Goodmans LLP Update

Mining and Natural Resources Law

April 5, 2012

2012 Federal Budget Proposals Applicable to Mining Companies

Environmental Proposals

The 2012 federal budget (the "**Budget**"), released last Thursday, promises legislative changes to the *Canadian Environmental Assessment Act* (the "**CEAA**") that will streamline the federal environmental assessment ("**EA**") process. The central purpose of the proposed changes is to implement a "one project, one review" process, with emphasis on reducing the red-tape and time associated with federal environmental approvals for "major economic projects" (a designation that is not yet defined but is likely to include mines that meet certain criteria). The Budget dedicates new money to the Major Project Management Office, to facilitate its mandate of assisting the proponents of major projects through the federal regulatory approval processes. In March 2012 alone, three new mining proposals were added to the list of projects that the Major Project Management Office will assist.

The streamlining of federal environmental approval processes for major projects will be accomplished by implementing the following priorities:

- Eliminating the need for a federal EA review for smaller projects that create little or no risk to the environment;
- Committing $13.6 million over two years to support consultations with Aboriginal peoples;
- Setting fixed, clear timelines for the EA process, including maximum periods of 24 months for Panel Reviews and 12 months for a standard federal EA; and
- Committing $54 million over two years to the Major Project Management Office Initiative.

Smaller and Mid-Size Projects

In addition to emphasizing major projects, the Budget also bodes well for smaller mining projects or smaller components of mining projects that frequently require provincial EA approvals. To keep its promise to redeploy federal resources to focus on major projects, the Canadian government will need to shift environmental regulation of smaller projects to the provinces. This shift will introduce the concept of equivalency, where comparable provincial approvals will be deemed to satisfy the requirement for a federal approval. Equivalency will help alleviate duplication of environmental review by multiple jurisdictions and should reduce the number of projects requiring a joint Federal-Provincial EA.

Also of note, the Budget promises to amend the *Metal Mining Effluent Regulations* to allow for some discharge of effluent from non-metal diamond and coal mines into certain bodies of water.

Tax Proposals

The Budget proposed two changes to the *Income Tax Act* (Canada) that specifically relate to mining corporations.

Mineral Exploration and Development Tax Credit

The Budget proposes to phase out the corporate tax credit for pre-production mining expenditures. Generally, the current rule allows corporations to claim a 10% credit for certain expenditures incurred for the purpose of:

- determining the existence, location, extent or quality of a mineral resource in Canada ("**Exploration Expenses**"); and
- bringing a new mine into production ("**Pre-Production Development Expenses**").

The credit is only available in respect of minerals that are diamonds, base or precious metals, and industrial minerals that become base or precious metals through refining.

This credit remains unchanged for expenditures incurred in 2012. However, the Budget proposes to reduce the available credit for Exploration Expenses to

5% for expenditures incurred in 2013. Thereafter, no credit will be available for Exploration Expenses. The credit for Pre-Production Development Expenses will remain at 10% for expenditures incurred in 2012 and 2013, but will be reduced to 7% for expenditures incurred in 2014 and to 4% for those incurred in 2015. No credit will be available for expenditures incurred thereafter.

Some transitional relief is available in respect of certain expenses agreed to or contemplated before the date of the Budget.

Mineral Exploration Tax Credit for Flow-Through Shares

In addition to deducting Canadian exploration expenses, individuals who invest in flow-through shares are entitled to a 15% tax credit for certain specified exploration expenses renounced to them. This measure was originally introduced in the 2000 federal budget as a temporary measure to encourage and support access to capital for mining corporations.

Past budgets have the extended temporary credit on an annual basis. In keeping with this, the Budget proposes to extend this tax credit for one year. Accordingly, flow-through shares issued pursuant to renunciation agreements entered into before April 1, 2013 will qualify for the credit. Given the "look back" rules applicable to flow-through shares, the issuing corporation would have until the end of 2014 to make the requisite qualifying expenditures.

Other Tax Proposals

The Budget also proposed a number of tax changes applicable to all corporations, including mining corporations. Of these, the following two are potentially particularly significant to mining companies.

Thin Capitalization

The "thin capitalization" rules limit the amount of interest that may be deducted in respect of debts owing by a Canadian corporation to certain non-resident lenders, generally lenders who own more than 25% of the votes or value of the Canadian corporation, or who do not deal at arm's length with such a shareholder. Currently, a portion of a Canadian corporation's interest deduction will be denied where the debt owing to such lenders exceeds a 2:1 debt to equity ratio. The Budget proposes to reduce this ratio to 1.5:1.

Foreign Affiliate Dumping

The Budget also introduced a new set of rules applicable to Canadian corporations controlled by a non-resident corporation. Generally, where such a Canadian corporation makes an investment in a foreign affiliate, the Canadian corporation may be deemed to have paid a dividend to its foreign parent. The deemed dividend would be subject to Canadian withholding tax. Where shares of the Canadian corporation are issued as payment for the foreign affiliate investment, a deemed dividend will not arise but rather the paid-up capital of the shares will be reduced. An investment in a foreign affiliate is defined broadly to include an acquisition of shares or debt of a foreign affiliate (including options to acquire such shares or debt) as well as capital contributions made to the affiliate. The Budget provides an exemption from this rule where the transactions in question satisfy a business purpose test.

Please contact any member of the Goodmans Mining and Natural Resources, Tax or Environmental Groups to discuss these changes.