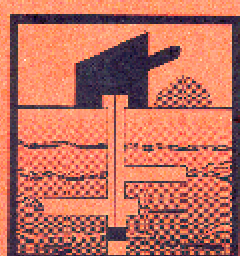

discussion paper

Proposed Amendments to The Northwest Territories Mining Royalty Regime in the Canada Mining Regulations

Indian and Northern Affairs Canada
Affaires indiennes et du Nord Canada

Canada

DISCUSSION PAPER

PROPOSED AMENDMENTS TO

THE NORTHWEST TERRITORIES MINING ROYALTY REGIME

IN THE

CANADA MINING REGULATIONS

FOREWORD

In the Northwest Territories (N.W.T.) the federal government through the Department of Indian Affairs and Northern Development (DIAND), is responsible for the management of water, hydrocarbon and mineral resources, as well as for the administration of most Crown land. The February 27, 1995 federal budget directed the Department of Indian Affairs and Northern Development (DIAND) to review its northern natural resource management legislation and proceed with a comprehensive series of amendments to increase revenues and ensure a fair return to the Crown. As a result, DIAND has initiated a comprehensive review of the mining royalty regime for the N.W.T. in the Canada Mining Regulations. In addition this review will also address changes necessitated by the advent of diamond mining, recent changes to the <u>Income Tax Act</u> and the frequent disagreements with the industry over the interpretation of certain provisions of the regulations.

An interdepartmental committee consisting of DIAND, Finance Canada, Natural Resources Canada, and National Revenue, as well as representatives from the Government of the Northwest Territories was formed to review the mining royalty regime. This committee developed a series of computer models to compare effective tax rates in the N.W.T and other mining jurisdictions, as well as to examine alternatives for, and possible changes to, the existing mining royalty regime. This review process has culminated in the proposed changes to the mining royalty regime set-out in this discussion paper.

This discussion paper is divided into two parts. The first part sets out: the context for the review of the mining royalty regime; the objectives for changing the regime; the methodology used for comparing the effective rates of mining royalty/tax/duty and income taxes in various mining jurisdictions in Canada and abroad; the results of these comparisons; the rationale for retaining the basic structure of the existing royalty regime; an analysis of the proposed changes and their impact on the effective rate of mining royalty and income tax in the N.W.T. relative to other mining jurisdictions. The second part (ANNEX) identifies the provisions of the Canada Mining Regulations that require amendment and sets out in detail the proposed changes to these provisions.

The discussion paper sets out the proposed changes in sufficient detail for the mining companies, exploration companies and the Aboriginal groups that have settled or are negotiating comprehensive land claim agreements in the N.W.T., to actually determine the economic and financial impact of these proposals. As such, it is *aimed at the legal, financial and taxation advisors to these organizations.*

This discussion paper has been sent to mining companies operating in the N.W.T., mining industry associations, and Aboriginal groups which have settled or are negotiating comprehensive land claim agreements in the N.W.T. This document is also available at DIAND's offices in Yellowknife, Northwest Territories and in Hull, Quebec.

DIAND's consultations on this discussion paper will be focussed on individual meetings with mining companies, industry associations and Aboriginal groups in the N.W.T. DIAND will meet with other interested groups on request.

The draft amendments to the Canada Mining Regulations will be published in Part I of the Canada Gazette and interested parties will have 60 days to submit comments. Changes resulting from these comments will again be published in Part I of the Canada Gazette and 30 or 60 days will be allowed for public review depending upon significance of the changes. The regulations will then go to the Governor in Council for approval.

EXECUTIVE SUMMARY

In the Northwest Territories (N.W.T.), the Department of Indian Affairs and Northern Development (DIAND) is responsible for the management of mineral resources. In response to the direction in the February 1995 federal budget, DIAND has initiated a comprehensive review of the mining royalty regime. This review will also address changes needed as a result of the advent of diamond mining in the N.W.T., recent changes to the *Income Tax Act*, and the frequent disagreements with industry over the interpretation of certain provisions of the royalty legislation. The goal of this process is to ensure that the mining royalty regime in the N.W.T.: generates a fair return to the Crown as well as the private sector developers of minerals; maintains a competitive level of taxation on the profits; treats mines of varying profitability equitably; and is clear, straightforward and simple to interpret and administer.

This review has been conducted in cooperation with the federal departments of Finance, Natural Resources and National Revenue, as well as the Government of the Northwest Territories. The review used a series of computer models of different types of mines of varying profitability to analyze options for changing the royalty regime and to compare effective rates of royalty and income taxes in the N.W.T. with those in other mining jurisdictions in Canada and abroad.

A comparison of the effective rate of mining royalty and income taxes under the current regime in the N.W.T. with other mining jurisdictions, indicates that the effective royalty rate in the Canada Mining Regulations is one of the lowest in Canada and among foreign mining jurisdictions and therefore can be increased without affecting the attractiveness of the N.W.T. as a jurisdiction for mining investment.

After extensive analysis, it was concluded that making modifications to the existing royalty regime could meet the objectives of the review without the uncertainties inherent in instituting a new royalty regime. Thus the mining royalty regime will continue to apply to all minerals regulated by the Canada Mining Regulations, including diamonds.

It is proposed that the following changes be made to the royalty regime in the Canada Mining Regulations:

- the 3 year royalty free period be eliminated;
- the annual maximum rates for the depreciation of buildings, plant, equipment and machinery and the amortization of preproduction expenses be increased from 15% to 100%;

- the assets eligible for depreciation be expanded from those used in production to all those used in the operation of the mine;
- the royalty rate on profits over $10,000 but less than $1 million be raised from 3% to 5%;
- the 12% maximum on the royalty rate, which increases 1% for each $5 million of additional profit, be raised to 14%;
- assets eligible for the processing allowance be narrowed to those used directly in processing and purchased prior to the start of commercial production or as part of a major expansion;
- contributions to a mining reclamation trust become deductible for royalty purposes;
- royalty become payable on a quarterly basis rather than 10 months after the end of a mine’s fiscal year and mines be required to make quarterly instalments towards the royalty due for the year;
- conditions be added to the leasing provisions of the regulations to make the mine assets security for unpaid royalty on new leases, to allow the Minister to cancel a lease for non-payment of royalty, and to prohibit the transfer of a lease where there are royalties outstanding without the provision of adequate security to the Minister; and
- diamond production be valued by a federal government appointed valuer prior to sale or export from Canada.

Based on the mine models used in the review, the royalty regime in the Canada Mining Regulations modified as proposed above would result in an effective royalty rate below the average of the effective rates of mining tax/duty in five major mining provinces; British Columbia, Manitoba, Ontario, Quebec and Newfoundland. It would also result in a combined rate of royalty and income tax which would be below the average of the effective rates of mining tax/duty and income taxes in these five provinces. Moreover, the combined effective rate of royalty and income tax in the N.W.T. would remain competitive with the effective rates of taxation on profits in major foreign mining jurisdictions.

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1. **INTRODUCTION**

In the Northwest Territories (N.W.T.) the federal government through the Department of Indian Affairs and Northern Development (DIAND), is responsible for the management of water, hydrocarbon and mineral resources, as well as for the administration of most Crown land. As such, DIAND is responsible for the administration of the *Territorial Lands Act*, and its regulations.

The *Territorial Lands Act* gives the Governor-in-Council the authority to "... make regulations for the leasing of mining rights in, under or on territorial lands and the payment of royalties therefor,...". In the N.W.T., the Canada Mining Regulations provide for the disposition of mineral rights for most minerals, other than industrial and quarry minerals, coal, petroleum and related hydrocarbons, in return for the payment of a royalty to the Crown.

The February 27, 1995 federal budget directed DIAND to proceed with a comprehensive review and amendments to northern natural resource management legislation in order "to increase revenues and ensure a fair return to the Crown." The advent of diamond mining in the N.W.T., and the need of diamond mine developers to have a clear picture of the mining royalty regime prior to making production decisions, has meant that the royalty regime in the N.W.T. is one of the first aspects of northern mineral legislation to be reviewed.

DIAND and mining companies operating in the N.W.T. have frequently disagreed over the interpretation of various royalty provisions in the Canada Mining Regulations. These disagreements point to the need for a broad review of the mining royalty regime that goes beyond the level of revenue generated, to clarify, where necessary, and to simplify, where possible, the interpretation and administration of the legislation. DIAND's experience with the insolvency of Curragh Inc. points to the need for additional provisions in the Canada Mining Regulations related to collection and enforcement. The March 1995 amendments to the *Income Tax Act* providing for the deductibility of contributions to a mining Reclamation trust suggest the need to revise the royalty regime to ensure that such contributions are recognized for the purposes of calculating mining royalties.

2. **OBJECTIVES FOR A MINING ROYALTY REGIME IN THE N.W.T.**

The objectives in revising the royalty provisions of the Canada Mining Regulations are to ensure that the mining royalty regime:

- generates a fair return to the Crown from the extraction of Crown minerals;

- allows a fair return to the private sector developers of Crown minerals;

- maintains a level of income tax/mining royalty which is competitive with other Canadian and international jurisdictions;

- treats equitably mines of different levels of profitability; and

- is clear, straightforward and simple to interpret and administer.

3. **EXISTING N.W.T. MINING ROYALTY REGIME**

The Canada Mining Regulations require each mine to pay an annual royalty to the Crown based upon the value of output of the mine. The value of output for this purpose is defined as the market value of the mine's production less allowable deductions for such items as:

- transportation, smelting and refining costs;
- mine and mill operating costs;
- exploration and development costs at the mine;
- depreciation of the buildings, plant, equipment and machinery used in production at the mine (an allowance of up to 15% of the cost of depreciable assets not to exceed 100% of the original cost of the assets);
- amortization of preproduction exploration and development costs (an allowance of up to 15% of such costs incurred prior to commercial production not to exceed 100% of these costs);
- exploration expenses incurred elsewhere in the N.W.T. up to 10% of market value of production; and
- if the production is further processed in the N.W.T., a processing allowance of 8% of the cost of processing assets to a maximum of 65% of the value of output.

Royalty is levied on this value of output on the following scale

$10,000 to $1 million: 3%
$1 million to $5 million: 5%

with the rate increasing 1% for each additional $5 million in value of output to a maximum of 12% at a value of output of $35 million and above.

No royalties are required to be paid for the first 3 years after the start of commercial production.

4. ROYALTY SHARING UNDER COMPREHENSIVE LAND CLAIM AGREEMENTS

Comprehensive Land Claim Settlements with the Gwich'in, the Sahtu Dene and Metis and the Inuit of the Nunavut Settlement Area provide for these Aboriginal groups to receive a share of the resource royalties, including those from mining, from Crown Land in the N.W.T.

The Gwich'in and the Sahtu Dene and Metis each receive 7.5% of the first $2 million and 1.5% of any additional amounts of resource royalties from the Mackenzie Valley Claim Area.

The Inuit of the Nunavut Settlement Area receive 50% of the first $2 million and 5% of any additional amounts of resource royalties from the Nunavut Settlement Area.

Where DIAND collects royalty on a mineral right under the Canada Mining Regulations which is located on Aboriginal owned subsurface, the Crown remits 100% of the royalty to the Aboriginal group owning the subsurface of the land.

5. METHODOLOGY FOR COMPARATIVE ANALYSIS

In Canada, mining projects are generally subject to three levels of taxation on profits: a mining royalty/tax/duty[1] which is levied by the level of government which owns the resource, the provincial governments in the provinces and the federal government in the N.W.T. and Yukon; a provincial/territorial income tax levied by the provincial and territorial governments; and federal income tax levied by the federal government.

Given the objectives of the review of the mining royalty regime, the first step was to compare the effective rate of mining royalty, as well as the combined effective rate of mining royalty and income taxes, in the N.W.T. with other major mining jurisdictions in Canada (British Columbia, Manitoba, Ontario, Quebec and Newfoundland), as well as a number of international jurisdictions (Alaska, South Africa, Western Australia and Chile). For Quebec the mining duty rules for mines north of 55 degrees latitude have been used, as the operating environment in this part of the province is similar to that found in the N.W.T.

Computer based spreadsheet models were used to compare the impact of the taxation rules for each of these jurisdictions on four specific mine models. The parameters for these four mine models are:

1. Higher Profit Base Metal Mine (Open-pit, pre-tax Internal Rate of Return(IRR) of 25%, 3,000 tonnes per day(tpd), 15 year mine life, average annual revenue of $225 million, total capital investment $400 million)

2. Lower Profit Base Metal Mine (Open-pit, pre-tax IRR of 13%, 3,000 tpd, 15 year mine life, average annual revenue of $150 million, total capital investment $400 million)

3. Higher Profit Gold Mine (Underground, pre-tax IRR of 25%, 2,000 tpd, 22 year mine life, average annual revenue of $135 million, total capital investment $300 million)

4. Lower Profit Gold Mine (Underground, pre-tax IRR of 13%, 2,000 tpd, 22 year mine life, average annual revenue of $100 million, total capital investment $300 million)

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[1] In the N.W.T., the federal government levies a "mining royalty", in Quebec, the provincial government levies a "mining duty" and British Columbia, Manitoba, Ontario and Newfoundland levy a "mining tax". Henceforth, the term "mining royalty" will be used to refer to this type of levy.

A diamond mine model has not been included because there is no information on diamond mining in Canada that is not commercially confidential. A hypothetical diamond mine could resemble any of the above four models depending upon the size, mining method and the structure of capital and operating costs.

For each model, the debt/equity ratio used was 1:1, the interest rate on debt was 10% and on mining reclamation trust balances 6%, and the inflation rate applied to revenues and operating costs was 3%.

Each model was assumed to be a stand-alone mining project. The base metal mine models were assumed to produce and sell concentrate, whereas the precious metal mine models were assumed to produce and sell dore bar. The taxation rules of each jurisdiction were applied on this basis. As such, the results of these models do not take into account the tax benefits in certain jurisdictions of being able to consolidate a number of mines for tax purposes and of further processing incentives for smelting and refining. In these situations the effective rate of mining royalty could vary significantly from those generated by these models.

The effective rate of mining royalty has been calculated by the discounted cash flow IRR method - the IRR of cash flow before mining royalty and income taxes less the IRR of cash flow after mining royalty but before income taxes as a percentage of the IRR of cash flow before mining royalty and income taxes.

The combined effective rate of mining royalty and income tax has been calculated using the same IRR method as was used to calculate the effective mining royalty rate - the IRR of cash flow before mining royalty and income taxes less the IRR of cash flow after mining royalty and income taxes as a percentage of the IRR of cash flow before mining royalty and income taxes.

6. COMPARATIVE ANALYSIS OF EFFECTIVE ROYALTY AND TAX RATES

Effective Mining Royalty Rates

Table 6.1 shows the effective rates of mining royalty on specific projects for the existing mining royalty regime in the N.W.T. as well as the mining royalty regimes of five major Canadian mining provinces.

TABLE 6.1

CURRENT EFFECTIVE MINING ROYALTY RATES BY IRR
N.W.T. AND SELECTED PROVINCES

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
B.C.	5.9%	5.6%	4.6%	3.6%
Manitoba	7.4%	6.4%	6.7%	7.2%
Ontario	11.3%	13.4%	8.5%	7.8%
Quebec	6.0%	7.2%	2.8%	2.4%
Nfld.	5.7%	9.9%	5.8%	8.2%
Provincial Average	7.3%	8.5%	5.7%	5.8%
N.W.T.	3.5%	3.5%	3.1%	2.7%

Based upon the results of these four mine models, with the exception of the gold mine models for the Quebec mining duty regime, the current mining royalty regime in the N.W.T. produces a lower effective rate than the mining royalty regimes in the other major Canadian mining jurisdictions analyzed.

All of the Canadian jurisdictions analyzed have a mining royalty which is profit based.

Manitoba, Ontario, Quebec, Newfoundland and the N.W.T. levy a mining royalty against a mine-mouth value of the minerals produced after deduction of production costs and an allowance for return on the capital employed in further processing - concentrating, smelting and refining. In Ontario and Quebec, this processing allowance increases with the degree of further processing. Manitoba and Ontario both allow processing allowance to be claimed for processing assets located in other Canadian jurisdictions; whereas Quebec, Newfoundland and the N.W.T. limit claims for processing allowance to assets within the jurisdictions.

British Columbia has a two staged system. Stage I tax is a two percent levy on gross revenue less mine operating expenditures. Stage II tax is calculated on "net revenue", which is essentially the cumulative profit derived from the mine after taking into account both operating and capital costs. British Columbia is unique in

Canada in that it lumps all expenses, operating and capital into one pool for deduction purposes. These pooled expenses may be carried forward for use in succeeding years. Stage I tax paid is credited against Stage II tax payable. British Columbia does not have a processing allowance as a deduction in calculating mining tax.

None of these jurisdictions allow interest expense as a deduction for the purposes of calculating mining royalty. However, British Columbia does have an Investment Allowance which is an interest factor to reflect the cost of capital. The unclaimed balance of the expense pool is escalated annually by this Investment Allowance.

British Columbia, Newfoundland and the Canada Mining Regulations levy mining royalty on a mine by mine basis; whereas Ontario, Manitoba and Quebec consolidate all of a company's operations in the jurisdiction into a single entity for mining royalty purposes. In jurisdictions which consolidate all of an operator's mines for mining royalty purposes, the effective rate may vary significantly from the results of a stand-alone project model due to the ability of an operator to use losses from one mine to shelter profits from another mine in that jurisdiction.

All of the provinces examined levy mining royalty at a flat rate on profits after deductions. The N.W.T. levies mining royalty at a graduated rate which increases from 3% to 12% by 1% for each additional $5 million in profit. The graduate royalty rate in the N.W.T. results in an effective royalty rate that generally increases with both profitability and size. This factor explains much of the difference in the effective royalty rates between the smaller gold mine models and the larger base metal mine models of the same profitability.

None of the jurisdictions examined allow the carry-back of losses for mining royalty purposes. None of the jurisdictions, with the exception of British Columbia, allow for the carry-forward of losses for mining royalty purposes. British Columbia does allow the effective carry-forward of losses for mining tax purposes through its system of pooling together of capital and operating expenses.

All of the jurisdictions examined have incentives to encourage new mine investment. In British Columbia, a new mine or expansion of an existing mine qualifies for an additional Investment Allowance of 33% of preproduction development expenditures incurred between 1995 and 1999 on projects which commence production before the end of 1999. Manitoba has a mining tax holiday which is equal to the cost of depreciable assets and development prior to commercial production.

In Ontario, income from a new mine or major expansion of an existing mine is exempt from mining tax for the first 3 years of commercial production to a maximum exemption of $10 million. Quebec has a 10 year mining duty holiday equal to 20% of the capital cost of processing assets for new mines north of the 55th parallel. In Newfoundland, provincial income taxes are a credit against mining taxes payable for the first 10 years of commercial production. In the N.W.T., a new mine is not required to pay mining royalty for the first 3 years after commercial production.

Combined Effective Mining Royalty and Income Tax Rates

In the N.W.T., the federal government levies mining royalty and the territorial government levies a territorial corporate income tax, whereas in the provinces the provincial government levies both the mining royalty and provincial corporate income tax. This allows a provincial government the flexibility to adjust the general level of corporate income tax against the level of taxation applied to the mining industry depending upon the fiscal objectives of the province. Federal corporate income tax is levied at a constant rate in all jurisdictions. As a result, to accurately compare the levels of taxation on mining profits in different jurisdictions, the combined effective rate of federal and provincial/territorial income tax and mining royalty must be examined. This combined effective rate of taxes on mining profits must also be used as the basis for comparisons with foreign jurisdictions, as some foreign jurisdictions only levy a single level of tax on profits, whereas others have more than one level of taxation.

Table 6.2 shows the combined effective rates on the four mine models of the income tax and mining royalty regimes for the N.W.T. and the five major mining provinces analyzed.

TABLE 6.2

CURRENT
COMBINED EFFECTIVE MINING ROYALTY AND INCOME TAX RATES BY IRR
N.W.T. AND SELECTED PROVINCES

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
B.C.	29.1%	34.6%	23.1%	25.4%
Manitoba	29.4%	31.6%	24.9%	28.8%
Ontario	31.3%	36.7%	24.4%	26.0%

Quebec	26.1%	30.8%	19.1%	21.4%
Nfld.	23.9%	30.9%	20.6%	25.6%
Provincial Average	28.0%	32.9%	22.4%	25.5%
N.W.T.	20.5%	22.1%	16.8%	18.1%

Manitoba, Newfoundland and the N.W.T. levy provincial/territorial income tax on the federal taxable income allocated to that jurisdiction. British Columbia, Ontario and Quebec have corporate income tax regimes which differ slightly from the federal rules. For example, British Columbia allows mining taxes paid as a deduction for calculating provincial income tax rather than using a resource allowance as is the case under federal income tax rules. Provincial/territorial corporate income tax rates among the jurisdictions examined range from 8.9% for Quebec to 17% for Manitoba. British Columbia, Manitoba, Ontario and Quebec also have provincial capital taxes which have been included in calculation of provincial income taxes.

The low effective rate of mining royalty in the N.W.T., combined with a relatively low rate of territorial corporate income tax has meant that the combined effective rate of the income tax and mining royalty regime in the N.W.T. is lower than those in the other Canadian jurisdictions analyzed.

Table 6.3 show the combined effective rates of the income tax and mining royalty regimes for the N.W.T. and four selected international jurisdictions which compete with the N.W.T. for mining investment.

TABLE 6.3

CURRENT
COMBINED EFFECTIVE MINING ROYALTY AND INCOME TAX RATES BY IRR
N.W.T. AND SELECTED FOREIGN JURISDICTIONS

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
South Africa	24.1%	27.2%	20.3%	21.0%
Western Australia	26.8%	32.7%	25.0%	32.9%

Alaska	16.4%	18.7%	18.4%	29.1%
Chile	22.0%	22.4%	19.0%	16.8%
Chile Fixed@42%	27.1%	27.6%	23.4%	20.8%
N.W.T.	20.5%	22.1%	16.8%	18.1%

South Africa has different income tax regimes for gold and other businesses, but does not levy a mining royalty. The general income tax system treats all expenses in the same way and is applied to all industries, including mining.

In Western Australia, the Australian federal government levies income tax and the state government levies a mining royalty which is different for each commodity. Mining royalty is generally levied on gross revenue less smelting/refining and transportation costs. Mining royalty is a deduction for the purposes of calculating federal income taxes. The effect of this system is to significantly increase effective tax rates as profitability declines.

For Alaska, the mine models were assumed to be located on state land, which accounts for half of the land open to mining in the state. All mines in the state are subject to federal income tax, federal alternative minimum tax, Alaska state income tax, Alaska state alternative minimum tax and mining licence tax. Those mines located on state land are also subject to a production royalty, which differs according to the commodity. Each of these taxes is calculated on a different base. State income taxes, mining licence tax and production royalties are deductible in calculating federal income tax. For state income taxes only the production royalty is allowed as a deduction. The structure of the federal and state alternative minimum taxes is largely responsible for the fact that the effective tax rates on the higher profit mine models is lower than for the lower profit mine models.

In Chile, mining operations are subject to income tax but not mining tax/royalty. A foreign company investing in Chile has a choice of paying income tax at the regular rate or entering into a contract with the state which fixes the income tax rate at 42% for 10-20 years.

Table 6.3 shows that for the base metal mine models, only the Alaskan income tax and mining royalty regime gives an effective rate lower than in the N.W.T. In the case of the high profit gold mine model, the effective rate of the income tax and mining royalty regime in the

N.W.T. is the lowest of the jurisdictions examined. In the case, of the low profit gold mine model, only the Chilean income tax and mining royalty regime results in a lower effective rate.

Based upon the above analysis, it is clear that there is room to increase the effective rate of mining royalty, without unduly compromising the attractiveness of the N.W.T. as a jurisdiction for mining exploration and development.

7. RATIONALE FOR RETAINING THE STRUCTURE OF THE EXISTING MINING ROYALTY REGIME

Given the above analysis, it is clear that the existing mining royalty regime in the N.W.T. provides the Crown with less than a fair return in the Canadian context. Furthermore, the number of disagreements over interpretation of certain provisions of the legislation indicate that the existing regime could be made clearer, more straightforward and simpler to interpret and administer. On this basis, the federal government is faced with a choice of either changing the current royalty regime or replacing it.

Single Mining Royalty vs. Alternatives

A number of provincial mining royalty and foreign tax regimes were reviewed for possible alternatives to the current royalty regime in the N.W.T. In this review, three broad categories of mining taxation structures were examined: project specific taxation through contract, as in the case of the Argyle Diamond mine in Australia; mineral specific mining taxation, as in Saskatchewan, Alaska and Australia; and a single regime that applies to all hard rock mining, as in the N.W.T.

Project specific taxation was rejected as an option. Such a system provides no certainty to potential mine developers. The level of taxation would be subject to negotiation once the mining company had found a deposit, and therefore would depend upon the expected profitability of the project and the political climate at the time. Moreover, the division of taxation powers between various levels of government would make any such agreement a complex and time consuming endeavour. A project specific agreement on royalty alone would only deal with a relatively small portion of the total taxes levied on a mining project.

Separate royalty regimes for different minerals, as has been suggested in the case of diamonds, was also rejected on the basis of equity. Diamond mining is not so significantly different from a technical perspective as to warrant a different structure of royalty. Moreover, there is no justification to levy a different level of royalty on two mines of equal profitability just because they happen to produce different minerals.

On the basis of the above considerations, the mining royalty regime will continue to apply to all minerals regulated by the Canada Mining Regulations, including diamonds. This will ensure that all mines which make the same amount of profit will pay the same amount of royalty regardless of the mineral they produce.

Current Mining Royalty Structure vs. Alternatives

Having decided to retain a single mining royalty regime for all hard rock minerals, the next step was to decide whether to modify the existing royalty regime or replace it with a new regime in order to meet the objectives set out above.

In this context, one alternative that was examined was a two-tiered system with a levy on gross revenue, as in Saskatchewan (uranium), New Brunswick and Australia. This was rejected because our research indicated that while a two tiered mining royalty regime does provide government with a more stable stream of revenue, it imposes an unreasonable royalty burden on mines which are unprofitable during the trough of the metals price cycle.

Other provincial mining royalty regimes were analyzed as alternatives to the existing regime. In this respect, the only provincial mining royalty regime which is significantly different from that in the Canada Mining Regulations is that in British Columbia. The other provinces maintain a more traditional mining royalty levied against a mine-mouth value of the minerals produced after deduction of production costs and a processing allowance. It was decided to maintain the more traditional structure of the mining royalty regime in the N.W.T. rather than replace it with a completely new regime based on the British Columbia model. The objectives for the mining royalty review can be effectively met by revising the existing regime on the basis of ideas borrowed from a number of other jurisdictions. This not only maintains a certain continuity to the mining royalty regime, but also avoids the administrative complexities of implementing a completely new regime.

In addition, the current mining royalty regime in the N.W.T. also has the advantage of providing an incentive for profitable mines to pay some royalty each year if they plan to minimize the royalty paid over the life of the project, without forcing mines to pay royalty when they are not profitable. Under the current system processing allowance cannot be carried forward, while depreciation can be carried forward indefinitely. This provides an incentive for profitable mines to claim the maximum available processing allowance rather than using depreciation. Because the processing allowance claimed is limited to 65% of profit prior to the processing allowance, if a mine is going to claim the maximum available processing allowance, it will automatically pay some royalty.

On the basis of the above considerations, it has been decided to retain the basic structure of the existing mining royalty regime with modifications to meet the federal government's objectives.

8. PROPOSED CHANGES TO THE MINING ROYALTY REGIME

In examining options for modifying the existing mining royalty regime, the mining tax/duty regimes of most of the provinces were reviewed for provisions that could serve as the basis for changes to the royalty regime in the Canada Mining Regulations. A number of possible changes to the regime were modelled both separately and in combination: various royalty holidays as an alternative to the current 3 year royalty free period, different depreciation rates, different processing allowance structures and maximum royalty rates from the current level up to 24%.

Elimination of 3 Year Royalty Free Period

The most straight forward and equitable way of significantly increasing the effective royalty rate would be the elimination of the three year royalty free period. This type of calender based incentive provides significantly more benefit to higher profit mines than lower profit mines. Moreover, the revenue loss to the federal government of such an incentive is unsupportable given the current difficult fiscal situation of the federal government. Therefore, the 3 year royalty free period would be eliminated.

Accelerated Depreciation and Preproduction Allowances

However, to recognize the high risk nature of mining, the annual maximum allowances for depreciation and preproduction costs would be increased from 15% to 100% of the original cost of the assets. This would give a mine the option to completely recover its capital investment for mining royalty purposes prior to actually paying any royalty.

Expansion of Asset Base For Depreciation Allowance

At the moment only the cost of buildings, plant, machinery and equipment used directly in production is eligible for the depreciation allowance. The definition of assets eligible for depreciation allowance will also be broadened to include all buildings, plant, machinery and equipment used in the operation of the mine. This will make capital expenditures on the camps and dedicated town sites that are necessary for the operation of mines in remote areas eligible for the depreciation allowance.

Narrowing of Asset Base for Processing Allowance

The definition of assets for the calculation of processing allowance would be narrowed to those assets used directly in processing and that were purchased prior to commercial production or as part of a major expansion. This would exclude replacement costs and those assets used indirectly in processing from the processing allowance asset base.

Increase in Maximum Royalty Rate

In order to ensure that the Crown receives a fair return on its mineral resources from larger and higher profit operations, the maximum royalty rate would be increased from 12% to 14%. At present, the 12% rate applies to profits of $35 million and above. Under this proposal, profits from $35 million to $40 million would remain subject to the 12% rate, profits between $40 million and $45 million would be subject to a 13% rate and profits of $45 million and above would be subject to a rate of 14%.

Increase in Initial Royalty Rate

The royalty rate on profits between $10,000 and $1 million would also be increased from 3% to 5%, the same rate as currently on profits between $1 million and $5 million.

Deductibility of Mining Reclamation Trust Contributions

Contributions to a mining reclamation trust that qualifies for the purposes of the *Income Tax Act* will be deductible for royalty calculation purposes in order to recognize the cost of providing this form of security for reclamation obligations under federal legislation in the N.W.T.

Royalty Payable in Quarterly Instalments

Currently, mining royalty becomes payable no later than 10 months after the end of the fiscal year of a mine. In contrast, most provincial mining tax, mining duty and royalty regimes, as well as federal and provincial income tax regimes require the payment of quarterly or monthly instalments of the tax, royalty or mining duty owed. It is proposed that operators be required to make quarterly instalments based upon the lesser of an estimate for the year and the amount paid in the previous year. Interest would become payable on the difference between the instalment paid and one quarter of the royalty owing for the year.

Royalty Related Lease Conditions

A number of specific conditions would be added to the section of the Canada Mining Regulations which deals with mineral leases in order to enable the Crown to enforce the payment of the mining royalties. These conditions would include making the assets of the mine security for amounts of royalty outstanding for new leases, allowing the Minister to cancel a lease for non-payment of royalties and prohibiting the transfer of a lease where there were assessed royalties outstanding without the provision of adequate security to the Minister.

Diamond Valuation Requirement

The royalty provisions would also be amended to require the valuation of diamond production by a federal government appointed valuer prior to sale or export from Canada. Unlike most minerals where the value for royalty purposes can be easily determined based upon quantity and a price quoted on a recognized commodities exchange, the price of diamonds varies according to both quantity and quality. Moreover, as diamonds do not usually trade on open markets, the determination of price is a specialized task. As a result, the governments of most diamond-producing countries generally insist on valuing diamond production prior to sale or export.

9. COMPARISON OF EFFECTIVE TAX AND PROPOSED ROYALTY RATES

Table 9.1 shows the effective rate of the mining royalty regime in the N.W.T. as modified by the above proposals, as well as the current mining royalty regimes of the five major Canadian mining provinces analyzed on the four mine models.

TABLE 9.1

EFFECTIVE MINING ROYALTY RATES BY IRR
PROPOSED N.W.T. REGIME AND SELECTED PROVINCES

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
B.C.	5.9%	5.6%	4.6%	3.6%
Manitoba	7.4%	6.4%	6.7%	7.2%
Ontario	11.3%	13.4%	8.5%	7.8%
Quebec	6.0%	7.2%	2.8%	2.4%
Nfld.	5.7%	9.9%	5.8%	8.2%
Provincial Average	7.3%	8.6%	5.7%	5.8%
N.W.T.	7.1%	7.6%	4.7%	3.8%

Based upon the results of these four mine models, the proposed mining royalty regime in the N.W.T. produces an effective rate which would be still at or below the average of the effective rates of the mining royalty regimes in the other major Canadian mining jurisdictions analyzed. On this basis, the proposed changes do meet the objective of increasing revenue and ensuring a fair return to the Crown, while at the same time maintaining an effective mining royalty rate which is competitive with other major Canadian mining jurisdictions.

Table 9.2 shows the combined effective rates on the four mine models of the income tax and proposed mining royalty regime in the N.W.T. and income tax and mining royalty regimes in the five major mining provinces analyzed.

TABLE 9.2

COMBINED EFFECTIVE MINING ROYALTY AND INCOME TAX RATES BY IRR PROPOSED N.W.T. REGIME AND SELECTED PROVINCES

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
B.C.	29.1%	34.6%	23.1%	25.4%
Manitoba	29.4%	31.6%	24.9%	28.8%
Ontario	31.3%	36.7%	24.4%	26.0%
Quebec	26.1%	30.8%	19.1%	21.4%
Nfld.	23.9%	30.9%	20.6%	25.6%
Provincial Average	28.0%	33.0%	22.4%	25.5%
N.W.T.	25.3%	27.7%	18.9%	19.4%

The effective rate of mining royalty proposed under the Canada Mining Regulations, combined with a relatively low rate of territorial corporate income tax would mean that the combined effective rate of the income tax and mining royalty regime in the N.W.T. would be lower than those in the other Canadian jurisdictions analyzed, except for the higher profit base metal mine model under the Newfoundland regime. However, the Newfoundland provincial government has though indicated that it intends to increase the effective rates of tax on higher profit projects.

Table 9.3 shows the combined effective rates of the income tax and proposed mining royalty regime in the N.W.T. and four selected international jurisdictions which compete with the N.W.T. for mining investment.

TABLE 9.3

COMBINED EFFECTIVE MINING ROYALTY AND INCOME TAX RATES BY IRR PROPOSED N.W.T. REGIME AND SELECTED FOREIGN JURISDICTIONS

	Base Metal High Profit	Base Metal Low Profit	Gold High Profit	Gold Low Profit
South Africa	24.1%	27.2%	20.3%	21.0%
Western Australia	26.8%	32.7%	25.0%	32.9%
Alaska	16.4%	18.7%	18.4%	29.1%
Chile	22.0%	22.4%	19.0%	16.8%
Chile Fixed@42%	27.1%	27.6%	23.4%	20.8%
N.W.T.	25.3%	27.7%	18.9%	19.4%

The higher profit base metal mine model produces a combined effective rate of income tax and mining royalty in the N.W.T which would be higher than that for the Alaskan and regular Chilean regimes, but lower than that for Western Australia or Chile at the fixed 42% rate.

For the lower profit base metal mine model, the combined effective rate of income tax and mining royalty in the N.W.T would be comparable to that in South Africa and to the Chilean Fixed 42% rate regime, but higher than the Alaskan and regular Chilean regimes. In this case, the combined rate for Western Australia would be significantly higher than that for the N.W.T.

For the higher profit gold mine model, the combined effective rate of income tax and mining royalty in the N.W.T would be comparable to that for the Alaskan and regular Chilean regimes, but lower than all of the other regimes analyzed.

For the lower profit gold mine model, the combined effective rate of income tax and mining royalty in the N.W.T would be lower than all of the regimes analyzed with the exception of the regular Chilean regime.

10. CONCLUSIONS

The above analysis indicates that the proposed changes to the mining royalty regime in the Canada Mining Regulations do satisfy the objectives of:

- generating a fair return to the Crown from the extraction of Crown minerals;

- allowing a fair return to the private sector developers of Crown minerals;

- maintaining a level of income tax/mining royalty which is competitive with other Canadian and international jurisdictions; and

- treating equitably mines of different levels of profitability.

The proposed changes also meets the objective of making the mining royalty regime clearer, more straight forward and simpler to administer.

ANNEX

PROPOSED CHANGES TO THE PROVISIONS OF THE CANADA MINING REGULATIONS

The following part of this document deals with the proposed changes to specific provisions of the Canada Mining Regulations. The text dealing with specific changes generally starts with a description of the provision in existing legislation, followed by DIAND's interpretation where necessary, and then the proposed changes are outlined in bold. Where completely new provisions are being added to the regulations the text only deals with the proposed amendment. Certain sections though do not deal with a change to the regulations but set out DIAND's interpretation of certain provisions and have been included in order to provide a complete picture of the royalty regime. The various sections in this part have been loosely grouped together according to topic, such as calculation of the royalty, administrative procedures, penalties, lease conditions, etc., rather than in the order in which they appear in the regulations.

Graduated Royalty Rate

Subsection 65(1) of the Canada Mining Regulations specifies that

> annual royalties shall be paid to Her Majesty in right of Canada on every mine acquired under these regulations on that part of the value of the output of the mine for a fiscal year thereof that exceeds $10,000, in accordance with the following percentages:
>
> (a) that part of the value of the output of the mine exceeding ten thousand dollars but not exceeding one million dollars, three per cent;
> (b) that part of the value of the output of the mine exceeding one million dollars but not exceeding five million dollars, five per cent;
> (c) that part of the value of the output of the mine exceeding five million dollars but not exceeding ten million dollars, six per cent;
> (d) where the value of the output of the mine exceeds ten million dollars, a proportional increase of one per cent for each additional five million dollars in

> excess of the ten million dollars but not exceeding, in any case, twelve per cent.

The royalty rate on that part of the value of output exceeding $10,000 but not exceeding $1 million would be increased from 3% to 5%, so that value of output between $10,000 and $5 million would be subject to a royalty rate of 5%. The current maximum of 12% on the graduated royalty rates in subsection 65(1)(d) would be raised to 14%.

<u>Repeal of the Three Year Royalty Free Period</u>

Subsection 65(3) states that

> any mine that commences production after the coming into force of these Regulations, shall not be required to pay royalties on the operation of the mine for a period of thirty-six months commencing with the date on which the mine commences production.

Subsection 65(3) would be repealed. For any mine which has not completed its 36 month royalty free period, the royalty free period would end on the date the proposed amendments to this regulation came into force.

<u>Definition of Commercial Production</u>

Subsection 65(4) indicates that “for the purposes of subsection (3), the date on which the mine commences production shall be the date determined by the Minister.” The Minister, for the purpose of the Canada Mining Regulations, is the Minister of Indian Affairs and Northern Development.

Normally, the Minister considers the date of commercial production to be the first day of the first ninety-day period throughout which the mill operates consistently at 60% of capacity. Where a mine does not have its own mill, the date of commercial production is considered to be when the mine begins to produce ore in reasonable commercial quantities.

As subsection 65(3) would be repealed, and a determination of commercial production is necessary for other parts of section 65, **subsection 65(4) would be changed to have the date on which a mine commences production for the purposes of section 65 be a date determined by the Chief. The definition of the Chief in section 2 will be updated to be the Director, Mineral Resources, Natural Resources and Environment Branch, to reflect the current organization of the department.**

Depreciation Allowance

Subsection 65(9) specifies that

> no allowance or deduction shall be made in respect of (a) the capital cost of plant, machinery, equipment or building except as provided in paragraph (8)(g);...

Subsection 65(8)(g) provides for

> a depreciation allowance determined by the operator, not exceeding 15 percent per year and 100 percent in the aggregate of the cost to the operator of the depreciable assets used in the production of the output of the mine;

Reading subsections 65(8)(g) and 65(9) together, it is clear that the capital cost of plant, machinery, equipment and buildings not directly used in the production of the output of the mine is not eligible for the depreciation allowance. Such assets would include campsite and town site buildings, and recreational facilities, even though these assets may be part of the mine as defined in section 2.

Original cost for the depreciation allowance excludes any interest that may have been capitalized for accounting or income tax purposes. Similarly, the original cost of a depreciable asset is not reduced by income tax credits directly related to the purchase of the asset, such as investment tax credits.

Where an asset is temporarily not being used in production, the operator is not able to claim depreciation allowance with respect to this asset. Where an asset is no longer being used in production, the undepreciated cost of the asset must be removed from the remaining asset base available for depreciation. Moreover, a loss on the disposal of a depreciable asset is not allowed as a deduction for royalty purposes. Similarly, gains on the disposal of depreciable assets are not taken into income for royalty purposes.

The annual maximum allowance for depreciation would be increased from 15% to 100% in order to allow the deduction of up to the full amount of the original cost of depreciable assets in calculating the value of output in a fiscal year. The total amount of depreciation claimable would remain limited to 100% of the original cost of the assets.

Subsection 65(8)(g) would be changed to broaden the assets eligible for the depreciation allowance to include all buildings, plant, machinery and equipment used in the operation of the mine. This would include residential and recreational facilities located at the mine, but would continue to exclude the capital costs of buildings that are part of a town site not solely dedicated to the mine.

On the date the changes to the regulations come into force, the undepreciated cost of existing plant, machinery, equipment and buildings <u>used directly in production</u> would become eligible for the new 100% depreciation rate. The cost of existing plant, machinery, equipment and buildings <u>not directly used in production</u> would continue to be excluded from the assets eligible for depreciation. Expenditures on all assets used in the operation of the mine incurred after the coming into force of changes would now be included in the assets eligible for depreciation.

<u>Preproduction Allowance</u>

Subsection 65(8)(h) provides for

> ... a preproduction allowance on consideration of the costs to the operator of all expenses incurred for prospecting and for exploration and development of the mine, not exceeding 15 per cent and 100 per cent in the aggregate of all such expenses incurred by the operator of the mine prior to the date on which the mine commenced production;

Subsection 65(9) excludes all capital expenditures on building, plant, machinery and equipment from the asset base for the calculation of preproduction allowance. Thus the cost of assets such as campsite and town site buildings, and recreational facilities, would not be eligible for preproduction allowance even though these costs may be have been incurred prior to the start of commercial production.

Preproduction costs exclude any interest which may have been capitalized for accounting or income tax purposes. Preproduction costs also exclude any exploration expenses previously claimed as an exploration deduction against the value of output of another mine. Preproduction costs are reduced by the market value of any output during the period prior to commercial production.

The annual preproduction allowance would be raised to allow the deduction of up to 100% of preproduction costs in calculating the value of output in a fiscal year. The total amount of preproduction allowance claimable would remain limited to 100% of the preproduction costs incurred.

On the date the changes to the regulations come into force, the unamortized balance of costs eligible for the preproduction allowance would become eligible for amortization at the new 100% rate.

<u>Claiming Depreciation and Preproduction Allowances</u>

It has been DIAND's practice to allow an operator to adjust the claims for depreciation, preproduction allowance and processing allowance if the audit of the return has resulted in an increase in the value of output subject to royalty. **Provisions would be added to section 65 to prevent an operator from increasing the amounts of depreciation and/or preproduction allowance claimed, without the approval of the Chief, where a proposed assessment would result in an increase in the value of output subject to royalty over the amount filed. Where a proposed assessment has reduced the value of output subject to royalty, the operator would still be able to reduce the amounts of depreciation and preproduction allowance claimed.**

<u>Asset Base for the Calculation of Processing Allowance</u>

Subsection 65(8)(j) provides for a deduction in calculating the value of output of a mine for a fiscal year

> if the ore, mineral or mineral bearing substance or any part thereof is not sold in the year but is treated by the operator of the mine within the Territories, [of] an annual processing allowance equal to the lesser of

(i) eight per cent of the original cost to the operator of the mine of the assets used in such processing, including machinery, equipment and plant, and
(ii) sixty-five per cent of the value of the output of the mine as determined under this section before deducting this allowance.

Where an asset is either temporarily or permanently not being used in further processing, the original cost of this asset must be excluded from the asset base for calculating the processing allowance for the year. Where the period of production in any fiscal year is less than 12 months, the 8% processing allowance is prorated based upon the number of months of production.

Subsection 65(8)(j) would be amended to limit the asset base used for the calculation of the processing allowance to the original cost of assets used directly and exclusively in the further processing of the ore. The value of this asset base would be fixed at the cost of processing assets at the start of commercial production. This asset base would be increased by the cost of processing assets added as part of a major expansion of the processing facilities and decreased by the cost of processing assets either temporarily or permanently not being used in processing. A major increase in production would be defined as a change in capacity, as measured by mill feed, of 25% or more. The processing allowance asset base could also be modified because of a significant change to the process used in the processing facilities. In this case, the cost of those assets no longer used in the process would be deleted from the asset base and the cost of the new assets would be added to the asset base. What would constitute a significant change in process would be determined by the Chief.

On the date the changes to the regulations come into force, the processing allowance asset bases of existing mines would be adjusted to exclude those assets not used directly and exclusively in the further processing of the ore.

Definition of Value of Output

Subsection 65(7) specifies that

> ... the value of the output of a mine for a fiscal year is
>
> (a) the actual market value of the output, or

(b) where there is no means of ascertaining the actual market value or where there is no established market price, the amount determined by the Chief as representing the value of the output of the mine for the fiscal year

minus

(c) the deductions permitted by subsection 65(8).

For the purposes of subsection 65(7) the actual market value of the output is the value of a mine's production when it has been processed to the point where it is in a saleable form. Due to a number of factors, namely the differences in the ore grades of various mines, how various minerals are processed and the structures of the markets into which different minerals are sold, this point varies from mine to mine and from one mineral to another. However, it is usually the point at which there is an established market for the output or the point at which the mine normally sells its production. For base metal mines, this point is normally the production of concentrate. For a precious metal mine, this point is normally the production of concentrate or dore bar depending upon the mine. For diamonds, this point will be when the rough diamonds have been cleaned, but prior to any cutting and polishing.

The price used to establish the value of output is the price at the stage where the mine actually sells the output. For example, if a base or precious metals mine refines its production, and then sells the refined metal, the price used to calculate the value of output would be the sale price of the refined metal. At the same time, all costs incurred up to this point would be deductible in calculating the value of output subject to royalty. However, the price used in calculating the value of output will never be at a point in processing beyond refined metal, in the case of base and precious metals, or cleaned rough stones, in the case of diamonds.

Where there is any question as to either the point at which the market value of the output is determined or the price used for calculating the value of output, these are determined by the Chief under subsection 65(7).

Subsections 65(1), 65(7) and 65(8) use the words "value of output" to describe both the gross value of production before deductions, as well as the net value after deductions that is subject to the royalty rates. **The wording of section 65 would be revised using different terms for these two concepts.**

<u>Establishing the Value of Output</u>

Subsection 68(1) provides that

> every person liable to pay the royalties required by subsection 65(1) shall keep at or near the mine proper books of account of the ore, mineral or mineral-bearing substances taken from the mine, showing
>
> (a) the quantity, weight, value and other particulars;
> (b) the returns from the smelter, mill or refinery; and
> (c) any other returns of the amounts derived from the sale of the ore, minerals or mineral bearing substances.

Subsection 68(2) states that

> no ore, mineral or mineral bearing substance taken from a mine shall be removed from the mine property or treated at any smelter, mill or refinery until the weight thereof has been correctly ascertained and entered in the books of account referred to in subsection (1).

Subsection 68(2) would be revised to require that the quantity, weight, and any other particulars necessary to establish the value of the output be ascertained and recorded in the books of account prior to removal from the mine. In addition, to ensure that the output from diamond mines is valued by the government prior to sale or export, **a provision would be added to authorize the Chief to appoint a person to establish the value of the output of a diamond mine prior to the sale or removal of the diamonds from Canada.**

<u>Toll Milling</u>

Subsections 65(7) through 65(9) do not specifically deal with the situation where an operator toll mills his production, that is pays another operator to process his output while retaining ownership of the output.

Provisions would be added to subsections 65(7) through 65(9) to specifically deal with how revenues and costs associated with "toll" milling would be treated for royalty purposes. Where an operator has

used the processing assets at the mine to process ore from another mine, the revenue earned from this activity would not be included in the operator's value of output. However, as the operator's processing assets were not being exclusively used to process production from the mine, the operator's deductions for mill operating costs, the asset bases for depreciation allowance on mill assets and the processing allowance would be reduced by the percentage of total mill feed accounted for by the tolled production.

Tailings Reprocessing

Subsections 65(7) through 65(9) do not specifically deal with the revenue from and costs associated with the reprocessing of tailings.

Provisions would be added to subsections 65(7) through 65(9) to specifically include revenue from and costs associated with tailings reprocessing in the calculation of the value of output of a mine.

Financial Transactions and Accounting Provisions

Subsection 65(9) specifies that

> no allowance or deduction shall be made in respect of: (h) interest on overdrafts, loans, debentures or bonds;...
>
> (n) bond discounts or discounts on shares sold or issued;
>
> (o) increase in reserves or provision for contingencies

DIAND has interpreted these provisions of subsection 65(9) to exclude all income and expenses related to financial transactions from the calculation of a mine's value of output subject to royalty. As such, gains or losses from the sale and purchase of metals futures contracts and options and associated costs, interest income and expense, gains or losses from sales of shares, currency exchange gains or losses, discounts and premiums realized on inventory and receivables financing are all excluded from the calculation of the value of output subject to royalty.
Gains or losses from the sale of assets and losses arising from the write-down of assets are simply accounting provisions, and are therefore not recognized as revenue or expenses in calculating the value of output subject to royalty under subsection 65(9)(o). As such, any write-down of parts inventories due to obsolescence is not deductible as an operating expense for royalty purposes.

Subsection 65(9) would be expanded to specifically exclude these types of revenue and expenses from the value of output subject to royalty.

Transportation Related Expenses

Subsection 65(8)(a) allows the deduction of "transportation charges to the smelter, treatment plant or refinery incurred in the year;" in calculating the value of output subject to royalty. **This subsection would be expanded to specifically include the related actual costs incurred for the selling of the output of the mine, such as storage, handling, transportation insurance, marketing expenses, and duties.**

General and Indirect Expenses

Subsection 65(8)(f) allows the deduction of "general and indirect expenses incurred in the year, ... where such expenses are incurred for property, employees or operations at the mine;" in calculating the value of output subject to royalty. **The list of expenses which are not eligible for an allowance or deduction for royalty purposes in subsection 65(9) would be revised to clarify those general and indirect expenses which are not deductible under subsection 65(8)(f).**

Discretion of the Chief

A provision would be added to subsection 65(8) to give the Chief the authority to limit the amount of the deduction received by the operator for any expense, which is incurred as a result of a non-arms length transaction or a transaction that in the judgement of the Chief is entered into for the sole purpose of reducing the amount of royalty payable, to that amount deemed reasonable by the Chief. Similarly, where a mine earns revenue as a result of a non-arms length transaction, the value of the output of the mine is determined by the Chief as provided for in subsection 65(7).

Exploration Expenses Not Incurred at the Mine

Subsection 65(8)(i) provides for a deduction in calculating the value of output of a mine subject to royalty

> if the costs incurred by the operator of the mine during the year in conducting exploratory

work on land to which these Regulations apply are not claimed by the operator of the mine, or the operator of any other mine under any other provision of these Regulations, the lesser of

(i) the said costs, or

(ii) ten per cent of the total value before deductions of the output of the mine for the year;

Subsection 65(8)(i) was originally intended to allow as a deduction in calculating the value of output, subject to the restrictions indicated in the subsection, costs incurred by the operator of the mine in conducting exploratory work on all lands to which the Canada Mining Regulations apply. Subsequently, section 2 of the Canada Mining Regulations was changed to include a definition of "exploratory work" which limits it to "work done for the purpose of determining the economic potential of a permit area". **Subsection 65(8)(i) would be changed to reinstate the original intent of this provision, namely that all mineral exploration expenditures on lands under the Canada Mining Regulations would be allowed as a deduction in calculating the value of output subject to royalty.**

Exploration expenses may only be claimed by the operator of the mine who has incurred those expenses. For example, exploration expenses incurred by an operator of a mine to earn an interest in another property, are deductible. However, where the operator of a mine has purchased flow-through shares in order to fund exploration on another property, these expenditures are not deductible by the operator of the mine. The cost of acquiring an exploration property is not deductible as an exploration expense.

To ensure against the possibility of an operator, or two operators, receiving two deductions for the same exploration expense, **a provision would be added to subsection 65(8) to require a declaration that any amounts being claimed as an exploration deduction or preproduction allowance had not previously been claimed as either an exploration deduction or as part of the preproduction allowance base of another mine, and are net of any revenue received from the sale of bulk samples.**

Contributions to a Mining Reclamation Trust

Section 65(8) does not allow a deduction for the purposes of calculating the value of output subject to royalty of amounts contributed to a Mining Reclamation Trust.

Section 65(8) would be amended to provide for a deduction for amounts contributed to a Mining Reclamation Trust in that year. Any amounts contributed to a Mining Reclamation Trust prior to the commencement of commercial production would be included in preproduction exploration and development costs eligible for the preproduction allowance.

A Mining Reclamation Trust would be defined as a trust which:

1. **qualifies as a "mining reclamation trust" under subsection 248(1) of the *Income Tax Act*;**
2. **is created by a trust indenture that has been approved by the Minister; and,**
3. **satisfies the requirements of a water licence issued in respect of the mine under the *Northwest Territories Waters Act* or a surface lease issued for the mine under the *Territorial Lands Regulations*.**

Any amounts withdrawn from a Mining Reclamation Trust would be included in the value of output of the mine in the year of withdrawal.

Subsection 65(9)(o), which specifies that no deduction is allowed for any "increase in reserves or provision for contingencies", will be amended to remove any conflict with the provisions in subsection 65(8) allowing the deductibility of contributions to a Mining Reclamation Trust.

Actual reclamation expenditures would continue to be treated as either operating expenses in the year incurred or as depreciable assets in the same manner as other expenses under subsection 65(8).

<u>Change in Mine Ownership</u>

The Canada Mining Regulations levies royalty on a mine-by-mine basis. Therefore, any change in ownership of a mine does not affect asset bases for the calculation of royalty. The unclaimed balance of the asset bases for the depreciation and preproduction allowances, as well as the asset base for the calculation of the processing allowance are transferred to the new owner of the mine.

Any amounts paid to purchase a mine or property may not be included in the asset bases for calculating the depreciation allowance, preproduction allowance or processing allowance. Where exploration and development expenses have been incurred to earn an interest in a property or mine which has not attained commercial production, these amounts may be included in the asset base for the preproduction allowance.

The new owner would become the beneficiary of any existing mining reclamation trust. The unclaimed balance of the deductions available from contributions to the mining reclamation trust as well as the liability for royalty on amounts withdrawn in the future would be transferred to the new owner of the mine.

New Mine Status For an Old Producing Property

Where an operator is producing minerals from a property which had been a mine in the past, whether it is treated as a new mine or a continuation of the old mine is determined by the Chief. This determination is based upon whether the old mine ever ceased to be a mine within the meaning of section 2 of the Canada Mining Regulations.

In section 2 of the Canada Mining Regulations a mine is defined as

> any work or undertaking in which minerals or ore containing minerals are removed from the earth or from talus by any method, and includes works, mills, concentrators, machinery, plant and buildings below or above ground belonging to or used in connection with the mine.

For example, if a mine has been put on care and maintenance, and all of the plant and equipment remains at the site, then when the mine recommences production, the mine would not be treated as a new mine for royalty purposes. If on the other hand, a mine is closed and the equipment is removed from the site and the workings allowed to flood, then when it is reopened it will probably be treated as a new mine for royalty purposes.

Requirement to File a Royalty Return

Section 66 requires "the owner, lessee, tenant, occupier, manager or operator of every mine from which ore, minerals or mineral bearing substance are being taken..." to notify the Mining Recorder of the

start of operations, the name of the mine, the name and address of the operator or other person to whom service under this section may be sent.
Subsection 66 would be modified to include a requirement to file a royalty return with the Chief in addition to the required notification to the Mining Recorder.

Subsection 67(1) requires that

> On or before the first day of the fourth month following the end of the fiscal year of a mine in respect of which royalties are payable, every person liable to pay the royalties required by subsection 65(1) shall deliver to the Mining Recorder a detailed statement in triplicate in Form 18 of Schedule III...

Subsection 67(1) would be modified to require any person required to file a royalty return by section 66 to deliver to the Chief a detailed statement in triplicate in Form 18 of Schedule III on the 15th day of the third month after the end of the fiscal year of the mine, rather than on the first day of the fourth month as is currently the case.

Liability to Pay Royalty

Subsection 65(2) specifies that

> the annual royalties assessed on a mine pursuant to subsection (1) shall be paid to Her Majesty in right of Canada by the owner, manager, tenant, lessee, occupier of operator of the mine and such persons are jointly and severally liable for those royalties.

The list of those liable for the payment of royalty under subsection 65(2) will be expanded to include the holder of any private royalty interest in a property.

Estimate of Royalty Payable in the Next Year

A new section would be added to the royalty return, which is Form 18 of Schedule III of the Canada Mining Regulations, that would require the operator to provide an estimate of the royalty to be payable in the next fiscal year of the mine.

Payment Schedule

Subsection 65(6) indicates that

> During any fiscal year of a mine, the royalty payable under subsection (1) shall accumulate during the year up to the end of the year and payment shall be made to the Receiver General and submitted to the Chief not later than 10 months next following the end of the year.

Subsection 65(6) would be revised so the royalty payable for the year would continue to accumulate during the year, but that one quarter of royalty payable for the year would be owed to the Crown at the end of each quarter of the mine's fiscal year. All mines would be required make quarterly instalments on account of the royalty payable for the year equal to one quarter of the lesser of the royalty paid for the previous year and the operator's estimate of the royalty for the current year. Instalments would be due on the last day of each quarter of a mine's fiscal year for which royalty is payable. The balance of the royalty for the year would be due and payable upon the filing of the royalty return for the year on the 15th day of the third month following the end of the fiscal year of the mine. Interest would be charged on the difference between any instalment paid and one quarter of the royalty owed for the year.

Interest Penalties

Section 155.1 of the *Financial Administration Act* states that "... except as otherwise provided by or pursuant to any other Act of Parliament... interest is payable to Her Majesty in accordance with the regulations on any amount owed to ... " the Crown. On April 1, 1996, the Interest and Administrative Charges Regulations came into effect, making this section of the *Financial Administration Act* operative. Section 27 of the *Territorial Lands Act* stipulates that "whenever interest is payable under or by virtue of this Act or for or on account of any claim, matter or thing arising under any provision of this Act, the rate of interest shall be five per cent per annum...". The net effect of section 155.1 of the *Financial Administration Act,* the Interest and Administrative Charges Regulations and section 27 of the *Territorial Lands Act* is that the rate of interest charged on amounts of royalty owed to the Crown under the Canada Mining Regulations is five per cent per annum.

Penalties

Subsection 30(1) of the *Territorial Lands Act* specifies that anyone "... who contravenes any provision of this Act or any regulation for which no other punishment is provided is guilty of an offence punishable on summary conviction." As no other punishment is specified in the *Territorial Lands Act* for contravention of the provisions of the Canada Mining Regulations, the punishment for a breach of any provision of the Canada Mining Regulations is specified in subsection 787(1) of the *Criminal Code of Canada* to be a fine of up to $2000 and/or 6 months in prison on summary conviction.

Right of Deduction and Set-off

Subsection 155(1) of the *Financial Administration Act* allows that

> where any person is indebted to (a) Her Majesty in right of Canada,... the appropriate Minister responsible for the recovery or collection of the amount of the indebtedness may authorize the retention of the amount of indebtedness by way of deduction from or set-off against any sum of money that may be due or payable by Her Majesty in right of Canada to the person or the estate of that person.

Subsection 155(4) of the *Financial Administration Act* provides that

> no amount may be retained under subsection (1) without the consent of the appropriate Minister under whose responsibility the payment of the sum of money due or payable referred to in that subsection would but for that subsection be made.

Thus once the period for requesting a review of an assessment under section 84 of the Canada Mining Regulations has expired and a royalty assessment remained unpaid, the Minister could make a request to the Minister of any other federal department which owed money to the operator to have the amount of the unpaid royalty assessment deducted from any payment made to the operator by that department.

Appeals

Section 84 provides that

> any person who is dissatisfied with any order, decision or direction or with any other action taken or omitted to be taken under these Regulations by the Supervising Mining Recorder, a Mining Recorder, the Chief, or by an engineer of mines may, within 30 days after the order, decision or direction or the taking of or omitting to take the action, apply to the Minister in writing for a review of the matter and the Minister shall review the matter, provide the applicant with any information considered during his review that is not already of public record that may be lawfully provided and, after allowing 30 days for the applicant to rebut any information so provided, the Minister shall advise the applicant in writing of his final decision with reasons.

A provision would be added to section 84 stipulating that where the operator of a mine was requesting a review by the Minister of a royalty assessment, the operator would be required to submit payment of the amount of the assessment with any request to the Minister to review the assessment in question.

Conditions on the Leasing of Mineral Claims

A number of specific conditions would be added to the provisions of the Canada Mining Regulations dealing with the leasing of mineral claims to enable the Crown to enforce the payment of the mining royalties assessed under section 65.

Subsection 60(4) requires that

> the Chief shall, thirty days after the date on which the rent is due, send to each lessee who has not paid his rent for the year a notice in Form 16 of Schedule III stating the amount of rent due for the year.

Subsection 60(5) provides that

> where the rent due under a lease of a recorded claim is not paid within sixty days from the date indicated on the notice sent pursuant to subsection (4), the Minister may cancel the lease.

Subsection 60(4) would be amended to require the Chief to send to each lessee, who has not paid royalty due, a notice to that effect. This notice would be sent 30 days after the date the royalty was due, or, where a royalty assessment was subject to court challenge, 30 days after the expiry of the appeal period for the court decision. Subsection 60(5) would be amended to allow the Minister to cancel a lease if the royalty due was not paid within 60 days of such notice being given by the Chief.

Subsection 61(1) states that

> a lease of a recorded claim shall be in such form as the Minister may determine and contain such terms and conditions as may be prescribed by these Regulations and other applicable legislation.

Subsection 61(1) would be amended to add that, as a condition of each lease, the lessee would be required to grant the Crown a security interest giving the Crown a first charge over the minerals extracted from the lease, the mining assets located on the lease and the lease itself as security for the payment of any outstanding amounts of royalty assessed on the minerals extracted from the lease.

Subsection 61(3) specifies that

> where a lease lapses or is cancelled,...
>
> (b) the lessee, if he is not under an obligation to pay any moneys to Her Majesty in respect of the lease, may remove from the area covered by the lease all his personal property including any minerals or ore extracted from the claim at any time within
>
> (I) 180 days from the date that the lease lapsed or was cancelled, or
>
> (ii) such additional period, not exceeding one year, as the Minister may fix.

Subsection 61(3) would be expanded to make it explicit that where a lease was cancelled or allowed to lapse, and the lessee owed the Crown moneys in respect of either rent or royalty, the Crown would be able to sell the assets of the lessee located on the lease in order to pay any outstanding debts due to the Crown for rent or royalty with respect to the lease.

Subsection 62(1) provides that “a recorded claim or any interest therein may be transferred at any time to any licensee.”
Section 62(1) would be amended to prohibit the transfer or assignment of a lease where the lessee owed the Crown rent or royalty unless adequate security was provided to the Minister for the amounts outstanding.

Subsection 62(5) states that

> a transfer of a recorded claim or lease or any interest in the claim or lease shall be subject to all liens or encumbrances that are registered, pursuant to subsection 63(1), against the claim or lease at the time of the registration of the transfer.

Subsection 63(1) provides that

> subject to... subsection 62(5), a Mining Recorder shall

(a) register every judgement or order that relates to a claim filed with him and is made by a judge of a court of competent jurisdiction, the Minister, the Supervising Mining Recorder or a Mining Recorder;

Subsection 62(5) would be amended to also make the transfer of a recorded claim or lease subject to any royalty assessment, or any security interest for an amount of outstanding royalty created by a lease under subsection 61(1), that is registered pursuant to subsection 63(1). Subsection 63(1) would be amended to require the mining recorder to register any royalty assessment or security interest for an amount of outstanding royalty created by a lease under subsection 61(1) at the request of the Chief.

Foreign Audits

Subsection 68(4) gives the Chief the power to "... determine the number and type of books to be kept and the place or places at which they shall be kept." **A provision will be added to this subsection establishing that as long as the books of account are located in Canada, the cost of audit for royalty assessment would be borne by the Crown. However, should an operator choose to maintain any books of account for a mine outside of Canada, the operator shall bear the cost of any audit work conducted outside the country by the Crown for royalty assessment purposes.**

Confidentiality of Royalty Returns

Subsection 69(1) authorises that

> the Mining Recorder or any person designated by him may enter any mining property at any time for the purpose of making an inspection or

> obtaining information as to the amount and value of the output of the mine,... but any information of a private or confidential nature acquired by the Mining Recorder or any person entering the mine for the purposes of this section shall not be disclosed to anyone, except as may be necessary for the purpose of this section.

Subsection 69(1) would be modified so that the Chief or any person designated by him could enter any property connected with the mine at any time for the purpose of making an inspection or obtaining information as to the amount and value of the output, but that any commercially confidential information acquired by the Chief or any person entering the mine for the purposes of this section could not be disclosed to anyone, except as may be necessary for the purpose of the administration of the mining royalty provisions of the Canada Mining Regulations.

Another subsection would be added to section 69 to confirm that any information, including Form 18 of Schedule III, provided under the royalty provisions of the Canada Mining Regulations would be considered to be private and confidential and would not be disclosed without the prior consent of the providing party.

Subsection 69 would also authorize the Chief to provide a summary of information contained in royalty returns to the Aboriginal organizations which receive a share of Crown resource royalties pursuant to comprehensive land claim settlement agreements. This information would be provided subject to the consent of the party filing the royalty return and on the condition that it was kept confidential by the officers of the Aboriginal organization designated to receive the Aboriginal share of Crown resource royalties collected.

Exchange of Information Agreements

In order to ensure that, where mining companies have mines in both the N.W.T. and another Canadian jurisdiction, income and expenditures are properly allocated among the jurisdictions in question, **a provision will be added to the Canada Mining Regulations allowing the Minister to enter into agreements with Revenue Canada and provincial and territorial governments to exchange information related to the collection of mining royalty.**