Ontario measures to encourage private investment into electricity distribution utilities

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Currently, Ontario has approximately 61 municipal electricity utilities (MEUs) that provide local electricity distribution services to municipalities across the province. Many MEU's are owned almost exclusively by the municipalities they serve. MEUs vary in size, from Toronto Hydro with approximately 768,000 residential, commercial and industrial customers, to MEU's serving much smaller populations in Northern Ontario.

The 2024 Ontario Fall Economic Statement was released by the Ontario Government on Oct. 30, 2024. It includes measures intended to encourage additional private investment in the electricity distribution sector by removing punitive tax consequences when private sector investors acquire more than a 10 per cent interest in an MEU.

Background to Existing Tax Measures under *Electricity Act*, 1998

Under the current regulations to the *Electricity Act, 1998*, the existing tax incentives available to MEUs were set to expire for transactions completed after Dec. 31, 2024, (except for a sale agreement that is entered into prior to that date and for which an application for Ontario Energy Board approval is made before that date). These tax incentives apply to an MEU that is exempt from federal and Ontario income tax, and as a result the affected MEU is currently making payments in lieu of taxes (PILs) under the *Electricity Act*, 1998 to the Ontario Electricity Financial Corporation.

Generally, an MEU would transition out of the PILs system once the share investment by municipal governments in the MEU fell below a 90 per cent shareholding threshold. In such circumstance, there is an automatic deemed disposition of all of the MEU's property at a moment in time just prior to that event, with the result that a PILs tax liability that is generally referred to as "departure tax" might be generated. Under the departure tax provisions, the MEU is treated as having received proceeds of disposition equal to the fair market value (FMV) on all of its property, and these proceeds could generate a capital gain to the MEU. Consequently, there is the potential for a significant

PILs tax liability payable by the MEU when its shares are acquired by a “taxable” private sector investor.

In addition to the departure tax, there was the potential for the sale of the MEU to attract “transfer tax” that was imposed on the gross sale proceeds that would have been receivable by the municipal shareholder on the sale of the shares of the MEU.

The three existing tax incentives under the *Electricity Act*, 1998 are as follows:

- The elimination of transfer tax on sales of the shares of an MEU, if that MEU has less than 30,000 customers.
- A reduction of transfer tax to a 22 per cent rate (reduced from the prior tax rate of 33 per cent) of the gross sale proceeds paid for the acquisition of the shares of an MEU that has more than 30,000 customers.
- The elimination of the taxation of any capital gain arising under the departure tax provisions.

Under the current regulations, if the sale agreement is entered into outside of this Dec. 31, 2024 deadline, then the transfer tax would revert to the 33 per cent rate for all transactions affecting the shares of an MEU, and as well the PILs taxation of the capital gains attributable to departure tax would be re-imposed on the MEU.

A share purchase made by a buyer that is owned by a municipal government does not cause the MEU to lose its tax-exempt status, and consequently the tax incentives were not directed at such buyers that were owned by a municipality. However, the transfer tax was still imposed if a “taxable” private sector were to purchase the shares of an MEU that had more than 30,000 customers. This potential application of the transfer tax served as a strong impediment to an acquisition by private sector investors into MEUs with a customer base in excess of the 30,000 threshold.

Relief under 2024 Ontario Fall Economic Statement

Through amendments to regulations under the *Electricity Act,* 1998, the Ontario Government is proposing further incentives to encourage private sector investment in any MEU regardless of the size of its customer base. These further incentives will apply to sale transactions that will occur during the period Jan. 1, 2025, through to Dec. 31, 2028.

Specifically, the transfer tax exemption for the acquisition of an MEU will be extended until Dec. 31, 2028, and will also be expanded by removing the 30,000-customer threshold. Therefore, the transfer tax rate will be set at zero, regardless of whether the affected MEU has more than 30,000 customers. This change will be effective for sale agreements that are made between Jan. 1, 2025, and Dec. 31, 2028.

The 2024 Ontario Fall Economic Statement is somewhat lacking in detail regarding the extension of the capital gains exemption from PILs tax arising under the departure tax provisions. However, it is expected that the capital gains exemption arising under the departure tax would continue to be available to share purchase transactions completed throughout the four-year period ending Dec. 31, 2028.

BLG's Energy - Power group can help with all power related matters, including electricity distribution. If you have any questions about these changes or any other electricity related matter, please reach out to any of the key contacts below.

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