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GOVERNMENT PROPOSES A NEW AIR QUALITY IMPROVEMENT TAX CREDIT FOR SMALL BUSINESSES

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As part of the Economic and Fiscal Update 2021 on December 14, the federal government proposed a new tax credit for owner-managed businesses called the Small Businesses Air Quality Improvement Tax Credit (SBAQITC). This temporary, refundable credit is designed to help offset some of the cost of investing in better ventilation and air filtration systems to improve indoor air quality.

Once enacted, the credit will be available to eligible entities for qualifying expenditures made between September 1, 2021 and December 31, 2022. The following comments are based on documents released by the government as part of the Economic and Fiscal Update. The credit has not yet been passed into law.

Quick facts about the Small Businesses Air Quality Improvement Tax Credit

As we examine the newly proposed tax credit, these basic points are worth outlining:

- The credit rate is 25% of qualifying expenditures to a maximum of $10,000 in qualifying expenditures, or a $2,500 tax credit, per eligible location.
- Each eligible entity would be limited to a maximum of $50,000 of eligible expenditures across all locations.
- Credit amounts will be included in taxable income for the year in which the credit is claimed. That said, we expect the draft legislation will confirm that the credit claimed can be netted against the cost of capital assets that are included in eligible expenditures incurred.

The announcement states that the limits on qualifying expenditures would need to be shared among affiliated businesses, but this may instead mean associated businesses.

Qualifying expenditures

Qualifying expenditures relate to the purchase and installation of mechanical heating, ventilation, and air conditioning (HVAC) systems. They also include expenditures to upgrade or convert existing systems and the purchase of devices designed to filter air using high efficiency particulate air (HEPA) filters. The primary purpose of the HEPA filter should be to increase outdoor air intake, or to improve air cleaning or air filtration.

To count as qualifying expenditures, they must be paid to an arm's length person. Employee wages to install or fabricate the equipment will not qualify.

Eligible entities

Eligible entities include unincorporated sole proprietors and Canadian-controlled private corporations (CCPCs) with taxable capital employed in Canada of less than $15 million in the immediately preceding taxation year. For example, for a taxpayer with a December year-end, this cap on taxable capital applies for the taxation year ended December 31, 2020 for expenditures made in 2021, and to the taxation year ended December 31, 2022 for expenditures made in 2022. For these purposes, the taxable capital of a group of associated corporations is the relevant measure of taxable capital employed in Canada for corporations in an associated group.

Certain partners will be able to claim the credit for qualified expenses are incurred by a partnership. The credit will only be able to be claimed by members of the partnership that are qualifying corporations or individuals (other than trusts). Such a credit would be based on each partner's proportionate interest in the partnership.

Required specifications of equipment

Expenses attributable to an HVAC system will only be considered qualifying expenditures if the system is:

- designed to filter air at a rate surpassing a Minimum Efficiency Reporting Value (MERV) of eight; or
- designed to filter air at a rate equal to MERV eight and to achieve an outdoor air supply rate in excess of what is required for the space by relevant building codes. For a system that is upgraded or converted prior to the improvement, the system must have been designed to filter air at a rate equal to MERV eight.

Restrictions

The proposed credit will have certain restrictions such as:

- The expenses cannot have been made or incurred under the terms of an agreement entered into before September 1, 2021.
- Expenses for routine repairs and maintenance will not qualify, nor will financing costs related to a qualifying expenditure.
- An expense that may be considered a qualifying expenditure will be reduced by the amount of any government assistance received by the eligible entity in respect of that expense.

Qualifying locations

Qualifying locations will be properties used by a claiming taxpayer primarily during its ordinary commercial activities in Canada (including rental activities), provided such a location is not a home or an apartment.

Timing

The proposed tax credit is to be available with respect to qualifying expenditures incurred between September 1, 2021 and December 31, 2022. However, for expenditures incurred before January 1, 2022, the tax credit claim could not be until the first taxation year of the claimant that ends on or after January 1, 2022. This would mean the 2022 tax return for a calendar-year taxpayer.

Though, for qualifying expenditures incurred on or after January 1, 2022, they could be claimed for the taxation year in which the expenditure was incurred.

SOURCE; BDO Canada website