**Legislative Proposals Related to the *IncomeTax Act* –
Clean Technology Manufacturing Investment Tax Credit**

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

February 5th, 2024

PROSPECTORS & DEVELOPERS ASSOCIATION OF CANADA

ASSOCIATION CANADIENNE DES PROSPECTEURS ET ENTREPRENEURS

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Re: Clean Technology Manufacturing Investment Tax Credit - Draft Legislation

The Prospectors & Developers Association of Canada (PDAC) is the leading voice of the mineral exploration and development sector, representing over 7,000 individual and corporate members from the mineral industry both in Canada and around the world. The mineral industry supports more than 650,000 jobs, contributes more than $100 billion in GDP each year. It is also the largest sector of public issuers representing 1/3 of all companies listed on Canadian exchanges and more than half of the listings on the TSX Venture exchange.

We appreciate the opportunity to comment on the proposed *Income Tax Act* amendments and applaud the Government of Canada for drafting legislation to define the Clean Technology Manufacturing Investment Tax Credit (CTM-ITC).

In particular, the inclusion of extraction and processing of critical minerals as eligible activities in the CTM-ITC is crucial, as this will bolster the upstream capacity of Canadian supply chains to deliver the necessary mineral products used in clean technology manufacturing. The credit will provide a significant boost to the economic feasibility of developing new sources of critical minerals, drive sustainable mine development and spur end-to-end investment into clean technology supply chains in Canada. We must incentivize this capacity, as our reliance on offshore sources will remain a counter force to lowering global emissions. With this as a backdrop, we'd like to highlight some concerns regarding the implementation of this new incentive on behalf of the mineral industry and based on geological and economic realities.

Our key concern is that to receive the credit, an operation must be '*producing all or substantially all qualifying materials*' (i.e. 90% or more). Since this requirement does not reflect the type of mineral deposits that have formed in Canada, it will make the CTM-ITC inaccessible for nearly every domestic known deposit. To remedy this incongruency we recommend adjusting the eligibility threshold to '*producing primarily'* qualifying materials (i.e. above 50%) with a gradual sliding scale reduction of the credit below this level.

There are still uncertainties to address in the legislative proposal, specifically the methodology to determine compliance with the *qualifying materials* production level threshold, and how this is calculated (i.e. by volume of production, market value, etc.). Lastly, mine fleet equipment is commonly leased by mineral companies to maximize economics and we recommend that the CTM-ITC be provided directly to critical mineral mine operators that lease equipment.

Please review the commentary below where we elaborate on rationales for our recommendations.

Sincerely,

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Matching Eligibility with the Reality of Canadian Deposits

In its announcement of the CTM-ITC in Budget 2023, the federal government emphasized that the incentive means to ensure our businesses remain competitive in major global industries and support the supply chains of Canada's allies around the world. To achieve these goals in a meaningful way, the CTM-ITC should be broadly applicable and eligibility criteria should reflect the geological realities that exist in Canada and the fact that the substantial majority of critical mineral deposits have a polymetallic composition.

However, the legislative draft states that *"CTM use means the use of a property in a qualifying mineral activity producing all or substantially all qualifying materials"*. This means that to qualify for the CTM-ITC, *qualifying materials* must account for 90% or more of mine production – an unrealistically high threshold. In fact, according to a recent analysis conducted by the Mining Association of Canada (MAC), only one operating copper mine in Canada, the Highland Valley Copper Mine, would comply with this threshold.

Considering the importance of domestic supply chains in supporting a transition to net-zero emissions, and given the urgent need to increase critical mineral production to build these supply chains, there are significant social and economic benefits in expanding CTM-ITC eligibility to mines where qualifying materials account for less than 90% of mine production.

When the Critical Mineral Exploration Tax Credit (CMETC) was introduced, eligibility was defined as exploration activity that is *"primarily targeting critical minerals"* whereby primarily means 50% or more. We think the same threshold is reasonable to define CTM-ITC eligibility, given the polymetallic nature of deposits in Canada and so that there is alignment between exploration and manufacturing credits.

Recommendation: We recommend that a project be entitled for CTM-ITC if it produces primarily qualifying materials (i.e. 50% or above), otherwise the CTM-ITC will be inaccessible to the substantial majority of critical mineral deposits in Canada.

Measurement Methodology

Another area of uncertainty from the legislative draft and explanatory notes are the details of the methodology by which the *qualifying materials* production level will be measured.

First, it is not clear what unit of measurement will be used. For example, measurement by in-situ value or production weight tonnage may not accurately reflect the operational dynamics of a mine. In our view, the measurement should be based on revenues a company received for its production, which provides an accurate and reliable measurement, and is given as part of companies' financial reporting. Therefore, we recommend applying a value-based measurement for the CTM-ITC (i.e. net smelter return, realized market value of metal sales, etc.).

Since the CTM-ITC will be based on reported production, it is important to note that fluctuating metal prices could create differences between forecasted prices in a mine feasibility study or near-term production plan, and the actual realized prices. In projects where production of *qualifying materials* is marginally above the CTM-ITC eligibility threshold, market price fluctuations could result in realized revenues from *qualifying materials* falling below the eligibility threshold, causing a loss of the entire credit and potential financial stress. To prevent this scenario from occurring, Finance should consider a sliding scale approach, whereby the credit would gradually decrease as production of *qualifying materials* declines below 50%.

Recommendations:

- We recommend using a value-based approach for production measurement, which will initially rely on forecasted prices from a critical mine operator's financial outlook, and with final validation based on realized prices and normal-course reporting requirements.
- Where production of qualifying materials falls below 50%, we recommend the CTM-ITC credit percentage gradually decline on a sliding scale.

Eligibility of Leasing Costs

In developing an economic feasibility study and working towards making the decision to build a new mine, a company will investigate all options to improve the Internal Rate of Return (IRR) of a project over its lifespan. Making a build decision often relies on an IRR that exceeds 20% and this measure is particularly sensitive to changes in profitability in the first few years of operation.

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 can help to streamline costs and improve overall efficiency of a mine.

According to the legislative draft, equipment lessors would enjoy the CTM-ITC where the lessee is using leased equipment for an eligible purpose. Adopting such an approach may reduce overall equipment costs for the lessors, and this may translate to lower lease costs for mine operators and enable them to partly benefit from the ITC. However, this approach will have a less direct and smaller-scale effect on the economic feasibility of a new critical mineral mine.

Recommendations: To ensure companies that aim to develop new critical mineral mines can realize the full benefit of the CTM-ITC, we recommend Finance ensure leasing costs are recognized in this incentive. Government could apply 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. Adopting such an approach will ensure all new projects that fit within the CTM-ITC mandate can receive equal benefit.