

An aerial photograph of a large solar farm with rows of solar panels installed in a field. The panels are arranged in neat, parallel rows, and the surrounding landscape includes green grass and some bare earth. A bright light source, likely the sun, is visible in the upper right, creating a lens flare effect. On the right side of the image, there are three overlapping circles in shades of blue and green, partially obscuring the solar panels.

Tax and Energy Series : Canada

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Energy Overview

Canada is fortunate to be a large country with many natural resources, making it a major producer of various forms of energy. In particular, the [Natural Resources Canada 2023-24 Energy Fact Book](#) identifies Canada as a top-5 global producer of:

- Crude oil
- Natural gas
- Uranium; and
- Hydroelectricity

Canada has developed a strong “green energy” initiative to reduce carbon emissions by moving away from fossil fuels and expanding renewable energy production. The [International Energy Association](#) notes Canada’s ambitious targets to cut greenhouse gas emissions by 2030, observing that energy production and use accounts for over 80% of Canada’s emissions. In addition to nuclear energy and hydroelectricity, hydrogen, bioenergy, wind, and solar are all important parts of [Canada’s energy future](#).

The exceptional levels of [U.S. government support](#) for the clean energy sector provided in the 2022 *Inflation Reduction Act* has forced Canada to take comparable steps. Most notably, the federal government has [provided Cdn. \\$28 billion in subsidies](#) to support the construction of two electric vehicle (EV) battery manufacturing plants in Canada. The government has also directed the [Canada Infrastructure Bank](#) to allocate Cdn. \$20 billion for lending into qualified green energy projects.

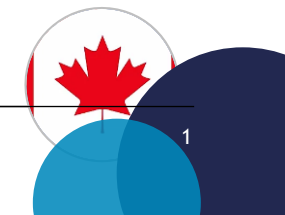
Canada’s tax policy has generally followed the country’s move away from fossil fuels and towards a low-carbon energy strategy. This can be seen in both the removal of some existing tax incentives for fossil fuel exploration, development and extraction, as well as the creation of new incentives to support the development of clean energy technologies and manufacturing. The imposition of carbon pricing/tax regimes (federally and provincially) and tax incentives for carbon capture, utilization and storage (CCUS) also evidence the role of tax policy within a broader strategy of reshaping Canada’s economy towards a [2050 net-zero objective](#).

Tax Overview

Canada levies a federal income tax on the world-wide income of persons (including corporations) that are resident in Canada. Federal income tax also applies to persons (including non-residents) earning income from carrying on business in Canada.

Canada’s provinces and territories impose analogous income taxes computed as an addition to the federal income tax, as well as taxes and royalties on natural resources produced or extracted within their territory (e.g., oil & gas, coal, uranium).

Canada also imposes a European VAT-style goods and services tax (GST), as well as withholding tax on various payments of a passive nature (e.g., interest, dividends, rents, royalties) made by Canadian residents to non-residents of Canada. See [here](#) for further detail on various aspects of Canada’s tax system.



Taxation of Energy Projects

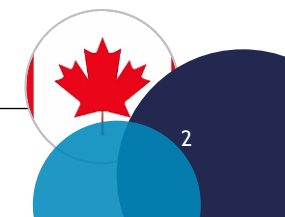
Canadian energy projects are typically carried out either within a corporation or a partnership, both of which offer some degree of limited liability for investors. A corporation is a taxpayer that computes its income or loss and pays taxes accordingly, while partnerships are fiscally transparent for Canadian tax purposes: a partnership computes its income or loss as if it were a taxpayer, but that income or loss is imputed to (and taxed in the hands of) the partners of the partnership, not the partnership itself. No group or consolidated filing regime exists in Canada.

Because energy projects are so capital-intensive, financing is typically an issue of major importance – in particular the mixture of debt and equity. In general terms, interest on debt incurred by the project entity to invest in the project will be deductible in computing income for tax purposes, while equity distributions (e.g., dividends on shares of a project corporation) are non-deductible by the payer. Interest deductibility is constrained by “thin capitalization” limits applicable to debt owing by a Canadian payer to non-residents who are (or do not deal at arm’s length with) significant (25%+) investors, as well as a new regime applicable to all debt essentially limiting deductible interest expense to no more than 30% of the debtor’s income before interest, taxes, depreciation and amortization.

Special rules may apply to debt where the creditor’s recourse against the debtor is limited. Interest paid to non-resident creditors does not bear withholding tax unless either the creditor does not deal at arm’s length with the debtor, or the interest is “participating” (i.e., computed by reference to profits, revenues, etc.). Dividends paid to non-residents are subject to withholding tax.

The tax treatment of significant expenditures on energy projects depends on which of various tax categories those expenditures fall into. Buildings, equipment and machinery are generally “depreciable property”, expenditures on which are pooled into different classes depending on the type and use of the property in question.

Taxpayers may claim a deduction from income (capital cost allowance or “CCA”) each year, computed as a percentage of the “undepreciated capital cost” (UCC) of that particular class for the year (i.e., cost of property acquired, less CCA claimed in previous years and proceeds of property sold). In this manner, the cost of such depreciable property is deducted from income for tax purposes over a period of years. Accelerated CCA is permitted on certain forms of renewable energy depreciable property, to encourage investment in such property. For example, various forms of clean energy generation and energy conservation equipment fall within Class 43.1 (30% CCA rate) or Class 43.2 (50% CCA rate)



Land is not depreciable property, and so its cost generally cannot be depreciated and thereby deducted against income. However, in the resource sector (i.e., mining or oil & gas), significant expenditures on property that is not depreciable property (including land) generally fall into one of three categories (Canadian Exploration Expense (CEE); Canadian Development Expense (CDE); and Canadian Oil & Gas Property Expense (COGPE)) that are deductible as a percentage of the cumulative total of each such class of expenses (again, less deductions taken in prior years). Similar to CCA on depreciable property, such capital expenditures are deductible for tax purposes over time.

Other Tax Issues To Be Considered

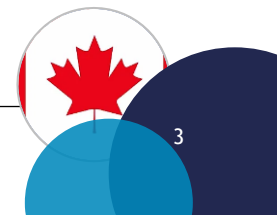
Canadian energy projects are complex and tax-intensive, and often include a variety of tax issues. These include the following:

- various restrictive rules applicable to partners and partnerships, generally designed to prevent partners with limited liability from using partnership losses against other income. Managing these rules can prove particularly onerous where limited-recourse debt financing is being used, as is often the case;
- the tax treatment of various forms of “government assistance” (e.g., grants, incentives, etc.), which has been the subject of [considerable controversy](#);
- managing the issues associated with the involvement of tax-exempt entities (e.g., pension funds and Indigenous Canadian communities (“First Nations”)) often participating in Canadian energy projects, including GST considerations for joint ventures not qualifying for the current joint venture GST election;

- optimizing the tax treatment of costs incurred on site remediation and project end-of-life activity; and
- with respect to asset sales, the GST and provincial sales tax (PST) treatment of assets used in the energy project.

In addition, clean energy projects (as well as carbon capture initiatives) will invariably want to investigate the potential to claim one or more of the new investment tax credits (ITCs) which [the government has offered](#) to support its “clean energy” strategy. These ITCs are particularly valuable, because (1) they are tax credits, rather than deductions in computing tax (i.e., \$1 of ITC is \$1 of taxes saved), and (2) they are refundable, meaning that if the taxpayer does not have positive taxable income in the year the ITC is claimed (a common occurrence) the government will pay the ITC amount to the taxpayer. For this reason, “green economy” ITCs frequently constitute a significant source of project funding for eligible expenditures.

A number of factors go into the structuring of energy projects in a manner that maximizes the ability of project participants to claim ITCs. Because they are new (and in some cases have not yet been fully enacted into law), there is little or no supporting guidance from tax authorities on them, making it that much more important to work with advisors who have practical experience working with them on actual projects. In general (and with some exceptions), they are limited to claimants who are taxable Canadian corporations (either directly or as members of a fiscally-transparent project partnership), and are computed as a percentage of the cost of qualifying expenditures.



Relevant Experience

BLG has worked on many of Canada's largest and most innovative energy projects. Set out below is a representative sample of some of our work in this sector.

EPCOR Utilities Inc. an on-site solar generating plant and battery storage at one of its water treatment plants in the Edmonton River Valley.

Northland Power Inc. and its affiliates on the acquisition, development, construction, debt and equity financing of the \$750 million, 250 MW Oneida battery storage project.

BC Hydro - in respect of various procurement, contract development, negotiation and administration and other commercial matters, real estate and other aspects associated with the \$10B Site C clean energy hydroelectric project.

Berkshire Hathaway Energy Company, in its indirect share purchase acquisition of the Montana Alberta Tie-Line from Enbridge Inc., a 215 mile, 230-kV merchant transmission line running from Great Falls, Montana to Lethbridge, Alberta.

- Spirit Pine Energy Corporation in its reorganization and sale to Enel Green Power Canada Inc., facilitating the co-ownership of a 185 MW wind project with First Nation's, Spirit Pine and Enel.
- Manitoba Hydro on various procurement and commercial matters in relation to the development of the 695 MW Keeyask hydroelectric project in Northern Manitoba.
- Alterra Power Corp. in its \$1.1 billion sale to Innergex Renewable Energy Inc. by way of an arrangement agreement.
- The Government of Canada in its \$4.5 billion acquisition of the Trans Mountain and Puget Sound Pipelines, and related terminals from Kinder Morgan.
- Petronas and Pacific Northwest as project counsel in its \$27 billion LNG project located near Prince Rupert, B.C.
- Meadow Lake Tribal Council (MLTC), in connection with its power purchase agreement and other material agreements for its 6.6 MW green energy biomass project located near Meadow Lake, Sask.
- The Ontario Independent Electricity System Operator with respect to Procurement of Electricity from Energy from Waste (EFW).
- Occidental Petroleum in its US\$1.1 billion acquisition of direct air capture technology innovator Carbon Engineering Ltd.





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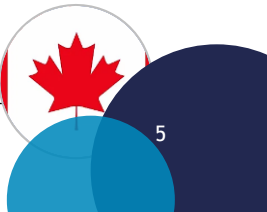
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