

**Responding to Clean Technology Manufacturing Investment Tax Credit and Alternative
Minimum Tax Legislative Proposals related to Budget 2024**

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



**PROSPECTORS &
DEVELOPERS
ASSOCIATION
OF CANADA**

**ASSOCIATION
CANADIENNE DES
PROSPECTEURS ET
ENTREPRENEURS**



Department of Finance Canada
Ottawa, Ontario

Sent via email: Consultation-Legislation@fin.gc.ca

Re: Legislative Proposals to Address Budget 2024 Measures Relating to the Clean Technology Manufacturing Investment Tax Credit and The Flow-through Shares Regime

The Prospectors and Developers Association of Canada (PDAC) is the leading voice of the mineral exploration and development industry, which along with mining contributes well over \$100 billion to Canada's GDP each year and represents more than 1/3 of all public issuers on Canadian exchanges. Our work supports +8,000 corporate and individual members in fostering a responsible and sustainable Canadian mineral industry, in connecting to people, lands and capital, and in creating an environment where our industry continues to generate significant economic and social benefits from coast to coast to coast.

We focus our comments on two legislative proposals relating to various Budget 2024 measures that aim to support the Canadian mineral sector – amendments to the Clean Technology Manufacturing Investment Tax Credit (CTM-ITC) and within Alternative Minimum Tax (AMT) legislation that have substantive influence on the flow-through share (FTS) regime.

We welcome continued engagement with Finance Canada on these two legislative proposals. Please contact Jeff Killeen, PDAC's Director, Policy & Programs (jkilleen@pdac.ca) if there are questions or clarifications required for the content provided of this letter.

1) Alternative Minimum Tax (AMT)

We recognize the drafted amendments to AMT legislation aim to offset a potential catastrophic decline in early-stage exploration investment that will result from an increase in AMT and the capital gains inclusion rate.

It is important to bear in mind that Canada's unique FTS regime has been an essential backstop to our competitiveness and has generated more than two-thirds of domestic exploration spending over the last decade.

Repealing paragraphs 127.52(1)(e) and (e.1), which require investors to add back resource deductions when AMT is calculated, will improve the attractiveness of FTS investments thereby encouraging investors to participate in FTS offerings.

However, this step will not be sufficient to fully offset the expected drop in investment in mineral exploration that will result from the overall AMT increase and the capital gains inclusion rate climbing to 66.7%. Therefore, we call Finance to initiate additional steps to support access to capital of the Canadian mineral exploration and development sector.

One of the most straightforward and fair ways to attract more investment into Canada's mineral exploration sector is assess taxes based on an investor's true capital gains, rather than assume a nil cost base for FTS shares.

“True” capital gains for donated FTS

Clause 24 also fixes a double-counting error with respect to capital gains for donated FTS, by amending paragraph 127.52(1)(d.1) and adding a new paragraph 127.52(1)(d.2). In the text on this change within the explanatory notes document, Finance states that *“this amendment provides that the taxable capital gains inclusion rate on the donation of publicly listed securities will be 3/10 (or 30%) for the purposes of computing an individual's minimum tax of the capital gain that is the “true” capital gain from the disposition of a flow-through share class of property.”*

As opposed to the conventional method of calculating capital gain based on the purchase price (i.e. issue price, acquisition cost) of a security, FTS capital gains are computed based on a \$0 (nil) cost base, which creates an artificial gain (Also called “phantom” capital gain) even if shares are sold below the issuance price.

In this context, our interpretation of the draft legislation’s reference to the “true” capital gain for AMT is that it proposes a change in the way capital gains are calculated for donated FTS by replacing the nil cost base assumption with the security’s issue price.

We recommend that Finance clarify the definition of “true” capital gain to reflect our interpretation.

Calculate capital gain based on issue price for regular income tax

The adjustment proposed in Clause 24 is a very welcome first step to address the access to capital crisis the mineral exploration sector is facing, but it will not be sufficient to outweigh the headwinds created by an overall increase to the capital gains inclusion rate from 50% to 66 2/3%.

As noted in our [pre-budget 2024](#) and [pre-budget 2025](#) submissions, **we continue to recommend** to government to base capital gains on the issue price of an FTS rather than the current approach of assessing gains based on a \$0 purchase price.

Making this change would not only mitigate some of the negative impacts created by an increased inclusion rate but can also make the FTS regime a viable investment product for a much larger cohort of Canadians. This change could both expand the investment cohort beyond the ultra-high net worth individuals that currently make up the vast majority of those who purchase FTS and encourage investors to hold shares for longer periods of time, which could have a positive impact on the market valuation of individual equities and the sector overall.

2) Clean Technology Manufacturing Investment Tax Credit (CTM-ITC)

We applaud Finance Canada for responding to concerns expressed by us and other industry stakeholders that the CTM-ITC’s eligibility threshold may be too high due to the polymetallic nature of mineral deposits in Canada, and accordingly replacing the requirement to produce “all or substantially all” qualified materials (90% or more) with the “primarily” test (over 50%).

We do have, however, several concerns with respect to the legislative proposal relating to the CTM-ITC.

CTM-ITC eligible expenses

The CTM-ITC is expected to provide a 30% refundable tax credit for investment in depreciable property such as equipment and machinery. This credit can be highly effective in boosting the economic viability of new greenfield mines. However, due to the long development times of greenfield projects (National average of 27 years from discovery to production, according to [recent research by S&P Global](#)), there is limited availability of ‘shovel-ready’ projects in the near-term.

To increase the pool of potential projects that can benefit from the CTM-ITC and support growth of Canada’s elective vehicle (EV) supply chain with domestic inputs, the government must expand types of expenses eligible for the credit so that it will support mine expansions and brownfield projects, which often have a more streamlined regulatory approval process and shorter lead times. However, such projects often use existing equipment and machinery, and therefore their returns are much more dependent on mine development costs (Canadian Development Expenses), which are currently not eligible expenses for the CTM-ITC.

Therefore, to advancement of critical minerals mines **we recommend** that eligible expenses should include all mine development costs, as well as all costs associated with installing and commissioning new machinery and equipment for mining companies that are primarily extracting and processing critical minerals.

Processing activities at a location other than the mine site

PDAC agrees with the proposed ITC amendment that stipulates the eligibility of certain qualified mineral activities (e.g. extraction or processing) performed at a mine site will be based on a “primarily” test (i.e. 50% or more) versus the previous proposition requiring “all or substantially all” of production (90% or more). PDAC welcomes this change as it more-closely reflects the reality of Canadian mineral deposits, and it could usher a greater number of undeveloped projects towards a build decision based on improved economic feasibility and the rate of return on invested capital.

However, we are concerned that the legislation proposes application of an “all or substantially all” threshold when assessing processing activities performed at a location other than a mine site.

Due to a range of considerations – environmental, logistical, legal, economical or other – it is common in the mineral industry for companies to locate mid-stream processing activities outside of the mine site. Off-site mineral processing activities are often at pre-commercial sale stages and typically represent the final touchpoints of extracted material for a mining company. Restricting off-site processing activities of pre-commercial mineral products to a 90% threshold for qualifying materials will disqualify many viable critical mineral projects that would be eligible to receive the CTM-ITC if the “all or substantially all” threshold was changed to “primarily”. This differential treatment may also create an unintended chokepoint in domestic mineral supply chains that will drive more of value-added stages of mineral processing outside of Canada.

Therefore, **we recommend** that the “primarily” test will apply to all processing activities needed to make the qualified materials commercially saleable.

Certification's Independence Requirement

In qualified activities where the new “primarily” requirement applies, (i.e. extraction or processing activities performed at a mine site) the legislative proposal introduces a new requirement for a certification signed by an independent engineer or geoscientist.

According to the explanatory notes, it means that *“in addition to meeting the requirements of the definition “qualified professional engineer or professional geoscientist” in subsection 127(9), an independent engineer or geoscientist for the purposes of section 127.49 must also be at arm’s length with, independent of, and not employed by each taxpayer claiming a related CTM investment tax credit.”*

We have concerns about the independence requirement, which seems unnecessary and to our knowledge doesn’t exist as a market disclosure requirement in any other key mining jurisdiction.

Often the most knowledgeable person regarding the information of a mineral property is an employee of the issuer and a Qualified Person who has had direct oversight of how a project’s data is collected and disclosed, as well as how interpretations have evolved over time. Requiring an independent engineer or geoscientist to attest CTM use means adding more complexity, time and costs to obtain a certification without improving accuracy.

In this context, it is important to note that qualified professional engineers or geoscientists are regulated by, and members of a professional association and are required to maintain integrity and professional standards irrespective of independence from an issuer. These professionals are also required to attest to an issuer’s technical public disclosures and face market scrutiny.

Therefore, **we recommend** that Finance amend the legislation to allow any qualified professional engineer or professional geoscientist to certify a CTM-ITC claim by removing the requirement for independence.

Challenge with auditing the CTM-ITC

Our understanding of the proposed CTM-ITC legislation is it includes a 10-year recapture period where the valuation of qualifying minerals output will be audited on an annual basis. We note the potential that inconsistencies in treatment may arise due to differences between interim and annual production results, and life-of-mine estimates.

Since production from polymetallic mineral deposits (i.e. containing multiple minerals) is dynamic, it is possible for a project to primarily produce qualifying materials over the entire mine life, but production profiles may vary from year to year and lead to less than 50% qualified material being produced in some years. Similarly, as ITC eligibility is based on production value, it is possible that material swings in metal prices in a reporting period could lead to ineligibility of viable critical mineral projects.

To illustrate the challenge, we point to a Copper-Zinc-Lead deposit that is expected to produce 60% copper (i.e. qualified materials) and 40% zinc / lead over a 10-year mine life as an example, which would be eligible for the CTM-ITC. However, due to geological and operational considerations, copper production will only reach 40% in the first three years of operation before climbing significantly in years 4-10 years to reach an accumulated copper production of 60% over the life of mine.

Based on the current legislative proposal, the above example project would represent a viable domestic source of a Tier 1 critical mineral that is ineligible to receive the CTM-ITC at the most critical start-up stages of operation.

We are concerned that audits on annual basis, without having a full understanding of the mine project throughout its planned lifespan, may trigger a requirement for credit recapture, create unnecessary and costly disputes for companies, and significantly limit effectiveness of the ITC.

To prevent misinterpretations and maintain the spirit of the CTM-ITC, **we recommend** establishing a mechanism to address the discrepancies between planned production over the life of mine and short-term production variations and ensure projects like the one described above are eligible for the credit.

Eligibility of leasing costs

PDAC emphasized in our previous [submission on the CTM-ITC](#) that equipment leasing is a common practice in mining fleet management. According to the legislative draft, equipment lessors would enjoy the CTM-ITC where the lessee is using leased equipment for an eligible purpose. This approach may reduce overall equipment costs for the lessors, which may translate to lower leasing costs for mine operators and extend partial benefits of the ITC. However, this approach will only offer reduced benefits for equipment and service providers with added complexity and costs that will delay benefits from flowing to the companies undertaking extraction and processing, as well as have a less meaningful impact on the rate of return on invested capital and overall economic viability of a critical mineral projects.

From both an economic and logistics perspective, it is often optimal for companies to lease certain types of equipment that are used in the extraction and processing of mineral ores to shift a significant portion of upfront capital to longer-term operating cost. As a result, equipment such as mine haulage and service fleet, on-site power generation or water treatment equipment may be leased rather than acquired outright. This approach can also have operational benefits from having service and replacement agreements that streamline costs and improve overall efficiency of a mine.

To ensure companies that aim to develop new critical mineral mines can realize the full benefit of the CTM-ITC, **we recommend** that equipment lessee will also be eligible to receive this incentive.

Finance could recognize the applicability of the ITC to critical mineral mine operators based on reported annual leasing costs for equipment that are used for qualifying purposes. Alternatively, Finance should allow critical mineral mine operators to claim the CTM-ITC where the lessee and lessor make an election under S. 16.1 of the Act.