Standing Committee on Finance Submission

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Summary

- Oil sands projects currently qualify for a 100% accelerated capital cost allowance which is a much higher rate than that provided to conventional oil and natural gas.
- The 100% accelerated capital cost allowance for oil sands makes such projects much more attractive than they would be otherwise and, according to the Commissioner on the Environment and Sustainable Development, results in a significant tax concession.[1]
- The Pembina Institute recommends that the Department of Finance eliminate the 100% accelerated capital cost allowance for oil sands and put oil sands on a level playing field with conventional oil and natural gas.
- The money saved by eliminating this preferential tax treatment should be reinvested in low impact renewable energy to facilitate a transition to a sustainable energy future.

Introduction

Governments around the world subsidize a number of socially beneficial services, including health care, education and energy services. **Subsidies to the oil sands sector that accelerate the pace of development, however, are currently not socially or environmentally beneficial.** These subsidies contribute to negative environmental impacts and hinder development of environmentally friendly alternative energy options. Canada's international commitment to reduce greenhouse gas pollution is seriously threatened by continued government support for oil sands developments, a sector with large and rapidly growing greenhouse gas (GHG) emissions**.**

The Accelerated Capital Cost Allowance for Oil Sands

In 2000, the Commissioner of the Environment and Sustainable Development undertook a study on the level of federal government support for energy investments in Canada. One of the key objectives of the study was to determine whether this support favoured the non-renewable energy sector, relative to the renewable energy sector for example. The commissioner was particularly interested in support provided through the federal tax system, as this type of support is less transparent and thus more difficult to track and quantify. While the commissioner found that, in most cases, federal government support for energy investments, including support through the tax system, did not particularly favour the non-renewable sector over the renewable sector, he found oil sands to be an exception.

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[1] Commissioner of the Environment and Sustainable Development. 2000. *Report of the Commissioner of the Environment and Sustainable Development.*

His analysis revealed that oil sands, like all mining investments, receive a significant tax break. With respect to income tax, **oil sands projects qualify for a 100% accelerated capital cost allowance (ACCA)**. With this generous provision in place, a company only pays federal income tax on the income from an oil sands operation once it has written off all of the eligible capital costs. These tax rules make oil sands projects much more attractive than they would be otherwise and, according to the Commissioner on the Environment, result in a significant tax concession.[2] Conventional oil and natural gas qualify for a 25% capital cost allowance, significantly lower than that provided to the oil sands. The 100% ACCA for oil sands provides an incentive that over stimulates the pace of capital investment and development. The federal Department of Finance estimates that the benefit of this tax concession is between $5 million and $40 million for every $1 billion invested (1996$).[3] This translates into potentially billions in deferred tax revenue given recent capital expenditure in the oil sands. Between 1996 and 2005, $42,623 million in capital investment took place in the oil sands. This means that between $202 million and $1,619 million in tax expenditure occurred over the same period of time. The figure below shows the trend in annual tax expenditure on the accelerated capital cost allowance for oil sands. The cost continues to escalate.

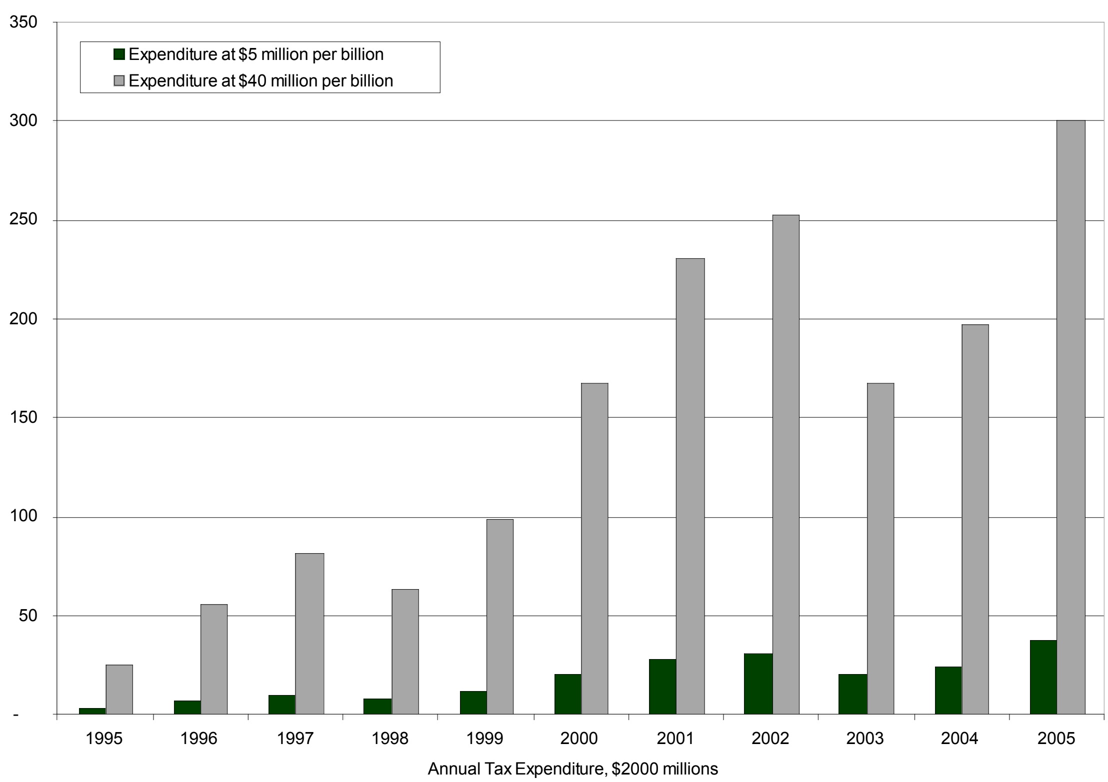

Figure 1 Tax expenditure on the accelerated capital cost allowance, millions (2000$), 1995 to 2005

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[2] Commissioner of the Environment and Sustainable Development. 2000. *Report of the Commissioner of the Environment and Sustainable Development.*

[3] http://cmte.parl.gc.ca/Content/HOC/committee/361/ensu/reports/rp1031515/ensurp02/app-a-e.htm

The oil sands sector claims that they need this tax concession. Yet, they face very different economics today, than they did in 1995, when the accelerated capital cost allowance was recommended for oil sands development. In particular, the price of oil has increased significantly. In 1995, the cost of production was approximately $14 (US$10) per barrel[4] and the world price for oil was about $22. In the fourth quarter of 2006, Shell Canada's Athabasca oil sands project (including mining and upgrading to synthetic crude oil) had operating costs of $24.46 per barrel while realizing an average sale price of $55.56 per barrel.[5] This means that in 1995, operating costs constituted 64% of the value of a barrel of oil. In 2006, operating costs constituted just 44% of the value of a barrel of oil.

In June 2006, the National Energy Board reported that with oil prices at $50, integrated oil sands projects, which mine bitumen and upgrade it to synthetic crude oil, would provide a 16 to 23 percent rate of return. Even at oil prices as low as $30 to $35 per barrel oil, companies would still reap a real rate of return of 10 percent.

This is clearly an unnecessary tax expenditure and a waste of tax payer's money. The oil sands sector no longer needs this preferential tax treatment. They are a highly profitable sector. In fact, the oil and gas industry achieved a historical record for profits in 2005 when operating profits reached $30.3 billion, an increase of 50% over 2004.[6] The oil and gas industry alone accounted for half of the overall profit gain in Canada's non-financial industries in 2005.[7]

Companies with high stakes in the oil sands are among the most profitable companies in Canada. According to the annual survey completed by the Report on Business Magazine, key oil sands players, including Husky, Imperial, Shell, Suncor, Petro Canada, Canadian Oil Sands Trust and Canadian Natural Resources Limited, rank in the top 50 for the most profitable companies in the country. Imperial ranked 5th in 2006 with $2.6 billion in profits-up 27% from the previous year. Shell and Husky ranked 10th and 12th respectively, with profits of more than $2.0 billion each. Petro-Canada isn't far behind, with a 15th place ranking and about $1.8 billion in profits. Suncor, Canadian Natural Resources Limited and the Canadian Oil Sands Trust ranked 24th, 31st and 36th respectively.[8]

The oil sands industry will also claim that if the accelerated capital cost allowance is reduced, there will be a flight of capital from the oil sands. The oil sands are uniquely and positively positioned with respect to global oil reserves. As the second largest oil deposit, and the only major deposit located in a secure, stable environment with unparalleled proximity to an American market, the argument that oil companies will abandon the oil sands rings hollow. One need only look at the nations that join Canada in the top-10 ranking of oil reserves to

[4] National Oil Sands Task Force, 1995, p.24

[5] Shell Canada, Q4 2006 Financial Report

[6] Rowat, Miles Ryan, *Boom Times: Canada's Crude Petroleum Industry,* (Ottawa: Statistics Canada, catalogue no. 11-621-MEI-No. 047, September 2006).

[7] Statistics Canada, *Quarterly Financial Statistics for Enterprises,* (Ottawa: Statistics Canada, Daily February 24, 2006).

[8] "The Top 1000," *Report on Business*, June 2006, http://www.theglobeandmail.com/v5/content/tp1000/index.php#.

recognize that there are fewer and fewer places for oil companies to safely invest given the uncertainty, instability and inhospitable nature of countries like Iran, Venezuela or Nigeria.

The Government's attempt to reconcile the irreconcilable — continued growth of the oil sands sector (and its pollution) aided by public expenditure, and reductions in Canada's total GHG emissions — carries a high price tag. Firstly, taxpayers are financially supporting the industry. But in addition, if Canada is to meet its international obligations, emission increases permitted for the oil and gas sector will have to be compensated — in effect, subsidized — by emission reductions undertaken and paid for by some combination of other industry sectors, general taxpayers, and the public.

Recommendation: A Level Playing Field for Oil Sands

The Pembina Institute **recommends that the Department of Finance eliminate the 100% accelerated capital cost allowance for oil sands** and put oil sands on a level playing field with conventional oil and natural gas. This can be done by eliminating the accelerated treatment currently granted to the oil sands within the *Income Tax Act*. The 100% ACCA for oil sands is a waste of tax payer's money. The money saved by eliminating this preferential tax treatment should be reinvested in low impact renewable energy to facilitate a transition to a sustainable energy future.