



Prospectors & Developers Association of Canada Association canadienne des prospecteurs et entrepreneurs

Submission to the House Standing Committee on Finance (FINA)

Pre-Budget Consultations, August 2010

PDAC recommendations to encourage Mineral Exploration in Canada

This submission is presented by the Prospectors and Developers Association of Canada (PDAC), representing 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 individual members include prospectors, geoscientists, consultants, mining executives, students and people working in the drilling, financial, legal and other supporting fields. The association's corporate members include exploration and junior mining companies (small and medium-sized enterprises or 'SMEs'), major producing companies, and organizations providing services to the industry.

Mineral exploration and mining is one of Canada's truly global industries, investing in 10,000 projects in over 100 countries, with 81% of worldwide mining equity transactions over the past five years being handled by the TSX and its venture exchange. Exploration and mining are central to Canada's economic brand. The industry employs over 351,000 Canadians in extraction, processing and manufacturing and contributed \$40 billion to Canada's GDP in 2008. Mining accounts for \$95 billion (19%) of Canada's annual goods exports.

The Economy and Exploration Financing

- As the 'research and development' branch of the mining sector, exploration companies do not have production revenue and, therefore, must rely on investors who are prepared to support higher-risk activities.
- The global recession and the slow return to economic growth have significantly reduced commodity demand.
- Market instability is having a negative effect on mineral exploration companies' share prices and on their ability to raise money for grassroots exploration programs.
- While Canada remains a leading destination for exploration investment, exploration expenditures in Canada **declined by 44%** from **\$3.3 billion** in 2008 to **\$1.8 billion** in 2009.
- Without sufficient investor support, exploration companies face a significant reduction and/or cancellation of a number of field programs, with a resulting impact on service companies, and other businesses and individuals, particularly those in rural, northern and Aboriginal communities.

- The situation is urgent as a loss of these companies and qualified workers will severely limit Canada’s long-term ability to retain its leadership position in the global exploration and mining industry.

PDAC recommendations to encourage Mineral Exploration in Canada

TAX INCENTIVES:

1. a. To ensure longer term investment in Canada, and to allow exploration companies to plan for the future, **make the current 15% Mineral Exploration Tax Credit (METC) a permanent feature** of the federal income tax system; and,
 - b. Encourage investment in Canadian projects by **temporarily increasing** the METC for exploration financed using flow-through shares from the current **15%** rate to **30%** for a **two year** period.

INFRASTRUCTURE:

2. a. Increase the knowledge of our natural resources and retain expertise in Canada’s world renowned mineral exploration sector by continuing to **invest in the Geo-mapping for Energy and Minerals (GEM)** infrastructure program. GEM encourages mineral exploration and contributes to the professional development of geology students.
 - b. Invest in **transportation infrastructure** (i.e. all weather roads, bridges, road upgrades, as well as improvements to sea ports and airports) in Canada’s north and remote regions of the provinces. **All weather roads**, in particular, greatly improve the economics of exploration projects, increasing access and allowing for extended exploration seasons. A “Roads to Resources” cost-sharing program should be developed to initiate projects that improve road access to minerals. Infrastructure projects should be selected based on their ability to improve access to regions of mineral exploration activity.

ISSUANCE AND COMPLIANCE COSTS; DUTY TO CONSULT:

3. Canadian mineral exploration companies face increased operating costs. These include **issuance and compliance costs** (i.e. costs associated with financing, legal and accounting expenses when working in Canadian jurisdictions) and costs related to the **Crown’s Duty to Consult** with Aboriginal communities (i.e. federal, provincial and territorial policies that establish new permitting conditions for companies beyond the existing regulations and community engagement practices).

Some costs qualify for renunciation as Canadian Exploration Expense (CEE) under flow-through share arrangements. The PDAC recommends a review of the current CEE guidelines and an expanded scope in order to allow companies to manage new costs associated with government requirements.

LONGER TERM MEASURES TO MAINTAIN A VIBRANT EXPLORATION SECTOR

A vibrant mineral sector in Canada helps to maintain existing jobs, creates new jobs, sustains communities, fosters new business opportunities and raises tax revenues that allow the federal, provincial and territorial governments to meet social needs. Over the past few years, the federal government has responded positively to our sector's recommendations through changes to tax policies and investments in specific programs.

Examples include the creation and extension of the **Mineral Exploration Tax Credit (METC)** and the expansion of the **Geo-mapping for Energy and Minerals (GEM)** program. In addition to making the METC permanent, the PDAC recommends the following policy initiatives as longer term measures that are intended to support a strong investment climate for the mineral industry in Canada.

Recommendations to support a continuing strong investment climate for the mineral industry in Canada:

4. CLARIFY CEE DEFINITION WITH RESPECT TO FORMER MINE SITES:

The federal government, as part of a long-term strategy for mineral exploration, should clarify that the Canadian Exploration Expense definition includes the costs related to carrying out exploration at former mine sites that have not operated for at least 5 years. 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. An objective test for this eligibility 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.

5. PROVIDE FLOW-THROUGH SHARE TREATMENT FOR QETS:

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 (FTS). The benefit to governments of allowing FTS treatment for expenditures incurred at abandoned mine sites is that the cost of the program would be offset by the reduction and/or transfer of the government's financial or environmental liabilities at abandoned mine sites to the private sector. There will also be benefits from increased economic activity and tax revenues associated with increased exploration and reclamation, as well as economic development and investment from potential discoveries, particularly in remote and northern communities.

We believe these recommendations will have an overall positive impact on the Canadian economy and will be beneficial to government by increasing the overall tax base.

Background on Recommendations

TAX INCENTIVES:

Mineral Exploration Tax Credit

- a. To ensure longer term investment in Canada, and to allow exploration companies to plan for the future, **make the current 15% Mineral Exploration Tax Credit (METC) a permanent feature** of the federal income tax system; and,
 - b. Encourage investment in Canadian projects by **temporarily increasing** the METC for exploration financed using flow-through shares from the current **15%** rate to **30%** for a **two year** period.
- The 15% federal METC is the centerpiece in the current system of federal and provincial exploration tax incentive programs designed to assist flow-through share financing. Almost all major mining provinces in Canada provide additional incentives to supplement the federal credit.
 - In the **March 2010 federal budget**, the METC was extended by one year to **March 31, 2011**. Funds raised with the credit during the first three months of 2011 can support eligible exploration until the end of 2012. The net cost of this extension to the government is an estimated **\$65 million** over the next two fiscal years.
 - Without sufficient investor support, exploration companies face a reduction and/or cancellation of many programs in 2010-11, with a significant negative impact on service companies and neighbouring communities, including those in remote and northern areas of Canada.

Benefits of a Two-Year Increase in the METC Rate from 15% to 30%

- Increasing the credit rate to 30% would allow the exploration industry to maintain a reasonable level of exploration activity during this period of depressed commodity prices. The after-tax cost would be further reduced if the provinces were to reinforce the proposed federal initiative by increasing their credit rates as well.

Benefits of making the 15% METC a permanent feature of the income tax system

- 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 partnerships to market the investments in an orderly and timely manner to new investors. Making this program permanent would increase investor certainty and provide a more rational time-frame for planning and executing exploration programs.

INFRASTRUCTURE:

Geo-mapping for Energy and Minerals (GEM) infrastructure program

- The PDAC has long advocated for the expansion of the federal government's geoscience and mapping activities. The PDAC was pleased with the Prime Minister's 2008 announcement of \$100 million to map the North (the GEM Program) and has recommended in-year increases in order to retain expertise in the sector during the financial crisis. In May 2009, the Natural Resources Minister announced accelerated funding of \$8 million (increasing GEM from \$22 million to \$30 million in 2009).
- Investment in geoscience research directly benefits both government and the mineral sector by advancing knowledge and encouraging new exploration activity. A high-quality and easily accessible geoscience database (i.e. geological data and maps) is a key competitive advantage internationally, attracting investment dollars and leading to the discovery of mineral deposits and to the development of new mines.

ISSUANCE AND COMPLIANCE COSTS; DUTY TO CONSULT:

- Many overhead costs are associated with issuing requirements established by provincial law or the rules of stock exchanges. They are a relatively fixed charge associated with share issuance. Allowing a portion of these costs to be treated as CEE and therefore eligible for flow-through share treatment will free up funds for grassroots exploration.
- The Income Tax Act places various restrictions on amounts that can be renounced as Canadian Exploration Expenses (CEE) and be financed through the METC.
- Overhead expenses – legal, regulatory and financial costs, etc - are excluded from the CEE definition and thus cannot be financed using flow through shares.
- Although overhead expenses are deductible, the typical junior mining company is not in a tax-paying position and thus is unable to use these deductions for many years.
- Overhead expenses are essentially a fixed cost associated with flow-through share issuance. In the current environment of depressed share prices, the fixed overhead charges severely restrict the funds available to junior mining companies for exploration activity.