Government of Canada Gouvernement du Canada

Investment Tax Credit for Exploration in Canada

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Exploration for minerals and metals is vital to ensuring that Canada remains a global leader in mining. It is the first link in a chain of activities that produce widespread benefits in the mining and mineral-processing industries. It helps ensure that every region of the country has the opportunity to move forward socially and economically on a rising tide of progress.

To stimulate investment in mineral exploration throughout Canada, particularly in the northern communities that depend on the resource industries, the Government of Canada introduced a 15% federal exploration tax credit for flow-through share investors in its October 2000 Economic Statement.

Since the introduction of the federal tax credit, several provinces - Ontario, Manitoba, Saskatchewan and British Columbia - have implemented complementary tax incentives.

I am confident that this combination of investor incentives will stimulate exploration across Canada and help build a strong economy for the 21st century. By working together, we can ensure Canada continues to lead the world in mine financing and that the minerals and metals sector continues to improve our quality of life, now and for the future.

John Efford
Minister of Natural Resources Canada

Program's Purpose and Scope

In the Economic Statement and Budget Update of October 18, 2000, the federal Minister of Finance announced a temporary 15% investment tax credit for investors in flow-through shares of mineral exploration companies. Budgets 2003 and 2004 provided for extensions of the tax credit.

This Investment Tax Credit for Exploration (ITCE) is a measure designed to assist junior mining companies in raising new equity through the issuance of flow-through shares. This additional financing should help exploration companies to maintain, or increase, their level of exploration activities in Canada. The ITCE applies to eligible exploration expenses incurred from October 18, 2000, to December 31, 2006, using flow-through share financing closed by December 31, 2005.

The program applies only to preliminary mineral exploration activities conducted from ground level or above ground level. It does not apply to oil and gas, coal, bituminous sands or oil shale. Expenses incurred to explore underground or for the purpose of bringing a mine into production are also excluded.

The information in this brochure is current as of January 1, 2005, and is intended as a general guide only.

Program Benefits

A tax credit of 15% of eligible expenses can be applied against a taxpayer's federal income tax otherwise payable for the taxation year during which the investment is made. The ITCE is a non-refundable tax credit that can be carried back three years and carried forward ten years. A taxpayer claiming the ITCE will also be allowed to claim the normal 100% Canadian Exploration Expense (CEE) deduction, which applies for both federal and provincial/territorial income tax purposes. Use of the ITCE will reduce the taxpayer's Cumulative Canadian Exploration Expense account. Taxpayers residing in provinces/territories that provide additional exploration incentives are allowed to claim them in combination with the ITCE, but the use of any tax credit offered by provinces/territories will reduce the amount of expenses eligible for the ITCE and the amount of deductible CEE.

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Who qualifies for the tax credit?

Individuals (other than a trust) who are deemed to incur eligible exploration expenses, either individually or through a partnership, pursuant to a flow-through share agreement with a "principal-business corporation," are eligible for the credit. Principal-business corporations, for these purposes, are corporations whose principal business is exploration, mining or mineral processing.

Which exploration expenses are eligible?

Eligible expenses for the purposes of the ITCE are specifically defined as "flow-through mining expenditures" (FTME). Technically, FTME are restricted to the portion of a Canadian Exploration Expense that is described in paragraph (f) of its definition, in subsection 66.1(6) of the federal *Income Tax Act* (ITA), and that meet additional criteria referred to in the definition of "FTME" included in subsection 127(9) of the ITA.

In general terms, FTME must be incurred:

1. for the purpose of determining the existence, location, extent and quality of a "mineral resource" that, for ITCE purposes,
   - is a deposit of base or precious metals, diamonds, ammonite gemstones, halite, sylvite, calcium chloride, gypsum, kaolin, or other industrial minerals subject to certification by the Minister of Natural Resources Canada (as described in Section 248 [1] of the ITA),
   - but excludes a deposit of coal, bituminous sands or oil shale.
2. from October 18, 2000, to December 31, 2005, or incurred in 2006 by a corporation, but deemed to have been incurred by a flow-through share investor on December 31, 2005, under the "look-back" rule.
3. in respect of a mining exploration activity that is conducted from or above the surface of the earth, and that includes prospecting, geological, geophysical and geochemical surveys, drilling (rotary, diamond, percussion or other methods), and "specified sampling," which includes the collecting and testing of samples in respect of a mineral resource to the extent that:
   - the weight of each sample collected does not exceed 15 tonnes; and
   - the total weight of all samples (other than samples that are less than one tonne in weight) collected in respect of any one mineral resource in a calendar year by any person or partnership or any combination of persons and partnerships does not exceed 1000 tonnes.

What does the "look-back" rule mean?

The "look-back" rule allows a corporation that incurs expenses in a given calendar year to renounce those expenses to a flow-through share investor effective as of the last day of the preceding year, provided the flow-through shares were acquired by the investor during that preceding year.

Can Canadian Exploration Expenses that do not qualify as FTME still be renounced to flow-through share investors?

The rules related to eligible exploration expenses for flow-through shares have not been changed. All Canadian Exploration Expenses that are described in paragraphs (f) and (g) of subsection 66.1(6) of the ITA, which include underground and "pre-production development expenses," can still be renounced to flow-through share investors. However, only the portion of the expenses that meets the requirements of the FTME is eligible for the ITCE.

The rules that specify the time periods during which Canadian Exploration Expenses related to flow-through shares must be incurred apply to the ITCE.

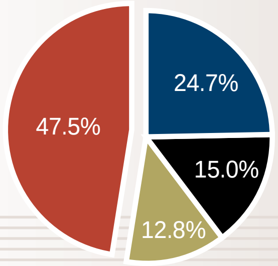
What are the advantages for the individual taxpayer of investing in flow-through shares that involve expenses eligible for the ITCE?

Because the federal investment incentive is delivered in the form of a tax credit, its value is the same for all individual investors, regardless of their marginal federal income tax rates. However, a large portion of federal flow-through share incentives is still delivered in the form of an income tax deduction (as a Canadian Exploration Expense), the value of which varies with a taxpayer's marginal tax rate. Due to the variability of provincial/territorial incentives for flow-through shares, the after-tax situation of a taxpayer will also depend on his/her province or territory of residence.

The figure below at left illustrates the average after-tax cost of a flow-through share investment for individual taxpayers facing the average top marginal tax rate under specific assumptions. The underlying calculations are for illustrative purposes only and may not reflect the particular circumstances of any specific taxpayer.

The ITCE program benefits are contingent upon the particular conditions of the flow-through share agreement. Due to the complex nature of the income tax rules applying to flow-through shares, qualified professional advice should be sought to help structure such agreements.

Average Tax Reductions and Incentives Available to an Investor in Flow-Through Shares, Percent



Provinces/Territories Without Additional Exploration Tax Incentives

- Federal Personal Income Tax Reduction
- Federal Tax Credit
- Provincial/Territorial Personal Income Tax Reduction
- Net Cost to Investor

Note: In provinces/territories that offer additional exploration incentives, the net after-tax cost of a flow-through share investment would be reduced in proportion to the incentive provided.

Further information is available from:

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