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Applying the Accelerated Capital Cost Allowance for oil sands, upgrading and petrochemical industries

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Background

Accelerated Capital cost Allowance (ACCA) has been a feature of mining sector taxation in Canada for decades to encourage investment and value-added processing. Capital cost allowance rules specify the rate at which capital assets can be expensed annually. ACCA allows the normal costs of capital to be deducted as fast as income from the project will allow rather than deferring the deductions over time. As corporations recover their initial investments sooner, ACCA reduces the investment risk associated with the mine or project, thus improving the overall economics of the project.

The ACCA for insitu oil sands projects was introduced by the Liberal government in 1996, when oil prices were low, in an effort to stimulate investment in the oil sands. In addition to the regular capital cost allowance, oil sands mining and in situ projects are able to claim ACCA on the assets of the particular mine, up to the income from the mine or project. Oil sands projects started prior to March 2007 currently qualify for a 100 percent accelerated capital cost allowance which is a much higher rate than that provided to conventional oil and natural gas. An oil sands company only pays federal income tax on the income from an oil sands operation once it has written off all of the eligible capital costs.

The ACCA for oil sands provided a significant boost for this costly industry and companies had announced investments of \$150-billion in spending before oil prices collapsed.

In the 2007 Federal Budget, Finance Minister Jim Flaherty eliminated ACCA for new projects and announced that by 2010 the government would phase out the ACCA for mining and oil sands projects. The timing for this decision was unfortunate. The elimination of the accelerated capital cost allowance coincided with a plunge in the price of oil as well as the ongoing threat of significant new costs to combat environmental issues including climate change.

While the federal government was eliminating the ACCA for oil sands, at the same time it introduced an ACCA for investments in manufacturing machinery and

equipment. Originally intended to be available for two years, the ACCA for manufacturing machinery and equipment was extended for a further year in 2008. In response to the economic crisis, last year the federal government extended the ACCA for machinery and equipment for a further two years until 2012. Clearly the government understands the power of the ACCA as an inducement to further investment.

The Issue

The Edmonton Chamber has consistently delivered the message to federal and provincial governments that the ACCA needs to remain in place as a key component of a strategy to attract new investment in value-added manufacturing including resource upgrading. In particular, for Alberta's value-added strategy it is critical that stand-alone upgraders and our petro-chemical industry be eligible for the accelerated depreciation treatment. Under the current rules they do not qualify.

As Greenfield projects, new upgraders in Canada are more costly especially with our higher construction (labour and material) costs as well as the need to develop supporting public and private infrastructure. Competing locations in the U.S. (e.g. the U.S. Gulf Coast and the U.S. Midwest) enjoy the benefits of existing infrastructure. They are also shielded from the inherent high cost of transporting heavy barrels through the averaging down of regulated pipeline tariffs based upon depreciated capital invested in pipelines constructed years ago at lower historic costs.

Alberta also has in place a rigorous environmental and socio-economic public interest tests for major energy projects operated through the EUB regulatory process. This process extends the lead-time and up-front costs of projects. Addressing climate change challenge will undoubtedly require investment of significant new capital investment. By providing for more rapid capital recovery, the ACCA will greatly assist making our upgrader projects more competitive with U.S. refineries.

In addition to the uneven playing field created by applying the ACCA to manufacturing machinery and equipment and not oil sands mining and upgrading in Alberta, the ACCA has not been available for merchant upgraders or for additional value added processing such as petrochemicals and refining. This means, for example, that some upgraders operating in Alberta's Industrial Heartland are eligible (those with common ownership and processing feedstock from a particular mine or in situ project) and some are not (those purchasing bitumen on the open market). This creates a further disincentive or barrier to investment in upgrading capacity in Alberta.

The transfer of potential upgrading capacity in Alberta to the U.S. will have devastating consequences.

The Alberta government has articulated a strategy to secure and strengthen an advantage in value-added manufacturing. This strategy is based on natural gas liquids (NGL) extracted from new northern gas supplies sourced through an “Alberta Energy Hub” and new supplies of petrochemical feedstocks and refinery grade petrochemicals are generated as co-products of the upgrading of bitumen. These new feedstocks are critical as conventional sources of petrochemical feedstocks will decline over time. Without the feedstocks from upgrading byproducts, there simply will be no petro-chemical industry.

The oil sands boom has been Canada’s economic engine over the past decade. Ultimately, the effective integration of oil sands, refining and petrochemical industries will position Alberta as the economic engine for decades to come. However, these industries are capital intensive, face competition from other jurisdictions, and considerable higher operating costs due to labour and regulatory controls. Faced with these challenges, seizing the new economic opportunities will require our governments to implement fiscal policies like the ACCA that encourage rather deter investment.

Fairness also dictates that standalone upgraders receive similar tax measures as those directly associated with upstream supply projects. And fairness dictates that value-added sectors like the petro-chemical industry should be treated similarly to other manufacturing sectors and be allowed to apply the ACCA.

Recommendation

That the federal government:

- Retain Accelerated Capital Cost Allowance for oil sands and mining projects in Alberta; and
- Extend Accelerated Capital Cost Allowance to include resource processing investment in the province, including merchant upgraders and other shared processing infrastructure, such as: gasification, cogeneration and water treatment facilities.