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Capital Cost Allowance and Cumulative Eligible Capital

INTRODUCTION

Paragraph 18(1)(b) prohibits the deduction of capital expenditures; however, **paragraph 20(1)(a)** allows a taxpayer to deduct an amount with respect to the capital cost of property to the extent allowed by the Income Tax Regulations.

The myriad of factors to be considered in determining a CCA claim are discussed below under three major headings:

1. eligibility for inclusion in CCA classes,
2. calculation of CCA, and
3. restrictions on CCA claims.

ELIGIBILITY FOR INCLUSION IN CCA CLASSES

Capital expenditures generally produce an enduring benefit → depreciate the asset over time.

Property must be included in the regulations in order to be eligible for CCA.

No CCA is allowed for land, inventory and certain R&D assets.

Property must be acquired for purpose of gaining or producing income before CCA can be taken.

Goodwill and other intangibles are entitled to a tax writeoff as **eligible capital expenditures** (discuss later).

Major Classes that will be covered in Class

- Class 1 – building (4%)
- Class 3 – building pre-1988 (5%)
- Class 8 – various machinery, equipment and furniture (20%)
- Class 10 – Vehicles and other (30%)
- Class 10.1 – “Luxury” cars (30%)
- Class 12 – computer software and small assets (100%)
- Class 13 – leasehold improvements (straight-line)
- Class 14 – limited life intangibles (straight-line, no half year rule)
- Class 29 - manufacturing and processing assets (straight-line 2 years)
- Class 43 – manufacturing and processing assets (30%)
- Class 44 – patents (25%)
- Class 45 – computer hardware and systems software (45%)

Ownership

An asset can generally be included in a CCA class only when the taxpayer has acquired a capital property or a leasehold interest in capital property for the purpose of gaining or producing income.

The taxpayer will generally be considered to have acquired a depreciable property at the earlier of:

1. the day on which the taxpayer obtains title to it
and

2. the date on which the taxpayer has all the incidents of title, such as possession, use, and risk.

Available-for-Use Rules

The timing of the inclusion of an asset in the UCC of a class is also affected by the “available-for-use rules”. These rules, contained in **subsections 13(26) to (32)**, prevent the taxpayer from claiming CCA until the time the property is “available for use.”

	A	B	C	D= A+B-C	E = ½ x (B-C)	F= D – E	G	H = F x G	I = D - H
Year	Beg UCC	Additions	Dispositions	UCC For Year	½ Year Rule	Reduced UCC	CCA Rate	Max CCA	End UCC

CALCULATION OF CCA

For purposes of calculating CCA, assets are grouped in prescribed classes.

Under **regulation 1100(1)(a)**, CCA is generally calculated by applying the prescribed CCA rate to the UCC of each class at the end of a taxation year.

Schedule II of the Act lists the classes and the current prescribed rates that apply.

Although CCA is calculated on a declining balance basis for most classes, the straightline method is prescribed for some classes (class 13, 14 and 29).

CCA is a discretionary deduction, and the taxpayer may claim any amount up to the maximum prescribed by the regulations.

Additions to UCC

The following amounts must be added to UCC:

- The capital cost to the taxpayer of depreciable property of a class acquired by the taxpayer. *Capital cost of a property is generally the purchase price plus any other related costs that must be incurred in order to make the asset operational (for example, installation and delivery charges).*
- All amounts included in income as recapture of CCA claimed in a previous taxation year.
- Repayments of assistance, inducements, or reimbursements received in respect of depreciable property of the class occurring after the disposition of the asset.

Deductions from UCC

The calculation of UCC includes the following deductions:

- Total depreciation previously allowed to the taxpayer for property of the class. Total depreciation is defined to be all CCA claimed plus any terminal losses previously allowed under subsection 20(16).

- The lesser of proceeds of disposition and the original capital cost (LCOP) of the disposed of property.

Adjustments to Capital Cost

I will not go through rules for adjusting the capital cost amounts. These rules apply mainly when there is a transactions between non-arm's length parties at transaction values different than the fair market value.

Recapture

Proceeds of disposition of a depreciable property up to its cost (e.g. LCOP) reduce the applicable CCA class balance.

If, as a result of this and other adjustments, a negative UCC balance in a class arises at the end of a taxation year, it must be added to the taxpayer's income for the year as recaptured depreciation.

Any proceeds of disposition in excess of the original cost of a property are treated as a **capital gain**.

Can a taxpayer have a capital loss on a disposition of depreciable property?

Terminal Losses

Where all of the assets of a particular class have been disposed of, **subsection 20(16)** provides for a mandatory deduction equal to the remaining UCC balance, referred to as a **terminal loss**.

Separate Classes

Separate classes can accelerate the recognition of recapture or terminal loss.

Required separate class:

- rental properties acquired after 1972 with a cost in excess of \$50,000
- passenger vehicles costing >\$30,000
- certified productions, and specified leasing properties (beyond scope of our class).

Elect separate class:

- outdoor advertising signs (**regulation 1101(5l)**), and rapidly depreciating electronic equipment (**regulation 1101(5q)**).

SPECIAL CLASSES

CLASS 13 – Leasehold Improvements

- Straight-line basis
- “special” 1/2 rule – half the normal CCA in the first year of improvements
- Lesser of:
 - Cost of improvements / 5
 - Cost of improvements / (remaining years left on lease plus first renewal terms)

CLASS 14 – limited life intangibles

- Straightline basis over legal life
- $(\text{Capital cost} / \text{legal life}) \times (\text{number of days remaining in the year} / 365) \dots 366$ for leap years

CLASS 10.1 – Luxury Vehicle

- Applies to “passenger vehicle” with cost greater than \$30,000
- Deemed cost to be \$30,000
- Separate class for each passenger vehicle
- 1/2 rule applies to first year of acquisition
- 1/2 normal CCA in the year of disposition
- No terminal loss, no recapture

RESTRICTIONS ON CCA CLAIMS

Short Taxation Years

Regulation 1100(3) limits the CCA allowed for short taxation years to the prorated portion (based on number of days in the taxation year divided by 365) of the CCA otherwise calculated in accordance with the regulations.

Half-Year Rule

The “half-year rule” in **regulation 1100(2)** restricts the CCA claim allowed on net acquisitions (consisting of additions for the year less the lesser of original cost and proceeds of disposition for the year) in the year to one-half of the normal claim.

Exclusions from the half-year rule--- certain class 10 and 12 assets, and assets in classes 13, 14, 15, 23, 24, 27, 29, and 34. Note that class 13 has a “special” half-year rule.

Rental Property

Regulation 1100(11) was introduced to limit the CCA claimed on a “rental property” to the amount of rental income.

Where a taxpayer owns more than one rental property, the restrictions are not applied to each individual rental property but to the aggregate of the CCA claims on all rental properties.

A “rental property” is defined in **regulation 1100(14)** to be, in general terms, a building or leasehold interest used for the purposes of gaining or producing gross revenue that is rent.

THE RULE: *CCA CANNOT create or increase a loss on a rental property.*

Regulation 1100(12) provides that **regulation 1100(11)** will **not** apply if the taxpayer is, throughout the year, a life insurance corporation or a corporation whose principal business was the leasing, rental, development, or sale, or any combination thereof, of real property owned by it.

Assignment Problem Five - 3 (CCA Calculations)

Opening Balances The taxation year of Burton Steel Ltd. ends on December 31. On January 1, 2015, the UCC balances for the various classes of assets owned by the Company are as follows:

Class 3 - Building	\$1,562,000
Class 8 - Office Furniture And Equipment	278,000
Class 10 - Vehicles	204,000
Class 13 - Leasehold Improvements	106,250
Class 29 - Manufacturing Equipment	126,000
Class 50 - Computer Hardware	11,000

Acquisitions During the year ending December 31, 2015, the following acquisitions of assets were made.

Class 1 - Building (Note 1)	\$258,000
Class 8 - Office Furniture And Equipment	72,000
Class 10 - Vehicles (Note 2)	63,000
Class 13 - Leasehold Improvements	58,000
Class 50 - Computer Hardware	17,000

Note 1 The \$423,000 total cost of the Building was allocated \$258,000 to the building itself, and \$165,000 to the land. The Building will be used 100 percent for non-residential activity, none of which involves manufacturing and processing activity. It will be allocated to a separate Class 1.

Note 2 The addition to Class 10 was made up of three passenger vehicles, with a cost of \$21,000 each.

Dispositions During this same period, the following dispositions occurred:

Class 8 - Office furniture and equipment were sold for cash proceeds of \$42,000. The original cost of these assets totalled \$38,000.

Class 10 - A delivery truck with an original cost of \$37,000 was sold for \$12,000.

Class 29 - Since Burton Steel Ltd. will only be involved in retail operations in the future, all of the manufacturing equipment was sold for total proceeds of \$89,000. The original cost of the equipment was \$504,000.

Other Information:

1. The Company leases its main office building for \$47,000 per year. The lease was negotiated on January 1, 2012 and had an original term of eight years. There are two renewal options on the lease, each for a period of two years. The Company made \$125,000 of leasehold improvements immediately after signing the lease. No further improvements were made until the current year.

2. During the year ending December 31, 2015, some of the Company's office furniture and equipment was destroyed in a small fire. At the time of the accident, the fair market value of the destroyed property was \$19,000. However, proceeds from the Company's insurance policy amounted to only \$11,000. The original cost of the destroyed property was \$18,000.

3. Maximum CCA has always been taken by Burton Steel.

Required: Calculate the maximum CCA that can be taken by Burton Steel Ltd. on each class of assets for the year ending December 31, 2015, and calculate the UCC for each class of assets on January 1, 2015. Indicate any other inclusions or deductions from Taxable Income resulting from the preceding information.

CAPITAL COST ALLOWANCE (CCA) (2006 and later tax years)

SCHEDULE 8
Code 0601

Name of corporation	Business Number	Taxation year and Month Day
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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	2 Undepreciated capital cost at the beginning of the year (undepreciated capital cost at the end of the year from column 13 of last year's CCA schedule)	3 Cost of acquisitions during the year (new property must be available for use)	4 Net adjustments (show negative amounts in brackets)	5 Proceeds of dispositions during the year (amount not to exceed the capital cost)	6 Undepreciated capital cost (column 2 plus or minus column 4 minus column 5)	7 50% rule (1/2 of the amount, if any, by which the net cost of acquisitions exceeds column 5)	8 Reduced undepreciated capital cost (column 6 minus column 7)	9 CCA rate %	10 Receipture of capital cost allowance	11 Terminal loss	12 Capital cost allowance (column 8 multiplied by column 9; or a lower amount)	13 Undepreciated capital cost at the end of the year (column 6 minus column 12)
	201	203	205	207	206	211	212	213	215	217	220	
1.												
2.												
3.												
4.												
5.												
6.												
7.												
8.												
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10.												

Totals

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Note 1. Include any property acquired in previous years that has now become available for use. This property would have been previously excluded from column 3. List separately any acquisitions that are not subject to the 50% rule, see Regulation 1100(2) and (2.2). Include amounts transferred under section 86, or on amalgamation and winding-up of a subsidiary. See the T2 Corporation Income Tax Guide for other examples of adjustments to include in column 4.

Note 2. The net cost of acquisitions is the cost of acquisitions (column 3) plus or minus certain adjustments from column 4. For exceptions to the 50% rule, see Interpretation Bulletin IT-285, Capital Cost Allowance – General Comments.

Note 3. If the tax year is shorter than 365 days, prorate the CCA claim. Some classes of property do not have to be prorated. See the T2 Corporation Income Tax Guide for more information.

Enter the total of column 10 on the 107 of Schedule 1.
Enter the total of column 11 on the 404 of Schedule 1.
Enter the total of column 12 on the 403 of Schedule 1.

CUMULATIVE ELIGIBLE CAPITAL (CEC)

Although the inter-relationship of the rules is often viewed as complex and convoluted, the framework for the operation of the rules is quite simple, and can be summarized as follows:

1. Qualifying eligible capital expenditures made in the taxpayer's year are added to the pool, known as the “cumulative eligible capital” property pool, at a specified inclusion rate;
2. The pool is decreased in a particular year by each “eligible capital amount” for the year. An eligible capital amount results from a disposition of eligible capital property and the eligible capital amount is generally determined as a specified rate multiplied by the “base for the eligible capital amount”;
3. Where a positive balance exists in the cumulative eligible capital account pool at the end of the taxpayer’s taxation year, the taxpayer may elect to take a deduction under **paragraph 20(1)(b)** in computing the taxpayer’s income for the year. The amount that may be deducted cannot exceed 7% of

the pool balance at the end of the year. The pool is decreased appropriately for the amount of the deduction; and,

4. In the event that there is a negative balance in the pool at the end of the year, **subsection 14(1)** requires that an amount be included in the income of the taxpayer, in manner that emulates the recapture of previously recognized capital cost allowance deductions. Most frequently, this will occur when the taxpayer's proceeds of disposition from a sale of eligible capital property is greater than the cost of the eligible capital property to the taxpayer.

The old adage, “the devil is in the details” is particularly applicable in respect of **section 14**, and its supporting and inter-related provisions in the Act, as the framework for income tax treatment of intangible property belies the complexity of the specific provisions. *Luckily for us, we will not go into any further details.*

CEC CLASS EXAMPLE

On January 1st, 2013, Crown Resources Inc. (CRI) has a CEC balance of nil. During the taxation year ending December 31, 2013, the Company acquires an unlimited life franchise for consideration of \$400,000.

During the taxation year ending December 31, 2015, CRI sells one of its operating divisions. The sales price included a \$600,000 payment for goodwill. As this goodwill was internally developed, its presence was not reflected in the Company's CEC balance.

Required:

What is the maximum deduction that CRI can claim for amortization of cumulative eligible capital in 2013, 2014, and 2015? Assume that no elections are made with respect to the CEC dispositions in any of these years.



Canada Revenue Agency

Agence du revenu du Canada

CUMULATIVE ELIGIBLE CAPITAL DEDUCTION (2002 and later taxation years)

SCHEDULE 10
Code 0201

Name of corporation	Business Number	Taxation year-end Year: _____ Month: _____ Day: _____
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- For use by a corporation that has eligible capital property. For more information, see the *T2 Corporation Income Tax Guide*.
- A separate cumulative eligible capital account must be kept for each business.

Part 1 – Calculation of current year deduction and carry-forward

Cumulative eligible capital – Balance at the end of the preceding taxation year (if negative, enter "0")	200	A
Add: Cost of eligible capital property acquired during the taxation year	222	
Other adjustments	226	
Subtotal (line 222 plus line 226)	_____ x 3/4 =	B
Non-taxable portion of a non-arm's length transferor's gain realized on the transfer of an eligible capital property to the corporation after December 20, 2002	228	
amount B minus amount C (if negative, enter "0")	_____ x 1/2 =	C
Amount transferred on amalgamation or wind-up of subsidiary	224	
Subtotal (add amounts A, D, and E)	230	F
Deduct: Proceeds of sale (less outlays and expenses not otherwise deductible) from the disposition of all eligible capital property during the taxation year	242	G
The gross amount of a reduction in respect of a forgiven debt obligation as provided for in subsection 80(7)	244	H
Other adjustments	246	I
(add amounts G, H, and I)	_____ x 3/4 =	J
Cumulative eligible capital balance (amount F minus amount J) (If amount K is negative, enter "0" at line M and proceed to Part 2)		K
Cumulative eligible capital for a property no longer owned after ceasing to carry on that business	249	
amount K	_____	
less amount from line 249	_____	
Current year deduction	_____ x 7% =	250
(line 249 plus line 250) (enter this amount at line 405 of Schedule 1)	_____	L
Cumulative eligible capital – Closing balance (amount K minus amount L) (if negative, enter "0")		300
* You can claim any amount up to the maximum deduction of 7%. The deduction may not exceed the maximum amount prorated by the number of days in the taxation year divided by 365.		

Part 2 – Amount to be included in income arising from disposition

(complete this part only if the amount at line K is negative)		
Amount from line K (show as positive amount)		N
Total of cumulative eligible capital (CEC) deductions from Income for taxation years beginning after June 30, 1988	400	1
Total of all amounts which reduced CEC in the current or prior years under subsection 80(7)	401	2
Total of CEC deductions claimed for taxation years beginning before July 1, 1988	402	3
Negative balances in the CEC account that were included in Income for taxation years beginning before July 1, 1988	408	4
Line 3 minus line 4 (if negative, enter "0")	_____	5
Total of lines 1, 2, and 5	_____	6
Amounts included in income under paragraph 14(1)(b), as that paragraph applied to taxation years ending after June 30, 1988 and before February 28, 2000, to the extent that it is for an amount described at line 400	_____	7
Amounts at line T from Schedule 10 of previous taxation years ending after February 27, 2000	_____	8
Subtotal (line 7 plus line 8)	409	9
Line 6 minus line 9 (if negative, enter "0")	_____	O
Line N minus line O (if negative, enter "0")	_____	P
Line 5	_____ x 1/2 =	Q
Line P minus line Q (if negative, enter "0")	_____	R
Amount R	_____ x 2/3 =	S
Amount N or amount O, whichever is less	_____	T
Amount to be included in income (amount S plus amount T) (enter this amount on line 108 of Schedule 1)	410	

