2018 FEDERAL FALL ECONOMIC STATEMENT

On November 21, 2018, Federal Finance Minister Bill Morneau announced a series of measures designed to make Canada's tax system more competitive with that of the United States. Rather than enter into a downward spiral of tax rate cuts, the government chose to make selective changes in certain deductions accelerating the write-off of capital equipment. Quite clearly, the intended primary beneficiary of these changes is the auto sector and other manufacturers in Ontario and Quebec.

Having said that, an accelerated write-off of capital equipment through capital cost allowance (tax depreciation) ("CCA") will be available to businesses of all sizes and sectors of the economy for certain arms-length acquisitions. This enhanced write-off will be available on "accelerated investment incentive property" which is defined to be any capital property acquired by a taxpayer after November 20, 2018.

The acceleration of CCA claims will be accomplished in two ways. The first of these is the removal of the general requirement to claim only 50% of the amount of CCA in the year of aquisition, commonly referred to as the "half-year rule". The removal of the half-year rule restriction will be available for capital assets acquired after November 20, 2018 which become available for use before January 2028.

The second mechanism for accelerating CCA claims will be a "gross-up" of the basis upon which CCA is determined. These gross-up amounts will vary by CCA class and vary by the date the asset becomes available for use. Ultimately, this gross-up allows for a larger deduction in the year a capital asset is acquired.

Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

An example of the CCA calculation will help illustrate the effect of these changes. Consider two motor vehicles each with a cost of $25,000. These assets would fall into Class 10 as prescribed by Regulations of the Income Tax Act. The first vehicle in this example was purchased on November 20, 2018 and the second purchased on November 21, 2018. Assuming a taxpayer with a December 31 year end, the effect on CCA claims for them in 2018 and 2019 is depicted below:

November 20, 2018 purchase (not an "accelerated investment incentive property"):

⇒ 2018 CCA claim = $25,000 X 50% half-year rule X 30% CCA rate = $3,750
⇒ 2019 CCA claim = ($25,000 - $3,750) X 30% = $6,375
⇒ Total claim for the two taxation years = $10,125

November 21, 2018 purchase (eligible "accelerated investment incentive property"):

⇒ 2018 CCA claim = $25,000 X gross-up factor of 1.5 X 30% CCA rate = $11,250
⇒ 2019 CCA claim = ($25,000 - $11,250) X 30% = $4,125
⇒ Total claim for the two taxation years = $15,375

In this example, the first year of CCA claim is three times higher for the vehicle purchased after November 20, 2018 and the overall CCA claimed over two years is more than 50% higher than for the vehicle purchased before November 21, 2018.

The gross-up factors will vary by asset class. The enhanced first year CCA deduction for "accelerated investment incentive property" for some other typical asset categories are noted below for acquisitions before January 1, 2024.

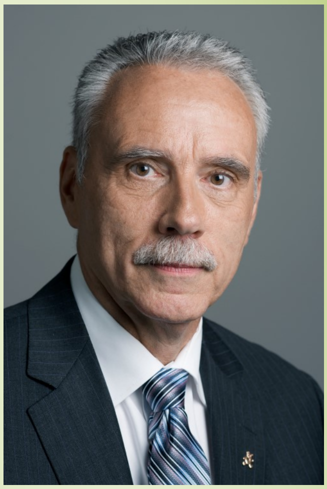
- Class 13 (Leasehold Improvements) - 150% of the amount otherwise determined.
- Class 14 (Patent, Franchise, concession or license for a limited period) - 150% of the amount otherwise determined.
- Class 43.1 (Energy efficient generating equipment) - 333% of the amount otherwise determined – essentially providing for an immediate write-off of the cost in the first year the asset is available for use.
- Class 50 (Computers) - 150% of the amount otherwise determined.

Clients are encouraged to pay particular attention to the date of acquisition for capital asset purchases as claims for CCA will be very different for the entire lifespan of the asset.

In addition to the accelerated write-off of capital equipment, the government is allowing for an acceleration of write-offs for the energy sector and initiatives targeted at removing internal trade barriers and promoting export diversification

Hendry Warren LLP would be happy to assist in the evaluation of the tax incentives available for your planned capital expenditure program. In some instances, purchasing capital assets may become more attractive than leasing. However, a careful evaluation of that decision should be carried out before implementation.

HENDRY WARREN LLP
CHARTERED PROFESSIONAL ACCOUNTANTS



Ian W. Hendry,
FCPA, FCA, CFP
Partner

Contact Us

Give us a call for more information about this article.

Hendry Warren LLP
881 Lady Ellen Place, Suite 200
Ottawa, ON K1Z 5L3

(613) 235-2000

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www.hwllp.ca