EMPLOYEE COSTS OF TOOLS

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CAN I WRITE-OFF MY TOOLS AS AN EMPLOYEE?

BACKGROUND

"Depends." This is the answer to every "quick question" when it comes to income tax.

For every rule there are exceptions. Then there are also exceptions to the exceptions - and exceptions to the exceptions of the exceptions, etc.

When it comes to tools and expenses, it is no different as we find a lot of misinformation in public forums on who, what, and when you can claim expenses for tools as an employee.

In our experience, this is commonly claimed incorrectly by laypersons filing returns themselves.

The actual formulae that apply are more complex, and the calculation does not end there. Claiming tools does not end in the year of the claim, rather they continue on for years until you dispose of them – and you might even have income to report.

In this newsletter

When it comes to claiming tool expenses it sounds simple, but many file it incorrectly and result in reassessments plus interest owing.

Which employees can claim expenses on tools?

How much can they claim?

What happens when you dispose of the tool in the future?

For previous newsletters, visit our info centre at: *https://CGLtax.ca/info_centre.html*

WHO CAN CLAIM TOOLS FOR EMPLOYMENT?

First in order to claim an expense related to employment, the employer must state that they require you to purchase tools for your employment.

The employer *(not employee)* must fill out Form ***T2200 Declaration of Conditions of Employment***.[1]

There are many questions for various types of possible expenses on this form, however we will focus on the ones relating to tools:

- Did this employee work in **forestry operations**?
- Did this employee work as a **tradesperson**?
- Did this employee work as an **apprentice mechanic**?

The T2200 form is required in order to make any claim - no form means no deduction.

NEW AND UNIMPROVED?

In 2020, the T2200 form was updated to also require the employee sign the form in addition to the employer.

We are not sure on the reasoning behind this additional step, since the employee is clearly claiming the expense, and since it is only required when the CRA requests the form, it seems unnecessarily redundant.

Unfortunately, we have already seen an audit disallowing the expenses because the ***employee's*** signature was missing from this form.

EMPLOYEES IN FORESTRY OPERATIONS

Although limited in *what* they can claim, employees working in forestry operations have less restriction on the *amount* they can claim.

With the proper paperwork, claims can be made for the very specific items and amounts of:

- cost of a chain saw or brush cutter (net of trade-in);
- interest on a loan to purchase a chain saw or brush cutter;
- insurance premiums;
- cost of fuel for saw/cutter;
- cost of repairs for saw/cutter (parts and labour);
- rental expenses of a chain saw or brush cutter; and
- cost of fuel, repairs (parts and labour), and insurance of snowmobile or all-terrain-vehicle (ATV) expenses related to employment.

Any reimbursement or tax-free allowance received from the employer must be deducted to reduce the amount of the claim.

There is no cap on the amount you can claim.

In theory, employees could start their new employment in December, incur these costs, and the deduction can be used against income from all sources prior to employment in the year.

EMPLOYEE WORKING AS A TRADESPERSON

CAPPED AMOUNT

While it is open to more industries than just being in the forest industry, there is a very small cap of $500 *(proposed to increase to $1,000 in Budget 2023).*[2]

However, what many commonly miss, is that this amount does not kick in until the tradesperson has spent more than the Canada Employment Credit.

The Canada Employment Credit is $1,368 in 2023 and does not require any actual outlay or expenses by an employee.

This means that the tradesperson who thought they would get a tax deduction for the $500 they spend on tools, is sadly mistaken.

OUTLAY REQUIRED

The tradesperson has to first spend $1,368 before getting any amount deducted, and even then it is only on the amount above that.

The tradesperson would have to spend $1,868 ($2,368 proposed) to get the full deduction of $500 ($1,000 proposed).

TAX IMPACT

Considering that the highest personal tax rate in Alberta at the time of writing is 48%, this is a maximum savings of $240 ($480 proposed) or put another way, roughly 20% at the highest end.

The reality, is that the majority of tradespersons working as employees in Alberta fall into the 30.5% tax bracket or lower.

This means the deduction-related tax-savings cap is $152.50 ($305.00 proposed). Put another way, 8.2% of total expenses (12.9% proposed).

This amount extremely small, since every employee gets the Canada Employment Credit even if they do not have any expenses.

ADDITIONAL RESTRICTION

Adding to the complexity, is that in addition to the T2200 form, a list of all tools and amounts must be first provided to the employer for their signature and date of approval for the tradesperson to claim on their return.

All amounts and receipts must be readily available in the event of a review by the Canada Revenue Agency.

Missing either of those above steps can result in a reassessment denying the expense.

EMPLOYEE WORKING AS AN APPRENTICE MECHANIC

ELIGIBILITY

As the name suggests, it is only availale to apprentice mechanics, other apprentices need not apply.

So while there is an industry restriction, the amount available to claim is not as restrictive.

APPRENTICE MECHANICS ARE TRADESPEOPLE TOO

Before the apprentice mechanic can claim any additional amount, they must first meet all the rules and spend amounts required for the tradesperson's tools credit.

This means that the apprentice mechanic has to first spend more than the tradesperson's capped amount and use it as a deduction before getting any additional amount available to be deducted under this provision.

NOT LIKE WORKING WITH TREES

Unfortunately, apprentice mechanics are unable to claim their expenses against other sources of income.

This means, using the forestry example earlier, if an apprentice mechanic starts working in December, they are not able to use their tool expenses against other sources of income earned prior to starting their employment.

STILL A CAP BUT BIGGER

The capped amount that an apprentice can claim is only if they have already used up the tradesperson tool credit.

The amount they can claim is capped at

- 5% of employment income earned as an apprentice mechanic;
- minus the toolsperson's credit.

That means for 2023, before any additional expenses can be claimed as an apprentice mechanic, the employee has to have expenses totalling more than $1,868 ($2,368 proposed) and wages from employment greater than $37,360 ($47,360 proposed).

WHAT IF THE EMPLOYEE SPENDS MORE?

For apprentice mechanics, they do have one extra "tool" for tax relief.

If they have already capped out the tradesperson's tool credit, but did not earn enough income to create more deduction room, the eligible expenses will carry forward to be used in a future year against future related income.

Disposing of tools in future years can cause income tax in the year of sale.

Tracking them properly in the year of purchase will help reduce the tax hit in the year of sale.

WHAT HAPPENS WHEN YOU SELL A TOOL?

This is a major trap that many tradespersons and apprentice mechanics are not aware of.

You are actually required to track the adjusted cost of the tools until it is disposed of and then you might have an amount to include in income.

CALCULATING THE TAX HIT

As the calculation is on a tool by tool basis, it can get a little confusing because it will change depending on the year and total tools purchased in that year.

The income inclusion is the amount that the proceeds of dispositon exceed the adjusted cost of the eligible tool.

The adjusted cost is the original cost minus the amount of the tax deduction. To illustrate this calculation let's use the following example.

A. **$1,000** = Original Cost of Tool purchased
B. **$2,200** = Deduction for all tools on tax return made from tradeperson's and apprentice mechanic deductions in year of purchase
C. **$5,000** = Total tool costs purchased that year

First we want to calculate the amount of the deduction previously claimed that relates to this specific tool. Since this tool cost 20% of the tools in that year (**$1,000** / **$5,000**) we calculate 20% of the credit received.

$2,200 x 20% = $440

Then subtract the amount calculated from the original cost to come up with the adjusted cost.

$1,000 - $440 = $560

So this formula can be expressed as:

A – [(A / C) x B]

or, it can also be expressed as:

A – [A x (B / C)]

WHY THE CALCULATION

The theory is that in the formula above you are coming up with your actual "out of pocket" cost net of any tax savings. If you sell it for less than that amount, you have no income to report.

However, if you sell it for more than that amount, then there is tax on the amount you are receiving that was originally paid to you by the government.

SO WHAT'S THE POINT?

Time value of money is one reason, a dollar saved today is worth more than paying that dollar back tomorrow thanks to inflation.

In addition, the example is showing where the tool is sold above the adjusted cost. However, many tools end up used until worn out, and are never sold.

While it does not explicitly say the reason for these calculations, one can only assume it was brought in to prevent abuse of the system which, without this recaptuning mechanism, could occur if someone did not complete their apprenticeship, and subsequently sold their tools.

IN CONCLUSION

Knowing exactly how much is eligible or amounts required in any given year can help you plan accordingly to get the maximum benefit available to you by timing your tool purchases and sales.

ENDNOTES

1 *https://www.canada.ca/en/revenue-agency/services/forms-publications/forms/t2200.html*
2 Budget 2023 was announced on March 28, 2023, with this change to be effective for 2023 and subsequent taxation years.