Manufacturing Operations

As noted previously, the income of a corporation from manufacturing and processing operations is eligible for reduced rates of corporate tax. These reduced rates apply whether or not the corporation is non-resident. Individuals earning manufacturing income would be subject to the usual personal tax rates. However, in most situations, manufacturing operations would be held in a corporation for normal business reasons.

The general Canadian tax rules discussed above apply to manufacturing income. The following rules are particularly relevant for this type of income, although they may apply in other situations as well.

Investment Tax Credits (ITCs)

Taxpayers who invest in certain assets or incur certain expenditures may be eligible for Investment Tax Credits. These credits are calculated as a percentage of the cost of the asset or expenditure and are deducted from federal tax payable or, for some taxpayers, partially or totally refunded.

The most widely available credit pertains to scientific research and experimental development expenditures ("R&D"). It is calculated at 20% of gross expenditures (including capital acquisitions), and is creditable against 100% of federal tax. Any ITCs not claimed in a year can be carried back 3 years or forward 10 years.

CCPCs with taxable income and taxable capital under certain limits for an associated group in the previous year are entitled to an additional 15% credit on up to $2 million of R&D.

Furthermore, CCPCs are eligible for a direct refund of 40% of the total credit for capital expenditures, and 100% of the total credit for current expenditures. Individuals (and unincorporated businesses) are also entitled to a refund and are able to apply the credit against 100% of their federal tax. See below for further details on the treatment of R&D expenditures.

Other investment tax credits are available for certain "qualified property" (equipment and buildings) installed and used in the Atlantic provinces. All credits claimed reduce the cost of the asset for tax purposes in the following year, and therefore reduce amounts deductible with regard to the asset.

Some provinces also provide their own ITCs.

Accelerated Capital Cost Allowance

To encourage taxpayers to invest in certain depreciable assets, a quicker write off period is allowed on some assets used in a specific activity. For example, manufacturing assets are generally written off at a rate of 30%. Business computer applications software may be written off in two years and capital expenditures incurred, before 1999, to control air and water pollution may be fully written off over three years.

Available-For-Use Rules

Businesses which acquire property after 1989 are restricted from claiming CCA and investment tax credits until the time that is the earlier of the year the property is used for its intended purpose and 24 months from the time it was acquired. The half-year CCA rule will not apply to property that becomes depreciable because of the 24-month rule. Property that becomes available for use within the two year limit will still be subject to the half-year rule.

There are specific rules for determining when property is considered to be "available-for-use". Their purpose is to ensure better matching of income and expenses and they are consistent with the tax depreciation rules of most industrial countries.

Research and Development

Under present Canadian tax law, 100% of current and capital expenditures for R&D may be written off in the year they are incurred, net of the investment tax credit on expenditures in respect of R&D (as discussed above). The 100% write-off and investment tax credits are no longer available for buildings acquired after 1987 for use in R&D activities.

As mentioned previously, investment tax credits earned are refundable in cash to certain taxpayers who are unable to fully utilize the credits to reduce their federal tax liability. Investment tax credits on current research and development expenditures earned at the 35% rate (i.e. qualifying CCPCs) are fully refundable. Any other credits are refundable at the 40% rate, as previously discussed.