Considerations & Recommendations for Federal Budget 2025

By: The Prospectors & Developers Association of Canada (PDAC)

August 2024

PROSPECTORS & DEVELOPERS ASSOCIATION OF CANADA | ASSOCIATION CANADIENNE DES PROSPECTEURS ET ENTREPRENEURS

Recommendation 1: Renew the Mineral Exploration Tax Credit (METC) and the Critical Mineral Exploration Tax Credit (CMETC) for a minimum of 5 years until March 2030, thereby aligning availability of these two cooperative incentives.

Recommendation 2: Adjust the capital gains tax treatment for flow-through shares (FTS) to reflect the issue price of the security versus the current nil cost base approach, to eliminate phantom capital gains and expand FTS participation by a broader base of Canadian investors.

Recommendation 3: Close the gap in FTS eligibility between the Canadian Exploration Expense (CEE) and Canadian Development Expense (CDE) categories, to ensure funds can be used towards the scoping and assessment work required to establish mineral reserves and make mine development decisions.

Recommendation 4: Create a mechanism that can extend FTS expenditure timelines in response to acute, unforeseen situations (e.g. wildfires, floods) and can apply to a specific company, region or nationally to mitigate unintended tax consequences arising for companies and individuals.

Recommendation 5: Explore ways to leverage successful projects and recapitalize the Critical Mineral Infrastructure Fund (CMIF) beyond the initial $1.5 billion commitment.

Recommendation 6: Substantially increase funding to the Geological Survey of Canada to develop comprehensive mineral potential models to bolster domestic competitiveness, accelerate mineral discoveries, and reduce development timelines for new mines in Canada.

Recommendation 7: Expedite development of a one-window access point for the Indigenous Loan Guarantee Program, and other government initiatives that contribute to Indigenous participation in the mineral industry and drive economic and capacity growth.

Maintaining Canada's Competitive Global Advantage

PDAC hoped to see METC rescued from expiry this spring by extending the credit for a minimum 5-year period in Budget 2024. However, only a single year METC renewal materialized. Budget 2025 represents a final opportunity to renew this extremely important incentive before it once again is set to expire in March 2025, and avoid sending a signal that Canada is disincentivizing mineral exploration.

With Canada's mineral potential nearly unrivaled by any other nation, PDAC has outlined the importance of the METC in fueling mineral discoveries, and how this incentive represents a unique Canadian advantage. Future discoveries represent the source points needed to establish new supply chains, deliver the inputs needed for our national energy and electrification goals in a reasonable timeframe, and for others to follow our lead. To meet these goals, we need to attract more mineral exploration investment, and this cannot be done by removing incentives or placing more financial barriers between investors and explorers.

History has shown that just 0.01% of mineral prospects become a new mine in Canada, and with S&P estimating it takes companies on average 27 years to navigate regulatory and permitting processes to build a mine, attracting investment is extremely difficult. To counter some of this risk, Canada's unique FTS mechanism has been an essential backstop to our competitiveness and has generated more than two-thirds of domestic exploration spending over the last decade.

The METC combines with FTS to incentivise early-stage, grassroots mineral exploration that very often occurs in remote regions with limited infrastructure. Grassroots exploration in Canada has declined materially from approximately 45% of activity in 2008 to only 28% in 2023, and this trend is leading towards a precipitous decline in new Canadian mines and mineral production capacity.

Figure 1 shows the amount of forgone revenue estimated by government that relates to the METC was roughly $545 million from 2019-2023. This is more than offset by over $3.5 billion raised via FTS and the METC for companies to explore in Canada and based on government evaluation, this cost to the public translates to roughly $11 billion in incremental expenditures across the country, or a 20x positive impact on our economy.

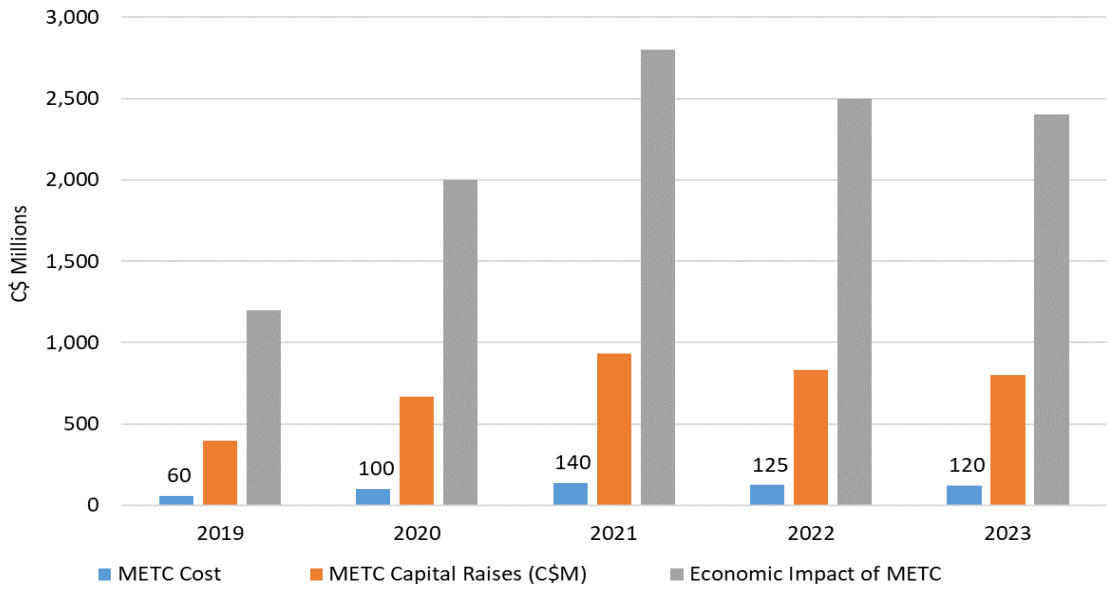

Figure 1: METC Cost vs. METC Capital Raises vs. Economic Impacts

We recommend renewing the METC and the companion Critical Mineral Exploration Tax Credit (CMETC) for additional 5 years until 2030, thereby aligning these two incentives, and that government create a formal review and renewal process for these two incentives within this 5-year timeframe.

The FTS mechanism is an essential piece of Canada's exploration landscape. Its design primarily attracts very high net-worth Canadian's, and some estimate this cohort is less than 2,000 individuals and represents >75% of FTS investments each year. A material decline in the amount of FTS investments in 2025 is anticipated by the proposed increase to capital gains tax, as well as 5.5% increase and other changes to AMT, unless mitigative measures are taken. FTS are currently deemed to have a nil cost base in calculating capital gains, triggering what we refer to as a phantom capital gain when FTS are sold below the initial issue price (i.e. typically a capital loss).

We recommend adjusting capital gains tax treatment of FTS to reflect issue price versus the current nil cost base approach. This would eliminate phantom capital gains and expand FTS participation by a broader base of Canadian investors

Even with FTS, the METC and CMETC incentives in place in recent years, both mineral reserve and production numbers are declining at an alarming rate for many key minerals. This trend is unfolding at a time when dramatic increases in critical mineral production are being sought out and is a stark reminder that maximizing our opportunities with mineral exploration, assessment and development incentives must be in constant focus.

Using copper as an example, Figures 2 & 3 below outline Canadian production relative to metal price, and domestic copper resource and reserve levels, respectively. The figures show that despite a notable rise in copper price between 2014 and 2022, Canadian production declined nearly 30% and mineable copper reserves declined by more than 15%. Although early-stage copper resources are up roughly 35%, these newly discovered resources are not effectively being upgraded to reserves as many projects are not reaching advanced scoping, or feasibility assessment stages.

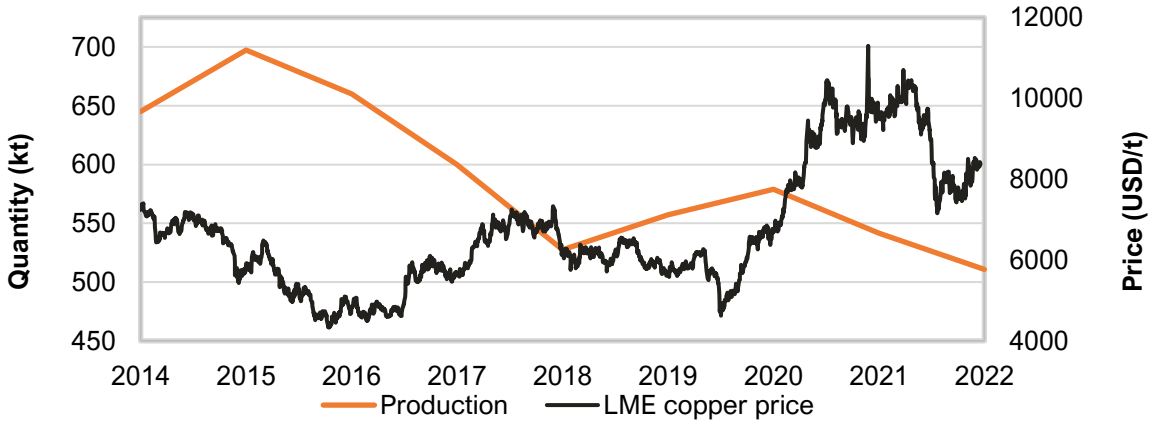

Figure 2: Canadian Copper Production vs. Price

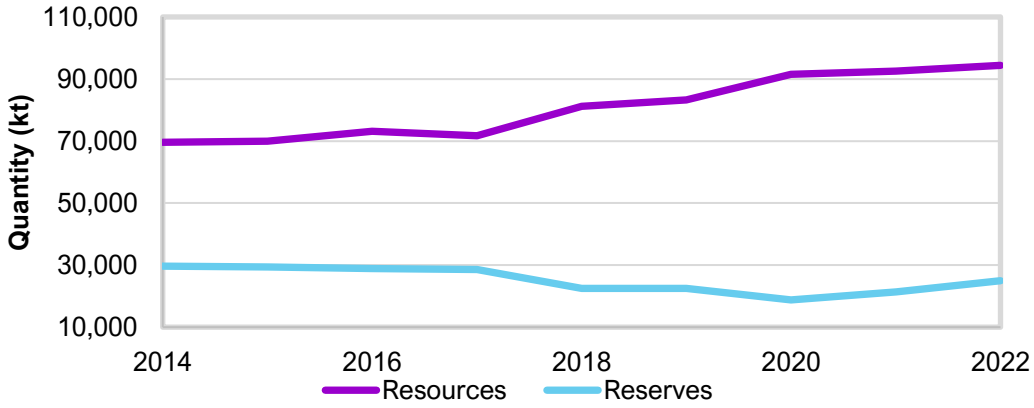

Figure 3: Canadian Copper Resources & Reserves

There is a significant gap in FTS eligibility that creates a barrier for new discoveries to become new mines. CEE permits FTS funds to go towards early-stage exploration, with CDE permitting funds to be used on later-stage mine development done after a build decision is reached. This decision point only comes through completing economic assessment and feasibility work, which is currently ineligible in the FTS regime.

We recommend government must close this gap by expanding FTS eligibility so companies can efficiently direct FTS funds towards essential work to determine the economic viability of a mineral resource, establish mineral reserves and reach development decision points.

We must also be cognizant that mine development in Canada is falling short of our future needs. As Natural Resources Canada has shown in the past (Figure 4), less than a handful of new critical mineral mines have come into production in recent years.

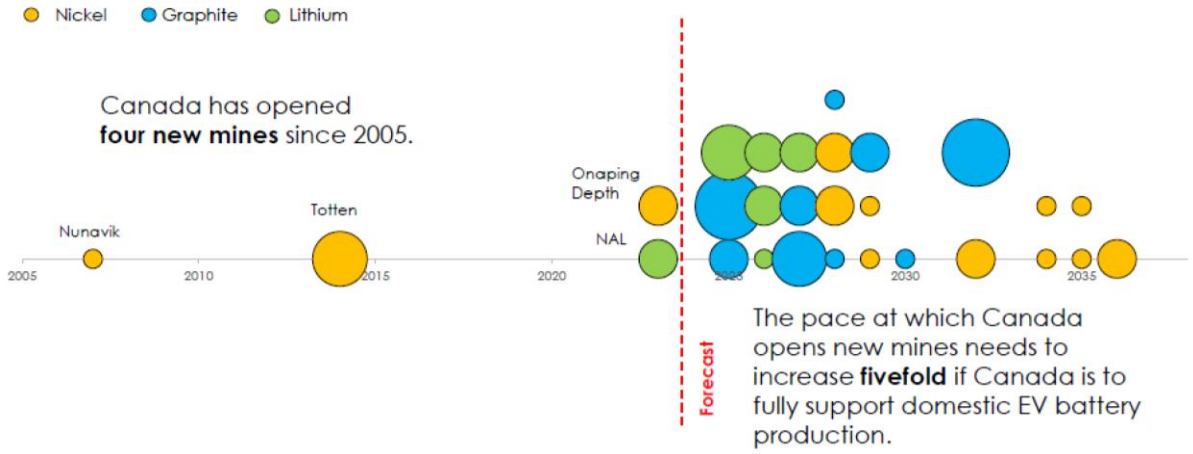

Figure 4: New Mines Supporting Domestic EV Battery Production

Government's launch of the CMIF was notable and with its eligibility includes *"studies; planning; design work; assessments; infrastructure-specific consultation; knowledge sharing;"* PDAC is encouraged that government has rightly identified this investment gap with targeted spending. However, the $1.5 billion committed to CMIF will fall far short of the amount of capital required to reverse the declining production and reserve trends we see in Canada.

The development of infrastructure in remote and northern Canada is critical to unlocking mineral potential and enhancing economic development opportunities in these regions. Estimates suggest more than 70% of mineral discoveries made in northern and remote Canada remain undeveloped, preventing potential economic benefits from reaching these areas. This shortfall is largely a result of the significantly higher cost of operating in remote areas, which may be 2 to 6 times more than projects within reach of transportation, energy and other public infrastructure.

We recommend a mechanism to recapitalize the CMIF by leveraging successful projects is established, like the US Defence Production Act and Inflation Reduction Act.

Central to the FTS regime is that companies must spend FTS funds within 12 to 24 months on eligible activities. The COVID-19 pandemic proved how unforeseen events can halt industries, including the loss of entire exploration seasons. This scenario creates significant tax liabilities for both companies that issue FTS and investors who purchase these shares. Wildfires in 2023

presented a less pervasive but similar situation for many companies exploring across Canada. Government allowed companies an additional year to spend funds raised prior to the onset of the pandemic and while industry was grateful for this temporary amendment, the process was lengthy, and hinged upon passing new legislation.

We recommend that the government create a mechanism (e.g. pre-filing request to CRA) to allow specific companies to request deferment of expenditure timelines associated with FTS to provide reasonable flexibility and avoid unintended negative tax implications for Canadians that arise from uncontrollable situations.

Increasing access to geoscience data and modeling

Public geoscience programs have proven merits time and again with research showing that every $1 in public geoscience spending generates more than seven times that in economic benefit to Canada (Ernst & Young, 2019).

Public geoscience informs on mineral potential across different parts of Canada and can be a basis for evidence-based land management decisions. Canada is falling far short of peers in funding new geoscience research, in updated data management and distribution tools, and in leveraging academic partnerships. These areas must be prioritized to accelerate mineral discoveries. For comparison, Canada spends roughly $5 million on public geoscience annually while Australia recently committed over A$566 million over 10 years to ‘fully map’ minerals and resources; this is a nearly 20x differential on a per capita basis.

We recommend a significant increase in funding for the GSC to support new public geoscience, comprehensive mineral potential modelling, improved public access and integration of this evidence into land management processes.

Accelerating Inclusion of Indigenous Peoples

The mineral industry is the largest private sector employer of Indigenous Peoples in Canada, a keen participant in implementing An Act Respecting the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP), and a key partner of Indigenous businesses from coast to coast to coast.

Mutually beneficial relationships between Indigenous Peoples and industry are reliant on effective regulatory regimes, expanding capital access and availability of education opportunities, which build capacity. These factors are also foundational to equitable participation in regulatory decision-making and maximization of economic and social opportunities generated by industry. To further this type of collaboration, government must ensure that relevant programs are easily accessible and effective, and that application of regulatory processes, Acts, and UNDRIP in Canadian law are consistent and clear.

We recommend government establish a one-window approach to add clarity on how Indigenous communities can access funding under national commitments related to

participation in the natural resource industry and progress towards Canada's critical minerals and climate change targets. Government should also commit to periodic evaluation of the program to gauge effectiveness, capacity, and expansion of available funding, if needed.

Furthermore, PDAC urges the Federal Government to implement the Truth and Reconciliation Commission's Calls to Action and National Inquiry into Missing and Murdered Indigenous Women and Girls' Calls for Justice. We encourage the government to deliver on promises to invest in education, health, and critical infrastructure such as housing, water and high-speed internet. Specifically, we recommend the government provide additional funding for training and educational services for Indigenous leaders and communities to build the capacity needed to ensure meaningful and equitable participation in the mineral industry and regulatory decision-making processes.