



***Written Submission for the Pre-Budget Consultations in Advance of the 2023
Federal Budget***

By: PearTree Financial Services Ltd.

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List of Recommendations

Recommendation 1: All 31 Critical Minerals, per the Natural Resource Canada ("NRCAN") list, should be eligible for the Critical Mineral Exploration Tax Credit (the "CMETC");

Recommendation 2: Critical minerals found in "bedded deposits" should be flow-through share eligible;

Recommendation 3: Increase the Mineral Exploration Tax Credit (the "METC") from 15% to 30% and the CMETC from 30% to 50% in Yukon, Northwest Territories, and Nunavut;

Recommendation 4: Expand eligible Canadian Exploration Expenses (the "CEE") to include expenses related to advanced exploration.

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



Introduction

PearTree is the Canadian resource sector's leading source of exploration capital. Annually PearTree deploys over \$500 million, in as many as sixty offerings 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 job creation and economic opportunities in rural and remote communities across Canada.



Recommendation 1: Include all critical minerals in CMETC treatment

PearTree applauds the government's introduction of a new 30% Critical Mineral Exploration Tax Credit ("**CMETC**") in Budget 2022. This new credit applies to exploration activity for 15 critical minerals. NRCAN has identified 31 minerals as being critical. As the production of all critical minerals are essential to Canada's economic and national security, and are required for Canada's transition to a low-carbon economy, we recommend that all 31 critical minerals identified by NRCAN be eligible for the CMETC. It is our understanding that the initial list of critical minerals eligible for the CMETC was limited due to concerns about abuse and scale. However, there are legislative safeguards that can be built into the *Income Tax Act* to alleviate these concerns. Our proposed legislative safeguards have been included in our submission on the draft legislation for Budget 2022, and are in part outlined in Recommendation 5 of this document.

Recommendation 2: Allow for critical minerals found in "bedded deposits" to be flow-through share eligible

When it comes to the exploration of identical minerals, one should expect identical tax incentives in support of discovering these minerals. While exploration for mined lithium (i.e. a non-bedded deposit) is eligible for funding through the flow-through share regime including the new CMETC, lithium found in brine in sedimentary basins (i.e. a bedded deposit), often found in the Western Sedimentary Basin, is not. We submit that it is in the best interest of Canada and its provinces and territories that lithium produced in Canada, regardless of its source, should be eligible for tax incentives that promote lithium exploration.

Similarly, helium, while listed as a critical mineral by NRCAN, is not on the current short list of critical minerals eligible for the CMETC. Helium is essential in the manufacture of many high-tech products such as semiconductors, imaging equipment including MRIs, and small modular reactors. The global demand for helium is increasing and, until recently, it was expected that Russia would supply the world's helium needs. However, given Russia's war in Ukraine, this is neither possible nor desirable. Canada is capable of and should be supplying the world's helium needs, and Canadians should be benefiting from this economic activity.

In the examples previously mentioned, lithium found in brine and helium are excluded from flow-through share tax treatment because they are "bedded deposits". A recent CRA technical interpretation (2020-088761E5) noted that this exclusion is due to a clause in the *Income Tax Act* which excludes mineral sources from bedded sedimentary deposits as flow-through share eligible. The definition of CEE in the *Income Tax Act* notes that a mineral resource is eligible for flow-through share treatment when, "the Minister of Natural Resources has issued a certificate that the



principal mineral extracted is an industrial mineral contained in a non-bedded deposit.” Thus, minerals such as helium and lithium found in brine are ineligible.

For both these minerals, exploration funding should be made available through the flow-through share regime and should be eligible for the CMETC. This change will likely result in new investments in exploring critical minerals in Western Canada, creating economic opportunity for skilled, but out of work, oil and gas sector workers, and will enable Canada to build up a high-tech manufacturing capacity with locally sourced helium and lithium, reducing the Western provinces’ economic dependency on the extraction of fossil fuels.

Recommendation 3: Increase the METC from 15% to 30% and the CMETC from 30% to 50% in Yukon, Northwest Territories and Nunavut

For more than fifty years, the flow-through share tax regime has provided most of the exploration capital in mining. Many provinces offer provincial tax credits as an adjunct to the flow-through share regime. For example, both British Columbia and Quebec offer an additional 20% tax credit if the resource company funds exploration in the province through the issuance of flow-through shares, with Quebec offering additional tax incentives which further reduce the after-tax cost (i.e. risk) of investing in this sector. Manitoba offers an additional 30% tax credit and Saskatchewan and Ontario also offer their respective provincial tax incentives. These provincial tax incentives are available to those who pay tax in such provinces and therefore drive mining exploration funding in these provinces. Though immaterial to this discussion, provincial tax credits also claw back the federal credits with some exceptions. For a comparison of the after-tax cost of investing in flow-through shares by province of activity, [please review the table issued by PDAC](#).¹

Unfortunately, with a combined total population of less than 120,000, the Yukon, Northwest Territories and Nunavut are at a competitive disadvantage for capital relative to the populous provinces that offer additional tax incentives. Economic expansion in these northern territories add the highest value to Canada. The territories have a very small individual tax base that may invest in flow-through shares. Northern exploration that results in mine development brings long-term high paying jobs (many to Indigenous people), increased living standards, electricity and potable water, and supports our northern sovereignty. It is in Canada’s best interest to further incentivize this development.

For these three territories, we recommend an increase in the federal METC from 15% to 30% and an increase to the CMETC from 30% to 50% as an incentive for

¹ https://www.pdac.ca/docs/default-source/priorities/access-to-capital/flow-through-shares/6-access-to-capital---fiscal-incentives---docs-for-right-hand-side---fts-brochure-eng.pdf?sfvrsn=70efb498_6



Canadians across the country to invest in resource exploration in Yukon, Northwest Territories and Nunavut. Our proposed federal tax credit increases for the territories simply evens the funding economics between the territories and the populous provinces.

PearTree has seen, first hand, the positive impact of the CMETC. Since the new tax credit was introduced in the April budget, we have already facilitated over \$40 million in critical mineral exploration. Issuers and investors have responded quickly and positively to a very smart government initiative to offer the CMETC and with some further fine tuning to the proposed legislation, we know that this can begin a new chapter for a greener and expanded Canadian resource sector.

Recommendation 4: Expand eligible CEE to include expenses related to advanced exploration

We recommend that eligible expenses for CEE treatment be expanded, to allow for accretive investment in advanced-stage exploration. This is well supported by comments heard by the Standing Committee on Natural Resources (June 2021), stating that “the scope of Canada’s flow-through share system could be expanded or reviewed to reflect the specific circumstances of mining companies that are exploring new deposits of critical minerals.” This would support the government’s objectives to drive research, innovation, exploration, accelerate project development and advance Indigenous Reconciliation.

Expanding the scope of CEE eligibility will allow for more exploration projects to cross the finish line from “exploration” to a functioning mine, and with it, long lasting economic opportunity and prosperity for communities that need it most. The expansion of eligible expenses is material if we are to see critical mineral mine development within a decade. The need for capital and the unresponsiveness of the public markets during late stage exploration and early development is well documented and best known as the [Lassonde Curve](#).

Therefore, we recommend that the CEE definition be broadened to include expenses related to advanced exploration, and project development activities, including:

- In-fill drilling beyond what is required to define resources;
- Metallurgical test work;
- Geotechnical evaluations;
- Environmental baseline studies and prescribed fees, relating to Environmental and Impact Assessments and operational permits;



- Indigenous and stakeholder engagement, including procedural aspects of consultation delegated by the authorities and negotiation of Impact Benefit Agreements;
- Engineering studies (costs relating to preliminary economic assessments, pre-feasibility studies, feasibility studies); and,
- Workforce development, including workplace readiness, training and education.

Expanding the eligible CEE expenses will reduce the funding impediments faced by issuers, while allowing for more critical mineral projects to become more attractive investments, and assist issuers in developing fully functional mines. This in turn will both expand job opportunities throughout the entire lifecycle of mine development, from opportunities for Indigenous peoples to meaningful participation in project exploration, development and permitting, to the lasting economic opportunity of a newly operational mine that will result in countless jobs, enhanced quality of life, and entrenched sovereignty in Northern and remote communities.

Recommendation 5: 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 subscription agreements include interest charged by the CRA to flow-through share subscribers, and 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 qualify for the CMETC.

Keeping tax legislation current across all sectors is a challenge, however 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 works to incent investment risk but may be susceptible to abuse. Upon reassessment of flow-through share subscribers by the CRA for failure by the issuer to renounce or properly spend exploration expenses the current law limits issuer tax indemnities to investors to the tax owing and not with respect to interest charged by the CRA to the flow-through share investors. 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 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



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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.

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