Borden Ladner Gervais

MINING BULLETIN

SIGNIFICANT MINING SECTOR TAX MEASURES IN 2013 FEDERAL BUDGET

The Canadian federal government released its 2013 budget (the Budget) on March 21, 2013 (Budget Day). Included in the Budget were a number of tax measures of relevance to the mining community, in particular with reference to the tax treatment of expenditures made by mining companies.

ACCELERATED CAPITAL COST ALLOWANCE ELIMINATED FOR MINING

Expenditures on certain kinds of capital property ("depreciable property") such as buildings and equipment are the subject of "capital cost allowance" (CCA), the tax version of the accounting concept of depreciation. Each year, the taxpayer is entitled to take as a deduction in computing income a percentage of the remaining expenditure balance in the relevant class of property (the "undepreciated capital cost", or "UCC" of that class). Different classes of property have different depreciation rates. The result is that the cost of the property is deducted from income for tax purposes over a period of years.

The applicable CCA rate for most mining depreciable property is generally 25%. However, in certain circumstances the taxpayer is entitled to claim a deduction of up to 100% of the UCC of certain depreciable properties (not exceeding income from the project for the year). In very general terms, this 100% rate applies where the property was acquired before the mine came into production or as part of a significant expansion of a mine. This accelerated CCA is meant to offset some of the risk of investing in new mines, by effectively deferring taxation of mine income until the cost of its capital assets has been recovered out of project earnings.[1]

The Budget announced the phase-out of accelerated CCA for the mining sector, occurring over the period 2017 – 2021. Property acquired before Budget Day is not affected. The existing additional allowance will also apply to property acquired before 2018:

- pursuant to a written agreement to acquire the property entered into before Budget Day; or

[1] For more on this topic, go to http://miningtaxcanada.com/treatment-of-expenditures/

- as part of a mine development or expansion where either construction was started, or engineering and design work for construction had commenced (as evidenced in writing), before Budget Day.[2]

The elimination of this important incentive is disappointing, particularly in what constitutes a challenging time for the mining industry. Affected taxpayers should review their projects and consider opportunities to maximize the use of accelerated CCA for the remaining period in which it is available.

PRE-PRODUCTION MINE DEVELOPMENT EXPENDITURES RECLASSIFIED

Many expenditures made by mining companies that are not on depreciable property for tax purposes fall into one of two categories of expenditures unique to the natural resource industry: "Canadian exploration expense" (CEE) or "Canadian development expense" (CDE). Essentially, CEE amounts can be 100%-deducted in the year they are incurred, while CDE amounts are deducted at the rate of 30% per year on a declining balance basis.[3]

CEE encompasses two types of expenditures: those on exploration with respect to a mineral resource in Canada, and those incurred in order to bring a new mine into production (and incurred before the mine is producing) in reasonable commercial quantities. The latter of these two types is often referred to as "pre-production development expenditures." Examples include amounts spent clearing or removing overburden, sinking a mine shaft or constructing an adit or other underground entry.

The Budget announced that pre-production development expenses will no longer be treated as CEE, but will instead be included in CDE. As such, they will be deducted for tax purposes more slowly. This will occur on a phased-in basis, starting in 2015. Such expenditures incurred during the period 2015 – 2017 will be treated as partly CDE and partly CEE; after 2017 all of such amounts will be CDE. Grandfathering relief will be provided for pre-production development expenditures made before 2017:

- pursuant to a written agreement entered into before Budget Day; or

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2 For this purpose, activities such as obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities is not considered to constitute construction or engineering and design work.

3 For more on this topic, go to http://miningtaxcanada.com/treatment-of-expenditures/

- as part of a mine development where either construction was started, or engineering and design work for construction had commenced (as evidenced in writing), before Budget Day.[4]

Again, slower recognition of these expenditures is unhelpful for the mining industry, and affected taxpayers should review their expenditures to maximize CEE classification where possible. From a practical perspective most flow-through share deals whereby a mining company renounces expenditure pools to investors are done using CEE incurred on exploration rather than pre-production development expenditures.[5] As such, flow-through shares should continue to play an important role in the financing of Canada's mining sector.

MINERAL EXPLORATION TAX CREDIT EXTENDED

Individuals (other than trusts) who invest in flow-through shares may be entitled to additional tax benefits above and beyond the renounced exploration expenses available on all flow-through shares. Where certain qualifying expenditures (essentially expenses incurred in mining exploration above or at ground level conducted in Canada) are incurred and renounced to a holder of flow-through shares that is an individual (other than a trust), that holder is entitled to an investment tax credit equal to 15% of the renounced qualifying expenditures. This tax credit on "grass-roots" surface exploration expenditures is called the "mineral exploration tax credit."

The ITA currently requires that qualifying expenditures must be incurred by the corporation by the end of 2013 and renounced to the investor under an agreement made before April 2013. The Budget extends the 15% mineral exploration tax credit for another year, by extending (1) the date for incurring qualifying expenditures to the end of 2014, and (2) the deadline for the corporation and the investor to enter into the flow-through share subscription agreement governing renunciation to March 31, 2014.

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4 See footnote 2.

5 This is because exploration CEE is required to use the "look-back" rule on expense renunciation and to obtain the mineral exploration tax credit (see below). For more on the taxation of flow-through shares, go to http://miningtaxcanada.com/flow-through-shares/

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