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## Budget 2010: significant tax changes announced affecting the development of district energy systems

Budget 2010 proposed a number of legislative amendments intended to encourage the development and use of various clean energy technologies. In particular, it proposes to extend the accelerated capital cost allowance ("**CCA**") regime in respect of certain renewable energy and energy conservation equipment included in Class 43.2 (or Class 43.1) to include distribution equipment for district energy systems and certain forms of heat recovery equipment. This will potentially enable taxpayers to claim CCA equal to 50 percent per year (30 percent per year for equipment included in Class 43.1) on a declining balance basis in respect of such equipment. Budget 2010 also proposes to clarify the availability of flow-through shares as a financing option for certain corporations proposing to develop district energy systems.

District energy systems transfer thermal energy between a central source and a group or district of buildings by circulating steam, hot water or cold water though underground pipes. At present, energy distribution equipment is only included in Class 43.2 (or Class 43.1) if it distributes heat produced by electrical cogeneration equipment included in Class 43.2 (or Class 43.1). However, it has been suggested that such a restriction fails to reflect the technologies typically used in many district energy systems or the technologies which have been recently added to Class 43.2 (and Class 43.1), such as active solar equipment and ground-source heat pumps. The changes proposed in Budget 2010 will remove that restriction and will extend the accelerated CCA regime to distribution equipment used to provide district heating (or cooling) using any combination of equipment described in Class 43.2 (or Class 43.1, as the case may be).

Budget 2010 also proposes to further expand Class 43.2 by removing the restriction which requires that heat recovery equipment included in Class 43.2 only be used to reuse heat in a process of the same type as the process which initially generated it. This amendment will allow heat recovery equipment used in a wider variety of applications to be eligible for the accelerated CCA regime in respect of Class 43.2 equipment.

The new proposals regarding the accelerated CCA regime will apply to eligible assets acquired on or after March 4, 2010, provided they have not been used or acquired for use before that date.

Finally, the Budget proposes to change the definition of a "principal-business corporation" to include a corporation whose principal business is the distribution of energy using equipment described in Class 43.2 (or Class 43.1), such as a district energy system. This change will ensure that such a corporation can use "flow-though shares" as a means of financing the development of energy distribution projects, such as district energy systems. Flow-through shares are a mechanism that allows a "principal-business corporation" to "renounce" or transfer to investors its "Canadian renewable and conservation expense" ("**CRCE**") tax deductions (which deductions relate to certain start-up costs for projects using Class 43.2, or Class 43.1, property, such as engineering and design work and feasibility studies). The ability of investors to claim renounced CRCE tax deductions provides an incentive for investors to invest in such flow-through shares, and helps renewable energy projects raise capital. The amendment to the definition of a "principal-business corporation" will apply in respect of taxation years ending after 2004.

Taken together, the announced changes, assuming they are enacted, will provide significant tax incentives for the development of district energy systems and the expanded use of heat recovery technologies. They will also ensure that flow-through shares will be available as a means of financing the development of district energy systems.

For more information, contact any of the lawyers listed below:

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## a cautionary note