Intelligence MEMOS

From: Charles DeLand

To: The Honourable Chrystia Freeland, Minister of Finance of Canada

Date: November 2, 2023

Re: **Some Easy Fixes for the New Carbon Capture Tax Credit**

Canada's federal government has proposed a range of policies over the past few years designed to reduce greenhouse gas (GHG) emissions. Among them, refundable investment tax credits (ITCs) in Budget 2022, designed to increase carbon capture and storage (CCUS) investment in industrial facilities.

Tax credit **legislation** is now out, but needs serious changes if it is to give investors the clarity and incentives they need to make the large-scale investments CCUS requires.

Large carbon capture projects face many obstacles, not least the lack of meaningful examples anywhere in the world. Financing is only one of the barriers and tax credits only one policy lever. But under the current proposal these credits are set to halve and end too soon, require unusual burdensome reporting, and present possibly confusing provisions to investors. Taken together, these gravely limit their real-world usefulness.

Investment tax credits return to a company a portion of what that organization spends on eligible projects. This should lower the ultimate cost of the project and, in theory, increase the likelihood investors will commit to the investment.

The government proposes time-limited credits for capturing carbon. Projects that capture carbon directly from ambient air receive 60 percent from 2022 to 2030, and other projects (like those planned in oil sands operations) receive 50 percent. Other transport and storage expenses receive 37.5 percent. After 2030 these rates drop by half and end completely by 2041.

Major projects take a long time (seven years according to a recent **estimate**) to plan, build, and complete under the best of circumstances, carbon capture projects are likely to take significantly longer. First, proponents face a nascent and limited supply chain and experienced labour force. Second, emission-reduction policies in the US and EU are also driving up demand for materials and workers. Those proposing direct air capture projects face yet longer project development time, for which the technology has yet to be commercialized (Glen and David Hodgson **suggest** that federal purchases could help build a market).

Moreover, investors in many provinces, like Ontario, are not yet eligible for the credit since their provinces are still working to develop the needed regulatory frameworks (see **this recent Intelligence Memo** on the need for Ontario to move faster).

To give the credit a chance to work, the federal government ought to extend the credit's maximum value by at least five years.

A too-limited window is not the only hurdle to the proposed ITC. Failing to meet certain labour requirements (a notion from the US *Inflation Reduction Act*) takes another 10 percentage points off the rate.

To receive the maximum tax credit rates under these investment tax credits, businesses are required to pay at least a "prevailing wage" based on certain prior collective bargaining agreements and ensure that at least 10 percent of tradesperson hours worked are performed by registered apprentices. It comes with added compliance and reporting requirements. Additional burdens like this erode effectiveness by introducing extraneous reporting and uncertainty over how much the tax credit will actually offer.

Investors also worry about a complex and confusing set of provisions which may deter investment, for example, those that "claw back" value under certain circumstances. In response to consultations, some **stakeholders** have said "claw back provisions, differing phase out schedules, narrow and confusing eligibility criteria, knowledge sharing requirements and a high-level auditing risk are just some of the provisions that could discourage companies and investors from using the ITCs. Meanwhile questions remain about the stackability of certain ITCs amongst themselves and with federal programs such as the Strategic Innovation Fund and projects supported by the Canada Infrastructure Bank, Canada Growth Fund, or provincial governments."

Investors, and provincial governments and their taxpayers contemplating their own support programs, need to know the risks beforehand – there are enough in carbon capture already without adding a layer from the Canada Revenue Agency. The legislation should be as simple as possible.

Reducing Canada's GHG emissions is neither cheap nor easy. Progress has been slower than many would like, especially in sectors like industrial manufacturing or oil sands where energy demands for heat or other processes are high, and few alternatives exist. If the federal government is serious about private sector investment to reduce emissions, Canada needs a more flexible, less burdensome approach, predisposed to removing barriers not erecting them.

To give the carbon capture investment tax credit a fair chance to work, the legislation ought to extend the time period of maximum credit, drop the unnecessary labour requirements feature, and simplify or eliminate confusing mechanisms.

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