

2024 Issue No. 6
21 February 2024

Tax Alert – Canada

Canada's new clean technology investment tax credit

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Bill C-59, *Fall Economic Statement Implementation Act, 2023*, which received first reading in the House of Commons on 30 November 2023, includes draft legislative proposals for the 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 measures contained in Bill C-59 have been amended, where applicable, to take into account comments received during the public consultation held in the summer of 2023. For an overview of the proposed legislation released on 4 August 2023 (the August proposals), see [EY Tax Alert 2023 Issue No. 33](#).

In this Tax Alert, we provide an overview of the draft legislation, including the key design features 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. We also highlight the more substantive changes in the rules since the release of the August proposals, including the addition of proposed section 127.47, which outlines various rules in respect of partnerships.

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 legislative proposals included in Bill C-59 are generally consistent with the August proposals. The purpose of the credit, as noted in proposed subsection 127.45(19), 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 in Bill C-59 include several definitions that are relevant for the purposes of determining the clean technology ITC of a taxpayer; some of the definitions have been amended since they were first included in the August proposals.

Qualifying taxpayers

The definition of “qualifying taxpayer” included in the August proposals ensured 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.

Bill C-59 expands this definition to include a mutual fund trust that is a real estate investment trust as defined in subsection 122.1(1) of the Act. In addition, the legislative proposals in Bill C-59 specify that for a limited partnership, the ITC allocated to the limited partner is restricted by the “at risk” amount in respect of the partnership, as defined in subsection 96(2.2) of the Act. Furthermore, the amount of ITCs allocated to each partner must be reasonable in the circumstances, in light of the capital invested in or work performed for the partnership by each member.

Clean technology property

To qualify for the ITC, an investment must be made in eligible equipment that qualifies as clean technology property. As detailed below, Bill C-59 does not include substantial changes to the eligible equipment described in the definition of “clean technology property” (proposed subsection 127.45(1) of the Act), which includes the following property types:

- ▶ 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 non-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 fossil fuel for sale; in the August proposals, equipment that was part of a system that extracted both heat from a geothermal fluid and fossil fuel for sale or use was excluded
- ▶ Concentrated solar energy equipment
- ▶ 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. Bill C-59 expands this requirement to include certain wind and water energy properties described in Class 43.1 (d)(v) or (d)(xiv) if they are installed in Canada’s exclusive economic zone.
- ▶ 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 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. Bill C-59 also permits the property to be leased to a partnership of which all the members are taxable Canadian corporations.

Bill C-59 also introduces proposed subsection 127.45(20), which provides that for the purpose of determining whether an expenditure qualifies as clean technology property, the Department of Natural Resources technical guidance, including any subsequent amendments, will apply conclusively with respect to engineering and scientific issues.

Clean technology ITC rates

Bill C-59 does not include any changes to the clean technology ITC rates as previously announced.

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, under proposed subsection 127.45(4), the equipment is deemed to have been acquired by the taxpayer when the property becomes available for use. However, this deeming rule is not applicable for property acquired before 28 March 2023. Property acquired before 28 March 2023 and after 31 December 2034 will not be eligible for the ITC.

	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

Calculating the ITC base

Similarly, Bill C-59 does not include any significant changes with respect to 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 carbon capture, utilization and storage (CCUS) tax credit or other future clean economy tax credits once they are enacted.

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 the assistance is subsequently repaid or the taxpayer is no longer eligible for the assistance, the amount by which the cost of the property was reduced is added back to the capital cost of the property for ITC calculation purposes.

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

Bill C-59 does not include any changes with respect to the 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 Canada Revenue Agency's discretion to waive this requirement.

Recapture of credit

As detailed below, Bill C-59 includes several changes with respect to the recapture rules.

Bill C-59 provides that recapture of the credit received will apply if the property is converted to a non-eligible use, disposed of or exported from Canada within 10 years of the date it was acquired. In the August proposals, the recapture period was 20 years; as such, this period has now been shortened.

The amount of the credit repayable will be the lesser of the amount of the ITC received in respect of the particular property and the amount 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.

In the August proposals, the recapture of the credit did not apply where the property was transferred to a related party (that was also a qualifying taxpayer) and that "purchaser" would use the property for qualifying clean technology purposes. However, in Bill C-59, this exception to the recapture rule has been narrowed. More specifically, proposed subsection 127.45(13) provides that the recapture of the credit does not apply where the particular property is transferred by a taxable Canadian corporation to a related taxable Canadian corporation. While the provision is intended to facilitate bona fide transfers of clean technology property within corporate groups, the relief will not be available to partnerships and real estate investment trusts within a corporate group.

In addition, the legislative proposals in Bill C-59 now provide that, where the recapture rules apply, or the recapture is deferred as a result of the related party relief, the taxpayer is required to notify the minister in prescribed form and manner, on or before the taxpayer's filing due date for that year. Consequential amendments to the Act will extend the assessment period where the notification has not been filed in prescribed form and manner with the minister.

Furthermore, Bill C-59 alters the recapture rules in respect of partnership arrangements that were included in the August proposals. The mechanics of the calculation are no longer consistent with the methodology used by non-partnership arrangements and other existing ITCs and are now subject to more complex standalone rules.

Labour requirements

As detailed below, Bill C-59 includes certain modifications to the labour requirements. The proposed draft legislation in section 127.46 of the Act applies in respect of specified property prepared or installed on or after 28 November 2023. In the August proposals, the coming-into-force date was 1 October 2023.

Also, consistent with the August proposals, Bill C-59 provides that certain labour requirements must be achieved 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

Consistent with the August proposals, except as noted below, 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 (e.g., a labour agreement with a trade union in agreement with provincial laws). If no collective agreement exists, the amount of compensation (including benefits) 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". Bill C-59 specifies that compensation excludes overtime.
- ▶ The ITC claimant must attest in prescribed form and manner that the prevailing wage requirement (described above) is met with respect to its 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 to the minister.

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 apprentices registered in a Red Seal trade work at least 10% of the total work performed by Red Seal workers 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. “Red Seal worker” is defined as a covered worker whose duties are, or are equivalent to, duties normally performed by workers in a Red Seal trade.

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.

Bill C-59 introduces proposed subsection 127.46(16), which provides specific steps required by the ITC claimant to demonstrate that the ITC claimant is deemed to satisfy the reasonable efforts requirement noted above. According to the Finance Explanatory Notes, the steps are intended to be illustrative of a means of meeting the reasonable efforts tests, as such variations to take into account the ITC claimant’s specific circumstances may also be considered reasonable efforts.

Certain steps must be taken at least every four months in respect of the installation year. These steps are mainly in respect of satisfying specific job posting requirements, communicating with the trade unions and various educational institutions, and confirming the availability of apprentices at designated work sites. The remaining steps require the ITC claimant to review and duly consider all applications received and to attest compliance of the requirements in prescribed form and manner.

Bill C-59 adjusts the definition of a Red Seal trade as a designation managed by the Canadian Council of Directors of Apprenticeship under the Red Seal Program and, in any other case, an equivalent provincially registered trade.

Penalties for non-compliance with labour requirements

Other than a reduction in the penalty amount for deficient apprentice hours noted below, the penalties for non-compliance with labour requirements are unchanged.

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, \$50 for every hour (reduced from \$100 in the August proposals) the total apprenticeship time falls below the specified hours. The amounts used to calculate the penalty will be indexed to inflation after 2023.

In addition, Bill C-59 introduces proposed subsection 127.46(17) to address the allocation of any additional tax or penalties imposed where the incentive claimant is a partnership.

Gross negligence

No changes were made in Bill C-59 to the gross negligence provision.

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

No changes were made in Bill C-59 to the corrective measure.

If the ITC claimant receives a notification from the minister 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 Canada Revenue Agency considers a longer period to be acceptable in the circumstances. The top-up amount would be considered salaries paid in the year and deductible from income tax purposes, but it will not qualify for the ITC.

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

As noted in the August proposals, 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 in a bill.

Draft legislative proposals on the clean hydrogen and clean technology manufacturing ITCs were released on 20 December 2023 for consultation.

Learn more

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