

Car Allowance – Tax Effective?

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Employment contracts with top managers of Russian companies (or local branches of foreign companies) often provide for the payment to the employee of a "compensation for transport costs" in the form of a fixed amount. In some cases, it is not clear from the text alone what type of transport costs are reimbursable. Typically, the wording used is: "compensation of the particular employee for the use of a private car for business purposes."

Can the employer deduct such compensation for profit tax purposes? Are there any potential problems with such tax deduction?

As per p. 1 (11) Art. 264 of the Russian Tax Code, compensation payable to employees for the use of their own private cars for business trips is deductible only within the limits stated by the Russian government.

The limits are as follows:

For passenger cars with an engine capacity of up to 2.0 liters — 1,200 rubles per month;

For passenger cars with an engine capacity exceeding 2.0 liters — 1,500 rubles per month.

Compensation exceeding the above limits should not be tax deductible.

The following is of interest, however, and should be noted:

Art. 188 of the Labor Code, which states the rules for reimbursement to employees of the costs of using their personal assets in the interests of the employer, expressly provides that the company should (i) pay the employee compensation for use of his/her personal asset, and separately (ii) reimburse the employee's costs actually incurred in connection with use of this asset for the company's benefit;

Hence, it would be logical for the compensation to be split between "compensation per se" (i.e. "depreciation" reimbursement) and "actual costs reimbursement." Deduction (for tax purposes) of the first amount should be limited as mentioned above, whereas the second one should be deductible based on amounts actually spent (which should be confirmed by supporting documents (cash receipts, waybills, etc.);

At the same time, we are aware that the Finance Ministry and Tax Service take a conservative position and rule that the government-stated limits should relate to deduction of ALL amounts payable to the employee in connection with his/her car usage — both "compensation" and "costs reimbursement" (fuel, servicing, etc.). We believe that this position is unjustified and contradicts the spirit of the relevant labor and tax laws, but nevertheless the authorities repeatedly state this position. As a consequence, we believe that if the employing company does not follow this policy, the risk of dispute with the tax authorities is very high.

In addition, to make deductions under the government-stated limits, however small they may be, the employing company must perform the following steps (as per the requirements of the tax authorities):

The company should sign a special written agreement with the employee (which forms an addendum to the employment contract) stating the amount of compensation for the use of a private car with reference to art. 188 of the Labor Code;

The employee should provide all information about his or her car (technical passport, license plates, other data confirming the car's identity);

The company should state in the employment contract that the work of this employee is of an itinerant nature, i.e. connected with numerous trips as instructed by the employer;

The job description of this employee should also contain a reference to itinerant work, i.e. to numerous business trips;

The company should issue an internal order describing the payment procedure for "compensation" and specific payment details for the months where the employee is partially absent due to sick leave or vacation;

The tax authorities also often claim that, for tax deduction purposes, employees should also prepare trip tickets ("putevoi list") when using the car, although the courts rule that this is not an obligatory document in this case.

As evidenced above, the deduction of small amounts up to certain limits implies a substantial degree of documentation for the employing company. Compensation exceeding the limits is not tax deductible in any case, irrespective of the documentation provided by the employee.

To ensure deduction of the full compensation amount, a company could consider signing a car lease agreement with the employee. Under certain conditions, a lease fee payable to the employee may be tax deductible for the company. In addition, a lease fee payable to the employee under a lease agreement is not subject to social duties.

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