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

August 4, 2023

Re: Renewing the Mineral Exploration Tax Credit (METC)

Dear Deputy Prime Minister Freeland,

The Prospectors & Developers Association of Canada (PDAC) is the leading voice of the mineral exploration and development industry, which supports 719,000 people in direct and indirect employment, and contributes more than $100 billion to Canada's GDP every year. The industry is also the largest private sector industrial employer on a proportional basis of Indigenous Peoples in Canada, and a key partner of Indigenous businesses.

Representing over 7,000 individual and corporate members both in Canada and around the world, PDAC's work centers on supporting a competitive, responsible, and sustainable mineral industry. The mineral industry is the largest group of public issuers in Canada, accounting for 1/3 of all companies listed on Canadian exchanges and more than half of the issuers listed on the TSX Venture exchange.

Canada holds top positions both as a hub for mineral exploration and mine finance with nearly 1/4 of all funds invested in the sector over the last decade coming from the Canadian marketplace. As the second largest nation on Earth and hosting deposits that range across the entire mineral, metal and commodity spectrum, Canada is also one of the world's top destinations to explore. A key reason for the success in both financing and exploration realms is the existence of the flow-through share (FTS) regime, and a crucial component in the success of FTS is the Mineral Exploration Tax Credit (METC).

With a 5-year METC renewal in 2019, we are now approaching its expiry in March 2024. Given this credit's material link to grassroots mineral exploration across Canada, **we urge the government to extend the METC for a minimum of an additional 5-year period**. Allowing the METC to expire would effectively disincentivize exploration of more than half of the minerals on Canada's critical list, putting the country at risk of losing the economies of scale in our capital markets that have made it the top jurisdiction for financing the mineral exploration industry.

The rest of this letter provides a brief background on the METC, highlighting the importance of this credit in fueling domestic mineral exploration and the potential ramifications if the METC expires.

We encourage Finance to engage PDAC to discuss the details in the attached background document and please contact Jeff Killeen, PDAC's Director, Policy & Programs (jkilleen@pdac.ca) to advance this effort.

Sincerely,

Lisa McDonald
Executive Director

August 4, 2023

Background on the Mineral Exploration Tax Credit

The FTS regime is an integral part in boosting Canada's competitiveness and encouraging investments in mineral exploration across the country. FTS financing accounts for roughly 2/3 of all the funds raised on Canadian exchanges for exploration in Canada[1], with increased importance during periods of market contraction and when alternate sources of capital are sparse.

FTS allow individuals to deduct 100% of their FTS investments from taxable income. Introduced in 2001, the METC is an additional incentive that provides FTS investors with a 15% non-refundable tax credit provided the funding generated from these shares goes towards grassroots exploration activities. This early-stage exploration activity is what drives new mineral discoveries within Canada. The METC helps to offset some of the significant risks and high costs involved in early-stage exploration within Canada and make investing in the sector more compelling for investors[2].

From an economic perspective, the METC is highly cost-effective as estimates suggest every $1 of implied government spending (via reduction in tax revenue) generates nearly $7 of flow-through funding and government evaluation implies that each FTS dollar expended results in an additional $3 in incremental expenditures (Finance Canada, October 1994[3]).

As illustrated in Figure 1 on the following page, government estimates the annual METC cost has ranged between $60M-$140M since the 2019 renewal to total $425M during this period. This cost to the public is more than offset as the incentive assisted in generating nearly $3 billion in capital raises for companies in the sector, which translates to roughly $8.5 billion in economic activity across the country, or a 20x positive impact on the Canadian economy.

[1] This is PDAC estimation based on data sourced from TMX Group and S&P Global Market Intelligence

[2] In its report, "Tax Expenditures and Evaluations 2013", Finance Canada notes that *"When investment tax credits are available (e.g., the federal 15% Mineral Exploration Tax Credit and the 5% Ontario Focused Flow Through Share Tax Credit), returns for the average flow-through share investor improve by an additional 11 percentage points…"*

[3] Flow-through Shares: An Evaluation Report, Finance Canada, October 1994: https://publications.gc.ca/collections/collection_2016/fin/F34-4-1994-1-eng.pdf

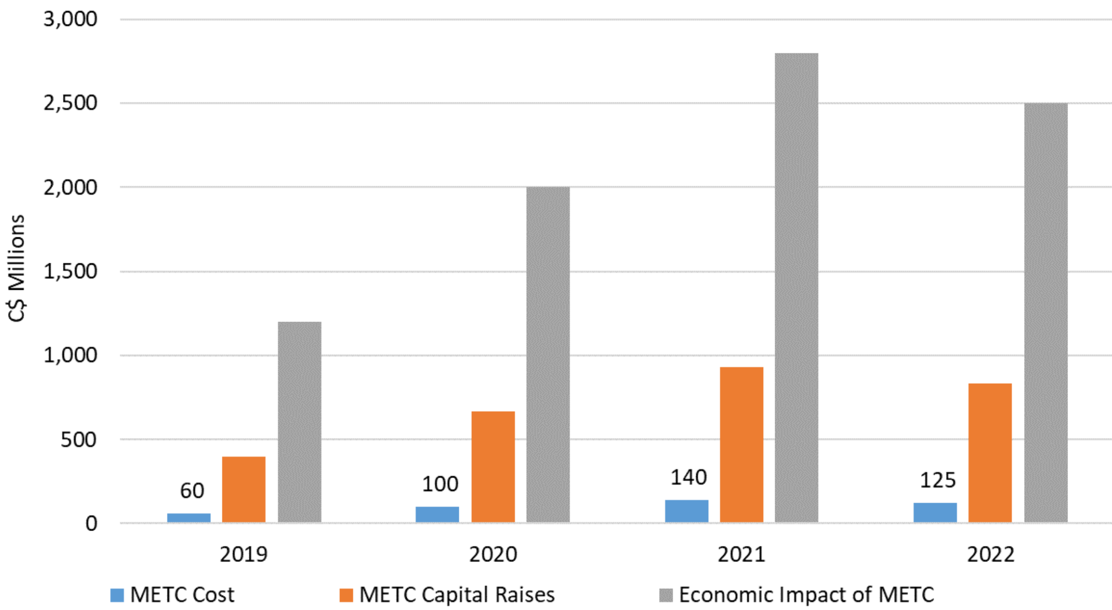

Figure 1: METC Cost vs. METC Capital Raises vs. Economic Impacts

It is important to note that spending by mineral exploration and mining companies generated through FTS and METC has a multiplier effect for regional economies, local vendors and the labor force in nearby communities.

METC market contributions and potential impacts of its elimination

Figure 2 shows the proportion of METC funding in comparison to the total amount of funds raised through FTS issuances since the last 5-year METC renewal began in 2019.

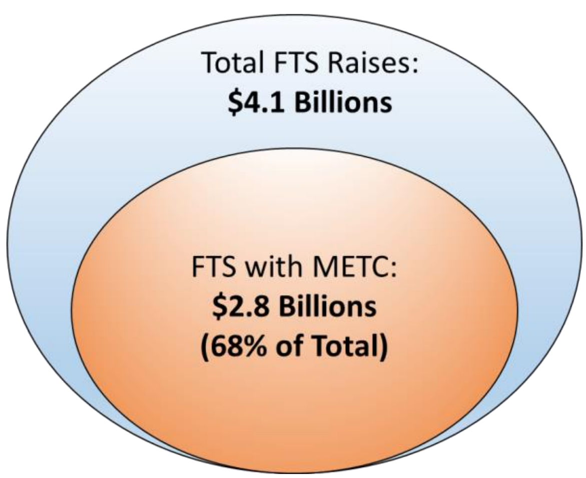

Figure 2 – proportion of METC related raises

Bearing in mind there is a higher cost to explore in northern and remote parts of Canada relative to many other regions of the world, this translates into a more challenging environment to add market value and generate positive returns for investors. In this context, the METC plays a significant role in offsetting these competitive headwinds, thereby encouraging domestic investment into Canadian projects and attracting increased foreign capital. Therefore, it is reasonable to assume that eliminating the METC will reduce the total FTS funds available for exploration companies, as investors may look to more competitive regions where exploration costs are lower and the likelihood of positive returns are greater.

Through stricter eligibility criteria versus FTS-only issuances, the METC drives greenfield exploration in Canada[4]. As such, the METC helps secure the future of the mineral sector in Canada by encouraging investments in the earlier parts of the cycle, which are more difficult to finance. Eliminating it will significantly reduce the investment in this type of exploration and reduce the number of new deposit discoveries and opportunities for building new mines within the country. It is important to recognize the METC incentivises the earliest stages of mineral exploration, which is becoming increasingly important given a declining trend in the proportion of grassroots spending in Canada, which fell from 45% of total expenditures in 2008 to just 29% in 2022.

We must point out that the Critical Mineral Exploration Tax Credit (CMETC) has been showing signs of success. Exploration for critical minerals such as lithium, graphite and Rare Earth Elements (REEs) is up nearly ten-fold over the last 3 years, which no doubt has links to the new credit. With this in mind, we must be cognisant that the CMETC is only eligible for 14 minerals (including REEs) out of the 31 critical minerals identified on Canada's list. That means the METC represents the only grassroots exploration incentive for the remaining 16 minerals on our critical list. By allowing the METC to expire in March of 2024, the Government of Canada is effectively sending a signal to the market that we are disnincetivizing exploration for half of our critical mineral list, which could have negative carry over implications for Canada's critical mineral strategy as a whole.

It is important to note that while METC is eligible in the case of non-critical minerals such as gold; its elimination may also negatively reduce the pursuit for critical mineral in Canada, for a few reasons.

Eliminating the METC has potential ramifications for the Canadian ecosystem that support mineral exploration. The position of Canada as both top financing hub of the global mineral sector and top destination to explore is largely based on the capabilities of this ecosystem, which is arguably the best in the world, to support diverse aspects of mineral exploration – from drilling expertise, to technical consulting, regulatory disclosure, accounting, financing, legal, etc. This ecosystem also depends on activities related to non-critical minerals such as gold, which account for ~60% of exploration spending in Canada. The elimination of the METC and a resultant decline in FTS funds will lead to contraction of this ecosystem, constrict capital access for exploration companies working in Canada, and temper the domestic pursuit for both critical and non-critical minerals alike.

---

[4] Finance Canada notes in its report on Tax Expenditures and Evaluations 2013 (footnote 2 on Page 32) that: *"Eligible exploration expenses for the Mineral Exploration Tax Credit are limited to above-ground greenfield exploration (i.e., expenditures for exploration in the vicinity of an operating mine, or formerly operating mine, are not generally eligible)…"*

Similarly, throughout remote terrains and areas of mineral potential, gold exploration and mining develops infrastructure and expands the reach of mineral exploration for other minerals. Therefore, allowing the METC to expire will lead to less infrastructure development in viable mineral prospective areas in remote Canada, which could support other critical mineral projects and identification of deposits that would otherwise remain undiscovered.

Recommendation

Given the importance of the METC in encouraging investments into Canadian projects and the direct investment it can attract for exploration of more than half of our critical mineral list, **we recommend that the Federal government extend the METC for an additional 5-year period in the 2023 Fall Economic Statement.** This would ensure the METC remains available until at least March 2029. Furthermore, we recommend extending the CMETC from its current expiry in March 2027 to March 2029, to align with a 5-year METC extension.