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The Tax Benefits of Green Energy and Energy Efficiency Projects

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Federal and provincial initiatives

- Scientific Research & Experimental Development
- Canadian Renewable Conservation Expense (CRCE)
- 2008 Federal Budget amendments- accelerated depreciation
- Flow-through financing

A context for SR&ED and the Environment

- Increasingly tough legislative environment
- Development of “Green” culture
- Many agricultural processes reliant on environmentally “unfriendly” processes
- Solutions not known or not economically viable
- Increasing investment and effort across industry

When does environmental work = SR&ED

- A common problem … but no common solution
  - Solution to problem is not evident
  - Insufficient knowledge of underlying mechanisms to make decisions
  - Experimental and/or analytical work required to answer questions (hypothesis – test – analysis)
- Applies to solution development
  - Product and process development
  - Knowledge development
  - Methodology development

Scientific Research and Experimental Development

- Overall context
- When does environmental work = SR&ED
- What is not SR&ED
- Environmental drivers for SR&ED
- Examples of SR&ED related to environment
- Issues with SR&ED in environmental projects
- Other particularities of environmental SR&ED

Environmental drivers for SR&ED

- Greenhouse gas emission reduction
- Energy costs
- Tightening emissions and health and safety standards
- Noise reduction, visible plume reduction
- Invasiveness of residential construction – proximity to agricultural sites
- Recycling
- Climate change

Environmental SR&ED Project Examples

- Reduction of net water use (closed cycle processes)
- Reduction of energy use
- Move to alternative energies
- Understanding impact of our activities

Issues with SR&ED in environmental projects

- Knowledge gain or technological advancement?
- Who has the right to claim?
- Qualifications of staff?
- Must consider baseline knowledge of consultants
- Advancement vs complex engineering
- Distinguishing SR&ED costs from commercial costs

Canadian renewable conservation expense (CRCE)

- What type expenses qualify?
- Qualified CRCE can be deducted in the year they are incurred, or carried forward
- CRCE may be renounced in favour of the shareholders who may claim the deductions- flow-through share agreement with shareholders

CRCE eligible expenses

- Service connection for transmission of electricity to purchaser
- Temporary road to site
- Land clearing necessary for the project
- Pre-feasibility studies
- Feasibility studies
- Negotiation and site approval costs
- Training of operators and maintenance personnel
- Test wind turbine

What is not CRCE?

- Costs for acquisition of and/or use of land
- Administration and management expenses
- Depreciable assets including costs directly associated with their acquisition and installation
- Amounts payable to non-residents other than for a test wind turbine
- An expenditure that would be claimed as a SR&ED expense
- These non-qualifying expenses may be deductible under other provisions in the *Income Tax Act (Canada)*

Income tax incentives

Previous

- Assets are normally depreciated at rates between 4% - 20%
- Uncertain tax treatment of soft costs (non-deductible or capitalized)

New Regime

- Faster write-off of capital
  - 30% for 43.1
  - 50% for 43.2
- 100% write-off of specific qualifying expenditures

Classes of assets

Class 43.1 – 30%

Class 43.2 – 50%

- Property acquired after February 22, 2005 and before 2020

Class 43.1 and 43.2 assets

Electricity generation systems

- Wind energy conversion systems
- Photovoltaic equipment
- Geothermal equipment
- Equipment fuelled by certain wastes

  (wood waste, landfill gas, spent pulping liquor, municipal waste, bio-oil, or any combination of these fuels)
- Anaerobic digestion systems
- Small scale hydro-electric equipment and plants
- High efficiency co-generation systems

Class 43.1 and 43.2 assets

Thermal energy systems

- Active solar heating equipment including ground source heat pumps
- Heat producing equipment fuelled by certain waste

  (wood waste, landfill gas, spent pulping liquor, municipal waste, bio-oil, or any combination of these fuels)
- Anaerobic digestion system

  Note: Thermal energy systems (other than waste to energy) only qualify if the heat energy is used directly in an industrial process or in a greenhouse

What does not qualify?

- Operating costs
- Buildings except for small scale hydro electric plants
- Electrical distribution equipment
- Electrical transmission systems except those used in wind energy, photovoltaic or small scale hydro-electric systems
- Waste storage facilities

2008 Federal Budget - accelerated depreciation

- Class 43.2 (50% accelerated CCA)
  - Include ground source heat pump systems such as space and water heating
  - Expansion of biogas production equipment
  - Changes to biogas, bio-oil rules

- CO_2 pipeline and equipment
  - Co2 pipeline equipment = 8% rate
  - Co2 compression and pumping equipment = 15% rate

CRCE Timing – Corporation vs. Partnership

- Timing of CRCE expenditures that allow investors to claim a deduction against their 2009 taxation year income:

	Corporation	Partnership
January 1, 2009 to date of issuance	No	Yes
From Issuance to December 31, 2009	Yes	Yes
January 1, 2010 to December 31, 2010	Yes	No

Flow-through shares

- A share of principal-business corporation issued under a flow-through agreement
- Flow-through agreement:
  - Agreement to incur and renounce eligible expenditures
  - Maximum duration of 24 months
  - Generally renounced by March 31 of the next calendar year
- CRCE is a form of Canadian Exploration Expense

The "look-back rule"

- Engine of public financing for alternative energy projects
- Investor and the issuer corporation must deal at arm's length
- If CEE not incurred?
  - CEE allocated to investor is reduced
  - Issuer liable for penalty tax

Part XII.6 Tax

- Monthly tax on corporations using the look-back rule
- Applies to the unspent but renounced amounts
- Unexpected funds on hand at December 31 of the following year are subject to a 10 percent penalty to the issuer

Timing issues

- Eligible CEE period starts when the agreement to incur CEE is made and ends 24 months later
- To be CRCE eligible, test wind turbines must be operating for at least 120 days prior to the installation of any infill turbines
- Orders for new turbines should be conditional upon the results of the 120 day test period
- To take advantage of look-back rule, must renounce CRCE by March of year after the expenses will be used against taxable income

Adjusted cost base

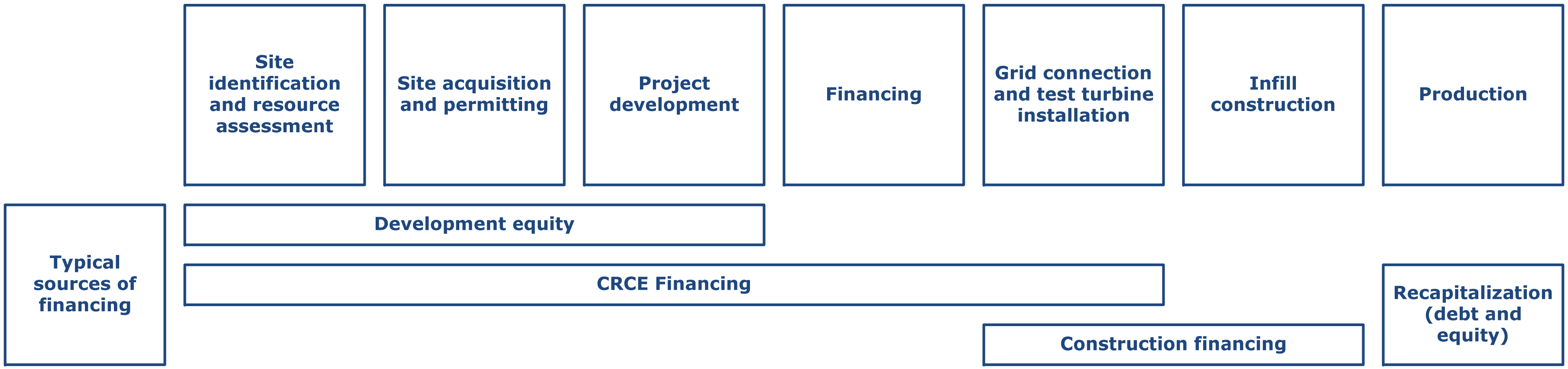
- ACB of flow-through shares deemed to be nil
- ACB of partnership interests reduced by CEE allocations
- Donation of publicly listed shares may be exempt from capital gains tax
  - Subject to hold period
  - Cannot donate limited partnership units

Structuring issues

Partnership-on-Corporation Structures

- CEE renounced to a partnership is allocated to its partners pursuant to the terms of its partnership agreement and the Tax Act
- CEE allocated to a partner is added to such partner's CCEE account
  - The deduction can be carried forward indefinitely
- A GP of a resource limited partnership can be principal business corporation and can issue flow-through

Wind project development process



- Although CRCE treatment of expenditures is applicable commencing in the initial stages of the project, third party CRCE flow-through funding is typically allocated from the later project development stages to the grid connection and test turbine installation stage

Liquidity issues

- Limited partners must hold partnership interests at year-end
- If a share is a “prescribed share” or a right is a “prescribed right” it cannot qualify as a flow-through share
- A “prescribed share” is essentially a share where the investor’s risk of loss is protected
- Consideration for which the share is to be issued cannot be determined more than 60 days after entering into the flow-through share agreement

Limitations on ownership and borrowing

At-risk rules for Partnerships

- Generally speaking, a limited partner cannot deduct more than the partner has put at risk in making the investment
- Initial “at-risk-amount” will be investment in the limited partnership, less any amount by which the investment is protected
- At-risk amount subject to adjustment

Limitations on ownership and borrowing (continued)

Limitations on investors

- No limited recourse financing
  - CRCE or other expenses renounced to or incurred by the partnership may be reduced by the amount of limited recourse financing
- No non-resident investors
  - Partnerships will not qualify as a "Canadian partnership" for purposes of the Tax Act
    - Withholding tax
    - A certificate of compliance may be required in connection with any disposition of flow-through shares by the partnership
- Limit on ownership by financial institutions

CRCE representations and warranties

The issuer

- The Company is a “principal-business corporation” as defined in subsection 66(15) of the Tax Act
- No property of the Company that is a property described in Class 43.1 of Schedule II of the Tax Act has been used in the Project for the purpose of earning income
- The Company will not be subject to the provisions of subsection 66(12.67) of the Tax act in a manner which would impair its ability to renounce Qualifying Expenditures to the Investor in an amount equal to the Subscription Amount

CRCE representations and warranties (continued)

The common shares

- Will be “flow-through shares” as defined in subsection 66(15) of the Tax Act
- Won’t be prescribed shares within the meaning of Section 6202.1 of the Regulations to the Tax act

CRCE representations and warranties (continued)

Qualifying expenditures to be renounced

- Will constitute CEE and be incurred before a date specified (generally Dec 31 of the following year)
- Will be CRCE incurred by the Company in relation to the project
- Will not include any amount that has previously been renounced
- Will not be subject to any reduction under subsection 66(12.73) of the Tax Act or otherwise

CRCE covenants

Positive covenants of the Company

- To continue to be a “principal-business corporation” until the Qualifying Expenditures are validly incurred and renounced pursuant to the Tax Act
- To incur Qualifying Expenditures in an amount equal to the Subscription Amount on or before a date specified
- To deliver the Prescribed Forms to the Investor on or before a date specified

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