



Canadian indirect tax news

Federal carbon backstop

March 14, 2019

Pricing carbon is one of the strategies by which Canada plans to achieve a low-carbon economy. Provinces and territories that have not designed their own carbon pricing system or have put systems in place that do not meet the benchmarks set by the federal government will be subject to the federal “backstop” scheme. The *Greenhouse Gas Pollution Pricing Act, 2018* (the Act) allows the federal government to designate any province or territory as a “listed province” and apply the backstop in that jurisdiction.

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Backstop overview

The federal backstop imposes carbon pricing through two mechanisms:

- a. **Fuel charge** – The Act would impose a fuel charge on fuels at the time of bringing or importing fuel into the listed provinces and on delivery or use of fuels in certain circumstances in the listed provinces or listed territories; and
- b. **Output-based pricing system** – In addition to the fuel charge, the Act imposes an output-based pricing system (OBPS) for emissions-intensive industrial facilities (large emitters). The Minister of Environment Canada is responsible for registering “covered facilities” under the Act and overseeing their reporting and compliance. The rules relating to large emitters came into effect as of January 1, 2019.

At this time, Ontario, New Brunswick, Manitoba and Saskatchewan (the “listed provinces”) do not meet the federal benchmarks, and a fuel charge will apply in these provinces on or after April 1, 2019. Yukon and Nunavut have voluntarily chosen to apply the federal backstop in their territories and are also considered to be listed provinces for the purpose of the Act. The federal backstop will apply in these territories as of July 1, 2019. The OBPS for large emitters will apply in Prince Edward Island as of January 1, 2019, supplementing the provincial carbon pricing scheme.

This document summarizes some of the rules with respect to the fuel charge and will not cover the rules under the OBPS.

Fuel charge rates

The fuel rates are set for the period from 2019 to 2022 and will then be reviewed by the federal government. The applicable rates is \$20 per tonne of carbon dioxide (CO₂) equivalent in 2019. The rates will increase by \$10 per tonne of CO₂ equivalent annually to \$50 per tonne of CO₂ equivalent in 2022. The fuel charge applies at the following rates to the selected types of fuel from 2019 to 2022:

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Fuel	2019 (\$20/tonne CO₂e)	2020 (\$30/tonne CO₂e)	2021 (\$40/tonne CO₂e)	2222 (\$50/tonne CO₂e)
Gasoline	\$0.0422/L	\$0.0663/L	\$0.0884/L	\$0.1105/L
Light Fuel Oil	\$0.0537/L	\$0.0805/L	\$0.1073/L	\$0.1341/L
Natural gas (marketable)	\$0.0391/m ³	\$0.0587/m ³	\$0.0783/m ³	\$0.0979/m ³
Propane	\$0.0310/L	\$0.0464/L	\$0.0619/L	\$0.0774/L
Coal (high heat value)	\$45.03/tonne	\$67.55/tonne	\$90.07/tonne	\$112.58/tonne
Coal (low heat value)	\$35.35/tonne	\$53.17/tonne	\$70.90/tonne	\$88.62/tonne

Application of the fuel charge

Generally, the fuel charge will apply to fuel imported into, brought into, or delivered in a listed province. "Delivery" of fuel under the Act includes circumstances in which fuel is "made available" to the recipient but may not have been physically delivered.

There are certain exceptions to this rule, including the following (selected listing):

- Registered distributors under the Act do not pay the fuel charge for bringing fuel or importing fuel into a listed province. This exception would only apply to the type of fuel for which the person is a registered distributor; however, a distributor will be required to pay the fuel charge if they use the fuel;
- The fuel charge does not apply to fuel in a sealed container prepackaged in a factory, provided the volume is 10 litres or less; and
- The fuel charge generally does not apply to fuel brought into or imported into a listed province in a supply tank of the vehicle for use in the operation of the vehicle or an auxiliary of the equipment by registered carriers.

There are special rules applicable to certain types of transportation companies, which may allow qualifying inter-jurisdictional transportation companies to acquire the fuel exempt from the fuel charge. The fuel charge would generally be payable by these entities on trips within a listed jurisdiction. While Yukon and Nunavut territories are listed provinces for the purposes of the Act, the fuel charge does not apply to aviation fuels in these territories.

Notable exemptions

The fuel charge does not apply where fuel is delivered by a registered distributor in listed provinces in some circumstances, including fuel delivered to the following persons:

- A registered distributor;
- A registered specified air carrier, a registered specified marine carrier or a registered specified rail carrier;
- A registered emitter under OBPS;
- A farmer only in the case of qualifying fuel;
- A registered user (for example, the person uses the fuel as a raw material in an industrial process that produces another fuel, another substance or material, or as a solvent or diluent in the production or transport of bitumen or another substance, and there is no combustion);
- A person that acquires the fuel in accordance with the *Ships' Stores Regulations*, designated as ships' store for use on board a conveyance of a class under those regulations; and
- A fisher in specific circumstances.

In most cases, the person claiming an exemption should provide an exemption certificate to its supplier, although there are some exceptions to this requirement.

Any fuel diverted from an exempt use to a non-exempt use will generally be subject to the fuel charge.

Registration

There are a number of mandatory and optional registration requirements under the Act. Some examples include registration as a distributor, registration as an emitter, importer or user of fuel, and registration as a type of carrier.

The scope of mandatory registration as a registered distributor of natural gas is relatively broad. The person will be required to register as a registered distributor in respect of natural gas if the person:

- Produces marketable and non-marketable natural gas in a listed province;
- Imports or brings marketable and non-marketable natural gas into a listed province;
- Delivers marketable or non-marketable natural gas in a listed province; and
- The person measures another person's consumption of marketable natural gas on a regular basis to invoice the person in the distribution system (i.e., the natural gas distributor).

Based on the current wording of the Act, natural gas traders must register as a distributor if the trade takes place at a trading hub in a listed province. The existing wording of the legislation does not permit non-resident traders acquiring natural gas in Canada for export to register to purchase gas exempt.

This is in contrast to the carbon levy regimes in British Columbia and Alberta that do not require natural gas traders to register for the provincial carbon levy.

For other types of fuel (i.e., anything other than marketable or non-marketable natural gas), persons producing fuel in a listed province are currently required to register. However, the Act permits a person to register if they deliver fuel to one or more of the following persons:

- Another person for the purpose of resale;
- A registered distributor in respect of the type of fuel for which the registered distributor is registered;
- A farmer if the fuel is qualifying;
- A fisher if the fuel is qualifying;
- A registered specified air carrier, registered specified marine carrier or a registered specified rail carrier;
- A person who operates a facility that is covered by OBPS;
- A registered user (for example, the person uses the fuel as a raw material in an industrial process that produces another fuel, another substance or material, or as a solvent or diluent in the production or transport of bitumen or another substance, and there is no combustion); and
- Another person if the fuel is, in accordance with the *Ships' Stores Regulations*, designated as ships' stores for use on board of a conveyance as prescribed by those regulations.

Rebates

The Act provides a number of rebate provisions. Some examples include the following:

- Fuel removed from a listed province by a registered user, registered importer, registered air carrier, registered marine carrier or a registered rail carrier in certain circumstances in which the charge became payable;
- Fuel brought by a registered emitter for use in a facility that is covered by OBPS, and the fuel charge had become payable at the time of import or bringing into the listed province or certain other circumstances in which the charge became payable;
- Fuel brought by a registered user for use in a facility to be used as a raw material in an industrial process that produces another fuel, another substance or material, or as a solvent or diluent in the production or transport of bitumen or another substance, and the fuel charge had become payable at the time of import or bringing into the listed province or other circumstances in which the charge became payable; or
- The person pays the fuel charge in error.

Assessments and Appeals

The standard assessment period under the Act for the fuel charge is generally four years. The Act also provides for filing a Notice of Objection to appeal an assessment to the Minister or appealing the decision of the Minister to the Tax Court.

Other incentives and rebates

To compensate for the increased cost of energy, the federal government intends to provide relief for farmers, fishers, and targeted relief programs. These targeted relief programs would include providing relief for residents of rural and small communities, greenhouse operators, power plants that generate electricity for remote communities, users of aviation fuels in Nunavut and Yukon Territories, and indigenous peoples.

Some consideration for going forward

Businesses should prepare their systems to account for the fuel charge on fuel sold in listed provinces. It is important to ensure that the fuel charge is remitted at the correct rate and for the correct volume of fuel sold in or brought into a listed province. Businesses should also keep track of the fuel that is moved from one province to another province, especially in circumstances in which the fuel charge should be remitted.

Businesses selling fuel should impose standard operating procedures in place to obtain exemption certificates from their customers who claim an exemption and who are required to provide their fuel sellers with the exemption certificate. Failure to obtain the correct certificate from customers claiming an exemption may result in a liability for the fuel charge on the type of fuel sold.

Outstanding questions

There are some outstanding concerns about how the Act will apply to certain industries. One key concern relates to non-resident natural gas traders. The natural gas traders that only purchase natural gas in Canada for resale outside Canada (i.e., in the United States) are not eligible to register as a registered distributor of natural gas. In addition, there is no clear exemption for entities purchasing natural gas for export purposes. Thus, natural gas traders selling natural gas to non-resident exporters of natural gas are currently required to charge the fuel charge on the trade. This would significantly increase the cost of doing business in Canada by non-resident natural gas traders. The Department of Finance and the Canada Revenue Agency (CRA) are aware of this issue, and natural traders are hoping that more information addressing this issue will be released prior to April 2019 to address this issue.

We also note that joint ventures currently face considerable compliance burdens under the Act. The Act defines a person to include a joint venture. This would require the fuel charge compliance to be done at the joint venture level as opposed to at the operator level. For GST/HST and under consumption taxes, generally the compliance for a joint venture is done at the operator level. In the natural resource sector, joint ventures are a commonly-used business structure. It would be administratively impractical to require a separate registration and separate returns to be filed for each joint venture given the number of joint ventures in the natural resource industry. The Department of Finance and the CRA are aware of the issue, and more information will likely be released on this issue soon.

In many industries, there is generally a one-month timing difference between when goods are delivered and sold and when the sale is recognized for accounting purposes. This may result in a gap between the month in which fuel is delivered and the month in which the fuel charge can be reported. The CRA is aware of this timing difference but it has not provided clear guidelines regarding how to address this issue.

Preparing for the fuel charge

If you would like to discuss the issues raised in this newsletter, or if you have any questions or concerns regarding the application of the federal carbon backstop, please contact your Deloitte advisor.

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