Electricity Canada Électricité Canada

CANADIAN GAS ASSOCIATION
ASSOCIATION CANADIENNE DU GAZ

To the members of the Standing Senate Committee on National Finance,

Re: Electricity Canada and Canadian Gas Association response to FINA decision on regulated utilities (Bill C-59)

On behalf of Electricity Canada and the Canadian Gas Association, I am following up on an issue that our associations raised on March 20th as part of the committee's pre-study of Bill C-59. On April 30th, the Standing Committee on Finance voted against an amendment (CPC-1) that would have exempted regulated utilities from the Excessive Interest and Financing Expenses Limitation ("EIFEL") – this amendment would have resolved our concerns regarding the unintended capture of regulated utilities.

In the absence of the exemption, capturing regulated utilities within the rules will inadvertently add tens of millions of dollars in extra costs to Canadians in several provinces. This will make paying energy bills harder and will restrict investments in net zero infrastructure.

In providing the government's rationale for voting against the amendment proposed by MP Philip Lawrence, MP Ryan Turnbull stated:

> *"In analyzing this, we feel that CPC-1 introduces a sector-specific exemption to the EIFEL rules for regulated utilities, and that that's unnecessary, because there's already relief provided to all taxpayers in highly leveraged industries such as regulated utilities. The amendment would undermine the policy of preventing the erosion of the Canadian tax base from excessive interest and financing expenses by large multinationals that are likely to use this debt to finance activities outside of the country.*
>
> *Lastly, I'll say the proposed regulated utility exemption is extremely broad. For instance, it would allow regulated utilities to claim excessive financing expenses for borrowings meant to support a utility business outside of Canada and for borrowings that support any part of the regulated utility business. In addition, the change be vulnerable to inappropriate tax planning, as it allows interest expenses to be claimed on non-arm's length borrowings."*

While we appreciate the intent behind this rationale, we feel it is important to point out that it **does not align with our analysis of Bill C-59 and the and its impacts on our members (regulated utilities and their holding companies) and their customers.**

First, it is important to note that **Bill C-59 does NOT provide sufficient relief for regulated utilities**. The principal relief measure in Bill C-59 for highly leveraged industries is the group ratio rule. **Although that rule is intended to allow a greater amount of interest to be deductible, it will generally not provide relief for regulated utilities** (which are required to be highly leveraged by their regulators).

Unlike the main EIFEL rule that is based on taxable income, the group ratio rule is based on accounting income. Various book to tax differences under the regulated accounting rules prevent the group ratio rule from applying as intended. Further details on the issues with the group ratio (as well as the indefinite carry forward of denied interest) are outlined in the Appendix.

Second, we note that **exempting regulated utilities from the EIFEL rules is entirely consistent with the underlying policy of the rules**. The recommendations in Action 4 of the G20/OECD Base Erosion and Profit Shifting Project (the "**BEPS Action 4 Report**") on which the EIFEL rules are based contemplated an exemption for privately-owned public-benefit assets (such as regulated utilities). The BEPS Action 4 Report states:

> *"In some countries, privately-owned public-benefit assets may be large-scale assets financed using a high proportion of debt. However, because of the nature of the assets and the close connection with the public sector, some such financing arrangements present little or no base erosion or profit shifting risk."*

Other jurisdictions, such as the United Kingdom and the United States, have adopted such exemptions without "opening the floodgates" for other sector-specific exemptions. An exemption for regulated utilities would simply recognize the clear benefit that the Canadian public generally will receive in the form of lower utility costs and a cleaner environment as our utilities incur the costs necessary to obtain net zero targets.

Third, the proposed exemption for regulated utilities is not excessively broad. We note that the regulated utility exemption in the United States applies to both domestic and foreign regulated utilities (recognizing that in each case capital levels and rates are determined within regulatory limits – and present little or no base erosion or profit shifting risk). Moreover, for commercial reasons it is often necessary for a Canadian parent company (with an external credit rating and relationships with lenders) to borrow funds on behalf of the corporate group. Where the Canadian parent then on lends the funds to its regulated utility subsidiary – the underlying debt should not be treated any differently than if the regulated utility had directly borrowed from third parties. In addition, if any regulated utility were controlled by a non-resident its borrowings would also be subject to the interest deductibility restrictions under the thin capitalization rules. The proposed exemption is narrowly crafted to only apply in respect of regulated utilities – which is obviously not a sector of the economy that taxpayers can somehow manipulate.

When questioned by the Committee, Ms. Gwyer (Finance Canada Director General – Tax Policy Branch) stated that the decision to pass costs on to Canadians would be up to the discretion of companies impacted by EIFEL. While this may be true for many companies, it is not the case in the regulated utilities industry, as utilities are regulated by their provinces and have an obligation to pass tax costs directly on to customers. **We are concerned that despite efforts to provide our rationale for why regulated utilities are uniquely suited for an exemption, there remain several misconceptions about our industry and how costs are absorbed or passed on to customers.**

We remain concerned that on its current course and without a carve-out for regulated utilities, this Bill C-59 will add costs to Canadians that will not benefit their services and will be counterproductive to Canada's climate objectives.

At the same time, these changes **increase energy bills for some Canadians while exempting others**, as the provisions exempt provincially owned utilities. However, some Canadian utilities do not meet the exemption criteria, creating a patchwork of winners and losers across Canada by province.

Utilities are at the forefront of building for a net zero economy, while also providing affordable and reliable services. For these reasons, other OECD countries including the United States and the United Kingdom, have provided exemptions to regulated utilities, recognizing their unique market structure and public interest benefit.

Budget 2024 recognized the need for public interest exemptions by providing an exemption to the EIFEL provisions for purpose-built housing development. The principle being applied to rental housing development should also be applied to keeping energy bills affordable, as we double or triple the size of the electricity grid.

On behalf of our associations and regulated utilities, I implore you to consider a Senate amendment for Bill C-59. We are pleased to meet with Senators in advance of the Bill's consideration in committee to further explain the rationale behind this amendment.

Sincerely,

Francis Bradley
President and CEO
Electricity Canada

Paul Cheliak
VP Strategy and Delivery
Canadian Gas Association

More resources:

- *Electricity companies warn tax changes could hamper push for net-zero*, (story in The Logic by Jesse Snyder)
- *Electricity, gas bills could rise given proposed tax change. Why?*, (story by the Canadian Press)
- Parliamentary appearance – Electricity Canada opening remarks start at 15:44:44
- Senate appearance – Electricity Canada & CGA opening remarks at 18:59:02

Appendix

Group Ratio

The group ratio rule does not provide relief for most regulated utilities primarily due to significant book to tax differences. Specifically, there is a large discrepancy between a consolidated group's book EBITDA (determined using accounting rules and referred to as "group adjusted net book income") and a Canadian company's tax EBITDA (determined using tax rules and referred to as "adjusted taxable income"). As a result, a Canadian company's net interest expense will likely exceed 30% of tax EBITDA, while simultaneously the consolidated group's net interest expense will be less than 30% of the consolidated group's book EBITDA. These discrepancies can arise for a variety of reasons, particularly due to rate-regulated accounting and the impact of consolidating foreign regulated utilities. The accounting rules governing regulated utilities generally result in a group adjusted net book income in excess of the adjusted taxable income because of temporary and/or permanent book to tax differences. Foreign regulated utilities can also skew the group ratio because other jurisdictions, such as the US, have a higher equity thickness (resulting in lower amounts of debt relative to equity) and the return on equity range is generally higher – leading to higher earnings which is compounded by the higher amount of equity. For example, a significant US acquisition could put a Canadian regulated utility offside for the group ratio.

Indefinite Carry Forward

Generally, regulated utilities have stable earnings and are not expected to generate excessive earnings in any year to be able to utilize the indefinite carry forward of denied interest expenses. There are commercial and regulatory constraints to significantly changing the capital structure and/or business operations to be in a position to generate sufficient taxable earnings to use both current year interest expense and the carry forward of denied interest expenses. The impact of the EIFEL rules will be compounded as a result of increasing interest rates.

The inability to use the restricted interest and financing expenses will become a permanent cost from an accounting perspective thus increasing the tax cost for accounting purposes and therefore increasing the cost to be recovered from customers. Many Canadian regulated utilities are only permitted the recovery of tax on a current basis with no future reduction in tax cost where the denied interest is not expected to be used; thus, the customers have a permanent cost.