



September 8, 2023

c/o Consultation-Legislation@fin.gc.ca

Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

This letter constitutes the submission of Energy Storage Canada (“ESC”) to the government’s invitation for comments on the draft legislation released August 4, 2023, pertaining to the new Clean Tech Investment Tax Credit (“CT ITC”). ESC strongly supports the government’s various initiatives as outlined in the Federal Budget of March 28, 2023 (“the 2023 Budget”) and other documents in support of clean energy and Canada’s green economy and appreciates the opportunity to provide input related to the CT ITC.

ESC is a not-for-profit organization and the only national trade association in Canada dedicated solely to the growth and market development of the country's energy storage sector as a means of accelerating the realization of Canada's ongoing energy transition and Net Zero goals through advocacy, education, collaboration, and research. ESC's technology-agnostic approach allows for a diverse membership of 90 members representing the end-to-end value chain of the country's energy storage industry.

We will be sharing our submission with NRCAN and PCO officials as well.

We would be happy to speak to our comments in greater detail as required.

Sincerely,

A handwritten signature in black ink that reads "Justin Rangooni".

Justin Rangooni
Executive Director
Energy Storage Canada

ENERGY STORAGE CANADA

SUBMISSION ON AUGUST 4, 2023 CLEAN TECHNOLOGY INVESTMENT TAX CREDIT

This letter constitutes the submission of Energy Storage Canada (“ESC”) to the government’s invitation for comments on the draft legislation released August 4, 2023 pertaining to the new Clean Tech investment tax credit (“CT ITC”).¹ ESC is strongly supportive of the government’s various initiatives set out in the federal budget of March 28, 2023 (“the 2023 Budget”) and elsewhere in support of clean energy and Canada’s green economy, and appreciates the opportunity to provide input on the terms of the CT ITC.

Energy Storage Canada

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Background: Canada’s Green Economy Sector

Energy storage constitutes an essential element of Canada’s clean energy strategy. The highly variable nature of both consumer demand and many of the sources of clean energy necessitate the creation and development of a strong and reliable network of short (4 hours), medium (1-4 days) and long term (weeks to months) energy storage facilities, without which Canada’s shift to a greener and cleaner economy will not be realized. As a nation already facing a serious productivity challenge,² Canada needs to ensure that capital investment is encouraged and that the output of that capital investment is optimized to ensure maximum return on investment, for the benefit of all Canadians.

There are various aspects of the business environment within which the clean energy sector (including energy storage) operates that must be fully appreciated to ensure that the government’s clean energy initiatives have the effect the government desires. The clean energy industry is technologically risky, heavily regulated, and capital-intensive, with the result that it inherently faces several uncertainties not found in “ordinary” commercial undertakings. Mitigation of project uncertainty, in all its forms, is critical to the development of the very clean

¹ <https://www.canada.ca/en/department-finance/news/2023/08/government-consults-canadians-on-budget-2023-measures-to-grow-the-clean-economy-close-tax-loopholes-and-deliver-tax-relief-for-canadians.html> .

² “The Canadian economy is mired in weak fundamentals, and investors are taking note” August 22, 2023: <https://www.theglobeandmail.com/investing/markets/inside-the-market/article-david-rosenberg-the-canadian-economy-is-mired-in-weak-fundamentals-and/>

energy projects that the CT ITC was created to support (“CT ITC Projects”), as they are otherwise not merely difficult but impossible to finance.

In addition, the nature of these investments is typically such that developers are legally committing themselves to an expenditure of tens or hundreds of millions of dollars on economics that must be modelled and legal terms that must be settled at the outset, without meaningful ability to revise them later. If the tax consequences of participating in a project turn out to be materially adverse relative to what was used in the economic modelling and relied upon when entering into the legal obligation to participate (often for a period of 20 years or longer), the results can be catastrophic. For this reason, material uncertainty as to these tax consequences (including the availability of the CT ITC) will inevitably and significantly impede development of CT ITC Projects.

As a result, private sector debt financing is typically not available for CT ITC Projects; certainly not on “normal” terms, and frequently not at all. The government acknowledged this commercial reality in the 2023 Budget by announcing that the Canada Infrastructure Bank (“the CIB”) would invest at least \$20 billion “to support the building of major clean electricity and clean growth infrastructure projects,”³ in addition to a further \$1.5 billion to “provide loans to Indigenous communities to support them in purchasing equity stakes in infrastructure projects in which the Bank is also investing.”⁴ As such, the government has identified CIB financing as a key element of its green economy strategy. ESC endorses this position and the need for government and quasi-government financing as an essential element of getting CT ITC Projects built.

Canada’s clean energy sector also faces intense competition from abroad. We are effectively competing for green economy investments against the United States, which one year ago enacted the *Inflation Reduction Act* (“IRA”) containing close to US\$400 billion in tax credits and incentives for various green economy projects focusing on clean energy in particular. The impact of the U.S. tax incentives has been dramatic, as they are more generous than the comparable Canadian regime (especially when framed as production tax credits), effectively bankable or saleable, and more certain (as the relevant legislation is already enacted).⁵ Recent reporting indicates that the IRA has already attracted to the U.S. five \$100M+ clean tech and semiconductor projects from Canadian companies.⁶ While the Canadian government cannot be expected to match the financial expenditure the U.S. is making in this area, the gravitational pull of the IRA in the clean energy sector is real, and the terms of Canada’s suite of five “Green Economy ITCs” (including the CT ITC) must take into account the reality that the policy tools it is employing exist within a globally competitive environment where time and resources are scarce.⁷

³ Page 81, <https://www.budget.canada.ca/2023/pdf/budget-2023-en.pdf> .

⁴ *Ibid.* page 128.

⁵ See for example <https://cleanprosperity.ca/wp-content/uploads/2023/08/Creating-a-Canadian-Advantage-Report-Aug-16.pdf> .

⁶ Financial Times, “Inside the \$220bn American cleantech project boom”, August 16, 2023.

⁷ See further <https://www.cbc.ca/news/canada/calgary/bakx-clean-tech-ira-ccs-1.6879129> ;

<https://www.cbc.ca/player/play/2228683843942> ; and <https://financialpost.com/commodities/mining/how->

In particular, Canadian project developers must compete for a finite amount of financial investment from potential sources, and financing steered towards U.S. projects because of uncertainty or delays in Canada make it that much harder for Canadian project developers.

Recommendations: Higher-Level Issues

i) Linking the CT ITC to provincial net-zero electricity

Major uncertainty over the viability of CT ITC Projects has been created by the federal government's recent pronouncement that it is considering restricting availability of all of the Green Economy ITCs to provinces that commit to an emissions-free electricity grid by 2035.⁸ This linkage of federal ITC availability to provincial agreement creates a risk for green economy participants over which they have no control, which directly impacts the financial viability of large-scale projects such as those producing clean energy and participants' ability to obtain financing for such projects. While ESC understands the importance of provincial commitment to an emissions-free electrical grid, the creation of more political uncertainty for CT ITC Projects is not an advisable or effective way for the federal government to achieve its desired result. ESC calls on the federal government to eliminate this element of uncertainty as to the availability of Green Economy ITCs (and the CT ITC specifically) as quickly and as publicly as possible, to facilitate the development and financing of CT ITC Projects. Furthermore, the federal government's recently proposed Clean Electricity Regulations provide the appropriate legislative framework to mandate provinces to achieve a net-zero electricity grid by 2035.

ii) CAE Inc. vs. His Majesty the King

Another issue of major concern to ESC and many other participants in the clean energy sector is the impact of the *CAE Inc.* case⁹ on the viability of CT ITC Projects, which has created tremendous uncertainty within the business community as to the potential scope of various rules in the *Income Tax Act (Canada)* ("ITA") that create adverse consequences for persons receiving (or expecting to receive) "government assistance", as discussed here:¹⁰

<https://www.blg.com/en/insights/2023/07/government-assistance-recipient-beware>

As noted therein, the CRA's application of "government assistance" provisions to unconditionally repayable loans was seemingly contrary to previously-announced CRA administrative policy.

What is particularly counter-intuitive with many people is the fact that under the rationale of the *CAE Inc.* case, a \$100 fully-repayable loan that carries a below-market rate of interest triggers the "government assistance" rules to the extent of the entire \$100 principal amount of the loan, not

inflation-reduction-act-changed-canada , in particular: "In contrast to Canada's approach, the IRA treats the private sector as a partner, not an obstacle, in achieving climate goals".

⁸ <https://globalnews.ca/news/9882253/canada-clean-power-target/> August 8, 2023.

⁹ <https://decisions.scc-csc.ca/scc-csc/scc-l-csc-a/en/item/19927/index.do>

¹⁰ Many of the concerns raised by the *CAE* case were subsequently raised directly with Finance in a submission from the CBA-CPA Joint Committee on Taxation dated August 11, 2023.

merely the economic benefit of the low interest rate. Hence, such a \$100 loan that benefits the taxpayer economically by, say, \$7 due to the below-market interest rate is treated as \$100 of government assistance, an amount greatly in excess of the actual economic benefit of \$7 received by the taxpayer relative to an “ordinary” commercial loan. The resulting tax impact of a \$100 reduction in the capital cost of the taxpayer’s property for CCA and ITC purposes dramatically reduces the economic feasibility of the large-scale clean energy projects the government is trying to support (note: the fact that this may be reversed many years later when the loan is repaid does little to remediate the immediate adverse impact of the “government assistance” rules, due to the time value of money and the up-front difficulty of financing these capital-intensive high-risk projects).

The CIB’s website describes its Clean Power strategy as “address[ing] gaps in the capital structure of projects such as renewables, district energy systems, energy storage and more.”¹¹ The CIB webpage describing its involvement in the Oneida Energy Storage project states as follows:¹²

It is challenging to attract or finance the project with only private capital because of the level of uncontracted revenue. . . . To assist with this financial challenge, we will bridge the financing gap with an innovative financing.

Notwithstanding the fact that the CIB is intended to serve as the principal financing source for the federal government’s clean energy strategy, CIB financing occurs on terms that would trigger the ITA’s “government assistance” provisions, most notably that reduce the capital cost of property acquired by the taxpayer and to which the financing relates, with the result that (1) the tax depreciation (“CCA”) available on property acquired is greatly reduced, and (2) the investment tax credits (including the new Green Economy ITCs announced in the past year) otherwise available on qualifying property are reduced or eliminated. Put simply, as it stands with the government’s existing tax policy on “government assistance,” the two key pillars of the government’s strategy (CIB financing and the new ITCs) are not compatible with one another, with the commercial result that the clean energy projects the government is seeking to incentivize become uneconomic (particularly relative to the economics of comparable projects underway in the United States) and in many cases will not go ahead. Note also that in North America’s largest energy storage procurement (which is currently underway in Ontario), project developers are entitled to keep all environmental attributes (e.g., carbon credits and offsets, etc.) related to the project, including any tax refunds issued as part of the Green Economy ITCs. Developers have therefore priced various Green Economy ITCs into their economic models that will or have supported their project bids. The province in turn, is depending on these energy storage projects to provide vital capacity to the province’s grid.

It seems counter-intuitive for the government to be looking to the CIB to finance the same green economy investments at which the Green Economy ITCs (including the CT ITC) are directed, but

¹¹ <https://cib-bic.ca/en/sectors/clean-power/>

¹² <https://cib-bic.ca/en/projects/clean-power/oneida-energy-storage/>

causing the negative tax effects of the former to cancel out (or even exceed) the economic incentives created by the latter. A rigid adherence to existing tax policy will prevent Canada's broader clean energy policy from being realized. ESC calls on the government to:

- amend the "government assistance" provisions in the ITA to (1) exclude unconditionally repayable loans, (2) provide much greater clarity as to what constitutes "government assistance", and (3) limit the quantum of what is considered to constitute "government assistance" to the economic value of whatever benefit the recipient actually receives;
- ensure the CRA develops and publicly states how it will administer the "government assistance" provisions in a manner that taxpayers can be confident will be adhered to;
- work with the CRA and the CIB to develop lending terms that all branches of government agree can be offered to participants in CT ITC Projects with certainty that the "government assistance" provisions will not apply, so that such participants can economically model potential projects with confidence as to the tax outcome; and
- at minimum exempt from "government assistance" those certain loans that fall under the Indigenous Community Infrastructure Initiative (ICII) or other similar programs, the purpose of which is to address legislative barriers to accessing capital by Indigenous groups and their sponsors/partners.

The importance of a quick and favourable resolution addressing impact of the *CAE Inc.* case to the success of the government's clean energy strategy cannot be overstated. If the government takes away with its left hand the incentives it provides with the right, it will not achieve its clean energy goals.

Specific Elements of the CT ITC Draft Legislation

The balance of our submission is directed at specific elements of the CT ITC draft legislation. The CT ITC has the potential to significantly impact the economic viability, legal structuring and pricing of CT ITC Projects, as the government no doubt intends. In keeping with the points previously raised about the importance of reducing or eliminating uncertainty as to risks that must be incorporated into economic modelling and legal obligations assumed when financing and developing a CT ITC Project, greater clarity and guidance from the government is needed so as to delineate the universe of what is permissible and what is not. Once contracts have been signed, there is no realistic prospect of renegotiating them to reallocate unanticipated negative tax outcomes, putting clarity and certainty at a premium for clean energy developers, and in many cases essential for financing the project. Such certainty and clarity is especially necessary going forward, given the government's stated intention in the August 4, 2023 Amendments to amend the general anti-avoidance rule ("GAAR") in s. 245 ITA to lower the threshold for applying GAAR and create an automatic penalty when GAAR applies. It is thus more important than ever for the government to clearly express its legislative rationale and articulate what is and is not permissible within them.

Confirmation of Previous Statements

In the supplementary materials accompanying the 2022 Fall Economic Statement, the government stated that “Businesses would be able to benefit from the full amount of both the Clean Technology Investment Tax Credit and the Atlantic Investment Tax Credit.”¹³ ESC asks the government to confirm this previous statement and make clear that both ITCs may be claimed.

In earlier discussions with the government, ESC had raised concerns with whether the wording of previous statements reflected an intention by the government to require qualifying energy storage systems to exclude energy created from fossil fuels. ESC asks the government to revise the CT ITC legislation to confirm its previous assurance that eligible stationary electricity storage equipment includes energy storage facilities that charge using electricity from a provincial or territorial electricity grid (whether connected to the transmission system or distribution system of such grid), and that only energy storage facilities that charge with energy derived exclusively from fossil fuels are excluded.

Permissible Structuring to Optimize ITCs

As the CT ITC is not available to all taxpayers, it is likely that CT ITC Projects will include participants that are able to use the CT ITC and others that are not (e.g., tax-exempts such as pension funds, municipalities, Crown corporations or First Nations). This will lead inevitably to consideration of how to structure CT ITC Projects in such a manner as to optimize the allocation of CT ITCs to those participants best able to utilize them. Further guidance from the government as to what sort of outcomes are within the scope of the object, spirit and purpose of the CT ITC is thus extremely important.

For example, a taxable developer seeking to keep the benefit of the CT ITC from a particular project that has other participants (taxable, tax-exempt or both) might create a structure whereby one taxable Canadian corporation (Developerco) acquires clean technology property (as defined in draft s. 127.45(1)) which is then leased to an operating limited partnership (OpLP) with one or more other partners. The intent would be for Developerco to claim all of the CT ITCs on the clean technology property it has acquired and leased to OpLP, as opposed to OpLP owning such property and its partners claiming the CT ITC. It is essential for participants in CT ITC Projects to have a greater understanding of what the government perceives as acceptable tax planning in this regard.

Similarly, as CT ITC Projects with multiple participants are likely to be set up as limited partnerships, further clarity around what the acceptable limits of how a partnership allocates CT ITCs amongst its partners would be very helpful. For example, frequently First Nations participants make partnership contributions in kind rather than in cash, the treatment of which is not clear under the proposed partnership allocation rules. While not all possibilities can be addressed, further clarity as to the government’s view as to what should not be allowable would

¹³ <https://www.budget.canada.ca/fes-eea/2022/report-rapport/tm-mf-en.html> .

be very helpful to CT ITC Project participants, and greatly reduce the risk of time-consuming and costly disputes with tax authorities and amongst project participants themselves (the government's answer to question 2 of our earlier list of queries in June 2023 indicated further guidance would be forthcoming). ESC urges the government to elaborate on the legislative rationale behind the CT ITC and what forms of basic and foreseeable tax planning to optimize their use are and are not within the scope of that legislative rationale. This will inform both the economics of CT ITC Projects (clarity of which is essential to financing them) and the legal rights and obligations that participants enter into and which will govern their conduct for 10 year, 20 years or more.

Technologies with Longer Construction/Permitting Periods

The existing format of the CT ITC is essentially binary in nature for any particular property: it either qualifies or it doesn't, based on whether or not the taxpayer is considered to have "acquired" it within the permitted timeframe (taking into account the "available for use" requirement in draft s. 127.45(4)). ESC is concerned that the "all or nothing" nature of this format could have dramatically negative and unintended effects in some circumstances, as the 2034 end date for the CT ITC is not that far away for some forms of CT ITC Projects.

Certain of the named technologies in the CT ITC (specifically, small modular nuclear reactors, small and run-of-river hydro, compressed air energy storage, pumped hydro storage and geothermal generation) have especially long permitting times and construction periods as compared with other named technologies such as wind and solar. For example, it is not unusual for a hydro project to take a decade to complete. As these projects grow in size, so does the uncertainty and risk of a regulatory or construction delay: this is simply the nature of the industry.

Given time-limited nature of the CT ITC and the unpredictable nature of environmental permitting processes in Canada and the potential for unforeseen delays in construction for large civil and/or highly technical generation and storage projects such as these, ESC is concerned that the "abrupt cliff" inherent in the current design of the CT ITC will create such a risk of losing significant amounts of CT ITCs on property that is not available for use by the end of 2033 or 2034 as to be unbearable for these long lead-time technologies. Lenders will not fund such binary, all-or-nothing risk, making it very difficult to fund these long-lead-time projects, and offtakers are unlikely to agree to power purchase agreements or other commercial underpinnings that pass through to them the risk of not achieving the ITC. The risk of being one day late (in terms of being "available for use") due to delays beyond a developer's control and a billion dollars short on a large project is too high.

We would suggest having a secondary test for a subset of large, long lead-time projects (for example, a project with total capital expenditures of at least \$1 billion, and being one of the relevant long-lead technologies). For this subset of projects which are most at risk of delays, the government could adopt the analogous U.S. practice in relation to tax credits of qualifying for ITC eligibility eligibility by substantial commencement of construction by a specific date and

continued efforts towards project completion thereafter, irrespective of when property finally becomes available for use. For example, projects meeting the size and technology requirements which have begun construction five years prior to the CT ITC cutoff date in 2034 would have the full amount of their qualifying expenditures on clean technology property eligible for the CT ITC even if any particular qualifying property does not become available for use until some time after 2034.

A less ideal solution (for CT ITC Project participants) that would nevertheless help mitigate this risk and improve bankability would be that for projects that meet the criteria as above, all capital expenditures on qualifying property that occur prior to (but are not yet available for use by) the 2033 or 2034 deadlines as a separate property that is deemed to be the available for use, so as to qualify for the ITC. Expenditures after those dates on such properties would be deemed to be separate properties for this purpose. The overall concept this suggestion is directed at is to reduce or eliminate the up-front risk of a complete loss of CT ITCs on large, expensive properties that CT ITC Projects using these long-lead-time technologies, the risk of which is enough to make them non-viable.

Clean Technology Property: Thermal Energy Storage

Industrial heat accounts for over half of all industrial energy emissions. Thermal batteries convert electricity into heat, store the heat for hours or days, and release it when the energy is needed, and are anticipated to be the lowest-cost option for fully decarbonizing industrial heat,¹⁴ and are capable of addressing the sectors (i.e., steel, glass, cement) that are hardest to decarbonize. They constitute an efficient, low-cost part of the clean energy storage solution.

It is not clear that the existing drafting of the CT ITC and surrounding provisions fully accommodate the inclusion of thermal batteries, notwithstanding it being identified in the 2022 Fall Economic Statement as a qualifying technology. Specifically, the reference in (d)(xviii)(B) of Class 43.1 should be clarified to ensure that heat-output thermal energy storage that does not also generate electrical energy comes within the scope of this provision. ESC urges the government to ensure that this technology is not excluded from the CT ITC.

Labour Requirements

The labour requirements set out in draft s. 127.46 constitute an important element of the CT ITC. Various elements of these requirements could very helpfully be clarified by the government for the benefit of CT ITC Project participants seeking to ensure that they are outside the requirements and thus eligible to claim the higher level of ITC without risk of incurring penalties for failing to comply.

To the extent that Red Seal trades are utilized, the claimant shall make reasonable efforts to ensure apprentices registered in Red Seal trades work at least 10% of Red Seal worker hours

¹⁴ See <https://energyinnovation.org/publication/thermal-batteries-decarbonizing-u-s-industry-while-supporting-a-high-renewables-grid-2/> .

(whether on a trade-by-trade basis or in aggregate) on preparation/installation of clean tech property. For greater clarity, such reasonable efforts are irrespective of the utilization of trades for which Red Seal certification does not apply.

Apprentices are frequently not available in sufficient numbers (a symptom of a much larger problem beyond the scope of this submission), and it is important that employers not be penalized when reasonable efforts have been made to attract apprentices. Further guidance would also be helpful on what constitutes “reasonable efforts” to comply with these requirements. For example, our members understand that with respect to comparable requirements in the U.S. claimants meet this requirement by advertising for apprentices and approach union halls in the vicinity of relevant projects.

Concerns have also been expressed with the “prevailing wage” concept. While ESC members are agreeable to the principle (as with other elements of the labour requirements), they seek clarity and certainty as to how to meet this requirement. ESC asks the government to cause the CRA or other responsible federal body to establish and post prevailing wages for each province that will be considered to meet this element of the CT ITC labour requirements. The CRA must consider what if any differences should be factored in for projects taking place on Crown lands, remote areas or on reserve lands held by First Nations/Indigenous groups. Often, projects will seek to employ members of proximate Indigenous communities to help build the project for capacity building purposes and partnership purposes.

It is to the benefit of everyone to make compliance with the relevant standard as simple as possible by clearly articulating that standard. This approach would mirror the approach of numerous state level labour departments in the US (which are being relied on for compliance with the US IRA) and would be used exclusively for the purposes of the Green Energy ITCs that incorporate labour requirements, so as not to intrude on provincial jurisdiction.

CT ITC Administration

Because the CT ITC is refundable and in many cases it will be key to actually funding capital-intensive CT ITC Projects, a number of ESC members have inquired as to how quickly CT ITC claims are likely to be processed and result in actual payments to claimants. Whatever insight the government can provide on this issue (including best practices to expediting claims processing and payment) would be welcome.

ITC Recapture

Draft s. 127.45(12)-(16) provide for a recapture of some or all of a CT ITC previously claimed by the taxpayer disposing of or exporting a clean technology property within 20 years of acquiring that property, or converting it to a non-qualifying use. An exception is permitted for dispositions to a related person that is itself a qualifying taxpayer, to facilitate transfers within related groups.

Where a clean technology property has been disposed of to an arm’s length buyer (i.e., outside the related-party exception) but continues to be used in a qualifying manner in Canada, the policy

rationale for recapturing the CT ITC is difficult to see. In this regard, the 20-year look-back period seems excessive (and will definitely create more undesirable uncertainty as to the availability of the CT ITC at the outset of the project), and goes well beyond the comparable 5-year period under the analogous U.S. rules. ESC urges the government to reduce the ITC recapture period to 5 years, which should be more than adequate to prevent inappropriate results the ITC recapture rule is directed at from occurring.

Deferral of Addition to Cost of Property

Various provisions of the ITA (including some in the draft CT ITC provisions themselves, such as draft s. 127.45(10)) defer the addition of an amount to the cost of property until a year after the year in which the taxpayer acquires the property. Since the CT ITC is computed with reference to clean technology property acquired in a particular year, it is not clear whether the deferral of an amount to the cost of a particular property has the effect of simply deferring the year in which the taxpayer may claim the associated CT ITC (potentially to a year after 2034) or (conversely) whether such deferral permanently disentitles the taxpayer from claiming the CT ITC in respect of that amount relating to a property actually acquired in an earlier year. It would be helpful for the government to elaborate on these timing issues.