CORPORATE Newsletter

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Recent Tax Changes for Small Businesses

There are two big tax changes that have been recently introduced. Small business owners should be aware of these changes, because both of them offer substantial tax breaks. First, there is the ability to immediate expense up to $1.5 million per year in newly acquired capital assets. Second, there is a new tax credit for investments made by a small business that will improve the air quality of their premises. Both of these measures are temporary, so utilize them while you can.

Immediate Expensing

The 2021 Federal Budget announced that a Canadian-controlled private corporation ("CCPC") will be able to immediately expense acquisitions of depreciable property of up to $1.5 million per year. The rules were to apply as of April 19, 2021, only a few details on these new rules were provided. The government recently provided more specifics on how these rules will work. It was also announced that sole proprietorships and partnerships, which were notably absent from the description in the budget documents, will also be eligible for the immediate expensing. This means that you can potentially reduce your income for tax purposes by the full cost of property that you acquire, subject to all the conditions and restrictions discussed below.

The immediate expensing incentive is only available to an "eligible person or partnership", which includes:

a. a corporation that was a CCPC throughout the year;
b. an individual (other than a trust) who was resident in Canada throughout the year; or
c. a Canadian partnership all of the members of which were, throughout the period, persons described in (a) or (b) or a combination thereof (excludes multi-level partnerships).

Very generally, a CCPC is a corporation that is not publicly traded or controlled by non-residents.

Eligible Property

To be eligible for the immediate expensing incentive, the property acquired must be "immediate expensing property", which is property that is eligible for capital cost allowance. However, the incentive is unavailable to buildings, certain intangible assets, and pipelines, because these are generally considered long-lived assets.

Also, the property must have been acquired within a specific time range. In the case of a CCPC, the property must be acquired after April 18, 2021. In the case of a Canadian partnership or Canadian resident individual, the property must be acquired after December 31, 2021.

Moreover, the property must be available for use by a particular time. If the eligible person or partnership is an individual or a Canadian partnership all the members of which are individuals throughout the taxation year, the property must become available for use before 2025. In any other case (i.e., a CCPC or a partnership with at least one member who is not an individual), the property must become available for use before 2024. An asset is generally available for use when you first use it for the purpose of earning income. If the asset is a vehicle, it becomes available for use when you obtained all the necessary licensing and credentials required to operate it.

Last, the property must meet one of two conditions. First, the property has not been used and no person or partnership has deducted CCA or a terminal loss in respect of the property. Or second, the property was not subject to a tax-deferred transfer and it was not previously owned or acquired by the eligible person or partnership or a non-arm's length person or partnership.

The assets that will benefit from the immediate expensing must be "designated immediate expensing property" in the taxation year, which is property that is immediate expensing property that became available for use in the taxation year. The designation is made on the tax return. The ability to designate immediate expensing property allows you to decide which property will benefit from the incentive. Property that takes longer to depreciate normally (for tax purposes) should generally be designated first.

Calculating the Deduction

The deduction for the immediate expensing incentive occurs before computing the deduction for regular CCA. The immediate expensing deduction for a taxation year is equal to the lesser of the following:

a. the immediate expensing limit for the year—generally $1.5 million, with exceptions discussed below;
b. the undepreciated capital cost at the end of the taxation year before the regular CCA deduction of designated immediate expensing property; and
c. if the person or partnership is not a CCPC, the amount of income earned from a source that is a business or property (before CCA is deducted) in which the relevant designated property is used.

This deduction reduces the undepreciated capital cost. Subsequently, the remaining UCC balance can be depreciated under the normal CCA procedures.

Normally in the year in which an asset is acquired or becomes available for use, CCA the claim is generally limited to half of what would otherwise be permitted. The limitation is referred to as the "half-year rule". However, the half-year rule does not apply to the immediate expensing incentive, so the entire capital cost of eligible property can be immediately deducted. Enhanced CCA claims under other incentives such as the accelerated investment incentive, do not reduce the amount available under the immediate expensing incentive, and vice versa. Similarly, the immediate expensing incentive does not reduce amounts available under the normal CCA rules.

Immediate Expensing Limit

The immediate expensing limit is $1.5 million per taxation year. If you do not use the full $1.5 million in a taxation year, the excess cannot be carried forward. Like the small business deduction, the $1.5 million limit must be shared among any corporations, partnerships, and individuals, who are associated with each other. Associated eligible persons and partnerships can file a prescribed form that contains an agreement to share the immediate expensing limit. A percentage of the limit can be allocated to each entity, the sum of which should be 100 percent. If your company has a short taxation year, your immediate expensing limit will be prorated accordingly.

Restrictions

There are various restrictions that are intended to protect the integrity of the CCA rules. These restrictions generally limit how much CCA you can deduct with respect to certain property, such as: leasing property, rental property, computer tax shelter property, and energy property. These restrictions will be extended such that they also apply to the immediate expensing incentive.

Small Businesses Air Quality Improvement Tax Credit

In the federal Economic and Fiscal Update 2021, the government presented a new temporary Small Businesses Air Quality Improvement Tax Credit. This credit will help businesses with the cost of upgrading their air systems in response to COVID-19. To access the credit, a taxpayer must be an eligible entity and incur qualifying expenditures attributable to air quality improvements in qualifying locations. The costs must be incurred between September 1, 2021 and December 31, 2022.

Eligible Entity

An eligible entity includes an individual (other than a trust), a partnership, or a qualifying corporation. A qualifying corporation means a Canadian-controlled private corporation (CCPC) with taxable capital employed in Canada of less than $15 million in the prior tax year.

Qualifying Expenditures

Qualifying expenditures include outlays and expenses that are directly attributable to the purchase, installation, conversion, or upgrade of a new or retrofitted HVAC system placed in service at a qualifying location. They would also include outlays and expenses that are directly attributable to the purchase of a device that is placed in service at a qualifying location and designed to filter air using a HEPA filter. The expenses are prescribed only to the extent that they are reasonable and intended primarily to increase outdoor air intake or to improve air cleaning.

However, qualifying expenditures do not include an expense

- made or incurred under the terms of an agreement entered into before September 1, 2021;
- related to recurring or routine repair and maintenance;
- for financing costs in respect of a qualifying expenditure;
- that is paid to a party with which the eligible entity does not deal at arm's length;
- that is salary or wages paid to an employee of the eligible entity; or
- that can reasonably be expected to be paid or returned to the eligible entity, or to a person or partnership either not dealing at arm's length with the eligible entity or at the direction of the eligible entity.

Qualifying Location

A qualifying location is a property used by the eligible entity primarily in the course of its ordinary commercial activities, which includes rental activities. However, it excludes a "self-contained domestic establishment" (i.e., a personal residence).

Calculating the Tax Credit

The refundable credit is equal to 25% of the qualifying expenditures. Total qualifying expenditures will be limited to $10,000 per qualifying location and $50,000 across all locations—these limits are shared among affiliated businesses. The term "refundable" basically means that you get additional money from the government regardless of whether you have a tax liability. A "non-refundable" credit is only helpful if you have a tax burden to reduce.

Qualifying expenditures incurred before January 1, 2022 would be claimed by an eligible entity for its first taxation year that ends on or after January 1, 2022. Qualifying expenditures incurred on or after January 1, 2022 would be claimed by an eligible entity for the taxation year in which the expenditure was incurred.

The amount of a claimable qualifying expenditure is reduced by the amount of any government assistance received in respect of that expense. Also, the amount of the tax credit must be included in the taxable income of the business in the year the credit is claimed.

Claiming Incentives on the Tax Return

Both the immediate expensing incentive and small business air quality improvement tax credit have not yet been officially enacted into law. Accordingly, at the time of writing, the CRA is not currently processing any claims for these incentives made on a tax return. The CRA will begin accepting these claims only once these rules receive Royal Assent in Parliament. Though you may have already incurred eligible expenditures, your claim may need to be made after your return is filed, depending on the deadline that applies to you.