BUDGET 2023: CLEAN ENERGY INCENTIVES AND RESOURCE SECTOR MEASURES

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Budget 2023, announced by the Federal Government on March 28, 2023 ("**Budget Day 23**"), contains several measures aimed at facilitating Canada's transition to a net-zero economy. It contains a suite of tax credits aimed at incentivizing clean energy technology development, manufacturing, and processing, expands the scope of critical mineral resources eligible for resource-related deductions and credits, and extends the availability of reduced corporate tax rates for eligible companies for zero-emission technology manufacturers. These measures are summarized below.

Clean Hydrogen Investment Tax Credit

The Federal Government signalled its intention to establish a tax credit to support investment in clean hydrogen production as part of Budget 2022. In the 2022 Fall Economic Statement ("FES 2022"), the Federal Government announced that it would begin a consultation process to determine how best to implement a refundable investment tax credit for clean hydrogen based on the lifecycle carbon intensity of hydrogen produced by a particular project.

Budget 2023 introduces the *Clean Hydrogen Investment Tax Credit* ("**CH Credit**"), a refundable tax credit available in respect of the cost of purchasing and installing "eligible equipment" for projects that produce hydrogen from:

- electrolysis, or
- natural gas, so long as emissions are abated using carbon capture, utilization and storage (CCUS).

The applicable CH Credit rate varies depending on the assessed carbon intensity (CI) of the hydrogen produced by the related project; assessments must be based on the *Fuel Life Cycle Assessment Model* that is maintained by Environment and Climate Change Canada, and submitted to the government for verification. CI is a measure of kilograms of carbon dioxide equivalent per kilogram of hydrogen produced. The table below illustrates the effect of CI on the CH Credit rate.

CI (kg of CO2 equivalent per kg of H)	CH Credit Rate

<0.75 kg	40%
≥0.75 kg but <2 kg	25%
≥2 kg but <4 kg	15%

The CH Credit is available in respect of eligible equipment that is acquired, and becomes available for use in Canada, on or after Budget Day 23, but is reduced by half for property acquired and available for use in 2034, and eliminated after 2034. In order for equipment to be eligible, all or substantially all of its use must be to produce hydrogen through either electrolysis or from natural gas. Equipment used to produce hydrogen from natural gas would only qualify if it does not otherwise qualify for the CCUS Credit (discussed further below).

Eligibility for the full CH Credit rate available based on a particular project's CI will be dependent on the project's adherence to certain prescribed labour requirements. If a project does not meet the prescribed labour requirements, the applicable CH credit rate will be reduced by 10 percentage points. These requirements are discussed in more detail below.

Clean Technology Investment Tax Credit

Budget 2023 also expands on, and provides additional details in respect of, the Clean Technology Investment Tax Credit ("**CT Credit**") first announced in FES 2022.

The CT Credit is a refundable tax credit equal to 30% of the cost of eligible property that is acquired, and becomes available for use, on or after Budget Day 23 and before 2035. The CT Credit rate is reduced to 15% in 2034 and will be eliminated in 2035.

FES 2022 provided the following list of eligible property for the CT Credit:

- Electricity Generation Systems, including solar photovoltaic, small modular nuclear reactors, concentrated solar, wind, and water (small hydro, run-of-river, wave, and tidal);
- Stationary Electricity Storage Systems that do not use fossil fuels in their operation, including but not limited to: batteries, flywheels, supercapacitors, magnetic energy storage, compressed air storage, pumped hydro storage, gravity energy storage, and thermal energy storage;
- Low-Carbon Heat Equipment, including active solar heating, air-source heat pumps, and ground-source heat pumps; and
- Industrial zero-emission vehicles and related charging or refueling equipment, such as hydrogen or electric heavy duty equipment used in mining or construction.

Budget 2023 expands the initially proposed list to include equipment described in subparagraph (d)(vii) of Class 43.1 and used primarily for the purpose of generating electrical energy, heat energy, or both, solely from geothermal energy. Examples of such equipment would include piping, pumps, heat exchangers, steam separators, and electrical generating equipment. It is important to note that equipment used for geothermal energy projects that co-produce fossil fuels are not eligible for the CT Credit.

As is the case for the CH Credit, eligibility for the full CT Credit rate is dependent on adherence to certain prescribed labour requirements. The CT Credit rate is reduced to 20% (or 10% in 2034) for businesses that fail to meet the prescribed requirements, which are discussed in more detail below.

Clean Electricity Investment Tax Credit

Budget 2023 proposes a new Clean Electricity Investment Tax Credit ("**CE Credit**"), a refundable 15% tax credit for eligible investments in;

- Non-emitting electricity generation systems: wind, concentrated solar, solar photovoltaic, hydro (including large-scale), wave, tidal, nuclear (including large-scale and small modular reactors);
- Abated natural gas-fired electricity generation (which would be subject to an emissions intensity threshold compatible with a net-zero grid by 2035);
- Stationary electricity storage systems that do not use fossil fuels in operation, such as batteries, pumped hydroelectric storage, and compressed air storage; and,
- Equipment for the transmission of electricity between provinces and territories.

The CE Credit is proposed to become available on Budget Day 2024 for projects that did not begin construction prior to Budget Day 23. The CE Credit is scheduled to remain in effect through 2034, and no phase-out period was referenced in the budget materials.

Eligibility for the full CE Credit rate will be dependent on adherence to certain labour requirements, the details of which will be determined following consultation by the government with labour unions and other stakeholders. Failure to adhere to the prescribed labour requirements would see the applicable CE Credit rate reduced to 5%.

Access to the credit will also require a commitment by a competent authority that the federal funding will be used to lower electricity bills, and a commitment to achieve a net-zero electricity sector by 2035. Additional details regarding these commitments and any other requirements can be expected to emerge following consultations between the federal government and its provincial and territorial counterparts.

Labour Requirements

Eligibility for the full benefit of each of the CH Credit, CT Credit, and CE Credit is dependent on the recipient's adherence, beginning on October 1, 2023, to certain labour requirements relating to wage and apprenticeship targets in respect of the project benefiting from the applicable credit. The labour requirements apply to workers (whether employees or contractors) primarily engaged in manual or physical labour, and do not apply to those in administrative, clerical, supervisory, or executive roles.

The wage requirement generally requires that workers involved in the project be paid at or above a "relevant wage" (taking into account the monetary value of standard benefits and pension contributions) as specified in an "eligible collective agreement". In Quebec, such an agreement would be one negotiated in accordance with provincial law. For territories and provinces other than Quebec, an "eligible collective agreement" would be the most recent multi-employer collective bargaining agreement between a trade union and a group of employers that may reasonably be considered the industry standard for the given trade in the particular region, province or territory.

The apprenticeship requirement generally requires that, subject to applicable labour laws and collective agreements, not less than 10% of the total labour hours of covered workers on a particular project be performed by registered apprentices. "Covered workers" in this context refers to workers whose duties correspond to those performed by a journeyperson in a Red Seal trade.

Investment Tax Credit for Clean Technology Manufacturing

Budget 2023 also proposes a new 30% refundable investment tax credit for clean technology manufacturing and processing, and critical mineral extraction and processing ("**CTM&P Credit**"). The CTM&P Credit would be available in respect of the capital cost of eligible property associated with certain manufacturing and mineral extraction/processing activities.

Eligible property for the CTM&P Credit would include certain depreciable property all or substantially all of the use of which is for eligible activities. Such property would generally include machinery and equipment used in manufacturing, processing, or critical mineral extraction, as well as related control systems.

Eligible activities for the CTM&P Credit would be:

- manufacturing of certain renewable (solar, wind, water, or geothermal) and nuclear energy equipment;
- processing or recycling of nuclear fuels and heavy water;
- manufacturing of nuclear fuel rods;
- manufacturing of electrical energy storage equipment used to provide grid-scale storage or other ancillary services;
- manufacturing of equipment for air- and ground-source heat pump systems;
- manufacturing of zero-emission vehicles, including conversions of on-road vehicles; as well as manufacturing of batteries, fuel cells, recharging systems, and hydrogen refuelling stations for zero-

emission vehicles;
- manufacturing of equipment used to produce hydrogen from electrolysis;
- manufacturing or processing of upstream components, sub-assemblies, and materials provided that the output would be purpose-built or designed exclusively to be integral to other eligible clean technology manufacturing and processing activities, such as anode and cathode materials used for electric vehicle batteries; and
- extraction and certain processing activities related to lithium, cobalt, nickel, graphite, copper, and rare earth elements.

CCUS

Budget 2023 expands several features of the Investment Tax Credit for Carbon Capture, Utilization, and Storage ("**CCUS Credit**") first introduced in Budget 2022.

Eligible equipment for the CCUS Credit will now include dual-use equipment that produces heat and/or power, or uses water, and is used for both carbon capture, utilization, and storage (CCUS) as well as another process (provided that such equipment satisfies all other conditions of the CCUS Credit). In order for dual-use power and/or heat production equipment to be eligible, CO2 emissions would need to be captured, stored or used, and such equipment would need to be primarily used to support either the CCUS process or hydrogen production that is eligible for the CH Credit.

The CCUS Credit available for dual-use equipment would be calculated on a pro-rated basis with regard to the expected energy balance or material balance supporting the CCUS process over the first 20 years of the relevant project.

Other amendments to the CCUS Credit regime include:

- the addition of British Columbia as an "eligible jurisdiction" for dedicated geological storage;
- providing eligibility for certain refurbishment costs incurred in the 20-year period immediately following commencement of project operation; and
- requiring that the process for using and storing CO_2 be validated by a qualified third party (rather than approved by Environment and Climate Change Canada) prior to such process constitute an eligible use for CCUS Credit purposes.

Finally, draft legislation for the knowledge sharing and climate risk disclosure requirements of the CCUS Credit were included in the Budget 2023 materials. In summary:

- A construction and completion knowledge sharing report, containing information prescribed by the

Minister of Natural Resources, must be filed within 6 months of commencement of commercial operations;

- A total of 5 annual operations knowledge sharing reports, containing information prescribed by the Minister of Natural Resources, must be filed. The first such report is due: (a) if commercial operations commence before October of a particular year, by June 30 of the following year, and (b) if commercial operation commence after September of a particular year, by June 30 of the second year following the particular year. Subsequent reports are due on June 30; and
- A climate risk disclosure report, containing information prescribed by the Income Tax Regulations, is required to be filed annually for the 20 years following commencement of commercial operations. The first such report is due 9 months after the end of the first tax year in which the taxpayer claimed the CCUS Credit in respect of a project. Subsequent reports must be filed within 9 months of the taxpayer's taxation year-end.

Situations Involving Eligibility for Multiple Credits

Given the nature of the eligibility criteria underlying each credit regime, it is certainly possible for a single piece of equipment or property to meet the criterial for multiple credits. Budget 2023 provides that, in such cases, only one credit may be claimed in respect of the relevant piece of property or equipment. Accordingly, we would expect taxpayers to carefully analyze which credit offers the greatest benefit in their circumstances having regard to the eligibility requirements. The highest credit rate available is under the CH Credit regime, which provides a 40% credit for eligible costs where the project achieves the lowest CI threshold and fully complies with the prescribed labour conditions.

Reduced Tax rates for Zero-emission Technology Manufacturers

Budget 2021 introduced reduced tax rates on eligible zero-emission technology M&P income for qualifying manufacturers. Budget 2023 provides that, for years beginning after 2023, eligible income would include income from the manufacturing of nuclear energy equipment, processing or recycling of nuclear fuels and heavy water, and manufacturing of fuel rods.

Budget 2023 also extends the availability of the reduced rates – the rates will be subject to a phase-out beginning in 2032 (with elimination scheduled for 2034), as opposed to the current schedule which calls for the phase-out to begin in 2029 and elimination scheduled for 2031.

Inclusion of Lithium from Brines as a Critical Mineral

Budget 2023 proposes to include lithium from brines as a mineral resource and a critical mineral for purposes of the Tax Act. Beginning after Budget Day 23, expenses related to lithium from brines would be eligible for qualification as Canadian exploration expense or Canadian development expense, and be eligible for the Canadian mineral exploration tax credit that was introduced in Budget 2022.

by Ted Thiessen

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.