Canada's Proposed Clean Economy Tax Credits: Insights as of March 2024

Tax Law Bulletin | March 7, 2024

This Tax Law Bulletin updates a Tax Law Bulletin that we originally prepared on December 4, 2023. It reflects developments to March 6, 2024.

The Canadian government has proposed five new refundable investment tax credits (ITCs) designed to grow Canada's clean economy and allow Canada to remain competitive in attracting investment in clean energy projects:

- **The Clean Technology ITC**: A refundable tax credit of up to 30% of investments in eligible property acquired and available for use on or after March 28, 2023 and before 2034. For property that becomes available for use in 2034, this tax credit would be up to 15%. No tax credit would be available for property that becomes available for use after 2034. Draft legislation for this tax credit received first reading in Parliament on November 30, 2023.
- **The Carbon Capture, Utilization and Storage ("CCUS") ITC**: A refundable tax credit for expenditures incurred between January 1, 2022 and December 31, 2030 of:
    - up to 60% of Qualified Carbon Capture Expenditures incurred to capture carbon from ambient air;
    - up to 50% of Qualified Carbon Capture Expenditures incurred to capture carbon other than directly from ambient air; and
    - up to 37.5% of Qualified Carbon Transportation Expenditures, Qualified Carbon Storage Expenditures and Qualified Carbon Use Expenditures.

  For the period January 1, 2031 to December 31, 2040, the tax credit would be reduced by one-half. No tax credit would be available after 2040. Draft legislation for this tax credit received first reading in Parliament on November 30, 2023.
- **The Clean Hydrogen ITC**: A refundable tax credit of up to 40% of investments in projects that produce hydrogen and become available for use on or after March 28, 2023 and before 2034. For investments that become available for use in 2034, this tax credit would generally be reduced by one-half. No tax credit would be available for property that becomes available for use after 2034. Draft legislation for this tax credit was released on December 20, 2023.
- **The Clean Technology Manufacturing ITC**: A refundable tax credit of 30% of investments in eligible property to be used in clean technology manufacturing and critical mineral extraction and processing that is acquired and available for use in 2024 to 2031. This tax credit would reduce to 20% for 2032, 10% for 2033 and 5% for 2034. Draft legislation for this tax credit was released on December 20, 2023.
- **The Clean Electricity ITC**: A refundable tax credit of up to 15% of investments in projects that generate clean electricity, store electricity without the use of fossil fuels, or transmit electricity between provinces and territories. This tax credit would be available as of the day that the 2024 federal budget is delivered

for projects that did not begin construction before March 28, 2023. No tax credit would be available after 2034. For publicly-owned utilities, consultations with the provinces and territories will take place in 2024. For non-publicly-owned utilities, design and implementation details will be published in early 2024. The Government is targeting to introduce legislation in Parliament in fall 2024.

These are refundable tax credits. That is, these tax credits would be treated as amounts that have been paid by the taxpayer on account of tax, and if no more tax is payable for the year, the taxpayer would receive a refund.

Taxpayers would generally be able to claim only one of these tax credits in respect of the acquisition of an eligible property, even if the particular property would be eligible for more than one of these tax credits.

None of these tax credits have yet been passed into law.

This bulletin provides a description of each of these proposed tax credits. Following these descriptions, certain tax considerations that are relevant to the design of these tax credits are discussed.

The Tax Credits

1. The Clean Technology ITC

The purpose of the Clean Technology ITC is "to encourage the investment of capital in the adoption and operation of clean technology property in Canada."

The Clean Technology ITC would only be available to (i) taxable Canadian corporations and (ii) mutual fund trusts that are real estate investment trusts, including (iii) taxable Canadian corporations and mutual fund trusts that are real estate investment trusts that are members of a partnership that makes an investment in eligible property.

The Clean Technology ITC would provide a 30% refundable tax credit for investments in eligible property that is both acquired and available for use on or after March 28, 2023 until December 31, 2033. Property that is acquired and available for use in 2034 would be eligible for a 15% refundable tax credit. No tax credit would be available for property that is acquired and available for use after 2034.

To be eligible for the Clean Technology ITC at the rates described above, a taxpayer must satisfy certain labour requirements. The labour requirements are generally met by paying "covered workers" in accordance with a collective agreement (or by paying amounts that similar workers are paid under a collective agreement agreement) (the "prevailing wage requirements") and by ensuring that at least 10% of the labour performed by workers in Red Seal trades is performed by registered apprentices (the "apprenticeship requirements"). Taxpayers that do not elect to meet the labour requirements could claim the Clean Technology ITC at the above-noted rates reduced by 10 percentage points.

The types of property that would be eligible for the Clean Technology ITC include:

- equipment used to generate electricity from solar, wind and water energy;
- stationary electricity storage equipment that does not use any fossil fuel in operation;
- active solar heating equipment, air-sourced heat pumps and ground-source heat pumps;
- non-road zero-emission vehicles, and related charging and refueling equipment;
- equipment used exclusively for the purpose of generating electrical or heat energy solely from geothermal energy, but excluding any equipment that is part of a system that will co-produce oil, gas or other fossil fuels for sale;

- concentrated solar energy equipment; and
- small modular nuclear reactors.

However, to be eligible for the Clean Technology ITC:

- the property must generally be situated in Canada and intended for use exclusively in Canada;
- the property must be new when acquired by the taxpayer; and
- if the property is to be leased by the taxpayer to another person,
    - the lessee must be (i) a taxable Canadian corporation, (ii) a mutual fund trust that is a real estate investment trust or (iii) a partnership all the members of which are taxable Canadian corporations; and
    - the equipment must be leased in the ordinary course of carrying on a business in Canada by the taxpayer whose principal business is selling or servicing property of that type, or whose principal business is leasing property, lending money, purchasing conditional sales contracts, accounts receivable, bills of sale, chattel mortgages or hypothecary claims on movables, bills of exchange or other obligations representing all or part of the sale price of merchandise or services, or any combination thereof.

The Clean Technology ITC would potentially be subject to "recapture" if, within 10 calendar years of the acquisition of the eligible property the property is converted to a non-clean technology use, is exported from Canada or is disposed of by the taxpayer.

The 2023 Fall Economic Statement proposed to expand eligibility for the Clean Technology ITC to include systems that produce electricity and/or heat from waste biomass. The expansion of the Clean Technology ITC to include waste biomass systems would be available for eligible property that is acquired and becomes available for use on or after November 21, 2023.

2. The Carbon Capture, Utilization and Storage ITC

The purpose of the CCUS ITC is "to encourage the investment of capital in the development and operation of carbon capture, transportation, utilization and storage capacity in Canada."

The CCUS ITC would be available only to taxable Canadian corporations that make investments in eligible property, including taxable Canadian corporations that are members of a partnership that makes an investment in eligible property.

The CCUS ITC would provide a refundable tax credit for expenditures incurred between January 1, 2022 and December 31, 2030 as follows:

- 60% for Qualified Carbon Capture Expenditures incurred to capture carbon from ambient air;
- 50% for Qualified Carbon Capture Expenditures incurred to capture carbon other than directly from ambient air; and
- 37.5% for Qualified Carbon Transportation Expenditures, Qualified Carbon Storage Expenditures and Qualified Carbon Use Expenditures.

For the period January 1, 2031 to December 31, 2040, the tax credit would be reduced to one-half of the rates described above, and no tax credit would be available after 2040. Taxpayers that do not elect to meet the labour

requirements (see the description of the labour requirement in the description of the Clean Technology ITC above) could claim the CCUS ITC at the above-noted rates reduced by 10 percentage points.

Qualified Carbon Capture Expenditures, Qualified Carbon Transportation Expenditures, Qualified Carbon Storage Expenditures and Qualified Carbon Use Expenditures would be required to be incurred in respect of a "Qualified CCUS Project" of a taxpayer.

- A Qualified CCUS Project must be a "CCUS Project" that is intended to support a "CCUS Process".
    - A CCUS Project is a project that is intended to support a CCUS Process by (i) capturing carbon dioxide that would otherwise be released into the atmosphere or directly from the ambient air (ii) transporting captured carbon, or (iii) storing or using captured carbon.
    - A CCUS Process is the process of carbon capture, utilization and storage that includes (i) the capture of carbon dioxide that would otherwise be released into the atmosphere or directly from the ambient air, and (ii) the storage or use of the captured carbon.
- A Qualified CCUS Project would need to meet several additional conditions. The definitional regime is extremely complex. Simplified, a CCUS Project would be a Qualified CCUS Project if:
    - there is a "project plan" that (i) reflects a front-end engineering design study for the CCUS Project, (ii) describes the quantity of captured carbon that the project is expected to support for storage or use over the project's "total CCUS project review period" (which is generally approximately 20 years) in "eligible use" and "ineligible use", (iii) contains information as required in guidelines published by the Minister of Natural Resources, and (iv) is filed with the Minister of Natural Resources before the first day of commercial operations;
        - "eligible use" means (i) the storage of captured carbon in dedicated geological storage; and (ii) the use of captured carbon in producing concrete in Canada or the United States using a "qualified concrete storage process".
        - "ineligible use" means (i) the emission of captured carbon into the atmosphere other than for system integrity or safety or incidental emission made in the ordinary course of operations, (ii) the storage or use of captured carbon for enhanced oil recovery, and (iii) any other storage or use that is not an eligible use.
    - it is expected, based on the project's most recent project plan, to support the capture of carbon dioxide in Canada for a period at least equal to the total CCUS project review period;
    - an initial project evaluation has been issued by the Minister of Natural Resources;
    - its "projected eligible use percentage" is at least 10% for each year of the project's total review period (the "projected eligible use percentage" is (i) the quantity of captured carbon that the CCUS project is expected to support for storage or use in "eligible use" during the period; divided by (ii) the total quantity of captured carbon that the CCUS project is expected to support for both "eligible use" and "ineligible use" during the period); and
    - it is not a project that is (i) operated to service a "unit" (as defined in the *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations*) with a commissioning date that is on or before April 7, 2022; and (ii) undertaken for the purpose of complying with the emission standards under the *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations.*

Qualified Carbon Capture Expenditures in respect of a Qualified CCUS Project would be a portion of an expenditure incurred to acquire property that is used for the capture aspect of a CCUS Project (in contrast to

property used in other parts of a CCUS project, such as for transportation, storage or use). The portion of the expenditure that qualifies is determined based on the proportion of the captured carbon that the CCUS project is expected to support for storage or use in "eligible uses" as compared to "ineligible uses".

The types of property that would be eligible for the CCUS ITC include equipment that is not expected to be used for hydrogen production, natural gas processing or acid gas injection and that:

- is not oxygen production equipment and is to be used solely for capturing carbon dioxide (i) that would otherwise be released into the atmosphere or (ii) directly from the ambient air;
- prepares or compresses captured carbon for transportation;
- generates or distributes electrical energy, heat energy or a combination of electrical or heat energy, that directly and solely supports a Qualified CCUS Project, unless the equipment uses fossil fuels and emits carbon dioxide that is not subject to capture by a Qualified CCUS Project;
- is transmission equipment that solely supports a Qualified CCUS Project by directly transmitting electrical energy from electrical generation equipment to the Qualified CCUS Project;
- delivers collects, recovers, treats and/or recirculates water that solely supports a Qualified CCUS Project; and
- certain "dual use equipment" (but only a portion of the cost of dual use equipment would be included as a Qualified Carbon Capture Expenditure).

Qualified Carbon Transportation Expenditures in respect of a Qualified CCUS Project would be a portion of an expenditure incurred to acquire equipment situated in Canada that is to be used solely for transportation of captured carbon, including equipment used for the transportation system safety and integrity. The portion of the expenditure that is eligible depends on the project's "projected eligible use percentage" and the remaining portion of the project's total review period.

Qualified Carbon Storage Expenditures in respect of a Qualified CCUS Project would be the cost of equipment situated in Canada that is to be used solely for storage of captured carbon in a geological formation, including equipment used for the storage system safety and integrity. The storage of captured carbon must be in "dedicated geological storage", which means (i) it is located in a "designated jurisdiction" (currently included are British Columbia, Saskatchewan and Alberta); (ii) it is capable of permanently storing captured carbon, (iii) it is authorized and regulated for the storage of captured carbon under the laws of the designated jurisdiction; and (iv) it is a formation in which no captured carbon is used for enhanced oil recovery.

Qualified Carbon Use Expenditures in respect of a Qualified CCUS Project would be the cost of equipment situated in Canada to be used solely for using captured carbon in industrial production (including for enhanced oil recovery) that is expected to support storage or use of captured carbon solely in producing concrete in Canada or the United States using a "qualified concrete storage process".

Qualified Carbon Capture Expenditures, Qualified Carbon Transportation Expenditures, Qualified Carbon Storage Expenditures, and Qualified Carbon Use Expenditures would also include (i) certain ancillary equipment that is physically and functionally integrated with the equipment described above and is used solely to support the equipment described above; (ii) equipment used for safety and integrity or as part of a control or monitoring system to support the equipment described above; and (iii) a building or other structure all or substantially all of which is used, or to be used, for the installation or operation of the equipment described above.

The CCUS ITC regime contemplates a recovery tax that may apply where the "projected eligible use percentage" is no longer projected or is not achieved. Recovery tax may also be payable if the taxpayer disposes of the property or exports the property from Canada.

3. The Clean Hydrogen ITC

The purpose of the Clean Hydrogen ITC is "to encourage the investment of capital in the production of clean hydrogen and clean ammonia in Canada."

The Clean Hydrogen ITC would only be available to taxable Canadian corporations, including taxable Canadian corporations that are members of a partnership that makes an investment in eligible property.

For "eligible clean hydrogen property", other than for "clean ammonia equipment", that is acquired and becomes available for use on or after March 28, 2023 and before 2034, the tax credit rate would be, depending on the carbon intensity of the hydrogen that is produced, 40%, 25% or 15%. For clean ammonia equipment acquired and available for use in a clean hydrogen project before 2034, the tax credit rate would be 15%. For property that is acquired and becomes available for use in 2034, these tax credit rates would be reduced by one-half. No tax credit would be available for property that becomes available for use after 2034. Taxpayers that do not elect to meet the labour requirements (see description of the labour requirements in the description of the Clean Technology ITC above) could claim the Clean Hydrogen ITC at the above-noted rates reduced by 10 percentage points.

To be "eligible clean hydrogen property", a property must become available for use in connection with a "qualified clean hydrogen project" of the taxpayer. A "qualified clean hydrogen project" is a project for which the Minister of Natural Resources has confirmed in writing that (i) hydrogen will be produced from "eligible pathway" (either electrolysis or from natural gas reforming (with carbon dioxide captured using a CCUS process)); (ii) the expected carbon capacity has been determined in accordance with specific rules and can reasonably be expected to be achieved based on the project's design; and (iii) if the project is intended to produce clean ammonia, the taxpayer has demonstrated sufficient production capacity and transportation feasibility.

"Eligible clean hydrogen property" must also (i) not have been used, or acquired for use or lease, by any person or partnership for any purpose whatever before it was acquired by the taxpayer and (ii) be situated in Canada.

The types of property that may be "eligible clean hydrogen property" include:

- equipment all or substantially all of the use of which by the taxpayer, or by a lessee of the taxpayer, is to produce hydrogen though electrolysis of water, water treatment and conditioning equipment and equipment used for hydrogen compression and storage, but not including, (i) equipment used for the transmission or distribution of hydrogen or electricity, (ii) automotive vehicles, (iii) auxiliary electrical generating equipment, or (iv) buildings or other structures;
- property that is used all or substantially all to produce hydrogen through natural gas reforming;
- property that is "clean ammonia equipment", "dual-use electricity and heat equipment" or "dual-use hydrogen and ammonia equipment";
- certain property that is physically and functionally integrated with the equipment described above; and
- equipment used for safety and integrity, or as part of a control or monitoring system, solely to support the equipment described above.

The Clean Hydrogen ITC would potentially be subject to recapture if, within 20 calendar years of the acquisition of the eligible clean hydrogen property, the property is converted to a non-hydrogen or ammonia use, is exported from Canada or is disposed of by the taxpayer.

4. The Clean Technology Manufacturing ITC

The purpose of the Clean Technology Manufacturing ITC is "to encourage the investment of capital in Canada for a CTM use" (the meaning of "CTM use" is discussed below).

The Clean Technology Manufacturing ITC would only be available to taxable Canadian corporations, including taxable Canadian corporations that are members of a partnership that makes an investment in eligible property.

The Clean Technology Manufacturing ITC would apply to eligible property acquired and available for use in 2024 to 2034. This tax credit would be 30% for property that becomes available for use in 2024 to 2031 and would reduce to 20% for 2032, 10% for 2033 and 5% for 2034. The labour requirements (see description of the labour requirement in the description of the Clean Technology ITC above) would not apply to the Clean Technology Manufacturing ITC.

The Clean Technology Manufacturing ITC is generally available in respect of "CTM property" that is acquired by a taxpayer for a "CTM use".

- CTM property includes:
    - machinery and equipment used for manufacturing or processing, such as industrial robots used to manufacture electric vehicles or vats used to process cathode active materials;
    - certain tangible property attached to buildings and other structures used for manufacturing or processing or that is required for machinery or equipment, such as ventilation systems used to remove chemical fumes or specialized electrical wiring used to provide power to solar panel manufacturing equipment;
    - certain property used for mineral extraction and processing, such as equipment used to crush rock containing copper ore or kilns used to calcinate nickel ore;
    - certain specialized tooling, such as moulds used to cast copper ingots at smelters or cutting parts of a machine used to cut solar cells; and
    - non-road vehicles and automotive equipment, such as electric vehicles designed for use in factories or hydrogen-powered vehicles designed for extracting rock from mine sites.
- However, to be CTM property:
    - the property must be situated in Canada and intended for use exclusively in Canada;
    - the property must be new when acquired by the taxpayer; and
    - if the property is to be leased by the taxpayer to another person,
        - the lessee must be a taxable Canadian corporation or a partnership all the members of which are taxable Canadian corporations; and
        - the equipment must be leased in the ordinary course of carrying on a business in Canada by the taxpayer whose principal business is selling or servicing property of that type, or

whose principal business is leasing property, lending money, purchasing conditional sales contracts, accounts receivable, bills of sale, chattel mortgages or hypothecary claims on movables, bills of exchange or other obligations representing all or part of the sale price of merchandise or services, or any combination thereof.

- A CTM use means all or substantially all of the use of the property is for activities performed in connection with the manufacturing or processing of specified types of property, including manufacturing or processing in connection with:
    - certain renewable energy equipment (solar, wind, water or geothermal);
    - electrical storage equipment used to provide grid-scale storage or other ancillary services;
    - equipment for air-source and ground-source heat pump systems;
    - zero-emission vehicles, including conversions of on-road vehicles and equipment used to charge, or dispense hydrogen to such vehicles;
    - equipment used to produce hydrogen by electrolysis of water;
    - equipment that is a component of the above-noted properties;
    - nuclear energy equipment;
    - nuclear fuels and heavy water; and
    - nuclear fuel rods.
- A CTM use also includes the use of the property in a "qualifying mineral activity" producing all or substantially all "qualifying materials" ("qualifying materials" being: lithium, cobalt, nickel, copper, rare earth elements and graphite).

The Clean Technology Manufacturing ITC would potentially be subject to recapture if, within 10 calendar years of the acquisition of the property, the property is converted to a non-CTM use, is exported from Canada or is disposed of by the taxpayer.

5. The Clean Electricity ITC

No draft legislation has been released to date for the proposed Clean Electricity ITC. The following description of the Clean Electricity ITC is based on the details provided in the 2023 federal budget and the 2023 Fall Economic Statement.

The Clean Electricity ITC would be available to taxable and non-taxable entities such as Crown corporations, publicly owned utilities, corporations owned by Indigenous communities, and pension funds.

The Clean Electricity ITC would provide a 15% refundable tax credit for eligible investments in:

- non-emitting electricity generation systems: wind, concentrated solar, solar photo-voltaic, hydro, wave, tidal and nuclear;
- certain abated natural gas-fired electricity generation;
- stationary electricity storage systems that do not use fossil fuels in operation; and
- equipment for the transmission of electricity between provinces and territories.

Both new projects and the refurbishment of existing facilities would be eligible.

Taxpayers that do not elect to meet the labour requirements (see description of the labour requirements in the description of the Clean Technology ITC above) would claim the Clean Electricity ITC at the above-noted rate reduced by 10 percentage points.

The Clean Electricity ITC would be available as of the day that the 2024 federal budget is delivered (anticipated to be tabled on April 16, 2024), for projects that did not begin construction before March 28, 2023. The Clean Electricity ITC would not be available after 2034.

The 2023 Fall Economic Statement proposed to expand eligibility for the Clean Electricity ITC to include systems that produce electricity or both electricity and heat from waste biomass.

Certain Tax Considerations

At-Risk Amount Limitation

The clean economy tax credits that can be allocated to a limited partner are limited by the limited partner's "at-risk amount". A limited partner's "at-risk amount" reflects, in part, the amount invested in the limited partnership by the limited partner. As a consequence, financing obtained by the partnership (which does not increase a limited partner's at-risk amount) – as opposed to financing obtained by the limited partners directly and used to make contributions to the partnership (which may increase the limited partners' at risk amounts) – may limit the amount of tax credits that are available to limited partners.

Tax Shelters and Tax Shelter Investments

The Canadian *Income Tax Act* contains rules that apply to "tax shelters" and "tax shelter investments". The tax shelter rules provide the government with an effective means of identifying tax shelters and the identity of the participants. The tax shelter investment rules can apply to reduce a taxpayer's cost in a tax shelter investment and may deny any expenditures incurred by the tax shelter investment itself. All investments that are tax shelters are also tax shelter investments.

- The Clean Technology ITC is denied if the clean technology property – or an interest in a person or partnership that has, directly or indirectly, an interest in such property – is a tax shelter investment.
- The CCUS ITC is denied in respect of a CCUS project (the entire project!) if a property used in the project – or an interest in a person or partnership that has, directly or indirectly, an interest in such property – is a tax shelter investment.
- The Clean Hydrogen ITC is denied if an eligible clean hydrogen property – or an interest in a person or partnership that has, directly or indirectly, an interest in such property – is a tax shelter investment.
- The Clean Technology Manufacturing ITC is denied if a CTM property – or an interest in a person or partnership that has, directly or indirectly, an interest in such property – is a tax shelter investment.

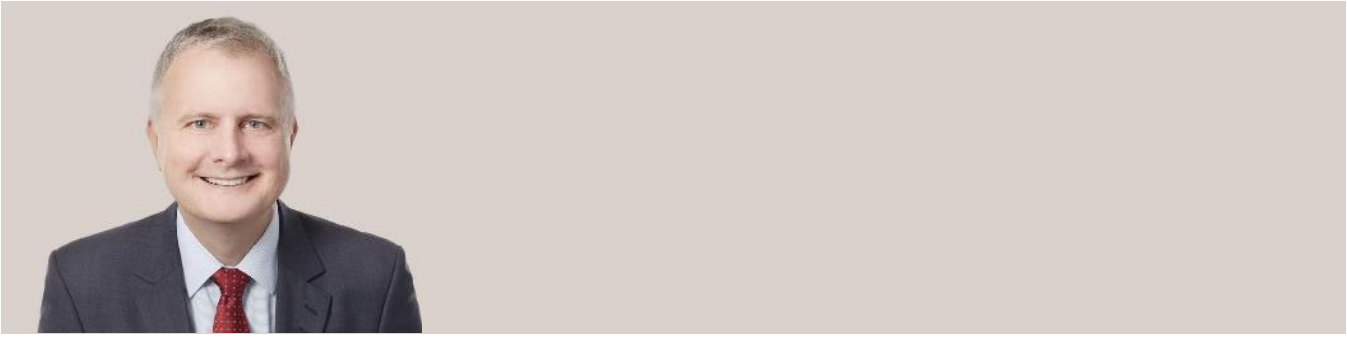
Allocation to Partners

The clean economy tax credits can be allocated by a partnership to its members, but only "the portion of the amount that can reasonably be considered to be the taxpayer's share thereof". Explanatory notes accompanying the draft legislation provide that relevant factors in the determination of a reasonable allocation include the capital invested and work performed by the members of the partnership.

The draft legislation also includes an “apportionment rule”. The explanatory notes provide an example to illustrate the application of this apportionment rule. The example appears to require each type of tax credit earned through a partnership to be allocated pro rata amongst the partners.

The application of the apportionment rule in this manner could have surprising consequences. For example, the apportionment of a tax credit to a partner that is not eligible to claim the tax credit (e.g., a partner that is not a taxable Canadian corporation would not be eligible to claim the CCUS ITC, the Clean Hydrogen ITC nor the Clean Technology Manufacturing ITC) would reduce the amount of the tax credit that would be available to partners that are eligible to claim the tax credit.

Author



Alex Pankratz
Partner
+1 416 865 4459
apankratz@fasken.com

Fasken is a leading international law firm with more than 950 lawyers and 10 offices on three continents. Clients rely on us for practical and innovative legal services.

We provide results-driven strategies to solve the most complex business and litigation challenges.

VANCOUVER	550 Burrard Street, Suite 2900	+1 604 631 3131	vancouver@fasken.com
SURREY	13401 - 108th Avenue, Suite 1800	+1 604 631 3131	surrey@fasken.com
TSUUT'INA	11501 Buffalo Run Boulevard, Suite 211	+1 403 261 5350	tsuutina@fasken.com
CALGARY	350 7th Avenue SW, Suite 3400	+1 403 261 5350	calgary@fasken.com
TORONTO	333 Bay Street, Suite 2400	+1 416 366 8381	toronto@fasken.com
OTTAWA	55 Metcalfe Street, Suite 1300	+1 613 236 3882	ottawa@fasken.com
MONTRÉAL	800 Victoria Square, Suite 3500	+1 514 397 7400	montreal@fasken.com
QUÉBEC	365 Abraham-Martin Street, Suite 600	+1 418 640 2000	quebec@fasken.com
LONDON	6th Floor, 100 Liverpool Street	+44 20 7917 8500	london@fasken.com
JOHANNESBURG	Inanda Greens, 54 Wierda Road West, Sandton 2196	+27 11 586 6000	johannesburg@fasken.com

FASKEN

Own tomorrow

fasken.com