Deadline for Green Investment Tax Credit submissions fast approaching

22 janvier 2024

Canada has unveiled five investment tax credits (ITCs) over the past 18 months to support businesses transitioning to a cleaner and greener economy. These “green” ITCs, supported by over $20 billion of associated financing commitments from the Canada Infrastructure Bank, constitute the cornerstones of Canada’s response to almost $400 billion of subsidies for clean energy included in the U.S. *Inflation Reduction Act*.

Canada’s “green” ITCs are computed as a percentage of the capital cost of specific capital investments on qualifying property to be used in Canada in eligible activities. In this manner, they differ from analogous U.S. tax credits based on production from property rather than the cost of acquiring it. They are also payable directly by the Canadian government, again differing from some of the U.S. tax credits that are typically monetized via agreements with third parties. Each of these “green” ITCs is also refundable, meaning that the government will pay them directly to qualifying taxpayers even if they do not have Canadian income tax owing. They are not “stackable”: a taxpayer may not claim more than one of them for the same expenditure if more than one "green" ITC could apply.

The government is taking some time to get these new ITCs into final form, and as of January 2024 none of them have yet been passed into law (see the table below for a summary of their status). Draft legislation for the Clean Hydrogen and Clean Technology Manufacturing ITCs was released for comment on Dec. 20, 2023, accompanying Explanatory Notes were subsequently released, and the Department of Finance has set Feb. 5, 2024 as the deadline for interested parties to make submissions on the initial draft legislation. Businesses interested in claiming either or both of them should review the draft legislation to ensure it fully encompasses their particular circumstances and make submissions to Finance by Feb. 5 if they believe that changes should be made to them (the next version of draft legislation will very likely be the final form).

Targeted Clean Economy Sectors

Each of these new “green” ITCs is directed at particular segments of the clean economy, although there is some degree of overlap in some cases. In general, qualifying expenditures are limited to those for new and previously unused property that will be situated in and used exclusively in Canada. Only taxable Canadian corporations[1] are eligible to claim them, with two exceptions: real estate investment trusts may also claim the Clean Technology ITC and tax-exempt entities may also claim the Clean Electricity ITC. These eligible taxpayers may claim ITCs on expenditures made directly or by a partnership they are members of.

Clean Technology

The 30%[2] Clean Technology ITC is available for capital investments in equipment used in generating various forms of clean energy, including from wind, solar, water and geothermal sources, as well as small modular nuclear reactors, air or ground-source heat pumps, and certain stationary electricity storage equipment that does not use fossil fuels in operation (non-road ZEVs also qualify). The details of this ITC were first released in the autumn of 2022, and in Nov. 2023 the government announced it would be expanded to include using waste biomass to generate heat and electricity.

Carbon Capture, Utilization & Storage (CCUS)

The CCUS ITC is directed at equipment used to capture, transport or store carbon dioxide in an eligible project (dual-use heat and/or power equipment may also qualify). This ITC was first announced in the 2021 federal budget, with details following in 2022. The amount of the ITC depends on the particular activity undertaken and the year in which the expenditure is incurred and the property is acquired.

	CO_2 Capture (From Ambient Air)	**CO_2 Capture (Other)**	**CO_2 Transportation, Storage or Use**
Pre-2031 ITC Rate	60%	50%	37.5%
2031-2040 ITC Rate	30%	25%	18.75%

The expenditures that qualify are largely those incurred prior to the “first day of commercial operations”[3] of the taxpayer’s CCUS project to capture, transport or use CO_2. Qualifying expenditures incurred after that date (“refurbishment”) are limited to 10% of the project’s total qualifying expenditures. Expenditures on “preliminary CCUS work activity”[4] are excluded from eligibility.

The CCUS ITC legislation is the most complex and detailed of the five “green” ITCs. In order for a CCUS ITC to be claimed, a “qualified CCUS project” must exist, requiring the taxpayer to submit a formal plan (including a front-end engineering design study) meeting specified conditions to the Ministry of Natural Resources. The Ministry of Natural Resources must issue an initial project evaluation, and the taxpayer is subject to various ongoing reporting requirements. In particular, annual reporting is required on project results (*i.e.*, how much CO_2 is being captured and used in eligible uses) relative to what the project plan anticipated, and if the deviation is sufficiently large then some or all of the CCUS ITC previously claimed is effectively taxed back.

Clean Hydrogen

The Clean Hydrogen ITC is applicable to equipment that produces hydrogen from either electrolysis or CO_2 emission-abated natural gas reforming, and has been extended to support equipment converting hydrogen into ammonia in some cases. There are three levels of ITC offered, depending on how carbon-intensive the hydrogen being produced is (no ITC applies if 4 kg or more of CO_2/H kg is produced):[5]

Carbon Intensity (CO_2 kg / H kg produced)			
	< .75	.75 - < 2	2 - < 4
Pre-2034 ITC Rate[6]	40%	25%	15%

For this purpose, carbon intensity is determined under the federal government's Fuel LCA Model, and upstream emissions from the production of inputs (*i.e.*, energy sources such as the provincial electricity grid) to the hydrogen production process are included. The draft legislation excludes "preliminary clean hydrogen work activity"[7] from the capital cost of ITC-eligible clean hydrogen property. Buildings and other structures, construction equipment, and equipment used for off-site transmission, transportation or distribution of hydrogen or ammonia are also excluded from being ITC-eligible property. Special rules apply to dual-use electricity and heat equipment used to produce hydrogen by reforming natural gas (including associated transmission and distribution equipment), and to equipment used solely to produce ammonia.

In all cases, claiming the Clean Hydrogen ITC requires submission of a formal plan (supported by a carbon intensity report prepared by a qualified validation firm and a front-end engineering project design study) to the Ministry of Natural Resources, and confirmation by that Ministry that the expected carbon intensity can reasonably be expected to be achieved. Annual compliance reporting is required, supported by a carbon intensity report from a qualified verification firm that is different from the qualified validation firm whose report was part of the initial project plan. Where the difference between the project's average actual carbon intensity and the expected carbon intensity set out in the most recent project plan exceeds .25 CO_2 kg / H kg, the taxpayer's Clean Hydrogen ITC is recomputed based on the actual carbon intensity, which could result in some or all of the ITC previously claimed being taxed back.

Clean Technology Manufacturing

The 30%[8] Clean Technology Manufacturing ITC is directed further up the supply chain, at Canadian companies that are manufacturing or processing clean technologies and their precursors. It applies to machinery and equipment acquired in 2024 or later that is used to (1) extract, process or recycle certain key critical minerals,[9] or (2) manufacture or process key clean technologies, and including machinery and equipment used in manufacturing (and related activities) of:

- Grid-scale electrical energy storage equipment

- Renewable (or nuclear) energy equipment
- Zero-emission vehicles
- Various upstream components and materials for such above-noted activities

Importantly, property used in the production of battery cells or modules is excluded from being ITC-eligible, if the production has benefitted from, or can reasonably be expected to benefit from, support under a contribution agreement with the Government of Canada. While this exclusion would appear to be directed at large-scale government-supported battery production projects such as those being undertaken by Volkswagen and Stellantis,[10] the exact scope of this exclusion and what constitutes a "contribution agreement" remains unclear.

Clean Electricity

The 15% Clean Electricity ITC will apply to eligible investments (including refurbishments) in the following types of property:

- Non-emitting electricity generation systems, *i.e.*, wind, solar, hydro, wave, tidal, and both large and small-scale nuclear
- Abated natural gas fired electricity generation meeting an emissions threshold
- Stationary electricity storage systems
- Inter-provincial electricity transmission equipment

In November 2023 the government announced this ITC would be expanded to include using waste biomass to generate heat and electricity.

Operation of "Green" ITCs

As noted, these "green" ITCs are in various stages of development: two of them are before Parliament in essentially final form,[11] and two others are in consultation stage with draft legislation released for comment by Feb. 5. Taxpayers have only 2023 federal budget descriptions of the Clean Electricity ITC to work with, and in Nov. 2023 the government just announced that the consultation process for this ITC would occur during 2024 in two stages: one for publicly-owned utilities and an earlier one for other taxpayers.

Various technical details apply to these "green" ITCs, dealing with many important aspects that will significantly affect when they are available and how taxpayers can optimize their ability to claim them. In general, only the owner of the relevant qualifying property may claim the applicable "green" ITC, subject to an exception for leased property that allows the lessor (not the lessee) to claim the ITC if certain conditions are met. In most cases the taxpayer cannot claim an ITC on an expenditure on ITC-eligible property until that property is actually "available for use", *i.e.*, installed and capable of operating.[12]

Partnerships

"Green" ITCs can be claimed by eligible taxpayers who directly make qualifying expenditures, or who are members of a (fiscally transparent) partnership that does so. Where the partnership makes qualifying expenditures, the ITC is computed as if the partnership were a taxpayer and is then allocated out amongst the partners. While partnerships are commonly used in clean energy projects, the government is clearly concerned with inappropriate results occurring in cases involving them. As such, the government has added a number of anti-avoidance rules[13] to police ITCs claimed by taxpayers through partnerships that will require very careful consideration and planning by those considering using them. In particular, these rules deal with how ITCs on expenditures incurred by a partnership are allocated amongst its partners, and restrict the extent to which partners whose liability is limited or who benefit from certain protections can claim them.

Labour Requirements

Except for the Clean Technology Manufacturing ITC, taxpayers wanting the full "green" ITC rate must formally commit to meeting certain standards ("labour requirements")[14] as to prevailing wages and the use of apprentices with respect to workers engaged in the preparation or installation of property on which an ITC has been claimed. Failure to do so results in a 10% reduction in the applicable ITC rate (*i.e.*, a 30% ITC becomes a 20% ITC), and taxpayers who so commit but fail to achieve the necessary standards are subject to penalties. The Explanatory Notes accompanying these provisions provide useful insight into how the government intends them to operate in practice.

Government Assistance

Government assistance[15] that can reasonably be considered to be in respect of a "green" ITC-eligible property adversely impacts the recipient's claim for the relevant "green" ITC. Specifically, any such government assistance that is received or receivable (or can reasonably expected to be received) by a taxpayer generally reduces the taxpayer's cost of that property, and thereby the "green" ITC to which it relates.[16] This "government assistance" rule does not apply to the CCUS ITC. As noted with reference to the Clean Technology Manufacturing ITC, in certain cases government support for a project can cause a property to which it relates to become completely ineligible. As such, taxpayers must very carefully consider the impact of any government assistance received or expected to be received in relation to a project in which "green" ITCs are being claimed. Note that government (or non-government) assistance received, receivable or expected to be received by a member of a partnership is attributed to the partnership for purposes of computing ITCs in respect of partnership expenditures.

Recapture Provisions

The four ITCs for which legislation has been released contain "recapture" provisions that apply when the property that is the subject matter of the ITC claim is disposed of, exported out of Canada or ceases to be used in a qualifying manner during a prescribed period of time (the "recapture period") following the year the ITC is claimed. In general terms, where applicable these "recapture" rules may cause some or all of the "green" ITCs claimed on such property to be taxed back. Where "green" ITCs are claimed through a partnership, the recapture rules in some cases may visit these adverse consequences on partners who may or may not be the same as the partners who claimed the relevant ITC at the time the qualifying expenditures were incurred. As such, the interaction of the recapture provisions with partnerships must be carefully considered to avoid inappropriate results from occurring.

	Clean Technology	Carbon Capture, Utilization and Storage†	Clean Hydrogen†	Clean Technology Manufacturing	Clean Electricity
Maximum ITC Rate Offered	30%*	60%/50%/37.5%*	40%/25%/15%*	30%	15%*
Eligible Taxpayers (directly or through a partnership)	Taxable Canadian corporations & real estate investment trusts	Taxable Canadian corporations	Taxable Canadian corporations	Taxable Canadian corporations	Canadian tax-exempts and taxable entities
Expenditure Start Date	March 28, 2023^GA	Jan. 1, 2022	March 28, 2023^ GA	Jan. 1, 2024^ GA	Date of 2024 Federal Budget
ITC Phase-out Starts	Jan. 1, 2034	Jan. 1, 2031	Jan. 1, 2034	Jan. 1, 2032	N/A
ITC End Date	Dec. 31, 2034	Dec. 31, 2040	Dec. 31, 2034	Dec. 31, 2034	Dec. 31, 2033
Recapture Period	10 years	20 years	20 years	10 years	Unclear
Status as of January 2023	Legislation before Parliament (s. 127.45 of Bill C-59)	Legislation before Parliament (s. 127.44 and Part XII.7 of Bill C-59)	S. 127.48 of draft legislation released for comment Dec. 20, 2023; input due by Feb. 5, 2024	s. 127.49 of draft legislation released for comment Dec. 20, 2023; input due by Feb. 5, 2024	Draft legislation scheduled to be released for comment during 2024

† Submission of project plan and certification by Ministry of Natural Resources required
* Labour requirements applicable to attain highest ITC %
^ "Available for use" rules defer ITC claim until year in which property is actually "available for use"
GA Cost of ITC-eligible property reduced by "government assistance" received, receivable or expected.

If you have any questions about any of the investment tax credits, reach out to BLG's tax group or any of the key contacts below.

Footnotes

[1] Being corporations whose governing corporate statute is Canadian (federal, provincial or territorial), and that are resident in Canada for purposes of (and are not exempt from tax under) the *Income Tax Act* (Canada) (ITA).

[2] Reduced to 15% for property acquired in 2034; no ITC is available for property acquired in 2035 or later.

[3] Defined as 120 days after the day on which captured CO_2 is first delivered to a carbon transportation, storage or use system for storage or use on an ongoing operational basis.

[4] *E.g*., obtaining permits or regulatory approvals, performing front-end design or engineering work (other than detailed design or engineering work relating to certain carbon-capture properties), conducting feasibility/pre-feasibility studies or environmental assessments, or clearing or excavating land.

[5] The government chose this threshold in 2022 to match comparable provisions in the U.S. *Inflation Reduction Act*.

[6] The ITC rate is cut in half for property acquired in 2034; no ITC is available for property acquired in 2035 or later.

[7] *E.g.*, obtaining permits or regulatory approvals, performing front-end design or engineering work (other than detailed design or engineering work relating to eligible clean hydrogen property), conducting feasibility/pre-feasibility studies or environmental assessments, or clearing or excavating land.

[8] The ITC rate is reduced to 20% for property acquired in 2032, 10% for property acquired in 2033, and 5% for property acquired in 2034; no ITC is available for property acquired in 2035 or later.

[9] Specifically, lithium, cobalt, nickel, copper, rare earth elements and graphite.

[10] See PBO legislative costing note Investment Tax Credit for Clean Technology Manufacturing dated Sept. 28, 2023.

[11] See Bill C-59; accompanying Explanatory Notes have also been released.

[12] This rule does not apply to the CCUS ITC, but another CCUS ITC-specific rule may apply to defer ITC eligibility where the relevant property is acquired in a taxation year after the year in which the relevant expense is incurred. Another rule applicable to all "green" ITCs treats expenditures on ITC-eligible property that are unpaid 180 days after the end of the taxation year in which it was incurred not to be recognized until they are paid.

[13] See s. 127.47 ITA of Bill C-59.

[14] See s. 127.46 ITA of Bill C-59.

[15] Broadly defined as a grant, subsidiary, forgivable loan or any other form of assistance received from a government or other public authority. Late in 2023 the government announced that low/no-interest loans with reasonable repayment terms would not be considered as “government assistance” for this purpose. ITC claims can also be reduced by “non-government assistance”, a comparable but less frequently encountered phenomenon.

[16] Such reduction in capital cost will also reduce the taxpayer’s deductible depreciation expense for tax purposes.

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