



MINISTRY OF EMPLOYMENT AND INVESTMENT

INFORMATION LETTER

MTA11

RESOURCE REVENUE BRANCH MINERAL TAXATION SECTION

SUBJECT: HEAD OFFICE ADMINISTRATIVE COSTS

BACKGROUND

The purpose of this information letter is to clarify which, and to what extent, head office administrative costs are allowable costs of mining operations under the *Mineral Tax Act*.

THE LAW

Administrative costs of a current nature are allowed under section 2 of the *Mineral Tax Costs and Expenditures Regulation*, which states:

- 2 (1) . . . the prescribed costs and expenses, to the extent reasonable, incurred for the purposes of earning gross revenue from the operation of a particular mine shall be:
- f) the current costs incurred in the operation of the mine including, for greater certainty, those administrative or corporate costs, including management fees, that are directly related to the operation of a particular mine.

Administrative costs of a capital nature, such as rentals and leases, are allowed under section 2(1)(c).

Certain administrative costs are specifically excluded for Mineral Tax purposes. Costs related to financing, organization, and restructuring are excluded under section 2 of the *Mineral Tax Costs and Expenditures Regulation*:

- 2(1) . . . but, for greater certainty, does not include any amount paid, payable or incurred as . . .
- (q) the costs of or associated with financing, including the costs of arranging financing,
 - (s) costs of incorporation, organization or reorganization

INTERPRETATION

The legislation requires that only costs *directly related* to the operation of the mine be allocated to the mine for Mineral Tax purposes. It is therefore important to ensure that head office costs be analysed and apportioned to all operations and activities of the company, including, but not limited to:

- Exploration
- Individual mining operations
- Financing activities
- Organization and restructuring
- Hedging activities
- Other projects

The following costs are not allowable because they are related to financing, organization, restructuring, or other activities not directly related to the operation of the mine:

- Stock exchange fees
- Stock transfer and registration fees
- Trustees' fees
- Charitable and political donations
- Shareholders' reports and meetings
- Legal, accounting, consulting and other expenses in connection with security issues, stock issues, organization, incorporation, or reorganizations
- Directors' fees, travel and other expenses not directly attributable to the mining operation

Under s. 3 of the *Mineral Tax Costs and Expenditures Regulation*, head office rent and other rentals and leases are costs on account of capital. If any portion of such costs are included in overheads allocated to the mine they should be reported on line 121 of the cumulative expenditure account, not in current operating costs.

METHODS OF ALLOCATION

Once nonallowable costs are removed, remaining overhead costs must be apportioned on a reasonable basis to the operation of the mine and to other activities. In order to determine what portion of these costs can reasonably be attributed to the operation of the mine, a suitable method of allocation must be established and used consistently from year to year. The method selected for Mineral Tax purposes must fairly approximate the amount of head office time and resources consumed in the operations of the particular mine.

Allocation of salary costs based on estimated time spent by specific employees

The most accurate method of allocating administrative salaries and employee benefits is based on the actual time spent by specific employees on various corporate activities. Although this method is the most precise, it is dependent on accurate employee time reports or a reasonable system of estimating employee time. If an operator does not normally maintain such records, other methods must be evaluated to determine the most suitable in the circumstances.

Allocation of costs in the same proportion as direct operating costs

Where accurate time records are not available, allocating overhead costs to various operations in the same proportion as direct operating costs is usually preferable to other methods. Generally, direct operating costs are a good indicator of the extent to which activities generate the need for overhead expenditures. For example, payroll and benefits administration tend to increase with larger wage and salary costs; accounting and audit costs are likely to increase with expenditures; and communications and computer system costs often correlate with increasing operating expenditures.

Allocation of costs in the same proportion as the cost or net book values of assets

Certain types of overhead costs bear a stronger correlation to the cost of capital employed in an operation than to direct operating costs. For instance, the costs of administering insurance and other capital overheads would be more reasonably allocated based on the relative cost of assets employed in various operations. The use of relative net book values of assets is not appropriate if assets that have been significantly depreciated or written off for accounting purposes are still consuming a high proportion of administration time and resources.

Allocation of costs in the same proportion as revenues

Allocations based on gross or net revenues may be acceptable when allocating costs to operations providing substantially similar goods or services. However, this method is less consistently accurate in situations where costs are being allocated to operations providing different goods and services. For example, market price variations may result in significant swings in relative gross revenues from two mines producing different commodities, while actual administrative time and resources spent on each operation remain constant.

Allocations of costs in the same proportion as net incomes or gross profits

Allocations based on relative net incomes or gross profits are usually not appropriate unless the operations to which costs are being allocated are very similar and have consistently comparable net or gross profit margins. In most cases, allocations based on net incomes result in unreasonable results in the long term because activities with low margins often consume the highest overheads. Using this method, operations incurring losses could receive a negative allocation of administrative costs, while time and resources consumed are actually greater than in profitable operations.

A combination of methods

The most accurate allocations involve a combination of methods, allocating each type of cost using the most reasonable indicator for that particular cost. For instance, salaries and benefits may be allocated on the basis of actual time spent as reported on employee time sheets while other general overheads may be allocated in the same proportion as direct operating costs. At the same time, overheads relating primarily to capital assets, such as insurance administration or provincial capital taxes, may be allocated based on the relative cost of capital employed.

When deciding upon an allocation method, the specific nature of the various costs involved and the particular business functions to which they will be allocated must be carefully considered. Any method chosen must be evaluated to ensure that it will result in reasonable allocations under differing circumstances from year to year. The validity of the allocation method should be tested by comparing the results to a reasonable estimation of the actual administrative time and resources that would be spent on any particular activity under various circumstances. Once a method is selected, it should be used consistently from year to year unless there is a significant change in the nature of the costs to be allocated or the business operations involved.

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