CARBON CAPTURE COALITION

Memorandum

New Canadian Clean Economy Investment Tax Credits (ITC)

Executive Summary

On June 20, 2024, the Canadian Parliament granted royal assent to Bill C-59, enshrining in law Canada's new Clean Economy Investment Tax Credit (ITC). The ITC provides refunds for expenditures incurred in four categories: Carbon Capture, Utilization, and Storage (CCUS), Clean Technology, Clean Hydrogen, and Clean Technology Manufacturing. This memo focuses on the key elements of Canada's ITC for CCUS and highlights similarities and differences with the federal Section 45Q Tax Credit in the US. The sections below describe in detail the relevant aspects of these two financial incentives.

IRS Federal Section 45Q vs. Canada's Clean Economy Investment Tax Credit

These two financial incentives fundamentally differ, as Canada's Clean Economy ITC provides a refund for eligible expenditures incurred for the deployment of carbon management projects. Unlike the ITC in Canada, 45Q is production-based, providing tax credits based on metric tons of captured CO_2 that are either demonstrably stored or reused.

Canada's ITC can be claimed by any "taxable Canadian corporation (including a taxable Canadian corporation that is a member of a partnership)" that has a "qualified CCUS project for which qualified CCUS expenditures are incurred from January 1, 2022, to December 31, 2040."

Table: Credit structure under Canada's Clean Economy ITC for eligible expenditures in CCUS projects

Timeframe	Direct air capture projects	Industrial and power capture projects	Transport, storage and utilization
2022 through 2030	60%	50%	37.5%
2031 through 2040	30%	25.5%	18.75%

Once the credit is claimed, there are also two main reporting requirements: an annual claim report to Natural Resources Canada (NRCan) and an annual climate risk disclosure report to the Canada Revenue Agency (CRA). A project's annual claim report may also require a publicly available knowledge-sharing report, depending on the total dollar amount of the ITC claimed by said project. Knowledge sharing reports include: **1)** a construction and completion knowledge sharing report and **2)** annual operations knowledge sharing reports. Knowledge sharing reports are only required if a project "is expected to incur $250 million or more of qualified CCUS expenditures over the life of the project (based on the most recent project evaluation) **or** has incurred $250 million or more of qualified CCUS expenditures before the first day of commercial operations of the CCUS project."

Eligible Expenditures or Activities

Canada's CCUS ITC provides tax refunds for expenditures incurred for commercial operation and deployment of CCUS projects after completing a front-end engineering and design (FEED) study. The eligible expenditures include project costs for facilities that intend to capture CO_2 that would otherwise be released into the atmosphere, capture CO_2 directly from the ambient air, transport captured carbon, and store or use captured carbon. In contrast to 45Q, activities associated with enhanced oil recovery and utilization of carbon – other than in producing concrete – do not qualify for Canada's ITC. Similar to 45Q's annual minimum capture threshold in the US, Canada's ITC is only available for CCUS projects that include an eligible use of at least 10 percent of captured CO_2. For example, a storage project that only stores 10 percent of captured CO_2 would still qualify for the full 60 percent rate of the ITC, assuming it meets the appropriate labor requirements, and the project is otherwise qualified.

Separately, the ITC is not eligible for preliminary CCUS work activity, defined by Bill C-59 as "an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of property" intended to be part of an eligible CCUS project. In other words, expenditures incurred for activities such as obtaining permits or even clearing land for construction *prior* to commencing construction do not qualify for reimbursement per the ITC.

Time Frame for Availability of Tax Credits

Canada's CCUS ITC provides tax refunds for eligible expenditures incurred for a qualified CCUS project from January 1, 2022, to December 31, 2040. Under current US provisions, 45Q is only available for activities related to the storage and use of carbon dioxide by equipment placed in service between February 8, 2018, or beginning constructions prior to January 1, 2033. In addition, under 45Q, a facility is only eligible to receive the 45Q tax credit during its first 12 years of operation.

Inflation Adjustment

Canada's ITC provides tax refunds for eligible expenditures based on a percentage rate – for e.g., 60 percent of total expenditures incurred on DAC. Therefore, if a given year has higher expenditures due to inflation than the previous year, the ITC adjusts to that automatically due to the percentage-based credit on the eligible expenditures. The 45Q tax credit, on the other hand, is only subject to inflation adjustment after 2026.

Direct Pay and Transferability

Both Canada's ITC and 45Q in the US include direct pay provisions for entities that own or contract for eligible CCUS activities. As for transferability, 45Q allows for a one-time transfer of the tax credit to another entity, which is not permitted under Canada's ITC.

Agency Responsible for Tax Credits

CRA oversees the implementation of the ITC in collaboration with NRCan, which is, in turn, responsible for project evaluations and property eligibility verification. NRCan validates all verifications against assessments of a project's final engineering design. In the US, CRA's role is analogous to that of the Internal Revenue Service (IRS), which, in technical consultation with the Environmental Protection Agency (EPA) and Department of Energy (DOE), oversees the monitoring, reporting, and verification of 45Q.

Conclusion

Canada's ITC is a unique incentive that supports the upfront cost incurred by the project developers across all carbon management projects. This support is especially valuable to projects that face a higher up-front cost barrier when deploying equipment on the ground, such as DAC projects. Additionally, the tax refund for capital costs incurred in deploying the equipment and support infrastructures is available to technologies across the carbon management value chain.