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Department of Finance Canada

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## Consultation on the possibility of introducing a domestic content requirement as part of the Clean Electricity investment tax credit and the Clean Technology investment tax credit

WaterPower Canada (WPC) welcomes the opportunity to comment on the possibility of introducing a domestic content requirement as part of the Clean Electricity Investment Tax Credit (CEITC), a tax credit our industry has long awaited to support the rapid buildout that is needed to meet Canadian demand.

As the national trade association representing Canada's hydropower industry, including 70 public and private power producers, equipment manufacturers, and engineering firms who collectively account for over 95% of Canada's waterpower capacity, WaterPower Canada is pleased to see that the Canadian federal government is planning to move ahead with the Clean Electricity Investment Tax Credit. One of Canada's greatest strengths is that hydropower accounts for more than 60% of the national electricity grid. We believe the CEITC could be a critical tool to extend and expand the life of existing hydropower while enabling new hydropower projects that will support economic growth and energy security for all Canadians.

To ensure the ITCs achieve their stated goals, measures to encourage greater domestic purchasing should be designed as an "adder", rewarding developers who are able to source from Canadian suppliers and provide necessary supporting information. A domestic content requirement reducing the CEITC's accessibility would not achieve the ITC's stated goals and could limit its accessibility due to sourcing limitations and administrative constraints.

Our detailed response to the consultation questions is provided below.

- 1. A requirement to use domestic content has been introduced in certain government measures to support domestic producers. For example, the U.S. has included domestic content requirements in their clean electricity tax credits, to encourage the use of U.S. materials and equipment assembled domestically. Another example is the recent announcement by the federal government regarding a new Buy Canadian Policy that will require the use of Canadian steel, aluminium and wood products,***

*and create preference for Canadian suppliers and Canadian content in federal procurement processes.*

*a. Would you be in favour of introducing a domestic content requirement under Canada's Clean Technology and Clean Electricity investment tax credits to encourage the use of Canadian products?*

No.

ITC domestic content requirements would duplicate existing policy tools available to the federal government, such as duties and tariffs, and in some cases also duplicate provincial buy-Canadian policies.

Notwithstanding its largely Canadian supply chain, Canada's hydropower industry views the introduction of a domestic content requirement into the investment tax credits (ITCs) as additional red tape on an already heavily burdened industry.

Implementing domestic content requirements under the ITCs would require developers to track the domestic and foreign content of supplies and services included in project costs with limited ability to control the origin of a variety of components.

This is primarily because imported products used by contractors are incorporated into other products before being sold to a project developer. For example, a construction company building a dam or powerhouse would incorporate imported Portland cement or reinforcing steel in their dam. The pay items in the contract between the construction company and the owner claiming the ITC are not necessarily the imported goods for which the documentation applies, making precise domestic content information difficult to track. Also, indirect supplies consumed by the contractor in the performance of their work are not billed directly to the project owner. Diesel fuel is an example of an indirect supply expenditure.

Supporting documentation to substantiate cost expended does not typically include details on the domestic or foreign origin of expenses, so a domestic content requirement could reasonably be expected to reach back into the supply chains of suppliers and contractors to substantiate the origin of materials and labour.

The requirement for increased supporting documentation and additional detail, along with increased administrative effort required to substantiate the domestic content of project costs is a significant consideration for both project developers and the Canadian Revenue Agency.

Moreover, a domestic requirement would put additional barriers on an ITC framework that is already complex and restrictive. Many other ITC criteria, such as restrictions on eligibility period, qualifying corporations and financing vehicles rules, to name a few, will already make it challenging for hydropower companies to access the ITC once it is implemented.

The labour requirement in particular may be challenging to meet given the significant labour shortage in the sector, resulting in the ITC being reduced to 5% before proposed domestic content requirements may apply. This challenge will be particularly acute for projects where procurement processes are already underway, while projects that have not yet started will suffer from restricted access to the ITC because of hydro's long lead times and the ITC's restrictive eligibility period and time of acquisition disposition.

Since the budget allocated to the CEITC (around \$30B) for all power sources falls short of the amount required to support planned investments in clean electricity over the same period (hydro's share only being around \$100B), introducing a domestic requirement would only make access to crucial funds more difficult.

Finally, this measure would be contrary to the Government of Canada's objective of enabling investment in large capital projects and advancing clean energy production. A domestic requirement will almost certainly increase costs for developers, diminishing the potential benefit of the ITCs. These costs will be passed on to Canadians through higher rates and potential delays in development.

#### Domestic Content Adder

If domestic content measures are introduced despite these considerations, we recommend the federal government consider an adder model or bonus credit (similar to the U.S. model), offering an additional incentive above the base ITC amounts to support Canadian procurement.

We support the implementation of a 10% bonus above the 5-15% CEITC for proponents able to produce proof of Canadian origin. A domestic content adder can provide support to build out and leverage Canadian supply chains while ensuring the overarching objectives of the CEITC are met.

- b. If a domestic content requirement were introduced under the Clean Technology and Clean Electricity investment tax credits, what kinds of products should it be applied to?*

*For instance, should such a requirement be applied to structural steel (e.g., load-bearing columns), advanced manufactured products (e.g., wind turbine generators, photovoltaic modules, battery modules), and/or other products?*

*Should an exemption be allowed to the requirement for certain products or under certain scenarios (if so, what evidence could be used to substantiate an exemption)?*

Labour is an essential component in hydro projects and must be included among eligible inputs if a domestic content requirement were introduced.

Creating exemptions would further complicate the administration of ITCs because this will require project developers to manage exemptions in addition to foreign and domestic components in project costing systems and ITC submissions.

We strongly recommend against this approach and reiterate our recommendation to consider the implementation of levies, duties, and tariffs at border entry rather than adding further complexity to the ITC framework itself.

We also recommend working with Canadian suppliers to increase their capability and competitiveness to support needed electrical investment rather than increasing administrative and cost burdens on urgently needed electricity system investments that have economy-wide benefits. The investments needed could reach as much \$2T between now and 2050<sup>1</sup>.

Moreover, Canada does not currently have sufficient cost-effective domestic capacity at scale to meet all the needs of Canada's hydropower industry, particularly in the case of very specialised equipment that is used within our sector. Domestic content *requirements* should be restricted to sectors where Canada possesses proven manufacturing capacity and resilient supply chains, ensuring that local suppliers can meet project timelines while maintaining price competitiveness.

Any measures ought therefore to be structured as a bonus in addition to the base ITC and based on a reasonable **threshold** (as is being proposed in some provinces).

Even structured as a bonus, we are concerned about the level of administration and detail required to substantiate Canadian content that could make auditing this type of measure an across the board administrative nightmare, especially on large projects.

c. ***If a domestic content requirement was introduced, what consequence could be associated with failing to meet a domestic content requirement? Please explain the rationale for your views.***

Adding a federal component to provincial buy-Canadian policies would be duplicative and detract from the federal government's red tape reduction objectives.

As mentioned above, we recommend an adder or bonus for domestic content over and above the base ITC rather than a penalty, as a better way to incent use of Canadian products and services.

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<sup>1</sup> <https://www.rbc.com/en/thought-leadership/economics/featured-insights/the-2-trillion-transition/>

Since supply decisions are based on many factors, including availability, conformance to technical specifications and operational requirements, it would be unreasonable to void the eligibility of a project based on its inability to completely meet domestic content requirements.

The hydro industry currently faces significant supply chain constraints but can avoid major project delays by sourcing globally. Adding a domestic content requirement could result in significant project delays since the wait list for specialty equipment like large turbine generators and transformers is already 4-5 years long.

The domestic content requirement's goal to strengthen Canadian supply chains would be better achieved by improving the ability of domestic supply chains to supply domestic needs. This could be done by working directly with suppliers to incentivize them, for instance by expanding the eligibility of the Clean Technology Manufacturing ITC beyond critical minerals. We view providing incentives to Canadian manufacturers as preferable to additionally burdening project developers.

- d. *If a domestic content requirement was introduced, what mechanism(s) could be used to administer the measure (e.g., certification of country of origin or other documentation of domestic content)?*

*Would established country of origin documentation mechanisms, for example those used in the context of tariffs or Canada-U.S.-Mexico Agreement, be appropriate and allow the country of origin of different products to be identified? If not, what mechanism would you envisage in order to identify the country of origin of products?*

We reiterate our recommendation that existing processes to administer country of origin and domestic content (tariffs, duties, and import controls) be used to administer domestic content rather than further burdening ITCs with another administrative process. We strongly recommend that once a product has legally entered Canada, that its cost be eligible for ITC treatment.

Should the requirement be introduced, the ITC should be available for expenditures from suppliers who comply with the federal government's 'Made in Canada' threshold of 51%.

Similarly, the use of foreign labour on a project is also controlled by the Government of Canada through its immigration policy. If temporary foreign workers are permitted to work in Canada, then further control in the ITC program is unnecessary.

Clear guiding principles such as these are important for our sector since certification of country of origin and documentation of domestic content is not readily available on standard commercial invoices, and our industry is concerned with the level of detail and evidence that

might be required by the Canadian Revenue Agency (CRA) to substantiate domestic content otherwise.

***e. Please outline potential positive and negative impacts of domestic content requirements on your business and/or sector of activities (e.g., impacts on costs, project timelines, employment).***

The immediate impacts of managing domestic and foreign content through ITCs would be to impose additional administrative burdens on industry, and in further constraining supply chains at a time when clean energy development is critical to the Canadian economy and energy sovereignty.

Positive impacts in the way of meaningful supply chain development in Canada are likely to come about after the end of the CEITC's eligibility period December 31, 2034.

Canadian supplies can be effectively supported using tariffs and duties rather than the ITC and we recommend the Government of Canada prioritize such levers.

***f. Is this an appropriate approach to support Canadian products?***

No. As explained above, we believe the federal government has more appropriate and existing policy levers than further complicating the ITC program.

Moreover, since industry is being asked how they can support potential new trade pacts through their purchases, this would send mixed signals as to how to plan procurements. For these reasons, a domestic content adder may be the best way to support both trade diversification and support for domestic suppliers, leveraging the most cost-effective purchasing for the benefit of electricity consumers.

The hydropower sector's mandate is to deliver abundant, low-cost, clean electricity for Canadians and we oppose any measure that would result in cost increases for rate payers.

***2. Are there other key considerations (such as administrative or implementation considerations, potential economic benefits, specific sectors in Canada affected by other countries' protectionist practices, supply chains challenges or opportunities) on the potential introduction of a domestic content requirement under the Clean Technology and Clean Electricity investments tax credits that you would like to bring to our attention? If so, please explain.***

As explained above, the proposed domestic content requirement would further complicate the framework for the Clean Electricity ITC and make it more onerous for hydro producers to access.

The industry has endured significant delays with regard to the implementation of the CEITC, the last of the Clean Economy suite of ITCs to be implemented, and any further delay or complexity will seriously undermine the usefulness of the Clean Electricity ITC for hydro.

Hydropower provides critical system value that supports the reliable integration of other clean energy resources over time. It provides many grid services that are not compensated by electricity markets, including storage capacity, energy, reserves, regulation, voltage support, and black start. Because it provides all these additional advantages to an energy system, Canada should support its development through the Clean Electricity ITC or other means. This will safeguard the grid's reliability, allow its development to meet Canada's increased demand for electricity, and support affordability for customers for generations to come.

Ultimately the most effective way to encourage organic growth of local supply chains is to ensure there is sufficient and consistent investment in new infrastructure projects to keep them active.

#### **About WaterPower Canada**

*Founded in 1998, WaterPower Canada is the national association representing the waterpower industry. Its members span the breadth of the sector and include publicly- and privately-owned hydropower producers, manufacturers, developers, engineering firms and other organizations.*

*Operating over 600 facilities across Canada, WaterPower Canada members represent more than 95% of the country's waterpower installed capacity, advocating for the responsible development and use of waterpower to meet our present and future electricity needs in a sustainable manner.*

*Waterpower provides more than 60% of Canada's electricity, ensuring our electricity grid is one of the cleanest globally.*