Canadian tax alert

Fall economic update – benefits for lessors and financing companies

November 30, 2018

The federal government's November 21, 2018 fall economic update offers significant tax planning opportunities to purchasers and users of depreciable property. It appears that lessors may obtain significant tax and business benefits.

Proposals for accelerated depreciation

The fall update proposes a number of provisions to permit faster tax write-offs for depreciable property through the capital cost allowance (CCA) system. The new rules will apply to property acquired after November 20, 2018.

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Most depreciable property will be subject to a rule that will suspend the half-year rule and allow the owner of property to CCA on 150% of the cost of the property in the first year. The purchaser of a class 10 property, for example, who would normally be able to write off 15% of the cost in the year of acquisition (50%x30%) can now write off 45% of the cost (150% x 30%).

The benefit is even greater for purchasers of manufacturing and processing equipment and specified clean energy equipment. The acquirers of such property can write off the entire cost in the year of acquisition.

Lessors

The Canadian tax system includes a number of rules that limit the benefits lessors can obtain from the CCA regime. With proper planning, some lessors have nevertheless benefited from the CCA system.

The fall economic update indicates that existing CCA restrictions will continue to apply to lessors. However, if the final legislation is consistent with the statements in the update, lessors who plan effectively should still be able to benefit from the new rules.

Specified leasing property

One of the more significant rules that restrict the benefits of the CCA system to lessors are the specified leasing property rules. These rules apply to a wide array of property, including heavy industrial equipment and transportation equipment such as planes and locomotives.

Lessors compute CCA on specified leasing property based on two limits: the regular CCA rules and the amount of principal repaid on a notional loan. The fall update indicates that the specified leasing property rules will continue to apply to lessors on property affected by the new rules. However, the way the specified leasing property limits function, lessors may obtain modest benefits from the increased CCA, particularly in the later years of long leases.

Section 16.1 election

The more important changes may not be to a lessor's tax position, but to its customers' position. If a lessor and lessee execute a Form T2145 (Election in Respect of the Leasing of Property), subsection 16.1(1) of the Income Tax Act deems the lessee to own the leased property for tax purposes. The wording of the fall economic update suggests that a lessee can benefit from the enhanced CCA rules by filing the election. Lessors should prepare for more questions from their customers about how to benefit from the new rules.

Non-specified leasing property

Lessors and their customers cannot file a section 16.1 election for non-specified leasing property, which includes property such as buildings, software and computer equipment and vehicles used to transport passengers and freight on roads.

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The update suggests that lessors of "non-specified leasing property" will be entitled to claim enhanced CCA on leased property. Lessors that qualify for an exemption from the leasing property restrictions in Income Tax Regulations 1100(11) and (15) may be able to defer significant income by making the enhanced claims.

Financing companies – GST/HST considerations

Financing companies have long had to consider whether they are better off financing their customers' equipment through leases or through debt. Canada's GST/HST system of permitting a financing company to obtain input tax credits for leasing, but not lending, activities has long favoured leasing. These GST/HST benefits will still be available, and together with the fall update provide a compelling reason why financing companies should have leasing programs in place.

This is one of the biggest examples of Canada using the tax system to stimulate economic growth in Canada in years. Lessors and financing companies should be thinking about how to take advantage of the benefits

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