

## Federal Government Issues Guidance under the *Extractive Sector Transparency Measures Act*

As we previously discussed in our *June 2015 bulletin*, the *Extractive Sector Transparency Measures Act* (the “**Act**”) was proclaimed into force on June 1, 2015. The Act requires extractive entities active in Canada to publicly disclose, on an annual basis, specific payments made to governments in Canada and abroad.

Draft guidance dated July 29, 2015 was released to help businesses in the exploration and extractive sectors understand the requirements of the Act. The guidance is intended to be practical and illustrative rather than prescriptive. The guidance is also not intended to replace legal advice. The comment period for the guidance expires on September 22, 2015.

### What is a Reporting Entity?

In order to be subject to the Act an entity must be a corporation, trust, partnership or other unincorporated organization that is engaged in the “commercial development of oil, gas or minerals”<sup>1</sup> in Canada or elsewhere, directly or through a controlled organization. Further, in order to be subject to the Act an entity must either be listed on a stock

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<sup>1</sup> “commercial development of oil, gas or minerals” means:

- (a) the exploration or extraction of oil, gas or minerals;
- (b) the acquisition or holding of a permit, licence, lease or any other authorization to carry out any of the activities referred to in paragraph (a); or
- (c) any other prescribed activities in relation to oil, gas or minerals.

“oil” means crude petroleum, bitumen and oil shale.

“gas” means natural gas and includes all substances, other than oil, that are produced in association with natural gas.

“minerals” means all naturally occurring metallic and non-metallic minerals, including coal, salt, quarry and pit material, and all rare and precious minerals and metals.

exchange in Canada or must have a place of business in Canada, conduct business in Canada or have assets in Canada, and must meet at least two of the following conditions for at least one of its two most recent financial years: (i) have at least C\$20 million in assets; (ii) have generated at least C\$40 million in revenue; or (iii) employ an average of at least 250 employees (the “**Size Related Criteria**”).

The four categories of “entity”, namely, corporation, trust, partnership or other unincorporated organization, are intended to be broadly interpreted and extend to similar forms of business organizations both within and outside Canada. If an entity subject to the Act becomes a reporting entity at any point in its financial year, it will be required to report on all payments made within that year even if it did not begin the year as a reporting entity. Individual natural persons and sole proprietorships are not captured within the classes of enterprises that may be an entity under the Act.

### Size Related Criteria

The Size Related Criteria relating to assets and revenue:

1. should be based on the consolidated financial statements of the entity in one of its two most recent financial years;
2. for assets, should be calculated on a gross basis, not a net basis;
3. are not restricted to assets and revenues in Canada or to the assets and revenues from the commercial development of oil, natural gas or minerals. Businesses should include all global assets and revenues in determining whether the Size Related Criteria are met for assets and revenues;
4. in respect of global assets and revenues, only relate to the entity itself and its global operations based on its consolidated financial statements. They do not include the global assets and revenues of a parent company; and
5. if the currency of the consolidated financial statements is not in Canadian dollars, should be calculated in and converted to Canadian dollars either by using (i) the exchange rate as of the entity’s financial year end, or (ii) the entity’s method of

translating the currency of assets and revenues employed in its financial statements.

The Size Related Criteria relating to the number of employees should be based on the average of all employees of the entity over each of its two most recent financial years. Employees include persons residing or employed in Canada as well as in any other jurisdiction and consist of full-time, part-time or temporary employees. Independent contractors do not constitute employees for purposes of the Act.

### Scope of Commercial Development of Oil, Gas or Minerals

Commercial development of oil, gas, or minerals captures two categories of activities: (i) the exploration or extraction of oil, gas or minerals; or (ii) the acquisition or holding of a permit, licence, lease and any other authorization to carry out any exploration or extraction of oil, gas or minerals. Commercial development is not limited to activities within Canada but also includes activities conducted in foreign jurisdictions.

Commercial development is not intended to extend to ancillary or preparatory activities for the exploration or extraction of oil, gas or minerals and generally does not include post-extraction activities. Refining, smelting or processing of oil, gas or minerals as well as the marketing, distribution, transportation or export is generally not captured as commercial development for the purposes of the Act.

Even if a business is not itself directly engaged in the commercial development of oil, gas or minerals, it is an entity for purposes of the Act if it controls a corporation, trust, partnership or other unincorporated organization that is engaged in such development and is not an entity under the Act in its own right. This analysis could, for example, apply to a joint venture or to a direct or indirect foreign subsidiary of a Canadian parent company if the joint venture or subsidiary is engaged in the commercial development of oil, gas or minerals and the Canadian parent is not subject to the Act but is subject to Canadian law.

## Reportable Payments

A reportable payment under the Act must meet the following criteria: (1) be either monetary or in kind; (2) within one of seven enumerated categories; (3) made to a single payee in relation to the commercial development of oil, gas or minerals; and (4) total, as a single or multiple payments, C\$100,000 or more.

## Categories of Reportable Payment

There are seven categories of reportable payments consisting of taxes, royalties, fees, production entitlements, bonuses, dividends and infrastructure improvement payments. All payments made by the reporting entity and by any entity controlled by the reporting entity must be reported.

The tax category is intended to capture income, profit and production tax payments of a reporting entity in relation to the commercial development of oil, gas or minerals. This does not include consumption tax<sup>2</sup>, personal income taxes and withholding taxes. The term “tax” generally refers to any type of government charge that is enforceable by law, imposed under statutory authority, levied by a public body and intended for a public purpose. Examples of taxes that would be reportable under the Act include corporate income and profit taxes, capital gains taxes, capital taxes, mining taxes, windfall profits taxes, resource surcharges and petroleum revenue taxes.

Royalties paid in kind should be treated in the same manner as other in kind payments under the Act.

The category of fees under the Act is substantively broad. It does not matter whether a payment is characterized as a fee or not and whether it is paid in cash or in kind. This category is not meant to include

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<sup>2</sup> Consumption tax is a tax on the consumption or use of goods and services. Typical examples include sales tax, goods and services tax, harmonized sales tax, motor fuel tax, value added tax and use tax. Consumption taxes, even if they related to the commercial development of oil, gas or minerals, are not payments under the Act. Carbon taxes, depending on their design, could be seen as a consumption tax but will need to be assessed by the reporting entity based on the facts and circumstances.

amounts paid in ordinary course commercial transactions in exchange for services provided by governments or government-owned entities. For example, payments made to a state-owned utility for electricity used by an entity's extraction operations are not likely a reportable payment under the Act.

A payee's share of oil, gas or mineral production extracted as part of a commercial development under a production sharing agreement or similar contractual or legislated arrangement should be characterized as a production entitlement under the Act. Production entitlements are often paid on an in kind basis. Reporting entities should report the cash value of the production entitlements of which a payee takes possession during the relevant financial year.

Signing, discovery, production and any other type of bonus paid to a payee in relation to the commercial development of oil, gas, or minerals must be reported under the Act. A payment that is not termed a "bonus", but which in substance is a bonus payment, is reportable under the Act. Share issuances by a reporting entity to a payee that are required by law or as consideration for the issuance of a licensed permit or concession are a typical example of an in kind bonus under the Act.

Dividends paid to a payee as an ordinary shareholder do not need to be reported under the Act, provided that the shares were acquired by the payee for consideration on the same terms as were available at the time of acquisition to other shareholders and the dividends are paid to the payee on the same terms as to other shareholders. Dividends that are paid to a payee on shares received in lieu of a bonus, production entitlements, royalties or any other payment category, on the basis of concessional terms for example, are likely to be reportable under the Act.

Reporting entities that make infrastructure improvement payments to a payee, whether under contractual obligations or otherwise, should report such payments under the Act. For example, if a reporting entity is obliged by a payee to build a road or sewage system, other than in circumstances where the road or sewage system is expected to be primarily dedicated to operational activities throughout its useful life, it

may be required to disclose the cost of building the road or sewage system as a payment to the payee under the Act.

### What is a Payee?

Under the Act, a payee is: (i) any government in Canada or in a foreign state at a national, regional, state/provincial or local/municipal level; (ii) a body that is established by two or more governments, or (iii) any trust, board, commission, corporation, body or authority that is established to exercise or perform, or that exercises or performs, a power, duty or function of the government for a government referred to in (i) above, or a body referred to in (ii) above.

Payees include Crown corporations and other state-owned enterprises that are exercising or performing a power, duty or function of government. Aboriginal and indigenous groups and organizations within Canada and in other jurisdictions may be regarded as governments for purposes of qualifying as a payee under the Act. The Act defers the requirement for reporting entities to report on payments made to Aboriginal governments in Canada until two years after the Act comes into force, i.e. on June 1, 2017. There may be cases where a payment is due to an Aboriginal government but is collected by another body or government and for the purposes of the deferral such payments do not have to be reported at this time.

For purposes of determining whether a series of payments constitute payments to the same payee under the Act, reporting entities must group together departments, ministries, trusts, boards, commissions, corporations, bodies and other authorities that perform or are established to perform a power, duty or function on behalf of a particular level of government, recognizing that there are various organizational structures for governments globally. For example, if several fee payments are made to the National Energy Board, Environment Canada and Natural Resources Canada, which are all Canadian federal bodies, that add up to C\$150,000 a year, a fee payment of C\$150,000 would be reportable. If possible, the report would note three separate payments made to the National Energy Board, Environment Canada and Natural Resources Canada.

## Conclusion

As the Canadian government states in the draft guidance, Canadian extractive companies already operate in a transparent and responsible manner. The Act is intended to bring Canada in line with disclosure measures already in place in certain developed foreign jurisdictions. While the Act draws certain “bright line” applicability conditions, the information and examples provided in the draft guidance are not intended to be exhaustive. Extractive entities active in Canada remain responsible for determining whether and how the Act’s provisions apply to them and for ensuring compliance in light of their particular facts and circumstances.

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### [a cautionary note](#)

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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