CANADA

Canadian Reforms to Taxation of Fossil Fuel Production

Action Plan

Accelerated Capital Cost Allowance for Oil Sands

Accelerated capital cost allowance (CCA) is available for tangible assets acquired for use in new oil sands projects or major project expansions. The accelerated CCA is an additional allowance that supplements the regular CCA claim (25 per cent on a declining balance basis). The additional allowance allows the taxpayer to deduct in computing income for a taxation year up to 100 per cent of the undepreciated cost of the eligible assets, not exceeding the taxpayer's income for the year from the project.

The accelerated CCA for oil sands projects will be phased out over the 2011-2015 period. The accelerated CCA will be maintained for oil sands assets acquired before March 19, 2007 and those acquired before 2012 that are required for the completion of project phases on which major construction began before March 19, 2007. For other assets, the accelerated CCA will be gradually reduced over the years 2011 to 2014, to 90 per cent, 80 per cent, 60 per cent, and 30 per cent, respectively, of the otherwise allowable accelerated CCA. No accelerated CCA may be claimed on these assets after 2014.

The revenue cost of providing accelerated CCA for oil sands is volatile and can vary considerably from year to year based on project and industry factors. The average cost on a current cash-flow basis over the period 2007-2011 was forecast as $300 million per year.

On May 3, 2010, the Government released detailed draft amendments to the *Income Tax Regulations* to implement the phase-out.

Past Reforms

Resource Allowance

The resource allowance, described below, was phased out, and a deduction for actual royalties and mining taxes paid was phased in (deductible under general principles as a cost of doing business), over the 2003-2006 period. As of 2007, the resource allowance was fully eliminated.

In 1974, the deductibility of Crown royalties and mining taxes in respect of the production of oil and gas and minerals (generally paid to provincial governments) was eliminated. This was a response to concerns that these provincial levies were eroding the federal corporate income tax base. The resource allowance was introduced in 1976 as a rough proxy, to provide recognition in the determination of taxable income, within reasonable limits, that provinces impose royalties and mining taxes.

The resource allowance was a deduction equal to 25 per cent of a corporation's resource profits. The resulting tax deduction could be in excess of, or lower than, actual royalties and mining taxes incurred in a particular year or over the life of a project. In aggregate, the value of the resource allowance became higher than the value of royalties or mining taxes actually paid, so the resource allowance was considered to be a tax expenditure.

The estimated revenue cost of the resource allowance, net of the non-deductibility of Crown royalties, was around $353 million per year (average 2000-2002[1]).

Syncrude Remission Order

The Syncrude remission order, described below, ended on December 31, 2003.

The Syncrude oil sands project was initiated in the early 1970s when Crown royalty charges paid to provincial governments were fully deductible in the computation of income taxes. In May 1976, the federal government granted a remission order to Syncrude participants by Order-in-Council. The remission order permitted project participants to deduct joint venture payments made to the Province of Alberta. This deduction was allowed in addition to the resource allowance, which was introduced in 1976 in the resource sector generally as a rough proxy in lieu of royalty deductibility, which had been removed in 1974.

The estimated revenue cost of the Syncrude Remission Order was around $143 million per year (average 2001-2002 to 2003-2004[2]).

Earned Depletion Deduction

Pursuant to an announcement made in 1987, additions to the depletion pools for earned depletion and mining exploration depletion, described below, were eliminated as of January 1, 1990. Companies now are only entitled to deduct pre-1990 depletion amounts not previously claimed.

Earned depletion was a deduction of up to 33⅓ per cent of certain exploration and development expenses in the oil and gas and mining sectors and of the cost of assets related to new mines (including oil sands mines) and major mine expansions. This deduction supplemented the deduction for actual costs.

The deduction was generally limited to 25 per cent of a corporation's annual resource profits, although mining exploration depletion could be deducted against non-resource income. Earned depletion amounts were pooled and any remaining balance could be carried forward indefinitely for use in later years.

The estimated revenue cost of the earned depletion deduction was around $102 million per year

[1] *Tax Expenditures and Evaluations*, Department of Finance (2005, 2006 and 2007).

[2] *Public Accounts of Canada – Additional Information and Analysis*, Government of Canada (2002, 2003 and 2004).

(1989 figure[3]).

Canada's Experience with Rationalization

Rationalization of the measures described above was facilitated by various factors:

- Consultation with Industry: For example, prior to announcing the phase-out of the resource allowance, the Government undertook an extensive series of consultations with industry on options to improve the tax structure for the resource sector. Following the announcement, the Department of Finance released a detailed technical paper in March 2003 which outlined the rationale for reform.

- Broader Package of Reforms: In certain cases, measures were phased out as part of a broader package of reforms. For example, the elimination of the resource allowance was announced as part of a broader package which included the gradual extension to the resource sector of the lower federal tax rate of 21 per cent that applied in other sectors. The phase-out of accelerated CCA for oil sands was announced together with enhancements to the accelerated CCA for clean energy generation equipment.

- Transitional Relief: The above measures involved a variety of transitional mechanisms, tailored to the situation, in order to provide industry with time to adjust where appropriate or to protect existing investments. Transitional measures included: advance notice of the change before it came into effect, preservation of the old rule for certain projects at an advanced stage at the time of announcement ("grandfathering"), and gradual implementation of the change on a phased basis.

Going Forward

Consistent with the goals set out in Advantage Canada (our 2006 strategic economic plan), Canada will continue to review its policies on an ongoing basis to ensure that they provide an internationally competitive economic environment, while achieving their aims in an efficient manner.

[3] *Personal and Corporate Income Tax Expenditures,* Department of Finance (December 1993). The last full year before phase-out was 1987, but tax expenditure estimates were not published for that year or 1988.