Advisory Services
Climate Change

the forecast*

Tax Implications of Climate Change
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PRICEWATERHOUSECOOPERS

High fuel costs and increased public awareness of climate change are pushing all levels of government to create new taxes and incentives for green energy options. To date, both the federal and provincial governments have used the income tax system to encourage investment and development in energy efficiency and greenhouse gas emission reduction programs.

In this newsletter, we take a closer look at two of these key climate change-related tax incentive programs—Canadian Renewable and Conservation Expenses (CRCE) and provincial carbon taxes—and examine how they work and the benefits they provide to consumers and businesses.

Canadian Renewable and Conservation Expenses (CRCE)

On March 6, 1996 the federal government introduced a new concept called Canadian Renewable and Conservation Expenses (CRCE), with a goal of encouraging investments in energy efficiency and renewable energy projects.

CRCE, along with asset Classes 43.1 and 43.2, provides investors with the opportunity to claim accelerated income tax deductions in respect of their investments in qualifying assets. Guidance for what qualifies for Classes 43.1, 43.2 and CRCE can be found in the *Class 43.1 Technical Guide and Technical Guide to Canadian Renewable and Conservation Expenses*, published by the CANMET Energy Technology Centre of Natural Resources Canada. Tax deductions can be claimed at an annual rate of 30% for Class 43.1, 50% for Class 43.2, and 100% for CRCE. Clearly, CRCE is the most favourable tax deduction, and taxpayers should track and assess their expenditures carefully to include as many costs in this category as possible.

CRCE includes intangible expenditures for the pre-production development phase (pre-feasibility and feasibility stages) of projects for which the equipment is included in Class 43.1 or 43.2. In order to qualify for CRCE, Class 43.1 or 43.2 assets must already be either in place or under development.

In respect of those assets, amounts that qualify for CRCE include costs to:

- Make electricity transmission connections to the project;
- Build a temporary access road to site;
- Acquire a right to access the project site, prior to the project's earning income;
- Clear land to the extent necessary to complete the project;
- Complete process engineering for the project (including data analysis, scientific analysis, prototype design, drilling or completion of a well for the project, testing wind turbine).

Certain costs are specifically excluded from CRCE, such as:

- Costs for the acquisition of, or use of, land;
- Financing and interest charges;
- Expenses related to administration and management;
- Expenses payable to non-residents or a partnership other than a Canadian partnership;
- Costs currently capitalized as depreciable expenditures under any CCA class, including all costs directly associated with their acquisition and installation.

Flow-through shares

Flow-through shares are popular and highly effective financing options for smaller companies in the oil & gas and mining sectors. The renewable and conservation expenses that qualify as CRCE are also eligible expenses for purposes of the flow-through share provisions, enabling purchasers of new equity to be allowed tax deductions directly for eligible expenses incurred by the company issuing the flow-through shares. This financing incentive has made it easier for renewable energy companies to gain access to share capital.

The CRCE placed renewable energy developers and providers on a level playing field with taxpayers in the non-renewable sectors by extending the benefits of accelerated tax deductions and access to flow-through share financing to eligible renewable energy and energy conservation projects.

The provincial move to a carbon tax

Many jurisdictions are looking at ways to limit or reduce emissions through new taxes and incentives. Quebec was the first Canadian province to implement a carbon production tax on energy producers; the approximately $200 million to be generated is earmarked to fund renewable energy sources. The much heralded British Columbia carbon consumption tax, effective July 1, 2008, is the world's first revenue-neutral carbon tax, introduced with the purpose of encouraging individuals and businesses to make environmentally responsible choices by reducing their use of fossil fuels and related emissions.

Highlights of British Columbia's carbon tax

- The carbon tax is a consumer tax imposed on all British Columbia businesses and individuals and will apply to virtually all fossil fuels, including gasoline, diesel, natural gas, coal, propane and home heating fuel.
- The tax is revenue-neutral, and legislation requires the provincial government to show each year how the revenue raised will be returned to taxpayers. All revenue generated by the carbon tax will be returned to individuals and businesses through reductions to other taxes; none of the carbon tax revenue will be used for expenditure programs.
- The tax rates will be phased in from July 1, 2008 through 2012, with the tax starting at a rate based on $10 per tonne of carbon dioxide-equivalents (CO_2e), and increasing by $5 each year to $30 per tonne of CO_2e by 2012. This adds up to an increase in gasoline prices by 2.41 cents per litre in 2008 to 7.24 cents per litre in 2012.
- To help offset the cost of the carbon tax, lower-income British Columbians will receive an annual Climate Action Dividend Credit of $100 per adult and $30 per child.

Our analysis of British Columbia's carbon tax

Many Canadian provinces are watching with interest as British Columbia's carbon tax unfolds, and the urgency of going green may seem sufficient to outweigh the incremental burden to businesses. However, increases in the world oil price since the carbon tax announcement may have shifted the populace's primary focus somewhat from the threat of global warming to that of higher fuel costs and may cool the carbon tax's reception.

Although the carbon tax is a good step forward, it is significantly below what economic models predict would be effective in changing behaviours to stabilize climate change. In order to significantly reduce greenhouse gas emissions, Canada must pursue the following three areas: reducing current emissions, encouraging technology development that reduces or provides alternatives to greenhouse gas emissions, and developing and implementing carbon capture and storage technology—a carbon tax addresses only one of these three necessary actions.

Moreover, the carbon tax may not provide enough incentive for change. Most studies indicate that a tax equivalent of $50-$100 per tonne of CO_2e is necessary to motivate the changes required for climate change stability—the British Columbia carbon tax has a starting tax rate of $10 per tonne of CO_2e, and increases to only $30 per tonne by 2012.

Conclusion

Climate change is one of the few marketplace drivers capable of modifying the entire business landscape across all sectors of the economy. As climate change strategies continue to evolve, we expect to see all levels of government creating additional taxes and incentives. Regardless of their size or business strategy, all businesses would be wise to stay abreast of these evolving regulations, manage their associated risks and take advantage of the opportunities they present.

PricewaterhouseCoopers' Climate Change practice provides services in strategic assessment of climate change risks and opportunities; due diligence for greenhouse gas credits; green technology feasibility assessments; climate change project documentation development for credit application; corporate inventories and greenhouse gas data management systems; and validation and verification of corporate inventories and project emission reductions or removal enhancements. PwC had a key role in developing the ISO 14064 standard on greenhouse gases and the GHG Protocol. Our practice extends to a variety of industries including the electricity, oil and gas, mining, forestry, chemical processing and telecommunications fields at a local, national and international level.

We anticipate more Canadian and international developments related to climate change in the months ahead. Our goal is to provide you with timely synopses and analyses of these developments as they occur.

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