Mining Voice

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Deloitte Canada's mining newsletter

In this issue

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Mining Voice

In a rapidly changing global economy, the energy and resources industry faces unprecedented challenges as it undergoes dramatic change. Our Canadian mining companies are not immune to these challenges. These challenges include the run-up in base metal prices, environmental concerns, industry consolidation and managing the impact of the exchange rate.

With the increasingly complex environment facing the mining industry, Deloitte will be issuing a new quarterly mining newsletter "Deloitte's Mining Voice" to share valuable insights on the topics relevant to mining companies.

We hope that you will enjoy our premier release of this new quarterly newsletter. We look forward to discussing with you various mining topics of interest. If you have any questions or comments, please feel free to contact any member of the team.

Introduction

In recent years, the resource industry has been faced with numerous tax changes – increasing the complexity of the tax implications of many operating decisions. Deloitte provides reliable advice on the most pressing tax issues, while delivering practical, well-crafted tax solutions specifically tuned to current government policies.

In this first release, we present two topics focusing on tax issues that we trust are of interest to decision-making professionals in the mining industry.

First, Lucie Chouinard explains the difficult balance between offering stimulating conditions for the development of mining ventures, while receiving fair compensation from the extraction of the resources. Her analysis is based on a series of recent tax changes from both the federal and provincial governments across Canada. She recently gave a lecture at the Federated Press mining sector conference discussing these recent changes.

Secondly, Geneviève Provost, Partner, discusses an important element of the tax filling requirement for Canadian companies electing to use a currency other than the Canadian dollar.

Finally, in each issue, we will spotlight one of Deloitte’s professionals offering their experience to the resource industry. This issue will focus on Lucie Chouinard, Associate Partner in Tax.

Recent changes in the tax environment of the mining industry

In the course of the last two to three years, the Canadian Federal and provincial governments implemented several tax measures applicable to the mining industry. These recent measures have triggered important changes to the mining industry's tax environment, especially as it relates to tax incentives intended to stimulate mining exploration and related activities.

Analyzing these changes, the following issues were prevalent in the most recent budgets:

- Government's focus on obtaining a fair compensation for their non-renewable resources;
- Encouraging primarily the development, and as a second priority, the processing of ore in Canada, with an objective of creating value and jobs in Canada derived from mining activities.

In fact, some of the measures implemented resulted in an increase in global taxes (both income and mining taxes) to be paid by mining entities. These measures include:

- In the 2012 Budget, the Federal government announced a phase out of the 10% non-refundable pre-production mining expenditure corporate tax credit and of the 10% Atlantic Investment Tax Credit (ITC) for oil and gas and mining activities. The Federal government also announced a reduction of the Scientific Research and Experimental Development (SR&ED) income tax credit rate ("ITC") from 20% to 15%.
- In the 2010 Budget, the Quebec mining duty tax system was completely revamped and, among other changes, there was an increase of the tax rate from 12% to 16% with a reduction of the eligible processing allowance. In the meantime, in the 2012 Budget, Quebec increased the ITC for processing for income taxes.
- In the 2012 Budget, the Quebec refundable resource ITC rates were reduced. However, an equivalent increase will be permitted in exchange for an option by the government to acquire an equity stake in the mine.
- The New Brunswick government is currently reviewing its mining royalties system with an objective of increasing its revenue streams.
- In the 2012 Budget, the Ontario government is proposing to work with stakeholders in reviewing the current mining duty regime. We expect that the changes that will emerge will lead to an increased tax burden, which is referred to by the authorities as a "fair compensation for non-renewable resources".

On the other hand, some measures were implemented so as to encourage mining activities. These measures include:

- In the 2012 Budget, The Federal's 15% tax credit on flow through shares ("FTS") was extended for an additional year. Furthermore, an ITC related to electricity generating equipment and clean energy equipment was created.
- In the 2011 Quebec Budget, the "Fonds du Plan Nord" was created and government funds will be dedicated to fund Northern Quebec projects.
- In the 2012 Quebec Budget, a new ITC on the acquisition of fixed assets used in the processing of ore was created to encourage mining processing in Quebec.
- In the 2012 Budget, the BC 's Training Tax Credit has been enhanced.
- In the 2012 Budget, the government of the North West Territories ("NWT") proposed to invest in initiatives to support sustainable resource development and economic diversification, which includes the negotiation and implementation of the final Devolution Agreement. The latter agreement will provide Northerners control over public land, resources and resource revenues, which will permit opportunities to expand the NWT economy.

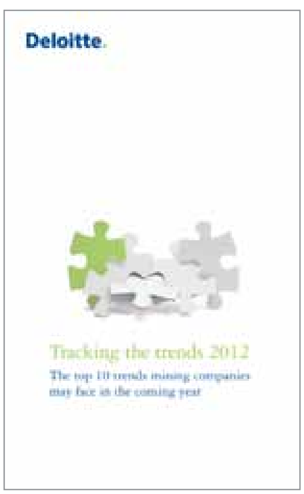
For a detailed list of recent changes, please refer to our document presented at the 2nd annual Natural Resources Taxation course organized by Federated Press.

The two goals of "fair compensation" and "encouraging measures" may be difficult to achieve simultaneously, since the underlying premise of fair compensation involves generating revenue streams by the taxation authorities, which is counterintuitive to the objective of encouraging mining activities though tax savings and incentives. The latter incongruence may lead to inconsistencies in tax legislation.

In our view, the "fair compensation" argument is a reaction by the different governments to promote social responsibility towards the mining industry given the controversial social issues associated with this industry. Social responsibility in the mining industry is an enormous undertaking and we are of the view that this issue is, in fact, one of top priorities of the mining industry. In addition, the recent myriad of tax changes in the industry has led to a complex tax environment, which will, in our view, continue to evolve as the taxation authorities and mining corporations continue their efforts in achieving social responsibility and redistributing "fair compensation".

In addition, the Canadian mining industry must remain competitive in order to continue to be viable on a global basis. The presence of an abundance of mineral resources in Canada does not necessarily translate into the ability by the mining industry to leverage the resources at a competitive cost. This is a current challenge that is being addressed by the governments and subject to increased public scrutiny.

For further details on the mining industry Top Trends, we invite you to read our document on the Mining Industry Top Ten Trends for 2012.



Tracking the trends 2012

www.deloitte.com/ca/mining-trends

Tax filings in a currency other than the Canadian dollar

In 2007, the federal government announced a major change to the *Income Tax Act*[1] (ITA) authorizing certain corporations to elect to use a currency other than the Canadian dollar when preparing their tax returns, i.e., a "functional currency" for tax purposes. Until recently, in all Canadian provinces, Canadian mining operators who elected to use a functional currency were still required to keep two separate sets of financial statements since the election was not recognized for the purposes of calculating their mining taxes.

The option of reporting revenues in a functional currency will enable mining companies to better control their tax burden as it relates to foreign currency fluctuations. This is an important policy change to an industry that makes a significant contribution to the Canadian economy. In 2010, mining exports represented 21.2% of Canada's exports. In addition, in that same year, the total amount of income taxes and mining duties collected at the federal and provincial levels reached nearly $8.4 billion.[2]

On May 12, 2011, the Ontario legislature approved Bill 173[3] while the Quebec legislature approved Bill 5 on June 6, 2011.[4] Among other things, this legislation amended Ontario's *Mining Tax Act*[5] and Quebec's *Mining Tax Act*[6] to authorize the application of the functional currency reporting rules for the purposes of mining duty returns and mining tax returns. If taxpayers elect to use a functional currency, their taxable income and tax payable are determined in the functional currency selected. This reporting method is usually recommended if most of a company's transactions are carried out in a currency other than the Canadian dollar.

Taxpayers considering the possibility of electing to report their income in a functional currency for the taxation year ending December 31, 2012 should act promptly. Filing of Form T1296 ("Election, or Revocation of an Election, to Report in a Functional Currency") with the Canada Revenue Agency (CRA) is required six months prior to the end of the taxation year to which the election applies, i.e., no later than June 30, 2012. Taxpayers wishing to file a functional currency election also have to notify the Quebec or the Ontario tax authorities (as applicable) of the election within the prescribed timeframe.[7]

Conditions to be met in order to make the election

In addition to complying with the election filing deadline, parties wishing to report their revenues in functional currency must meet the following conditions[8]:

a) Must be a corporation (other than an investment corporation, a mortgage investment corporation or a mutual fund corporation) resident in Canada throughout the taxation year.

b) Must use an eligible functional currency for the first taxation year to which the election applies.

c) Must not have filed an election to report in a functional currency different from that currently used.

d) Must not have revoked a previous election to report in a functional currency.

In addition, throughout the taxation year, the functional currency selected by the taxpayer must be:

a) An eligible currency (U.S. dollar, euro, pound sterling, Australian dollar and any other prescribed currency).

b) The primary currency in which the taxpayer's records and books of account are maintained for financial reporting purposes.

Specific provisions for corporations that are members of a partnership

Mining exploration projects may often involve the use of partnerships. Specific provisions apply to corporations wishing to file a functional currency election if they hold an interest in a partnership.

Subsection 261(6) of the ITA sets out the applicable criteria when one of the partners of a partnership elects to report in a functional currency.[9] For purposes of calculating the partner's mining tax in such cases, the general rules for functional currency reporting in section 261 of the ITA apply as if the partnership were a taxpayer whose first year of reporting in a functional currency corresponds to the first year ending at the same time as or after the first year in which the partner reported in a functional currency.

Impact of functional currency reporting

For companies operating in the mining sector, the election to report revenues in a functional currency may have a significant impact on the effect of exchange rate fluctuations between the functional currency and the Canadian dollar. For example, the losses and gains resulting from converting functional currency transactions into Canadian dollars for reporting purposes would be eliminated; therefore, there would be no more distortion in this regard when calculating revenues for tax purposes compared with accounting revenues.

For the first year in which a mining company makes this election, the opening balance of the company's tax attributes (including losses, undepreciated capital cost and exploration expense balance) must be converted into the company's functional currency.

Deloitte – specialists in functional currency reporting

Using a comprehensive approach, Deloitte carries out tax planning to help companies assume their worldwide tax obligations while exploring planning possibilities aimed at reducing their global tax burden. We believe that the best tax strategies should be aligned with the company's operations and incorporated within the company's business plan. Deloitte has the experience to help with the transition to functional currency reporting; thereby enabling companies to minimize the tax exposure to exchange rate fluctuations.

Featured profile

Lucie Chouinard, CPA, CA, M.Fisc.
Associate Partner – Abitibi-Témiscamingue

Our featured profile this first edition will focus on one of our authors, Ms. Lucie Chouinard.

Ms. Lucie Chouinard has 25 years of experience in the mining industry. Lucie's depth of experience in the mining industry enables her to identify potential tax problems when conducting due diligence and enables her to find solutions and filing positions to minimize income and mining taxes and to maximize government assistance (income tax credits and refundable mining duties taxes) for her clients.

Lucie has worked on many assignments such as:
- federal and provincial income tax compliance and related consulting services;
- provincial mining duties compliance (in both Quebec and Newfoundland);
- tax planning for mining clients (mines at their operating stage or at their exploration stage); and,
- acquisitions (due diligence, purchase price allocations).

Lucie wrote her essay for her master's degree in tax at the University of Sherbrooke in Quebec concerning the financing of the mining sector. She has been with the Deloitte team since 2003.

Endnote

1 R.S.C. 1985, c 1, 5th supplement.

2 Mining Association of Canada, Facts and Figures 2011. *The Canadian Mining Industry,* http://www.mining.ca/www/media_lib/MAC_Documents/F&F2011-English.pdf

3 *Act respecting budget measures, interim appropriations and other matters*, S.O. 2011, c. 9.

4 *Act to amend the Taxation Act, the Act respecting the Québec sales tax and other legislative provisions*, S.Q. 2011, c. 6.

5 R.S.Q., c I-0.4.

6 R.S.O. 1990, c M.15.

7 In Quebec, taxpayers who elect to do so must notify the ministère du Revenu du Québec in writing (attaching a copy of the document submitted to the CRA) within 30 days following the date of election or, if said deadline occurs later, prior to the deadline for filing the election with the CRA. In Ontario, taxpayers who elect to do so must notify the Ministry of Finance (attaching a copy of the document submitted to the CRA) no later than six months prior to the end of the taxation year for which the election is made.

8 Subsection 261(3) ITA.

9 For Quebec tax purposes, the equivalent provision is section 21.4.20 of the Quebec *Taxation Act.*

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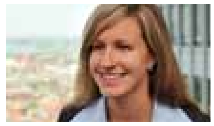

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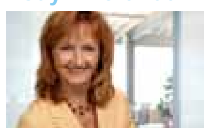

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