Submission

2026 Pre-Budget Submission for Finance Canada

September 2026

The Canadian Association of Petroleum Producers (CAPP) is a non-partisan, research-based industry association that advocates on behalf of our member companies, large and small, that explore for, develop, and produce oil and natural gas throughout Canada. CAPP's members produce nearly three quarters of Canada's annual oil and natural gas production, and our associate members provide a wide range of services that support the upstream industry.

Canada's upstream oil and natural gas industry provides approximately 450,000 direct and indirect jobs in nearly all regions of Canada. Last year, the industry contributed over $85 billion to Canada's GDP, delivered over 20 percent of the country's value of exports, and between 2022 and 2024 generated $116 billion in taxes and royalties for governments nationwide.

CAPP is a solution-oriented partner and works with all levels of government to ensure a thriving Canadian oil and natural gas industry. We strive to meet the need for safe, reliable, affordable, and responsibly produced energy, for Canada and the world. We are proud to amplify industry efforts to reduce GHG emissions from oil and gas production and support Indigenous participation and prosperity.

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RE: 2026 Pre-Budget Consultations

Dear Minister Champagne,

The Canadian Association of Petroleum Producers (CAPP) welcomes the opportunity to contribute to Finance Canada's pre-budget consultations ahead of Budget 2026. We support the government's recent reforms and the progress achieved through the Alberta-Canada Memoranda of Understanding.[i] Building on this momentum, Canada must accelerate efforts to improve project approvals, reduce unnecessary administrative burden and duplication, strengthen climate competitiveness, and attract investment to unlock growth, enhance economic resilience, and establish Canada as a global energy superpower and the fastest-growing economy in the G7.

CAPP members support Prime Minister Carney's priorities to grow oil and natural gas production, expand energy infrastructure and market access, strengthen competitiveness, and lower emissions as outlined in the Canada-Alberta Memorandum of Understanding. Efforts to advance new export opportunities for Canadian oil and natural gas are important steps toward attracting investment, growing Canada's economy, and strengthening energy security in an increasingly uncertain world.

At a time of growing geopolitical uncertainty, Canada is uniquely positioned as a stable, democratic, and responsible energy producer, recognized as "a world leader in reducing the carbon intensity of our barrels."[ii] With abundant oil and natural gas resources, Canada can strengthen global energy security, support allies with reliable supply, and provide affordable energy to growing markets. By bringing more Canadian energy to the world, we can reduce geopolitical risks, strengthen supply chain resilience, and drive economic growth at home. The opportunity is clear; Canada's challenge is ensuring we have the competitiveness and investment environment needed to fully realize it.

Achieving our goal of becoming a global energy superpower will require continued action to strengthen Canada's competitiveness and attract investment. Investment does not flow based on resource potential alone; it flows to jurisdictions that provide competitive returns, predictable and efficient regulatory processes, lower administrative burden, and confidence that projects can be built. As government advances its growth agenda, competitiveness should be assessed through the cumulative impact of fiscal, regulatory, compliance, and other policy costs, including emerging costs. As competing jurisdictions move aggressively to attract capital, Canada must build on recent progress through targeted fiscal, regulatory, and project-approval reforms that enable investment, egress and production growth, and expanded access to global markets to deliver lasting economic benefits for Canadians.

Canada has a generational opportunity to strengthen economic growth, government revenues, and energy security through expanded oil and natural gas exports. While the Canadian Energy Regulator projects oil production could reach 6.7 million barrels per day by 2044 and natural gas production 32

Bcf/d by 2050, planned and proposed export infrastructure suggests the potential for even greater growth.[iii] Recent analysis suggests that additional oil export capacity could contribute more than $30 billion annually to GDP and support over 100,000 jobs, while expanded LNG exports up to 50 mtpa could add a further $11 billion annually to the economy.[iv] Realizing this opportunity will depend not on resource availability or global demand, but on Canada's ability to attract investment, build projects, and compete successfully for globally mobile capital. Canada's challenge is not a lack of resources, expertise, or demand. It is ensuring our policy, regulatory, fiscal, and investment environment is competitive enough to turn those advantages into growth, jobs, government revenues, and long-term energy security.

Tax measures that improve the economics of incremental production will have the greatest impact when producers have access to sufficient transportation capacity and diversified, higher-value markets. Expanded egress not only improves price realization for Canadian oil and natural gas, it also provides the revenue certainty and long-term market outlook needed to attract the substantial private capital required to build new transportation, LNG and export infrastructure. Starting with Budget 2026, government fiscal and regulatory strategies should therefore pair measures that improve capital recovery with continued federal action to enable timely investment in oil, natural gas and LNG infrastructure, strengthen investor confidence, and expand access to domestic and global markets.

Budget 2026 presents an opportunity to turn growing global demand and energy security needs into Canadian growth. To support this objective, CAPP has developed a focused set of recommendations aimed at strengthening Canada's investment climate, to help ensure Canada can compete globally to enable the production, infrastructure and market access required to establish Canada as a leading energy superpower. We look forward to working with government to advance these recommendations and unlock lasting economic growth, prosperity, and energy security for Canadians.

Sincerely,

Lisa A. Baiton, MBA, ICD.D

President and CEO

Summary of Recommendations

1. Modernize and rationalize the Capital Cost Allowance regime.
2. Reform the Canadian Development Expense and the Canadian Exploration Expense.
3. Make the Accelerated Investment Incentive and accelerated deduction for Canadian Oil and Gas Property Expenses permanent and extend immediate expensing to upstream classes.
4. Reduce Canadian withholding tax to nil on dividends.
5. Re-instate the Atlantic Investment Tax Credit for the oil and gas sector.
6. Establish a Western Exploration and Development Investment Tax Credit.
7. Streamline redundant and disproportionately burdensome bare trust reporting for the oil and natural gas sector by amending section 150 of the *Income Tax Act*.
8. Ensure producers' surface lease and mineral lease payments are not treated as economically equivalent to interest under Excessive Interest and Financing Expenses Limitation rules.
9. Reform Canada Revenue Agency audit, dispute, and performance-incentive frameworks to provide more certainty and timely resolution.
10. Create a regime for consolidated corporate tax filing, beginning with group loss transfer rules.
11. Repeal the Foreign Affiliate Dumping rules.
12. Require the cost to the Canadian economy of tax measures to be estimated.

Please see our detailed list of recommendations for Budget 2026 beginning on page vii.

CAPP's Recommendations for Budget 2026

Upstream investment competitiveness has two dimensions. Fiscal competitiveness influences the cost of investment and the timing of after-tax cash flows, while market access influences expected revenues through transportation costs, price realization and access to growing markets. Competitiveness is also shaped by the cumulative burden of policy, regulatory, compliance, and operating costs facing investment decisions, including emerging pressures and trade uncertainty. Canada must improve both to fully capitalize on its resource advantage and maximize investment and production growth.

Budget 2025, the Spring Economic Update 2026, and subsequent government communications have emphasized that the productivity super-deduction has lowered Canada's aggregate marginal effective tax rate (METR) to 13.0%, the lowest in the G7.[vi] That progress is important and should be recognized. However, the aggregate METR is a weighted economy-wide measure that excludes several capital-intensive sectors, including oil and gas, mining, finance and insurance, real estate, and small businesses. As a result, it does not provide a complete picture of the investment conditions facing critical industries that are central to Canada's growth, productivity, and energy security objectives.

For Canada's oil and natural gas sector, the METR is 26% - approximately double the aggregate rate - and is projected to rise to 31.2% by 2034 as current fiscal and tax measures sunset.[viii] While the sector's METR appears broadly comparable to the United States at the headline level, that comparison masks the central competitiveness challenge: Canadian projects recover capital more slowly, reducing after-tax internal rates of return (IRR) and making Canada less attractive for globally mobile investment. CAPP estimates that Canada's slower capital recovery creates an after-tax IRR gap of approximately 4.2 percentage points relative to comparable U.S. projects under immediate expensing.

The competitive gap has widened because the United States has made 100% bonus depreciation permanent for mining, oil and gas, and development capital, while Canada's core development capital continues to recover more slowly. The Canadian Development Expense (CDE) is deducted at 30% on a declining-balance basis and the Canadian Oil and Gas Property Expense (COGPE) at 10%, with enhanced measures scheduled to phase out. By contrast, U.S. immediate expensing provides permanent, faster and more certain recovery of invested capital. This difference affects investment decisions directly. Capital-intensive projects depend on early after-tax cash flow, and uncertainty about future Canadian treatment increases the risk of allocating capital here rather than in competing jurisdictions.

The effect is most acute in the capital categories that matter most for upstream growth. Oil and natural gas assets in Classes 41 and 41.1 are generally recovered at a 25% declining-balance rate in Canada, compared with 100% immediate expensing in the United States. CDE is recovered at 30% declining balance in Canada, compared with immediate expensing in the United States. For acquired reserves under COGPE, Canada's 10% declining-balance rate is also slower than the U.S. treatment of 15% over the reserve life. These timing differences reduce the present value of deductions and weaken the economics of Canadian projects.

This competitiveness gap is the result of policy choices that can be changed. Successful exploration wells moved from 100% immediate expensing to 30% declining balance when Canada shifted costs from Canadian Exploration Expense (CEE) to CDE in 2017. Flow-through shares were repealed for the sector in 2023. Accelerated capital cost allowances for mining and oil sands were eliminated in 2021 and 2015, respectively. Canada's remaining accelerated capital recovery measures are also scheduled to phase out between 2030 and 2033. The cumulative effect is a less durable and less competitive capital recovery framework than the one now available in the United States.

Capital recovery is only one component of investment competitiveness. For upstream projects, confidence that incremental production can reach growing markets is fundamental to capital allocation decisions. Market access through pipelines, LNG export capacity, and related infrastructure works alongside tax reform to improve investment attractiveness. Improved capital recovery enhances the economics of producing the next barrel or gigajoule, while expanded market access strengthens the economics of selling it. Together, both are needed to maximize investment and production growth.

Canada has resource strength, technical expertise, and growing global demand, but those advantages will not automatically attract investment. Capital will flow to jurisdictions that offer competitive returns, faster recovery of invested capital, and durable policy. Budget 2026 provides an opportunity to close this gap by modernizing Canada's capital recovery rules, reducing uncertainty, and aligning the tax treatment of upstream investment with the scale of Canada's energy and economic ambitions. CAPP's recommendations below are designed to achieve that objective through targeted, evidence-based reforms that improve capital recovery timelines and strengthen Canada's investment climate.

CAPP recommends that Budget 2026 advance a targeted reform package built on a competitiveness strategy that advances egress capacity, production growth, and improves market access. A targeted fiscal reform package should be built on two mutually reinforcing pillars : first, modernizing Canada's capital recovery rules so upstream oil and natural gas investment can recover capital more quickly, predictably, and competitively with the United States; and second, reducing tax uncertainty and administrative complexity by repealing redundant rules and streamlining requirements that discourage investment, increase compliance costs, and weaken Canada's ability to retain high-value head office functions.

Pillar 1: Capital Recovery Reform to Attract Global Investment and Improve Competitiveness

Capital recovery is the central driver of Canada's upstream investment competitiveness gap. Although Canada's headline tax metrics may appear competitive, the pace at which companies can deduct capital investment against taxable income has a direct impact on project-level after-tax cash flow, internal rates of return, and capital allocation decisions. Canada's capital cost allowance regime has not been substantively modernized since the 1970s, and the scheduled phase-out of accelerated deductions creates investment-timing uncertainty that has no equivalent under the now-permanent U.S. immediate expensing regime.

CAPP's modelling of a representative $100 million upstream facility indicates that Canadian projects face an after-tax IRR shortfall of approximately 4.2 percentage points relative to comparable U.S. projects, driven primarily by timing differences in capital expensing. The recommendations below address this gap directly. Taken together, they would improve early after-tax cash flow, reduce the upstream METR, narrow the gap between headline and realized tax competitiveness, and restore the capital recovery parity needed to attract and retain growth investment in Canadian basins. Making the COGPE enhanced deduction permanent is also necessary to avoid a further capital recovery cliff that would compound Canada's existing disadvantage as other temporary measures phase out.

Importantly, the tax regime should not create materially different capital-recovery timelines that disadvantage one component of an integrated growth project.

1. **Modernize and rationalize the CCA regime.**

   Schedule II of the Income Tax Regulations (ITR) enumerates approximately 30 active classes, many referencing acquisition dates of 1962, 1972, and 1976. A single asset such as a pipeline can fall in any of more than a half dozen different classes with vastly different depreciation rates ranging from 4 to 25% depending on subjective and objective criteria, generating frequent and avoidable taxpayer–CRA disputes. The resulting complexity increases compliance costs, creates uncertainty, and can result in economically similar assets receiving materially different tax treatment. In addition, several resource-sector asset classes, including Classes 41 and 41.1, provide significantly slower capital recovery than comparable treatment available in the United States, which increases the cost of capital for new investment.

CAPP recommends that Classes 41 and 41.1 be modernized to permit 100% expensing and that immediate expensing be extended to CCUS Classes 57, 58, 59 and 60 for new growth investment, improving capital recovery and strengthen Canada's competitiveness for investment relative to the United States. This should be followed by an expert review to consolidate classes, reduce the number of standardized rates, and improve neutrality by ensuring that economically similar assets receive comparable tax treatment. The expert review should also assess whether capital recovery for energy infrastructure that enables incremental production, transportation, processing and export capacity appropriately reflects its economic role and useful life.

2. **Reform the Canadian Development Expense (CDE) and the Canadian Exploration Expense (CEE)**

The 30% declining-balance rate under subsection 66.2(2) of the ITA has not changed since the 1970s, when conventional vertical wells generally recovered capital and production over much longer time horizons than today's unconventional developments. However, over the past 50 years there has been a shift in drilling methodologies from vertical to almost entirely horizontal wells, resulting in a fundamental restructuring of upstream development economics due to hyperbolic production decay with initial-year decline rates of 65–80%. This mismatch forces producers to pay tax on income that is partly a return of capital rather than economic profit, structurally elevating the realized METR on development investment.

CAPP recommends amending subsection 66.2(2) to increase the CDE rate from 30% to 100%, permitting full expensing in the year incurred, aligning with the U.S. treatment of intangible drilling costs for independent producers under IRC s.263(c). This also more accurately reflects the steep early production decline observed in contemporary wells. CEE under subsection 66.1(6) should be enhanced to reinstate drilling and completion costs for successful exploration wells.

3. **Make the Accelerated Investment Incentive (AII) and accelerated deduction for COGPE permanent and provide immediate expensing for new upstream growth investment, including Classes 41 and 41.1 and CCUS Classes 57, 58, 59 and 60**

The AII was originally introduced in the 2018 Fall Economic Statement and reinstated as part of the Productivity Super-Deduction (Budget 2025) but remains a temporary measure. Capital recovery cliffs resulting from the phase-out distort multi-year investment timing and erode the competitiveness benefit the measure is designed to deliver. Equally important, the immediate expensing (100% first-year write-off) component of the Productivity Super-Deduction is restricted to specific classes and does not cover the capital investments required to grow

Canada's upstream oil and natural gas production. A competitive capital-recovery framework should provide immediate expensing of new growth investment, including upstream production assets in Classes 41 and 41.1 and carbon capture, utilization and storage (CCUS) assets in Classes 57, 58, 59 and 60.

Providing immediate expensing for qualifying CCUS capital would improve early project cash flow, reduce the cost of capital associated with emissions-reduction infrastructure, and better align Canada's tax framework with the government's objectives to simultaneously grow production and reduce emissions.

The same temporary structure applies to the acquisition of oil and gas property. The COGPE pool under subsection 66.4(5) of the ITA captures the acquisition cost of Canadian resource property, including oil and gas land, exploration rights, licenses, leases, and well interests, at a base rate of 10% declining balance. The accelerated deduction enhancement for COGPE, most recently reinstated by Bill C-15 provides a 1.5x first-year deduction for expenses incurred before 2030, reducing to 1.25x for expenses incurred from 2030 to 2033, with the enhancement expiring entirely after 2033. This sunset introduces planning uncertainty for new upstream growth projects and perpetuates a structural asymmetry between Canadian and U.S. treatment of oil and gas property acquisition costs.

CAPP recommends making permanent: (a) the suspension of the half-year rule; (b) the 1.5x first-year multiplier for eligible capital property *and* for COGPE. In addition, Budget 2026 should provide 100% immediate expensing for new upstream growth investment, including Classes 41 and 41.1 and CCUS Classes 57, 58, 59 and 60. These changes would eliminate investment-timing distortions, strengthen early project cash flow and ensure that capital required both to expand production and reduce emissions receives competitive tax treatment. Finance should further initiate a review of the base 10% COGPE rate with a view to aligning capital recovery timelines with the useful economic lives of modern oil and gas property interests

For further details and analysis on the impact of our top three capital recovery focused policy recommendations above, please see Appendix 1.

4. **Reduce Canadian withholding tax to nil on dividends.**

   Canada's current withholding tax regime creates an uneven treatment of capital by favouring arm's length debt, and debt held by U.S. persons, over equity investment. While interest on these forms of debt is generally exempt from withholding tax, dividends remain subject to a 5% to 25% withholding tax. This differential treatment creates a distortionary incentive to finance Canadian operations through debt rather than equity, which can reduce the Canadian tax base, increase leverage, and discourage long-term investment in Canada. To support neutral and competitive capital formation, Canada should eliminate withholding tax on dividends to reduce the preference for debt over equity capital.

5. **Re-instate the Atlantic Investment Tax Credit (AITC) for the oil and gas sector.**

   To further unlock the economic potential of Canada's offshore resources, Budget 2026 should reinstate and strengthen the Atlantic Investment Tax Credit for the oil and natural gas industry. CAPP recommends increasing the AITC to 15% and making it refundable to improve investment certainty, enhance Atlantic Canada's competitiveness, and support the capital-intensive projects needed to grow offshore production.

6. **Establish a Western Exploration and Development Investment Tax Credit.**

   Modelled on the Atlantic Investment Tax Credit under section 127 of the ITA, a 10% non-refundable investment tax credit on eligible CEE and CDE would help offset the upstream-specific METR burden associated with industrial carbon compliance costs. A Western Exploration and Development Investment Tax Credit would improve the economics of incremental western Canadian supply needed to serve growing domestic demand and expanded pipeline and LNG export capacity, while addressing the upstream-specific METR burden associated with industrial carbon compliance costs.

Pillar 2: Reduce Complexity and Administrative Burden and Streamline Rules that Discourage Investment

The gap between Canada's headline tax competitiveness and the investment conditions are driven not only by capital recovery rules, but also by the cumulative burden of administrative complexity, duplicative compliance measures, and an audit and dispute resolution environment that is increasingly out of step with peer jurisdictions. These costs must also be considered alongside broader competitiveness pressures and other policy-driven costs that affect investment decisions and Canada's ability to achieve its growth objectives. Canada remains the only G7 country without a corporate group filing or loss transfer regime, forcing corporate groups to incur significant non-productive compliance costs to achieve outcomes that other jurisdictions treat as a matter of course. At the same time, several anti-base erosion rules, most notably the foreign affiliate dumping rules, now impose compliance costs and structural disincentives that are largely redundant given Canada's adoption of Excessive Interest and Financing limitation (EIFEL) rules, Global Minimum Tax Act, and other BEPS measures Canada has enacted. The recommendations below address these structural friction costs directly, by reducing uncertainty, simplifying compliance, and lowering the effective investment hurdles that discourage capital allocation to Canadian projects.

7. **Streamline redundant and disproportionately burdensome bare trust reporting for the oil and natural gas sector by amending section 150 of the ITA.**[vii]

   Canada should rescind the current T3 bare trust reporting requirement and instead leverage existing income tax filings to declare participation in these arrangements. In addition, exemptions from filing should be expanded. These changes will support the global commitment to transparency in combatting money laundering and terrorist financing while avoiding tens of thousands of annual T3 returns. Three changes can achieve this outcome, while eliminating duplicative reporting requirements, reducing unnecessary paperwork, and advancing the government's objective of reducing regulatory burden while preserving transparency.

   CAPP recommends:

   a. Leveraging existing T2 and T5013 return filings by adding check boxes to indicate participation in bare trust arrangements in lieu of wholly additional T3 returns that are largely blank. The CRA could audit what type of bare trust relationship exists if they believe a taxpayer, is a high risk. Public corporations and their subsidiaries should be exempt from filing T3 bare trust returns, such as they were in the *Underused Housing Tax Act*.
   b. Revising proposed paragraph 150(1.31) (f) to exempt reporting for any property that is directly or indirectly held by a "principal business corporation" as defined in subsection 66(15), or subsidiary corporation, trust or partnership of same.
   c. Revising proposed paragraph 150(1.31) (f) to relax the "each of which is" constraint to allow a minority of participants to not meet the eligibility requirements (e.g., a trust would not be required to file if the majority of the beneficial ownership of the trust property is held by public companies).

8. **Ensure producers' surface lease and mineral lease payments are not treated as economically equivalent to interest under EIFEL rules.**

CAPP recommends amending EIFEL provisions in section 18.2 of the ITA to clarify the definition of "*interest and financing expenses*" to explicitly exclude producers' surface lease and mineral lease payments. The current breadth of the EIFEL definition of "*interest and financing expenses*" creates interpretive risk related to certain lease payments (e.g., surface leases) and provincial Crown mineral payments being subject to new interest deduction restriction rules, despite being long-standing routine operational costs of oil and gas production clearly outside the policy scope of these rules. Clarifying these provisions would reduce compliance complexity and provide a simpler, more predictable tax framework.

9. **Reform CRA audit, dispute, and performance-incentive frameworks to provide more certainty and timely resolution.**

   Large-corporation audits routinely run 5–7 years with most Tax Court of Canada decisions not being published until over a decade after the taxation year at issue and some not until two or three decades later; large corporations are required under ITA subsection 225.1(7) to prepay 50% of reassessed federal tax, penalties and interest to pursue a Notice of Objection and do not receive a refund until after final resolution of the objections. The pre-payment requirement is without parallel in peer jurisdictions. The introduction of a $20 billion Direct Compliance Revenue Effects (DCRE) target in the CRA 2026–27 Departmental Plan further misaligns CRA performance incentives toward assessment quantity rather than assessment quality. Withholding tax issues never become statute barred. These reforms would reduce administrative burden on both taxpayers and government while accelerating dispute resolution.

   CAPP recommends: (a) repealing the 50% prepayment requirement (the existing ability of the CRA to collect immediately for all taxpayers where there is any credit issue would continue to protect the government against loss); (b) legislating service standards capping large-file audits at 36 months and introducing a ten year drop-dead date for auditing issues and tax amounts from historic tax years; (c) rebalancing DCRE with Compliance Yield as a primary indicator; (d) extending the Advance Pricing Arrangement model to a formal pre-clearance program for complex BEPS, Foreign Affiliate Dumping (FAD), and Pillar Two positions; and (e) reforming the CRA rulings process so it can serve as a tool to provide more certainty for taxpayers in circumstances where the legislative rules and/or appropriate tax consequences are unclear.

10. **Create a regime for consolidated corporate tax filing, beginning with group loss transfer rules.**

    Establishing a corporate group filing regime represents one of the most significant opportunities to reduce tax-related red tape in Canada. Canada is the only G7 jurisdiction without a corporate group filing or consolidation regime. Corporate groups in Canada must currently engage in complex, transaction-heavy structures — share subscriptions, internal dividends, loans, and reorganizations — to achieve loss utilization outcomes that other jurisdictions treat as automatic. These structures are costly to design, document, and administer; are a routine focus of CRA audit activity despite involving no disputed economic income; and impose significant non-productive compliance costs on both taxpayers and the CRA. The layered adoption of OECD initiatives (EIFEL, Qualified Domestic Minimum Top-up Tax under the *Global Minimum Tax Act*, Mandatory Disclosure Rules, and transfer pricing) multiplies these compliance costs by the number of legal entities in a Canadian group, making the absence of a consolidation regime increasingly costly relative to peer jurisdictions.

CAPP recommends the following phased approach: (a) immediate enactment of election-based current-year group loss transfer rules, modelled on existing mechanisms in ITA (e.g., the Part VI.1 transfer mechanism, the paragraph 66.7(10)(g) transfer mechanism and the existing EIFEL excess capacity election), permitting related corporations to transfer non-capital losses and specified attributes without artificial transactions; (b) as an initial step, allowing intra-provincial loss transfer with a province opt-in mechanism for cross-provincial loss sharing to address any inter-provincial concerns; and (c) public consultation in short order on a broader optional federal consolidated return regime, which could be designed with provincial safeguards where required, with a commitment to formal implementation in a subsequent budget cycle.

11. **Repeal the Foreign Affiliate Dumping (FAD) rules.**

The FAD rules in section 212.3 of the ITA are duplicative, harmful and without parallel in peer jurisdictions. Their principal policy objective to address Canadian base-erosion, is now addressed by the EIFEL rules in section 18.2 of the ITA, the Global Minimum Tax Act, and other globally accepted BEPS Pillar Two measures adopted by Canada. In practice, the FAD rules go beyond their original purpose and capture commercially legitimate outbound investment by Canadian-domiciled producers. They are also counter-intuitive - deeming a dividend to be paid by a Canadian entity up-the-chain to foreign parent entities when the Canadian entity makes an investment down-the-chain in its foreign subsidiary. More significantly, the rules impose a structural deterrent to the use of Canada as a head office or intermediate holding jurisdiction. Where a foreign acquirer purchases a Canadian parent that owns foreign subsidiaries, FAD creates a strong incentive to immediately reorganize and strip foreign affiliates out of Canada, the so-called “bump and run”, rather than leave the Canadian head office in place. The result is a smaller Canadian head office footprint, fewer high-value Canadian jobs in tax, finance, legal, strategy, and senior management, and a reduced corporate tax base relative to what would otherwise more naturally remain in Canada.

Repealing FAD would remove a redundant layer of tax administration and compliance that duplicates protections already provided through EIFEL and other BEPS measures.

CAPP recommends that the FAD rules be repealed as they are harmful in effect, redundant in purpose, counter-intuitive and without parallel in peer jurisdictions.

12. **Require cost to Canadian economy of tax measures to be estimated.**

New tax measures generally do not adequately consider the administrative burden they impose on Canadian taxpayers, making it impossible for decision-makers and the public to understand the true costs of the measures to corporations and to Canadians.

CAPP recommends any new measures proposed to be introduced include an estimate of the cost of such measures, including the cost of taxpayer administrative burden to comply with the proposed rules and CRA administrative burden to enforce them.

Conclusion

Collectively, these recommendations would modernize Canada's tax framework, reduce unnecessary administrative burden, eliminate duplicative requirements, and strengthen Canada's ability to attract globally mobile investment. They are practical, targeted, and most are achievable within the existing legislative framework. They would preserve the integrity of Canada's anti-avoidance regime and the OECD BEPS architecture, while addressing areas where the current tax system has become more complex, less neutral, and less competitive than peer jurisdictions.

Budget 2026 is an opportunity to align Canada's fiscal framework with the government's stated ambition to make Canada a global energy superpower and the fastest-growing economy in the G7. Canada has the resources, expertise, Indigenous and regional partnerships, and growing global and domestic demand needed to responsibly expand energy production and exports. Realizing this opportunity requires a competitive investment framework that supports both upstream development and the infrastructure needed to connect incremental Canadian supply to growing markets. Budget 2026 can help unlock this virtuous cycle: improved capital recovery attracts upstream investment and accelerates project development; expanded market access improves price realization and strengthens project economics; and increased production and exports generate jobs, investment, government revenues and long-term energy security.

Thank you for considering CAPP's recommendations. We would welcome the opportunity to meet with Finance Canada to discuss these proposals in greater detail and to work collaboratively on practical measures that strengthen Canada's investment climate, support responsible oil and natural gas development, and advance the government's broader economic and energy security objectives. Should you have any questions or require further information, please contact **Siân Pascoe**, Vice President, Research and Data, at sian.pascoe@capp.ca or **Johanne Senécal**, Vice President, Sustainability, External Relations and Indigenous Affairs, at johanne.senecal@capp.ca.

Appendix 1

Closing the Canada-U.S. Oil and Gas Investment Gap Through Competitive Capital Recovery

Supporting analysis for the Department of Finance: why growth capital is flowing to the United States and how targeted tax policy can reduce the IRR delta for Canadian oil and gas development.

> **Core message**
>
> Canada's challenge is an investment competitiveness gap: Canadian projects must offer competitive after-tax returns while providing confidence that incremental production can access diversified, higher-value markets. Compared with the United States, Canada delays the value of tax shields on core oil and gas development costs, reducing early project cash flows, lowering Canadian project IRRs, and making growth capital more likely to flow south.

1. Headline competitiveness is not translating into growth investment

Canada's aggregate marginal effective tax rate (METR) appears competitive, but aggregate indicators are not translating into oil and gas growth capital. The investment signal is more evident in observed capital allocation: Canadian producers are being valued more as income-oriented vehicles, while U.S. producers are more strongly positioned for reinvestment and new development.

Metric	Canada	United States	Implication for Finance
Aggregate METR	13.0%	15.5%	Headline rate suggests Canada is competitive.
Oil and gas METR	26.0%	29.9%	O&G tax burden is much higher than Canada's aggregate benchmark.
Combined statutory CIT	26.1%	25.7%	The statutory rate is effectively level.
Large Cap Dividend yield	4.1%	2.9%	Canada is being treated more as an income market.
Rig Count per MMbp/d	30.7	40.4	Canada is drilling 30% less proportionally to the USA highlighting lower growth investment.
Capital allocation pattern	Returned to shareholders	Reinvested into new development	Capital markets are responding to project-level after-tax returns, not headline rates alone.

For Canada, the policy issue is therefore not whether Canada is competitive on an economy-wide average. The issue is whether Canada's project-level tax treatment supports the early after-tax cash flows needed to attract growth capital into new oil and gas development.

2. The competitive gap is driven by the timing of deductions

For capital-intensive resource projects, the timing of cost recovery is a major determinant of investment economics. Faster write-off raises the present value of deductions, strengthens early after-tax cash flows, and lowers the effective tax burden on new investment. The United States has locked in a permanent recovery advantage through full expensing for many capital costs, while Canada's core oil and gas development capital is recovered more slowly.

Figure 1. Capital recovery mechanism: timing of deductions affects after-tax cash flows and project IRR.

Capital pool / expense	Canada	United States	Investment signal
Equipment / M&E (Class 53)	100% immediate	100% immediate	Capital recovery parity
Clean energy (43.1/43.2)	100% immediate	100% immediate	Capital recovery parity
Exploration (CEE)	100% immediate (dry only)	50% over 2 years	Mixed
LNG liquefaction	15–25% declining balance	15% over 7 years	Comparable / mixed
Mining & O&G M&E (Class 41)	25% declining balance	100% immediate	U.S. advantage
Development (CDE)	30% declining balance	100% immediate	U.S. advantage
Acquired reserves (COGPE)	10% declining balance	15% over reserve life	U.S. advantage
Buildings (Class 1)	2–5% declining balance	2.5% over 39 years	Comparable / Canada can be faster

Interpretive Note

Canada is not uniformly disadvantaged across every asset class. The gap is concentrated in the development-cost categories that matter most for new oil and gas growth projects: Class 41 equipment and Canadian Development Expense. Those categories are therefore the highest impact policy levers.

The modelling focuses on the development-cost categories represented in the illustrative upstream project and therefore does not quantify the incremental impact of immediate expensing for CCUS assets. However, for new growth projects requiring material emissions-reduction investment, the same capital-recovery principle applies. Delayed recovery of CCUS capital reduces its present value, weakens early project cash flow and increases the effective cost of integrating emissions reduction with production growth. Accordingly, CAPP recommends that immediate expensing of new growth investment extend to CCUS Classes 57, 58, 59 and 60.

3. Scenario modelling shows targeted reforms reduce the Canada-U.S. IRR gap

The scenario modelling compares otherwise similar Canadian and U.S. tight oil development projects: a $100 million facility, identical wells drilled at 10 wells per year for a 15-year campaign, 20-year well life, and average first year production of 350 b/d. The scenarios isolate how changes to Canadian capital recovery affect the IRR gap relative to the United States.

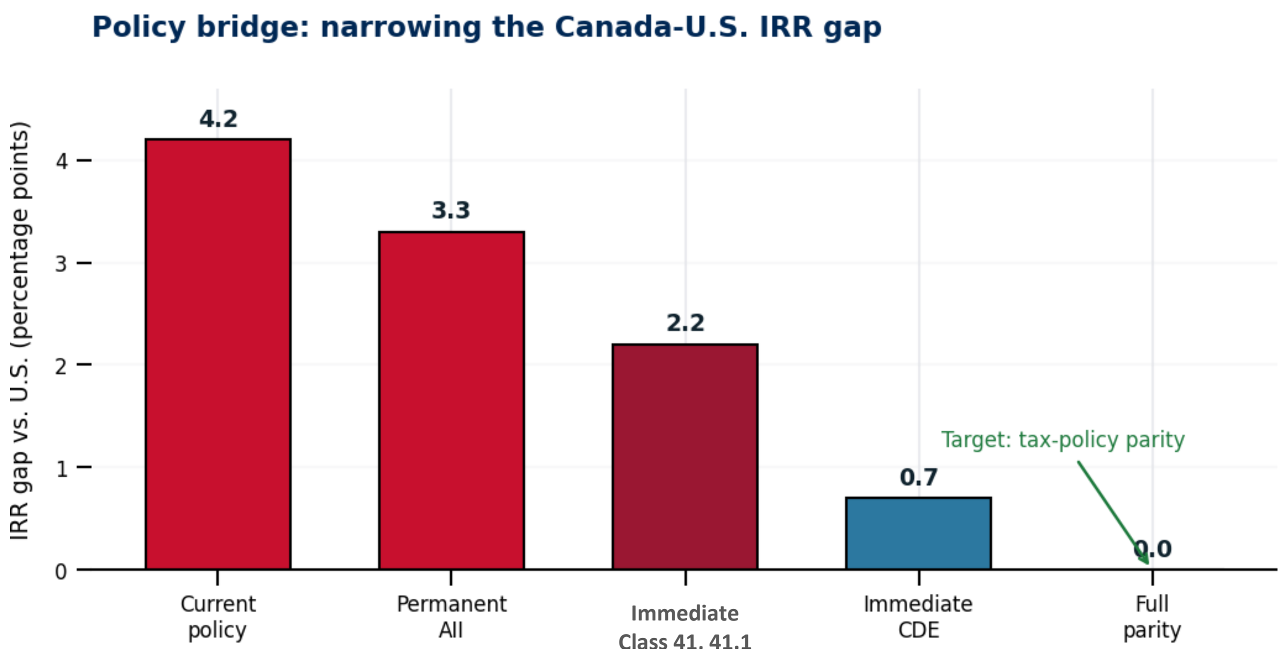

Figure 2. Modelled capital-recovery parity

Policy scenario	Tax policy change	IRR gap vs. U.S.	Finance-facing interpretation
Current policy / base case	Existing Canadian capital recovery rules; AII sunsets; 30% CDE; 25% Class 41, 41.1	**4.2 p.p. shortfall**	Canada remains materially disadvantaged for growth capital.
Permanent AII	Remove the sunset on accelerated investment treatment; 30% CDE; 25% Class 41, 41.1	**3.3 p.p. shortfall**	Helpful, but insufficient on its own.
Immediate Class 41 & 41.1	100% Class 41, 41.1; AII sunset; 30% CDE	**2.2 p.p. shortfall**	Materially improves economics for capital-intensive development.
Immediate drilling expense	100% CDE; AII sunset; 25% Class 41, 41.1	**0.7 p.p. shortfall**	Brings Canadian projects close to U.S. parity.
Full parity	100% CDE and 100% Class 41, 41.1	**0.0 p.p. shortfall**	Closes the modelled tax-policy IRR gap.

While the modelled IRR gap is 4.2 percentage points in Figure 2, the underlying projects are otherwise identical in scale, risk, operating assumptions, and long-term economics. The difference arises from the timing of capital recovery, which shifts a greater share of investor value into later years under Canadian tax rules. This effect is especially important for growth-oriented investors, who typically evaluate returns over a 5-7 year holding period. As shown in Figure 3, the present value of the first seven years of equity cash flows is 48% higher under U.S. rules, creating a significant structural advantage for U.S. projects when competing for growth capital.

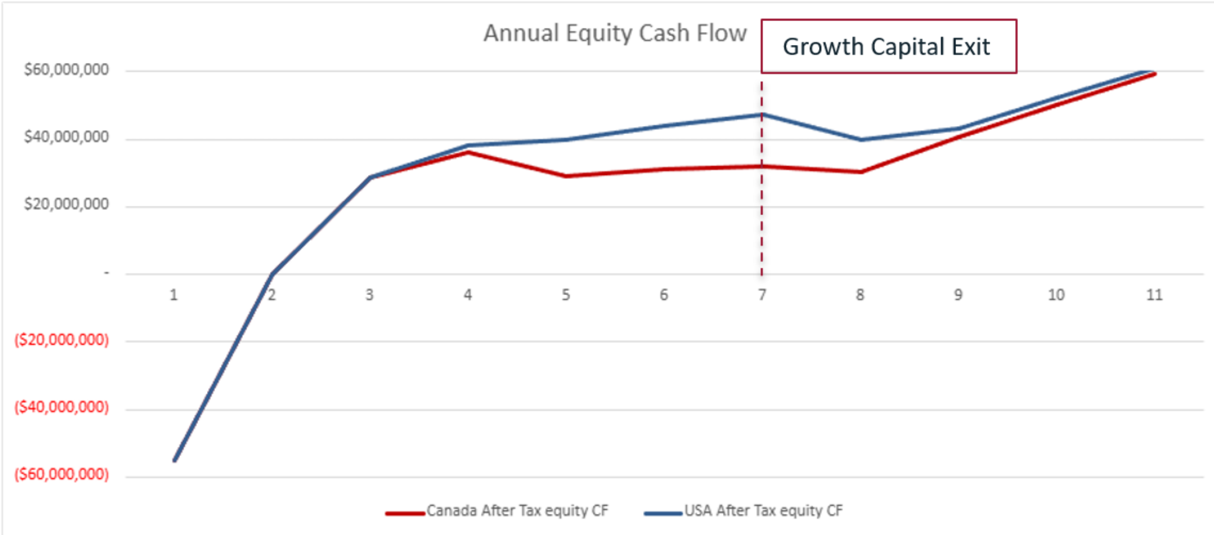

Figure 3. Modeled Cash Flow timing impact on growth investment between Canadian and United States fiscal environments.

4. Policy recommendations should target the development-cost categories that drive the IRR gap

The policy objective is competitive neutrality, not preferential treatment. The analysis points to a sequenced package that would reduce the Canadian project IRR penalty and make domestic oil and gas development more competitive with comparable U.S. projects.

1. Make accelerated investment treatment permanent. Permanent treatment reduces policy uncertainty and narrows the modelled IRR shortfall from 4.2 to 3.3 percentage points. This should be positioned as a baseline competitiveness measure, but not a complete solution.

2. Provide immediate expensing for Classes 41 and 41.1 oil and gas equipment. This measure reduces the gap to 2.2 percentage points and directly addresses the capital-intensive equipment component of new development.

3. Provide immediate expensing for Canadian Development Expense. This is the strongest single policy lever in the sensitivities, reducing the modelled gap to 0.7 percentage points and restoring much of the early project cash flow that growth investments require.

4. Move toward comprehensive capital-recovery parity for new growth investment. Immediate expensing of CDE and Classes 41 and 41.1 closes the modelled tax-policy IRR gap attributable to the capital categories included in CAPP's representative project. For projects incorporating CCUS, the same immediate-expensing principle should extend to Classes 57, 58, 59 and 60 so that emissions-reduction capital does not create an additional capital-recovery disadvantage for Canadian growth investment. Overall investment competitiveness will continue to reflect other factors, including royalties, carbon costs, transportation, market access and price realization.

Conclusion:

Canada's current capital recovery framework places Canadian oil and gas development at a measurable disadvantage against comparable U.S. projects. Permanent accelerated investment treatment narrows the gap; adding immediate equipment expensing narrows it further; adding immediate expensing of development costs brings Canada close to parity; and adding combined CDE/Class 41 immediate expensing closes the modelled tax-policy IRR gap. These reforms would improve Canada's ability to attract growth capital for domestic oil and gas development.

Technical note

The modelling is intended to isolate the tax-policy burden associated with capital recovery timing. It should be presented as representative project analysis rather than a forecast of any specific company's investment decision. **The impacts of royalties and carbon pricing policy are not included, and as a result, the structural IRR gap between Canada and the U.S. is likely larger than what CAPP's modeling demonstrates here for the purposes of this study**. First-year deduction percentages in the capital recovery table are illustrative approximations harmonized to a year-one-claim basis, consistent with the slide source data.

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[iv] ATB Financial, Studio.Energy. "The GDP Payoff of Additional Oil Pipeline Capacity." The GDP Payoff of Additional Oil Pipeline Capacity

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[viii] C.D. Howe Institute Big Bang Tax Reform: Unleashing Growth in the Canadian Economy, J. Mintz, A. Laurin, N Dahir. https://www.cdhowe.org/wp-content/uploads/2026/03/Commentary_707.pdf