BUDGET 2016: CANADIAN RESOURCE TAXATION PROPOSALS

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In Budget 2016, the Government proposed to extend the "super flow-through share" program for another year. The extension comes as welcome relief to members of the junior resources community in light of the uncertainty that arose from the contents of the "Mandate Letter" sent by the Prime Minister to the Minister of Finance late last year. The Mandate Letter indicated that it was a priority of the Government to "[d]evelop proposals to allow a Canadian Exploration Expenses tax deduction only in cases of unsuccessful exploration and re-direct any savings to investments in new and clean technologies". It was unclear to the tax community how this priority would be reconciled with the current rules in the Income Tax Act (the "Tax Act") relating to the deductions and credits that may be claimed in respect of resource expenses.

The Government also indicated that it intends to proceed with tax measures previously announced relating to the qualification as Canadian exploration expenses ("CEE") of certain costs associated with undertaking environmental studies and community consultations.

Extension of "Super Flow-Through Share" Program

The Government proposes to extend the "super flow-through share" program for an additional year. The super flow-through share program was initially introduced in October 2000 in response to a severe downturn in mineral exploration in Canada. The program had expired at the end of 2005, but was re-introduced in the 2006 Budget in respect of flow-through shares issued pursuant to agreements made after May 1, 2006 and on or before March 31, 2007. The program was extended for additional one-year periods in each of the 2007 to 2015 Budgets.

Canada's flow-through and super flow-through share programs provide tax incentives to promote the exploration and development of mineral resources in Canada, particularly by encouraging new equity investment in junior mining companies. Under Canada's flow-through share program, a company is permitted to renounce or "flow-through" certain expenses associated with its Canadian exploration activities to investors. In turn, investors can generally deduct such expenses in calculating their own taxable income.

The super flow-through share program provides an additional benefit to those who invest in flow-through shares. Under this program, an investor may claim a 15% tax credit in respect of certain grassroots exploration expenses incurred by the issuer of the shares in Canada and renounced to the flow-through shareholder. The tax credit may be applied to reduce certain federal income taxes otherwise payable by the investor.

Grassroots mining expenditures include expenses incurred in conducting certain mining exploration activities for the purpose of determining the existence, location, extent or quality of a mineral resource.

The Government proposes to extend the super flow-through share program to apply in respect of flow-through share agreements entered into on or before March 31, 2017. Under the "look-back" rule, funds raised in a particular calendar year (e.g., 2016) with the benefit of the program can be spent on eligible exploration up to the end of the following calendar year (2017), and renounced to the flow-through shareholder effective December 31st of the particular calendar year (2016).

Canadian Exploration Expense Treatment of Environmental Studies and Community Consultations

Many expenses related to resource exploration in Canada are classified as CEE for income tax purposes. Generally, CEE includes expenses incurred for the purpose of determining the existence, location, extent or quality of a mineral resource or an accumulation of petroleum or natural gas in Canada and is 100% deductible in the year incurred. In addition to expenses that are associated with the physical exploration for resources, CEE can include the cost of certain environmental studies and community consultations that are carried out for the purpose of facilitating physical exploration.

Under the existing rules in the Tax Act, where environmental studies and community consultations are a pre-condition to obtaining a permit or licence to explore for resources, the expenses may be treated as part of the cost of the permit or licence. Expenses that are treated as part of the cost of the permit or licence do not qualify as CEE.

Some provinces and territories in Canada require mining, oil and gas companies to undertake environmental studies and community consultations as a pre-condition to obtaining a permit or licence to explore and, therefore, expenses relating to such environmental studies and community consultations may be treated differently for tax purposes from one jurisdiction to another (depending on the particular requirements of the jurisdiction).

In March of 2015, the Government proposed that the costs associated with undertaking environmental studies and community consultations that are required in order to obtain an exploration permit would be eligible for treatment as CEE. However, this proposal was not enacted into law in 2015.

In Budget 2016, the Government confirmed its intention to amend the law to characterize certain costs associated with undertaking environmental studies and community consultations as CEE.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.