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TaxNewsFlash Canada

Resource Industry Tax Reporting — Ready, Set, Go

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Oil and gas and mining companies operating in Canada now have the final version of guidance, technical specifications and forms they need to start reporting tax and other payments they make to Canadian and foreign governments under Canada's new reporting regime. Affected businesses must file reports for their fiscal years that begin after June 1, 2015.

The reporting regime is administered by Natural Resources Canada (NRCan). A new website posted by NRCan on March 1, 2016 provides information about the reporting regime, the enrollment and reporting forms and tools for businesses including information sheets, and the final guidance and technical reporting specifications.

The final guidance expands upon the enrollment requirements for reporting businesses and attestation requirements for reports. The guidance also provides more information on the use of reports prepared for other jurisdictions to meet Canadian requirements, among other things.

Background

The new transparency and reporting obligations were enacted by the Extractive Sector Transparency Measures Act (ESTMA) on June 1, 2015. The reporting rules apply to entities that are subject to Canadian law and that are engaged in the commercial development of oil, gas or minerals (for example, exploration or extraction activities) anywhere in the world and that are either listed on a stock exchange in Canada, or have a place of business or are doing business in Canada, or have assets in Canada, and meet two of the following three size-related criteria in one of their two most recent fiscal years (all amounts are in Canadian dollars):

- At least $20 million in assets
- At least $40 million in revenue

- An average of at least 250 employees.

Businesses that meet these requirements must report annually on payments of $100,000 or more, or a series of payments in any category totalling $100,000 or more, made to any level of government in Canada and abroad. Examples of these payments include taxes, licenses, fees, royalties, production entitlements, bonuses, dividends and infrastructure payments. The reporting must be done on a payee basis and on a project basis (for example, an oil field or mining site) when the payments can be attributed to a specific project.

Reports are due no later than 150 days after the business' fiscal year-end, starting with fiscal years that begin after June 1, 2015.

For purposes of these rules, entities include corporations, trusts, partnerships or other unincorporated organizations. These categories extend to similar forms of business organizations both within and outside Canada, for example, unlimited liability corporations, limited partnerships and royalty trusts.

For details, see KPMG's *TaxNewsFlash-Canada* 2015-27, "Resource Companies — Drill Down into New Tax Reporting Regime" and *TaxNewsFlash-Canada* 2014-47, "Resource Companies — Get Ready for Showtime".

Enrollment

NRCan has now released its final forms, guidance and technical reporting specifications for the ESTMA reporting regime. Since the deadline for the first reports is coming up soon, businesses will need to prepare to file these reports on time.

For example, businesses need to enroll with NRCan to receive an ESTMA Identification Number before they submit their first report. NRCan's new website expands on the requirements for companies to enroll and provides the enrollment form. NRCan states that it "encourages enrollment before June 30, 2016."

Substitution of reports prepared for other jurisdictions

The ESTMA legislation provides that businesses may be allowed to use tax reports prepared to meet the reporting requirements of another jurisdiction to meet Canada's requirements where NRCan has determined such reporting requirements are an acceptable substitute. Businesses must still meet ESTMA's publishing requirements using their report prepared under the other jurisdiction's reporting requirements.

NRCan has announced that reports submitted to EU and European Economic Area member countries that have implemented the EU Accounting and Transparency Directives are considered acceptable substitutes for ESTMA reports.

Final guidance and technical specifications — Some questions remain

NRCan released draft guidance and technical reporting specifications for consultation in August 2015 (see *TaxNewsFlash-Canada* 2015-27, "Resource Companies — Drill Down

into New Tax Reporting Regime"). These documents were intended to provide further guidance for resource companies and clarify some issues that remained unclear after the legislation to enact the new regime came into force on June 1, 2015.

Some of these areas have been further clarified in the final versions of the guidance and technical reporting specifications but some questions remain.

Some of the areas of continued uncertainty in the guidance and technical reporting specifications are as follows.

Commercial development of oil, gas and minerals

The reporting rules apply to entities that are engaged in the "commercial development of oil, gas and minerals"; only payments related to such activities are required to be reported. These activities include the exploration or extraction of oil, gas or minerals.

The final guidance notes in section 1 that "Commercial development generally does not include post-extraction activities…However, certain initial processing activities are often integrated with extraction operations, and may comprise commercial development of oil, gas or minerals."

KPMG observation
There may be some uncertainty in the mining industry about which initial processing activities comprise commercial development of minerals. For example, it could be argued that all activities up to and including the production of a concentrate for minerals such as nickel and copper (i.e., grinding of ore through a mill) might be included as "extraction". However, it is not clear how taxes paid on profits derived from smelting of third party feed should be treated.

The final guidance does not include any examples that would help to clarify the cut-off point for these activities. As stated in the final guidance, companies will be responsible for determining whether they are required to report based on the facts and circumstances of their operations.

However, the final guidance notes that NRCan intends at this point to proceed on the basis of the ESTMA legislation alone but that the legislation allows for regulations to be introduced. This option may be pursued if it becomes evident that the implementation of the legislation requires a more formal regulatory framework. As such, it remains to be seen whether regulations may be introduced in the future that could provide more clarity on the types of processing activities that would be included in extraction, among other things.

Application of the reporting regime to non-resident businesses

A non-Canadian resident business that owns a Canadian subsidiary engaged in the commercial development of oil, gas or minerals may be a "Reporting Entity" subject to the ESTMA reporting regime in certain circumstances.

The final guidance states that ESTMA "does not have extra-territorial application to businesses that are not subject to Canadian law." Further, "businesses that are not subject to Canadian law, but may have subsidiaries operating in Canada are not subject to [ESTMA reporting requirements] by virtue of their ownership of or interests in any Canadian subsidiary business, even if the subsidiary itself is a Reporting Entity."

However, section 2 of the final guidance does not provide further clarity on how broadly "ownership of or interests in any Canadian subsidiary businesses, even if the subsidiary itself is a Reporting Entity" is to be interpreted. The concern is whether such interests might be considered "assets in Canada".

KPMG observation
It seems that ownership of a receivable by a foreign parent from a Canadian subsidiary should not result in the foreign parent being subject to ESTMA reporting requirements, assuming the business of the foreign parent is not considered subject to Canadian law.

Treatment of property taxes as a reportable payment

NRCan's guidance addresses the types of taxes that are reportable under the new regime, noting that only taxes that were paid in relation to the commercial development of oil, gas or minerals are reportable.

Concerning the treatment of property taxes, the draft guidance stated, "A Reporting Entity leases office space in a city and pays property tax to that municipality. That payment, while a tax, does not related to commercial development activities that the Reporting Entity is conducting, so would not be required to be reported."

The final guidance adds in section 3.5, "However, some property taxes may relate to commercial development of oil, gas or minerals. For example, property taxes on a building on an extraction site would be a reportable payment."

KPMG observation
This clarification is welcome and should help businesses in their decisions on when to include property taxes in their ESTMA reports.

Subsidiary reporting through a parent entity

In circumstances where a parent and a wholly owned subsidiary of the parent are Reporting Entities for ESTMA purposes, the subsidiary is permitted by ESTMA to report its payments through the parent upon meeting certain reporting conditions.

The final guidance expands upon the circumstances when this relieving provision can be relied upon to include other subsidiary Reporting Entities where the parent does not have 100% ownership. The guidance also expands upon when control of a subsidiary is considered to occur, and specifically indicates in section 2.1.3 that if one business controls another enterprise under the accounting standards applicable to it (e.g., IFRS or U.S. GAAP), that will generally be sufficient evidence of control for ESTMA purposes.

KPMG observation
For IFRS purposes, a subsidiary is defined as an entity that is controlled by another entity. NRCan's clarifications in the final guidance are welcome as they seem to indicate that NRCan will take a similar approach and consider any form of business captured under the definition of "entity" for ESTMA purposes to be a subsidiary that could report through its parent. These entities include a corporation, trust, partnership or other unincorporated organization.

For example, if a parent company (Parentco) owns the controlling interest in a partnership (Partnership), which owns majority interest in the shares of a corporation (Opco) that carries on commercial development of oil, gas or minerals, it appears that Partnership and Opco may be able to report their respective payments through Parentco's report. This approach can help simplify the group's administrative burden.

Attestation of reports

Each ESMTA report must include attestation by a director or officer of the business or an independent auditor that the information is true, accurate and complete, under section 9(4) of the legislation.

The final technical reporting specifications have added that "either option emphasizes that the Reporting Entity (i.e., director or officer of the entity) is responsible for the contents of the ESTMA report, as required by the Act" (see section 2.3.6). The technical reporting specifications also provide some guidance on the form of the report.

Assurance standard for ESTMA audits

The ESTMA legislation provides that NRCan may require an entity to submit an independent audit of its report to verify compliance. The legislation specifies that an audit is to be carried out in accordance with generally accepted auditing standards but does not specify the assurance standard to be followed. (See paragraph 14(1)(d) and section 14(2) of the legislation.)

KPMG observation
The guidance includes administrative concessions that are not included in the legislative provisions of ESTMA. As a result, it appears that any audit opinion for a company relying on these administrative concessions will have to include reference not only to the provisions of ESTMA but also to the administrative practices set out in NRCan's guidance and section 2.3.6 of the technical reporting specifications.

Allocation of income tax payments

Businesses must report payments made to governments in relation to the commercial development of oil, gas or minerals, including income taxes (other than personal income taxes). However, resource businesses may also pay income tax on profits earned on activities that are not considered to fall within the ambit of "commercial development of oil, gas or minerals". (See sections 3.1 and 3.5 of the final guidance.)

KPMG observation

Income tax is often based on an entity's entire net income, which many include income related to the "commercial development of oil, gas or minerals" as defined within ESTMA as well as income from other sources. It is not clear whether NRCan intends for such taxes to be prorated on a particular basis.

Additional clarification as to how such situations should be handled would be helpful for companies with integrated operations.

We can help

Your KPMG adviser can help you assess the impact of the new tax reporting regime on your resource industry company. For details on this new legislation and its implications for your company, contact your KPMG adviser.