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your BUSINESS

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Rental properties have been a popular investment for individual for many years. The popularity of rental properties has also made its way into major media with the launch of television shows such as *Income Property* on HGTV. Understanding the income tax considerations of your rental property is important and this article highlights the importance of properly considering the use of Capital Cost Allowance.

Should You Claim CCA On Your Rental Property?

The Income Tax Act allows you to deduct certain expenses directly related to your rental property such as property taxes, interest, insurance, accounting fees, and advertising. While you can't deduct the full cost of the property itself, you are permitted to claim an amount every year as "capital cost allowance" (CCA).

CCA appears to be an attractive way to reduce their tax bill. But like most income tax decisions, a little planning can sometimes save you thousands of dollars.

Overview Of CCA

CCA works on a declining balance: You add property to a "pool" of similar assets and claim a percentage of the balance as a deduction. The amount deducted for tax purposes is also used to reduce the value of the pool.

In the context of a rental property, CCA can only be claimed on the cost of the building but not the land. When purchasing a rental property, be sure to get separate valuations for the land and building.

CCA can only be used to reduce rental income to zero. It cannot be used to create a rental loss.

Finally, when the property is sold for more than its cost (or the remaining balance in the CCA pool) you may have a "recapture," where previously claimed CCA is added back to income as a lump-sum. In some cases, this can cost you more in taxes than you saved along the way.

A Real-World Example

James owns a rental property and has been claiming CCA. His marginal tax rate is 33% based on $70,000 of employment income.

It's been ten years and Joe can now sell his rental property for $275,000 to realize a capital gain of $100,000. However, Joe will also have a recapture.

Over the last 10 years, Joe claimed $53,700 of CCA which provided tax savings of $17,721 (at a 33% tax rate).

When the property is sold, the CCA pool is cleared out and he will realize a recapture of $53,700. After the capital gain was accounted for, Joe will pay tax of $24,702 at a rate of 46% on the recapture.

By claiming the CCA annually on the rental property, the recapture cost him $7,000 more in taxes.

Tax Rates Change The Outcome

If Joe's marginal tax rate was at the top of the range, claiming CCA would allow a deferral of tax. In other words he avoids the tax now at a rate of 46% only to pay it later at the same rate.

Conclusion

Whether you should claim CCA depends on your current circumstances, tax rate and long-term objectives. If you are considering purchasing a rental property or want to maximize the value of your income, you should seek the advice of an accountant.

Dean Paley CGA CFP is a professional accountant and a financial planner who serves the needs of business and individuals. Dean has appeared in major medial such as the National Post, Globe and Mail, Money Sense Magazine, and The Toronto Star.

If you would like to find out how Dean can add value to your business, please call **289-288-1206** or e-mail **dcpaley@deanpaley.com**.

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