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Government Proposes Relief for Issuers of Flow-Through Shares

On July 10, 2020, the Department of Finance (Canada) proposed changes to Canada's flow-through share regime in response to the impact of the COVID-19 pandemic on junior mining exploration in Canada (the "**Proposed Changes**"). The Proposed Changes extend the timelines within which corporations are required to spend amounts raised on the issuance of flow-through shares on Canadian exploration expenses that are to be renounced to the subscribers of the flow-through shares.

The Flow-Through Share Program

At the early stages of exploration, mining ventures typically do not generate taxable revenue that exceed the amount of their exploration expenditures. Canada's flow-through share regime permits certain mining companies to renounce (or "flow through") certain types of exploration expenses to flow-through shareholders who may personally deduct these expenses when calculating their incomes for Canadian tax purposes. Flow-through share offerings have proven to be an effective way for mining companies to raise funds for certain types of exploration and development activities in Canada.

The eligible exploration expenses that a mining company may renounce to the holders of flow-through shares include certain "Canadian exploration expenses" ("**CEE**"), which are defined in the *Income Tax Act* (Canada) (the "**Tax Act**").

Current Time Limitations on the Renunciation of CEE

Under the current flow-through share rules, a company that issues flow-through shares may incur and renounce CEE to flow-through shareholders under a "general rule" or a "look-back rule".

1. Under the general rule, the issuing company must incur the CEE to be renounced within 24 months of the date on which the flow-through share agreement is entered. Such expenses can be renounced to a shareholder after the expenses have been incurred and before March of the first calendar year that begins after this 24-month period.

2. Under the look-back rule, based on a commitment to incur the CEE to be renounced in the calendar year that immediately follows the one in which the flow-through share agreement is entered into, the issuing company can renounce the CEE to the flow-through shareholders, effective December 31 of that year, despite not having yet incurred the expenses at the time of renunciation.

To the extent that amounts have been renounced under the look-back rule and have not been incurred before the end of each month (other than January) following the calendar year in which the flow-through share agreement is entered into, the issuer may be subject to a special tax under Part XII.6 of the Tax Act. An additional tax of 10 per cent of the unincurred CEE is payable by the issuing company if it fails to incur CEE equal to the amount renounced by the end of the calendar year following the calendar year in which the flow-through share agreement is executed. In such circumstances, investors are also faced with retroactive adjustments to their tax payable.

Proposed Changes

Under the Proposed Changes, flow-through share issuers will be granted an additional 12 months under both the "general rule" and the "look-back rule" to incur CEE that is to be renounced to flow-through shareholders.

The government also proposes to amend Part XII.6 such that Part XII.6 will be administered as if CEE was incurred up to one year earlier than the date that such expenses were actually incurred. Such relief will generally apply to flow-through share agreements entered into in 2019 or 2020.

Under the general rule, the 12-month extension would apply to flow-through share agreements entered into on or after March 1, 2018 and before 2021. Similarly, under the look-back rule, the 12-month extension would apply to flow-through share agreements entered into in 2019 or 2020.

The Proposed Changes, which have yet to be incorporated into draft legislation to be introduced in Parliament, are welcome news to junior mining companies that have experienced interruptions to their exploration activities as a result of the COVID-19 pandemic.

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