



Prospectors & Developers Association of Canada

l'Association canadienne des prospecteurs et entrepreneurs

Submission by the
Prospectors and Developers Association of Canada (PDAC)
to the House Standing Committee on Finance
Pre-Budget Consultations

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135 King Street East
Toronto, Ontario, Canada M5C 1G6
Website: pdac.ca; email: info@pdac.ca
Telephone 1 416 362 1969; Fax 1 416 362 0101

Introduction

This submission is presented by the Prospectors and Developers Association of Canada (PDAC) on behalf of Canada's mineral exploration industry. The PDAC is a national organization with 7,000 members representing the range of companies and individuals in mineral exploration and development. Our corporate members include senior producing companies and junior companies (small and medium enterprises [SMEs]). Our individual members include prospectors, geoscientists, geological consultants, company executives, and junior exploration and senior mining company representatives. Our members also include people in the financial, legal, and academic communities, students, and those who supply services and equipment to the mineral industry.

Maintaining a Vibrant Mineral Exploration Sector in Canada

A vibrant mineral sector in Canada creates jobs, sustains communities, fosters new business opportunities and raises tax revenues that allow government to meet social needs.

The following recommendations are intended to support a strong investment climate for the mineral industry in Canada through a competitive tax policy and the development and maintenance of a high-quality geoscience database.

Recommended Government Actions for Ensuring a Vibrant Mineral Sector

a. Provide a permanent Mineral Exploration Tax Credit

The PDAC recommends that the federal government make the 15% Mineral Exploration Tax Credit (METC) a permanent feature of the income tax system.

The METC program provides investors in companies exploring for minerals in Canada with a 15% tax credit on the eligible expenditures incurred which are financed using flow-through shares. PDAC believes that the Mineral Exploration Tax Credit is a fundamental component in any strategy to increase exploration activity in Canada. The PDAC welcomed the one-year extension of the METC (to March 31, 2009) and recommends that the METC should become a permanent feature of the federal income tax system.

Benefits

- The METC program addresses the need for maintaining a high level of exploration investment in Canada across a broad spectrum of mineral resources, including base metals. It is designed to focus on grassroots exploration (the earliest stage of exploration), when the investment risk is high and the difficulty in raising funds is greatest.
- The current METC program has encouraged a steady flow of capital for junior companies exploring in this country. From October 2000 to March 2006, companies raising capital for exploration in Canada through the issuance of flow-through shares raised close to \$1.9 billion. From January to April 2007, \$215

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million was raised, an increase of 34% compared to \$160 million during the same period in 2006.

- The tax credit has stimulated mineral exploration activity in Canada, providing both direct and indirect employment opportunities, contributing to the discovery and development of new mineral deposits, and supporting the growth and development of many suppliers and service providers.

Background

- In the February 28, 2008 federal budget, the current METC was extended by one year to March 31, 2009. While the mineral exploration industry greatly appreciated this one year extension, making this program permanent would increase investor certainty, provide a more rational time-frame for planning and executing effective exploration programs and would further position Canada as a premier destination for mineral exploration.
- Mineral exploration companies are generally small and medium enterprises (SMEs). They are not currently paying corporate income taxes since they are in a growth phase and may not yet have producing mines. These companies must often depend heavily on new equity investors. Flow-through share financing is vital to their growth and to the survival of their operations in Canada. The METC is critical for financing grassroots exploration expenditures.
- Larger mining companies in Canada who generally do not choose to use flow through share financing are currently eligible to earn a 10% investment tax credit on their eligible “pre-production mining expenditures” which are part of the CEE definition. This is a permanent tax credit that does not have to be renewed each year. This credit is not generally of any immediate benefit to smaller companies.
- Mineral exploration companies are comparable to small high tech or start-up innovation companies who must also finance their high risk speculative expenditures which are similar to grassroots mineral exploration. These companies currently receive significant direct federal and provincial income tax support through the refundable Scientific Research and Experimental Development (SR&ED) tax credit even when they are not yet taxable. For example qualifying Canadian Controlled Private Corporations (CCPCs) can now get cash refunds of over \$1 million each year when they incur \$3 million of eligible R&D expenditures.
- Mineral exploration companies need a permanent 15% METC to help them raise new equity funding in domestic capital markets where they have to compete with both larger mining companies raising conventional equity as well as high tech and start-up innovation companies.
- Flow-through share funding is raised and must be spent in Canada, and it is credited with attracting additional exploration investment to Canada in the face of intense international competition (e.g. Canada’s share of global funds invested in mineral exploration climbed from 15% in 2000 to 19.3% in 2006).
- The METC is the cornerstone of the current system of harmonized provincial exploration tax credit programs. Almost all major mining provinces in Canada provide additional incentives to supplement the federal credit. The METC is an important complementary incentive to the 10% “pre-production mining expenditures” tax credit which is earned by larger producing companies on their own exploration activity that is not financed by flow through shares.
- Investor uncertainty about the future of the METC impairs the ability of companies to effectively plan multi-year exploration program financing. It limits the ability of

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partnerships to market the investments in an orderly and timely manner to new investors. Finally, the delivery of future annual extensions of the METC can easily be disrupted if the federal Budget is delivered late or if the normal budget timing is altered due to a minority government and a general election being called.

b. Clarify CEE definition with respect to former Mine Sites

The PDAC recommends that the federal government, as part of a long-term strategy for mineral exploration, clarify that the Canadian Exploration Expense definition includes the costs of carrying out exploration at former mine sites that have not operated for at least 5 years. The PDAC recommends providing a specific quantifiable test that would permit CEE to include eligible costs of exploring in the vicinity of old mines that have not been operating for at least 5 years.

Benefits

- An objective test would eliminate uncertainty in the application of the existing law, and encourage the discovery of new resources that could help maintain existing mining communities and revive ones that have low levels of activity.
- Treating costs associated with these activities as CEE will promote mineral exploration in Canada in areas that might otherwise be overlooked because of uncertainty about the tax treatment of the expenditures incurred.
- The change to a 5 year rule will also reduce the administrative and compliance burdens for both CRA and PDAC members while enhancing the fairness of Canada's tax regime in treatment of similar geological opportunities.
- The change will reduce uncertainties about the tax treatment of exploration costs which is particularly important when the costs have been financed through the sale of flow-through shares.

Background

- PDAC members greatly appreciated the initiative led by the Canada Revenue Agency to provide more detailed Guidelines for the industry in the interpretation of the Canadian Exploration Expense (CEE) definition. This initiative was completed last year and will provide additional important certainty to both CRA and the industry about the treatment of various types of expenditures such as those for community consultations and land access.
- There remains some concern about the income tax treatment of costs where new exploration activity takes place in the vicinity of a previously existing mine.
- The tax treatment of on-site exploration expenses applies irrespective of whether the related mine is in operation or is inactive, unless the taxpayer can demonstrate to the CRA that the closed mine has lost all the essential characteristics of a mine. The CRA determination involves evaluating the property-specific facts against the essential characteristics established by jurisprudence.
- The tax treatment is applied in the same way unless it can be demonstrated to the CRA that the proposed exploration expenses are related to a potential new mine whose exploitation will not materially benefit from existing facilities and workings.

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- The process of reaching these decisions can involve many subjective factors. CRA often must seek guidance from officials from Natural Resources Canada and provincial mining departments to help make these determinations as well as refer to any relevant jurisprudence.
- There would be greater certainty if a specific quantifiable test were used: one such test that industry has discussed is a simple 5 year period during which a mine has not produced. This test would be easier for CRA to administer and is consistent with provisions in certain provinces.
- The IGWG for the Mineral Industry studied the issue and submitted a report to MMC in September 2007. Most provinces recognized the need for a change but there was no unanimity on the exact nature of the new approach.
- PDAC suggests that treating exploration activities as CEE when incurred in the vicinity of a mine where there has been no production for 5 years is fully consistent with the policy intent of the CEE definition since these costs are being incurred to determine the existence, location, extent or quality of a mineral deposit.
- The precedent for such a test in the CEE definition tied to a specific time period already exists. For example, an oil or gas well that has not produced for 24 months is classified as a CEE cost rather than a CDE cost. The introduction of this time limit test rule for these types of wells helped improve the administration and compliance for the CEE definition for both CRA and the oil and gas industry.

c. Provide Flow-Through Share Treatment for QETs

The PDAC recommends that the federal government allow specified costs related to the activities of a Qualified Environmental Trust (QET) to be eligible expenses that can be financed using flow-through shares.

The PDAC recommends that, as a minimum first step, the federal government should permit eligible site remediation costs incurred on orphan and abandoned mines to qualify as a CEE expenditure that could be financed using flow-through shares (FTS). These remediation expenditures are conceptually very similar to “preproduction mining expenditures” except that they are required to stabilize a mine site and restore it to an environmental acceptable condition for future generations.

The PDAC also suggests that the federal and provincial governments should consider whether the existing flow-through share mechanism could be utilized to develop suitable rules to permit deductions for contributions to QETs that cannot be utilized at the corporate level.

Benefits

- The benefit to governments of allowing FTS treatment for expenditures incurred at abandoned sites is that the costs of the program would be offset by the reduction and/or transfer of the government’s financial or environmental liabilities at abandoned sites to the private sector.
- There will also be benefits from increased economic activity and tax revenues from increased exploration and reclamation and from economic development and

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investment from potential discoveries, particularly in remote northern communities.

- This proposal assists with addressing several major issues affecting the Canadian mining industry including: declining mineral reserves, the clean-up of abandoned sites and the difficulty for juniors to finance reclamation security.

Background

- In the 1994 Budget the federal government established tax rules with the objective of permitting mining companies to make deductible contributions to prescribed trusts (now called Qualified Environmental Trusts) related to mining properties. The purpose of these trusts is to set aside funds to ensure the rehabilitation of mine sites when they cease production. In the 1997 Budget the rules were broadened to include similar trust funds for waste disposal sites and quarries for the extraction of aggregates and similar materials. QETs exist at the provincial level in BC, Ontario, Quebec and Saskatchewan.
- A QET is controlled by an independent trustee and dedicated to a specific site. With concurrence of regulators, funds in a QET can be used to fund reclamation work as security requirements decrease with completion of progressive reclamation.
- QETs are restricted in their investment activities. The trusts may not borrow or invest in anything other than certain types of secure assets. The investment income which is earned in the trust on the funds on deposit is taxable both to the trust and the beneficiary which is the contributing company. However the beneficiary receives a refundable tax credit for the tax paid in the trust.
- Contributions that are required to be made to the trust are deductible. Companies that are in production or have a revenue stream can benefit from the deduction. However for junior companies (small to medium sized) who are undertaking advanced exploration or mine start up, the deduction is not useful or may not be useable for many years.
- The current rules for QET are expensive and it is complicated to effectively use the existing QET tax deduction. Thus, QETs are being under-utilized despite the potential benefits they could provide for government, the environment and industry.
- The outstanding liability to governments in Canada for remediation of over 10,000 abandoned mine sites is estimated at over \$3 billion and growing. Governments are being asked to find creative and financially responsible solutions to such environmental problems and to protect Canadians from future environmental liabilities.
- Providing flow through share treatment to contributions to Qualified Environmental Trusts (QET) is a creative means to engage the private sector in innovative and cost effective solutions to help government remediate abandoned and environmentally degraded mine sites and to unlock value from brown sites.
- It is believed that junior companies, which are major contributors to economic activity and discoveries in the mining sector, should have the same ability as larger producing companies to take advantage of the tax write-off provisions of QET.
- Some abandoned and closed mine properties may have significant potential for mine development and junior companies are particularly well suited to take on the exploration challenges offered by such sites and the proposed implementation of FTS for QETs would remove an important barrier. Implementing FTS for QETs would also reduce risk for governments by increasing the funding available for high quality reclamation security, and encourage sustainable economic development,

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progressive reclamation and innovative solutions to environmental remediation problems.

- FTS for QETs is an environmental initiative that would reduce risks to governments and help to keep the Canadian junior exploration and mining sector competitive. It could be implemented quickly using existing and known provisions of the Income Tax Act and produce immediate results benefiting the government, mining companies and the public image of the industry.
- The existing QET tax provisions could be more effectively utilized by junior companies if FTS could be used to fund QET reclamation security. Support and interest for the FTS for QETs proposal has been received from industry associations as well as, some Provincial/Territorial governments.

d. Commit to Long-term Funding for Geoscience Mapping

Federal Budget 2008 provided \$34 million over the next two years to Natural Resources Canada for geological mapping, primarily focused in Canada's North, and for logistical support for mapping activities provided by the Polar Continental Shelf Project. The Budget further noted that resources allocated for geological mapping in southern Canada will be cost-shared with the provinces.

The PDAC strongly supports this initiative and recommends that the federal, provincial and territorial governments make a long-term commitment to investment in geoscience mapping.

Benefits

- Geoscience research directly benefits each province and territory by advancing the public's knowledge of our natural resources and encouraging new exploration activity.
- There remain significant areas, particularly in northern and remote regions in Canada, for which geological, geophysical, or geochemical maps are either non-existent or lacking sufficient detail to provide guidance to exploration.
- The value of previously acquired data decreases as scientific understanding advances and new, more precise survey technologies are introduced.
- A high-quality and easily accessible geoscience database (i.e. geological data and maps) is a key competitive advantage internationally, especially as other countries improve the quality of their geological databases.