

## Ontario Current Cost Adjustment: Pollution Control Equipment

References: Sections 13, 35

### Application

*This bulletin discusses the Ontario Current Cost Adjustment (OCCA) deduction in respect of new pollution control equipment acquired after December 31, 1990. This bulletin replaces the comments regarding OCCA contained in Information Bulletin 2742 originally published February 1993 and is updated for comments contained in previous Information Bulletins 2745 and 2748.*

*The bulletin sets out the policy of the Corporations Tax Branch. It is provided as a guide to taxpayers and is not intended as a substitute for the relevant legislation. Any references to legislation are to the provisions of the Corporations Tax Act (Ontario) (CTA) and its Regulations, unless otherwise noted.*

### Introduction

1. The OCCA deduction is an incentive to assist corporations with the costs involved in purchasing new pollution control equipment for use in Ontario. The OCCA deduction previously also applied to prescribed manufacturing and processing equipment acquired after December 31, 1988 and before January 1, 1992.
2. Pursuant to section 13, corporations are entitled to a one-time deduction in computing Ontario taxable income in respect of the “eligible cost” to the corporation of all “eligible assets” acquired by the corporation for the taxation year. The deduction is in addition to the capital cost allowance (CCA) deductions allowed for federal and Ontario income tax purposes.

## Calculating the OCCA Deduction

### Formula: Subsection 13(2)

3. The OCCA deduction is calculated using the formula  $B/C \times D$ , where,
  - B = the corporation’s eligible asset pool for the taxation year
  - C = Ontario allocation factor for the year; (if 0, then  $C = 1$ ), and
  - D = 30%, which is the corporation’s specified rate for acquisitions of eligible assets after December 31, 1990.

## Eligible Asset Pool (“B”)

### Calculating the Eligible Asset Pool “B”

4. The eligible asset pool of a corporation for a taxation year is the amount, if any, by which the total of the:
  - eligible cost on hand at the end of the taxation year of eligible assets for the taxation year or a prior taxation year
  - eligible cost of eligible assets for the taxation year or a prior taxation year that were acquired and disposed of before the end of the taxation year, and

## Calculating the Eligible Asset Pool "B" (continued)

- repaid government assistance in respect of eligible assets
- exceeds the sum of:**
- federal investment tax credits deducted from tax in a previous taxation year in respect of a disposed eligible asset
- government assistance the corporation received or is entitled to receive in respect of eligible assets after their disposition
- federal investment tax credits in respect of eligible assets acquired in a preceding year and included in the income of the corporation, a subsidiary corporation or a predecessor corporation, for the taxation year, or for a preceding taxation year under paragraph 12(1)(t) of the *Income Tax Act* (Canada)(ITA), and
- eligible asset pool for the most recent taxation year in which the corporation was entitled to OCCA.

## Eligible Assets

5. The corporation must add the cost of pollution control equipment to its eligible asset pool and claim an OCCA deduction only in the taxation year in which the equipment first qualifies for a capital cost allowance claim. For example, this would occur when the equipment becomes "available for use". Ontario follows the "available for use" rules for both OCCA and capital cost allowance purposes as they apply for purposes of the ITA.
6. An eligible asset is defined in subsection 13(1) as prescribed pollution control equipment acquired by the corporation after May 17, 1989, that:
  - has not been used by any person for any purpose before being acquired by the corporation
  - is first used by the corporation in Ontario
  - is used by the corporation for the purpose of earning income from a business, and
  - has not been deemed to have been acquired by a lessee corporation pursuant to a joint election between the lessee and lessor under paragraph 16.1(1)(b) of the ITA (see paragraphs 18 to 20 below).
7. Eligible assets are further defined in subsection 202(2) of Regulation 183 to include new pollution control equipment acquired:
  - by a corporation to primarily prevent, reduce or eliminate water or air pollution in Canada caused by the corporation's:
    - operations at a site, building or plant in Ontario, or
    - operation of transportation or other movable equipment in Ontario
  - to earn income from a business in which the equipment is used primarily to prevent, reduce or eliminate the types of pollution discussed above that is caused by other persons, or
  - by a corporation whose principal business is the purchasing of trade paper, lending money, leasing property, or a combination thereof and the equipment is leased to other persons to prevent, reduce or eliminate the types of pollution discussed above.
8. Equipment used to control pollution caused by another person's Ontario operation will not be eligible for the OCCA deduction where:
  - the other person is a corporation exempt from tax pursuant to subsection 57(1), or
  - the other person is exempt from federal tax pursuant to subsection 149(1) of the ITA.

## Eligible Costs

9. The eligible cost of pollution control equipment is the capital cost of the equipment, restricted to \$20,000,000 of acquisitions for each taxation year. The \$20,000,000 limit is prorated for short taxation years. If the \$20,000,000 limit is not used in a particular year, the unused amount cannot be carried forward to a following year.
10. Assets may be acquired or constructed over several taxation years and become eligible for capital cost allowance and inclusion in the eligible asset pool for OCCA purposes in a later taxation year. To determine the eligible cost of the assets for the eligible asset pool, it is necessary to first sort the eligible assets for the taxation year by year of acquisition, and then apply the \$20,000,000 limit separately to each year of acquisition.
11. For purposes of the additions to the eligible asset pool and the \$20,000,000 limit, pursuant to clause 1(3)(a), the CTA generally adopts the federal definition of “capital cost”. Consistent with the federal definition in subsection 13(7.1) of the ITA, the “capital cost” of an eligible asset is reduced by any federal investment tax credits deducted from federal income tax payable in a preceding taxation year and any government assistance received or receivable.
12. OCCA and the related Ontario corporate income tax savings are not considered “government assistance” as defined in paragraph 127(9) of the ITA. In addition, these amounts are not government assistance for the purposes of paragraphs 37(1)(d), 12(1)(x) and subsection 13(7.1) of the ITA and are not deducted from the capital cost of the related asset or the eligible cost for purposes of the OCCA deduction.

## Ontario Allocation Factor (“C”)

### Rationale for Using the Ontario Allocation Factor

13. OCCA is a deduction from Ontario income. Therefore, where the corporation allocates a portion of its income to other jurisdictions, the amount of the deduction is effectively “grossed up” to offset the impact of this allocation. This is achieved by dividing the deduction otherwise calculated by the corporation’s Ontario allocation factor as defined in subsection 12(1).

### Determining the Ontario Allocation Factor

14. For resident corporations with permanent establishments in more than one jurisdiction, the Ontario allocation factor is the same as the percentage of a corporation’s taxable income allocated to Ontario. For non-resident corporations, it is the percentage of taxable income earned in Canada that is allocated to Ontario. The allocation of taxable income is determined in accordance with the rules set out in Part III of Regulation 183. For further information on allocation, refer to Interpretation Bulletin 3008.

## Example - Calculating the OCCA Deduction

### Facts

15. Consider the following facts regarding the acquisition of pollution control equipment:

	Asset X	Asset Y	Asset Z
Cost incurred in 1999	\$1,000,000	\$9,000,000	NIL
Government Assistance received in 1999	NIL	\$(500,000)	NIL
Cost incurred in 2000	NIL	NIL	\$2,000,000
Year eligible for CCA	1999	2000	2000

The corporation’s year end is December 31 and its Ontario allocation factor for both 1999 and 2000 is 20%.

## Solution

## 16. 1999 Year

Eligible costs for Asset Y are not part of the Eligible Asset Pool for 1999 because Asset Y is not eligible for CCA until the 2000 year.

$$B = \text{Eligible asset pool for 1999} = \$1,000,000$$

$$C = \text{Ontario allocation factor} = 20\%$$

$$D = \text{Specified Rate} = 30\%$$

$$\begin{aligned} \text{OCCA deduction} &= (B/C) \times D \\ &= (\$1,000,000 / 20\%) \times 30\% \\ &= \$1,500,000 \end{aligned}$$

## 17. 2000 Year

$$\begin{aligned} B = & \text{ELIGIBLE ASSET POOL FOR 2000} \\ & \$ 1,000,000 \quad \text{1999 Purchase} \\ & + 8,500,000 \quad \text{1999 Purchase of Asset Y less government assistance,} \\ & \quad \quad \quad \text{(eligible for CCA in 2000)} \\ & + \underline{2,000,000} \quad \text{2000 Purchase of Asset Z (eligible for CCA in 2000)} \\ & \quad \quad \quad 11,500,000 \\ & - \underline{1,000,000} \quad \text{1999 Eligible Asset Pool} \\ & \underline{\$ 10,500,000} \quad \text{2000 Eligible Asset Pool} \\ C = & \text{Ontario allocation factor} = 20\% \\ D = & \text{Specified Rate} = 30\% \\ \text{OCCA deduction} &= (B/C) \times D \\ &= (\$10,500,000 / 20\%) \times 30\% \\ &= \$ 15,750,000 \end{aligned}$$

## Other Considerations

## Leasing Rules

18. If a lease agreement is essentially a sale for tax purposes, the lessee is entitled to claim capital cost allowance and the OCCA deduction on the leased property. On the other hand, if a lease agreement is an ordinary lease for tax purposes, the lessor is entitled to claim capital cost allowance and the OCCA deduction with respect to the leased property. Refer to federal Interpretation Bulletin IT-233R for further guidance on whether a lease is an ordinary lease or a sale/purchase transaction.
19. Where a lessor and lessee jointly elect under section 16.1 of the ITA, special rules apply for calculating the income of the lessee. This election permits the lessee to claim CCA on the leased property and also permits the lessor to claim a restricted amount of CCA on the same property.
20. The definition of "eligible asset" in subsection 13(1) clarifies that when an election has been filed under section 16.1 of the ITA relating to lease agreements entered into after April 26, 1989, the OCCA deduction is available only to the lessor and not the lessee.

**Partnerships**

21. Where the corporation is a member of a partnership, it is entitled to OCCA on any eligible assets acquired by the partnership, subject to the \$20 million annual limit for the corporation. Under subsection 13(4), the corporate partner's share of the eligible cost of the partnership's assets is its share of income or loss in the partnership in which the partnership is first entitled to deduct CCA for the asset.
22. The asset is added to the corporate partner's eligible asset pool in the taxation year that includes the end of the fiscal period of the partnership in which the partnership is first entitled to deduct CCA for the asset.
23. The corporate partner's eligible asset pool includes the partner's share of the eligible cost (as explained in paragraphs 9 to 12) of the assets. The eligible cost is reduced by the partner's share of any government assistance received by the partnership. Conversely, the eligible cost is increased by the partner's share of any government assistance repaid by the partnership.

**Amalgamations and Wind-up's - Subsection 13(5)**

24. Specific rules apply where a corporation was previously involved in an amalgamation (section 87 of the ITA) or a winding-up (section 88 of the ITA) and claims the OCCA deduction. In general, the amalgamated corporation or the parent is deemed to have acquired the eligible assets of the predecessor or subsidiary on the same date that the assets were acquired by the predecessor or subsidiary. The capital cost of the assets remains the same. Also, the eligible asset pool of the predecessor or the subsidiary is considered to be an eligible asset pool of the amalgamated corporation or the parent.

**Reduction of Non-Capital Loss****Adjustment for Artificial Losses**

25. As discussed in paragraph 13, the OCCA deduction is "grossed-up" by the Ontario allocation factor to offset the impact of allocation to other jurisdictions. In cases where a loss has been sustained, the effect of such a "gross-up" could be to artificially increase such a loss.
26. To prevent the application of artificially-increased losses to other years, a reduction of the loss may be necessary. This occurs in situations where the Ontario allocation factor is materially larger in the year(s) in which the loss is applied than it is in the year in which the loss occurred.
27. Where a non-capital loss results, at least in part, from a "grossed-up" Ontario income tax incentive or deduction, section 35 permits the Minister to reduce the amount of the non-capital loss that may be applied to reduce the taxable income of other years. In addition to the OCCA deduction, the reduction under section 35 may apply to the following Ontario income tax incentives or deductions under sections 12 to 13.5:
  - research and development super allowance
  - Ontario new technology tax incentive (gross-up portion)
  - workplace child care tax incentive
  - workplace accessibility tax incentive
  - Ontario school bus safety tax incentive, and
  - educational technology tax incentive.
28. The Minister of Finance may direct that the amount of non-capital loss be reduced if:
  - the allocation factor for the taxation year the loss is being applied to is greater than 120 per cent of the allocation factor for the taxation year in which the loss occurred, or
  - the Minister has already limited the amount of that loss that was deductible in a previous taxation year.
29. Where the Minister of Finance restricts the amount of the non-capital loss application, the restriction is based on a formula to proportionately reduce the loss to the Ontario allocation factor for the year of application.

Maximum  
Non-Capital  
Loss Carryover  
Formula -  
Subsection 35(2)

30. The calculation of the maximum amount of the loss incurred in a particular year which may be applied in the current year is illustrated by the following steps:

Step	Action
1	Determine the portion of the non-capital loss of the particular year resulting from the grossed-up OCCA deduction or other incentives listed in paragraph 27.  Note: Where the corporation has taxable income before the OCCA deduction in the particular year, use the non-capital loss amount, not the OCCA deduction.
2	<i>Where all or part of the loss determined in Step 1 was applied in another year and the applied loss was restricted by subsection 35(2), Step 2 must be performed; otherwise, proceed to Step 3.</i>  Determine the portion of the grossed-up non-capital loss in Step 1 which was carried over and applied to other years and adjust the loss to the "grossed-up" amount of the loss year:  Amount of loss deducted in each year loss applied X $\frac{\text{Ontario allocation factor in the year loss was applied}}{\text{Ontario allocation factor in the loss year}}$
3	Calculate the portion of the grossed-up non-capital loss in Step 1 which is available for deduction in the current year:  Amount in Step 1 <b>minus</b> amount in Step 2.
4	Calculate the maximum non-capital loss carryover available for deduction in the current year which relates to OCCA and the other Ontario incentives listed in paragraph 27:  Amount in Step 3 X $\frac{\text{Ontario allocation factor in the loss year}}{\text{Ontario allocation factor in the current year}}$
5	Determine the portion, if any, of the unused non-capital loss from the particular year not related to the grossed-up Ontario incentives.
6	Compute the maximum portion of non-capital loss that may be applied in the current year:  Add the amounts in Steps 4 and 5.

## Example - Reduction of Non-Capital Loss

### Facts

31. The following facts highlight the effect of this restriction in the application of non-capital losses.

Year	1998	1999	2000
Taxable Income/(Loss) before OCCA or non-capital losses	\$(15,000)	\$60,000	\$20,000
OCCA deduction	60,000	nil	nil
Non-capital loss	(75,000)	nil	nil
Ontario allocation factor	50%	90%	80%

### Example - Reduction of Non-Capital Loss Facts (continued)

Based on the above facts, the corporation has a non-capital loss in 1998 which is created in part by the grossed-up OCCA deduction. As explained in paragraph 28, the Minister may direct that the non-capital loss applied to the 1999 and 2000 taxation years be proportionately reduced because the corporation's allocation factor in these years is greater than 120 per cent of the allocation factor in 1998.

### Solution

32. Using the steps outlined in paragraph 30, the maximum non-capital loss from 1998 that may be applied in 1999 and 2000 is computed as follows:

Step	1999		2000	
1	1998 loss related to OCCA (per facts)	\$60,000	1998 loss related to OCCA (per facts)	\$60,000
2	subsection 35(2) not previously applied	\$0	\$33,333 x 90% / 50% (applied in 1999)	\$60,000
3	\$60,000 - \$0	\$60,000	\$0 - \$0	\$0
4	\$60,000 x 50% / 90%	\$33,333	\$0 x 50% / 80%	\$0
5	\$15,000	\$15,000	1998 loss was used in 1999	\$0
6	\$33,333 + \$15,000 (maximum available)	\$48,333	\$0 + \$0 (Step 4 + 5)	\$0

Assuming the maximum loss deduction of \$48,333 is claimed by the corporation in 1999, the 1998 loss related to the OCCA deduction is completely utilized.

33. Based on the restricted non capital loss as computed in step 6 above, the corporation's taxable income for 1999 and 2000 is as follows (assuming the maximum loss deduction is claimed in 1999):

	1999	2000
Income before losses	\$60,000	\$20,000
1998 non-capital loss applied (after impact of subsection 35(2) loss reduction)	(48,333)	0
<b>Taxable Income</b>	<b>\$11,667</b>	<b>\$20,000</b>

### For More Information

For further information, please contact Desk Audit, general tax enquiries

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