming fuel and maintenance costs and then also used the same costs to reduce the taxable benefit of the private use of his employer's vehicle.

These changes will, however, not stop the practice of reducing the value as calculated for the purposes of Practice Note 24. The restriction refers only to the situation when the employee 'also" receives a travel allowance in terms of s 8(1)(b). It does not address the situation when a self-employed taxpayer who does

not maintain adequate records claims his motor vehicle expenses. A sole trader or partner could therefore still benefit from the possible double deduction.

Travel allowance

The deemed cost table is again adjusted for the year of assessment that commences on 1 March 2006. Although all values increased, the values attached to the lower cost vehicles increased proportionally more than those attached to the more expensive vehicles. The percentage of the travel allowance that is subject to monthly employees" tax also increased from 50% to 60% effective as from 1 March 2006.

Company vehicle vs Travel allowance

Individual circumstances determine whether the best tax benefit can be derived from a company vehicle or a travel allowance. With the more stringent parameters for calculating tax benefits with travel allowances and company cars, it again, however, became necessary to determine whether the company vehicle or the travel allowance is most beneficial for a specific individual. In doing this, it is important to consider:

- total kilometres covered during a year of assessment,
- the split between business and private use, and
- certain other variables.

In the following discounted cash flow model, a comparison between a company vehicle and a travel allowance is made.

Assumptions

- The motor vehicle is purchased in terms of a forty-eight month finance lease agreement. Its cost is R171 000. The finance lease will be obtained at a nominal rate of 11% a year. The lease payments are paid monthly in arrears and repay the full cost of R171 000 and interest. The motor vehicle is a 'motor car" as defined in the Value-Added Tax Act. It was purchased on 1 March 2005.
- At the end of the financing period the market value of the motor vehicle is 60% of its cost (including VAT). The lessee will take over the motor vehicle without paying any additional amount. If the employee has had the use of the vehicle, the employer will award it at the end of the forty-eight month period to him at no cost.
- Fuel and maintenance costs 0,98 per kilometer.
- Insurance costs will be R500 a month (payable at the end of each month).
- Annual licensing fee is R108 (payable at the end of the first month of each financial year).
- The computer model discounts the net after-tax cost of the different alternatives to their current value. A real rate of 12% for the employer and 10% for the employee are used.
- The tax rate of the employer is 29%.
- The marginal tax rate of the employee is 40%.
- The employer and the employee pay their tax liabilities (except PAYE) for a specific year, six months after year end. PAYE for a specific month is paid on the last day of that month.
- The employer is a category C VAT vendor. The only VAT implication taken into account is the cost of the output VAT payable on the fringe benefit of providing a company vehicle to an employee.
- The employer does not have an assessed loss brought forward from the previous year of assessment.
- The employee does not earn commission.
- With a company vehicle the employer bears all its costs, but these are financed out of the employee"s package.
- It is important to note that all the calculations are done on the assumption that the total cost of the package of the employee will be the same under both alternatives.

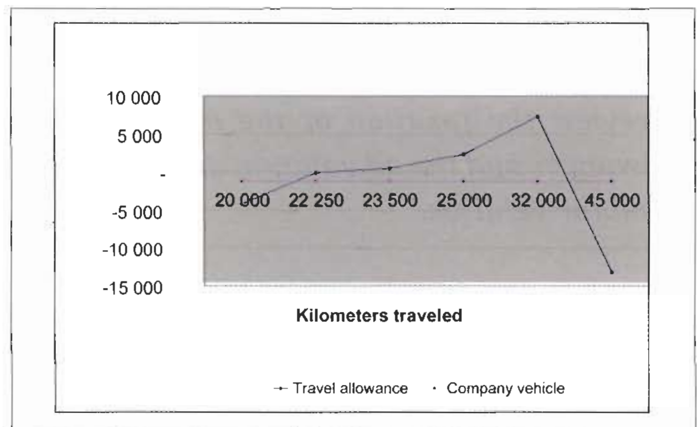
What is the best?

These assumptions are applied to different options. The net after-tax cost of the employee"s cash flow is discounted to compare the net present value of the various options.

Company vehicle vs Travel allowance: when no log book is kept

The Table below deals with the 2006 year of assessment. It covers the situation when no log book is kept.

Company vehicle vs travel allowance (2006)

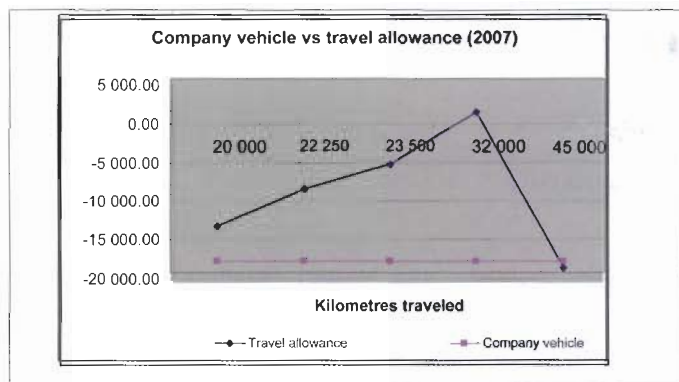


This table reveals that the travel allowance is more beneficial if more than 22 250 kilometres are travelled in a year. As the kilometres travelled increase, so does the benefit of the travel allowance. The benefit of the travel allowance will, however, decrease if more than 32 000 kilometres are travelled and no logbook being kept. If 45 000 kilometres are travelled, without any logbook being kept, the company vehicle is thus by far the better option. This conclusion should in most situations be true for vehicles valued up to and including R340 000.

The table overleaf relates to the 2007 year of assessment (including all amendments).

For the above scenario the following conclusions are reached:

- Surprisingly this table reveals that although the benefit of the travel allowance decreases, the additional tax of the fringe benefit on a company vehicle increases proportionately more. Although the actual amount of additional tax is not necessary more for the company vehicle when compared with the travel allowance, these payments are spread on a monthly basis (PAYE on a monthly remuneration) whereas the additional



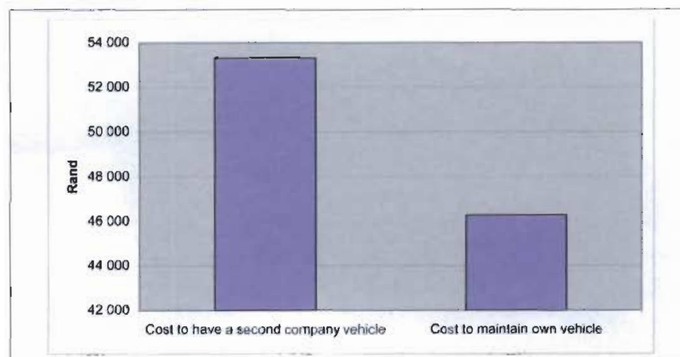
tax (or lower refund) on the travel allowance results in a cash outflow (or lower inflow) only approximately eighteen months from the beginning of a year of assessment (when the third provisional tax payment is made or when the tax assessment is finalised).

- It appears that the travel allowance should still be more beneficial if between 22 250 and 32 000 kilometres are travelled. It is also clear that the travel allowance might after all the changes in the legislation, be more beneficial than before the changes in the legislation.
- The net advantage of the travel allowance decreases in favour of the company vehicle when the percentage of business kilometres declines in relation to the total kilometres travelled. The company vehicle should also always be more beneficial if the employee travels less than the deemed private kilometres per annum. This is because no portion of the travel will then be deemed to be for business purposes.
- The opinion might be that the conclusions reached are invalid as an important cash flow was excluded in the comparison. This cash flow occures when the employer awards the employee (who is in possession of a company vehicle) a reimbursive allowance that relates to actual business usage. It is limited to 8 000 kilometres per employee per annum and it is paid at the maximum deemed rate per kilometre of R2,46. The opinion is then that, in addition to the company vehicle, an employer could thus grant an employee an additional tax-free amount of R19 680 (8 000 x R2,46) a year. The employee does not usually expend any costs for business travel but relies on the deemed costs to be set off against the travel allowance. He argues that it is only the provisions of s 8(1)(b)(ii) that disallows the users of company vehicles from setting off the deemed costs. Section 8(1)(b)(iii) applies when the allowance is based on actual distances travelled and because the deemed cost prohibition is not contained in this provision, it is argued that the deemed costs are available for set off against a travel allowance based on the actual distance travelled. It should, however, be born in mind that s 8(1)(b)(iii) specifically states that the deemed costs are available 'unless the contrary appears". In regard to this tax-avoidance 'scheme" it might be that the Commissioner argues that the 'contrary appears" and therefore the full amount of the reimbursive allowance received is taxable.

Second company vehicle

The table below compares the net present value of the cost for an employee to maintain his own motor vehicle (travelling a distance of 32 000 kilometres a year) versus the cost to acquire the same motor vehicle as a second company vehicle from the employer. No travel allowance was taken into account as it was assumed that this vehicle will only be used for private purposes (second vehicle).

The table reveals that the discounted-cash cost of having a second company vehicle is much higher than the discounted cash cost if the employee bought and maintained his own vehicle.



It follows that cash flow is not necessarily the reason why an employee chooses to receive a second company vehicle. It might be that a more luxurious model is obtained from the employer, who could be a motor vehicle manufacturer, therefore resulting in a lower cost of the vehicle to the employer and also a lower taxable fringe benefit. On the other hand, however, an employee of a motor vehicle manufacturer may be allowed to buy a car at a discounted price. This could again result in the lower discounted cash cost of an employee buying and maintaining his own vehicle. It would thus seem, however, that the Commissioner is successfully taxing the full fringe benefit of having a second company vehicle. It could be that the 'extra" amount of tax on this benefit is for the fact that the employer carries the administration burden of the vehicle.

As we assumed that the vehicle will be kept for a period of four years, it might be that a second company vehicle becomes more beneficial if an employee prefers to annually upgrade to the latest model.

Conclusion

The above conclusions were reached only for employees that do not keep a log book. When a logbook is kept, it will usually be more beneficial to have a travel allowance if the actual business travel exceeds 50% of the total kilometres travelled. It might also be that because of the R340 000 limit on the cost of the vehicle, it may be more beneficial to have a company vehicle for higher value vehicles. It is also important to remember that tax consequences should not be the only factor to consider when the choice between the two options is exercised.

The debate on company vehicle versus travelling allowances therefore continues. It is not only impossible, but also unwise to express an opinion that always promotes the one above the other. The bottom line is that the benefits derived from either option are linked to the costs and usage of the vehicle. A conclusion can be drawn only once an accurate and comprehensive comparison between the two has been made for each specific employee.