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TaxNewsFlash
Canada

Canada Announces Enhanced Capital Cost Allowances

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Canadian businesses will be able to more quickly recover the costs of certain investments under new rules announced in Finance's 2018 Fall Economic Update. The Update, which was released on November 21, 2018, announces new rules to temporarily allow businesses to immediately expense, for tax purposes, the cost of certain new investments in qualifying machinery and equipment, as well as specified clean energy equipment, and to accelerate tax depreciation on other capital investments. The rules apply to capital property acquired after November 20, 2018 and available for use before 2028. In addition, Finance says it will extend the 15% Mineral Exploration Tax Credit to 2024 and introduce a new refundable tax credit for qualifying news organizations, among other changes.

Finance's new proposals affecting investments in qualifying machinery and equipment and other capital investments have been issued in response to recent U.S. tax measures that allow U.S. businesses to immediately claim a tax deduction for 100% of certain capital investments. This change was included as part of the U.S. tax reform enacted at the end of 2017.

The Update also projects the deficit to be $19.6 billion for 2019-20.

Background
Following U.S. federal tax reforms in 2017, Canada indicated in its 2018 federal budget that it would conduct a detailed analysis to assess the potential impacts on Canada. Many of these U.S. tax changes significantly affect Canadian companies doing business in the United States. Among other changes, U.S. tax reform introduced amendments to permanently reduce the corporate tax rate to 21%, repeal the corporate alternative

minimum tax (AMT) and allow immediate expensing of certain capital investments placed in service after September 27, 2017 and before 2023.

Finance previously indicated that its Fall Economic Update would be developed with consideration towards maintaining Canada's competitive position.

Capital Cost Allowance changes and other deductions

Accelerated Investment Incentive

The Update introduces a new Accelerated Investment Incentive to generally allow Canadian businesses that acquire capital property to be eligible for an enhanced first-year tax depreciation on qualifying assets acquired after November 20, 2018. This incentive will apply to tangible capital assets (e.g., vehicles, equipment and buildings) as well as intangible capital assets (e.g., patents and intellectual property) that are subject to the Capital Cost Allowance (CCA) rules. To qualify, neither the taxpayer nor a non-arm's-length person must have previously owned the property; and the property cannot have been transferred to the taxpayer on a tax-deferred "rollover" basis.

Under this change, businesses will be able to deduct up to three times the amount of tax depreciation that would otherwise apply in the year that an asset is available for use. This is achieved by allowing businesses to apply the prescribed CCA rate to one-and-a-half times the net qualifying addition to the class for the year, and to not apply the "half-year" rule. However, this larger deduction for the first year is ultimately offset by reductions to the deductions allowed in future years.

The Accelerated Investment Incentive, which will apply on a pro-rated basis for short taxation years, will be gradually phased out starting in 2024, where the maximum enhanced tax depreciation will be up to two times the normal amount, and will not apply to capital property available for use after 2027. In addition, the Accelerated Investment Incentive will not be available for manufacturing and processing machinery and equipment or clean energy equipment that benefits from the new expensing rules announced in the Update.

Deductions for the oil and gas industry

The Update notes that, under the Accelerated Investment Incentive, eligible Canadian development expenses and Canadian oil and gas property expenses will also generally be eligible for a first-year deduction equal to one-and-a-half times the deduction that would otherwise be available.

Expensing for Manufacturing and Processing Equipment

The Update allows Canadian businesses a 100% write-off of the cost of machinery and equipment to manufacture and process goods used in Canada in the year it is available for use in the business. Businesses will be able to immediately expense qualifying assets acquired after November 20, 2018. Specifically, these new rules effectively increase the tax write-off for machinery and equipment currently included in CCA Class 53 (or 43, if acquired after 2025) to 100% in the year it is available for use in a business.

This change will be gradually phased out for investments that become available for use in 2024, where the first-year deduction will drop to 75% (with a subsequent drop to 55% for investments available for use in 2026), and will no longer be in effect for investments available for use after 2027. These rules will also apply on a pro-rated basis for short taxation years.

To qualify, neither the taxpayer nor a non-arm's-length person must have previously owned the property; and the property cannot have been transferred to the taxpayer on a tax-deferred "rollover" basis.

Expensing for clean energy equipment

The Update allows specified clean energy equipment to be eligible for immediate expensing, for eligible assets acquired after November 20, 2018. Specifically, these new rules effectively increase the tax write-off for specified clean energy equipment currently included in CCA Classes 43.1 and 43.2 to 100% in the year it is available for use in a business.

The new clean energy equipment expensing rules will be gradually phased out for investments that become available for use in 2024, where the allowance will drop to 75% (with a subsequent drop to 55% for investments that become available for use in 2026), and will no longer be in effect for investments available for use after 2027. These rules will also apply on a pro-rated basis for short taxation years.

To qualify, neither the taxpayer nor a non-arm's-length person must have previously owned the property; and the property cannot have been transferred to the taxpayer on a tax-deferred "rollover" basis.

Other measures

Mineral Exploration Tax Credit extended

The Update extends the 15% Mineral Exploration Tax Credit to March 31, 2024 (from March 31, 2019). The Mineral Exploration Tax Credit is available to individuals who invest in mining flow-through shares, and applies to specified mineral exploration expenses incurred in Canada and renounced by a corporation to flow-through share investors.

News organizations

The Update announces a new refundable tax credit for qualifying news organizations, effective January 1, 2019. The Update notes that the eligibility criteria for this tax credit has not yet been determined. Finance says it will provide additional details in the 2019 federal budget.

In addition, the Update announces that Canada intends to allow eligible non-profit journalism organizations to qualify as qualified donees under the charity rules. As a result, these organizations will be allowed to issue official donation receipts and be eligible to receive funding from registered charities. Finance does not provide further details on this change.

Digital news subscribers

The Update announces that Canada plans to introduce a new temporary, non-refundable 15% tax credit for qualifying subscribers of eligible digital news media.

Funding measures

The Update also announces that Canada will:

- Launch an Export Diversification Strategy to increase Canada's overseas exports by 50% by 2025
- Provide a further $800 million over five years to the Strategic Innovation Fund to support eligible Canadian businesses involved in innovative projects

We can help

Your KPMG adviser can help you assess the effect of the tax changes in this year's fall economic update on your personal finances and business affairs. We can also keep you abreast of the progress of these proposals as they make their way into law.

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