26 November 2018

Global Tax Alert

News from Americas Tax Center

Canada: Federal Fall Economic Statement announces significant acceleration of CCA for most capital investments

Executive summary

On 21 November 2018, Canada's Finance Minister Bill Morneau presented the Fall Economic Statement in the House of Commons. A summary of the technical tax measures included in this statement is set out below. On the same day, the Minister tabled a notice of ways and means motion to amend the *Income Tax Act* and the Income Tax Regulations, which was accompanied by explanatory notes relating to these measures.

Finance states that these changes are in part to address "the challenge" of United States (US) Tax Reform. In the absence of the tax measures proposed in the Fall Economic Statement, "it is expected that … US tax reforms could significantly reduce the overall tax advantage that Canada has built over the years, doing potential harm to investment, jobs, and economic growth in Canada."

Detailed discussion

Capital cost allowance measures

The Fall Economic Statement introduced three key capital cost allowance (CCA) acceleration measures:

- Full expensing for M&P machinery and equipment
- Full expensing for clean energy equipment
- An accelerated investment incentive

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access information about the tool and registration here.

EY Americas Tax Center

The EY ATC brings together the experience and perspectives of over 10,000 tax professionals across the region to help clients address administrative, legislative and regulatory opportunities and challenges in the 33 countries that comprise the Americas region of the global EY organization. Access more information here.

EY

Building a better working world

These measures are described below.

Full expensing for manufacturing and processing machinery and equipment

Machinery and equipment acquired after 2015 and before 2026 for use in Canada primarily in the manufacturing or processing of goods for sale or lease (M&P machinery and equipment) currently qualifies for a temporary accelerated CCA rate of 50% (subject to the half-year rule and calculated on a declining-balance basis) under Class 53. After 2025, M&P machinery and equipment is included in Class 43 and is eligible for a 30% CCA rate (subject to the half-year rule and calculated on a declining-balance basis).

The 2018 Fall Economic Statement proposes to allow for full expensing of M&P machinery and equipment on a temporary basis. Specifically, the proposed rules operate by providing an enhanced first-year allowance for M&P machinery and equipment acquired after 20 November 2018 that becomes available for use before 2028. The enhanced first-year allowance will provide taxpayers with an immediate write-off of the full cost of M&P machinery and equipment if the property becomes available for use before 2024 (the half-year rule will not apply). The enhanced first-year allowance will then be phased out as follows:

- For property that becomes available for use in 2024 and 2025, the enhanced first-year allowance is reduced to 75% of the cost of the M&P machinery and equipment; and
- For property that becomes available for use in 2026 and 2027, the enhanced first-year allowance is reduced to 55% of the cost of the M&P machinery and equipment.

The enhanced first-year allowance is completely eliminated for property that becomes available for use after 2027. M&P machinery and equipment that becomes available for use after 2027 will be included in Class 43 and subject to a 30% CCA rate (subject to the half-year rule).

Table A compares the portion of the cost of M&P machinery and equipment that may be expensed in the first year the equipment becomes available for use under the current and proposed rules.

Table A:

Year property becomes available for use*	Current: First-year allowance (after applying half-year rule)	Proposed: First-year enhanced allowance
21 November 2018 to 2023	25%	100%
2024 and 2025	25%	75%
2026 and 2027	15%	55%
2028 onwards	15%	n/a**

*Property must be acquired after 20 November 2018.

**First-year enhanced allowance is eliminated and available CCA returns to normal first-year allowance rate of 15% (after applying half-year rule).

Full expensing for clean energy equipment

Under current legislation, specified clean energy equipment qualifies for an accelerated CCA rate of 30% under Class 43.1, or, if acquired after 22 February 2005 and before 2025, may qualify for an accelerated CCA rate of 50% under Class 43.2. Class 43.1 and Class 43.2 property are subject to the half-year rule and the CCA is calculated on a declining-balance basis.

The 2018 Fall Economic Statement proposes to allow for full expensing of clean energy equipment included in Class 43.1 or 43.2, on a temporary basis. As with the proposed rules for M&P machinery and equipment, the proposed rules provide an enhanced first-year allowance for clean energy equipment acquired after 20 November 2018 that becomes available for use before 2028. The enhanced first-year allowance will provide taxpayers with an immediate write-off of the full cost of clean energy equipment if the property becomes available for use before 2024 (the half-year rule will not apply). The enhanced first-year allowance will then be phased out in the same manner as described above for M&P machinery and equipment.

Clean energy equipment that becomes available for use after 2027 will be included in Class 43.1 and subject to a 30% CCA rate.

Table B compares the portion of the cost of clean energy equipment that may be expensed in the first year the equipment becomes available for use under the current and proposed rules.

Table B:

Year property becomes available for use*	Current: First-year allowance (after applying half-year rule)		Proposed: First-year enhanced allowance
	Class 43.1	Class 43.2	
21 November 2018 to 2023	15%	25%	100%
2024	15%	25%	75%
2025	15%	n/a	75%
2026 and 2027	15%	n/a	55%
2028 onwards	15%	n/a	n/a**

*Property must be acquired after 20 November 2018.

**First-year enhanced allowance is eliminated and available CCA returns to normal first-year allowance rate of 15% (after applying half-year rule).

Short taxation years and CCA restrictions

Existing rules that require CCA claims to be prorated for short taxation years will also apply to the enhanced first-year allowance for a property, and no further enhanced allowance will be available in the following taxation year in respect of that property. Also, any existing rules that restrict the amount of CCA that may be claimed in certain circumstances (such as the leasing property rules, specified leasing property rules, specified energy property rules, and rental property rules) will continue to apply.

The first-year enhanced allowance is not available where:

- The property was previously owned or acquired by the taxpayer or by a person or partnership with which the taxpayer did not deal at arm's length, and
- The property was transferred to the taxpayer on a tax deferred rollover basis.

These rules also apply to the accelerated investment incentive described below.

Accelerated investment incentive (including CDE and COGPE)

For essentially any capital property that is subject to the existing CCA rules, excluding property subject to the full expensing measures described above, the 2018 Fall Economic Statement introduces an accelerated investment incentive to write off a larger share of the costs of newly acquired assets in the year the investment is made or the year the asset becomes available for use.

In general terms, the accelerated investment incentive is composed of two elements:

- A 50% increase of the net capital cost addition to a class in respect of property acquired after 20 November 2018 that becomes available for use before 2024.
- The suspension of the existing CCA half-year rule in respect of property acquired after 20 November 2018 that becomes available for use before 2028.

As a result, as shown in the examples below, an enhanced CCA deduction of up to three times the normal first-year CCA deduction will be available for property that would otherwise be subject to the current half-year rule. The enhanced allowance is reduced to two times the normal first-year CCA in the 2024–2027 period.

Accelerated investment incentive – Example 1		
Scenario #1: A Class 8 (20%) property of CA$200[1] is acquired in 2023 and becomes available for use in that year		
	Current rules	Proposed rules
Undepreciated capital cost (UCC) at the beginning of 2023 **(A)**	$0	$0
Plus: Capital cost **(B)**	$200	$200
Plus: Adjustment **(C)** = 50% x **(B)**	n/a	$100
Minus: Half-year rule **(D) = 50% x (B)**	$100	n/a
Adjusted UCC **(E) = (A) + (B) + (C) − (D)**	$100	$300
CCA for 2023 **(F) = 20% x (E)**	$20	$60
UCC at the end of 2023 **(G) = (A) + (B) − (F)**	$180	$140
CCA for 2024 **(H) = 20% x (G)***	$36	$28
UCC at the end of 2024 **(I) = (G) − (H)**	$144	$112

*After the first-year, regular CCA calculations are applicable.

Accelerated investment incentive – Example 2		
Scenario #2: Same scenario but the property is acquired and becomes available for use in 2024		
	Current rules	Proposed rules
Undepreciated capital cost (UCC) at the beginning of 2024 **(A)**	$0	$0
Plus: Capital cost **(B)**	$200	$200
Plus: Adjustment **(C) = 50% x (B)**	n/a	n/a
Minus: Half-year rule **(D) = 50% x (B)**	$100	n/a
Adjusted UCC **(E) = (A) + (B) + (C) − (D)**	$100	$200
CCA for 2024 **(F) = 20% x (E)**	$20	$40
UCC at the end of 2024 **(G) = (A) + (B) − (F)**	$180	$160
CCA for 2025 **(H) = 20% x (G)***	$36	$32
UCC at the end of 2025 **(I) = (G) − (H)**	$144	$128

*After the first-year, regular CCA calculations are applicable.

The accelerated investment incentive applies to property for which CCA is calculated on a declining-balance basis (including Class 14.1 intangible property), as well as for classes of property with straight-line depreciation (e.g., leasehold improvements, patents, and limited period licences) or on which depreciation is based on unit of use (e.g., industrial mineral mines), as well as for certain additional allowances (e.g., Canadian vessels), but with certain variances. However, the incentive won't apply to the additional allowance for mining property in Class 41.2, which is being phased-out, and will only partly apply to Class 12 property (i.e., only to suspend the half-year rule when it would otherwise apply) – for example, in the case of application software, the half-year rule will be suspended in the first year, thereby allowing an immediate 100% write-off for that year (since the CCA rate for Class 12 property is already 100%).

The accelerated investment incentive does not change the total amount that can be deducted over the life of the property, it simply allows a larger deduction to be taken in the first year. Similar to the full expensing measures, the accelerated investment incentive is completely eliminated for property that becomes available for use after 2027.

The short taxation year rules and CCA restrictions mentioned above for the full expensing measures also apply to the accelerated investment incentive.

CDE and COGPE

The accelerated investment incentive described above will also generally apply to eligible Canadian development expenses (CDE) and Canadian oil and gas property expenses (COGPE). Although these expenses are not subject to a CCA half-year rule equivalent (and thus cannot benefit from any suspension of such rules), they will nevertheless qualify for a first-year deduction of 150% of the 30% or 10% deduction that would otherwise be available, for expenses incurred after 20 November 2018 and before 2024, and 125% for expenses incurred after 2023 and before 2028.

Tax credits to support Canadian journalism

- **Refundable tax credit to support news organizations**

  The Government announced its intention to introduce a new refundable tax credit for qualifying news organizations, effective 1 January 2019; an independent panel will be struck to advise on credit eligibility. This measure was not included in the notice of ways and means motion.

- **Non-refundable tax credit for subscriptions to Canadian digital news media**

  A new 15% non-refundable tax credit will be introduced for qualifying subscribers of eligible digital news media. No application date was provided and this measure was not included in the notice of ways and means motion; however, additional details are to be provided in the 2019 federal budget.

- **Access to charitable tax incentives for eligible news organizations**

  The definition of qualified donee will be expanded to include certain non-profit journalism organizations, meaning that donors will be able to receive a tax receipt for donations to such organizations. Having qualified donee status will also allow the organizations to receive funding from registered charities. No application date was provided, and this measure was not included in the notice of ways and means motion.

Other measures

- **Mineral exploration tax credit**

  The Government announced its intention to extend eligibility for the mineral exploration tax credit for a further five years. This means that the tax credit would apply to flow-through share agreements entered into on or before 31 March 2024. This measure was not included in the notice of ways and means motion.

- **Communal organizations**

  It was announced that the Income Tax Act will be amended to allow business income of a communal organization to retain its character when allocated to members of the organization. This measure will apply beginning with the 2014 taxation year, but was not included in the notice of ways and means motion.

Endnote

1. Currency references in this Alert are to CA$.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (Canada), Nova Scotia

- Allan Bonvie allan.bonvie@ca.ey.com
- Brett Copeland brett.copeland@ca.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Americas Tax Center

© 2018 EYGM Limited.
All Rights Reserved.

EYG no. 012055-18Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com