

Energy Tax Services

Conventional and beyond*

Oil and Gas Taxation in Canada

*connectedthinking

PRICEWATERHOUSECOOPERS 



Conventional and beyond

Oil and Gas Taxation in Canada

Foreword

Conventional and beyond: Oil and Gas Taxation in Canada has been prepared by the Canadian Energy Tax Group of PricewaterhouseCoopers, a specialty practice that serves the unique tax needs of the oil and gas industry.

This publication summarizes the main features of how Canadian oil and gas operations are taxed by the Canadian federal government and the provincial governments of Alberta, British Columbia and Saskatchewan (the “Western producing provinces”). The commentary is based on legislation in effect on January 1, 2008, and, when appropriate, includes references to draft legislation as of the time of writing.

For more than 100 years, PricewaterhouseCoopers has served the oil and gas industry. Our aim is to continue that service, at the highest standards possible. The professionals listed on the next page exemplify the skills, resources and experience of the worldwide PricewaterhouseCoopers organization, with which we anticipate and meet the needs of businesses and individuals around the globe.

Angelo F. Toselli
Leader, Canadian Energy Tax Group
April 2008

Contributors, Editors and Contacts

Contributors and Editors

Angelo Toselli
Bharat Patel
Catherine Uy
Chandra Patel
Claudio Costa
Dwayne Arnason
Eugene Quo
Howard Kazdan
Jessica Zhang
Leanne Sereda
Racquel Endaya
Shawn Reain

Contacts

Angelo Toselli	403 509 7581	angelo.f.toselli@ca.pwc.com
Leanne Sereda	403 509 7586	leanne.a.sereda@ca.pwc.com
Kevin Hinz	403 509 7567	kevin.a.hinz@ca.pwc.com
Bharat Patel	403 509 7472	bharat.k.patel@ca.pwc.com

Contents

Basic Framework of the Canadian System	1
Rate of Tax	1
Investment Tax Credits.....	1
Federal Income Tax	2
Loss Carryover.....	2
Capital Cost Allowance.....	2
Canadian Oil and Gas Property Expense.....	3
Canadian Development Expense.....	3
Canadian Exploration Expense.....	3
Foreign Resource Expense.....	4
Successor Corporation Rules.....	4
Flow-Through Shares.....	5
Canadian Renewable and Conservation Expense.....	5
Provincial Income Tax	6
Allocation of Taxable Income.....	6
Alberta.....	6
British Columbia.....	7
Saskatchewan.....	7
Taxation of Oil Sands Operations	8
Publicly Traded Trust Structures	9
Capital Taxes	10
Capital Tax Overview.....	10
Saskatchewan.....	10
Scientific Research and Experimental Development	11
Scientific Research and Experimental Development Tax Credits.....	11
SR&ED Tax Incentives.....	11
Enhanced Incentives for Certain Corporations.....	11
What Projects Qualify?.....	12
Claiming SR&ED Tax Incentives.....	12
Indirect Taxes	13
Federal Goods and Services Tax and the Harmonized Sales Tax.....	13
Provincial Taxes.....	13
Alberta.....	13
British Columbia.....	13
Saskatchewan.....	13
Insurance Premium Tax.....	14
Customs.....	14
Alberta's New Royalty Regime	15
Major Changes and Features.....	15
Oil Sands.....	15
Conventional Oil and Natural Gas.....	15
Other Issues.....	15
Implications of the Report.....	16
Appendices	
Appendix A – Income for Federal Tax Purposes.....	19
Appendix B – Taxable Income and Tax (Federal Tax Purposes).....	20
Appendix C – Taxable Income and Tax (Alberta).....	21
Appendix D – CCA Calculation.....	22
Appendix E – COGPE, CDE and CEE.....	23
Appendix F – Abbreviations.....	24

Basic Framework of the Canadian System

Income from Canadian oil and gas operations is taxed under a three-tier system:

Tier 1	A federal income tax, levied on the “taxable income” of an oil and gas operation.
Tier 2	Provincial income taxes, based on the same or similar taxable income.
Tier 3	Provincial taxes, lease rentals or royalties (“Crown charges”), levied on the ownership of Canadian resource property or on production of oil and gas from wells or oil sands projects situated in the particular jurisdiction.

Under the *Income Tax Act*, the federal government levies income tax on a corporation’s taxable income. For federal tax purposes, a corporation resident in Canada is required to account for income from all sources, both within and outside Canada.

Provincial governments levy corporate income tax only on income reasonably attributable to permanent establishments that exist in the particular province. Provincial income is determined by a formula based on gross revenues and salaries and wages paid in each jurisdiction.

In this publication, for purposes of illustrating how the Canadian federal and provincial tax system works, it is assumed that a Canadian-resident corporation carries on only an oil and gas business.

Canada and the United States – Key Differences

The Canadian and U.S. corporate income tax systems have substantial similarities. In both cases, taxes at prescribed rates are levied on taxable income. However, for the oil and gas industry, the three key differences between the two systems are the treatment of:

- levies imposed by a provincial government on oil and gas production (including natural gas liquids) from wells or oil sands projects situated in the province;
- depreciation for tax purposes; and
- expenditures incurred in exploring and drilling wells, mining oil sands, and on the acquisition of oil and gas or oil sands properties.

Rate of Tax

The net federal rate on oil and gas income is computed as follows:

(December 31 year ends)	2007	2008	2009	2010	2011	2012
Basic federal rate	38%					
Less: Abatement	(10%)					
Federal surtax	1.12%	Nil ¹				
General federal rate	29.12%	28%				
General rate reduction	(7%)	(8.5%)	(9%)	(10%)	(11.5%)	(13%)
Net federal income tax rate	22.12%	19.5%	19%	18%	16.5%	15%

1. The corporate surtax, calculated at 1.12% of taxable income, was eliminated effective January 1, 2008.

The 10% Federal Abatement

The 10% abatement of federal tax is designed to give the provinces and territories room to impose corporate income taxes.

The abatement is available only in respect of taxable income allocated to a Canadian province or territory. Income earned in a foreign jurisdiction is subject to the full basic rate of federal tax.

Oil and gas operations are like all others, in that income taxes imposed by one jurisdiction in Canada (whether federal, provincial or territorial) are not deductible in another. The full deductibility of Crown charges imposed on, or in respect of, the production of oil and gas in Canada in computing income for federal tax purposes was phased in from 2003 to 2007. To compensate for the non-deductible portion of Crown charges, a taxpayer was entitled to a “resource allowance” deduction. This deduction was phased out gradually and was entirely eliminated in 2007. The provincial income tax systems of Alberta, Saskatchewan and British Columbia do provide for the full deduction of those Crown charges.

Investment Tax Credits (ITCs)

Investment tax credits (ITCs) have been largely phased out as a tax incentive for capital investment. An exception is the 10% credit of the cost of qualified property acquired for use in the Atlantic Provinces, the Gaspé region of Quebec and prescribed offshore regions. Also, ITCs continue to be available for expenditures on qualified scientific research and experimental development (SR&ED) incurred anywhere in Canada, as discussed in more detail later (see page 11).

ITCs for SR&ED are calculated by multiplying the capital cost of the qualified property or the amount of qualified expenditures in respect of SR&ED by a specified percentage. The applicable ITC rate is 35% for CCPCs and 20% for other corporate taxpayers, as explained in the SR&ED section of this publication (see page 11).

Unused investment tax credits can be carried forward twenty taxation years and carried back three.

Federal Income Tax

Loss Carryover

In computing taxable income, non-capital losses can be carried forward:

- twenty taxation years for those that arose in taxation years ending after December 31, 2005;
- ten taxation years for those that arose in taxation years ending after March 22, 2004, and before January 1, 2006; and
- seven taxation years for those that arose before taxation years ending before March 23, 2004.

Non-capital losses can be carried back three taxation years. Net capital losses can be carried back three taxation years and forward indefinitely.

When control of a company is acquired, all net capital loss carryovers are lost and the subsequent deduction of pre-acquisition-of-control non-capital loss carryovers becomes restricted. In addition, a tax year end is deemed to occur immediately before the change of control. Generally speaking, pre-acquisition-of-control non-capital losses are allowed as a deduction against income from the same business in which the losses were incurred, or a similar business, but only if that loss business is carried on after the acquisition of control with a view to profit.

A company's pre-acquisition-of-control net capital losses and non-capital losses will be reduced if the value of certain assets has eroded relative to their cost for tax purposes. Examples include non-depreciable capital property, depreciable property and accounts receivable.

Capital Cost Allowance (CCA)

Capital cost allowances (CCAs) are discretionary deductions allowed to a taxpayer in computing income for tax purposes in lieu of depreciation calculated for book purposes on depreciable property. For conventional oil and gas production, depreciable property includes the tangible equipment used to facilitate the production of oil or gas, and comprises mainly wellhead equipment, flow lines, gathering systems, batteries, compressors, dehydrators and gas plants for the extraction of excess hydrocarbons from "wet" gas and sulphur from "sour" gas.

The costs of tangible property that is "available for use" are accumulated by classes. For each undepreciated capital cost (UCC) class, a specified CCA rate may be applied to the balance of UCC at the end of a taxation year on a declining balance basis. The rate is the maximum amount of CCA that can be claimed. A taxpayer can claim less, or even nothing at all, for a taxation year. In a short taxation year, the claim is restricted to the fraction that the number of days in the tax year is of 365 days.

The main classes of depreciable property relevant to the oil and gas industry are as follows:

		CCA Rate
Class 1	Pipelines that are not part of gathering systems acquired before February 23, 2005 (see also Class 49)	4%
Class 7	Vessels primarily designed for drilling oil. Pipeline pumping and compression equipment acquired after February 22, 2005	15%
Class 8	Tangible equipment not otherwise included in another class	20%
Class 41	Oil and gas well equipment and gas plant equipment	25%
Class 43.1	Alternative energy assets	30%
Class 43.2	Specified clean energy generation equipment acquired before 2020	50%
Class 45	Computers and systems software	55%
Class 49	Pipelines that are not part of the gathering systems acquired after February 22, 2005 (see also Class 1)	8%

Oil and gas well equipment generally includes production tubing, wellhead equipment, flow lines, gathering systems, dehydrators and compressors. It excludes well casing, the cost of which will be either a Canadian development expense or Canadian exploration expense, depending on the characterization of the well being drilled.

As part of the federal government's clean-air initiative, the 2008 federal budget proposed to:

- expand the eligibility for class 43.2 treatment for assets acquired after February 25, 2008, to generate energy in the form of electricity or heat using ground-source heat pump systems or biogas production equipment;
- remove the restrictions that required a taxpayer that produced energy from waste to use the output energy; and
- increase the CCA rate for carbon dioxide pipelines acquired after February 25, 2008 from 4% to 8% (by including them in Class 49) and for the ancillary pumping and compression equipment from 4% to 15% (by including them in Class 7).

Canadian Oil and Gas Property Expense (COGPE)

Canadian oil and gas property expense (COGPE) encompasses the acquisition cost of oil and gas Canadian resource properties, including:

- oil and gas rights;
- oil and gas wells; and
- royalty interests.

These costs are pooled in a fashion similar to costs in respect of depreciable property and are deducted, on a discretionary basis, at a maximum rate of 10% per year (declining balance). In a short tax year, the claim is restricted to the fraction that the number of days in the tax year is of 365 days.

The following key rules apply to COGPE:

- All intangible proceeds of disposition of oil and gas Canadian resource properties are credited to the COGPE pool (referred to as "cumulative COGPE"), while proceeds of disposition of depreciable property are credited to the appropriate UCC pool.
- If, at the end of a taxation year, the balance of cumulative COGPE is in a credit position (i.e., because the proceeds of disposition in the year exceed the balance of available costs), the entire credit balance is applied to reduce the balance of cumulative Canadian development expense.
- If all of the oil and gas Canadian resource properties of a taxpayer are sold, any remaining balance of cumulative COGPE continues to be deductible at a maximum rate of 10% per year (declining balance).

Canadian Development Expense (CDE)

Canadian development expense (CDE) comprises intangible drilling and completion expenses that are not otherwise a Canadian exploration expense. They are accumulated in the CDE pool and deducted at a maximum rate of 30% per year (declining balance). The claim is discretionary. In a short tax year, the claim is restricted to the fraction that the number of days in the tax year is of 365 days.

As indicated above, a negative balance of cumulative COGPE in a year reduces the balance of cumulative CDE to which the 30% rate is applied.

If the balance of cumulative CDE at the end of a taxation year is in a credit position, the entire balance is included in the taxpayer's income.

Canadian Exploration Expense (CEE)

Canadian exploration expense (CEE) comprises, in general terms:

- geological, geophysical, and geochemical costs;
- dry-hole costs, if the wells are abandoned in the year or within six months of the end of the year; and
- drilling and completion costs in respect of the first discovery well in a natural underground reservoir.

These costs are accumulated in the CEE pool, the balance of which is 100% deductible on a discretionary basis.

Drilling and completion costs in respect of a well previously included in CDE may be transferred to CEE if the well, other than for testing purposes:

- never produced before being abandoned; or
- did not produce within 24 months of completion.

A principal business corporation (i.e., a corporation the principal business of which includes, among other things, the carrying on of an oil and gas business) cannot create or increase a loss by claiming CEE.



Foreign Resource Expense (FRE)

Foreign resource expense (FRE) includes the acquisition cost of foreign resource properties and any drilling or exploration expense incurred by the taxpayer in respect of exploring or drilling for petroleum or natural gas outside Canada. FRE is separated into pools by country.

A taxpayer can deduct the lesser of:

- its foreign resource income from a country; and
- 30% of the cumulative FRE (CFRE) in respect of that country.

In aggregate, the taxpayer will be allowed to claim the lesser of 30% of its total CFRE for all countries and its total foreign resource income from all countries for the year. In any case, the taxpayer can claim up to 10% of its total FRE (pro-rated for short taxation years), regardless of the amount of foreign resource income, and thereby offset income from other sources.

Successor Corporation Rules

Canadian income tax provisions reflect an underlying policy that income tax relief should be available in respect of all exploration and development expenditures. This includes, in defined circumstances, those incurred by previous taxpayers (as long as a deduction is claimed only once in respect of any particular expense). To this end, the so-called “successor corporation” rules of the *Income Tax Act* contain complex provisions. Under those provisions, in specified circumstances the unclaimed exploration and development expense balances (i.e., COGPE, CDE, CEE and FRE) of a particular taxpayer may be “inherited” by another corporation (the “successor corporation”).

A successor corporation becomes entitled to deduct an amount in respect of the predecessor’s unclaimed exploration and development balances, if it:

- has acquired “all or substantially all” (usually interpreted as being 90% or more) of the transferor’s (the “predecessor’s”) Canadian resource properties; and
- jointly elected with the predecessor in a prescribed manner.

These deductions, however, can be applied only to reduce the aggregate income the successor corporation earned that is reasonably attributable to production from properties acquired from the predecessor corporation.

Acquisition of control of a corporation will also result in the corporation's exploration and development pools becoming successor pools that are subject to the same restrictions.

The successor rules are extremely complex and can apply in different ways to:

- a liquidation or statutory amalgamation of wholly owned subsidiaries; and
- statutory amalgamations of sister corporations.

Flow-Through Shares

Structuring an oil and gas venture through conventional share financing limits the deductibility of the expenses of the venture to the income generated in the corporation. Given the uncertainty inherent in an oil and gas venture, it is possible that the corporation may not have sufficient income to fully use otherwise deductible CEE and CDE.

Flow-through shares are shares issued by a principal business corporation, pursuant to an agreement under which the issuing corporation agrees to incur certain qualifying CEE and/or CDE in an amount equal to the consideration given by the subscriber for the shares. The corporation "renounces" to the subscribing taxpayer an amount in respect of the CEE and/or CDE incurred by the issuing corporation during a qualifying period of 24 months from the date of the agreement. The renounced CEE and/or CDE are thereby deemed to be those of the shareholder and not of the corporation.

As a result, the shareholder can deduct these expenses as if they had been incurred directly. The advantage of flow-through shares is that the shareholder has the opportunity to deduct expenses that may not be used by the issuing corporation in the foreseeable future.

Flow-through shares are deemed to have a nil cost base. Therefore, when sold, the entire proceeds of disposition normally will be treated as a capital gain.

Special rules allow a qualifying corporation to renounce eligible exploration and development expenses up to a year in advance of their being incurred, in certain circumstances. A special tax is payable by the issuing corporation if the qualifying expenses are not fully incurred by the end of February following the year for which the expenses are renounced to the subscribing shareholder.

In limited circumstances, costs that are otherwise CDE may be renounced as CEE to a subscribing shareholder of flow-through shares.

The following expenses are not eligible for flow-through renunciation:

- Canadian Exploration and Development Overhead Expense (CEDOE);
- costs related to certain purchased seismic information; and
- COGPE.

In general, CEDOE includes overhead expenses that are capitalized as CEE or CDE but are not directly incurred in exploration and development activity.

Canadian Renewable and Conservation Expense (CRCE)

Canadian Renewable and Conservation Expense (CRCE) encompasses intangible costs associated with the development of projects for which the equipment is eligible for Class 43.1 or 43.2 CCA treatment. In general, Class 43.1 and 43.2 include equipment used to produce energy or electricity by use of alternative sources, such as solar, tidal and biomass. The policy reason behind these provisions is to provide consistent treatment for different types of energy investments and to expand domestic and international markets for renewable energy products and expertise. CRCE also provides investors in renewable energy and energy conservation projects with faster deductions for certain types of expenses that would normally be treated as capital. CRCE encourages investment in the pre-production stage of these projects.

CRCE is similar in concept to CEE in that:

- the full amount of CRCE is fully deductible in any taxation year and can be carried forward indefinitely; and
- CRCE can be renounced to shareholders that have entered a flow-through share agreement.

The 2008 federal budget expanded the eligibility of assets that qualify for inclusion in class 43.2, which in turn expands the scope of projects that qualify for CRCE.

Provincial Income Tax

Allocation of Taxable Income

Taxable income of corporations that have a permanent establishment in more than one province is allocated based on the gross revenues and on total salaries and wages attributed to those establishments.

The definition of a permanent establishment includes, among other things, an office, a branch and an oil well.

The major oil and gas producing provinces are Alberta, British Columbia and Saskatchewan. Only Alberta requires the filing of a tax return separate from the federal one.

Alberta

The basic Alberta corporate tax rate is 10%. The small business tax rate is 3%, applicable to a Canadian-Controlled Private Corporation's (CCPC's) active business income. The small business threshold is \$430,000 in 2007, \$460,000 in 2008 and \$500,000 in 2009, starting April 1 of those years.

Alberta's income tax statute is separate from its federal counterpart, but adopts a substantial portion of the federal provisions. However, a number of provisions are specific to Alberta, as follows:

- Although the Alberta and federal CCA classes and rates are the same, a corporation can choose to deduct different amounts for federal and Alberta income tax.
- Capital taxes that are payable by corporations in other provinces are non-deductible for purposes of Alberta corporate income tax, but are deductible (within limits) for federal purposes.
- For years before 2007, a royalty tax deduction could be claimed, equivalent to the excess crown royalties disallowed for federal income tax purposes over the 25% federal resource allowance. This deduction cannot reduce Alberta income tax below zero. Unused deductions from years before 2007 can be carried forward to the subsequent seven taxation years, but expire on December 31, 2013.

The 2008 Alberta budget introduced a SR&ED tax credit of 10% on up to \$4 million of eligible expenditures incurred, for a maximum annual credit of \$400,000. The credit will be calculated using the definition of eligible expenditures in the federal SR&ED tax credit program. It will be refundable to all taxpayers, regardless of size or industry, and will apply to eligible expenditures incurred after December 31, 2008.



British Columbia

The basic British Columbia corporate tax rate is 12% (4.5% on the first \$400,000 of a CCPC's active business income). However, the province's 2008 budget reduces the corporate tax rate to 11% (3.5% on the first \$400,000 of a CCPC's active business income). Both rates decline effective July 1, 2008, and by a further 1% by 2011.

Generally, British Columbia uses the same taxable income base as the federal one. However, for taxation years before 2007, the Royalty and Deemed Income Rebate can increase or decrease the provincial corporate income tax base. Under this rebate program, the taxpayer calculates the tax by adding back the resource allowance and deducting the provincial royalties and taxes paid under the *Mineral Tax Act*.

With the phase-out of the resource allowance, effective January 1, 2007, British Columbia eliminated the Royalty and Deemed Income Rebate.

Qualifying corporations are entitled to a 10% tax credit on their SR&ED expenditures. This tax credit is also available to active members of partnerships, to the extent of their proportionate share of the partnership's SR&ED qualified expenditures incurred in the province after February 20, 2007. (An active member of a partnership includes a qualifying corporation that is otherwise engaged in a business similar to that carried on by the partnership, but excludes a limited partner.)

This tax credit is scheduled to expire on September 1, 2014.

Saskatchewan

The basic Saskatchewan corporate tax rate is 13% and is scheduled to be reduced to 12% on July 1, 2008. The small business rate of 4.5% applies on the first \$450,000 of a CCPC's active business income. This threshold will increase to \$500,000 on July 1, 2008.

Saskatchewan, like British Columbia, adopts the federal income base that is used to calculate federal taxable income. For years before 2007, a tax credit mechanism (the Saskatchewan Royalty Tax Rebate Program) applied. Under that program, if non-deductible Crown charges exceeded the 25% federal resource allowance, the taxpayer was entitled to a royalty tax rebate. If the royalty tax rebate exceeded the income tax payable for a particular taxation year (before deducting the rebate and after deducting any foreign tax credits), the excess could be carried forward to subsequent taxation years.

Effective January 1, 2007, much as in other provinces, the elimination of the federal resource allowance and full deductibility of the provincial royalties and taxes, made the Royalty Tax Rebate unnecessary. However, any outstanding Royalty Tax Rebate that arose before January 1, 2007, can still be carried forward for the next seven years.

Saskatchewan permits qualifying corporations to claim a 15% non-refundable tax credit on their SR&ED expenditures. Unused SR&ED tax credits can be carried back three years and forward ten.

Taxation of Oil Sands Operations

Oil sands production refers to the extraction of crude bitumen, a highly viscous hydrocarbon mixture, from oil sands. In its natural state, bitumen cannot be recovered by using conventional oil production methods. The two most common methods of extracting bitumen from oil sands are open-pit mining and *in situ* (in place) extraction.

Although for the most part oil sands production is taxed similarly to conventional production, several key differences are important to note.

The acquisition costs of leases receive different tax treatment for oil sands than for conventional oil and gas. An oil sands deposit is a mineral resource. As such, the cost of acquiring the mineral lease, regardless of the method of extraction used (i.e., open-pit mining or *in situ*), is included in the cumulative CDE pool. Conventional oil and gas and coalbed methane accumulations are considered “petroleum and natural gas and related hydrocarbons.” Consequently, the cost of acquiring this property is included in the cumulative COGPE pool. As discussed earlier, the CDE pool is deductible at 30% (declining balance) while the COGPE pool is deductible at 10% (also declining balance).

Another difference is in the treatment of intangible costs to bring the well or mine into production. Generally, intangible costs incurred to bring a new mine in a mineral resource into production in reasonable commercial quantities are included in CEE. In contrast, intangible costs incurred in bringing an oil or gas well into production are generally included in CDE (unless the costs qualify as CEE, as explained on page 3).

The CCA claim for mines is more generous than for oil and gas wells. While equipment expenditures for mines and oil and gas wells are included in class 41, mining equipment expenditures are eligible for an accelerated CCA claim in addition to the general 25% rate applied to the UCC balance at the end of the year. A taxpayer can claim an additional amount in respect of eligible mining equipment costs, not exceeding the lesser of:

- income from the mine for the year before the deduction for exploration and development expenses and the additional CCA; and
- the remaining UCC in the separate prescribed class at the end of the year before the additional claim.

Eligible costs are those incurred in respect of new projects or a major expansion of existing projects after March 6, 1996. A major expansion is defined as an expansion that

increases the greatest designed capacity of the mine by at least 25%. If the conditions for a major expansion are not met, the accelerated CCA may be available for a certain portion of qualifying expenditures, if these expenditures exceed 5% of the gross revenue from the mine for the year.

In 1996, the federal government extended the accelerated CCA regime to include *in situ* projects, thereby treating all types of oil sands projects on the same basis. However, for *in situ* wells to be treated as a mine, the Minister of National Revenue, in consultation with the Minister of Natural Resources, must make a determination that the wells constitute one project and therefore one mine. This determination generally must be made to support any accelerated CCA claims made in respect of an *in situ* project.

The half-year rule does not apply for purposes of the accelerated CCA claim, and it is possible to obtain an immediate 100% write-off for qualifying expenditures.

In March 2007, the federal government proposed the phase-out of accelerated CCA for both mining and *in situ* oil sands projects. However, the following transitional relief was provided:

- accelerated CCA will continue to be available for otherwise qualifying assets that were:
 - acquired before March 19, 2007; or
 - acquired before 2012 that are part of a project phase on which major construction began before March 19, 2007; and
- for qualifying assets that are not covered by these two exceptions, accelerated CCA will be phased out as follows:

	2010	2011	2012	2013	2014	2015
Allowable percentage of accelerated CCA	100%	90%	80%	60%	30%	0%

Oil sands projects normally take more than three years to complete. Under ordinary “available for use” rules, mentioned in the CCA section of this publication (page 2), this would mean that the taxpayer would not be entitled to claim CCA until the assets are fully constructed. To enable taxpayers to claim CCA earlier, the *Income Tax Act* provides two rules that allow portions of the asset costs to be treated as “available for use” in the third and subsequent years. The first is the two-year “rolling start” rule, for which no election is required. The second is the “long-term project” rule, for which an election is required in the third year of the project. A detailed review of these complex rules is beyond the scope of this publication.

Publicly Traded Trust Structures

Over the past several years, the economic environment of strong oil and gas prices, combined with low interest rates, has fueled the popularity of certain publicly traded trust structures, referred to as royalty trusts or income trusts. These forms of financing provided an effective means of investment in the energy industry based on tax-efficient revenue streams derived from mature, producing resource assets.

The major tax benefit of these structures was that they established a single level of taxation for distributions to the unitholders. They largely eliminated the corporate level of taxation through the use of a mutual fund trust, which is essentially treated as a flow-through vehicle for tax purposes.

This tax benefit was removed on October 31, 2006, when the federal government announced a new set of rules that changed the taxation of publicly traded income and royalty trusts. These rules, which were enacted into law on June 22, 2007, essentially:

- classify certain publicly traded trusts and partnerships as “Specified Investment Flow-Throughs” (SIFTs); and
- impose a “distribution tax” on the income distributed by a SIFT to its unitholders.

In general terms, the changes leave the SIFT paying approximately the same amount of tax on its income as if it were earned in corporate form. As a result, the tax advantage that these structures once enjoyed has been lost.

The rate of tax applied is the federal general corporate rate plus a provincial tax component. The 2008 federal budget proposed that the provincial tax component be based on the general provincial corporate income tax rates for each province (except for Quebec) in which the SIFT has a permanent establishment. The combined rate is meant to be approximately the same rate as if the income were earned by a corporation.

This new distribution tax applies as of the 2007 taxation year for new SIFTs, but is deferred until the 2011 taxation year for SIFTs that were publicly traded on October 31, 2006. This grandfathering of the distribution tax will not apply if the SIFT’s equity capital exceeds certain allowed percentage increases. Under these equity growth guidelines, a SIFT essentially will not be allowed to increase its equity by more than 100% of its equity capital on October 31, 2006.

Introduction of the SIFT rules has had a major effect on the market value of many publicly traded trusts and partnerships, and has caused them to rethink the legal form that they will use to carry on operations after 2010.



Capital Taxes

Capital Tax Overview

The *Large Corporation Tax* disappeared on January 1, 2006, eliminating federal capital tax for the oil and gas industry. All but four provinces in Canada (Alberta, British Columbia, Newfoundland and Labrador, and Prince Edward Island) impose a capital tax, although these are being phased out. The territories do not impose capital tax. Consequently, only Saskatchewan capital tax is discussed below.

Provincial capital tax is calculated as a percentage of taxable capital allocated to the province. Taxable capital is allocated to a province the same way taxable income is allocated to a permanent establishment, as explained under Allocation of Taxable Income on page 6. However, the calculation of taxable capital varies.

Generally, provincial capital tax paid or payable by a corporation is deductible in calculating its net income for income tax purposes. Some of the provinces, for example Alberta, do not allow provincial capital taxes to be deducted for income tax purposes.

Saskatchewan

Corporations with a permanent establishment in Saskatchewan are required to pay a tax on their paid-up capital if taxable paid-up capital (paid-up capital, less allowable deductions) exceeds zero. The calculation is outlined below.

Saskatchewan paid-up capital	
Amounts included in taxable paid-up capital	Paid-up capital stock and contributed surplus
	Retained earnings
	Reserves not allowed for income tax purposes
	All liabilities other than accounts payable outstanding for less than 90 days
	A \$10 million basic exemption (additional exemption of \$10 million can apply ¹)
Amounts that reduce taxable paid-up capital (but taxable paid-up capital cannot be negative)	A goodwill allowance
	An investment allowance
	Amounts deducted for income tax purposes in excess of amounts recorded in the books
	A discretionary deduction for exploration and development expenses that were not previously deducted for income tax purposes

1. An additional \$10 million exemption is based on the proportion of total salaries and wages that are paid in Saskatchewan by the corporation and associated companies. For example, if 100% of salaries and wages paid by the associated group are to Saskatchewan residents, then the full \$10 million additional exemption applies.

Saskatchewan is phasing out its capital tax:

	Capital tax rate
Before July 1, 2006	0.6%
July 1, 2006 to June 30, 2007	0.3%
July 1, 2007 to June 30, 2008	0.15%
July 1, 2008	Nil

Also, new capital (i.e., additions to depreciable property) invested in Saskatchewan after June 30, 2006, is eligible for a non-refundable tax credit that can be applied against a corporation's capital tax liability.

In addition, Saskatchewan levies a "resource surcharge" on certain resource companies and resource trusts. The resource surcharge payable is the amount by which a percentage of the value of resource sales in Saskatchewan for a particular taxation year exceeds the regular capital tax for that year. The applicable percentages are outlined below.

Resource sales include revenues obtained from the sale of natural gas, petroleum, coal, potash and uranium. A deduction in respect of resource sales of up to \$2.5 million may be available for corporations with assets not exceeding \$100 million. The \$2.5 million deduction is pro-rated by the ratio of Saskatchewan wages and salaries to total wages and salaries paid by the corporation and associated corporations.

The resource surcharge payable (i.e., the excess of the resource surcharge over the regular capital tax) is not deductible in calculating net income for income tax purposes.

Saskatchewan Resource Surcharge Rates

The resource surcharge rates for oil and gas wells with a finished drilling date after September 31, 2002, and for incremental oil related to new or expanded enhanced oil recovery projects or waterflood projects having a commencement date after September 31, 2002 are:

	Resource surcharge rate
October 1, 2002 to June 30, 2006	2.0%
July 1, 2006 to June 30, 2007	1.85%
July 1, 2007 to June 30, 2008	1.75%
July 1, 2008	1.70%

The rates for all other oil and gas, coal, potash and uranium value of resource sales are:

	Resource surcharge rate
Before July 1, 2006	3.6%
July 1, 2006 to June 30, 2007	3.3%
July 1, 2007 to June 30, 2008	3.1%
July 1, 2008	3.0%

A corporation that is not subject to ordinary Saskatchewan capital tax is also not subject to the resource surcharge, unless it is part of a group of "affiliated persons" that has total assets exceeding \$100 million. If the group's assets exceed \$100 million, each affiliated person must pay the full resource surcharge.

Scientific Research and Experimental Development

Scientific Research and Experimental Development Tax Credits

The Canadian resource sector is in a pivotal stage, with the decline in production of conventional oil and natural gas. To replace production and reserves, greater emphasis is being put on production of heavy oil, oil sands, non-conventional gas (coal bed methane, tight gas, gas hydrates and shale gas) and offshore production. Investment in technology is increasing the life of mature fields and enabling the industry to develop complex, costly and remote resources effectively and in a more environmentally friendly manner. Research and Development (R&D) is a key element in achieving this mandate.

Canada's Scientific Research and Experimental Development (SR&ED) program is one of the most generous in the industrialized world in its support of business investment in R&D. The program offers tax incentives to taxpayers that carry on business in Canada and incur qualifying research and development expenditures. Companies file claims for incentives in respect of R&D projects that they believe meet the program's technical eligibility criteria. The SR&ED program provides more than \$4 billion in tax credits to Canadian businesses annually.

The program is a key element in an innovation strategy that aims for Canada to be among the top five countries in R&D by 2010. Since its creation in 1985, many companies have used the SR&ED program (the largest federal program supporting industrial R&D in Canada) to increase cash flow, improve profitability and foster an innovative culture.

The scope of eligible projects goes beyond traditional "white lab coat" work, and the majority of the eligible work generally falls under experimental development. In the resource industry, eligible projects can include the development of new petroleum recovery processes such as vapour extraction (VAPEX) and Enhanced Steam Assisted Gravity Drainage (E-SAGD). Bench scale tests as well as field pilots could qualify. In the oil sands surface mining operations, potential projects include bitumen extraction, bitumen/sand separation, tailing pond clean-up, bitumen upgrading, and water treatment and clean-up. In addition, new product development in areas such as corrosion chemicals, demulsifiers, drilling and pumping technologies, sulphur reduction, water-based drilling fluids and information technology may be eligible projects.

SR&ED Tax Incentives

Investment Tax Credit

The program allows a 20% ITC for qualified project expenditures incurred in the year, which can reduce tax otherwise payable. The number of projects and amounts that can be claimed are unlimited, if the technical criteria are met. ITCs can be carried forward twenty taxation years and carried back three, and are included in income in the year after being used.

Income Tax Pool for Eligible Expenditures

Qualifying project expenditures are treated as a deductible current expense whether the item is current or capital in nature. The deduction is discretionary and any unused amount can be carried forward indefinitely.

Provincial Incentives

Various provinces offer additional tax incentives that can be used in conjunction with the federal SR&ED program. These incentives are summarized on page 47 of *Tax Facts and Figures 2007* (and on page 38 of our upcoming edition of *Tax Facts and Figures*, to be released in the summer of 2008). See www.pwc.ca/com/taxfacts.

Enhanced Incentives for Certain Corporations

An enhanced ITC rate of 35% is available for the first \$2,000,000 of eligible expenditures for CCPCs whose:

- taxable income did not exceed \$400,000 in the previous taxation year; and
- taxable capital did not exceed \$10,000,000 in the previous taxation year.

The thresholds are on an associated basis. The tax credits may be refundable to CCPCs.

The 2008 federal budget increases the thresholds used to determine the enhanced SR&ED ITCs available to CCPCs, as follows:

		Taxation years ending	
		before February 26, 2008	after February 25, 2008
Annual expenditure limit		\$2 million	\$3 million
Phase-out range	Taxable income	\$400,000 to \$600,000	\$400,000 to \$700,000
	Taxable capital	\$10 million to \$15 million	\$10 million to \$50 million

To determine the expenditure limit for a taxation year that includes February 26, 2008, separate calculations with the old and new phase-out ranges are required.

The budget also extends SR&ED ITCs to certain salary or wages incurred in respect of SR&ED carried on outside Canada after February 25, 2008.

What Projects Qualify?

To qualify, a project must fall into one of the following categories:

- **Experimental development:** Work done to achieve technological advancement to create or improve new materials, devices, products or processes. More than 90% of SR&ED claims involve experimental development.
- **Applied research:** Work done to advance scientific knowledge with a specific practical application in view (usually performed at corporate R&D facilities or government research facilities).
- **Basic research:** Work done to advance scientific knowledge without a specific practical application in view (usually performed at universities).
- **Support work:** Work that directly supports and is commensurate with the needs of experimental development, applied research and basic research.

The project must also satisfy all of the following criteria if it is to qualify:

- **Scientific or technological advancement:** The work carried out must generate information that advances the understanding of scientific relations or technologies.
- **Scientific or technological uncertainty:** Uncertainty arises in either of two forms:
 - it may be uncertain whether the advance can be achieved at all; or
 - it is certain the advance can be achieved, but there is uncertainty about which of the alternative methods will work to meet the target technological and/or cost specifications.
- **Scientific or technological content:** There must be evidence that qualified personnel with relevant experience have conducted a systematic investigation through experiment or analysis.

Claiming SR&ED Tax Incentives

A claim for SR&ED is made in a corporation's income tax return. Form T661, Schedule 31 and related project descriptions must be completed and filed with the Canada Revenue Agency (CRA) within 18 months of the taxation year end. A claim consists of both technical descriptions and related costs of the various projects that are submitted.

Indirect Taxes

Federal Goods and Services Tax and the Harmonized Sales Tax

The Goods and Services Tax (GST) is a value-added tax on the supply of all taxable goods and services made in Canada. Effective January 1, 2008, the rate was reduced from 6% to 5%. Residents of Canada that have annual world-wide gross revenues in excess of \$30,000 and non-residents of Canada that are carrying on business in Canada are required to be registered for GST purposes.

Registrants are required to collect GST on all taxable goods and services provided in Canada, and may also be entitled to recover any GST paid to suppliers for goods and services acquired for consumption, use or supply in the course of the registrant's commercial activities. Generally speaking, most GST paid on expenses relating to oil and gas activities in Canada is recoverable.

The Harmonized Sales Tax (HST) is also a value-added tax on all taxable goods and services supplied in a participating province. HST is a harmonization of federal and provincial sales taxes. It was reduced from 14% to 13% effective January 1, 2008. New Brunswick, Newfoundland and Labrador and Nova Scotia are the only participating provinces. In many respects, HST is similar to the GST in application and, like GST, is administered by the federal government. A combined GST/HST return must be filed.

Of particular interest to the oil and gas industry is the election that is available to certain oil and gas joint ventures. Normally, each participant in a joint venture is required to report its proportionate share of any net GST/HST owing or refundable for a particular period. When applicable, participants of a qualifying joint venture can elect to have the operator prepare all of the GST/HST returns in respect of the joint venture activities, to further simplify the GST/HST accounting for participants. For GST/HST purposes, a partnership is a separate person and may be required to be registered.

Provincial Taxes

Unlike the federal GST/HST, provincial sales taxes are not recoverable and become a cost of doing business in the province for the consumer (individual or commercial) of the taxable goods or services. Provincial sales taxes are generally imposed on tangible personal property and taxable services as defined by each provincial sales tax act. Real property and services in respect of real property are generally exempt.

The Canadian federal government appears intent on achieving full harmonization, so additional provinces could be adopting the HST in the future.

Alberta

Alberta does not impose a provincial sales tax on goods and services.

British Columbia

British Columbia imposes a 7% sales tax on purchases and leases of tangible personal property and taxable services acquired for consumption or use in the province. The tax is generally payable at the time of purchase or lease on the GST-excluded purchase price. Certain production machinery and equipment purchased or brought into the provinces are exempt from tax if it is for use:

- only in the exploration and development of petroleum or natural gas; or
- primarily and directly at a processing plant or refinery.

Persons that import taxable tangible personal property in the province are required to self-assess the sales tax on the purchase price of equipment when it is brought into the province. However, qualifying tangible personal property for temporary use may be self-assessed at 1/3 of the sales tax otherwise owing for each year or part year the property is in the province, or at 1/36 of the sales tax otherwise payable for each month during which the property is in the province (up to 36 months).

The 2008 British Columbia budget proposed that, effective July 1, 2008, a broad-based revenue-neutral tax will apply to the purchase or use in British Columbia of fossil fuels such as gasoline, diesel fuel, natural gas, home heating fuel, propane and coal. The initial rate of tax for each fuel will be based on \$10 per tonne of carbon dioxide equivalent emissions released from the burning of the fuel. This is estimated to be 2.4¢ per litre of gasoline. The tax rate will increase annually by \$5 per tonne over the next four years, reaching \$30 per tonne on July 1, 2012.

Saskatchewan

Saskatchewan imposes a 5% sales tax on purchases and leases of tangible personal property and taxable services in the province. Some mobile capital equipment used for exploration, development, testing and servicing in the oil, gas and potash industries is exempt from tax. Certain services, including accounting, geoscience, engineering, legal and computer services, are subject to tax. Similar to British Columbia, persons that import taxable property into Saskatchewan are required to self-assess tax on the GST-excluded purchase price at the time of importation, and the property may also qualify for self-assessment on a 1/3 or 1/36 basis (in limited cases).

Insurance Premium Tax

Canada imposes a 10% tax on net premiums payable in respect of a contract of insurance (other than a contract of reinsurance) that:

- is entered into or renewed against a risk ordinarily within Canada at the time the contract is entered into or renewed; and
- is secured with a non-admitted insurer or through a non-resident broker.

Taxpayers are required to remit any tax payable on a return on or before April 30 of the year following the year in which the net premiums were payable. The tax does not apply to premiums in respect of contracts that, in the opinion of the CRA, are not available in Canada.

Customs

All goods imported into Canada may be subject to both 5% GST and applicable duties. Under the North American Free Trade Agreement (NAFTA), many goods that are made in the United States and Mexico that qualify for NAFTA treatment are not subject to duties, subject to certain conditions. Any GST paid by a person who is a GST registrant at the time of importation is generally recoverable. However, duties payable at the time of importation are not recoverable.



Alberta's New Royalty Regime

On October 25, 2007, Alberta announced its New Royalty Framework. The Framework changes the current royalty and income tax system in Alberta, adopting some, but not all, of the recommendations of the Alberta Royalty Review Panel (the "Panel"), whose report was issued on September 18, 2007. The changes, to be effective January 1, 2009, will have a significant effect on the oil and gas industry in Alberta and, in particular, on the economics of major oil sands projects.

Major Changes and Features

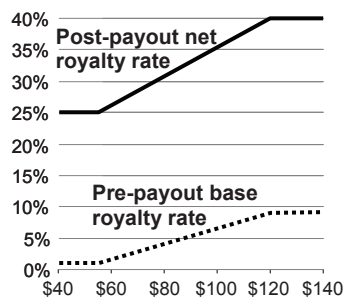
The Framework contains the following major changes and features:

Oil Sands

The base royalty rate will start at 1%, increasing for every dollar the oil price is above CAD\$55 per barrel. The maximum is 9% when the oil price is \$120 per barrel for the "pre-payout" period of an oil sands project. The base royalty will not be payable after the payout period.

The net revenue royalty will start at 25%, increasing for every dollar the oil price is above \$55 per barrel, to a maximum of 40% when the oil price is \$120 or higher. The Alberta government believes that the current 25% rate is unnecessarily low and that the new rate, which factors in price sensitivity, provides a much fairer return to Albertans, as owners of the oil sands resources.

		Pre-payout base royalty rate	Post-payout net royalty rate
Oil price (CAD\$)	≤ \$55	1.00%	25.00%
	\$65	2.23%	27.31%
	\$75	3.46%	29.62%
	\$85	4.69%	31.92%
	\$95	5.92%	34.23%
	\$105	7.15%	36.54%
	\$115	8.38%	38.85%
	≥ \$120	9.00%	40.00%



The Framework rejected the Oil Sands Severance Tax, a new tax that the panel had recommended.

The Framework states that the government will adopt a permanent generic "bitumen valuation methodology" by June 30, 2008, which will apply to non-arm's length sales of bitumen.

Excluded from the Framework was the Panel's proposed Upgrader Royalty Credit of 5% of eligible capital expenditures on additional upgrading capacity in Alberta. Instead, to encourage construction of upgraders in Alberta, the government is considering options such as:

- taking bitumen in kind rather than cash to supply to potential upgraders and refiners in Alberta;
- adjusting pipeline tolls that can have the effect of subsidizing bitumen exports; and
- expediting regulatory approvals for projects with upgraders.

The government will not grandfather existing oil sands projects.

Conventional Oil and Natural Gas

The Framework will eliminate specialty royalty programs and the "old" and "new" tiers. Royalties will be calculated monthly by a single sliding-rate formula that will factor in oil price and well production.

The current Enhanced Oil Recovery and Innovative Energy Programs will be retained to encourage research and additional oil recovery.

Other issues

Under the Framework, no grandfathering will be allowed for any of the changes, to ensure fair treatment to all participants.

The current Freehold Mineral Rights Tax covers Alberta's cost of administering the regulatory system and will be reviewed to ensure that it is achieving its purpose.

Implications of the Report

If the entire Framework is implemented, Alberta expects to receive an additional \$1.4 billion in royalties in 2010, an increase of approximately 20%. Every company in the energy sector in Alberta will be affected, not just oil sands players.

Because provincial royalties are fully deductible for federal income tax purposes, the new regime would result in a significant decline in federal income tax revenues from the oil sector. This would prompt a situation similar to the early 1970s, when increases in provincial royalty rates led to the introduction of the federal resource allowance system,

which was designed to mitigate the loss of federal revenues from high provincial royalty rates. Ironically, the phase-out of the resource allowance system became fully effective on January 1, 2007. This raises the question of how the federal government will react.

While the Alberta government believes that the new regime will not have any immediate negative effect on Alberta's economy, the oil and gas industry has voiced serious concerns. As companies continue to analyze the implications of the changes, investment decisions with respect to existing and future oil and gas projects in Alberta are likely to be affected.



Appendices

Appendix A – Income for Federal Tax Purposes	19
Appendix B – Taxable Income and Tax (Federal Tax Purposes)	20
Appendix C – Taxable Income and Tax (Alberta)	21
Appendix D – CCA Calculation	22
Appendix E – COGPE, CDE and CEE.....	23
Appendix F – Abbreviations	24

Appendix A – Income for Federal Tax Purposes

	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
Gross revenues					
Oil sales	600,000	600,000	600,000	600,000	600,000
Gas sales	400,000	400,000	400,000	400,000	400,000
Royalties	140,000	140,000	140,000	140,000	140,000
Dividends	10,000	10,000	10,000	10,000	10,000
Other non-resource income	150,000	150,000	150,000	150,000	150,000
	1,300,000	1,300,000	1,300,000	1,300,000	1,300,000
Royalty charges					
Crown royalties	(300,000)	(300,000)	(300,000)	(300,000)	(300,000)
Other royalties	(90,000)	(90,000)	(90,000)	(90,000)	(90,000)
	(390,000)	(390,000)	(390,000)	(390,000)	(390,000)
Net revenues	910,000	910,000	910,000	910,000	910,000
Expenses					
General and administrative expenses	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
Operating expenses	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
Depletion, depreciation and amortization expense	(75,000)	(75,000)	(75,000)	(75,000)	(75,000)
Interest expense	(65,000)	(65,000)	(65,000)	(65,000)	(65,000)
	(340,000)	(340,000)	(340,000)	(340,000)	(340,000)
Net income for accounting purposes	570,000	570,000	570,000	570,000	570,000
Add (deduct):					
Depletion, depreciation and amortization expense	75,000	75,000	75,000	75,000	75,000
Charitable donations	5,000	5,000	5,000	5,000	5,000
Alberta royalty tax credit ¹	45,000	-	-	-	-
Capital cost allowance (see Appendix D)	(150,000)	(175,000)	(181,250)	(160,938)	(133,203)
Canadian oil and gas property expense (see Appendix E)	(25,000)	(35,500)	(44,950)	(53,455)	(61,110)
Canadian development expense (see Appendix E)	(60,000)	(72,000)	(80,400)	(86,280)	(90,396)
Canadian exploration expense (see Appendix E)	(65,000)	(95,000)	(125,000)	(155,000)	(185,000)
	(175,000)	(297,500)	(351,600)	(375,673)	(389,709)
Income for federal tax purposes	395,000	272,500	218,400	194,327	180,291
Alberta royalty tax credit inclusion	2008				
Cash receipt	75,000				
Inclusion rate with full transitional relief	60.0%				
	45,000				

Notes:

1. The ARTC program was discontinued effective January 1, 2007. The ARTC in this illustration is assumed to have become receivable before January 1, 2007.

Appendix B – Taxable Income and Tax (Federal Tax Purposes)

	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
Taxable income					
Income for tax purposes (see Appendix A)	395,000	272,500	218,400	194,327	180,291
Less: Charitable donations ¹	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Intercorporate dividends received ²	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
Non-capital losses from prior years ³	-	-	-	-	-
Taxable income	380,000	257,500	203,400	179,327	165,291
Tax computation					
Effective federal tax rate (see below)	19.5%	19.0%	18.0%	16.5%	15.0%
Federal tax	(74,100)	(48,925)	(36,612)	(29,589)	(24,794)
Effective federal tax rate					
Basic rate	38.0%	38.0%	38.0%	38.0%	38.0%
Less: Provincial tax abatement ⁴	(10.0%)	(10.0%)	(10.0%)	(10.0%)	(10.0%)
Less: Small business deduction ⁵	-	-	-	-	-
Less: General rate reduction	(8.5%)	(9.0%)	(10.0%)	(11.5%)	(13.0%)
Effective tax rate	19.5%	19.0%	18.0%	16.5%	15.0%

Notes:

- Charitable donations are deductible up to 75% of income for the year. Excess donations in a particular year can be carried forward and deducted in computing income for up to five succeeding years, subject to the 75% income limit.
- Intercorporate dividends between Canadian corporations are generally tax-free. In certain circumstances related to private corporations, a 33 1/3% refundable tax may be imposed on the recipient of dividends.
- Non-capital losses (e.g., business losses) of a particular taxation year can be carried back three taxation years and forward twenty in the calculation of taxable income.
- A federal tax reduction (abatement) in federal tax otherwise payable of 10% of taxable income is applicable to income earned in a province.
- A “small business deduction,” which is in lieu of the general rate reduction, is 17% for 2008 and beyond, and is allowed in respect of a CCPC’s active income earned in Canada that does not exceed the small business threshold. Effective January 1, 2007, this threshold is \$400,000.

In general terms, a CCPC is a Canadian corporation that is not controlled by, or by any combination of, non-resident persons or public corporations. The small business deduction begins to be phased out for corporations when taxable corporate capital exceeds \$10 million, and is totally eliminated when taxable corporate capital reaches \$15 million.

Appendix C – Taxable Income and Tax (Alberta)

Assumption: For this example, all oil and gas operations of this company are assumed to take place in Alberta only.

	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
Taxable income					
Taxable income – federal tax purposes (see Appendix B)	380,000	257,500	203,400	179,327	165,291
Deduct: ARTC income included in federal taxable income ¹	(45,000)	-	-	-	-
Taxable income – Alberta	335,000	257,500	203,400	179,327	165,291
Tax computation					
Basic rate:	10.00%	10.00%	10.00%	10.00%	10.00%
Tax at basic rate:	33,500	25,750	20,340	17,933	16,529
Less tax credits: Small business deduction ²	-	-	-	-	-
Net Alberta tax	33,500	25,750	20,340	17,933	16,529

Notes:

1. ARTC is not taxable for Alberta corporate tax purposes.
2. A small business deduction of 7% of the small business threshold is available to CCPCs. The Alberta and federal thresholds differ. The Alberta threshold is \$430,000 effective April 1, 2007, \$460,000 effective April 1, 2008, and \$500,000 effective April 1, 2009.

Appendix D – CCA Calculation

This illustration shows how the CCA system works for Class 41 property (see page 2), which has a 25% CCA rate.

	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
Tax pool (Class 41)					
Opening balance	500,000	550,000	675,000	593,750	532,812
Additions at cost	200,000	300,000	100,000	100,000	-
Proceeds of disposition ¹	-	-	-	-	-
Balance at year end	700,000	850,000	775,000	693,750	532,812
CCA claim for year ²	(150,000)	(175,000)	(181,250)	(160,938)	(133,203)
Closing balance	550,000	675,000	593,750	532,812	399,609
Claim calculation					
Opening balance	500,000	550,000	675,000	593,750	532,812
CCA rate	25%	25%	25%	25%	25%
	125,000	137,500	168,750	148,438	133,203
Additions	200,000	300,000	100,000	100,000	-
Proceeds of disposition	-	-	-	-	-
	200,000	300,000	100,000	100,000	-
CCA rate	12.50%	12.50%	12.50%	12.50%	12.50%
	25,000	37,500	12,500	12,500	-
CCA claim – available	150,000	175,000	181,250	160,938	133,203
CCA claimed ³	150,000	175,000	181,250	160,938	133,203

Notes:

- Proceeds of disposition are calculated as the lesser of:
 - the actual proceeds of disposition; and
 - the cost of property disposed of.

If proceeds exceed cost, a capital gain will result, of which 50% is included in income as a taxable capital gain. If the proceeds of disposition of property of a class exceed the balance of costs in the class, resulting in a negative balance, that negative balance will be included in income for tax purposes as "recapture." If an unclaimed balance of costs remains after all property of a particular class is sold, that balance can be deducted in the computation of income for tax purposes as a "terminal loss."

- CCA on additions is restricted to 50% of the regular 25% rate in the year in which the asset is acquired. The CCA claims are calculated as shown in the table, under "Claim calculation." In general, CCA cannot be claimed in respect of property acquired until that property is "available for use."
- The CCA claim in this illustration is made at maximum. The company can claim any amount from nil up to the maximum amount.

Appendix E – COGPE, CDE and CEE

	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
COGPE (10%)					
Opening balance	120,000	225,000	319,500	404,550	481,095
Current additions	180,000	180,000	180,000	180,000	180,000
Proceeds on sale of resource properties	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Subtotal	250,000	355,000	449,500	534,550	611,095
Claim available for the year	(25,000)	(35,500)	(44,950)	(53,455)	(61,110)
Claim made for the year ¹	(25,000)	(35,500)	(44,950)	(53,455)	(61,110)
Ending balance	225,000	319,500	404,550	481,095	549,985
CDE (30%)					
Opening balance	100,000	140,000	168,000	187,600	201,320
Current additions	100,000	100,000	100,000	100,000	100,000
Subtotal	200,000	240,000	268,000	287,600	301,320
Claim available for the year	(60,000)	(72,000)	(80,400)	(86,280)	(90,396)
Claim made for the year ¹	(60,000)	(72,000)	(80,400)	(86,280)	(90,396)
Ending balance	140,000	168,000	187,600	201,320	210,924
CEE (100%)					
Opening balance	-	-	-	-	-
Current additions	95,000	95,000	125,000	155,000	185,000
Proceeds on sale of seismic data	(30,000)	-	-	-	-
Subtotal	65,000	95,000	125,000	155,000	185,000
Claim available for the year	(65,000)	(95,000)	(125,000)	(155,000)	(185,000)
Claim made for the year ²	(65,000)	(95,000)	(125,000)	(155,000)	(185,000)
Ending balance	-	-	-	-	-
Total COGPE, CDE & CEE claims	150,000	202,500	250,350	294,735	336,506

Notes:

1. The resource pool claims in this illustration are made at maximum. The company can claim any amount from nil up to the maximum amount.
2. A principal-business corporation (see page 3) cannot create or increase a non-capital loss by claiming CEE.

Appendix F – Abbreviations

ARTC	Alberta Royalty Tax Credit	E-SAGD	Enhanced Steam Assisted Gravity Drainage
CCA	Capital Cost Allowance	FRE	Foreign Resource Expense
CCPC	Canadian-Controlled Private Corporation	GST	Goods and Services Tax
CDE	Canadian Development Expense	HST	Harmonized Sales Tax
CEDOE	Canadian Exploration and Development Overhead Expense	ITC	Investment Tax Credit
CEE	Canadian Exploration Expense	NAFTA	North American Free Trade Agreement
CFRE	Cumulative Foreign Resource Expense	R&D	Research and Development
COGPE	Canadian Oil and Gas Property Expense	SR&ED	Scientific Research and Experimental Development
CRA	Canada Revenue Agency	UCC	Undepreciated Capital Cost
CRCE	Canadian Renewable and Conservation Expense	VAPEX	Vapor Extraction

Tax News Network (TNN) provides subscribers with Canadian and international information, insight and analysis to support well informed tax and business decisions. Try it today at www.ca.taxnews.com.

This booklet is published with the understanding that PricewaterhouseCoopers is not thereby engaged in rendering accounting, legal or other professional service or advice. The comments included in this booklet are not intended to constitute professional advice, nor should they be relied upon to replace professional advice.

The firms of the PricewaterhouseCoopers global network (www.pwc.com) provide industry-focused assurance, tax and advisory services to build public trust and enhance value for clients and their stakeholders. More than 146,000 people in 150 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice. In Canada, PricewaterhouseCoopers LLP (www.pwc.com/ca) and its related entities have more than 5,200 partners and staff in offices across the country.



The pages of this document are printed on Supreme Matte 100 lb. cover and Supreme Matte 80 lb. text which are coated stocks containing 10% post-consumer waste.

www.pwc.com/ca

© 2008 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.