Name that Mineral: Navigating the New Critical Mineral Exploration Tax Credit ("CMETC")

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Background

Background

- Budget 2022 proposed the elimination of flow-through share ("**FTS**") renunciation for oil, gas and coal expenditures (effective for FTS agreements entered into after March 31, 2023). However, Budget 2022 has introduced a new credit for holders of FTS in respect of certain critical mineral mining expenditures.
- In general, mineral exploration tax credits are non-refundable tax credits for eligible exploration expenses that can be applied against an individual's Canadian income tax otherwise payable for the particular taxation year.

Background

- To be eligible, the taxpayer must be an individual (other than a trust) who is deemed to incur eligible exploration expenses, either individually or through a partnership, pursuant to a FTS agreement with a “principal-business corporation” (“**PBC**”) (as defined in ss. 66(15) of the *Income Tax Act* (Canada) (the “**ITA**”). For these purposes, a PBC is a corporation whose principal business is exploration, mining or mineral processing.

Background

- The current 15% Mineral Exploration Tax Credit (“**METC**”) provides a 15% tax credit in respect of eligible flow-through mining expenditures.
- The new CMETC provides an <u>additional</u> tax credit of 30% for individuals investing in flow-through shares issued by a PBC in respect of eligible flow-through critical mineral mining expenditures.
- For example, an individual investor will subscribe for shares with flow-through attributes under a FTS agreement entered into with a PBC, which allows the corporation to renounce or “flow through” specified expenditures to individual investors who can deduct the expenses in calculating their taxable income.
- The METC and the new CMETC augment the tax benefits associated with the deductions that are flowed to FTS investors, providing a credit of 15% or 30%, respectively, of such renounced mineral exploration expenses.

Mineral Exploration Tax Credits: How Do They Work?

How Do the Mineral Exploration Tax Credits Work?

- **METC**
  - Targeted non-refundable tax credit equal to 15% of the individual taxpayer's "flow-through mining expenditures" ("**FTME**") (defined in ss. 127(9) of the ITA, as amended in the Draft Legislation)
- **CMETC – Draft Legislation (released Aug 9, 2022)**
  - Targeted non-refundable tax credit equal to **30%** of the individual taxpayer's "flow-through critical mineral mining expenditures" ("**FTCME**") (defined in ss. 127(9) of the ITA, as amended in the Draft Legislation)

How Do the Mineral Exploration Tax Credits Work?

- **METC**
  - FTME eligible for the METC are commonly referred to as "grassroots" mining expenditures, and are restricted to certain of the expenses described in paragraph (f) of the definition of "Canadian exploration expense" in ss. 66.1(6) of the ITA incurred by a corporation after March 2019 and before 2025

- **CMETC – Draft Legislation (released Aug 9, 2022)**
  - FTCME eligible for the CMETC are restricted to certain of the expenses described in paragraph (f) of the definition of "Canadian exploration expense" in ss. 66.1(6) of the ITA incurred by a corporation after April 7, 2022 and before March 31, 2027

How Do the Mineral Exploration Tax Credits Work?

- **METC**
  - Applies to costs relating to prospecting and carrying out geological, geophysical or geochemical surveys conducted from or above the surface of the earth in searching for a base or precious metal deposit (see paragraphs (a) and (d) of the definition of "mineral resource" in ss. 248(1) of the ITA)
- **CMETC – Draft Legislation (released Aug 9, 2022)**
  - Applies to costs related to prospecting and carrying out geological, geophysical or geochemical surveys conducted from or above the surface of the earth in searching primarily for "**critical minerals**" (as defined in amended ss. 127(9) of the ITA)

How Do the Mineral Exploration Tax Credits Work?

- Specified minerals eligible for the CMETC:
  - copper, nickel, lithium, cobalt, graphite, rare earth elements, scandium, titanium, gallium, vanadium, tellurium, magnesium, zinc, platinum group metals and uranium

Investment Tax Credits: Impact on Next Year's CCEE

- A taxpayer is entitled to a federal or provincial investment tax credit ("**ITC**") when it incurs specified expenditures, including "Canadian exploration expenses" ("**CEE**") such as expenses incurred or deemed incurred in conducting mining exploration activity from or above the surface of the earth, for purposes of the METC
- The CCEE of the taxpayer for the taxation year is reduced by the amount of the ITC claimed in the preceding taxation year, such as the METC
- A negative CCEE account balance at the end of the taxation year must be included in income
- The taxpayer can mitigate the CCEE grind by incurring more CEE to stay ahead of a negative CCEE account balance
- Proposed legislation for the CMETC amends the CCEE definition to add any CMETC deduction to the grind in the next year's CCEE

Timeline of the CMETC

Timeline of Mineral Exploration Tax Credits

- Budget 2000 introduced a temporary 15% METC aimed at increasing Canadian mineral exploration activity, to expire Dec 31, 2003
- Budgets 2003 and 2004 each further extended the expiry date of the METC for one year, to expire Dec 31, 2005
- Budget 2006 reintroduced the expired METC for the period of May 2, 2006 – March 31, 2007

Timeline of Mineral Exploration Tax Credits

- Budgets 2007 to 2018 each further extended the expiry date of the METC to March 31 of the following year, and included a "look-back" rule for the year subsequent
- Budget 2019 further extended for 5 years, to expire March 31, 2024
- Budget 2022 introduced the 30% CMETC for 5 years, to expire March 31, 2027
- Draft Legislation released August 9, 2022
- Consultation period open for comments until September 30, 2022

Implementation of the CMETC under FTS Agreements

Budget 2022 – New 30% CMETC for Specified Minerals

- The CMETC will apply to expenditures renounced under FTS agreements entered into after April 7, 2022 and on or before March 31, 2027

- The CMETC will generally follow the rules in place for the current METC – however, eligible expenditures will **not** benefit from both the METC and the CMETC

- To be eligible, a "qualified engineer or geoscientist" must certify that the expenditures to be incurred and renounced are part of a project that targets the "specified minerals" and there is a reasonable expectation that the minerals targeted by the exploration are primarily specified minerals

Legislative Concerns/Gaps

The “Qualified Engineer or Geoscientist” Requirement

- For a particular mining expenditure to be eligible to form the basis for a CMETC claim, a “qualified engineer or geoscientist” must certify that the expenditures will be incurred pursuant to an exploration plan that primarily targets critical minerals
- A “qualified engineer or geoscientist” is largely based on the definition of a “qualified person” as defined under National Instrument 43-101, *Standards of Disclosure for Mineral Projects*, which was published by the Canadian Securities Administrators (“**CSA**”) as of April 7, 2022
- On April 14, 2022, one week after Budget 2022 was released, the CSA published Consultation Paper 43-401, *Consultation on National Instrument 43-101 Standards of Disclosure for Mineral Projects,* as a way to obtain feedback from stakeholders regarding the efficacy of several key provisions and priority areas for revision, including the “qualified person” definition (comment period closed September 13, 2022)

The “Qualified Engineer or Geoscientist” Requirement

- The “qualified engineer or geoscientist” definition in the Draft Legislation restricts the requirement to those individuals regulated and in good standing with a professional association in Canada
- The Explanatory Notes to the Draft Legislation provide that where the definition of “qualified engineer or geoscientist” is satisfied, an employee of the issuer corporation may act as the “qualified engineer or geoscientist”
- No details have been released by the CRA regarding the prescribed certification process by which the “qualified engineer or geoscientist” must certify that the expenditures will be incurred pursuant to an exploration plan that primarily targets critical minerals
- **Timing concern: the CMETC is already in force, however any expenditure is contingent on certification by a “qualified engineer or geoscientist”, for which there is no prescribed process in place**

New Para 127(9)(e) of "flow-through mining expenditure"

- ***flow-through mining expenditure*** of a taxpayer for a taxation year means an expense deemed by subsection 66(12.61) (or by subsection 66(18) as a consequence of the application of subsection 66(12.61) to the partnership, referred to in paragraph (c) of this definition, of which the taxpayer is a member) to be incurred by the taxpayer in the year

  [(a) – (d)]

  (e) that is not an expense that the taxpayer has included under paragraph (a.21) of the definition of *investment tax credit* in the computation of its investment tax credit in respect of which the taxpayer has, <u>at any time</u>, sought a deduction (i.e., 30% CMETC)

New Para 127(9)(e) of “flow-through mining expenditure”

- **Paragraph (e) prevents a taxpayer from deducting the METC and the CMETC in respect of the same expense**

- Further, paragraph (e) prevents a taxpayer from claiming a deduction (whether the deduction is allowed or not) for the CMETC in respect of expenses eligible for that credit then later claiming the METC on the basis that the expenses meet the conditions of the “flow-through mining expenditure” definition (i.e., no “fallback” where claim subsequently disallowed)

- **For example, if a taxpayer deducted the CMETC in respect of an expense at the time it filed its return for the taxation year, but was subsequently reassessed and denied the CMETC, the taxpayer would not be able to claim the METC**

Common Questions

Common Questions:

- If we file for the CMETC and CRA determines the primarily “critical minerals” standard isn’t met, can we refile for the METC?
  - *No*
- What is the process if CRA audits or challenges a CMETC claim?
  - *Uncertain, but likely an onus on the taxpayer to prove the correctness of the claim (i.e., similar to a denied CEE claim)*
- Will the CMETC eligibility flow through limited partnerships to its limited partners?
  - *Yes*

For more information

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