

GLOBAL MINING GROUP NEWS

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Canada's 2008 federal budget includes good news for mining sector

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The February 26, 2008 Canadian federal budget did not contain much in the way of significant tax changes. Considering the track record of recent budgets, this is something of a relief. There were, however, a number of welcome proposals that affect the mining industry.

One clearly welcome proposal is the extension of the flow-through mining tax credit by another year. In addition, Budget 2008 provides a number of revisions to the "section 116" clearance certificate rules that have frustrated international investors in Canadian corporations. These are discussed in more detail below and may decrease the administrative headaches associated with investing into Canada.

Budget 2008 proposes certain improvements to the scientific research and experimental development (SR&ED) tax incentive program for qualifying Canadian-controlled private corporations. The Budget proposes to enhance the SR&ED tax incentive program by increasing expenditure limits and providing greater flexibility in respect of SR&ED performed outside Canada.

Budget 2008 also contains proposals to extend the scope of assets that are eligible for the enhanced 50% capital cost allowance rate provided in Class 43.2. This special class of CCA is available for certain clean-energy generation equipment (such as wind turbines and certain solar equipment). The expanded list of assets eligible for Class 43.2 will generally apply to assets acquired on or after February 26, 2008. It is worth noting that certain expenses in respect of Class 43.2 assets may be renounced to flow-through shareholders as Canadian exploration expenses.

Extension of the flow-through mining tax credit

Budget 2008 once again proposes to extend eligibility for the mineral exploration tax credit (sometimes called the "super flow-through share" program) by a year. The flow-through mining tax credit was introduced in October 2000 as a temporary measure to help promote mineral exploration in Canada. The tax credit has been very successful and has received several one-year extensions since then.

The flow-through mining tax credit is proposed to be available for flow-through share agreements entered into on or before March 31, 2009. By using the look-back rule in the *Income Tax Act* (Canada) (the *Tax Act*), funds raised with the credit during the first three months of 2009 can support eligible exploration until the end of 2010.

The flow-through mining tax credit provides a 15% non-refundable tax credit to individual investors. It is generally available in respect of certain "grass-

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roots” mining expenses that can be renounced as “Canadian exploration expenses” to flow-through shareholders under a flow-through share agreement.

Compliance for non-residents disposing of taxable Canadian property

Budget 2008 proposes a number of significant changes to the current compliance regime applicable to non-residents who dispose of certain property (referred to as “taxable Canadian property”), the income or gain from the disposition of which may be taxable in Canada. Most notably, taxable Canadian property of a non-resident includes unlisted shares of Canadian corporations.

Currently, to ensure that any Canadian tax liability of the non-resident who disposes of such property is collected, section 116 of the *Tax Act* generally requires the non-resident seller to notify the Canada Revenue Agency (CRA) of such disposition. Most importantly, the *Act* makes the purchaser liable to pay an amount to the CRA on account of the non-resident seller’s possible Canadian tax liability, unless the purchaser obtains a clearance certificate from the CRA, the property is “excluded property” (including, generally, listed shares, units of a mutual fund trust, and certain types of indebtedness), or after reasonable inquiry the purchaser had no reason to believe that the seller was a non-resident of Canada. A purchaser that is faced with potential liability under section 116 will normally withhold a portion of the purchase price otherwise payable to the non-resident seller, pending receipt of the appropriate clearance certificate. To obtain a clearance certificate from the CRA, the non-resident seller is generally required to remit the appropriate amount to the CRA, post adequate security for any potential tax liability, or satisfy the CRA that no tax will be owing.

In the case of a non-resident who is resident in a country with which Canada has a tax treaty, most (albeit not all) of Canada’s tax treaties would typically exempt a resident of that country from Canadian taxation on capital gains, except for gains on Canadian real and resource properties and shares of companies that derive more than half of their value from such properties. However, any exemption from Canadian taxation afforded by an applicable tax treaty is not currently taken into account under the existing section 116 regime. Therefore, for example, a non-resident who disposes of unlisted shares of a Canadian corporation that derive less than half of their value from Canadian real and resource properties is likely to face the prospect of a significant portion of the proceeds being withheld (and potentially remitted to the CRA), even if any gain realized on the disposition of those shares is exempt from Canadian taxation under the terms of an applicable tax treaty. The prospect of this withholding is often a significant concern for non-resident investors in Canadian enterprises, and the section 116 compliance regime has been subject to considerable criticism in recent years as the length of time required for the review of transactions and the issuance of a clearance certificate by the CRA has increased as a result of a severe administrative backlog.

Effective for dispositions that take place in 2009 and subsequent years, Budget 2008 proposes three significant changes in an attempt to “streamline and simplify” the compliance process that arises in this context.

Global Mining Group #1 in Mining Sector Corporate Finance for 2007

Stikeman Elliott was ranked #1 by the Financial Post as legal advisers on equity offerings in the mining sector in 2007. The firm was first by deal value in acting for underwriters (over \$2.2 billion) and in acting for issuers and underwriters combined (over \$2.97 billion), including acting on the year's top deal, the \$1.2 billion IPO by Franco-Nevada Corp., and 5 of the top 10 largest deals of the year.

First, the category of “excluded property” will be expanded to exempt from the section 116 compliance process the disposition of a property by a non-resident that is, at the time of its disposition, a “treaty-exempt property” of the non-resident. A property will be considered a “treaty-exempt property” of a non-resident at the time of its disposition if the income or gain from the disposition of that property by the non-resident would be exempt from tax in Canada because of a tax treaty in force at that time and, in the case of a disposition between related persons, if the purchaser sends a notice to the CRA, on or before the day that is thirty days after the acquisition of the property by the purchaser, setting out certain basic information about the non-resident seller and the transaction.

Second, the “reasonable inquiry” defence available under section 116 to purchasers of taxable Canadian property from non-residents will be expanded. As indicated above, currently the defence is only available if the purchaser, after reasonable inquiry, had no reason to believe that the seller was not resident

in Canada. Budget 2008 proposes to expand this defence so that the purchaser would also be absolved from liability under section 116 if:

- i) the purchaser concludes after reasonable inquiry that the non-resident seller is, under a tax treaty that Canada has with a particular country, resident in that country;
- ii) the property is a property any income or gain from the disposition of which by the non-resident would be exempt from Canadian tax because of a tax treaty if the non-resident were—because of the tax treaty referred to in (i)—resident in the particular country; and
- iii) the purchaser sends a notice to the CRA, on or before the date that is thirty days after the acquisition of the property by the purchaser, setting out certain basic information about the non-resident seller and the transaction.

In certain instances, a purchaser may simply be unwilling to take any risk arising from the interpretation or application of a particular relieving provision in an ostensibly applicable tax treaty and may, as a result, seek to withhold from the purchase price in order to protect itself. Therefore, as a practical matter, the most significant impact of the proposed changes to the section 116 compliance process may only be on related-party transfers. Whether this was intended or not is unclear.

Finally, a related change proposed by Budget 2008 is to exempt certain non-residents from filing a Canadian income tax return in respect of a disposition of taxable Canadian property. Currently, a non-resident is required to file a Canadian income tax return for any taxation year in which the non-resident (or a partnership of which the non-resident is a member) disposes of taxable Canadian property. This requirement is typically viewed by non-resident investors as an onerous feature of the Canadian tax compliance landscape, particularly in circumstances where no Canadian income tax would be payable because of, for example, the application of a tax treaty. Budget 2008 proposes to ease this burden by exempting non-residents from filing Canadian income tax returns for any taxation year in which the non-resident satisfies all of the following criteria:

- i) no mainstream Canadian tax is payable by the non-resident for the taxation year (including, it would seem, tax on the disposition of the taxable Canadian property);
- ii) the non-resident is not currently liable to pay any amount under the *Tax Act* in respect of any previous taxation year (other than, generally, in respect of certain stipulated amounts for which the CRA has been provided with adequate security); and
- iii) each taxable Canadian property disposed of by the non-resident in the year is either “excluded property” (which, as described above, will now include “treaty-exempt property”) or a property for which the CRA has issued to the non-resident a clearance certificate under section 116 of the *Tax Act*.

For further information, please contact your Stikeman Elliott representative, the author listed above, or any member of our Global Mining group listed on the following page.

Global Mining Group members speaking at Canadian Mining Conference

Toronto partners **Jay Kellerman** and **Quentin Markin** will be speaking at the Toronto Canadian Mining Law & Finance 2008 conference (April 7-8) on "*Resource and Reserve Committees: The Evolution of Corporate Governance for Mining Companies?*" and "*A Primer on Royalties*", respectively. Vancouver partner **Jonathan Drance** will be speaking on the former topic at the same conference in Vancouver (April 14-15). Visit www.mininglaw.ca to register.

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