Energy/Natural Resources - Canada

Taxation of Mining Hedging Transactions

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What constitutes 'hedging' for the purposes of the federal Income Tax Act (RSC 1985 (5th Supp) c 1, as amended) may not constitute 'hedging' for the purposes of the Ontario Mining Tax Act (RSO 1990, c M15, as amended). This conflicting treatment arose from the Ontario Court of Appeal's decision in *Place Dome Canada Limited v Ontario (Minister of Finance)* (190 OAC 157 (Ont CA) 2004). However, an appeal is due to be heard by the Supreme Court of Canada, so the decision may be overturned.

Section 3(1) of the Mining Tax Act imposes income tax on the profits earned from the operation of a mine in Ontario. Section 3(5) of the act defines 'profit' as the amount by which "the operator's proceeds for the taxation year from mines" exceed certain listed expenses. Included in a mine operator's proceeds is "all consideration received or receivable from hedging and future sales or forward sales of the output of the mine". The Mining Tax Act defines 'hedging' to include "the fixing of a price for output of a mine before delivery by means of a forward sale or a futures contract on a recognized commodity exchange". 'Output' means any "mineral substances…taken or obtained from any mine in Ontario" for sale as they are or when further processed for sale (Mining Tax Act, Section 1(1)).

As part of a related group of companies, Placer Dome Canada Limited conducted a hedging programme, which included certain financial transactions, so as to insulate the group's financial returns from gold mining operations from fluctuations in the spot price of gold. While the Ontario Court of Appeal recognized that the transactions were within the general scope of 'hedging' as that term is commonly understood, the transactions did not, in the court's view, satisfy the technical definition of 'hedging' in the Mining Tax Act. Since no part of Placer Dome's transactions related to a forward sale or future contract involving the actual delivery of gold production or output from a mine (ie, the transactions involved synthetic derivative contracts), the specific Mining Tax Act definition of 'hedging' was inapplicable. As such, any net gains or profits realized from the transactions were not taxable under the Mining Tax Act (although they were still taxable under the Ontario Corporations Tax Act (RSO 1990, c C40, as amended) and the federal Income Tax Act). In fact, the court's decision was consistent with the Ontario Ministry of Finance's own policy statement, which took effect prior to October 1998.

In contrast, subsequent to the *Placer Dome Case*, the Canada Revenue Agency confirmed in a ruling issued on May 6 2005 that it would continue to follow the Federal Court of Canada decision in *Echo Bay Mines Ltd v The Queen* (92 DTC 6437 (FCTD)). In *Echo Bay* the court found that the definition of 'resource profits' in the Income Tax Act encompasses net gains from synthetic derivative contracts. The agency's continued adoption of *Echo Bay* after *Placer Dome* is based on the position that the Mining Tax Act contains a technical definition of 'hedging' that is narrower than the concept of 'resource profits' under the Income Tax Act. Since a company's resource profits are used for calculating a deduction from income under the Income Tax Act, the *Echo Bay* decision and the agency's continued reliance on it are beneficial to mining companies that realize net gains from synthetic derivative contracts.

Ontario mining operators need to be aware of the different income tax treatment in Canadian and provincial legislation for synthetic derivative contracts in order to plan their affairs in the most tax-efficient manner possible. Consulting a professional tax adviser when structuring transactions can prove to be a worthwhile investment.

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