Taxation of the Natural Resources Industry in Quebec: The wave of changes still goes on

January 1, 2014

On December 20, 2013, the Quebec Department of Finance and the Economy issued Information Bulletin 2013-14 (the "**Bulletin**"), announcing *inter alia* changes to various tax measures specifically applicable to the natural resources industry.

The Bulletin is certainly important in respect of both the income tax for mining corporations and the "super" tax deductions to which an individual who subscribes for flow-through shares issued by a corporation which, directly or indirectly, conducts exploration activities from the surface of the soil in Quebec is generally entitled to.

The Bulletin also makes public the intention of the Government to make some changes to those already announced in the context of the proposal for the revision of the *Mining Tax Act* unveiled on May 6, 2013 through Information Bulletin 2013-4.

INCOME TAX FOR MINING CORPORATIONS

A qualified mining corporation which incurs certain exploration expenses in Quebec is eligible to a refundable tax credit under the *Taxation Act* (Quebec). *The Tax Credit relating to Mining, Petroleum, Gas or Other Resources* (the "**Resources Credit**") may reach, in certain cases, 38.75% of the eligible expenses, particularly where a qualified corporation that does not operate a mineral resource or an oil or gas well in reasonable commercial quantities incurs certain exploration expenses in certain northern areas. Furthermore, to obtain the highest Resources Credit rate (the "**Preferential Rate**"), the qualified mining corporation must not be related to a corporation operating a mineral resource or an oil or gas well in such quantities.

The following table shows the Resources Credit rates that currently apply depending on the various applicable parameters.

In the March 20, 2012 Budget Speech, rate reductions for the Resources Credit[1] were announced regarding expenses incurred after December 31, 2013: a 10% reduction for corporations not operating any natural resource and 5% for the other corporations.

It was furthermore stated that such corporations could benefit from an increase of the Resources Credit equal to such rate reduction in exchange for an option to the Quebec government to acquire an equity stake in the development. However, the terms of such option to acquire an equity stake in the development have not to date been unveiled by the Government.

Acknowledging that the international context is less favourable to investments in mining exploration, which may among other things be explained by a decrease in metals prices, the Government announced the postponement to January 1st, 2015 of the coming into force of these modifications to the Resources Credit.

The Bulletin also contains two technical modifications which will restrict the scope of the notion of "qualified corporation that does not operate a mineral resource or an oil or gas well in reasonable commercial quantities" for the purposes of the Resources Credit.

First, the notion of "related corporation" used to determine whether there is operation or not of a resource for the purposes of such notion will be replaced with the notion of "associated group", similar to the notion used in respect of the *Tax Credit for Investments relating to Manufacturing and Processing Equipment*.[2]

It is also intended to replace the condition that the qualified corporation must not operate a mineral resource or an oil or gas well in reasonable commercial quantities with the requirement that no gross income be earned from the operation in reasonable commercial quantities of such a resource. Thus, corporations which indirectly earn gross income derived from the operation of a mineral resource, under the form of royalties for example, will henceforth no longer be eligible to the Preferential Rate, even if they don't operate any natural resource and are not associated with any corporation that operates such a resource.

A corporation which earns gross income of any nature whatsoever (including royalties) from the operation of a mineral resource or an oil or gas well in reasonable commercial quantities will therefore "taint" all the other corporations of its associated group and no corporation of the group will be eligible to the Preferential Rate.

It is intended that the amendments pertaining to the Resources Credit will apply to the taxation years beginning after December 20, 2013. It should be noted that these new rules will also apply *mutatis mutandis* to partnerships.

THE FLOW-THROUGH SHARE REGIME

The Quebec legislation provides for two additional deductions of 25% each (the "super" deductions) for individuals who subscribe for flow-through shares, the first one respecting some exploration expenses incurred in Quebec and the second one when the exploration expenses in question are surface exploration expenses. At the present time, the eligibility for these "super" deductions is among other things conditional upon the issuing corporation not operating or having operated a mineral resource or an oil or gas well in reasonable commercial quantities at the time it incurred the expenses and throughout all of the preceding 12 months. In addition, the eligibility to these "super" deductions is conditional upon the issuer not controlling a corporation that operates such a natural resource or being controlled by such a corporation.

It is stated in the Bulletin that changes similar to those pertaining to the Resources Credit will be made to the flow-through share regime. More specifically, the notion of "operation of a mineral resource or oil or gas well" will be replaced with the requirement that no gross income be earned from the operation in reasonable commercial quantities of such a resource.

Furthermore, like the modification respecting the notion of related corporations in the context of the Resources Credit, the notion of “control” will be replaced with the broader notion of association, i.e. that of the “associated group”.

A mining corporation will thus no longer be allowed to issue flow-through shares providing an entitlement to the “super” deductions if it is associated with another corporation (for example, a sister corporation) which derives gross income from the operation in reasonable commercial quantities of a mineral resource or an oil or gas well.

The modifications to the flow-through share regime are intended to apply to shares issued after December 31, 2013.

MINING TAX ACT

The Government also announced through the Bulletin its intention to ease the restriction applicable to the depreciation allowance which may be claimed in the computation, for mining tax purposes, of the annual earnings from a mine. This restriction generally provides that no amount on account of depreciation may be deducted in respect of class 4 property (which is essentially comprised of property acquired by an operator after March 30, 2010) if the undepreciated capital cost (“**UCC**”) of its classes 1 to 3 is greater than zero. In other words, an operator must fully amortize, for mining tax purposes, the property it acquired on or before March 30, 2010 before being allowed to claim a depreciation allowance in respect of its class 4 property.

The easing considered by the Government would allow an operator to claim, in the calculation of its annual earnings from a mine, an amount on account of depreciation allowance in respect of class 4 property provided it also deducts the maximum amount of the depreciation allowance relating to its class 1, 2 and 3 property used in the operation of this mine. There would no longer be a requirement that the UCC of the classes 1 to 3 be equal to zero before being able to obtain a depreciation allowance in respect of class 4 property.

The Bulletin states that this measure will be declaratory, which means that the Government will apply it as if it had been passed at the same time as the coming into force of the restriction in 2010. Accordingly, to the extent that the four-year limitation period from the date of the first assessment for a fiscal year is not expired or that a waiver was sent in due time, an operator may amend the return filed in respect of that fiscal year if the restriction on the depreciation allowance applied to it.

It should be noted that the Bulletin further indicates that the easing for class 4 property would apply *mutatis mutandis* to class 4A property. However, the creation of class 4A (which would include some items of property currently included in class 4) is provided for in Bill 55, which has not yet been passed by the Quebec legislature.

It is worthwhile to remember that Bill 55 was not warmly received by the opposition parties and that, accordingly, many amendments may still be made to it. This reform of the Quebec mining tax has never been detailed or even announced by the Government in a budget. In this very particular context, taxpayers should remain prudent in respect of the amendments to the *Mining Tax Act* announced on May 6, 2013 in Information Bulletin 2013-4 and included in Bill 55, their coming into force being subject to the Quebec legislature passing the Bill in question.

CONCLUSION

The decision to postpone for one year the decrease of the Resources Credit rates seems to indicate that the decline in mining investments in Quebec, particularly respecting mineral exploration activities, has continued during the last few months and that the Government seeks to stimulate this sector after a 2013 filled with uncertainty and turmoil.

As to the restrictions pertaining to the eligibility to the Preferential Rate and the “super” deductions, these technical changes were foreseeable since the underlying tax policy has always been to direct this kind of tax incentive toward corporations that lack access to the necessary funds to finance their exploration activities. However, it remains that these restrictions could have unforeseen consequences on the financial projections of some mining corporations and the representations made to Quebec investors in the context of the issuance of flow-through shares.

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[1] With the exception of the 15% Resources Credit with regards to the eligible expenses related to renewable energy and energy savings.

[2] While the concept of “related persons” generally refers to legal control, the concept of “associated corporations” is wider. For example, two corporations are associated if one has the *de facto* control over the other, but they will not necessarily be related if there is no *de jure* control.