Applying the Accelerated Capital Cost Allowance for Oil Sands, Upgrading and Petrochemical Industries

Issue

The Alberta Chambers of Commerce has consistently delivered the message to federal and provincial governments that the accelerated capital cost allowance (ACCA) needs to remain in place as a key component of a strategy to attract new investment in resource extraction and value-added manufacturing including resource upgrading. In particular, for Alberta's value-added strategy it is critical that standalone upgraders and other petrochemical industry be eligible for the accelerated depreciation treatment. Under the current rules they do not qualify. With oil prices approaching all-time lows, a stagnating economy and the near complete withdrawal of energy investments, now is the time for the government to reinstate ACCA for all oil and gas related projects.

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. Accelerated capital cost allowance or ACCA, as the name implies, 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 in situ 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 were 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-per-cent 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 mining 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, 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.

As green-field 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. (i.e., 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 Energy Utilities Board regulatory process. This process extends the lead-time and upfront costs of projects. Addressing the climate change challenge will undoubtedly require investment of significant new capital investment. By providing for more rapid capital recovery, the ACCA will greatly assist in making Canadian 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, 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 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 Canada.

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

A strategy is to secure and strengthen an advantage in value-added manufacturing. Partly based on natural gas liquids (NGL) extracted from new northern gas supplies and new supplies of petrochemical feedstocks and refinery grade petrochemicals that 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 by-products, there simply will be no sustainable 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 Canada as an energy leader for decades to come. However, these industries are capital intensive, and face competition from other jurisdictions and considerably 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 petrochemical industry should be treated similarly to other manufacturing sectors and be allowed to apply the ACCA.

The Alberta Chambers of Commerce recommends the Government of Canada:

1. Reinstate the accelerated capital cost allowance for oil sands projects.
2. Extend accelerated capital cost allowance to include resource processing investment, including integrated upgraders, merchant upgraders and petrochemical industrial projects.