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Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES:

Whether certain expenses to be incurred in relation to community consultations or environmental studies will be Canadian exploration expenses.

POSITION:

Expenses that are directly related to community consultations or environmental studies and that are incurred for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada will generally be Canadian exploration expenses, subject to the application of any of the exceptions set out in that definition.

REASONS:

Application of the CRA guidelines in 2016-0675902I7.

XXXXXXXXXXXX 2018-076220

Judy Gorman

November 15, 2018

Dear XXXXXXXXXXXX

Re: Classification of Costs Associated with Community Consultations and Environmental Assessments and Studies

This is in reply to your letter of May 22, 2018 wherein you requested our views as to whether certain costs associated with proposed exploration activities qualify as Canadian Exploration Expenses ("CEE") as that term is defined in subsection 66.1(6) of the Income Tax Act (Canada). (footnote 1) Generally speaking, these costs are related to community consultations and environmental studies or assessments concerning the proposed exploration activities.

Our consideration of this issue has been limited to an overall review of general principles. Whether any particular expense incurred by a taxpayer will qualify as CEE will depend on the particular facts of a given situation.

FACTS

You describe the following hypothetical fact situation:

1. Canco is a corporation that is incorporated under the laws of Canada, and that is a "taxable Canadian corporation" and a "principal business corporation" as those terms are defined in the Act.
2. Canco is seeking to commence an exploration program on a potential mineral property in Canada (the "Property"). The proposed exploration expenditures would not be considered to be related to a mine that has come into production in reasonable commercial quantities or related to a potential or actual extension of such a mine.
3. An Aboriginal community (the "Community") has asserted an interest in the Property, insofar as any mineral exploration or development could affect existing or potential Aboriginal or Treaty rights to the land on which the Property is situated.
4. In order to secure access to and explore the Property, Canco is engaging with the Community (the "Community Consultations") to seek its support for an exploration program to be carried out on the Property.
5. Canco will incur the following expenses as part of the exploration of the Property:
 - a. Capacity Payment Expenses: In the course of initial discussions with the leaders of the Community, Canco will advance funds to the Community to enable it to consult with and inform its members about the potential impact of the proposed exploration program (the "Capacity Payments"). The Community has discretion on how to use the funds and is not required to account to Canco regarding its use of the funds. Among other things, the Community might use the Capacity Payments to engage consultants to provide advice on environmental matters; obtain legal counsel to assist with negotiations; or fund travel related expenses.

b. Ongoing Consultations Expenses: As part of its engagement with the Community to secure access to and explore the Property, Canco will commit to ongoing consultations with the Community to report progress on the exploration program. The Ongoing Consultations Expenses will be incurred after Canco's right to explore has been granted by the applicable provincial government. These expenses will include costs of Community meetings; costs of preparing reports for the Community (including costs for translation services); and costs for Canco employees, consultants and advisors to assist with the ongoing consultation (including travel and accommodation).

c. Environmental Assessment Expenses: As part of the process to obtain the right from the applicable provincial government to explore the Property, Canco will incur expenses to undertake various environmental studies or assessments. These studies and assessments will relate to the potential impact the exploration program may have on such things as biodiversity and species at risk.

d. Legal Documentation Expenses: Canco will incur costs with respect to consultants and legal counsel who will prepare agreements that will set out the various arrangements agreed to with the leaders of the Community (e.g. employment and contracting opportunities to be made available to members of the Community) in relation to Canco carrying out the proposed exploration program. These expenses will be incurred to formalize actions agreed to in consultation with the Community to secure access to and the right to explore the Property. The documents provide written support as to the various undertakings and conditions agreed upon by both Canco and the Community to obtain the Community's support for undertaking the exploration program.

6. Canco will raise funds for the expenses listed in paragraph 5 above through the issuance of flow-through shares as defined in subsection 66(15) of the Act. Canco will renounce exploration expenses that qualify as CEE in favour of the flow-through share subscribers pursuant to subsection 66(12.6) of the Act.

OUR COMMENTS

This technical interpretation provides general comments about the provisions of the Act and related legislation (where referenced). It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R8, Advance Income Tax Rulings and Technical Interpretations.

1. Overview of Paragraph (f) of the Definition of CEE

The Purpose Test

In order for an expense incurred by a taxpayer in respect of community consultations or environmental assessments to qualify as CEE under paragraph (f) of the definition of CEE, it must have been incurred by the taxpayer "for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada" (the "Purpose Test"). Paragraph (f) expressly states that an expense meeting the Purpose Test includes such an expense for environmental studies or community consultations.

Courts have considered a similar purpose test in the context of an accumulation of petroleum or natural gas. Those cases have concluded that for an expense to have been incurred for the purpose of determining the existence, location, extent or quality of an accumulation of petroleum or natural gas, there would have to be a connection between that expense and the actual exploration work (see e.g., *Gulf Canada Ltd. v. The Queen* 92 DTC 6123 at para. 17 (FCA); *Global Communications Limited v. The Queen* 99 DTC 5377 at para. 19 (FCA); and *Petro-Canada v. The Queen*, 2004 FCA 158 at para. 35).

The CDE Exception

For purposes of the hypothetical facts, we have assumed that the only relevant exception to CEE characterization in paragraph (f) is in subparagraph (v). The subparagraph (v) exception excludes an expense from being CEE under paragraph (f) if it is a Canadian Development Expense ("CDE"). However, paragraph (f) includes parenthetical wording which states that an expense for an environmental study or community consultation undertaken to obtain a right, licence or privilege for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada will be CEE notwithstanding the subparagraph (v) exception (i.e., even if the expense would otherwise be CDE).

2. Discussion of Specific Payments

Capacity Payment Expenses

Capacity payments similar to those described above have been recognized by provincial regulatory authorities as being directly related to the community consultation process. For example, Ontario policy on "Consultation and Arrangements with Aboriginal Communities at Early Exploration" notes that addressing capacity leads to more effective consultation processes. (footnote 2) Therefore, assuming the Capacity Payments are used entirely to assist the Community in building their capacity to engage in an effective consultation process, the Capacity Payments would be considered to be related to community consultations. Moreover, the payment of such Capacity Payments would generally be considered to satisfy the Purpose Test on the basis that they are incurred in order to secure access to and explore the Property and therefore are connected to the actual exploration work.

In addition, the parenthetical words in the preamble to paragraph (f) will ensure that these expenses will not be excluded from being CEE if they would otherwise be CDE in circumstances where they are legally or informally required to obtain an exploration permit.

Therefore, expenses for Capacity Payments similar to those described above would generally be considered to be CEE.

Ongoing Consultations Expenses

Although ongoing consultation expenses would be incurred after the exploration permit has been obtained, they could nevertheless be considered to meet the Purpose Test if they are in respect of the exploration process only. Ongoing consultations expenses similar to those described above would appear to be in respect of the exploration process only and therefore would generally be considered to be CEE.

Environmental Assessment Expenses

Expenses for environmental assessments undertaken to meet a legal or informal requirement to obtain an exploration permit would generally satisfy the Purpose Test. Moreover, the parenthetical words in paragraph (f) will ensure that these expenses are not excluded from being CEE if they would otherwise be CDE. In addition, targeted environmental assessments that are conducted at a taxpayer's discretion could also satisfy the Purpose Test if they are conducted in conjunction with a specific exploration activity.

The reference in 2016-067590217 -- Canadian exploration expense to "vegetation, fisheries and water assessments" are examples of targeted environmental assessments which might be conducted in conjunction with exploration activities and are not an exhaustive list. Expenses incurred for other types of targeted environmental assessments, such as biodiversity and species at risk, that are conducted in conjunction with exploration activities would generally be considered to be CEE.

Legal Documentation Expenses

The importance of documenting arrangements made during community consultations is apparent in jurisprudence considering the Crown's duty to consult the Aboriginal community before issuing an exploration permit. Case law has stated that the Crown's duty to consult "requires conduct that demonstrates a genuine and good faith intention to listen, consider and respond to Indigenous concerns" and that meaningful consultation always requires a process that enables "determining how to proceed, including proposals to address concerns raised, where appropriate" (*Eabametoong First Nation v. Minister of Northern Development and Mines*, 2018 ONSC 4316 at paras. 20 and 94 (Div Ct)).

Therefore, expenses for legally documenting arrangements agreed to with the leaders of a community during community consultations would generally be considered to meet the

Purpose Test and therefore would be considered to be CEE, to the extent that such legal documentation relates to the exploration process.

Any expenses relating to the negotiation or legal documentation of agreements or arrangements reached with a community that relate to aspects of the project other than exploration (including, for example, the development, production or reclamation stages of the project), would not meet the Purpose Test and therefore would not qualify as CEE.

General Comments

This letter does not address the income tax consequences associated with any payments made under agreements or arrangements, such as an impact benefit agreement, that are not directly related to community consultations or environmental studies. The tax consequences associated with payments not directly related to community consultations or environmental studies would need to be determined based on the specific facts and circumstances and the specific nature of such payments.

Pursuant to section 67 of the Act, no deduction may be made in respect of an expense except to the extent that it is reasonable in the circumstances. The determination of whether any outlay or expense is reasonable under section 67 is primarily a question of fact and can only be determined once all the facts and circumstances are known.

We hope that these comments will be of assistance.

Yours truly,

Kimberley Wharram

Manager, Resources Section

Reorganizations Division

Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch

FOOTNOTES

Note to reader: Because of our system requirements, the footnotes contained in the original document are shown below instead:

1 R.S.C. 1985, c. 1 (5th suppl.) as amended (the "Act").

2 See the Ontario Ministry of Northern Development and Mines' written policy on "Consultation and Arrangements With Aboriginal Communities At Early Exploration" (September 2012) at page 9. Retrieved from the Ontario Ministry of Energy, Northern Development and Mines website: www.mndm.gov.on.ca/sites/default/files/aboriginal_exploration_consultation_policy.pdf