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

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DISCLAIMER

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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.
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 claims 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

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**Diagram Description:**
- **Subscription Agreement**
  - Investors (Individuals, Corporations, Partnerships)
  - Cash for share subscription
  - Common shares
  - CEE or CDE deductions renounced to investor
- **Mining Company**
  - Share proceeds used to fund qualifying exploration
  - CEE or CDE deductions arising from expenditures
- **Canadian Mineral Property**

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**Flowchart Notes:**
- **FTS**
  - Must be related to qualifying exploration activities carried out in Canada

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**Footnotes:**
- History: Current flow-through share regime was introduced in 1986, but previous forms have been allowed since the 1950s.
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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

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

**Extra Tax Deduction in Quebec:**
- 120% provincial tax deduction
- Only for Qualified Corporations

<table>
<thead>
<tr>
<th>Province</th>
<th>Investor's Net Cost for a $1,000 investment in FTS</th>
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<tbody>
<tr>
<td>Ontario</td>
<td>$397</td>
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<tr>
<td>Saskatchewan</td>
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**Investors’ Net Cost for a $1,000 investment in FTS**
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

#### Issuer

<table>
<thead>
<tr>
<th>Total of $20 million, composed of:</th>
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<tr>
<td>Quebec: $10 million @ $1.67/share</td>
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<th>67% premium</th>
<th>35% premium</th>
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Quebec: PearTree Donors subscribe for FT shares at $1.67 (Retain Federal & Quebec Tax Benefits)

National: PearTree Donors subscribe for FT shares at $1.35 (Retain Federal Tax Benefits)

Shares donated to Canadian Charities

$13.395 million @ $1.00/share

Charities sell common shares to Global Investors*

At market price

#### Delta: The ratio between the Issue Price and the Charity Sale Price. In this example the **Quebec Delta is 1.67** ($1.67 ÷ $1.00) and the **National Delta is 1.35** ($1.35 ÷ $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.
The Federal government expands the CEE definition to include certain environmental studies and community consultations required to obtain an exploration permit.

CRA published revised Guidelines for CEE; industry feedback indicates uncertainties remain.

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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