3 August 2020
Global Tax Alert
News from EY Americas Tax

Finance Canada announces extension to incur flow-through qualifying expenditures

On 10 July 2020, Canada's Department of Finance announced proposals to change the flow-through share rules in order to alleviate the challenges faced by exploration companies in the mining industry amid the COVID-19 pandemic. The proposals aim to extend the timeline for resource corporations to incur eligible expenses by 12 months. As of the date of writing, legislative amendments to implement the proposals have not been released.

Background

Generally speaking, a resource corporation issues flow-through shares to obtain financing for exploration and development by offering investors the opportunity to obtain the benefit of tax deductions associated with exploration and development expenditures. The flow-through share rules allow a resource corporation and an investor to enter into an arrangement whereby the corporation issues shares to the investor and agrees, in writing, to incur and renounce the qualifying expenditures in the amount of share subscription proceeds within a legislated time frame.

There are two sets of rules that use different reference periods for the qualifying expenditures – these are known as the general rule and the look-back rule. Under the general rule, a corporation must incur the qualifying expenditures within 24 months after the end of the month in which the agreement was entered into.

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Under the look-back rule, the corporation must incur the qualifying expenditures by the end of the calendar year following the year in which the agreement was entered into. Where the look-back rule applies, the issuer is subject to a special tax under Part XII.6 of the *Income Tax Act* on any funds that are unspent on qualifying expenditures (unexpended amount) at the end of each month starting from February to December of the following year. In addition, a 10% penalty tax applies on any unexpended amount if the corporation fails to incur sufficient qualifying expenditures. As well, the tax liability of the investor is adjusted.

Proposed changes

The following are the proposed changes:

1. Extension of the timeline to incur qualifying expenditures by 12 months under the general rule for flow-through share agreements that were entered into on or after 1 March 2018 and before 2021. The corporation now has 36 months as opposed to 24 months to incur and renounce the expenditures.
2. Extension of the timeline to incur qualifying expenditures by 12 months under the look-back rule for flow-through share agreements that were entered into in 2019 or 2020. As a result of the extension, the corporation will have until 31 December 2021 instead of 31 December 2020 for a flow-through share agreement entered in 2019 and renounced by 31 December 2019.
3. Relief provided in respect of Part XII.6 of the *Income Tax Act* for flow-through share agreements entered into in 2019 and 2020. For Part XII.6 of the *Income Tax Act*, the qualifying expenditures are treated as incurred up to one year earlier than the date they are actually incurred. Where the resource corporation fails to meet the extended deadline, the additional 10% penalty tax under Part XII.6 of the *Income Tax Act* would apply and the tax payable of investors would be adjusted accordingly.

Implications

These proposals are a welcome relief for resource corporations that have issued or are planning to issue flow-through shares. However, it will be important for any resource corporations that will rely on these extended timelines to ensure that a review is undertaken of the terms and conditions of any flow-through agreements to determine whether any amendments are required to accommodate the revised timelines as the agreements commonly specify the dates by which qualifying expenditures should be incurred.

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EYG no. 005355-20Gbl

1508-1600216 NY
ED None

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