Written Submission for the Department of Finance Canada

Pre-Budget Consultations in Advance of the 2025 Budget

By: PearTree Financial Services Ltd.

August 1, 2024

PearTree

Recommendations

Recommendation 1: Modify the Alternative Minimum Tax ("AMT") schedule to reduce the negative economic impact on the mineral exploration industry by:

a) Eliminating the phantom capital gain in line 1 of the AMT Schedule; and
b) Reducing the add back of Canadian Exploration Expenses ("CEE") as funded through the Flow-Through Share ("FTS") structure to 30%.

Recommendation 2: Renew the Mineral Exploration Tax Credit ("METC") for 5 years beyond March 2025, and extend the Critical Mineral Exploration Tax Credit ("CMETC") by 3 years, from 2027, thereby aligning the two incentives to expire March 2030.

Recommendation 3: Make all 34 minerals on Canada's Critical Minerals List eligible for the CMETC and update section 248(a), the definition of "mineral resource", in the Income Tax Act (Canada) ("ITA") to read: "a base or precious metal or a critical mineral".

Recommendation 4: Provide authority to the Minister of Natural Resources to allow an extension of expenditure timelines associated with FTS in the event of unforeseen situations (e.g. wildfires, floods, etc.) that create significant liabilities for resource companies and their FTS investors.

PearTree Canada
www.peartreecanada.com
110 Eglinton Avenue West, Suite 400
Toronto, Ontario M4R 1A3
T 416.613.3848
F 647.436.7460

PearTree

Introduction

About PearTree

This submission is provided by PearTree Financial Services Ltd. and its wholly owned subsidiary PearTree Securities Inc. (collectively "PearTree"). PearTree was founded in 2007 now employing approximately 40 individuals and is the leading source of mineral exploration capital exclusively funding Canadian projects. Annually, PearTree funds over $500M, in more than 60 financings, all within the FTS tax incentive regime.

PearTree has the data to support all statements made in this submission and will provide further disclosure upon request.

About Flow-Through Shares

FTS financings represented over 83% of all capital raised for Canadian mineral exploration in 2023. In most years, over $1B is raised in the public capital markets and deployed on exploration projects, mainly labour and services in rural and remote regions of Canada.

A FTS is a newly issued common share in which the issuer agrees to spend the funds raised on direct exploration activities as defined in the ITA. Business expenses and tax deductions normally available to a corporation incurring expenses are flowed through to subscribers funding the activity. The net outcome is a dollar of tax deduction by the FTS subscriber results in a dollar of taxable activity.

The PearTree structure is now the fundamental way in which nearly 90% of all FTS financings are completed. It is a simple three step structure in which FTS subscribers purchase FTS at a premium and immediately donate the FTS to charity. The charities immediately sell the shares to global investors at a discount to market, stripped of tax value. This structure provides Canada with an investment pricing advantage over every other country and provides an opportunity for global institutional investors to invest in early stage Canadian exploration projects at a risk adjusted cost of capital.

The federal government provides additional tax credits to incentivize high-risk exploration investments: the 15% METC for most minerals and the 30% CMETC for 15 critical minerals. For instance, an investor purchasing $10,000 in FTS for gold exploration can deduct $10,000 as CEE and claim a 15% or $1,500 METC, but must add back the $1,500 as income on their T1 return the following year, reducing the net tax incentive to about 7%. Similarly, for lithium exploration, the investor deducts $10,000 and claims a 30% or $3,000 CMETC, with the credit added back as income, reducing the incentive to about 14%. The introduction of the CMETC directly led to over $500M raised for critical mineral exploration within 18 months of its implementation.

PearTree

Alternative Minimum Tax

Recommendation 1: Modify the AMT schedule to reduce the negative economic impact on the mineral exploration industry by:

a) Eliminating the phantom capital gain in line 1 of the AMT Schedule; and
b) Reducing the add back of CEE as funded through the FTS structure to 30%.

Discussion:
AMT is a feature of the ITA designed to ensure that all taxpayers remit a minimum amount of tax relative to income in any one year, even though a taxpayer may have participated in tax incentive transactions, such as FTS, which could otherwise reduce one's taxable income to nil. Current AMT rules limit the effectiveness of the FTS regime and dis-incent FTS investment.

Under the current AMT rules the recalculation of taxable income for a year adds back into income 100% of capital gains on the disposition of FTS with a deemed tax value of nil, and adds back 100% of the CEE deduction. These provisions, in tandem with the rate increase, materially limit the FTS tax incentive, since it significantly reduces (and possibly eliminates) the room to absorb the METC / CMETC in the year of investment. Based on the current architecture of the ITA, the deductibility / recognition of federal investment tax credits – whether 15% METC or 30% CMETC – is limited to the difference between taxes otherwise owing and the AMT calculation.

When a FTS is disposed, the entire sale price is treated as a capital gain, since the adjusted cost base is deemed to be nil for tax purposes. The rationale being that the taxpayer fully deducted the cost of the FTS. However, holistically a $1.00 of tax deduction results in a $1.00 of taxable exploration activity. The fiscal authority is materially whole. The capital gains tax paid when the shares are disposed recoups any tax revenue leakage including the METC or CMETC. A FTS purchased at $1.00 and sold for $0.40 (which is common) triggers a capital gain of $0.40 even though there is an economic loss. We call this a "phantom capital gain".

PearTree recommends that the $1.00 subscription amount funding $1.00 of exploration (CEE), be added back into the AMT schedule at a rate of 30% (instead of 100%). In addition, while maintaining the full 66 2/3% capital gain on the T1 return, eliminate the "phantom capital gain" for the purposes of the AMT calculation **only**, from a deemed nil ACB.

The 2024 changes to capital gains and AMT significantly reduces the amount an individual can invest in FTS before reaching the AMT threshold, above which the investment incentive effectively disappears. Based on analysis from 2022 and 2023 taxation years we know that the current investor base, funding almost all mineral exploration, will reduce FTS investment by not less than a third. The recommendation presented here will reverse the impact imposed by the changes and further encourage investment by way of the FTS structure.

PearTree

Exploration Tax Credits

Recommendation 2: Renew the METC for 5 years beyond March 2025, and extend the CMETC by 3 years, from 2027, thereby aligning the two incentives to expire March 2030.

Discussion:

Mineral exploration is a high-risk business, with roughly 1 in 10,000 mineral showings advancing to become a new mine. Canada's FTS regime is the primary source of investment capital for these non-revenue generating companies, bringing in over 83% of funds raised for exploration companies exploring in Canada. The additional 15% non-refundable METC and the 30% non-refundable CMETC, help to balance the high costs associated with operating in remote areas, and the risk of advancing geological knowledge with no guarantee of finding mineralization.

According to the Prospectors and Developers Association of Canada, the Government estimated the public cost of the METC was ~$425M from 2019-2022. These costs were more than offset by the $3B in capital raises using the METC over the same time period. Based on Government's own evaluation, the $3B translates into $8.5B in exploration related economic development expenditures across the country, or a positive impact of 20 times.

In the 18 months following the introduction of the CMETC, more than $500M was raised for critical mineral exploration work. The METC and CMETC are proven, effective tax incentives helping industry achieve their goals while ensuring the Canadian government can continue to move towards meeting its climate goals. The 15 minerals covered by the CMETC are clearly important to Canada's future; however, gold, silver and the remaining 19 minerals on Canada's critical mineral list, covered by METC are also critical to our continued technological development. Both METC and CMETC incentives should be extended to March 2030, to provide long-term certainty to an already high-risk industry.

Expand Flow-Through & CMETC Eligibility

Recommendation 3: Make all 34 minerals on Canada's Critical Minerals List eligible for the CMETC and update section 248(a), the definition of "mineral resource", in the ITA to read: "a base or precious metal or a critical mineral".

Discussion:

As Canada developed its Critical Mineral Strategy, there was rational to identify 31 (now 34) critical minerals that are vital to supporting Canada's economic growth, competitiveness, environmental protection, reconciliation, and global security. For Canada to be global leaders in the fight against climate change, it needs to commit to exploring, extracting and processing all 34 of these critical minerals, not just the subset of 15 listed in the ITA. The remaining 19 critical minerals are generally rare and occur is small qualities, thus arguably more in need of the CMETC to encourage exploration and development.

PearTree

Additionally, the definition of "mineral resource" in the ITA should be updated to include all critical minerals. Currently minerals that are not "base or precious minerals" and found in "bedded deposits" do no fit the definition of a "mineral resource" and are not flow-through eligible. Canada's mandate is to increase our reliability on our own critical mineral resources. Therefore, all 34 minerals on the critical mineral list should be made flow-through eligible by updating the wording in section 248(a) of the ITA to include "or a critical mineral".

Wildfires Expenditure Timelines

Recommendation 4: Provide authority to the Minister of Natural Resources to allow an extension of expenditure timelines associated with FTS in the event of unforeseen situations (e.g. wildfires, floods, etc.) that create significant liabilities for resource companies and their FTS investors.

Discussion:

As the climate continues to change, disruptive natural phenomena are more prevalent. In 2023, Canada witnessed an unprecedented wildfire season, and massive flooding events.

Fires cut access to land, roads and remote project sites and many evacuation orders were issued for weeks on end during the height of the exploration season. Governments seconded heavy equipment, helicopters and people to aid in the fight against the fires. Exploration companies, understanding the importance of health and safety, diligently complied with emergency evacuation orders. However, many projects were halted for weeks and companies were not able to meet their FTS expenditure requirements, resulting in penalties and tax liabilities which also flowed through to FTS subscribers.

For example, a Quebec explorer was restricted from accessing their property for 2 months due to a wildfire evacuation order. The company was $2.83M short of their required FTS expenditure and was therefore required to pay an indemnity to the FTS subscribers of $2.27M (80% of capital raised). The company would have been able take advantage of Quebec's relief program, which removed the provincial indemnity, but would still require them to spend the $2.83M on exploration the following year. With the federal indemnity of $1.39M, the company's total cash outlay would have been $4.22M, or 150% of capital raised, therefore the company was forced to pay the indemnity instead (federal and provincial).

The lack of relief, a simple extension of time to spend the required CEE funds in extraordinary circumstances, from the federal government is unfair to safety conscious exploration companies and their investors. This situation has a significant financial impact on the company and soured FTS investor sentiment. The Minister should have the ability to grant relief to companies working in areas that meet specific criteria, including being directly impacted by evacuation orders.

Please direct questions or comments to Kendra Johnston, Managing Director, by email: kendra.johnston@peartreecanada.com.