BUDGET 2022: SIGNIFICANT CHANGES TO THE FLOW-THROUGH SHARE PROGRAM UNVEILED

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The Federal Government proposed two tax changes in Budget 2022 that materially affect the ability of companies operating in the resource exploration and development sector to raise capital by issuing "flow-through shares". The first proposal calls for the introduction of a new 30% tax credit that would benefit investors in mining companies that explore for certain specified minerals (the Critical Mineral Exploration Tax Credit, or "**CMETC**", discussed below). The second proposal accelerates the phase-out of the ability of companies that explore for fossil fuels to issue flow-through shares.

Critical Mineral Exploration Tax Credit

The development and production of clean energy technologies is a key component of Canada's plan to achieve net-zero emissions by 2050. Certain clean energy technologies depend on a select group of minerals that have not necessarily been the focus of significant commercial exploration efforts in Canada to date. For example, supplies of lithium, cobalt, nickel, graphite, and magnesium are required to produce the batteries relied on by zero-emission vehicles. Budget 2022 proposes to incentivize investment in Canadian exploration and development activities in respect of certain specified minerals by introducing a new tax credit, the CMETC, as an additional benefit that may be claimed by subscribers of flow-through shares issued by mining companies that incur expenses related to the exploration for the following minerals: copper, nickel, lithium, cobalt, graphite, rare earth elements, scandium, titanium, gallium, vanadium, tellurium, magnesium, zinc, platinum group metals and uranium (the "**Select CMETC Minerals**").

By way of background, a mining company that carries out exploration activities related to mineral resources in Canada is generally permitted to renounce certain expenditures to subscribers of flow-through shares. Where that occurs, and subject to the detailed tax rules that govern the flow-through share regime, subscribers are generally allowed to deduct such renounced expenditures (up to the amount originally paid for the flow-through shares) – instead of the mining company that incurred the expenses – when calculating their taxable income for Canadian purposes.

In October, 2000, the Federal Government introduced the Mineral Exploration Tax Credit (the "**METC**"), a targeted tax credit aimed at increasing the relatively low level of Canadian mineral exploration activity at the time. The METC remains on the books and, in addition to the base deduction benefits afforded to investors in mining companies that incur qualifying expenses under the flow-through share regime, provides a 15%, non-refundable tax credit on eligible exploration expenses (which generally include, but are not limited to, costs related to prospecting and carrying out geological, geophysical, or geochemical surveys).

The CMETC proposed in Budget 2022 is a new tax benefit aimed at incentivizing investors to fund exploration for specified minerals required to develop and produce clean energy technologies. Similar to the METC, it only applies to certain eligible exploration expenses (i.e., it is not available in respect of development or post-production expenses). As a targeted measure aimed at increasing exploration for minerals required to develop clean energy technologies, expenses must be incurred in respect of the Select CMETC Minerals in order to be eligible for the CMETC.

The CMETC is intended to serve as an enhanced alternative to the METC and not a supplementary tax credit. Accordingly, a taxpayer will potentially be eligible to claim the CMETC or the METC, but not both credits.

For a particular expenditure to be eligible to form the basis for a CMETC claim, Budget 2022 proposes that a “qualified person”[1] must certify that the expenditures to be renounced to the flow-through shareholder will be incurred as part of an exploration program that targets Select CMETC Minerals. If the “qualified person” is unable to demonstrate and certify that there is a “reasonable expectation” that the minerals targeted by the applicable mining company’s exploration program are Select CMETC Minerals, the contemplated exploration expenses will not be eligible for the CMETC. The government proposes to recover the amount of any CMETCs claimed by a shareholder under circumstances where proper certification is not obtained.

The CMETC will apply to eligible expenses renounced to shareholders under eligible flow-through share agreements entered into after April 7, 2022 and on or before March 31, 2027.

Detailed legislation implementing the CMETC has not yet been released, but we expect the framework of the required tax amendments necessary for its implementation to look similar to the METC-related amendments introduced in 2000.

Phasing Out Flow-Through Shares for Oil, Gas, and Coal Activities

Canada’s G20 climate change commitments include a 2016 promise to phase out inefficient fossil fuel subsidies by 2025. The Liberal party platform released in connection with the 2021 election included a promise to accelerate that phase-out from 2025 to 2023, and the flow-through share benefits afforded to Canadian fossil fuel companies were identified for elimination in 2023. Budget 2022 follows through on that platform promise by proposing to fully eliminate the benefits of the flow-through share regime insofar as they relate to oil, gas and coal exploration and development activities, effective for agreements entered into after March 31, 2023.

The use of flow-through share issuances as a financing method by oil and gas companies in Western Canada had already slowed greatly following the introduction in 2017 of restrictions on the ability of such companies to renounce "Canadian exploration expenses" to investors looking for the enhanced deduction rate associated with those expenses. The Budget 2022 proposals simply formalize the end of a fossil fuel flow-through share regime that had already been rendered largely ineffectual in that space.

[1] As defined in the version of National Instrument 43-101 published by the Canadian Securities Administrators that was applicable on April 7, 2022; qualified persons would generally be engineers or geoscientists with relevant experience and appropriate accreditation.

by Ted Thiessen

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.