DRIVING TECHNOLOGY | TAX REFORM ON THE HORIZON? | CONNECTING TO A GLOBAL MARKET

The official magazine and voice of the Saskatchewan Heavy Construction Association

THINK BIG

Q3 2014

The Equipment Issue

PLUS:

The Enbridge Line 3 Replacement Program

saskheavy.ca

"You can depreciate a piece of equipment within six years, which is a level that is consistent with the useful service life of an asset."

– Bill Ferreira, Director of Government Relations for the CCA

Tax Reform on the Horizon?

Definition of 'useful service life' open to interpretation when it comes to equipment depreciation rate

By Heather Hudson

If you're in heavy construction, you know how quickly an expensive piece of mobile equipment can depreciate after eight to 10 hours of daily use, often in punishing winter conditions.

According to the Canadian Construction Association (CCA), the federal government doesn't quite get it.

That's why they've been lobbying for reform to the current Government of Canada tax policy regarding the 30 per cent declining balance basis. The CCA seeks changes to bring the depreciation rates for mobile assets in line with those in the U.S., which, by comparison, are able to achieve full depreciation within five years. In Canada, it would take up to 13 years to achieve that.

"The government's basic policy on depreciation is that assets should be linked to the operational life of the asset itself…so the rate at which you can depreciate that asset is based on its useful service life," says Bill Ferreira, director of government relations for the CCA.

"The problem is that when you look at our industry, most of the equipment has a functional operational life of about five to seven years."

He argues that while the equipment may not be disposed of after that, it's no longer a productive asset and isn't typically used on the jobsite to earn revenue.

"Our view is that the current depreciation rates don't encourage productivity in this country because they encourage owners to hang on to assets for as long as possible," Ferreira says.

How capital cost allowance works

The capital cost allowance system determines how much of the capital cost of an asset a company may deduct each year for income tax purposes. Rates are generally set so that the deduction for capital costs is spread over the useful life of the asset to ensure the accurate measurement of income for tax purposes. It's also intended to ensure the tax system is neutral with respect to investment in assets with different lifespans.

Power-operated movable equipment designed for the purposes of excavating, moving, placing or compacting earth, rock, concrete or asphalt (generally referred to as "earth-moving equipment") is included in capital cost allowance A Class 38 and depreciates at a rate of 30 per cent per year, on a declining balance basis.

This means that you can claim 15 per cent rate of depreciation in the equipment's first year. The second year, you can apply 30 per cent to the remaining balance – not of the purchase price, but of the residual value of the asset. From there, the rate continues to decline until you reach 13 years, when the asset is 99 per cent devalued.

The CCA points out that in other countries, such as the U.S., the depreciation rate is much higher. "You can depreciate a piece of equipment within six years, which is a level that is consistent with the useful service life of an asset," Ferreira says.

"In Canada, at seven years, you're still at 90 per cent. That might not seem like a lot, but when an asset is a million dollars or more, that's significant."

IZABELL/SHUTTERSTOCK

While he acknowledges that some off-road equipment may have a longer productive service life of up to nine years and some equipment, like cranes, may last as long as 15 years, the majority of heavy equipment in Canada works hard and dies fast.

Reform requests

"We believe that a 25 per cent straight line depreciation would be more in line with the productive service life of the asset and complement the government's goal to improve domestic competitiveness and productivity," Ferreira says.

If the government chose to continue with the declining balance method, the CCA would recommend an increase of the applicable rate to 50 per cent. This would translate into a 9.4 per cent residual value on an asset after five years of ownership (the current residual value rate is 29.2 per cent), a 2.3 per cent residual value after seven years (the current rate is 14.3 per cent) and a 1.3 per cent value after 10 years of ownership (current rate is 4.9 per cent).

"If the actual asset value is higher than the capital cost allowance-rated value, recapture rules would ensure that if the asset owner sells the asset for a profit, those profits would be taxed at the appropriate level, so the government would never be out of pocket," Ferreira explains.

The Department of Finance reviews the capital cost allowance rates in the income tax system on an ongoing basis to ensure they reflect the useful life of assets.

Ferreira says it's not enough.

"This [review] has been done in the past and yielded no change. We are seeking another meeting with officials to help bolster our case," he says.

In terms of comparisons with other jurisdictions, the Department of Finance says that Canada does not aim to match individual tax features (such as tax depreciation rates) of other jurisdictions such as the U.S.

They point out that while the U.S has higher tax depreciation rates for some assets than Canada, the U.S. statutory general corporate income tax rate (federal rate plus weighted average provincial/state rate) is also much higher – approximately 39.1 per cent versus 26.3 per cent in Canada.

While the CCA is on board with the reduction of the corporate tax rate, Ferreira argues that those changes don't directly contribute to the improved business productivity or reinvestment in the business. They are working to get a meeting with department officials to see if there's some scope to adjusting the existing rate.

"Our proposal is that the government should be doing for the heavy construction industry what they did for the manufacturing sector, which was an accelerated capital cost allowance that allowed fixed machinery to be depreciated on a three-year cycle to encourage businesses to become more productive by investing in machinery," Ferreira says.

"The incentive was introduced to encourage businesses to automate and reduce costs to be more globally competitive. Why wouldn't they do the same for other industries that rely on mobile equipment?"

He says PricewaterhouseCoopers reviewed the CCA's proposal and concluded that it would translate to a minor financial hit within the first five years, but after that, the change would be revenue neutral or possible revenue positive over the longer term.

"We've been pushing this for about four years to one degree or another but we haven't really made a lot of headway with [The Department of] Finance because it always comes back to question of affordability. The major push back is they don't want to have to do it for other industries," Ferreira notes.

But it's not like they're going to give up easily.

"You have to keep at it and eventually you'll find a receptive ear," he says.

In the meantime, Ferreira says those in the industry are always encouraged to bring it up when they have the ear of a federal politician.

"The more they hear about it, the more likely they are to support us in proposing change," he says.