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Tax Alert — Canada

Canada releases federal carbon tax pricing proposals

On 15 January 2018, the Department of Finance and the Department of Environment and Climate Change released for public comment draft legislative proposals and explanatory notes for a federal carbon backstop pricing system. These proposals are a follow-up to a technical paper on federal carbon pricing released on 18 May 2017.

In accordance with the proposed *Greenhouse Gas Pollution Pricing Act* (GGPPA) and the implementation of future regulations, the federal carbon pricing system would consist of two elements:

- A broad-based charge on fossil fuels, or carbon tax, payable by fuel producers and distributors; and
- An output-based pricing system regulatory framework for industrial facilities with high emission levels.

The federal system, however, will not apply in provinces that have imposed their own carbon pricing system (i.e., British Columbia, Alberta, Ontario, and Quebec, to date), provided the province's system meets or exceeds the federal benchmark.

The proposed federal carbon pricing system is modelled on Alberta's current carbon pricing regime to a large extent. However, the federal government's aim is to provide a benchmark that all provinces and territories will need to meet, while also allowing some flexibility in their choice of carbon pricing mechanisms. All elements of the federal system would apply in provinces and territories that do not have a carbon pricing system. In addition, the federal system would apply to supplement or top up provincial or territorial carbon pricing regimes that do not fully meet the federal benchmark.

Interested parties are invited to provide comments on the federal carbon tax proposals by 12 February 2018, while comments on the output-based pricing system may be submitted until 9 April 2018. The federal government indicated it will continue to engage with provincial and territorial governments, Indigenous peoples, industry, environmental groups, and other stakeholders during the winter and spring of 2018.

Federal carbon tax – application

In general, the federal carbon tax under Part I of the GGPPA would apply where:

- A registered distributor for a type of fuel delivers such fuel to another person in a listed province;
- A registered distributor for a type of fuel uses such fuel in a listed province;
- A person brings or imports fuel into a listed province;
- A person produces fuel in a listed province; or
- A person burns combustible waste in a listed province for the purposes of producing heat or energy.

In addition, tax would apply if a person diverts fuel from a non-taxable use. For example, the tax would apply where:

- A person removes fuel from a covered facility (i.e., a facility that is subject to the output-based pricing system in accordance with Part 2 of the GGPPA) of the person in a listed province;
- A registered user for a type of fuel:
  - Uses the fuel otherwise than in a *non-covered activity* (e.g., fuel used as a raw material in an industrial process that produces another fuel or substance), or
  - Delivers the fuel to another person, unless that other person is a registered distributor; or
- A registered distributor delivers fuel to a farmer, and the farmer:
  - Uses the fuel otherwise than in eligible farming activities, or

- Delivers the fuel to another person, unless that other person is a registered distributor.

The GGPPA would provide for certain exemptions from the federal carbon tax. For instance, federal carbon tax would generally not apply to fuel:

- Used by a farmer in eligible farming activities;
- Used by registered carriers for interjurisdictional journeys; or
- Brought or imported in the supply tank of a vehicle, if the fuel is used for operating the vehicle, an auxiliary component of the vehicle, or an auxiliary component of another vehicle attached to the vehicle.

In general, a person could not purchase fuel on a tax-exempt basis unless the person provided an exemption certificate to the vendor at the time of purchase. For example, farmers would be entitled to purchase fuel on a tax-exempt basis by presenting an exemption certificate to a registered distributor. Other entities that could use exemption certificates to acquire fuel include registered air, marine, rail and road carriers. Such entities would generally be required to account for the tax after determining the amount of fuel used in a listed province for the applicable reporting period.

The legislation also provides flexibility to the federal government to introduce further exemptions through regulations. For example, Alberta has exempted raw and natural gas used in upstream oil and gas production from the province's carbon levy until 2022. Whether the federal government will introduce similar industry-specific exemptions remains to be seen.

Federal carbon tax – rates

The federal government intends to implement the federal carbon tax on fossil fuels at some point in 2018. Once enacted, the tax will apply at the rate of $10 per tonne of carbon dioxide-equivalent (CO_2e) emissions for the remainder of 2018. Beginning 1 January 2019, the tax will increase by $10 per tonne on 1 January of each calendar year until the tax reaches $50 per tonne effective 1 January 2022.

The following table sets out the proposed federal carbon tax rates.

Fuel	Unit	2018 ($10/tonne)	2019 ($20/tonne)	2020 ($30/tonne)	2021 ($40/tonne)	2022 ($50/tonne)
Liquid and gaseous fossil fuels						
Aviation gasoline	¢/litre	2.49	4.98	7.47	9.95	12.44
Aviation turbo fuel	¢/litre	2.58	5.16	7.75	10.33	12.91
Butane	¢/litre	1.78	3.56	5.34	7.12	8.90
Ethane	¢/litre	1.02	2.04	3.06	4.08	5.09
Gas liquids	¢/litre	1.67	3.33	4.99	6.66	8.32
Gasoline	¢/litre	2.21	4.42	6.63	8.84	11.05
Heavy fuel oil	¢/litre	3.19	6.37	9.56	12.75	15.93
Kerosene	¢/litre	2.58	5.16	7.75	10.33	12.91
Light fuel oil	¢/litre	2.68	5.37	8.05	10.73	13.41
Methanol	¢/litre	1.10	2.20	3.29	4.39	5.49
Naphtha	¢/litre	2.25	4.51	6.76	9.02	11.27
Petroleum coke	¢/litre	3.84	7.67	11.51	15.35	19.19
Pentanes plus	¢/litre	1.78	3.56	5.34	7.12	8.90
Propane	¢/litre	1.55	3.10	4.64	6.19	7.74
Coke oven gas	¢/m^3	0.70	1.40	2.10	2.80	3.50
Marketable natural gas	¢/m^3	1.96	3.91	5.87	7.83	9.79
Non-marketable natural gas	¢/m^3	2.59	5.17	7.76	10.34	12.93
Still gas	¢/m^3	2.70	5.40	8.10	10.80	13.50
Solid fossil fuels						
Coke	$/tonne	31.80	63.59	95.39	127.19	158.99
High heat value coal	$/tonne	22.52	45.03	67.55	90.07	112.58
Low heat value coal	$/tonne	17.72	35.45	53.17	70.90	88.62
Combustible waste (i.e., tires or asphalt shingles)	$/tonne	19.97	39.95	59.92	79.89	99.87

Federal carbon tax – remittance and returns

In general, registrants would be required to file returns and remit tax for each calendar month. The payment and return for a particular calendar month would be due on the last day of the following month.

Registered road carriers (i.e., IFTA registrants) would be permitted to file returns and remit tax on a quarterly basis. Registered road carriers are interjurisdictional transporters that provide commercial transportation of passengers or goods by road from one province to another province, or from one location to another location if one location is in Canada and the other location is outside Canada.

Pursuant to section 164 of the GGPPA, the Minister of National Revenue would be required to distribute net amounts of carbon tax collected in a listed province to the province or to prescribed persons, or to both.

Output-based pricing system regulatory framework

Part 2 of the GGPPA sets out a statutory framework for an output-based pricing system, which aims to provide pricing incentives for certain industries to reduce their greenhouse gas emissions.

Rather than paying carbon tax on purchased fuels, industries in this system would pay a charge on the amount of greenhouse gases they emit above a specified level. The initial excess emissions charge would be $10 per tonne of CO2e emissions in 2018 and would rise by $10 annually until it reaches $50 per tonne in 2022. A facility that reduced emissions below its limit could earn additional revenue by selling compliance units (i.e., surplus credits) to other facilities.

For 2018 and 2019, this system would apply for facilities that emit a minimum of 50 kilotonnes of CO2e emissions per year. In accordance with this aim, the government initially intends to develop output-based standards for the following industrial sectors:

- Oil and gas
- Pulp and paper
- Chemicals
- Nitrogen fertilizers
- Lime
- Cement
- Base metal smelting and refining
- Potash
- Iron ore pelletizing
- Mining
- Iron and steel
- Food processing

The federal government has indicated it may develop standards for additional sectors such as offshore oil and gas, as well as electricity generation.

This system would be implemented in provincial or territorial jurisdictions that adopt the federal system or that implement a system that does not meet the federal standard.

Provincial carbon pricing mechanisms

The following provinces already have some form of carbon pricing in place or have announced plans to implement carbon pricing:

Alberta – Alberta implemented a carbon tax applicable to all fossil fuels in accordance with the *Climate Leadership Act* (CLA), effective 1 January 2017. The CLA imposes a carbon price of $30 per tonne (increased from $20 per tonne effective 1 January 2018). Alberta also applies a Specified Gas Emitters Regulation (SGER) framework to carbon emissions produced by large final emitters. However, Alberta is transitioning from the SGER framework to product- and sector-based performance standards, effective 2018.

British Columbia – British Columbia has imposed a carbon tax applicable to all fossil fuels in accordance with the *Carbon Tax Act* since 1 July 2008. The current tax rate of $30 per tonne has been in effect since 1 July 2012. Beginning 1 April 2018, British Columbia will increase carbon tax rates by $5 per tonne of CO2e emissions annually until rates are equal to $50 per tonne on 1 April 2021.

Manitoba – Manitoba imposes an emissions tax on coal and petroleum coke in accordance with *The Emissions Tax on Coal and Petroleum Coke Act*. On 27 October 2017, Manitoba released its *Made-in-Manitoba Climate and Green Plan*, which would include a carbon tax of $25 per tonne that would not rise over time. The carbon tax would take effect sometime in 2018.

Nova Scotia – As part of its September 2017 budget, Nova Scotia announced it would implement a cap and trade program "over the next year." The province expects approximately 20 companies to participate, including industrial facilities with annual greenhouse gas emissions of at least 100,000 tonnes CO2e. Cap and trade implementation legislation has not yet been introduced.

Ontario and Quebec – The provinces of Ontario and Quebec participate in a cap-and-trade regime with the state of California.

For the most part, the remaining provinces and territories have not specifically indicated their carbon pricing intentions. It seems likely they will adopt the federal carbon pricing backstop in whole or in part. However, the Government of Saskatchewan has indicated it will oppose the imposition of a federal carbon tax in the province, including through a legal challenge if necessary. Given the federal government's broad taxation powers, it is unclear whether such a challenge would succeed.

Different concerns may apply where a province implements a carbon pricing regime that sets prices below the federal benchmark. For example, the Government of Manitoba has indicated its carbon tax will not exceed $25 per tonne, on the basis it has already undertaken or will undertake a number of initiatives to reduce greenhouse gas emissions, such as extensive investments in hydroelectric power. An independent legal opinion provided to the province stated that Manitoba could argue "the federal government was arbitrarily denying its authority to craft its own legislative measures in response to the issue of greenhouse gas emissions." The extent to which provinces and territories that administer their own carbon pricing mechanisms will be allowed to define their own exemptions is also unclear.

Submissions regarding federal proposals

Interested parties may submit comments concerning the federal carbon tax at carbonpricing-tarificationcarbone@canada.ca until 12 February 2018. Comments relating to the federal regulatory framework may be submitted at ec.tarificationducarbone-carbonpricing.ec@canada.ca until 9 April 2018.

As indicated in a Department of Environment and Climate Change news release dated 20 December 2017, any province or territory that wishes to adopt the federal system should make that request by 30 March 2018. Provinces and territories must confirm their plans to adopt carbon pricing regimes that meet the federal standard by 1 September 2018.

Learn more

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