

2008 Federal Budget CEA Pre-Budget Submission

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Canadian Electricity Association canadienne de l'électricité



The voice of Canadian Electricity. La voix de l'électricité canadienne.



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Introduction

The Canadian Electricity Association (CEA) founded in 1891, is the voice of Canadian electricity, the only national association representing the views of both public and private companies engaged in the use of all fuels across the generation, transmission, distribution, customer and power marketing sectors of the electricity industry. CEA members also include international manufacturers, suppliers, and consultants to the electricity industry that offers globally renowned expertise in high technology solutions, environmental issues, and asset and risk management.

CEA welcomes the opportunity to provide comment to the Standing Committee on Finance regarding the direction the Government of Canada should take when formulating corporate tax policy. The purpose of this Brief is to offer constructive input to changes in the federal tax system on behalf of the Canadian electricity industry.

Electricity is the critical enabler of the Canadian economy and Canadians' expectations for an enhanced quality of life. CEA members seek to assure a safe, secure, reliable, sustainable and competitively priced supply of electricity, essential to Canada's prosperity. The electricity industry requires tax changes at this time to enhance productivity, improve international competitiveness, and to invest in new technology that will advance the federal government's objectives on clean air and energy efficiency.

In the most recent international tax survey completed by KPMG International, Canada was found to have one of the highest corporate tax rates in the world at 36.1 percent, 33 percent higher than the average European Union rate of 24 percent.¹ The five lowest corporate tax regimes in the world, were also the most competitive economies: Switzerland, Finland, Sweden, Denmark and Singapore, all of which were deemed to be the most competitive economies in the world by the *Global Competitiveness Index (GCI) Report* released by the World Economic Forum in September 2006. Canada ranked 16th on that list, behind Israel and Iceland, while the U.S. ranked 6th overall.² Therefore, the link between competitive corporate taxation and competitiveness globally, seems irrefutable. KPMG in their study also concluded that: *"The way to increase corporate tax revenue is to cut the corporate tax rate."*

The overall health of the electricity industry is crucial to Canadian competitiveness. In order to attract global capital that creates jobs, and to ensure that industrial resource based and energy intensive industries, as well as the growing service sector are competitive globally, the electricity sector must be at the leading edge of R&D and technology. This Brief will outline how the federal government can enhance Canada's economic growth, promote increased industrial and corporate competitiveness, and assist companies to meet clean air objectives.

¹ KPMG's Corporate and Indirect Tax Rate Survey 2007

² http://www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/gcr_2006/chapter_1_1.pdf

Recommendations

Canada today provides nearly 100 percent of its electricity exports to the United States as well as 94 percent of all its natural gas exports. CEA members are a critical part of the trading of power into and out of the United States. Along with crude oil and refined petroleum products, Canada exports over \$41 billion worth of energy annually to the United States.³ For these reasons, the federal government should be sensitive to the fact that Canada needs to be particularly competitive on taxation rates and incentives with the United States. Yet, Canada faces a huge capital infrastructure deficit at this time as it attempts to meet growing domestic and foreign demand for electricity. The International Energy Agency (IEA) has forecast a Canadian electricity infrastructure requirement of USD 190 billion from 2005-2030. Broad measures such as reducing corporate tax rates, and providing targeted enhancements within the Capital Cost Allowance (CCA) regime, will assist companies to meet this daunting investment objective.

The historical notion of “useful life” as the key determinant for establishing tax policy rules and regulation in Canada is outdated. Depreciation rates must be set based on the expected “economic life” of the assets, considering factors, in addition to the physical life of an asset to include the functional life, including:

- Inadequacy
- Changes in demand
- Changes in the physical environment
- Changes in management requirements

³ Canadian Embassy, Canada-United States: The World's largest Trading Relationship (April, 2004)-
<http://www.canadianembassy.org/trade/wltr%202004.pdf>

- Changes in government requirements
- Obsolescence due to the introduction of new technologies.

Recommendation 1

Set depreciation rates on the expected “economic life” of assets, taking into consideration inadequacy, obsolescence, changes in technology, in demand, in the physical environment, in management requirements and in requirements of governments.

Policy uncertainty when added to the rapid regulatory, environmental, technological, and other risks faced by electric utilities in Canada today, indicate the notion that all electricity assets have longer-term economic viability is simply no longer the reality. The electricity industry instead, is hampered in modernizing its stock, investing in leading edge technologies, and in providing enhanced environmental performance.

The *Advantage Canada* plan states that Canada needs a business tax advantage to encourage businesses to invest in Canada instead of other countries. A glaring example of the existing tax system in Canada being unattractive to investors is found in CCA rates for new infrastructure. New investment in electricity infrastructure is set at 8 percent, reflecting a 25-year useful life under our tax system. For new transmission build in the United States however, the U.S. Energy Policy Act (EPACT) of 2005 has already brought transmission infrastructure (greater than 69 KV lines) depreciable lives down to 15 years (reflecting a 12 percent CCA rate equivalent) and provide for other incentives in congestion zones. As well, the House of Representatives are considering a provision in a new committee provision for the energy bill to reduce distribution equipment

depreciable lives to 15-years. Therefore, Canada continues to be significantly out of step with our largest trading partner on attracting capital for much needed new strategic infrastructure. Compounding the tax inequity are the Canadian rates of return that are approximately 10 percent, while U.S. rates of return are in the 13.5 percent range which make it a superior choice for capital investment.

Recommendation 2

Increase the CCA rates from 8 to 12 percent for investments in transmission and distribution infrastructure to encourage modernization of the grid systems.

On modernizing the United States' entire electricity grid, a 5-year accelerated depreciation provision for Smart Meters and related infrastructure is being considered in the US Congress. Canada fails to differentiate between innovative distribution assets by continuing to treat Smart Meters and Advanced Metering Infrastructure (AMI) that are comprised of IT, telecom, electronics and software, as part of the "distribution plant". Improving Canada's distribution networks would be a huge strategic goal that would enhance productivity and competitiveness by ensuring improved power quality, grid reliability, and greater energy conservation.

Recommendation 3

Reclassify Smart Meters and AMI, primarily used in the distribution of electricity, from a CCA rate of 8 percent to a more equitable CCA rate of 45 percent to encourage energy conservation among consumers.

Capital is mobile and will not migrate to uncompetitive regimes. Therefore the federal government must ensure that corporate taxation in Canada is competitive with that in other countries. In a recent Conference Board of Canada study, Canada's performance in Innovation was rated as a disappointing 14th out of 18th place, with the report further commenting: "Innovation is fundamental to Canada's productivity and competitiveness. It is also fundamental to Canada's performance in education, health, society and the environment...We lag in investment in R&D and in machinery and equipment and we produce a lower share of graduates in science, engineering and the trades..."⁴

Recommendation 4

Reduce corporate income tax rates to 18.5 percent (effective 2011) be advanced to 2008, with further reductions to follow.

On capital investment, Canadian R&D continues to lag behind other countries on a global basis. Although the SR&ED Tax Incentive Program provides more than \$2.5 billion⁵ in aid to private sector innovation, the program is in decline and faces stiff competition. As the Canadian dollar rapidly continues its ascent, capital will continue to flow away from Canada as R&D is conducted in emerging lower cost economies. According to the Canadian Advanced Technology Alliance ("CATA Alliance"), the SR&ED system requires immediate action to foster national efforts at innovation that are globally competitive.

⁴ Conference Board of Canada, "How Canada Performs- A Report Card on Canada", pg. 4

⁵ CATA Alliance Executive Briefing July/August 2007

Recommendation 5

CEA supports the views of the CATA Alliance which include improving the SR&ED system in Canada so that the following issues are addressed:

- **Refundability**
- **Scope**
- **Improving administrative practices**
- **Interpretive issues on complexity of the legislation**
- **Technical analysis: best case practices in other countries⁶**

The Conference Board of Canada Study on Canada's Performance cited for poor performance by Canada on the environment, with only the U.S. and Australia having higher per capital GHG emissions.⁷ While Canada has the disadvantage of having a resource intensive economy, coupled with a colder climate and expansive geography, there are tax based strategies Canada can implement. CEA has been asking the federal government to re-enact Class 24 (air) and Class 27 (water) to achieve a higher CCA rate than 8 percent to incent electric utilities that use coal to install the best available Canadian made technologies in pollution control and abatement equipment. The U.S. EPACT 2005 has already reduced the cost recovery period from 20 to 7 years for pollution control equipment. CEA believes this will translate to \$4 billion in capital expenditures, help mitigate air pollution and smog, and act as a "bridge" solution until Carbon Capture and Storage (CCS) and Integrated Gasification Combined Cycle (IGCC) technology becomes commercially viable.

⁶ CATA Alliance, SR&ED Tax Credits Campaign

⁷ COB, Ibid, page 7

Recommendation 6

Re-enact both Class 24 (air) and Class 27 (water) in the federal regulations, for a 5-year period to achieve lower emissions in Canada.

Energy efficiency is an effective strategy to help reduce air emissions. More needs to be done to encourage Canada to achieve its energy efficiency potential. The federal government must focus on energy efficiency as a strategic energy policy that is supported by a long-term and sustained commitment to energy efficiency programs and incentives. CEA believes the federal government should establish a Federal Energy Efficiency Grant program to fund Energy Efficiency programs. The Energy Efficiency Grant Program would provide an opportunity to support programs yielding significant energy savings but which are not cost effective to deploy on an individual utility basis or which do not pass regulatory economic tests. Funding would fill in gaps in program access (through existing programs such as the ecoENERGY suite) and help mitigate utility market differentials that impact the business case for energy efficiency.

Recommendation 7

Establish a Federal Energy Efficiency Grant program to fund Energy Efficiency programs that would fill in gaps in program access and help mitigate utility market differentials that impact the business case for energy efficiency.

Conclusion

The Canadian electric utility industry seeks to hold further collaborative and constructive dialogue on the recommendations contained in this Brief with the Standing Committee and the federal government. CEA believes that broad based tax reform is a meaningful goal for the government to pursue, as it increases the amount of disposable income available for individuals as well as enhances corporate productivity. Enhanced corporate productivity in the electricity industry is required to encourage more R&D and greater capital investment that will continue to create jobs and drive the broader economy well into the future. Broad tax reform should include lower corporate taxes that over the longer term will increase federal revenues, economic competitiveness, and wealth creation. Finally, improved corporate tax treatment will lead to lower greenhouse gas emissions, reduced air pollutants, and encourage energy efficiency.

Summary of Recommendations

To create fair tax policy that considers the externalities that impact the actual usefulness of an asset, CEA recommends that the government:

- Set depreciation rates on the expected “economic life” of assets, taking into consideration inadequacy, obsolescence, changes in technology, changes in demand, and changes in requirements of governments.

To modernize the ageing transmission and distribution grids in Canada, and to compete with other capital opportunities available to global investors:

- Increase CCA rates from 8 percent to 12 percent for transmission and distribution

infrastructure to encourage modernization.

Re-classifying Smart Meters and AMI technology as technologies that are not synonymous with “distribution infrastructure” will provide consumers with an opportunity to conserve electricity:

- Reclassify Smart Meters and AMI technology from a CCA rate of 8 percent to a higher CCA rate of 45 percent.

To encourage Canadian industry to become more innovative, the SR&ED system will require reconfiguration such that the views of the CATA Alliance should be addressed, namely:

- Expand refundability to large corporations, broaden the scope by making SR&ED incentives available to limited partners up to their risk amount, allow the credits to be applied to other taxes including payroll taxes, streamline the administration of the program, and remove restrictions to access the credits by companies with losses.

Lower corporate income taxation is required to enable corporate Canada to realize its national competitiveness on par with other industrialized nations, CEA recommends:

- That the corporate rate reduction to 18.5 percent (effective 2011) be advanced to 2008, with further reductions to follow.

Given the federal government’s desire to reduce greenhouse gas emissions and improve air quality for all industries, CEA recommends the temporary re-instatement of dormant regulations:

- Re-enactment of both Class 24 (air) and Class (27) for a period of 5 years.

To improve the business case for energy efficiency, CEA recommends:

- Establish a Federal Energy Efficiency Grant program to fund Energy Efficiency programs that would fill in gaps in program access and help mitigate utility market differentials that impact the business case for energy efficiency

CEA has demonstrated the need for the government to reduce corporate taxation, improve the CCA regime for new infrastructure and emerging technologies, improve the SR&ED system – all of which will lead to greater innovation, prosperity, and help to restore Canada's global competitiveness. CEA believes that these measures, if implemented, will address the concerns of the Standing Committee on Finance in advancing Canada's economic growth including job creation, the generation of additional federal revenues to fund social programs, and in meeting federal objectives on climate change and the environment.

