

CEA Pre-Budget Submission

September 5th, 2006

Canadian Electricity Association *canadienne de l'électricité*



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



Canadian Electricity Association
Association canadienne de l'électricité
www.canelect.ca

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Introduction

The Canadian Electricity Association (CEA) is pleased to provide the Government of Canada with policy, legislative and regulatory recommendations to improve Canada's investment landscape for electricity, a critical foundation to Canada's prosperity. The recommendations, if implemented, will help promote competitiveness and enhance national productivity and security.

For decades, reliable, low-cost electricity has been a competitive advantage, enabling Canadian business to prosper and individual Canadians to enjoy a high quality-of-life. Electricity powers the Canadian economy and provides safe, secure and reliable energy for all Canadians. To meet the future challenges of ensuring that the national economy remains competitive and that Canadians benefit from sustainable environmental stewardship, action will be required to ensure that electricity can continue to contribute as an enabler of future prosperity.

As the economy continues to expand, the demand for electricity continues to grow, even taking into account significant efforts to use electricity more efficiently. The challenges facing the Canadian electricity sector are significant: meeting new demand as well as replacing aging infrastructure. Based upon the International Energy Agency (IEA) estimates, investments in the order of \$212 (US) billion over the next 25 years are required to ensure that infrastructure is maintained, facilities are in-place to meet new demand, and Canadians continue to benefit from secure, safe, and reliable electricity.

Given long planning horizons and construction lead times needed for new infrastructure, ensuring an efficient, diverse and reliable power supply for tomorrow depends on investment decisions made today. The Canadian electricity sector competes within international capital markets where demand for investment worldwide is high. Appropriate fiscal and tax regimes are crucial to ensure that the Canadian industry can compete for needed capital. In order for the electricity industry to meet Canada's future needs, significant investment in conventional and emerging generation, transmission and distribution technologies, as well as human resources development and energy efficiency will be required.

In this submission, CEA is proposing a series of recommendations designed to foster a more competitive business environment to ensure a strong and sustainable electricity industry in Canada. While we have grouped the recommendations based upon the questions posed by the House of Commons Standing Committee on Finance, we recognize that there is an inter-relationship between all, and that each of the recommendations addresses more than one objective in the Committee's questions.

CEA also calls for renewed action in support of more efficient and timely regulatory regimes in order to improve the conditions for investment in Canada's electricity sector. CEA believes that a more effective, coordinated approach to regulation is critical to attracting investment. Accordingly, CEA urges the Government to take actions to foster better coordinated and more timely provincial, territorial and federal regulatory regimes.

CEA thanks the Committee for the opportunity to share its views on how electricity can continue to play a central role in an environmentally sustainable, competitive and prosperous Canadian future.

CEA Budget Recommendations In Brief:

Health and Labour Skills of Canadians

1. Re-enact Class 24 (air) and Class 27 (water) to incent the electricity industry to improve air quality of Canadians by implementing state-of-the-art pollution controls and abatement equipment on its thermal generating stations.
2. Support a robust Foreign Credential Recognition Program and ensure the immigration system facilitates the entrance of skilled trade workers aligned with Canadian labour market requirements.

Competitiveness

1. Amend Section 162 (2) of the Excise Tax Act to provide GST relief to payments for rights to use and exploit wind resources in Canada that will eliminate the administrative burden to the wind industry.
2. Lower corporate tax rates to 19 percent immediately as opposed to reducing the rate by 2010 as outlined in Budget 2006. Reduce corporate tax rates over time to 17 percent to enhance competitiveness.
3. The Federal government should establish a Federal Energy Grant for Energy Efficiency programs.

Infrastructure

1. Enhance CCA rates for the electricity industry in generation, transmission and distribution to 12 percent from 8 percent for new investment, to accelerate the replacement of older capital stock to improve environmental performance and industrial competitiveness. Remove the inequity of distinguishing between used and new equipment to jumpstart capital stock change-out by harmonizing rules for used equipment that has inherently shorter lives.
2. Reclassify Smart Meters and all Advanced Metering Infrastructure (AMI) from a CCA rate of 8 percent to a CCA rate of 45 percent for communications software, firmware and related Information Technology (IT) components, and a CCA rate of 12 percent for hardware. This would encourage energy conservation through the faster deployment to customers of smart meters and AMI.

Innovation

1. Amend Section 127(8) of the Income Tax Act to allow active partners in LLPs to utilize SREDS that provide new solutions to electricity technology challenges.
2. Permit SREDS to be refundable and extendable to all research performers while allowing the unused portions of the tax credit to offset other levies, to spur industrial innovation.

CEA Recommendations

Section I: Health and Labour Skills of Canadians

1. Re-enact Class 24 (water) and Class 27 (air)

The electricity industry faces challenges to enhancing its productivity while simultaneously meeting more stringent environmental regulations including new air quality standards established by governments. All levels of government are considering aggressive targets to improve air and water quality.

The Government of Canada should re-activate Class 24 (water) and Class 27 (air) to assist the industry in investing in pollution control equipment to improve air and water quality. In 1994, the federal government decided to phase out these classes by 1998. As such, Canada is now out of step with U.S. tax rules as amended by the Energy Policy Act of 2005 that allows for a 7-year recovery period for the cost of certain certified air pollution control facilities used in connection with electricity generating plants (coal-fired). Alternatively, all eligible pollution abatement equipment for water and air can be inserted directly into Class 43.1 as they serve to improve the environmental performance of thermal oriented generation equipment, but with a 50 percent CCA rate.

While CO₂ is not a pollutant, it is captured under provisions of the *Canadian Environmental Protection Act* (CEPA). Class 27 should also take into account covered air emissions such as CO₂.

International Best Case Practices:

1. The Netherlands uses an Environmental List for a range of environmental technologies that the government agrees meet a set of defined criteria – technologies on the list are eligible for 100 percent write-off and reviewed regularly to incent only the most innovative technologies.
2. The UK's system of Enhanced Capital Allowances (100 percent first year write-off) currently includes a category of investments for water saving and water quality plant and machinery. In order to qualify for the incentive, technologies must meet certain criteria and a proposal must be accepted by the Department of Environment, Food and Rural Affairs.

Recommendation:

Re-enact Class 24 and Class 27 at a 50 percent straight line with the half-year rule, with Environment Canada or NRCan approving eligible assets that will improve air and water quality as well as the health of Canadians while simultaneously boosting productivity and competitiveness. The provisions can be deemed finite with a 5-year utilization window ending in 2012.

2. Foster resource and skills development in Canada

Canada faces an urgent need to attract and retain a skilled workforce to ensure a reliable supply of electricity as the electricity sector workforce faces a possible 40 percent retirement crunch by 2015. CEA supports the newly established Electricity Sector Council as an example of a strong public-private partnership that requires on-going federal support.

However, foreign skilled workers face impediments in entering the workforce including foreign credential recognition, visa and security restrictions. Recruitment and retention issues require the government to support school-to-work transitions and career awareness strategies. Finally, there is increased potential for the electricity sector and governments to engage aboriginal communities and train people for work in this sector via a new fund for collaborative support.

Recommendations:

- 1. Support more aggressively HRSDC's Foreign Credential Recognition Program to complement the Canadian Council of Professional Engineer's initiative and execute an action plan to integrate international engineering graduates more quickly into the Canadian labour market.**
- 2. Citizenship and Immigration Canada should ease visa restrictions from a select list of countries where work opportunities in Canadian trades can be met.**
- 3. The Immigration Point System should be better aligned with Canadian labour market information to secure more skilled trade workers.**

Section II: Competitiveness

1. Eliminating GST on Royalty Payments on Wind Energy

CEA and the Canadian Wind Energy Association (CanWea) have jointly made representations to the Department of Finance on the need to eliminate GST on royalty payments on wind energy developments. The wind power industry is growing rapidly in Canada in part due to emerging provincial renewable portfolio standards, procurement targets, and federal incentives under the Wind Power Production Incentive (WPPI) in concert with applicable Canadian Renewable and Conservation Expenses (CRCE) / Class 43.1 policies. The Canadian electricity industry supports an ongoing federal commitment to these programs. Currently, there are several thousand megawatts of new wind energy being proposed primarily by independent power producers. Most projects being developed are on private lands, secured through land leases that provide a royalty payment to landowners that can equate to up to 2 percent of gross revenues.

Certain wind projects require 100 or more landowner agreements, with project developers required to pay GST on land lease payments to GST registered landowners. This imposes a significant administrative burden on the wind industry, and is inequitable when contrasted to the treatment of developers for other natural resources.

Recommendation:

Domestic tax equity within the resource sector requires an amendment to Section 162 (2) of the Excise Tax Act to provide GST relief to payments for rights to use wind resources.

2. Corporate Tax Rates

Reduce the federal corporate tax rate further from 21 percent to 19 percent, earlier than 2010, as promised in Budget 2006. Consider lowering the corporate taxes to 17 percent to provide Canada with a competitive boost to offset higher labour and dollar costs for the manufacturing and resource sectors. Improving the corporate tax treatment for industry will foster a more competitive and productive economy.

Recommendation:

Reduce Corporate Tax rates to 19 percent now, and 17 percent in the next five years.

3. Energy Efficiency

Energy efficiency requires long term and sustained funding for energy efficiency programs commensurate with renewable energy and other supply options. The Government of Canada should ensure that energy efficiency programs are funded with provincial/territorial and utility partners on a long-term basis in order to reap the full benefits of these programs

Recommendation:

The Government of Canada should establish a Federal Energy Efficiency Grant program to fund Energy Efficiency programs.

Federal Energy Efficiency Grant Objectives

The Energy Efficiency Grant Program would provide an opportunity to support programs yielding significant energy savings but are not cost effective to deploy on an individual utility basis. Funding would fill in gaps in program access and help mitigate utility market differentials that impact the business case for energy efficiency. Finally, additional resources are needed where individual organizations cannot provide incentives and resources of sufficient significance to influence the market. A national focus on improved energy efficiency is needed that complements regional efforts to significantly increase market impact.

Examples of Federal Energy Efficiency Grant Recommendations:

- A federal core program should be used as the basis for a comprehensive suite of programs, implemented under a single brand across multiple product categories and which includes labeling, incentives and measurement of energy efficiency results.
- Multi-year support is needed for housing and equipment standards and labeling.
- Program support for commercial facilities such as ice rinks and community centers is required.
- Tax incentives such as a rebate program for residential, commercial and institutional markets are required to encourage widespread upgrading to Energy Star appliances.
- A national lighting initiative is required to improve the energy efficiency of lighting in Canada.



Section III: Infrastructure

The electricity industry faces a massive need to re-capitalize and turn over older stock. Enhancing CCA rates for the electricity industry in generation, transmission and distribution to 12 percent from 8 percent to foster new investment, accelerate the replacement of older capital stock and improve environmental performance and industrial competitiveness. Removing the inequity of distinguishing between used and new equipment would jumpstart capital stock change-out by harmonizing rules for used equipment for the electricity industry since used equipment have inherently shorter lives.

1. CCA Rates

Generation Assets

Improving CCA rates for new generation will help address air and other environmental challenges while improving national competitiveness. Supply technologies are capital intensive and require long lead times. Incentives are needed to encourage supply to turn over aging capital stock. As well, significant tax inequities remain between the U.S. and Canada, especially within the nuclear technology sector (e.g. CCA rate of 8 percent in Canada for new investment, versus an equivalent 12 percent in the U.S. for new nuclear plant and 30 percent for nuclear fuel assembly rods).

Transmission and Distribution Assets

CEA acknowledges the enhanced CCA rate of 8 percent for new investment in transmission and distribution assets announced in Budget 2005. However, it should be noted that Canadian tax treatment has slipped relative to U.S. tax treatment as a result of the U.S. Energy Policy Act 2005. U.S. tax treatment now allows for new transmission and distribution assets to receive a 15-year amortization period (equivalent to 12 percent CCA).

Treatment of Used Equipment

Economic lives for used assets are inherently shorter than for new assets. Used assets should be at least harmonized with the existing rules for new assets, to account for a far shorter remaining life of the asset. The electricity sector remains one of the only major industries where this inequity remains.

Recommendation:

CEA recommends the Federal Government enhance CCA rates to 12 percent for new supply especially in the area of nuclear power, and by improving CCA rates to 12 percent for new transmission and distribution assets, and remove an unwarranted impediment to capital stock turnover by harmonizing rules for used assets by recognizing inherently shorter lives.

2. Advanced Metering Infrastructure (AMI)

AMI is defined as technology that allows for differentiated time-based (i.e. real-time) pricing and demand response programs. AMI technology can assist in conserving energy by enabling utilities to provide customers with enhanced services such as load management. Further deployment of AMI technology is urgently required at this time since a particular characteristic of the Smart Meter includes the ability to support utility-led energy conservation programs that would reduce costs to consumers and emissions in thermal dominated regions. While some jurisdictions have mandated the deployment of AMI

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technology, tax treatment more inline with the inherent components of these devices would help incent their use across the country.

Recommendation:

AMI technology, including “Smart Meters” and related AMI equipment require an incentive rate in the order of 45 percent CCA rate for communications software, firmware and related information technology components, and 12 percent CCA rate for hardware. This would encourage energy conservation through the faster deployment to customers of smart meters and AMI.

Section IV: Innovation

Scientific Research & Experimental Development Tax Credits (SREDs)

Canada's ranks 15th within the OECD community for business expenditures on R&D. SR&ED tax credits are vital to both Canadian economic growth and productivity. They can encourage private capital to invest in various Canadian industries. As such, CEA has two areas of concern that require the Federal Government to make modifications, via legal structure, and in the area of refundability. *(Source: “Improving Productivity Through Changes to the Federal SR&ED Tax Program”, A Joint ITAC-OCRI Position Paper, by Bill Toms and David B. Watters, June 2006, page 6 and page 22-23).

Limited Liability Partnerships (LLPs) in the Electricity Generating Industry

LLP structures are a preferred setup to expand electricity generation capacity and share the risk with investors. Electric utilities and independent power companies are profitable and do not pursue non-profit solutions. Partners are generally corporations active in the same or similar business. Under Subsection 127(8) of the ITA, flowthrough of tax credits to limited liability partners is presently denied. This is an impediment to SR&ED investment in the electricity generation industry in Canada as there is an uneven playing field for partnerships as compared to corporations. In the United States, R&D Credits provide a 20 percent tax credit on qualified costs and R&D tax credits apportioned to partners of a partnership. Equal treatment for both corporations and partnerships is required to create economic incentive to conduct R&D. Access to SREDs would provide equality with the U.S credit system while retaining R&D in Canada.

SR&ED Refundability Issues

The SR&ED Tax Credits program is a proven instrument to enhance innovation in Canada. Despite certain carry forward and carry back provisions extended in Budget 2006, the program only applies to credits earned after 2005. Significant amounts of earned tax credits often remain unused due to lack of taxable income by the research performer. Rapidly growing firms and firms investing heavily in capital equipment and innovation often lack sufficient taxable income to take advantage of the tax credits. Other mechanisms to allow some of the benefits to be transferred, such as flow-through shares (e.g. mining, oil and gas industries), help companies raise equity. This technique is being used as well in wind and small hydro projects. Additionally, investors in Special Recovery Share Purchase Tax Credits could transfer tax credits to new share purchasers. The SR&ED Tax Credits program already recognizes this principle by virtue of the refundable provisions for earned but unused tax credits for small businesses.

Recommendation:

CEA recommends that Subsection 127(8) of the ITA now allow the flow-through of tax credits to limited liability partners, and the refundable feature of the SR&ED Tax Credits be extended to research performers of all sizes. Finally, unused amounts of the tax credit should go to offset other levies due to the federal government, such as the employer portion of the Employment Insurance or CPP premiums, providing real value to large corporations.

Conclusion

Electricity is a vital component of our quality of life and the foundation of a thriving economy. In order to help optimize the potential of Canada's electricity system, CEA calls on the Government of Canada to implement the recommendations contained in this brief. These policy actions, if realized, will contribute to ensuring an electricity system that meets the needs of all Canadians in the near and long-term.