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Tax Alert – Canada

Legislative update for the CCUS investment tax credit

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 4 August 2023, the Department of Finance released for public comment updated draft income tax legislative proposals relating to the new investment tax credit (ITC) for carbon capture, utilization and storage (CCUS). Draft legislative proposals for the new clean technology ITC, as well as new labour requirements relating to both the CCUS ITC and the clean technology ITC, were also released on 4 August 2023. The draft legislative proposals relating to the clean technology ITC are discussed in EY Tax Alert 2023 Issue No. 33, [Proposed clean technology investment tax credit](#). Interested parties are invited to provide comments on the draft legislative proposals by 8 September 2023.

The CCUS ITC was first announced in the 2021 federal budget and subsequently updated in both the 2022 and 2023 federal budgets. The 4 August 2023 draft legislative proposals for the CCUS ITC are generally consistent with previous announcements and most notably incorporate the latest changes proposed in the 2023 federal budget. The initial draft proposals were outlined in EY Tax Alert 2022 Issue No. 31, [Proposed federal investment tax credit for CCUS](#) with subsequent proposals outlined in EY Tax Alert 2022 Issue No. 41, [Proposed federal investment tax credit for carbon capture, utilization and storage - update](#), and EY Tax Alert 2023 Issue No. 20, [Federal budget 2023-24](#).

This alert highlights specific CCUS ITC updates contained in the latest round of legislative proposals and provides a summary of the related proposed labour requirements.

Background

The CCUS ITC (proposed section 127.44 and Part XII.7 of the *Income Tax Act* (the Act)) will be refundable and available to businesses that incur qualified CCUS expenditures after 2021 and before 2041. Qualified CCUS expenditures will include the cost of acquiring eligible equipment used in qualified CCUS projects.

Eligible equipment, as described in our previous Tax Alerts noted above, will include equipment that is situated in Canada and used solely to capture, transport, store or use carbon dioxide (CO₂) as part of a qualified CCUS project. This equipment will be included in new capital cost allowance (CCA) Classes 57 and 58, which will have 8% and 20% declining-balance-basis CCA rates, respectively, and will be eligible for enhanced first-year depreciation under the accelerated investment incentive.

For qualified CCUS expenditures incurred after 2021 and before 2031, credit rates are 60% for qualified carbon capture expenditures used to capture carbon directly from ambient air, 50% for other qualified carbon capture expenditures and 37.5% for qualified carbon transportation, storage or use expenditures. These credit rates are reduced by half for eligible expenses incurred after 2030 and before 2041. Also, the credit rates are reduced by 10 percentage points if certain proposed labour conditions are not met (see “Labour requirements” below).

The tax credit may be claimed for the taxation year in which qualified CCUS expenditures are incurred, regardless of when the related equipment becomes available for use. The extent to which the tax credit will be available is also dependent on the projected eligible use percentage of the CO₂ being captured. Proposed Part XII.7 recovery taxes may also be imposed to recoup any excess tax credits claimed where the projected eligible use percentage is not met at the end of each of the four project periods.

2023 federal budget changes

The legislative proposals incorporate various changes that were announced in the 2023 federal budget, including the separation of the credit into a cumulative CCUS development tax credit (for qualified CCUS expenditures incurred before the first day of commercial operations of a CCUS project) and a CCUS refurbishment tax credit (for qualified CCUS expenditures incurred during the total CCUS project review period).

Other changes announced in the 2023 federal budget and included in the 4 August 2023 legislative proposals include:

- ▶ The expansion of eligible equipment to include dual-use equipment that produces heat or electrical power (or a combination of the two) or uses water and is used in support of a CCUS project as well as another process (provided it otherwise meets the conditions of the credit);

- ▶ The addition of British Columbia to the list of designated jurisdictions for dedicated geological storage;
- ▶ Validation of concrete storage requirements by an accredited third party (rather than obtaining approval from Environment and Climate Change Canada) – see “Proposed eligible use ratio” below;
- ▶ Changes relating to recovery of the credit; and
- ▶ Clarification of the interaction of this credit with other government assistance.

As described below, rules related to knowledge sharing and climate risk disclosure are also included in the draft legislative proposals (with some legislative modifications since their initial release on 28 March 2023).

Proposed eligible use ratio

As noted above, the extent to which the CCUS tax credit may be claimed is dependent on the projected eligible use percentage of the CO₂ being captured. The eligible use ratio refers to the quantity of captured carbon that the CCUS project is expected to support for storage or use in an eligible use divided by the total quantity of captured carbon expected for both eligible and ineligible use.

For these purposes, eligible use is defined as:

- ▶ Storage of captured carbon in dedicated geological storage; or
- ▶ Use of captured carbon in producing concrete in Canada or the United States using a qualified concrete storage process.

Under the updated proposals, a “qualified concrete storage process” means a process that has been evaluated against the ISO 14034:2016 standard, *Environmental management – Environmental technology verification*, to confirm that at least 60% of the captured carbon injected into concrete is expected to be mineralized and permanently stored. Validation in meeting these requirements must be issued by an accredited verification body that meets the requirements of a third-party inspection body as described by ISO/IEC 17020:2012.

Changes in project or eligible use

The requirement to file a revised project plan in certain circumstances has been modified to specify that the provision applies at any time before the first day of commercial operations of a qualified CCUS project, as well as to provide for a 90-day-period filing deadline.

Specifically, a taxpayer must file a revised project plan with the Minister of Natural Resources within 90 days of:

- ▶ The Minister of Natural Resources requesting that the taxpayer file a revised project plan; or
- ▶ There being a reduction of more than five percentage points in the quantity of captured carbon that the project is expected to support for storage or use in eligible use during any project period.

Failure to file a revised project plan will result in the taxpayer's projected eligible use percentage being deemed nil for the total CCUS project review period, until the revised project plan is filed.

Reduction to qualified CCUS expenditures

As indicated in EY Tax Alert 2022 Issue No. 41 (referenced above), qualified CCUS expenditures must be reduced for certain amounts. Under the updated proposals, qualified CCUS expenditures will also be reduced for:

- ▶ Clean technology ITCs claimed under section 127.45;
- ▶ An expenditure incurred on or after the first day of commercial operations of the project to the extent that the total of all such amounts exceeds 10% of the total of all qualified CCUS expenditures incurred before the first day of commercial operations; and
- ▶ An expenditure incurred by a taxpayer to acquire property that is disposed of, or exported from Canada, in the same taxation year as it was acquired (unless an election is filed under new proposed subsection 211.92(11), as described below).

Subsection 211.92(11) election - CCUS project sale

If a taxpayer (the vendor) disposes of all, or substantially all, of its property that is part of a qualified CCUS project to another taxable Canadian corporation (the purchaser), the taxpayer and the purchaser can jointly elect under proposed subsection 211.92(11) to avoid the recapture of CCUS ITCs at the time of the disposition and instead have the purchaser assume the relevant tax history of the vendor to ensure the appropriate future application of Part XII.7 taxes.

If the election is filed, the purchaser is deemed to have made the qualifying expenditures of the vendor (at the times incurred by the vendor) and to have claimed the ITCs that were deducted by the vendor against its taxes payable in respect of the CCUS project. The purchaser is also deemed to have filed any project plans that were prepared and filed by the vendor and is liable for amounts in respect of the CCUS project properties on a go-forward basis.

Repayment of assistance

The updated proposals clarify that if assistance was repaid or is no longer receivable and was applied to reduce the capital cost of a property, the amount paid or no longer receivable shall be added to the capital cost of the taxpayer for the purpose of determining the taxpayer's qualified CCUS expenditure for the particular year.

Revocation of designation

Under the updated proposals, British Columbia has been added as a designated jurisdiction, along with the provinces of Alberta and Saskatchewan. As well, the definition of a designated jurisdiction includes any other jurisdiction within Canada or the United States that has been designated by the Minister of the Environment under proposed subsection 127.44(13); this essentially facilitates the designation of additional jurisdictions.

However, under proposed subsection 127.44(14), if one of these jurisdictions makes significant changes to their environmental laws or enforcement governing the permanent storage of captured carbon, the Minister of the Environment can revoke the designation. A minimum of 30 days' notice will be given before such a revocation comes into effect.

Knowledge-sharing report

As announced in the 2023 federal budget, for projects with qualified CCUS expenditures of \$250 million or more, a construction and completion knowledge-sharing report and annual operations knowledge-sharing reports must be submitted to the Minister of Natural Resources. The reports must contain information described in *CCUS-ITC Technical Guidance Document*, which will be published by the Minister of Natural Resources and amended from time to time. As of the time of writing, a final version of this document has not been released by the Minister of Natural Resources.

Construction and completion knowledge-sharing reports are due the last day of the sixth month beginning after the first day of commercial operations and must cover the period that begins on the day the first qualified CCUS expenditure is incurred for the qualified CCUS project to first day of commercial operations.

The first annual operations knowledge-sharing report is due as follows:

- ▶ If commercial operations for the CCUS project began before 1 October of a calendar year, the report is due on 30 June of the immediately following calendar year,
- ▶ If those commercial operations began after 30 September, the report is due 30 June of the second following calendar year.

All subsequent annual operations reports for the next four calendar years must be submitted within six months (i.e., by 30 June) of the end of each of those calendar years.

Taxpayers that fail to submit construction and completion and annual operations knowledge-sharing reports are subject to a \$2 million penalty payable the day after the reporting-due day indicated above.

Knowledge-sharing taxpayers (other than certain exempt corporations) must also submit a public annual climate risk disclosure report that describes climate-related risks and opportunities for the corporation and explains how the corporation's governance, strategies, policies and practices contribute to Canada's Paris Agreement commitments and net-zero emissions goal by 2050. This report is due by the day that is nine months after the reporting taxation year ends.

Penalties for not submitting a climate risk disclosure report for a given reporting taxation year are the lesser of:

- ▶ 4% of total CCUS ITCs received for all taxation years preceding the reporting-due day; and
- ▶ \$1 million.

Labour requirements

The draft legislation also proposes that certain labour requirements be achieved in order to fully maximize the incentive available under the CCUS ITC. If the labour requirements are not met, the maximum credit rate is reduced by 10 percentage points.

To meet the labour requirements, the ITC claimant must elect in prescribed form and manner for each installation taxation year (i.e., a taxation year during which preparation or installation of the CCUS property occurs). The reduced rates of ITC will automatically apply in situations where the taxpayer has not elected in the prescribed manner to meet the prevailing wage and apprenticeship requirements for an installation taxation year.

Prevailing wage requirements

The taxpayer must meet the following labour requirements to qualify for the full incentive:

- ▶ Each covered worker must be compensated for their labour in accordance with the worker's relevant collective agreement. If no collective agreement exists, the amount of compensation must be at least equal to the amount specified in the most comparable agreement that is relevant to the given worker's experience level, tasks and location (calculated on a per-hour or similar basis). This condition is referred to hereinafter as the "prevailing wage".
- ▶ The ITC claimant must confirm in writing (in prescribed form and manner) that the prevailing wage requirement (described above) is met with respect to their own covered workers and that a reasonable effort was taken to verify that covered workers employed by others involved in the installation of CCUS property also meet the prevailing wage requirement.

- ▶ The ITC claimant is also required to take steps to ensure that all covered workers are aware of the requirements by posting notices that are clearly visible and accessible or by electronic means. The ITC claimant must also provide a plain language explanation of what the prevailing wage requirements mean for workers and instructions as to how to report any failures to meet these standards.

For these purposes, a covered worker means an individual:

- ▶ Who is engaged in the installation of the CCUS property at the designated work site;
- ▶ Whose work duties are primarily manual or physical in nature; and
- ▶ Who is not an administrative, clerical or executive employee, or a business visitor to Canada (within the meaning of section 187 of the *Immigration and Refugee Protection Regulations*).

Apprenticeship requirements

In addition to the prevailing wage requirements set out above, the ITC claimant must make reasonable efforts to ensure that Red Seal registered apprentices work at least 10% of the overall Red Seal registered trades time on the installation of the CCUS property. If a labour law or other agreement restricts the use of apprentices, then the ITC claimant must make every effort to ensure the highest percentage of labour hours is achieved.

In addition, the ITC claimant must attest in prescribed form and manner that it has met the apprenticeship requirements in respect of covered workers at the designated work site.

Note, Red Seal trade is a designation managed by the Canadian Council of Directors of Apprenticeship under the Red Seal Program.

Penalties for non-compliance with labour requirements

The proposed legislation includes a penalty in the form of an additional tax amount payable when the taxpayer has claimed the ITC based on electing to satisfy the labour conditions but fails to meet the requirements. The penalty is calculated as \$20 for every day a covered person was not paid the prevailing wage rate during the installation year and, with respect to the apprenticeship requirements, \$100 for every hour the total apprenticeship time falls below the specified hours. The amounts used to calculate the penalty will be indexed to inflation after 2023.

Gross negligence

If the incentive claimant has claimed the regular ITC rate based on meeting the labour requirements and it is later determined that the claimant knowingly (or in circumstances amounting to gross negligence) did not satisfy the conditions, the taxpayer must pay back the portion of the incentive they were not eligible for as well as a penalty equal to half of that ineligible amount. This does not apply in respect of a CCUS refurbishment tax credit as described in 127.44(5).

Corrective measure

If the ITC claimant receives a notification from the CRA specifying that it did not meet the prevailing wage requirement set out above, the claimant may provide a “top-up” amount, plus interest, to each covered worker for the shortfall in pay to remain in compliance with the requirements. The claimant must pay the top-up amount (including interest) within one year after receipt of the notification (unless the CRA considers a longer period to be acceptable in the circumstances).

If the top-up amount is not paid to any particular covered worker, a penalty equal to 120% of the top-up amount will apply.

Conclusion

The CCUS ITC, complemented by ITCs for clean technology, clean hydrogen, clean electricity and clean technology manufacturing, is critical for Canada achieving its emissions reduction targets.

Guidance on the CCUS project pre-approval process from Natural Resources Canada is still forthcoming and will clarify the upfront requirements for accessing this incentive.

Learn more

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