

Intelligence MEMOS



From: Benjamin Dachis and Daniel Lang

To: The Hon. François-Philippe Champagne, Minister of Finance and National Revenue and The Hon. Tim Hodgson, Minister of Energy and Natural Resources

Date: June 26, 2025

Re: **TAX CHANGES NEEDED TO UNLOCK PRIVATE CAPITAL FOR ONTARIO'S ELECTRICITY GRID**

Canada's net-zero targets demand massive electricity distribution infrastructure investment. Ontario's municipal financing structure – and outdated federal tax rules – stand in the way of unlocking the private capital needed to build.

Addressing this aligns directly with Mark Carney's ministerial mandate to accelerate infrastructure at "speeds not seen in generations." and advances the government's core priorities of expediting nation-building infrastructure, lowering household energy costs, and making housing more affordable.

The bulk of Ontario households receive electricity from municipally owned Local Distribution Companies (LDCs). Clean Prosperity [research](#), building on over a [decade](#) of [C.D. Howe Institute work](#) and other estimates, shows LDC [capital](#) investment needs of tens or hundreds of billions. Without reform, municipalities will either delay necessary grid upgrades or impose costs on ratepayers.

LDCs are exempt from federal taxation so long as private investors own less than 10 percent of their equity. Their taxable income is exclusively levied by the Ontario government under the Payments in Lieu of Taxes (PIL) regime imposed under the *Ontario Electricity Act, 1998*.

Once non-municipal ownership exceeds 10 percent, the LDC would transition out of payments in lieu and would begin paying taxes under the *Income Tax Act* to the Canada Revenue Agency. This exit out of the PILs taxes would trigger an immediate tax liability – a "departure tax" like that imposed on death or departure from Canada – based on the LDC's asset values at the time of sale.

Last October, Ontario amended its PILs rules and committed to eliminating the capital gains portion of this departure tax for a four-year window up to December 31, 2028, and removed an unrelated transfer tax. The remaining barrier to attracting new capital to the Ontario electricity sector is the depreciation recapture liability on the LDC's plant and equipment at 26.5 percent, which is paid only to Ontario. The exact amounts of each component will differ by company, but we anticipate the depreciation recapture will be the larger tax cost.

This departure tax makes sense in traditional departure scenarios of a person's death or move out of the country but is poorly suited to the LDC context. Ontario's PILs regime already mimics the federal tax system. When an LDC shifts to private ownership, it is not "leaving" the tax system but transitioning to a similar one. Treating this as a taxable departure by revaluing the LDC's assets is inconsistent and policy-distorting. Further, our understanding is that LDCs and their municipal shareholders are reluctant to seek new capital investment if it would cause them to pay a departure tax. Reform is justified.

The federal government holds the primary levers of the *Income Tax Act* to address the remaining tax on the recaptured depreciation. Investors are ready. But without federal clarity or the province proposing another alternative, billions in potential capital will stay on the sidelines – or flow to other sectors or jurisdictions. This is a time-sensitive opportunity to lead.

Ottawa has two options:

1: Raise the Non-Municipal Ownership Threshold

One broad solution – mentioned in the 2024 Fall Economic Statement as part of Steven Poloz's review of pension fund investment – is that Ottawa could raise the ownership threshold that triggers the departure tax from 10 percent to a higher level, such as 49 percent. This option could possibly be limited to only Canadian pension funds that invest in LDCs.

The consequences of this option would be that the LDCs continue to be subject to PILs, so it would be status quo for both federal and Ontario tax revenues. However, this change would potentially erode the future federal tax base.

If eligibility is restricted to certain investor types (e.g. pension funds, which are generally exempt from federal tax anyway), such a change may favour the capital provided by one group (tax-exempt pension funds) to the detriment of attracting capital from Canadian private-sector investors subject to federal income taxes, who may be the better partners to provide LDCs capital.

2: Targeted Reform to Departure Tax – Section 149(10)(b)

Ontario's decision to refrain from collecting the capital gains portion of the departure tax points to a narrower and more effective option for the remaining issue. This option specifically targets the application of paragraph 149(10)(b) of the *Income Tax Act*, which requires companies that become taxable under the Act to revalue all their assets – including plant and equipment – to fair market value. This paragraph makes sense if a tax-exempt entity that has never paid income tax starts paying taxes under the *Income Tax Act*. In that case, it would be important for the company to have a clear calculation basis of its future tax depreciation deductions. However, the requirement does not make sense for LDCs already paying PILs taxes and which already have well-established tax depreciation cost amounts.

Newly privatized LDCs would still start paying federal taxes and would still have a portion of their ongoing tax liabilities allocated to Ontario. However, such LDCs would carry forward their existing tax values of their asset and continue to claim tax depreciation based on their historic balances and would thereby avoid triggering an immediate recapture liability.

If LDCs exiting the PILs regime had their departure tax eliminated (by virtue of a favourable interaction with Ontario Reg. 162/01), Ontario would mostly recoup the lost revenue in future years. The reason is that the LDC would now be subject to tax under the *Income Tax Act* but would forego incremental capital cost allowance on depreciable assets. Better for Ontario to have about half of a larger tax base from corporate income tax revenue, than being entitled to receive the departure tax that has simply not materialized from sales of the LDC entities.

We suggest that this is the smallest possible change to eliminate the key remaining barrier to investment in the Ontario electricity distribution sector while:

- Preserving federal tax integrity;
- Avoiding broader changes to tax-exempt structures;
- Preventing tax arbitrage or distortions in other sectors; and
- Supporting immediate investment in nation-critical infrastructure.

Because few other provinces operate LDCs in this structure, the impact would be narrowly focused on Ontario. This reform does not require new federal spending and avoids the need for costly infrastructure subsidies – while unlocking billions in private investment.

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