CHAPTER 6

THE ACQUISITION, USE, AND DISPOSAL OF DEPRECIABLE PROPERTY

Review Questions

1. Under the income tax system, neither capital expenditures nor amortization/depreciation can be deducted when income for tax purposes is being calculated. The same system imposes an arbitrary and uniform method of cost allocation based on the type of asset used. Explain the reason for this significant departure from generally accepted accounting principles in arriving at income for tax purposes.

2. Can an individual who earns employment income claim a deduction for CCA in arriving at income from employment? If yes, are any restrictions imposed?

3. A business acquires land for a customer parking lot and incurs the following costs:

Land	$50,000
Legal fees to complete purchase agreement	2,000
Legal fees in connection with obtaining a mortgage loan for the land	1,000
Small building for attendant	10,000
Exterior landscaping	2,000
	$65,000

Briefly explain the tax treatment of these costs.

4. A business can obtain the right to use property through ownership or leasing. Briefly compare the tax treatment of purchasing land and building with that of leasing land and building. Refer to both the amount and timing of the related deductions for tax purposes.

5. What is the meaning and significance of the term "capital cost" of an asset?

6. Explain why the deduction of capital cost allowance is a "discretionary" deduction.

7. Depreciable properties are divided into a number of different classes, and a specific allocation rate (CCA rate) is assigned to each class. Explain why this system is fair to some taxpayers, unfair to others, and more than fair to others.

8. Briefly explain what is meant by the "pool concept" in the CCA system.

9. "In all cases, the acquisition of a new asset in a particular class will result in the increase of the normal maximum rate of CCA by 50% in the year of purchase." Is this statement true? Explain.

10. To what extent, if any, does the pooling concept inherent in the CCA system affect the tax treatment of any gains and losses that occur on the disposition of depreciable property? In general terms, explain when a gain or loss will occur.

11. Describe the possible ramifications of purchasing new depreciable property on the last day of the

current taxation year as opposed to the first day of the next taxation year (that is, one day later).

12. What is a leasehold improvement, and how does its tax treatment vary from the normal CCA treatment?

13. Taxpayer A leases a building for 15 years. Taxpayer B secures the right to lease a building for 15 years by signing a three-year lease with two renewable option periods—one for 2 additional years and a second for 10 years. Both A and B incur leasehold improvement costs at the beginning of the lease. Explain the tax treatment of the leasehold improvements to both A and B. Which taxpayer has signed the better lease? Explain.

14. If the sale of an asset results in income from a recapture of CCA, is it necessary to acquire another asset in the same year in order to avoid the recapture? Explain.

15. Explain the tax consequences, if any, when an individual proprietor of a new business transfers personal-use office furniture for use in the business.

16. Describe two alternative tax treatments that may apply when a business purchases a franchise.

17. Explain why a businessperson might view the cost of a $100,000 building as being significantly higher than the cost of a $100,000 delivery truck. Make a cost comparison, assuming the taxpayer is subject to a 45% tax rate and can invest funds to generate an after-tax cash return of 9%. (Assume the building qualifies for the 6% CCA rate).

Solutions to Review Questions

R6-1. The determination of amortization for accounting purposes is extremely subjective, requiring an estimate of an asset's useful life, annual usage, and salvage value. Consequently, assets of a similar type are subject to a wide range of amortization rates and methods even though they may be used for similar purposes in similar business types.

The arbitrary capital cost allowance system overcomes the consequence of subjectivity associated with amortization methods and eliminates the need for an excessive amount of assessment review by CRA. In addition, it treats all assets within a general category in the same manner providing equal treatment to each taxpayer. In some respects, the system is unfair because it gives no consideration to the way in which different businesses use similar assets and, therefore, the CCA system may not conform to economic reality.

R6-2. Yes, individuals who are employed may claim capital cost allowance in certain circumstances. For employees earning employment income, CCA can be claimed only on automobiles, aircraft (and musical instruments). Employment income cannot be reduced by CCA on any other type of asset even if it is used in the performance of employment duties [ITA 8(1)(j) & (p)].

R6-3. Although total cost of acquiring and preparing the land for use is $65,000, the several component parts are treated differently.

Land ($50,000) is a capital asset because it has a long- term and enduring benefit and is not deductible as an expense. In addition, it does not qualify as depreciable property and no capital cost allowance is available.

Legal fees ($2,000) to complete the purchase agreement are capital in nature, associated with the cost of the land. The fees are not deductible but are merely added to the land cost [ITA 18(1)(b)].

Legal fees ($1,000) in connection with obtaining mortgage financing are also a capital item. However, by exception, the expense qualifies as a cost incurred to issue debt and is permitted to be deducted over five years at 1/5 per year [ITA 20(1)(e)].

The small building ($10,000) is a property separate from the land. It is a capital expenditure and not deductible. However, the building qualifies as Class 1 property and is subject to CCA at 4%, declining balance. If the building was not used prior to March 19, 2007 and is placed in a separate Class 1, the CCA rate will increase by 2% to 6%. The CCA is increased by 50% for the net additions to the Class in the year.

Exterior landscaping ($2,000) is a capital item and not normally deductible. However, by exception, ITA 20(1)(aa) permits the full amount to be deducted when paid.

R6-4. If the property is purchased, the cost of the land cannot be deducted for tax purposes. The building cost can be deducted as capital cost allowance at 4% or 6% annually declining balance. The CCA is increased by 50% for the net additions to the Class in the year.

In comparison, if the property is leased, a deduction for tax purposes is available for the land as well as the building. The full amount of rent for the land and building is deductible in the year in which it is incurred.

R6-5. The term capital cost refers to the total cost amount associated with the acquisition of a depreciable property. It is significant because it is the base to which the CCA rate is applied. The capital cost includes the original purchase price or construction cost plus all costs incurred to bring the asset to a state of working order.

R6-6. The rate of capital cost allowance permitted annually signifies the maximum amount that is available but does not require that all or any portion must be claimed in any one year. Therefore, within the constraint of the maximum annual limit, the timing of the deduction of capital cost allowance is at the discretion of the taxpayer. Failure to claim all or a portion of the maximum in a particular year does not result in any penalty as the undepreciated capital cost of the Class simply remains at a higher amount which increases the deduction available in the future [Reg. 1100(1)].

R6-7. When assets are designated to a particular Class, the rate of CCA associated with the Class may be indicative of some general average use for those types of properties. To the extent that a particular asset conforms to the average use, the tax treatment is equitable. However, if a taxpayer owning the same type of asset uses the asset significantly more than another taxpayer thereby reducing the asset's useful life, the same rate of CCA must be used which is inequitable. Conversely, an asset could be used less than the average use resulting in an increase to its useful life, but the CCA rate permits a faster write-off making the tax treatment more than equitable.

R6-8. The pool concept means that all assets of the same Class (e.g., Class 8 or Class 10) are lumped together as a single total for the entire class. Therefore, each asset loses its individual identity and CCA is not claimed or determined separately for each asset within the class.

R6-9. The statement is not true. Although it is true that there is a CCA enhancement for new acquisitions, the degree of enhancement varies for certain asset groups.

For the straight-line classes (Class 13 and 14), the CCA is increased by 50% in the year the cost is incurred.

However, for classes where CCA is calculated on a declining balance, even where the 50% CCA enhancement applies, it only applies to the extent that there are net additions for the year. If, for example, there are additions in the year but there are also disposals, the 50% enhancement applies only on the amount by which the additions exceed the disposals.

Assets do not qualify for the enhanced first-year CCA when acquired from a non-arm's length person or on a tax-deferred basis.

Finally, Canadian-controlled private corporations (CCPCs), Canadian resident individuals and Canadian partnerships can designate assets acquired in the year as immediate expensing property [Reg 1100(3.1) & (3.2)]. A first-year CCA rate of 100% is available on up to $1.5 million of assets designated [Reg 1100(0.1), (0.2)]. Assets acquired by CCPCs on or after April 19,2021 and available for use prior to 2024 qualify. In the case of Canadian resident individuals and Canadian partnerships, assets acquired on or after January 1, 2022 and available for use before 2025 qualify. The assets can be used in carrying on a business or for earning income from property. For individuals and partnerships, the immediate expensing incentive cannot be used to create or to increase a loss.

Property in CCA Classes 1 to 6, 14.1, 17, 47, 49 and 51 cannot be designated as immediate expensing property.

R6-10. Because all assets of a class are pooled in a single total, it is not possible to establish if the price from the sale of an individual asset is less than or greater than the undepreciated capital cost of that specific asset. The pool concept recognizes that some assets in the pool will be sold at less than their depreciated value and some will be sold at a greater amount. By reducing the pool by the selling price of the asset, any gain or loss simply affects the pool's total and its impact is, therefore, averaged over the life of the pool. Gains or losses on depreciable property are only recognized as follows:

a) a loss will occur when there is a balance in the pool at the year end but no assets are left in the pool. The loss is referred to as a terminal loss [ITA 20(16)].

b) income will occur when, at the end of any year, the pool balance is negative whether assets are left in the pool or not. This income is referred to as recaptured capital cost allowance [ITA 13(1)].

c) if, at any time, the selling price of an asset exceeds its original cost, a capital gain is recognized [ITA 40(1)]. A capital loss is never recognized on depreciable assets.

R6-11. The timing of a purchase may affect the recognition of both terminal losses and recaptured capital cost allowance [ITA 13(1), 20(16)].

Where a terminal loss is about to occur because there is a balance in the pool but no assets remain, the acquisition of an asset on the last day of the year, regardless of its cost, will eliminate the recognition of the terminal loss leaving the balance to be deducted by normal CCA. If the purchase was delayed until the first of the new year, the full terminal loss would be recognized for tax purposes.

The reverse may be true where a recapture is imminent. A purchase of a new asset before the year end will reduce the amount of the recapture. Delaying the purchase for one day, to the next taxation year, forces the recognition of the recapture and starts a new pool balance in the next year.

R6-12. A leasehold improvement is the cost incurred by the tenant of a leased building to improve the premises to their specific needs. Because the improvement is to the landlord's property, it will belong to the landlord at the end of the lease. Nevertheless, leasehold improvements are eligible for CCA under Class 13 [Reg.1100(1)(b), Sch III].

Class 13 varies from the normal CCA rules in that the rate of write-off is based on a straight line approach (over the term of the lease plus one option period) as opposed to the declining balance method [Sch III].

R6-13. Taxpayer A has signed a single lease for 15 years with no options to renew. The cost of leasehold improvements are written off at the lesser of 1/5 (arbitrary) or 1/15 (number of years in lease). Therefore, the cost is amortized over 15 years (with the CCA increased by 50% in the year the cost is incurred).

Taxpayer B has the right to use the property for 15 years (lease plus options) but the cost of the improvements can be written off at the lesser of:

a) 1/5 per year

or

b) <u>Cost</u> = 1/5 per year
3+2
(lease term + one option period)

Therefore, the cost of leasehold improvements for Taxpayer B can be deducted over five years (with the CCA increased by 50% in the year the cost is incurred).

It is difficult to determine which taxpayer has signed the better lease. Taxpayer B has the advantage of writing-off the cost of improvements over five years, thereby enhancing after-tax cash flow significantly in the early years of the lease. However, the cost of this advantage is that Taxpayer B may have to renegotiate the rental payments whenever the renewal options are exercised. In comparison, Taxpayer A has a lower after-tax cash flow in the early years because the cost of improvements are written-off over 15 years, but the rent payments are guaranteed for 15 years and will not increase.

R6-14. Normally, to avoid or reduce a recapture of CCA in a year in which it is about to occur requires the purchase of another asset before the year-end. However, in the case of property that is real estate (Class 1), a recapture in the current year can be avoided or reduced if a replacement property is acquired within one year or 12 months after the end of the taxation year in which the original property was sold. This extension is permitted only where the real estate is used in a business (not as an investment earning rents) and the replacement property is used for similar purposes [ITA 13(4), 44(1)&(5)].

R6-15. The transfer of the property to the business is a change of use from personal to business and therefore results in a deemed acquisition at fair market value for tax purposes [ITA 45(1)]. The business is deemed to have acquired the furniture at fair market value and that value qualifies as an addition to Class 8 which is eligible for capital cost allowance at the rate of 20%. This result assumes that the furniture's fair market value is less than its original cost [ITA 13(7)(b)].

If the value of the property is greater than the original cost (resulting in a capital gain to the taxpayer) the amount eligible for CCA is reduced by 1/2 of the capital gain, i.e., the non-taxable portion of the gain [ITA 13(7)(b)].

The enhanced CCA in the first year is not available to the business since the property is acquired from a non-arm’s length person.

R6-16. A franchise may qualify as a Class 14 asset if it has a limited legal life. As such, the full cost is normally deducted on a straight-line basis over the legal life of the franchise [Reg. 1100(1)(c)]. A faster write-off rate can apply if it conforms to the asset’s economic value, e.g., where legal agreements and other relevant factors indicate that such is reasonable. Alternatively, if the franchise has an unlimited life, it is not Class 14 but rather is Class 14.1.

R6-17. The real cost of a property is equal to its cash cost minus the tax savings that will be achieved from any related tax deductions. In addition, the timing of the related tax savings is important because increased cash flow can be reinvested. A building may be regarded as having a greater cost than a delivery truck because the cost of the building, in this case, is deducted at a rate of 6% annually, whereas, the cost of the delivery truck is deducted at 30% annually. Therefore, the delivery truck produces greater tax savings in the early years.

By determining the present value of the tax savings from capital cost allowance, the after-tax cost of a purchase can be determined. The building and truck are compared below using the formula:

$(C\mathit{d}T/(\mathit{d}+\mathit{r})) \times ((1+1.5\mathit{r})/(1+\mathit{r}))$,

where C = net initial investment
T = tax rate
r = discount rate or time value of money
d = maximum rate of capital cost allowance.

Building: (($100,000 x 6% x 45%) / (6% + 9%)) x ((1 + 1.5 x 9%) / (1 + 9%)) = $18,743

Delivery Truck: (($100,000 x 30% x 45%) / (30% + 9%)) x ((1 + 1.5 x 9%) / (1 + 9%)) = $36,044

	Building	Truck
Cash Price	$100,000	$100,000
Present value of tax savings:		
Building:	(18,743)	
Truck:		(36,044)
Net Cost	$ 81,257	$ 63,956

The above calculations ignore the potential resale value of the properties when they are no longer needed. Obviously, the resale value of the building would be quite different from that of the truck, and this factor should be considered when comparing costs.

Key Concept Questions

QUESTION ONE

In the current year, Eddie Enterprises Ltd., a public corporation, purchased new office equipment costing $40,000. The vendor gave Eddie Enterprises $3,500 for the old office equipment, which was purchased three years ago for $6,000. At the beginning of the current year, the Class 8 UCC balance was $10,000.

Calculate the maximum CCA deduction for Class 8 for the current year, 2022.

CPA Competency 6.2.2 CCA: additions exceed disposals. Income tax reference: ITA 13(21), 20(1)(a); Reg. 1100(1), (2).

QUESTION TWO

In the current year, Decrease Ltd., a public corporation, purchased Class 8 equipment costing $20,000. Later in the year, Decrease Ltd. sold other Class 8 equipment for $30,000. The equipment sold originally cost $108,000. At the beginning of the current year, the Class 8 UCC balance was $42,000.

Calculate the maximum CCA deduction for Class 8 for the current year, 2022.

CPA Competency 6.2.2 CCA: disposals exceed additions. Income tax reference: ITA 13(21), 20(1)(a); Reg. 1100(1), (2).

QUESTION THREE

At the end of last year, the UCC balance for Class 12 was $1,300. During the current year, a Class 12 item with an original cost of $8,000 was disposed for $2,000. There were no other Class 12 transactions in the current year.

Calculate the effect of the disposal on business income for the current year, 2022.

CPA Competency 6.2.2 Recapture. Income tax reference: ITA 13(1).

QUESTION FOUR

A few years ago, Fast Ltd. purchased a new photocopier for $48,000 and elected to put the photocopier in a separate Class 8. At the end of last year, the UCC balance for the separate Class 8 was $33,000. During the current year, the photocopier was sold for $25,000.

Calculate the effect of the disposal on business income for the current year, 2022.

CPA Competency 6.2.2 Terminal loss. Income tax reference: ITA 20(16).

QUESTION FIVE

On May 1, 2022, Kayla Tsuji purchased a Frosty Frozen Foods franchise and began carrying on business immediately as a sole proprietor. She paid $60,000 for the franchise. The franchise agreement has a 10-year term. The frozen foods business was so successful that Kayla quickly needed more space. On November 1, 2022, Kayla purchased a small building for $200,000 (land $100,000 + building $100,000) and moved her business into it immediately. Assume the building was constructed after March 18, 2007.

Calculate the maximum CCA deduction for these assets for 2022 and 2023. Assume Kayla does not designate the franchise as immediate expensing property.

CPA Competency 6.2.2 Classes 1 & 14; short taxation year; separate class election. Income tax reference: ITA 20(1)(a.2); Reg. 1100(1)(a.2), (c), 1100(2), (3), 1101(5b.1)

QUESTION SIX

On October 1, 2021, Neo Enterprises Ltd. signed a lease for new office space. The contract gives Neo Enterprises the use of the space for four years with the option of renewing the lease for two additional three-year periods. In November 2021, Neo Enterprises spent $84,000 renovating the office space. In February 2022, they spent an additional $30,000 on leasehold improvements. Neo Enterprises has a December 31 year-end.

Calculate the maximum Class 13 CCA for years 2021, 2022, and 2023. Assume the Class 13 UCC balance at the end of year 2020 is $0 and the leasehold improvements are not designated as immediate expensing property.

CPA Competency 6.2.2 Class 13. Income tax reference: ITA: 20(1)(a); Reg. 1100(1)(b).

QUESTION SEVEN

X Ltd. is a GST registrant. At the end of last year, the Class 10.1 UCC balance was $24,500. In the current year, X Ltd. disposed of the Class 10.1 car for $28,000. The car had originally cost $35,000 plus GST and PST at 7%. At the same time, X Ltd. purchased a new car costing $38,000 plus GST and PST at 7%.

Determine the income tax implications for X Ltd. for the current year, 2022. Assume the new car is not designated as immediate expensing property. How would your answer change if X Ltd. was an HST registrant?

CPA Competency 6.2.2 Passenger vehicles costing more than $30,000. Income tax reference: ITA: 13(7)(g); 20(1)(a), 20(16.1); Reg. 1101(1af), 1100(2.5), 7307.

QUESTION EIGHT

Noluck Enterprises Inc. has a December 31 year-end. On March 20, 2022, the company's warehouse was destroyed by fire. The original cost of the warehouse was $120,000. At the time of the fire, the warehouse was valued at $300,000 and was insured. Class 1 had a UCC balance of $95,000 at December 31, 2021. Noluck was forced to lease a warehouse until a new one could be acquired. On November 30, 2024, Noluck purchased a new warehouse costing $325,000. Assume the new warehouse was constructed after March 18, 2007.

Calculate the minimum recapture of CCA on the warehouse destroyed by fire.
CPA Competency 6.2.2 Replacement property. Income tax reference: ITA 13(1), (4).

QUESTION NINE

Takeover Corp. purchased another business in 2020. The purchase price included $100,000 for goodwill. In 2022, the acquired business was sold. The sale price included $140,000 for the goodwill.

Calculate the amount to be included in Takeover Corp.'s business income in 2022.
Assume the Class 14.1 balance at the beginning of 2020 is $0.

CPA Competency 6.2.2 Goodwill. Income tax reference: ITA: 13(1), 20(1)(a); Reg. 1100(2).

QUESTION TEN

Steve Bishop purchased a computer for $2,000 last year for his personal use. In February of the current year, Steve started a home-security business and began to use the computer exclusively for business purposes. He purchased an IPad for his personal use.

Explain the tax implications for the current year, 2022.

CPA Competency 6.2.2 Change in use. Income tax reference: ITA 13(7).

QUESTION ELEVEN

In the current year, Tom Lopez sold a rental property, consisting of land and a building, to a corporation wholly owned by him and his spouse. The corporation paid Tom $400,000 for the building. Tom purchased the building some years ago for $250,000. The UCC of the building at the beginning of the current year was $200,000. Tom does not deal at arm's-length with the corporation.

Determine the tax consequences for Tom and the corporation resulting from the sale of the building.

CPA Competency 6.2.2 Non-arm's length acquisition of depreciable property. Income tax reference: ITA 13(7)(e); Reg 1100(2.2).

QUESTION TWELVE

Karen Dennis sold equipment to her wholly owned corporation for its fair market value, $40,000. Karen initially purchased the equipment for $100,000 and at the beginning of the current year, the UCC of the equipment was $65,000. The equipment was the last asset remaining in the class. Karen does not deal at arm's length with the corporation.

Determine the tax consequences for Karen and the corporation.

CPA Competency 6.2.2 Terminal loss denied on sale to affiliated person. Income tax reference: ITA 13(21.2), 13(7)(e)(iii), Reg 1100(2.2).

QUESTION THIRTEEN

Olivia Nunez owns a rental property. She purchased the land for $200,000 and built the building at a time when construction costs were high. Her total cost for the building is $400,000. In the current year, she sold the rental property for $450,000 (land $300,000; building $150,000). At the beginning of the year, the UCC of the building was $320,000.

Determine the amount to be included in Olivia's income with respect to the sale of the rental property.

CPA Competency 6.2.2 Dispositions of land and building. Income tax reference: ITA 13(21.1).

QUESTION FOURTEEN

On January 1, 2022, PZ Ltd., a Canadian-controlled private corporation, purchased the following assets from an arm's length person:

- Building - $1,200,000 (Class 1 – 6%)
- Equipment - $90,000 (Class 8 – 20%)
- Computer equipment - $50,000 (Class 50 – 55%)

The assets acquired were available for use immediately. PZ Ltd. does not hold any other Class 1, Class 8 or Class 50 properties.

Determine the maximum CCA deduction for PZ Ltd. for 2022. How would your answer change if PZ Ltd. was a public corporation, or if the business was carried on by a sole proprietor?

CPA Competency 6.2.2 CCA: immediate expensing incentive. Income tax reference: ITA 13(21), 20(1)(a); Reg. 1100(0.1),(0.2),(0.3),(1),(2), 1104(3.2)(4).

Solutions to Key Concept Questions

KC 6-1

[ITA: 13(21), 20(1)(a); Reg. 1100(1),(2) - Additions to the pool exceed Disposals]

Class 8

UCC balance, beginning of year		$10,000
Purchases	$40,000	
Disposals	(3,500)	36,500
		46,500
CCA: $10,000 x 20%	$ (2,000)	
$36,500 x 20% x 1.5	(10,950)	(12,950)
UCC balance, end of year		$33,550

KC 6-2

[ITA: 13(21), 20(1)(a); Reg. 1100(1),(2) – Disposals exceed Additions]

Class 8

UCC balance, beginning of year		$42,000
Purchases	$20,000	
Disposals	(30,000)	(10,000)
		32,000
CCA: $32,000 x 20%		(6,400)
UCC balance, end of year		$25,600

KC 6-3

[ITA: 13(1) – Recapture]

Class 12

UCC balance, beginning of year		$1,300
Purchases	$ 0	
Disposals	(2,000)	(2,000)
		(700)
Recapture of CCA		700
UCC balance, end of year		$ 0

KC 6-4

[ITA: 20(16) – Terminal loss]

Class 8

UCC balance, beginning of year		$33,000
Purchases	$ 0	
Disposals	(25,000)	(25,000)
		8,000
Terminal loss		(8,000)
UCC balance, end of year		$ 0

A terminal loss is available because there are no assets left in the class.

KC 6-5

[Reg. 1100(1)(a.2), (c); 1100(2) 1/2 year rule; Reg. 1100(3) - Short taxation year; Reg 1101(5b.1) – separate class election]

The building is an addition to Class 1. Since the non-residential building was constructed after March 18, 2007, it has a 6% CCA rate based on the declining-balance [Reg. 1000(1)(a.2)] provided Kayla elects to place the building in a separate Class 1 [Reg 1101(5b.1)]. The solution assumes she did so. The election is made by attaching a letter to the tax return for the year in which the building is acquired. Since Class 1 is a declining balance class, CCA is increased by 50% for net additions for the year [Reg. 1100(2)].

Since the business was started on May 1, 2022, the first taxation year is a short year, causing CCA for Class 1 to be prorated based on the number of days from May 1 to December 31 (245 days).

Note that the building cannot be designated as immediate expensing property.

Class 1:

(2022)	Capital cost of building	$100,000
	CCA: $100,000 x 6% x 1.5 x 245/365 days	(6,041)
	UCC	93,959
(2023)	CCA: $93,959 x 6%	(5,638)
	UCC	$ 88,321

The franchise, having a limited legal life (10 years) is an addition to Class 14, a straight-line class. CCA on Class 14 is calculated by multiplying the cost by the number of days the franchise is owned in the year divided by the total number of days in its legal life [Reg. 1100(1)(c)]. The CCA is increased by 50% in the year the cost is incurred [Reg. 1100(1)(c)(i)].

Class 14:

(2022) CCA:	$60,000 x	245 (# of days owned in 2022) / 3,650 (# of days in life of the franchise)	=	$4,027
For Class 14, the CCA is increased by 50% in the year the cost is incurred.				× 1.5
				$6,041

(2023) CCA:	$60,000 x	365 (# of days owned in 2023) / 3,650 (# of days in life of the franchise)	=	$6,000

[Note – the number of days in the life of the franchise would technically include additional days for leap years.]

If the franchise is designated as immediate expensing property, the maximum CCA for 2022 is $60,000.

KC 6-6

[ITA: 20(1)(a); Reg. 1100(1)(b) – Class 13 CCA]

Class 13:

2021:	UCC balance, beginning of year		$ 0
	Purchases	$84,000	
	Disposals	(0)	84,000
			84,000
	CCA ($12,000 x 1.5)		(18,000)
	UCC balance, end of year		$66,000
2022:	UCC balance, beginning of year		$ 66,000
	Purchases	$30,000	
	Disposals	(0)	30,000
			96,000
	CCA ($12,000 + $7,500)		(19,500)
	UCC balance, end of year		$ 76,500
2023:	UCC balance, beginning of year		$76,500
	Purchases	$ 0	
	Disposals	(0)	0
			76,500
	CCA ($12,000 + $5,000)		(17,000)
	UCC balance, end of year		$59,500

Leasehold improvements:

2021 improvement: $\dfrac{\$84{,}000 \text{ (capital cost)}}{4 \text{ (lease term)} + 3 \text{ (1}^{st}\text{ option term)}} = \$12{,}000$

Limited to 1/5 x $84,000 = $16,800

2022 improvement: $\dfrac{\$30{,}000 \text{ (capital cost)}}{3 \text{ (remaining lease term)} + 3 \text{ (1}^{st}\text{ option term)}}$ = $ 5,000

Limited to 1/5 x $30,000 = $6,000

The Class 13 CCA is increased by 50% in the year the cost is incurred [Reg. 1100(1)(b)(i)]. Therefore, in 2021, the CCA is increased from $12,000 to $18,000, and in 2022, the CCA of $5,000 on the 2022 improvement is increased to $7,500.

KC 6-7

[ITA: 13 (7)(g); 20(1)(a), 20(16.1); Reg. 1101(1af), 1100(2.5), 7307 – Luxury Automobiles]

X Ltd. will be able to deduct CCA of $3,675 on the old car and $16,371 on the new car in the current year.

Class 10.1 has a number of special rules.

- CCA can be claimed on only $34,000 plus tax, even though the car cost more ($38,000 + tax) [ITA 13(7)(g); Reg. 7307]. Since X Ltd. is a GST registrant, the 5% GST is not a cost since it will be recovered [ITA 248(16); 13(7.4)]. Therefore, the capital cost addition to Class 10.1 is $36,380 ($34,000 plus PST @7%).

- Each car is placed in its own class, and CCA is calculated on each car separately [Reg. 1101(1af)].

- When a vehicle is sold, neither a recapture of CCA nor a terminal loss is permitted [ITA 13(2), 20(16.1)].

- CCA in the first year is increased by 50% [Reg. 1100(2)]. Also, CCA of 15% is allowed in the year of sale [Reg. 1100(2.5)].

	Class 10.1 Car sold UCC	**Class 10.1 Car purchased UCC**
Opening balance	$24,500	$ 0
Purchases		36,380
CCA: $24,500 x 15%	(3,675)	
$36,380 x 30% x 1.5		(16,371)
Closing balance	$ 0	$20,009

If X Ltd. were an HST registrant, the HST would not be included in the cost since it would be recoverable. Therefore, the capital cost addition to Class 10.1 would be $34,000. CCA on the new car for the current year would be $15,300 (30% x $34,000 x 1.5).

If the new car is designated as immediate expensing property, the maximum CCA for the current year is $40,055 ($3,675 + $36,380).

KC 6-8

[ITA: 13(1), (4); Involuntary disposition]

Class 1:

2022:	UCC balance, beginning of year		$ 95,000
	Purchases	$ 0	
	Disposals (limited to original cost)	(120,000)	(120,000)
			(25,000)
	Recapture of CCA		25,000
	UCC balance, end of year		$ 0

When the disposition is involuntary and recapture occurs, the taxpayer is permitted to defer recognition of the recapture if property with a similar use is acquired within 24 months after the taxation year in which the forced disposition occurs [ITA 13(4)].

The new warehouse was acquired on November 30, 2024 which is within the 2-year time limit. Noluck should attach a letter to its 2024 tax return indicating that an election under ITA 13(4) is being made to defer the 2022 recapture. The letter should include an amended calculation of the 2022 recapture as follows:

2022 Amended:

UCC balance, beginning of year		$95,000
Purchases		0
Disposals (limited to original cost)	$(120,000)	
Reduced by the lesser of:		
• Normal recapture $25,000		
• Cost of new warehouse $325,000	25,000	(95,000)
Recapture of CCA		$ 0

If the disposition of the warehouse was voluntary, the new warehouse would have to be acquired by December 31, 2023, being 12 months after the end of the 2022 taxation year, in order to defer the recapture.

If the new warehouse is placed in a separate CCA Class, it will qualify for an additional allowance of 2% bringing the CCA rate to 6%. The 6% rate applies for buildings that were not used by anyone prior to March 19, 2007, where more than 90% of the floor space of the building is used at the end of the year for a non-residential use [Reg 1100(1)(a.2)].

KC 6-9

[ITA: 13(1), 20(1)(a); Reg. 1100(2)]

Class 14.1:

Year 1:	Opening balance	$ 0
	Purchase of goodwill	100,000
		100,000
	CCA ($100,000 x 5% x 1.5)	(7,500)
		92,500
Year 2:	Deduction ($92,500 x 5%)	(4,625)
		87,875
Year 3:	Sale of goodwill	(100,000)
		(12,125)
	Recapture	12,125
	UCC at the end of Year 3	$ 0

Recapture of $12,125 is included in Business income.

Note that Class 14.1 additions cannot be designated as immediate expensing property.

KC 6-10

[ITA 13(7) – Change in use to income-producing]

For computing his business income, Steve is deemed to have acquired the computer at its fair market value in February when he changed the use from personal use to income-producing [13(7)(b)].

KC 6-11

[ITA 13(7)(e); Reg 1100(2.2) – Depreciable property acquired from related person]

Tom: Tom has a taxable capital gain of $75,000 (1/2 x (proceeds $400,000 – ACB $250,000)) and recapture of $50,000 (UCC $200,000 – cost $250,000).

Corporation: Where a depreciable asset is acquired from a non-arm's length person, ITA 13(7)(e) prevents an increase in the depreciable base of property where the transferor benefits from the half-taxation of capital gains. If the cost of the depreciable property to the transferee would otherwise exceed the capital cost to the transferor, the capital cost to the transferee is limited to the sum of the capital cost to the transferor and the transferor's taxable capital gain. In other words, the capital cost for the corporation is reduced by the non-taxable portion of the capital gain.

The corporation's cost of the building is $400,000 but the capital cost for tax purposes is deemed to be only $325,000 [ITA 13(7)(e)]. This is equal to Tom's capital cost ($250,000) plus Tom's taxable capital gain ($75,000). The corporation can claim CCA on only $325,000. For capital gains purposes, the corporation's cost remains the actual price of $400,000.

The corporation does not qualify for the enhanced first-year CCA on the building since it was acquired from a non-arm's length person [Reg 1104(4)]. The building cannot be designated as immediate expensing property because it belongs to Class 1 and also because it was acquired from a non-arm's length person.

KC 6-12

[ITA: 13(7)(e)(iii), (21.2) – Terminal loss denied on transfer to affiliated person]

Karen: Without ITA 13(21.2) Karen would have a terminal loss of $25,000 (UCC $65,000 – proceeds $40,000). ITA 13(21.2) deems a terminal loss that occurs on the sale of depreciable property to an affiliated person to be nil. The amount of the denied terminal loss ($25,000) remains with Karen who can continue to claim CCA on the amount. She can recognize the terminal loss ($25,000 less CCA claimed) when the equipment is no longer owned by an affiliated person. An affiliated person means an individual and spouse and any corporation controlled by either of them [ITA 251.1(1)]. Two corporations are affiliated if they are controlled by affiliated persons.

Corporation: The corporation's cost and capital cost for the equipment is $100,000. Since the depreciable asset has been acquired from a related person, the capital cost to the corporation cannot be less than Karen's capital cost [ITA 13(7)(e)(iii)]. The UCC is $40,000, the price paid. The excess of the capital cost ($100,000) over the UCC ($40,000) is deemed to be CCA claimed by the corporation and, thus, subject to recapture.

The corporation does not qualify for the enhanced first-year CCA on the equipment since it was acquired from a non-arm's length person [Reg 1104(4)]. Similarly, the equipment cannot be designated as immediate expensing property because it was acquired from a non-arm's length person.

KC 6-13

[ITA: 13(21.1) – Disposition of land and building]

Without ITA 13(21.1), the sale of the land and building would result in a capital gain on the land of $100,000, one-half of which is taxable, and a terminal loss of $170,000 (UCC $320,000 – proceeds $150,000) on the building. The net effect of this would be to reduce Olivia's income by $120,000 (taxable capital gain $50,000 – terminal loss $170,000).

Where land and building are sold together, any terminal loss on the building is reduced to the extent of any capital gain on the land [ITA 13(21.1)]. This is achieved by increasing the proceeds for the building by the lesser of the terminal loss on the building and the capital gain on the land. In this case, the proceeds for the building are increased by $100,000 to $250,000 and the proceeds for the land are reduced by $100,000 to $200,000. This reduces the taxable capital gain on the land to Nil (proceeds $200,000 – ACB $200,000) and reduces the terminal loss to $70,000 (UCC $320,000 - Proceeds $250,000).

KC 6-14

[ITA: 13(21), 20(1)(a); Reg. 1100(*ITA 13(21), 20(1)(a); Reg. 1100(0.1),(0.2),(0.3),(1),(2), 1104(3.2)(4)*
– Immediate expensing incentive]

The immediate expensing incentive applies to CCPCs, Canadian resident individuals carrying on business as sole proprietors, and Canadian partnerships (where each partner is a Canadian resident individual). A first-year CCA rate of 100% is available on up to $1.5 million of eligible assets acquired in the year.

PZ Ltd. – a CCPC

The immediate expensing incentive applies to assets acquired by CCPCs on or after April 19, 2021 and available for use prior to 2024. PZ Ltd. has an immediate expensing limit of $1.5 million for 2022.

Class 1 assets are excluded from the immediate expensing incentive and are subject to the normal CCA rules.

The total CCA claim for 2022 for a CCPC would be $248,000, computed as follows:

- Building - $1,200,000 (Class 1 – 6%)
  CCA: $1,200,000 x 6% x 1.5 = $108,000 (not eligible for immediate expensing incentive)

- Equipment - $90,000 (Class 8 – 20%)
  CCA: $90,000 (eligible to be designated as *immediate expensing property*)

- Computer equipment - $50,000 (Class 50 – 55%)
  CCA: $50,000 (eligible to be designated as *immediate expensing property*)

PZ Ltd – a public corporation

A public corporation is ineligible to claim the immediate expensing incentive. The total CCA claim for 2022 for a public corporation would be $176,250, computed as follows:

- Building - $1,200,000 (Class 1 – 6%)
  CCA: $1,200,000 x 6% x 1.5 = $108,000

- Equipment - $90,000 (Class 8 – 20%)
  CCA: $90,000 x 20% x 1.5 = $27,000

- Computer equipment - $50,000 (Class 50 – 55%)
  CCA: $50,000 x 55% x 1.5 = $41,250

Sole Proprietor

The immediate expensing incentive applies to assets acquired by individuals carrying on business as sole proprietors (or earning property income) on or after January 1, 2022 and available for use prior to 2025. The immediate expensing incentive cannot be used to create or increase a loss for individuals. Class 1 assets are excluded from the immediate expensing incentive and would be subject to the normal CCA rules.

The total CCA claim for 2022 for a sole proprietor would be $248,000, computed as follows:

- Building - $1,200,000 (Class 1 – 6%)
  CCA: $1,200,000 x 6% x 1.5 = $108,000 (not eligible for immediate expensing incentive)

- Equipment - $90,000 (Class 8 – 20%)
  CCA: $90,000 (eligible to be designated as *immediate expensing property*)

- Computer equipment - $50,000 (Class 50 – 55%)
  CCA: $50,000 (eligible to be designated as *immediate expensing property*)