GREEN BUDGET COALITION

FOSSIL FUEL SUBSIDY REFORM

Recommendation Summary

The Green Budget Coalition (GBC) recommends that the Government of Canada phase-out, through a legislated schedule in Budget 2017, all tax provisions that provide preferential treatment to the fossil fuel sector, including the:

- Accelerated Capital Cost Allowance (ACCA) provided to Liquefied Natural Gas projects that was introduced in Budget 2015[6];
- Flow-through Share Deductions available to investors in the oil and gas sector through the acquisition of shares and through limited partnerships; and,
- Canadian Exploration Expenses immediate write-offs.

In addition to the above, the GBC recommends that the Government of Canada phase-out before 2020 the fossil fuel component of all federal tax provisions, production subsidies, and fiscal instruments, including the:

- Canadian Development Expense;
- Duty Exemption for Imports of Mobile Offshore Drilling Units in the Atlantic and Arctic;
- Canadian Oil and Gas Property Expense; and,
- Foreign Resource Expense (FRE), and Foreign Exploration and Development Expense (FEDE).

Financial Savings: Approximately $1.5 billion in annual savings

The GBC further calls on the Government of Canada to:

- Announce a comprehensive review to quantify and publicly report the costs of all federal direct spending, production subsidies, tax deductions and all other public support available to coal, oil and gas, and the natural gas industry. We recommend this information be provided to the Parliamentary Budget Office and the Department of Finance in time for the pre-budget economic and fiscal outlook and in order for anticipated revenues to be included in Budget 2018 and subsequent federal budgets.
- Initiate work with partner countries, in the context of the G7 and G20 commitments, to define efficient fossil fuel subsidies.

6 Despite the fact that the new ACCA for the liquefied natural gas sector is set to expire in 2025, the Green Budget Coalition recommends that it be revoked immediately in Budget 2017.

Background and Rationale

Many of these tax preferences and accelerated deductions recommended for reform date back to the 1970s and have since outlived their original objectives.[7] These measures were historically premised on factors such as exploration risk, spillover benefits of exploration to third parties (similar to R&D), large capital requirements, price volatility, and a desire to be competitive. Today, however, it is not clear that these factors are unique to the mining and fossil fuel sectors, or that these sectors merit preferential treatment.

7 Sawyer, Dave and Seton Stiebert, 2010, http://www.iisd.org/gsi/sites/default/files/ffs_awc_3canprovinces.pdf

The Government of Canada has reiterated its commitment to phase out inefficient fossil fuel subsidies including in the G7[8], G20 [9] and APEC[10] communiqués. At the North American Leader's Summit (NALS) in Ottawa in June 2016, the Government of Canada restated its commitment to phase out such subsidies by 2025.[11]

8 G7. 2016, 26-27 May. G7 Ise-Shima Leaders' Declaration, available at: http://www.mofa.go.jp/files/000160266.pdf
9 IISD. 2015. Fossil fuel subsidy reform in Canada: A post-partisan issue, available at: https://www.iisd.org/blog/fossil-fuel-subsidy-reform-canada-post-partisan-issue
10 APEC. 2015, 19 November. 2015 Leaders' Declaration, available at: http://www.apec.org/Meeting-Papers/Leaders-Declarations/2015/2015_aelm.aspx
11 NALS. 2016, 29 June. Leaders' Statement on a North American Climate, Clean Energy, and Environment Partnership,

The GBC commends these commitments in principle. However, policy clarity is needed on what governments consider as "efficient" subsidies and its implication on the timely phase out of fossil fuel subsidies. The GBC recommends that all direct subsidies, preferential tax treatment, other fiscal instruments, and all other public support provided to producers of coal, oil, and natural gas (including liquefied natural gas) be removed by 2020, ahead of the G7 and NALS timeline.

Eliminating fossil fuel subsidies falls within the purview, and is referenced in the mandate letters, of the Minister of Finance[12] and the Minister of Environment and Climate Change.[13] It can support the Government's efforts related to the pan-Canadian framework for clean growth and climate change. Fossil fuel subsidies can distort the market and undermine Canada's climate objectives. Furthermore, the Government of Canada has committed to introducing a national price on carbon by 2018. It is important to note that fossil fuel subsidies act as a negative price on carbon and can undermine the principle objectives of carbon pricing.

Furthermore, Canada has supported the Friends of Fossil Fuel Subsidy Reform communiqué,[14] along with 83 other countries and major corporations. The Communiqué recognizes that the elimination of fossil-fuel subsidies would make a significant contribution to reducing global greenhouse gas emissions and that "accelerating the reform of fossil-fuel subsidies is therefore an urgent priority." The GBC's recommendations would allow Canada to meet the principles agreed to in the Communiqué related to communication and transparency and ambition in the scope and timeframe for implementing subsidy reform.[15]

The federal government should also work with other levels of government to identify opportunities and encourage the phase out of subnational fossil fuel subsidies. In addition to the GBC recommendations below, the pan-Canadian framework should include an agreement on a set of common fiscal principles to reform federal and provincial tax systems to encourage investment in clean and low carbon sources of energy.

available at: http://pm.gc.ca/eng/news/2016/06/29/leaders-statement-north-american-climate-clean-energy-and-environment-partnership

12 Canada, Office of the Prime Minister. 2015. Minister of Finance Mandate Letter, available at: https://pm.gc.ca/eng/minister-finance-mandate-letter

13 Canada, Office of the Prime Minister. 2015. Minister of Environment and Climate Change Mandate Letter, available at: https://pm.gc.ca/eng/minister-environment-and-climate-change-mandate-letter

14 Friends of Fossil Fuel Subsidy Reform. 2016. Fossil-Fuel Subsidy Reform Communiqué, available at: http://fffsr.org/communique/

15 Friends of Fossil Fuel Subsidy Reform. 2016. Fossil-Fuel Subsidy Reform Communiqué, available at: http://fffsr.org/communique/

Recommendations

The GBC recommends that the following measures for the fossil fuel sector be eliminated:

The Accelerated Capital Cost Allowance (ACCA) provided to Liquefied Natural Gas projects.
Budget 2015 introduced a new ACCA treatment for assets used in facilities that liquefy natural gas, and Budget 2016 locked in the tax expenditure until 2025.[16] This new ACCA allows investments in eligible equipment used for natural gas liquefaction to be written off from taxable income at a substantially higher rate: a 22 percent allowance that brings the CCA rate up to 30 percent for those eligible expenses. For non-residential buildings used at a facility that liquefies natural gas, the ACCA was increased to 10 percent.
Estimated Savings: $9 million per year[17]

Flow-through Share Deductions available to investors in coal, oil, and gas projects.
This tax benefit enables corporations to pass on (renounce) certain amounts of their CEE and CDE to shareholders, who can then claim the resulting tax deductions themselves.[18]
Estimated savings: $133 million[19]

Exploration Limited Partnerships.
Profit gains from exploration limited partnerships are taxed as capital gains, for which the tax rate is 50 percent.[20]
Estimated savings: Unknown

The Canadian Exploration Expense (CEE) tax deductions.
The CEE allows for further deductions, at a rate of 100%, for costs incurred for geological, geophysical, and geothermal (G3) surveys and exploratory drilling. CEE are expenses incurred for the purpose of determining the existence, location, extent, or quality of petroleum, natural gas or a mineral resource in Canada. Until 2018, CEE also included expenses incurred for the purpose of bringing a new mine into production, including clearing,

16 Budget 2016, Chapter 8, p.221: http://www.budget.gc.ca/2016/docs/plan/budget2016-en.pdf.

17 Budget 2015 projected the deferral of tax associated with this measure would reduce federal tax revenue by $45 million over the 2015–16 to 2019–20 period. Strong Leadership, a balanced budget, low tax plan for jobs, growth and security, tabled in the House of Commons on April 21, 2015 p.212. http://www.budget.gc.ca/2015/docs/plan/toc-tdm-eng.html

18 Oil Change International, Overseas Development Institute, International Institute for Sustainable Development, November 2015: https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9988.pdf.

19 OECD, 2016. OECD analysis of budgetary support and tax expenditures: Canada. Data extracted on 13 Sept 2016. http://stats.oecd.org/Index.aspx?DataSetCode=FFS_CAN

20 International Institute for Sustainable Development, September 2016. Estimate based on 2013-2015 data. http://www.iisd.org/faq/ffs/canada/

removing overburden and stripping, and sinking a mine shaft.[21]
Estimated savings: $148 million per year[22]

The Canadian Development Expense tax deductions (CDE).
At present, oil and natural gas producers and mining companies can claim up to 30% of expenses against taxable income for a wide range of drilling, development and excavation expenses. After 2017, mining pre-production development expenses will be fully transitioned from being considered exploration expense to falling under the purview of the CDE as well. The cost of any Canadian mineral property, or of any right to or interest in any such property also qualifies as a CDE. CDE are accumulated in a pool called Cumulative Canadian Development Expenses (CCDE), from which the company can deduct up to 30% of the unclaimed balance at the end of each year; unclaimed balances may be carried forward indefinitely.[23]
Estimated Savings: $1.018 billion per year[24]

Duty Exemption for Imports of Mobile Offshore Drilling Units in the Atlantic and Arctic.
This tax break was originally designed to promote offshore oil and gas exploration in the Atlantic and Arctic. The duty exemption was rendered permanent in Budget 2014.
Estimated savings: Unknown

The Canadian Oil and Gas Property Expense (COGPE).
The COGPE allows oil and gas companies to claim a 10 percent deduction from taxes for the costs of acquiring oil and gas wells and rights.
Estimated savings: $36 million per year[25]

The Foreign Resource Expense (FRE), and Foreign Exploration and Development Expense (FEDE).
These credits currently enable Canadian mining companies to deduct 30% of exploration expenses incurred overseas. Data is not available to estimate the amount of foregone federal tax revenues for these two measures.
Estimated savings: Unknown

The GBC also recommends that the Department of Finance undertake a comprehensive review to quantify and publicly report the cost of all production subsidies and tax credits to coal, oil and gas, including the fuel transport and refining sectors. This will require that tax expenditures specific to fossil fuels be disaggregated from those available to the mining sector.[26] In addition, categorizing the tax expenditures available within the energy sector (i.e. to oil, gas, coal, wind, geothermal, solar etc.) will be necessary to determine the impact of the tax system on investments in clean energy, and to enhance existing tax measures to generate more clean technology investments.

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21 Budget 2011 proposed that development expenses incurred for the purpose of bringing a new oil sands mine into production in reasonable commercial quantities be treated as Canadian Development Expenses (CDE) rather than CEE as in the past. Budget 2013 further proposes that pre-production mine development expenses be treated as Canadian Development Expenses (CDE) which are deductible on a 30% declining-balance basis. (Source, Natural Resources Canada, 2014)

22 International Institute for Sustainable Development, September 2016. Estimate based on 2013-2015 data. http://www.iisd.org/faq/ffs/canada/

23 Natural Resources Canada. 2014. 'Mining-specific Tax Provisions'. Ottawa. Government of Canada. http://www.nrcan.gc.ca/mining-materials/taxation/mining-taxation-regime/8892#lnk11

24 International Institute for Sustainable Development, September 2016. Estimate based on 2013-2015 data. http://www.iisd.org/faq/ffs/canada/

25 International Institute for Sustainable Development, September 2016. Estimate based on 2013-2015 data. http://www.iisd.org/faq/ffs/canada/

26 The costs of the following tax deductions are particularly difficult to accurately and reliably estimate: the Canadian Development Expenses, the Canadian Exploration Expenses, the Canadian oil and gas property expense, the Foreign Resource Expense, and Foreign Exploration and Development expense. These are deductions of capital costs that can be pooled each year and then claimed whenever the owner chooses to, and the data specific to these tax deductions does not appear to be readily available. The most recent analysis for this from Finance Canada appears to be Part 2 of the Tax Expenditures and Evaluations 2012, Tax Expenditures for Accelerated Deductions of Capital Costs. Mostly, the document explains why it may be too difficult to come up with accurate figures in such cases, due in part to the intricate relationship with other tax deductions. Flow-through Share deductions present a similar challenge of being reported in an aggregate fashion.