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EFFECTS OF RECENT MINING TAXATION CHANGES IN QUEBEC, ONTARIO, AND MANITOBA

by

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EDITOR'S FOREWORD

This is the second in a series of topical analyses of the effects of federal and provincial budget changes on the Canadian mineral industry. The series is based on the authors' major study, Effects of Taxation on Base Metal Mining in Canada (Kingston: Centre for Resource Studies, 1979), an analysis of actual data compiled on a deposit-by-deposit basis for all major base metal discoveries made during the 1951-74 period.

This paper presents the results of independent research conducted under the auspices of the Centre for Resource Studies, as part of a program of looking into areas of current concern in the Canadian mineral industry. It is offered for information, discussion, and debate, and is an attempt to encourage feedback and further research. The views presented are those of the authors, and do not necessarily represent the views of the Centre nor of its sponsors.

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SUMMARY

Recent mining taxation changes in Quebec, Ontario, and Manitoba significantly increase investment incentive in the base metal sector, particularly in the case of Manitoba. As a result of the changes, tax burdens are much more uniform across the three provinces. Furthermore, Manitoba rises from the bottom to the top of the list, in terms of investment incentive.

The provincial changes increase the number of economically viable deposits, thereby enlarging the actual net value realized. At the same time, governments' share of this increased value is significantly reduced.

The reduced burden of taxation should stimulate new investment in base metal exploration and mine development, particularly in Manitoba, but also in Ontario. The provincial tax measures will also improve Canada's competitive standing in world mineral markets.

By far the most important single provision is the replacement of the two-tier Manitoba mining taxation system by a flat-rate profit tax. The only other provincial change of overall significance is the removal of the two top marginal tax rates for the Ontario mining tax. The Quebec measures are directed towards encouraging realization of the full potential of small mines.

If these provincial mining tax changes are viewed as a response to the improved incentives embodied in the Liberals' November 1978 federal budget, it is clear that they complement the announced federal measures and in some cases more than match the degree of tax relief afforded there.

The 'stock savings plan' announced in the Quebec budget and the 'small business development program' introduced in Ontario could significantly improve investment incentive for smaller mineral enterprises. Although a substantial tax-incentive gap would still remain between large and small companies, and although the measures appear administratively complex, they do address financing and investment problems associated with small-company exploration.

While the provincial changes are consistent with mining industry proposals for tax relief, and with the mutually expressed desire of federal and provincial officials for a healthy mining industry, we have some lingering concerns. In light of the dramatic improvement in metal prices and mining company profits which have occurred in recent months, the provision of new tax incentives at this time may be inadvertently encouraging the imposition of new tax burdens in the longer term.

The continuing process of change which has characterized Canadian tax regimes over the past decade will continue. The fundamental problem which prevents the attainment of stability in mining taxation is the variable, uncertain, and cyclical nature of the base metal sector. The behaviour of the Canadian tax system, as currently formulated, under these conditions will inevitably be unstable. The only solution is a tax policy which has the flexibility to adjust to variable mineral endowment characteristics and unexpected changes in economic conditions. Such a policy, it is suggested, would be in the long-term interests of mining companies, governments, and Canadian society.

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INTRODUCTION

The November 1978 federal budget, introduced by the former Liberal government, contained tax measures of particular importance to the mining industry. These measures, analyzed in an earlier paper,[1] were shown to have potential for increasing investment incentive in the Canadian base metal sector. These provisions were viewed within a framework of mining industry proposals and declared federal-provincial resource taxation objectives. Thus, the budget was considered to represent an opening move by the federal government, laying down a challenge to the provinces for reciprocal action.

The tax-amending bill resulting from the Liberals' November budget was not passed before the election call. At this time, it is not known what the new Conservative government will do. It could either drop or reaffirm the Liberals' proposals. A budget is expected in October.

In the meantime, events have proceeded almost as if the federal budget measures had been enacted. Spurred primarily by a strong upturn in metal prices, mining projects are being re-evaluated and a steady stream of mine expansion and development decisions has been announced, based in part on a perception of the intended federal tax incentives. At the same time, the governments of Quebec, Ontario, and Manitoba have brought down budgets embodying important mining taxation changes.

The purpose of this paper is to assess the effects of the 1979 Quebec, Ontario, and Manitoba budget changes as further steps in the continuing process of mining taxation change.

THE MEASURES ANALYZED

For each provincial budget, we have analyzed the individual and combined effects of two mining tax measures. In addition, we have separately assessed the possible implications, for smaller mineral enterprises, of provisions to credit individuals for the cost of new shares in certain types of corporations.

Quebec Mining Tax Changes[2]

i Tax-exempt income for computing the Quebec mining tax is increased from $150,000 to $250,000 per year, and the taxable income brackets are adjusted accordingly, as shown in table 1. The reduction in tax payments provided by this measure will be of significance to small or marginal mine developers and operators.

1. B.W. Mackenzie and M.L. Bilodeau (6 December 1978).
2. J. Parizeau (27 March 1979).

Manitoba Mining Tax Changes[4]

i A flat-rate profit tax of 18 percent of income replaces the two-tier tax system, whereby a rate of 15 percent was paid on 'normal profits' and a rate of 35 percent was paid on 'excess profits' (normal and excess profits being defined in terms of an 'investment base').

Associated changes are made in the determination of Manitoba mining tax. The 10 percent per year minimum depreciation allowance rule is removed. The processing allowance rate is increased from 8 percent to 10 percent per year of the original cost of processing assets, but the allowable processing assets are more narrowly defined. They include only those assets which are used solely for processing, and exclude costs, previously allowed, that are associated with the use of common service facilities.[5] Furthermore, the processing allowance is now subject to a minimum of 15 percent and a maximum of 65 percent of income for processing allowance.[6]

It is clear that this measure will provide tax relief for existing producers and an increased incentive for new investment, particularly during periods of above-average prices and for the more profitable ventures.

ii A 5 percent investment tax credit is introduced. This credit applies to capital expenditures on mine development, mine plant and machinery, and processing assets, which have been made for the purposes of bringing a new mine into production, carrying out a major expansion, or 'modernizing' existing facilities to increase potential production. The investment tax credit is deducted from the Manitoba mining tax which would otherwise be payable, in effect resulting in a reduction in purchase price by the amount of the credit.[7] Thus, the provision will reduce total tax payments. However, this benefit is offset in part by a requirement that allowable expenditures for depreciation allowance be reduced by the amount of the credit. To this extent, the investment tax credit only shifts the tax burden from earlier to later years.

Possible Relief Mechanisms for Smaller Mineral Enterprises

The 'stock savings plan' announced in the Quebec budget and the 'small business development program' introduced in Ontario are intended to encourage new equity investment by individuals in certain types of business corporations.[8] These measures are viewed here as possible ways of providing those smaller

4. D. Craik (15 May 1979); Manitoba (1979).
5. This provision has apparently been made to ease administration of mining taxation.
6. These are the limits which apply in all other provinces. Previously, a maximum rate of 50 percent was operative in Manitoba.
7. The Manitoba investment tax credit works in basically the same way as the federal tax credit, the indefinite extension of which was proposed in the November 1978 budget.
8. J. Parizeau (27 March 1979); F.S. Miller (10 April 1979).

Table 3

Investment Incentive by Province and Tax System: Base Case Conditions, Shield Region Endowment

	Rate of Return on Investment (Percent)		
	Quebec	Ontario	Manitoba
Pre-tax potential	17.1	17.1	17.1
1978 taxation system	14.0	13.0	11.5
After November 1978 federal budget measures	14.5	13.4	12.1
After November 1978 federal budget measures and 1979 provincial budget changes	14.6	14.2	15.4

Changes in the incidence of taxation associated with these improvements in investment incentive are illustrated in table 4. While governments' share of the actual net value realized is significantly reduced as a consequence of the provincial provisions, it is important to realize that the results shown involve more than a simple trade-off of increased investment incentive for less tax collected. Our analysis shows that the provincial changes increase the number of economically viable deposits, thereby enlarging the actual net value realized. In this respect, the announced tax measures will benefit all concerned – the mining company, governments, and Canadian society.

Table 4

Company and Government Shares of Actual Net Value: Base Case Conditions, Shield Region Endowment

	Share of Actual Net Value Realized (Percent)		
	Quebec	Ontario	Manitoba
1978 taxation system			
Mining companies' share	35.2	27.2	19.8
Governments' share	64.8	72.8	80.2
After November 1978 federal budget measures			
Mining companies' share	37.5	29.5	22.4
Governments' share	62.5	70.5	77.6
After November 1978 federal budget measures and 1979 provincial budget changes			
Mining companies' share	37.7	35.8	45.3
Governments' share	62.3	64.2	54.7

full potential of such deposits is to be realized. Broadening the earned depletion allowance for the Quebec mining tax will be particularly effective in encouraging these activities by reducing their after-tax cost. Such benefits are not reflected in our overall results.

Changes in the pattern of take by different taxation instruments resulting from the federal and provincial budget measures are assessed in table 6. The share of taxation payments attributable to provincial mining tax drops dramatically in the case of Manitoba, is significantly reduced in Ontario, and shows no appreciable change in Quebec. If provincial changes are viewed as a response to the improved incentives embodied in the November 1978 federal budget, then it is obvious that these changes complement the announced federal measures and more than match the tax relief afforded federally, particularly in the cases of Manitoba and Ontario.

Table 6

Federal and Provincial Shares of Taxation Payments: Base Case Conditions, Shield Region Endowment

	Share of Taxation Payments (Percent)		
	Federal Corporate Income Tax	Provincial Corporate Income Tax	Provincial Mining Tax
Quebec			
1978 taxation system	45.3	15.1	39.6
After Nov. 1978 federal budget measures	44.3	15.4	40.3
After Nov. 1978 federal budget measures and 1979 Quebec budget changes	44.4	15.4	40.2
Ontario			
1978 taxation system	40.9	14.0	45.1
After Nov. 1978 federal budget measures	39.8	14.2	46.0
After Nov. 1978 federal budget measures and 1979 Ontario budget changes	43.2	15.5	41.3
Manitoba			
1978 taxation system	38.6	16.1	45.3
After Nov. 1978 federal budget measures	38.0	15.9	46.1
After Nov. 1978 federal budget measures and 1979 Manitoba budget changes	49.3	20.6	30.1

The 'stock savings plan' announced in the Quebec budget and the 'small business development program' introduced in Ontario could significantly improve investment incentive for smaller mineral enterprises as illustrated in table 7. Although a substantial gap between large and small companies still would remain, and although the measures appear administratively complex, they do seem to address the financing and investment problems associated with the exploration activities of smaller mineral enterprises.

CONCLUSIONS

Our analysis indicates that the Quebec, Ontario, and Manitoba budget measures will stimulate substantial investment in exploration and mine development. These changes are a response to mining industry proposals for tax relief.[11] Furthermore, the provisions also appear consistent with the desire, expressed by both federal provincial officials, to work towards a 'healthy' mining industry and to achieve an adequate level of capital investment, growth, and development.[12]

Nevertheless, we view these provincial tax measures with some concern. Recent months have witnessed a dramatic improvement in metal prices. First quarter after-tax profits of major listed Canadian metals and minerals companies are up 450 percent compared to a year ago.[13] Therefore, we are concerned that the provision of new tax incentives to the mining industry at this time may be inadvertently encouraging the imposition of new tax burdens in the longer term.

A stable tax system for the mining industry is a common objective of all concerned. However, the Canadian mining tax system has undergone a continuing process of change over the past decade. We see no evidence that this process is about to end.

Basic geological factors create fundamental problems which bedevil those who seek mining taxation stability. In our view, the imposition of flat-rate profit taxes, such as those which are generally being applied in Canada, will inevitably prove to be unstable because of the variable, uncertain and cyclical nature of the base metal sector.[14]

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11. See, for example, M.A. Upham (23 May 1979).
12. Federal and Provincial Officials (November 1978).
13. Financial Post (16 June 1979), p. 1.
14. The graduated mining tax structures in Quebec and Ontario, and the two-tier Manitoba mining tax now being replaced, illustrate attempts to achieve stability by introducing more flexibility into the tax system. However, it is not clear to what extent the tax base and rates used in these instances respond to the fundamental problems cited. In any case, the recent budget changes indicate a trend back toward more uniform tax rates in such jurisdictions.

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