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TaxNewsFlash

Canada

Clean Economy Incentives — Finance Releases Proposals

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Businesses investing in clean energy may qualify for new investment tax credits. Finance recently released draft legislation for several green economy incentives including the new Clean Technology Investment Tax Credit, the Carbon Capture, Utilization and Storage (CCUS) Investment Tax Credit, and the related labour requirements to access the highest credit rates. The draft legislation also includes enhancements to the reduced tax rates for zero-emission technology manufacturers and expanded eligibility for the Critical Mineral Exploration Tax Credit. Finance is asking for feedback on this draft legislation by September 8, 2023.

Businesses who currently invest in clean energy or who are considering such investments should review this new draft legislation to determine whether they are eligible for these credits and to decide if they wish to provide feedback. Note that, alongside this new draft legislation, Finance also announced that it soon intends to publish details on the Clean Hydrogen Investment Tax Credit. Finance states that eligibility for this credit is intended for the cleanest forms of blue hydrogen (hydrogen produced from natural gas where emissions are abated using CCUS).

Background
Finance announced several new tax investment tax credits in recent federal budgets and the 2022 Federal Fall Economic Update, including the CCUS Investment Tax Credit and the Clean Technology Investment Tax Credit. In addition, Finance announced several additional clean economy measures in the 2023 federal budget related to zero-emission technology manufacturers and flow-through shares and the Critical Mineral Exploration Tax Credit.

For more information on these credits, see *TaxNewsFlash-Canada* 2023-20, "Your Business May Qualify for New Funding and Incentives", *TaxNewsFlash-Canada* 2023-17, "2023 Federal Budget Highlights".

Note that, in addition to these credits and clean energy measures, Finance also announced other specific investment tax credits in the 2023 federal budget and the 2022 Federal Fall Economic Update, including:

- Clean Hydrogen Investment Tax Credit
- Clean Electricity Investment Tax Credit
- Clean Technology Manufacturing Investment Tax Credit.

However, Finance has not yet released draft legislation for these credits.

Clean Technology Investment Tax Credit

The new legislative proposals include the 30% refundable Clean Technology Investment Tax Credit, which is available for taxable Canadian corporations that invest in clean technology, including such corporations that are members of partnerships. Eligible clean technology property generally includes certain zero-emission power generation technologies (including concentrated solar energy equipment and small modular nuclear reactors), certain stationary electricity storage equipment for zero-emission energy, certain non-road zero-emission vehicles and geothermal energy systems that do not co-produce oil, gas or other fossil fuels. To qualify for the credit, the property must also meet certain other conditions, including that:

- The property is situated in Canada and be intended for use exclusively in Canada
- The property is new (i.e., not previously been acquired for use or lease before it was acquired by the taxpayer)
- If the property is leased by the taxpayer to another person, the property is 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, leasing property, lending money or certain other specified activities, and the lessee must be a qualifying taxpayer.

This credit applies to property that is acquired and becomes available for use on or after March 28, 2023, subject to a phase-out beginning in 2034 and is no longer available after 2034. Specifically, the rate decreases to 15% for eligible property that becomes available for use in 2034 until the credit is completely phased out for property that becomes available for use after 2034.

The proposed legislation also introduces recapture rules. Under these rules, taxpayers may be required to repay all or part of the credit if a previously eligible clean technology property no longer meets certain criteria within 20 years of its acquisition. Specifically, taxpayers will have to repay all or part of the credit if the property is converted to a non-clean technology energy use, is exported from Canada, or is otherwise disposed of.

To claim this credit, taxpayers must file a prescribed form no later than the day that is one year after the taxpayer's filling-due date for the year.

CCUS Investment Tax Credit

The proposed rules also include an investment tax credit for certain expenditures incurred in respect of CCUS projects that generally applies to qualifying expenditures incurred on or after January 1, 2022 and before 2041. This credit is available to taxable Canadian corporations for qualified carbon capture, carbon transportation, carbon storage or carbon use expenditures, and includes look-through rules for such corporations that are members of partnerships.

Among other conditions, these expenditures must be incurred for a qualified CCUS project to be eligible for the tax credit. For a project to be qualified CCUS project, it must meet four conditions:

- The project is expected to support the capture of carbon dioxide in Canada
- An initial project evaluation has been issued by the Minister of Natural Resources in respect of the project
- Based on the project's most recently filed project plan, in each of the project's first 20 years of operation, the proportion of the amount of captured carbon the project is expected to support for storage in an eligible use exceeds 10% of the amount of captured carbon the project is expected to support for storage or use in both eligible and ineligible use during the year
- If the project is operated to service a facility that existed on April 7, 2022, it cannot be undertaken for the purpose of complying with emission standards that apply, or will apply, under the *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations.*

For expenses incurred after 2021 and before 2031, the credit rate for a qualified carbon capture expenditure is 60% if incurred to capture carbon directly from ambient air or 50% in any other case. These rates decrease by 50% for expenditures incurred after 2030 and before 2041, and are reduced to nil for expenditures incurred to capture carbon after 2040. For all other types of qualified CCUS expenditures (being qualified carbon transportation expenditures, qualified carbon storage expenditures and qualified carbon use expenditures) the rate is 37.5% (for expenditures incurred after 2021 and before 2031) or 18.75% (for expenditures incurred after 2030 and before 2041) and nil (for expenditures incurred after 2040).

Taxpayers may also be subject to recapture rules under this credit. Generally, a taxpayer may be required to repay certain CCUS tax credits for CCUS projects that do not meet their projected eligible use percentage (for tax credits on qualified carbon capture expenses or qualified carbon transportation expenses). In addition, a taxpayer may be required to repay all or part of the credit where they dispose of a property or export it from Canada during a particular taxation year and the taxpayer obtained, or would otherwise have obtained, a CCUS tax credit in respect of the property.

To claim this credit, taxpayers must generally file a prescribed report with each return of income for taxation years of the taxpayer that include any part of the relevant project period of a CCUS project. This annual report must include the actual amount of carbon captured, during the calendar year ending in the taxation year, for storage or use in eligible use; and the aggregate quantity of captured carbon during that calendar year that supported storage or use in both eligible use, as well as ineligible use (e.g., the emission of captured carbon dioxide into the atmosphere). In addition, for projects that expect to incur qualified expenses of $250 million or more, taxpayers must make a climate risk disclosure report publicly available and submit a knowledge sharing report to the Minister of Natural Resources for each reporting period. Taxpayers who do not produce these reports as required may face significant penalties.

Labour requirements for investment tax credits

The draft legislation also outlines certain labour conditions that taxpayers must meet to be eligible for the maximum rates for certain clean economy incentives, effective October 1, 2023. These conditions which are generally related to paying prevailing wages and meeting certain apprenticeship requirements apply to the Clean Technology Investment Tax Credit and the CCUS Investment Tax Credit. Taxpayers that meet these conditions will also need to file an election in prescribed form. If the labour requirements are not met, these taxpayers' entitlement to the relevant regular credit rates will be reduced by 10%. The labour requirements generally apply to employees of the taxpayer claiming the relevant credit, as well as employees of any other person or partnership, who are engaged in the preparation or installation of specified property at a designated worksite and whose work is primarily manual (covered workers).

Meeting the requirements

Generally, to meet the prevailing wage requirement, the taxpayer must ensure that all covered workers are paid either in accordance with the terms of an eligible collective agreement, or are compensated at a level that meets or exceeds the value of compensation (including benefits) provided to similar workers under such an agreement.

To meet the apprenticeship requirement, the taxpayer must ensure that at least 10% of the total labour performed by workers in the Red Seal trades is performed by registered apprentices.

KPMG observations
Although Finance's package of draft legislation includes labour conditions that will apply for purposes of claiming the Clean Technology Investment Tax Credit and the CCUS Investment Tax Credit, the accompanying explanatory notes confirm that these

conditions are also intended to apply to the Clean Hydrogen Investment Tax Credit and the Investment Tax Credit for Clean Electricity, consistent with the 2023 federal budget proposals.

Zero-emission technology manufacturers

The draft legislation allows certain nuclear manufacturing and processing activities to qualify for the reduced tax rates for zero-emission technology manufacturers. Specifically, income from manufacturing of nuclear energy equipment, processing or recycling of nuclear fuels and heavy water, and manufacturing of nuclear fuel rods will qualify for the tax rate reduction. The legislation also extends the 50% corporate income tax rate reduction for qualifying zero-emission technology manufacturers in respect of eligible zero-emission technology and manufacturing and processing income. The planned phase-out will now start in taxation years that begin in 2032 and the rate reduction will fully phase out for taxation years that begin after 2034.

Flow-through shares & Critical Mineral Exploration Tax Credit

The draft legislation provides that certain expenses for extraction of lithium from brines are eligible for flow-through treatment and the Critical Mineral Exploration Tax Credit (CMETC). As a result, relevant principal-business corporations that undertake certain exploration and development activities for the extraction of lithium from brines can issue flow-through shares and renounce expenses to their investors, and individual investors (other than trusts) in flow-through shares may also be able to claim the CMETC. These changes apply to expenses incurred on or after March 28, 2023.

We can help

Your KPMG adviser can help you assess the effect of these new developments. In particular, we have established a dedicated team which can help you assess eligibility for these credits. Our service offering includes the ability to work with our Deal Advisory team to design tailored financing arrangements and structural planning to optimize the accessibility to these credits for your project. For more details, contact your KPMG adviser.