

### Income Tax

IMP. 1136-15/R4      The Financing of Vehicles Purchased for Resale  
Date of publication:      June 30, 2011

Reference(s):      *Taxation Act* (CQLR, c. I-3), sections 1136 and 1137

*This version of interpretation bulletin IMP. 1136-15 supersedes the version of September 30, 2003. The bulletin was revised to ensure it is relevant and up to date. Even though the capital tax rate is nil for the calendar year 2011 and subsequent calendar years, the interpretation remains valid and useful for determining the paid-up capital of a corporation, since paid-up capital is still a relevant concept with respect to various tax measures.*

The purpose of this bulletin is to explain how transactions made by a corporate dealership (hereinafter a “dealership”), in connection with the financing of vehicles purchased for resale, affect the computation of its paid-up capital.

#### APPLICATION OF THE ACT

1. To determine a dealership’s paid-up capital, it is important to examine the various transactions made in connection with the financing of new or used vehicles purchased for resale.
2. The financing process can be described as follows. A dealership acquires the vehicles required to operate its business from a manufacturer under an instalment sales contract. The first paragraph of article 1745 of the *Civil Code of Québec* defines an instalment sale as a term sale by which the seller reserves ownership of the property until full payment of the sale price. Generally speaking, the dealership authorizes a financing corporation, by means of a wholesale merchandise financing agreement (a line of credit), to pay the manufacturer directly for the vehicles ordered. Once the financing corporation has paid for the vehicles, the manufacturer assigns and transfers all its rights in the contracts of sale to the financing corporation.
3. In *Autobus Thomas Inc. v. Canada* (2000 D.T.C. 6299), which was affirmed by the Supreme Court of Canada (2001 SCC 64, [2001] 3 S.C.R. 5), the Federal Court of Appeal mentions that such transactions cannot be considered in isolation or out of context; the various contractual operations must be examined to determine the intent of the parties. It was held that, in a situation such as the one described in point 2 of this bulletin, the money the dealership owes the financing corporation constitutes a loan and the amount must be included in computing the dealership’s paid-up capital pursuant to paragraph (d) of subsection 1 of section 1136 of the *Taxation Act* (TA).

The contractual relationship between the dealership and the financing corporation is determined by the initial contract between them when the line of credit was established. The line of credit constitutes loan commitment and the use of the line of credit gives effect to the loan. The transfer of the instalment sales contract from the manufacturer to the financing corporation provides security for payment of the money loaned.

**4.** Where a dealership purchases used vehicles for resale, the amount that must be included in computing the dealership's paid-up capital depends on the transactions between the parties. If the transaction is financed by a financing corporation in a situation such as the one described in point 2 of this bulletin, the amount of the loan must be included in the dealership's paid-up capital pursuant to paragraph (d) of subsection (1) of section 1136 of the TA. If the transaction is financed by the seller, the balance of the sale price must be included in the dealership's paid-up capital pursuant to paragraph (e) of subsection (1) of section 1136 of the TA, provided the debt has existed for more than six months. In the latter case, where payment of the debt (the balance of the sale price) had to be secured by property of the dealership and the debt has not existed for more than six months, the amount of the debt does not have to be included in computing the dealership's paid-up capital, in accordance with paragraph (c) of subsection (1) of section 1136 of the TA, since it constitutes a trade account.

**5.** Paragraph (b.0.1) of section 1137 of the TA provides that where a corporation has included in the computation of its paid-up capital an amount relating to the financing of new automotive equipment that it has acquired for the purpose of resale, the corporation may deduct in doing that computation an amount equal to 50% of the lesser of the amount shown in its financial statements in relation to such automotive equipment it has in stock and the amount so included in that computation. Said paragraph (b.0.1) applies from 1 January 2005 and a transitional provision applies when the paid-up capital must be computed for a period that includes 1 January 2005.

**6.** "Automotive equipment" means automotive vehicles, including snowmobiles, personal watercraft, outboard motorboats and all-terrain vehicles.

**7.** The automotive equipment must be new when acquired by the corporation.

**8.** Demonstrator or courtesy automotive equipment acquired by a corporate dealership that sells such equipment is intended for sale in the ordinary course of its business and as such must be included in the corporation's stock. However, under paragraph (b.0.1) of section 1137 of the TA, the corporation may deduct an amount in respect of the automotive equipment, provided all the conditions in that paragraph are met.