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ARTICLE

Department of Finance proposes relaxed flow-through share rules

Many junior resource exploration companies have seen their operations interrupted by the COVID-19 pandemic. On July 10, 2020, to help offset the economic burden of this impact, Canada's Department of Finance announced a proposal which would extend the timelines for spending capital raised via flow-through share agreements by 12 months.

What you need to know

- Flow-through share agreements, and the "look-back rule" exception, are available to qualifying junior mining and oil and gas exploration companies.
- In response to the COVID-19 pandemic, the Department of Finance has announced a 12-month deadline extension to allow some companies more flexibility in meeting their flow-through share obligations.
- While the exact details of the proposal have not yet become law, this announcement signals the potential for enhanced opportunities for both investors and issuers of flow-through shares.

Flow-Through share agreements and the "look-back rule"

Under Canada's current *Income Tax Act*, mining and oil and gas companies may enter into flow-through share agreements with investors to effectively transfer the tax benefit of qualifying exploration and development expenses from the company to the investor. This makes the share purchase more attractive to the investor and results in more cash for the issuing company to spend on exploration and development activities.

Companies issuing shares under flow-through agreements are generally required to incur the qualifying expenses in the same year that they are renounced for the benefit of the investor. However, many companies can take advantage of an exception to the general requirement, the "look-back rule", which permits those companies to incur the qualifying expenses in the year following the year in which those expenses are renounced to the investor. Employing the look-back rule provides flexibility to the company but comes with added cost in the form of a monthly tax on the company until it incurs the expenses, as well as narrower qualification requirements for the expenses.

The Department of Finance's proposed changes

The Department of Finance has indicated that it will extend the deadline for an issuer of flow-through shares to incur qualifying expenses renounced to the investor by 12 months. The proposal will add 12 months to the period for incurring expenses under both the general rule and the look back rule. For expenses incurred under the general rule, the extension applies for flow-through share agreements entered into between March 1, 2018 and December 31, 2020. For expenses incurred using the look-back rule, the extension applies for agreements entered into in 2019 and 2020.

The relief may effectively provide the timing benefits available under the look-back rule without the corresponding additional tax cost. The proposal provides relief from the monthly tax normally applicable under the look-back rule, treating expenses as having been incurred one year before they actually were.

Have you optimized your use of flow-through shares?

Companies and investors seeking to take advantage of the flow-through rules may be interested in following developments flowing from the Department of Finance's proposal, combined with the more direct effects of the COVID-19 pandemic on the mining and oil and gas exploration industries and on the investment community. Under flow-through share agreements and associated underwriter's agreements, the issuer typically covenants to spend the full subscription amount that it receives for the issuance of the flow-through shares on qualifying expenses by the end of the current year, or by the end of the following year if the look-back rule is used. Companies will need to review the wording of their agreements to determine whether they can benefit from the proposed relief. Under pre-existing agreements, issuers may be able to benefit from the proposed relief only by failing to meet their contractual covenants to spend the funds before the current year-end. In that case, however, investors will presumably not have indemnity claims against the company, assuming that their tax deductions remain available.

To read the Department of Finance's news release regarding this proposal, please visit the [Government of Canada website here](#).

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