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Global Investment and Innovation Incentives (G*i*³)

Clean energy tax credits introduced by the government of Canada to support the decarbonization of the economy

March 13, 2024

Background

From the beginning of the 20th century to the present, a series of innovations and discoveries have occurred at a remarkable speed, including the first flight of an airplane by the Wright brothers in 1903, the first steps on the moon by Buzz Aldrin and Neil Armstrong in 1969, and the discovery of the Higgs boson in 2012 during research work carried out at the Large Hadron Collider (LHC). Just over a hundred years of scientific innovation and discovery have allowed us to go into space and "see" the unseen.

In the 21st century, however, human ingenuity will be called upon as never before to meet the greatest challenge of our time: the energy transition. This transition will focus on climate change mitigation and adaptation and will require a metamorphosis of Canada's energy system. Among other things, to meet the challenge of net-zero emissions, electricity use, which currently accounts for about 20% of Canada's annual energy consumption, will need to more than double by 2050.[1] However, we do not have a hundred years to succeed in the energy transition to decarbonize the economy.

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[1] Canada, "Powering Canada Forward: Building a Clean, Affordable, and Reliable Electricity System for Every Region of Canada,"(Ottawa: Natural Resources Canada, August 31, 2023), p. 6.

It is in this context that, in 2016, Canada formally ratified the Paris Agreement to limit the average global temperature increase to 1.5°C above pre-industrial levels.[2] In addition, Canada's 2030 Emissions Reduction Plan aims to reduce greenhouse gas emissions by 40% to 45% below 2005 levels by 2030 and put us on a path to achieve net-zero emissions by 2050.[3] This will require massive investment from governments and the private sector. In this regard, public investment in Canada's clean economy accounted for 4.6% of GDP in 2022,[4] while globally, investment in clean energy has increased by 40% since 2020.[5]

Given the urgency of taking action to achieve net-zero emissions by 2050,[6] investments in clean energy are currently insufficient and will necessarily need to be scaled up and accelerated in the short and medium term. In fact, to achieve this goal of net-zero emissions by 2050, global investments in renewable energy (technology and infrastructure) will need to be at least US$4 trillion per year until 2030.[7]

So, we are invited to an investment sprint, not a marathon. "Canada's future economic prosperity depends on the speed and scale of its response to this challenge [net-zero]."[8] It is also important for Canada to keep pace with other countries, particularly the United States and their *Inflation Reduction Act* (IRA), to support economic agents in their efforts to consolidate a clean Canadian economy in the short and medium term. The architect of the IRA, Brian Deese, said recently at a symposium at Columbia University, "*We need to think urgently and build massively.*" Canada needs to be part of this narrative as well.

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The support measures put in place by the Canadian government since 2015 to achieve a clean economy are part of this logic in the fight against climate change.[9] In particular, the Canadian government's strategy relies heavily on the following five fully refundable investment tax credits:

1. Clean Technology Investment Tax Credit (CTITC)
2. Clean Electricity Investment Tax Credit (CEITC)
3. Clean Hydrogen Investment Tax Credit (CHITC)
4. Clean Technology Manufacturing Investment Tax Credit (CTMITC)
5. Carbon Capture, Utilization and Storage Investment Tax Credit (CCUS)

For ease of reference, these tax credits will be referred to collectively as the "clean economy investment tax credits."

These tax credits represent the largest portion of the measures introduced by the Canadian government as part of its plan to decarbonize the economy. The total aid is expected to be $70.5 billion as indicated in Appendix 1. Considering the rate of each of these tax credits, $300 billion in investments could be made over the next decade to decarbonize Canada's economy.

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2 Canada ratified the Paris Agreement on October 5, 2016, following a vote in Parliament. The Paris Agreement entered into force on November 4, 2016.
3 Canada, "2030 Emissions Reduction Plan – Canada's Next Steps for Clean Air and a Strong Economy,"(Ottawa: Environment and Climate Change Canada, March 29, 2022), p. 7.
4 Canada, Department of Finance, 2023 Fall Economic Statement, November 21, 2023, p. 54.
5 International Energy Agency, "Global Economic Outlook 2023," October 24, 2023, p. 17.
6 United Nations, "For a livable climate: net-zero commitments must be backed up by credible action."
7 United Nations, "Renewable energy – powering a safer future."
8 Canada, Department of Finance, 2023 Budget, March 28, 2023, p. 16.
9 Ibid., see Canada's Plan for a Clean Economy, p. 74.

The eligibility criteria for these tax credits generally reflect the urgency of decarbonizing the Canadian economy. These tax credits were discussed in our previous publication[10] last June and a summary table is included in Appendix 1. In addition, the Honourable Chrystia Freeland, Deputy Prime Minister and Minister of Finance, released the Economic Statement on November 21, 2023, which introduced changes to these tax credits while providing an update on the timeline for passage of the legislation.[11]

However, two aspects of these tax credits are likely to have a demobilizing effect and could hinder the achievement of their primary objective, which is to decarbonize the Canadian economy. These aspects are, on the one hand, the limitation of the amount of assistance provided by these tax credits in the presence of a limited partnership and, on the other hand, the ineligibility of non-taxable entities, particularly Indigenous communities organizations, to access these tax credits (with the exception of the CEITC for which these organizations will be eligible).

In addition, the level of assistance provided by these investment tax credits (with the exception of the CTMITC) is subject to labour requirements that may impose an additional administrative burden on clean energy investment projects given the current labour shortages in many regions of Canada.

In this publication, we discuss these aspects of the clean economy investment tax credits that may have a disincentive effect and hinder the growth of the investments needed to achieve the goal of net-zero emissions by 2050 and we suggest some changes to alleviate those undesirable effects.

Changes announced in the 2023 Fall Economic Statement

It should be noted that the changes announced in the 2023 Fall Economic Statement are essentially intended to enhance the CTITC and CEITC so that the production of electricity, heat, or both electricity and heat, from waste biomass is eligible for these tax credits.[12]

The expansion of eligibility for the CTITC would apply in respect of property that is acquired and becomes available for use on or after November 21, 2023, provided it has not been used for any purpose prior to its acquisition.

Expanded eligibility for the CEITC would be available as of the day of Budget 2024 to be tabled on April 16, 2024, and for projects that did not begin construction before March 28, 2023.

The CTITC was also enhanced in Bill C-59[13] so that a mutual fund trust that is a real estate investment trust[14] would be eligible for this tax credit.

Special rules for partnerships

Under the provisions contained in Bill C-59, as well as those contained in the December 2023 legislative proposals,[15] a taxable Canadian corporation that is a member of a partnership may be eligible for the CTITC and the CCUS (Bill C-59), as well as the CHITC and the CTMITC (legislative proposals).

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[10] Deloitte, Canadian Tax & Legal Alert, "2023 federal budget 2023: Canada has committed $83 billion to foster decarbonization of the economy," June 13, 2023.

[11] These measures were first announced in the 2022 Fall Economic Statement 2022, and then enhanced in Budget 2023 (Tax measures: Supplementary information). On August 4, 2023, the CCUS and CTITC were the subject of legislative proposals. The November 21, 2023, Economic Statement (supra note 4), was followed by Bill C-59 tabled on November 28, 2023, and legislative proposals on December 20, 2023.

[12] Amendments to the CTITC and the CEITC were announced in the 2023 Fall Economic Statement (supra note 4) to support the generation of electricity, heat, or electricity and heat, from biomass waste; these amendments are not yet included in a bill.

[13] Bill C-59, *Fall Economic Statement Implementation Act, 2023*, first reading on November 30, 2023.

[14] Section 122.1(1) of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (hereinafter referred to as "the Act").

[15] Canada, Department of Finance, *Legislative Proposals Relating to the Income Tax Act* (Ottawa : Department of Finance, December 2023).

However, a taxable Canadian corporation that is a member of a limited partnership is limited to its *at-risk amount*. The allocation of its share of a clean economy investment tax credit, which may not be allocated to it due to the application of the at-risk amount, may not be reallocated to another partner, such as the general partner of the limited partnership.[16]

For the purposes of the application of the clean economy investment tax credits, the meaning of the term at-risk amount shall be as otherwise provided in the Income Tax Act.[17]

It should be noted that the concept of at-risk amount was introduced into the Income Tax Act in the 1986 Budget to reduce "the proliferation of tax-motivated investments."[18] This integrity and fairness measure in the tax system was a response to the era of film industry tax shelters that prevailed in the 1970s and 1980s.

In addition, this measure was somewhat supplemented by the introduction in 1989 of the requirement to obtain a tax shelter identification number[19] from the Canada Revenue Agency (s. 237.1 of the Act), which was also intended to identify and counteract tax shelter schemes designed to generate positive investment income financed by deductions and tax credits.

At the time, these were financing structures that pale in comparison to the financing of Canada's energy transition projects in the era of climate change. Today's clean economy investment projects undertaken by limited partnerships are large-scale, multi-year and require large upfront investments with the potential for long-term returns.

Thus, the era of the introduction of the at-risk amount concept and the era of the fight against climate change are two eras with very different realities. While this concept may still adequately serve the integrity of the tax system, it is ill suited in the 21st century in the context of the financing of clean economy projects.

It is now clear that the scale of projects required to achieve Canada's energy transition will require an unprecedented influx of capital in the short to medium term.

In this context, to ensure that the objective pursued by clean economy investment tax credits prevails, and that these tax credits can effectively play their catalytic role in incentivizing and supporting the completion of energy transition projects, we believe the concept of at-risk amount should not apply to clean economy investment tax credits.

In this regard, Bill C-59 already contains integrity rules to control situations involving partnerships that do not meet the objectives of integrity and fairness of the tax system. On the one hand, they provide that the reasonable allocation of a clean economy investment tax credit among the members of a partnership should take into account the capital invested and the work performed by the partners.[20] On the other hand, it is not possible to benefit from these tax credits where, for example, a clean technology property for the purposes of the CTITC is a tax shelter investment for the purposes of section 143.2 of the Act.[21]

In addition, with respect to Bill C-59, its swift enactment by Parliament would provide reassurance to stakeholders in the clean energy sector who rely on the predictability and certainty of clean economy investment tax credits as part of their investment projects.

Indigenous communities

With the inability for non-taxable entities to claim the refundable investment tax credits, this has a particular impact on Indigenous communities. Indigenous communities are partners in the Canadian government's climate change strategy, and it is agreed that the

[16] Section 127.47(3) of the Act (Bill C-59).
[17] Section 127.47(1) of the Act, definition of "at-risk amount" (Bill C-59).
[18] Canada, Department of Finance, "Securing Economic Renewal," Budget Papers, February 26, 1986, p. 31.
[19] *Information Circular* IC89-4, "Tax Shelter Reporting," August 14, 1989.
[20] Section 127.47(2) of the Act (Bill C-59).
[21] Section 127.45(10) of the Act (Bill C-59).

design and implementation of energy projects must be done in collaboration with these communities, which will contribute to advancing reconciliation with Indigenous peoples.[22]

In addition, mitigation measures to avoid worst-case scenarios of global warming, as well as adaptation measures to better manage the onset of global warming, represent a daunting task that will require the input of as many stakeholders as possible.

In this regard, Indigenous communities could benefit from sharing their traditional knowledge and practices through collaborations with other stakeholders in the clean energy sector. Such collaborations could also help reduce Indigenous communities' reliance on fossil fuels for electricity generation in the interest of sustainable development.

In this sense, similar to the CEITC, clean economy investment tax credits should all be designed to ensure that Indigenous communities themselves, or through their organizations, are eligible.

This would contribute to a more equitable and inclusive relationship with Indigenous communities, which could play a greater role in the development of the clean economy sector, and thereby promote job creation, skills development, and diversification of economic activities within Indigenous communities.

Workforce requirements

The labour requirements apply to the following investment tax credits:

- Clean Technology Investment Tax Credit
- Carbon Capture, Utilization and Storage Investment Tax Credit
- Clean Hydrogen Investment Tax Credit
- Clean Electricity Investment Tax Credit

In summary, the highest rate for these tax credits can be claimed when labour requirements are met. However, a choice may be made not to meet these requirements. The rate of these tax credits is then reduced by ten percentage points.

There are two main aspects to labour requirements:

- **Prevailing wage requirements**. These requirements are met when the workers are compensated, either in accordance with the terms of an eligible collective agreement, or at an amount that is at least equal to regular wages (including benefits) paid to similar workers under such an agreement. Covered workers are those hired directly by the company or indirectly by a contractor or subcontractor, and these requirements apply to workers whose duties are primarily manual or physical in nature (labourer and tradespeople) and do not apply to workers whose duties are primarily administrative, supervisory, or managerial in nature.
- **Apprenticeship requirements**. These requirements are met when at least 10% of the work performed by workers in Red Seal trades is performed by registered apprentices.

These requirements apply in respect of property that is "prepared or installed" on or after November 28, 2023 (property all or a portion of the cost of which qualifies for one of the tax credits listed above).

The objective of introducing labour requirements is laudable in that it is to create good jobs in the energy sector in Canada. However, these requirements will impose additional administrative burdens for both the tax administration and taxpayers.

To increase the predictability of these tax credits, the scope of the terms "prepared or installed" for the purposes of the effective date of these requirements should be clarified as a first step, for example in the form of administrative guidelines from the Canada Revenue Agency.

[22] Supra note 1, p. 17.

On the other hand, although a relaxation was provided to labour requirements so that a taxpayer is deemed to have made reasonable efforts to hire apprentices,[23] the steps that must be taken to adequately respond to the relaxed requirements and the addition of a prescribed form[24] increase the administrative burden for the application of these tax credits.

In addition, for administrative relief purposes, and to take into account the current labour shortages in several regions of Canada, this relaxation could be reviewed in order to (i) make it more flexible, as in its current *one-size-fits-all* form it does not address Canada's regional disparities, and (ii) reduce the number and frequency of steps required to fill apprenticeship positions.

Conclusion

The goal of net-zero emissions by 2050 will require massive investments from governments and the private sector. In this regard, the federal government's initiative introducing the clean economy investment tax credits is a key element in achieving this goal, as investments in clean energy are currently insufficient and will need to be increased and accelerated in the short and medium term.

However, some aspects of these tax credits could have a disincentive effect and hinder the growth of the investments needed to decarbonize Canada's economy. We hope that the considerations discussed above regarding the limitation on the amount of assistance provided in the case of a limited partnership, as well as regarding the ineligibility of Indigenous communities (with the exception of the CEITC), will, if adopted, contribute to improving the efficiency of these tax credits.

In addition, the administrative reliefs suggested above with respect to labour requirements are also, if adopted, intended to improve the efficiency of these tax credits.

How can Deloitte help you?

Deloitte will continue to monitor the legislative process and any changes to the eligibility or criteria for these clean economy investment tax credits.

Deloitte professionals can help you understand how these clean economy measures, or any previously announced measures, may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this publication. More specifically, Deloitte's G*i*³ group is available to assist you in identifying potential incentives, current and/or forthcoming, to support your investments.

[23] Section 127.46(16) of the Act (Bill C-59).
[24] Section 127.46(16)(c) of the Act (Bill C-59).

Appendix 1

Summary table of the five refundable federal investment tax credits for clean technologies

Name	Acronym	Eligible entities	Eligible assets	Rate	Budget estimate	Effective date	End date	Status of legislation
Clean Technology Investment Tax Credit	CTITC	Taxable Canadian corporations**	Certain Class 43.1, Class 43.2 properties, and Class 56 properties	30%*	$6.9 billion by 2028	March 28, 2023	15% in 2034 0% in 2035	Bill C-59 introduced November 28, 2023 (s. 127.45)
Clean Electricity Investment Tax Credit	CEITC	Taxable and non-taxable Canadian entities	New equipment and renovation of former installations	15%*	$25.7 billion by 2035	2024 (date of tabling of the budget)	2034 (incl.)	Possible draft legislation – 2024)
Clean Hydrogen Investment Tax Credit	CHITC	Taxable Canadian corporations	New dedicated equipment for hydrogen/ammonia productions	40%*, 25%* or 15%*	$17.7 billion by 2035	March 28, 2023	Reduced in 2035	Proposed legislation – December 20, 2023 (s. 127.48)
Clean Technology Manufacturing Investment Tax Credit	CTMITC	Taxable Canadian corporations	Machinery and equipment for manufacturing of clean tech, extraction or processing of critical minerals	30%	$11.1 billion by 2035	January 1, 2024	20% in 2032 10% in 2033 5% in 2034	Proposed legislation – December 20, 2023 (s. 127.49)
Carbon Capture, Utilization and Storage Investment Tax Credit	CCUS	Taxable Canadian corporations	Assets used to capture, store and reuse CO_2	37.5% to 60%*	$9.1 billion by 2030	January 1, 2022	2040 (incl.)	Bill C-59 introduced November 28, 2023 (s. 127.44)

** This rate will be reduced by 10% if the company does not comply with the labour requirements (i.e., the compensation level meets or exceeds the relevant wage, and at least 10% of total labour hours are performed by apprentices [section 127.46]).*
*** Including certain REITs (November 28, 2023 – Bill C-59).*

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