



# Prospectors & Developers Association of Canada

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## Association canadienne des prospecteurs et entrepreneurs

### Submission to the House Standing Committee on Finance (FINA)

### Pre-Budget Consultations, August 2011

#### Executive Summary

This submission is presented by the Prospectors and Developers Association of Canada (PDAC), representing Canada's mineral exploration industry. The PDAC is a national organization with over 8,000 members representing the range of companies and individuals in mineral exploration and development. Our individual members include prospectors, geoscientists, consultants, mining executives, students and people working in the drilling, financial, legal and other supporting fields. The association's corporate members include exploration and junior mining companies (small and medium-sized enterprises or 'SMEs'), major producing companies, and organizations providing services to the industry.

Mineral exploration and mining are mainstays of Canada's economy, particularly in northern and remote regions. Canada's mining industry accounts for approximately 20% of Canada's annual goods exports and generally between 3 and 4% of Canada's GDP. The industry employs over 300,000 Canadians in mineral extraction, processing and manufacturing. However, the mineral reserves which sustain mining have fallen dramatically over the past 25 years, threatening the future of the industry. The only way to replace the reserves is by mineral exploration (research and development). It is essential that policies initiated by the federal government to encourage exploration continue and that tax rules are reviewed to ensure they reflect the needs of the current economic environment.

The PDAC recommends that the following measures be adopted to sustain the mineral industry in Canada and create jobs:

1. Make the current Mineral Exploration Tax Credit (METC) - which has been renewed, often on an annual basis since 2000 - permanent, thereby providing greater certainty to the exploration industry and investors.
2. Increase the knowledge of our natural resources as a key driver to exploration success through continued investment in the Geomapping for Energy and Minerals (GEM) initiative, and the Targeted Geoscience Initiative (TGI).
3. Encourage good corporate social responsibility and environmental practices by undertaking a review, in consultation with industry, of the tax rules governing the extent to which community consultation and environmental compliance costs are eligible for the Canadian Exploration Expense (CEE) deduction.

## **The role of Mineral Exploration and Mining in Canada's economy**

Canada dominates the global mineral exploration industry, with financing provided through the TSX and its venture exchange for projects in over 100 countries. Exploration is the lifeblood of the mining industry at home and abroad and Canada needs to continue to attract a significant share of global exploration investment to projects within its borders.

The Canadian mining industry accounts for approximately 20% of Canadian goods exports and, according to the Mining Association of Canada, paid \$8.4 billion to Canada's federal, provincial and territorial governments in 2010, a significant increase from \$5.1 billion the preceding year. The exploration and mining industry generates thousands of high-skilled, high-paying jobs across Canada. In remote regions this is particularly important. As an example of the impact that a new mine can have on a region, the Meadowbank gold mine, which opened in Nunavut in 2010, has provided approximately 500 new jobs and contributed almost 12 % of the GDP of Nunavut.

However, the future of mining in Canada is threatened by an inability to replace the mineral reserves at the same pace that they are being extracted; reserves of base metals are close to their lowest levels in 30 years and gold reserves are far below their highs.

### **Mineral Exploration Financing**

- As the 'research and development' branch of the mining sector, exploration companies do not have production revenue and therefore must rely on investors who are prepared to support higher risk activities.
- Due to the fragile state of the global economy there is downward pressure on companies' share prices and their ability to raise high-risk financing.
- While Canada remains a leading destination for exploration financing, exploration expenditures declined significantly from \$3.3 billion in 2008 to \$1.9 billion in 2009. Exploration financing recovered in 2010 to \$2.6 billion but this recovery is threatened by the current global downturn.
- Flow-Through shares, a unique Canadian innovation, have been an important factor in Canada's success in exploration financing. This mechanism allows a company to "flow" its tax deduction for exploration to an investor in return for high-risk financing. The investor then has a share in the company and a federal tax deduction, which may be matched by a provincial tax incentive.
- The attractiveness of Flow-Through shares has been enhanced since 2000 by additional tax incentives, including the Mineral Exploration Tax Credit (METC) and various provincial incentives. In the June 2011 federal budget, the METC was extended for an additional year to March 31, 2012.

- In addition to market uncertainty, Canadian mineral exploration companies face increased operating costs. These include compliance costs related to the Crown's Duty to Consult with Aboriginal communities and increased environmental regulatory costs (i.e. federal, provincial and territorial policies that establish new permitting conditions for companies beyond the existing regulations and community engagement practices). The PDAC believes that most of these costs qualify for renunciation as Canadian Exploration Expense (CEE) under flow-through share arrangements.
- The situation is urgent, as without sufficient investor support, companies will carry-out less exploration causing an impact on service companies and individuals, particularly those in rural, northern and Aboriginal communities. In addition, the sustainable replacement of Canada's mineral reserves will be at risk.

### **Expected Costs and Benefits of the proposed measures**

#### **1. Tax Measure: Mineral Exploration Tax Credit**

**Make the current 15% Mineral Exploration Tax Credit (METC) a permanent feature of the federal income tax system.**

#### Background

The mineral exploration tax credit was introduced in 2000 at a time when it was very difficult to raise financing for mineral exploration even using the flow-through share system. The credit provided a 15% tax credit on top of the 100% tax deduction for CEE. Several provinces added their own harmonized incentives. This system called "Super-Flow-Through" by the industry provided the incentive needed to attract investors. This system has been in place for over a decade and has helped ensure that Canada continues to attract the greatest share of global exploration (Canada is currently first among countries with 19% of the world's exploration investment).

#### Cost

In the June 2011 federal budget, it was estimated that the extension of this measure for an additional year would result in a net reduction of federal revenues of \$90 million over the 2011–12 to 2012–13 period.

#### Benefits

- In an average year, the METC investors collectively provide companies with \$400 million in new financing to be spent on grassroots exploration in Canada.
- The money has to be spent in Canada, thereby ensuring that, if a mine is discovered, the jobs and associated economic opportunities benefit Canadians directly.

- If even a single mine is discovered, the taxes paid to all levels of government are significant. The Mining Association of Canada reports that \$8.4 billion was paid to governments by the mining industry in 2010.

## 2. Geoscience mapping

### **Continue to invest in the Geo-mapping for Energy and Minerals (GEM) and the Targeted Geoscience Initiative (TGI).**

#### Background

These programs have provided important new breakthroughs in geological knowledge that have resulted in significant exploration success. The government has planned on continuing these programs. The PDAC supports this decision and recommends that this research remains a firm commitment in future budgets.

#### Costs

Both GEM and TGI are multi-year programs that have been funded for several years. The annual costs to the federal government are \$22 million for GEM and \$5 million for TGI.

#### Benefits

- To ensure that the costs to the federal government are kept to a minimum, some projects undertaken are in partnership with the provincial governments and, in the case of TGI, academia and the mineral industry as well, who provide co-funding.
- The information gathered increases the knowledge of our natural resources, encourages mineral exploration and contributes to the professional development of geology students.
- The Geological Survey of Canada estimates that each dollar spent on these programs results in over \$100 being spent on exploration.

### **3. Support for Responsible Exploration and Development**

**Clarify the current CEE guidelines to allow companies to manage new costs associated with government and societal requirements.**

#### Background

In 2007, the Canada Revenue Agency (CRA) sent a letter to the PDAC, providing guidance regarding expenditures related to community consultation, environmental studies and feasibility studies and their eligibility for CEE treatment. However, differences in the interpretation of these guidelines by industry and the CRA have led to some confusion as to which expenses are eligible.

#### Cost

No new cost associated with providing a clearer definition of the eligibility criteria.

#### Benefits

Improved corporate social responsibility and environmental practices by exploration companies. Communities located near where the exploration is taking place, often northern and Aboriginal communities, will be better informed and more involved in mineral exploration, resulting in additional employment and business opportunities. Companies and Canada Revenue Agency auditors will have greater certainty regarding the eligibility of costs related to exploration.