Incentives for Mineral Exploration

“When and How Much”

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Presentation Outline

1. Canada’s standing as a source of mining exploration financing.
2. Types of incentives for exploration
3. Tax-based incentives, long-term and temporary
4. Timing of the introduction and removal of incentives
5. Effectiveness of incentives
6. Conclusions
Canada’s Share of Worldwide Exploration

1999 Worldwide Exploration Spending by Region (US$ 2.56 B)

- Canada: 12%
- Latin America: 28%
- Pacific/SE Asia: 8%
- United States: 10%
- Rest of World: 8%

2009 Worldwide Exploration Spending by Region (US$ 7.32 B)

- Canada: 16%
- United States: 6%
- Australia: 12%
- China: 4%
- Brazil: 3%
- Chile: 5%
- Peru: 7%
- Mexico: 5%
- South Africa: 3%
- Rest of World: 33%

Source: Metals Economics Group
Mining Companies on Selected Stock Exchanges 2009

Source: TMX Group’s mining presentation, as of June 2009
Types of Incentives for exploration

- In Canada, the vast majority of the incentives for exploration are delivered through the federal provincial and territorial corporate income tax systems.
- The federal corporate income tax act provides for different treatment for exploration for higher value “mineral resource” deposits as opposed to exploration for lower value industrial minerals generally used in the construction industry.
- The provincial and territorial income tax acts generally follow the federal scheme.
- Only minor amounts are provided as direct grants, usually by provinces and territories.
Tax Based Incentives permanent and temporary at Federal level

Long-term Incentives

- The principal incentive for exploration is the 100% deduction from taxable income for Canadian Exploration Expenses (CEE).
- A 10% tax credit for mining CEE.
- Flow-Through Shares (FTS) which allow an oil and gas, mining or renewable energy company to flow the CEE through to their investors for deduction against their personal or corporate taxable income.

Temporary Incentives

- Currently 15% tax credit for surface exploration linked to Flow-Through Shares to create Super Flow-Through Shares.
After-Tax Cost of a $1,000 Investment in Flow-Through Shares
Top Marginal Tax Rates (as of Oct. 2009)

Provinces and Territories

Qué  Man  BC  Sask  Ont  NS  PEI  NB  NFL  NWT  Yukon  Nuv  Alb

Federal Tax Reduction  Federal Tax Credit  Prov/Terr Tax Reduction  Prov/Terr Tax Credit  Net Cost
Timing of introduction of temporary tax incentives

When timed correctly at the bottom of a cycle

To Government
- Addresses government priorities.
- Helps stimulate exploration and encourages risk taking.
- Unusable or unused tax benefits transferred to investors providing a premium on market price of shares.

To Industry
- Provides a lifeline to the junior mining industry when risk financing is difficult to obtain
Timing of removal of temporary tax incentives

- The bottom of a cycle is usually well defined by bankruptcies, layoffs and mine closures and incentives are usually introduced in a timely fashion.
- However, the point at which the recovery from a cycle is robust is much more difficult to determine and incentives are often removed at the wrong time as the cycle turns negative and government deficits become a priority.
Exploration Expenditures versus Metals Price Index

Constant 2008
$ millions

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Other developments:
- 1981, proceeds subject to capital gain tax
- 1985-1994, $100K lifetime capital gains exemption
- 1996, Look back rule
- 2001, capital gain inclusion rate reduced to 50%

Canada’s Natural Resources – Now and for the Future
Annual Percentage Changes in Exploration Expenditures and MPI

Annual Percentage Changes in Exploration Spending (Canada vs. Rest of the World) and in the Metal Price Index (MPI), 2000-2008

Source: Mineral Economics Group data
Effectiveness – Distribution

- 2007 - $2,831 M
- 2008 - $3,280 M
- 2009 - $1,840 M (Revised intentions) ($ millions)

Canada’s Natural Resources – Now and for the Future
Effectiveness – Commodity Emphasis

Exploration Expenditures by Commodity Sought (2008$)

Note: Includes on-mine-site plus off-mine-site activities for field work and overhead
Cost Effectiveness to Government

- For period 1987 – 1991:
  - Federal tax expenditures = $462.9M;
  - Incremental Renunciations = $1,205.6M (49% of actual);
  - Incremental Renunciations / Federal Tax Expenditures = 2.6 {That is one dollar of tax expenditure resulted in $2.6 of new (incremental) exploration spending (from Finance Canada report 1994)}.

- For the period 2000 – 2008:
  - The multiplier is calculated to average 2.3.
Cost Effectiveness to the Public - Mineral Discoveries

- Studies by Queen’s University indicated that the cost of discovering an ounce of gold rose rapidly in the late 1980s, however, Canada’s gold production doubled from 5% to 10% of the global share by 1990.
- Prominent discoveries attributed in part to flow-through shares by the PDAC:
  - Ekati Diamond Mine – NWT
  - Louvicourt Base Metal Mine – Quebec
  - Lindsley Base Metal Mine – Ontario
  - Eskay Creek Gold Mine – BC
  - Nickel Rim South – Ontario.
Conclusions

- Flow-Through Shares have been a key tax incentive for exploration in Canada for half a century with the provision of temporary add-on incentives during difficult times.
- Timing is critical to the success of temporary add-on incentives.
- The timing of new incentives usually corresponds well with the bottom of a cycle and widespread financing difficulties.
- The timing of the removal of incentives is more difficult, since it is complicated by the determination of when the recovery is robust enough to remove the credit and lobbying to keep it.