

2020 Issue No. 63  
17 December 2020

# Tax Alert – Canada

## Finance releases legislative proposals regarding the time extension to incur flow-through qualifying expenditures

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 16 December 2020, the Department of Finance released draft legislative proposals to implement the previously announced measures aimed at extending the timelines for resource corporations to incur eligible expenses by 12 months. The legislative proposals follow on from the Department's 10 July 2020 announcement concerning the flow-through share rules in order to alleviate the challenges faced by exploration companies in the mining industry amid the COVID-19 pandemic. Further details of the July 10, 2020 announcement can be found in our previous [Tax Alert 2020 Issue No. 43](#). The proposals mean that resource companies who have issued flow-through shares would be allowed additional time to incur eligible expenses.

Generally speaking, a resource company 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 company 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. 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 tax 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.

The proposed changes are as outlined below:

1. Extension of the timeline to incur qualifying expenditures by 12 months under the general rules 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 expenses.
2. Extension of the timeline to incur qualifying expenditures by 12 months under the look-back rules 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 versus 31 December 2020 for a flow-through share agreement entered into in 2019 and renounced by 31 December 2019.
3. Relief provided in respect of Part XII.6 tax for flow-through share agreements entered into in 2019 and 2020 under the look-back rules. For Part XII.6 tax, new deeming provisions will apply such that the qualifying expenditures are treated as incurred up to one year earlier than the date they are actually incurred. The provisions will also provide a reduction to the Part XII.6 tax that would otherwise be payable. For example, for agreements entered into in 2019, all qualifying expenditures incurred in 2020 (the normal look-back year) will be deemed to have been incurred in January 2020. Since Part XII.6 tax does not apply to amounts expended in January of the normal look-back year, the result is that any amounts expended in the normal look-back year will be exempt from Part XII.6 tax. Qualifying expenditures incurred in the year following the normal look-back year will be deemed to be incurred 12 months earlier than they are actually incurred. Using the above example, qualifying expenses incurred in 2021 will be deemed to be incurred 12 months earlier for purposes of determining the Part XII.6 tax liability.
4. In addition, the filing and payment deadline in respect of Part XII.6 tax is extended by one year.
5. Where the resource company fails to meet the extended deadline, the additional 10% penalty tax under Part XII.6 would apply and the tax payable of investors would be adjusted accordingly. Accordingly, if the amounts are not actually expended by the end of 2021 (where the agreement was entered into in 2019) or 2022 (where the agreement was entered into in 2020), the additional 10% penalty tax would apply.

These proposals are a welcome relief for resource corporations that had issued or are planning to issue flow-through shares in 2019 or 2020. In particular, corporations using the look-back rules may be able to eliminate their Part XII.6 obligation for agreements entered into in 2019 or 2020 if all qualifying expenses under the flow-through agreement are incurred in the immediately following year.

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.

## **Learn more**

For more information, contact your EY or EY Law tax advisor, or one of the following professionals.

### **West**

**Michael Sabatino - Mining & Metals Tax Leader**  
+1 604 891 8448 | [michael.sabatino@ca.ey.com](mailto:michael.sabatino@ca.ey.com)

**David Pope**  
+1 403 206 5468 | [david.pope@ca.ey.com](mailto:david.pope@ca.ey.com)

### **Central**

**Lee Boswell**  
+1 416 941 1807 | [lee.j.boswell@ca.ey.com](mailto:lee.j.boswell@ca.ey.com)

### **East**

**André Lortie**  
+1 514 879 6686 | [andre.lortie@ca.ey.com](mailto:andre.lortie@ca.ey.com)

#### **About EY**

EY is a global leader in assurance, tax, strategy and transactions and consulting services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation is available via [ey.com/privacy](http://ey.com/privacy). For more information about our organization, please visit [ey.com](http://ey.com).

#### **About EY's Tax Services**

EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit [ey.com/ca/tax](http://ey.com/ca/tax).

#### **About EY Law LLP**

EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit [eylaw.ca](http://eylaw.ca).

#### **About EY Law's Tax Law Services**

EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit <http://www.eylaw.ca/taxlaw>

© 2020 Ernst & Young LLP. All Rights Reserved.

A member firm of Ernst & Young Global Limited.

*This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.*