Zero-Emission Vehicles and New Class 56

Income Tax Act

Clause 1

Definitions

ITA
248(1)

Subsection 248(1) of the *Income Tax Act* (the "Act") provides a number of definitions that apply for all purposes of the Act.

"zero-emission vehicle"

The definition "zero-emission vehicle" in subsection 248(1) of the Act describes a class of assets that, if they are acquired and become available for use after March 18, 2019 and before 2028, are eligible for a temporary first-year enhanced capital cost allowance (CCA), subject to certain conditions. Zero-emission vehicles are included in either Class 54 or Class 55 of Schedule II to the *Income Tax Regulations* (the "Regulations").

Paragraph (c) of the definition currently requires that, prior to its acquisition by the taxpayer, the vehicle not have been used, or acquired for use, for any purpose. Furthermore, no CCA or terminal loss may have been claimed in respect of the vehicle by another person or partnership.

For vehicles acquired after March 1, 2020, paragraph (c) of the definition is amended in two respects. First, the prior usage restriction is being removed. Second, the automatic disqualification of a vehicle in respect of which CCA or a terminal loss has been claimed is being removed and replaced with a rule, in new paragraph (d), that mirrors the restrictions for "accelerated investment incentive property" in subsection 1104(4) of the Regulations.

Thus for vehicles acquired after March 1, 2020, paragraph (d) provides that a vehicle may still qualify as a "zero-emission vehicle" where the vehicle was subject to a prior CCA or terminal loss claim provided that the vehicle was neither acquired by the taxpayer on a tax-deferred "rollover" basis nor was it previously owned or acquired by the taxpayer or a non-arm's length person or partnership.

Income Tax Regulations

Clause 2

Capital cost allowance

ITR
Part XI

Part XI of the Regulations provides rules that allow for deductions of capital cost allowance (CCA) in respect of depreciable capital property.

Various provisions of Part XI are amended in order to add new Class 56. The primary effect of these amendments is to provide for a temporary first-year enhanced CCA deduction for zero-emission automotive equipment acquired after March 1, 2020 and before 2028.

Rates

ITR
1100(1)(a)

Paragraph 1100(1)(a) of the Regulations provides various declining-balance CCA rates applicable to certain classes of depreciable property. It is amended by adding new subparagraph 1100(1)(a)(xlii), which sets the general CCA rate for Class 56 at 30%.

Property acquired in the year

ITR
1100(2)

Subsection 1100(2) of the Regulations provides rules for computing the CCA deduction in respect of a property for the year in which the property first becomes available for use. Subsection 1100(2) has two main parts. The first part, as expressed by elements A and B, relates to the enhanced first-year CCA in respect of "accelerated investment incentive property" of a taxpayer, as defined in subsection 1104(4) of the Regulations, and property included in Classes 54 and 55, relating to "zero-emission vehicles," as defined in subsection 248(1) of the Act. The second part, as expressed by element C, is the so-called "half-year rule", which applies to any other depreciable property and limits a taxpayer's CCA claim to one-half of the otherwise applicable amount, for the year in which the property first becomes available for use.

Subsection 1100(2) is amended in a number of places in order to add references to new Class 56. The intended effect of these amendments is to provide a CCA deduction of 100% for Class 56 property that becomes available for use after March 1, 2020 and before 2024, a 75% CCA deduction for Class 56 property that becomes available for use in 2024 or 2025 and a 55% CCA deduction for Class 56 property that becomes available for use in 2026 or 2027.

Clause 3

ITR
1102(14.13)

Subsection 1102(14.13) excludes from the application of subsection 1102(14) property that is a “zero-emission vehicle,” as defined in subsection 248(1) of the Act, that is included in Class 54 or 55. Subsection 1102(14) of the Regulations might otherwise provide that such property, if acquired by a taxpayer from a non-arm’s length party, or in the course of a certain type of reorganization, remains property of the same class as that of the vendor.

Subsection 1102(14.13) is amended to also exclude from the application of subsection 1102(14) property in new Class 56. As such, subsection 1102(14.13) will now ensure that eligibility for Class 54, 55 or 56 treatment in the context of certain non-arm’s length or reorganization-related acquisitions will be determined solely based on whether the property, as acquired by the purchaser, meets the relevant criteria for that class as set out in Schedule II to the Regulations.

Clause 4

ITR
1103(2j)

Subsection 1103(2j) of the Regulations provides taxpayers the ability to opt-out of Class 54 or 55 treatment and instead include the relevant property in its otherwise applicable CCA class, such as Class 10, 10.1 or 16.

Subsection 1103(2j) is amended in order to provide a similar option for property that is eligible for inclusion in new Class 56.

Clause 5

ITR
1104(4)

Subsection 1104(4) of the Regulations defines “accelerated investment incentive property” for the purposes of Part XI and Schedules II to VI of the Regulations. This definition is one of the main provisions that implements the enhanced CCA rules that were first announced in November 2018.

Subsection 1104(4) currently contains exclusions for Class 54 and Class 55 property. The rules relating to these classes provide an independent means of granting enhanced CCA deductions.

Consequential on the introduction of new Class 56, which is also subject to an independent enhanced CCA regime, subsection 1104(4) is amended to exclude property that is included in that class.

Clause 6

Capital cost allowance – prescribed classes

ITR
Schedule II

Schedule II to the Regulations lists the properties that can be included in each CCA class. A portion of the capital cost of depreciable property is deductible as CCA each year. CCA rates for each type of property, identified by their CCA classes, are set out in section 1100 of the Regulations.

Class 56 (30% CCA rate)

New Class 56 is introduced to provide a temporary first-year enhanced CCA deduction for certain property that is acquired, and becomes available for use, by the taxpayer after March 1, 2020 and before 2028. While generally subject to a 30% CCA rate, Class 56 property is eligible for a first-year accelerated CCA rate as a result of amended subsection 1100(2). For more information, see the commentary on subsection 1100(2) of the Regulations.

To be eligible for inclusion in Class 56, property must meet the conditions in paragraphs (a) and (b).

Paragraph (a) generally provides that the property must be automotive equipment, other than a motor vehicle (as defined in subsection 248(1) of the Act), and must be fully electric, fully powered by hydrogen or fully powered by a combination of electricity and hydrogen. The exclusion of motor vehicles is generally intended to result in Class 56 capturing all such automotive equipment that is not designed for use on highways or streets. Those that are designed for use on highways or streets should generally be eligible for inclusion in Class 54 or 55.

Class 56 is intended to include any type of zero-emission automotive (*i.e.*, self-propelled) equipment that is not a motor vehicle. Notable examples would be zero-emission aircraft, watercraft, trolley buses and railway locomotives.

Paragraph (a) also provides, under subparagraph (a)(ii), that the costs of certain additions or alterations may qualify for Class 56 treatment. Additions or alterations will so qualify if they convert automotive equipment (other than a motor vehicle) into zero-emission property. Thus, for example, the costs of converting a gas-powered watercraft into a fully electric watercraft could be eligible for Class 56 treatment. The intention is that such costs would generally be considered to be available for use once the entire equipment can be used in a manner that produces no emissions.

Paragraph (b) contains a restriction in that property can qualify for Class 56 treatment only if such property would otherwise be considered “accelerated investment incentive property” under subsection 1104(4). Essentially, this condition is meant to exclude from Class 56 property in respect of which CCA has previously been claimed by another person or partnership where the equipment was acquired by the taxpayer on a tax-deferred “rollover” basis or it was previously owned or acquired by the taxpayer or a non-arm’s length person or partnership. In this regard, all rules relating to the “accelerated investment incentive property” definition must be taken into account, such as the anti-avoidance rule in subsection 1102(20.1) of the Regulations.