

## 2. MEASURES CONCERNING BUSINESSES

### 2.1 Revision of the mining duties regime

#### *Objective of the regime*

The primary objective of a mining duties regime is to enable the government to collect fair compensation for the use of a non-renewable resource that belongs to the public domain.

Similar to what generally exists elsewhere, the tax base of Québec's mining duties regime is based on the notion of mining profit. Accordingly, the mining duties collected by the government capture part of the economic rent derived from the theoretical value of the ore at the mine shaft head.

In principle, the rent the owner of the resource must collect is the one attributable to the consumption of such resource. Since the tax base is the operator's profit, a component of such profit may be attributable to value added beyond the mine shaft head by the processing of such resource. For this reason, the mining duties regime stipulates a processing allowance, reflected in the recognition, in a way, of a perpetual financial return to the investor regarding the cost of property used to process the ore.

Under the existing system, an operator must pay mining duties on the basis of its annual profit, using a 12% tax rate. Briefly, an operator determines his annual profit by subtracting from the gross value of his annual output (whether from one or more mines), all the deductions and allowances stipulated by the mining duties regime (whether they relate to one or more mines). These allowances include the depreciation allowance, additional depreciation allowance, additional allowance for a northern mine, the allowance for exploration, mineral deposit evaluation and mine development and the additional exploration allowance.

Where the operator suffers a loss during a fiscal year, he may, subject to certain specific rules, claim a credit on duties refundable for losses, provided the loss is attributable to exploration, mineral deposit evaluation and mine development expenses. The rate of this credit on duties refundable is 12%, i.e. the same as the tax rate applicable to annual profit.

#### *Observation*

The experience of the mining duties regime in Québec is not satisfactory in all regards, in particular concerning the overall financial yield of the regime since 1994, even when resources are highly valued.

The regime also suffers from certain shortcomings, in particular concerning the calculation of the gross value of annual output and the recognition of certain expenditures and allowances. Lastly, it is complex and places a heavy administrative burden on operators and the government.

### ***Revision of the regime***

To achieve the primary objective of the regime, i.e. to enable the government to collect fair compensation for the use of a non-renewable resource that belongs to the public domain, many amendments will be made to the *Mining Duties Act*<sup>41</sup> (MDA).

First, the tax rate will be raised gradually from 12% to 16%.

Second, changes will be made to three allowances an operator may claim:

- The rate of the depreciation allowance will be reduced to better reflect the useful life of assets.
- The parameters used to calculate the processing allowance will be reviewed.
- The additional allowance for a northern mine will be replaced with an additional allowance for a mine located in Northern Québec, in particular to offer an allowance with a more extensive territorial reach.

Third, major changes will be made to the treatment applicable to all the exploration, mineral deposit evaluation and mine development expenses an operator may incur, in particular by creating three different cumulative accounts covering such expenses. These three cumulative accounts will give rise to three separate allowances.

Fourth, the credit on duties refundable for losses, which has substantial effects on the net compensation the government collects under the mining duties regime, will be limited.

Fifth, always with the objective of limiting situations where the government does not obtain fair compensation for the use of a non-renewal resource belonging to the public domain, the calculation method of an operator's annual profit will be changed by making use of a "mine-by-mine" approach.

Sixth, in the context where the gross value of annual output from precious stones, diamonds in particular, may grow substantially over the coming years, special rules will be put in place to facilitate the determination of the gross value of annual output attributable to this resource.

Lastly, a clarification will be made to the treatment applicable to certain amounts paid by an operator to a community or a municipality.

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41 R.S.Q., c. D-15.

### 2.1.1 Increase in the tax rate

The existing 12% tax rate is insufficient to allow fair compensation for the use of a non-renewable resource that belongs to the public domain. Accordingly, it will be raised gradually to 16% by January 1, 2012.

The following table shows the tax rates of the mining duties regime applicable before and after these increases.

TABLE A.2

#### Tax rates of the mining duties regime (per cent)

|                                       | 2010<br>up to the budget | 2010<br>after the budget | 2011 | 2012 |
|---------------------------------------|--------------------------|--------------------------|------|------|
| Tax rates of the mining duties regime | 12                       | 14                       | 15   | 16   |

The new tax rates will come into force the day following the day of the Budget Speech, January 1, 2011 and January 1, 2012 respectively.

Where an operator's fiscal year straddles the rate change dates, the tax rate that effectively applies for such taxation year will be a weighted rate reflecting the number of days of the taxation year included in each of the periods concerned.

For greater clarity, an operator's instalment payments, for a fiscal year that straddles the rate change dates, must be calculated using the weighted rate applicable to such fiscal year.

In the specific case of instalment payments of an operator whose fiscal year straddles the day of the Budget Speech, these payments must be adjusted as of the first instalment following that day to reflect the effects of these changes.

### 2.1.2 Changes to three of the allowances an operator may claim

The mining duties regime includes a variety of allowances an operator may claim in calculating his annual profit. These allowances seek to recognize certain situations, foster certain behaviour or achieve specific objectives.

Changes will be made to three of these allowances.

## □ Reduction in the rate of the depreciation allowance

Under the rules that currently apply, the depreciation allowance an operator can claim in calculating its annual profit for a fiscal year, regarding property of a class, generally corresponds to the lesser of the following amounts:

- a percentage of the capital cost of the property of such class, for such fiscal year;
- the undepreciated capital cost of property of such class, at the end of the fiscal year.

Depreciable property is divided into three classes:

- property of the first class, i.e. a road, a building or equipment purchased before April 1, 1975 and actually used in mining operation. The rate of the depreciation allowance for property in this class is 15%;
- property of the second class, i.e. a road, a building or equipment purchased after March 31, 1975 and before May 13, 1994 and actually used in mining operation. The rate of the depreciation allowance for property in this class is 30%;
- property of the third class, i.e. a road, a building, equipment or a service property acquired after May 12, 1994 and regularly used in mining operation. The rate of the depreciation allowance for property in this class is 100%.

So that the depreciation allowance better reflects the length of the useful life of property, the rate of the depreciation allowance will be reduced from 100% to 30% for property acquired after the day of the Budget Speech.<sup>42</sup> To that end, property of the third class will correspond to property acquired after May 12, 1994 and no later than the day of the Budget Speech<sup>43</sup> and a fourth class of property will be created. The rate of the depreciation allowance for property of the fourth class, i.e. a road, a building, equipment or a service property acquired after the day of the Budget Speech<sup>44</sup> and regularly used in mining operations will be 30%.

Moreover, to limit over time the excessive flexibility offered by 100% depreciation of property of the third class, an operator may not claim a depreciation allowance regarding property of the fourth class until the balance of the undepreciated capital cost of property of the third class equals zero.

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42 Subject to the transition rule according to which property acquired after the day of the Budget Speech, but no later than one year after that day, will be included in class three, if it is acquired in accordance with a written obligation contracted no later than that day or, if the construction of such property by the operator, or on his behalf, had started no later than that day.

43 See prec. note.

44 See prec. note.

**□ Change to the parameters of the processing allowance**

Since the mining duties tax base is the operator's profit, a component of such profit may be attributable to value added beyond the mine shaft head by the processing of the mineral substance. For this reason, the mining duties regime stipulates a processing allowance.

This processing allowance, for a fiscal year, is determined, initially, depending on the rates of return calculated on the capital cost, for the operator, of each property that is an asset used in processing during the fiscal year and is in his possession at the end of such fiscal year. Briefly, these rates of return are 8% where the operator does no smelting or refining or only smelts or refines ore from a gold or silver mine, and 15% where the operator smelts or refines ore that is not from a gold mine or silver mine. However, regarding assets used for ore concentration, the 15% rate is reduced by seven percentage points (7%), in the proportion where such assets are used to concentrate ore that is not smelted or refined by such operator.

In addition, these rates of return of 8% and 15% are respectively increased to 23% and 30% regarding the capital cost of each property in the possession of an operator at the end of its fiscal year and that is a processing asset, that it acquired new after March 31, 1998 and that it uses in Québec, during such fiscal year, exclusively to process mine tailings.

Lastly, such processing allowance, for a fiscal year, cannot exceed 65% of the operator's annual profit, for such fiscal year, calculated before deducting certain allowances.<sup>45</sup>

Moreover, these rules are also used in the calculation of an operator's adjusted annual loss, for a fiscal year, to determine the credit on duties refundable for losses.<sup>46</sup>

While it is difficult to accurately establish the "processing" component of mining profit, the rates of return allowed on processing assets, as well as the limit based on annual profit, are currently too high and do not enable the government to obtain fair compensation for the use of a non-renewable resource that belongs to the public domain.

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45 I.e. the processing allowance, the supplementary depreciation allowance and the additional allowance for a northern mine.

46 For more details, see subsection 2.1.4.

Accordingly, the parameters used to calculate the processing allowance will be changed. More specifically, the rates of return of 8% and 15% allowed on processing assets will be reduced to 7% and 13% respectively. The 7% rate of the proportional reduction applicable to the 15% rate in the case where an operator's assets are used for concentration of ore that is not smelted or refined by such operator, will be replaced by a 6% rate, i.e. the difference between the new rates of 13% and 7%. The higher 23% and 30% rates of return regarding processing assets of mine tailings will be eliminated. The limit of 65% based on annual profit will be reduced to 55%. These changes will also apply to the calculation of an operator's adjusted annual loss, for a fiscal year, to determine the credit on duties refundable for losses.

These new rates and the elimination of the 23% and 30% rates will apply regarding an operator's fiscal year ending after the day of the Budget Speech. Should an operator's fiscal year include that day, the rates actually applicable for such fiscal year will be weighted rates reflecting, on the one hand, the number of days of the fiscal year preceding the day after the day of the Budget Speech and, on the other, the number of days of the fiscal year following the day of the Budget Speech.

**□ Replacement of the additional allowance for a northern mine with an additional allowance for a mine located in Northern Québec**

Under existing rules, an operator can claim, in calculating its annual profit for the first ten fiscal year of operation of a northern mine, i.e. a mine located north of 55° North latitude, an additional allowance for a northern mine. In particular, the amount of such allowance is based, in particular, on the capital cost, for the operator of the northern mine, of each asset located in Québec and used in processing ore from such mine.

The additional allowance for a northern mine will be replaced with an additional allowance for a mine located in Northern Québec. This allowance will cover, in addition to the Far North, the Mid-North, i.e. a larger territory than the existing allowance covers.

For the purposes of this additional allowance for a mine located in Northern Québec:

- the Mid-North means:
  - the territory included between 50° 30' North latitude and 55° North latitude and limited to the East by the Grenville Front;
  - the part of the territory of the Côte-Nord located between 59° West longitude and 66° West longitude;
- the Far North means the territory located north of 55° North latitude.

In addition, this allowance will no longer be based on the capital cost, for the operator of the mine, of each asset located in Québec and used in processing ore from the mine.

The amount of the additional allowance for a mine located in Northern Québec that an operator may claim regarding a new mine will correspond to \$2 million, over a period of 36 months, for each new mine located in the Mid-North and \$5 million, over a period of 36 months, for each new mine located in the Far North, up to the annual profit from such new mine, calculated before such allowance.

More specifically, an operator may claim this allowance only regarding the annual profit from such new mine and attributable to the period beginning on the date when the such mine reaches the stage of production in reasonable commercial quantities and ending 36 months after such date.<sup>47</sup> To the extent that the amount of \$2 million or \$5 million, as the case may be, regarding a mine, is limited, for a fiscal year, by the annual profit from the mine, the excess may be carried over to a later fiscal year included in such 36-month period.

Should a fiscal year of an operator include the date when the new mine enters production in reasonable commercial quantities or the date 36 months after such date, the additional allowance for a mine located in Northern Québec the operator may claim, for such fiscal year, will correspond to the lesser of the following amounts:

- the annual profit for the fiscal year from such mine, before deducting the additional allowance for a mine located in Northern Québec, multiplied by the fraction obtained by dividing the number of days in such fiscal year included in the 36-month period by the total number of days in such fiscal year;
- the additional allowance for a mine located in Northern Québec the operator could otherwise claim regarding such mine for the fiscal year.

The additional allowance for a northern mine will continue to apply to a mine for which ore processing has started no later than the day of the Budget Speech. The additional allowance for a mine located in Northern Québec will apply to a new mine that enters production in reasonable commercial quantities<sup>48</sup> after the day of the Budget Speech, unless such mine allows the operator to claim the additional allowance for a northern mine.

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47 For more details on the concept of “mine reaching the stage of production in reasonable commercial quantities”, see the heading “Creation of separate cumulative accounts for exploration expenses, mine development and mineral deposit evaluation expenses before production and mine development and mineral deposit evaluation expenses after production”, page A.36.

48 For more details on the concept of “new mine entering production in reasonable commercial quantities”, see the heading “Creation of separate cumulative accounts for exploration expenses, mine development and mineral deposit evaluation expenses before production and mine development and mineral deposit evaluation expenses after production”, page A.36.

### 2.1.3 Changes concerning exploration, mineral deposit evaluation and mine development expenses

Exploration, mineral deposit evaluation and mine development expenses are important items in the calculation of an operator's annual profit. A significant part of these expenses can give rise to the exploration, mineral deposit evaluation and mine development allowance, which an operator can deduct in calculating its annual profit for a fiscal year. This allowance must not exceed the cumulative exploration, mineral deposit evaluation and mine development expenses at the end of such fiscal year.

Other expenses that can also be qualified as mineral deposit evaluation and mine development expenses, but are not covered by the exploration, mineral deposit evaluation and mine development allowance, can also be incurred by an operator.<sup>49</sup> The operator can generally deduct such expenses in calculating his annual profit for the fiscal year during which they are incurred.

Moreover, some exploration expenses covered by the exploration, mineral deposit evaluation and mine development allowance can enable an operator to claim an additional exploration allowance representing 50% of the expenses covered by this additional allowance.

The exploration, mineral deposit evaluation and mine development expenses that an operator funds by means of Québec's flow-through regime are generally deemed not to be expenses incurred by such operator. However, this presumption does not apply to such expenses funded by means of the federal flow-through regime.

#### **Creation of separate cumulative accounts for exploration expenses, mine development and mineral deposit evaluation expenses before production and mine development and mineral deposit evaluation expenses after production**

The treatment applied to all exploration, mineral deposit evaluation and mine development expenses, i.e. the expenses covered by the existing exploration, mineral deposit evaluation and mine development allowance and the other mineral deposit evaluation and mine development expenses incurred by an operator, will be extensively revised.

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<sup>49</sup> For example, expenses relating to mineral deposit evaluation work incurred after a decision to bring an orebody into production.

First, all exploration, mineral deposit evaluation and mine development expenses will be divided into three separate cumulative accounts each giving rise to a separate allowance. The definitions of the expenses covered by each of these separate cumulative accounts will draw broadly from the definitions of Canadian exploration expenses and Canadian development expenses of the *Taxation Act*,<sup>50</sup> for the purpose of simplifying the application of the tax provisions, both for operators and for the government.

Second, the concepts of “mine which has come into production in reasonable commercial quantities” and “new mine that enters production in reasonable commercial quantities” used in the definitions of the *Taxation Act* will also be used for the new definitions of the expenses covered by each of these cumulative accounts. These concepts will replace the notion of “decision to bring an orebody into production” currently used in the MDA. In addition, these concepts will be applicable throughout the MDA.

More specifically, all exploration, mineral deposit evaluation and mine development expenses will be divided into three separate cumulative accounts each giving rise to a separate allowance, namely:

- “cumulative exploration expenses” giving rise to the exploration allowance. Briefly, the exploration expenses that will be added to this cumulative account will include expenses incurred to determine the existence of a mineral substance in Québec, to locate such substance or determine its extent or quality, including those incurred during prospecting, geological, geophysical and geochemical studies, drilling and digging of exploration trenches or holes or preliminary sampling, other than any mineral deposit evaluation and mine development expenses before production, any mineral deposit evaluation and mine development expenses after production and any expense that can reasonably be related to a mine that has come into production in reasonable commercial quantities or to a real or possible extension of such mine;
- “cumulative mineral deposit evaluation and mine development expenses before production” that give rise to the allowance for mineral deposit evaluation and mine development before production. Briefly, the mineral deposit evaluation and mine development expenses before production that will be added to this cumulative account will include expenses incurred to bring a new mine in relation to a mineral substance in Québec to the stage of production in reasonable commercial quantities, including expenses for excavation, clearing and removal of surface layers, boring a mine shaft and construction of an adit or other underground entry, provided such expenses were incurred before the new mine enters into production in reasonable commercial quantities;

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50 R.S.Q., c. I-3. More specifically, the definitions in sections 395 and 408 of the Act.

- “cumulative mineral deposit evaluation and mine development expenses after production” that give rise to the allowance for mineral deposit evaluation and mine development after production. Briefly, the mineral deposit evaluation and mine development expenses after production that will be added to this cumulative account will include the expenses incurred, other than an amount included in the capital cost of a depreciable property:
  - either to bore or excavate a mine shaft, a main haulageway or similar underground structure designed for continuous use, for a mine in relation to a mineral substance in Québec, built or excavated after the mine goes into production in reasonable commercial quantities;
  - or for the extension of such a shaft, haulageway or structure.

These three cumulative accounts will be determined according to the same principles as those currently applicable to cumulative exploration, mineral deposit evaluation and mine development expenses.<sup>51</sup>

These changes will apply to all exploration, mineral deposit evaluation and mine development expenses incurred by an operator after the day of the Budget Speech. For greater clarity:

- the exploration, mineral deposit evaluation and mine development expenses incurred no later than the day of the Budget Speech will be added to cumulative exploration, mineral deposit evaluation and mine development expenses and an operator may continue to deduct the exploration, mineral deposit evaluation and mine development allowance according to the rules that apply currently;
- the other expenses that can also be qualified as mineral deposit evaluation and mine development expenses, but are not covered by the exploration, mineral deposit evaluation and mine development allowance, incurred no later than the day of the Budget Speech, will continue to be deductible according to the rules that apply currently;
- all the exploration, mineral deposit evaluation and mine development expenses incurred after the day of the Budget Speech will be allocated among the three separate cumulative accounts and may be deducted by the operator by means of the three allowances to which these cumulative accounts give rise.

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<sup>51</sup> For example, regarding the treatment applicable to government assistance received or reimbursed and relating to eligible expenses, or regarding the general exclusions relating to the capital cost of property covered by the depreciation allowance, to general and administrative expenditures relating to exploration, mineral deposit evaluation and mine development work and the acquisition costs of a mining property, or an interest in such property.

**■ Exploration allowance**

Generally speaking, the exploration expenses that will be added to the cumulative account giving rise to the exploration allowance can currently be deducted in full during the fiscal year when they are incurred or during a subsequent fiscal year by means of the exploration, mineral deposit evaluation and mine development allowance.

Moreover, the cumulative exploration, mineral deposit evaluation and mine development allowance (i.e. the cumulative exploration, mineral deposit assessment and mine development expenses) includes a 25% increase applicable to certain exploration expenses incurred in the Mid-North and the Far North.

This 25% increase will be maintained and will apply to exploration expenses incurred in northern Québec. The cumulative account giving rise to the exploration allowance (i.e. the cumulative exploration expenses) will therefore include a 25% increase regarding exploration expenses incurred in northern Québec.

To that end, northern Québec means:

- the territory included between 50°30' North latitude and 55° North latitude and limited to the East by the Grenville Front;
- the part of the territory of the Côte-Nord located between 59° West longitude and 66° West longitude;
- the territory located north of 55° North latitude.

The maximum amount an operator may deduct in relation to this allowance will depend on his status, i.e. whether or not he is an eligible operator.

For the purposes of this allowance and the changes relating to the calculation of an operator's annual profit or annual loss,<sup>52</sup> an eligible operator, for a fiscal year, means an operator who satisfies the following conditions:

- he develops no mineral substance in reasonable commercial quantities at the end of the fiscal year;
- during the fiscal year, he is not associated, for the purposes of the *Taxation Act*, with another entity that develops a mineral substance in reasonable commercial quantities.

To prevent the rules on associated corporations from being circumvented, where it may reasonably be considered that one of the main reasons for the separate existence of two or more entities, in a fiscal year, is for an operator to enjoy eligible operator status regarding such fiscal year, such entities will be deemed to be associated with each other during such fiscal year.

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52 For more details, see subsection 2.1.5.

An eligible operator may deduct, in calculating his annual profit or annual loss, for a fiscal year, on account of the exploration allowance, an amount not exceeding the balance in his cumulative exploration expense account at the end of such fiscal year.

An operator other than an eligible operator may deduct, in calculating his annual profit or annual loss, for a fiscal year, on account of the exploration allowance, an amount not exceeding the lesser of the following two amounts:

- the balance of his cumulative exploration expense account at the end of such fiscal year;
- 10% of his annual profit for the fiscal year calculated before such allowance and the allowance for mineral deposit evaluation and mine development before production.

This exploration allowance will apply to a fiscal year of an operator ending after the day of the Budget Speech, regarding exploration expenses incurred after that day.

In the case of an operator's fiscal year that includes the day of the Budget Speech, the above 10% rate will be replaced by a rate corresponding to 10% of the fraction obtained by dividing the number of days in such fiscal year following the day of the Budget Speech by the number of days in such fiscal year.

#### ■ Allowance for mineral deposit evaluation and mine development before production

Generally speaking, the mineral deposit evaluation and mine development expenses before production that will be added to the cumulative account giving rise to the allowance for mineral deposit evaluation and mine development expenses before production can currently be deducted in full during the fiscal year when they are incurred or during a subsequent fiscal year by means of the exploration, mineral deposit evaluation and mine development allowance.

An operator will, for a fiscal year, be able to deduct in calculating his annual profit or annual loss, on account of the allowance for mineral deposit evaluation and mine development before production, an amount not exceeding the balance of his cumulative mineral deposit evaluation and mine development expenses before production account at the end of such fiscal year.

This allowance for mineral deposit evaluation and mine development before production will apply to a fiscal year of an operator ending after the day of the Budget Speech, regarding mineral deposit evaluation and mine development expenses before production incurred after that day.

■ **Allowance for mineral deposit evaluation and mine development after production**

In general, mineral deposit evaluation and mine development expenses after production that will be added to the cumulative account giving rise to the allowance for mineral deposit evaluation and mine development after production can currently be deducted on account of current expenditures. Accordingly, these expenses are deductible in full in calculating the operator's annual profit for the fiscal year during which they are incurred, but only for such fiscal year.

This treatment can have undesirable effects: this type of expenses normally brings a benefit that extends well beyond the fiscal year during which they are incurred; the treatment currently applied to this type of expenses does not allow them to be appropriately matched with the value of the mineral substances whose extraction they make possible; it is possible that an operator who incurs such expenses in substantial amounts during a fiscal year may pay very low, and even no, mining duties, even though the value at the mine shaft head of the mineral substances he develops is in other respects high. This is precisely the type of situation where the state does not obtain fair compensation for the use of a non-renewable resource that belongs to the public domain. This revision of the mining duties regime is designed to correct such situations.

Second, the fact that these expenses are treated as current expenditures, combined with the absence of a loss carry-forward mechanism, can result in such expenses, or part of them, conferring no benefit on an operator. In such a situation, the operator is disadvantaged.

The calculation details of the allowance for mineral deposit evaluation and mine development after production must therefore avoid such undesirable situations.

Accordingly, this allowance, clearly attributable to mineral deposit evaluation and development of a mine in particular,<sup>53</sup> will be deductible in calculating the annual profit from such mine. A separate cumulative account will therefore be created for each mine of an operator.

More specifically, an operator must, for a fiscal year beginning after the day of the Budget Speech, deduct in calculating the annual profit from a mine, on account of the allowance for mineral deposit evaluation and mine development after production of such mine, an amount corresponding to the lesser of the following two amounts:

- 30% of the balance of his cumulative mineral deposit evaluation and mine development after production account of such mine at the end of such fiscal year;

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53 See prec. note.

- the annual profit from such mine calculated before such allowance and the processing allowance.

Moreover, where an operator's fiscal year comprises fewer than 12 months, the 30% rate will be reduced by the proportion represented by dividing 365 less the number of days in such fiscal year by 365.

This allowance for mineral deposit evaluation and mine development after production will apply to an operator's fiscal year ending after the day of the Budget Speech, regarding mineral deposit evaluation and mine development expenses before production incurred after that day.

In the case of an operator's fiscal year that includes the day of the Budget Speech, such operator must deduct in calculating his annual profit, for such fiscal year, on account of the allowance for mineral deposit evaluation and mine development after production for all his mines, an amount corresponding to the lesser of the following two amounts:

- 30% of the total of all the balances of his cumulative mineral deposit evaluation and mine development after production accounts of all his mines at the end of such fiscal year;
- his annual profit calculated before such allowance, the exploration, mineral deposit evaluation and mine development allowance, the exploration allowance, the additional exploration allowance, the allowance for mineral deposit evaluation and mine development before production and the processing allowance, multiplied by the fraction obtained by dividing the number of days of such fiscal year that follow the day of the Budget Speech by the number of days of such fiscal year.

#### **□ Elimination of the additional exploration allowance regarding exploration expenses incurred after the day of the Budget Speech**

Under the rules that currently apply an operator may claim an additional exploration allowance, which is based in particular on a cumulative account.

Briefly, this cumulative account consists, at any time, of the total of all amounts each of which is an expense incurred by the operator after May 12, 1994 and before that time, in respect of exploration or underground core drilling work carried out in Québec, where the mineral substances in respect of which the work is carried out form part of the domain of the state and where the work is performed in connection with the operator's mining operation:

- elsewhere than on land under a mining lease or mining concession, and performed before ore is extracted;
- on land under a mining lease or mining concession, except land from which ore has been or was extracted in the five fiscal years preceding that time.

Expenses incurred after the day of the Budget Speech will no longer be eligible for the additional exploration allowance.

**❑ Exclusion of exploration expenses, mineral deposit evaluation and mine development expenses before production and mineral deposit evaluation and mine development expenses after production covered by flow-through financing**

In general, under existing rules, an operator's exploration, mineral deposit evaluation and mine development expenses funded by issuing flow-through shares and covered by a waiver, under the *Taxation Act*, in favour of the acquirers of the flow-through shares are deemed not to be such expenses incurred by such operator.<sup>54</sup>

This principle will be extended to also apply to such expenses funded by issuing flow-through shares and covered by a waiver under the *Income Tax Act*.<sup>55</sup>

Accordingly, an operator's mineral deposit evaluation and mine development expenses before production and mineral deposit evaluation and mine development expenses after production funded by issuing flow-through shares and that are covered by a waiver, under the *Taxation Act* or under the *Income Tax Act*, in favour of the acquirers of the flow-through shares will be deemed not to be expenses incurred by such operator.<sup>56</sup>

This exclusion will apply regarding exploration expenses, mineral deposit evaluation and mine development expenses before production and mineral deposit evaluation and mine development expenses after production funded by issuing flow-through shares incurred after the day of the Budget Speech.

For greater clarity, the provisions of the *Taxation Act* and the *Income Tax Act* allowing expenses to be deemed incurred the last day of a preceding calendar year will be without effect where the question is one of establishing whether expenses were incurred after the day of the Budget Speech for the purposes of the MDA.

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54 Exceptions apply to this rule, in particular in the case where the flow-through shares are issued to a legal person who undertakes in writing with the Minister of Natural Resources and Wildlife not to waive, under the *Taxation Act*, the expenses funded by these flow-through shares, and such legal person honours his undertaking.

55 R.S.C. 1985, c. 1 (5th Supp.).

56 The exceptions referred to in note 54 will also apply to this rule, in particular in the case where the flow-through shares are issued to a legal person who undertakes in writing with the Minister of Natural Resources and Wildlife not to waive, under the *Income Tax Act*, the expenses funded by these flow-through shares, and such legal person honours its undertaking.

#### **2.1.4 Adjustments to the credit on duties refundable for losses**

Under existing rules, the credit on duties refundable for losses an operator may claim, for a fiscal year, corresponds, briefly, to 12% of the lesser of:

- his adjusted annual loss for such fiscal year;
- certain exploration, mineral deposit evaluation and mine development expenses<sup>57</sup> he incurred, for the fiscal year, not exceeding the amount he deducted on account of the exploration, mineral deposit evaluation and mine development allowance in calculating his annual profit for such fiscal year.

An operator's adjusted annual loss, for a fiscal year, corresponds to his annual loss, for such fiscal year, reduced by the lesser of the following amounts:

- the processing allowance he could claim, for such fiscal year, if it were calculated based solely on the limit based on the capital cost to him of each property that is a processing asset;
- 65% of his annual loss for such fiscal year.

The credit on duties refundable for losses has significant effects on the net compensation the government collects under the mining duties regime. In this context, there is reason to review the parameters of the calculation of the credit on duties refundable for losses.

#### **□ Changes to the parameters of the calculation of the credit on duties refundable for losses**

The allocation of all the exploration, mineral deposit evaluation and mine development expenses among three separate cumulative accounts will have major effects on the amount of the credit on duties refundable for losses an operator may claim, mainly because of the parameters of the calculation of the amounts an operator may claim, for a fiscal year, regarding each of the allowances these three cumulative accounts give rise to.

Because of the calculation applicable to the exploration allowance, the amount an operator other than an eligible operator can claim, regarding such allowance, for a fiscal year, is limited to 10% of his annual profit for the fiscal year.

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<sup>57</sup> Some exploration expenses incurred in the Mid-North and the Far North give rise to an increase of 25% of these expenses.

In the case of cumulative mineral deposit evaluation and mine development expenses after production, the amount an operator must deduct, for a fiscal year, on account of the allowance for mineral deposit evaluation and mine development after production, is limited on the basis of the annual profit of the mine to which such cumulative mineral deposit evaluation and mine development expenses after production relate.

First, the rate of the credit on duties refundable for losses will rise gradually, exactly at the same pace as the mining duties rate, reaching 16% January 1, 2012. The rate of the credit on duties refundable for losses, for a fiscal year of an operator that is partially included in the period during which the tax rate gradually rises, will correspond to the weighted tax rate applicable to such fiscal year.<sup>58</sup>

Second, to reduce the cost to the government of the credit on duties refundable for losses, at most half the exploration expenses incurred during a fiscal year will enable an eligible operator to claim a credit on duties refundable for losses for such fiscal year. The portion of such expenses that an operator does not claim as a deduction in calculating his annual profit, for the fiscal year, will remain allowable in calculating his annual profit for a subsequent fiscal year. Because of the increase in the tax rate to 16%, the credit on duties refundable for losses an eligible operator may claim regarding its exploration expenses may reach 8% of such expenses.

Briefly, the credit on duties refundable for losses an eligible operator may claim, for a fiscal year, will correspond to the weighted tax rate or the 16% tax rate, as the case may be, applicable to such fiscal year, multiplied by the lesser of:

- his adjusted annual loss for such fiscal year;
- the total of:
  - 50% of the expenses he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the exploration allowance;
  - the mineral deposit evaluation and mine development expenses before production he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for mineral deposit evaluation and mine development before production.

In the case of an operator other than an eligible operator, the credit on duties refundable for losses he may claim for a fiscal year will correspond, briefly, to the weighted tax rate or the 16% tax rate, as the case may be, applicable to such fiscal year, multiplied by the lesser of:

- his adjusted annual loss for such fiscal year;

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58 For more details, see subsection 2.1.1.

- the mineral deposit evaluation and mine development expenses before production he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for mineral deposit evaluation and mine development before production.

For a fiscal year that includes the day of the Budget Speech, the credit on duties refundable for losses an operator may claim may be attributable, on the one hand, to exploration, mineral deposit evaluation and mine development expenses incurred no later than the day of the Budget Speech and, on the other, to exploration expenses and mineral deposit evaluation and mine development expenses before production, incurred after that day, where the total of such expenses is limited by the adjusted annual loss for such fiscal year.

In this context, briefly, the credit on duties refundable for losses an eligible operator may claim for a fiscal year that includes the day of the Budget Speech will correspond to the weighted tax rate applicable to such fiscal year, multiplied by the lesser of:

- his adjusted annual loss for such fiscal year;
- the total of:
  - the exploration, mineral deposit evaluation and mine development expenses he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for exploration, mineral deposit evaluation and mine development;
  - 50% of the exploration expenses he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the exploration allowance;
  - the mineral deposit evaluation and mine development expenses before production he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for mineral deposit evaluation and mine development before production.

In the case of an operator other than an eligible operator, the credit on duties refundable for losses he may claim for a fiscal year that includes the day of the Budget Speech will correspond, briefly, to the weighted tax rate applicable to such fiscal year, multiplied by the lesser of:

- his adjusted annual loss for such fiscal year;
- the total of:
  - the exploration, mineral deposit evaluation and mine development expenses he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for exploration, mineral deposit evaluation and mine development;

- the mineral deposit evaluation and mine development expenses before production he incurred, for such fiscal year, not exceeding the amount he deducted, for such fiscal year, on account of the allowance for mineral deposit evaluation and mine development before production.

**□ Adjustments resulting from the change to the parameters of the processing allowance**

The change to the parameters used to calculate the processing allowance will also apply to the calculation of an operator's adjusted annual loss for the purposes of the determination of the credit on duties refundable for losses. The modified parameters of the processing allowance concern the rates of return allowed on processing assets, including the elimination of the increased rates of return applicable in the case of mine tailings processing, and the rate based on the annual profit.

Accordingly, an operator's adjusted annual loss, for a fiscal year, will correspond to his annual loss, for such fiscal year, reduced by the lesser of the following amounts:

- the processing allowance he could claim, for such fiscal year, if it were calculated depending solely on the limit based on the capital cost to him of each property that is a processing asset using the new 7% and 13% rates of return;<sup>59</sup>
- 55% of his annual loss for such fiscal year.

The 55% rate and the new 7% and 13% rates of return will apply regarding an operator's fiscal year ending after the day of the Budget Speech. Should an operator's fiscal year include that day, the rates actually applicable for such fiscal year will be weighted rates reflecting, on the one hand, the number of days of the fiscal year preceding the day after the day of the Budget Speech and, on the other, the number of days of the fiscal year following the day of the Budget Speech.

For example, the rates applicable for the 2010 fiscal year of an operator whose fiscal year corresponds to the calendar year will be 57.44%, 7.24% and 13.49%<sup>60</sup> respectively.

59 For more details, see the heading "Changes to the parameters of the processing allowance", page A.33.

60 These rates are calculated using the following formula:  $(A \times (B / C)) + (D \times (E / C))$   
where:

- A represents the rate applicable up to the day of the Budget Speech.
- B represents the number of days of the fiscal year that precede the day after the day of the Budget Speech.
- C represents the total number of days of the fiscal year.
- D represents the new rate applicable after the day of the Budget Speech.
- E represents the number of days of the fiscal year that follow the day of the Budget Speech.

## □ Impact resulting from the exclusion of expenses covered by flow-through financing

Since an operator's exploration expenses and mineral deposit evaluation and mine development expenses before production, funded by issuing flow-through shares and that are covered by a waiver, under the *Taxation Act* or under the *Income Tax Act*, in favour of the acquirers of the flow-through shares will be deemed not to be expenses incurred by such operator, they obviously will no longer be eligible for the credit on duties refundable for losses.

### 2.1.5 Changes to the calculation of an operator's annual profit or annual loss

Under the existing system, an operator must pay mining duties on the basis of its annual profit for a fiscal year. Briefly, an operator's annual profit for a fiscal year is established by adding up all the items to be included for such fiscal year (mainly the operator's gross value of annual output, whether from one or more mines) and subtracting the total obtained by adding up the items he may deduct (mainly the various deductions and allowances stipulated by the mining duties regime, whether they relate to one or more mines). An operator's annual loss, for a fiscal year, is established by applying the same rules as for the annual profit, with the necessary adaptations.

This method of establishing an operator's annual profit, for a fiscal year, may enable an operator that operates more than one mine to pay very low, and even no, mining duties, despite the fact that the value at the mine shaft head of the resource at one of these mines is significant. This situation can occur in particular where the operator must incur substantial expenditures regarding one of his mines, i.e. expenditures that significantly exceed the revenues such mine generates.

In this context, the calculation method of an operator's annual profit, for a fiscal year, will be changed by making use of a "mine-by-mine" approach, with the objective of limiting situations where the government does not obtain fair compensation for the use of a non-renewal resource belonging to the public domain.

Accordingly, an operator's annual profit, for a fiscal year, will correspond henceforth to the excess of the sum of the annual profits from each mine he operates, for the fiscal year, over the total formed by the amount of the exploration allowance, the amount of general and administrative expenditures relating to exploration work, the amount of the additional exploration allowance, the amount of the allowance for mineral deposit evaluation and mine development before production, the amount of the exploration, mineral deposit evaluation and mine development allowance, the amount of the gifts made to Québec he can deduct under the existing rules and the amount of expenditures for scientific research and experimental development (R&D) he can also deduct under the currently rules, for the fiscal year.

Gifts made to Québec by an operator, during a fiscal year, are deductible only up to 10% of the sum of the annual profits of each mine he operates for the fiscal year.

The annual loss of an operator, other than an eligible operator, from a mine, for a fiscal year, will be deemed to be zero for the determination of his annual profit or annual loss, for such fiscal year.

Moreover, an operator who is an eligible operator, for a fiscal year, will be deemed to operate a single mine in the course of such fiscal year, for the calculation both of his annual profit and annual loss.

An operator's annual profit from a mine, for a fiscal year, will be established according to the same rules as those currently used to establish an operator's annual profit, for a fiscal year,<sup>61</sup> subject to the following clarifications:

- the items to be included in the calculation of the annual profit from a mine will correspond to:
  - the share of the operator's gross value of annual output that are reasonably attributable to such mine;
  - the portion of an item to be included in the operator's annual profit that can reasonably be attributable to the operation of such mine;
- the items to be deducted in the calculation of the annual profit from a mine will correspond to:
  - the portion of an expenditure reasonably attributable to the operation of such mine;
  - in the case of the depreciation allowance, the amount of such allowance reasonably attributable to such mine;
  - in the case of the additional depreciation allowance, the amount of such allowance reasonably attributable to such mine;

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61 For example, an operator will not be able to deduct, in calculating his annual profit from a mine, for a fiscal year, the items mentioned in section 8.0.1 of the MDA.

- in the case of the additional allowance for a northern mine, the amount of such allowance reasonably attributable to such mine;
- in the case of the processing allowance, the amount of such allowance established on the basis of the use made of each property that is a processing asset used in processing the ore from such mine during the fiscal year and that is held by the operator at the end of such fiscal year, on the basis of the proportion of utilization of each such property in the processing of ore from such mine;
- in the case of the additional allowance for a mine located in Northern Québec, the amount of such allowance calculated for such mine;
- in the case of the allowance for mineral deposit evaluation and mine development after production, the amount of such allowance calculated for such mine.

The following items are not deductible in the calculation of an operator's annual profit from a mine since they are deductible in the calculation of the operator's annual profit: gifts made to Québec, expenditures incurred for R&D work, the exploration allowance, the general and administrative expenditures relating to exploration work, the additional exploration allowance, the allowance for mineral deposit evaluation and mine development before production and the exploration, mineral deposit evaluation and mine development allowance.

An operator's annual loss, for a fiscal year, will be established by applying the same rules as for an operator's annual profit, with the necessary adaptations.

For the purposes of the MDA, the expression "mine" means any place, located in Québec, whose purpose is the extraction of a mineral substance, within the meaning of the MDA.

This new method of calculating an operator's annual profit or annual loss, for a fiscal year, will apply to an operator's fiscal year beginning after the day of the Budget Speech.

### **2.1.6 Determination of the value of precious stones**

Although precious stones are currently covered by the MDA mining duties regime, this regime is poorly adapted to the reality of this type of resource, particularly in regards to the determination of the gross value of annual output.

Unlike most other mineral substances, there is no market price that makes it easy to know the value of a precious stone, since the value of each precious stone must be established on the basis of its specific characteristics.

Moreover, it is possible for precious stones from one mine to be mixed with precious stones from another mine. Such other mine could even be located outside Québec.

In the context where the gross value of annual output from precious stones may grow substantially over the coming years, there is reason to stipulate special rules to facilitate the determination of the gross value of annual output attributable to precious stones.

For the purposes of these special rules, the expression “precious stone” means a diamond, emerald, ruby or sapphire.

#### **□ Determination of gross value**

The determination of the gross value of precious stones will be based on their value before cutting or polishing. It must be established at the mine site and the operator must sort and clean the precious stones to facilitate their evaluation. The determination of the gross value of precious stones must also be made by the operator and an appraiser mandated by the Minister of Natural Resources and Wildlife (the Minister).

If the operator and the Minister agree on the value of the precious stones, the gross value of the precious stones will then correspond to the amount they have agreed. If the operator and the Minister fail to agree on the value of the precious stones, the gross value of the precious stones will then correspond to the maximum value that could be obtained from selling the stones on a free market, once they are sorted according to their commercial classification.

However, in the case where precious from a mine in Québec are ultimately sold by the operator, without being mixed with precious stones from another mine, to a person other than a person related to the operator, the gross value of such precious stones will then correspond to the proceeds of such sale. In the event that such a sale takes place during a fiscal year subsequent to the one during which the value of the precious stones is determined, an appropriate adjustment, corresponding to the difference between the proceeds of the sale and the value of the precious stones initially considered, will be made to the calculation of the annual profit from the mine from which such precious stones were obtained for such subsequent fiscal year.

Moreover, the MDA already stipulates that in case of doubt, or where the gross value of an operator’s annual output, for a fiscal year, does not correspond to the market value, the Minister may value the mineral substance and, where applicable, the processing products from the operator’s mining operation, for such fiscal year, and that such valuation constitutes the gross value of the operator’s annual output for the fiscal year, for the purposes of the Act. This rule will also apply to the determination of the value of precious stones.

#### **Application conditions**

The operator must reimburse the Minister for the costs of the evaluation of the precious stones by the appraiser mandated by the Minister.

The obligations relating to the determination of the value of precious stones will henceforth be part of the conditions an operator must satisfy to maintain the mining lease or mining concession granted to him under the *Mining Act*.<sup>62</sup>

#### **Application date**

This new way of determining the gross value of the precious stones will apply regarding an operator's fiscal year beginning after the day of the Budget Speech.

### **2.1.7 Clarification regarding amounts paid to a community or a municipality**

Under existing rules, an operator cannot deduct, in calculating its annual profit or annual loss, for a fiscal year, an expenditure, unless it was incurred by the operator regarding a mining operation to achieve the gross value of annual output from such mining operation and provided such expenditure is directly related to it.

Certain amounts paid by an operator to a community or a municipality under an agreement and intended to provide such community or municipality with benefits or spinoffs have always been considered non-deductible for the reason that they do not relate directly to the operator's mining operation.

To avoid any ambiguity in this regard, the MDA will be clarified to stipulate that an operator may not deduct any amount, other than a gift that is otherwise deductible, paid to a community or a municipality and intended to provide such community or municipality with benefits or spinoffs.

This clarification will apply by declaration.

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62 R.S.Q., c. M-13.1.