The Canadian Government Announces Mining Tax Changes

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The 2016 federal budget delivered by Canada's new Liberal government on March 22, 2016, contained a number of tax items relevant to the mining community.

CEE expansion

Many expenditures made by mining companies that are not on buildings or equipment fall into one of two categories of expenditures unique to the natural resource industry: "Canadian exploration expense" (CEE) or "Canadian development expense" (CDE). Essentially, CEE amounts can be 100 per cent-deducted in the year they are incurred, while CDE amounts are deducted at the rate of 30 per cent per year on a declining balance basis. Mineral exploration often involves very significant expenditures on environmental studies and community consultations (ESCC expenses), the cost of which the Canada Revenue Agency (CRA) has said is not CEE, even if undertaken in order to obtain an exploration permit.[1]

In March 2015, the government announced a proposal to include in CEE ESCC expenses incurred after February 2015 as a pre-condition to obtaining a licence or permit to explore, making them fully deductible in the year incurred and eligible for renunciation to purchasers of flow-through shares. The Budget states that the government intends to proceed with enacting legislation to implement this initiative.

Mineral Exploration Tax Credit

Individuals (other than trusts) who invest in flow-through shares may be entitled to additional tax benefits above and beyond renounced exploration expenses available on all flow-through shares.[2] Where certain qualifying expenditures (essentially CEE incurred in mining exploration above or at ground level conducted in Canada) are incurred and renounced to a holder of flow-through shares that is an individual (other than a trust), that holder is entitled to an investment tax credit equal to 15 per cent of the renounced qualifying expenditures. This tax credit on "grass-roots" surface exploration expenditures is called the "mineral exploration tax credit."

Currently, qualifying expenditures must be renounced to the investor under an agreement made before April 2016. The Budget extends the 15 per cent mineral exploration tax credit for another year, by extending to March 31, 2017, the deadline for the corporation and the investor to enter into the flow-through share subscription agreement governing renunciation. The extension of the mineral exploration tax credit enhances the attractiveness of flow-through share financing in what are challenging times for the mining industry.

Employee stock options

As part of its election campaign, the Liberals stated that they planned to limit the favourable tax treatment of employee stock options, which, in most cases, entitle the holder to be taxed on only 50 per cent of the income otherwise received. Specifically, the campaign proposal had been to limit the amount of income qualifying for this benefit to $100,000 per year.[3]

The Budget did not include any measures to implement this campaign pledge, which had been widely criticized by the technology community, for which employee stock options are a critical compensation tool. In fact, in a post-Budget news conference the Finance Minister stated that the government was dropping this proposal altogether.[4]

Royalties

Where a Canadian pays a royalty to a non-resident person, the payer and recipient are jointly liable for Canadian withholding tax at a rate of 25 per cent, unless a tax treaty with the recipient's country of residence reduces or eliminates that tax. The Budget announces new anti-"back-to-back" rules applicable where the recipient of the royalty in turn has an obligation to make certain payments to another non-resident, and the second non-resident would be taxed at a higher rate than the actual recipient had the Canadian paid the royalty directly to the second non-resident. This proposal may make Canadian payers liable for higher withholding obligations even if they are unaware of the arrangements between the recipient and the second non-resident.

International tax compliance

The Budget announces various initiatives to enhance international tax compliance, including the implementation of rules to require multinational enterprises to file standardized information for each country of activity (country-by-country reporting) and enhanced exchange of information between tax authorities in different countries. The CRA will also receive additional funding to hire more auditors and specialists. M

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References

1. See CRA document 2007-0252761E5, dated September 19, 2007.
2. Flow-through shares are explained at http://miningtaxcanada.com/flow-through-shares.
3. See *Canadian Mining Magazine*'s article *Employee Stock Options: Changes Coming?* in the Winter 2016 issue, found here: http://canadianmining-magazine.com/past-issues.
4. See *Globe and Mail*, "Liberals drop controversial stock options tax plan", March 22, 2016, at www.theglobeandmail.com/report-on-business/small-business/startups/liberals-drop-controversial-stock-options-tax-plan/article29337792.