CUMULATIVE ELIGIBLE CAPITAL

For tax purposes, **intangible** assets with unlimited lives (i.e. goodwill, the cost of trademarks, patents, licences, and franchises with unlimited lives) are not eligible for CCA; however, they are eligible for the **Cumulative Eligible Capital Deduction**.

Eligible Capital Property (ECP) :

- Eligible capital property are **intangible** capital property with **unlimited life**
- Examples include the following:
  - Goodwill
  - Customer list
  - Cost of patents, trademarks, licences and franchises with unlimited legal life
  - Appraisal costs of valuing eligible capital properties
  - Expenses of incorporation, reorganization, or amalgamation
  - Government rights

Cumulative Eligible Capital (CEC) Deduction

- Eligible capital properties are eligible for the cumulative eligible capital deduction
- The cumulative eligible capital deduction is similar to CCA however there are some differences:
  - There is only one pool (or class) for all ECP's
  - CECA rate of **7%** applies to balance remaining the pool with no half year rule
  - All additions are made to the pool at **75%** of the cost
  - The CECA is prorated for shortened tax years (similar to CCA)

Cumulative Eligible Capital Deduction Formula

Cumulative Eligible Capital - opening balance	$ xxx
add: 3/4 * ECP acquired during year	xxx
less: 3/4* Proceeds of ECP disposed during year	(xxx)
CEC balance before CEC deduction	$ xxx
CECA rate (7%)	7%
CEC deduction	**$ XXX**

Example:

Suppose you purchased a licence with unlimited legal life for $10,000; assuming you have no other eligible capital properties, what is your cumulative eligible capital deduction for the current year?

CEC deduction = (10,000 * ¾) * 7% = $525

What happens if the CEC pool becomes negative after a disposal?

- There are two things that can happen:
  1. **Recapture** – of previous CEC deduction taken (this is considered **business income**)
     - A recapture always happens whenever you have a negative CEC pool
  2. **Economic gain** – ½ of the gain on the disposal (this is also considered **business income**)
     - An economic gain only occurs if you dispose the property for a price higher than the original cost

- **This example below will help you understand this:**
  - Suppose I purchased a licence with unlimited legal life for $10,000 in 2009. In 2012, I disposed of the licence $12,000.
    - In 2009, 2010, and 2011 I took CEC deductions of $525, $488, and $454 respectively; therefore the total deduction over those three years = 525+488+454= $1,467
    - The **opening CEC balance** for 2012 = 10,000*3/4 – 1467 = $6,033
    - The CEC balance after disposal = $6,033 – 12,000*3/4 = - $2,967
      - **Recapture** = previous CEC deduction taken = $1,467
      - **Business income from gain on sale** = (12,000-10,000)*50% = 1,000
      - Therefore total business income = 1,000 + 1,467 = 2,467

  - There is also a **formula** designed by CRA to calculate the economic gain:
    - Recapture = previous CEC deduction taken
    - Business income from gain on sale = (negative CEC balance – recapture) * 2/3
      - Recapture = $1,467
      - Business income from gain on sale = (2,967-1,467)*2/3 = $1,000

  - Now suppose, I sold the licence for $10,000; I would have a recapture of $1,467 but no gains.

Implication of gain on disposal of ECP on Capital Dividend Account (CDA)

- Keep in mind that even though the gain on the sale of the eligible capital property is treated as business income, the non-taxable portion of the gain will increase the **Capital Dividend Account (CDA) for corporations**
  - In our example if the taxpayer was a corporation, the CDA balance will increase by $1,000 [(12K-10K) *50%]

Terminal Loss

- Terminal losses on eligible capital properties only occur if the following 2 are met:
  - The business is terminated; **and**
  - A balance remains in the CEC pool

Another important note: Internally generated intangibles

- Goodwill for example can be internally generated, and since you didn't purchase it, you will not add it to the CEC pool nor will you take CEC deduction on this goodwill
- However, when you sell your business, you also sell this goodwill; or if you do a section 85 rollover of business assets, you also rollover the goodwill
- This disposal of goodwill will decrease your CEC pool by 3/4th of its fair value, even though you never took CECA in the past
- **Example**
    - Suppose I disposed an internally generated goodwill for $10,000 and assuming I have no other eligible capital properties; I will have a negative CEC pool of 10,000 * ¾ = -7,500
    - I will have business income of ($10,000-0)*50% = $5,000 (or 7500*2/3 using CRA's formula)