

Make Flow-Through Financing Work For You: Practical Tips For The Deal And Beyond



**PROSPECTORS &
DEVELOPERS
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RECENT DEVELOPMENTS IN SUPPORT OF CANADIAN MINING EXPLORATION

1. Extension of the Mineral Exploration Tax Credit (METC) for a 5-years period (until 2024).
2. BC provincial government makes the B.C. Mining Exploration Tax Credit a permanent incentive.
3. Greater clarity from federal and Quebec governments on scope of expenditures eligible for fiscal incentives.

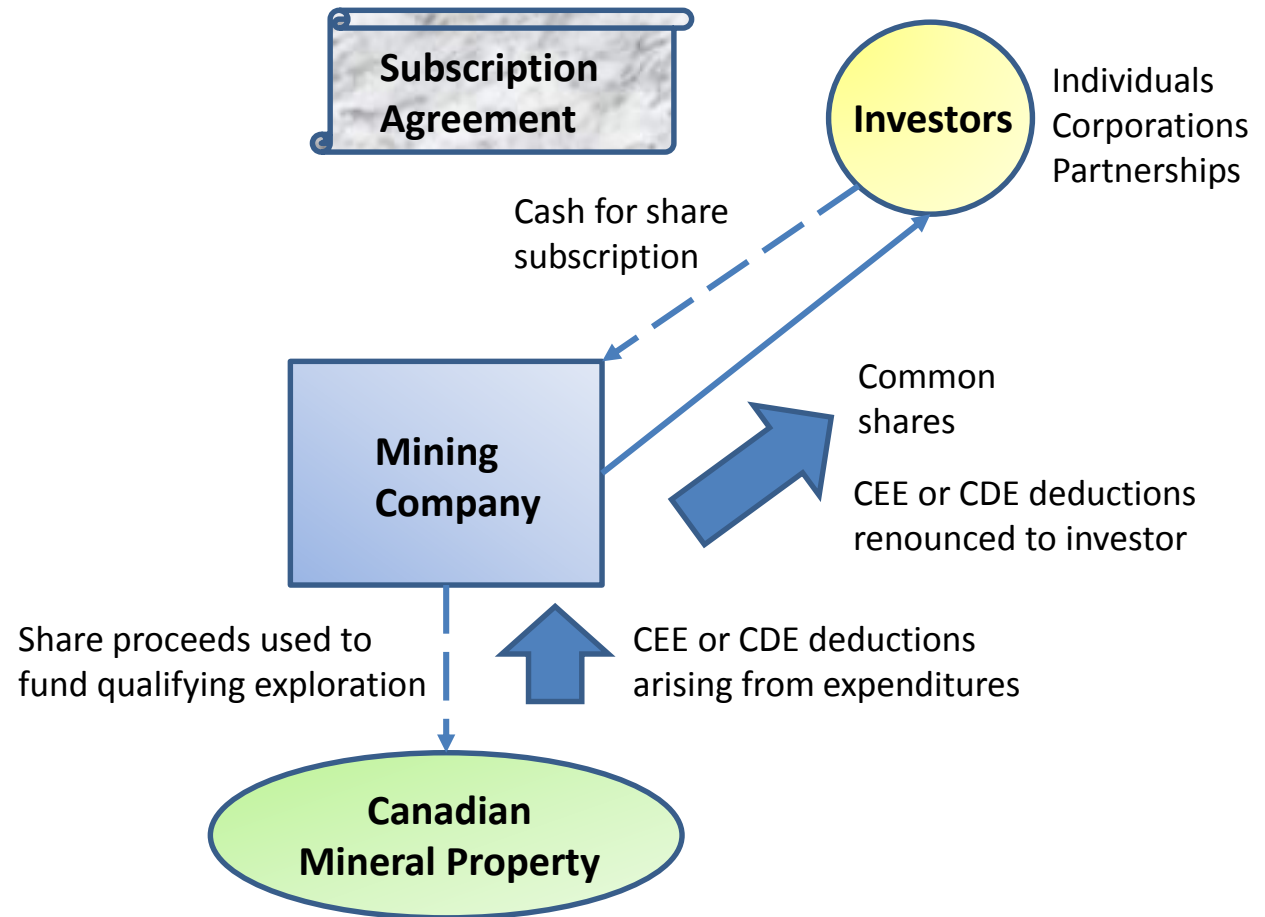


FLOW-THROUGH SHARES: INTRODUCTION

- Exploration companies which are **non-revenue producing** generally have limited options for financing other than raising equity.
- The **high risk, speculative nature of investments** in junior exploration companies makes attracting equity capital very challenging.
- Such companies **may not generate income for many years** limiting the merits of the tax deductions resulting from its exploration activities.
- The flow-through share regime allows issuers to **transfer certain exploration expenses** to the investor (“renounce” in the language of the *Income Tax Act*), who can claim the deduction directly.
- The regime is specifically **designed to attract investors** to the financing of exploration and usually affording issuers the opportunity to issue shares at a premium to their market price.
- The **Flow-Through Share Donation structure** also provides an opportunity for global strategic or institutional investors to participate in flow through financings at attractive prices

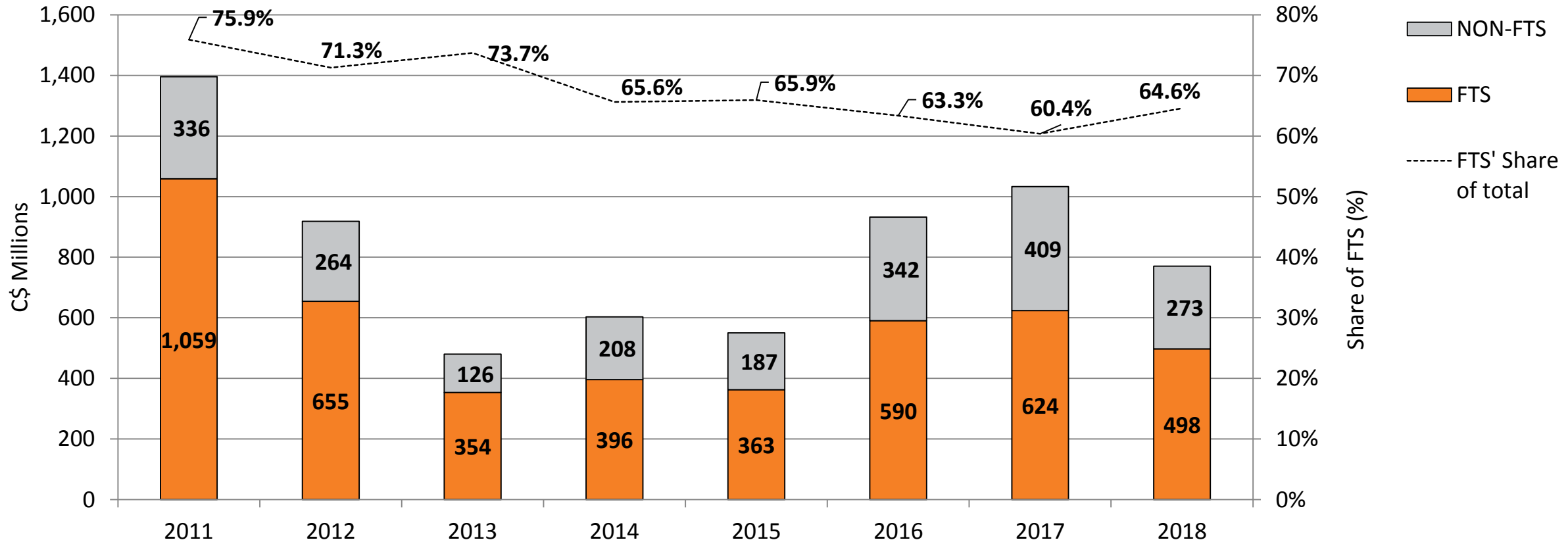
FLOW-THROUGH SHARES: MECHANISM

- **History:** Current flow-through share regime was introduced in 1986, but previous forms have been allowed since the 1950s.
- **Benefits to mining companies:** help juniors in raising capital (usually at a premium), especially in tough times.
- **Benefits for Investors:** Tax deductions as “sweetener” or compensation for investing in high risk sector
- **Benefits to Canada:** FTS Must be related to qualifying exploration activities carried out in Canada



EQUITY FINANCING IN CANADA FOR CANADIAN EXPLORATION

Flow-through Shares (FTS) VS. NON-FTS (C\$M)



Source: TMX Group, S&P Global Market Intelligence and PDAC analysis

FLOW-THROUGH SHARES: NET COST FOR INVESTOR- CANADA WIDE COMPARISON

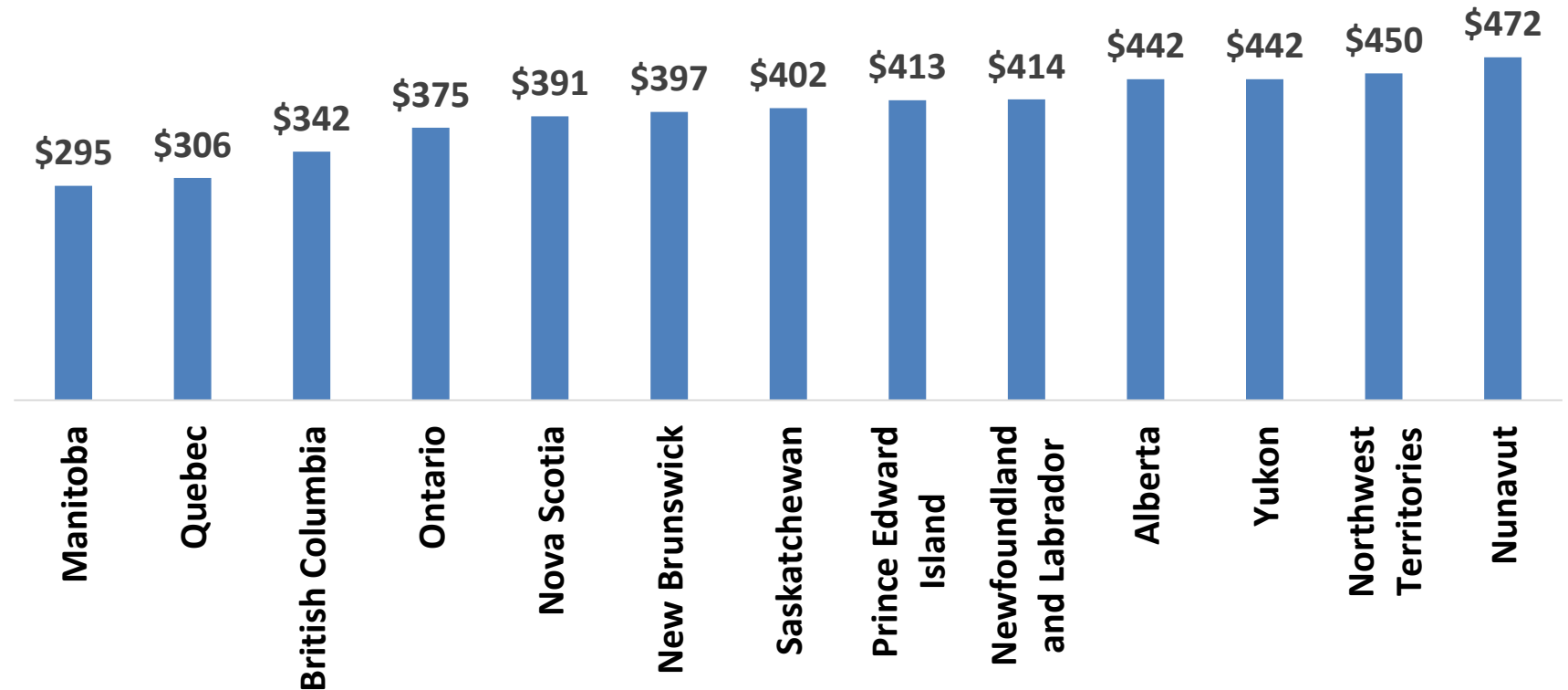
Investors' Net Cost for a \$1,000 investment in FTS

Provincial METC

- Ontario – 5%
- Saskatchewan – 10%
- British Columbia – 20%
- Manitoba – 30%

Extra Tax Deduction in Quebec:

- 120% provincial tax deduction
- Only for Qualified Corporations



FLOW-THROUGH SHARES: QUALIFYING EXPENSES

- Only a “principal-business corporation” (**PBC**) can issue flow-through shares
- Canadian exploration expenses (**CEE**)
 - Grassroots exploration
- Canadian development expenses (**CDE**)
 - Mine development expenses
- If expenses incurred by a PBC are not qualifying CEE or CDE, the renunciation of expenses is not valid
- FTS subscriber preference for CEE over CDE

CEE: GRASSROOTS EXPLORATION

Expenses incurred for the purpose of determining the existence, location, extent, or quality of a mineral resource in Canada

- **Includes:**

- Prospecting,
- Carrying out geological, geophysical or geochemical surveys,
- Drilling by rotary, diamond, percussion or other methods, or
- Trenching, digging test pits and preliminary sampling

- **Excludes:**

- A CDE
- The capital cost of depreciable property of a prescribed class
- Expenses related to a mine that has come into commercial production

- Recent amendments for certain environmental / community costs incurred to acquire an exploration permit/license

MINERAL EXPLORATION TAX CREDIT (METC)

- There are 2 types of CEE flow-through share investments:
 - **REGULAR:** 100% deduction of subscription amount when CEE renounced
 - **SUPER:** REGULAR flow-through shares + Additional 15% federal tax credit for grassroots exploration (METC) + Applicable Provincial/Territorial deductions and tax credits
 - METC available to individuals only (not corporations)
- To be eligible for METC, the expenditures must be “Flow-Through Mining Expenditures” (**FTME**).
- 2018 Fall Economic update announced a **five year extension** of the METC to March 31, 2024

CANADIAN DEVELOPMENT EXPENSES (CDE)

- **Pre-production:** costs incurred for the purpose of bringing a new mine in Canada into production “in reasonable commercial quantities”
 - Includes expenses for clearing, removing overburden, stripping, sinking a mine shaft or constructing an adit or other underground entry
 - Incurred before the new mine reaches a commercial level of production
- **Post-production:** cost of sinking or excavating a mine shaft, constructing a main haulage way, or carrying out similar underground work designed for continuing use after the mine has come into production
- Excludes the capital cost of depreciable property of a prescribed class
- Costs of a Canadian resource property are not FTS qualifying expenses

FLOW-THROUGH SHARES: NON QUALIFYING EXPENSES

- Overhead expenses:
 - Administration, management or financing expenses
 - Salary or wages of employees whose duties are not 90% or more for exploration/development
 - Maintenance or rental of property that is not used 90% or more for exploration/development
- Acquisition cost of a mineral property
- Acquisition cost of a depreciable property

FLOW-THROUGH SHARES: TRAPS

- Need to incur “qualifying expenditures” within required timelines
- Government assistance or proceeds from activities (e.g. sale of ore produced from bulk sample) reduce amount of the expenditures that can be renounced
- Failure to implement back-to-back arrangements
- What if corporation fails to meet its obligations ?
 - Subject to a 10% penalty tax
 - Must amend renunciation forms previously issued to investors
 - May need to reimburse investors for reduction in tax savings
 - Damage reputation among investor base – impact on future equity raises
- Provincial mining tax may eliminate deductions to corporations for expenses renounced to investors

FLOW-THROUGH SHARES: TRAPS (continued)

- Interpretive difficulties:
 - When does a mine come into production in reasonable commercial quantities?
 - New mine vs. existing mine
- Consider “purpose test” and CRA guidelines:
 - Environmental studies
 - Community consultation
 - Feasibility studies
- Underground exploration expenditures may qualify as grassroots CEE if incurred for the purpose of further defining a resource, and not for mine development purposes
 - No “bright-line” test to determine when expenditures are considered to be incurred to bring a new mine into production (CDE)

TIMING: GENERAL RULE OR “LOOK-BACK”

- Only qualifying expenditures incurred after the subscription agreement is executed may be renounced to a FTS holder
- PBC must incur qualifying expenditures during the following period:
 - Begins on the date the subscription agreement is signed
 - Ends 24 months after the end of the month the subscription agreement is signed
- “Look-Back Rule”:
 - Effect is to accelerate the deduction of CEE renounced to the subscriber
 - Permits a PBC that incurs certain qualifying expenses in a calendar year to renounce them to a subscriber effective December 31 of the previous year
 - Must meet requirements

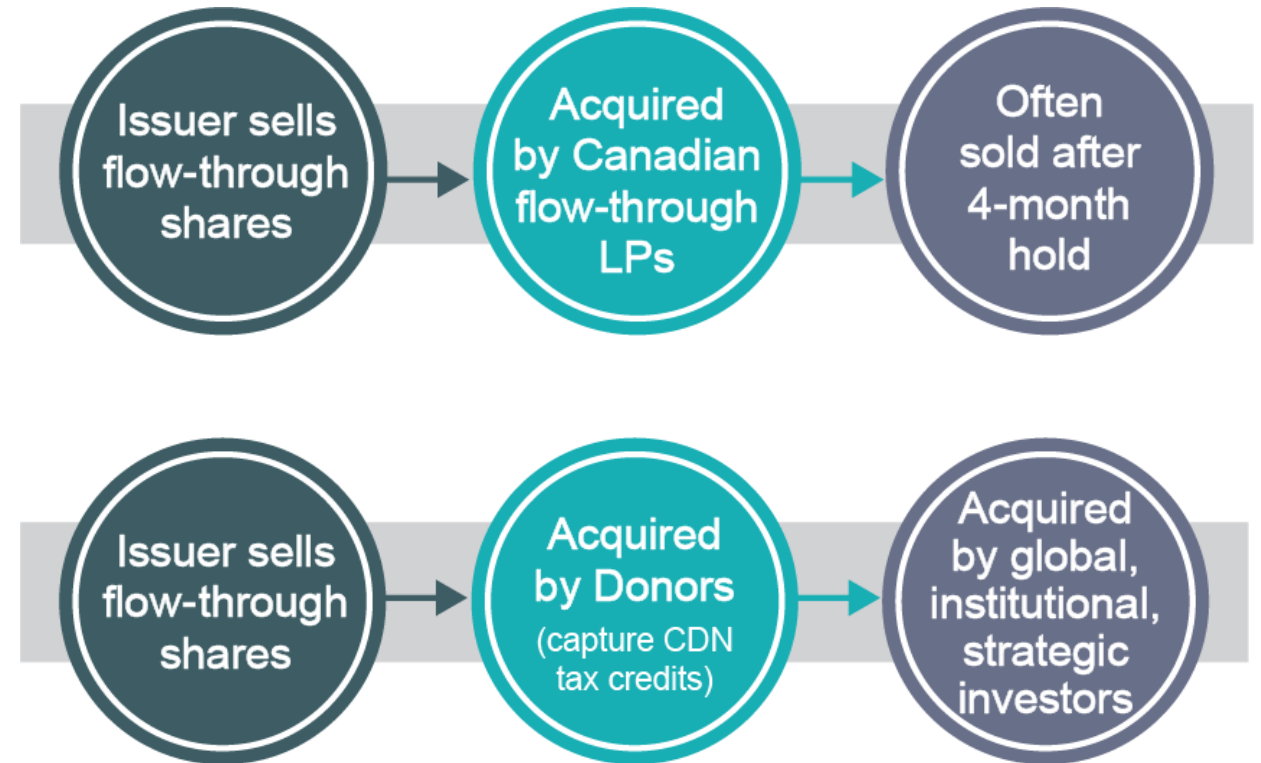
TRADITIONAL FTS VS. CHARITABLE FTS

Traditional Flow-Through

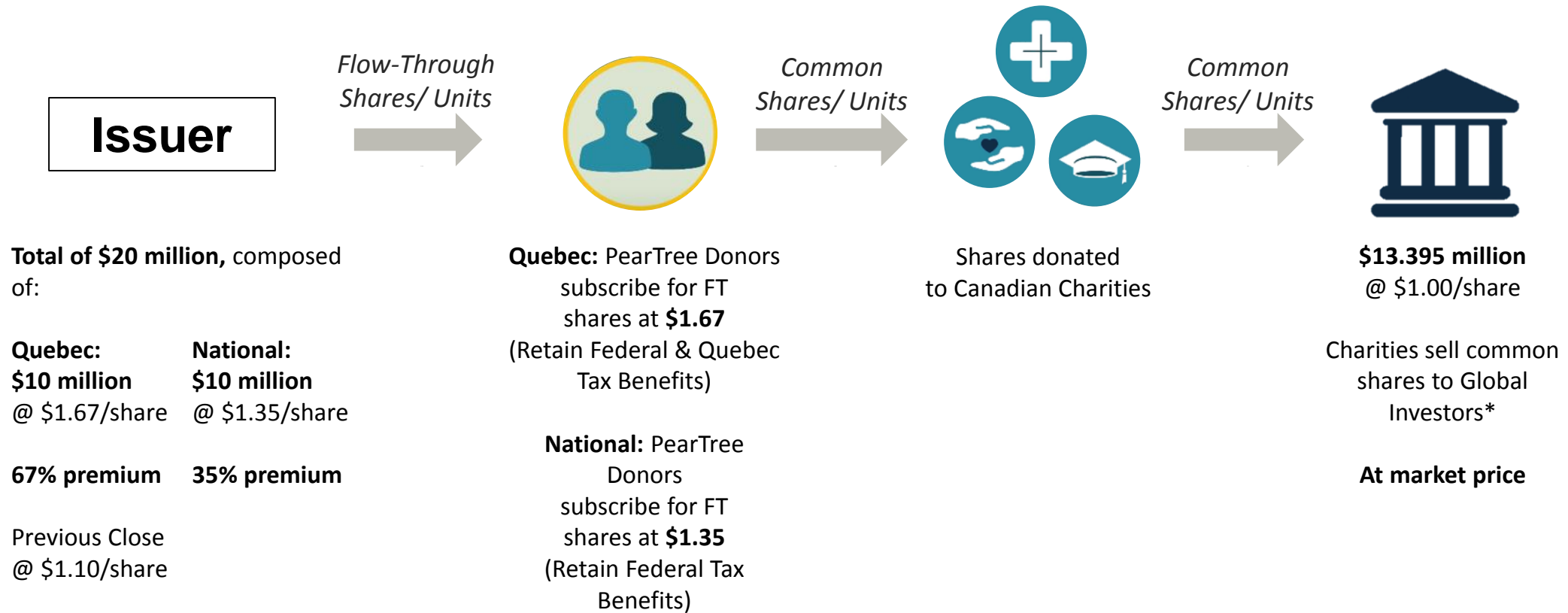
- Purchasers are individual Canadian taxpayers
- Typically a short investment horizon

Charitable Flow-Through

- Purchasers are global, strategic and institutional investors, many with long term investment horizon
- Less dilutive – shares issued at a premium to market



CHARITABLE FTS ILLUSTRATION: Quebec and National



Delta: The ratio between the Issue Price and the Charity Sale Price. In this example the **Quebec Delta is 1.67** ($\$1.67 \div \1.00) and the **National Delta is 1.35** ($\$1.35 \div \1.00). Deltas vary by province/territory depending on the availability/size of provincial tax credits. For a detailed discussion of the Flow-Through regime see the Prospectors & Developers Association of Canada website.

CEE – Recent changes to Legislation and Guidelines

- ★ 2015: The Federal government expands the CEE definition to include certain environmental studies and community consultations required to obtain an exploration permit.
- ★ 2017: CRA published revised Guidelines for CEE; industry feedback indicates uncertainties remain
- ★ 2018: PDAC obtains additional clarity on environmental studies and community consultation from CRA in the form a Technical Interpretation.

2018 Technical Interpretation

- In the hypothetical scenario a Taxpayer commenced an exploration program where the CEE incurred would be renounced to FTS subscribers.
- Taxpayer planned to incur certain costs to obtain support from an Aboriginal community to undertake the exploration program, including:
 - *Capacity Payments*
 - *Ongoing Consultation*
 - *Environmental Assessments*
 - *Legal Documentation*
- The CRA indicated that the CEE purpose test would **generally** be satisfied for each of the planned expenditures.
- The CRA highlighted the importance of there being a connection between the expense and the exploration program, and that expenses must be reasonable in the circumstances.

QUESTIONS?

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