OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

Cost Estimate of Election Campaign Proposal

Publication date:	2019-09-25
Short title:	Eliminating Flow-through Share Deductions for Coal, Oil and Gas Projects
Description:	This measure will eliminate all flow-through shares (FTS) for coal, oil and gas projects. FTS are a tax-based financing incentive that allows corporations to renounce the tax benefits of Canadian Exploration Expenses (CEE) and Canadian Development Expenses (CDE) to investors.
Operating line(s):	Corporate Income Taxes, Personal Income Taxes

Data sources:

Variable	Source
Corporate Income Tax (CIT) CEE & CDE for FTS	T2-LEAP, Statistics Canada, CRA Finance Canada, Tax Expenditure Report 2013, 2019
Personal Income Tax (PIT) Flow-through-Shares	27.1 SPSD/M[1]
Energy Price Index	PBO EPC Baseline

Estimation and projection method:

This measure has an implementation date of January 1st, 2020. FTS issued prior to January 1st, 2020 are assumed to be grandfathered and will be fully renounced to investors within a 2-year period.

The CIT impact is estimated using the Tax Expenditure Report published by Finance Canada and T2 returns provided to Statistics Canada by the Canada Revenue Agency. Simulations were run on 2009-2015 tax data. CEE is 100% deductible in the year expenses are incurred. CDE is deductible at a 30% declining balance basis. The net cost is calculated as the aggregate corporate share of the deductions multiplied by the proportion of oil, gas and coal industry. Capital gains implications and the depreciation schedules of CDE were considered.

The PIT impact is estimated using SPSD/M data. Assumptions from T2 data were applied to the 'Exploration and development expenses deduction.' The marginal tax rates of individuals were used to calculate the share of the impact. Capital gain costs were considered.

The proportion of clean energy investment was removed. All excluded industries were assumed to maintain FTS. This estimate assumes historical investment, on average, is reflective of future investment. To account for the

[1] This analysis is based, in part, on Statistics Canada's Social Policy Simulation Database and Model (SPSD/M). The assumptions and calculations underlying the SPSD/M simulation results were prepared by the Office of the Parliamentary Budget Officer (PBO) and the responsibility for the use and interpretation of these data is entirely that of the PBO.

increase since 2015, the net cost was scaled up using the PBO EPC Baseline Energy Price Index.

This estimate also accounted for the interaction with an increased corporate income tax rate from 15% to 21% on large firms.

Uncertainty assessment:	The estimate has high uncertainty. The estimate is based on historical data which may not be representative of the future investment behaviour of firms. To identify the coal, oil and gas corporations from the T2 data, assumptions were imputed based on the firm-reported NAICS. Proportions from the NAICS were assumed to hold across the data. Flow-through shares for corporations were assumed based on the 2019 Tax Expenditure Report published by the Department of Finance. The removal of FTS may result in changes to the amount of capital available to firms and reduce the amount of future CEE and CDE. No behavioral effects were considered. The accelerated measures under the FES 2018 were not considered.

Cost of proposed measure

$ millions	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029
Eliminating Flow-through Share Deductions for Coal, Oil and Gas Projects.	-7	-49	-98	-108	-110	-112	-114	-116	-119	-121
Interaction effects	-1	-4	-7	-10	-10	-10	-11	-11	-11	-11
Total cost	-7	-54	-106	-118	-120	-122	-125	-127	-130	-132

Note:
Estimates are presented on an accruals basis as would appear in the budget and public accounts.
Positive numbers subtract from the budgetary balance, negative numbers contribute to the budget balance.
"-" = PBO does not expect a financial cost