WeirFoulds LLP

PROPERTY
— LEASING UPDATE

FEBRUARY 2015

FOR MORE INFORMATION OR INQUIRIES

Lisa Borsook
416.947.5003
» full bio

Robert Eisenberg
416.365.1110
Student-at-law

The (Carbon) Taxman Cometh: The Impact of Carbon Taxes on Landlords and Tenants

What is a Carbon Tax?

A carbon tax is a tax on the greenhouse gas (GHG) emissions generated from burning fossil fuels. In economic terms, it means putting a price on each tonne of GHG emitted. This increase in price will then, theoretically, discourage their use on the basis of economic inefficiency. In practical terms, it means the government placing a surcharge on the use of different forms of energy/fuel based on their carbon content or GHG emissions.

Carbon Taxes in Canada

Alberta

Although enacted in 2007, Alberta's tax on carbon is not seen as a "true" carbon tax. The Specified Gas Emitters Regulation (SGER) requires facilities that emit more than 100,000 tonnes of GHGs per year to cap their emissions intensity at 12 per cent below the average for 2003-05 or pay a penalty of $15 for every tonne by which they exceed the limit.
The SGER has so far raised $500 million to be spent on technological advancements to reduce emissions. However, the regulation is set to expire in June 2015 and the provincial government has not yet announced a replacement program.

British Columbia

In 2008, British Columbia introduced the first "true" carbon tax in Canada. The province taxes most types of fuel at the rate of $30 per tonne of carbon dioxide emitted (approximately 7 cents per litre of gasoline) and the tax is collected from consumers by fuel vendors.
B.C.'s tax is – by law – revenue-neutral, meaning that all revenue raised by the tax is returned to individuals and businesses through other tax reductions. As a result, the province now has the lowest personal income tax rate in Canada and one of the lowest corporate rates in North America.

Quebec

In 2013, Quebec instituted a cap-and-trade system which, since 2014, is linked with California. This regime necessitates participation from the industrial and electricity sectors, as well as fossil fuel distributors. The program requires companies to buy credits to release GHGs into the atmosphere. The number of credits are reduced by 1 to 2 per cent per year to wean the province off fossil fuels. The money raised in government auctions of carbon credits is funnelled back into the private sector to help companies pay to convert to green technology.

WeirFoulds LLP
66 Wellington Street West
Suite 4100, PO Box 35
Toronto-Dominion Centre
Toronto, Ontario, Canada
M5K 1B7
Office 416.365.1110
Facsimile 416.365.1876
www.weirfoulds.com

Follow us on:

Ontario

In the 2014 provincial election, Premier Kathleen Wynne promised that there would not be a carbon tax instituted in Ontario, instead contemplating the implementation of a cap-and-trade system; however, in January 2015, Premier Wynne refused to rule out a "true" carbon tax. Although the exact method of carbon pricing has yet to be determined, the Government of Ontario has promised to release its plans in Spring 2015.

Potential Impact on Landlords and Tenants

The uncertainty surrounding the future of carbon taxing in Ontario extends to the commercial leasing industry. The potential implementation of either a "true" carbon tax or a cap-and-trade system in Ontario will affect landlords and tenants in different ways.

Carbon Taxes

Whether specified within a lease or not, it is likely that landlords will endeavour to treat a carbon tax as an operating cost or tax and pass it on to tenants. The typical landlord will ordinarily draft its tax provisions over-inclusively in order to cover any possible eventuality, including a carbon tax. Conversely, the thoughtful tenant will attempt to limit the language accordingly.

Cap-and-Trade

If such a system is implemented in Ontario, landlords and tenants will need to consider how the cost of acquiring emission credits will be allocated. For example, one solution is for the landlord to purchase the credits and then pass the cost of doing so on to its tenants as operating costs or a tax related item. Alternatively, landlords could enter into cost-sharing agreements with tenants who wish to bear the initial cost of acquiring emission credits, and then share in the potential revenue from trading surplus credits through either an offset against operating costs or a straight payout of a share of the revenue from surplus credits sold.

Dealing with Existing Leases

Under a typical net lease, the landlord will normally be entitled to recover any additional costs incurred from an increase in taxes or other rates (ex. utility rates, where the tenant does not contract for utilities directly). If this is the case, then a landlord will generally not be personally impacted by a carbon tax, as the cost will be passed on to the tenant through a lease's operating costs or tax provision. Similarly, a tenant should review the provisions of the lease to understand exactly what it is required to pay.

Conversely, if operating under a gross lease, landlords need to ensure either that they have left a sufficient "buffer" in the rent calculation to allow for an increased tax burden or that there is an escalation clause which allows the rent to increase to offset the tax increase. Likewise, tenants should review the terms of the lease for an escalation clause to ascertain whether their rent obligations will change.

One way or the other, the carbon taxman cometh.

PROPERTY

Since the First World War, we have acted on the largest and most significant property and infrastructure developments in Canada. These projects have ranged from shopping centres to public transportation projects, from waterfront re-development to hydro transmission corridors, from land fill sites to office towers, from highways to industrial projects, and virtually everything in between. We are regarded as having the premier Property practice in Ontario – in one of the most dynamic economies on the continent and home to North America's fifth largest city – Toronto.

ABOUT THIS NEWSLETTER

For over 150 years, the lawyers of WeirFoulds have been proud to serve our clients in their most difficult and complex matters. We are the firm of choice for discerning clients within our core areas of practice: (1) Litigation; (2) Corporate; (3) Property; and (4) Government Law. Within these core areas, as well as key sub-specialties, we address highly sophisticated legal challenges. We have acted in some of Canada's most significant mandates and have represented clients in many landmark cases. Reflecting the firm's focus, our lawyers are consistently recognized as leaders in their chosen areas of practice and in the profession at large. To learn more about our firm, visit www.weirfoulds.com.

Information contained in this publication is strictly of a general nature and readers should not act on the information without seeking specific advice on the particular matters which are of concern to them. WeirFoulds LLP will be pleased to provide additional information on request and to discuss any specific matters.

If you are interested in receiving this publication or any other WeirFoulds publication by e-mail, or if you would like to unsubscribe from this newsletter, please let us know by sending a message to publications@weirfoulds.com.