The clean economy ITC labour requirements: How they work, new CRA guidance and some residual issues

July 27, 2026

Canada's clean economy investment tax credits (ITCs) constitute a major tax policy expenditure supporting Canada's efforts to achieve a net-carbon-zero economy by 2050. These ITCs, which are explained and summarized here, are often a critical element in the financial viability of many carbon capture, energy generation, battery storage and other clean economy projects.

While the details of the different clean economy ITCs vary somewhat, they generally follow a more or less common format:

- eligible taxpayers, generally taxable Canadian corporations, incur expenditures that qualify for a particular clean economy ITC ("qualifying expenditures"), generally being the cost of specific tangible property designated as ITC-eligible, such as a wind turbine;
- qualifying expenditures generally include the full cost of acquiring and installing ITC-eligible property and putting it into active service, but generally exclude "preliminary work activity" such as front-end design or engineering work; and
- for each taxation year, the eligible taxpayer claims an amount of the particular clean economy ITC equal to total qualifying expenditures for that year, reduced by any "government assistance" received or receivable by the taxpayer, multiplied by the **ITC rate** for that particular clean economy ITC. This is done by completing and filing the prescribed form applicable to that particular clean economy ITC by the deadline permitted for so doing. Prescribed forms and other information can be found on the Canada Revenue Agency's clean economy ITC webpage. The amount of ITC the taxpayer is entitled to is credited to the taxpayer's CRA account and either reduces its taxes owing or is paid to the taxpayer.

Taxpayer's \$ ITC entitlement = ITC rate × \$ taxpayer's qualifying expenditures

When it comes to the ITC rate, the taxpayer has a choice to make when claiming the ITC and completing the required prescribed form (except for the Clean Technology Manufacturing ITC, to which the labour requirements do not apply). If a taxpayer elects to meet the "labour requirements" set out in s. 127.46 ITA, it may claim the particular clean economy ITC at the "regular tax credit rate." This means the full ITC rate specified in the legislation, such as 30 per cent for the Clean Technology ITC, 15 per cent for the Clean Electricity ITC and so on. Otherwise, the taxpayer may claim only the "reduced tax credit rate," being 10 percentage points lower than the "regular tax credit rate," *viz*., 20 per cent for the Clean Technology ITC, five per cent for the Clean Electricity ITC and so on. It is not uncommon on major clean economy projects for the difference between the regular and reduced ITC rate to amount to tens of millions of dollars, or more on the largest projects.

- if the CRA determines that the taxpayer failed to meet those requirements "knowingly or in circumstances amounting to gross negligence" (the **K/GN Standard**), the taxpayer effectively suffers a 15 per cent ITC rate reduction, *i.e.,* what would normally be a 30 per cent rate for the Clean Technology ITC essentially becomes 15 per cent instead, a catastrophic result for many clean economy projects; or
- otherwise, the taxpayer gets the regular tax credit rate but must pay a *per diem* tax in ss. 127.46(6) or (7) to the CRA and top-up payments to any underpaid employees.

The discussion that follows describes some of the interpretive and practical issues associated with the labour requirements, and reviews the conclusions reached by the CRA's Income Tax Rulings Directorate (Rulings) in CRA document 2025-1081341E5, dated April 28, 2026 (the New CRA Guidance). In the New CRA Guidance, Rulings answers questions about a situation where the taxpayer has engaged a contractor whose employees (1) are not covered by an eligible collective agreement and (2) are paid less than what the labour requirements prescribe to be the compensation necessary to comply with the "prevailing wage" element of the labour requirements.

The New CRA Guidance makes the following interpretive determinations:

- in a situation where no eligible collective agreement applies to covered workers who have been paid less than the prevailing wage, the taxpayer can correct this deficiency, *i.e.,* pay these workers the shortfall to bring them up to the prevailing wage, any time before the taxpayer prepares and files their ITC claim for the relevant taxation year and **be in full compliance** with this element of the prevailing wage requirement. As a result of being in compliance, the *per diem* tax in s. 127.46(6) will not be applicable, and the late payment of these workers will not prevent the taxpayer from attesting to having met the labour requirements or risk transgressing the K/GN Standard if the taxpayer elects to meet the labour requirements and claim the regular tax credit rate;
- in cases where the *per diem* tax in s. 127.46(6) *does* apply, it is computed with reference to the number of days of work for which the relevant worker was not paid the prevailing wage, *viz*., "each day" means "each day of work for which the worker was short-paid," not "each day such shortfall remains unpaid" or any other interpretation;
- a taxpayer who has actual knowledge of a prevailing wage requirement deficiency cannot remedy it so as to come into compliance by paying the top-up penalty described in s. 127.46(13) to the CRA;
- a taxpayer who has actual knowledge of a prevailing wage requirement deficiency for a particular taxation year, elects to meet the labour requirements and claims the regular tax credit rate for that year risks transgressing the K/GN Standard and the very adverse consequences that entails, and should instead claim only the reduced tax credit rate for that year;
- a taxpayer may claim the reduced tax credit rate in one taxation year without thereby disentitling itself from claiming the regular tax credit rate in other years, *viz*., the reference to "each installation taxation year" in s. 127.46(2) should not be interpreted as requiring a taxpayer to elect to meet the labour requirements for *every* installation taxation year in respect of any particular clean economy ITC; and
- where a taxpayer does transgress the K/GN Standard in respect of a particular taxation year, the adverse implications of that are limited to that particular taxation year, *viz*., the reference in s.

127.46(9)(a) to being "not entitled to the regular tax credit rate" is limited to *that* taxation year (referred to in s. 127.46(9) as the "claim year").

This article goes on to address an apparent legislative gap in the rules relating to the K/GN Standard that is problematic where an ITC claimant knows, or strongly suspects, some element of the prevailing wage requirement has not been met for one or more covered workers, and is practically unable to remedy the situation in a way that meets the definition of "compliance" within the meaning of the statute. For example, where a covered worker is an employee of a contractor or subcontractor retained by the taxpayer to work on the project, *i.e.*, the taxpayer has no direct relationship with the relevant employee, the taxpayer may have no practical ability to ensure that any shortfall is paid to the employee if the contractor becomes unco-operative, goes out of business or loses contact with the employee.

Read literally, the rules as drafted would appear to prevent such a taxpayer from claiming the regular tax credit rate for fear of being found to have "knowingly or in circumstances amounting to gross negligence failed to meet those requirements" if they claim the regular tax credit rate. Such a taxpayer would thus be forced into claiming only the reduced tax credit rate because the compliance deficiency, no matter how small, they are aware of is one they do not have the ability to fix. The imposition of a 10 per cent ITC rate reduction for the *entire amount* of the taxpayer's clean economy ITC claim for the year seems profoundly disproportionate and unfair in such circumstances.

Fundamentally, some mechanism is needed for allowing a taxpayer who is aware of a compliance deficiency and is willing to address it to do so in a way that is considered to constitute "compliance" with the labour requirements, allowing the taxpayer to claim the regular tax credit rate without fear of transgressing the K/GN Standard. For example, deeming self-reported compliance deficiencies not to meet the K/GN Standard would encourage taxpayers trying to meet the policy objectives of the labour requirements to do so rather than opt out of them and claim the reduced tax credit rate, a lose-lose outcome.

I. The labour requirements: Overview

The labour requirements are intended to "incentivize companies to create good jobs". They are modelled on similar requirements that exist under comparable U.S. tax credit legislation, although they are used in the U.S. for other purposes and American taxpayers have decades of experience in dealing with them. The labour requirements have two distinct elements:

- the "prevailing wage requirements", which require "covered workers" to be adequately compensated for the "preparation or installation" of ITC-eligible property at the taxpayer's work site (herein, P&I Work); and
- the "apprenticeship requirements", which require the taxpayer to make reasonable efforts to ensure that apprentices registered in Red Seal trades (or equivalent provincially registered trade) work at least 10 per cent of the hours worked during the year by "covered workers" who are Red Seal workers performing P&I Work at the taxpayer's project site. For this purpose, a safe harbour rule deems the taxpayer to have met this requirement where it takes the prescribed actions.

"Covered workers"

A key concept of both labour requirements is "covered workers", defined as an individual:

- who is an employee (whether of the taxpayer or someone else, such as a contractor retained by the taxpayer or sub-contractor of such contractor) engaged in P&I Work;
- whose duties at the taxpayer's work site are primarily manual or physical; and
- who is neither an administrative, clerical or executive employee nor a "business visitor to Canada" as described in section 187 of the *Immigration and Refugee Protection Regulations*.

The "covered worker" definition raises various interpretive questions. For example, the scope of what constitutes P&I Work is a matter of some judgment. As a general rule, it seems logical to presume that the scope of P&I Work would not include activities that are excluded from ITC eligibility. For example, one would think that activities excluded from eligibility for the CCUS ITC as "preliminary CCUS work activity" generally should not be considered to be "preparation or installation" of CCUS ITC-eligible property, by virtue of being "preliminary to the acquisition, construction, fabrication or installation of" such property.

To some degree, this is supported by a careful reading of the ITC legislation and, in particular, the "covered worker" definition, which refers to the preparation or installation "of" ITC-eligible property. Some looser connection between the preparation/installation work and the ITC-eligible property could have been used, such as preparation or installation activities "relating to" or "in respect of" ITC-eligible property. The choice was made to limit activities that are in-scope of the labour requirements as P&I Work to those with a closer, more direct link between ITC-eligible property and the in-scope activities created by the use of the preposition "of."

In this regard, CRA document 2025-1081921E5, dated February 25, 2026, is interesting. It considered the case of a very large property described in Class 57(a) to be used in a carbon capture project. This property required a large hole to be excavated, and pilings installed in the hole in order to create a concrete foundation to permanently support the ITC-eligible property. The foundation constituted a Class 57(f) property[1] so as to be itself be ITC-eligible, leading Rulings to conclude as follows:

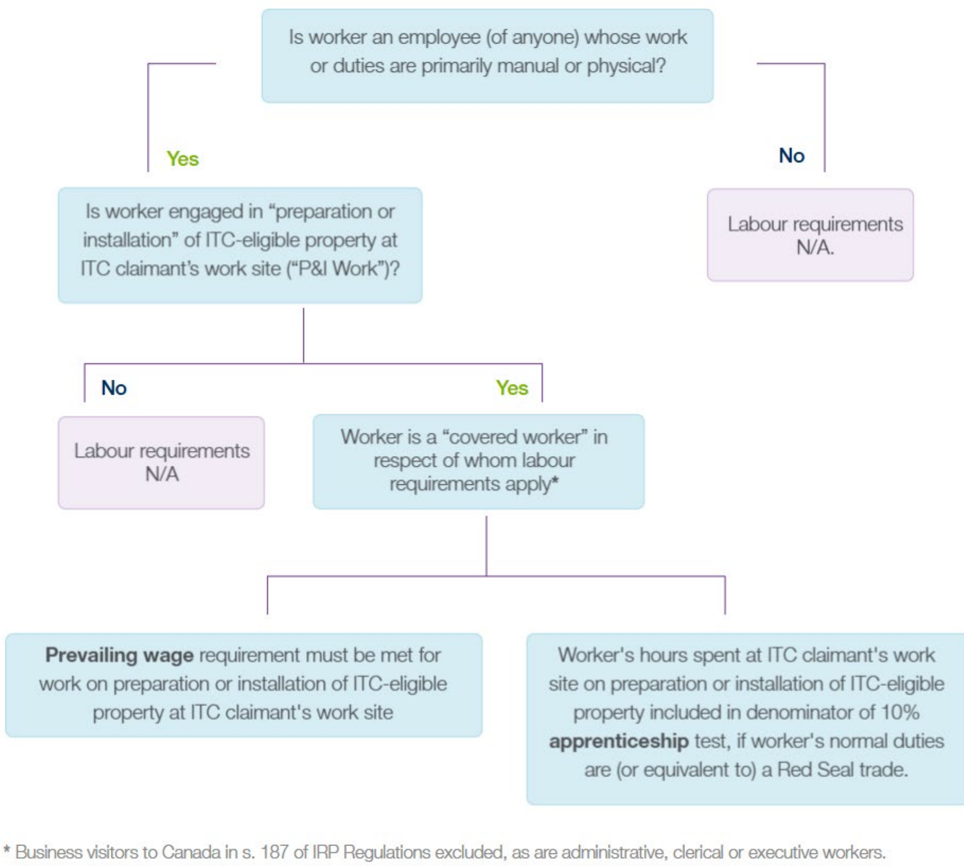
> As a result, Canco would be subject to the labour requirements for the preparation or installation of the Foundation (a specified property), provided that Canco elects to meet the labour requirements under subsection 127.46(2). In our view, this would include the excavation of the hole into which the Foundation will be placed, the installation of the pilings and the pouring of the concrete to construct the Foundation. All of these activities are part of the installation of the Foundation and therefore would constitute the "preparation or installation of specified property" for purposes of the labour requirements in section 127.46.

Similarly, it will not always be clear whether a particular worker's P&I Work duties are "primarily manual or physical in nature." For example, a foreman directly supervising the activities of those who are engaged in manual P&I Work may not meet this test in many cases, depending on their actual duties, while a lead hand who is herself operating machinery while advising less-experienced workers often will. Presumably, the key distinction is how frequently a worker's duties involve hands-on activity versus supervising those engaged in such work. This would be consistent with CRA document 2025-1070641E5, dated Oct. 2, 2025, where Rulings states: "It is our view that the phrase 'manual or physical in nature' as it appears in the definition of 'covered worker' within the Labour Requirements refers to those duties that involve physical exertion (including using tools or machines to perform the physical labour) as opposed to mental exertion."

There is also CRA guidance as to what constitutes the taxpayer's work site, being the geographic location where activities are potentially in-scope of the labour requirements. In CRA document 2025-1070641E5, Rulings stated as follows:

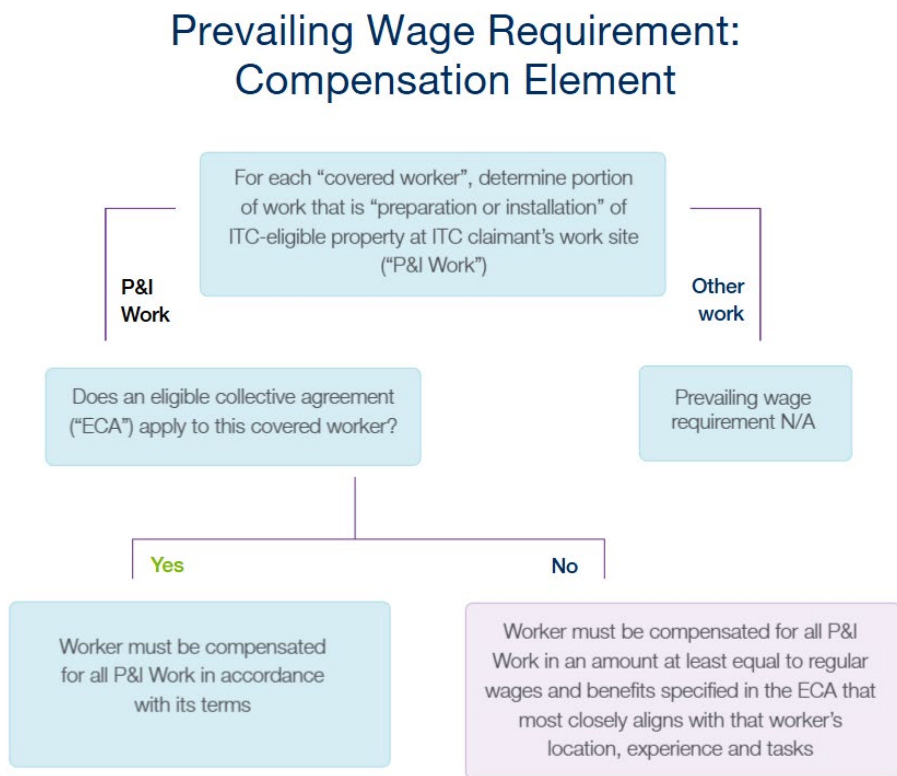
> In our view, a work site will only be a designated work site of an incentive claimant if the work site is at the disposal of the incentive claimant, based on a textual, contextual and purposive analysis of section 127.46. This could include a work site that the incentive claimant owns, rents or to which the incentive claimant otherwise has legal access, provided that it has control over the work site and can access it at its own discretion.

Labour Requirements: Overview



The prevailing wage requirements

The prevailing wage requirements consist of three distinct components: a compensation element (s. 127.46(3)(b)(i)), an attestation element (s. 127.46(3)(b)(ii)) and a notice element (s. 127.46(3)(b)(iii)). First, the **compensation element** mandates that all covered workers be compensated for their P&I Work either (1) in accordance with any eligible collective agreement applicable to that worker or (2) if no such eligible collective agreement applies, in an amount no less than the non-overtime wages and benefits specified in the eligible collective agreement that most closely aligns with the covered worker's experience level, tasks and location. It is unclear whether the text is to be read literally as creating a substantively broader requirement when an eligible collective agreement applies, *i.e.,* the taxpayer becomes non-compliant if *any* term of that eligible collective agreement isn't fully met. To date, the CRA has not provided any guidance on this point, although from a tax policy perspective it seems counterintuitive to hold employers governed by an eligible collective agreement to a more stringent standard for ITC purposes than other employers.



In addition, the **notice element** requires the taxpayer to meet a job site notice requirement, while the **attestation element** requires the taxpayer to attest that it has (1) in fact met the compensation element of the prevailing wage requirement for its own employees and (2) taken reasonable steps to ensure the employers of any other covered workers, *i.e.*, contractors, subcontractors and others, have done likewise. The CRA has provided guidance online as to what "reasonable steps" means. The New CRA Guidance includes further commentary on how a taxpayer can demonstrate that "reasonable steps" have been taken.

The attestation element is **not** an attestation to having actually met the prevailing wage requirements. Instead, it requires the taxpayer to attest to having in fact met the prevailing wage requirements as regards *its own* employees, but only to having "taken reasonable steps to ensure that any covered workers employed by any other person" have been compensated in accordance with the required standard.

It is also important to understand that while the apprenticeship requirements can be definitively met by making "reasonable efforts" to achieve a specified result,[2] the same is not true of the prevailing wage requirements. To comply with the prevailing wage requirements, one must *in fact* achieve the prescribed results: reasonable efforts do not suffice.

There is thus a gap between what a taxpayer must attest to as part of meeting the prevailing wage requirements and what the taxpayer must actually achieve in order to meet them and thereby comply with the prevailing wage requirements. Specifically, while meeting the *attestation element* of the prevailing wage requirements requires only "reasonable steps" of the taxpayer as regards the employees of contractors and subcontractors, meeting the *compensation element* demands that all covered workers have **in fact** been compensated as required. In many cases, this is not always entirely within the taxpayer's control.

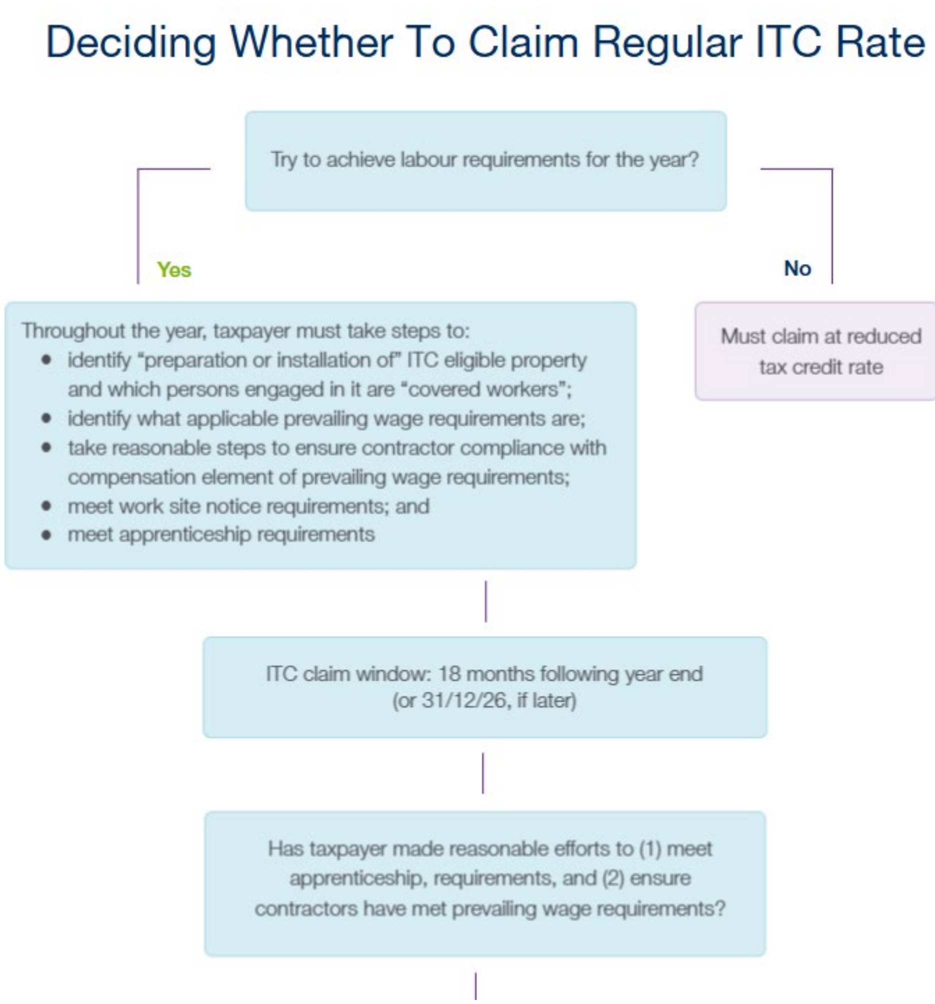
There are two principal implications from the fact that making "reasonable efforts" to comply with the compensation element of the prevailing wage requirements is insufficient to have complied with the prevailing wage requirements:

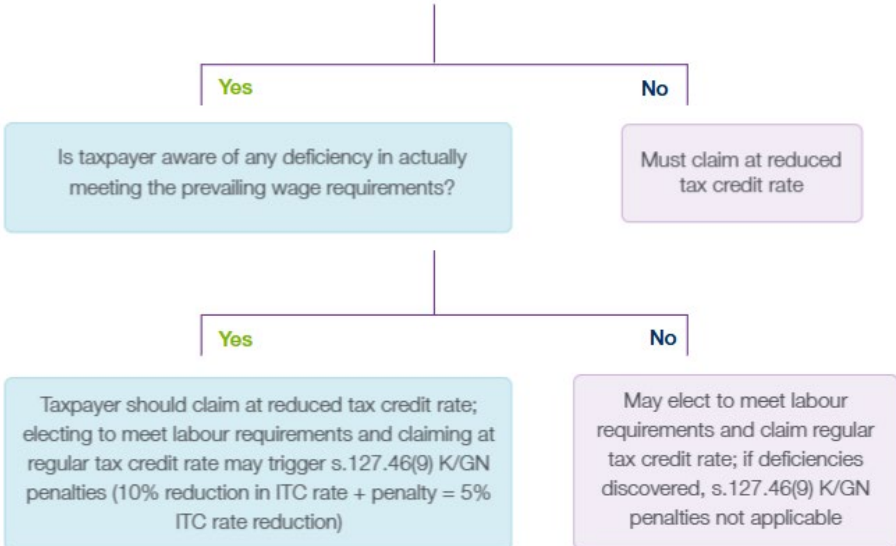
- if the "normal" compliance deficiency rules apply (*i.e.*, the taxpayer's actions do not meet the K/GN Standard), the applicable penalty/remediation provisions effectively hold the taxpayer strictly liable for any deficiency in paying the prevailing wage to *all* covered workers, not just the taxpayer's own employees. Simply making "reasonable efforts" towards complying with the prevailing wage requirements is not enough to avoid the consequences of failing to actually meet them; and

- a taxpayer who has taken reasonable steps to prevent a compliance deficiency as to the compensation element of a contractor's covered employees but who is aware a deficiency exists (1) can truthfully make the necessary attestation, but (2) risks the consequences of s. 127.46(9) if it claims at the regular tax credit rate while having knowledge of the contractor's compliance deficiency. Put another way, making reasonable efforts to ensure that contractors meet the compensation element of the prevailing wage requirements may not be good enough to claim the regular tax credit rate without transgressing the K/GN Standard if the taxpayer knows of, or perhaps strongly suspects, that a compliance deficiency exists.

II. Labour requirements compliance

As noted, taxpayers claiming clean economy ITCs have a choice. A taxpayer can choose not to elect to meet the labour requirements and simply claim the relevant ITC at the reduced tax credit rate. Alternatively, if a taxpayer elects to meet the labour requirements and is determined not to have fully complied with them, the consequences depend on whether the taxpayer's actions are considered to have met the K/GN Standard or not.





Non-compliance: Normal circumstances

In "normal" circumstances where the K/GN Standard is not met, the consequences of non-compliance are much less severe. The taxpayer's entitlement to the regular tax credit rate remains undisturbed. However, a taxpayer who has not complied with the apprenticeship requirements is liable to pay, as additional Part I tax, an additional $50[3] for each hour of work that was required to be performed by apprentices registered in Red Seal trades on P&I Work for the year in order to meet the statutory target but was not, under s. 127.46(7). A taxpayer that has not complied with the prevailing wage requirements faces two sanctions:

- s. 127.46(6), which obligates the taxpayer to pay, as additional Part I tax, "an amount equal to $20[4] for each day in the installation taxation year on which the covered worker was not paid the prevailing wage" (the s. 127.46(6) *per diem* tax); and
- ss. 127.46(11)-(14), which applies where the CRA has notified the taxpayer of a compliance deficiency and which obligates the taxpayer to either make up any deficiency in the compensation element of the prevailing wage requirements (plus interest) to the short-paid employee (a top-up amount) or pay 120 per cent of that amount to the CRA as a penalty.

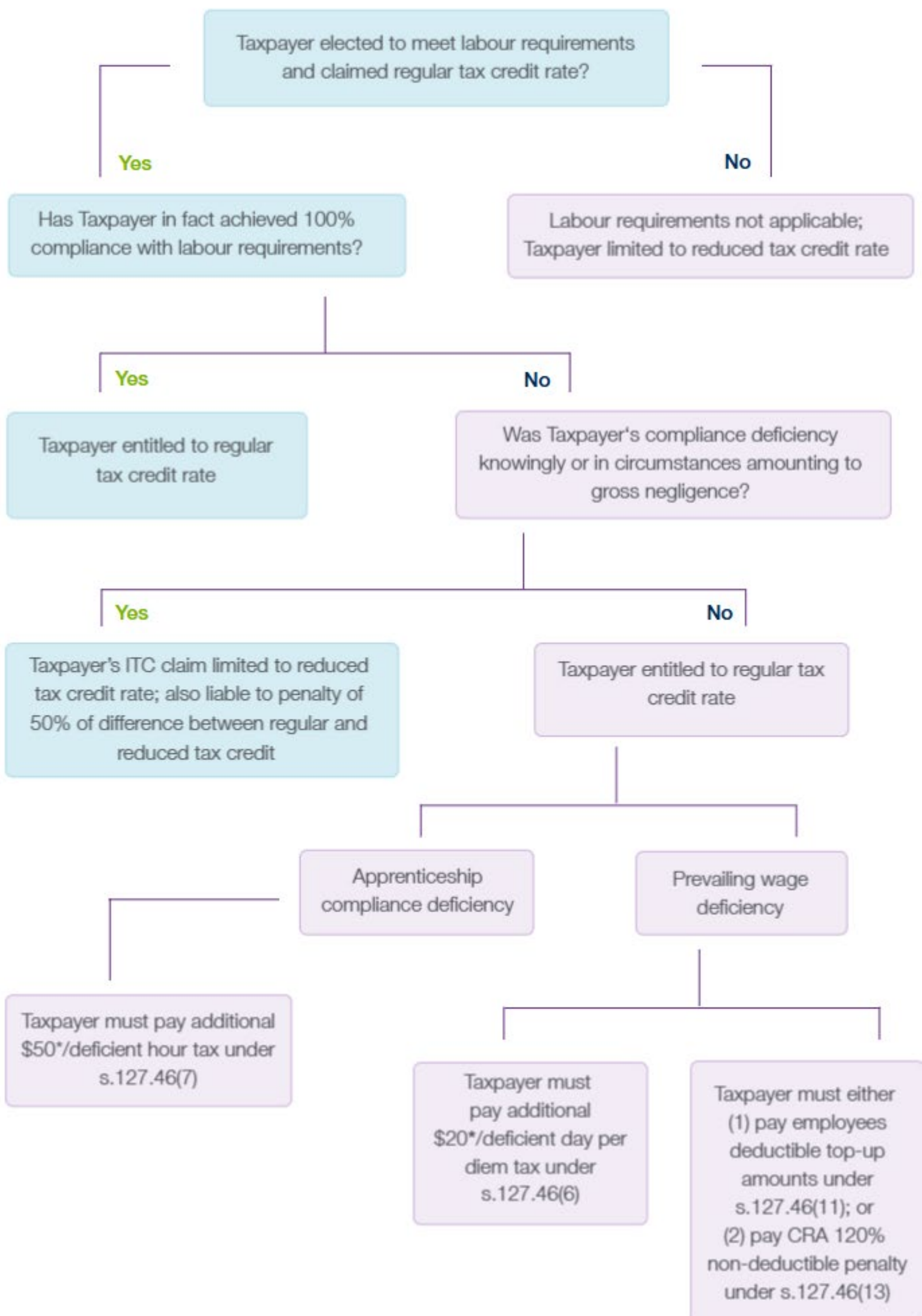
Amounts paid as additional tax or penalty are non-deductible, while penalties are potentially eligible for CRA relief under s. 220(3.1) in appropriate circumstances. Top-up amounts are treated as salary and wages and so are deductible to the payer when paid, but are excluded from being eligible for the relevant clean economy ITC under s. 127.46(14).

The wording of the *per diem* tax in s. 127.46(6) reads as follows:

> **(6)** Unless subsection (9) applies, if an incentive claimant claims a specified tax credit at a regular tax credit rate in a taxation year but does not meet the prevailing wage requirements in respect of a covered worker for one or more days in an installation taxation year in respect of that specified tax credit, there shall be added to the tax payable under this Part for the installation taxation year by the incentive claimant an amount equal to $20 for each day in the installation taxation year on which the covered worker was not paid the prevailing wage.

There is some degree of interpretive uncertainty as to the scope of "each day in the installation taxation year on which the covered worker was not paid the prevailing wage." Specifically, this phrase could be read as describing each day of work for which a particular worker received less than the prevailing wage, or potentially as each day during the year where the shortfall for any such underpaid work date remained outstanding and unpaid. The New CRA Guidance resolves this question, indicating that the former is the correct interpretation in the answer to Question 2.

Labour Requirements Compliance Overview



* Indexed for inflation under s.127.46(8)

Non-compliance: Knowingly or in circumstances amounting to gross negligence

Alternatively, if the taxpayer is determined to have failed to comply knowingly or in circumstances amounting to gross negligence, ostensibly on *any* element of the labour requirements and in *any* amount, it effectively suffers a 15 per cent ITC rate reduction, *i.e.*, what would normally be 30 per cent for the Clean Technology ITC effectively becomes 15 per cent. The maximum ITC claim allowed is the reduced tax credit rate, and a penalty amount equal to another five per cent ITC rate reduction applies, thus making the consequences of claiming the full rate where the K/GN Standard has been met much worse than simply claiming the reduced tax credit rate.

The framing of one-third of the adverse consequence as a penalty rather than a further reduction in the applicable tax credit rate in theory allows the CRA to waive it under s. 220(3.1), although presumably the scope for such relief will be limited given the "knowingly or grossly negligent" threshold for when this penalty applies. Logical cases for penalty relief would include ones where the amount of K/GN non-compliance was fairly minimal, or where the taxpayer self-reports after having made good-faith remediation efforts. The CRA's policies on discretionary penalty relief are set out in IC07-1R1.

The phrase "knowingly or in circumstances amounting to gross negligence" as used in s. 127.46(9) is almost identical to the standard prescribed in s. 163(2) for penalties for false statements or omissions. As such, *prima facie*, one would expect the jurisprudence developed under that latter provision to be equally applicable to interpreting the K/GN Standard established in s. 127.46(9).

In *Canada v. Paletta Estate* (2022 FCA 86),[5] the Federal Court of Appeal had occasion to review what the K/GN Standard entails and what differentiates it from "normal" negligence:

> [65] Neglect under subparagraph 152(4)(a)(i) refers to a lack of reasonable care. The duty of reasonable care is met if the taxpayer has "thoughtfully, deliberately and carefully assesse[d] the situation and file[d] on what he believe[d] bona fide to be the proper method"; in other words, "in a manner that the taxpayer truly believe[d] to be correct" (*Regina Shoppers Mall Ltd. v. Canada*, [1990] 2 C.T.C. 183, 90 D.T.C. 6427 (F.C.T.D.), aff'd (1991), 126 N.R. 141, 91 D.T.C. 5101 (F.C.A.); see also *Canada v. Johnson*, 2012 FCA 253, 435 N.R. 361, [2013] 1 F.C.R. D-2). This test is not disputed by the parties. The Court may also draw inferences of negligence from an omission to verify the validity of a taxpayer's belief (*Robertson v. Canada*, 2016 FCA 303, 2016 D.T.C. 5131, at paragraphs 5 and 6).
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> [66] In contrast, subsection 163(2) requires that the false statement be made knowingly or in circumstances amounting to gross negligence. This burden can be met either directly or constructively, through a demonstration of wilful blindness (*Wynter v. Canada*, 2017 FCA 195, 2017 D.T.C. 5114 (*Wynter*), at paragraph 16):
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>> In sum, the law will impute knowledge to a taxpayer who, in circumstances that suggest inquiry should be made, chooses not to do so. The knowledge requirement is satisfied through the choice of the taxpayer not to inquire, not through a positive finding of an intention to cheat.
>
> [67] *Wynter* teaches that although wilful blindness and gross negligence often converge, they are conceptually different. Rennie J.A., writing for this Court, explains this difference as follows (*Wynter*, at paragraphs 18 and 19):
>
>> Gross negligence is distinct from wilful blindness. It arises where the taxpayer's conduct is found to fall markedly below what would be expected of a reasonable taxpayer. Simply put, if the wilfully blind taxpayer knew better, the grossly negligent taxpayer ought to have known better.
>>
>> Gross negligence requires a higher degree of neglect than a mere failure to take reasonable care. It is a marked or significant departure from what would be expected. It is more than carelessness or misstatements. The point is captured in the decision of this Court in *Zsoldos v. Canada (Attorney General)*, 2004 FCA 338 at para. 21, 2004 D.T.C. 6672:

> In assessing the penalties for gross negligence, the Minister must prove a high degree of negligence, one that is tantamount to intentional acting or an indifference as to whether the law is complied with or not. (See *Venne v. R.* (1984), 84 D.T.C. 6247 (Fed. T.D.), at 6256.)

[68] It can be seen from this that subsection 163(2) imposes a higher threshold with the result that conduct warranting the reopening of statute-barred years pursuant to subparagraph 152(4)(a)(i) will not necessarily justify the imposition of a penalty under the former (see for example *Van der Steen v. The Queen* (1984), 2019 TCC 23, 2019 D.T.C. 1024; see also *Venne v. The Queen*, 84 D.T.C. 6247, [1984] C.T.C. 223 (F.C.T.D.)). The opposite is however true; conduct that justifies the imposition of a penalty under subsection 163(2) will necessarily meet the threshold contemplated by subparagraph 152(4)(a)(i).

The CRA's interpretation of these concepts can be found in the relevant portion of the CRA's Income Tax Audit Manual (Chapter 28), which discusses the terms "knowingly" and "gross negligence":

28.4.2 Knowingly or under circumstances amounting to gross negligence

It is vital to understand the meaning of the term "knowingly or under circumstances amounting to gross negligence" to apply a gross negligence penalty.

Knowingly, as used in subsection 163(2) of the ITA, implies that a taxpayer knew or ought to have known that the amount of tax paid was less than should otherwise have been paid for the purposes of the ITA or that the amount of refund or rebate claimed was greater than the amount that the person was eligible to receive for the purposes of the ITA. **Knew** implies that a taxpayer deliberately or intentionally acted in such a manner, while **ought to have known** does not mean actual knowledge, but means that the taxpayer had in effect the means of knowledge.

Gross negligence, as used in subsection 163(2), covers a set of facts which clearly indicates either that the taxpayer knew or ought to have known that an offence was committed under this subsection or that the taxpayer acted so carelessly or so negligently that the way in which the taxpayer handled their affairs amounted to gross negligence (that is, negligence of conspicuous magnitude). The set of facts typically fall in the categories of "(a) the magnitude of the omission in relation to the income declared, (b) the opportunity the taxpayer had to detect the error, (c) the taxpayer's education and apparent intelligence, (d) genuine effort to comply." [Lauzon v The Queen, 2016 TCC 71, para 29, and 2016 FCA 298] "Gross negligence may be established where a taxpayer is wilfully blind to the relevant facts in circumstances where the taxpayer becomes aware of the need for some inquiry but declines to make the inquiry because the taxpayer does not want to know the truth" [Strachan v The Queen, 2015 FCA 60, para 4] and "consequently, the law will impute knowledge to a taxpayer who, in circumstances that dictate or strongly suggest that an inquiry should be made with respect to his or her tax situation, refuses or fails to commence such an inquiry without proper justification." [Panini et al v The Queen, 2006 FCA 224, paragraph 43].

Go to 28.4.18, Other gross negligence penalties, for a list of court cases that discuss "knowingly" and "gross negligence."

The factors cited by the CRA as relevant to determining whether the K/GN Standard has been met include the following:

28.4.4 Specific factors to consider when imposing gross negligence penalties

To determine if gross negligence penalties should be applied, consider (not an exhaustive list):

- materiality of the false statement or omission
- taxpayer's history of contact with the CRA
- taxpayer's knowledge of tax matters
- nature of the false statement or omission

- taxpayer’s involvement in preparing the return
- misinterpretation of the legislation
- books and records
- number of sources of taxable income
- disclosure of other sources of taxable income
- taxpayer’s history of compliance
- signature on the return

The burden the CRA must discharge in order to support a K/GN finding has been described by the courts as a “heavy”[6] one, and “the imposition of gross negligence penalties is to be applied in the clearest cases with the [CRA] being required to prove intent or reckless misconduct, otherwise taxpayers should be given the benefit of the doubt.”[7] However, because the sanctions contained in s. 127.46(9) for being found to have breached the K/GN Standard are so severe, and will likely also create serious adverse non-tax implications, *e.g.*, under relevant financing agreements, taxpayers can be forgiven for having a very low willingness to risk the CRA applying s. 127.46(9).

One of the questions posed in the New CRA Guidance was whether a taxpayer who was aware of a compliance deficiency beyond its ability to remedy at the time its ITC claim was filed could claim the regular tax credit rate, on the basis that it was ready and willing to correct the deficiency but simply could not do so. Not surprisingly, Rulings’ response (in the answer to Questions 1 and 2) was that the taxpayer could not claim the regular tax credit rate without risking the application of the K/GN consequences of s. 127.46(9):

> If Canco *knows* that it *did not meet* one or more of the Labour Requirements *at the time that it claims* its CCUS tax credit for its 2025 taxation year, then it should not elect under subsection 127.46(2) in respect of that claim. If it does, Canco could be subject to the gross negligence penalty in subsection 127.46(9), if the Minister determines that it elected to meet the Labour Requirements and knowingly failed to meet those Labour Requirements.

This conclusion was further reiterated in the answer to Question 3:

> The hypothetical facts state that, at the time of making its CCUS tax credit claim for Canco's 2025 taxation year, the three covered workers were *not* compensated in accordance with subparagraph 127.46(3)(b)(i). Therefore, at that time, Canco is aware that it has not complied with all of the Labour Requirements and should not elect under subsection 127.46(2) in respect of that specified tax credit or it could be subject to the gross negligence penalty in subsection 127.46(9).
>
> Canco may decide to wait to make its claim for the CCUS tax credit for the 2025 taxation year until the prevailing wage requirements are met.

In fairness, there is not really much other answer Rulings could have provided, given the text of the statute and the K/GN jurisprudence. The response referenced the CRA’s further comments on s. 127.46(9) made at the 2025 Canadian Tax Foundation Round Table, memorialized as CRA document 2025-108081, which described a K/GN determination as “a question of fact that can only be determined after an examination of all the relevant facts and circumstances.” In this previous statement, the CRA indicated that while an “inability to substantiate that covered workers employed by others were compensated in accordance with subparagraph 127.46(3)(b)(i) should not, in and of itself” support a finding that the K/GN Standard had been met, the failure to take reasonable steps to ensure such compliance could support such a finding, and that in such circumstances “the gross negligence penalty under subsection 127.46(9) should generally apply.”

The further question was asked whether such a taxpayer could pre-emptively pay the CRA the shortfall penalty described in s. 127.46(13) in order to come into compliance and legitimately claim the regular tax credit rate. The answer to this suggestion was also “No”:

> The “top-up penalty” in subsection 127.46(13) that you referred to in your question is only applicable if Canco receives a notification from the Minister specifying that it did not meet the prevailing wage

requirements for a designated work site for a taxation year, pursuant to subsection 127.46(11). This is referred to as a Corrective Measure, and it is initiated by the CRA. There is no mechanism available to Canco to voluntarily pay the top-up penalty without having received this notification from the Minister.

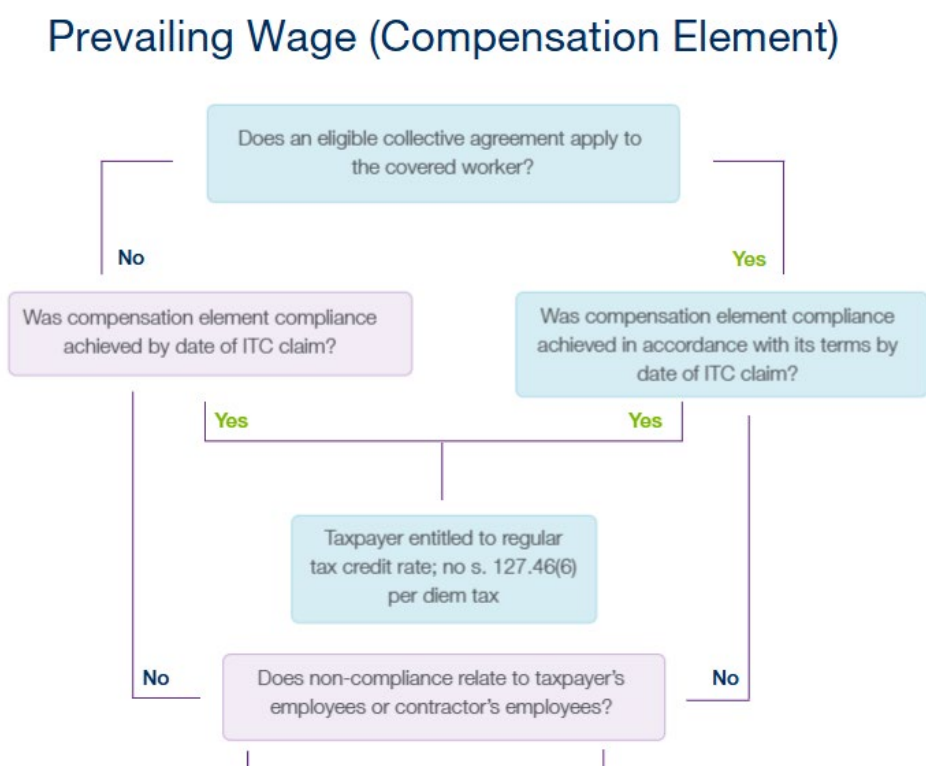
This would also seem to be an accurate interpretation of the statute, as strictly speaking the procedure described in s. 127.46(13) is a sanction for non-compliance, and its text does not characterize payment as constituting compliance with the labour requirements. This then leaves a taxpayer with knowledge of a compliance deficiency that it cannot remedy in the unsatisfactory position of either claiming the reduced tax credit rate, which is bad, or claiming the regular tax credit rate and risking the consequences of s. 127.46(9), which is worse.

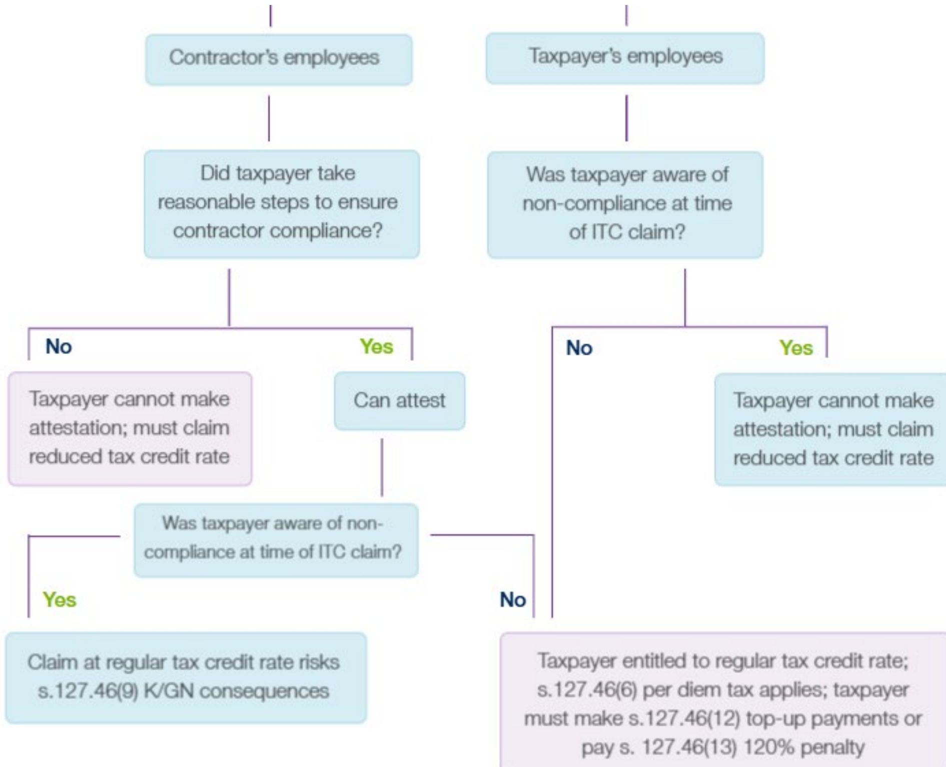
Non-compliance: Common problems

In practice most issues associated with labour requirements compliance arise from the compensation element of the prevailing wage requirement. Common problem areas include the following:

- failing to correctly determine that a worker's duties are primarily manual or physical, such that someone who was thought not to be a "covered worker" in fact is;
- determining the scope of P&I Work too narrowly for one or more workers, such that more work and/or workers are in-scope of the labour requirements than originally thought; and
- for a covered worker to whom no eligible collective agreement applies, incorrectly determining the regular wages and benefits applicable under the closest comparable eligible collective agreement.

This could occur for either the taxpayer's own employees or, more typically, employees of a contractor or subcontractor, in respect of whom the taxpayer has less information and control and where the employer, *i.e.*, not the taxpayer, generally has less incentive to achieve labour requirements compliance since it does not bear the cost of failure, subject to contractual allocation of consequences. For example, where a covered worker is an employee of a contractor or subcontractor retained by the taxpayer to work on the project, *i.e.*, the taxpayer has no direct relationship with or information about the relevant employee, the taxpayer may have no practical ability to ensure that any shortfall is paid to the employee.





On large ITC-eligible projects with hundreds or thousands of covered workers and dozens of contractors, subcontractors and sub-subcontractors, the reality is that there will very often be situations where the taxpayer knows or has very good reason to think someone has been paid less than the prevailing wage. Taxpayers can try to remedy this, but there will not always be a solution offering reasonable certainty that compliance can be achieved. For example, contractors or subcontractors go out of business or become non-co-operative over contractual disputes, or their covered workers move away, sometimes without leaving contact information. This is often simply the on-the-ground reality. In such circumstances, the taxpayer's ability to claim the regular ITC rate by electing into the labour requirements and in fact meeting the prevailing wage requirement is effectively frustrated by the inability to actually meet that requirement for literally each and every in-scope worker the taxpayer knows has, or believes may have, been underpaid.

One such potential compliance concern relates to *when* covered workers are paid the prevailing wage. Particularly on larger projects with numerous contractors and subcontractors, prevailing wage shortfalls arising from any of the foregoing reasons (or others) are virtually inevitable. If a taxpayer discovers a particular covered worker has been paid less than she should have been, can this be corrected in such a manner as to be considered compliant with the compensation element of the prevailing wage requirements?

There is no time specified in s. 127.46 by which the required compensation must be paid to the covered worker. Hence, at least in cases where no eligible collective agreement applies to the covered worker, so long as the required amount of compensation has been paid to the covered worker by the time the taxpayer files its ITC claim, it can truthfully attest to having met (past tense) the compensation element of the prevailing wage requirement. This was confirmed in the New CRA Guidance, where Rulings states in its Response to Questions 1 and 2:

> Canco can **elect** to meet and **attest** that it met the Labour Requirements at the time that it makes its claim for the CCUS tax credit for its 2025 taxation year, provided that, at the time of making the claim, the three

> short-paid covered workers were compensated in accordance with the applicable Compensation Requirement above, based on the hypothetical facts.

This determination is both consistent with the text of the statute and the tax policy underlying the labour requirements: incentivizing employers to create good jobs that pay the prescribed level of wages. Given the severe potential consequences for non-compliance with the labour requirements, there is no apparent policy reason to find employers non-compliant if they pay the required wages but do so past an arbitrary deadline. The same tax policy would seem to be applicable in cases where an eligible collective agreement does apply, although the CRA has not expressed a view on this.

Non-compliance: Electing the reduced rate vs. s. 127.46(9) consequences

A taxpayer with actual knowledge or strong suspicion of a labour requirements deficiency has the unenviable choice of either claiming the reduced tax credit rate or claiming the regular tax credit rate and taking their chances that the CRA considers their circumstances to have met the K/GN Standard such that the punitive consequences of s. 127.46(9) apply. Both alternatives raise interpretive questions which the New CRA Guidance addresses.

Can one elect the reduced tax credit rate in one year and the regular rate in another?

A taxpayer considering whether to choose not to meet the labour requirements in a particular year and simply claim the reduced tax credit rate will want to understand the consequences of doing so. Specifically, if the choice to opt out of labour requirements compliance for one year has consequences in other years, this would greatly diminish the viability of doing so.

The operative labour requirements rule in s. 127.46(2) reads as follows:

> **(2)** Despite sections 127.44, 127.45, 127.48 and 127.491, the applicable rate for each specified tax credit of an incentive claimant is the reduced tax credit rate unless the incentive claimant elects in prescribed form and manner to meet the prevailing wage requirements under subsection (3) and the apprenticeship requirements under subsection (5) for each installation taxation year in respect of the specified tax credit.

Paraphrasing, this provision establishes the reduced tax credit rate as the taxpayer's applicable ITC rate unless the taxpayer elects to meet the labour requirements "for each installation taxation year". A literal reading of this provision raises some concern that unless a taxpayer elects to meet the labour requirements for *every* installation taxation year in respect of any particular clean economy ITC, the applicable ITC rate for that particular ITC will be the reduced tax credit rate for *every* such year. Put another way, the legislative text does not make explicit that electing into the labour requirements in respect of a particular year only impacts that year, and that not electing for one year does not affect other years.

Fortunately, the New CRA Guidance provides a definitive interpretation that this is indeed the case, a common-sense result that is very helpful to have clarified. This is provided in the last sentence of the response to Question 4:

Response to Question 4

> Since the subsection 127.46(2) election is made with a claim for a specified tax credit, and the hypothetical facts strongly suggest that Canco will not meet the Labour Requirements in 2025 (specifically the Compensation Requirement), Canco should not elect, and should claim the CCUS tax credit for the 2025 taxation year at the reduced tax credit rate. However, the hypothetical facts state that Canco will meet the Labour Requirements in 2026 and in 2027, therefore Canco can elect under 127.46(2) when it makes its claims for the CCUS tax credits for its 2026 and 2027 taxation years.

This response effectively reads the legislation as inferring the words “for any particular installation taxation year” after the words “the applicable rate”, and the reference to “each” installation taxation year as “that” installation taxation year. Interpreting the provision in a textual, contextual and purposive manner, it is eminently logical to conclude that electing to meet the labour requirements (or not) and claim the regular (or reduced) tax credit rate is a year-by-year exercise. In this manner, a taxpayer who cannot (or chooses not to) meet the labour requirements in one year is not disincentivized from trying to meet them (and thereby claim the regular tax credit rate) in other years.

Does a “knowingly/gross negligence” finding in one year affect other years?

As noted, the consequences of being found to have been non-compliant in a manner that reaches the K/GN Standard are severe. The text of s. 127.46(9) reads as follows:

> **(9)** If an incentive claimant has claimed a specified tax credit at the regular tax credit rate in a taxation year (referred to in this subsection as the “claim year”) but has failed to meet the prevailing wage requirements or the apprenticeship requirements for an installation taxation year in respect of that specified tax credit and the Minister determines that the incentive claimant knowingly or in circumstances amounting to gross negligence failed to meet those requirements, then
>
> > **(a)** the incentive claimant is not entitled to the regular tax credit rate, and is entitled to not more than the reduced tax credit rate, for the specified tax credit; and
> >
> > **(b)** the incentive claimant is liable to a penalty for the claim year equal to the amount determined by the formula
> >
> > **50 per cent × (A − B)**
> >
> > where
> >
> > **A** is the amount of the specified tax credit claimed by the incentive claimant at the regular tax credit rate for the claim year, and
> > **B** is the amount that the incentive claimant would have been entitled to claim as a specified tax credit at the reduced tax credit rate for the claim year.

Unlike in paragraph (b) where the penalty is explicitly stated to be “for the claim year”, the disentitlement to the regular tax credit rate in paragraph (a) makes no reference to any particular year. This raises the question of whether denial of the regular tax credit rate applies to more than the particular year in which the K/GN Standard was found to have been met.

Once again, the New CRA Guidance interprets the legislation in a textual, contextual and purposive manner to clarify that the disentitlement to the regular tax credit rate should be read as referring only to “the claim year.” This is contained in the response to Question 5:

> *Response to Question 5*
>
> Assuming that the conditions of subsection 127.46(9) *only* apply to Canco for its claim for the CCUS tax credit for its 2025 taxation year (not the other claim years), the implications imposed under subsection 127.46(9) will only apply to its 2025 claim year (not the other claim years).

This is demonstrably the right answer, and the certainty it provides is helpful.

III. The labour requirements: Problems and suggestions

A taxpayer claiming clean economy ITCs to which the labour requirements apply has basically two choices:

- forego meeting the labour requirements, and claim at the reduced tax credit rate (*i.e.*, for the Clean Technology ITC, at the 20 per cent rate instead of the regular 30 per cent rate); or

- decide to meet the labour requirements, invest the time and effort required to pursue compliance with them, and then formally elect to meet them for the year and claim the regular tax credit rate, on the basis that while compliance may not be perfect there are no compliance deficiencies that meet the K/GN Standard, so that the worst-case scenario is entitlement to the regular tax credit rate but possible *per diem* taxes and/or top-up payments.

As the law presently stands, a taxpayer who knows or has good reason to believe non-compliance exists with some element of the labour requirements and who nonetheless elects to meet them risks a result worse than claiming at the reduced tax credit rate.

Do the existing rules create the optimal incentives?

Some of the most common compliance problems highlight an important policy issue. It is very much in the interests of both taxpayers seeking clean economy ITCs and governments encouraging labour requirements compliance that any deficiencies that taxpayers become aware of be "curable," in the sense of taxpayers having some avenue for taking corrective steps that both meet the relevant tax policy objectives and are deemed to constitute "compliance" with the labour requirements generally and the compensation element of the prevailing wage requirements specifically. If taxpayers are left in the position of finding compliance deficiencies that they are ready and willing to fix but that either:

- they are practically unable to fix, for reasons outside their control; or
- if fixed in a substantive sense, do not technically constitute full "compliance" with the labour requirements,

whatever time and effort they have spent trying to comply with the labour requirements is potentially for naught:

- if such a taxpayer elects to meet the labour requirements and claims the regular tax credit rate, the danger is that the CRA applies s. 127.46(9) on the basis that the taxpayer did so "knowing" that it did not pay 100 per cent of the full amount required to be the "prevailing wage", or paid it but in some way not within the legislative definition of "compliance"; and
- alternatively, such a taxpayer must absorb the cost of claiming the reduced tax credit rate on the taxpayer's entire qualifying expenditure for the year.

The problem is that the application of s. 127.46(9) is binary: it either applies to the taxpayer's *entire* claim for a particular clean economy ITC in a given year, or it doesn't apply at all. As a result, a taxpayer who knows, or perhaps merely suspects, that *any* amount of non-compliance with the labour requirements has occurred and remains unremedied at the time the ITC claims form is completed takes the risk that s. 127.46(9) will apply to their *entire* clean economy ITC claim for the year. Put simply,

- the cost of suffering either a 10 per cent or 15 per cent reduction in the taxpayer's ITC claim for the year bears no relationship (and may be completely disproportionate) to the degree of labour requirements non-compliance; and
- no legislative safety valve exists for a taxpayer who wants to correct a known or suspected compliance deficiency but cannot, for whatever reason.

There is no explicit discretion within the legislation for the CRA to waive or ignore situations where, despite making good-faith efforts to achieve 100 per cent compliance, at the time the taxpayer makes its ITC claim it knows or has very good reason to believe compliance has been less than perfect, *e.g.,* some number of covered workers have been paid something less than the prevailing wage for some number of work days. While a particular CRA auditor ultimately reviewing the claim might exercise such discretion, the consequences of that not happening are so severe as to make it completely impractical to claim the regular tax credit rate and risk s. 127.46(9) applying in the hope of that discretion. Moreover, most clean economy ITC-eligible projects of any size are going to be audited by an accounting firm that will force a taxpayer in such circumstances who claims the regular tax credit rate to report an uncertain tax position or a reserve in their financial statements, which will be completely unacceptable to lenders and other stakeholders. As such, many taxpayers in this position who cannot know with confidence that all labour requirements non-compliance they know of, or they believe is likely to exist, can somehow be remedied will simply forego trying to remediate any non-compliance and just claim at the reduced tax credit rate.

This is a lose-lose outcome for taxpayers and government alike if the result is that no matter how much time and effort the taxpayer has put in towards achieving full compliance, a fairly *de minimis* amount of **known** non-compliance can effectively disentitle a taxpayer from millions or tens of millions of dollars of clean economy ITCs, by forcing claims at the reduced tax credit rate. On a larger project, such situations can easily occur, which can in turn incentivize a taxpayer *at the outset* of a project to not bother incurring the cost and effort of trying to achieve labour requirements compliance *at all*, and just accept the reduced tax credit rate, a result that benefits no one and does not achieve the policy objectives of the labour requirements.

Suggested legislative improvements

Taxpayers who know or suspect they have a compliance issue and want to fix it deserve to be treated differently from those who don't care or who make minimal compliance efforts and claim the regular tax credit rate anyway. Viewed within the overall tax policy context of wanting to provide fiscal support to green economy projects while generating well-paying jobs in Canada, it seems unfair, and counterproductive, to deny the regular tax credit rate to taxpayers who become aware of a compliance deficiency before they file their ITC claims and are willing to remedy it, but cannot do so in a way that constitutes compliance within the meaning of s. 127.46.

There are at least two ways in which the labour requirements could usefully be amended to better achieve the government's underlying tax policy objective of encouraging taxpayers to pursue labour requirements compliance on clean economy projects while providing taxpayers with greater certainty and fairness:

- provide a mechanism to remedy known or suspected compliance deficiencies before the time the taxpayer makes its ITC claim for the year that is deemed to bring the taxpayer into labour requirements "compliance", so as to allow the taxpayer to claim the regular tax credit rate without fear of s. 127.46(9) applying; and
- eliminate the all-or-nothing consequences facing taxpayers legitimately trying to address compliance deficiencies, and make the consequences of non-compliance meeting the K/GN Standard proportionate to degree of non-compliance.

As to the first point, effectively what is required is some mechanism whereby a taxpayer who has made reasonable efforts to achieve full compliance and finds itself at a dead end can take action that is deemed to constitute compliance with the prevailing wage requirements. For example, the U.S. version of the prevailing wage requirement in 26 CFR § 1.45-7 includes such relief in some cases. Specifically, the following rule in § 1.45-7(c)(1)(v) applies:

> ***Special rule for laborers and mechanics who cannot be located.*** A taxpayer will be deemed to have paid a correction payment, under this paragraph (c)(1), to a laborer or mechanic who cannot be located if the taxpayer can establish that correction payments have been made. A taxpayer may establish that correction payments have been made by demonstrating compliance with the applicable State unclaimed property law and all Federal and State withholding and information reporting requirements with respect to the payments.

In its simplest form, such a mechanism could be an addition or appendix to the ITC claims form whereby the taxpayer self-reports any known compliance concerns with the compensation element of the prevailing wage requirements, much like a disclosure schedule for representations and warranties in a share purchase agreement operates. If considered necessary or desired, such mechanism could include paying estimated amounts to the CRA or a trusted third party, although this may not really be needed given the existing consequences for "normal" non-compliance. In either case, self-reported compliance concerns would be deemed to be outside the scope of s. 127.46(9), and the "normal" sanctions for non-compliance (*i.e.*, the s. 127.46(6) *per diem* tax and s. 127.46(11) obligation to pay top-up amounts) could be made applicable. This seems like a simple and costless way in which the government can incentivize taxpayers to do the right thing and pursue labour requirements compliance without penalizing those who have taken reasonable steps towards compliance (the attestation element of the prevailing wage requirement already establishes this baseline) but are aware of potential deficiencies.

Such action would go a long way towards relieving the risk of disproportionately adverse consequences from conduct that is found to reach the K/GN Standard. However, the binary, all-or-nothing nature of s. 127.46(9) remains potentially draconian, and this seems needlessly punitive. Gross negligence penalties in s. 163(2) based on the same K/GN Standard apply on an issue-by-issue basis, rather than to the taxpayer's entire tax owing for the year. Some consideration could usefully be given to limiting the scope of s. 127.46(9) to something more proportionate to the scope of the taxpayer's knowing or grossly negligent conduct, either by expressly amending the consequences of that provision to that effect or at least creating a statutory authority within its text to give the CRA discretion to reduce its impact in appropriate circumstances. Not all conduct meeting the K/GN Standard is equal and ensuring that the crime fits the punishment is a reasonable and appropriate result that does not dilute the deterrence effect on those who are truly bad actors seeking to take advantage of a relatively generous tax expenditure program.

FOOTNOTES:

[1] A building or other structure all or substantially all of which is used for the installation or operation of Class 57(a) equipment.

[2] Including the statutory safe harbour for doing so in s. 127.46(16).

[3] Indexed to inflation: s. 127.46(8).

[4] *Ibid*.

[5] Application for leave to appeal to the Supreme Court of Canada dismissed March 16, 2023. For further discussion of this issue, see Mark Stevens, "False Statement or Omission Penalties in Canadian Tax Law" (2024) 72:1 *Canadian Tax Journal* 33-64.

[6] *Corriveau v. The Queen*, [1999] 2 CTC 2580, para. 24.

[7] *Chaloux v. The Queen*, 2015 TCC 284.

By

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