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Budget 2008: Capital investment will garner writedowns

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(February 2008) Canadian business owners shopping for capital equipment south of the border got an additional boost from the federal government today. However, entrepreneurs outside of manufacturing found little in terms of direct aid in the Conservative budget.

A strong loonie has already been boosting business owners' purchasing power, and now a proposal to implement three years of accelerated capital cost allowance (CCA) treatment will let those buying manufacturing and processing equipment between 2009 and 2011 write off that equipment at an accelerated rate over a three-year period.

"There are some good things for capital cost allowances for manufacturers, railway companies, and anybody who buys clean energy generation equipment," says Marc Lamontagne, a principal at Ryan Lamontagne Inc. in Ottawa. "But, as a business owner, there's no reason to revise your financial plan tomorrow."

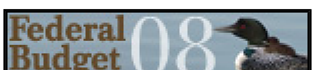
Last October's goodie-laden mini-budget got the ball rolling when it unveiled a temporary, two-year, 50% straight-line accelerated CCA rate for those buying new equipment before next year. This budget extends the treatment for three more years. "This will include a one-year extension of the 50% straight-line accelerated CCA treatment, followed by a two-year period during which the accelerated treatment will be provided on a declining basis," according to budget documents.

The hope is that by extending the breaks until 2011, businesses will be able to retool, boost productivity and add value to production processes at a time when the surging dollar has made Canadian goods expensive for importers. The budget further proposes to increase the CCA on the purchase of rail equipment to 30% from 15% with an eye toward encouraging operators to switch to more fuel-efficient locomotives.

"Step back to 1999, during Y2K, when we had to replace all our technology. The government offered an incentive that allowed businesses to write off the purchase of computers in one year; computer sales went through the roof," says Peter Merrick, president of MerrickWealth.com. "So, in essence, our antiquated industries are being given the incentive to make those large purchases. Because it's such a fast writedown, businesses that purchase, write off and then sell their equipment may also be able to recapture some of those expenses."

Of course, notes Lamontagne, whether businesses bite is another matter. "The fact that the government is signalling a slower economy could get a business owner to say, 'Well I'm not sure if I should have a big spending spree. Maybe I shouldn't hire those extra bodies,'" he says. "It kind of telegraphs a slowdown of the economy."

Mark McNulty, author of *The Canadian Small Business Guide to Financial Independence*, disagrees. He believes that by acknowledging the uncertain economy and opting for fiscal prudence, the budget will benefit entrepreneurs in the long-run. "We didn't get direct money into the pockets [of entrepreneurs]. This government did that in the last budget and in October's mini-budget," said McNulty, a Markham, Ont.-based CFP and the youngest half of the father-son McNulty team, a fee-only financial planning firm that caters to dentists. "I'm glad the government decided to pay down the debt and build up reserves. That's a lot of money that went into building another cushion [for entrepreneurs] and this helps avoid a recession. Nothing hurts entrepreneurs more than a recession."



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While McNulty maintains this budget really has no significant impact on Canadian businesses, he is hopeful the long-term strategy of the Conservatives will offer boomer-entrepreneurs a chance to realize their potential.

"The amount of money funnelled into education is very promising," he says "The Canadian Federation of Independent Business has conducted countless studies that show the landscape of businesses will dramatically change when the boomers start to retire. By funnelling money into education the government is [grooming] potential purchasers for boomers selling their businesses and about to retire."

More direct benefits will come from a promise to improve processing of a tax incentive program tied to Scientific Research and Experimental Development (SR&ED), says Lamontagne. While the program has provided significant tax assistance, he says the application process can be ponderous to the point where he's told applicants not to hold their breath.

The budget will "increase the expenditure limit from $2 million to $3 million [and] increase the upper limit for the taxable capital phase-out range from $15 million to $50 million," the documents say, and the upper limit of the taxable income phase-out range will also be increased, from $600,000 to $700,000. The changes will be effective for tax years ending on or after February 26, 2008. "They're giving you a bit more headroom before you bump into the caps," notes Jason Safar, a tax partner at PricewaterhouseCoopers.

Adds Lamontagne: "What they've announced in this budget is that they're going to make the forms simpler and actually hire more people to read the applications and qualify people. That will be an improvement."

Entrepreneurs with large numbers of employees will benefit from a reduction in penalties if they're late disbursing withholding payments to the government. Currently, a business owner who is as little as one hour late with a payment can be penalized 10%. Under the budget proposal, the penalties will be stratified so that it takes one week to reach that level. "It's quite punitive," says Safar. "It's 10% of whatever holdings you were supposed to remit. So if you have a large payroll, or you're paying a big bonus, that 10% can be quite painful."

And, if you have to drive for work, the budget will simplify the current system that now requires the keeping of detailed log books indicating the number of kilometres driven, whom was met and what the business purpose was. Under the new arrangement, a taxpayer who provides a sampling of auto use will be given the benefit of the doubt regarding legitimacy of the business travel. "We do tax preparation for a number of clients and we find they just hate to keep log books, so the fact that they made it easier will make a big difference," says Lamontagne.

Safar notes that a huge percentage of taxpayers don't actually maintain log books, and that becomes an issue in the event the CRA audits. "I've always been successful saying, 'Can we give you the typical month?' and they agree," he says. "So they've formalized what I have experienced as their internal administrative process."

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