

Budget 2010: expansion of specified leasing property rules

The specified leasing property rules of the *Income Tax Act* are designed to place a lessor of most tangible property in a similar taxable income position to that of a lender which made a loan to the lessee of the property with a principal amount equal to the fair market value of the property. The specified leasing property rules achieve this objective by limiting the capital cost allowance deductible in any year by the lessor to a notional amount of principal that would be considered to have been repaid in the year if the lease were deemed to be a loan with the rent payments being blended payments of principal and interest on the loan. In this way, in computing the income of the lessor, the rent payments may only be reduced by capital cost allowance equal to a notional principal amount, leaving the lessor with an income inclusion equal to a notional interest amount, which is the amount a lender which had made a loan to the lessee would be required to include in its income.

The specified leasing property rules are quite broad in that they apply to all tangible property with a value in excess of \$25,000 that is leased to an arm's length person with a term over one year. There are certain exceptions to the general rule ("exempt property"), including general office equipment, computers with a value of no more than \$1 million, residential use property, automobiles, trucks and trailers, railway cars and most buildings.

The budget proposes to expand the scope of the specified leasing property rules by narrowing the definition of exempt property. Property with a value of \$1 million or more that is leased to a non-resident, government or other tax exempt entity will no longer qualify as exempt property. The new rules will apply to leases entered into after 4:00 pm EST on March 4, 2010.

The government suggested that the new rules are necessary because "some taxpayers have exploited these exemptions by leasing exempt property, and claiming capital cost allowance in respect of that property, to a lessee who is not subject to Canadian income tax and therefore cannot make use of the capital cost allowance, either because the lessee is tax exempt

or non-resident.” However, the existing specified leasing property rules specifically recognize that exempt property may be leased to tax exempts and in this regard only excluded from the definition of exempt property, buildings under lease to a tax exempt if the building had been previously owned by the tax exempt (to prevent the sale and lease back of buildings). While it is always open for the government to expand the exclusion from exempt property to a greater range of properties leased to tax exempts, to suggest that the leasing of exempt property to a tax exempt under the existing law was not fully contemplated and expected under the existing rules is simply false.

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a cautionary note

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