PearTree

Response to:

Budget 2022 Tax Measures and Amendments to Support a Growing Economy, Draft Legislation Consultation

September 30, 2022

PearTree Financial Services Ltd.
110 Eglinton Avenue West, Suite 400, Toronto, Ontario M4R 1A3
T 416 613 3848
www.peartreecanada.com

PearTree

Introduction

PearTree is the Canadian resource sector's leading source of exploration capital. Annually PearTree deploys over $500 million in as many as sixty financings through Canada's flow-through regime. We work and invest alongside resource issuers, institutional and strategic investors in a structured format which results in much of the funding coming from global investors. Over the past 15 years we have funded billions of dollars in flow-through offerings from coast to coast to coast, and are proud of the work that we do which leads directly to jobs and opportunity in Northern and remote communities across Canada.

We share the government's view that the development of Canada's critical minerals is a generational opportunity that will drive the Canadian economy, provide meaningful employment opportunities, advance indigenous employment and reconciliation, and enhance security and partnerships with allies. PearTree has seen, first hand, the impact of the Critical Minerals Exploration Tax Credit ("CMETC"). Since the new incentive came into effect in April 2022, we have already facilitated over $40 million in critical mineral exploration financings, with more in the works for the balance of 2022.

Our submissions for budget 2022 implementation are limited to five recommendations with respect to the flow-through share regime and the new CMETC provisions. They seek to provide greater certainty for issuers and investors resulting in flow-through funded exploration and follow-on mining jobs, ensuring that the current capital momentum is maintained while increasing tax compliance potentially enabling the expansion of the current list of CMETC eligible activities to include the full NRCAN list of critical minerals.

We note one current observation is support of a robust CMETC incentive. Based on 15 years in this sector we are at the forefront of capital deployed for exploration. Historically Canada's exploration and mining industry has been driven by gold. With gold prices languishing and investor confidence in precious metals significantly eroded, we are seeing a significant reduction in precious metals financings. When the CMETC was introduced in April, we believed that this incentive would drive accretive exploration jobs. In fact, we are already seeing a trend in which exploration for critical minerals is a replacement for many of the exploration jobs previously deployed in exploring for gold and other precious metals. In the fullness of time we would expect the precious metals sector to rebound, but over the near term – the five-year term of the CMETC, it is our sense that the CMETC tax incentive for exploring for critical minerals is more about maintaining northern employment than creating new exploration jobs, while supporting Canada's green energy transition.

PearTree

The five recommendations detailed below relate to the following:

1. Qualified Person (QP) prescribed manner and form of certificate (the “QP Certificate”) – transitional provision for 2022 CMETC financings completed prior to the publication of the prescribed form as set out in ITA s.66(12.61) (e);

2. Absent fraud or gross negligence proven by the CRA, the QP Certificate certifying that the “expense will be incurred pursuant to an exploration plan that primarily targets critical minerals” as set out in ITA s.66(12.61) (e) is uncontestable by the CRA;

3. If recommendation 2 above is not accepted, then reformatting the CMETC as a subset of the broader METC;

4. Increasing resource issuer tax compliance by amending the ITA Regulation s.6201.1(5)(c) definition of ‘excluded obligations’ so that issuers’ obligations under the standard flow-through share tax indemnity contained in subscription agreements include (1) interest charged by the CRA to flow-through share subscribers and (2) that the indemnity obligation is a first charge against the assets of the issuer in priority to banks but always subordinate to government claims. This provision would apply to all flow-through offerings, not just those that otherwise quality for the CMETC.

5. Allow for the 3 Year Carryback of the CMETC

Recommendation 1: The QP Certificate in Prescribed Form

We recommend that for flow-through financings of critical minerals eligible for the CMETC completed prior to the publication of the prescribed form, the requirement for a QP certificate is met if the QP Certificate is provided by a QP in language adopted from the April 7, 2022 budget along the lines of confirming that the proceeds of the Offering will be used for expenditures that will be incurred as part of an exploration project that targets specified minerals, and confirms that there is a reasonable expectation that the minerals targeted by Issuer’s exploration on the Projects are primarily the specified minerals.

The Draft Income Tax Legislation to Implement Outstanding Budget 2022 Tax Measures released by the Minister of Finance (Canada) on August 9, 2022 requires that in order for exploration expenses to be eligible for the CMETC a “qualified engineer or geoscientist” would need to certify that the expenditures that will be

PearTree Financial Services Ltd.
110 Eglinton Avenue West, Suite 400, Toronto, Ontario M4R 1A3
T 416 613 3848
www.peartreecanada.com

PearTree

renounced will be incurred as part of an exploration project that targets the specified minerals. If the qualified person (QP) cannot demonstrate that there is a reasonable expectation that the minerals targeted by the exploration are primarily specified minerals, then the related exploration expenditures would not be eligible for the CMETC." S.66(12.61) (e) contained on PDF page 40/99 requires in respect of those exploration expenditure that "a qualified engineer or geoscientist certifies in prescribed manner and form that the expense will be incurred pursuant to an exploration plan that primarily targets critical minerals." The 'prescribed manner and form', generally referred to as the QP Certificate, has not been published.

The CMETC is effective as of April 7, 2022. Financings have been consummated based on QP Certificates negotiated as a condition of financing by those funding flow-through shares eligible for the CMETC. Please see the attached form developed by PearTree.

Recommendation 2: The QP Certificate to Be Uncontestable by the CRA

Absent fraud or gross negligence proven by the CRA, we recommend that the QP Certificate certifying that the "expense will be incurred pursuant to an exploration plan that primarily targets critical minerals" as set out in ITA s.66(12.61) (e) is uncontestable by the CRA

The CRA has six years to reassess taxpayers with respect to claiming Canadian Exploration Expenses (CEE) which includes reassessment of the claim for CMETC. The six years can be extended by a year in Quebec. The taxpayer subscribers for flow-through shares have no knowledge of the activities of the resource issuer and have no way of disputing the CRA claim other than with the assistance of the issuer. The only recourse for the taxpayer is to make a claim under the tax indemnity contained in the subscription agreement. This investment risk is heightened with respect to the CMETC if the QP Certificate is open for dispute. Some of the critical minerals in respect of which exploration expenditures that qualify for the CMETC commonly occur in association with minerals not on the Critical Minerals list. This is especially so for copper and gold. A QP may reasonably conclude that the exploration plan very legitimately targets copper only to find that the assays determine gold value in excess of copper. With the benefit of hindsight, a CRA auditor may very well dispute the QP opinion made years before. This risk will be an impediment to the success of the CMETC tax incentive and can be easily met with the implementation of Recommendation 2 as set out above.

Recommendation 3: CMETC as a Subset of METC

If Recommendation 2 above is not accepted, then we recommend reformatting the CMETC as a subset of the broader METC.

The CMETC otherwise fits the definition of the broader 15% Mineral Exploration Tax Credit and in fact an issuer could choose to simply characterize the exploration activity as qualifying for the METC. For example, where an issuer's QP is unsure of whether the exploration targets gold or copper. If the CMETC is to be successful during this initial five-year period the lower the risk of tax reassessment the greater the impact of the incentive. If the QP Certificate is open to normal course dispute by the CRA then in mitigation we recommend that in denying the 30% CMETC the CRA reassessment be limited to the difference between the CMETC and the METC, being a 15% net difference. This assumes that the expenditures otherwise qualify as flow-through eligible and meet the requirements of the METC.

Recommendation 4: Amend the ITA Regulation s.6201.1(5)(c) to Increase Resource Issuer Tax Compliance

We recommend increasing resource issuer tax compliance by amending the ITA Regulation s.6201.1(5)(c) definition of 'excluded obligation' so that issuers' obligations under the standard flow-through share tax indemnities contained in the subscription agreements include (1) interest charged by the CRA to flow-through share subscribers and (2) that the indemnity obligation is a first charge against the assets of the issuer in priority to banks but always subordinate to government claims. This provision would apply to all flow-through offerings, not just those that otherwise quality for the CMETC.

In an ever-more complicated world keeping tax legislation current across all sectors is a Herculean task. The prescribed share rules which govern the flow-through share regime have not been materially changed in decades even though the market has changed significantly. The CMETC 30% works to incent investment risk but is susceptible to abuse. The current law limits issuer tax indemnities for failure to comply with the list of accepted expenses to the tax owing either as a result of a failure by an issuer to renounce eligible expenditures or as a result of a reassessment. The CRA has six years to reassess and if the CRA denies the expenses it charges the flow-through subscriber non-deductible interest at the prescribed rate plus 4%. As of today, that non-deductible rate is approximately 7% or a pre-tax equivalent of over 14%. We have seen flow-through tax reassessments in

PearTree

which over a quarter of the tax owing is on account of interest and this has been during a period of very low interest / prescribed rates. Investment in flow-through share offerings is venture capital at the riskiest end of the continuum. Years later many issuers do not have the ability to honour the tax indemnities. To qualify as CEE and by extension to be eligible for the tax credits, issuers need not be successful in the exploration program. Management simply has to comply with tax legislation, particularly with respect to the use of CEE funds as set out in the ITA. The current schema needs revision but two easy amendments set out in our recommendation above will go a very long way in driving compliance by issuers and in doing so supports the CMETC incentive and adds an element of investor / consumer appreciation for a fairer tax regime.

Recommendation 5: Allow for the 3 Year Carryback of the CMETC

We recommend allowing for the 3-year carryback of the CMETC in the exact manner as the current METC notwithstanding that the critical mineral tax credit was not available in previous years. Based on our reading of the August 9, 2022 Draft Legislation we have reached the conclusion that it is not possible to carry back the CMETC from the 2022 tax year to the 2021 or previous years Some of the general items related to our conclusion are as follows:

1. For purposes of the 2021 year, we believe that 30% of the 2022, 2023, or 2024 qualifying expenditures would be included in the definition of ITC pursuant to subsection 127(9) of the ITA.

2. However, the provision of the Act that allows for a carry back of an ITC claim is pursuant to subparagraph 127(5)(a)(ii) of the ITA.

3. Subparagraph 127(5)(a)(ii) of the ITA, as amended, refers to the ITC at the end of the current year in respect of flow-through critical mineral mining expenditures for subsequent years. The amended wording will be deemed to come into force on April 7, 2022.

4. For purposes of a 2021 ITC claim, the existing (old) wording of subparagraph 127(5)(a)(ii) of the ITA would thus apply, and that existing (or old) wording contains no such reference to flow-through critical mineral mining expenditures for subsequent years.

5. As a result, and for that reason, it does not appear that it is possible to have a 2021 ITC claim that pertains to flow-through critical mineral mining expenditures from the 2022 or subsequent years.

The CMETC is intended to incent and accelerate high risk investment in exploring for critical mineral resources desperately required in the migration from a fossil fueled economy to one based on electricity and to mitigate against supply chain interruption due to geo-political global events. As such anything that can be done to promote the government's policy in this regard, ought to be considered. Whilst very few individual investors have the financial need or capacity to carry back tax credits, it seems to us that maintaining a simplified approach in treating the CMETC and the METC in the exact same manner will result in additional critical mineral financings in 2022 and 2023. If we were asked for the order of magnitude we would suggest an accretive $40 million of flow-through financings during 2022 and 2023. Holistically, a dollar of flow-through financing and CEE tax deduction in urban Canada results in a dollar of taxable activity in Northern and remote communities. In this instance it is our submission that the CMETC tax incentive will drive jobs and discovery and the carry back is merely another accretive incentive to some investors willing to take the risk.

Conclusion

To summarize, we recommend the following amendments to the Draft Legislation:

- The QP Certificate in Prescribed Form
- The QP Certificate to Be Uncontestable by the CRA
- CMETC as a Subset of METC
- Amend the ITA Regulation s.6201.1(5)(c) to Increase Resource Issuer Tax Compliance
- Allow for the 3 Year Carryback of the CMETC

In recent years the global geo-political situation has fundamentally changed. Canada's resource wealth should be the foundation upon which we build our own manufacturing capabilities based on availability of critical mineral supply. Canada should be the global supplier of choice for critical minerals. Canada has a wealth of resources required for the transition to a green energy economy from copper to lithium and 29 other elements and metals in between. Long term demand is increasing, and we can materially help the world in this transition. Please accept these recommendations in this spirit of opportunity.

Please direct any questions or comments to Alanna Clark, Vice President of Government Relations, PearTree Canada. Alanna can be reached by email at alanna.clark@peartreecanada.com or by phone at (416) 937-6742.

QP CRITICAL MINERAL CERTIFICATE

To: PearTree Securities Inc. and the subscribers purchasing flow-through shares of **[insert name of Issuer]** Pursuant to the Offering of flow-through shares scheduled to close on **[insert Closing Date]**

I, _________________, **[Insert Credentials]**., am a Qualified Person (QP) as defined under National Instrument 43-101 Standards of Disclosure for Mineral Projects (NI 43-101) published by the Canadian Securities Administrators.

This Certificate is being provided in connection with ***Issuer's*** Exploration Projects (the Projects), in **[insert province / territory]**, Canada to confirm the commodities that are the primary exploration targets at the Projects. The Projects include the following exploration targets:

1.

2.

3.

I am providing this Certificate in the knowledge that you will rely on it in connection with your decision to subscribe for flow-through shares of ***Issuer*** which have been offered to you to fund exploration expenses on the Projects which will be eligible for the Critical Mineral Exploration Tax Credit.

I hereby certify that:

1. I am **[Insert title and name of employer]**.
2. I am a **[insert education details]**.
3. I am **[insert professional credentials eg registered as a Professional Engineer in the Province of Ontario]**. I have worked as **[insert relevant work history]**. My relevant experience for the purpose of this Certificate is:
   - A
   - B
   - C etc.
4. **If applicable**: I am independent of ***Issuer*** applying the test set out in Section 1.5 of NI 43-101.
5. All documents and information required for the certification herein have been made available to me, and I have conducted such inquiries and verified such facts as are necessary for the purposes of executing this Certificate.
6. The supporting information relied upon in arriving at the conclusion in this Certificate is summarized in the appendices attached hereto.
7. At the effective date of this Certificate and to the best of my knowledge, information, and belief, I certify that the proceeds of the Offering will be used for expenditures that will be incurred as part of an exploration project that targets **[insert specified minerals]**, and I confirm that there is a reasonable expectation that the minerals targeted by ***Issuer's*** exploration on the Projects are primarily the specified minerals.

Signed this XXth day of Month, Year

(Signed)

APPENDIX 1 – Summary Support Tables

Table 1: Critical Mineral Support Information for the XXX Project
Issuer – Province / Territory Exploration Projects

1. Item	Description
Main Commodities	
Geological Environment	
Prospecting Results	
Geophysical Results	
Geochemical Results	
Key Grab Sample Results	
Key Trenching Results	
Key Drilling Results	
Other Comments	

Table 2: Critical Mineral Support Information for the XXX Project
Issuer – Province / Territory Exploration Projects

Item	Description
Main Commodities	
Geological Environment	
Prospecting Results	
Geophysical Results	
Geochemical Results	
Key Grab Sample Results	
Key Trenching Results	
Key Drilling Results	
Other Comments	

Table 3: Critical Mineral Support Information for the XXX Project
Issuer – Province / Territory Exploration Projects

Item	Description
Main Commodities	
Geological Environment	
Prospecting Results	
Geophysical Results	
Geochemical Results	
Key Grab Sample Results	
Key Trenching Results	
Key Drilling Results	
Other Comments	