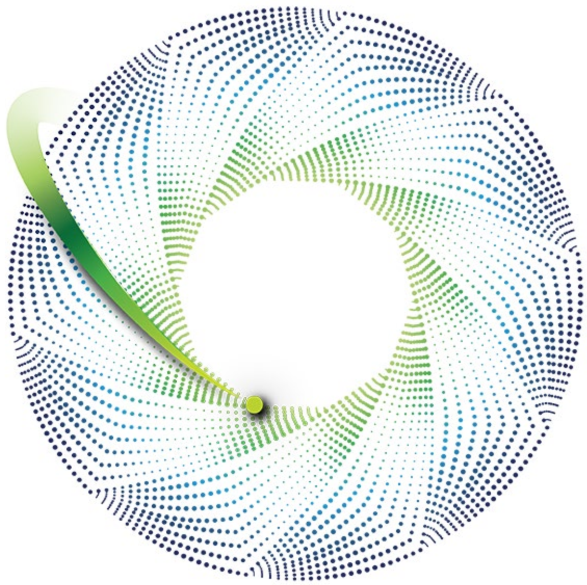

Canadian Tax & Legal Alert

2023 federal budget: Canada has committed $83 billion to foster decarbonization of the economy

June 13, 2023

Context

In Budget 2023, the government of Canada restated and enhanced its commitment to supporting efforts to achieve net-zero carbon emissions by 2050.

The government of Canada's plan for decarbonization includes a set of predictable investment tax credits (ITCs) and low-cost strategic financing. It also incorporates targeted investments and targeted programs to provide the flexibility to support projects of national economic significance.

Part of Budget 2023 is in response to the US *Inflation Reduction Act* (IRA), which includes tax credits, grants, and loans that total US$258 billion over 10 years. As certain measures are not capped, some are estimating that funding over the 10-year horizon of the measures could be significantly higher. In response to the IRA, the government of Canada demonstrated its commitment to ensuring Canada remains a first-choice destination for businesses to invest and create jobs. Following public consultations, Budget 2023 announced $83 billion in additional/enhanced funding, including $70.5 billion across five ITCs.

The United States offers ITCs to offset capital as well as production tax credits (PTCs) to offset operational costs. Canada's approach so far is only to support offsetting the capital cost of a decarbonization project. Therefore, functioning compliance markets for carbon offsets and pricing will be required to level the playing field in support of operational costs.

Key pillars of Budget 2023

Clean economy

Budget 2023 includes new and enhanced measures designed to help Canada compete on the world stage and to advance our clean economy. The clean economy proposals include five specific focus areas: clean manufacturing, clean hydrogen, clean technology, cleaner transition fuels, and carbon capture and underground storage.

- **Clean Technology Manufacturing Investment Tax Credit (CTMITC)**
  - Purpose: to support companies investing in new machinery and equipment for manufacturing and processing key clean technologies, as well as for extracting, processing or recycling key critical minerals
  - Rate: **30% refundable tax credit**
  - Total investment: **$11.1 billion**, which will become available from January 1, 2024 to 2034
  - Status: **new** measure / **new** investment money

- **Clean Hydrogen Investment Tax Credit (CHITC)**
  - Purpose: to encourage investment in a growing energy source, ensure that Canadian companies can remain globally competitive and encourage the use of clean energy to reduce pollution
  - Rates:
    - **15%-40% refundable tax credit** (depending on the lifecycle carbon intensity of hydrogen), where labour requirements[1] are met; and
    - **15% refundable tax credit** to the equipment needed to convert hydrogen to ammonia if the ammonia production is associated with the production of clean hydrogen, where labour requirements[2] are met
  - Total investment (announced in Budget 2023): **$17.7 billion** from 2023 through 2035
  - Status: previously announced / budget allocation released in Budget 2023

- **Clean Technology Investment Tax Credit (CTITC)**

  Details of the CTITC were previously announced in the 2022 Fall Economic Statement. However, Budget 2023 proposes to expand the eligibility criteria to include geothermal energy systems under the CTITC and to modify the phase-out year. The CTITC is now expected to phase out starting in 2034.

  - Purpose: to support Canadian businesses in adopting clean technology
  - Rate: **30% refundable tax credit**, where labour requirements[3] are met
  - Total investment: **$6.9 billion** from 2023 through 2034
  - Status: **enhanced** measure / **new** investment money

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[1] The government of Canada has attached labour requirements to these tax credits, which eligible businesses must meet to receive the maximum tax credit rate. If the labour requirements are not met, businesses will receive a reduced tax credit rate. Details on the labour requirements are forthcoming and, per Budget 2023, will come into effect on October 1, 2023.

[2] Ibid.

[3] Ibid.

- **Carbon Capture, Utilization, and Storage Investment Tax Credit (CCUSITC)**
  Budget 2023 proposes the following enhancements: 1) inclusion of dual use heat and/or power equipment and water use equipment, with tax support prorated based on the use of energy or material in CCUS process, 2) addition of British Columbia as an eligible jurisdiction for projects storing CO_2 using dedicated geological storage.

  - Purpose: to support high-emissions sectors to implement technologies that capture CO_2 emissions to either store the CO_2 or to use it in other industrial processes, such as permanent mineralization in concrete
  - Rate: **37.5%-60% refundable tax credit**, where labour requirements[4] are met
  - Total investment: $9.1 billion from 2022 through 2030, including a newly announced $520 million for enhancements
  - Status: previously announced / **enhanced** measure / **new** investment money

- **Canada Growth Fund**
  - Purpose: to attract private capital to build Canada's clean economy by using investment instruments that absorb certain risks in order to encourage private investment in low-carbon projects, technologies, businesses, and supply chains
  - Access: various investment instruments; contracts for difference are a vehicle offered via this fund to make carbon pricing more predictable, while supporting investments needed to build a competitive clean economy
  - Total investment: $15 billion public investment vehicle; now intended to be managed by the Public Sector Pension Investment Board (PSP Investments)
  - Status: **enhanced** measure / **repurposed** investment money

- **Targeted programming – Reduced corporate tax rate for zero-emission technology manufacturers**
  Budget 2023 proposes the extension of the reduced tax rate for zero-emission technology manufacturers by three years with a phase-out starting in 2032. Additionally, eligible activities would be expanded to include the manufacturing of nuclear energy equipment, the processing or recycling of nuclear fuels and heavy water, and the manufacturing of nuclear fuel rods.

  - Purpose: to help businesses innovate and build more zero-emission technologies; and to drive investment and create new jobs
  - Rate: reduced federal corporate income tax rate by one half for zero emission technology manufacturers (i.e., **4.5%** on income otherwise eligible for the small business deduction and **7.5%** for other active business income)
  - Total investment: $1.32 billion from 2023 through 2035
  - Status: **enhanced** measure / **new** investment money

- **Targeted programming – Strategic Innovation Fund – Clean Technology**
  - Purpose: to support targeted investment in clean technology development and application in Canada, including critical minerals and industrial transformation
  - Total investment: $500 million (new) + $1.5 billion (repurposed) from 2023 through 2032
  - Status: **enhanced** measure / **new** and **repurposed** investment money

- **Targeted programming – Critical Minerals Infrastructure Fund**
  - Purpose: incentive to support clean energy and transportation infrastructure projects needed to accelerate critical minerals production
  - Percentage contribution to project costs: details forthcoming

[4] The government has announced its intention to apply these requirements to this tax credit, but the methodology has not been specified.

- Total investment: $1.5 billion from 2023
- Status: **new** measure

- **Transition Fuels**
  Clean fuels (hydrogen, biofuels, and biomass) will be an integral part of Canada's fuels mix, where electricity would be inefficient or impractical. In addition to ITCs and related targeted investments, the government of Canada will engage with the biofuels industry to explore opportunities to promote its growth in Canada. This will include a review of different mechanisms to support the sector in meeting the growing demand for low-emissions fuels.

Clean electricity

One of Budget 2023's strategic areas of focus is clean electricity, building on our country's strength.[5] In accordance with the government's three-pronged strategy of (i) predictable ITCs, (ii) low-cost strategic financing, (iii) and targeted investments and targeted programs to support projects of national economic significance, Budget 2023 incorporates all three in respect of electricity.

- **Clean Electricity Investment Tax Credit (CEITC)**
  - Purpose: to support and accelerate clean electricity investment in Canada; based on details currently available, the CEITC is intended to be leveraged where entities and/or assets do not qualify for the CTITC, which offers a higher rate
  - Rate: **15% refundable tax credit**, where labour requirements[6] are met
  - Eligible investments:
    - Non-emitting electricity generation systems
    - Abated natural gas-fired electricity generation
    - Stationary electricity storage systems that do not utilize fossil fuels for operation
  - Eligible applicants: taxable and non-taxable entities (e.g., Crown corporations, publicly owned utilities), indigenous-owned corporations, pension funds
  - Total investment: **$25.7 billion,** which is to become available for use from the day of Budget 2024 through 2034
  - Status: **new** measure / **new** investment money

- **Canada Infrastructure Bank**
  - Purpose: to support the building of major clean electricity and clean growth infrastructure
  - Rate: financial instruments specific to each project's needs; Budget 2023 announced funds targeted to be deployed through two priority areas: clean power (new) and green infrastructure (existing)
  - Total investment: at least $20 billion
  - Status: **enhanced** measure / **repurposed** investment money

- **Targeted programming – Clean Electricity**
  - To advance clean electricity projects, Budget 2023 proposes enhanced investments to:
    - Recapitalize the **Smart Renewables and Electrification Pathways Program** to support critical regional priorities and Indigenous-led projects, and add transmission projects to the program's eligibility criteria
    - Renew the **Smart Grid** program to advance utility-led smart grid projects
    - Create new investments on science-based activities in order to capitalize on Canada's offshore wind potential (e.g., off the coasts of Nova Scotia and Newfoundland and Labrador)
  - Total investment: $3.0 billion over 13 years, starting in 2023-24, provided to Natural Resources Canada
  - Status: **enhanced** measure / **new** investment money

[5] Canada has currently one of the world's cleanest electrical generation and distribution systems, with over 80% of Canada's electricity nationally coming from non-carbon-emitting sources. See Canada, Powering our future with clean electricity.
[6] Supra, note 1.

SR&ED program announcement

No further details on the previously announced Scientific Research and Experimental Development (SR&ED) investment tax credit review were included in Budget 2023. However, it was stated that the Department of Finance and the government of Canada will continue to engage with stakeholders on the next steps in this process, including the consideration of adopting a patent box regime, in the coming months.

How can Deloitte help you?

It is apparent that Budget 2023 is intended to support, in a material way, the decarbonization of the economy. Companies have always wanted clarity, predictability, transparency, geographic parity, and accessibility regarding investment incentives, and Budget 2023 includes much of that kind of wording.

Currently, many details about these measures remain unknown. However, we anticipate the federal government will continue to develop and refine these measures over the coming months, in some cases based on budget approval and further consultations with stakeholders. Deloitte will continue to monitor the consultation process and the release of draft legislation to implement the measures announced in Budget 2023. The Department of Finance launched consultations on June 6, 2023, to continue to gather feedback from stakeholders on design details for certain investment tax credits.

Deloitte professionals can help you understand how these measures, or any previously announced measures, may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this alert. More specifically, Deloitte's Gi3 group is available to assist you in identifying potential incentives, current and/or forthcoming, to support your investments.

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