

Project Management Institute, New Brunswick Chapter (PMI-NB) - January 2016

Overview Canadian Capital Allowance (Tax Depreciation) System

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Capital Expenditures by Businesses

- Each year businesses investment millions/billions of dollars in capital expenditures
 - New or expanded production plants, warehouses, offices
 - Automating specific aspects of operations
 - Site modifications - roads, effluent ponds, landscaping
 - Renovating facilities, renewable energy projects
- These capital expenditures can be depreciated (deducted) over a number of years by the businesses. These deductions generate cash tax savings for the businesses.
- How these expenditures are classified for income tax purposes determines how fast the expenditures can be deducted and cash tax savings accessed by the businesses.
- The faster the expenditures are deducted the faster the businesses recover the cash tax savings.

Capital Cost Allowance (Tax Depreciation) System

- Capital expenditures are classified into capital cost allowance (CCA) pools or CCA classes
- Canadian Income Tax Act allows the CCA pools/classes to be deducted over a number of years [typically the life of property]
- Two types of CCA pool/class depreciation methods:
 - Declining balance depreciation – most common type; tax depreciation is a percentage of the undepreciated balance
 - Straight line (S.L.) depreciation – applicable to limited classes only; depreciation is deducted straight line over a period of years

Capital versus Current Expenditure

- Is the expenditure on account of capital (i.e. a capital expenditure) or currently deductible?
- Currently deductible means the cash tax savings are realized in year one!
- What is the asset? [unit of property concept]
- Expenditure evaluated based on established case law principles
- Canada Revenue Agency Guidance (IT-128R)
 - Enduring benefit
 - Maintenance or betterment
 - Integral part or separate asset
 - Relative value

Current Expenditure Examples

- First question related to capital expenditures – is it a capital or current expenditure
- Replace flooring in a retail store with comparable material
- Repave/resurface parking lot at a distribution centre
- Repair a damaged portion of an exhaust stack in a manufacturing plant
- IT project - user support or staff training activities may be currently deductible rather than capital expenditures

Examples of Pool/Class Depreciation (deductions)

- Class 1 building \$1,000 expenditure - 4% CCA declining balance rate
 - Year one CCA/depreciation = $4\% * 50\% * 1,000 = 20$
 - Year two CCA/depreciation = $(1,000 - 20) * 4\% = 39$
 - Year three CCA/depreciation = $(1000 - 20 - 39) * 4\% = 38$... and so on
 - NOTE - $\frac{1}{2}$ rate (50%) depreciation in year one – “1/2 rate rule”
- Class 14 license \$1,000 expenditure - 10 year S.L. depreciation [life of the license]; $\frac{1}{2}$ rate rule N/A
 - Year one CCA/depreciation = $1000 / 10 = 100$
 - Year two CCA/depreciation = $1000 / 10 = 100$... and so on

CCA/Tax Depreciation System Considerations

- **Schedule 008** - A taxpayer's capital property is tracked in summary on Schedule 008 of the taxpayer's income/partnership return by CCA pool – see example attached
- **Capital Cost of Property** - Includes all costs required to make the property operational/usable including architectural, engineering design, installation/support costs, freight, labor, attributable overhead, etc. "Cost of an Asset" concept.
- **Maximum Class/Pool Depreciation** - Taxpayer has discretion to claim any amount of depreciation up to the maximum annual amount each year.
- **Reduction to Class/Pool** – Typically, when property is disposed of the lower of the original cost of the property or actual proceeds reduces the Class/Pool

CCA/Tax Depreciation System Considerations

➤ Federal and Provincial CCA rules

- All Canadian provinces currently follow the federal CCA/tax depreciation rules for classifying property [harmonized]
- Specific provincial tax credits utilize the federal CCA class definitions e.g. Class 29, Class 43.2

➤ Schedule II of the Federal Income Tax Regulations

- Outlines/describes the various CCA property classes/pools - currently there are over 50 CCA classes [some are historical]

CCA/Tax Depreciation System Considerations

➤ Capitalized Interest Rules

- For tax purposes, interest is only required to be capitalized to certain classes. Interest related to other classes is deductible.

➤ Indirect/Pro-ratable Costs

- Certain expenditures relate to the entire scope of a project or a contractor and are allocable over the direct cost classes or expense components (e.g. costs include architectural, design, building permits, supervision, etc.)

➤ Demolition Costs

- In specific circumstances these costs are immediately deductible

Types of Buildings

March 2007 budget created three types of buildings

- Class 1 4% declining CCA rate [regular building class, 50 year life]
- Class 1 6% declining CCA rate - Non residential building [40 year life]; at least 90% s.f. is used for non residential purposes; separate class election required
- Class 1 10% [15 year life] declining CCA rate
 - M&P buildings; at least 90% s.f. is used for M&P purposes; separate class election required
 - Definition of manufacturing & processing activities for tax purposes – this is a whole discussion itself

Accelerated CCA/Tax Depreciation Classes

- Class 29 M&P equipment/property
 - 3 year S.L. depreciation; promotes investment in M&P property [until end 2015]; Class 53, 50% declining balance /CCA rate will replace
- Class 43.1/43.2 Energy Efficient & Renewable Energy equipment/property
 - 30-50% declining balance depreciation/CCA rate; e.g. co-generation power plant, solar/wind project; promotes investment in efficient & renewable energy projects [currently until end 2019]
- Class 50 GPEDP [55% declining balance depreciation/CCA rate] - computer hardware; definition of GPEDP is somewhat “broad”
- Class 12 Application Software [100% declining balance depreciation/CCA rate, subject to ½ rate rule]

Income Tax Act - Immediately Deductible Items

Certain expenditures are immediately deductible under the Canadian Income Tax Act

- Landscaping
- Certain site investigation costs
- Utility service connection costs
- Representation costs
- Disability modification costs

Also, certain costs are viewed as deductible as general expense - e.g. site safety, security, etc.

Investment Tax Credits Related to Capital Expenditures/Investments

- Manufacturing investment tax credits (5-10% or more of the cost of the property) can be accessed federally or provincially in the following provinces:
 - Federally – Nova Scotia, Newfoundland, New Brunswick, Prince Edward Island (PEI), certain parts of Quebec
 - Provincially – Quebec, PEI, Manitoba, Saskatchewan
- Certain provinces provide data centre property, green property tax credits (e.g. Manitoba) as well as specific rebates based on the cost of the property (e.g. energy efficiency rebates)

Areas Where Classifications Can Be Optimized

- Identify Immediately deductible/current costs for tax purposes
- “Cost of an Asset” concept
- Building versus equipment costs - identify costs related to installing or supporting equipment
- Cost in support of M&P activities e.g. cost to control facility environment
- Site costs - parking area, landscaping, utility connections
- Identify specific equipment - e.g. generators
- Soft/indirect costs - e.g. interest, architectural, engineering
- Type of building - 4% to 10%

Project Management Can Help to Optimize Tax Depreciation Classifications

- Identify costs related to installing/supporting equipment
- Assist to allocate/break-out costs related to building versus equipment e.g. electrical, steel, HVAC, piping, etc.
- Identify costs specifically related to M&P activities
- Assist with analysis of the square footage of a building
- Review and identify site cost elements - parking, landscaping
- Utilize architectural drawings or published estimating sources to break-out the above items
- Work with contractors/vendors to ensure their invoices/ contracts support required cost break-outs.

Cash Tax Savings – General Equipment Reclassification

- Cash income tax savings of reclassifying \$1.0 million of project costs in 2015:

	CCA Reclassification - Class 8 – General Equipment – Tax Savings [20% CCA tax depreciation rate]			
Initial CCA Classification	Year 1	Year 2	Year 3	Total Years 1-3
1 – 4% Building	22,000	38,000	29,000	89,000
1 - 6% Building	14,000	22,000	14,000	50,000

Cash Tax Savings – Expense Reclassification

- Cash income tax savings of reclassifying \$1.0 million of project costs in 2015:

Initial CCA Classification	CCA Reclassification – Expense – Tax Savings [Immediate Deduction]			
	Year 1	Year 2	Year 3	Total Years 1-3
1 – 4% Building	265,000	(11,000)	(10,000)	244,000
1 - 6% Building	262,000	(16,000)	(15,000)	231,000

Misclassified Property Studies

- Misclassified Property Studies or Capital Asset Reviews (CARs) can be carried out on new projects, future/planned projects and prior year projects
- Taxpayers can access prior year project classification opportunities several ways:
 - Project costs can be reviewed, misclassified property identified and returns amended [open taxation years - 3-4 years prior]
 - Projects older than 3-4 years can be reviewed, the undepreciated balance reclassified in the first open taxation years and returns amended
 - Undepreciated costs can be reclassified in the current year

Taxpayer Benefits of Conducting Misclassified Property Study

- Significant income tax cash savings
- Immediately deductible expenditures
- Expenditures eligible for accelerated depreciation/CCA classes
- Expenditures eligible for investment tax credits/rebates
- Property/asset ownership planning - accelerate depreciation

Identifying Taxpayer Classification Opportunities

- Significant capital spend
 - New construction - 5 to 10 million CAPEX.
 - Renovations/remodels - 2 million plus CAPEX
- Taxable Income – current, prior three years or near future
- Presence slower depreciation/CCA classes e.g. building, tanks, general equipment
- Applicable to numerous taxpayer/project types – retailers, manufacturers, commercial real estate, electrical utilities, P3, IT projects, refrigerated facilities, oil refineries, pulp mills, food processors, gas bars, auto dealers, pipelines, renewable energy projects, data centres, saw mills, amusement parks, telecoms, cable providers, etc.

Contact Details & Credentials

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Credentials:

- Performed over 170 CARs (Misclassified Property Studies) in the last 11 years
- Over \$9.0 billion CAPEX reviewed
- Over \$235 million income tax savings identified
- 99% favourable CRA audits
- Co-author of “Guide to Capital Cost Allowances” 5th Edition

Example

2013-12-28

Canada Revenue Agency / Agence du revenu du Canada

Schedule 8

Capital Cost Allowance (CCA)

Corporation's name ABC Company Ltd.	Business Number	Tax year end Year Month Day 2013-12-28
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For more information, see the section called "Capital Cost Allowance" in the T2 Corporation Income Tax Guide.

Is the corporation electing under regulation 1101(5q)? **101** 1 Yes 2 No

1 Class number (See Note)	2 Description	2 Undepreciated capital cost at the beginning of the year (amount from column 12 of last year's schedule 8)	3 Cost of acquisitions during the year (new property acquired for use)*	4 Adjustments and transfers**	5 Proceeds of dispositions during the year (amount not to exceed the capital cost)	6 50% rule (1/2 of the amount, if any, by which the net cost of acquisitions exceeds column 5)***	7 Reduced undepreciated capital cost	8 CCA rate %****	9 Recapture of capital cost allowance***** (line 107 of Schedule 1)	10 Terminal loss (line 404 of Schedule 1)	11 Capital cost allowance (for declining balance method, column 7 multiplied by column 8, or a lower amount) (line 403 of Schedule 1)*****	12 Undepreciated capital cost at the end of the year (column 6 plus column 7 minus column 11)
200		201	203	205	207	211		212	213	215	217	220
1.	1	6,866,319		-22,719	0		6,843,600	4	0	0	273,744	6,569,856
2.	1b Non-Residential Buildings After 1987	517,641	38,500	-27,054	0	19,250	509,837	6	0	0	30,590	498,497
3.	2	2,135			0		2,135	6	0	0	128	2,007
4.	3	7,765,196			0		7,765,196	5	0	0	388,260	7,376,936
5.	6	122,607			0		122,607	10	0	0	12,261	110,346
6.	8	1,433,098	142,744		0	71,372	1,504,470	20	0	0	300,894	1,274,948
7.	9	221			0		221	25	0	0	55	166
8.	10	161,805	124,785		0	62,393	224,197	30	0	0	67,259	219,331
9.	12	868,258	317,320		0	158,660	1,026,918	100	0	0	1,026,918	158,660
10.	13	58,885			0		58,885	NA	0	0	10,706	48,179
11.	13		493,201		0	246,601	246,600	NA	0	0	35,229	457,972
12.	13				0			NA	0	0		
13.	13				0			NA	0	0		
14.	13				0			NA	0	0		
15.	13				0			NA	0	0		
16.	13				0			NA	0	0		
17.	17	323,433			0		323,433	8	0	0	25,875	297,558
18.	29	1,487,024	493,946	-156,285	10,136	241,905	1,572,644	NA	0	0	1,053,445	761,104
19.	39	142,658			0		142,658	25	0	0	35,665	106,993
20.	43	267,547	5,916		0	2,958	270,505	30	0	0	81,152	192,311
21.	45	21,505			0		21,505	45	0	0	9,677	11,828
22.	46 Data Network Equipment and Re	664,573	258,256		0	129,128	793,701	30	0	0	238,110	684,719
23.	50 Computers After Mar 18-07	179,439	694,986		0	347,493	526,932	55	0	0	289,813	584,612
Totals		20,882,344	2,569,654	-206,058	10,136	1,279,760	21,956,044				3,879,781	19,356,023