TAX EXECUTIVES INSTITUTE, INC.

June 30, 2017

Environment and Climate Change Canada
Department of Finance Canada

Via: Carbonpricing-tarificationcarbone@canada.ca;
gervais.coulombe@canada.ca; sean.keenan@canada.ca

RE: Comments on Technical Paper on the Federal Carbon Pricing Backstop

Dear Sir or Madam:

On behalf of Tax Executives Institute ("TEI"), we write to comment on the Technical Paper on the Federal Carbon Pricing Backstop ("Technical Paper") released by the Department of Finance ("Finance"). TEI appreciates the opportunity to provide feedback as part of the Canadian Government's consultation regarding the federal benchmark ("Federal Benchmark" or "Benchmark") and federal backstop ("Federal Backstop" or "Backstop") for carbon pricing. TEI notes the implementation of the Federal Backstop raises significant challenges requiring input and collaboration from many government agencies and stakeholders to ensure Canadians are provided a fair and consistent national carbon policy.

About Tax Executives Institute

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 56 chapters in North and South America, Europe, and Asia, including four chapters in Canada. Our approximately 7,000 members represent 2,800 of the largest companies in the world, many of which either are resident or do business in Canada.

As the preeminent association of business tax professionals worldwide, TEI has a significant interest in encouraging the uniform and equitable enforcement of tax laws, and reducing the cost and burden of tax administration and compliance to the benefit of taxpayers and government. TEI is committed to maintaining a system that works — one that builds upon the principle of voluntary compliance, is consistent with sound tax policy, is easy to administer, and is efficient.

Comments on the Technical Paper

The Pan-Canadian Framework on Clean Growth and Climate Change ("Framework") is Canada's plan to grow the economy while reducing greenhouse gas emissions and building resilience to adapt to a changing climate. The Federal Benchmark published by the Canadian government in October 2016 mandated the application of carbon pricing to a broad set of emission sources throughout Canada by 2018. The Federal Benchmark provided provinces and territories flexibility to implement their own carbon pollution pricing systems and committed to implement a Federal Backstop that would be imposed upon any province or territory that did not have a qualifying carbon pricing system in place by 2018.

The Federal Backstop will apply in jurisdictions that do not have a carbon pricing system or do not have carbon pricing systems that fully meet the Federal Benchmark. The Federal Backstop is composed of two key elements – a federal carbon levy ("FCL") applied to fossil fuels and an output-based pricing system for industrial facilities emitting above a certain threshold, with an opt-in capability for smaller facilities with emissions below the threshold. The Technical Paper seeks to inform Canadians and stakeholders about the proposed Federal Backstop and to obtain feedback on its design.

A. Timing to Implement the Federal Backstop

The Technical Paper states the FCL will become effective in 2018 and the OBS will not become effective prior to January 1, 2019. The request for comments on the Technical Paper are due June 30, 2017, at which time the Parliament will be in recess, not to reconvene until the fall of 2017.

TEI recommends legislation be introduced in Parliament at the earliest opportunity during the fall session and any related regulation(s) be released by March 1, 2018, with an FCL implementation date no earlier than July 1, 2018. Such delay is necessary to provide time for the Canada Revenue Agency ("CRA") and businesses across the country to learn the new rules and develop compliance processes/systems (for the CRA, registration forms, registration systems, memoranda, policy papers, etc. and for businesses, new reporting processes, systems functionality, and other resources) prior to the implementation date. An earlier implementation date would create considerable administrative burdens for the CRA and businesses alike.

B. Point of Taxation

The Technical Paper states that, in most cases, the FCL will be applied early in the supply chain of each fuel used in a Backstop jurisdiction. Further, the end user of a fuel will generally not have any special rights or obligations with respect to the FCL, as the end user will purchase levy-paid fuel in most cases.

The proposed Federal Backstop places onerous reporting obligations upon nontaxable transactions and will be complex to administer. TEI thus maintains that the point of taxation should be moved further downstream to the point at which the fuel is put into use or sold to an end user. Such treatment is analogous to the manner in which gasoline and diesel are taxed under the Federal Excise Tax ("FET") applied to fuels under the non GST/HST portion of the Excise Tax Act ("ETA"). The methodology proposed by TEI would substantially reduce the administrative impact on businesses across the country while still meeting the carbon pricing requirements set forth in the Benchmark.

C. Evaluation of Provincial Carbon Pricing Systems and Integration of the Federal Backstop in Provinces Not Meeting the Federal Benchmark

The Technical Paper does not indicate how provincial carbon pricing programs will be evaluated for compliance with the Federal Benchmark. Moreover, it is not clear how the Federal Backstop will be integrated if the Federal Government determines a province's carbon pricing system does not meet the Federal Benchmark's standards. TEI requests clarity regarding how provincial carbon pricing systems will be evaluated and how the Federal Backstop will be integrated should the Federal Government determine the provincial system is insufficient.

D. Inconsistencies Between PCLs and FCLs

TEI also seeks clarification as to how the Federal Government will compare provincial carbon levies ("PCL") to the Federal Benchmark and how it will determine when the Federal Backstop will be applied. Consider a situation in which there are nominal differences between proposed FCL and PCL rates for the same fuel type. For example, the Alberta PCL rate for 1 litre of gasoline is $0.0449 and the FCL rate for 1 litre of gasoline is $0.0465, with each rate being based on a $20.00 per tonne of carbon emission equivalent. Will the Federal Backstop be imposed where there is a fraction of a cent difference between the provincial and federal rates? TEI recommends the FCL legislation/regulations include provisions and tolerance levels to disregard nominal inconsistencies, consistent with the principles outlined in the Framework.

TEI also recommends that the Federal Government examine and evaluate exemptions currently offered under current provincial legislation. Provinces have established exemptions to encourage and support industries within their jurisdictions. For example, in Alberta, the upstream conventional oil and gas industry is generally exempt from the PCL pursuant to an oil and gas production process exemption until 2023. The Alberta exemption is not aligned with the Federal Benchmark in terms of non-payment for emissions. The Federal Government should consider why Alberta offered this exemption and whether similar exemptions should be provided under the Backstop. Provincial governments have unique insights into the needs of their industrial sectors and the Federal Backstop should avoid creating inter-provincial advantages or disadvantages.

General Comments on the Oil and Gas Industry

The Canadian oil and gas industry is a complex chain of businesses that collectively work to provide end-user products that Canadians enjoy daily, such as home heating, automotive fuels, and fuel for electrical generation. The oil and gas industry is typically divided into three separate sectors: Upstream, Midstream, and Downstream. Each of these sectors is unique and it is critical to understand the chain when making decisions regarding how to implement the FCL.

Upstream

Upstream includes businesses engaged in exploration and production ("E&P"). Alberta accounts for a significant portion (80% plus) of Canada's overall oil and gas production. Companies in this sector range from small/junior oil and gas companies to major international E&P companies.

Midstream

Midstream includes businesses engaged in processing, storage, and transportation for the industry. Companies within this sector include processing, fractionation, pipeline, rail and trucking.

Downstream

Downstream includes the marketing sector of the industry. Companies within this sector include bulk fuel stations and natural gas distributors.

In addition, there are hundreds to thousands of other businesses that support the oil and gas industry at every stage of the production process. The impacts to these ancillary businesses also need to be considered in the context of implementing an FCL.

A. Upstream & Midstream Concerns

The Technical Paper proposes an approach to imposing the FCL that is similar to Alberta's approach. It is crucial for the Federal Government to understand the challenges and burdens this approach has placed on industry.

The proposed approach would require all upstream companies to register or obtain license(s). Such companies will be required to make compliance filings and report volume even though their transactions are not subject to tax. The approach makes it complex to track fuel through processing. In sum, the approach is difficult to understand and implement, creates unnecessary volume reporting requirements, and is administratively burdensome.

As discussed above, TEI generally proposes that the FCL be imposed at the point where the fuel is put into use or sold to an end user. This approach would eliminate unnecessary reporting.

Moreover, such sellers already track volumes and sales of fuels at this point. By imposing tax closer to sales to end users and consumption, the FCL would have much less administrative impact upon businesses while still meeting the carbon pricing requirements.

The following summarizes TEI's recommendation by product type.

- ***Raw Natural Gas*** - Raw natural gas generally must be processed (at a gas processing facility) into marketable natural gas before it can be used as fuel by end users. However, there are instances where raw natural gas may be flared, vented, or sold to third parties prior to being processed at a gas processing facility.

  TEI recommends that the FCL only apply to raw natural gas that is consumed (flared/vented). We note that upstream businesses already have metering infrastructures in place to measure such volumes for other regulatory and commercial reasons. Raw natural gas subject to further processing should be exempt.

- ***Marketable Natural Gas*** - Marketable natural gas (and other products including propane, butane, ethane, etc.) is the product of processing raw natural gas. TEI recommends that the FCL be imposed when marketable natural gas is put into use or sold to an end user.

- ***Natural Gas Liquids*** – Natural gas liquids ("NGLs") are products resulting from the processing of raw natural gas and/or crude oil. NGLs are never consumed in their raw format and require further fractionation to pull out separate products, such as propane, butane, ethane, and pentanes. Because NGLs are never sold to end users, the FCL would not be imposed upon NGLs and instead will be imposed upon the separate products.

- ***Separate Products*** - TEI recommends that the FCL be imposed when propane, butane, ethane, and pentanes are put into use or sold to an end user.

B. Downstream Concerns

It is our understanding that the Federal Backstop will be administered as a separate program that is distinct from the FET. The Federal Government should provide businesses with online systems for FCL compliance activities. For example, registered users should be permitted to file FCL returns, access FCL registration and exemption number databases, confirm customer status for fuel sales, and perform account maintenance through a Federal Government-administered website or similar application. Moreover, registered users should be able to use their Federal Business Number for FCL purposes, thus reducing administrative complexity.

The Federal Backstop should allow for FCL-exempt fuel sales between the various classes of proposed FCL registrants or license holders; e.g. Registered Fuel Distributors ("RFDs"), Registered Fuel Importers ("RFIs"), and Registered Fuel Users ("RFUs"). Such

registrant/license holders should be required to self-assess FCL on any product consumed. Eligibility for registration in the FCL system that permits the FCL-exempt purchase of fuel products between these registrants should not be unduly restricted or onerous.[1] Further consultation with industry is required to establish the appropriate criteria for licensing/registration that balances financial risk to the Crown against simplification and cash flow impacts for stakeholder businesses.

Conceptually, the accounting for volumes and incidence FCL, particularly on motive fuels, should occur when a "finished" or "marketable" product enters the supply chain at the "rack" or direct delivery to a retail site/terminal site, with FCL assessed upon sale to the end user or consumption. This would mean that prior transactions and movements would be exempt from FCL reporting.

Significant registration, administrative, reporting and audit issues will arise, for businesses and government alike and with no incremental tax consequences, if the FCL is imposed early in the supply chain. For example, the number of registered users and audits would be significantly greater under a model that imposes tax prior to sale to an end user or consumption.

Finally, under the Technical Paper, biofuels are exempt from FCL, including that portion of biofuel that is blended with fossil fuels. Administratively, it is extremely difficult, if not impossible, for most refiners and marketers to accurately assess the biofuel component in blended fuel inventories in most instances. Additional consultation within the industry stakeholder group is necessary to ascertain whether administration of a FCL exemption is feasible except in very limited circumstances.

* * *

In sum, the approach proposed in the Technical Paper will impose significant reporting requirements and complexity upon businesses and CRA alike. Moving the taxation point further downstream to the sale to the end user or consumption will alleviate many of these concerns. Appendix A, attached hereto, details industry-specific issues and concerns that warrant further investigation and consultation.

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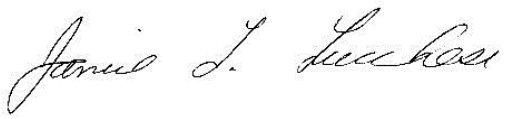
[1] This is a perceived shortfall of the existing FET model for wholesalers, etc.

TEI's comments were prepared under the aegis of TEI's Canadian Commodity Tax Committee, whose chair is David Card. Pilar Mata, Tax Counsel for TEI, coordinated the preparation of TEI's comments. If you have questions about TEI's comments, please contact David Card at (403) 699-1463 or david.card@enbridge.com or Pilar Mata at +1 202 464 8346 or pmata@tei.org. TEI consents to the disclosure of this submission in full.

Respectfully submitted,
Tax Executives Institute



Janice Lucchesi
International President

Appendix 'A' – Federal Carbon Levy Concerns

Appendix A provides additional questions, comments, or concerns the Federal Government should consider as it implements its national carbon pricing regime. TEI requests that all governmental stakeholders be made aware of these questions and concerns so they can be properly addressed when implementing this national policy.

Depending on the final model chosen, many more questions and comments may need to be addressed.

A. REGISTRATION

- What additional resources will the Federal Government (i.e., "CRA") provide to enable businesses to register quickly, review required returns, add or delete fuel types, and set up authorizations, etc.?
    - Note that if the point of taxation is moved further to the point of consumption of sale to an end user, the strain on governmental resources would be considerably less, given the smaller required registration base.
- CRA will be tasked with administration and enforcement of the FCL. TEI recommends that CRA utilize the existing Business Number system by adding a post fix to each registered entity.
- TEI recommends that CRA develop an infrastructure similar to the existing GST/HST Registry that will allow businesses to refer, on a real-time basis, to registration or exemption information, types of fuels in which an RFD, RFI, or RFU is registered for, etc.
- With respect to adding or deleting types of fuel to which an exemption or license applies, TEI recommends that CRA utilize a real-time system similar to the system available for the Excise Tax Act section 156 election ("s. 156 election"). Under s. 156 election tool in the My Business Number Account ("MyBN"), a person can go into MyBN and enter the relevant information to effect or revoke said election. A similar real-time infrastructure to add fuel types would significantly minimize resources required of CRA's personnel and avoid delays to business operations.
- Only one Federal registration, that would cover all backstopped provinces, should be required for each business. Such registration could tie into the use of MyBN.

- Only one license number should be required for a person that qualifies as an RFD, a RFU and/or an RFI. For example, for the same type of fuel, a RFD would not need to register as a RFU and/ or a RFI.

- For vehicles that have an International Fuel Tax Agreement ("IFTA") license, TEI recommends that the FCL be paid via the IFTA license instead of having to register as a RFU.

- TEI recommends that the Canada Border Services Agency charge and collect the FCL from non-registered persons entering in Canada.

B. ADMINISTRATION

- Please provide clarification regarding the refund process, such as the timing of refunds, documentation requirements, etc. Currently, refunds can take months or years to receive under certain provincial systems. This delay places a significant cash flow burden on businesses. TEI recommends allowing businesses to request refunds on their next filing.

- Depending on the outcome of the FCL model, please be aware that many upstream oil and gas activities are conducted using the current joint venture rules in section 273 of the ETA. Please consider the impact of the operator election and whether the operator will be afforded this same extension to report and remit any FCL.

- How will the Federal Government enable credits earned under a provincial or international cap and trade regime to be used or transferred for offset under the Federal Backstop?

- Registered vendors should only be required to obtain the license number of purchasers to support FCL exemptions; they should not be required to obtain a paper copy of said exemption.

- To ensure that a manufacturer/distributor/importer does not have a blend of tax paid and tax excluded inventory, RFDs should be entitled to a refund of tax on tax-included fuel. Any refund could be offset against current FCL remittance obligations and be reported on a separate line of the return. For RFDs who are not in a remittance position, a refund claim should be permitted on the same return with a net refund issued to the RFD.

C. REPORTING

- Page 12 of the Technical Paper states "the levy is not payable on natural gas until it is delivered to a final user." TEI recommends that the FCL be due

once invoiced, as opposed to when the volume is physically delivered to a final user. For instance, there can be a month lag between delivery and invoicing in some instances for upstream, midstream, and downstream activities for natural gas, NGLs, and fuel. Producing fuels is much different than simply purchasing fuel at the pump.

- The Technical Paper mentions that RFIs will generally not be able to bring fuel into a Federal Backstop jurisdiction and hold it on a levy-deferred basis. How long would it be acceptable to hold inventory before it must be resold or before a RFI must self-assess?

- It is important to only require reporting of taxable volumes for taxable transactions. Tracking volumes for volume reporting on non-taxable transactions should be avoided. For instance, RFD to RFD volumes should not be subject to reporting. TEI recommends that the FCL only apply on usage/consumption/sale transactions and that general fuel movements be outside the scope of reporting.

D. AUDIT

- What must a business require as proof of export or removal from a Backstop province? This will depend upon the mode of transport (pipeline, truck, rail, marine); however, guidance in advance would be appreciated. TEI recommends that the Federal Government consider adopting the same proof of export that currently is required for GST/HST purposes.

- The Technical Paper refers to the development of exemption certificate(s). Will such certificates be generic enough to cover all fuel types and modes of transport, such as a blanket exemption? TEI recommends that such certificates be simple. Moreover, TEI recommends that such certificates be completed on an annual basis rather than a transaction-by-transaction basis. Further, if an exemption certificate is absent, will auditors accept and allow other documentation to prove the export status of a particular fuel?

- Will an RFD be immune from liability if it accepts an exemption certificate in good faith? TEI maintains that in such cases, any FCL payable should fall on the purchaser that fails to export the fuel or uses the fuel in a non-qualifying manner.

E. Output-Based Allocations

- Who will be setting the Annual Facility Emissions Limits and where will this information be made available?

- Who will sell the federal offset carbon credits? Will these credits be subject to GST/HST?

- The proposed rules require that emissions be verified by third parties. TEI is concerned by the requirement, as it will increase the cost of an already onerous process and potentially create a new audit industry. TEI recommends that CRA review the financials and tax remittances for emissions in the same manner that CRA conducts other audits.

- TEI recommends that no limit be set on the number of years that offset credits can be banked, as this would reduce the economic efficiency of the system.

F. INDUSTRY SPECIFIC – OIL AND GAS PRODUCERS

- Has consideration been given to trading exchanges or platforms where these commodities are physically traded?

- Uncertainty exists around the definition of light fuel oil and heavy fuel oil, and the extent to which drilling base oils, refinery feedstocks, vacuum gas oils, and distillates may be considered liquid fossil fuels. Many of these products are not subject to FET or PCLs.

- Condensates/Pentanes Plus should be excluded entirely as fuels for FCL purposes as these products are not used for fuel and are instead used to manufacture fuels (feedstock). They thus appear to qualify under the current list of exemptions in the Technical Paper.

- TEI recommends that exemptions be expanded to include movements for transfers of C1 to C5 products:

  - C1 – Non-Marketable Gas

  - C2 – Ethane

  - C3 – Propane

  - C4 – Butane

  - C5 – Pentanes Plus

G. INDUSTRY SPECIFIC - RAIL

The proposed rules require inter-jurisdictional railways to register as RFUs to purchase fuel in a Backstop jurisdiction with the levy embedded and to obtain relief only when the fuel is used

outside the Backstop jurisdiction. The rules also require the RFU to self-assess and pay the FCL on inventory located in Backstop jurisdictions on the FCL implementation date (as well as on each subsequent annual levy rate increase dates).

These requirements imply that a monthly reconciliation of fuel purchases/sales, imports/exports, consumption, etc. will be mandatory. This would create a significant administrative burden for inter-jurisdictional railways and CRA, and generate significant cash outflows for inter-jurisdictional railways. In contrast, the current provincial fuel tax and carbon tax/levy compliance processes related to locomotive fuel allow inter-jurisdictional railways to purchase locomotive fuel on a levy-deferred basis and to self-assess and remit the tax/levy based on the fuel used in each jurisdiction.

- TEI recommends that inter-jurisdictional railways be allowed to purchase fuel in Backstop jurisdictions on levy-deferred basis, and be required to self-assess and remit the FCL to CRA based on the fuel used in each Backstop jurisdiction. In such case, the inter-jurisdictional railway should not be required to self-assess and remit the FCL on fuel inventory to CRA.

- TEI also recommends that inter-jurisdictional railways be allowed to make adjustments for the FCL remitted during the previous calendar year.

Under the proposed rules, inter-jurisdictional commercial carriers would also be considered RFUs for fuel consumed by non-propulsive equipment (e.g. generators, refrigerated containers, etc.) attached to their inter-jurisdictional commercial vehicles or trailers.

- TEI recommends that inter-jurisdictional railways be allowed to purchase fuel for inter-jurisdictional, non-propulsive equipment in Backstop jurisdictions on a levy-deferred basis, and to self-assess and remit the FCL to CRA on the fuel used in Backstop jurisdictions.

- TEI also recommends that inter-jurisdictional railways be allowed to report to CRA both the fuel used by the locomotives and the fuel used by non-propulsive equipment, in all Backstop jurisdictions, on the same monthly return, even if the type of fuel used in non-propulsive equipment differs from the locomotive fuel.

Finally, the proposed rules discriminate against inter-jurisdictional railways from inter-jurisdictional airlines and marine carriers, which are only required to pay FCL on intra-jurisdictional journeys. TEI maintains that inter-jurisdictional railways, airlines, and marine carriers should be treated equally.

H. INDUSTRY SPECIFIC – AIRLINES - CORSIA (Carbon Offsetting and Reduction Scheme for International Aviation)

- Why are we implementing the Backstop on airlines when the proposed CORSIA agreement is doing the same on an international level?
- If the Federal Government deems the CORSIA agreement to be insufficient, why does it not allow exemption of airline purchases with a self-assessment mechanism?
    - Most of the fuel purchased in a particular province will not be used in that province and a substantial amount of the fuel purchased in Canada will not be used in Canada. Allowing exemption certificates will simplify the compliance and audit burden for both the taxpayer and governments.