



Fuelling the Problem

Why it is time to end tax breaks to oil, coal and gas companies in Canada

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Introduction

The Canadian Government hands out around a billion dollars a year in tax breaks to oil, coal and gas companies. These tax breaks go to some of the richest companies in the country and are increasingly recognized as unnecessary and obsolete.

A new report from the International Institute for Sustainable Development shows that federal government subsidies and tax breaks to the oil and gas sector in Canada are close to 1.4 billion dollarsⁱ. Of this \$1.4 billion, \$840 million come in the form of special tax breaks.

Pressure to end these tax breaks has grown significantly over the past two years. Polls show that 70% of Canadians would support a phase-out of fossil fuel subsidiesⁱⁱⁱ, and both Environment Minister Jim Prentice and senior officials in the Department of Finance have urged the federal government to take action. The Organization for Economic Cooperation and Development and the International Energy Agency, organizations established by industrialized nations to provide advice on economic and energy policy, have also called for an end to fossil fuel subsidies, and leaders like President Barack Obama have been working to end tax breaks for oil, coal and gas companies in the U.S., while championing a global phase-out in international forums like the G20.

Prime Minister Stephen Harper took some small steps towards a phase-out of a specific tax break to fossil fuel companies in the government's 2007 budget, but he

What is a subsidy?

Subsidies are support offered by the government to a certain industry. A common form is monetary support through direct and indirect transfers (including tax breaks, loan guarantees, indemnification programs, etc.). Subsidies can also include shifting costs of industry activity to the public (e.g. government reclamation of industry pollution) and government spending on things that complement the industry (e.g. paving roads for vehicles instead of investing in electric-light rail).

stopped there. According to one recent analysis, the government could save close to \$1 billion annually by eliminating a handful of the special tax breaks that go to the oil and gas industry. The G20 meeting in South Korea on the 11 and 12th of November, and the drafting of the 2011 Federal Budget offer clear opportunities for the Prime Minister to move decisively to end this giveaway ^{iv}.

This report describes the problems with tax breaks for the fossil fuel industry, and outlines the global initiatives that are in place to encourage their eradication. It provides an overview of Canada's existing tax breaks as well as actions taken by the federal government in the lead up to the Toronto G20 in June 2010 and it describes how Prime Minister Harper chose not to act on the subsidies phase-out initiative at this G20 meeting. The report also proposes concise actions and timelines for the federal government in order to move towards the elimination of tax breaks to the oil and gas sector in the 2011 federal budget.

The problems with fossil fuel tax breaks and subsidies

By subsidizing fossil fuel producing companies the government is encouraging faster production and facilitating the rapid expansion of large fossil fuel projects such as the Alberta tar sands, Canada's fastest growing source of greenhouse gas pollution. The recent IISD report shows that emissions from the tar sands are around 12% higher than they otherwise would be if this sector was not subsidized^v.

Globally - artificially low costs of fossil fuels have been shown to encourage wasteful consumption, distort energy markets, and allow for increased greenhouse gas pollution, thereby fueling the climate crisis. Subsidizing oil extraction also makes investments in oil more attractive compared to lower carbon, lower risk alternatives, thereby increasing the lock-in of economies into fossil fuels.

In a time of fiscal constraint, the federal government could generate hundreds of millions of dollars in extra revenue by ending unfair tax breaks to some of the richest companies in the world. Eliminating handouts to oil and gas corporations operating in Canada would also help the country take a step towards a cleaner energy economy.

Prime Minister Harper's initial action

The 2007 federal budget included a phase-out of accelerated capital cost allowances for oil sands, which allows companies operating in the tar sands to claim tax breaks on up to 100% of assets acquired to build new projects. The phase-out is scheduled to take place between 2011 and 2015 and result in additional tax revenue of \$300 million per year by 2015 for the federal government.

Since that time, the Canadian government has taken no additional action to reduce, phase-out or eliminate other fossil fuel tax breaks or subsidies and continues to give up well over a billion dollars in revenue to the oil, gas and coal sector each year.

G20 pledges to end fossil fuel subsidies and tax breaks

With the election of President Obama in 2008, there is a new willingness in the U.S. to take action on climate change and clean energy.

President Obama used the Leaders' Summit at the September 2009 G20 meeting in Pittsburgh to spearhead a G20 initiative to end fossil fuel subsidies and tax breaks. Obama already had support for this initiative from the Organization for Economic Co-operation and Development (OECD) and the International Energy Agency (IEA)—two international institutions that industrialized countries established to advise them on economic and energy policy.

At the conclusion of the Pittsburgh summit G20 leaders, including Prime Minister Harper, released a statement in which they acknowledged that:

"Enhancing our energy efficiency can play an important, positive role in promoting energy security and fighting climate change. Inefficient fossil fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change^{vi}."

What is the OECD?

The Organization for Economic Co-operation and Development (OECD) is composed of and controlled by 33 industrialized countries and focuses on world trade. It is committed to the market economy and sound economic expansion. It helps coordinate domestic and international economic policy among its members.

Founded by the OECD in response to the 1970's oil crisis, the International Energy Agency (IEA) advises 28 member countries on energy policy, energy security, and climate change. It is also governed by wealthy industrialized nations.

With this in mind, all G20 leaders committed to:

"[...]phase out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption."

The agreed final commitments also tasked G20 Energy and Finance Ministers to develop concrete strategies for phasing out fossil fuel subsidies in their countries. Each leader was expected to present a national strategy at the next G20 meeting to be held in Toronto in June of 2010.

To act or not to act?

Acting on the commitment made in Pittsburgh, a memo was prepared by senior officials at the Department of Finance Canada and presented to Minister Flaherty on how best to move forward in order to end fossil fuel subsidies and tax breaks in Canada. The Department of Finance began to develop proposed options for a new Canadian position on fossil fuel subsidies.

Normally this decision-making process within the Department of Finance would have occurred behind closed doors, but in May 2010, a confidential Department of Finance memo was leaked to the media. This memo outlined Finance Canada's recommendations for Canada's position and was submitted to the Minister of Finance, Jim Flaherty, by his Deputy Minister, Michael Horgan on March 18th (days before Canada had to submit its initial proposal to the G20). The memo opened as follows:

"This note sets out two broad possible approaches to respond to the [Pittsburgh G20] commitment: 1) explore opportunities for selective [phase out of fossil fuel subsidies] by Canada (which we recommend); or 2) seek to minimize the commitment. Once we have your view, we would draft a letter from you to the PM setting out the proposed approach." (see appendix 1 for the memo in full).

In greater detail the two options described in the leaked memo were as follows:

Option 1

To Act: take action towards an immediate phase-out of fossil fuel subsidies

The memo stated, in no uncertain terms, that Canada should take action to reduce fossil fuel tax breaks and subsidies in Canada.

In the memo, Finance Canada officials argued that times have changed and the reasons that the government once used to justify tax breaks to fossil fuel companies

may no longer apply. Factors such as the relatively high risks associated with exploring for oil and other fossil fuels, volatile prices in the sector, or the need to ensure that Canadian fossil fuel companies could compete with companies in other countries, might have at one time justified subsidies. The memo states that “[today] it is not clear that these factors are unique to the sector or merit preferential treatment.”

Officials also argued that removing tax subsidies, “may be beneficial, even if undertaken unilaterally,” and that taking action would help:

- “improve Canada’s international image, e.g. with respect to the oil sands”;
- bolster Canada’s desire to be known as a “clean energy superpower”;
- “defend against U.S. government or individual company actions targeted, for example, against oil sands,”; and
- reduce the budget deficit.

The authors of the memo pointed out that as, “host of the [G20] June Leader’s summit in Toronto, Canada will be expected to lead by example in delivering on the commitments agreed to in Pittsburgh.” They reiterated the arguments outlined in the Pittsburgh G20 communiqué, namely that “inefficient fossil fuel subsidies encourage wasteful consumption, distorts markets, impede investment in clean energy sources and undermine efforts to deal with climate change.”

Finally, Finance Canada officials argued that phasing out fossil fuel subsidies would be broadly supported. They pointed out that the OECD had already recommended reducing fossil fuel subsidies in Canada on “both economic and environmental grounds,” that Environment Minister Jim Prentice had already supported “reducing tax breaks for fossil fuel companies” in his pre-budget memo to [Finance Minister Jim Flaherty], and that the International Monetary Fund (IMF), International Energy Agency (IEA), some provinces (especially Ontario and Quebec), and environmental organizations “would be supportive.”

On the other hand, Finance Canada officials warned that the fossil fuel industry “would likely be critical of any [phase-out],” and some “provinces with active oil and gas and coal mining industries may also be critical.”

The memo suggested a list of fossil fuel tax breaks that could be phased out pending the Minister’s choice of approach.

Option 2

Not to act: ‘minimize the obligation’

The second option proposed in the memo was to reject the G20’s recommendation to phase out tax breaks to oil and other fossil fuel companies. Finance Canada officials laid out a strategy in the case that “Canada [was] not prepared to undertake

any substantive reforms,” which was designed to create the appearance of action without undertaking any new action to meet the G20 commitment.

The memo describes how “Canada could take the position that it has already removed significant producer tax preference, and must be given credit for early action.” For example, the memo lists three previous fossil fuel subsidies that had expired or been eliminated, such as the Syncrude Remission Order, which expired in December 2003.

This “minimize the commitment” strategy involved taking credit for expired and/or eliminated fossil fuel subsidies that were concluded well before the G20 meeting in Pittsburgh. According to Finance Canada officials, this could include not only the initial actions taken by Prime Minister Harper in the 2007 federal budget, but also actions that were taken as far back as 2003 and 1989, well before the current government came to power.

Wait and see

Civil society and media jumped on the leaked document, interested in this rare glimpse at the confidential interaction between civil servants and politicians. Would the politicians follow their own department’s advice, or would the decision reflect the Prime Minister’s close relationship with oil and gas companies, who would no doubt prefer not to see their tax breaks slip away?

In the run-up to the G20, the Prime Minister had a unique opportunity to make a decision that would be supported by the Minister of the Environment, senior officials in the Department of Finance, non-governmental organizations, many provinces, G20 countries, the OECD, IMF and IEA, as well as the Canadian public.

The government refused to comment on the internal document, and made no announcements of changes to fossil fuel tax policies. As a result, Canadians’ only options was to wait and see what the government’s final position on fossil fuel subsidies would be at the G20 meeting in Toronto.

The Toronto G20

The June 2010 G20 meeting in Toronto put Canada in the spotlight. Countries’ plans for fossil fuel tax breaks and subsidies phase-out were to be captured in an annex of the final leaders’ statements coming out of the G20.

Instead of releasing this Annex on the last day, as expected, Canada refused to make it public. (The Annex was not officially released until three months later.) However,

a scanned copy of the annex was leaked to the media before the end of the G20 summit.

The text that Canada submitted to the annex was nearly identical to the second option — i.e. to minimize Canada’s commitments — in the Department of Finance’s memo. Just as the strategy suggested, the federal government tried to take credit for its initiatives from 1989, 2003 and 2007, but it proposed no new plans for reducing the remaining subsidies.^{vii}

Side by side memo and G20 annex:

Department of Finance memo – Option 2

- If producers subsidies are covered, Canada could take the position that it has already removed significant producer tax preferences, and must be given credit for its early action:
 - earned depletion deduction (eliminated 1989);
 - favourable tax treatment provided under the Syncrude Remission Order (expired 2003); and
 - resource allowance (replaced with royalty deductibility in 2003-2006).
- Implementing the phase-out of accelerated capital cost allowance for oil sands over the 2011-2015 period (announced in Budget 2007) could be cited as a current action helping to fulfill the commitment.

Final Canadian text of fossil fuel subsidies implementation plan

Earned Depletion Deduction

Pursuant to an announcement made in 1987, additions to the depletion pools for earned depletion and mining exploration depletion, described below, were eliminated as of January 1, 1990. Companies now are only entitled to deduct pre-1990 depletion amounts not previously claimed.

Past Reforms

Resource Allowance

The resource allowance, described below, was phased out, and a deduction for actual royalties and mining taxes paid was phased in (deductible under general principles as a cost of doing business), over the 2003-2006 period. As of 2007, the resource allowance was fully eliminated.

Syncrude Remission Order

The Syncrude remission order, described below, ended on December 31, 2003.

The Syncrude oil sands project was initiated in the early 1970s when Crown royalty charges paid to provincial governments were fully deductible in the computation of income taxes. In May 1976, the federal government granted a remission order to Syncrude participants by Order-in-Council. The remission order permitted project participants to deduct joint venture

For the second time in months, the leaked Department of Finance memo was the centre of attention. The Minister of Finance and the Prime Minister had sided with the oil companies - by refusing to phase out tax breaks- against the advice of top officials and the Minister of the Environment.

It is no secret that Prime Minister Harper meets frequently with oil and gas companies operating in Canada^{viii}, many of which make billions of dollars per year extracting dirty oil from the tar sands. A look at the billion dollar revenues of some of these companies makes it difficult to understand why our government hands out around a billion dollars a year in tax breaks to oil and other fossil fuel companies.

Lobby Registry

Preferential treatment is given to oil & gas companies in accessing the Harper government. Oil & gas meetings account for 9% of all lobbying since July 2008, more than any other single industry or civil society lobby. Over 40% of all the PM's oil & gas meetings were with Alberta-based Suncor Energy.

Fossil Fuel Company revenues in Canada

Companies with tar sands investments have combined annual revenues over \$1.2 trillion. Of these revenues, more than \$1.1 trillion belong to foreign-owned companies. For example, US-owned ExxonMobil, with investments in the Syncrude development, brings in almost \$320 billion

Room for improvement

Prime Minister Harper's refusal to phase out any new fossil fuel tax breaks and subsidies, despite the pressure of the G20 summit, reflects a broader recklessness in his approach to climate change and energy issues. Over the past 4 years, the Harper government has made a series of empty promises, refused to cap or price industrial greenhouse gas pollution, and has allowed support for the only major federal program focused on renewable energy to expire.

There are two major opportunities in the coming months for the Harper government to change course and phase out tax breaks to fossil fuel producers: the next G20 Leaders' Summit, which will be held in South Korea in November 2010, and the 2011 federal budget.

The Green Budget Coalition, a coalition of over 20 non-governmental organizations in Canada that submits priority recommendations for each annual federal budget, has prepared a preliminary list of tax breaks that could be phased out in the forthcoming budget. If these tax breaks were to be eliminated, the federal government could generate over \$930 million annually — nearly equivalent to the annual operating budget of Environment Canada.

The Green Budget Coalition's recommendations include 7 distinct government tax breaks that go specifically to the oil and gas industry and that are more than they would be under a neutral tax system. The GBC's recommendations include eliminating tax breaks for the exploration of new sites, new property and equipment, as well as eliminating special depreciation rates for tar sands infrastructure.^{ix}

Reality Check

Ongoing subsidies and tax breaks to the fossil fuel industry are irresponsible and are fuelling climate change, one of the biggest crises facing humanity today. The government's inability to take action even on the most elemental levels, such as putting an end to tax breaks for the richest companies in the world, reflects a broader recklessness towards this problem.

Vulnerable regions around the world are already bearing the brunt of some of the devastating consequences of global warming, and the prognosis is not encouraging. In East Africa, over 20 million people are enduring a humanitarian crisis with the worst droughts to hit their region in history, and in West Africa another ten million face a similarly extraordinary crisis.^x The World Health Organization estimates the number of people at risk of hunger will increase by over 50 million people in the next 40 years as a result of climate change.^{xi}

Here in Canada, the impacts of extreme weather are also becoming increasingly severe. In the wake of unprecedented forest fires in British Columbia this year, the province has admitted its forest fire strategies are outdated in light of the dramatic climate change the province is experiencing.^{xiii} In our northern regions, entire cultures are being challenged as traditional ways of life become incompatible with the changing climate.^{xiii}

The National Round Table on the Environment and the Economy (NTREE) warns that unless action is taken to address climate change, with projected warming, Canada can expect sea level rise, increased frequency of wildfires in the Western provinces, desertification and drought in the Prairie provinces, reduced water quality and quantity across the country, increased risk to people and property from extreme weather events, increased exposure to vector-borne diseases, and increasing risk to farming from drought and agriculture pests and disease (among many other impacts).^{xiv}

While other world governments are taking this problem seriously, the Government of Canada continues to ignore the will of Parliament and the majority of the Canadian public that wants strong action on climate change now. Prime Minister Harper may have failed to protect our environment and our climate up until now, but if we act urgently, it is not too late.

Ending tax breaks and other subsidies to dirty oil will not in and of itself avoid dangerous climate change, but unless we stop fuelling the problem it will be that much harder to embrace the solutions. This government has an opportunity to change direction and move towards a cleaner future. In the 2011 budget Prime Minister Harper and Minister Flaherty should end tax breaks for oil, gas and coal companies. This will lead to increased revenue of over one billion dollars and eliminate an important obstacle to fighting climate change.

ⁱ International Institute for Sustainable Development, November 2, 2010. Fossil fuels: at what cost? *Government support for upstream oil activities in three Canadian Provinces*. <http://www.iisd.org/media/press.aspx?id=180>

ⁱⁱⁱ De Souza, Mike. The Calgary Herald, June 25, 2010. *2 in 3 Canadians want G8/G20 summiteers to discuss fossil fuel fix: Poll*. <http://www.calgaryherald.com/technology/Canadians+want+summiteers+discuss+fossil+fuel+Poll/3201488/story.html>

^{iv} The Green Budget Coalition, September 2010. *Preliminary recommendations for budget 2011. Building on success: strategic opportunities in nature conservation, energy efficiency, and water*. Page. 23. [http://greenbudget.ca/pdf/Green%20Budget%20Coalition%27s%20Preliminary%20Recommendations%20for%20Budget%202011%20\(September%202010\).pdf](http://greenbudget.ca/pdf/Green%20Budget%20Coalition%27s%20Preliminary%20Recommendations%20for%20Budget%202011%20(September%202010).pdf)

^v International Institute for Sustainable Development, November 2, 2010. Fossil fuels: at what cost? *Government support for upstream oil activities in three Canadian Provinces*. <http://www.iisd.org/media/press.aspx?id=180>

^{vi} Leaders' Statement: The Pittsburgh Summit. September 2009. Energy Security and Climate Change. Paragraph 29. <http://www.pittsburghsummit.gov/mediacenter/129639.htm>

^{vii} *G20 Initiative on Rationalizing and Phasing Out Inefficient Fossil Fuel Subsidies: Implementation Strategies & Timetables – Annex 2, pg.11*

^{viii} Mayeda, A. and Kennedy, M. Vancouver Sun. October 2, 2010. Lobbyists for oil, industry had most access to Harper: www.vancouversun.com/life/Lobbyists+industry+most+access+Harper/3614585/story.html

^{ix} The Green Budget Coalition, September 2010. *Preliminary recommendations for budget 2011. Building on success: strategic opportunities in nature conservation, energy efficiency, and water*. Page. 23. [http://greenbudget.ca/pdf/Green%20Budget%20Coalition%27s%20Preliminary%20Recommendations%20for%20Budget%202011%20\(September%202010\).pdf](http://greenbudget.ca/pdf/Green%20Budget%20Coalition%27s%20Preliminary%20Recommendations%20for%20Budget%202011%20(September%202010).pdf)

^x Oxfam Canada. *The human cost*: <http://www.oxfam.ca/news-and-publications/pressroom/press-releases/oxfam-launches-165m-appeal-east-africa>; <http://www.oxfam.ca/what-we-do/emergencies/sahel>

^{xi} World Health Organization, 2007. *Climate and Health Fact Sheet*.

^{xii} Shore, Randy. Vancouver Sun, October 2, 2010. *Climate change causes overhaul of wildfire strategy*: <http://www.vancouversun.com/technology/Climate+change+causes+overhaul+wildfire+strategy/3614563/story.html#ixzz11CPBbOn1>

^{xiii} Climate Action Network Canada. Canada's Climate Change Calendar. 2010. *National Aboriginal Communities; climate change impacts*. <http://climatecalendar.ca/country/national-aboriginal-communities>

^{xiv} National Round Table on the Environment and the Economy; and the Royal Canadian Geographical Society. 2010. Degrees of Change: http://www.canadiangeographic.ca/climate-prosperity/degrees_of_change/CanGeoClimateChange_EN.html