Making the Accelerated Capital Cost Allowance for Computer Equipment Permanent

Capital Cost Allowances (CCA) rates are generally intended to reflect the economic benefit of the asset over time – i.e. over its useful life. The depreciation rate is intended to reflect the fact that depreciable assets contribute to earnings over a period of time and are not consumed in the year in which they are acquired. Given how quickly technology changes, however, it would seem inappropriate to assume that computer equipment has a useful life and contributes to the earnings potential of a business over a period of more than 1 year.

Economic Incentive Program

On February 1, 2011, a special economic incentive program to stimulate computer equipment upgrades expired. Now, businesses will depreciate computer equipment (fully) over a longer period of time – i.e. roughly over a period of 9-10 years with most of the depreciation being taken within the first 3-4 years. This depreciation rate (even over 3-4 years) would appear to be inconsistent with the intended principal behind the CCA rates (i.e. depreciating an asset over its useful life) as most computer equipment is not useful for that period of time.

Following is a chronology of tax depreciation for computers:

- Computer equipment acquired before March 23, 2004 – depreciated at 30% per year on a declining balance basis and subject to the half year rule (15% in year one or year of acquisition)
- Computer equipment acquired on or after March 23, 2004 and before March 19, 2007 – depreciated at 45% per year on a declining balance basis and subject to the half year rule (22.5% in year one or year of acquisition)
- Computer equipment acquired after March 18, 2007 depreciated at 55% per year on a declining balance basis and subject to the half year rule (27.5% in year one or year of acquisition)
- As part of their economic stimulus the federal government temporarily changed the depreciation rate on computer equipment. The 2009 Federal Budget provided a temporary depreciation rate of 100% for eligible computers and software acquired after January 27, 2009 and before February 2011. The half-year rule would not apply to these assets. Therefore with this temporary measure, businesses were permitted to deduct 100% of the cost of an eligible computer in the first year or the year in which it was acquired. In general, eligible computers and software eligible for this accelerated depreciation rate consisted of general purpose computer equipment, including related system and data processing equipment. The equipment must also have been situated in Canada and it must have been acquired for the purpose of either earning income in a business carried on in Canada or earning income from property situated in Canada

Impact of the proposed change on tax revenue:

On a $1000 piece of computer equipment, the difference in the tax shield under both depreciation rates is not significant. In summary:

- 55% depreciation rate – the tax shield ranges between $250 and $260
- 100% depreciation rate- the tax shield is $265

The tax shield represents the value of the tax depreciation in today's dollars to a corporation under certain assumptions. Conversely, it would also represent the lost tax revenue to the federal government as a result of permitting the depreciation deduction in the calculation of taxable income. What the above example illustrates is that by comparison the lost revenue to the federal government in today's dollars is not significant. However, the benefit to a small business owner is significant from a cash flow perspective as they will receive an immediate benefit of the tax depreciation deduction in the first year as opposed to spreading that benefit out over 3-4 years.

Recommendation

That the federal government permanently change the Cost Capital Allowance (CCA) depreciation period for computer equipment, to a period of two years (as reflected in the recent accelerated CCA program).