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Tax Alert – Canada

Legislative details released for the new clean technology investment tax credit

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 4 August 2023, the Department of Finance released for public comment draft income tax legislative proposals related to the introduction of a new clean technology investment tax credit (ITC) and related labour requirements, as announced in the 2022 federal fall economic statement¹ and the 2023 federal budget.² The 4 August 2023 draft legislation also contained updated legislative proposals relating to the ITC for carbon capture, utilization and storage (CCUS), which was originally announced in the 2021 federal budget and updated as a part of the 2022 and 2023 federal budgets. The updated CCUS ITC proposals will be discussed in a separate tax alert.

Interested parties are invited to provide comments on the draft legislative proposals by 8 September 2023; as such, the proposals described below may undergo further amendments before they are tabled in a bill.

The following discussion provides an overview of the draft legislative proposals, including the key design features of the clean technology ITC (included in proposed section 127.45 of the *Income Tax Act* (the Act)) and the associated labour requirements (included in proposed section 127.46 of the Act).

¹ See [EY Tax Alert 2022 Issue No. 42](#), *Federal Fall Economic Statement 2022*.

² See [EY Tax Alert 2023 Issue No. 20](#), *Federal budget 2023-24*.

Overview of the clean technology ITC

The clean technology ITC draft legislative proposals are generally consistent with the previous announcements relating to the credit by the federal government. The purpose of the credit as provided for in proposed subsection 127.45(17) is to encourage the investment of capital in the adoption and operation of clean technology property in Canada.

The ITC will be refundable and available to qualifying taxpayers that make eligible investments in clean technology property after 28 March 2023 and before 2035. The tax credit rate varies depending on the year in which the property is acquired and becomes available for use, and on whether certain labour requirements are met (see “Labour requirements” below). The various tax credit rates are outlined below (see “Clean technology ITC rates”).

The credit is available in respect of the capital cost of certain eligible equipment that qualifies as clean technology property (as described below). Eligible equipment will include certain property described in capital cost allowance (CCA) Classes 43.1, 43.2 and 56, which have 30%, 50% and 30% declining-balance-basis CCA rates, respectively. Eligible equipment included in these CCA classes will also be eligible for enhanced first-year depreciation under the accelerated investment incentive if acquired and available for use before 2028.

The legislative proposals include several definitions that are relevant for the purposes of determining the clean technology ITC of a taxpayer.

Qualifying taxpayers

The definition of “qualifying taxpayer” ensures that the clean technology ITC is only available to taxable Canadian corporations, including taxable Canadian corporations that are members of partnerships that acquire clean technology property.

Clean technology property

As indicated above, to qualify for the ITC, an investment must be made in eligible equipment that qualifies as clean technology property. Eligible equipment described in the definition of “clean technology property” in proposed subsection 127.45(1) of the Act includes the following property types (that were previously identified by the Department of Finance in the 2022 fall economic statement and 2023 federal budget):

- ▶ Equipment used in generating electricity through solar, wind and water sources described in Class 43.1 (d)(ii), (iii.1), (v), (vi) or (xiv)
- ▶ Stationary electricity storage equipment described in Class 43.1 (d)(xviii) or (xix) that does not use any fossil fuel in its operation
- ▶ Active solar heating equipment and air and ground source heat pumps described in Class 43.1 (d)(i)

- ▶ Zero-emission vehicles designed for off-road use (described in Class 56) and the related charging/refuelling equipment described in Class 43.1 (d)(xxi) or Class 43.2 (b)(ii) that is used primarily for such vehicles (such as hydrogen or electric heavy-duty equipment used in mining or construction)
- ▶ Equipment used exclusively to produce electrical or heat energy solely through the use of geothermal sources described in Class 43.1 (d)(vii) (but excluding any equipment that is part of a system that extracts both heat from a geothermal fluid and fossil fuel for sale or use)
- ▶ Concentrated solar energy equipment used all or substantially all to generate heat or electricity exclusively from concentrated sunlight (such as reflectors and related solar tracking systems and thermal energy storage equipment), other than certain excluded equipment³
- ▶ A small modular nuclear reactor

In addition, the eligible equipment described above must also meet the following conditions to qualify as clean technology property that is eligible for the ITC:

- ▶ It must be situated in and intended to be used exclusively in Canada.
- ▶ It must be new property (not previously used equipment).
- ▶ If it is to be leased by the taxpayer to another person, it must be to a qualifying taxpayer and not an individual, and it must be leased in the ordinary course of carrying on business in Canada by the taxpayer whose principal business is selling or servicing property of that type or is a leasing or moneylending (or similar) business.

Clean technology ITC rates

Qualifying clean technology property is eligible for the ITC at the following rates, depending on the time of acquisition and whether certain labour requirements are met (discussed below). Similar to other ITCs addressed in section 127 of the Act, the equipment is deemed to have been acquired by the taxpayer in the year the property becomes available for use.

	Acquired after 27 March 2023 and before 2034	Acquired after 2033 and before 2035	Acquired after 2034
Labour rate achieved	30%	15%	Nil
Labour rate not achieved	20%	5%	Nil

³ Excluded equipment is defined in proposed subsection 127.45(1) and includes, for example, auxiliary heating or electrical generating equipment that uses fossil fuel, distribution equipment, and buildings or structures (other than a structure whose sole function is to support or house concentrated solar energy equipment).

Calculating the ITC base

The capital cost base on which the ITC is calculated must be adjusted for any other ITCs applicable to the property under section 127. In addition, the clean technology ITC cannot be claimed on property that is eligible for the CCUS tax credit.

Where the taxpayer has received assistance, either from the government or non-government organizations, the ITC is calculated on the cost base of the equipment net of any financial assistance received.

If a portion of the cost of the property capitalized remains unpaid after 180 days from the end of the fiscal year in which it became available for use, the capital cost of the property must be reduced by the unpaid amount. The amount can later be added back to the capital cost upon payment of the outstanding balance.

Time limit for ITC application

Proposed subsection 127.45(3) places a time limit on filing the prescribed form necessary to be eligible for the clean technology ITC. Specifically, the prescribed form must be filed on or before the day that is one year after the taxpayer's filing due date for the year. A consequential change to subsection 220(2.2) removes the CRA's discretion to waive this requirement.

Recapture of credit

A recapture of the credit received will apply if the property is converted to a non-eligible use, disposed of or exported from Canada within 20 years of the date it was acquired. The amount of the credit repayable will be calculated by multiplying the ITC by the amount of the proceeds of disposition in an arm's length transaction, or the fair market value of the property when it is sold to a non-arm's length party or converted to a non-eligible use, as a percentage of the capital cost of the property on which the ITC had been claimed.

The recapture of the credit does not apply where the property is transferred to a related party (that is also a qualifying taxpayer) and that "purchaser" will use that property for qualifying clean technology purposes.

Labour requirements

The draft legislation also proposes that certain labour requirements be achieved in order to fully maximize the incentive available under the clean technology ITC. If the labour requirements are not met, the maximum credit rate is reduced by 10 percentage points.

To meet the labour requirements, the ITC claimant must elect in prescribed form and manner for each installation taxation year (i.e., a taxation year during which preparation or installation of the clean technology property occurs). The reduced ITC rates (see table above) will automatically apply in situations where the taxpayer has not elected in the prescribed manner to meet the prevailing wage and apprenticeship requirements for an installation taxation year.

Prevailing wage requirements

The taxpayer must meet the following labour requirements to qualify for the full incentive:

- ▶ Each covered worker must be compensated for their labour in accordance with the worker's relevant collective agreement. If no collective agreement exists, the amount of compensation must be at least equal to the amount specified in the most comparable agreement that is relevant to the given worker's experience level, tasks and location (calculated on a per-hour or similar basis). This condition is referred to hereinafter as the "prevailing wage requirement".
- ▶ The ITC claimant must confirm in writing (in prescribed form and manner) that the prevailing wage requirement (described above) is met with respect to their own covered workers and that a reasonable effort was taken to verify that covered workers employed by others involved in the installation of clean technology property also meet the prevailing wage requirement.
- ▶ The ITC claimant is also required to take steps to ensure that all covered workers are aware of the requirements by posting notices that are clearly visible and accessible or by electronic means. The ITC claimant must also provide a plain language explanation of what the prevailing wage requirements mean for workers and instructions as to how to report any failures to meet these standards.

For these purposes, a covered worker means an individual:

- ▶ Who is engaged in the installation of the clean technology property at the designated work site;
- ▶ Whose work duties are primarily manual or physical in nature; and
- ▶ Who is not an administrative, clerical or executive employee, or a business visitor to Canada (within the meaning of section 187 of the *Immigration and Refugee Protection Regulations*).

Apprenticeship requirements

In addition to the prevailing wage requirements set out above, the ITC claimant must make reasonable efforts to ensure that Red Seal registered apprentices work at least 10% of the overall Red Seal registered trades time on the installation of the clean technology property. If a labour law or other agreement restricts the use of apprentices, then the ITC claimant must make every effort to ensure the highest percentage of labour hours is achieved.

In addition, the ITC claimant must attest in prescribed form and manner that it has met the apprenticeship requirements in respect of covered workers at the designated work site .

Note, Red Seal trade is a designation managed by the Canadian Council of Directors of Apprenticeship under the Red Seal Program.

Penalties for non-compliance with labour requirements

The proposed legislation includes a penalty in the form of an additional tax amount payable when the taxpayer has claimed the ITC based on electing to satisfy the labour conditions but fails to meet the requirements. The penalty is calculated as \$20 for every day a covered person was not paid the prevailing wage rate during the installation year and, with respect to the apprenticeship requirements, \$100 for every hour the total apprenticeship time falls below the specified hours. The amounts used to calculate the penalty will be indexed to inflation after 2023.

Gross negligence

If the incentive claimant has claimed the regular ITC rate based on meeting the labour requirements (as outlined in the table above) and it is later determined that the claimant knowingly (or in circumstances amounting to gross negligence) did not satisfy the conditions, the taxpayer must pay back the portion of the incentive they were not eligible for, as well as a penalty equal to half of that ineligible amount.

Corrective measure

If the ITC claimant receives a notification from the CRA specifying that it did not meet the prevailing wage requirement set out above, the claimant may provide a “top-up” amount, plus interest, to each covered worker for the shortfall in pay to remain in compliance with the requirements. The claimant must pay the top-up amount (including interest) within one year after receipt of the notification (unless the CRA considers a longer period to be acceptable in the circumstances).

If the top-up amount is not paid to any particular covered worker, a penalty equal to 120% of the top-up amount will apply.

Exceptions

The labour requirements do not apply to ITC claims for the acquisition of off-road zero-emission vehicles or to the acquisition and installation of low-carbon heat equipment.

Conclusion

The clean technology ITC, along with the CCUS ITC, is one of several new proposed ITCs aimed at helping Canada transition to a clean economy. These two credits are the first for which detailed draft legislative proposals have been released. Draft legislative proposals on the clean hydrogen, clean electricity and clean technology manufacturing ITCs are expected in the coming months.

Learn more

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