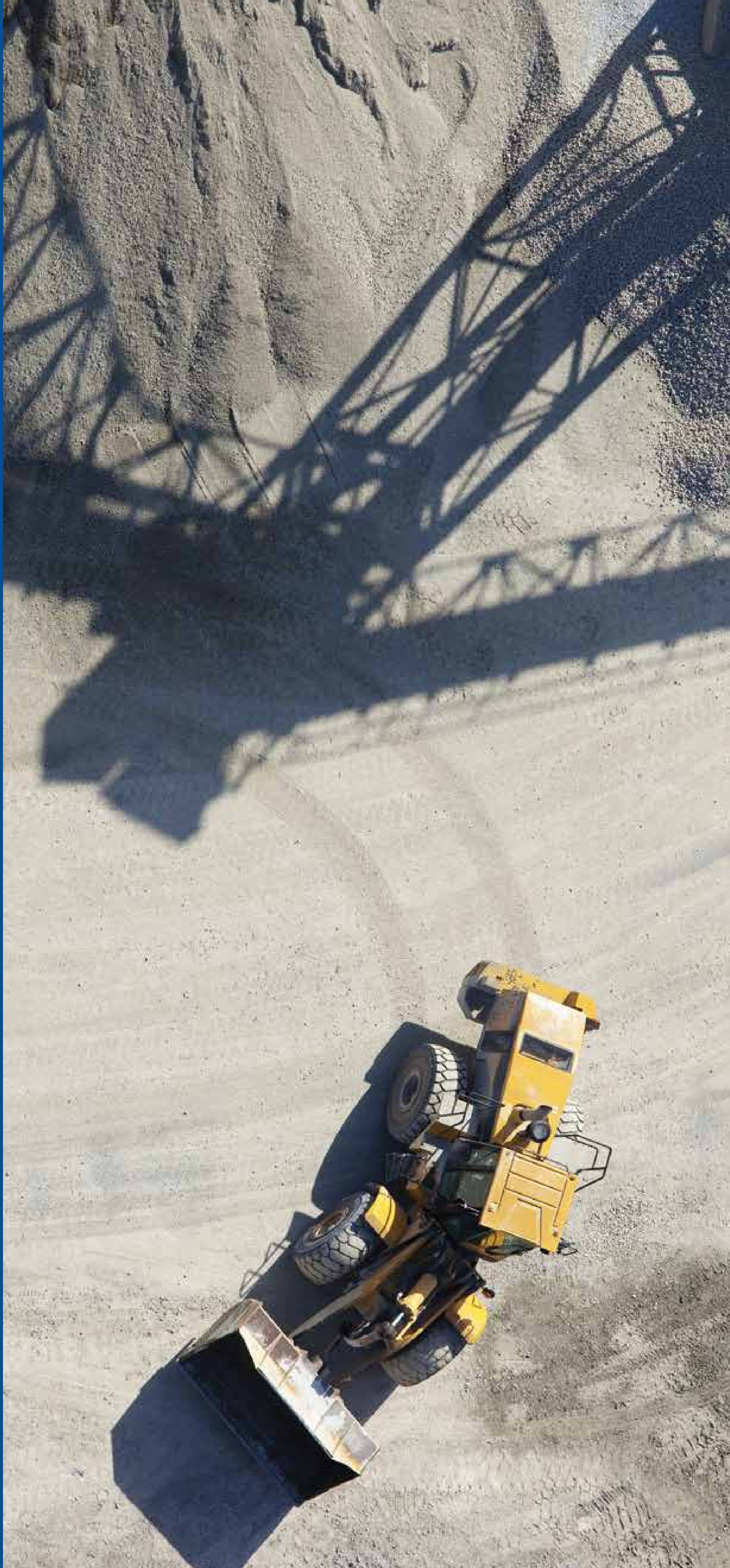
A guide to Canadian mining taxation

Third Edition

February 2016

kpmg.ca/mining



Preface

This is the third edition of *A Guide to Canadian Mining Taxation*, which we publish bi-annually.* For the past three to four years, the mining industry has been wrestling with a combination of issues it has not experienced before. Economic stagnation in emerging markets has softened commodity prices, stemming mining revenues and disenchanting investors. How much capital will eventually flow back to mining equities is in doubt, given the success of commodities ETFs. At the same time, mining companies have been struggling to control operating and capital costs that threaten their margins. In these circumstances, many mining companies have been more concerned about protecting the business than growing the business.

To protect their businesses, mining companies have needed to rely on risk management and carefully crafted financial strategies that preserve value. Taxation is an important piece of this puzzle, and we are proud to contribute our updated guide to a field that is becoming more complex with each passing year. Global mining operates across a plethora of national, regional and local jurisdictions, most of which engage the mining industry with their own policies, regulations and taxes.

When mining is in a rising commodity price cycle, as it was in the first decade of this century, governments tend to raise mining taxes to capture a higher share of profits. When mining reverts to a falling commodity price cycle, as it is doing now, governments take time to adjust to the new reality. Although the industry is now showing signs of stabilizing, external business conditions such as the global economy and commodity prices do not herald a return to growth in the short term. Looking farther out, however, we continue to see a very bright future for the mining industry in Canada. Much potential economic growth remains in emerging markets (the world's major mining markets) and many companies have taken impressive steps toward stabilizing their financial issues.

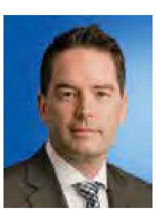
As this edition of *A Guide to Canadian Mining Taxation* goes to press, two issues are capturing global attention. The first is base erosion and profit shifting (BEPS), a tax-specific ethical issue. Governments are formally expressing concern about erosion of their tax bases by multinational corporations that can exploit inter-relationships and treaties among global jurisdictions. News media have reported the story as corporations unwilling to pay their fair share of taxes. The Organization for Economic Co-operation and Development (OECD) has made recommendations to empower governments, and some changes are beginning to appear. We expand on BEPS in a section beginning on page 97.

The other potentially larger issue is the new Canadian and global resolve to halt climate change. Canada's new federal government is enthusiastic about this movement, and several provinces are in alignment. Alberta, most notably, has announced a new climate change agenda that will have consequences for the Province's coal industry as well as the oil sands. Moreover, the US has now formally rejected the Keystone XL pipeline. We await further developments in this area and expect some global impacts on all extractive industries.

We hope this book will be a helpful summary of the main features of our current mining tax regime. Readers who require further information or assistance are invited to contact any of KPMG's mining professionals listed on the following page.

*We would like to express our sincere appreciation for the significant contributions made by Brian Carr in the creation of the first two editions of this book. Without Brian's tireless efforts and passion, we would not be in a position to release this third edition.

Statements of law in this book are current to December 31, 2015.



Scott Jeffery
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KPMG's Mining Tax Contacts

If you require more information on the matters discussed in this publication, please call your local mining tax advisor.
We welcome the opportunity to meet with you to discuss how we can best assist you.

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Introduction

Canada's Mining Industry

For over a decade, mining has been one of Canada's fastest-growing sectors. The mining industry is vital to the country's economic well-being.

Canada has traditionally been a world leader in the mining industry. Currently, it is a leader in the production of potash, uranium, nickel, and cobalt. Canadians, largely through the TSX and TSX-V, have also been leaders in the financing of mining projects throughout the world. A significant portion of the equity funds raised for worldwide mining activities has been raised in Canada.

The first decade of this century saw an explosion of activity in the mining industry throughout the world. This explosion was fuelled by a dramatic increase in the prices of precious and base metals. In the 4 years since the first edition of this work was published (2011), participants in the mining industry have had to deal with the retreat of metal prices from their highs. The prices of gold, silver, lead and zinc on December 31, 2000, June 30, 2011, June 30, 2013 and June 30, 2015 are set out in Table 1.

In addition, more recently, mining corporations have seen their costs increase faster than metal prices. This has had a negative short-term impact on the share prices of many mining corporations. We are optimistic that mining corporations will be successful in taking the necessary steps to deal with the escalation of costs. As a result, we continue to see a very bright future for the mining industry in Canada.

Finally, the governments of Canada and its provinces have increased their share of mining tax revenues in the last two years. However, the tax regime in Canada is still a very favourable one for the mining industry.

The Tax Environment

The taxes imposed by any particular government are crucial to the viability of a mining project. Too high a tax burden can make a project uneconomic even though the project may have excellent mining fundamentals.

Canada's system of government consists of a federal government and 10 provincial governments. Canada also has three territories, which are governed by the federal government. The federal government, the provinces, and the territories each levy income taxes on corporations and individuals. With the exception of Prince Edward Island (which has no mining activity), each province and territory also levies separate mining taxes or royalties on mining activities. For tax purposes, there is little distinction between a province and a territory; consequently, any reference in this book to an unspecified province includes a territory.

Although in recent years the federal and provincial governments have eliminated some of the incentives available to the mining industry, Canada's tax environment continues to be favourable to businesses engaged in mining activities and their investors. The federal and provincial tax regimes offer a series of mining-specific tax incentives to

Table 1: Prices of Gold, Silver, Lead and Zinc, December 31, 2000, June 30, 2011, June 30, 2013 and June 30, 2015 (in US dollars)

	12/31/2000	6/30/2011	6/30/2013	6/30/2015	Unit
Gold	$ 272.25	$ 1,511.40	$ 1,234.53	$1,172.35	ounce
Silver	$ 4.60	$ 35.08	$ 19.68	$15.74	ounce
Lead	$ 470.00	$ 2,681.75	$ 2,057.00	$1,749.25	tonne
Zinc	$ 1,025.50	$ 2,293.75	$ 1,822.50	$2,000.00	tonne

Sources: Forex; Bloomberg; and London Metal Exchange

encourage investment in the capital-intensive and high-risk mining industry. The following are some of the favourable attributes of the current system:

- The rates of income tax are low relative to most other jurisdictions in which mining activities take place.
- The rapid write-off of intangible expenses and the cost of tangible assets permits taxpayers to recover their costs of bringing a mine into production before any tax must be paid. While recent legislative changes will in the future reduce the rate at which these expenses may be written off, as a practical matter, most taxpayers should be able to recover their costs of bringing a mine into production before any tax must be paid.
- Tax credits for intangible expenses reduce the tax liability of corporations; such credits can be carried forward for a period of 20 years. Although most credits are being phased out, existing credits may still be carried forward for a period of 20 years.
- Operating losses can be carried forward for 20 years, making it almost certain that a taxpayer will be able to use start-up losses if it does develop viable mining operations.
- Only one-half of a capital gain is included in income.
- Capital taxes have been eliminated in most jurisdictions.
- Most provinces have sales and use taxes that allow businesses to pass along the tax to the ultimate consumer. Therefore, in the end, businesses do not bear the cost of these taxes.
- Most provinces impose a profit tax instead of royalties on mining operations.
- A flow-through share mechanism allows corporations to renounce intangible expenses to investors. This allows corporations engaged in certain exploration activities to monetize expenses that they are unable to utilize in the foreseeable future.
- There is no withholding tax on non-participating interest paid by a corporation to an arm's-length non-resident lender.
- Most of Canada's treaties provide that the rate of withholding tax on dividends paid to a non-resident parent corporation is limited to 5 percent.

The following features of the Canadian tax system are not so favourable to the mining industry:

— Some provinces (Manitoba, Saskatchewan, and British Columbia) impose sales and use taxes that are borne by businesses, rather than the ultimate consumer.

— Some provinces (Alberta and Saskatchewan) require mining operators to pay royalties and not profit-based taxes.

— There are other taxes and charges for which a business is liable, whether or not it is profitable. These include Canada Pension Plan and Employment Insurance payments at the federal level, and provincial employer health taxes and payroll taxes.

About This Book

We have written this book for business entities that invest in mining activities to help them understand the Canadian tax regime and how it applies to such activities in Canada and abroad. The book is a summary of the relevant Canadian legislation and provides an overview of the broad principles applicable to any particular mining activity. The statements of the law are current to December 31, 2015, unless otherwise noted. At that time, there was legislation in draft or proposal form that had not been finalized. For ease of discussion, we have assumed that all the relevant legislation will become law. Where proposed legislation is not enacted, the relevant government usually provides transitional legislation for the benefit of those taxpayers that relied on the proposed legislation. In a few instances, where there are proposals which have not been reduced to legislation, we have described the nature of the proposals.

This book concentrates on the federal, provincial, and territorial taxes applicable to mining activities and does not consider other taxes and charges, such as payroll taxes, to which all taxpayers carrying on business may be liable. A person contemplating carrying on business in Canada should consult a tax adviser about the application of these other taxes.

The relevant tax rules are detailed and complex, and we have not endeavoured to discuss the many nuances of such legislation. We have eschewed the word "generally" and the phrase "in general" in order to make the text simpler and more readable. We accept that there may be esoteric exceptions to many of our statements, but we consider it more important to give readers straightforward statements that may not be true in every factual circumstance than to bog down the reader by forcing her or him to read unending caveats. Therefore, this book should not be seen as a substitute for consultation with a knowledgeable tax adviser. For a more detailed and technical review of the federal legislation, see *Canadian Resource Taxation*, General Editors, Brian R. Carr and C. Anne Calverley, QC (Toronto: Carswell, looseleaf).

We have attempted to make the content of the book user-friendly by keeping specific references to legislative provisions to a bare minimum. In addition, we have provided a glossary at the end of the book that includes concise definitions of tax and mining industry terms. Throughout the text, the tax terms and abbreviations are highlighted in bold type the first time they are used in a section, to refer the reader to the glossary. We have provided cross-references where a particular concept is more fully discussed in another section of the book; these cross-references are colour-coded and underlined for easy identification. Finally, an index is included to guide the reader to the pages where specific topics are discussed.

Overview of the Canadian Tax Regime

Mining Activities

Canada's tax regime for mining activities applies to three principal stages of a mining operation:

1. exploration and development;
2. extraction;
3. processing (including concentrating, smelting, milling, and refining).

The tax regime provides for special treatment of these activities to create and maintain a favourable environment for investment in the mineral resource sector. This special treatment includes deductions, allowances and credits that may be claimed against the income from the mining operation, either in the year of expenditure or, sometimes, in a prior or subsequent year.

Different rules may apply to different forms of organization. It is therefore important to consider the applicable tax treatment before deciding what type of structure will be used for investment in a mining project.

Forms of Organization

Canadian tax law contemplates that mining activities may be carried on by an individual, a corporation, a trust, or a **partnership**. Such legislation also provides for the issuance of **flow-through shares** by a corporation, which permit the corporation to renounce its deductible **resource expenses** to the purchasers of the shares.

A non-resident individual or corporation may carry on business directly in Canada or indirectly through a **Canadian corporation**.

The use of partnerships and **joint ventures** has recently become more common for structuring investments in the mining industry. There are two reasons for this development. First, new mining projects have become comparatively more expensive because these activities often take place in remote locations, and investors in these projects wish to share the risks. Second, mining has become more international in scope as other countries (such as China) look to external sources for supplies. As a result, partnerships and joint ventures increasingly include foreign entities that contribute funding to the Canadian corporations that own the resources and have the operating expertise. While these non-resident investors may participate directly in the projects, more typically they will participate through Canadian subsidiaries, so that all the members of the joint venture or partnership will be Canadian corporations.

Trusts are excellent vehicles for flowing income through to their beneficiaries; however, trusts cannot flow losses through to their beneficiaries. As a result, trusts are not used frequently in active mining operations, although they may be used as investment vehicles to purchase royalties and other mining interests. Trusts are taxed as individuals on their income except in respect of income that is subject to the **SIFT legislation** (discussed in Structuring Mining Investments – Partnerships and Joint Ventures – Income Tax Consequences – SIFT Legislation).

Income Taxation

Both the federal and the provincial governments levy income taxes on corporations and individuals. In all provinces except Québec and Alberta, a single corporate income tax return is filed, and in all provinces except Québec, a single personal income tax return is filed, with the federal government collecting both taxes. In Québec and Alberta, the basis for taxation is similar to the basis for federal taxation.

Individuals, corporations, and trusts are all subject to federal income tax under Canada's *Income Tax Act* **(ITA)**. Most **partnerships** are not themselves liable to tax; instead, the individual partners are taxed on their share of partnership income.

The basis for federal taxation in Canada is residency. Residents of Canada are taxed on their worldwide income, whether from sources inside or outside Canada. Non-residents are taxed only on their Canadian-source income (subject to any available treaty exemption). Corporations incorporated in Canada are resident in Canada regardless of the residency or nationality of their shareholders.

Individuals are subject to federal tax and provincial tax in the province in which they are resident on the last day of the calendar year (December 31). However, business income earned through a permanent establishment is subject to tax in the province or territory of the permanent establishment.

The ITA provides an abatement of tax for income earned by a corporation through a permanent establishment in a province or territory. Where a corporation carries on business in two or more provinces, there is an allocation formula that allocates the income between those provinces.

The ITA also allows a 100 percent deduction for provincial royalties and mining taxes payable.

The calculation of tax follows four steps. First, income (also called net income) is calculated. Then certain deductions are claimed to arrive at taxable income. Next, federal tax and provincial tax are calculated on taxable income. Finally, applicable tax credits are applied to reduce taxes payable.

Resident corporations are taxed at flat corporate rates. The combined federal and provincial rates range from 26 percent to 31 percent for the 2015 calendar year, depending on the province or territory. Table 2 shows the federal and provincial income tax rates for each province and territory as at January 1, 2016.

Table 2: Federal and Provincial Corporate Income Tax Rates as at January 1, 2016

	Rates as at January 1, 2016 (%)		
	Federal	**Provincial**	**Combined**
British Columbia	15	11.0	26.0
Alberta	15	12.0	25.0
Saskatchewan	15	12.0	27.0
Manitoba	15	12.0	27.0
Ontario	15	11.5	26.5
Québec†	15	11.9	26.9
New Brunswick	15	12.0	25.0
Nova Scotia	15	16.0	31.0
Prince Edward Island	15	16.0	31.0
Newfoundland and Labrador	15	14.0	29.0
Yukon	15	15.0	30.0
Northwest Territories	15	11.5	26.5
Nunavut	15	12.0	27.0

† *Québec rate will be gradually reduced to 11.5% by way of a reduction of 0.1% per year from 2017 to 2020.*

Canadian-resident individuals are taxed at graduated rates based on federal and provincial tax brackets. Table 3 shows the maximum federal and provincial income tax rates and the highest tax brackets for each province and territory for the 2016 calendar year.

Table 3: Maximum Federal and Provincial Personal Income Tax Rates as at January 1, 2016

	Federal Rate (%)	Highest Federal Tax Bracket ($)	Provincial Rate (%)	Highest Provincial Tax Bracket ($)
British Columbia	33.00	200,000	14.70	106,543
Alberta	33.00	200,000	15.00	300,000
Saskatchewan	33.00	200,000	15.00	127,430
Manitoba	33.00	200,000	17.40	67,000
Ontario	33.00	200,000	13.16	220,000
Québec	33.00	200,000	25.75	103,150
New Brunswick	33.00	200,000	25.75	250,000
Nova Scotia	33.00	200,000	21.00	150,000
Prince Edward Island	33.00	200,000	16.70	63,969
Newfoundland and Labrador	33.00	200,000	15.30	175,700
Yukon	33.00	200,000	15.00	500,000
Northwest Territories	33.00	200,000	14.05	133,353
Nunavut	33.00	200,000	11.50	140,388

Note: Income above the amount listed in the highest federal tax bracket column is taxed at the rate provided in the table. Ontario and Prince Edward Island also impose surtaxes. The maximum surtax rate is 36% in Ontario and 10% in Prince Edward Island. Accounting for the surtaxes, the highest marginal rate is 20.53% in Ontario and 18.37% in Prince Edward Island. Québec taxpayers receive an abatement that reduces the highest-bracket combined rate to 53.31%.

Non-residents are subject to federal withholding tax on payments received from Canadian residents. The payer withholds tax on the payment at a rate specified under the ITA or at a reduced rate as provided by an applicable tax treaty.

Canadian residents may be entitled to claim a foreign tax credit against their federal income tax liability for taxes paid or payable to a foreign jurisdiction.

Capital Gains

A disposition of **capital property** may give rise to a **capital gain**, 50 percent of which is included in income as a **taxable capital gain**.

Utilization of Losses

There are two types of losses for Canadian tax purposes, **non-capital losses** and **net capital losses**. Non-capital losses are business or property losses that may be carried back for 3 taxation years or carried forward for 20 taxation years to be applied against income from any source.

Capital losses are losses incurred on a disposition of capital property. One-half of such losses (**allowable capital losses**) may be applied against the taxable portion of capital gains realized in the year, with any excess being carried back or forward as a net capital loss. Net capital losses may be carried back for 3 years or carried forward indefinitely, but may be applied only against capital gains.

There is currently no tax consolidation or group relief in Canada. The losses of one corporation in a corporate group cannot be applied against the income of another corporation in the group in the tax returns of the corporations. There are various reorganization techniques that allow corporations to utilize losses within a corporate group.

The Canadian tax system provides corporations in the mining industry with flexibility in utilizing non-capital losses before they expire by allowing an elective deduction of qualifying resource expenditures.

Where there is an amalgamation of two or more corporations and there is no acquisition of **control** of a predecessor corporation by virtue of the amalgamation, the amalgamated corporation can utilize the losses of the predecessor corporations as if those losses were its own.

Where there is an amalgamation of a parent and a wholly owned subsidiary, the amalgamated corporation can carry back any losses it realizes against income of the parent subject to the restrictions described below.

Where a parent corporation winds up a subsidiary corporation in accordance with the tax-deferral rules, the losses of the subsidiary can be applied against income of its parent in the taxation year beginning after commencement of the wind-up.

Restrictions apply to the utilization of losses of a corporation on an acquisition of control of the corporation, whether by way of amalgamation or otherwise.

The rules applying to corporate reorganizations, amalgamations, and wind-ups are discussed in Structuring Mining Investments – Corporate Reorganizations.

Tax Administration

The ITA is administered by the Canada Revenue Agency (**CRA**). The CRA has powers to conduct audits, require the production of tax-related information, collect taxes owing, and impose interest and penalties on unpaid amounts.

To assist taxpayers with the application of federal income tax rules and regulations, the CRA publishes guidance in the form of income tax folios, information circulars, interpretation bulletins, technical interpretations and periodic releases as required. It also provides advance tax rulings in response to taxpayer requests for clarification of the tax treatment that may apply in particular situations.

Provincial tax legislation is administered by the appropriate government department or ministry (usually Finance). These provincial tax authorities also publish guidance on the application of the legislation, in various forms.

The websites of the federal and provincial tax authorities are listed in the Appendix.

Filing Requirements and Tax Payments

Corporations

Corporate income tax returns are due six months following the end of the corporation's fiscal year. With the exception of Alberta and Québec, the federal government collects taxes on behalf of the provinces so an additional provincial corporate income tax return is not required.

Corporations are required to pay monthly federal and provincial tax instalments during the year.

The balance of federal and provincial taxes owing (after instalments) is due two months after the end of the taxation year. The deadline may be extended to three months after the end of the taxation year for a **Canadian-controlled private corporation** with taxable income (together with associated corporations) no greater than $500,000 for the particular year.

Individuals

An individual must file a federal income tax return and, if applicable, a Québec income tax return. Individuals must use a calendar year for tax purposes. Federal and Québec personal income tax returns for individuals other than self-employed individuals must be filed by April 30 of the following year. Self-employed individuals with professional income or income from an unincorporated business have until June 15 of the following year to file their federal and Québec personal income tax returns.

Employed individuals are subject to source withholdings by the employer (payroll tax). Individuals who are not employed but have income from a business or property above a specified threshold are required to pay quarterly federal and provincial income tax instalments.

For all individuals, whether employed or self-employed, the balance of federal and provincial tax owing for a taxation year is due by April 30 of the following year.

Trusts

There are two categories of trusts, **inter-vivos trusts** and **testamentary trusts**. An inter-vivos trust is established by a living person; a testamentary trust is established on the death of an individual. Inter-vivos trusts, which include virtually all commercial trusts, must have calendar fiscal years. They must file federal and, if applicable, Québec returns, and pay the balance of tax owing (after instalments), within 90 days of the end of each taxation year. Testamentary trusts can establish a year-end that is different than a calendar year. Special rules apply to the filing requirements of testamentary trusts. However, effective January 1, 2016, the federal government has eliminated these and other advantages in order to align the treatment of testamentary trusts with that of inter-vivos trusts. Testamentary trusts are rarely used in commercial arrangements.

Partnerships

A **partnership** is not a taxpayer in its own right. The tax liability in respect of the business of the partnership is imposed on its partners except in the case of **specified investment flow-through entities (SIFTs)**, which are taxed on their earnings from **non-portfolio property**. (The **SIFT legislation** is discussed in Structuring Mining Investments – Partnerships and Joint Ventures – Income Tax Consequences – SIFT Legislation.)

Partnership Information Returns

The partners of a partnership that carries on business in Canada are required to file a federal information return, and may be required to file a Québec information return, that reports the income or loss of the partnership and the allocation of such amount to each of the partners. The applicable information return can be filed by one partner on behalf of all partners.

Federal Requirements

The **Regulations** prescribe that a federal information return be filed:

— within five months after the end of the fiscal period for a partnership, all members of which were corporations throughout the fiscal period;

— on or before the last day of March in the calendar year immediately following the calendar year in which the fiscal period ended for a partnership, all members of which were individuals (including trusts) throughout the fiscal period; or

- in any other case, on or before the earlier of:
  - the day that is five months after the end of the partnership's fiscal period and
  - the last day of March in the calendar year immediately following the calendar year in which the partnership's fiscal period ended.

Where a partnership discontinues its business or activity, the federal information return in respect of any fiscal period prior to the discontinuance of the business or activity must be filed on or before the earlier of:

- the day that is 90 days after the discontinuance of the business or activity, and
- the day the return is required to be filed under the preceding paragraph.

The Canada Revenue Agency has tailored these rules on an administrative basis, such that:

- professional corporations are excluded from the rule that governs partnerships, all members of which were corporations and, instead, fall into the rule that applies for a partnership, all members of which were individuals throughout the fiscal period; and
- partnerships that are tax shelters fall into the same rule that governs partnerships, all members of which were individuals throughout the fiscal period.

On an administrative basis, a partnership does not need to file a federal information return unless:

- at the end of the fiscal period, the partnership has a combined absolute value of revenues and expenses of more than $2 million, or has more than $5 million in assets; or
- the partnership has a partnership as a partner or is a member of another partnership, has a corporation or trust as a partner, or invested in flow-through shares.

However, the CRA has reserved the right to request that a partnership file a federal information return in other circumstances.

Each person who holds an interest in a partnership as a nominee or agent for another person must complete and file a separate federal information return for each partnership in which an interest is held for another person.

Québec Requirements

The partners of a partnership will also be required to file a Québec information return if:

1. the partnership carries on a business
   - in Québec, or
   - in Canada, outside Québec, and one of its members is an individual (including a trust) resident in Québec or a corporation that has an establishment in Québec;
2. the partnership is a Canadian partnership or SIFT partnership, and one of the members is an individual (including a trust) resident in Québec or a corporation that has an establishment in Québec; or
3. the partnership owns a specified immovable (situated in Québec), and one of the members is a specified trust.

According to the Québec *Regulations Respecting the Taxation Act* (the "Québec Regulations"), a Québec information return can be filed by one partner on behalf of all other partners provided that the filing member is designated for the purpose of filing the information return.

The Québec Regulations prescribe that the Québec information return be attached to and filed with the fiscal return that the person or member files for that year (or for the person's or the member's taxation year during which the partnership's fiscal period ends).

On an administrative basis, the partners of a partnership do not need to file a Québec information return unless:

- at the end of the fiscal period, either:
  - the total combined absolute value of the partnership's revenue and expenses exceeded $2 million, or
  - the partnership has more than $5 million in assets
- at any time during the fiscal period:
  - the partnership had more than five members,
  - either the partnership was itself a member of another partnership or one of its members was also a partnership,
  - one of the members of the partnership was a trust or a corporation,
  - exploration and development expenses were renounced in favour of the partnership, or amounts of assistance were allocated to the partnership, because the partnership invested in flow-through shares, or
  - the partnership was a SIFT entity and had an establishment in Québec.

Each person who holds an interest in a partnership as an agent or representative must complete and file a separate Québec information return for each such holding.

Joint Ventures

The participants in a **joint venture** are considered to carry on directly the activities of the joint venture. The participants are required to report the tax results of the joint venture in their own tax returns.

Functional Currency Tax Reporting

Qualifying **Canadian corporations** can elect to compute their Canadian tax results using their functional currency for financial reporting purposes rather than the Canadian dollar.

The functional currency election is advantageous for the following reasons:

— Corporations need not maintain Canadian-dollar books solely for income tax purposes. This reduces the burden of compliance.

— Corporations can eliminate the distorting effect of foreign exchange gains and losses on their tax and financial results that arise solely from computing their Canadian tax results using the Canadian dollar.

Corporations must meet the following conditions to make the functional currency election:

— The corporation must be a Canadian-resident corporation throughout the particular taxation year; a Canadian branch of a foreign owner is not entitled to file on this basis.

— The corporation must file the election to have the functional currency rules apply.

— The functional currency of the corporation (currently limited to the US dollar, the British pound, the euro, and the Australian dollar) must be the primary currency in which the corporation maintains its books and records for financial reporting purposes throughout the year. This will be the same as the functional currency determined under **generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS), as applicable**.

— The corporation must not have previously filed a functional currency election.

In its first **functional currency year**, an electing corporation must translate its Canadian-dollar tax attributes into the functional currency using the spot rate in effect on the last day of the preceding tax year. For debt obligations denominated in a currency other than the functional currency, the principal amount at the end of the preceding tax year must be converted using the spot rate at that time. Any unrealized foreign exchange gains and losses at the time of conversion (including on amounts denominated in the functional currency) are "locked in" and must be recognized for tax purposes on a pro-rata basis as the debt's principal amount is repaid. A corporation should evaluate trends in currency movement to determine the optimal timing of making the election.

A corporation is allowed to revoke the election and revert to using Canadian dollars. If the corporation has revoked its election, or if it ceases to qualify as a functional currency reporter, it can never again make the election. Also, once the election has been made, the corporation cannot subsequently switch to a different functional currency. Specific anti-avoidance rules apply to prevent circumventing this one-time rule by means of corporate reorganizations or asset transfers.

Canadian corporations operating in the mining, energy, and other resource industries are obvious beneficiaries of the functional currency election because the commodity markets in which they operate are conducted mostly in US dollars. The election will often allow these corporations to align their Canadian tax computations with their financial reporting, eliminating permanent differences arising from foreign exchange gains or losses recognized for tax purposes but not financial reporting purposes, and vice versa.

However, in all provincial jurisdictions except Ontario and Québec, mine operators are still required to compute provincial mining tax and file mining tax returns in Canadian dollars.

Deductions, Allowances, and Credits

The **ITA** and the provincial statutes provide a number of deductions, allowances, and credits that are specifically available to taxpayers engaged in qualifying mining activities. These provisions apply over and above the standard deductions, allowances, and credits available to individuals and entities that are subject to tax on income earned from a business or property.

The mining provisions described below are designed to encourage and support the exploitation of oil, gas, and mineral resources by recognizing certain business challenges that are unique to this industry. A particular aspect of this planning – the tax-efficient structuring of mining investments – is discussed in a separate section of this book.

Canadian Exploration Expenses

The ITA provides a deduction for **Canadian exploration expenses (CEE)** incurred during the exploration and development stage of the mining life cycle. These costs can currently be separated into two categories:

— **Grassroots exploration:** This category includes costs incurred for the purpose of determining the existence, location, extent, or quality of an oil, gas, or mineral resource in Canada. These costs do not include expenses related to a mine that has come into commercial production or expenses that are a **Canadian development expense (CDE)** as described below.

— **Mine development:** This category currently includes costs incurred for the purpose of bringing a new mine in Canada into production in "reasonable commercial quantities." These costs must be incurred before the new mine reaches a commercial level of production.

The second category (mine development) is being phased out. After 2017, all mine development costs will be treated as **CDE**.

Transitional rules provide that expenses incurred before 2017 may be grandfathered as CEE if they are incurred:

— under an agreement entered into before March 21, 2013; or

— as part of the development of a new mine.

In order to satisfy the second criterion:

— the construction of the new mine must have been started by March 21, 2013; or

— the engineering and design work for the construction of the new mine must have been started before March 21, 2013.

"Construction" and "engineering and design work" do not include obtaining permits or regulatory approvals, conducting environmental assessments, community consultations, impact benefit studies, or similar activities.

A portion of the expenses incurred during the transition period will be CEE in accordance with the formula set out in Table 4.

Table 4: Amount of CEE Under Transitional Rules, 2015–2017

Year	Portion of Expense that is CEE
2015	80%
2016	60%
2017	30%

The **CRA** has historically interpreted the purpose requirement in the current categories of grassroots exploration and mine development quite narrowly. For example, the CRA takes the position that the cost of a feasibility study to determine whether it is economically possible to bring a mine into production will not qualify. On the other hand, the cost of an assessment of the physical and chemical characteristics of the deposit to assess its potential as a commercial deposit will be allowed as a CEE.

On March 1, 2015 rules were announced to expand the definition of CEE to include costs associated with undertaking environmental studies and community consultations that are required in order to obtain an exploration permit.

CEE exclude the costs of **depreciable property**, such as machinery and equipment. (These costs are discussed in Deductions, Allowances, and Credits – Capital Cost Allowance.)

Any revenues earned as a result of incurring exploration expenses will reduce the amount of CEE that can be claimed. For example, if a corporation incurs CEE in bringing a gold mine into production and recovers and sells gold during this "pre-commercial" stage of production, the gold revenues will reduce the CEE.

A taxpayer includes its CEE in its **cumulative Canadian exploration expense (CCEE)** account.

— A **principal-business corporation** may deduct up to 100 percent of its CCEE balance at the end of the year to the extent of its income for that particular taxation year. A principal-business corporation cannot create a loss by claiming a deduction in respect of its CCEE account in excess of its income for that year.

— A taxpayer that is not a principal-business corporation may claim a deduction of up to 100 percent of its CCEE account at the end of the year without restriction. However, a deduction in excess of the taxpayer's income may have significant adverse consequences under federal, and in some cases provincial, minimum tax legislation.

A taxpayer deducts from its CCEE account any amount claimed as CEE in the year. Any balance remaining in the account can be carried forward indefinitely and deducted in future years (subject to the successor corporation rules discussed below).

Canadian Development Expenses

The ITA also provides a deduction for **Canadian development expenses (CDE)** incurred in the mining context. With the implementation of the new CEE rules described above, there are three broad categories of CDE:

— Acquisition costs of a **Canadian resource property** that is a **mining property:** This category includes the cost of land, exploration and mining rights, licences, permits and leases, and a royalty interest in a mining property in Canada. The costs of oil sands rights, licences, permits, and leases are not CDE. Such costs are **Canadian oil and gas (COGPE)**, discussed below.

— Mine development: This category of expenses includes costs incurred for the purpose of bringing a new mine in Canada into production in "reasonable commercial quantities." These costs must be incurred before the new mine reaches a commercial level of production. This category of expenses was previously classified as CEE. However, starting in 2015, a portion of such expenses will be classified as CDE, and after 2017, all such costs will be treated as CDE.

— Costs incurred after a mine has come into production: This category includes the cost of sinking or excavating a mine shaft, constructing a main haulage way, or carrying out similar underground work designed for continuing use.

CDE exclude the costs of **depreciable property**, such as machinery and equipment (discussed in Deductions, Allowances, and Credits – Capital Cost Allowance).

A taxpayer includes its CDE in its **cumulative Canadian development expense (CCDE)** account. The taxpayer may deduct up to 30 percent of the balance in a year (subject to proration for short years). The deduction that a taxpayer may claim in respect of its CCDE account is discretionary.

A taxpayer deducts from its CCDE account any amount claimed as CDE in the year. If the taxpayer disposes of a Canadian resource property that is a **mining property**, the disposition does not give rise to a **capital gain** or a **capital loss**; instead, the taxpayer deducts the proceeds from its CCDE account in that year. In addition, a taxpayer deducts from its CCDE account any amount by which its **CCOGPE** account is negative at the end of the year. If the CCDE account is negative at the end of the year, the taxpayer includes the amount of the negative balance in its income for the year.

A taxpayer may carry forward indefinitely any undeducted balance in its CCDE account and claim the amount in future years (subject to the successor corporation rules discussed below).

Canadian Oil and Gas Property Expenses

A third category of deductible expenses under the ITA is **Canadian oil and gas property expenses (COGPE)**. COGPE include the cost of acquisition of a **Canadian resource property** that is an **oil and gas property**. This includes the cost of land, exploration rights, licenses, permits, leases, and a royalty interest in an oil and gas property in Canada.

Many oil sands activities are more akin to mining than they are to conventional oil and gas activities. The costs of oil sands rights, licenses, permits, and leases were formerly treated as CDE but are now classified as COGPE.

A taxpayer includes its COGPE in its **cumulative Canadian oil and gas property expense (CCOGPE)** account. The taxpayer may deduct up to 10 percent of the balance in a year (subject to proration for short years). The deduction that a taxpayer may claim in respect of its CCOGPE account is discretionary.

A taxpayer deducts from its CCOGPE account any amount claimed as COGPE in the year. If the taxpayer disposes of an oil and gas property that includes an oil sands property, the disposition does not give rise to a **capital gain** or a **capital loss**; instead, the taxpayer deducts the proceeds from its CCOGPE account in that year. If the CCOGPE account is negative at the end of the year, the taxpayer deducts the negative amount from its CCDE account. If the CCDE becomes negative, this amount is included in income, which may be reduced by CCEE or NCL, depending on certain restrictions.

A taxpayer may carry forward indefinitely any undeducted balance in its CCOGPE account and claim the amount in future years.

Foreign Resource Expenses

A fourth category of deductible expenses under the ITA is **foreign resource expenses (FRE)**. FRE include expenses in respect of drilling, exploration, prospecting, surveying, and acquisition costs relating to a **foreign resource property**. They do not include, among other things, the cost of **depreciable property** and expenditures incurred after the commencement of production.

Where a taxpayer carries on business directly in one or more foreign jurisdictions in respect of a foreign resource property, and incurs FRE, those expenses are added to the taxpayer's **cumulative foreign resource expense (CFRE)** account on a country-by-country basis. The taxpayer does not claim a deduction directly in respect of any FRE but instead claims a deduction in respect of its **adjusted cumulative foreign resource expense (ACFRE)** account. Unlike other accounts, the CFRE is adjusted for transactions subject to the successor corporation rules – discussed below – and a taxpayer claims a deduction in respect of its ACFRE and not in respect of its CFRE. Unless a taxpayer has been involved in a transaction that is subject to the successor corporation rules, its ACFRE will be the same as its CFRE.

Where a taxpayer disposes of a foreign resource property, the taxpayer may elect to deduct the proceeds from its ACFRE account in respect of that country. If the taxpayer chooses not to make the election, it will be required to include the amount of the proceeds in income. The latter option may be preferred if the taxpayer has **foreign exploration and development expenses (FEDE)**, or **non-capital losses** that might expire in the near future, or if the taxpayer is concerned about losing foreign tax credits.

In computing its income for a taxation year, the taxpayer may claim an optional deduction of up to 10 percent of the balance in its ACFRE account for a country (subject to proration for short taxation years), whether or not it has any foreign resource income for the year from that country. The maximum deduction is equal to the lesser of 30 percent of the ACFRE for the particular country (subject to proration for short taxation years) and the foreign resource income for that country. Where the taxpayer has an ACFRE account in respect of two or more countries, the taxpayer may also claim an additional deduction so that its maximum deduction (subject to proration for short taxation years) is equal to the lesser of 30 percent of its aggregate ACFRE balances in respect of all countries and its foreign resource income from all countries in the taxation year.

Successor Corporation Rules

The **successor corporation rules** (the "**SC** rules**"**) provide an exception to the basic scheme of the ITA restricting the deductibility of expenses to the taxpayer that incurred those expenses. The SC rules are a mixture of relieving and limiting legislation. They permit a corporation that acquires **all or substantially all** of the Canadian or foreign resource properties of another **person** to deduct any unused expenses of the transferor subject to the limitations described below. In this sense, the rules provide an exception to the basic premise of the ITA that only a taxpayer that incurs expenses may deduct them. At the same time, the SC rules impose limitations that may apply where a corporation participates in a reorganization or where a person or group of persons acquires **control** of the corporation.

The SC rules allow a purchaser (the **"successor"**) that acquires all or substantially all of the **Canadian resource properties** or **foreign resource properties** of a vendor (the **"original owner"**) to elect jointly with the vendor to treat any undeducted **resource expenses** of the vendor as successored expenses of the purchaser. The successor may apply successored expenses only against:

— income from production from, and

— proceeds of disposition of,

the properties acquired from the original owner.

Original Owner

The original owner is the person who originally incurred the particular resource expense. The original owner may be an individual, corporation, or other person. A **partnership** is not a person for the purposes of the SC rules; in addition, resource expenses are allocated to and deducted by the partners and not by the partnership. (See Structuring Mining Investments – Partnerships and Joint Ventures.)

The amount of qualifying expenses incurred by an original owner that are available to a successor in a taxation year is the aggregate of such expenses that were incurred by the original owner before it disposed of the particular property less the amount of such expenses:

— deducted by the original owner,

— deducted by any **predecessor owner** of the particular property, and

— deducted by the successor in computing its income for a preceding year.

Successor

A corporation that is entitled under the SC rules to deduct the expenses of another person is referred to as a successor. Only a corporation may be a successor. There is no requirement that a successor corporation be a **Canadian corporation**.

With respect to acquisitions of Canadian resource properties, a successor may claim the maximum allowable deduction in respect of CEE (up to 100 percent), CDE (30 percent per annum on a declining balance basis), and COGPE (up to 10 percent) if it has sufficient income from production or proceeds of disposition from the acquired properties to use those deductions. Any proceeds of disposition are deducted from and reduce the appropriate CCDE and CCOGPE account balances of the original owner that the successor corporation may deduct.

Similar rules apply to acquisitions of foreign resource properties; however, they may operate independently from the rules relating to Canadian resource properties.

Predecessor Owner

One of the complications of the SC rules is that they contemplate an infinite number of transfers and therefore an infinite number of successors. The link or links between the original owner that incurs resource expenses and the successor that may deduct the expenses is called a **predecessor owner**.

A predecessor owner of a **resource property** is a corporation that:

— acquired the property in circumstances in which the SC rules apply;

— disposed of the property in circumstances in which the SC rules apply; and

— but for the application of the SC rules, would have been entitled to deduct resource expenses incurred by an original owner of the property against income from production from, or proceeds of disposition of, the property in computing its income for a taxation year after it disposed of the property.

A corporation may be an original owner in connection with resource expenses that it incurred in respect of a property and may be a predecessor owner with respect to resource expenses that previous original owners of that property incurred. Example 1 illustrates this concept.

Provided that the property has been transferred from one corporation to another in accordance with the SC rules, the successor that owns the property in a given taxation year may claim the resource expenses incurred by each original owner against income from the property.

The SC rules work on a "pool" concept. They look at all of an original owner's expenses and the properties that it owns at the time it disposes of the properties in accordance with the rules. The SC rules do not track the expenditures to a particular property.

Suppose that in Example 1, Corporation A owned 10 Canadian resource properties (properties 1 through 10) but incurred resource expenses only on properties 1 through 5. If Corporation A transferred properties 1 through 10 to Corporation B in a transaction that satisfied the SC rules, Corporation B could deduct any expenses of Corporation A against income from all of properties 1 through 10, even though Corporation A did not incur any expenses on properties 6 through 10.

Suppose that Corporation B purchased property 11 and incurred expenses on that property, but did not incur expenses on properties 1 through 10. Suppose further that

EXAMPLE 1

Expenses Deductible to a Predecessor Owner and a Successor

In the sequence of transactions illustrated below, Corporation A transfers resource properties to Corporation B in accordance with the SC rules; Corporation B transfers resource properties to Corporation C in accordance with the SC rules; and Corporation C transfers resource properties to Corporation D in accordance with the SC rules.

Corporation A → **Corporation B** → **Corporation C** → **Corporation D**

— Each of Corporations A, B, and C is an original owner with respect to any expenses it incurs on the properties.

— Each of Corporations B and C is a predecessor owner with respect to any expenses that Corporation A incurred on the properties.

— Corporation C is a predecessor owner with respect to any expenses incurred by Corporation B on the properties.

— Corporation D is the successor with respect to the expenses that Corporations A, B, and C incurred on the properties.

Corporation B sold properties 1 through 5 and property 11 in transactions that were not subject to the SC rules (because they did not constitute the sale of all or substantially all of Corporation B's Canadian resource properties) and then sold properties 6 through 10 to Corporation C in a transaction that was subject to the SC rules. Corporation C could deduct the SC expenses of Corporation A against income from properties 6 through 10 notwithstanding that Corporation A had not incurred any of those expenses on those properties. Corporation C could also deduct any undeducted expenses of Corporation B that Corporation B had incurred on property 11 against income from properties 6 through 10, even though Corporation B had not transferred property 11 to Corporation C.

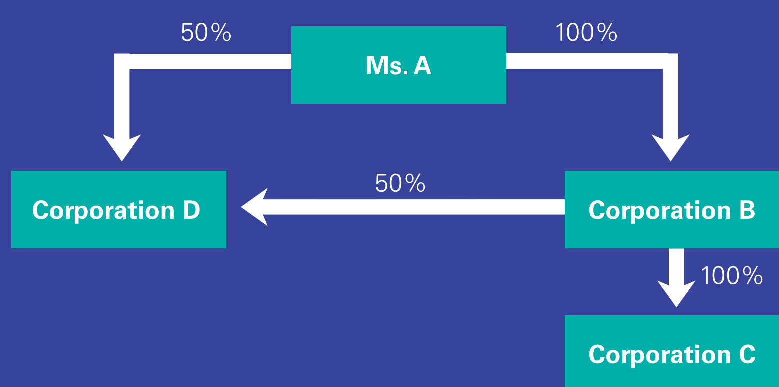
Amalgamations

Where there is an amalgamation of two or more corporations, the new corporation is a successor to each of its predecessor corporations, and the SC rules apply to the deduction by the new corporation of the resource-related expenses of each of the predecessor corporations. There is an exception to this rule where there is an amalgamation of a corporation and one or more of its subsidiary wholly-owned corporations, or an amalgamation of two or more corporations, each of which is a subsidiary wholly-owned corporation of the same person. In such circumstances, the new corporation is deemed to be the same corporation as, and a continuation of, each amalgamating corporation.

EXAMPLE 2

Structure Allowing for a Qualifying Amalgamation of Wholly-Owned Subsidiaries

Ms. A owns all of the outstanding shares of Corporation B, Corporation B owns all of the outstanding shares of Corporation C, and each of Ms. A and Corporation B owns 50% of the outstanding shares of Corporation D. The corporate organization is as follows:



— Ms. A is the "parent."

— Corporation B is a subsidiary wholly owned corporation of Ms. A.

— Corporation C is a subsidiary wholly owned corporation of Ms. A.

— Corporation D is a subsidiary wholly owned corporation of Ms. A.

— Corporation C is a wholly owned subsidiary of Corporation B.

Since all of the corporations are subsidiary wholly owned corporations of Ms. A, any amalgamation of two or more of the corporations will satisfy the conditions for the exception to apply and will not be subject to the limitations of the SC rules.

For these purposes, a subsidiary wholly-owned corporation of a person (the "parent") is a corporation, all of the issued and outstanding shares of which belong to the parent, to a corporation that is itself a subsidiary wholly-owned corporation of the parent, or to any combination of persons, each of which is a parent or a subsidiary wholly-owned corporation of the parent.

Since "person" includes a reference to an individual and not just to a parent corporation, a corporation can be a subsidiary wholly-owned corporation of an individual. Consequently, an amalgamation of two or more corporations, all shares of which are owned by the same individual, will satisfy the conditions for the exception. Example 2 illustrates such a situation.

Where the exception applies, the new corporation may deduct the expenses of a predecessor corporation on the same basis as each of the predecessor corporations. Consequently, the amalgamated corporation will be able to claim any expenses that a predecessor corporation could have claimed as its own expenses. Since the SC rules apply to an amalgamation unless the exception applies, it is advisable, if possible, to implement a corporate reorganization as an amalgamation that qualifies for the exception.

Wind-Ups

The ITA permits a tax-deferred wind-up of a Canadian subsidiary into its parent where certain conditions are met. (This provision is discussed later in Structuring Mining Investments – Corporate Reorganizations.)

Where a parent winds up a subsidiary corporation in accordance with the tax-deferral rules, the parent is deemed to be the same corporation as, and a continuation of, the subsidiary. As a result, the parent can claim the resource-related deductions of the subsidiary under the SC rules. Even if the subsidiary's own resource-related expenses at the time of winding up exceed the fair market value of the resource properties of the subsidiary, the parent will be entitled to deduct the full amount of those expenses.

Where a corporation is wound up and the tax-deferral rules do not apply, the wound-up corporation is deemed to have distributed all of its resource properties at their fair market value. If it is possible for the wound-up corporation to transfer all or substantially all of its Canadian or foreign resource properties to one corporation, that person could be a successor corporation to the wound-up corporation.

Acquisition of Control

The SC rules apply on an acquisition of control of a corporation to treat the corporation as a successor to itself. As a result, the corporation is in the same position that it would have been in if it had acquired all of its property from another corporation with the same resource expenses and properties, which it had owned immediately prior to the acquisition of control, and it had elected to have the SC rules apply.

The ITA contains relieving provisions that provide for exceptions to the effect of the SC rules on an acquisition of control of a corporation.

Designations Among Corporations

A "transferor corporation" may make a designation in respect of its income from resource properties it owns immediately before an acquisition of control in favour of a "transferee corporation" for any taxation year ending after the acquisition of control. The transferee must be either the parent corporation or a subsidiary wholly-owned corporation of the transferor corporation, or of a corporation that is a wholly-owned subsidiary of the person who is a parent of the transferor corporation throughout the taxation year.

The transferee may use the designated income to compute the amount of the deduction that it is entitled to claim in respect of its successored resource expenses that it incurred while it was a parent or subsidiary wholly-owned corporation of the transferor. This designation is advantageous in a situation where one member of a corporate group had resource expenses but no property prior to an acquisition of control. The designation causes income that is from a resource property to lose that character to the transferor corporation and to cause income of the transferee to take on that character. The designation does not cause income of the transferor to become income of the transferee.

Partnership Income

When a partnership owns **resource property**, a partner of the partnership does not have an interest in that property as a result of having an interest in the partnership. In addition, a partnership cannot deduct any resource expenses that it incurs, but instead allocates those expenses to the partners at the end of the taxation year of the partnership. But for specific relieving provisions in the SC rules, a corporation could not apply any of its **resource expenses** existing immediately prior to an acquisition of control against income from and proceeds

of disposition of resource properties owned by a partnership in which it had an interest immediately prior to the acquisition of control.

The relieving provision treats the corporation as having owned, immediately before the acquisition of control, a portion of the resource property owned by the partnership at the time of the acquisition of control equal to its percentage share of the aggregate of amounts that would be paid to all members of the partnership if it were wound up at that time.

In addition, for taxation years ending after the acquisition of control, a partner's share of the income of the partnership is deemed to be income of the corporation for the year attributable to production from the property. The corporate partner's share of income of the partnership for such purposes is the lesser of its share otherwise determined and the amount that would be its share of the income of the partnership if that share were determined on the basis of the corporate partner's percentage entitlement to the property of the partnership on a wind-up of the partnership.

A similar issue arises where there is an amalgamation of corporations that are not subsidiary wholly-owned corporations of a person and one of the corporations is a partner of a partnership. In this situation, the amalgamated corporation is entitled to a similar relieving provision.

Capital Cost Allowance

Calculation of Capital Cost Allowance

The **capital cost allowance (CCA)** provisions in the ITA allow a taxpayer to claim an annual deduction in respect of **depreciable property** owned at the end of the taxation year. Each depreciable property is allocated to a class, and the amount of the deduction varies according to the class in which the property belongs. For most classes, the CCA deduction that may be claimed in a particular year is calculated on a declining balance basis. Any balance remaining in the particular class at the end of a taxation year is referred to as **undepreciated capital cost (UCC)** and represents the opening balance for the following taxation year.

The UCC balance for each class is adjusted each year to reflect any acquisitions or dispositions of property in that class. For acquisitions, the balance is increased by the net cost of additions in the year; however, for some classes, a "half-year rule" applies that limits the increase in the year of acquisition to one-half of the net cost for purposes of computing CCA for that year. For dispositions, the UCC balance is reduced by the lesser of the proceeds of disposition and the original capital cost of the property.

The capital cost of a property for the purposes of calculating CCA may be reduced by the amount of any assistance that the taxpayer receives or is entitled to receive from a government, municipality, or public authority in respect of or for the acquisition of the property, less any amount of such assistance that the taxpayer has repaid. **Investment tax credits (ITCs)** claimed in respect of a particular property will also reduce the UCC. (ITCs are discussed in a separate section below.)

An asset is not added to a particular class and CCA cannot be claimed until the asset is available for use. An asset is considered available for use when it is first used for an income-earning purpose. Since the construction of a mine may take many years, there are special rules that allow acceleration of the time at which depreciable property is considered available for use. These rules permit the taxpayer to start claiming CCA during the lengthy construction period. Special rules also allow public corporations to start claiming CCA when depreciation is first claimed for financial reporting purposes.

There are relatively few CCA classes that are particularly relevant to the mining industry. **Most depreciable property** has historically been included in Class 41. However, the classification of mining assets into the CCA classes was made more complex by the introduction of Class 41.2 in 2013 to implement the elimination of the **accelerated capital cost allowance** for depreciable property acquired after March 20, 2013, as discussed further below. Class 41 and Class 41.2 are separated into subcategories, the most relevant of which are as follows:

— Class 41(a): Includes buildings, machinery, and equipment acquired for the purpose of producing income from a mine operated by the taxpayer and situated in Canada, and that was acquired prior to the commencement of production of a new mine or mines, or for a major expansion of an existing mine. A major expansion is an increase in mill capacity of 25 percent.

— Class 41(a.1): Includes property that is the same type as property included in Class 41(a) but that does not belong to Class 41(a) because it was acquired for a producing mine (rather than for a new mine or for an expansion of an existing mine). The portion of the cost of property added to Class 41(a.1) is the cost of the property that became available for use in a year in excess of 5 percent of gross revenue from the mine for the year (subject to gross-up for short taxation years). Example 3 illustrates the calculation.

— Class 41(b): Mining property that is not described in Class 41(a) or Class 41(a.1) is included in Class 41(b).

— Class 41.2(a): Property that is described in Class 41(a) or (a.1), and that is acquired after March 20, 2013 and before 2021, unless it is an **eligible mine development property.**

— Class 41.2(b): Property that is described in Class 41(a) or (a.1), and that is acquired after 2020.

The CCA rate for Class 41 and Class 41.2 is 25 percent. However, a taxpayer is entitled to claim an additional amount of CCA **(accelerated capital cost allowance, or ACCA)** of up to 100 percent in respect of property belonging to Class 41(a) and (a.1), and Class 41.2(a). The ACCA claim cannot exceed the lesser of:

— the taxpayer's income from the new mine or mines, before resource deductions, minus the regular CCA deduction claimed for the year, and

— the remaining UCC in the class, without reference to the half-year rule.

The calculation of ACCA is illustrated in Example 4.

ACCA for property added to Class 41.2 is being phased out over the 2017 to 2020 calendar years in accordance with the schedule set out in Table 5.

Oil sands property is included in Class 41.1. Class 41.1 has a CCA rate of 25 percent. ACCA in respect of oil sands property was phased out by 2014.

EXAMPLE 3

Calculation of Eligible Costs for Class 41(a.1)

A corporation earns gross revenues of $10 million from a mine and incurs expenditures on Class 41 property of $8 million. It is entitled to add to Class 41(a.1) 93.75 percent of $8 million or $7.5 million. This percentage is the percentage that $7.5 million (the expenditures in excess of 5 percent of the gross revenue) is of $8 million.

EXAMPLE 4

Calculation of ACCA

A corporation incurs capital costs of $100 million on Class 41(a) and 41(a.1) assets to bring a mine into production. In the year it acquires the assets, the corporation does not claim any CCA. In the first year of operation, the mine earns $40 million. The corporation may claim CCA of $25 million, so that its income from the mine is $15 million and its UCC balance is $75 million. It can then claim an additional deduction of $15 million, reducing its income to nil and the UCC balance to $60 million.

Table 5: Phase-Out Percentage for Accelerated Capital Cost Allowance for Mining, 2016–2020

Calendar Year	Percentage
2015 through 2016	100
2017	90
2018	80
2019	60
2020 and after	0

Capital Cost Allowance for Industrial Mineral Mines

Industrial mineral mining operations are excluded from the federal mining tax system unless the industrial mineral qualifies as a mineral resource, which includes potash. The term "industrial mineral" is not defined in the ITA but is generally understood to mean non-metallic minerals capable of being used in industry. Some of the most common industrial minerals include gravel, sand, potash, sulphur, graphite, clay, and asbestos. The Minister of Natural Resources (Canada) may certify a non-bedded industrial mineral as a mineral resource. As a result, industrial mineral mines will primarily include only bedded deposits.

The taxation of the operating income and capital gains associated with the production of industrial minerals that do not qualify as mineral resources is similar to the general taxation of business income under the ITA.

The CCA provisions apply to the capital cost to the taxpayer of an industrial mineral mine that is not a mineral resource, and to a right to remove industrial minerals from an industrial mineral mine. The deductible amount in a taxation year is calculated in accordance with the **Regulations**.

The applicable CCA rate depends on whether a taxpayer has been granted an allowance in respect of an industrial mineral mine or a right to mine an industrial mineral mine for a previous year. If the taxpayer has not been granted an allowance or right for a previous year, the rate is based on the capital cost of the mine, the residual value of the mine, and the number of units of commercially mineable material estimated as being in the mine when the mine or right was acquired (or the number of units subject to the right where a right to remove only a specified number of units was acquired). Where an allowance has been granted in a prior year, the same rate is used unless it has been established that:

— the number of units of material remaining to be mined in the previous taxation year was in fact different from the quantity that was employed in determining the rate for the most recent year for which an allowance was granted, or

— the capital cost of the mine or right is substantially different from the amount that was employed in determining the rate for the previous year.

The disposition of an industrial mineral mine is considered to be on income account or on account of capital, depending on the facts in the particular case.

Flow-Through Shares

The **flow-through share** provisions are an exception to the basic scheme of the ITA that only the taxpayer that incurs an expense may deduct the expense.

The concept of a flow-through share is that an investor enters into an agreement with a **principal-business corporation** to subscribe for shares of the corporation, and the corporation uses the subscription funds to incur **qualifying CEE** or **qualifying CDE**, which it then renounces to the investor.

In most arm's-length situations, an investor will want only CEE, because of the rapid write-off available for these expenses in contrast to the comparatively slow write-off for CDE. Therefore, in an arm's-length agreement between the corporation and the investor, the corporation will warrant that it will incur CEE and renounce those expenses to the investor.

For a share of a corporation to be a flow-through share, it must:

- be a share or a right to acquire a share of a principal-business corporation;
- not be a prescribed share or a prescribed right; and
- be issued by the corporation to an investor pursuant to an agreement in writing under which the corporation agrees to incur CEE or CDE and to renounce such expenses to the investor.

It is not entirely clear from the definition precisely when the corporation must qualify as a principal-business corporation. Therefore, for certainty, the agreement with the investor will require the corporation to warrant that it will be a principal-business corporation at all relevant times and that it will provide an indemnity to the investor if the investor is not entitled to the expenses renounced by the corporation.

The flow-through share concept is a tax concept, not a corporate concept. There is nothing in the corporate constating documents that would indicate that a share is a flow-through share. A share will be a flow-through share only to the **person** that enters into the agreement with the corporation, and not to any subsequent purchaser. Provided that a share is not a prescribed share (as determined under the **Regulations**), the share can have any attributes that the corporation and the investor choose. However, the Regulations are so detailed and restrictive that, effectively, only voting and non-voting common shares can be flow-through shares.

The corporation can renounce only the qualifying expenses incurred during the period commencing on the day the agreement is entered into and ending 24 months after the end of the month that includes that day. Investors in public transactions will require that the corporation renounce the expenses for the year in which the investor subscribes for shares. The amount of CEE or CDE renounced to the investor is limited to the amount that the investor paid for the shares.

Although it is not necessary that the investor contribute its subscription proceeds to the corporation at the time the agreement is entered into, the subscription proceeds must be advanced before the corporation may issue the shares.

A corporation may not renounce as CDE the cost of acquisition of a **Canadian resource property**.

Where a corporation renounces CEE or CDE to an investor, the corporation is deemed never to have incurred those expenses.

The Look-Back Rule

The look-back rule permits a corporation that incurs specific **grassroots CEE** in a calendar year to renounce those expenses to an investor effective December 31 of the previous calendar year. The expenses are then considered to have been incurred by the investor in that previous calendar year.

For the look-back rule to apply to an expense:

- the agreement must have been made in the calendar year preceding the year in which the expense is incurred;
- the investor must have paid the consideration for the share in that preceding calendar year; and
- the corporation and the investor must deal with each other at arm's length.

The effect of the look-back rule is to accelerate the deduction of CEE renounced to the investor. To compensate the government for the potential loss of tax revenue, the corporation is subject to an additional tax under Part XII.6 of the ITA. A summary of the Part XII.6 rules is provided on the following page.

Stacking Arrangements

A stacking arrangement allows a public corporation to renounce CEE or CDE incurred by a subsidiary where the parent and the subsidiary are both principal-business corporations. In a stacking arrangement, the parent issues flow-through shares to the public and the subsidiary issues flow-through shares to the parent. The subsidiary incurs **resource expenses** and renounces those resource expenses to the parent. The parent then renounces to the purchasers of its flow-through shares the expenses incurred by the subsidiary and renounced to the parent.

The look-back rule permits a subsidiary to renounce qualifying CEE to the parent in one year, which the parent can in turn renounce to the purchasers of its flow-through shares effective the previous year.

Part XII.6 Tax: Summary of the Rules

Application

As a result of the look-back rule, where a corporation renounces CEE or CDE in a particular calendar year, the investor is deemed to have incurred the expenses in the preceding year and is entitled to deduct them in computing the tax payable for that year. The corporation, however, is required to incur expenses only before the end of the calendar year in which the renunciation is made. This difference in timing potentially results in a loss of tax revenue to the government, from the tax saving to the investor and the deferral of expenditures by the corporation. Part XII.6 therefore imposes a tax on the corporation, to compensate the government for the acceleration of the deduction provided to the investor.

Calculation of Tax

Tax is payable for each month after January of the calendar year in which the renunciation is made and at the end of which all the expenses have not been incurred. The tax for a month is the product of:

— the amount of the expenses that have not yet been incurred by the end of the relevant month

multiplied by

— the quotient obtained by dividing the prescribed rate of interest by 12.

In addition, if the corporation has failed to incur the renounced expenses by the end of the year, the corporation is liable to pay a tax in an amount equal to 10 percent of the unspent amount.

Use of a Limited Partnership

A **limited partnership** is often used to subscribe for flow-through shares in a number of different corporations. For the purposes of the flow-through share rules, a partnership is a person.

In a typical transaction, after the limited partnership has renounced the CEE or CDE, it transfers the shares on a tax-deferred basis to a corporation that qualifies as a mutual fund corporation. The partnership is then dissolved, also on a tax-deferred basis. From the viewpoint of an investor, one advantage of this arrangement is increased liquidity in respect of the investment. Another is that the investor's risk is spread over several share issues instead of being concentrated in a single issue.

Dispositions of Flow-Through Shares

The cost of a flow-through share to an investor is deemed to be nil. In most circumstances, flow-through shares will be considered capital property to the investor. Accordingly, the investor will realize a **capital gain** on disposition equal to the full proceeds from the sale of the shares.

Advantages and Limitations of Flow-Through Shares

For the Investor

Advantages

An investor is entitled to deduct from income renounced CEE or CDE equal to the full amount it paid for the flow-through shares. In addition, the investor may be able to claim an investment tax credit (ITC) as discussed below. As a result, the cost of the shares on an after-tax basis will be less than the cost of similar shares acquired on an ordinary subscription basis.

Limitations

There are no particular income tax disadvantages to an investor acquiring flow-through shares; however, under securities legislation, it may be necessary for the investor (that is, the original purchaser of the shares) to hold the shares for a particular period of time. As a result, if the shares start to decline in value, the investor may not be able to dispose of the shares immediately and limit the loss.

For the Corporation

Advantages

Because of the tax saving available to the investor from the deduction of the renounced expenses, flow-through shares can be issued at a premium over the subscription price for ordinary shares of the corporation. The amount of the premium will depend upon market forces. There is less dilution as a result of the issuance of flow-through shares.

Limitations

A corporation is not entitled to renounce expenses other than CEE or CDE. This restriction limits the utility of flow-through shares for a corporation engaged in mining, since a substantial portion of any funds used to bring a mine into production will be used to acquire **depreciable property**. In addition, flow-through shares cannot be issued to raise funds for general corporate purposes. To overcome these disadvantages, a corporation will frequently issue a unit consisting of a flow-through share and an ordinary common share. The corporation can then use the proceeds from the ordinary share portion for general corporate purposes and to acquire depreciable property.

There is also a potential tax cost to the issuance of flow-through shares, since the corporation is giving up deductions to which it would otherwise be entitled. The corporation must therefore consider whether the premium paid on the shares is sufficient to outweigh the increased incidence of tax resulting from the renunciation of CEE or CDE.

Investment Tax Credits

A taxpayer is entitled to a federal or provincial **investment tax credit (ITC)** when it incurs specified expenditures. A taxpayer may deduct ITCs against its tax payable. A dollar of ITC will reduce a taxpayer's tax payable by one dollar, whereas a dollar of deduction will reduce the tax payable only by one dollar multiplied by the tax rate; therefore, a dollar of ITC is more valuable than a dollar of deduction. In very limited circumstances, the ITA allows taxpayers to obtain cash payment for ITCs.

The credits described below require a taxpayer to incur CEE. For federal tax purposes, a taxpayer deducts any ITC claimed from its CCEE account in the year following the year in which it claims the credit. The overall result is that a taxpayer is entitled to a credit and a deduction equal to the expenditure less the amount of the credit. For example, a taxpayer that incurs CEE of $100 as a **pre-production mining expenditure** is ultimately entitled to an ITC of $10 and a deduction for CEE of $90.

Any provincial tax credits reduce the amount of the federal tax credits.

A taxpayer may currently carry forward federal unused ITCs for 20 years, although most of the mining credits are being phased out.

Pre-Production Mining Expenditures

Currently, taxable **Canadian corporations** are entitled to limited ITCs in respect of certain pre-production mining expenditures they incur. Pre-production mining expenditures are CEE incurred on a mineral deposit from which the principal mineral to be extracted is diamonds, base metals, or precious metals. A taxpayer is not entitled to an ITC in respect of any CEE that it renounces under a **flow-through share** agreement.

ITCs in respect of pre-production mining expenditures are being phased out. Since 2014, taxable Canadian corporations have not been entitled to an ITC for mining **grassroots CEE**.

However, ITCs can be claimed for mine development CEE, subject to the following limitations. Except where a corporation entered into a written agreement to incur costs in respect of a new mine prior to March 29, 2012, taxable Canadian corporations will be entitled to ITCs in respect of pre-production mining development expenditures at the rate of:

- 4 percent for such expenses incurred in 2015, and
- nil after 2015.

A corporation that entered into a written agreement to incur mine development costs in respect of a new mine prior to March 29, 2012 will be entitled to ITCs at the rate of 10 percent in respect of costs incurred prior to 2016.

Flow-Through Mining Expenditures

A taxpayer's federal ITC includes 15 percent of the taxpayer's **flow-through mining expenditures**. A flow-through mining expenditure is an expenditure allocated to an individual, to which the individual is entitled by virtue of a flow-through share agreement renouncing **qualifying CEE** incurred by a corporation to the individual or to a **partnership** of which the individual is a member. Only an individual may have a flow-through mining expenditure. For these purposes, an individual does not include a trust.

The expenditure must be CEE incurred before 2016 and flow-through investors must have entered into a flow-through share agreement with the corporation on or before March 31, 2016 (including, for greater certainty, an expense that is deemed by the look-back rule to have been incurred before 2016) by a corporation conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence or location of a mineral resource. (The look-back rule is discussed in Deductions, Allowances, and Credits – Flow-Through Shares.)

Only specific grassroots CEE may qualify as flow-through mining expenditures.

Where a corporation renounces grassroots CEE in a given year in accordance with the look-back rule, it is deemed to have incurred the expenses on December 31 of the prior year. A corporation that incurs such expenses in 2016 and renounces them in January, February, or March of that year, pursuant to an agreement made before April 1, 2015, may be deemed to have incurred and renounced the expenses effective December 31, 2015 for the purposes of the flow-through mining expenditure provisions. In this situation, an individual may claim ITCs for 2015 with respect to flow-through mining expenditures that are renounced in accordance with the look-back rule.

Atlantic Tax Credit

A taxpayer is entitled to an ITC for qualified resource property acquired for use in the mining industry in Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland and Labrador, the Gaspé Peninsula, or a prescribed offshore region. This ITC is also being phased out.

Under grandfathering provisions introduced in 2012, expenses incurred before 2017 for qualified resource property may earn ITCs at the rate of 10 percent if they are incurred in respect of qualified resource property acquired:

- under a written agreement entered into before March 29, 2012; or
- as part of a phase of a project if construction or engineering and design work was started before March 29, 2012.

Phase-in provisions also have been introduced for the implementation of the new rules. The specified percentage applicable to qualified resource property that is not grandfathered is:

- 10 percent if the property is acquired after March 28, 2012 and before 2014, and
- in any other case:
  - 5 percent in 2014 and 2015, and
  - 0 percent after 2015.

Scientific Research and Experimental Development Credit

The Scientific Research and Experimental Development **(SR&ED)** Program is designed to encourage Canadian companies to conduct research and development **(R&D)** activities in Canada that will lead to new, improved, or technologically advanced products or processes. The SR&ED program provides tax incentives in the form of deductions in computing income, and ITCs based on the amount of expenditures incurred on eligible R&D activities.

Eligible SR&ED expenditures may include wages, materials, machinery, equipment, some overhead, and third-party R&D contracts. Only 80 percent of contract payments constitute eligible expenditures. After 2013, eligible expenditures have not included capital expenditures.

Corporations (other than **Canadian-controlled private corporations**) that incur eligible SR&ED expenditures may claim a non-refundable federal ITC equal to 20 percent. Corporations that are Canadian-controlled private corporations are entitled to ITCs of up to 35 percent and are entitled to a refund of all or a portion of the credit.

Provincial R&D tax credits may also be available ranging from 4.5 percent in Ontario to 37.5 percent in Québec.

A taxpayer may carry forward unused federal ITCs for 20 years and carry back such federal ITCs for 3 years.

The SR&ED program covers technological projects carried out with the objective of creating or improving materials, devices, products, and processes, or solving problems of a technical nature, provided that they meet all of the following criteria:

- Scientific or technological advancement: The activity is carried out to create a new product or a new process or to improve an existing product or process, and the activity must generate information that brings a scientific or technological advancement to the corporation.
- Scientific or technological uncertainties: Based on generally available scientific or technological knowledge or experience, it is not known whether a given result or objective can be achieved, or how to achieve it.
- Scientific or technological content: There must be evidence that qualified personnel with relevant experience in science, technology, or engineering have conducted a systematic investigation through means of experimentation or analysis.

The success or failure of the R&D activities is not important in determining whether the work undertaken is eligible for SR&ED ITCs.

In the mining context, R&D relating to the following activities may qualify for the SR&ED program:

- extraction and processing methodologies;
- geophysical and geochemical analysis methods;
- modelling and seismic interpretation;
- climate and topographical constraints (permafrost, geological formations);
- site remediation technologies developed for unique applications (acid drainage, forestation);
- efficiency improvements in general mining operations;
- equipment development; and
- blasting, explosive, and detonation technology.

To make an SR&ED claim, it is necessary to maintain documentation to support the work undertaken in order to meet the three criteria above.

Qualifying Environmental Trusts

A taxpayer may deduct reclamation expenses in respect of a **mining property** only at the time the expense is actually incurred. Historically, this has been after the mine has ceased production and is no longer generating income. Consequently, taxpayers in the mining industry have often been placed in a position where they have no income against which to deduct the reclamation expense. The **qualifying environmental trust (QET)** provisions of the ITA (and some provincial statutes) provide a mechanism allowing a taxpayer to set aside funds for future reclamation obligations and obtain a current deduction for the amount set aside.

The sole purpose of a QET must be for funding the reclamation of a site in Canada that had been used primarily for, or for any combination of:

— the operation of a mine;

— pipeline abandonment;

— the extraction of clay, peat, sand, shale, or aggregates (including dimension stone and gravel); or

— the deposit of waste.

The following is a summary of the QET rules:

— A taxpayer is entitled to a deduction for an amount contributed to a QET. There is no limitation on the amount that a taxpayer may contribute to a QET.

— Income earned in the QET is taxed at the trust level. However, the beneficiary is also required to report the income as if it had been earned directly, subject to the receipt of a refundable credit for tax already paid by the trust.

— When funds are withdrawn from a QET, the beneficiary is required to include amounts received from the QET in computing its income. However, there should be an offsetting deduction for reclamation costs actually incurred.

— A vendor is required to include in income and a purchaser may deduct any consideration paid to a vendor for the acquisition of an interest as a beneficiary under a QET. Such consideration does not include consideration that is the assumption of a reclamation obligation in respect of the trust.

To qualify as a QET, the trust may invest only in qualified investments.

Provincial Flow-Through Mining Tax Credits and Deductions

Some provinces also provide tax credits or deductions to individuals who invest in **flow-through shares**.

British Columbia

The credit is non-refundable and equal to 20 percent of eligible **flow-through mining expenditures** incurred in British Columbia in the current year and before 2016 (or deemed to be incurred). Unused tax credits can be carried back for 3 years and forward for 10 years.

Saskatchewan

The credit is non-refundable and equal to 10 percent of eligible flow-through mining expenditures incurred in Saskatchewan in the current year. Unused tax credits can be carried back for 3 years and forward for 10 years.

Manitoba

The credit is non-refundable and equal to 30 percent of eligible flow-through mining expenditures incurred in Manitoba in the current year and before 2016. Unused tax credits can be carried back for 3 years and forward for 10 years. The provincial government must approve the issuance of the credit.

Ontario

The credit is refundable and equal to 5 percent of eligible flow-through mining expenditures incurred in Ontario in the current year.

Québec

In addition to the base deduction of 100 percent of the acquisition cost, a deduction of 10 percent is allowed where exploration expenses are incurred in Québec, and an additional deduction of 10 percent is allowed where the expenses incurred are for surface mining exploration. To access these additional deductions, the issuing corporation must not, at the time it incurred the expenses and throughout all of the preceding 12 months, have operated a mineral resource.

Other Provincial Credits and Adjustments

British Columbia Mining Exploration Tax Credit

Corporations and active members of **partnerships** conducting mineral exploration in British Columbia may qualify for the **mining exploration tax credit (METC)**.

The METC is a refundable tax credit equal to 20 percent of qualified mining exploration expenses incurred in excess of any assistance received. An additional 10 percent credit is currently available for qualified mineral exploration undertaken in prescribed areas affected by the mountain pine beetle. This additional credit is set to expire on December 31, 2016.

Qualified mining exploration expenses include costs incurred before January 1, 2017 for the purpose of determining the existence, location, extent, or quality of a mineral resource in British Columbia. The credit applies to exploration for all base and precious metals, coal, and some industrial minerals.

Québec Resource Tax Credit

A corporation that incurs exploration expenses in Québec may be entitled to claim a Québec resource tax credit. The credit is refundable and varies between 12 percent and 31 percent, depending on the location of the mine and whether the corporation previously operated a mine. Eligible exploration expenses are expenses incurred for the purpose of determining the existence, location, extent, or quality of a mineral resource in Québec. An increase in the tax assistance granted by the refundable tax credit for resources will be available for corporations that wish to avail themselves of such assistance in exchange for an option allowing the government of Québec to acquire an equity stake in the development. These corporations may claim an additional credit of 10 percent for eligible expenses. This option will be managed by Resources Québec.

The credit is treated as a payment by the corporation on account of its tax payable for the year. That is, the credit is applied first against any taxes owing for that year, and any excess is refunded to the corporation. Exploration expenses that have been renounced under a **flow-through share** agreement are not eligible for the resource tax credit.

However, if shareholders subscribing to the flow-through shares are non-residents of Québec, it may be possible for the corporation to claim the Québec resource tax credit.

Credits claimed are government assistance and are subject to federal and Québec income tax and Québec mining tax (discussed under Provincial Mining Tax) as either an income inclusion or a reduction of the applicable resource expenditure account.

Québec Investment Tax Credit

An eligible corporation that acquires a qualified property may receive a Québec investment tax credit ranging between 4 percent and 32 percent for investments relating to manufacturing and processing equipment used in certain regions. To qualify for the tax credit, the property must be:

- acquired after March 20, 2012 and before January 1, 2023;
- included in CCA Class 29; and
- acquired for use:
  - exclusively in Québec, and
  - primarily in the course of ore smelting, refining, or hydrometallurgy activities, other than ore from a gold or silver mine, extracted from a mineral resource located in Canada.

Ontario Resource Allowance Adjustment

Prior to May 7, 1974, royalties and taxes paid by a corporation to a provincial government in respect of the extraction of natural resources were deductible in computing income for the purposes of the ITA. In 1974, in response to soaring commodity prices, provincial governments substantially increased their royalties and taxes. This had the effect of substantially reducing the federal tax base. The federal government initially reacted by disallowing the deduction of provincial royalties and taxes and providing for an abatement. It subsequently replaced the abatement with the resource allowance, effective January 1, 1976. The resource allowance was 25 percent of resource profits as computed under the **Regulations**.

The federal government reversed its policy in 2002. It removed the resource allowance from the ITA and again allowed a federal deduction for provincial resource royalties and taxes.

At the time, Ontario also had a policy of providing tax incentives and preferences to stimulate the development of the province's mining resources.

Ontario therefore chose not to adopt the new federal regime, but continued to allow the resource allowance for provincial purposes.

The harmonization of legislation required that income for the purposes of the Ontario legislation be the same as income under the ITA. However, Ontario wanted to maintain its distinct treatment of its mining industry. As a result, the harmonization legislation provides for additional tax and additional credits to put the taxpayer in the same position that it would have been in if the federal government had made no change to the resource allowance. Where the mining taxes are greater than the resource allowance to which the taxpayer would have been entitled, the taxpayer must pay additional tax. Where the resource allowance is greater than the mining taxes, the taxpayer is entitled to a credit. The amount of tax or credit depends upon the Ontario rate of tax and the portion of income allocable to Ontario. Credits not used in a year may be carried forward and applied in other years.

Effective April 23, 2015, Ontario has harmonized with the federal government by removing the resource allowance adjustment. Any accrued but unused credits are eligible for carry forward to offset Ontario income tax payable in the first five taxation years beginning after April 23, 2015.

Structuring Mining Investments

A key decision for investors in the mining industry is what structures to use for holding resource properties, carrying out exploration and development activities, and conducting mining operations.

The most common structures used by investors in mining projects in Canada are corporations, **partnerships**, and **joint ventures**. For direct investments in projects or operations outside Canada, Canadian residents can choose to operate through a branch of a Canadian corporation or through a foreign-incorporated subsidiary; similar options are available to non-residents investing directly in Canadian mining operations. Alternatively, investments can be made indirectly through the purchase of interests in partnerships or shares in holding corporations. (While trusts are also an option, they lack the flexibility and tax advantages of other structures.)

The decision will depend on the investor's objectives, including the desired return, the intended duration of the investment, and whether the investor seeks a **controlling** or a minority interest. Potential tax advantages associated with the choice of a particular structure in the particular circumstances are relevant to the decision. For example, there may be opportunities to defer or reduce Canadian tax liabilities by reorganizing **resource property** holdings or transferring assets to more tax-favoured entities. In the case of foreign property holdings, tax benefits may be available for certain holding arrangements or transactions under an applicable tax treaty.

This section highlights some tax-planning strategies that might be considered by Canadian residents and non-residents in structuring their mining investments.

Corporate Reorganizations

The **ITA** contains rules related to tax-deferred corporate reorganizations that are applicable to all industries. However, certain aspects of these rules are particular to corporations carrying on a mining business. In some circumstances, the rules limit the type or flexibility of reorganizations available to such corporations. One example is the successor corporation rules, discussed earlier, which may limit the deductibility of **resource expenses** of a corporation after a corporate reorganization. (See Deductions, Allowances, and Credits – Successor Corporation Rules.)

In other circumstances, the rules provide planning opportunities or greater flexibility in restructuring **resource property** holdings within a corporate group. In the case of corporate reorganizations involving resource properties held at the **partnership** level, the ITA provides that resource tax accounts are to be computed at the partner level, with the result that resource expenditures incurred by a partnership are automatically flowed out to partners at the end of the fiscal period of the partnership. This is different than the treatment of **UCC** balances, which are computed at the partnership level.

Tax-Deferred Transfers

Where a taxpayer transfers an eligible property to a taxable **Canadian corporation** for consideration that includes shares of the corporation, the transferor and the corporation may jointly elect under the ITA an amount ("the elected amount") that is then deemed to be the transferor's proceeds of disposition and the corporation's cost of the property. Similar rules apply to the transfer of an eligible property by a partnership to a corporation. For the purpose of these provisions, an eligible property includes a **Canadian resource property** and a **foreign resource property**.

Elected Amount

The elected amount cannot:

— exceed the fair market value of the property transferred, or

— be less than the fair market value of the non-share consideration received by the transferor on the transfer.

For most property, the elected amount also cannot be less than the lesser of the tax cost of the transferred property and the fair market value of the property.

Usually, the transferor and the transferee will elect an amount that will not result in an income inclusion for the transferor. For example, where the property transferred is a **non-depreciable capital property**, the elected amount will usually be the adjusted cost base of the property. A **resource property** has no cost associated with it since its cost is added to the relevant account of the transferor. As a result, the parties may elect nominal proceeds.

In a straightforward situation in which the transferor has incurred only **CEE** and **CDE** (discussed in Deductions, Allowances, and Credits), the elected amount in connection with a transfer of a Canadian **mining property** will be an amount not exceeding the aggregate of the **CCDE** and **CCEE** accounts of the transferor. In the case of an oil sands property, it will be an amount not exceeding the aggregate of the CCEE, CCDE, and **CCOGPE** accounts of the transferor. Similar considerations will apply to the transfer of foreign resource properties.

Amalgamations

Federal and provincial corporate statutes provide rules that apply where two or more corporations amalgamate and become one corporation. Under such legislation, the amalgamating corporations are treated like tributaries that flow together to form a single river; each amalgamating corporation is generally considered to continue to exist as the amalgamated corporation (there is no concept of one surviving corporation and one or more corporations that cease to exist). The amalgamation will be a tax-deferred event for both the corporations and their shareholders provided that:

— all property of the amalgamating corporations becomes property of the new corporation;

— all liabilities of the amalgamating corporations become liabilities of the new corporation; and

— all shareholders of the amalgamating corporations receive shares of the new corporation.

The successor corporation (SC) rules may apply to an amalgamation. (See Deductions, Allowances, and Credits – Successor Corporation Rules.)

Wind-Ups of Subsidiaries

Tax-Deferred Wind-Ups

A tax-deferred wind-up of a Canadian subsidiary corporation into its parent is permitted under the ITA where:

— the parent is a taxable Canadian corporation and owns at least 90 percent of each class of shares of the subsidiary corporation;

— the subsidiary is a taxable Canadian corporation; and

— all shares of the subsidiary that are not owned by the parent immediately before the wind-up are owned at that time by persons with whom the parent was dealing at arm's length.

In practice, the parent typically owns 100 percent of the shares of the subsidiary.

Where the tax-deferral rules apply, the subsidiary is considered to have disposed of, for nil proceeds, and the parent is deemed to have acquired, for nil cost, each Canadian resource property and each foreign resource property distributed by the subsidiary to the parent upon windingup. As a result, where all of the resource properties of the subsidiary are transferred to the parent, there is no reduction in the resource-related accounts of the subsidiary and no addition to the resource-related accounts of the parent. However, for the purposes of computing resource deductions, the parent is deemed to be a continuation of the subsidiary and can deduct the resource deductions. If any Canadian resource properties or foreign resource properties are transferred to minority shareholders, those properties are considered to have been disposed of by the subsidiary and acquired by the shareholders at their fair market value. Such a disposition will result in a reduction of the relevant resource-related accounts of the subsidiary and an increase in the corresponding accounts of the minority shareholders. (See Deductions, Allowances, and Credits – Successor Corporation Rules.)

Other Wind-Ups

If the tax-deferral rules do not apply to the wind-up of a corporation, the wound-up corporation is deemed to have distributed all of its resource properties at their fair market value. As a result, there will be a reduction in the resource-related accounts of the corporation, and the corporation may realize income. There will also be a corresponding increase in the resource-related accounts of the shareholders of the corporation. If it is possible for the wound-up corporation to transfer **all or substantially all** of its Canadian or foreign resource properties to one corporation, that person could be a successor corporation to the wound-up corporation. The successor corporation rules may apply on a wind-up. (See Deductions, Allowances, and Credits – Successor Corporation Rules.)

Election to Bump Cost of Acquired Property

Where a parent winds up a subsidiary corporation under the tax-deferral rules or a parent corporation amalgamates with one or more wholly-owned subsidiary corporations, the parent or the amalgamated corporation may elect to step up or "bump" the cost of non-depreciable capital property of the subsidiary. Property that is eligible for the bump includes land, shares of subsidiary corporations, and partnership interests.

The cost of the bumped property cannot be increased to more than the fair market value of the property at the time the parent last acquired **control** of the subsidiary. The total amount by which the cost of all the properties can be increased (the "bump room") is the amount by which the cost of the shares of the subsidiary to the parent exceeds the net cost of all the assets to the subsidiary. The bump room may be restricted for the following types of property of the subsidiary:

— A partnership interest, to the extent that the fair market value of that interest is attributable to depreciable property imbued with an inherent capital gain, Canadian resource property or foreign resource property, or inventory and eligible capital property imbued with an inherent capital gain. This rule strives to deny the bump of a partnership interest to the extent that the property of the partnership would not be eligible for the bump.

— Shares of a foreign affiliate, to the extent that the affiliate has a "tax-free surplus balance." This rule strives to deny the bump of shares of a foreign affiliate to the extent that the bump would otherwise result in duplication of tax attributes. (See Structuring Mining Investments – Non-Resident Investors – Acquiring Assets Versus Acquiring Shares.)

The bump is quite important, and is most often used, where a corporation acquires control of another corporation and wishes to sell property of the acquired corporation or transfer such property within the acquiror's structure. (See Structuring Mining Investments – Non-Resident Investors – Operating in Canada Through a Subsidiary.)

Acquisition of Control

The ITA contains rules that apply to a corporation where a **person**, or a group of persons, acquires **control** of the corporation. Acquisition of control includes de jure control in all circumstances and de facto control in some limited circumstances.

These acquisition-of-control rules are designed to restrict loss trading between arm's-length parties. The acquisition-of-control rules include:

— an automatic end to the taxation year of the acquired corporation immediately before the acquisition of control (the deemed year-end rule);

— a limitation on the utilization of non-capital losses;

— elimination of capital losses;

— a limitation on the deduction of UCC and cumulative eligible capital (CEC) balances;

— a limitation on the deduction of ITCs; and

— a limitation on deductions in respect of CCEE, CCDE, CCOGPE, and ACFRE accounts.

The deemed year-end rule was designed to make it more difficult for taxpayers to traffic in losses. However, it is a rule of general application and has widespread implications.

The ITA imposes restrictions on the entitlement of a corporation to claim losses when a person or a group of persons acquires control of the corporation. The corporation cannot carry forward **net capital losses** after the acquisition of control. A corporation is permitted to file an election to crystallize accrued gains on capital property (including certain **depreciable property**). The election will result in an income inclusion; however, the corporation can apply against that income any net capital losses that would otherwise expire upon the acquisition of control and any non-capital losses.

A corporation may not carry back its net capital loss for a taxation year beginning after an acquisition of control to taxation years commencing before the acquisition of control. In addition, the corporation must treat as a capital loss realized in the year ending immediately before the acquisition of control the amount by which the adjusted cost base of any capital property exceeds the fair market value of the property.

After an acquisition of control of a corporation, the corporation can deduct pre-acquisition-of-control non-capital losses only if the business that gave rise to those losses is carried on with a view to profit, and only against income arising from carrying on the same or a similar business. Non-capital losses arising after an acquisition of control can be carried back only against income from the same or a similar business.

In computing the amount of non-capital losses available, any amount by which the UCC or CEC balance exceeds the fair market value of the related depreciable property or **eligible capital property** is treated as a non-capital loss. The UCC or CEC balances are reduced accordingly. The deemed losses are subject to the acquisition-of-control rules.

The ITCs of a taxpayer on an acquisition of control are subject to rules similar to those applicable to non-capital losses.

On an acquisition of control of a corporation, deductions from the CCEE, CCDE, CCOGPE, and ACFRE accounts of the corporation are subject to the successor corporation rules.

ITCs and the successor corporation rules are discussed in Deductions, Allowances, and Credits.

Partnerships and Joint Ventures

In the mining industry, a **partnership** or a **joint venture** may provide a more flexible investment structure, compared with a corporation, when arm's-length parties wish to undertake joint exploration, development, or production activities.

Unlike corporations, which are purely creations of statute, partnerships are to a large extent created and governed by contract; however, various provinces have enacted legislation applicable to partnerships. Joint ventures are completely created and governed by contract.

The distinction between a joint venture and a partnership is not always clear-cut. In simple terms, a joint venture can be described as a contractual arrangement under which two or more parties hold a property in common. Typically, each party contributes the use of its own assets to the venture and shares in the expenses and revenues of the venture, as agreed by contract.

While a partnership is often governed by a contract, a partnership may also be considered to exist in some circumstances where the parties did not intend to participate in such an arrangement. Under a partnership contract, the parties specifically agree that their intention is to carry on business together as a partnership; and, as in a joint venture, they each contribute their own assets in exchange for a share in the expenses and the revenues of the business. Where there is no contract, a partnership may nevertheless be found to exist if the parties carry on business in common with a view to profit.

Apart from the tax consequences, described below, the following consequences flow from a partnership arrangement:

— Subject to statutory rules governing limited partnerships, partners are jointly and severally liable for the actions of any partner in respect of the partnership activities.

— Property used in the business of the partnership will be considered property of the partnership and not the property of any particular partner.

— Subject to statutory rules governing limited partnerships, one partner may bind all other partners in the normal course of the business of the partnership, whether or not the partner has authority under the partnership agreement to bind the partnership, unless the person with whom the partner is dealing knows that the partner in question has no authority to act on behalf of the partnership.

To overcome the disadvantage of unlimited liability, participants in a mining project may establish a limited partnership, in which a general partner manages the interests of the participants (the limited partners). However, investors may prefer the flexibility afforded by a joint venture arrangement. In order to ensure that the arrangement is not considered to be a partnership, the parties should:

— explicitly state in the joint venture agreement that their intention is not to create a partnership;

— share gross revenues and not net revenues; and

— fund each expense directly and not out of undrawn revenues.

The tax treatment of joint ventures and partnerships, discussed below, may govern the investment decision.

Income Tax Consequences

The ITA does not recognize joint venture arrangements. A joint venture therefore is not a separate taxable entity; instead, each party to the joint venture is directly taxable in its own right, with no intermediary computation of income or loss at the joint venture level.

In contrast, the ITA recognizes the existence of partnerships and provides for extensive rules relating to the computation of income and deductions by a partnership.

Except for some specific provisions (such as the rules applying to **flow-through shares** and to **SIFT entities**) discussed below, a partnership is not a separate taxable entity under the ITA. However, a partnership computes its income as if it were a separate person resident in Canada, and each partner is required to include in computing income in a taxation year-end its share of the income or loss of the partnership for each fiscal period of the partnership ending in that taxation year. As a result, where a corporation is a member of a partnership and the fiscal period of the partnership ends after the taxation year of the corporation, the corporation may be able to defer its share of partnership income until the following taxation year. However, the ITA contains detailed rules that limit this deferral.

If the corporate partner (together with related or affiliated persons or partnerships) owns more than 10 percent of the interests in the partnership, the corporation is required to accrue partnership income for the portion of the partnership's fiscal period that falls within the corporation's taxation year (a stub period). In particular, the corporation must include in income an amount called "adjusted stub period accrual" (**ASPA**) in respect of the partnership for the stub period. ASPA is computed by a formula that prorates forward over the stub period the corporation's share of a partnership's net income from a business or property and net taxable capital gains for the partnership's fiscal periods that fall within the corporation's taxation year. The corporation may reduce ASPA by making either or both of the following discretionary designations:

- If the partnership incurs qualified resource expenses (QRE), which consist of CEE, CDE, FRE, and COGPE incurred by the partnership in the stub period, the corporation may be entitled to designate some or all of such QRE for the year to reduce its ASPA.
- The corporation may designate a discretionary amount to reduce ASPA to reflect the corporation's expectation or knowledge of the partnership's actual income for the stub period. The corporation may be required to include an interest charge in its income in the following year if the designation results in a deferral of partnership income by the corporation.

These rules were introduced in 2011. As a result of these new rules, a corporation might have been required to include in income an amount that represented more than one year of partnership income. A transitional reserve apportions the incremental income realized by the corporation on the transition over a five-year period.

The computation of the income or loss of the partnership excludes any proceeds from the disposition of a **Canadian resource property** or **foreign resource property** and any deductions in respect of CEE, CDE, **COGPE,** or **FRE**. Instead, proceeds of disposition are allocated to the partners according to their respective interests in the partnership; and CEE, CDE, COGPE, or FRE incurred by a partnership in the partnership's fiscal year are included in computing the CCEE, CCDE, CCOGPE, and ACFRE accounts of each of the partners, who can then claim deductions for those expenses.

In contrast, other deductions or expenses, such as **CCA** claimed by a partnership and operating expenses of the partnership, are deductible by the partnership in computing its income or loss.

Provided that a partnership claims the maximum deductions available to it, the income tax consequences to a partner will be the same whether or not the partner claimed a share of the deductions directly.

SIFT Legislation

In the first decade of this century, a number of publicly traded corporations converted to trusts or partnerships. The conversion enabled the entities to avoid corporate-level income tax and **capital tax**.

The government became concerned about the erosion of the corporate tax base and perceived distortions to the economy that arose because the entities chose to distribute most of their income rather than reinvest in their businesses. Accordingly, the government introduced the **SIFT legislation** to tax publicly traded trusts and partnerships in a manner similar to corporations. In particular, the SIFT legislation imposes an entity-level tax on the non-portfolio earnings of SIFT partnerships and SIFT trusts that is similar to a corporate tax, and treats distributions of non-portfolio earnings by SIFT partnerships and SIFT trusts as dividends.

The ITA imposes tax on the business income of public partnerships; these are partnerships whose units are listed or traded on a stock exchange or other public market. The ITA harmonizes the tax treatment of these partnerships with corporations in respect of their non-portfolio earnings. Partners pay tax on their share of the after-tax business income of a SIFT partnership as if it were a dividend received from a corporation resident in Canada.

Advantages of Partnerships

A partnership can be used by a small number of persons wishing to carry out exploration and development where the desired tax and commercial results cannot be secured by the use of a corporate structure. A non-resident member of a partnership will be deemed to be carrying on business in Canada and will be required to file an annual federal income tax return.

A partnership provides a number of advantages over the use of other forms of organization.

Reorganization of Partnerships

The ITA contains a set of beneficial reorganization provisions for **Canadian partnerships**. These provisions permit:

— a person to transfer property to the partnership on a tax-deferred basis in exchange for a partnership interest,

— the winding-up of the partnership on a tax-deferred basis, and

— the merger of two or more Canadian partnerships.

A partnership form of organization permits one person to transfer an indirect interest in mining assets to another in exchange for the funding by the other of the exploration for or development of the assets. In some circumstances, this result may be accomplished through the use of a **farm-in** arrangement, described below. In contrast, the direct transfer of an interest in the mining assets from one person to another would be a taxable event.

Dispositions

Partnership interests may be held on capital account so that a future disposition could result in a **capital gain**. In contrast, since parties to a joint venture hold assets directly, a disposition of a joint venture interest is regarded as a disposition of the underlying assets in respect of that joint venture. Such dispositions may result in income in the case of **resource property** (if the proceeds cause the CCDE account to be negative at the end of the year) or recapture in the case of **depreciable property,** as well as a capital gain on capital property.

EXAMPLE 5

Allocation of Partnership Expenses

— Corporation A contributes a mineral resource property to the arrangement.

— Corporation B contributes the funds necessary for exploration.

— Corporations A, B, and C agree to fund the development of any discovered reserves.

From a business perspective, it is appropriate to allocate the development expenses arising from the contribution of the property to Corporation A; to allocate to Corporation B all the exploration expenses; and to allocate the cost of development, including CCA, to each of Corporations A, B, and C in their respective portions. This result can be accomplished through the use of partnership allocations but not through the use of a corporation. Flow-through shares may be used in some circumstances to accomplish some of the objectives.

As an Alternative to a Corporation

Frequently, two or more persons (usually corporations) wish to cooperate in carrying out an exploration or development program. If the persons entering into the project are in different circumstances and wish to participate differently in the project, the creation of a new corporation may not be appropriate for the project.

Subject to anti-avoidance rules, a partnership may be used to allocate disproportionately the amount of eligible deductions incurred through the project, as illustrated in Example 5.

A partnership may also be used as an alternative to a sole purpose corporation for the development of a project. A sole purpose corporation may not be appropriate because the deductions generated by the project may be used only against the income generated from the project. It may well be that the partners could use the deductions generated by the project directly against their own income long before the sole purpose corporation would be entitled to do so. Consequently, in such circumstances, a partnership could be used and the various expenses could be allocated to the partners that could use the deductions sooner.

Farm-Ins/Farm-Outs

A **farm-out** arrangement is one in which one party (a **farmor**) has an interest in a **resource property** and agrees to grant an interest in that resource property to another party (a **farmee**), in exchange for the farmee's either funding or performing exploration and development work on the farmor's property. The farmee's undertaking is typically referred to as a **farm-in** and the farmor's commitment is referred to as a **farm-out**. There is no standard form of farm-out agreement. Instead, the terms of each farm-out agreement are unique to the particular circumstances.

The taxation of farm-out arrangements is, in practice, heavily dependent on certain administrative concessions by the **CRA**. In the absence of these concessions, a farm-out arrangement involving a transfer to the farmee of beneficial ownership of all or part of a farmor's **working interest** in a resource property might result in a taxable disposition by the farmor.

Because there is little case law that has considered the taxation of farm-out arrangements, taxpayers will typically try to fall within the CRA's administrative policies concerning these arrangements. In particular, it is the CRA's assessing practice that a farm-out results in the farmor having a disposition but not receiving any proceeds of disposition. Instead, the farmee is considered to incur **resource expenses** in order to earn an interest in the property. After the farmee has completed its spending commitment, the farmor and the farmee will have an agreed ownership interest in the **working interest**. The CRA, however, limits this administrative position to unproven resource properties, which the CRA considers to be resource properties to which proven reserves have not been attributed. Furthermore, in contrast to its position relating to farm-outs in the oil and gas industry, the CRA has not developed a position in the mining industry permitting the farmor to give up and the farmee to acquire **depreciable property** on a tax-exempt basis. The CRA's administrative position in the mining industry extends only to intangible rights.

In the mining industry, the most common form of farm-out arrangement is one in which the farmor is a prospector or grubstaker with an interest in mining claims and the farmee is a major mining corporation. Usually, the farmee agrees to incur a fixed dollar amount of exploration work over a specified period of time. Provided that the farmee incurs the expenses in accordance with the agreement, the farmee will typically be entitled to receive a transfer of the mining claims and the farmor will be entitled to a net smelter return **(NSR)** or a net profit interest **(NPI)** in the property.

A second form of arrangement in the mining industry is one in which the farmee agrees to incur a fixed dollar amount of exploration work on the farmor's mining claims over a specified period of time in order to earn an interest in the property. Thereafter, the parties share the requisite expenses to explore and develop the property in proportion to their interests.

A number of years ago, the CRA gave a favourable ruling on an arrangement pursuant to which the farmee incurred the expenses necessary to bring a known ore body into production in return for an interest in the resulting mine. This is commercially not a typical arrangement and may not now fit within the administrative requirement that farm-ins must relate to unproven properties.

Foreign Operations

For a Canadian resident carrying on mining operations in a foreign jurisdiction, an important decision is whether it is better, from a tax perspective, to carry on the activity through a branch or through a foreign entity. While most foreign jurisdictions will allow the investor to choose the vehicle through which it prefers to carry on business, some will require a non-resident to set up a subsidiary in the particular jurisdiction to undertake the mining activities. From a Canadian tax perspective, the difference between operating through a branch and operating through a foreign entity can be significant.

Where a **Canadian corporation** carries on business through a foreign entity, the Canadian tax consequences will depend greatly on whether the foreign entity is treated as a corporation for Canadian tax purposes. In making this determination, the legal characteristics of the foreign entity under the laws of the foreign jurisdiction must be compared with the legal characteristics of entities in Canada. The entity should be classified in the same manner as the Canadian entity with which it shares the most similarities. It is sometimes very difficult to determine the appropriate classification of the foreign entity.

Operation Through a Branch

Canadian corporations operating in foreign jurisdictions through a branch are subject to Canadian tax on the income earned by that branch, whether or not any funds are remitted to Canada. Operating through a branch may be advantageous during the initial exploration and start-up phases of a mining project, since losses incurred by the branch may shelter other income earned by the Canadian corporation from Canadian tax. However, a subsequent transfer of the assets of the foreign branch to a foreign subsidiary would be a taxable transaction for Canadian tax purposes. Any proceeds of disposition of a **foreign resource property** would be deducted from the ACFRE account of the taxpayer and may result in income subject to tax. Under the ITA, proceeds of disposition of a foreign resource property are on income account and not on capital account. (See Deductions, Allowances, and Credits – Foreign Resource Expenses.)

There is therefore a trade-off between tax payable in the future and the upfront deduction of losses. There is also a risk that the assets of the branch may not be transferable to a corporation on a tax-deferred basis under foreign law. Therefore, theoretically, assets should be transferred at an early stage before a significant appreciation in value occurs. This is easier said than done. In mining, one successful drill hole may turn a property with nominal value into one of significant value.

A transfer of property may also result in other taxes such as sales and transfer taxes. Consequently, the potential liability for such taxes must be taken into account in considering which vehicle to use at the time of commencement of operations. In addition, a subsequent transfer of assets may require government approvals, as well as consents from third-party participants in the mining operations.

Where the income earned by the branch is subject to tax in the foreign jurisdiction, a foreign tax credit may reduce the Canadian federal income tax liability and prevent double taxation. A foreign tax credit may be claimed for the income taxes paid or payable to a foreign jurisdiction in respect of the business profits of the branch to the extent that the foreign taxes do not exceed the Canadian income taxes otherwise payable on those profits. To the extent that the foreign income taxes paid to a jurisdiction exceed the Canadian income taxes otherwise payable on branch profits, the unused credit may be carried back for 3 years and forward for 10 years in the case of business-income taxes.

These carryforward and carryback provisions do not apply to taxes that are not in respect of income earned by the taxpayer from a business carried on in the country (e.g., non-business-income taxes, such as foreign withholding taxes on dividends, interest, and royalties). Furthermore, the foreign tax credit is available only in respect of taxes assessed, based on a measure of income or profits. Therefore, royalties, stamp duties, **capital taxes**, and sales, value-added, or turnover taxes are not eligible for the foreign tax credit.

While foreign oil and gas production taxes paid to a foreign country may be eligible for the foreign tax credit, no similar relief currently exists for production taxes paid in respect of other types of resources, such as metals.

Provincial foreign tax credits are available only for non-business-income taxes paid or payable, since foreign business profits should not be subject to tax in any Canadian province.

Operation Through a Foreign Corporation

Where foreign operations are expected to be profitable, there may be significant advantages to the use of a foreign subsidiary corporation over a branch. As described in more detail below, the **active business income** earned by a **foreign affiliate** should not be taxable in Canada until a dividend is paid to a Canadian-resident corporation or individual. Further, dividend income received by a Canadian corporation from a foreign affiliate that is resident in and carries on an active business in a jurisdiction with which Canada has concluded an income tax treaty or a **tax information exchange agreement (TIEA)** should be exempt from Canadian income tax. (See Structuring Mining Investments – Foreign Affiliates.) Income of a foreign entity that is not a foreign affiliate is subject to Canadian tax only when the income is distributed to Canada by way of dividend.

The exemption from Canadian tax is available only where the foreign corporation is a resident of the foreign jurisdiction under Canadian domestic law as well as an applicable income tax treaty. Under Canadian domestic law, a foreign corporation may be considered to be a resident of Canada if the central management and **control** of the foreign corporation is exercised in Canada. To substantiate that the foreign entity is not resident in Canada, it is critical that the directors (or equivalent) of the foreign affiliate meet regularly in that foreign jurisdiction, that they have the authority to manage and oversee the affairs of the corporation, and that they exercise their authority independently. The directors can consider the wishes of the Canadian shareholders in arriving at their decisions, but they must still exercise independence in deciding whether or not to implement those wishes.

Distributions from a foreign corporation to a Canadian shareholder may be subject to foreign withholding tax, and a gain realized on a sale of the shares of the foreign corporation (including, in some jurisdictions, an indirect sale) may also be subject to foreign income tax under local domestic law, as well as to Canadian income tax. Intermediary holding corporations in treaty jurisdictions may be used to reduce the rate of foreign withholding tax on distributions to Canada, and eliminate Canadian and foreign income tax on capital gains that may otherwise be payable on the disposition of the shares of the foreign corporation. Although the tax benefits of these structures may be substantial (see the discussion in Structuring Mining Investments – Foreign Affiliates), they may be subject to challenge by foreign tax authorities under a "substance-over-form" doctrine or general beneficial ownership principles. Furthermore, certain foreign jurisdictions have enacted specific anti-avoidance rules that could deny the benefits of a treaty to the intermediary holding corporation, by looking through the structure to the Canadian parent. Other countries have enacted rules of general application that deem capital gains derived from the sale of an offshore company to be subject to local tax if more than a specified percentage of the fair market value, assets, or income of the foreign holding corporation is directly or indirectly derived from domestic operations or assets.

Foreign Affiliates

As discussed above (see Structuring Mining Investments – Foreign Operations), a Canadian-resident investor undertaking mining activities outside Canada must weigh the domestic and foreign tax consequences associated with the different business structures through which mining operations can be carried on. Where the mining venture is generating a profit, it can be advantageous to operate through a **foreign affiliate**. However, Canada's foreign affiliate rules are complex, and careful planning is necessary to achieve the desired tax result. The summary that follows provides a simplified overview of the tax treatment of foreign affiliates under the ITA.

The Foreign Affiliate Regime

The ITA provides a combined exemption/credit system for income earned by a Canadian-resident taxpayer through a foreign affiliate. A foreign affiliate of a Canadian resident is defined as a non-resident corporation in respect of which the Canadian resident owns:

— not less than 1 percent, and

— either alone or together with related persons, 10 percent or more

of the shares of any class of the corporation. A foreign affiliate is a **controlled foreign affiliate** if the Canadian resident:

— owns more than 50 percent of the voting shares of the foreign affiliate, or

— would own more than 50 percent of the voting shares if it held all the shares owned by related persons and up to four arm's-length Canadian residents and persons related to them.

An exemption/credit applies to income received by the Canadian-resident corporation in the form of dividends paid by the foreign affiliate. A reduction of tax may also be available in respect of gains on a sale of shares of the foreign affiliate.

The Canadian tax rules relating to foreign affiliates can be grouped into two categories: the **surplus rules** and the **foreign accrual property income (FAPI)** rules.

The Surplus Rules

The surplus rules are relevant in determining:

— the tax payable by a Canadian corporation on dividends received from both controlled and non-controlled foreign affiliates, and

— the gain that is subject to tax on a sale by a Canadian-resident corporation of shares of a foreign affiliate.

A Canadian-resident taxpayer that sells shares of a foreign affiliate is subject to tax on the **taxable capital gain**. A Canadian-resident taxpayer is also subject to tax on the taxable capital gain realized on the sale by one foreign affiliate of shares of another foreign affiliate unless the shares of the foreign affiliate that are sold are **excluded property**. Shares of a foreign affiliate are excluded property if they derive **all or substantially all** of their value from assets used in an active business. A Canadian corporation may elect to reduce the proceeds of disposition (which are relevant to computing the **capital gain** or **capital loss**) to the extent of the underlying surplus. Where an election is made, these rules deem a dividend to have been paid to the extent of the surplus, and consequently reduce the gain.

Regardless of its legal form, a pro rata distribution by a foreign affiliate is deemed to be a dividend except where the distribution is made:

— in the course of a liquidation and dissolution of the affiliate;

— on a redemption, acquisition, or cancellation of a share of the affiliate; or

— on a "qualifying return of capital" in respect of the share.

On a distribution of paid-up capital of a foreign affiliate, which otherwise would be treated as a dividend, a taxpayer may elect to treat the distribution as a qualifying return of capital. Under this election:

— the distribution is received tax-free to the extent of the adjusted cost base of the taxpayer's shares of the foreign affiliate, and
— the adjusted cost base to the taxpayer of its foreign affiliate shares is reduced by the amount of the distribution.

The tax payable by a corporation resident in Canada in respect of a dividend received from a foreign affiliate depends on the surplus account of the foreign affiliate out of which the dividend is paid. There are four surplus accounts:

— exempt surplus,
— hybrid surplus,
— taxable surplus, and
— pre-acquisition surplus.

Dividends paid by a foreign affiliate to a Canadian resident are deemed to be paid out of the surplus accounts in the following order:

— exempt surplus,
— hybrid surplus,
— taxable surplus, and
— pre-acquisition surplus.

A taxpayer may be able to vary the application of the dividend ordering rules by making an appropriate election. Pursuant to such an election, dividends may, in certain circumstances, be paid out of taxable surplus before exempt surplus, taxable surplus before hybrid surplus, and pre-acquisition surplus before exempt, hybrid, or taxable surplus.

Dividends can be paid out of a particular surplus account only if the balance in that account exceeds the total of any deficit balances in the other surplus accounts. For example, dividends may be paid out of exempt surplus only to the extent that the amount of exempt surplus exceeds the total of any hybrid deficit and taxable deficit. A similar rule applies for dividends paid out of hybrid and taxable surplus. Pre-acquisition surplus is a residual concept – any dividend paid in excess of the net positive balance in the other surplus accounts is deemed paid from pre-acquisition surplus.

The amount of the tax payable by the Canadian resident on the dividend depends on the type of surplus from which the dividend is paid.

Exempt surplus of a foreign affiliate includes the **active business income** of the foreign affiliate that is earned in a treaty country or in a country with which Canada has a TIEA, provided that the foreign affiliate is also resident in a treaty country or a TIEA country. Exempt surplus also includes any capital gain from the disposition of property used in a qualifying active business, and the non-taxable portion of other capital gains (with the exception of gains included in hybrid surplus – see below). Dividends that are received by a Canadian-resident corporation out of a foreign affiliate's exempt surplus are exempt from tax in Canada.

Hybrid surplus includes the amount of a capital gain realized by a foreign affiliate on a disposition of a share of another foreign affiliate, a partnership interest, or a currency hedging contract that relates to certain excluded property. One-half of the amount of dividends received out of hybrid surplus is exempt, and the other half is taxable, subject to a deduction for a grossed-up amount of the foreign tax paid on the capital gain that generated the dividend and for any foreign withholding tax paid on the dividend itself.

Taxable surplus includes all other income earned by the foreign affiliate, including FAPI, as well as **non-qualifying active business income**. Taxable surplus also includes taxable capital gains that are not included in exempt surplus or hybrid surplus. Dividends received by a Canadian-resident corporation out of a foreign affiliate's taxable surplus are taxable in Canada, subject to a deduction for the foreign tax paid on the income that generated the dividend and for any foreign withholding tax paid on the dividend itself.

Pre-acquisition surplus is a residual concept in that only dividends in excess of exempt, hybrid, and taxable surplus are deemed to arise from pre-acquisition surplus. Dividends from pre-acquisition surplus are exempt from tax in Canada, but unlike other surplus dividends, they reduce the tax cost of the shares of the foreign affiliate payer. If the cumulative pre-acquisition surplus dividends and returns of capital exceed such tax cost, a deemed capital gain arises.

The Upstream Loan Rules

It was previously common practice for foreign affiliates engaged in mining operations to repatriate amounts by way of loans to their Canadian parent or, if the Canadian parent was a subsidiary of a non-resident corporation, to the non-resident corporation. This technique avoided the Canadian tax that would have arisen on a dividend paid out of taxable surplus.

The "upstream loan rules" seek to ensure that no Canadian tax benefit is obtained through the use of an upstream loan rather than a dividend. Where a foreign affiliate of a taxpayer makes a loan to a "specified debtor," such as the Canadian-resident shareholder of the foreign affiliate or a person that does not deal at arm's length with such shareholder, the taxpayer must include in income the "specified amount" of the loan. Where the "specified debtor" is the Canadian taxpayer, the "specified amount" is the product of the principal amount of the loan and the Canadian-resident shareholder's direct or indirect equity interest in the lending foreign affiliate. If the "specified debtor" is another foreign affiliate of the Canadian-resident taxpayer, the "specified amount" is the product of the principal amount of the loan and the difference between the Canadian-resident shareholder's direct or indirect equity interest in the lending and borrowing foreign affiliates. If the loan is repaid (other than as part of a series of loans or other transactions and repayments) within two years, the taxpayer is not required to include the "specified amount" in income. Where the taxpayer does have an income inclusion, the taxpayer is entitled to a deduction in the year in which the loan is ultimately repaid in proportion to the amount that was previously included in income. The rules provide for a five-year grandfathering period for loans outstanding on August 19, 2011.

Where a taxpayer has an income inclusion pursuant to the upstream loan rules, it may deduct all or a portion of such income inclusion under a special reserve-like mechanism. More specifically, the taxpayer may deduct a portion of the income inclusion if the taxpayer demonstrates that the portion would, were it paid to the taxpayer directly or indirectly by the foreign affiliate as dividends out of exempt, hybrid, taxable, or pre-acquisition surplus, reasonably be considered to have been deductible in computing taxable income. The taxpayer is required to add back into income its deduction for the immediately preceding taxation year, and may then claim

a fresh deduction for the current year if the conditions for application continue to be met. The reserve mechanism does not reduce the surplus accounts of the foreign affiliate, but if those surplus accounts diminish for a taxation year while the loan remains outstanding, the taxpayer may realize an income inclusion.

The Foreign Accrual Property Income (FAPI) Rules

The purpose of the FAPI rules is to prevent the deferral of Canadian tax on passive property income earned offshore.

FAPI includes property income (e.g., interest, dividends, rents, and royalties) as well as income from an **investment business** and certain taxable capital gains. A Canadian resident is taxable on a current basis in respect of FAPI earned by a controlled foreign affiliate (but not a non-controlled foreign affiliate), whether or not the income is repatriated (distributed to the Canadian resident), subject to a tax credit for foreign taxes paid on the income.

An investment business includes a business carried on by a foreign affiliate whose principal sources of income include:

— income from property,

— income from the insurance or reinsurance of risk,

— income from the factoring of receivables, or

— profits from the disposition of investment property (including commodities and Canadian and foreign resource properties).

A business (other than a business conducted principally with non-arm's-length parties) that derives income or profit principally from these sources may not be an investment business if it employs, alone or together with certain other related parties, more than five full-time employees in the business throughout the year. This exception does not apply to all types of "passive" businesses listed above (only certain listed types of activities qualify), although it should apply to royalties on foreign resource properties.

In some cases, income that would otherwise be FAPI is recharacterized as active business income for tax purposes, with the result that the FAPI rules do not apply. This occurs typically where the income is connected to an active business carried on by another foreign affiliate of the Canadian resident. For example, the interest income of a foreign affiliate derived from an intercompany financing arrangement with another foreign affiliate is not FAPI to the extent that the other foreign affiliate deducts the interest payment from its active business earnings. The same treatment will apply to royalty income where, for example, one foreign affiliate earns resource royalties paid by another foreign affiliate with an active mining operation.

Canada has rules to prevent taxpayers from eroding the Canadian tax base by diverting income from Canadian-source activity to foreign affiliates. This income may relate to income from the sale of property, services, interest and leasing, and insurance and reinsurance. In such cases, the income is considered FAPI.

The entitlement of a Canadian resident to deduct a tax credit for foreign taxes paid on FAPI is subject to the "foreign tax credit generator" rules. The foreign tax credit generator rules can deny a foreign tax credit where foreign taxes are incurred as a part of a transaction that involves a "hybrid instrument" that is characterized as equity for Canadian tax purposes but as debt under foreign tax law. These rules are intended to deny recognition of foreign tax credits where the foreign tax burden is not ultimately borne by the taxpayer. However, the rules are broadly drafted and can apply in unexpected circumstances. Specifically, there is no requirement for a direct link between the hybrid instrument and the transaction generating the FAPI; the rules will apply whenever there is a hybrid instrument in the same chain of ownership as the affiliate earning the FAPI. Thus, if a hybrid instrument or entity is present in a foreign affiliate group, the implications for all affiliates in the same ownership chain need to be considered.

The Foreign Affiliate Dumping Rules

The foreign affiliate dumping rules deter certain arrangements that allowed non-residents of Canada with Canadian subsidiaries to undertake transactions that reduced their liability for Canadian tax without, in the government's view, providing an economic benefit to Canada.

The foreign affiliate dumping rules apply to an "investment" in a foreign affiliate by a corporation resident in Canada (**CRIC**) that is controlled by a non-resident corporation. An "investment" in a foreign affiliate includes:

— an acquisition of shares of the foreign affiliate;

— a contribution of capital to the foreign affiliate;

— an acquisition of shares of another corporation resident in Canada whose shares derive more than 75 percent of their value from foreign affiliate shares;

— a loan to or an acquisition of a debt of a foreign affiliate;

— the extension of the maturity date of a debt obligation owing by a foreign affiliate to a CRIC; and

— the extension of the redemption, acquisition, or cancellation date of shares of a foreign affiliate held by a CRIC.

Certain trade debts and debts acquired from an arm's-length person in the ordinary course of business are excluded. In certain cases, an election is available to treat a debt obligation as a "pertinent loan or indebtedness" (**PLOI**). The foreign affiliate dumping rules do not apply to the PLOI, but the CRIC must include in income interest on the PLOI at a prescribed rate (less any interest actually charged pursuant to the terms of the debt obligation).

Where the rules apply, the following consequences may result:

— If the CRIC paid non-share consideration for the investment, the CRIC is deemed to have paid to its foreign parent a dividend in the amount of such consideration. Canadian withholding tax applies to the deemed dividend. In certain circumstances, under an offset mechanism, the paid-up capital in the shares of the CRIC can be reduced to decrease or eliminate the deemed dividend.

— If the CRIC issued shares in consideration for the investment, the paid-up capital in such shares is reduced by the amount of the investment in the foreign affiliate. The elimination of paid-up capital restricts thin capitalization room to limit the ability of the CRIC to deduct interest expense on cross-border debt and restricts the amount that can be repatriated as a return of capital free of Canadian withholding tax.

There are two main exceptions that will preclude the application of the rules where a CRIC makes an investment in a foreign affiliate. The first exception is intended to exempt investments that are strategic expansions of a Canadian business abroad; however, this exception is unlikely to be useful since its scope is very narrow. The second exception applies where the investment is part of an internal reorganization that is not considered to result in a new investment in a foreign affiliate.

Where the paid-up capital in the shares of the CRIC is reduced under the rules, such paid-up capital can be reinstated immediately before:

— a return of capital by the CRIC to its foreign parent, or

— an in-kind distribution of:

  – the shares of the foreign affiliate that constituted the original investment,

  – shares of another foreign affiliate substituted therefor, or

  – the proceeds of disposition of such shares or certain other distributions from another foreign affiliate.

The paid-up capital reinstatement before the return of capital avoids a deemed dividend arising on the transaction to the extent that the amount distributed on the return of capital exceeds the paid-up capital in the shares of the CRIC.

Specific Application Issues for Mining Corporations

Net Smelter Returns and Net Profits Interests

A junior mining corporation will frequently sell a promising **mining property** to a more senior mining corporation in exchange for an NSR or an NPI. Similarly, a senior mining corporation may sell a marginal property that it does not intend to actively exploit itself to another senior mining corporation for an NSR or NPI.

Income realized by a controlled foreign affiliate on the sale of a foreign resource property and royalty income from an NSR or an NPI may be FAPI. Such income should not be FAPI where the income is incidental to the active business of the affiliate.

In addition, income from an NSR or an NPI should be active business income where the Canadian taxpayer owns at least a 10 percent interest (by both votes and value) in the entity paying the royalty. However, a specific anti-avoidance rule targets structures where such an ownership interest is created principally to avoid taxes (as may be found to be the case where the economic benefits from the equity stake are nominal compared with the tax benefits of avoiding FAPI status on the royalties).

International Holding Corporations

Holding corporations incorporated in foreign jurisdictions are often considered by mining corporations to hold other foreign

mining corporations. Both the commercial and tax aspects of a foreign holding corporation need to be considered.

Dividends paid to a holding corporation will not be subject to Canadian tax and may be subject to little or no tax in the jurisdiction of the holding corporation. The use of a holding corporation therefore defers tax on the earnings until they are ultimately repatriated to Canada. Distributions to Canada may qualify for an exemption or credit where they are paid out of exempt, hybrid, or taxable surplus, as described above.

A holding corporation may also be used to defer the payment of Canadian tax on capital gains realized from a sale of shares of a foreign affiliate where the shares constitute **excluded property**.

However, the use of holding corporations presents a number of issues. Many jurisdictions are becoming more aggressive in challenging international holding corporations based on either specific legislation or more general rules such as substance over form, beneficial ownership, and treaty abuse. This is particularly the case where the holding corporation does not carry on active business operations of its own.

A number of jurisdictions have also introduced legislation to tax sales of the shares of foreign corporations that derive a significant portion of their value from domestic assets, operations, or shares of a domestic company (so-called "indirect sales"). Typically, the source country will impose liability for any tax unpaid by the vendor (and related interest and penalties) on the purchaser or the domestic (target) entity.

International Financing Corporations

Most inter-affiliate payments (including interest, rents, royalties, and insurance premiums) are exempt from FAPI treatment (and thus not taxable in Canada) if the payer is a foreign affiliate in which the Canadian taxpayer has an interest consisting of at least 10 percent of the votes and value of the foreign affiliate and the expense is deductible from the active business income of the payer. It is thus common for a Canadian multinational to establish an affiliate in a low-tax jurisdiction to finance its foreign operations. Similar benefits can be achieved using international leasing, licensing, or captive insurance affiliates. If the financing affiliate is resident in a treaty or TIEA country and the payer is both resident in and carries on business in (another) treaty country, the income earned by the financing entity is exempt surplus and can be repatriated to Canada free of tax. This allows for a permanent tax saving to the Canadian parent.

Transfer Pricing

Transfer pricing refers to the process of setting prices for cross-border transactions within a multinational group. Most countries, including Canada, have rules in place to prevent the erosion of the country's tax base through inappropriate transfer pricing.

Common cross-border intra-group transactions in the mining industry which would be subject to transfer pricing rules include:

— The sale of ore or concentrates from an extraction location to a refining location
— The provision of management and technical services from a head office location to mine locations
— The marketing of finished and semi-finished products from regional trading hubs
— Debt financing and guarantees

Canadian Transfer Pricing Rules and Guidance

The foundation of Canada's transfer pricing rules is the 'arm's length principle' found in the Related Persons article of most tax treaties. The arm's length principle requires associated enterprises to transact with each other at terms and conditions that would otherwise have prevailed in the open market.

Where a Canadian taxpayer transacts with an associated enterprise on terms and conditions that are less favorable than would have been agreed with an arm's length party, the transfer pricing rules allow the CRA to adjust the amounts of the transaction in computing the taxpayer's taxable income. In exceptional circumstances, the transaction can be disregarded, where such a transaction would, in the opinion of the CRA, not have occurred between arm's length parties.

In interpreting the operation of the transfer pricing rules, the CRA has issued substantial guidance in the form of information circulars and transfer pricing memoranda. This guidance closely follows the guidance in the internationally recognized OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).

Transfer Pricing Penalties and Contemporaneous Documentation Requirements

Where a transfer pricing adjustment is made, a penalty may apply if the CRA determines that the taxpayer did not make reasonable efforts (as defined in Transfer Pricing Memorandum 9) to determine and use arm's length transfer prices. If applied, the penalty is computed as 10 percent of any transfer pricing adjustments, irrespective of whether any income tax has been underpaid. The penalty will only apply where the adjustment to income exceeds the lesser of 10 percent of gross revenue or $5 million.

For purposes of calculating transfer pricing penalties, taxpayers are deemed not to have made reasonable efforts unless they have prepared contemporaneous documentation, as prescribed in the ITA, to document the analysis undertaken to determine and use arm's length transfer prices.

In addition to penalties, transfer pricing adjustments may also give rise to deemed dividends, subject to withholding tax.

OECD BEPS Project and the Impact on Transfer Pricing Rules

Transfer pricing, as well as a number of other international tax areas, is currently undergoing a substantive global review as part of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan. This extremely ambitious endeavour, fully supported by the G-20, and with extensive consultation with developing countries, is expected to substantively modernize and change current transfer pricing and international tax norms and standards, as well as documentation and reporting obligations.

Canada is an active participant in the BEPS project and is expected to enact the majority of the OECD's transfer pricing recommendations which include:

— The introduction of country-by-country reporting of profits, assets and activity measures for multinationals with consolidated revenues in excess of €750 million (for taxation years beginning on or after January 1, 2016)
— Expanded transfer pricing documentation requirements following a global 'masterfile' and local country file format

— Adoption – likely retroactively to all open tax years – of revisions to the OECD Guidelines including:
  – An increased emphasis in transfer pricing analyses on the performance of significant people functions, including strategic leadership, as a key value driver.
  – A requirement to positively confirm that the taxpayer's actual conduct matches relevant written intercompany agreements.
  – A new chapter on determining transfer pricing for commodities
  – A safe harbor for low value intragroup services

Non-Resident Investors

Acquiring Assets Versus Acquiring Shares

A non-resident investor that intends to start up a mining business in Canada, or to acquire an existing business, must consider:

— whether it will acquire the assets directly or acquire shares of a corporation holding the assets, and
— whether it will carry on business in Canada directly or through a Canadian corporation.

An asset purchase may be advantageous to the purchaser from a Canadian income tax perspective because it will allow the purchaser to claim deductions, such as CCA and **resource deductions**, using the fair market value of the assets at the time of purchase rather than their historical cost to the vendor. An asset purchase may, however, result in the realization of ordinary income to the vendor, as opposed to a **capital gain**. In particular, the sale of intangible mining rights may give rise to ordinary income. Asset sales are more complicated than share sales and frequently require government consents and third-party approvals.

There may also be an opportunity to increase (or bump) the tax cost of non-depreciable capital assets (land, other than **Canadian resource property**, and shares of a subsidiary) held by the acquired corporation to their fair market value subsequent to the acquisition. (See Structuring Mining Investments – Corporate Reorganizations.) The tax benefits of a bump are limited because it is not possible to increase the tax cost of property in respect of which a taxpayer may claim deductions in computing income.

However, the bump can be of great significance to a foreign purchaser of a **Canadian corporation** where the Canadian corporation owns subsidiaries that carry on business only in foreign jurisdictions. A foreign purchaser in such circumstances may want to:

— incorporate a Canadian corporation to purchase the Canadian target;
— wind up the Canadian target (or amalgamate the Canadian purchaser and the Canadian target) in order to bump the tax cost of the shares of the foreign subsidiaries; and
— transfer the foreign subsidiaries out from under the Canadian target.

The reason for this form of transaction is that it may be more efficient for the foreign purchaser to hold such foreign subsidiaries directly or in a dedicated offshore holding structure. (For example, such a corporate organization avoids an additional layer of Canadian withholding tax on future repatriations.) The bump may allow the purchaser to effect the transfer without incurring any significant Canadian tax. This feature of the Canadian tax system is particularly useful on a takeover where the target has no Canadian operations but is a holding corporation that has only subsidiaries with

mining properties situated in other jurisdictions; such a corporate organization is very common for junior and intermediate mining companies listed on a Canadian stock exchange. However, the bump is not available where the foreign purchaser issues its own shares as consideration for the acquisition if shares of the foreign purchaser derive more than 10 percent of their fair market value from bumped property. (See Structuring Mining Investments – Wind-Ups of Subsidiaries – Election to Bump Cost of Acquired Property.)

Where a Canadian corporation owns shares of foreign subsidiaries, two other considerations may affect the decision of a non-resident investor to acquire shares of the Canadian corporation:

— The foreign affiliate dumping rules may apply in certain cases. In particular, certain Canadian public companies do not undertake significant direct mining operations but act as holding companies for foreign subsidiaries that carry on mining activities in foreign jurisdictions. The foreign affiliate dumping rules may apply where a foreign corporation acquires such a Canadian public company through the use of a Canadian acquisition corporation.

— Certain rules attempt to ensure that an unrelated party cannot obtain aggregate tax attributes of a foreign affiliate on an acquisition of control in excess of the fair market value of the foreign affiliate's shares. Two rules work together to achieve this objective:

  – On an acquisition of control of a Canadian corporation, the exempt surplus of the corporation's top-tier foreign affiliates is reduced immediately before the acquisition of control to the extent that the aggregate of each affiliate's tax-free surplus balance and the adjusted cost base of the affiliate's shares exceeds the fair market value of those shares. The top-tier foreign affiliate's tax-free surplus balance is the total of the top- and lower-tier foreign affiliates' surplus balances to the extent that a dividend paid by the top-tier foreign affiliate would be fully deductible.

  – On a tax-deferred wind-up of the Canadian corporation or an amalgamation, the bump of the shares of the foreign affiliate can be restricted. More specifically, the bump room in respect of the foreign affiliate's shares is reduced by the foreign affiliate's tax-free surplus balance.

Operating in Canada Through a Branch

A foreign corporation may operate in Canada directly as an unincorporated business, or through a **joint venture** or **partnership** structure. (See Structuring Mining Investments – Partnerships and Joint Ventures.) In these circumstances, the foreign corporation will be subject to tax in Canada on income from its Canadian branch, similar to a Canadian corporation. The branch will be treated as a separate and independent entity for the purposes of determining its Canadian-source income subject to tax in Canada, and expenses incurred by the head office may be allocated to the branch under general transfer pricing principles. Since Canada does not have a loss consolidation regime (see Overview of the Canadian Tax Regime – Income Taxation – Utilization of Losses), losses incurred by the branch cannot be used to offset any income earned by other Canadian corporations held by the foreign investor in Canada. Foreign corporations carrying on business in Canada through a branch are required to file a corporate tax return annually with the CRA.

Foreign corporations carrying on business in Canada are also subject to a branch profits tax, which is a statutory 25 percent tax on after-tax income of the branch that is not reinvested in Canadian business assets. The tax rate is reduced under Canada's tax treaties to the rate of withholding tax imposed on dividends paid by a Canadian subsidiary to a parent in the jurisdiction of the parent (usually 5 percent). Some treaties also provide for an exemption for the first $500,000 of earnings subject to the branch profits tax. An exemption from branch profits tax is available under the ITA for corporations whose principal business is mining iron ore in Canada.

A key advantage to the use of a branch is that the losses incurred by the branch may be used to shelter other sources of income from tax in that foreign jurisdiction. This structure may not be advantageous, however, where the foreign jurisdiction does not have an exemption system and the corporate tax rate in that jurisdiction is higher than the Canadian corporate tax rate. Further, the foreign corporation will have limited control over the payment of Canadian branch profits tax (which is determined by formula regardless of actual transfers of cash to the head office) as compared with the payment of dividends by a Canadian corporation. The branch tax formula may hamper the ability to adequately plan in jurisdictions with a foreign tax credit system.

A Canadian branch can be incorporated into a Canadian subsidiary on a tax-deferred basis for Canadian tax purposes. The new subsidiary inherits the CCA and resource deductions (albeit subject to restrictions for resource deductions). (See Deductions, Allowances, and Credits – Successor Corporation Rules.) However, any loss carryforwards of the branch cannot be transferred to the Canadian subsidiary or otherwise offset against income of any Canadian-resident entity or any other foreign entity with a Canadian branch. The tax consequences in the foreign corporation's country of residence to incorporating the assets must also be considered. Such consequences may include the recognition of gain and the recapture of branch losses previously deducted in computing the income of the foreign corporation.

For taxation years beginning after 2013, a Canadian branch will be denied a deduction for interest paid or payable on "outstanding debts to specified non-residents" to the extent that such debts exceed 1.5 times its "equity amount." In this regard:

- "outstanding debts owing to specified non-residents" will include a loan used by the Canadian branch from any non-resident that does not deal at arm's length with the non-resident corporation (including a debt from the non-resident corporation itself); and
- the "equity amount" of the non-resident corporation will be 40 percent of the amount of the difference between:
  - the cost of its property used in carrying on business in Canada, and
  - the total of its debts outstanding (other than an outstanding debt to specified non-residents of the corporation).

Accordingly, a debt-to-asset ratio of 3:5 will apply for Canadian branches. This parallels the 1.5:1 debt-to-equity ratio used for Canadian subsidiaries (discussed below).

If the thin capitalization rule denies the deduction of interest expense by the Canadian branch, the non-resident corporation may bear additional branch tax liability. As branch tax and dividend withholding tax function similarly, the treatment of denied interest expense under the thin capitalization rule will be treated similarly for both branches and subsidiaries of non-resident corporations.

Operating in Canada Through a Subsidiary

Corporations organized under the laws of Canada or a province of Canada are Canadian-resident corporations for the purposes of the ITA and therefore subject to tax in Canada on their worldwide income. All transactions between the Canadian corporation and its foreign parent or other related companies must take place on arm's-length terms and conditions, and must be supported by contemporaneous transfer pricing documentation. Losses incurred by the corporation can be carried back for 3 taxation years or carried forward for 20 taxation years from the year in which the loss was incurred.

Repatriation of Profits

Dividends paid by a Canadian corporation to a non-resident **person** are subject to withholding tax at a statutory rate of 25 percent under Canadian domestic law. The domestic rate may be reduced to as low as 5 percent under Canada's tax treaties. Canada has an extensive tax treaty network, comprising some 90 treaties currently in force; however, this obviously leaves many foreign investors, or potential investors, without direct access to treaty benefits in their country of residence. A foreign investor in a non-treaty country may nevertheless be able to use an intermediary holding corporation in a treaty jurisdiction to avail itself of reduced rates of withholding tax on dividends paid from Canada, or to reduce tax on a future disposition. In order for the treaty-reduced dividend withholding tax rate to apply, the corporation incorporated in the treaty jurisdiction must be able to establish that it is resident under the treaty in that jurisdiction and is the beneficial owner of the dividend. The application of Canada's **general anti-avoidance rule (GAAR)** should also be considered.

Equity contributions made to the corporation increase the corporation's paid-up capital balances, subject to the foreign affiliate dumping rules. Distributions made by a private Canadian corporation (which includes a subsidiary of a foreign public corporation) out of paid-up capital to a non-resident corporation are treated as a return of capital that is not subject to Canadian withholding tax. Distributions out of paid-up capital will, however, reduce the adjusted cost base of the shares and, as a result, may increase the gain otherwise realized on the sale of the shares of the corporation in the future. Unlike many other jurisdictions, Canada allows for distributions from paid-up capital before the payment of taxable dividends. Accounting capital is not the same as paid-up capital determined for tax purposes. Paid-up capital is based on legal stated capital. Therefore, legal counsel should determine stated capital and paid-up capital before the corporation makes a return of capital, to ensure that the amount distributed is paid-up capital and not deemed to be a dividend that is subject to withholding tax.

Financing

Interest expense paid or payable by a corporation on borrowed money used for the purpose of earning income from a business or property in Canada is deductible for Canadian tax purposes. The thin capitalization rules, however, may limit the deduction of interest paid by a corporation to non-resident parties that are related to the Canadian corporation, or that hold a substantial interest in the Canadian corporation. In particular, the interest deduction of the Canadian corporation will be reduced to the extent that the corporation's ratio of interest-bearing debt owing to such non-resident persons to its equity held by related non-residents exceeds 1.5:1. A guarantee is not considered to be a loan for these purposes (however, see discussion below regarding Back-to-Back Loan Arrangements).

Non-participating interest payments made by a resident of Canada to foreign arm's-length lenders are not subject to withholding tax. However, interest expenses denied pursuant to the thin capitalization rules are deemed to be dividends subject to Canadian withholding tax.

Where financing is to be obtained from related corporations, interest payments are subject to withholding tax at a statutory rate of 25 percent subject to reduction by an applicable tax treaty. The reduced rate varies, depending on the treaty, but is typically 10 percent or 15 percent. For non-participating interest payments made to US residents, the withholding rate is reduced to zero under the Canada-US treaty. Foreign investors that wish to finance their Canadian operations from internal sources may be able to benefit from the exemption under the Canada-US treaty by providing the funds through a US-resident entity. However, such financing arrangements will be subject to the limitation-on-benefits article of the Canada-US treaty and to GAAR. To qualify for the treaty rate, the ultimate parent must be publicly listed on a major US stock exchange and meet minimum trading requirements, or it must be majority-owned by US or Canadian residents. The zero withholding rate may also apply if the US entity carries on an active trade or business that is sufficiently similar and is substantial relative to the Canadian business. This may be the case where a multinational has operating mines in both countries.

Back-to-Back Loan Arrangements

In an effort to curtail attempts to circumvent the thin capitalization and withholding tax rules through the use of intermediaries to facilitate financing of Canadian corporations, the Canadian government introduced legislation in 2014 to expand the existing anti-avoidance rule in the thin capitalization provisions and add a back-to-back loan provision to the withholding tax rules.

For thin capitalization purposes, the back-to-back loan rules apply where certain conditions are met.

The Canadian taxpayer must have certain outstanding debts or obligations to pay amounts to an intermediary (the taxpayer debt).

For the purposes of the thin capitalization rules, an intermediary does not include:

— a person resident in Canada with whom the taxpayer does not deal at arm's length;

— a non-resident person who owns (either alone or together with persons with whom that non-resident person is not dealing at arm's length) at least 25 percent of the votes or value of the Canadian corporation (a specified non-resident shareholder); or

— a non-resident person that does not deal at arm's length with a specified shareholder of the Canadian taxpayer; (the latter two persons are collectively referred to herein as the connected non-residents).

The intermediary (or a person that does not deal at arm's length therewith) must also have an outstanding obligation owing to a connected non-resident ("intermediary debt") that meets either of the following two conditions:

— recourse in respect of the intermediary debt is limited in whole or in part to the taxpayer debt; or

— it can reasonably be concluded that all or part of the taxpayer debt became owing, or was permitted to remain owing, because all or part of the intermediary debt was entered into or was permitted to remain outstanding.

The rules will also apply where the intermediary (or a person that does not deal at arm's length therewith) has a specified right in respect of a particular property that was granted directly or indirectly by a connected non-resident, and either:

— the existence of the specified right is required under the terms and conditions of the taxpayer debt, or

— it can reasonably be concluded that if the specified right were not granted, all or part of the taxpayer debt would not have been entered into or permitted to remain outstanding.

A specified right in respect of a property means a right to use, mortgage, hypothecate, assign, pledge, or in any way encumber, invest, sell or otherwise dispose of, or in any way alienate, the property.

The rules will not apply unless the total of the outstanding intermediary debt and the fair market value of property in which a specified right was granted in respect of a taxpayer debt is at least 25 percent of:

— the taxpayer debt; and

— all other amounts owed to the intermediary by the taxpayer or a person not dealing at arm's length with the taxpayer under the agreement, or a connected agreement, if the intermediary is granted security and the security secures the payment of the relevant debts.

The back-to-back loan rules target situations where the connected non-resident effectively funds 25 percent or more of the loan made by the intermediary to the Canadian taxpayer. While the *de minimis* threshold may permit a multinational group to make use of cross-collateralized loans and notional cash pooling arrangements, very strict conditions must be met or the back-to-back loan rules will be triggered.

Where the rules apply, all or a portion of the taxpayer debt is deemed to be owed directly by the Canadian taxpayer to the connected non-resident. Interest payable thereon is deemed payable to that person and the taxpayer debt becomes subject to the thin capitalization rules.

For withholding tax purposes, the back-to-back loan rules apply in a similar manner except that the rules apply to back-to-back loans with all non-residents as there is no exclusion for connected non-resident intermediaries. Where the withholding tax payable to the intermediary is lower than the withholding tax payable to the non-resident person, the rules will apply to deem all or a portion of the loan to have been made directly for the purposes of determining the appropriate withholding tax rate.

Disposing of Canadian Subsidiary

Capital gains realized by non-residents on the sale of taxable Canadian property are subject to tax in Canada. Taxable Canadian property includes shares of a Canadian or a foreign corporation that derives its value principally from **Canadian resource properties**. A number of tax treaties exempt the sale of such shares from tax in Canada where the resource property is used by the corporation in its business operations. This exemption is not available in all treaties. In particular, it is not available in Canada's treaties with the United States and Japan.

Provincial Mining Tax

British Columbia

British Columbia's *Mineral Tax Act* imposes a two-part mineral tax on operators of mines in the province, consisting of:

— a 2 percent net current proceeds tax, and

— a 13 percent net revenue tax.

BC mineral tax is levied on a mine-by-mine basis. An operator cannot transfer tax attributes of one mine to another (with the exception of certain exploration expenses in limited instances). Net current proceeds tax is fully deductible from net revenue tax so that, in effect, only one part of the tax or the other will be payable. Tax is payable in advance, in monthly instalments based on the operator's estimated tax liability for the year. If the amount paid by instalment exceeds the actual tax liability, the operator is credited with interest on the amount of the excess payment.

Net Current Proceeds Tax

The net current proceeds tax serves as a minimum tax on the net current proceeds of an operator of a mine. The net current proceeds of an operator are the amount by which the operator's **gross revenue** from the mine exceeds the current operating costs (excluding capital costs). Net current proceeds tax is levied at a rate of 2 percent on the net current proceeds for the year.

An operator's gross revenue from a mine includes:

— the revenues from the sale of mineral production, and

— any cost recoveries or government assistance received in respect of the operation of the mine.

Gains and losses from commodity or currency hedging are excluded from the calculation of gross revenue. Current operating costs are expenses incurred relating directly to the operation of the mine and to the processing and distribution of production, including reclamation expenditures, provided that such costs are not capital costs. Foreign exchange gains and losses associated with mining operations are taxable or deductible, as the case may be. Capital costs include:

— exploration and pre-production discovery costs,

— certain pre-production development costs,

— equipment leasing costs, and

— the cost of inventories.

Net current proceeds tax paid by an operator accumulates in the operator's cumulative tax credit account **(CTCA)** and is available to offset the net revenue tax payable by the operator on revenues from the mine. An operator cannot carry back the CTCA balance to offset net revenue tax paid in prior taxation years, nor can an operator use the accumulated credits in the CTCA for one mine to reduce the revenue tax from other mines.

Net Revenue Tax

Net revenue tax is levied at a rate of 13 percent on the operator's net revenue from a mine for the year, and can be offset by the operator's CTCA balance for the mine at the end of the year. The net revenue of an operator is the amount by which the total of:

— the operator's gross revenue for the year;

— government grants, subsidies, and other assistance receivable in the year; and

— the proceeds from the disposition of capital assets in the year

exceeds the sum of:

— the operator's cumulative expenditure account **(CEA)** balance at the end of the previous year;

— the operator's current operating costs for the year;

— capital costs incurred in the year, such as capital assets, exploration and pre-production discovery costs, certain pre-production development costs, equipment leasing costs, and the cost of inventories;

— the new mine allowance (discussed below); and

— the investment allowance for the year (discussed below).

If the expenditures exceed the revenue receipts at the end of the taxation year, the operator's CEA is increased by the net excess amount. An operator can carry forward its CEA account indefinitely and apply the balance in the account to offset future revenue receipts.

In computing the allowable expenditures, the *Mineral Tax Act* specifically excludes, among other items:

— interest expense,

— royalties,

— hedging losses,

— head office costs not directly related to the operation of the mine, and

— costs of incorporation or reorganization.

New Mine Allowance

To encourage investment and new mine development in British Columbia, the new mine allowance permits an operator to claim an additional allowance equal to one-third of the capital cost of a new mine or an expansion of an existing mine commencing production in reasonable commercial quantities after 1994 and before 2020. As a result, an operator can offset net revenue by 133 percent of its qualifying capital costs.

Investment Allowance

The investment allowance is intended to provide a return on the capital invested in the mine by the operator and to compensate operators for the non-deductibility of interest. The computation of the investment allowance for each particular year of the mine is based on the average CEA balance for the year and the prescribed rate.

Alberta

Most mining activities in Alberta are conducted on land owned by the Crown in right of Alberta and managed by the Alberta government. The province charges and collects royalties from such mining operations in exchange for the right to explore for, extract, produce, and sell minerals found on Crown land.

Unlike most other provinces, Alberta does not have a separate mining taxation statute applicable to operators of mines on freehold land. Revenues from mining operations are taxed under the federal and Alberta income tax regimes, in the same manner as revenues from other business activities in the province.

Crown royalties are established by the Alberta government, with the rates being based principally on the type of mineral and the volume of production. The Alberta government periodically reviews the royalty regulations to ensure that the rates remain competitive and fair. The latest revision to the regime came into effect on January 1, 2011.

The discussion that follows summarizes Alberta's current royalty regime applicable to various types of minerals under production on Crown land, excluding oil and natural gas production.

Metallic and Industrial Minerals Other than Coal and Oil Sands

The royalty treatment of metallic minerals is more complex than the treatment of other minerals.

The rate before payout in respect of a mine from which the mineral is recovered is 1 percent of mine mouth revenue for the month before payout. After payout, the royalty rate is equal to the greater of 1 percent of mine mouth revenue and 12 percent of net revenue from the mine for the month.

Mine mouth revenue in respect of a mine is calculated as:

— gross revenue for the mine, less

— certain permitted costs and allowances (such as transportation costs) between the mine mouth and point of sale.

Net revenue is determined by deducting exploration, development, recovery, processing, and transportation costs or allowances, as well as any carryforward deductions. Example 6 illustrates the different royalty computations for metallic minerals.

For non-metallic minerals, a standard flat rate applies. Some of the more common rates are outlined in Table 6.

Coal

Coal royalties are governed under separate regulations from other minerals. The royalty rate depends on the type of coal. The applicable rates in 2015 are as follows:

— For sub-bituminous coal situated in the Plains region of Alberta and used to generate electricity, the rate is $0.55 per tonne.

Table 6: Royalty Rates Applicable to Selected Non-Metallic Minerals, Alberta as at June 30, 2015

Commodity	Rate
Limestone, other "stone"	$0.0441/tonne
Bentonite	$0.11/tonne
Clay for pottery and fireclay	$0.11/tonne
Other clay, marl, volcanic ash	$0.0655/cubic meter
Silica sand	$0.37/tonne
Salt	$0.45/tonne

— For bituminous coal situated in the Foothills or Mountain regions of Alberta, the rate is equal to 1 percent of mine mouth revenue before mine payout and 1 percent of mine mouth revenue plus 13 percent of net revenue after mine payout.

Oil Sands

Alberta's royalty regime for oil sands projects also has differentiated rates depending on the current price of oil, the financial status of the project, and whether payout has been achieved in respect of the project. The applicable rates in 2015 are as follows:

— The royalty before payout is calculated as 1 percent to 9 percent of gross revenue (project revenue).

— The royalty after payout is the greater of 1 percent to 9 percent of gross revenue and 25 percent to 40 percent of net revenue (project revenue less allowable costs).

EXAMPLE 6

Computation of Alberta Royalty Payment, Metallic Minerals

Minimum royalty (1% of mine mouth revenue)

Revenue	$1,000,000
Less: Deductible costs and allowances	(500,000)
Mine mouth revenue	$500,000
Royalty rate	1%
Royalties payable	$5,000

After-payout royalty (12% of net revenue)

Revenue:	$1,000,000
Less: Deductible costs and allowances	(750,000)
Net revenue	$250,000
Royalty rate	12%
Royalty payable	$30,000

Saskatchewan

The tax regime applicable to production from mining operations in Saskatchewan is a patchwork of statutory rules, regulations, and levies. In simple terms, the regime can be described as a combination of net profit taxes, royalties, and minimum taxes, plus a surcharge on sales from mining production.

This group of taxes is intended to allow the province to reap the benefits of a profitable industry, based on the profit taxes levied, while ensuring that during economic downturns, when the industry may be less profitable or not profitable at all, the province will still be entitled to collect taxes on sales of the output from producing mines.

Saskatchewan's mining tax legislation is contained in the *Mineral Taxation Act, 1983*. The specific levies to which a particular mining operation may be subject vary according to the type of minerals produced, as set out in the statute and regulations that apply to that area of production. These levies may be reduced by certain legislated allowances, deductions, tax credits, or targeted incentives.

Saskatchewan formerly imposed a **capital tax** on long-term financing and shareholder equity of corporations carrying on business in the province; however, that tax was eliminated effective July 1, 2008. Currently, producers in Saskatchewan's mining industry are subject to a **resource surcharge** of 3 percent of their resource sales, which is not a capital tax but is levied under Saskatchewan's *Corporation Capital Tax Act*. The resource surcharge is reduced for corporations with assets of less than $100 million, based on the corporation's balance sheet as determined by its income tax accounts.

The key elements of Saskatchewan's mining tax regime are described briefly below for five categories of production: potash, uranium, coal, diamonds, and precious and base metals.

Potash

Potash is a significant source of provincial revenues from mining production in Saskatchewan.

Under the *Mineral Taxation Act, 1983*, there are three taxes that apply to potash mining operations in Saskatchewan:

— royalties,

— base payment production tax, and

— profit tax.

For profitable operations, the government relies primarily on the profit tax; however, the combination of the resource surcharge, royalties, and base payment ensures that the province collects a minimum amount from the development of potash deposits and from sales of the mineral.

Royalties

Potash producers are charged a Crown royalty payable to the province that varies between 2.1 percent and 4.5 percent of the sales value, depending on the grade of the ore and the value of production on Crown land (government-owned mineral rights).

Base Payment Production Tax

Operators of potash mines are the only producers in the province subject to a base payment tax. The base payment is a monthly payment based on estimated sales for the calendar year.

The province will receive a minimum amount of tax ranging between $11.00 and $12.33 per K_2O tonne sold. There is a holiday from the base payment tax for the first 10 years for new mines or new production capacity expansions in excess of 122,000 K_2O tonnes per year.

Profit Tax

The net profit tax is based on the profit from the mine operation and not profits or losses from other activities of the producer.

The rate of tax is based on the mine's profit per tonne sold (indexed for inflation) as shown in Table 7. For new entrants to the industry, the tax base for calculating the net profit tax payable is 75 percent of total sales for the year up to a maximum of 1 million K_2O tonnes. (Sales in excess of the maximum are not subject to additional profit tax.) All producers are subject to a tax floor of 35 percent of total sales.

The profit tax is also affected by the base number of tonnes of production for each producing mine, adjusted for a "common industry adjustment factor." This factor is based on the industry as a whole determined by the government of Saskatchewan. In the past the adjustment has been small, since there have been no new mines or significant expansions in Saskatchewan for many years. However, there are currently a number of proposed new mines and expansions that may affect the production of the industry. While this increased production may in turn affect the common industry adjustment factor, it is difficult to predict the impact this may have on the taxes levied.

Table 7: Net Profit Tax Rates Applicable to Potash Producers in Saskatchewan as at June 30, 2015

Profit per K_2O tonne sold	Rate
$0.00 to $67.35	15%
$67.36 and over	35%

The profit tax payable for the taxation year is reduced to the extent that the producer has paid any applicable resource surcharge, royalties, and base payments.

The profit tax is also reduced by the following provincial allowances, deductions, and credits:

— Corporate allowance: There is a deduction of 2 percent of gross revenue, in lieu of non-deductible corporate administrative, overhead, financial, and general management expenses.

— Corporate office incentive: There is a deduction of $25,000 for each existing corporate office position in Saskatchewan and a deduction of $100,000 for each new corporate office position in Saskatchewan for the first five years.

— Depreciation allowance: There is a deduction of 120 percent of the cost of new capital expenditures in excess of historic thresholds.

— Loss carryforward: Losses may be carried forward against future profits for up to five years.

— Targeted tax credit: Producers that participate in approved market development or **R&D** programs may claim a tax credit of 40 percent of the approved expenditure.

— A Saskatchewan resource credit (**SRC**): A credit may be deducted against the profit tax based on 0.75 percent of gross revenues used in the calculation of the basic royalty. The SRC is meant to partially offset the resource surcharge levied under the *Corporation Capital Tax Act*.

2015 Potash Tax Review

In the Saskatchewan Budget 2015, the Province introduced changes to potash taxes and a plan to review the tax structure for potash.

The depreciation rate for capital additions will be reduced for 2015 and onwards. Capital expenditures will continued to be depreciated based on 120 percent of the cost but the depreciation rate will be reduced resulting in more profit taxes payable.

The Saskatchewan tax regime for potash has been criticized for its complexity by commentators and politicians, who have debated if the taxes collected are appropriate. As a result, the Province will conduct a review of the potash tax. The uranium taxes were updated in 2013, so we may expect that a similar process apply to potash taxes.

Uranium

Amendments to Saskatchewan's royalty regime applicable to producers in the uranium industry were implemented on April 1, 2013 with retroactive effect from January 1, 2013.

The new uranium royalty regime has three components:

- A basic royalty: Producers pay a basic royalty based on 5 percent of gross sales (as under the old system).
- A tiered royalty: In addition, producers are subject to a tiered royalty with two rates based on the profit earned per kilogram:
  - 10 percent of net profit up to $22 per kg;
  - 15 percent of net profit over $22 per kg.
- SRC: As described above in respect of the potash industry, a credit may be deducted against the basic and tiered royalties, based on 0.75 percent of gross revenues used in the calculation of the basic royalty. The SRC is meant to partially offset the resource surcharge levied under the *Corporation Capital Tax Act*.

Net profit will be based on sales revenues less operating costs, exploration costs, and the full dollar value of capital costs. Regulations have been developed to provide detail on the costs to be included in determining the net profits. However, as this is a new tax system, there are still growing pains in applying them to the industry.

Transitional rules were implemented for projects under construction.

Coal

Royalty charges for the coal industry are imposed under the *Mineral Taxation Act, 1983*. The applicable rates are as follows:

- for Crown coal, 15 percent of the fair market mine mouth value of the coal, and
- for freehold coal, 7 percent of the fair market mine mouth value of the coal.

Fair market mine mouth value is the gross sale price of the coal less the transportation costs to the point of sale less other approved costs, such as loading facilities.

Fair market mine mouth value is the sales contract value to arm's-length parties. If the coal is not sold to an arm's-length party or if the coal is for consumption, Saskatchewan Energy and Resources will set fair market value as an average price of all Saskatchewan coal sold under contract to arm's-length parties during the reporting period.

A resource credit may be claimed equal to 0.75 percent of sales to partially offset the resource surcharge described above.

Diamonds

Because Saskatchewan's diamond industry is still in its infancy, there are no legislated tax provisions particular to diamond mining operations.

However, the published proposals from 2010 are as follows:

- a 1 percent royalty based on the value of mine production;
- an initial five-year royalty tax holiday;
- a stepped royalty rate on profits to a maximum of 10 percent after capital investment is fully recovered; and
- full cost recognition, including a 100 percent depreciation rate for capital costs and a processing allowance.

Precious and Base Minerals

Gold is the principal mineral in this category currently in commercial production in Saskatchewan. Other minerals are at the exploration phase of development. Producers are subject to net profit taxes and royalties under the *Mineral Taxation Act, 1983*.

There is an initial tax holiday for the first 10 years after the province issues an approval certificate. This certificate is required before construction of the mine can begin. Once the holiday period has passed, the following royalties are payable:

- Initial production: The royalty is based on 5 percent of the net profit for the first 1 million troy ounces of sales or 1 million metric tonnes of sales, depending upon the mineral sold.

— Remainder of production: Once the initial production is reached (1 million troy ounces or 1 million tonnes), the royalty is 10 percent of net profit.

Net profit is calculated as mineral sales less mining/milling costs, overhead, developing/expanding markets, insurance, exploration, depreciation, pre-production, reclamation, transportation, and losses carried forward.

There is a capital recovery system so that the tax does not apply until pre-production start-up costs are recovered:

— Until 150 percent of initial exploration and development costs are recovered, there are no royalties payable.

— Sales in pre-production are offset by pre-production expenses (which include exploration for 10 years prior to production plus design, development, and construction of the producing mine and mill).

These minerals are not subject to the resource surcharge discussed above. Also, fuel taxes will not apply to off-road fuel use or to fuel used in power generation at remote sites.

Manitoba

Operators of mines in Manitoba are subject to a mining tax on profits from their operations under the province's *Mining Tax Act*. The applicable rate increases with increasing revenues as shown in Table 8.

In addition, a special refundable tax of 0.5 percent is imposed on the operator's profit for the year. The amount of the refund depends on the amounts of income tax and special tax payable for the year.

Profits subject to tax under the *Mining Tax Act* are calculated as revenues from the sales of mineral products in the year less specified expenses, payments, and allowances. The deductible expenses include:

— costs of mining, milling, smelting, and refining;

— insurance;

— marketing costs;

— municipal taxes;

— expenditures on research;

— costs of operations;

— depreciation;

— exploration expenses;

— approved reclamation expenses; and

— a processing allowance.

Non-deductible items include the acquisition cost of a mineral property or rights, as well as interest and financing costs. An operator may not carry a loss back or forward.

Table 8: Tax Rates Applicable to Profits from Mining Operations, Manitoba as at June 30, 2015

Profit for the Year	Rate
Less than $50 million	10%
$50 to $55 million	10% on the first $50 million + 65% on the next $5 million
$55 to $100 million	15%
$100 to $105 million	15% on the first $100 million + 57% on the next $5 million
Over $105 million	17%

Exploration and Development Expenses

Exploration expenditures in Manitoba may be deducted at a rate of up to 100 percent. In addition, exploration expenditures in a fiscal year that exceed the average exploration expenditures incurred in the previous three fiscal years may be deducted at a rate of up to 150 percent. Pre-production development expenses are considered depreciable assets and included in the computation of depreciation allowance.

Depreciation Allowance

Depreciable assets, including pre-production development expenses, can be deducted on a declining balance basis at a rate of 20 percent.

Processing Allowance

A processing allowance of up to 20 percent of the original cost of processing assets may be deducted. However, the processing allowance is limited to 65 percent of an operator's profit in a fiscal year.

New Mine Tax Holiday

A new mining operation may be allowed a tax exemption (a "new mine tax holiday"), subject to government approval, until the operator has fully recovered its cost of depreciable assets, including pre-production development expenses, incurred before the commencement of commercial production.

Ontario

Ontario Mining Tax

Ontario's *Mining Tax Act* imposes an Ontario mining tax on operators of mines in the province that produce defined mineral substances. These substances include all minerals except diamonds; operators of diamond mines are not subject to the *Mining Tax Act* but to the *Mining Act*, discussed in a separate section below.

The mining tax is levied at a rate of 10 percent on annual taxable profits in excess of $500,000 from all mines; however, a reduced rate of 5 percent applies to profits from operations at remote sites. While Ontario's corporate tax legislation has been harmonized with the **ITA** (see Deductions, Allowances, and Credits – Other Provincial Credits and Adjustments – Ontario Harmonization Adjustment), the mining tax legislation has not. As a result, there are some significant differences between the federal and the provincial statutes with respect to the determination of profit for tax purposes.

For the purposes of the *Mining Tax Act*, profit is calculated as the excess of proceeds received or receivable from the output of the mines over the permitted allowances and deductions. Proceeds are defined to include:

— all consideration received or receivable from the sale of the output of the mines; and

— gains from hedging, future sales, and forward sales.

Deductible expenses and allowances include:

— expenses incurred by the operator that are attributable to the production of output from the mines;

— operating and maintenance expenses incurred with respect to social assets for the mines (in excess of rents, fees, grants, and other amounts received in respect of those expenses);

— administrative and overhead expenses incurred that are attributable to the production or sale of the output of the mines;

— scientific research conducted in Canada or product use development research conducted in Canada to the extent that it is related to the output of the mines;

— donations made for charitable, educational, or benevolent purposes related to mining operations in Ontario;

— exploration and development expenses;

— an allowance for depreciation at prescribed rates;

— expenses and outlays incurred for transportation of output from the mines to purchasers;

— processing expenses; and

— a processing allowance at prescribed rates.

No deduction or allowance is available for:

— an amount on account of capital, or an amount in respect of depreciation, amortization, obsolescence, or depletion unless expressly permitted under the *Mining Tax Act*;

— interest and other financing costs;

— dividend payments;

— income or profit taxes and **capital taxes**;

— royalties for the right to extract mineral substances or for the use of real property in connection with the extraction of mineral substances paid to anyone other than the Government of Canada or Ontario; or

— a government-imposed fine or penalty.

A loss for the year cannot be carried forward or back.

Exploration and Development Expenditures

Exploration and development expenditures in Ontario are added to a pool of expenditures and are available to be claimed at a rate of 100 percent. This deduction is completely discretionary; the operator can claim the full amount in the year incurred or carry forward the unclaimed expenditures indefinitely.

Depreciation Allowance

An allowance for depreciation may be claimed in respect of **depreciable property**. The rates for 2015 are shown in Table 9.

The allowance for new and existing mining assets is discretionary except during a period of exemption for a new mine or a major expansion of an existing mine (see above), when a deduction of 30 percent or 15 percent, respectively, must be taken. Similarly, the allowance for processing assets is discretionary except during a period of exemption, when a deduction of 15 percent must be taken.

Asset Rehabilitation Expenses

The *Mining Tax Act* provides that reclamation expenses are deductible in the year in which such expenses are incurred. There is no provision for a carryforward or carryback. However, as a matter of administrative practice, the Ministry of Finance (Ontario) may, in certain circumstances, allow the mining operator to carry reclamation expenses back to the last full year of commercial production.

Processing Allowance

An annual processing allowance deduction may be claimed. The processing allowance is computed as follows:

— Where the output has been processed in a concentrator located in Canada and owned by the operator at the end of the year, the processing allowance is equal to 8 percent of the cost of these processing assets.

Table 9: Depreciation Rates for Depreciable Mining Assets, Ontario as at June 30, 2015

Asset Category	Rate	Basis
New mining assets	30%	straight-line basis
Other mining assets	15%	straight-line basis
Assets acquired before the commencement of production of a new mine or from a major expansion of an existing mine	100% but not in excess of the amount of profit from the mine in the year	
Processing and transportation assets	15%	straight-line basis
Social assets	0%	n/a

— Where the output has been processed in a concentrator and a smelter both of which are located in Canada and owned by the operator at the end of the year, the processing allowance is equal to 12 percent of the cost of these processing assets.

— Where the output has been processed in a concentrator, a smelter, and a refinery all of which are located in Canada and owned by the operator at the end of the year, the processing allowance is equal to 16 percent of the cost of these processing assets.

— Where the output has been processed in a concentrator, a smelter, a refinery, and a semi-fabricating plant all of which are located in Northern Ontario and owned by the operator at the end of the year, the processing allowance is equal to 20 percent of the cost of these processing assets.

An operator that does not own processing assets and sells output that has been processed by another **person** on behalf of the operator is entitled to claim a processing allowance equal to 15 percent of the operator's profit for the year.

An operator that owns processing assets and sells processed output in a year may claim a processing allowance of not less than 15 percent of the operator's profit and not more than 65 percent of that profit.

No processing allowance is allowed in respect of processing carried on outside Canada.

Tax Exemption for a New Mine or Major Expansion of an Existing Mine

An operator that starts up a new mine or undertakes a major expansion of an existing mine is entitled to a mining tax exemption. The exemption covers up to 36 months commencing from the time the new or expanded mine comes into commercial production or until the first $10 million of profits is reached.

Remote Mine Incentives

Special incentives are provided for mining operations in remote areas of the province. Where a new mining operation is certified as a remote mine, the tax exemption referred to above is extended from 36 months to 120 months up to the $10 million maximum profit level. After expiry of the exemption period, the applicable mining tax rate for a remote mine is 5 percent.

Diamond Mining Tax

Operators of diamond mines in Ontario are subject to tax under the *Mining Act*, not the *Mining Tax Act*. However, the method of calculating the tax is fundamentally the same under both statutes.

The annual tax is the lesser of:

— 13 percent of the net value of output for the fiscal year, and

— the amount of tax calculated at graduated rates applied to the net value of the output.

The first $10,000 of net value is taxed at a zero rate, and graduated rates ranging from 5 percent to 13 percent apply to the net value of output between $10,000 and $45 million. The net value of output over $45 million is subject to a rate of 14 percent.

The net value of output for a fiscal year is the proceeds from the sale of diamonds (excluding gains and losses from hedging transactions), less allowable costs, expenses, and allowances. The latter include:

— differences between the market value of the inventory of diamonds on hand at the beginning and end of the year;

— costs of cleaning, sorting, valuing, marketing, and selling diamonds;

— costs of mining and processing;

— repairs and maintenance costs; and

— general and indirect costs for property, employees, and operations.

The *Mining Act* lists excluded expenditures that are similar to those listed for mining operators subject to the *Mining Tax Act*, as described above.

Québec

The mining duties that an operator is required to pay are the greater of:

— the operator's minimum mining tax for the fiscal year, and

— the operator's mining tax on annual profit for the fiscal year.

Minimum Mining Tax

The minimum mining tax of an operator corresponds to the aggregate of the following amounts:

— 1 percent of the lesser of the operator output value at the mine shaft head (**OVMSH**) and $80 million, plus

— 4 percent of the OVMSH in excess of $80 million.

The OVMSH of an operator is generally equal to the excess of the gross value of the operator's annual earnings above:

— the aggregate of all expenses otherwise deductible in calculating the operator's annual earnings if they are incurred in the fiscal year and are attributable to

  – activities of crushing, grinding, sieving, processing, handling, transportation, and storage of the mineral incurred after the mineral substance is brought to the first accumulation site and of the processing of the products obtained, and

  – marketing activities of the mineral substance and of the processing products obtained, including general administrative expenses incurred by the operator and relating to any such activities, plus

— depreciation allowance that relates to mining operation activities from the first accumulation site of the mineral substance after it is removed from the mine, plus

— a processing allowance.

Where the OVMSH is less than 10 percent of the operator's gross value of annual output from the mine, it will be deemed to be equal to such amount.

Mining Tax on Annual Profit

The calculation of annual profit is made on a mine-by-mine basis, so that the revenues from one mine cannot be offset by the losses from another. However, exceptions apply for eligible operators that satisfy the following conditions:

— the operator produces no mineral substance in reasonable commercial quantities at the end of the fiscal year; and
— during the fiscal year, the operator is not associated, for the purposes of the *Taxation Act* (Québec), with another entity that produces a mineral substance in reasonable commercial quantities.

A corporation in Québec will be subject to mining taxes on the annual profit earned on its property that is reasonably attributable to the mine and that can reasonably be attributable to the operations of the mine.

For the purposes of the *Mining Tax Act*, annual profit is determined by subtracting from gross revenue the operating expenses and allowances directly related to the mine, including:

— exploration and development expenses;
— depreciation;
— a processing allowance; and
— an additional allowance for a mine located in the North or mid-North, described below.

No deduction is allowed for:

— any amount paid to a community or a municipality for the benefit of that community or municipality;
— an expense incurred for constitution, organization, or reorganization;
— a capital loss, a payment of capital, or a depreciation, obsolescence, or depletion allowance, except to the extent permitted by the *Mining Tax Act*;
— a royalty paid or payable in respect of output;
— a premium in respect of an insurance contract, except where the insurance contract pertains to property regularly used in the mining operation or to a **person**, other than an executive or director, who is an employee of the operator and whose duties relate to the mining operation;
— costs of financing;
— an amount paid or payable under the *Mining Tax Act*;
— taxes on profits and on capital;
— income tax under a federal, provincial, or foreign law, and professional fees incurred in respect of an objection or an appeal in respect of an assessment provided for in any such law;
— a reserve or provision other than a reserve or provision prescribed by regulation of the government; or
— a loss resulting from a hedging or a speculative transaction.

A loss for the year cannot be carried forward or back.

Exploration and Development Expenses

Exploration and development expenses are divided into three separate cumulative accounts, each giving rise to a separate allowance:

— Exploration expenses incurred to determine the existence of a mineral substance in Québec, to locate such substance, or to determine its extent or quality: Eligible operators can deduct 100 percent of the costs (125 percent in the case of mines located in the North or mid-North, described below). Other operators can claim the lesser of the total of such expenses and 10 percent of the annual profit before the deduction of those expenses and any pre-production allowance.
— Expenses incurred to bring a new mine into production where those expenses are incurred before production in reasonable commercial quantities commences: Operators can deduct up to 100 percent of such expenses from the annual profit from the mine.
— Expenses incurred to bring a new mine into production where those expenses are incurred after production in reasonable commercial quantities commences: Operators can deduct 30 percent of such expenses from the annual profit from the mine (but the deduction cannot exceed the annual profit calculated before the deduction and the processing allowance).

Depreciation Allowance

Operators can depreciate assets acquired between May 12, 1994 and March 31, 2010 at a rate of 100 percent, and assets acquired after the latter date at a rate of 30 percent.

Processing Allowance

The processing allowance, unlike the tax depreciation on capital assets, is a perpetual allowance based on the cost of the property acquired and used to process ore.

The processing allowance percentage of the capital cost of the property is as follows:

- 10 percent where the operator does not carry out smelting or refining;
- 10 percent where the property is used solely in processing ore from gold or silver exclusively outside Québec;
- 20 percent where the property is used to carry out, in Québec, smelting or refining of ores other than gold or silver.

Where the property may fall into two of the above categories, the processing allowance will be prorated in accordance with the use of the property.

The maximum amount of the processing allowance that an operator may deduct in calculating its annual earnings from a mine it operates will be increased to the lesser of:

- the established percentage pursuant to the above; and
- the greater of:
  - 75 percent of the operator's annual earnings from the mine for such fiscal year, determined without taking into account the processing allowance, the additional depreciation allowance, the additional allowances in respect of expenses incurred in Northern Québec, and
  - 30 percent of the operator's OVMSH in respect of the mine for the fiscal year, determined without taking the processing allowance into account.

Progressive Rate Based on Profit Margin

The applicable tax rate is progressive and determined on the profit margin for the year as shown in Table 10.

Table 10: Progressive rate based on profit margin

Profit Margin	Applicable Rate	Effective Rate at Segment Maximum
0% to 35%	16.00%	16.00%
35% to 50%	22.00%	17.80%
50% to 100%	28.00%	22.90%

An operator's profit margin for a fiscal year corresponds to the operator's annual profit divided by its gross value of annual output.

Additional Allowance for a Mine Located in Northern Québec

A mining corporation may claim, over a 36-month period, an additional allowance of $2 million for a mine located in the mid-North and $5 million for a mine located in the North. Mid-North means the territory between 50°30′N latitude and 55°N latitude, limited to the east by the Grenville Front, and the part of the territory of the Côte-Nord located between 59°W longitude and 66°W longitude. North means the territory located north of 55°N latitude.

Refundable Credit for Losses

In some circumstances, a refundable tax credit is provided under the *Mining Tax Act* to an operator that sustains an annual loss from a particular mine.

The tax credit is calculated as 16 percent of the lesser of:

- the adjusted annual loss; and
- the total of:
  - pre-production mineral deposit evaluation and mine development expenses incurred in the fiscal year, not exceeding the amount deducted for that year in respect of such expenses, plus
  - 50 percent of the exploration expenses incurred by an eligible operator.

Under the *Mining Tax Act*, the tax credit is not included in income and does not reduce any amounts otherwise deductible. For income tax purposes, under both the ITA and the *Taxation Act* (Québec), the credit is not taxable.

Value of Precious Stones

In determining the net revenue of a mine, the gross value of precious stones is based on their value before cutting or polishing. The determination of the gross value of precious stones must also be made at the mine site by the operator and an appraiser mandated by the Minister of Natural Resources and Wildlife. The operator must sort and clean the precious stones to facilitate their evaluation.

Integrity Rules

Some "integrity rules" may apply to ensure that operators obey the spirit and letter of the law. These integrity rules deem the relevant properties to be alienated at the lesser of the property's capital cost and its fair market value where:

— a person or partnership ceases to be an operator; or
— a property ceases to be used (or regularly used for the purposes of CCA Class 3, 3A, 4, or 4A) for mining operations.

The integrity rules also stipulate that an operator and the associated entity will be deemed to be one and the same person where:

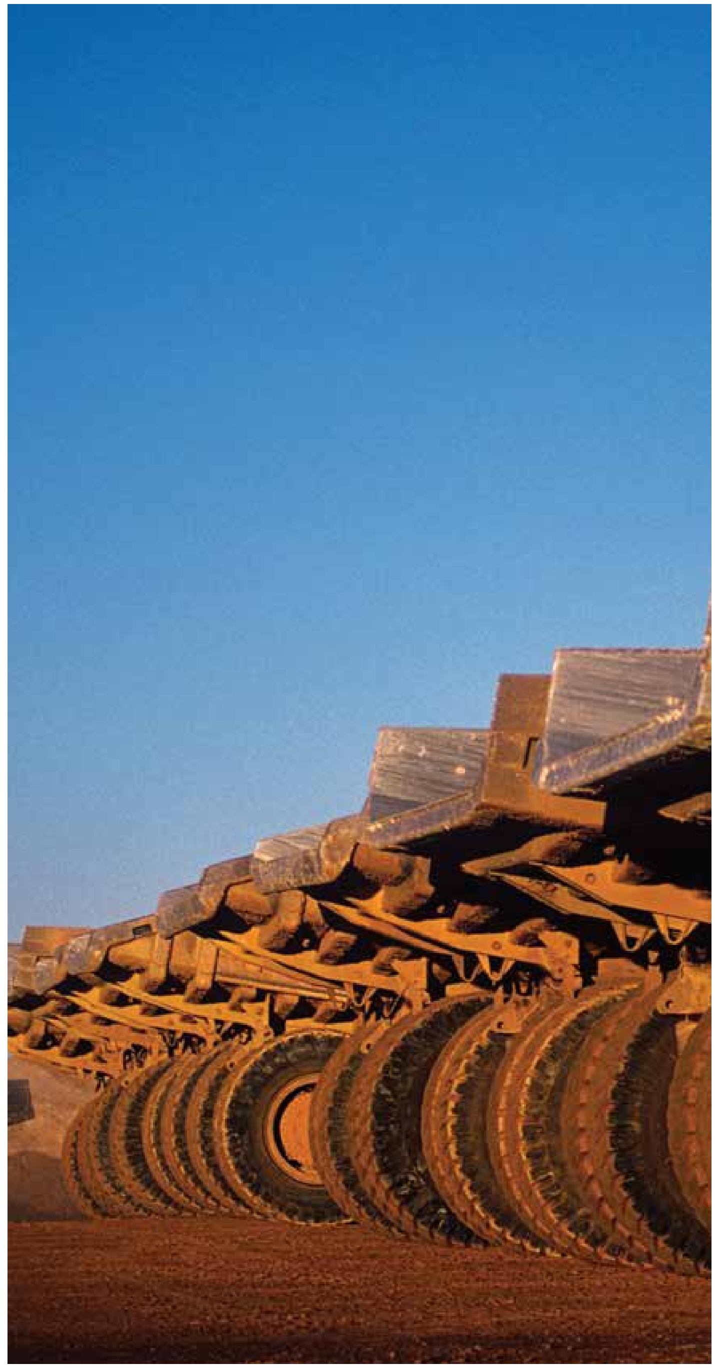
— during a fiscal year, an operator alienates, directly or indirectly, all or part of the mineral substances and/or the processing products from the operation of a mine in Québec in favour of an associated entity;
— the associated entity would be considered to be carrying out mining operations work if it had itself extracted the mineral resources from Québec soil; and
— in the view of the Minister of Natural Resources (Québec), it is reasonable to consider that one of the main reasons for the separate existence of the operator and the associated entity is to reduce the amount of mining duties.

Non-Refundable Credit on Account of the Minimum Mining Tax

For a given fiscal year, an operator required to pay mining duties pursuant to its mining tax on its annual profit may deduct from its mining duties payable an amount equal to the lesser of:

— the amount by which the mining tax on the annual profit exceeds the minimum mining tax for the fiscal year, and
— the cumulative balance on account of the operator's minimum tax at the end of the fiscal year.

The amount of the minimum mining tax in excess of the mining tax on the annual profit may be carried forward indefinitely. The non-refundable credit on account of the mining tax cannot be used to allow an operator to pay an amount of duties that is lower than the minimum mining tax calculated.



New Brunswick

The *Metallic Minerals Tax Act* imposes two forms of mineral tax on operators of metallic mineral mines in New Brunswick:

— a 2 percent royalty based on annual net revenue (net revenue tax), and

— a 16 percent net profit tax.

Mineral tax applies on the operator's combined revenues and profits from mining operations in the province.

Net Revenue Tax

The 2 percent net revenue tax applies to the operator's net revenue for the year. Net revenue is the amount of the **gross income** from mining operations for the taxation year less allowable costs. Allowable costs include the following:

— transportation costs for output sold;

— smelting, processing, and milling costs; and

— 8 percent of the original cost of the milling or concentrating assets and 15 percent of the original cost of smelting or refining assets (together not exceeding 25 percent of net revenue).

No deduction is allowed for:

— the capital cost of property, plant, and equipment;

— capital investment; or

— depreciation or depletion.

However, certain leasing costs in respect of plant and equipment may be deductible up to a specified amount.

A two-year tax holiday from the net revenue tax is available for a new mine, subject to government approval.

Net Profit Tax

Net profit tax is levied at a rate of 16 percent on the operator's net profit for the year in excess of $100,000. Net profit is the amount of gross income from mining operations for the taxation year less allowable costs. Allowable costs include the following:

— transportation costs for output sold;

— underground and aboveground expenses of the mine;

— salaries and wages of persons employed in the mining operations;

— smelting, milling, and processing costs;

— insurance;

— real property tax;

— a depreciation allowance (5 percent to 100 percent) in respect of assets used in a new mine or processing plant (or in an expansion of a mine or processing plant, in certain circumstances);

— an allowance in respect of the cost of other undepreciated assets (up to 33 percent);

— the amount of net revenue tax before tax credits allowed (discussed below);

— royalties or rentals paid to other parties for ore extracted within the province; and

— an allowance in lieu of interest equal to 8 percent of the undepreciated balance of depreciable assets.

In addition, a special deduction is allowed for 150 percent of each dollar of eligible exploration expenditures, other than expenditures claimed as pre-production development costs, incurred by the operator. Any such expenditures that are not claimed in the year can be carried forward and deducted in any succeeding year.

A deduction is also allowed equal to the aggregate of:

— 8 percent of the original cost of depreciable assets used in the milling or concentrating of mineral ore or mineral products derived from the mineral ore, and

— 15 percent of the original cost of depreciable assets located in New Brunswick and used in the smelting or refining of mineral ore or mineral products.

This deduction is subject to a limit of 65 percent of net profits if it has been claimed in two or more previous years.

No other deduction is allowed for the capital cost of property, plant, and equipment, or for capital investment, depreciation, or depletion. However, certain leasing costs in respect of plant and equipment may be deductible up to a specified amount.

Taxation of Royalty and Rental Payments

Payments of royalties or rentals for ore extracted within New Brunswick are subject to a 16 percent tax. The operator paying the royalties or rentals is required to withhold and remit the tax payable in respect of the payment.

Mining Tax Credits

Up to 18 percent of expenditures incurred after the commencement of production in New Brunswick in respect of a 3D seismic survey, deep drilling, or any other advanced exploration technology may be eligible for a credit against the total mining tax payable (subject to pre-approval of the expenditure). The tax credit is limited to $1 million in any given year. Any portion of the credit that has not been applied against the total mining tax payable in the year may be claimed in any succeeding year.

In addition, a tax credit against net profit tax is available, equal to 25 percent of eligible process research expenditures. This credit may be granted only after production commences. Any credit not fully utilized in a year may be used in the succeeding year.

Coal Royalty

New Brunswick's *Mining Act* imposes a royalty of $0.16 per tonne of coal obtained or extracted under the authority of a mining lease.

Operators of mines that are taxable under the *Metallic Minerals Tax Act* are not subject to the royalty provisions of the *Mining Act*.

The government may, at its discretion, suspend the requirement to pay royalties under the *Mining Act* for a period not exceeding 10 years.

Nova Scotia

Operators of mines in Nova Scotia are subject to the payment of royalties (mineral tax) under the province's *Mineral Resources Act*. There is an additional tax applicable to gypsum mining (see below). The applicable rate is one of the following:

- the greater of:
  - 2 percent of the operator's net revenue, and
  - 15 percent of the total net income for the year; or
- upon written notice from the Mine Assessor where the operator's gross income for the year is less than a prescribed amount, 2 percent of the estimated net revenue for the year; or
- a rate determined at the discretion of the government.

Royalties are payable in advance in quarterly instalments, with any balance payable on the due date for filing the annual tax return or within three months of the end of the operator's fiscal year, whichever is earlier.

One component of the calculation of tax is the net revenue of the operator. Net revenue for a fiscal year is the gross income derived from output less deductible expenditures. Gross income is calculated using the market price of the mine output either at the time of sale or at the time of shipment, in situations where the output is sold, or otherwise at the time of transfer or consumption of the output. Deductible expenditures include costs of:

- marketing,
- shipping,
- smelting and refining,
- packaging,

and other associated and related costs borne by the operator.

No deduction is allowed for (among other items):

- the cost of plant, machinery, equipment, or buildings;
- interest or other financing costs;
- depletion of property;
- the acquisition cost of a mineral property;
- royalties payable under the *Mineral Resources Act*;
- taxes on profits;
- lease payments; or
- direct costs incurred by the operator in respect of the processing of output derived from mining operations outside the province or operations not controlled by the operator.

The other component of the tax is the net income of the operator. Net income is determined by deducting from the amount of net revenue (as calculated above) the reasonable operating expenses of the operation borne by the operator. Reasonable operating expenses include the following costs and allowances:

- a depreciation allowance (discussed below),
- a processing allowance (discussed below),
- reclamation costs,
- processing costs,
- underground and aboveground operating expenses,
- insurance,
- utilities,
- fuel,
- security, and
- maintenance and repairs.

Depreciation Allowance

An allowance is provided for the undepreciated value of depreciable assets, to a maximum of 100 percent of depreciable costs per year for the first three years of a mining operation and a maximum of 30 percent of the undepreciated value at the end of each year thereafter. Depreciable assets include the costs of the mine, mill, plant, and equipment, as well as exploration and development expenses.

Processing Allowance

The processing allowance provides a return on capital employed in the secondary crushing, grinding, concentrating, chemical extraction, smelting, refining, or packaging of output in Nova Scotia. The allowance is equal to 8 percent of the cost of the processing assets plus 25 percent of assets necessary to the servicing and management of the processing activities. The allowance cannot exceed 65 percent of net income otherwise determined.

Reclamation

The costs of reclamation completed after a mining operation has ceased production may be considered as prior years' operating expenses. As such, these costs may be applied in reverse order to royalty returns for prior fiscal years and can be used to reduce royalties payable in prior years. The reduction cannot exceed 2 percent of net revenue for each fiscal year in which it is applied.

Gypsum Mining Income Tax

Profits from gypsum mining are subject to tax at a rate of 33 1/3 percent. A taxpayer may either pay this tax on its actual profits from gypsum mining, or elect to assume a legislated profit per ton of gypsum mined. A taxpayer's profits from gypsum mining are its net revenues from mining gypsum less:

— the actual working expense of the mine, including salaries and wages of employees immediately connected to the gypsum mining;
— the cost of power and lighting;
— the cost of food and provisions supplied by the employer;
— the cost of explosives;
— the costs incurred in providing mine safety and security;
— the costs of insuring mine physical assets;
— depreciation of mine assets;
— exploration and development costs;
— municipal taxes upon the mine; and
— charitable donations in Nova Scotia.

The *Gypsum Mining Income Tax Act* expressly disallows deductions for investments in capital assets. Income is computed annually for the operations at each mine, and losses cannot be carried forward or back.

Prince Edward Island

Prince Edward Island does not impose mining tax.

Newfoundland and Labrador

The *Revenue Administration Act* imposes the following taxes (collectively, mineral tax) on operators of mines in Newfoundland and Labrador:

— a 15 percent tax on taxable income,
— a 20 percent tax on amounts taxable, and
— a 20 percent mineral rights tax.

Tax on Taxable Income

Taxable income of the operator is calculated as net income less the greater of 20 percent of the net income, if positive, and amounts paid to a **person** who receives royalties subject to the mineral rights tax. The applicable tax rate is 15 percent.

Net income is the **gross revenue** of the taxpayer less all expenses reasonably incurred in mining operations, processing, and smelting. Gross revenue is the revenue from the sale of minerals as a result of mining operations in a year, including:

— income from processing,
— gains or losses resulting from the fixing of a price for output of a mine before delivery,
— gains or losses from hedging transactions related directly to the proceeds of the output of a mine, and
— government assistance related to revenue.

Deductible expenses include:

— unamortized pre-production expenditures over the estimated remaining life of the mine;
— rentals, royalties, charges, and other payments to the Crown for the right to engage in mining operations; and
— any undeducted exploration expenditures exclusively incurred by the taxpayer anywhere in Newfoundland and Labrador before the commencement of commercial production.

Operators can also claim allowances for depreciation and processing.

Depreciation Allowance

Depreciation may be claimed on vehicles, machinery, plant, equipment, buildings, and other assets of a capital nature used in mining operations and in processing and smelting. The depreciation on processing or smelting assets (Class 1 assets) and mining assets that are not Class 3 assets (Class 2 assets) cannot exceed 25 percent of the **UCC**. The depreciation on mining assets acquired for and used in a new mining operation or a major expansion project (Class 3 assets) can be up to 100 percent of the UCC. Only 50 percent of the assets may be included in the UCC in the year of acquisition for the purposes of calculating depreciation. The deduction is prorated for short taxation years. Where a mining operation ceases to be a new mining operation, or a major expansion project, the Class 3 assets are reclassified as Class 2 assets.

Processing Allowance

An operator may deduct a prescribed amount by way of return on capital directly and necessarily employed by the taxpayer in processing. In addition, an operator may deduct a processing allowance equal to 8 percent of the original cost of processing assets and 15 percent of the original cost of smelting assets, both of which are permanently located in Newfoundland and Labrador, and exclusive of interest or financing charges. The processing allowance cannot exceed 65 percent of net income excluding this deduction.

Credit Against Tax on Taxable Income

A credit is available against the 15 percent tax on taxable income for a year. The credit is based on the corporate income tax paid to Newfoundland and Labrador in the year and serves as a deduction against the tax on taxable income.

The credit applies for 10 consecutive years beginning in the year in which commercial production is achieved in the mine from which the mining income is derived. The cumulative amount of the credit cannot exceed $20 million. The credit can be claimed only if all depreciation and exploration expenses available in the year have been utilized by the operator.

The amount of the credit in respect of corporate income tax for a year is the lesser of $2 million and corporate income tax payable under the provincial *Income Tax Act* for the year in respect of mining operations.

Tax on Amounts Taxable

A 20 percent tax applies to amounts taxable, which are calculated as 20 percent of the net income (as determined above), if positive, minus amounts paid to a person who receives royalties subject to the mineral rights tax.

Mineral Rights Tax

Mineral rights tax applies where a person receives consideration, including rent and royalties, that is contingent upon production of a mine, or computed by reference to the production from a mine, for the grant or assignment of any right issued under the *Mineral Act*.

The annual tax is 20 percent of the net revenue received in the year in excess of $200,000. Where the consideration received is from an operator and the net revenue of the person in that year is $100,000 or less, no mineral rights tax is payable. Where net revenue in a year is greater than $100,000 and less than $200,000, the tax payable is 40 percent of net revenue in excess of $100,000.

Net revenue is the total value of mineral production royalties received less the total of legal expenses incurred by the person in the collection of the revenue, exploration expenditures incurred by the person, and royalties paid by the person to another person, where that other person is subject to mineral rights tax in respect of the royalty paid.

The operator paying the royalties or rentals is required to withhold and remit the tax from the payment.

Yukon

Yukon imposes three separate royalties:

— a royalty on all ore and minerals mined (the mining royalty),

— a royalty on all gold exported from Yukon (the gold royalty), and

— a royalty on coal (the coal royalty).

Mining Royalty

Under Yukon's *Quartz Mining Act*, a mining royalty applies to all ore, minerals, or mineral-bearing substances mined in Yukon in a calendar year. The mining royalty is computed in reference to the value of the output from the mine on an escalating basis using the rates shown in Table 11.

The mining royalty is computed on a mine-by-mine basis.

Value of the Output

The value of the output of a mine for a calendar year is the amount by which the value of the minerals produced exceeds the sum of:

— the deductions for the mine,

— the development allowance for the mine,

— the depreciation allowance for the mine, and

— the community and economic development expense allowance for the mine.

Table 11: Mining Royalty Rates, Yukon, as at June 30, 2015

Annual Profits	Royalty Rate*
$0 to $10,000	0%
Over $10,000 to $1 million	3%
Over $1 million to $5 million	5%
Over $5 million to $10 million	6%
Over $10 million to $15 million	7%
Over $15 million to $20 million	8%
Over $20 million to $25 million	9%
Over $25 million to $30 million	10%
Over $30 million to $35 million	11%
Over $35 million	12%

* *The rate is applied to profits within each specified increment, not to the total profits.*

The value of the minerals produced is the sum of:

— the proceeds from the sale of minerals,

— the change in the market value of the mineral inventory during the calendar year,

— proceeds from the sale of mining assets in excess of the UCC,

— the amount of cost reimbursements received in the calendar year, and

— the amount of insurance proceeds receivable in the calendar year.

Gains from commodity or currency hedging are excluded from the calculation of the value of minerals produced.

Deductions

A deduction may be claimed in computing the value of the output of a mine over a calendar year for the operating costs of mining and processing minerals from the mine, including:

— maintenance,

— exploration and development costs incurred at the mine,

— storage and transportation costs, and

— reclamation costs.

The *Quartz Mining Act* specifically prohibits the deduction of:

— financing costs,

— royalties,

— hedging losses,

— costs for an off-site office, and

— the cost of goods or services not directly related to the mine.

Development Allowance

The development allowance provides a deduction, calculated on a units-of-production basis over the life of the mine, for certain exploration and development expenditures incurred prior to the commencement of production (the "pre-production expenditures"). The development allowance for a calendar year is equal to the proportion of the undeducted pre-production expenditures for the mine that the amount of ore produced by the mine for the year is of the mineral reserves of the mine at the beginning of the year.

Depreciation Allowance

An operator may deduct a depreciation allowance equal to 15 percent of the original capital cost of mining assets on an annual basis until the original capital cost is fully claimed. Mining assets are assets used in the operation of a mine that have a capital cost in excess of $10,000 and an expected useful life of over one year.

Community and Economic Development Expense Allowance

An operator must deduct a community and economic development expense allowance (**CEDEA**) equal to the least of:

— the undeducted balance of qualifying expenditures for the mine for the year;

— 15 percent of all amounts claimed as deductions, development allowance, and depreciation allowance; and

— 20 percent of the value of the output of the mine for the year after all deductions.

Qualifying expenses for the purposes of the CEDEA include:

— capital costs for constructing or repairing community infrastructure and facilities;

— costs to operate or maintain community facilities; and

— the cost of environmental cleanup for land not included in the mine property.

To qualify for the CEDEA, an expense must be approved by Natural Resources Canada.

Gold Royalty

Under the *Placer Gold Act*, a 2.5 percent royalty applies to all gold dust as mined and gold bars shipped from Yukon. The gold is valued at a fixed price of $15 per ounce for the purposes of computing the gold royalty.

Coal Royalty

The Coal Regulation levies a royalty on each holder of a lease equal to $0.10 per tonne of merchantable coal mined on lands acquired by lease and a royalty on each holder of a coal mining permit equal to $0.25 per short ton of merchantable output of the mine.

Northwest Territories and Nunavut

The *Northwest Territories Mining Regulations* (Canada) and *Nunavut Mining Regulations* (Canada) impose a mining royalty on an operator or owner of a mine located in the Northwest Territories or Nunavut ("the Crown royalty").

The Crown royalty is levied on a mine-by-mine basis and is equal to the lesser of 13 percent of the value of the output of the mine and the amount determined using the escalating rates shown in Table 12.

The value of the output of a mine for a fiscal year is the amount by which the fair market value of minerals produced and certain other amounts exceed the permitted deductions and allowances. The other amounts to be included in the value of the output of a mine include:

— payments received for the reimbursement of costs previously deducted,

— proceeds of disposition received from the disposition of mining assets in excess of the undeducted balance of depreciable assets,

— proceeds received from insurance of minerals produced from the mine,

— amounts withdrawn from a mining reclamation trust, and

— any grants received from the federal government.

Hedging gains are specifically excluded in computing the value of the output of a mine for the year.

An operator may claim a deduction in computing the value of the output of a mine for a fiscal year for the following:

— operating costs of mining and processing minerals from the mine, including general and indirect costs incurred at the mine;

— the cost of marketing, selling, storing, and transporting minerals produced from the mine;

— the cost of reclamation at the mine;

— certain exploration costs incurred on Crown land other than the mine site;

— a depreciation allowance equal to 100 percent of the cost of the depreciable assets of the mine, not exceeding the undeducted balance of depreciable assets;

— a development allowance equal to 100 percent of the exploration and development costs incurred at the mine, not exceeding the undeducted balance at the end of the fiscal year;

— an allowance for contributions to a mining reclamation trust; and

— an annual processing allowance equal to the lesser of 8 percent of the cost of processing assets and 65 percent of the value of the output of the mine after deduction for the preceding amounts.

The mining regulations specifically prohibit the deduction of:

— financing costs,

— royalties,

— hedging losses,

— costs for an office not located at the mine, and

— the cost of goods or services not directly related to the mine.

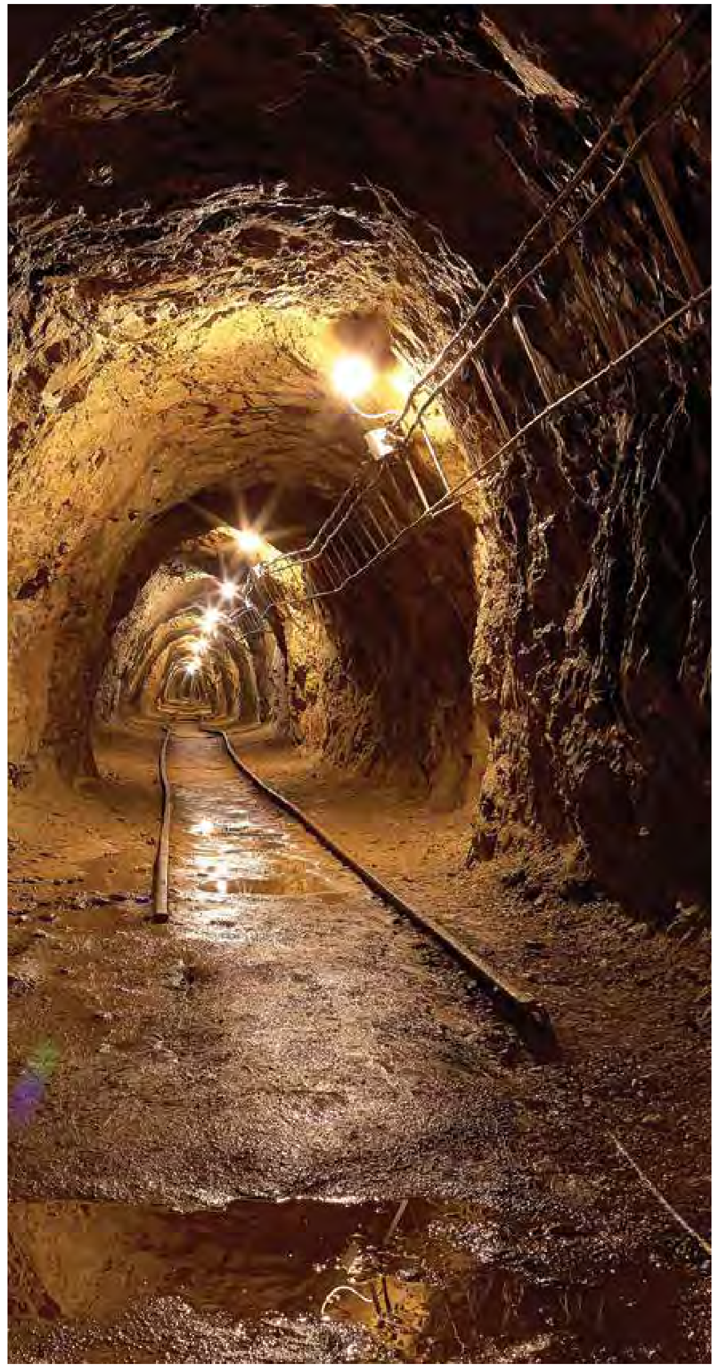


Table 12: Mining Royalty Rates, Northwest Territories and Nunavut, as at June 30, 2015

Annual Profits	Royalty Rate*
$0 to $10,000	0%
Over $10,000 to $5 million	5%
Over $5 million to $10 million	6%
Over $10 million to $15 million	7%
Over $15 million to $20 million	8%
Over $20 million to $25 million	9%
Over $25 million to $30 million	10%
Over $30 million to $35 million	11%
Over $35 million to $40 million	12%
Over $40 million to $45 million	13%
Over $45 million	14%

* *The rate is applied to profits within each specified increment, not to the total profits.*

Other Taxes

Mining activities in Canada may be subject to other federal and provincial taxes, in addition to the taxes on income described in the preceding sections of this book. These additional taxes include value-added and sales taxes, customs duties, and land transfer taxes or registration fees. A brief summary of these types of levies is provided below.

Value-Added and Sales Taxes

Federal

The federal government levies a form of value-added tax known as the goods and services tax **(GST)**. The current GST rate is 5 percent and applies to a broad range of property and services supplied in Canada, with certain specified exceptions. Property and services that are not subject to 5 percent GST may be zero-rated (taxable at 0 percent) or exempt (not taxed).

In common with most value-added tax regimes around the world, the GST applies at each stage of the production and distribution of property and services; however, it is fully recoverable to the supplier at each stage up to purchase of the supply by the final consumer. Thus, it is the final consumer who ultimately bears the tax. The recovery mechanism is the availability of an input tax credit for GST incurred on expenditures.

Five provinces – Ontario, Prince Edward Island, New Brunswick, Nova Scotia, and Newfoundland and Labrador – have harmonized their provincial sales taxes **(PST)** with the GST. In these provinces, the PST has been repealed and the GST rate increased. The result is a single harmonized sales tax **(HST)** consisting of a federal and a provincial component. Both components of the HST are recoverable by suppliers, with some exceptions.

British Columbia's commodity tax system was harmonized from July 1, 2010 to March 31, 2013; however, following the results of a provincial referendum in 2011, the British Columbia government reversed its decision to harmonize, reinstating a separate PST and returning to the GST effective April 1, 2013. British Columbia's current PST is substantially the same as the one it repealed in July 2010.

The GST/HST legislation is contained in the federal *Excise Tax Act*.

Provincial

Three provinces – Saskatchewan, Manitoba, and British Columbia – currently levy a PST under provincial statutes that operate independently from the federal GST/HST legislation. These provincial sales taxes are similar to the sales and use taxes levied in many US states (see Overview of the US Mining Tax Environment). PST typically applies to sales and leases of goods and to certain services at the retail level (subject to various exemptions). Unlike GST/HST, PST incurred by businesses is not recoverable.

Québec levies its own form of value-added tax, the Québec sales tax **(QST)**. Like the GST/HST, the QST applies to a broad range of property and services at each stage of production and distribution, and it is recoverable by the supplier as an input tax refund in the same manner as the GST/HST input tax credit. The QST applies in the same manner as the GST.

Alberta, Yukon, the Northwest Territories, and Nunavut do not currently impose separate retail sales taxes. Supplies of property and services in these jurisdictions are subject to GST.

Table 13 shows the federal and provincial rates for value-added and sales taxes in effect as at June 30, 2015.

Table 13: Value-Added and Sales Tax Rates, Canada, as at June 30, 2015

British Columbia	5% GST + 7% PST
Alberta	5% GST
Saskatchewan	5% GST + 5% PST
Manitoba	5% GST + 8% PST
Ontario	13% HST
Québec	5% GST + 9.975% QST
New Brunswick	13% HST
Nova Scotia	15% HST
Prince Edward Island	14% HST
Newfoundland and Labrador*	13% HST
Yukon*	5% GST
Northwest Territories	5% GST
Nunavut	5% GST

* The proposed increase to 15%, effective on January 1, 2016, was canceled in December 2015

Application to the Mining Industry

GST/HST and QST

The mining industry is subject to the same GST/HST and QST rules as other businesses. GST/HST and QST apply to inputs (acquisitions of materials/products and services) and outputs (supplies of products and services made to others) in the course of mining exploration, development, and operation. As discussed above, the rate of tax that applies depends on the province in which the mining operations take place. For example, in 2013, expenditures incurred by a mining business will attract 13 percent HST in Ontario, 14.975 percent combined GST and QST in Québec, and 5 percent GST in Alberta and the three territories.

While GST/HST incurred is recoverable through input tax credit claims, large businesses (those with annual revenues over $10 million) are not entitled to recover the provincial portion of the HST incurred in Ontario on expenditures in the following categories:

— energy (excluding energy used in production);

— telecommunications (other than internet access and toll-free number charges);

— vehicles under 3,000 kg and (in Ontario only) fuel used in such vehicles (excluding diesel); and

— meals and entertainment, to the extent that these expenses are restricted for income tax purposes.

These restrictions are transitional rules, introduced when Ontario's HST came into effect on July 1, 2010; they will be phased out over three years, beginning in 2015.

In Québec, large businesses (those with annual revenues in excess of $10 million) are not entitled to claim an input tax refund for the QST incurred on the same categories of expenditures listed for Ontario above. Québec will phase out these restrictions on the same basis as Ontario as part of its plan to make the QST operate in the same manner as the GST in virtually all respects.

The rate of GST/HST that applies to the sale of mining products depends on the shipping destination of the product. Where the shipping destination is in Canada, the GST/HST rate that applies is the rate applicable in the province/territory to which the product is shipped. Mining product shipped to a destination outside Canada is zero-rated (taxable at 0 percent). Precious metals are zero-rated whether delivered in Canada or exported. The term "precious metal" is defined to mean a bar, ingot, coin, or wafer that is composed of gold, silver, or platinum and is refined to a purity level of at least 99.5 percent in the case of gold and platinum, and 99.9 percent in the case of silver.

The QST applies to mining products shipped to a destination in Québec. Mining product shipped to a destination outside Québec is zero-rated. As under the GST/HST, the sale of precious metals is zero-rated for QST purposes regardless of where such metals are shipped.

PST

British Columbia

Effective April 1, 2013, British Columbia's 7 percent PST applied to goods and certain services (repair and maintenance, telecommunications, and legal services) acquired for use in that province. Most of the exemptions that existed prior to July 1, 2010 under the "old" PST apply under the new PST and include:

— machinery and equipment used exclusively in the exploration for or development of mineral resources; and

— machinery and equipment used primarily in the processing of minerals.

The sale of mineral products in British Columbia is subject to PST unless the product is acquired for resale or further processing.

Saskatchewan

Saskatchewan's 5 percent PST applies to goods and a variety of services acquired for use in that province. All equipment and materials acquired for use in mine exploration, development, and operation are subject to PST unless a specific exemption applies.

Specific exemptions are provided for:

— equipment designed for and used exclusively in mining exploration or geophysical exploration; and

— energy used in processing minerals, as well as catalysts and direct agents used for that purpose.

The sale of mineral products in Saskatchewan is subject to PST unless the product is acquired for resale or further processing.

Manitoba

Manitoba's 8 percent PST applies in a similar manner to Saskatchewan's PST. All equipment and materials acquired for use in mine exploration, development, and operation are subject to PST unless a specific exemption applies. The exemptions include the following materials and equipment:

— prescribed equipment used in mining exploration or geophysical exploration,

— drill bits and explosives used in mineral exploration or development, and

— prototype equipment purchased and used to develop new mining technologies.

Manitoba also provides an 80 percent reduction in the rate of PST on electricity used in mining.

The sale of mineral products in Manitoba is subject to PST unless the product is acquired for resale or further processing.

British Columbia Carbon Tax

Cap and Trade Legislation

British Columbia has introduced legislation authorizing hard limits (caps) on greenhouse gas **(GHG)** emissions through the *Greenhouse Gas Reduction (Cap and Trade) Act*. This legislation enables British Columbia's participation in the trading system being developed with other jurisdictions through the Western Climate Initiative. Through the *British Columbia Reporting Regulation*, which falls under the Act, reporting operations outside the public sector that emit more than 10,000 tonnes of carbon dioxide-equivalent (CO_2e) are required to report annually. The *British Columbia Reporting Regulation* also requires any British Columbia business facility that emits 25,000 tonnes or more of CO_2e per year to complete a third-party audit of its annual emissions report. The British Columbia Ministry of Environment estimates that 160 to 200 British Columbia facilities are required to file reports, and 80 to 100 of those are required to have third-party audits. Many of the latter are companies with mining operations in British Columbia (as the requirement to file is based on the location of the actual operations and not the location of head office). Currently the information is used as an inventory of emissions; however, if cap and trade is implemented, the reported emissions for each sector and operation will be used to drive the cap and trade process.

Carbon Tax

British Columbia levies a carbon tax – a tax based on GHG emissions generated from burning fossil fuels. Carbon tax applies to the purchase or use of fossil fuels within British Columbia, including gasoline, diesel fuel, natural gas, home heating fuel, propane, coal, pentanes, and gas liquids. The tax also applies to tires and peat used as fuel. Table 14 shows the tax rates that apply for the principal fuel types as at June 30, 2015.

All consumers and businesses purchasing fossil fuels in British Columbia are subject to the tax, with certain exceptions; for example, fuel purchased for air or marine travel out of British Columbia and fuel purchased as feedstock to produce other products.

For fuels other than natural gas, collection and remittance procedures for the carbon tax are similar to those under the *Motor Fuel Tax Act*, with fuel sellers being required to pay security equal to the tax payable on the final retail sale and consumers being ultimately liable to pay the tax. For natural gas, the tax is collected at the time of sale to a person intending to consume or use the gas in British Columbia.

Table 14: Carbon Tax Rates, British Columbia, as at June 30, 2015

Type of Fuel	Rate
Gasoline	6.67 cents per litre
Diesel fuel	7.67 cents per litre
Natural gas	5.70 cents per cubic meter
Propane	4.62 cents per litre
Coal – high heat value	$53.31 per tonne
Coal – low heat value	$62.31 per tonne

Alberta Climate Leadership Plan

On November 22, 2015, the Government of Alberta announced the Alberta Climate Leadership Plan, which aims to accomplish a number of climate-related initiatives, including an accelerated transition from coal to renewable energy, the development of carbon pollution reduction measures, and the introduction of a carbon tax. The aspects of the Climate Leadership Plan relevant to the mining industry are the carbon pricing and the introduction of emissions limits for the oil sands. The proposed legislation had not been released at the time of publication, and the following summary is based on the government's public announcements.

Carbon Pricing

Alberta addresses GHG emissions under the *Specified Gas Emitters Regulation* **(SGER)**, which requires facilities that emit 100,000 tonnes or more of GHG a year to reduce their emissions intensity by 12 percent (increasing to 15 percent on January 1, 2016, and to 20 percent on January 1, 2017). There are a number of ways a facility can comply with the SGER, including by contributing to Alberta's Climate Change and Emissions Management Fund **(Fund)**. Contributions to the Fund are set at $15 for every tonne of GHG emissions over the facility's targeted reduction (the contribution price will change to $20 on January 1, 2016, and to $30 on January 1, 2017). The SGER applies to approximately 45 percent of the province's total emissions.

Under the Climate Leadership Plan, the SGER will be replaced by the *Carbon Competitiveness Regulation* **(CCR)** beginning in 2018. The CCR will impose an economy-wide carbon pricing regime in Alberta, which will cover an estimated 90 percent of the province's emissions. A carbon price of $20 per tonne will be applied to all sectors in 2017, increasing to $30 per tonne in 2018, and will increase by 2% per year thereafter (plus inflation). Large final emitters (facilities that emit in excess of 100,000 tonne) may receive an output-based emissions credit based on top quartile performance, depending on sector. As a result, poor performers (facilities that fall far below the top quartile) will be paying more than those facilities with relatively low emission intensities.

Cap on Oil Sands Emissions

There is currently no limit on GHG emissions for oil sands facilities. The Climate Leadership Plan will set an overall oil sands emissions limit of 100 megatonnes annually, with provisions for cogeneration and new upgrading capacity.

Customs Duties

Canada's *Customs Act* defines duties to mean "any duties or taxes levied or imposed on imported goods under the *Customs Tariff*, the *Excise Act, 2001*, the *Excise Tax Act*, the *Special Import Measures Act* or any other Act of Parliament." Therefore, imported commercial goods are subject to both import duty and the GST.

Customs duty is assessed on the basis of the tariff classification of the imported goods and the corresponding duty rates set out in the *Customs Tariff*. The Most Favoured Nation **(MFN)** rates apply unless the imported goods are eligible for preferential tariff treatment based on their country of origin. The MFN rates of duty usually range from free to 8 percent on machinery and equipment used in production.

The following summary highlights a few key areas relating to mining.

Machinery and Equipment

The federal government has gradually eliminated tariffs on a wide range of manufacturing inputs, machinery, and equipment imported into Canada. The MFN rates of duty on the selected products were reduced to free as of January 1, 2015. However, duty rates still apply to certain goods in the

above-noted categories so it is important for importers to determine whether tariffs apply.

There are various other provisions in the *Customs Tariff* that may also be considered if the imported goods attract customs duty. For example, there are special provisions that provide relief of customs duty on certain goods used in specific mining applications.

Anti-dumping and countervailing duties may be applicable to certain products that are used in the mining industry. For example anti-dumping and countervailing duties are applicable to fasteners and carbon steel welded pipe originating from China.

Ores and Concentrates

Importers of ores and concentrates should be aware of potential compliance risks relating to tariff classification and valuation. Declarations of tariff classification and customs value have been the subject of audits undertaken by the

Canada Border Services Agency (CBSA). For instance, ores are often composed of more than one mineralogical type (e.g., zinc ore with copper and lead content). As a result, it may be difficult to determine the correct tariff classification for customs declaration purposes.

With respect to customs valuation, ores and concentrates are often imported using provisional pricing and a final price may not be settled upon until sometime after importation. If the provisional price is used for customs declaration purposes, the declared value for duty may need to be adjusted. In such cases, it is important for the importer to apply an acceptable customs valuation methodology to ensure that the import value is correctly declared, and, where necessary, make the required adjustments. With respect to ores and concentrates, customs declaration errors can result in assessment of additional GST, punitive interest, and monetary penalties.

Temporary Importations

There are provisions that allow machinery and equipment to be imported free of customs duty if it is imported temporarily for use in Canada. To qualify for these provisions, the goods must be exported within a certain timeframe and cannot be imported for sale, lease, on-lease (the imported goods can be leased to the importer but the importer cannot lease the goods to another party in Canada), further manufacturing, or processing (among other conditions). Full or partial relief from the GST may be available, depending on the specific goods being imported and their use while in Canada. If the goods do not attract duty upon full importation and no relief from the GST is available, there is no benefit to importing the goods under these provisions.

Capital Tax

Canada no longer imposes a federal **capital tax**. The large corporations tax **(LCT)** was eliminated effective January 1, 2006.

Until recently, the majority of the provinces also imposed a provincial capital tax on corporations. However, by July 1, 2012, all provinces except Saskatchewan had eliminated their corporate capital taxes on resource companies.

Saskatchewan eliminated its capital tax on July 1, 2008. However, large resource companies and resource trusts in Saskatchewan continue to be subject to a capital tax surcharge – the **resource surcharge** – equal to 3.0 percent of the value of sales of potash, uranium, and coal produced in the province. (The surcharge is discussed in Provincial Mining Tax – Saskatchewan.) Provincial capital tax is deductible in computing taxable income.

Land Transfer Taxes

Most of the provinces impose land transfer taxes on transfers of real property – land, buildings, and other improvements. The rates of land transfer tax vary by province and range from 0.25 percent to 2.00 percent of the consideration for the real property transferred. Certain exemptions from land transfer taxes apply to non-arm's-length transactions. In addition, transfers of resource properties are in many cases exempt from land transfer tax.

No stamp or transfer duties are payable on the transfer of shares. Some provinces may impose land transfer tax if a transfer of shares occurs within a certain period after the transfer of real property that was eligible for a non-arm's-length exemption.

Public Reporting of Tax Payments for Mining Companies

Mining companies operating in Canada will be required to publish annual reports detailing tax and other payments they make to all levels of Canadian and foreign governments, starting with their fiscal year that begins after June 1, 2015. Complying with these new reporting standards will be challenging — many companies will have to modify their systems, controls and processes to track reportable payments.

The reporting requirements apply to businesses engaged in the commercial development of minerals, oil or natural gas. Commercial development includes activities such as exploration, extraction and the acquisition or holding of a permit, license or lease but excludes preparatory activities (e.g. manufacturers of equipment) and post-extraction activities (e.g. refining, smelting, processing). Businesses are required to report if they are either listed on a Canadian stock exchange or are doing business in Canada and meet two of the following three criteria in one of their two most recent fiscal years:

— At least $20 million in assets
— At least $40 million in revenue
— An average of 250 employees.

These businesses must report annually on payments of $100,000 or more, or a series of payments in any category totalling $100,000 or more. Examples of payment types include taxes, licenses, fees, royalties, production entitlements, bonuses, dividends and infrastructure improvements. The reporting must be done on a project basis, for example, for each mining site.

Businesses are required to publish their report on the Internet so that it is available to the public and provide a direct link to Natural Resources Canada. The report requires attestation by a director or officer of the business or an independent auditor that the information is true, accurate, and complete.

These measures are similar to the proposed mandatory reporting requirements for the extractive sector in other jurisdictions, such as the US and European Union. The Canadian government may allow businesses to submit reports prepared in another jurisdiction to meet Canada's requirements if the other jurisdiction's requirements are deemed to be equivalent.

A company's ability to efficiently comply with these obligations and reduce the long-term financial burden of the reporting will depend on properly adapting accounting and project systems and controls to automatically gather and report on the data. Typically, Enterprise Resource Planning (ERP) systems like SAP and Oracle are not designed to capture the information on a cash basis, and therefore must be modified. In many instances, companies will need to find a method of consolidating the data from various legacy systems in addition to their ERP system. Collecting consolidated information from controlled joint ventures and entity acquisitions and dispositions will also be a challenge. In addition to system changes, Businesses should also consider producing centralized guidance procedures and a control framework to ensure accuracy and consistency in the report. Most importantly business should consider the impact and risks of publishing the report in the public domain. Many businesses are already planning to provide a narrative to help give context and explanations to the numbers in the report.

Overview of the US Mining Tax Environment

Foreign mining companies operating in the United States are subject to state and local indirect tax regimes and federal and state income tax regimes.

State and local indirect tax regimes may include severance tax, sales and use tax, property tax, customs duties, or other indirect taxes as outlined in the specific jurisdiction's regulations. Certain states and municipalities exempt equipment used in the mining process from sales and use taxes in their jurisdiction. Customs duties assessed on imported materials and capital can vary greatly, depending on the product and the country of origin.

Although the income tax rules in the separate state tax jurisdictions mirror federal income tax rules, each state has separate tax rules and regulations, including rules specific to mining operations in its jurisdiction. The combined federal and state income tax rate is in the range of 38 percent to 40 percent (state taxes are deductible in computing federal taxes). For income tax purposes, the deductibility of various costs incurred during the mining process varies, depending on the state in which the costs are incurred.

The federal tax rules are contained in the Internal Revenue Code **(IRC)** and related Treasury regulations. The federal tax law is administered by the Internal Revenue Service **(IRS)**. Like the **CRA**, the IRS issues guidance and rulings on a variety of matters relating to the interpretation and application of the tax law.

Under the IRC, US citizens and residents are taxed on a worldwide basis. Non-residents are taxed on income derived from US sources, including income derived from carrying on a trade or business in the United States. The tax treatment under US domestic law may be varied by an applicable tax treaty.

For federal tax reporting purposes, members of a corporate group within the US can elect to file on a consolidated basis. Consolidation permits the aggregation of the earnings and losses of group members in calculating US tax payable, subject to certain limitations.

Allowable Deductions

For US tax purposes, mining stages are divided into three categories: exploration, development, and production. Mine exploration costs are those costs incurred after an area of interest is defined or mineral rights are acquired and before the development stage of the mine begins (i.e. before the existence of ore/minerals in commercially marketable quality and quantity has been established). Exploration costs can include drilling, detailed geophysical and geological studies, core sampling, trenching, and other costs incurred to ascertain the existence, location, extent, or quality of a mineral deposit.

Costs associated with purchasing or improving depreciable property would not qualify as exploration costs, but depreciation on equipment used in the exploration work is considered an exploration cost.

Mine exploration costs are subject to capitalization and included in the basis of mineral rights acquired unless an election is made to deduct such expenditures. For corporate taxpayers electing to deduct, 30 percent of current-year expenditures must be capitalized and amortized ratably over 60 months. The election to deduct is made at the taxpayer level and applies to all subsequent years unless revoked.

To the extent that mine exploration expenditures have been deducted with regard to a mine, such amounts are subject to recapture once the mine reaches the production stage. Recapture is by either a reduction in the current-year depletion allowance or, at the election of the taxpayer, the inclusion of all previously claimed deductions in the calculation of income for the year in which production commences. Any amounts that are recaptured may be either included in the property's adjusted basis for the purposes of computing cost depletion, or offset against the amount realized on a sale or disposition of the property.

In general, development costs are costs incurred for the development of a mine that are paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed. Development costs can include the costs of audits, drilling, removal of mine overburden and waste, drifts, and sinking of shafts or other physical undertakings that have no salvage value. Development costs are deductible as incurred. As is the case with exploration expenditures for corporate taxpayers, 30 percent of current-year expenditures must be capitalized and amortized ratably over 60 months. Alternatively, a taxpayer may elect to capitalize mine development expenditures related to the ore benefited and amortize such amounts on a units-of-production basis as the mineral is produced and sold. Elections can be made mine-by-mine and year-by-year. An election must cover all development expenditures for the taxable year for each mine covered by the election, and elections cannot be revoked. If an election to defer development expenditures is made while the mine is still in the development stage, it covers only the excess of the expenditures over the net receipts, if any, from sales. This limitation does not, however, apply to development expenditures made when the mine is in a producing stage.

If a mineral property is located outside the US but is owned by a US taxpayer, exploration expenditures and development costs incurred with respect to a mineral property are deducted ratably over 10 years unless the taxpayer elects to add the expenditures to the property's basis for cost depletion.

Depletion

The IRC allows the owner of an economic interest to deplete property (i.e., claim the US equivalent of **CCA**). Availability of deductions depends on whether the taxpayer acquires an economic interest in a mining property or mining rights. An economic interest exists where a taxpayer has acquired, by investment, any interest in the mineral in place, and secures, by any form of legal relationship, income derived from the extraction of the mineral, to which it must look for a return of its capital. An economic interest is defined to include a working or operating interest, a royalty, an overriding royalty, a net profits interest, or a production payment (to the extent that the latter is not treated as a loan under the IRC).

Depletion deductions are allowed with respect to a separate mineral property. A property is each separate interest owned by a taxpayer in each mineral deposit in each separate tract or parcel of land. For example, two contiguous leasehold interests over the same mineral deposit, which were simultaneously acquired from separate owners, would constitute two separate properties.

A taxpayer can claim cost depletion (a depletion deduction calculated upon the adjusted basis of the property) or percentage depletion (a deduction calculated upon a percentage of gross income from the property). The depletion deduction can be taken only with respect to property that is exhaustible for tax purposes.

While cost depletion is allowed for all exhaustible mineral resources, percentage depletion is restricted to minerals and, in certain cases, oil and gas. Where percentage depletion is allowed, the basis for the deduction is gross income from the property less an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. In the case of mineral properties, percentage depletion cannot exceed 50 percent of the taxable income from the property. A taxpayer is required to claim the amount that generates the larger depletion allowance on a property-by-property basis.

Research and Development Tax Credits

There is currently no credit available for amounts paid or incurred after December 31, 2014; however, the credit may be retroactively extended at a future time to include amounts paid or incurred from January 1, 2015 onwards.

R&D expenditures incurred in relation to the development of mining equipment, new metallurgic processes, or other innovations may be eligible for a tax credit equal to 20 percent of the increase in certain qualified expenditures over those incurred during a base period. In no case may the base period amount be less than 50 percent of the total qualified expenditures. Qualified research expenses eligible for the R&D tax credit include wages for employees directly engaged in R&D activities and their immediate supervisors, as well as supplies and computer use charges.

Domestic Production Activities Deduction

The domestic production activities deduction (**DPAD**) is allowable in an amount equal to 9 percent of the lesser of:

- qualified production activities income of the taxpayer for the taxable year, and
- taxable income for the year.

For oil-related income, the DPAD is reduced to 6 percent.

Qualified production activities income includes income from the disposition, lease, or licence of tangible personal property that was extracted by the taxpayer within the US; however, only income from an active trade or business is taken into account. As a result, royalties, net profit interests, and production payments received by a taxpayer in its capacity as an investor should not qualify for the DPAD. The DPAD can result in reduction of the effective US federal tax rate from the maximum of 35 percent to as low as 31.85 percent.

Disposition of Property

A US person or a foreign person engaged in a US trade or business can be eligible for capital gains treatment on the disposition of an economic interest in a mining property or a mining interest. If the property was a capital investment but was used in a trade or business, the IRC allows capital gains treatment to the extent that capital gains exceed capital losses. If capital losses exceed capital gains, the resulting loss should be treated as an ordinary loss. The taxpayer is required to recapture, as ordinary income, depletion and other deductions taken with respect to the property.

A foreign taxpayer will also be taxable on the disposition of a US real property interest **(USRPI)**, even if the taxpayer is not engaged in a US trade or business. A USRPI is defined to include an interest in real property, including an interest in a mine, well, or other natural deposits located the United States or the Virgin Islands, as well as certain US corporations whose value is primarily derived from other USRPI. For this purpose, the term "real property" includes land and unsevered natural products of the land, improvements, and personal property associated with the use of real property.

If a foreign person disposes of a USRPI, a purchaser should withhold tax at the rate of 10 percent on the amount realized on the disposition. The amount realized is the sum of the cash paid or to be paid, the fair market value of other property transferred or to be transferred, and the outstanding amount of any liability assumed by the purchaser.

For example, if the sale price is US$1 million for USRPI and the basis is $1.5 million, then the potential withholding tax should be US$100,000. The vendor will then be required to file a US income tax return and calculate actual US income tax on the amount of the loss from the disposition. Under these facts, the vendor should receive a refund of the tax withheld, because the amount of tax withheld ($100,000) is higher than the maximum tax liability.

PFIC Regime

US investors in Canadian-based mining companies may be subject to taxation under the passive foreign investment company **(PFIC)** rules. A foreign corporation is a PFIC if 75 percent or more of its gross income for a taxable year is passive (the 75 percent passive-income test) or at least 50 percent of the average fair market value of the assets held by the corporation during a taxable year consists of passive assets (the 50 percent passive asset test).

Generally, passive income includes dividends, interest, rents and royalties, annuities, net gains from transactions in any commodities, and net gains on the sale of property producing passive income; passive assets are defined as assets that produce, or are held for the production of, passive income.

Where a US person invests in a PFIC, the US investor will not be entitled to the long-term capital gains tax rate on any gain resulting from the sale of the shares of the PFIC (the long-term capital gains tax rate is a maximum of 20 percent for tax years after 2012 if the shares are held for more than one year). In addition, the individual US investor will not be entitled to the qualified dividend tax rate on certain dividends received from the PFIC (the qualified dividend tax rate is also a maximum of 20 percent for tax years after 2012). Instead, any gain (or dividend) is allocated over the period throughout which the PFIC shares were held, and is taxed at the highest rate applicable to ordinary income in the year (39.6 percent for tax years after 2012), plus an interest charge. The items of income noted above may also be subject to the 3.8 percent unearned income Medicare contribution tax if earned by certain individual taxpayers and trusts whose adjusted gross income (as modified) exceeds a specified threshold amount.

The punitive provisions of the PFIC rules – in general, the allocation of gains and certain distributions to various years during the holding period, and the taxation of those gains and distributions as ordinary income at the highest rates plus interest – do not apply to a taxpayer that makes the qualifying electing fund **(QEF)** election. In general, the company must have been a QEF with respect to the taxpayer for each taxable year (since 1986) in which the company was a PFIC and that included any part of the taxpayer's holding period.

As a result of the QEF election, the US shareholder must include his or her share of ordinary income of the QEF in income annually (as ordinary income) – whether or not distributed – as well as net capital gains of the QEF (as long-term capital gains). This election is shareholder-specific and does not affect foreign (non-US) shareholders.

Another available option is to make the mark-to-market election. This requires that the shareholder mark the PFIC stock to market each year for US tax purposes. The shareholder must include in gross income (as ordinary income) the excess, if any, of the fair market value of the stock at the end of the year over its adjusted basis. In addition, in contrast to the QEF election, any gain on the sale of the stock is treated as ordinary income.

Any US person holding PFIC stock will be required to file IRS Form 8621 in any year in which such PFIC stock is held, regardless of whether or not a QEF or mark-to-market election is in place.

Canada's Response to BEPS

Base Erosion and Profit Shifting (BEPS) has become a hot button issue in the international tax community and the Canadian government is taking steps to protect its tax base from perceived inappropriate erosion.

Background

A global debate has emerged between governments and multinational corporations over transparency and how multinational businesses are being taxed in light of increased mobility. Media and public scrutiny over whether companies are paying their "fair share" of tax has also resulted.

The **OECD Action Plan**, which was presented at the meeting of G20 Finance Ministers on July 19, 2013, makes 15 recommendations that focus on key areas including the digital economy, hybrid mismatch arrangements, controlled foreign corporation rules, excessive intercompany interest payments, harmful tax practices, treaty abuse, avoidance of permanent establishment status, transfer pricing, aggressive tax planning, and greater transparency and disclosure. After 2 years of significant work, on October 5, 2015, the OECD published its final reports for all 15 items.

These recommendations are intended to equip governments with the domestic and international instruments to address challenges related to BEPS in a comprehensive and coordinated manner.

The OECD's recommendations may lead to new rules that could have a significant effect on multinational corporations that undertake generally accepted tax planning.

Canada's Response

While Canada has not yet issued a specific formal response to the OECD's recommendations, Canada's Department of Finance has indicated that is likely to wait and see the BEPS developments made in other countries as well as get input from the new Liberal majority government on its policy priorities. However the new Liberal government did generally endorse the OECD's recommendations at the G-20 Summit in Turkey in November 2015.

In recent years, Canada has addressed the issue of BEPS in the domestic context through the imposition of several previously discussed rules (see, for example, the Foreign Affiliate Dumping Rules and Back-to-Back Loan Arrangements).

In the 2014 federal budget, the Canadian government proposed a general, main purpose provision and a domestic law approach to combat treaty shopping. On August 29, 2014 the Canadian government announced that, after engaging in consultations on the proposed treaty-shopping rule, it would await further work by the OECD and the G-20 on its BEPS initiative. Since the release of the OECD's final reports, the Canadian government has not clarified whether it will continue to pursue a domestic anti-treaty shopping rule. Rather, it is possible that Canada's concerns may be resolved through the adoption of certain of the OECD's recommendations, such as the adoption of a multi-lateral instrument with other countries to address treaty related BEPS issues.

While the Canadian anti-treaty shopping rule is currently on hold, Canadian-based multinationals and foreign corporations investing in Canada will want to closely follow the status of this, and other BEPS-related legislation as it emerges.

Glossary

Abbreviations

ACCA	Accelerated capital cost allowance
ACFRE	Adjusted cumulative foreign resource expense
ASPA	Adjusted stub period accrual
CBSA	Canada Border Services Agency
CCA	Capital cost allowance
CCDE	Cumulative Canadian development expense
CCEE	Cumulative Canadian exploration expense
CCOGPE	Cumulative Canadian oil and gas property expense
CDE	Canadian development expense
CEA	Cumulative expenditure account
CEC	Cumulative eligible capital
CEDEA	Community and economic development expense allowance
CEE	Canadian exploration expense
CFRE	Cumulative foreign resource expense
COGPE	Canadian oil and gas property expense
CRA	Canada Revenue Agency
CRIC	Corporation resident in Canada
CTCA	Cumulative tax credit account
DPAD	Domestic production activities deduction
FAPI	Foreign accrual property income
FEDE	Foreign exploration and development expense
FRE	Foreign resource expense
GAAP	Generally accepted accounting principles
GAAR	General anti-avoidance rule
GHG	Greenhouse gas

GST/HST	Goods and services tax/harmonized sales tax
IFRS	International financial reporting standards
IRC	Internal Revenue Code (US)
IRS	Internal Revenue Service (US)
ITA	Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended
ITC	Investment tax credit
LCT	Large corporations tax
METC	Mining exploration tax credit (British Columbia)
MFN	Most favoured nation
NPI	Net profits interest
NSR	Net smelter return
OVMSH	Output value at the mine shaft head
PFIC	Passive foreign investment company (US)
PLOI	Pertinent loan or indebtedness
PST	Provincial sales tax
QEF	Qualifying electing fund (US PFIC regime)
QET	Qualifying environmental trust
QRE	Qualified resource expense
QST	Québec sales tax
R&D	Research and development
SC	Successor corporation
SIFT	Specified investment flow-through
SR&ED	Scientific research and experimental development
SRC	Saskatchewan resource credit
TIEA	Tax information exchange agreement
UCC	Undepreciated capital cost
USRPI	US real property interest (US tax rules)

Tax Terms

Accelerated capital cost allowance	Rapid capital cost allowance for a specific class of property in specific circumstances. In the mining context, a taxpayer is entitled to accelerated capital cost allowance of up to 100 percent for property belonging to Class 41(a) or Class 41(a.1).
Active business income	In the context of the foreign affiliate rules, active business income includes income earned from any business (other than an investment business or a non-qualifying active business) and certain income from property such as interest, royalties, and rent that is deemed by the foreign affiliate rules to be active business income.
Adjusted cost base	The cost of acquisition of a property as adjusted by the ITA.
Adjusted cumulative foreign resource expense	Consists of cumulative foreign resource expenses as adjusted to take into account a transaction subject to the successor corporation rules.
Adjusted stub period accrual	See discussion page 38.
All or substantially all	The ITA does not define the term "all or substantially all." The CRA takes the position that all or substantially all means 90 percent but does not provide a methodology to use in the calculation of all or substantially all. The limited jurisprudence available does not provide much guidance.
Allowable capital loss	One-half of a capital loss.
Allowance for depreciation	Allowance for depreciation means an allowance for the undepreciated value of depreciable assets for certain provincial mining tax regimes. Depreciable assets include the costs of the mine, mill, plant, and equipment, as well as exploration and development expenses. The allowance is permitted as part of the calculation to determine the theoretical value of the ore, at the mouth of the mine, on which the mining tax is calculated.
Allowance for processing	An allowance by way of return on capital employed in the secondary crushing, grinding, concentrating, chemical extraction, smelting, refining, or packaging of output. The allowance is permitted as part of the provincial mining tax calculation to determine the theoretical value of the ore, at the mouth of the mine, on which the mining tax is calculated.
Canadian-controlled private corporation	A private corporation that is a Canadian corporation and that is not controlled by one or more non-residents of Canada, one or more public corporations, or any combination of them.
Canadian corporation	A corporation incorporated in any jurisdiction in Canada or resident in Canada.

Canadian development expense	See discussion on page 16.
Canadian exploration expense	See discussion on page 15.
Canadian oil and gas property expense	See discussion on page 16.
Canadian partnership	At any time is a partnership all of the members of which are resident in Canada at that time.
Canadian resource property	A mining property or an oil and gas property in Canada.
Capital cost allowance	The amount allowed to be deducted from income to account for the depreciation of capital property. The amount of capital cost allowance available for a property in a year will depend on its cost and the type of property. The Regulations contain a detailed categorization of types of property and the rates at which they can be depreciated.
Capital gain	A capital gain from a disposition of capital property is the amount by which the proceeds of disposition exceed the adjusted cost base and any reasonable costs of disposition.
Capital loss	A capital loss from a disposition of capital property is the amount by which the adjusted cost base and any reasonable costs of disposition exceed the proceeds of disposition.
Capital property	Capital property is property that, when disposed of, will give rise to a capital gain or a capital loss, rather than a gain or loss recognized on account of income. Property is capital property if the taxpayer acquires it to produce income rather than to resell it for a profit. Thus, inventory is not capital property, but each of land (other than a resource property) and machinery used in the mining process is capital property.
Capital tax	A tax on the capital of a corporation. For these purposes, the capital of a corporation consists of its equity and debt less an investment allowance for its interests in the equity and debt of other corporations.
Control	There are two types of control of a corporation recognized by the ITA: de jure control and de facto control. De jure control contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors. De facto control contemplates control of a corporation, directly or indirectly in any manner whatever, as a matter of fact by the exertion of influence on the business and affairs of the corporation. For the purposes of the acquisition-of-control rules in the ITA, an acquisition of control of a corporation occurs where a person acquires de jure control of the corporation.

Controlled foreign affiliate	A foreign affiliate is a controlled foreign affiliate if a Canadian resident owns more than 50 percent of the voting shares of the foreign affiliate, or would own more than 50 percent of the voting shares if it held all of the shares owned by related persons and up to four arm's-length Canadian residents and persons related to them.
Corporation resident in Canada	Includes all corporations incorporated in Canada.
Cumulative Canadian development expense	See discussion on page 16.
Cumulative Canadian exploration expense	See discussion on page 16.
Cumulative Canadian oil and gas property expense	See discussion on page 17.
Cumulative eligible capital	Three-quarters of the cost of eligible capital property is added to cumulative eligible capital and three-quarters of the proceeds of disposition of eligible capital property is deducted from cumulative eligible capital. A taxpayer may claim a deduction of 7 percent on a declining balance basis of its cumulative eligible capital.
Cumulative foreign resource expense	See discussion on page 17.
Depreciable property	Capital property the cost of which can be deducted from income over time. The amount that can be deducted in a year is limited to the capital cost allowance for the particular class of property.
Eligible capital expenditure	The cost of eligible capital property.
Eligible capital property	Consists of intangible capital property such as goodwill, franchises, incorporation fees, and customer lists.
Eligible mine development property	Depreciable property acquired after March 20, 2013 and before 2018 for the purpose of producing income from a new mine or an expansion of mine if (i) the property was acquired under a written agreement entered into before March 21, 2013 (ii) construction was started before March 21, 2013, or (iii) the engineering and design work for the construction was started before March 21, 2013.
Excluded property	Property the disposition of which by a foreign affiliate of a Canadian resident does not result in foreign accrual property income.
Exempt surplus	See discussion on page 44.
Farm-in/farm-out	See discussion on page 40 and following.
Farmee	A person who acquires an interest in a resource property of another person (the farmor) in consideration for funding or performing exploration and development work on the property.

Farmor	A person that has an interest in a resource property and grants an interest in that resource property to another person (the farmee) in consideration for the farmee's either funding or performing exploration and development work on the property.
Flow-through mining expenditure	A form of grassroots CEE that is renounced by a corporation to an individual (other than a trust) or a partnership of which the individual is a member pursuant to a flow-through share agreement that entitles the individual to an investment tax credit of 15 percent of the expenditure.
Flow-through share	A share or a right to acquire a share of a principal-business corporation issued by the corporation to an investor pursuant to an agreement in writing under which the corporation agrees to incur qualifying CEE or qualifying CDE and to renounce such expenses to the investor.
Foreign accrual property income	Income of a controlled foreign affiliate of a Canadian resident that is imputed to the Canadian resident as it is earned. Includes most passive property income such as interest, rent, royalties, and taxable capital gains realized by the controlled foreign affiliate on dispositions of property other than excluded property.
Foreign affiliate	A non-resident corporation will be a "foreign affiliate" of a Canadian-resident taxpayer if the Canadian resident owns directly or indirectly 1 percent or more of the shares (of any class) of the non-resident, and, either alone or together with related persons, 10 percent or more of the shares (of any class) of the non-resident.
Foreign exploration and development expense	An expense that would be a foreign resource expense if it were incurred after 2000.
Foreign resource expense	See discussion on page 17 and following.
Foreign resource property	Property that would be a Canadian resource property if it were located in Canada.
Functional currency year	A taxation year in which a functional currency election is effective.
Generally accepted accounting principles and international financial reporting standards	Accounting standards accepted by a recognized professional body.
General anti-avoidance rule	A statutory rule in the ITA that applies to deny a tax benefit arising from an avoidance transaction if the transaction otherwise would result in a misuse or abuse of the provisions of the statute. An avoidance transaction is a transaction, or a transaction that is part of a series of transactions, that cannot reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

Grassroots CEE	Canadian exploration expense incurred for the purpose of determining the existence, location, extent, or quality of an oil, gas, or mineral resource in Canada.
Gross income	A term used in many mining tax statutes referring to the sale proceeds of a product. Gross income is the starting point for computing the income that is subject to tax.
Gross revenue	A term used in many mining tax statutes and that refers to the sale proceeds of a product. Gross income is the starting point for computing the income that is subject to tax.
Hybrid surplus	See discussion on page 44.
Inter-vivos trust	A trust that takes effect during the lifetime of its creator.
Investment business	See discussion on page 46 and following.
Investment tax credit	A deduction from tax payable earned by incurring qualifying expenses such as pre-production mining expenditures and scientific research and experimental development expenses.
Joint venture	An undertaking carried out by two or more persons pursuant to which assets of the business are owned directly by the participants in the joint venture.
Large corporations tax	A federal capital tax that was previously imposed under Part I.3 of the ITA.
Limited partnership	A partnership in which one or more partners is a general partner that manages the business of the partnership and has unlimited liability for the debts of the partnership, and one or more partners is a limited partner that does not manage the business of the partnership and has limited liability for the debts of the partnership.
Mining exploration tax credit	See discussion on page 30 and following.
Mining property	Includes any right, licence, or privilege to prospect, drill, or mine for minerals; rental or royalty interests in a mineral resource; and any land that derives its principal value from its mineral resource content.
Net capital losses	The difference between allowable capital losses and taxable capital gains realized on the disposition of capital properties.
Non-capital losses	Net operating losses from a business or a property (i.e., losses other than net capital losses).
Non-depreciable capital property	Capital property for which a deduction for capital cost allowance is not permitted. Includes land (other than a resource property), shares, and partnership interests held as an investment to produce income.

Non-portfolio property	Includes Canadian resource properties, Canadian real property, and shares or securities of another entity that have a value in excess of 10 percent of the value of the subject entity.
Non-qualifying active business income	Active business income earned in a non-treaty or non-TIEA country.
Oil and gas property	Includes any right, licence, or privilege to take petroleum, natural gas, or related hydrocarbons; rental or royalty interests in an oil or gas well; and any land that derives its principal value from its petroleum or natural gas content.
Original owner	The person who incurred resource expenses that a successor may deduct in accordance with the successor corporation rules.
Partnership	A business carried on in common with a view to profit by the members of the partnership.
Person	An individual, a trust, or a corporation. A partnership is not a person for the purposes of the ITA except where expressly provided. A joint venture is not a person for tax purposes.
Pertinent loan or indebtedness	See discussion on page 47.
Pre-acquisition surplus	See discussion on page 44.
Predecessor owner	A person who acquires properties from an original owner and transfers them to a successor in accordance with the successor corporation rules.
Pre-production mining expenditure	Canadian exploration expenses incurred on a mineral deposit from which the principal mineral to be extracted is diamonds, base metals, or precious metals.
Principal-business corporation	A corporation whose principal business includes: — mining or exploring for minerals; — processing mineral ores for the purposes of recovering metals therefrom; — the production, refining or marketing of petroleum, petroleum products or natural gas; or — exploring or drilling for petroleum or natural gas; and all or substantially all of the assets of which are shares of the capital stock or indebtedness of one or more other corporations that are related to the corporation and whose principal business is described in the foregoing items. A principal-business corporation may be a Canadian corporation or a foreign corporation.

Qualifying CEE and qualifying CDE	Canadian exploration expense and Canadian development expense that may be renounced in accordance with the flow-through share rules.
Qualifying environmental trust	See discussion on page 29 and following.
Qualified resource expense	See discussion on page 38.
Regulations	The Income Tax Regulations (Canada) promulgated under the ITA.
Resource deduction or resource expense	Canadian development expense, Canadian exploration expense, Canadian oil and gas property expense, foreign exploration and development expense, or foreign resource expense.
Resource property	A mining property or an oil and gas property.
Resource surcharge	A capital tax imposed by Saskatchewan on large resource companies and resource trusts, equal to 3.0 percent of the value of sales of potash, uranium, and coal produced in Saskatchewan.
SIFT entity	A specified flow-through partnership or trust resident in Canada that holds property that constitutes non-portfolio property, the units of which have a public market.
SIFT legislation	Legislation that imposes a tax on income from a business carried on in Canada by a SIFT entity.
Successor	See discussion on page 18 and following.
Surplus rules	See discussion on page 43 and following.
Stub period	See discussion on page 38.
Tax-free surplus balance	See discussion on pages 35 and 51.
Taxable capital gain	One-half of a capital gain.
Taxable surplus	See discussion on page 44.
Tax information exchange agreement	A bilateral agreement entered into by two countries to exchange information for tax purposes.
Testamentary trust	A trust that takes effect on the death of its creator.
Undepreciated capital cost	The portion of the cost of a depreciable property of a particular class prescribed by the Regulations that has not been deducted from income in previous years. Calculated as the cost of the property less the capital cost allowance claimed for that class of property in previous years.
Working interest	The right that a person receives from the owner of the resource to drill and mine for minerals or to take petroleum, natural gas, or related hydrocarbons. Frequently the Crown is the owner of the resource but, in the case of freehold rights, the working interest holder will be someone to whom the Crown has granted the resources.

Mining Terms

Adit	A horizontal or near-horizontal entrance to an underground mine, from which the mine can be entered, ventilated, etc.
Anomaly	A deviation from the general survey, which may indicate an ore body; can be synonymous with ore body or structure.
Assay	A compositional analysis to determine the amount of metal in an ore or alloy (e.g., fire assay).
Backfill	The waste that is used to fill the void created by mining an ore body to keep mine shafts or stopes stable.
Ball mill	A cylindrical piece of processing equipment used to grind ore into powder for further processing; the cylinder is rotated causing the steel balls to impact and grind the ore in the ball mill.
Block caving	A method of bulk mining that uses gravity to extract ore in an efficient manner; large blocks of ore are undercut causing the ore to cave, which is then extracted via the haulage access.
Bulk sample	A large and representative sample of rock selected to determine the metallurgical characteristics of a potential ore body.
Bullion	An uncoined solid mass of gold or silver; typically in the form of bars or ingots.
Cathode	A rectangular plate of metal, often copper, produced by electrowinning refining process.
Chute	An inclined passage for the transfer of ore to a lower level using gravity.
Complex ore	An ore containing multiple minerals of varying value and use; the interaction of the different minerals in complex ore can lead to issues with metallurgical recovery.
Concentrate	The fine, powdery output from the milling process, containing a high percentage of valuable metals.
Concentrator	A type of processing equipment that separates particles within the ground ore using gravity to produce concentrate as the finished product.
Crusher	Apparatus in which ore is broken into progressively smaller pieces (e.g., jaw crusher, gyratory crusher).
Cut and fill	A method of underground mining in which ore is mined in lifts or slices, which is then backfilled prior to mining the next lift or slice.
Diamond drilling	A method of drilling using a rotary drill and diamond bit to extract a solid core of rock in long cylindrical sections from the ore body.
Doré	Unrefined gold and silver bullion bars usually consisting of approximately 90 percent precious metals that will be further refined to almost pure metal.

Drift	A horizontal passageway in an underground mine that follows a vein of ore or rock formation.
Dump	The site for disposal of waste rock from the mine that may be extremely low grade.
EIS	Environmental impact study.
Flotation	The process of mixing powdered ore with water and chemical reagents to separate the metallic particles from the waste rock; the metallic particles are collected and dried and this concentrate is sent to the smelter for refining.
Gangue	The undesired materials or valueless mineral particles associated with ore that must be rejected or discarded.
Geophysical survey	A method of prospecting that measures and maps the physical properties of rock formations by analyzing magnetic anomalies, assessing rock density with gravity surveys, and measuring electrical conductivity anomalies and radioactivity.
Grade	The amount of metal in each ton or tonne of ore, expressed as troy ounces per ton or grams per tonne for precious metals and as a percentage for other metals. A term such as cut-off grade refers to the minimum metal grade at which an ore body can be economically mined.
Grizzly	A steel grate or mesh placed over a chute that restricts the size of ore or rock that passes through.
Head grade	The average grade of ore fed into a mill.
Heap leaching	The process of extracting valuable metals (usually gold and silver) from crushed ore by applying leaching solutions, which percolate through the stacked ore (or heap) and are collected by a sloping, impermeable liner below the heap.
Indicated Mineral Resource*	That part of a Mineral Resource for which quantity, grade or quality, densities, shape and physical characteristics can be estimated with a level of confidence sufficient to allow the appropriate application of technical and economic parameters, to support mine planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough for geological and grade continuity to be reasonably assumed.
Industrial minerals	Non-metallic minerals used in the chemical and manufacturing industries.
Inferred Mineral Resource*	That part of a Mineral Resource for which quantity and grade or quality can be estimated on the basis of geological evidence and limited sampling and reasonably assumed, but not verified, geological and grade continuity. The estimate is based on limited information and sampling gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes.
Kimberlite	Volcanic rock formations that may contain diamonds.

Leaching	A chemical process for the extraction of valuable minerals from ore (see Heap Leaching above).
Measured Mineral Resource*	That part of a Mineral Resource for which quantity, grade or quality, densities, shape, and physical characteristics are so well established that they can be estimated with confidence sufficient to allow the appropriate application of technical and economic parameters, to support production planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough to confirm both geological and grade continuity.
Mill	A processing facility where ore is finely ground and thereafter undergoes physical or chemical treatment to extract the valuable metals.
Mine mouth	The place at which minerals leave a mine.
Mineral	A substance that may or may not be of economic value, which occurs naturally in the earth. It is homogeneous, has a certain chemical composition, and appears in crystal or grain form.
Mineral Reserve*	The economically mineable part of a Measured or Indicated Mineral Resource demonstrated by at least a Preliminary Feasibility Study. This Study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified. A Mineral Reserve includes diluting materials and allowances for losses that may occur when the material is mined. Mineral Reserves are sub-divided in order of increasing confidence into Probable Mineral Reserves and Proven Mineral Reserves.
Mineral Resource*	A concentration or occurrence of diamonds, natural solid inorganic material, or natural solid fossilized organic material including base and precious metals, coal, and industrial minerals in or on the Earth's crust in such form and quantity and of such a grade or quality that it has reasonable prospects for economic extraction. The location, quantity, grade, geological characteristics and continuity of a Mineral Resource are known, estimated or interpreted from specific geological evidence and knowledge. Mineral Resources are sub-divided, in order of increasing geological confidence, into Inferred, Indicated and Measured categories.
Mining claim	That portion of applicable mineral lands that a party has staked or marked out in accordance with applicable mining laws to acquire the right to explore for and exploit the minerals under the surface.
Net profits interest (NPI)	A royalty that is based on the net profit from the mine.
Net smelter return (NSR)	A royalty that is based on the gross value of the metal produced less transportation, smelting, and refining charges.

Open pit	A form of surface mining in which ore is extracted from a large open pit or burrow.
Ore	Rock, generally containing metallic or non-metallic minerals, that can be mined and processed at a profit.
Ore body	A sufficiently large amount of ore or a natural concentration of valuable material that can be economically extracted.
Placer	An alluvial, marine, or glacial deposit containing valuable metals, especially gold.
Preliminary Feasibility Study*	A comprehensive study of the viability of a mineral project that has advanced to a stage where the mining method, in the case of underground mining, or the pit configuration, in the case of an open pit, has been established and an effective method of mineral processing has been determined, and includes a financial analysis based on reasonable assumptions of technical, engineering, legal, operating, economic, social, and environmental factors and the evaluation of other relevant factors that are sufficient for a Qualified Person, acting reasonably, to determine if all or part of the Mineral Resource may be classified as a Mineral Reserve.
Probable Mineral Reserve*	The economically mineable part of an Indicated and, in some circumstances, a Measured Mineral Resource demonstrated by at least a Preliminary Feasibility Study. This Study must include adequate information on mining, processing, metallurgical, economic, and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified.
Proven Mineral Reserves*	The economically mineable part of a Measured Mineral Resource demonstrated by at least a Preliminary Feasibility Study. This Study must include adequate information on mining, processing, metallurgical, economic, and other relevant factors that demonstrate, at the time of reporting, that economic extraction is justified.
Qualified Person*	An individual who is an engineer or geoscientist with at least five years of experience in mineral exploration, mine development or operation, or mineral project assessment, or any combination of these; has experience relevant to the subject matter of the mineral project and the technical report; and is a member or licensee in good standing of a professional association.
Rare earth metals	A set of 17 chemical elements that are typically dispersed and not often found in concentrated and economically exploitable deposits: scandium (Sc), yttrium (Y), lanthanum (La), cerium (Ce), praseodymium (Pr), neodymium (Nd), promethium (Pm), samarium (Sm), europium (Eu), gadolinium (Gd), terbium (Tb), dysprosium (Dy), holmium (Ho), erbium (Er), thulium (Tm), ytterbium (Yb), and lutetium (Lu).
Recovery	The percentage of valuable metal that is recovered from the ore.
Refining	The final stage of metal production in which impurities are removed from molten metal.
Rod mill	A cylindrical piece of processing equipment used to grind ore; the cylinder is rotated causing the steel rods to impact and grind the ore in the rod mill.

Rotary drill	A type of drilling machine for drilling holes into rock by rotating a rigid, tubular string of rods to which a drill bit is attached.
Run-of-mine	A loose term used to describe ore of average grade.
Sampling	The analytical testing of a representative portion of a mineral resource to estimate the mineral content and grade.
Shaft	A long vertical or inclined tunnel giving access to an underground mine.
Skip	A container or bucket used for hoisting ore or waste up through a shaft.
Slag	The vitreous by-product produced in the smelting process, which consists of the impurities in the ore.
Social asset	An asset that benefits individuals in a community living near a mine, such as a recreational facility.
Stockpile	A storage of broken ore waiting for treatment or shipment.
Stope	An open area or space in an underground mine from which ore has been or will be extracted.
Strip mine	A form of surface mining in which a mineral seam near the surface is accessed by removing a long strip of overburden.
Strip ratio	The ratio of waste removed in relation to the amount of ore mined.
Stripping	The removal of overburden or waste to access the mineralized material in preparation for open pit mining.
SX-EW or Solvent extraction electrowinning	A metallurgical technique in which metal is dissolved from the rock by organic solvents and recovered from solution by electrolysis.
Tailings	The finely ground residue or waste materials rejected from a mill after most of the recoverable minerals have been extracted.
Tailings pond	A containment area for refused tailings, which allows for the separation of solid particles from the water.
Trenching	A method of exploration in which channels are excavated with the objective of confirming the size, direction, and continuity of mineralized structures.
Waste	Ore that is not minable at a profit.

** As defined in the Canadian Institute of Mining (CIM) Definition Standards (November 22, 2005).*

Appendix

Contact numbers and websites for various relevant federal and provincial/territorial government organizations

Canada Revenue Agency
1-800-267-6999
cra-arc.gc.ca

British Columbia Ministry of Finance
1-877-388-4440
fin.gov.bc.ca

Alberta Tax and Revenue Administration
1-780-427-3044
finance.alberta.ca/publications/tax_rebates/index.html

Saskatchewan Ministry of Finance
1-306-787-6768
finance.gov.sk.ca

Manitoba Finance
1-204-945-5603
gov.mb.ca/finance

Ontario Ministry of Finance
1-866-668-8297
fin.gov.on.ca/en

Revenu Québec
1-800-567-4692
revenuQuébec.ca/en

New Brunswick Department of Finance
1-506-453-2451
gnb.ca/0024/index-e.asp

Nova Scotia Finance
1-902-424-5554
gov.ns.ca/finance/en/home/taxation/default.aspx

Prince Edward Island Department of Finance and Municipal Affairs
1-902-368-4000
gov.pe.ca/finance

Newfoundland and Labrador Department of Finance
1-709-729-3166
fin.gov.nl.ca/fin

Northwest Territories Department of Finance
1-867-873-7500
fin.gov.nt.ca

Yukon Department of Finance
1-867-667-5343
finance.gov.yk.ca

Nunavut Department of Finance
1-867-975-6000
gov.nu.ca/page/finance

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Mining Industry Insights

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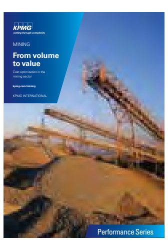
Insights into Mining: Mining Looks into the future
This publication provides a review of the 9th Annual Mining Executive Forum's plenary sessions and features keynote speakers Paul Wright, Chief Executive Officer, Eldorado Gold Corporation, and Geoff Burns, President & CEO, Pan American Silver Corp.



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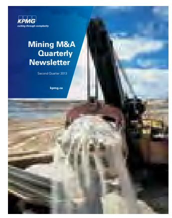
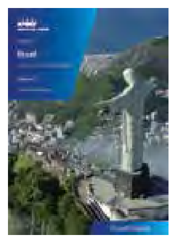
This report looks at nine different levers that mining companies need to consider when implementing cost optimization programs to sustain profitability in today's more challenging economic environment.



Mining M&A Quarterly Newsletter
Mining companies around the world are facing business uncertainty owing to ongoing volatility in demand and prices. This publication highlights how mining companies can use M&A strategies to create more value for shareholders.



Country Mining Guide – Brazil
Growing global demand for precious and base metals has driven mining companies to explore investments in resource-rich regions like Latin America. As part of a series of country guides focused on Latin America, these particular guides provide a general overview on various areas of interest, such as economic and fiscal policy, key commodities, tax environment, etc. in doing business in Mexico & Peru from a mining industry perspective.

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KPMG is committed to the mining industry. We have made considerable investments in the industry for professional development, research, and innovative solutions. Through these investments, we strive to be the best in everything we do, turning our experience and industry knowledge into real value for our clients. This is the KPMG Way.

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