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REGULATIONS RESPECTING ROYALTIES ON PETROLEUM PRODUCED
FROM FRONTIER LANDS

FRONTIER LANDS PETROLEUM ROYALTY REGULATIONS

SHORT TITLE

~~1. These Regulations may be cited as the *Frontier Lands Petroleum Royalty Regulations*.~~

INTERPRETATION

2. (1) In these Regulations,

"abandonment and reclamation" means activities in respect of wells, production infrastructure and geological, geophysical and geochemical operations that are allowed capital costs of the project relating to the

(a) abandonment of wells;

(b) destruction, scrapping, removal, disassembling or permanent decommissioning of production infrastructure;

(c) cleanup of environmental damage, including remediation of soils, to the extent that the damage was consistent in scope and magnitude with incidental damage to the environment that would reasonably be expected where activities have been conducted using good production practices; and

(d) reclamation of lands. (*abandon et restauration*)

"abandonment and reclamation royalty trust" means a trust certified pursuant to section 7.1 (*fiducie de redevance pour l'abandon et la restauration*)

"Act" means the *Canada Petroleum Resources Act, (Loi)*

~~"adjusted cumulative cost base" of an interest holder of a production licence in relation to a project in respect of any month means the amount determined in accordance with sections 6 to 8; (*coût de base cumulatif rajusté*)~~

~~"adjusted gross revenues" of an interest holder of a production licence from petroleum produced from project lands in a month means the aggregate of~~

(a) the gross revenues of the interest holder from that petroleum;

~~(b) insurance proceeds payable to the interest holder in that month under a policy of insurance for loss of revenue from that project, and~~

~~(c) the absolute amount equal to the adjusted cumulative cost base of the interest holder in relation to the project in respect of that month, where the adjusted cumulative cost base has a negative value; (*revenus bruts rajustés*)~~

"allocated" means allocated in accordance with an agreement referred to in subsection 13(1); (*attribué*)

"allowed capital costs" of an interest holder of a production licence in relation to a project in respect of any month means, where there is only one interest holder, the allowed capital costs of the project or, where there is more than one interest holder, the allowed capital costs of the project allocated to that interest holder, that are

(a) described in and calculated in accordance with Schedule I, and

(b) incurred in that month; (*coûts en capital déductibles*)

"allowed operating costs" of an interest holder of a production licence in relation to a project in respect of any month means, where there is only one interest holder, the allowed operating costs of the project or, where there is more than one interest holder, the allowed operating costs of the project allocated to that interest holder, that are

(a) described in and calculated in accordance with Schedule I, and

(b) incurred or payable in that month; (*frais d'exploitation déductibles*)

"capital cost adjustment" of an interest holder of a production licence in relation to a project means

(a) in respect of a month preceding the month in which the project commencement date falls, an amount equal to five per cent of the allowed capital costs of the interest holder in relation to the project in respect of that month, and

(b) in respect of the month in which the **project commencement date falls** ~~development plan for the project is approved by the Minister pursuant to section 5.1 of the *Oil and Gas Production and Conservation Act* and any month following the **project commencement date** month in which the project commencement date falls~~, an amount equal to one per cent of the allowed capital costs of the interest holder in relation to the project in respect of that month, other than any amounts considered pursuant to subsection (2) to be an allowed capital cost of the interest holder in relation to the project in respect of the following month; (*rajustement du coût en capital*)

"cumulative ~~adjusted~~ gross revenues" of an interest holder of a production licence in relation to a project in respect of any month means the aggregate of the ~~adjusted~~

gross revenues of the interest holder from petroleum in respect of that month and the preceding months; (*montant cumulatif des revenus bruts*)

"cumulative capital cost adjustments" of an interest holder of a production licence in relation to a project in respect of any month means the aggregate of the capital cost adjustments of the interest holder for that month and the preceding months; (*montant cumulatif des rajustements des coûts en capital*)

"cumulative costs base" of an interest holder of a production licence in relation to a project in respect of any month means, **subject to any adjustments arising from section 8**, the aggregate of

(a) the allowed capital costs of the interest holder in relation to the project in respect of that month and the preceding months,

(b) the allowed operating costs of the interest holder in relation to the project in respect of that month and the preceding months,

(c) the prescribed royalty payable by the interest holder in that month and the preceding months in respect of petroleum produced from the project lands,

(d) the cumulative capital cost adjustments in respect of the costs referred to in paragraph (a),

(e) the cumulative operating cost adjustments in respect of the costs referred to in paragraph (b), and

(f) the cumulative return allowance of the interest holder in relation to the project in respect of that month; (*coût de base cumulatif*)

"cumulative operating cost adjustments" of an interest holder of a production licence in relation to a project in respect of any month means the aggregate of the operating cost adjustments of the interest holder for that month and the preceding months; (*montant cumulatif des rajustements des frais d'exploitation*)

"cumulative return allowance" of an interest holder of a production licence in relation to a project in respect of any month means the aggregate of the return allowances for the months preceding that month; (*montant cumulatif de l'allocation de rendement*)

"delineation well" means a well that is so located in relation to another well penetrating an accumulation of petroleum that there is a reasonable expectation that another portion of the accumulation will be penetrated by the first-mentioned well and that the drilling of the first-mentioned well is necessary in order to determine the commercial value of the accumulation; (*puits de délimitation*)

"development plan" means a development plan or an amended development plan approved pursuant to the *Canada Oil and Gas Operations Act*. (*plan de mise en valeur*)

"development well" means a well that is so located in relation to another well penetrating an accumulation of petroleum that it is considered to be a well or part of a well drilled for the purpose of production or observation or for the injection or disposal of fluid into or from the accumulation; (*puits d'exploitation*)

"discovery well" means the well drilled on a geological feature that indicates that a significant discovery has been made; (*puits de découverte*)

"exploratory well" means a well drilled on a geological feature on which a significant discovery has not been made; (*puits d'exploration*)

"facility" means a gas plant or a transportation facility. (*installation*)

"gas plant" means a facility for processing transportable petroleum by any process including absorption, adsorption and refrigeration, designed to recover residue gas or gas plant products. (*usine de traitement du gaz*)

"gross revenues" of an interest holder of a production licence from petroleum produced from project lands means the gross revenues of the interest holder as determined in accordance with Schedule II; (*revenus bruts*)

"Her Majesty" means Her Majesty in right of Canada; (*Sa Majesté*)

"inflation index" means the monthly *Consumer Price Index* as published by Statistics Canada under the authority of the *Statistics Act*; (*indice d'inflation*)

"investment royalty credit" of an interest holder twenty-five per cent of that portion of the qualified frontier exploration expenses claimed by the interest holder as Canadian exploration expenses under the *Income Tax Act*, as amended from time to time, and certified by the Minister pursuant to subsection 10(3); (*crédit de redevance à l'investissement*)

"investment royalty credit balance" of an interest holder in respect of any month means the amount, if any, by which the aggregate of all investment royalty credits of that interest holder exceeds the aggregate of all amounts deducted under **subsection paragraph 3(2)(e)** in respect of the months preceding that month; (*solde du crédit de redevance à l'investissement*)

"long-term government bond rate" in respect of any month means the average percentage yield, during the calendar year immediately preceding the calendar year in which that month falls, of securities issued by the Government of Canada maturing in over ten years, as published by the Bank of Canada in the *Bank of Canada Review*; (*taux des obligations à long terme du gouvernement*)

~~"marketable condition" means petroleum that is sufficiently free from impurities and is otherwise in such a condition that it will be accepted for transportation through a transportation facility; (*hydrocarbures commercialisables*)~~

"month of payout" of an interest holder of a production licence in relation to a project means the first month in respect of which the cumulative ~~adjusted~~ gross revenues of

the interest holder in relation to the project are equal to or greater than the adjusted cumulative costs base of the interest holder in relation to the project; (*mois de recouvrement de l'investissement initial*)

"net revenues" of an interest holder of a production licence in relation to a project in respect of any month means the amount by which the gross revenues of the interest holder from petroleum produced from the project lands in that month exceed the aggregate of

(a) the allowed capital costs of the interest holder in relation to the project in respect of that month,

(b) the allowed operating costs of the interest holder in relation to the project in respect of that month, ~~excluding any premiums payable for insurance for loss of revenue,~~

(c) the capital cost adjustment of the interest holder in relation to the project in respect of that month, and

(d) the operating cost adjustment of the interest holder in relation to the project in respect of that month, ~~calculated on the allowed operating costs excluding any premiums payable for insurance for loss of revenue;~~ (*revenus nets*)

"non-qualifying expense" means an expense

(a) that is a Canadian exploration and development overhead expense within the meaning of section 1206 of the *Income Tax Regulations*, as amended from time to time, **or**

~~(b) that is an eligible expense in respect of which, or in respect of part of which, an incentive has been paid or is payable under the *Petroleum Incentives Program Act*, the *Canadian Exploration and Development Incentive Program Act* or the *Canadian Exploration Incentive Program Act*, or~~

~~(c) in respect of which a reimbursement, compensation or other payment is made, including any amount of assistance or benefit from a government, municipality or other public authority, whether as a grant, subsidy, forgivable loan, deduction from royalty or tax, investment allowance or any other form of assistance or benefit;~~ (*frais non admissible*)

"operating cost adjustment" of an interest holder of a production licence in relation to a project in respect of any month means an amount equal to ten per cent of the allowed operating costs of the interest holder in relation to the project in respect of that month; (*rajustement des frais d'exploitation*)

"point of production" ~~in respect of petroleum~~ means the point at which the **transportable petroleum leaves production infrastructure. is in marketable condition;** (*point de production*)

~~"production facility" means equipment, located on project lands, that is for the production of petroleum from those project lands, and includes separating, treating and processing facilities, equipment and facilities used in support of production operations and landing areas, heliports, storage areas, tanks and gathering lines and personnel accommodations, but does not include equipment or facilities in respect of which a gas processing allowance or transportation allowance is deducted in accordance with Schedule II for the purpose of determining gross revenues;
(*installation de production*)~~

"production infrastructure" means equipment and buildings used for the production of petroleum or transportable petroleum and includes equipment for natural pressure reduction, mechanical separation, heating, cooling, dehydration and compression, batteries and equipment and buildings used in support of production and treatment of petroleum and landing areas, heliports, gathering lines, storage areas, tanks and personnel accommodations. (*infrastructure de production*)

"production month" means a calendar month in which petroleum is produced from project lands on one or more days in that month; (*mois de production*)

~~"project" means a project described in a development plan. or a revised development plan approved pursuant to section 5.1 of the *Oil and Gas Production and Conservation Act*; (*projet*)~~

~~"project commencement date" means the date on which a development plan in respect of a project is approved. by the Minister pursuant to section 5.1 of the *Oil and Gas Production and Conservation Act*; (*date de démarrage du projet*)~~

"project lands" means the frontier lands, described in the production licence or licences issued for the purpose of producing petroleum from those lands in accordance with a project; (*terres domaniales du projet*)

"qualified frontier exploration expenses" means the aggregate of all expenses incurred in the drilling or completing of an exploratory well, an exploratory probe or a delineation well located on frontier lands in respect of which the Act applies, or in preparing the site in respect of such a well or in the building of a temporary access road to the site, that are

(a) are incurred on or before September 30, 2007; after November, 1985,

(b) do not more than exceed \$5,000,000 in respect of any one well;

(c) are not non-qualifying expenses; and

(d) are reasonable in the circumstances. (frais d'exploration admissibles sur des terres domaniales)

"return allowance" of an interest holder of a production licence in relation to a project in respect of any month means the return allowance for that month calculated in accordance with section 9; (*allocation de rendement*)

"transportable petroleum" means petroleum produced from project lands that is acceptable for transportation through a transportation facility and may have undergone treatment at a production infrastructure. (*hydrocarbures acheminables*)

"transportation facility" means a pipeline, tanker or other transportation equipment, not on project lands, facility used to deliver transportable transport petroleum beyond the point of production but does not include any gas plant or production infrastructure. ~~from project lands to the point at which the petroleum is delivered to the first purchaser thereof, but does not include facilities, including gathering lines, that are used to transport petroleum solely within project lands.~~ (*réseau de transport*)

(2) Where, in determining the net revenues of an interest holder in relation to a project in respect of the month of payout or any month thereafter, the aggregate of the costs and adjustments, referred to in paragraphs (a) to (d) of the definition "net revenues", of the interest holder in relation to the project in respect of that month exceeds the gross revenues of the interest holder in relation to the project in respect of that month, the excess shall, for the purposes of these Regulations, be considered to be an allowed capital cost of the interest holder in relation to the project in respect of the following month.

(3) Subject to subsection (4), for the purposes of these Regulations, the provisions of the *Income Tax Act*, as amended from time to time, apply, with such modifications as the circumstances require, in respect of the determination of whether or not a person is dealing at arm's length with another person.

(4) For the purpose of the determination referred to in subsection (3),

(a) a partnership or trust shall be considered to be a corporation; and

(b) where a trust is determined to be related to a person, the trustee of the trust shall be considered to be related to that person.

(5) Where a percentage is required to be determined by these Regulations, the percentage shall be calculated to eight decimal points and rounded off to seven decimal points.

PRESCRIBED ROYALTY

3. (1) The prescribed royalty reserved payable to Her Majesty under subsection 55(1) of the Act for by each interest holder is

(a) in respect of petroleum produced from project lands in a month preceding the month of payout

(i) beginning with the first production month and ending with the eighteenth production month, one per cent of the gross revenues of the interest holder from that petroleum,

(ii) beginning with the nineteenth production month and ending with the thirty-sixth production month, two per cent of the gross revenues of the interest holder from that petroleum,

(iii) beginning with the thirty-seventh production month and ending with the fifty-fourth production month, three per cent of the gross revenues of the interest holder from that petroleum,

(iv) beginning with the fifty-fifth production month and ending with the seventy-second production month, four per cent of the gross revenues of the interest holder from that petroleum, and

(v) beginning with the seventy-third production month and ending with the last production month preceding the month of payout, five per cent of the gross revenues of the interest holder from that petroleum, or

(b) in respect of petroleum produced from project lands in the month of payout or any month thereafter, the greater of

(i) thirty per cent of the net revenues of the interest holder from that petroleum **minus the deferred royalties referred to in section 6 for the month in question**, and

(ii) five per cent of the gross revenues of the interest holder from that petroleum.

less

~~(c) a credit equal to the lesser of~~

~~(i) the amount of the investment royalty credit balance of the interest holder in respect of the month in which payment of the prescribed royalty is due, and~~

~~(ii) the amount calculated for that interest holder under paragraph (a) or (b).~~

~~(2) For the purpose of calculating the prescribed royalty referred to in subsection (1), the petroleum produced from project lands shall be measured at the point of production. **The prescribed royalty payable in any month is the prescribed royalty reserved to Her Majesty under subsection (1), which shall be reduced by an amount equal to the lesser of**~~

~~(a) the amount of the investment royalty credit balance of the interest holder in respect of the month in which payment of the prescribed royalty is due; and~~

~~(b) the prescribed royalty reserved to Her Majesty under subsection (1) for that interest holder.~~

3.1 Royalties are payable on petroleum transported from the project lands by a transportation facility or consumed, lost or wasted by the interest holder.

EXEMPTION

4. (1) Subject to subsection (2), no royalties are payable in respect of petroleum, produced from project lands, that is

(a) consumed **on project lands** in drilling, ~~producing,~~ or testing **or in any production infrastructure**, ~~separating or processing~~ for the purposes of the project;

(b) injected into a formation for conservation purposes;

(c) consumed ~~in the operation or maintenance of the production facilities of the project~~ **in the operation or maintenance of a gas plant, to the extent that**

(i) **it is for processing gas produced from the project, and**

(ii) **it is not included in the gas processing allowance; or**

(d) flared.

(2) Subsection (1) does not apply to any petroleum that is wasted within the meaning of subsection 18(2) of the **Canada Oil and Gas Operations Act** ~~Oil and Gas Production and Conservation Act~~.

PAYMENT OF PRESCRIBED ROYALTY

~~5. Payment of a prescribed royalty is due~~

~~(a) in the case of petroleum that is transported from the project lands by ship, vehicle or pipeline, on the last day of the month following the month in which the loading of the ship or vehicle is completed or the petroleum enters the pipeline, as the case may be; and~~

~~(b) in the case of petroleum that is consumed, lost or wasted by the interest holder, on the last day of the month following the month in which the petroleum is consumed, lost or wasted.~~

5. (1) The prescribed royalties, in respect of a month, are payable in two installments

(a) the first installment of which is equal to the royalty paid pursuant to section 3 for the previous production month and due on the last day of the month following the month; and

(b) the second installment of which is equal to the difference between the amount payable pursuant to section 3 for the month and the first installment and due on the last day of the second month following the month.

(2) If the amount calculated under paragraph (1)(b) is negative,

(a) no second installment is due for that month; and

(b) the amount, as a positive value, is included as payment for the first installment of the following month.

~~ADJUSTED CUMULATIVE COST BASE~~

~~6. Subject to sections 7 and 8, the adjusted cumulative cost base of an interest holder of a production licence in relation to a project in respect of any month is the cumulative cost base of the interest holder in relation to the project in respect of that month.~~

~~7. (1) Subject to subsection (2), where an interest holder is in any month entitled to receive an amount under a policy of insurance for loss or damage to property, or an amount from the licensing or from the sale, lease or other disposition of any tangible or intangible asset, and the cost of that property or that asset is an allowed capital cost or an allowed operating cost of the project in respect of which the adjusted cumulative cost base is being determined, for the purpose of that determination, in calculating the cumulative cost base of the interest holder~~

~~(a) the allowed capital costs of the interest holder in respect of that month shall be reduced by the amount of that entitlement, where the cost of the property or asset to which the entitlement relates is an allowed capital cost of the project;~~

~~(b) the allowed operating costs of the interest holder in respect of that month shall be reduced by the amount of that entitlement, where the cost of the property or asset to which the entitlement relates is an allowed operating cost of the project but not an allowed capital cost thereof; and~~

~~(c) the capital cost adjustment and operating cost adjustment of the interest holder in respect of that month shall be based on the reduced costs determined under paragraph (a) or (b), as the case may be, in respect of that month.~~

~~(2) Where the amount by which the allowed capital costs or the allowed operating costs are reduced under paragraph (1)(a) or (b), as the case may be, exceeds the amount of those costs, the difference shall, for the purpose of determining the adjusted cumulative cost base under subsection (1), be considered to be the allowed capital costs or allowed operating costs of the interest holder, as the case may be, expressed as a negative value.~~

Deferral of Royalty

6. (1) An interest holder may choose to defer royalty for a production month, as determined under subparagraph 3(1)(b)(i), equal to 30 per cent of part or all of a contribution that it makes into an abandonment and reclamation royalty trust.

(2) The deferral may apply, in whole or in part, to royalties payable during the month in which the contributions were made or to those of the following month or months.

(3) Gains and losses arising from the disposition of properties in the trust, in the case of

(a) gains may be

(i) withdrawn by the interest holder without being subject to royalty under paragraph 3(1)(c), or

(ii) left in the trust and claimed as contributions to the trust; and

(b) losses shall be treated as withdrawals from the trust in the month in which they are realized and be subject to royalty in accordance with paragraph 3(1)(c).

(4) Any funds remaining in a trust shall be treated as a withdrawal and the interest holder shall be subject to royalty on that amount in accordance with paragraph 3(1)(c) when

(a) all abandonment and reclamation is completed; or

(b) an interest holder sells the entire interest in a project.

7. (1) Where there is a withdrawal from the trust of contributions that have been used to defer royalties,

(a) if the withdrawal is made for the purpose of abandonment and reclamation in respect of the project, it has the effect of terminating the debt owed on the portion of the deferred royalty equal to 30 per cent of the amount withdrawn;

(b) if the withdrawal is made for a purpose other than abandonment and reclamation in respect of the project, an amount equal to 30 per cent of that amount becomes payable immediately; and

(c) if the withdrawal is for a purpose other than abandonment and reclamation in respect of the project and has the effect of reducing the trust balance to an amount equal to or less than the sum of royalties deferred and not paid, the royalties become payable immediately and shall be paid to the Minister by the trustee on that part of the balance that is not for abandonment and reclamation expenses.

(2) For the purposes of paragraph (1), all losses incurred by the trust shall be considered to be a withdrawal.

CERTIFICATION OF AN ABANDONMENT AND RECLAMATION ROYALTY TRUST

7.1. (1) An interest holder in relation to a project, may apply to the Minister, in the prescribed form, for the certification of an abandonment and reclamation royalty trust for that interest holder's interest in the project.

(2) The Minister shall approve the application made under subsection (1) where

(a) the trust is established by written agreement;

(b) the trust is managed by a trustee that is dealing at arm's length and that is a corporation resident in Canada that is licensed or otherwise authorized by the laws of Canada or a province to carry on in Canada the business of offering to the public its services as trustee;

(c) the trust is restricted to holding property described in any of paragraphs (a), (b) and (f) of the definition "qualified investment" in section 204 of the *Income Tax Act*;

(d) the trust is established for the sole purpose of managing funds to be used by the interest holder for abandonment and reclamation; and

(e) the interest holder cannot transfer ownership of the trust to another person.

ACQUISITION OF AN INTEREST

8. (1) Where a person (in this section referred to as the "successor") acquires, by purchase or otherwise, from an interest holder (in this section referred to as the "predecessor") a share in an interest in relation to a project **that has not reached the month of payout, the cumulative costs of the successor in relation to that share in respect of the month of acquisition are, subject to subsection (3), for the purpose of determining the adjusted cumulative cost base of the successor in relation to the project in respect of the month of acquisition, there shall be added to the cumulative cost base of the successor in relation to that project in respect of that month an amount equal to the product of**

(a) the aggregate of

(i) the amount, if any, by which the ~~adjusted cumulative costs~~ **base** of the predecessor in relation to that project in respect of the month immediately preceding the month of acquisition exceeds the cumulative ~~adjusted~~ gross revenues of the predecessor in relation to that project in respect of the month immediately preceding the month of the acquisition, and

(ii) the return allowance of the predecessor in relation to that project in respect of the month immediately preceding the month of acquisition, and

(b) the ratio that the share of the interest acquired by the successor bears to the share of the interest held by the predecessor immediately before the disposition.

(2) **The cumulative costs of the predecessor in a share in an interest in relation to a project in respect of the month of acquisition shall be reduced by the same amount determined for the successor in accordance with subsection (1)**~~Where, in respect of any month, an amount is added to the cumulative cost base of the successor in relation to a project pursuant to subsection (1), for the purpose of determining the adjusted cumulative cost base of the predecessor in relation to the project in respect of that month, there shall be deducted a like amount from the cumulative cost base of the predecessor in relation to that project in respect of that month.~~

(3) ~~For the purposes of subsection (1), where the cumulative cost base of a predecessor in relation to a project in respect of the month of acquisition~~ **Where the**

amount calculated under subsection (1) exceeds the cost of the acquisition, the cumulative costs base of the successor in a share in an interest in relation to that project in respect of that month are is the cost of the acquisition.

(4) Where the successor is currently an interest holder in a project and either the predecessor or successor have not reached the month of payout for their interests in the project, the cumulative costs, cumulative gross revenues and royalties payable for all interests held by the successor in the project shall continue to be determined separately until all have reached the month of payout.

RETURN ALLOWANCE

9. (1) A return allowance of an interest holder of a production licence in relation to a project shall be calculated for the month in which the project commencement date falls and every month thereafter, up to but not including the month of payout, if where

(a) the interest owner or the representative of the interest owner has notified the Minister of the month in which the interest owner proposes to commence production for the purpose of sale; and

(b) the month proposed by the interest owner for the commencement of production for the purpose of paragraph (a) is consistent with the development plan.

~~(2) The month proposed by the interest owner for the commencement of production for the purpose of subsection (1) shall be consistent with the information contained in the development plan for the project approved by the Minister pursuant to section 5.1 of the *Oil and Gas Production and Conservation Act*.~~

(3) Subject to subsections (4) and (5), the return allowance of an interest holder in relation to a project in respect of any month for which a calculation is required by subsection (1) shall be equal to the product of

(a) $(1.1 + X)^{1/12} - 1$, where X equals the long term government bond rate

and

(b) the amount by which the ~~adjusted~~ cumulative costs base of the interest holder in relation to the project in respect of that month exceeds the cumulative ~~adjusted~~ gross revenues of the interest holder in relation to the project in respect of that month.

(4) Subject to subsection (5), where production of petroleum from project lands for the purpose of sale does not begin on or before the proposed month referred to in subsection (1), the return allowance of an interest holder for each month in the period beginning with the month immediately following the proposed month and ending with the month immediately preceding the month in which such production begins shall be equal to the product of

(a) the ratio that the inflation index for the month bears to the inflation index for the immediately preceding month, and

(b) the amount by which the ~~adjusted~~ cumulative costs ~~base~~ of the interest holder in relation to the project in respect of that month exceeds the cumulative ~~adjusted~~ gross revenues of the interest holder in relation to the project in respect of that month.

(5) For the purpose of calculating the return allowance of an interest holder for a month, each allowed capital cost of the interest holder shall be adjusted as follows:

(a) where the cost was incurred before the project commencement date, it shall be multiplied by the ratio that the inflation index for the month in which the project commencement date falls bears to the inflation index for the month in which the allowed capital cost was incurred; and

(b) where the cost is a qualified frontier exploration expense, it shall be reduced by the amount of any credit that has been deducted under paragraph 3(1)(c) to determine the prescribed royalty payable in a preceding month where that credit includes an investment royalty credit that is calculated on the basis of that expense.

(6) For the purpose of paragraph (5)(b), where the credit deducted under paragraph 3(1)(c) is less than the amount of the investment royalty credit balance in respect of the month in which the prescribed royalty is payable, the credit shall be considered to be calculated on the basis of expenses in the order in which they were incurred.

CERTIFICATION OF QUALIFIED FRONTIER EXPLORATION EXPENSES

10. (1) An interest holder may make an application to the Minister, in the prescribed form, for the certification of qualified frontier exploration expenses.

(2) The ~~interest holder shall file the application with the Minister~~ application referred to in subsection (1) shall be made

~~(a) in the case of a qualified frontier exploration expense incurred before the coming into force of these Regulations, not later than one year after the coming into force of these Regulations; and~~

~~(b) in the case of a qualified frontier exploration expense incurred after the coming into force of these Regulations, not later than one year after the year in which the expenses are incurred.~~

(3) Where ~~the~~ an application for the certification of expenses as qualified frontier exploration expenses is made ~~filed~~ within the time period required by ~~subsection (2)~~ paragraph (2)(a) or (b), the Minister shall, where the Minister determines that the expenses are qualified frontier exploration expenses, certify those expenses as qualified frontier exploration expenses.

REPORTS AND RETURNS

11. (1) Each interest holder of a production licence in relation to a project shall file with the Minister, in the prescribed form, ~~in respect of the project~~

(a) a **pre-project commencement cost statement, for that interest, in the first production month** ~~periodic royalty return in respect of each month preceding the month in which a prescribed royalty is due in relation to the petroleum in respect of which that royalty is payable; and~~

(b) a **royalty return for that interest starting in the first production month and for every following month whether a prescribed royalty is payable for that month or not** ~~an annual royalty return in respect of each calendar year containing a month in respect of which a periodic royalty return is required to be filed in relation to the petroleum to which each such periodic royalty return relates.~~

(2) **The interest holder shall file the pre-project commencement cost statement and the royalty return not later than the last day of the second month following the month referred to in subsection (1)** ~~Each periodic royalty return shall be filed, pursuant to paragraph (1)(a), not later than the day on which the prescribed royalty for the petroleum to which the return relates is due.~~

~~(3) Each annual royalty return in respect of a calendar year shall be filed, pursuant to paragraph (1)(b), not later than April 30th of the following year.~~

12. (1) Each interest holder of a production licence in relation to a project shall file with the Minister a payout statement, in the prescribed form, in respect of the project for each six month period, beginning with the period that starts with the month in which the project commencement date falls and ending with the period that includes the month of payout.

(2) Each payout statement shall be filed, pursuant to subsection (1), not later than the last day of the **second** month ~~immediately~~ following the six month period to which it relates.

13. (1) Where the interest owner of a production licence in relation to a project consists of only one interest holder, the holder shall file with the Minister and, where the interest owner of a production licence in relation to a project consists of two or more interest holders, the representative of the interest owner shall file with the Minister a project statement, in the prescribed form,

(a) a **commencement of production statement** for the month in which the project commencement date falls; and

(b) a **production and cost statement for the month in which the project commencement date falls and for every month thereafter that month** in respect of the volumes of petroleum from the project that are produced, consumed or transported from project lands in that month and the project costs for that month and containing the prescribed information in respect of any applicable allocation agreement.

(2) Each **commencement of production statement and production and cost** ~~project~~ statement shall be filed, pursuant to subsection (1), not later than the **fifteenth** ~~last~~ day of the second month following the month to which it relates.

14. Each interest holder of a production licence shall, when paying a prescribed royalty, ~~penalty, interest or installment~~, shall identify, in the prescribed form, ~~writing~~ the interest holder and the project in respect of which the payment is made.

14.1 Within 60 days of the change in ownership of a share in an interest in relation to a project occurring, the successor and predecessor referred to in section 8 shall file a report with the Registrar that

(a) sets out the changes in ownership of interests in a project;

(b) sets out the amount of cumulative costs for the successor and predecessor in respect of the month of acquisition; and

(c) includes a summary of the terms and conditions of the sales agreement or arrangement and if the information in the summary is insufficient, the Minister may require that a copy of the agreement or arrangement be filed with the Registrar.

RETENTION PERIOD

15. Each interest holder of a production licence shall retain the information required to be kept pursuant to subsection 59(1) of the Act, in respect of ~~an annual~~ royalty returns and statements referred to in ~~subsections~~ paragraph 11(1)(b), 12(1) and 13(1), at the place of business or residence in Canada of the interest holder, for a period of six years after the day on which the ~~respective annual~~ royalty returns and statements are filed with the Minister pursuant to ~~subsections~~ 11(2), 12(2) and 13(2) ~~11(3)~~.

INTEREST, PENALTIES AND REFUNDS

16. (1) For the purposes of section 56 of the Act, the prescribed rate of interest for any period is the rate prescribed by Part XLIII of the *Income Tax Regulations* in respect of that period.

(2) The interest payable by an interest holder pursuant to section 56 of the Act on arrears of royalties, ~~or on arrears of interest or penalties relating to those arrears~~, or interest shall be calculated from the day ~~the royalty, penalty, or interest payable was~~ is due to the day payment is ~~received by the Minister~~ made and shall be compounded monthly.

(3) Where, in the opinion of the Minister, the arrears have occurred through no fault of the interest holder, the interest payable by the interest holder on those arrears shall be calculated from the end of the month following the month in which the arrears were discovered.

17. (1) The prescribed penalty to be paid by an interest holder for failing to file a royalty return or statement referred to in sections 11 to 13 within the time period required by those sections or for filing a royalty return or statement that, in the opinion of the Minister, is substantially incomplete or contains information of inadequate quality to properly calculate the prescribed royalty is \$1,500 for each month or part of a month from the day the royalty return or statement is due to the day the royalty return or statement is filed.

(2) The prescribed penalty to be paid for failing to file a report in accordance with section 14.1 is \$1,500 for each month or part of a month from the day the report is due to the day the report is filed with the Registrar.

(3) Payment of penalties prescribed under this section are due on the last day of the month following the month in which they are imposed.

~~The prescribed penalty to be paid by an interest holder for failing to file, within the time required by section 11,~~

~~(a) a periodic royalty return is, for every month or part of a month during which the return remains unfilled, an amount equal to five per cent of the prescribed royalty, the payment of which is due on the same day by which the return is required to be filed; and~~

~~(b) an annual royalty return is, for every month or part of a month during which the return remains unfilled, an amount equal to five per cent of the amount of any prescribed royalty, the payment of which was due during the year to which the return relates, that remains unpaid on the day by which the return is required to be filed.~~

18. (1) For the purposes of section 66 of the Act, the circumstances in which the Minister shall refund any overpayment made on account of royalties, interest or penalties are

(a) where, on an assessment, the Minister determines that an overpayment has been made;

(b) where royalties, interest or penalties are remitted in error; or

(c) where such a refund is required to be made by order of a court.

(2) The Minister shall not refund any overpayment on the amount set out in paragraph 5(2)(b) except for the last production month.

19. (1) For the purposes of section 66 of the Act, the prescribed rate of interest for any period is the rate referred to in subsection 16(1).

(2) The interest payable by the Minister pursuant to section 66 of the Act on an overpayment made by an interest holder on account of royalties, or on account of interest or penalties relating to those royalties, shall be calculated from the date of the overpayment to the date of the refund of the overpayment by the Minister, and shall be compounded monthly.

20. Where interest or penalties are payable by the interest holder, any payments received shall be applied first to penalties payable, second to interest payable and third to prescribed royalties payable.

21. (1) Interest is payable on deferred royalties due under paragraph 7(1)(b) from the time the deferral was first made.

(2) For the purpose of calculating interest referred to in subsection (1), withdrawals from an abandonment and reclamation royalty trust are attributed to royalties deferred in the order in which they are deferred.

SCHEDULE I

(Subsection 2(1))

ALLOWED PROJECT COSTS

1. (1) Subject to sections 2 to 54 of this Schedule, allowed capital costs of a project are costs or expenses that are reasonably attributable to the project and that are

(a) incurred in drilling or completing a discovery well, a delineation well or a development well located on the project lands;

(b) incurred in building an access road to or preparing a site in respect of a discovery well, a delineation well or a development well, where the well is located on the project lands;

(c) incurred, after the drilling of a discovery well, in respect of the collection in the field of basic geological, geophysical and geochemical information for the purpose of delineating the significant discovery indicated by the discovery well located on the project lands;

(d) a geological, geophysical or geochemical expense incurred in respect of logging, coring or testing conducted in the course of the drilling of a well referred to in paragraph (a);

(e) incurred in drilling or converting a well for

(i) the disposal of waste liquids from a well located on the project lands,

(ii) the injection of water, gas or any other substance into a petroleum formation to assist in the recovery of petroleum from another well located on the project lands, or

(iii) the purposes of monitoring fluid levels, pressure changes or other phenomena in an accumulation of petroleum located on the project lands;

(f) incurred in drilling for water or gas on the project lands for injection into a petroleum formation located on the project lands;

(g) incurred in drilling or recompleting a petroleum well located on the project lands after the commencement of production from the well;

~~(h) incurred in abandoning a well located on the project lands;~~

(i) incurred in acquiring or constructing production **infrastructure facilities** that are to be located on the project lands or installing **production infrastructure facilities** on the project lands;

(j) incurred in order to licence or purchase technology for the project, including any royalty or other cost paid in respect of letters patent;

(k) incurred in order to repair or maintain production **infrastructure facilities** located on the project lands where the cost of the repairs or maintenance is equal to or greater than fifty per cent of the cost of equivalent new **production infrastructure facilities**; or

(l) incurred in conducting a study of some aspect of the project that is required by or under law before the project or the relevant part of the project is allowed to proceed;
or

(m) expressly incurred as a cost under paragraphs (i) or (k) but, for economic, environmental or logistical reasons, are for production infrastructure not located on project lands.

(2) Subject to sections 2 to 4 of this Schedule, allowed operating costs of a project are costs or expenses, other than allowed capital costs, that **are** ~~may~~ reasonably be ~~considered to be~~ attributable to the project and that are

(a) incurred on account of the salary, wages or other remuneration or related benefits of persons employed by the operator of production **infrastructure facilities** located on the project lands;

(b) incurred

(i) in respect of the repair or maintenance of production **infrastructure facilities** located on the project lands, where the cost of such repairs or maintenance is less than fifty per cent of the cost of equivalent new **production infrastructure facilities**,

(ii) on account of taxes in respect of production **infrastructure facilities** located on the project lands, or

(iii) on account of the rental or leasing of production **infrastructure facilities** located on the project lands;

(c) incurred on account of premiums payable in respect of a policy of insurance, **other than a policy of insurance for loss of revenue**;

(d) incurred on account of

(i) the use of or the right to use any property located on the project lands,

(ii) compensation for a service performed on the project lands,

(iii) the acquisition of materials, parts or supplies for use on the project lands, or

(iv) the transportation of supplies or personnel to or from the project lands;

(e) incurred on account of telecommunications, power, water or fuel used on the project lands; or

(f) incurred on account of the disposal of waste materials, including sewage, from the project lands;

(g) incurred in abandonment and reclamation except for those costs which when paid result in the cancellation of royalties under paragraph 7(1)(a); or

(h) incurred on account of any production infrastructure the cost of which is an allowed capital cost under paragraph (1)(m) that otherwise would be an allowed operating cost under paragraphs (a) to (g) and paragraph (i) if incurred in respect of production infrastructure located on project lands.

2. Subject to section 4 of this Schedule, the following are not allowed capital costs or allowed operating costs of a project:

(a) the part of a cost that is subject to reimbursement, compensation or other payment, including any amount of assistance or benefit from a government, municipality or other public authority, whether as a grant, subsidy, forgivable loan, deduction from royalty or tax, investment allowance or any other form of assistance or benefit where, at the time the cost is incurred, the interest holder who incurs the cost has received or has an absolute right to receive that payment;

(b) an amount on account of interest, including an amount or expense described in paragraph 20(1)(c), (d) or (e) of the *Income Tax Act*, as amended from time to time;

(c) a payment to a person who does not deal at arm's length with the interest holder making the payment, to the extent that the payment exceeds the fair market value of the property, the use of the property, the right to use the property or the performance of a service in respect of which the payment is made;

(d) a cost or expense in respect of the administration, management, overhead or financing of an interest holder or of the operator of production ~~infrastructure facilities~~;

(e) a payment on account of an overriding royalty, a net profits interest, a carried interest or other similar interest;

(f) a cost or expense resulting from any act or omission that constitutes a breach of any federal, provincial or municipal law;

(g) a cost or expense in respect of processing petroleum, other than a cost or expense in respect of producing transportable petroleum the processing required to put petroleum produced from the project lands into a marketable condition;

(h) a cost or expense in respect of the transportation of petroleum produced from the project lands to a point beyond the boundary of the project lands;

(i) an allowed capital cost or allowed operating cost, respectively, of another project, unless approved or required by the Minister pursuant to section 3;

(j) a tax imposed under Part IX of the *Excise Tax Act*, as amended from time to time; or

(k) the administrative costs of an abandonment and reclamation royalty trust; or

(l) a cost or expense that is not expressly provided for in section 1 of this Schedule.

3. Where allowed capital costs or allowed operating costs are attributable to more than one project or use, those costs shall be allocated to each project on a reasonable basis.

4. For the purposes of paragraph 2(a) of this Schedule, where a person has transferred or assigned a right referred to in that paragraph, the person is considered to have received the amount of the reimbursement, compensation or other payment at the time of the transfer or assignment.

5.(1) Subject to subsection (2), where an interest holder is in any month entitled to receive an amount under a policy of insurance for loss or damage to property, or an amount from the licensing or from the sale, lease or other disposition of any tangible or intangible asset, and the cost of that property or that asset is an allowed capital cost or an allowed operating cost of the project,

(a) the allowed capital costs of the interest holder in respect of that month shall be reduced by the amount of that entitlement, or by the fair market value of that property or asset, whichever is greater, where the cost of the property or asset to which the entitlement relates is an allowed capital cost of the project; and

(b) the allowed operating costs of the interest holder in respect of that month shall be reduced by the amount of that entitlement, where the cost of the property or asset to which the entitlement relates is an allowed operating cost of the project but not an allowed capital cost thereof.

(2) Where the amount by which the allowed capital costs or the allowed operating costs are reduced under paragraph (1)(a) or (b), as the case may be, exceeds the amount of those costs in that month, the difference shall be considered to be the allowed capital costs or allowed operating costs of the interest holder, as the case may be, expressed as a negative value.

SCHEDULE II DETERMINATION OF REVENUES AND ALLOWANCES

Interpretation

1. In this Schedule,

~~"allowed operating costs" of an interest holder of a production licence in relation to a project in respect of a period means the allowed operating costs of the project where there is only one interest holder or, where there is more than one interest holder, the allowed operating costs allocated to that interest holder that are~~

~~(a) described and calculated in accordance with section 7 of this Schedule, and~~

~~(b) incurred or payable in that period; (*frais d'exploitation déductibles*)~~

"average capital", in respect of a **month** period, means the sum of the average net capital for the period, the land value and the working capital allowance for the **month** period; (*capital moyen*)

"average net capital", in respect of a **month** period, means the sum of the opening net capital and closing net capital for the **month** period divided by two; (*capital net moyen*)

~~"average spare parts inventory", in respect of a period, means the sum of the undepreciated book value of spare parts for the facility at the beginning of the period and the undepreciated book value of the spare parts for the facility at the end of the period divided by two; (*stock moyen des pièces de rechange*)~~

"closing net capital", in respect of a **month** period, means the book value, before depreciation, at the end of the **month** period, of all depreciable assets forming part of or permanently used at a facility at the beginning of the **month** period plus 101 **per cent**% of the book value, before depreciation, of all depreciable assets acquired during the **month** period and forming part of or permanently used at the facility at the end of the **month** period, less all depreciation allowances in respect of those assets for that **month** period and the preceding **months** periods; (*capital net de fermeture*)

"depreciable assets" means property in respect of which capital cost allowances may be deducted under the *Income Tax Act*, as amended from time to time; (*bien amortissable*)

~~"facility" means a gas plant or transportation facility; (*installation*)~~

"facility operating costs" of an interest holder of a production licence in relation to a project in respect of a month means the facility operating costs where there is only one interest holder or, where there is more than one interest holder, the facility operating costs allocated to that interest holder that are

(a) described and calculated in accordance with section 7 of this Schedule, and

(b) incurred or payable in that month; (*frais d'exploitation d'installation*)

~~"gas plant" means a facility for processing gas to produce residue gas or gas plant products but does not include facilities for putting unprocessed gas into marketable condition; (*usine de traitement du gaz*)~~

~~"gas plant products" means separate marketable elements, compounds or mixtures, other than residue gas, whether in liquid, gaseous or solid form, resulting from gas processing; (*produits gaziers*)~~

~~"gas processing" means any process designed to remove elements or compounds from gas, including absorption, adsorption and refrigeration, but does not include field processes that normally take place on project lands for the purpose of putting unprocessed gas into marketable condition, such as natural pressure reduction, mechanical separation, heating, cooling, dehydration and compression; (*traitement du gaz*)~~

~~"land value" means the acquisition cost of land on which a facility is permanently located; (*valeur foncière*)~~

~~"opening net capital", in respect of a **month** period, means the book value, before depreciation, at the beginning of the **month** period, of all depreciable assets forming part of or permanently used at a facility at the beginning of the **month** period, less all depreciation allowances in respect of those assets for the preceding **months** period; (*capital net d'ouverture*)~~

~~"period" means a calendar year or, where the operation of a facility begins on a day other than January 1 in any calendar year or ends on a day other than December 31 in any calendar year, that portion of the calendar year during which the facility was in operation; (*période*)~~

~~"residue gas" means gas resulting from gas processing and consisting principally of methane; (*gaz résiduaire*)~~

~~"return on average capital", in respect of a **month** period, means an amount equal to the average capital for the **month** period~~

~~(a) multiplied by that percentage equal to five per cent plus the average of the long-term government bond rate, **and** for that period~~

~~(b) **divided by twelve**; (*rendement du capital moyen*)~~

~~"working capital allowance", in respect of a **month** period, means an amount equal to the sum of 110 per cent of the **facility** operating costs **for that month multiplied by two divided by six**, and the average spare parts inventory for a facility. (*déduction pour fonds de roulement*)~~

Determination of Gross Revenues

2.(1) The gross revenues of an interest holder from petroleum produced from project lands are

(a) where the petroleum is sold by the interest holder to a purchaser with whom the interest holder is dealing at arm's length **and there is no arrangement of hedging or other similar arrangement**, the aggregate of

(i) the amount of money and other consideration payable to the interest holder for the petroleum,

(ii) all amounts payable to or on behalf of the interest holder by the purchaser in respect of costs or expenses that by industry custom are normally paid by the interest holder, and

(iii) in the case of a sale under a take or pay agreement, the amount, if any, by which the fair market value of the petroleum, as of the last day of the month preceding the month in which the prescribed royalty is due, exceeds the aggregate of the amounts described in subparagraphs (i) and (ii);

~~less the sum, not exceeding 95 per cent of that aggregate, of any gas processing allowance and transportation allowance for that petroleum as determined in accordance with sections 4 to 7 of this Schedule;~~

(b) where the petroleum is sold by the interest holder to a purchaser with whom the interest holder is ~~not~~ dealing at arm's length, **and there is an arrangement of hedging or other similar arrangement**, the greater of

~~(i) the fair market value of the petroleum as of the date of sale, and~~

~~(ii) the amount of money and other consideration payable to the interest holder for the petroleum,~~

~~less the sum, not exceeding 95 per cent of that value or amount, of any gas processing allowance and transportation allowance for that petroleum as determined in accordance with sections 4 to 7 of this Schedule;~~

(c) where the petroleum is sold by the interest holder to a purchaser with whom the interest holder is not dealing at arm's length, the greater of

(i) the fair market value of the petroleum as of the date of sale, and

(ii) the amount of money and other consideration payable to the interest holder for the petroleum;

(d) where the petroleum is lost and that loss is insured under a policy of insurance, the greater of

(i) the insurance proceeds payable to the interest holder under the policy, and

(ii) the fair market value of the petroleum as of the date of the loss;

~~less the sum, not exceeding 95 per cent of those proceeds or that value, of any gas processing allowance and transportation allowance for that petroleum as determined in accordance with sections 4 to 7 of this Schedule; and~~

~~(e) in any case not described in paragraph (a), (b) or (c), to (d) the fair market value of the petroleum for as of the last day of the month preceding the second month in which the prescribed royalty is due, less the sum, not exceeding an amount equal to 95 per cent of that value, of any gas processing allowance and transportation allowance for that petroleum as determined in accordance with sections 4 to 7 of this Schedule.~~

(2) The amounts calculated under subsection (1) shall be reduced by the sum, not exceeding 95 per cent of those proceeds or that value or amount, of any gas processing allowance and transportation allowance for that petroleum as determined in accordance with sections 4 to 7 of this Schedule.

(3) For the purpose of calculating the gross revenues or fair market value referred to in this section, the petroleum produced from project lands shall be measured and valued at the point of production.

3. For the purposes of section 2 of this Schedule, the fair market value of petroleum shall not include hedging and shall be determined by reference to

(a) published posted prices, market prices and index prices for sales of petroleum in that month;

(b) the revenues received by the interest holder in respect of other petroleum produced from project lands and sold under comparable conditions to purchasers with whom the interest holder deals at arm's length;

~~(b) the revenues received by other interest holders for petroleum produced from project lands and sold under comparable conditions to purchasers with whom those other interest holders deal at arm's length;~~

~~(c) revenues from petroleum of similar quality produced from other projects and sold under comparable conditions;~~

~~(d) posted prices for petroleum and prices for spot sales of petroleum; and~~

~~(e) (c) such other factors as may be reasonable in the circumstances.~~

3.1 For the purposes of section 2 and 3, an arrangement of hedging or a similar arrangement does not include contracts for the forward sale of petroleum where the contract provides for the physical delivery of the petroleum.

Gas Processing Allowance

4. The gas processing allowance of an interest holder in respect of gas processed at a gas plant is

(a) where the plant is wholly owned by a person or persons with whom the interest holder deals at arm's length, the amount payable by the interest holder to the owner or owners of the gas plant for that processing; and

(b) where the plant is owned in whole or in part by the interest holder or by a person with whom the interest holder does not deal at arm's length, that portion of the facility allowance determined in accordance with section 6 of this Schedule for the gas plant that is reasonably attributable to that processing.

Transportation Allowance

5. (1) Subject to subsection (2), the transportation allowance of an interest holder for petroleum delivered through a transportation facility to a purchaser at a point beyond the boundary of the project lands is

(a) where the facility is wholly owned by a person or persons with whom the interest holder deals at arm's length, the amount payable by the interest holder to the owner or owners of the facility for transporting the petroleum; and

(b) where the facility is owned in whole or in part by the interest holder or by a person with whom the interest holder does not deal at arm's length, that portion of the facility allowance determined in accordance with section 6 of this Schedule for that transportation facility that is reasonably attributable to the transportation of the petroleum.

(2) The transportation allowance of an interest holder for petroleum delivered to a purchaser at a point beyond the boundary of the project lands through a transportation facility, the tolls and tariffs of which are regulated pursuant to the laws of Canada or of a province, is the amount payable by the interest holder for that transportation in accordance with the approved tolls and tariffs for the facility in force at the time the petroleum is transported.

Facility Allowance

6. (1) Subject to subsections (2) and (3), the facility allowance of an interest holder in respect of a gas plant or transportation facility for any month period shall be equal to the result obtained from the following formula sum of those portions of the following amounts allocated to the interest holder:

(A + B + C - D) where

(a) A represents 110 per cent of the aggregate of the facility allowed operating costs of the facility as described in section 7 of this Schedule for the month period;

(b) B represents the depreciation allowance for the facility for the month period; and

(c) C represents the return on average capital for the month; and period

D represents any amounts payable in that month to that interest holder for use of that facility by persons with whom the interest holder is dealing at arm's length.

(2) For the purpose of calculating the depreciation allowance referred to in subsection paragraph (1)(b) for a period, all depreciable assets forming part of or permanently used at the facility shall be depreciated on a straight line basis over the useful life of the facility.

(3) ~~Where the period in respect of which a facility allowance is calculated is less than one calendar year, the depreciation allowance and return on average capital for that period shall be reduced pro rata~~ When a facility that is owned in whole or in part by an interest holder or by a person with whom the interest holder does not deal at arm's length is sold to a person or persons with whom the interest holder deals at arm's length, the facility allowance of the interest holder shall be adjusted in the month of the sale by deducting the amount, if any, that the proceeds from the sale of the facility exceeds the value of the closing net capital of the facility at the time of the sale of the facility.

(4) For the purposes of subsection (3), if the facility allowance is negative after adjustment, the absolute amount of the negative facility allowance shall be added to the gross revenues in that month.

7. (1) Subject to subsections (2) and (3), ~~facility allowed~~ operating costs of a facility are costs or expenses, other than costs or expenses relating to depreciable assets, that may reasonably be ~~considered to be~~ attributable to the facility and that are

(a) incurred on account of the salary, wages or other remuneration or related benefits of persons employed by the operator of the facility;

(b) incurred

(i) in respect of the repair or maintenance of the facility, where the cost of the repair or maintenance is less than fifty per cent of the cost of an equivalent new facility,

(ii) on account of taxes in respect of the facility, or

(iii) on account of the rental or leasing of the facility;

(c) incurred on account of premiums paid in respect of a policy of insurance other than insurance for loss of revenue;

(d) incurred on account of

(i) the use of or the right to use any property,

(ii) compensation for the performance of a service, or

(iii) the acquisition of material, parts or supplies;

(e) incurred on account of telecommunications, power, water or fuel; or

(f) incurred on account of the disposal of sewage.

(2) Subject to subsection (4), the following are not ~~facility allowed~~ operating costs of a facility:

(a) the part of a cost subject to reimbursement, compensation or other payment, including any amount of assistance or benefit from a government, municipality or other public authority, whether as a grant, subsidy, forgivable loan, deduction from royalty or tax, investment allowance or any other form of assistance or benefit where, at the time the cost is incurred, the interest holder who incurs the cost has received or has an absolute right to receive the payment;

(b) an amount on account of interest, including an amount or expense described in paragraph 20(1)(c), (d) or (e) of the *Income Tax Act*, as amended from time to time;

(c) a payment to a person who does not deal at arm's length with the interest holder making the payment to the extent the payment exceeds the fair market value of the property, the use of the property, the right to use the property or the performance of a service in respect of which the payment is made;

(d) a cost or expense in respect of the administration, management, overhead or financing of an interest holder or of the operator of the facility;

(e) a cost or expense resulting from any act or omission that constitutes a breach of any federal, provincial or municipal law;

(f) a ~~facility n-allowed~~ operating cost of another facility;

(g) a cost or expense ~~that is an allowed capital cost or an allowed operating cost of a project under Schedule I in respect of the processing of petroleum that is required to put petroleum into marketable condition;~~

(h) a cost or expense in respect of the transportation of petroleum produced from the project lands to a point within the boundary of the project lands;

(i) a tax imposed under Part IX of the *Excise Tax Act*, as amended from time to time; or

(j) a cost or expense not expressly provided for in subsection (1).

(3) ~~Facility Allowed~~ operating costs that are attributable to more than one facility shall be allocated to each facility on a reasonable basis.

(4) For the purposes of paragraph (2)(a), where a person has transferred or assigned a right referred to in that paragraph, the person is considered to have received the amount of the reimbursement, compensation or other payment at the time of transfer or assignment.