

September 11, 2024

RE: Stakeholder Consultation— Legislative Proposals Relating to the Income Tax Act and the Income Tax Regulations

Submitted via email to:

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CC:

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On August 12, 2024, the Department of Finance Canada announced proposed legislative amendments to Bill C-59,¹ namely to the Clean Economy Tax Credits, more specifically, those of interest to our industry, the Clean Technology Investment Tax Credit (ITC) and the Clean Electricity ITC.

When geothermal technology was announced to be eligible property for the Clean Technology ITC, in mid 2023, we were elated. We were likewise elated when Bill C-59 received royal assent. Based on the language in the bill as well as that in the U.S. Inflation Reduction Act, it has always been our understanding, or rather, our assumption that drilling-for-geothermal-energy (the most expensive part of a geothermal project) would be eligible for the tax credit as a capitalized expense. If we have misinterpreted the legislation, we are certainly open to correction or clarification.

With the recent legislative proposals which insert new language on “preliminary work activity,” it is now apparent that implementation of these proposals would clearly exclude the drilling of wells from the Clean Technology ITC and Clean Electricity ITC—which would severely inhibit our industry’s access to the credit.

For context – Paragraph 127.45(5) of Bill C-59 is below—

Special rules — adjustments

(5) For the purpose of the definition clean technology investment tax credit in subsection (1), the capital cost of clean technology property shall...

¹ <https://www.canada.ca/en/departement-finance/news/2024/08/government-consults-canadians-on-budget-2024-measures-to-deliver-fairness-for-every-generation.html>

The Canadian Geothermal Energy Association (CanGEA) is the collective voice of Canada's geothermal energy industry. As a non-profit industry association, we represent the interests of our members with the primary goal of unleashing the country's tremendous geothermal energy potential to provide clean, 24/7, reliable heat and electricity to Canadian markets. CanGEA promotes the promise of geothermal energy in Canada through events, networking, research, and most prominently – policy advocacy to reduce capital risk, cut permitting and regulatory red tape, and boost the general visibility of the industry and its supply chain.

(7) Paragraph 127.45(5)(a) of the Act is replaced by the following:

(a) not include any amount

...

(iv) that is in respect of an expenditure incurred for a preliminary work activity; ...

And from the Explanatory Notes—³

“preliminary work activity”

Expenditures in respect of a “preliminary work activity” cannot be included in the capital cost of clean technology property for purposes of computing a taxpayer’s clean technology investment tax credit because of subparagraph 127.45(5)(a)(iv).

A preliminary work activity is an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of eligible clean technology property...

Preliminary work activity is defined in the proposals to include “drilling of a well.” We interpret this to mean that drilling costs for the sole purpose of generating geothermal energy, even if capitalized and not expensed, would be excluded from the ITC. As you know, drilling is the bulk of the cost of a geothermal heat project and approximately half of a geothermal electricity project.

The Canadian Geothermal Energy Association (CanGEA) is disappointed by this proposed amendment just shortly after Bill C-59 received Royal Assent, and that greater notice or warning was not provided for such a proposal that would be severely detrimental to our industry and to the spirit and purpose of the tax credit.

It is unclear to CanGEA if geothermal wells were never intended to be included as an eligible expense, and that Finance Canada is now simply proposing enhanced clarity, or if Finance Canada is now proposing to exclude geothermal drilling as an adjustment. Regardless, it was our understanding that the Clean Economy ITCs were always intended to mirror those the United States— which “qualified property” expenditures are outlined below:

(2) Qualified property

For purposes of this section, the term “qualified property” means property-

² <https://fin.canada.ca/drleg-apl/2024/ita-lir-0824-l-2-eng.pdf>

³ <https://fin.canada.ca/drleg-apl/2024/ita-lir-0824-n-5-eng.pdf>

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(A) which is-
(i) tangible personal property, or
(ii) other tangible property (not including a building or its structural components), but only if such property is used as an integral part of the qualified facility [emphasis added],

(B) with respect to which depreciation (or amortization in lieu of depreciation) is allowable, and

(C)(i) the construction, reconstruction, or erection of which is completed by the taxpayer, or

(ii) which is acquired by the taxpayer if the original use of such property commences with the taxpayer.⁴

For geothermal energy to be produced, wells must be drilled into the geothermal deposit (reservoir). The construction and maintenance of production wells (tangible property) are integral to the geothermal system and facility. Therefore, we understand that drilling costs, for the purpose of constructing tangible property (production wells), are considered part of the equipment and infrastructure used to produce geothermal energy, making them eligible as “qualified property” under the U.S. ITC. The geothermal industry considers drilling costs to be an integral part of the capital expenditures eligible for the ITC because these costs directly relate to the development of property that produces energy from geothermal resources.

The Canadian Geothermal Industry Association (CanGEA) respectfully asks that the proposed legislative amendments with respect to “preliminary work activity,” which would disqualify geothermal energy production (by way of excluding drilling), be struck down. This would be our preferred outcome.

However, if the inclusion of “preliminary work” exclusions is indeed deemed necessary to be added to the Clean Economy Tax Credits, we propose that “exploration” wells/drilling be distinguished from “production” wells/drilling. We acknowledge that there may be additional risks and costs associated with exploration drilling, in the context of preliminary work prior to geothermal energy production. However, while exploration wells may be considered “preliminary work,” production wells are integral to the geothermal system and the ongoing production of energy.

⁴ 26 USC 48E: Clean electricity tax credit. <https://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title26-section48E&num=0&edition=prelim>

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In the spirit of the original intended purpose of the tax credit, in square brackets below, we propose potential legislative adjustments to page 50 of the proposals.⁵

(5) Subsection 127.45(1) of the Income Tax Act is amended by adding the following in alphabetical order:

preliminary work activity means an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of property including, but not limited to, a preliminary activity that is

(a) obtaining a right of access to a project site or obtaining permits or regulatory approvals (including conducting environmental assessments);

(b) performing front-end design or engineering work, including front-end engineering design studies, or process engineering work for the project, including

(i) collecting and analyzing of site data,

(ii) calculating energy, mass, water or air balances,

(iii) simulating and analyzing the performance and cost of process design options,

(iv) selecting the optimum process design, and

(v) conducting feasibility studies or pre-feasibility studies;

(c) clearing or excavating land;

50

(d) constructing a temporary access road to the project site; or

(e) drilling of a[n] [exploration] well. (travaux préliminaires) ...

Whether the preliminary work provisions of the proposals are struck entirely or amended as we suggested above, clarity that the Clean Technology and Clean Electricity ITCs are inclusive of equipment used to produce geothermal energy by drilling for it, would be appreciated regardless. Drilling is inherent to geothermal energy production and must be included in the tax credits that are intended to incentivize geothermal energy production to offset carbon emissions and catalyze the clean economy.

One final point to consider— it appears that no changes have been proposed for the CCUS ITC— and is therefore not subject to the same “preliminary work” well drilling exclusions proposed for the Clean Technology ITC and Clean Electricity ITC. Although CCUS is subject to its own “preliminary CCUS work activity” exclusions, drilling is not expressly prohibited by these exclusions (unlike by the Clean Technology / Clean Electricity ITC “preliminary work” proposals).⁶ As a result, we are under the assumption that CCUS drilling, as obviously integral to a “CCUS project,” remains eligible as “CCUS expenditure” under Bill C-59.

⁵ <https://fin.canada.ca/drleg-apl/2024/ita-lir-0824-l-2-eng.pdf>

⁶ Bill C-59, “preliminary CCUS work activity”

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While we support that CCUS drilling be included in its respective ITC, we propose that the development of other clean, GDP-generating, and energy-portfolio enhancing sectors— particularly geothermal energy— be given an equal priority.

If the government is committed to an energy transition or an energy portfolio transformation, even a gradual one, it is only logical to diversify with clean, renewable, environmentally-safe, low-footprint sources— which includes geothermal energy. This isn't just about the environment and improving air quality; it's about Canadian prosperity, sustainability, and ensuring energy and economic security for generations to come.

We look forward to cooperation and further questions, corrections, clarifications, and discussions, as necessary.

Signed:



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