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An Overview of Capital Cost Allowance

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The capital cost allowance rules are essentially how the cost of property with an enduring benefit is deducted for income tax purposes—it is basically the tax version of depreciation methods used in accounting. This article provides an overview of the basic rules and some important temporary incentives that the government recently introduced.

The Basics

With a few exceptions, expenditures of a capital nature may not be deducted in full in computing income for tax purposes in the year the expenditures are made. Instead, most capital expenditures are depreciated for tax purposes over a period of several years. The annual deductions which may be claimed will eventually result in the cost of capital assets being allowed as a deduction to the taxpayer. These deductions are known as "capital cost allowances" (often referred to as "CCA").

The amount which may be depreciated for tax purposes is the "capital cost" of depreciable property. This amount is subject to numerous possible adjustments, rules, and restrictions—too many to discuss in a single article. CCA claimed reduces the "undepreciated capital cost" ("UCC") of depreciable property. The UCC is therefore the balance left for further depreciation in future years. CCA deductions are not calculated using a single property's capital cost, but rather using the UCC of a pool ("class") of similar property.

Depreciable Property

Most classes of depreciable property have a fixed depreciation rate. This rate is multiplied by the UCC of the depreciable property in the class after additions, deductions, and adjustments for the year to compute the tax deduction ("CCA claim") for that class for the year.

Depreciable property in itself is simply property which is entitled to depreciation for tax purposes. Depreciable property can only be depreciated in computing the income from a business or from property, except for automobiles and aircraft required for employment, which can be depreciated against employment income.

Disposing of Depreciable Property

When you dispose of depreciable property, your proceeds of disposition (up to the original cost of the property sold) are subtracted from the UCC of the class. Where the pool balance is negative at the end of the taxation year, the

negative balance is included in income as "recapture" of CCA. Proceeds received for property sold in excess of its capital cost are considered capital gains, half of which is included in income for tax purposes.

Where all the property in a class is disposed of in a taxation year and a positive balance remains after accounting for proceeds of disposition, that balance is a "terminal loss" which is deductible from income. Note however, that recapture or terminal loss do not apply to vehicles with a cost exceeding $30,000.

Capital Cost Allowance Versus Accounting Depreciation

Depreciation in your accounting records is usually not the same as CCA for tax purposes—they are calculated using completely different methods. Obviously, you cannot use your accounting depreciation for tax purposes. Conversely, accounting depreciation or amortization is not relevant for income tax purposes.

The generally accepted method of calculating accounting depreciation requires the amortization of the cost of the assets, less their estimated eventual salvage value, divided by the estimated useful life of the assets. When the variation in useful lives and salvage values of assets is considered, this calculation will rarely produce a result identical to a CCA calculation where many different assets are grouped in one class at one rate.

CCA rules are provided by tax laws that are often influenced by government and politics, so these rates are not always designed to reflect an accurate measure of the decrease of an asset's value as is calculated for accounting purposes. In some cases, CCA rates may be higher than would be appropriate for proper accounting, particularly where accelerated rates are granted to stimulate purchases of capital assets. Because of the "accelerated investment incentive" and immediate expensing for the small businesses, the rate of depreciation for the tax purposes is historically high at the moment.

General Calculation Method of Calculation

The calculation begins with the UCC of a particular class of assets as determined at the beginning of the tax year. To this value, the capital cost of assets acquired during the year is added and the proceeds received from disposing of any assets in the Class (up to the original cost of the asset) are subtracted. Lastly, the prescribed CCA rate is applied to the resulting value, which will yield the CCA amount which is deducted from income. This description oversimplifies the process as there are more adjustments, but it should give you an understanding of how things work.

Capital Cost Allowance Claims are Optional

The CCA rates are the maximum rates which may be claimed in the year. You are not obliged to claim the maximum CCA in any year, but you may claim any amount you wish, from zero up to the maximum amount. Thus, unclaimed amounts remain on hand for claims in any future year, subject to the maximum allowance calculation in that future year.

Accordingly, you may not wish to claim the maximum amount of CCA available for the year if, by doing so, a loss would be created which could not be offset against other income. If you are claiming some but not all of the CCA available to you, it may be to your advantage to claim the maximum amount in the lower rate classes rather than in higher rate classes as this will maximize the deductions available to you in future years.

Available-for-Use Rules

The basic principle of the "available-for-use" rules is that property may not be depreciated for tax purposes until the earlier of the time it is put in use or in the second taxation year following the year of acquisition. You may depreciate buildings when they are either complete or "substantially" (usually 90%) in use. These rules are complex, but you merely need to understand that you cannot depreciate an asset for tax purposes if you have not yet begun to use the property to earn income.

The Half-Year Rule

Prior to November 21, 2018, the CCA allowed in the first year that a property was available for use was generally limited to half the amount that would otherwise be available (the "half-year" rule). On November 21, 2018, the government announced a temporary enhanced first-year allowance, referred to as the Accelerated Investment Incentive, equal to up to three times the previously applicable first-year allowance. In addition, the government announced immediate expensing for investments in machinery and equipment used in manufacturing or processing, as well as for specified clean energy generation equipment.

Thus, though the half-year rule is an important part of the CCA rules, it is currently of little relevance in most cases.

Accelerated Investment Incentive

Nearly all depreciable property that is "accelerated investment incentive property" is eligible for an accelerated first-year CCA deduction. In the year that property becomes available-for-use, the half-year rule does not apply, and the normal CCA amount is increased by an additional 50%, so the amount is three times the amount it would normally be. The accelerated investment incentive applies to property acquired after November 20, 2018, and available-for-use before 2028.

Accelerated investment incentive property is depreciable property that is acquired after November 20, 2018, and becomes available for use before 2028. Moreover, the property must meet either of the following conditions:

a. it is not a property in respect to which a deduction of CCA or a terminal loss was previously made by any person; or

b. the property was not previously owned by the taxpayer or by a non-arm's length person or partnership, or was not acquired in circumstances where:

   i. the taxpayer was deemed to have previously claimed CCA (i.e., property acquired on a rollover basis), or

   ii. the undepreciated capital cost ("UCC") was reduced by an amount determined by refer ence to the amount by which the capital cost of the property to the taxpayer exceeds its cost amount (e.g., where the taxpayer acquired the property from an amalgamation).

Proposed Immediate Expensing

The 2021 federal Budget proposed to provide temporary immediate expensing in respect of certain property acquired by a Canadian-Controlled Private Corporation (CCPC). This immediate expensing would be available for "eligible property" acquired by a CCPC on or after April 19, 2021 and that becomes available for use before January 1, 2024, up to a maximum amount of $1.5 million per taxation year. The immediate expensing would only be available for the year in which the property becomes available for use. The $1.5 million limit would be shared among associated members of a group of CCPCs. The limit would be prorated for taxation years that are shorter than 365 days. The half-year rule would be suspended for property for which this measure is used. For those CCPCs with less than $1.5 million of eligible capital costs, no carry-forward of excess capacity would be allowed.

Eligible property under this new measure would be capital property that is subject to the CCA rules, other than property included in CCA classes 1 to 6, 14.1, 17, 47, 49, and 51, which are generally long-lived assets.

This measure would apply to property that becomes available for use before 2024.

Note that at the time of writing, the immediate expensing rules were still proposed because the laws had not been enacted by Parliament. This means that the proposed rules are subject to change, or may not be implemented at all, especially considering any impact of the federal election.