Tax Policy for Environmental Restoration Costs and Financial Assurances for Environmental Restoration

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Executive Summary

1. Introduction

The Canadian tax treatment of expenditures on environmental restoration is changing rapidly. In the 1994 Budget, the Federal Government of Canada announced changes in the tax treatment of expenditures on environmental restoration for the mining industry. In the 1996 Federal Budget, the government announced its intention to study the possibility of extending these rules to other sectors, including aggregates, forestry and waste disposal.

The task of defining a fair tax treatment for expenditures on restoration has been complicated by the recent use of environmental trust funds as financial assurance vehicles. Financial assurance is a guarantee that funds will be available for a specific purpose at some future date. In some provinces, governments accept, or even require, cash deposits that are held in trust for restoration at a later date. These trusts give rise to several relatively unique tax issues which have not been fully resolved.

The purpose of this paper is to assess the possibility of extending fair rules for the tax treatment of restoration costs to all sectors of the Canadian economy. In carrying out this study, the paper identifies current issues in the tax treatment of restoration costs and financial assurances, and proposes concrete policy options in the context of current environmental policies and the practices of private companies.

2. Conceptual Framework For The Tax Treatment of Expenditures on Environmental Restoration

When private activities impact on the environment, allocating responsibility for environmental costs is a key environmental policy issue. The responsibility for environmental restoration costs, like any other environmental costs, can fall upon society at large, on specific private interests, or some combination. If financial assurances for environmental restoration are provided, the associated costs too can be distributed in any proportion, between public and private interests.

A subsidy can be defined to occur where restoration costs are paid for by the public, or where the environment sustains long-term damage. Some of the issues in providing a subsidy for environmental restoration include the following:

- *Jobs and Investment* – By changing the cost of doing business, and creating or reducing business opportunities, subsidies may increase or decrease the level of jobs and investment in the economy.

- *Environmental Quality* – By affecting the cost of carrying out environmental restoration activities, subsidies may increase environmental quality.

- *Fiscal Considerations* – By altering the level of government revenue and/or expenditures, subsidies may impact on the overall fiscal position.

If a subsidy is provided through the tax system, rather than through a direct expenditure program, there are further issues to consider. Although tax subsidies, or "tax expenditures" may be simpler in some cases than direct subsidy programs, some of the potential problems associated with tax expenditures include the following:

- *Revenue Uncertainty* – Since tax subsidies may alter behaviour, it is almost impossible to determine the level of expenditure – the cost to the public – before the provision is actually implemented.

- *Potential Inequities in Distribution of Tax Subsidies* – Since it is difficult to target tax expenditures to specific companies, the distribution of the benefit is unpredictable and potentially inequitable.

3. Regulatory Framework for Environmental Restoration and Financial Assurances

3.1 Regulations

Regulatory requirements both for environmental restoration and for financial assurances to ensure that this restoration is carried out vary significantly according to the specific industry sector and province, as follows:

- *Mining Sector* -- Operators generally must outline a closure plan for the protection and reclamation of the land and provide financial assurance to cover future restoration costs prior to commencing mining activities. Regulations typically provide that any financial assurance provided may take one or more of several forms, including cash, bonds, letters of credit, and deposits to site-specific trusts.

- *Aggregates Sector* – As a condition of obtaining a licence or permit to operate a pit or quarry, applicants are generally required to restore the site after damage to the surface of the land. In addition, operators generally must provide financial assurance to cover future restoration costs. In Manitoba and Ontario, this financial assurance takes the form of annual payments to government-managed funds based on the amount of aggregate material removed from the site. In Manitoba, the Quarry Rehabilitation Reserve Account is a general fund from which monies may be drawn to pay for rehabilitation of lands on which quarries are situated. In Ontario, funds are held in separate accounts and refunded to operators with interest upon proof of progressive rehabilitation.

- *Oil and Gas* - In Alberta, operators of oil and gas wells are required to conserve and reclaim sites after drilling or producing oil or gas from a well. Nonetheless, while oil sands and heavy oil operations are subject to regulatory requirements to provide financial assurance to ensure that this restoration is carried out, oil and gas well sites are not subject to this requirement unless so designated by the Minister.

- *Forestry* – Regulations generally stipulate that forestry companies must either pay forest renewal fees to the Crown or assume responsibility for forest renewal themselves. In Quebec and New Brunswick, regulations provide that the cost of plants or planting itself are borne by the government. In British Columbia and Manitoba, forestry companies may be required to provide financial assurance in a form acceptable to the Minister. As well, in Manitoba, Ontario and Saskatchewan, forest renewal fees must be paid into a site-specific account for the purpose of future renewal.

- *Waste Disposal* – Site restoration is required by regulation for waste disposal sites in most provinces. Many provinces also require some form of financial assurance for waste disposal sites.

3.2 Financial Assurance Actually Posted

Environmental trusts and assurances posted in Canada mirror the patchwork regulatory framework. As the following summary explains, the practice of posting some form of financial assurance is wide-spread, but the level and type of assurance varies widely across sectors and provinces.

Canadian companies in the mining, forestry, aggregates, waste disposal and other industries together post hundreds of millions of dollars in environmental financial assurance. Types of assurance currently posted include cash (or liquid assets such as t-bills and bonds) held in trust, (trusts may be site-specific or not) letters of credit, performance bonds, and insurance premiums. Letters of credit seem to be the most common form of assurance.

Site-specific trusts are rarely used and generally contain small amounts of money relative to other forms of assurance. The exceptions to this rule are forest companies in Ontario, which deposited about $95 million into site-specific trust funds last year, and aggregates companies in Ontario, which deposited about $59.5 million. Site-specific trusts are used in the forestry, aggregates and mining sectors but generally do not seem to be used in the waste sector or other sectors.

4. *Current Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration*

In general, four income tax issues are associated with current regulatory requirements both to restore the environment to a state approximating that prior to the specific activity carried on and to provide financial assurances that this restoration will be carried out.

First, where taxpayers are required to restore sites for environmental purposes, it must be decided whether the resulting environmental cleanup expenditures are deductible in computing income for tax purposes or non-deductible capital outlays. Second, assuming that these restoration costs are deductible as business expenses, it is necessary to determine the period in which these expenses may be deducted. Third, where financial assurances are provided in order to ensure that environmental restoration is carried out, one must consider the extent to which costs associated with these financial assurances themselves may be deductible and/or the extent to which the existence of such financial assurances affects the appropriate period in which deductions for environmental cleanup costs may be taken. Finally, where these assurances take the form of specific trusts to which funds are deposited, it is also necessary to decide upon the appropriate tax treatment of the income received by the trusts.

A review of the current tax treatment of restoration costs and financial assurances suggests the following conclusions with respect to each of these issues:

- While Canadian courts have not considered whether environmental restoration costs should be regarded as deductible expenses or non-deductible outlays on account of capital, English and Australian cases have taken opposing views on this question. Nonetheless, as an administrative matter, Revenue Canada appears to have accepted that the costs of environmental restoration are deductible against income and need not be capitalized.

- While generally accepted accounting principles require the costs of future environmental restoration to be matched against current revenues from activities giving rise to the need for future environmental restoration, these costs are generally not deductible for income tax purposes until actually incurred. Although recent decisions suggest that Canadian courts may be more willing to accept matching principle of accounting for the purposes of defining income for tax purposes, both the courts and Revenue Canada are likely to deny current deductions for future expenditures on environmental restoration on the grounds that these expenditures are not "definite and ascertainable" and/or that current obligations to carry out environmental restoration in the future are not "expenses" incurred in the current period.

- Where companies provide financial assurances in respect of environmental restoration obligations, the tax treatment of these financial assurances depends on the character of the financial assurance. Where the financial assurance involves the granting of security (for example, in the form of a letter of credit or performance bond), the amount of the security is not deductible, but a deduction will typically be allowed for expenses such as fees or premiums incurred in respect of this security. Where the financial assurance involves the creation of a trust to which cash or property is deposited under an arrangement whereby the property of the trust may be refunded to the contributor, amounts contributed to the trust are generally not deductible on the basis that they constitute a reserve on account of a contingent liability. On the other hand, where the financial insurance takes the form of payments to a government-mandated site restoration fund, Revenue Canada will allow a current deduction for these payments provided that the payment is not refundable

("irrevocable"), that the payments become "the absolute property" of the government, and that the payor's obligation to restore the site is "discharged contemporaneously". Finally, where the financial assurance qualifies as a "mining reclamation trust" as defined in subsection 248(1) of the *Income Tax Act*, contributions will be deductible under special rules enacted pursuant to the 1994 Federal Budget.

• Where cash or property is deposited to a trust, the tax treatment of income earned by the trust depends on the character of the trust. In general, where the trust property is held on the condition that it may revert to the contributor, subsection 75(2) of the *Income Tax Act* attributes the income of the trust to the contributor. On this basis, the trust income would be taxable to the contributor at the contributor's marginal tax rate as it accrues in the trust. In contrast, where government-mandated site restoration funds provide that deposits may be refunded "with interest" if the payor restores the site, it is likely that this interest is taxable only when deposits are actually refunded. Finally, where the trust is a "mining reclamation trust" within the meaning of the Act, statutory provisions stipulate that the income of the trust is taxable as it accrues and again when funds are withdrawn from the trust.[1]

5. Issues in the Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

The current tax treatment of environmental restoration costs and financial assurances involves a number of potential issues for Canadian governments and businesses. Some issues relate to the uneven application of tax laws across different sectors. Other issues relate to uncertainties in the tax treatment of expenditures on environmental restoration and financial assurances. Still others relate to the definition of an appropriate benchmark for the "neutral" tax treatment of environmental restoration costs and financial assurances in order to determine whether specific tax provisions reflect tax neutrality, a tax penalty or a tax expenditure. Finally, having defined this benchmark, a fourth set of issues are involved in deciding whether or not to depart from this benchmark, and in selecting the specific method, if any, in which such a departure is achieved.

5.1 Uneven Tax Treatment Across Sectors

With respect to uneven tax treatment across sectors, the existence of special rules for mining reclamation trusts alone raises serious issues regarding horizontal equity and economic efficiency. By allowing current deductions only for contributions to mining reclamation trusts, the *Income Tax Act* violates a basic principle of tax fairness. Further, by providing uneven tax treatment across different sectors, the mining trust reclamation

[1] More precisely, the current rules tax the trust at the top corporate rate of tax, tax each beneficiary on its share of the trust income as it accrues in the trust, provide a refundable credit to each beneficiary in an amount equal to its proportionate share of the tax paid by the trust, and tax beneficiaries on all amounts withdrawn from the trust. The net effect of these provisions is to tax the trust income as it accrues at the beneficiary's marginal rate and again when it is withdrawn from the trust.

rules may bias investment decisions and encourage a higher level of reclamation activity in the mining sector than in others.

5.2 Uncertainties in the Current Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

Current legislative, judicial and administrative standards for the tax treatment of environmental restoration costs and financial assurances for environmental restoration suggest three areas of uncertainty:

- Although the mining reclamation trust rules have removed the uncertainty surrounding the current deductibility of contributions for these kinds of financial assurances and the tax treatment of trust income both as it accrues and when it is withdrawn, a degree of uncertainty remains for other sectors for which the mining trust reclamation rules are currently unavailable.
- Although Revenue Canada appears to have accepted, as an administrative practice, that expenditures on environmental restoration constitute deductible expenses rather than non-deductible capital outlays, this characterization issue is uncertain as a matter of law.
- Even if expenditures on environmental restoration are considered to be deductible expenses, a further element of uncertainty persists with respect to the specific taxation year in which these deductions may be claimed.

These uncertainties can lead to inefficient investment decisions on the part of business and distorted revenue and fiscal projections for governments.

5.3 Defining a Benchmark for the Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

Concerns about uncertainty and unevenness suggest that tax rules for environmental restoration costs and financial assurances should be clear and equally applicable to all industry sectors. However, they say nothing about the specific content which these revised tax rules should take. For this purpose, it is necessary to define a benchmark for the neutral income tax treatment of environmental restoration costs and financial assurances, and to evaluate various policy reasons and methods for departing from this benchmark.

We believe that such a benchmark should have the following characteristics:

- Expenditures on environmental restoration should be regarded as deductible expenses for the purposes of determining a taxpayer's income rather than non-deductible outlays on account of capital.

- Although future restoration costs are matched against current revenues when calculating income for accounting purposes, for tax purposes these restoration costs generally should be deductible only when they are actually incurred.

- Nonetheless, where amounts in respect of future environmental restoration are actually set aside in a trust from which funds can be withdrawn only for the purposes of environmental restoration, these amounts should be deductible in the year in which they are set aside.

- Where financial assurance is provided through a letter of credit, performance bond or other similar security, current deductions should be available only for expenses such as fees or premiums incurred in respect of these assurances.

- Where amounts are contributed to a trust for the purpose of future environmental restoration, the income of this trust should be taxable at the contributor's marginal rate as it accrues in the trust. In general, this tax should be payable by the contributor, though it should be able to elect to have the associated tax paid out of the income of the trust.

- Amounts that are withdrawn from the trust for the purposes of environmental restoration should be partly taxable and partly free of tax, with the taxable portion based on the ratio of the aggregate value of deductible amounts contributed to the trust to the total value of all property held by the trust.

5.4 Issues in Departing from the Benchmark Tax Treatment

The definition of a neutral benchmark does not preclude departures from this benchmark in order to achieve particular policy objectives. Nonetheless, it establishes a standard for a fair and neutral tax system, any departure from which should be understood and evaluated not from the perspective of tax policy narrowly defined as the raising of revenues in a fair and neutral manner, but instead from the perspective of the alternative policy objectives sought to be pursued through the tax system.

Governments may choose to depart from a neutral benchmark in the interests of environmental quality, jobs and competitiveness or for fiscal reasons. Departures may take the form of a more generous or more onerous treatment than that suggested by a neutral benchmark. In the former case, departures should be recognized as tax subsidies or tax expenditures; in the latter as tax penalties. In either case, these departures should be evaluated in terms of the specific policy objectives that they are intended to achieve, the likely consequences for other policy objectives, and the availability of other policy measures to achieve the same objective.

6. *Policy Options and Recommendations for the Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration*

In addition to the initial question of whether the tax treatment of environmental restoration costs and financial assurances for environmental restoration should differ by sector, the key options for the tax treatment of environmental restoration costs and financial assurances for environmental restoration relate to the tax treatment of environmental restoration costs when incurred, the tax treatment of future environmental restoration costs, the tax treatment of financial assurances, the tax treatment of the income of environmental trusts.

- When restoration costs are actually incurred they may be recognized as deductible expenses or treated as non-deductible outlays on account of capital.
- Future restoration costs may be deductible upfront according to their treatment for accounting purposes, or deductible only when they represent a current liability to pay a definite amount.
- Where funds are actually set aside for future environmental restoration costs that may be allowed or disallowed as current period deductions for the purposes of income tax. Likewise, where other forms of financial assurance are provided, the economic costs associated with the granting of these assurances may or may not be recognized for income tax purposes.
- Where amounts are deposited to trusts for the purpose of future environmental restoration, the income of these trusts may be taxable or non-taxable as it accrues in the trust, and taxable, non-taxable or partly taxable when it is withdrawn for the purposes of environmental restoration.

On balance, we believe that tax policy, environmental policy and economic policy are best served by a tax system in which environmental restoration costs are deductible in computing income when actually incurred, where amounts contributed to environmental trusts are deductible in the year in which the contribution is made, where the income of these trusts is taxable at the beneficiary's marginal rate of tax as it accrues, where withdrawals from the trust are partly taxable and partly non-taxable based on the ratio of the aggregate value of deductible amounts contributed to the trust to the total value of all property held by the trust, and where these rules apply equally to all industry sectors. To the extent that specific measures are sought to subsidize the costs of environmental restoration or to penalize conduct or activities causing environmental degradation, we believe that further attention should be devoted to the analysis of refundable tax credits for environmental restoration and the study of specific taxes for environmentally harmful conduct or activities.

1. Introduction

The Canadian tax treatment of environmental restoration costs and financial assurances for site restoration is changing rapidly. In the 1994 Budget, the Federal Government of Canada announced changes in the tax treatment of certain kinds of financial assurances for environmental restoration carried out by mining industry. In the 1996 Budget, the government announced its intention to study the possibility of extending these rules to other sectors, including aggregates, forestry and waste disposal.

Changes in the tax system are resulting from changes in societal values. As society places a higher value on environmental quality, companies are increasingly pressured to spend greater sums on environmental restoration. Shareholders and creditors are demanding that companies spend more money on environmental restoration. In some instances, they support putting funds aside to ensure that sufficient financial resources are available in the event of an environmental accident or financial crisis.

At the same time, governments have enacted increasingly stringent regulations requiring companies to make larger expenditures on environmental restoration. As these forces lead private companies to increase expenditures on reclamation, the tax treatment of the expenditures has a greater potential to affect a company's after-tax profits. Ensuring that the tax treatment is fair then becomes a more pressing issue.

The task of defining a fair tax treatment for expenditures on environmental restoration has been complicated by the recent use of environmental trust funds as financial assurance vehicles. A financial assurance is a guarantee that funds will be available at a future date for a specific purpose. In some provinces, governments accept, or even require, cash deposits that are held in trust for clean-up at a later date. These trusts give rise to several relatively unique tax issues which have not been fully resolved.

The purpose of this paper is to assess the possibility of extending fair rules for the tax treatment of restoration costs to all sectors of the Canadian economy. In carrying out this study, the paper identifies current issues in the tax treatment of restoration costs and financial assurances, and proposes concrete policy options in the context of current environmental policies and the practices of private companies.

In Section 2 we set out a conceptual framework for the tax treatment of expenditures on environmental restoration. In Section 3, we survey current regulatory requirements for environmental restoration and financial assurance, and available data on amounts and types of financial assurance currently set aside or pledged in Canada. In Section 4, we explain the current Canadian tax treatment of environmental restoration costs and financial assurances, both in general and according to the rules for "mining reclamation trusts" introduced in the 1994 Budget. In Sections 5 and 6, we identify relevant policy issues and options, and recommend specific policy measures for the tax treatment of environmental restoration costs and financial assurances.

2. Conceptual Framework for Tax Treatment of Expenditures on Environmental Restoration

2.1 Private Payment for Environmental Costs versus Public Payment

When private activities impact on the environment, allocating responsibility for environmental costs is a key environmental policy issue. Costs can be allocated to society at large, either through financial subsidies for environmental reclamation or through long-lasting environmental degradation. As an alternative, costs can be allocated to the private sector by banning environmental degradation or requiring that private interests pay for any damage they cause. Finally, the costs of environmental degradation can be shared between the broad public and specific private interests.

The allocation of site clean-up and reclamation costs is no exception – the costs of clean-up can be paid for by society at large, by specific private interests, or some combination. Private costs are incurred where companies spend money on reclamation and clean-up. Public costs are incurred where the environment is permanently degraded or where taxpayers subsidize restoration and reclamation activities through direct subsidies and taxation.

The provision of financial assurance – in the form of a trust or otherwise -- for reclamation may also give rise to private sector costs. Whatever the form of any financial assurance costs, they should be considered as a component of the total reclamation expense. Like all other components of the expense, financial assurance costs can be subsidized by the public.

Arguments for and against public subsidization of environmental costs have centered around efficiency and fairness. The potential inefficiency of public subsidization – whether in a monetary form or through environmental degradation – has been demonstrated by economic theorists for decades. Economists have argued that the greatest public benefit will be realized when producers and consumers face the full private and public (spillover) costs of their actions.[1]

A fairness argument for internalization of environmental costs, called the "Polluter-Pays Principle" (PPP) spawned from the economic efficiency argument in the early 1970s. The PPP was developed by the Organization for Economic Co-operation and Development (OECD) in an attempts to establish fair guidelines for sharing environmental costs. The PPP suggests that polluters should bear the full environmental cost of their actions without public subsidy, except in cases where severe socio-economic problems would arise as a result of this approach.[2]

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[1] See, e.g., A.C. Pigou, *The Economics of Welfare* (London: Macmillan & Co., Ltd., 1946).
[2] Organization for Economic Co-operation and Development, *Economic Instruments for Environmental Protection* (Paris: OECD, 1989).

2.2 Jobs and Investment vs. Taxpayer Cost

The OECD's suggestion that subsidies are appropriate in some cases is a recognition that subsidies may be necessary for companies to compete in a global economy. Under a policy of zero subsidies for environmental clean-up, Canadian-based operations may not be able to compete with operations in other countries offering generous subsidies. In turn, Canada may lose investment and jobs. The elimination of all subsidies for environmental restoration and site reclamation may make sense in principle, but may not be practical in a global economy.

In designing appropriate responsibilities for environmental clean-up, the government will have to balance concerns for taxpayer cost with competitiveness. Any subsidies will have to be financed through increased taxes, reduced expenditures, or an increased deficit, all of which can be considered potential costs to taxpayers. Environmental degradation is another form of subsidy that generates costs for society at large. Subsidies may also generate some tax revenue, however, if they help attract investment and create employment.

2.3 Subsidies and Environmental Quality

Financial subsidies for site clean-up and reclamation are likely to affect environmental quality. To the extent that subsidies increase or decrease the cost of site restoration and reclamation, they are likely to discourage or encourage private companies to invest in these activities. One of the considerations in designing environmental policies, therefore, is that a financial subsidy may improve environmental quality.

The regulatory framework will significantly affect the degree to which financial subsidies impact on environmental quality. If the regulatory framework includes strict provisions for financial assurance and a high quality of clean-up/reclamation, financial subsidies are unlikely to affect environmental quality. In this case, the legal requirement for clean-up/reclamation already guarantees a high level of environmental quality. On the other hand, if the regulatory framework and/or the requirement for financial assurance is weak, a financial incentive may encourage companies to undertake clean-up and reclamation activities.

The benefits associated with subsidies that improve environmental quality must be weighed against the costs. Site clean-up and reclamation currently costs Canadian companies hundreds of millions of dollars and could cost several billions of dollars in the mining industry alone.[3] The tradeoff in spending large sums on reclamation is foregone investment or consumption opportunities. Some authors have suggested that these tradeoffs are short-term rather than long-term because, they argue, environmental

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[3] For cost estimate, see, e.g., Mining Association of Canada, *Financial Assurance for Mine Reclamation, Decommissioning and Post Closure Obligations*, September, 1994.

degradation ultimately leads to lower productivity and lower consumption.[4] Governments must weigh these considerations in allocating responsibility for site clean-up and reclamation.

2.4 Fiscal Considerations

Governments must consider their fiscal positions in providing any subsidies. At least in the short-term, subsidies will either result in decreased revenue or increased expenditures. The potential benefits to subsidies will have to be balanced against these direct, short-term costs.

Governments can also attempt to achieve fiscal objectives by providing negative subsidies through the tax system, or "tax penalties". This aggressive approach to raising revenue could be accomplished in two ways. Governments can levy special taxes on particular substances or activities, which have the effect of a penalty on the taxed activity. As an alternative, governments can establish a tax treatment for a particular activity, or type of expenditure, which is more onerous than the general tax treatment of other activities and expenditures.

Tax penalties have the potential to undermine competitiveness and distort investment decisions. As explained above, it is generally accepted that tax penalties on substances or activities that generate costs for society at large can improve the allocation of resources in society and increase society's quality of life in the long-term. Tax penalties that are not designed to compensate society for spill-over costs, however, can harm the economy by discouraging investment in particular activities and unduly increasing the cost structure for some businesses. Governments must reflect on these pitfalls in contemplating any tax penalties designed solely for the purpose of raising revenue.

2.5 Delivering Subsidies Through The Tax System or Through Direct Expenditures

The government can subsidize environmental clean-up and reclamation costs through the tax system or through a direct expenditure program. A subsidy delivered through the tax system is called a tax expenditure. A substantial literature has developed around the use of tax expenditures and the relative merits of these subsidies relative to direct subsidies.[5]

To judge whether a particular tax provision is a tax expenditure, it is necessary to identify a benchmark, or standard tax treatment. Tax expenditures are identified by the relatively generous treatment of particular costs relative to the benchmark. Tax expenditures can

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[4] See, e.g., World Commission on Environment and Development, Our Common Future (Oxford, Oxford University Press, 1987). Also see Michael Keating, *Toward A Common Future* (Ottawa, Ministry of Supply and Services Canada, 1989).

[5] See, e.g., Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures* (Cambridge, Massachusetts: Harvard University Press, 1985). Also see Sheila Block and Allan Maslove "Ontario Tax Expenditures", *Taxes as Instruments of Public Policy* (Toronto: Queen's Printer for Ontario, 1994).

take the form of deductions, exemptions/exclusions and credits. A tax expenditure for environmental clean-up and reclamation, for example, may take the form of a generous deduction or tax credit for expenditures on clean-up.

The potential problems associated with tax expenditures are well documented. One of the main problems is that, unlike direct expenditure programs, it is almost impossible to determine the level of expenditure – the cost to the public – before the provision is actually implemented. This cost uncertainty is a significant issue for reclamation expenditures which can range from tens of millions to even billions of dollars.

It is also difficult to target the benefits of a subsidy through the tax system. Companies might receive different levels of benefit depending on their size, their marginal tax rate, the extent of any available tax losses and the amount of taxable income. The ultimate distribution of benefits through the tax subsidy might be skewed (for example between large and small companies), and therefore inequitable. Direct subsidies could be targeted in a more deliberate and, therefore, potentially more equitable manner.

From an industry perspective, these arguments against tax expenditures are often outweighed by a number of potential advantages. One possible advantage arises from the difficulty in identifying some tax expenditures. To identify a tax expenditure, it is necessary to identify the benchmark tax system – a task that is often complex and certainly not well understood by the general public. If a tax subsidy is more difficult to identify than a direct subsidy, it may be easier to establish without public scrutiny, and to maintain in the long term, than a direct subsidy.

In some instances, tax subsidies may also be simpler to design and easier to comply with than direct subsidies. Depending on the subsidized activity, a direct subsidy program may require detailed criteria for compliance, and extensive, costly monitoring systems. A tax subsidy for the same activity may be relatively straightforward to design and require little scrutiny. The government will have to balance these potential benefits against the potential problems with tax expenditures listed above.

3. Regulatory Framework for Environment Restoration and Financial Assurances for Environmental Restoration

3.1 Introduction

In Section 2, we set out a general conceptual framework for understanding alternative policy approaches to environmental restoration and alternative tax measures that might be adopted with respect to the costs of environmental restoration. In light of this conceptual framework, this section examines existing regulatory approaches in Canada for environmental restoration in various industry sectors and reviews available data on amounts currently pledged or set aside for the purpose of environmental restoration and the forms in which these amounts are pledged. Section 4 considers the tax treatment of these expenditures and financial assurances under the Canadian *Income Tax Act.*[8]

In examining both the regulatory and tax regimes for environmental restoration, it is important to distinguish two separate issues: first, restoration obligations themselves and the income tax treatment of the restoration costs associated with these obligations; second, requirements for financial assurances and the income tax treatment of different kinds of assurances. As this section demonstrates, legislative requirements both to restore the environment and to provide financial assurances that this restoration will be carried out have increased significantly in Canada over the last several years. As section 4 indicates, these developments have in turn posed novel tax issues and industry concerns about the treatment of restoration costs and financial assurances under the *Income Tax Act.*

3.2 Regulations for Environmental Restoration and Financial Assurances

Appendix A reviews regulatory requirements both for environmental restoration and for financial assurances to ensure that this restoration is carried out. Although this review is not comprehensive for all industries or all provinces, it provides a general picture of current regulatory requirements for the mining industry, aggregates, oil and gas, forestry and waste disposal. This review suggests that these requirements vary significantly according to the specific industry sector and province, as follows:

- *Mining Sector* -- Operators generally must outline a closure plan for the protection and reclamation of the land and provide financial assurance to cover future restoration costs prior to commencing mining activities. Regulations typically provide that any financial assurance provided may take one or more of several forms, including cash, bonds, letters of credit, and deposits to site-specific trusts.

- *Aggregates Sector* – As a condition of obtaining a licence or permit to operate a pit or quarry, applicants are generally required to restore the site after damage to the surface of the land. In addition, operators generally must provide financial assurance to cover

[8] RSC 1952, c. 148, as amended by SC 1970-71-72, c. 63, and as subsequently amended [the "Act"]. Unless otherwise noted, all statutory references in this paper are to the Act.

future restoration costs. In Manitoba and Ontario, this financial assurance takes the form of annual payments to government-managed funds based on the amount of aggregate material removed from the site. In Manitoba, the Quarry Rehabilitation Reserve Account is a general fund from which monies may be drawn to pay for rehabilitation of lands on which quarries are situated. In Ontario, funds are held in separate accounts and refunded to operators with interest upon proof of progressive rehabilitation.

- *Oil and Gas* - In Alberta, operators of oil and gas wells are required to conserve and reclaim sites after drilling or producing oil or gas from a well. Nonetheless, while oil sands and heavy oil operations are subject to regulatory requirements to provide financial assurance to ensure that this restoration is carried out, oil and gas well sites are not subject to this requirement unless so designated by the Minister.

- *Forestry* – Regulations generally stipulate that forestry companies must either pay forest renewal fees to the Crown or assume responsibility for forest renewal themselves. In Quebec and New Brunswick, regulations provide that the cost of plants or planting itself are borne by the government. In British Columbia and Manitoba, forestry companies may be required to provide financial assurance in a form acceptable to the Minister. As well, in Manitoba, Ontario and Saskatchewan, forest renewal fees must be paid into a site-specific account for the purpose of future renewal.

- *Waste Disposal* – Site restoration is required by regulation for waste disposal sites in most provinces. Many provinces also require some form of financial assurance for waste disposal sites.

3.3 Summary of Financial Assurance Posted in Canadian Provinces

One of the most contentious issues in the tax treatment of expenditures on environmental restoration is how to treat costs associated with posting financial assurance. In order to develop and evaluate various tax designs for environmental trusts and assurances, it is useful to understand the current level and type of financial assurance posted in Canadian provinces. By understanding the current distribution of financial assurance, it is possible to identify potential tax inequities between sectors or provinces. It may also be possible to evaluate the potential impacts on government revenues or company profits of changes to the existing tax policy.[9]

Current regulations allow a range of financial assurance vehicles that vary across sectors and provinces. Environmental trusts and assurances posted in Canada mirror the

[9] To determine the impacts of a tax regime on government revenues and on company profits, it would be necessary to estimate the amount of financial assurance, and the type of assurance, that would be posted under that regime. Although these estimates are unavailable (estimates would have to account for changes in the relative attractiveness of different assurance vehicles that depend on the tax regime, and the regulatory framework that applies), the current level of assurance provides a starting point for examining potential impacts of different tax regimes.

patchwork regulatory framework. As the following summary explains, the practice of posting some form of financial assurance is wide-spread, but the level and type of assurance varies widely across sectors and provinces. (Also see Appendix B for overview.)

Canadian companies in the mining, forestry, aggregates, waste disposal and other industries together post hundreds of millions of dollars in environmental financial assurance.[10] Types of assurance currently posted include cash (or liquid assets such as t-bills and bonds) held in trust, (trusts may be site-specific or not) letters of credit, performance bonds, and insurance premiums. Letters of credit seem to be the most common form of assurance.

Site-specific trusts, funds that are set aside for future use on one ore more pre-determined sites, are rarely used and generally contain small amounts of money relative to other forms of assurance. The exceptions to this rule are forest companies in Ontario, which deposited about $95 million into site-specific trust funds last year, and aggregates companies in Ontario, which deposited about $59.5 million. Site-specific trusts are used in the forestry, aggregates and mining sectors but generally do not seem to be used in the waste sector or other sectors.[11]

Other highlights of financial assurance posted across Canada are as follows:

- The highest level of financial assurance posted by any sector in any province is $156 million posted entirely in the form of letters of credit by oil and mining companies in Alberta.
- The form of assurance can be highly varied, even within a sector in a particular province. For example, waste companies in Manitoba post performance bonds, letters of credit, letters of guarantee and insurance policies.
- Mining companies deposit very little money into environmental trust funds (a total of $4.6 million in B.C. and about $2 million in Ontario) relative to other types of companies, and considering their size relative to the size of other sectors.
- The use of site-specific trusts seems most common in the forestry sector where companies in 3 of the provinces we reviewed (Ontario, Manitoba and Saskatchewan) have established site-specific funds.
- The practice of posting financial assurance is common to a wide range of business activities. For example, in British Columbia, financial assurance is required for almost

[10] We reviewed five sectors -- mining/oil, forestry, aggregates, solid waste disposal and transport, and other which includes sewer treatment, water treatment, pipelines, and transport of hazardous goods – and we reviewed these sectors in the six provinces from British Columbia to Quebec.
[11] There may be a small amount of cash posted in the waste disposal or waste transport sector in Ontario.

all forms of potentially contaminated sites. In Quebec, financial assurance is required for activities including battery recycling and biomedical waste incineration.

4. Current Income Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

4.1 Introduction

In general, four income tax issues are associated with current regulatory requirements both to restore the environment to a state approximating that prior to the specific activity carried on and to provide financial assurances that this restoration will be carried out. First, where taxpayers are required to restore sites for environmental purposes, it must be decided whether the resulting environmental restoration expenditures are deductible in computing income for tax purposes or non-deductible capital outlays. Second, assuming that these environmental restoration costs are deductible as business expenses, it is necessary to determine the period in which these expenses may be deducted. Third, where governments require financial assurances in order to ensure that environmental restoration is carried out, one must consider the extent to which costs associated with these financial assurances themselves may be deductible and/or the extent to which the existence of such financial assurances affects the appropriate period in which deductions for environmental restoration costs may be taken. Finally, where these financial assurances take the form of specific trusts to which funds are deposited, it is necessary to decide upon the appropriate tax treatment of the income received by these trusts.

As a basis for identifying key issues and exploring policy options in sections 5 and 6, this section examines each of these issues in light of the Canadian *Income Tax Act*, judicial decisions, and administrative interpretations issued by Revenue Canada. As section 4.2 demonstrates, while Revenue Canada generally accepts that environmental restoration costs are deductible when actually incurred, both it and the courts have been reluctant to allow deductions against income until these expenses are actually incurred in the process of environmental restoration, even where taxpayers are required to pay cash or property to government authorities in the form of financial assurances. For this reason, there has been increasing interest in the idea of environmental trusts, contributions to which might be deductible in advance of actual expenditures on environmental restoration. Section 4.3 examines the introduction and structure of such a trust regime under the *Income Tax Act* for "mining reclamation trusts" and reviews more recent proposals to extend these rules to other sectors.

4.2 General Income Tax Principles

4.2.1 Accounting Principles and Tax Principles

For accounting purposes, most sophisticated taxpayers employ the so-called accrual method of accounting according to which income is recognized when the right to payment arises, regardless of when payment actually occurs, and expenses are "matched" to the period in which income associated with these expenditures is received. In accordance with

this matching principle, principles of accrual accounting typically require the cost of a capital asset to be spread over the periods during which the asset will be used to produce income rather than deducted from income in the period in which the asset is acquired.[12] Likewise, recognizing that future liabilities should be matched with current receipts with which they are connected, generally accepted principles of accrual accounting require these future liabilities to be deducted in computing net income provided that they are both likely and reasonably determinable.[13] Indeed, appreciating the increasing environmental restoration obligations surveyed earlier in section 3 of this paper, in 1990 the Canadian Institute of Chartered Accountants added a specific provision to the *CICA Handbook*, recommending that:

> When reasonably determinable, provisions should be made for future removal and site restoration costs, net of expected recoveries, in a rational and systematic manner by charges to income.[14]

More specifically, the *Handbook* explains that:

> Provisions are needed to accrue the liability for future removal and site restoration costs, when the likelihood of their incurrence is established as a result of environmental law, contract, or because the enterprise has established a policy to restore a site, and when such costs can be reasonably determined.[15]

On this basis, estimated expenditures for future environmental restoration should be taken into account in determining net income for financial statement purposes.[16]

The relationship between accounting and tax definitions of income has been a subject of ongoing litigation in Canadian courts. Under the *Income Tax Act*, the starting point for determining whether a particular expense is deductible in calculating the income from a business is subsection 9(1) of the Act, according to which "a taxpayer's income for a taxation year from a business" is, subject to the rules in Part I of the Act, the taxpayer's "profit" from that business.[17] Interpreting the meaning of "profit" for the purposes of this provision, courts have adopted a net concept, so that business expenses are deductible in determining profit under subsection 9(1) of the Act.[18] On this basis, some courts have

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[12] See, e.g., Brian J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes*, (Toronto: Canadian Tax Foundation) at 279-81.
[13] See *ibid.* at 225-27.
[14] Canadian Institute of Chartered Accountants, *CICA Handbook* (Toronto: CICA) (loose-leaf), section 3060.39.
[15] *Ibid.*, section 3060.40.
[16] See Robin J. MacKnight, "Square Pegs and Round Holes: Environmental Cost Under the Income Tax Act," in *Report of the Proceedings of the Forty-Second Tax Conference*, 1990 Conference Report (Toronto: Canadian Tax Foundation, 1991), 10:1-32 at 4.
[17] Authority for this approach may be found in *Symes v. Canada*, [1994] 1 CTC 40 at 51(SCC).
[18] See, e.g., *Daley v.* MNR, [1950] CTC 254 at 261 (Ex. Ct.); Royal *Trust Co. V. MNR*, [1957] CTC 32, 57 DTC 1055 (Ex. Ct.); and *MerBan Capital Corp. v. R.*, [1989] 2 CTC 246, 89 DTC 5404 (FCA).

suggested that the concept of net income for accounting purposes is the appropriate starting point for defining business income for the purposes of income taxation.[19]

In general, however, Canadian courts have held that the concept of "profit" for the purposes of subsection 9(1) of the Act is a legal concept for determination by the courts, rather than a purely accounting concept determined according to generally accepted accounting principles.[20] As Iacobucci, J. explained in the recent Supreme Court of Canada decision in *Symes v. Canada*, this conclusion reflects the different purposes for which accounting and tax concepts of income are intended:

> . . . whereas an accountant questioning the propriety of a deduction may be motivated by a desire to present an appropriately conservative picture of current profitability, the *Income Tax Act* is motivated by a different purpose: the raising of public revenues.[21]

As a result, instead of defining "profit" for the purposes of subsection 9(1) of the Act by reference to generally accepted accounting principles, courts typically refer to phrases such as "ordinary commercial principles"[22] or "well accepted principles of business practice".[23]

Despite the explicitly *legal* nature of this test, a number of recent decisions suggest that courts may be placing greater emphasis on the traditional matching principle of accounting in determining the meaning of "profit" under subsection 9(1) of the Act. In *West Kootenay Power and Light Co. v The Queen*,[24] for example, MacGuigan, J.A. explained that:

> The approved principle is that whichever method presents the "truer picture" of a taxpayer's revenue, which more fairly and accurately portrays income, and which "matches" revenue and expenditure, if one method does, is the one that must be followed.[25]

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[19] See, e.g., *The Queen v. Metropolitan Properties Co.*, [1985] 1 CTC 169 at 180-81 (FCTD): "Generally accepted accounting principles (GAAP) should normally be applied for taxation purposes also, as representing a true picture of the corporation's profit or loss for a given year. . . . GAAP principles should only be departed from if something in the Act specifically requires or authorizes this."

[20] See, e.g., *Neonex International Ltd. v. The Queen*, [1978] CTC 485 at 499 (FCA); and *Foothills Pipe Line (Yukon) Ltd. v. Canada*, [1990] 2 CTC 448 at 455 (FCA). See also *Symes*, *supra* at 52, where Iacobucci, J. explained that exclusive reliance on generally accepted accounting principles in defining the meaning of "profit" for the purposes of subsection 9(1) of the Act would imply "a degree of control by professional accountants which is inconsistent with a *legal* test for "profit" under subsection 9(1)."

[21] *Symes*, *supra* at 52.

[22] *Dominion Taxicab Association v.* MNR, [1954] CTC 34 at 37 (SCC). See also *Canadian General Electric Co. Ltd. v. MNR*, [1961] CTC 512 at 520 (SCC); and *Associated Investors of Canada Ltd. v. MNR*, [1967] CTC 138 at 143 (Ex. Ct.).

[23] *Royal Trust*, *supra* at 40.

[24] [1992] 1 CTC 15 (FCA).

[25] *Ibid.* at 22.

Deciding that income was taxable in the year in which it was earned, even though the taxpayer had yet to issue bills in respect of the services rendered, the Court concluded that the accrual method of calculating profit "presented a truer picture of the appellant's revenue because it more accurately matched revenue and expenditure."[26] More recently, in *Canada v. Canderel Ltd.*,[27] the Federal Court of Appeal has stated that "the matching principle of accounting has, at least in this Court, been elevated to the status of a legal principle."[28] On this basis, it is arguable that future environmental restoration costs should be matched against current income in order to determine taxable "profit" within the meaning of subsection 9(1) of the Act.

Nonetheless, even if current deductions for future environmental restoration costs are recognized for the purposes of calculating "profit" under subsection 9(1) of the Act, the opening words of this provision, which state that it is "subject to" Part I of the Act, indicate that these future expenditures may not be currently deductible nor deductible at all if their deductibility is specifically precluded elsewhere in the Act. In this respect, it is essential to consider three provisions of the *Income Tax Act*, which generally prohibit deductions in respect of payments on account of capital, expenses that are not incurred for the purpose of gaining of producing income, and amounts comprising a reserve, contingent liability or sinking fund.[29] Together, these provisions determine both whether environmental restoration costs may be deducted in computing a taxpayer's income, and, if deductible, the time period in which these costs may be deducted.

4.2.2 Characterizing Expenditures on Environmental Restoration

According to paragraph 18(1)(b) of the Act, in computing the business income of a taxpayer, no deduction shall be made in respect of "an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion" except as expressly permitted by Part I of the Act. If an expenditure is considered to be on account of capital rather than income, it cannot be deducted currently, but may be recovered when property acquired or enhanced by the expenditure is disposed of, or under special provisions of the Act allowing deductions for capital cost allowances (in the case of depreciable property) or eligible capital expenditures (for intangible property including "goodwill").[30]

In general, courts have held that expenditures made "once and for all" and "with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade" should

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[26] *Ibid.* at 23. See also *Maritime Telegraph and Telephone Co. v. Canada*, [1992] 1 CTC 264 (FCA).
[27] [1995] 2 CTC 22 (FCA). In this case, the Court held that tenant inducement payments were not fully deductible in the year in which they were paid, but instead had to be matched against the revenue stream derived from the specific leases to which they related.
[28] *Ibid.* at 24, *per* Stone, J.A.
[29] Paragraphs 18(1)(b), 18(1)(a), and 18(1)(e) of the Act.
[30] In general, see subsection 40(1) and paragraphs 20(1)(a) and 20(1)(b) of the Act.

properly be treated as being on account of capital not income.[31] Although the characterization of environmental restoration costs has not been considered by Canadian courts, this issue has been examined by British and Australian courts, to which Canadian courts often refer when Canadian law is lacking.[32] Unfortunately, these cases suggest two completely divergent approaches to this issue of characterization.

In *Robert Addie & Sons' Collieries Ltd. v. Commissioners of Inland Revenue*,[33] the taxpayer was required under a mining lease to reinstate land occupied by it or damaged by its underground workings, or at its option to pay an amount calculated by reference to the value of the land for agricultural purposes. Rejecting the company's argument that the amount paid under the option should be deductible against income, Lord President Clyde concluded that neither the payment nor the costs of restoring the site (had the company chosen to reinstate the land) were deductible expenses, but instead represented non-deductible capital expenditures:

> [I]t is clear that it was within the contractual contemplation of parties that the lessees working under the lease and in accordance with its provisions would, or might, cause damage to land by subsidence of a character so serious and permanent as to destroy its value unless restored in some way. A right to work the coal in such a manner as to sacrifice the value of the surface was a material asset for the Company to possess . . . . The price of acquiring that right is a capital outlay. . . . Neither the expense of restoration, nor the compensation payable failing restoration, appear to me to fall within working expenses. They are, in my opinion, capital charges.[34]

In other words, the Court concluded, because the expenditures for restoration or in lieu of restoration were incurred in order to obtain a property right (the mining lease) which provided an "enduring benefit" to the taxpayer, these expenditures were on account of capital and therefore non-deductible.

While *Addie & Sons' Collieries Ltd.* was decided in 1924, a more recent British case suggests that the conclusion may continue to apply today. Relying on the decision in *Addie & Sons' Collieries Ltd.*, in *RTZ Oil Ltd. v. Elliss*,[35] the court rejected the taxpayer's claim to deduct in advance future reclamation expenses in connection with its North Sea oil business, concluding that these reclamation costs were "part of the costs that had to be incurred or which the consortium had agreed to incur in the future" in order to obtain the right to drill for oil and "before it could commence its trading operations."[36]

[31] *British Insulated and Helsby Cables, Ltd. v. Atherton* [1926] A.C. 205 at 213 (H.L.). This statement was accepted for purposes of Canadian income tax law in *MNR v. The Dominion Natural Gas Co. Ltd.*, [1940-41] CTC 155 (SCC).
[32] See, e.g, *Stubart Investments Ltd. v. The Queen*, [1984] CTC 294 (SCC).
[33] (1924), 8 TC 671 (Scot. Ct. of Sess.).
[34] *Ibid.* at 677.
[35] (1987), 61 TC 132 at 173-75 (Ch. Div.).
[36] *Ibid.* at 173-75.

On the other hand, an even more recent Australian case, in which a mining company sought to deduct amounts spent to clean up lands contaminated by radioactive material contained in tailings used as landfill, explicitly rejects the position that environmental restoration costs should be regarded as non-deductible capital expenditures.[37] In *Associated Minerals Consolidated Ltd.*, the court rejected the Commissioner's argument that these restoration expenditures were capital expenditures designed to protect the goodwill of the company, concluding instead that, in the late 20th century, environmental restoration costs are "part of the recurring costs of mining businesses" necessitated by pressure from the public and from government, and therefore "necessary to the conduct of the business of mining" and related to "the ongoing cost of the mining activity."[38]

The absence of Canadian case law on the subject and the divergent conclusions reached in these British and Australian cases create considerable uncertainty with respect to the characterization of environmental restoration costs for the purposes of the Canadian *Income Tax Act*. On the basis of the British cases, it is arguable that the costs of environmental restoration mandated by governments prior to issuing a lease or permit under the legislative requirements outlined in section 3 constitute non-deductible capital expenditures incurred in order to obtain the lease or permit. In stark contrast, the decision in *Associated Minerals Consolidated Ltd.* suggests that environmental restoration costs should be deductible expenses where they are affirmatively required by legislation.

Despite this uncertainty, as an administrative practice, Revenue Canada appears to have accepted that environmental restoration costs are generally deductible expenses and need not be capitalized. In a private opinion letter released through Access to Information, the Department indicates that reclamation costs are considered to be deductible expenses provided that "the business activity that caused the environmental damage was carried on by the same party that incurred the clean-up costs."[39] Nonetheless, the qualified manner in which this conclusion is stated, as well as the further statement that "clean-up costs incurred to preserve or protect an asset are considered to be capital,"[40] suggest that Revenue Canada's administrative position itself is far from certain.

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[37] *Associated Minerals Consolidated Ltd. v. FC of TA*, 94 ATC 4499 (Full Fed. Ct.).

[38] *Ibid.* at 4506.

[39] RC document no. 9510337, May 23, 1995. See also RC document no. 9315240, June 17, 1993, which states the Department "has adopted the position that reclamation costs are recognized for the purposes of the Income Tax Act in the year they are incurred"; and the Department of Finance, *Tax Measures: Supplementary Information*, Federal Budget, February 22, 1994, at 19, where the Department states that: "Under current income tax rules, mine reclamation expenses are deductible in computing the taxpayer's income only in the year they are incurred." The issue of *when* reclamation costs may be deducted is considered in this paper in section 4.2.3 on "The Making or Incurrence of an Outlay or Expense" and section 4.2.4 on "Reserves, Contingent Liabilities, and Sinking Funds".

[40] *Ibid.*

4.2.3 The Making or Incurrence of an Outlay or Expense

According to subsection 18(1)(a) of the Act, in computing the business income of a taxpayer, no deduction shall be made in respect of "an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business". For a specific amount to be deductible in a given taxation year, therefore, a taxpayer must have "made or incurred" an "outlay or expense" and must have done so "for the purpose of gaining or producing income".

There seems to be little doubt that expenditures on environmental restoration that are made necessary by contract or government regulation are for the purpose of gaining or producing income from the site that must be restored.[41] Likewise, where taxpayers are required to provide financial assurances as security in respect of future environmental restoration obligations, the furnishing of these assurances should also be recognized as being for the purpose of gaining or producing income. It is another issue altogether, however, whether and when expenditures on environmental restoration and/or the provision of financial assurances constitute the making or incurrence of an outlay or expense.

In general, the making of an outlay denotes the actual disbursement of cash or property.[42] On this basis, assuming that they are not considered to be non-deductible capital expenditures, the costs of environmental restoration are deductible in the year in which payments in respect of this restoration are made. Likewise, aside from any other provision of the Act,[43] where financial assurances involve the payment of cash or property, the deductibility of these payments in the year in which they are made should not be precluded by paragraph 18(1)(a). In contrast, where financial assurances involve the granting of security rather than the disbursement of cash or property, no deduction is available for the amount of the security. On the other hand, in these circumstances, a deduction will typically be available where a taxpayer granting security is required to make payments or incur expenses in respect of this security.[44]

While the meaning of the term "outlay made" is limited to the actual payment of cash or property, the words "expense incurred" refer to the creation of a liability even though the amount owing is not paid in the taxation year.[45] More specifically, Canadian courts have established three requirements for the purpose of determining whether an expense has been incurred within the meaning of paragraph 18(1)(a) of the Act. First, as the Federal Court of Appeal stated in *Newfoundland Light & Power Co. v. Canada*, "in order for an expense to be incurred during the year, the obligation to pay must be created during the

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[41] See Richard Carson, "Mining Reclamation Trusts" in *Report of the Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 14:1-24 at 4.
[42] Arnold, *Timing and Income Taxation*, supra at 223.
[43] In this respect, see paragraph 18(1)(e) of the Act and the discussion of "Reserves, Contingent Liabilities, and Sinking Funds" in section 4.2.4 of this paper.
[44] For example, where fees are payable in order to obtain a letter of credit or performance bond, these fees will generally be deductible for the purposes of calculating income.
[45] Arnold, *Timing and Income Taxation*, supra at 223.

year."[46] Second, as the Tax Court of Canada explained in *Co-Operators General Insurance Company v. MNR*, "the amount payable must be ascertainable in the year."[47] Finally, as the Federal Court of Appeal concluded in *The Queen v. Burnco Industries Ltd.*, the "expense" must constitute "an obligation to pay a sum of money" not "an obligation to do something which may in the future entail the necessity of paying money".[48]

While liabilities incurred in respect of future environmental restoration obligations clearly satisfy the first of these three tests for determining whether an expense has been incurred for the purposes of paragraph 18(1)(a) of the Act to the extent that a legal obligation is incurred during the taxation year, it is more likely than not that these legal obligations will fail the second and third of these tests. Although it may be possible to estimate the cost of future expenditures on environmental restoration, it is unlikely that these estimates will satisfy the standard of certainty that Canadian courts appear to have required under the second test.[49]

Perhaps more importantly, to the extent that contractual or regulatory obligations require taxpayers to restore a specific site to a condition approximating that prior to the activity carried on, *not* to pay a sum of money once the activity is completed, the decision in *Burnco Industries* suggests that the costs of this future restoration will not be deductible on an accrual basis -- even if these future expenditures are currently ascertainable. Indeed, this was the very result in *Burnco Industries*, where the taxpayers, who had been granted a license by the City of Calgary to mine gravel and remove earth on condition that they progressively restore the site, sought, unsuccessfully in the end, to deduct in 1974 estimated expenses for backfilling operations that were carried out and completed in 1975. Likewise, in a more recent case in which the taxpayer sought to deduct estimated future silviculture costs, the Tax Court of Canada, relying on *Burnco Industries*, dismissed the taxpayer's appeal on the basis, among others, that the obligation to "pay the costs" had not come into existence at the time the deduction was claimed, notwithstanding that the obligation to engage in reforestation came into existence as trees were harvested.[50]

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[46] *Newfoundland Light & Power Co. v. Canada*, [1990] 1 CTC 229 at 239 (FCA), *per* Pratte, J.A.

[47] *Co-Operators General Insurance Company v. MNR*, 93 DTC 303 at 311 (TCC), *per* Brule, T.C.C.J. See also *Newfoundland Light & Power Co. v. Canada*, *supra* at 238, *per* Dejardins, J.A.; and *Day & Ross Ltd. v. The Queen*, [1976] CTC 707 at 714 (FCTD), where the Court held that the term "expense" in the predecessor to paragraph 18(1)(a) "implies a liability present and certain, an amount definite and ascertainable." While Canadian courts have insisted on this requirement for the purpose of determining whether an "expense" has been "incurred" under paragraph 18(1)(a), it may be more appropriate to view this requirement as part of the test for determining whether a deduction is denied under paragraph 18(1)(e). See the discussion of "Reserves, Contingent Liabilities, and Sinking Funds" in the section 4.2.4 of this paper.

[48] *The Queen v. Burnco Industries Ltd.*, [1984] CTC 337 (FCA).

[49] See, e.g., *Newfoundland Light & Power Co. v. Canada*, *supra* at 238, where Dejardins, J.A. emphasized that the taxpayer "does not know for sure the full cost of the work" and "could not ascertain the exact cost".

[50] *Northwood Pulp and Timber Limited v. The Queen*, 96 DTC 1104 at 1114 (TCC).

4.2.4 Reserves, Contingent Liabilities, and Sinking Funds

According to subsection 18(1)(e) of the Act, in computing the income of a taxpayer from a business or property, no deduction shall be made in respect of "an amount as, or on account of, a reserve, a contingent liability or amount or a sinking fund" except as expressly permitted by Part I of the Act. As a result, even if an outlay or expense is recognized to have been made or incurred in a specific taxation year, its deductibility may nevertheless be precluded under paragraph 18(1)(e) if the outlay or expense is on account of "a reserve, a contingent liability or amount or a sinking fund".

The term "sinking fund" has a particular meaning for the purposes of paragraph 18(1)(e), which would not apply to amounts set aside for the purposes of future environmental restoration.[51] Nonetheless, where a taxpayer attempts to deduct these amounts in calculating its "profit" under subsection 9(1) of the Act, deductibility might well be denied on the basis that these amounts are "contingent" or that they constitute a "reserve".

For accounting purposes, a "contingent liability" is defined as "a legal obligation that may arise in the future out of past and/or present circumstances provided certain developments occur."[52] Revenue Canada and the courts have adopted essentially the same definition for the purposes of paragraph 18(1)(e).[53] More specifically, according to Canadian courts, a liability to make a payment is contingent if "the terms of its creation include uncertainty in respect of any of these three things: (1) whether the payment will be made; (2) the amount payable; or (3) the time by which the payment shall be made.[54] As a result, to the extent that there is uncertainty regarding the obligation to incur environmental restoration costs, the amount of these costs, or the timing of these costs, these cases suggest that deductibility of amounts set aside to fund future environmental restoration may be denied under paragraph 18(1)(e) of the Act.

While Revenue Canada appears to have accepted the accounting definition of a "contingent liability" for income tax purposes, it has not done so with respect to the meaning of the word "reserve". For accounting purposes, a "reserve" is defined as "an amount which, though not required to meet a liability or contingency known or admitted or a decline in which has already occurred as at the balance sheet date, has been

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[51] See *Interpretation Bulletin* IT-215R, "Reserves, contingent accounts and sinking funds," January 12, 1981, paragraph 3, where Revenue Canada defines the term "sinking fund" as "a pool of cash and investments, usually built up systematically, earmarked to provide resources for the redemption of debt or capital stock."

[52] Canadian Institute of Chartered Accountants, *Terminology for Accountants*, rev. ed. (Toronto: CICA, 1976), p. 26.

[53] See *Interpretation Bulletin* IT-215R, *supra*, paragraph 3; and *TNT Canada Inc. v. The Queen*, [1988] 2 CTC 91 at 96 (FCTD).

[54] *Samuel F. Investments Ltd. v. MNR*, [1988] 1 CTC 2181 at 2184 (TCC). See also *J.L Guay Ltee v. MNR*, [1971] CTC 686 (FCTD), aff'd [1975] CTC 97 (SCC); *Harlequin Enterprises Ltd. v. The Queen*, [1974] CTC 838 (FCTD), aff'd [1977] CTC 208 (FCA); *Northern and Central Gas Corp. v. The Queen*, [1985] 1 CTC 192 (FCTD); and *Dunblane Estates Ltd. v. MNR*, [1989] 1 CTC 2248 (TCC).

appropriated from retained earnings or other surplus."[55] For purposes of the *Income Tax* Act, however, Revenue Canada argues that the word "reserve" has "a broader meaning than in current accounting terminology and . . . means more generally an amount set aside that can be relied upon for future use."[56] Consequently, where a taxpayer sets aside amounts for future environmental restoration, whether on its own account or by way of financial assurance, Revenue Canada's stated position suggests that these amounts may not be deductible by virtue of paragraph 18(1)(e) of the Act.

Despite Revenue Canada's position, it is doubtful whether the scope of this limitation on deducting amounts set aside as a reserve is quite this broad. In *Day & Ross Limited v. The Queen*, the court stated that a "reserve" implied "the setting aside of an amount to meet a contingency, an unascertainable and indefinite event which may or may not occur."[57] On this basis, amounts set aside for future environmental restoration should be deductible if the cost of this liability is definite and ascertainable. Of course, to the extent that it is impossible to estimate the costs of future environmental restoration precisely, deductibility of amounts set aside for this environmental restoration may be precluded under paragraph 18(1)(e) of the Act, even applying this more specific definition of the word "reserve".

In Canada, only one case has considered the deductibility of amounts set aside for future environmental restoration. In *Nomad Sand and Gravel Ltd. v. Canada*,[58] the taxpayer, which operated a sand and gravel pit at Brighton, Ontario, sought to deduct amounts paid to the Ontario government as security toward the cost of site rehabilitation pursuant to the *Pits and Quarries Control Act*, S.O. 1971, c. 96. Noting that these payments remained on deposit with the Treasurer of Ontario, bore interest at 6%, and were refundable if and when the taxpayer rehabilitated the site itself, the Minister of National Revenue denied the deduction on the grounds that the amounts were not "expenses" that the taxpayer had "incurred" in the year, and were prohibited under paragraph 18(1)(e) of the Act. In contrast, the taxpayer argued that it had no legal obligation to carry out the rehabilitation should the cost of rehabilitation exceed the yearly payments made over the life of the pit, that the payments would not in fact be refunded since the costs of rehabilitation greatly exceeded the amounts expected to be paid as security, that the payments therefore constituted "expenses" incurred in the year in which they were paid, and that these payments should be deductible in accordance with generally accepted accounting principles.

Accepting the taxpayer's arguments, both the Tax Review Board and the Federal Court - Trial Division, on appeal by the Crown, allowed the payments as deductions against the taxpayer's income for its 1976 taxation year.[59] For the Federal Court of Appeal,

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[55] *CICA Handbook*, *supra*, section 3260.01.
[56] *Interpretation Bulletin* IT-215R, *supra*, paragraph 2.
[57] *Day & Ross Ltd. v. The Queen*, *supra* at 714.
[58] [1991] 1 CTC 60 (FCA).
[59] *Nomad Sand & Gravel Ltd. v. MNR*, [1982] CTC 2035 (TRB); *The Queen v. Nomad Sand & Gravel Ltd.*, [1987] 2 CTC 112 (FCTD).

however, the question to be asked was not whether the tax treatment of these payments should follow their accounting treatment, but whether the payments, as a matter of law, had "the characteristics of expenses or outlays made in earning or producing income" or "the characteristics of transfers to a reserve for the purpose of securing the performance of the [taxpayer's] obligation to rehabilitate the site, within the meaning of paragraph 18(1)(e)."[60] Noting that the payments were "not made once and for all, without recourse" but constituted "*security*" "*on deposit*" which could "be refunded in whole or in part, together with interest thereon, upon discharge of the payer's . . . obligation to rehabilitate the pit site," the Court reversed the decisions of the lower courts and allowed the Crown's appeal.[61]

While there appears to be some uncertainty regarding the basis on which the Federal Court of Appeal reached its decision in *Nomad Sand and Gravel*,[62] Revenue Canada has made its administrative position quite clear in a number of private opinion letters. First, it suggests in one letter:

> . . . a payment to a government-mandated site restoration fund would be deductible under the Act where, for example, the payment was made pursuant to a levy by a province which itself would be responsible for the site restoration, the payment to the province was irrevocable (that is, it had no element of refundability), the payor's obligation for the site restoration was discharged contemporaneously and the payment is not one to which paragraph 18(1)(m) of the Act [denying a deduction for royalties and resource taxes[63]] applies.[64]

Second, the Department states in another letter:

> To the extent that the payor has not parted irrevocably with the amount paid into the fund, we would consider the amount to be a deposit that is being held until the [site restoration] has been performed [which] is not deductible in computing income under the Act because it is not a business expense deductible under paragraph 18(1)(a) of the Act.[65]

Third, it continues in the same letter:

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[60] *Nomad Sand and Gravel Ltd. v. Canada, supra* at 65.
[61] *Ibid.* at 65-66.
[62] According to the headnote, *ibid.* at 61, "the payments were clearly deposits and denied deduction under paragraph 18(1)(e)." At least one commentator, however, suggests that the Federal Court of Appeal denied the deduction on the basis that the payments were not "an outlay or expense". See Barrie M. Philp, "Is It Time to Place More Reliance on GAAP?" in *Report of the Proceedings of the Forty-Third Tax Conference*, 1991 Conference Report (Toronto: Canadian Tax Foundation, 1992), 25:1-55 at 27-28. For a helpful discussion of the reasons for the decision in *Nomad Sand and Gravel Ltd.*, see MacKnight, "Square Pegs and Round Holes," *supra* at 6-10.
[63] This paper does not deal with royalties and resource taxes.
[64] RC document no. 260, November 1991.
[65] RC document no. 60, February, 1991.

Consequently, while the Department of Finance has defended the current mining reclamation trust rules in part on the basis that they should be designed to ensure neutrality across different financial assurance mechanisms,[103] we believe that the tax treatment of different kinds of financial assurances should differ under a neutral income tax where these financial assurances involve entirely different cost commitments. Whether it makes sense to depart from this benchmark in order to maintain existing revenues is considered below in section 6.4 of this paper.

5.4.4 Tax Treatment of Trust Income

Where amounts are contributed to a trust for the purpose of future environmental restoration, a benchmark must be determined for the neutral tax treatment both of income accumulated within the trust and amounts that are withdrawn from the trust to be spent on environmental restoration. With respect to the taxation of income as it accrues in the trust, it is necessary to decide whether a neutral income tax should or should not tax this income, and if so, the rate at which it should be taxed and the persons who should be responsible for paying this tax. With respect to the treatment of amounts withdrawn from the trust by each beneficiary, it is necessary to determine whether these amounts should be non-taxable, fully taxable, or partly taxable and partly nontaxable. Finally, if it is determined that a neutral income tax should make withdrawals partly taxable and partly nontaxable, it is necessary to determine a benchmark allocation rule in order to determine the appropriate tax treatment for each particular withdrawal from the trust.

5.4.4.1 Tax Treatment of Trust Income as it Accrues

As indicated in section 4.3.1 of this paper, the mining industry favours RPP-type treatment for the taxation of environmental trusts, whereby amounts deposited to the trust would be deductible in the taxation year in which the contribution is made and tax on trust income would be deferred until amounts are withdrawn from the trust. In contrast, while the existing mining reclamation trust rules allow a current deduction for contributions to the trust, they also tax the trust income as it accrues.

While some of the mining industry's arguments in favour of RPP-type treatment involve the pursuit of deliberate policy goals that must be considered separately from the definition of an appropriate benchmark for a neutral income tax,[104] the industry's argument that this deferral approach is "a working model of financial assurance in the field of human resource activity"[105] suggests that deferral may be regarded as the proper benchmark for the neutral tax treatment of the accrued income of environmental trusts.

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[103] See Testimony to the Standing Committee on Natural Resources by Bob Hamilton, *supra*.

[104] See, e.g., Mining Association of Canada, *Financial Assurance for Mine Reclamation, Decommissioning and Post Closure Obligations, supra* at 10-11, in which the mining industry argues for RPP-type treatment on the grounds of its impact on jobs, competitiveness and environmental quality. We consider these arguments more fully in section 6.5.1 of this paper.

[105] *Financial Assurance for Mine Reclamation, Decommissioning and Post-Closure Obligations, supra* at 7.

> Even if an amount paid to a [site restoration] fund could be shown to be the future costs of [site restoration], it is our view that the provisions for such future costs could not be permitted as deductions for income tax purposes by virtue of paragraph 18(1)(e) of the Act which generally prohibits the deduction of an amount as or on account of a reserve, a contingent liability or a sinking fund.[66]

Finally, Revenue Canada explains in yet another private opinion letter:

> The Department's position is that levies paid to a Province in a taxation year to secure [restoration] of a . . . site area are not deductible for the taxation year where the deposits do not become the absolute property of the province.[67]

While the first and second of these propositions may be largely justified on the basis of current law,[68] the third and fourth statements cannot be similarly supported. To conclude that payments to a government-mandated fund are not deductible even when they equal the future costs of site restoration and the amount of these future costs is definite and ascertainable is to ignore the legal definition of the word "reserve" adopted in *Day & Ross Limited v. The Queen*. Likewise, to argue that levies paid to a province in a taxation year to secure the restoration of a site are not deductible for the taxation year unless the payments become "the absolute property of the province" is to overlook the possibility that liabilities in respect of future environmental restoration may be deductible if they are "incurred" in the taxation year, are "expenses" within the meaning of the Act, and are "definite" and "ascertainable". While this combination of characteristics may be difficult to achieve in practice, Revenue Canada's categorical statements are difficult to defend.

4.2.5 Taxation of Trust Income

Where a financial assurance takes the form of a specific trust, a further issue concerns the tax treatment of income received by or credited to the trust. Under the Ontario *Pits and Quarries Control Act* considered in *Nomad Sand and Gravel*, for example, the taxpayer could have obtained a refund of its security "with interest" if it had reclaimed the site itself. How is this interest or other investment income of a trust established for the purpose of future environmental restoration treated for tax purposes?

Neither the courts nor Revenue Canada have dealt with this issue directly. Nonetheless, current tax rules suggest two alternatives, depending on the character of the trust. On the one hand, where the taxpayer contributing funds to the trust retains the authority to

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[66] *Ibid.*

[67] RC document no. 9403675, May 4, 1994.

[68] Nonetheless, on the basis of existing law, it seems difficult to justify the requirement in the first statement that "the payor's obligation for the site restoration was discharged contemporaneously" with payment to the government-mandated fund.

revoke the trust, to determine the beneficiaries or to direct or veto dispositions of trust property, subsection 75(2) of the Act provides that any income received by or credited to a trust is taxable to the contributor as it accrues. On the other hand, where the contributor's right to a refund of trust property "with interest" depends upon the subsequent restoration of a specific site, the taxation of this interest is likely to be deferred until the site restoration is actually carried out on the basis that the interest does not have the character of income to the taxpayer until it is actually receivable.[69] As a general rule, the latter treatment is likely in the case of government-mandated restoration funds which are refundable with interest to the payor when the payor actually restores the site.

4.3 Environmental Trusts

4.3.1 From *Nomad Sand and Gravel* to Mining Reclamation Trusts

The Federal Court of Appeal decision in *Nomad Sand and Gravel* and Revenue Canada's resulting administrative position caused considerable concern in the tax community and among industries subject to increasingly stringent regulatory requirements to provide financial assurances in respect of future environmental restoration obligations.[70] In addition to concerns related to the design and impact of these regulatory requirements themselves, the mining industry in particular identified two problems with the tax treatment of environmental restoration costs and financial assurances for environmental restoration: first, that single-site operations might not be able to fully utilize deductions for actual site restoration because the majority of these expenses occur at the end of the activity, when the site no longer produces income;[71] and second, that taxpayers required to provide financial assurances, particularly in the form of cash payments, might experience cash-flow problems if amounts paid out as security in respect of future environmental restoration obligations could not be deducted in the year in which they were paid.[72]

In April 1991, four months after the Federal Court of Appeal decision in *Nomad Sand and Gravel*, the Mining Association of Canada, in consultation with the Provincial and Territorial Mining Associations and the Coal Association of Canada, released a discussion paper proposing that trust funds established for the purposes of future mine reclamation should be subject to the same tax treatment as trusts governed by a registered pension plan (RPP), employer contributions to which are deductible under paragraph 20(1)(q) of the

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[69] See, e.g., *MNR v. J. Colford Contr. Co.*, [1962] CTC 546 (SCC).

[70] See, e.g., MacKnight, "Square Pegs and Round Holes," *supra*; and Philp, "Is It Time to Place More Reliance on GAAP?" *supra*.

[71] Although deductions for these reclamation expenditures might generate losses that could be carried back or forward to offset income in other taxation years, paragraph 111(1)(a) of the Act limits these loss carryovers to a three-year carryback and a seven-year carryforward.

[72] These problems were identified in the 1994 Federal Budget. See Department of Finance, *Tax Measures: Supplementary Information*, *supra* at 19.

Act, and the income of which is exempt from tax under paragraph 149(1)(o) of the Act.[73] Although the Department of Finance did not accept the Mining Association's recommendation for RPP-type treatment,[74] it is this proposal that was the genesis of the "mining reclamation trust" provisions of the *Income Tax Act*, first introduced in the 1994 Federal Budget and subsequently enacted in 1995.[75]

4.3.2 Mining Reclamation Trusts

Pursuant to subsection 248(1) of the Act, a "mining reclamation trust" is generally defined as a trust that is maintained "to secure the mining reclamation obligations of one or more persons or partnerships that are beneficiaries under the trust", "for the sole purpose of funding the reclamation of a mine" in a province, and the maintenance of which "is or may be required under the terms of a contract entered into with Her Majesty in right of Canada or the province or is or may become required pursuant to the law or Canada or the province." According to this definition, the trust is prohibited from borrowing money[76] and required to invest in specified low-risk investments,[77] while the trustees must be Her Majesty in right of Canada or a province or a Canadian resident corporation authorized to carry on the business of acting as a trustee.[78] As well, the statutory definition specifically excludes trusts relating to the reclamation of a well or a mine that is "a clay pit (other than a kaolin pit), a deposit of peat, a gravel pit, a peat bog, a sand pit, a shale pit or a stone quarry."[79]

Given this definition, a trust established under regulation to secure future site restoration obligations in respect of most mining operations should qualify as a "mining reclamation trust" provided that it adheres to the statutory requirements regarding trustees, investments, and borrowed funds. However, similarly constituted trusts for the purposes of site restoration in the aggregates industry, will not qualify as "mining reclamation trusts".

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[73] *Financial Assurance for Mine Reclamation, Decommissioning and Post-Closure Obligations*, A Discussion Paper Prepared by The Mining Association of Canada in Consultation with the Provincial and Territorial Mining Associations and the Coal Association of Canada, April 1991.

[74] The Department's "alternative approach", which formed the basis of the Budget proposal, is set out in *Tax Treatment of Contributions for Provincially-Mandated Mine Reclamation Funds*, Federal/Provincial Alternative Approach, July, 1993. See also the Testimony to the Standing Committee on Natural Resources by Bob Hamilton, Director, Business Taxation , Department of Finance, November, 1994. The policy issues involved in these divergent approaches to the design of environmental trusts are discussed in sections 5 and 6 of this paper.

[75] For a description of the provisions introduced in the 1994 Budget, see Department of Finance, *Tax Measures: Supplementary Information*, *supra* at 18-20. Revised provisions were ultimately enacted by S.C. 1995, c. 3, retroactive to taxation years ending after February 22, 1994.

[76] See paragraph (e) of the definition of "mining reclamation trust" in subsection 248(1) of the Act.

[77] See paragraph (f) of the definition of "mining reclamation trust" in subsection 248(1) of the Act, which prohibits the trust from acquiring "any property that is not described in any of paragraphs (a), (b) and (f) of the definition of "qualified investment" in section 204" of the Act. In general, these paragraphs refer to money, government bonds, and trust company GICs. This paper does not consider the policy issues involved in these investment restrictions.

[78] See paragraph (d) of the definition of "mining reclamation trust" in subsection 248(1) of the Act. This paper does not deal with the policy issues involved in the governance of mining reclamation trusts nor environmental trusts more broadly defined.

[79] See paragraph (b) of the definition of "mining reclamation trust" in subsection 248(1) of the Act.

The basic structure of the tax provisions in respect of these trusts is to allow a current deduction for contributions to mining reclamation trusts of which the taxpayer is a beneficiary,[80] to tax the income of these trusts at the same rate of tax as the net federal corporate tax rate of 28%,[81] to tax each beneficiary on its share of the trust income as it accrues in the trust,[82] to provide a refundable credit to each trust beneficiary in an amount equal to its proportionate share of the tax paid by the trust,[83] and to tax beneficiaries on all amounts withdrawn from the trust.[84] To the extent that amounts withdrawn from the trust are spent on mine reclamation in the same taxation year, these payments should be deductible under general tax principles so that no net tax is payable.

In sum, therefore, while this scheme allows a current deduction for contributions to a mining reclamation trust, it does not provide the RPP-type treatment sought by the Mining Association of Canada. On the contrary, as the Mining Association and other critics have observed, these provisions amount to "double taxation" of the trust income, by taxing this

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[80] See paragraphs 20(1)(ss) and 75(3)(c.1) of the Act, the former of which allows a deduction for contributions "made in the year by the taxpayer", while the latter excludes mining reclamation trusts from the income attribution rules otherwise applicable under subsection 75(2) in respect of trust property which may revert to the settlor. See also paragraph 20(1)(tt) of the Act, which treats the consideration paid by a taxpayer for a beneficial interest in a mining reclamation trust as a deductible expense rather than a non-deductible outlay on account of capital.

[81] See new Part XII.4 of the Act, and paragraph 149(1)(z) of the Act, which exempts the income of a mining reclamation trust from tax under Part I of the Act. The federal rate assumes that provincial governments will also tax the income of mining reclamation trusts as rates equal to the highest provincial tax rates applicable to corporate income. See e.g., sections 2.1 and 4.1 of the Ontario *Income Tax Act*, R.S.O. 1990, c. I.2 [as amended] , which levy an additional tax of 15.5% on "the trust's income for the year that is subject to tax under Part XII.4 of the Federal Act." See also subsection 8.9(2) of the British Columbia *Income Tax Act*, R.S.B.C. 1979, c. 190 [as amended], which provides that "a mining reclamation trust shall pay a tax equal to 16.5% of its income that is subject to tax under Part XII.4 of the federal [Income Tax] Act for that taxation year". Under paragraph 123(1)(a) the federal corporate tax rate is 38%. Subsection 124(1) allows a deduction from tax otherwise payable under Part I of the Act equal to "10% of the corporation's taxable income earned in the year in a province." As a result, the net federal corporate tax rate is 28%. Provincial governments impose corporate taxes at rates ranging from 8.9% in Quebec to 17% in Manitoba, New Brunswick and Saskatchewan. In general, lower rates are available for profits from manufacturing and processing and for the first $200,000 of active business income earned by Canadian-controlled private corporations. See sections 125.1 and 125 of the Act.

[82] See paragraph 107.3(1)(a) of the Act, which flows through the amount of any income or loss of the trust from a particular source to each beneficiary "to the extent of the portion" of this income or loss "that can reasonably be considered to be the [beneficiary's] share of such income or loss".

[83] See section 127.41 of the Act.

[84] See paragraph 12(1)(z.1) of the Act, which requires taxpayers to include in computing income from a taxation year all amounts received as a beneficiary under a mining reclamation trust, "whether or not such amounts are included because of subsection 107.3(1) in computing the taxpayer's income for any taxation year." See also paragraph 12(1)(z.2) and subparagraph 39(1)(a)(v) which treat amounts received in consideration for the disposition of a beneficial interest in a mining reclamation trust as income rather than capital gains.

income both as it accrues in the trust and once again when it is actually received by a beneficiary.[85]

4.3.3 From Mining Reclamation Trusts to Environmental Trusts

A more obvious criticism of the mining reclamation trust provisions is their availability to the mining industry alone. This bias is plainly apparent in the statutory exclusion with respect to trusts relating to the reclamation of a well or a mine that is "a clay pit (other than a kaolin pit), a deposit of peat, a gravel pit, a peat bog, a sand pit, a shale pit or a stone quarry."[86] It is also apparent when one considers the many other industries (e.g., oil and gas, forestry, and waste management) in which financial assurances are often required in respect of future environmental restoration.[87]

Not surprisingly, these other industries have questioned the introduction of special rules for mining reclamation trusts alone. At the Annual Conference of the Tax Executives Institute held at Hull, Quebec in May 1995, Revenue Canada was asked to provide guidelines on "the tax treatment of environmental expenditures covering a broader range of industries" than the mining industry.[88] In response, the Department confirmed the unequal treatment of trust contributions in different sectors, explaining that:

> The Department has always taken the position that when a taxpayer makes an expenditure, for the purposes of complying with environmental legislation concerning subsequent years reclamation expense, that the amount is not deductible pursuant to 18(1)(a) or 18(1)(e). This will continue to be the Department's position in situations where amounts are set aside or set up as reserves for reclamation costs that will incur in a subsequent year.

More interestingly, however, Revenue Canada proceeded to suggest that "the industry groups affected should forge an alliance with their provincial regulators, and approach the Department of Finance to introduce tax legislation that is similar to that enacted for the mining industry."[89]

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[85] See The Mining Association of Canada, *Financial Assurance for Mine Reclamation, Decommissioning and Post-Closure Obligations*, A Discussion Paper Prepared for the Mines Ministers' Conference, Victoria, B.C., September, 1994, at 10; and Carson, "Mining Reclamation Trusts," *supra* at 19 and 23. The issue of double-taxation is contentious because, in some sense, all income is taxed more than once (often under different statutes such as income and sales tax statutes) as it flows through the economy and changes hands. Nonetheless, the Act contains a number of specific provisions designed to lessen or prevent so-called double-taxation, for example deductibility of taxable dividends received by corporations resident in Canada, and the dividend gross-up and credit mechanisms for dividends received by individual taxpayers. In general, see section 112, paragraph 82(1)(b) and section 121 of the Act. We examine this issue of double taxation below in sections 5.4.4.4 and 6.5 of this paper.

[86] See paragraph (b) of the definition of "mining reclamation trust" in subsection 248(1) of the Act.

[87] See section 3 of this paper. See also the discussion in Carson, "Mining Reclamation Trusts," *supra* at 21-22.

[88] Question #34, "Guidelines on Tax Treatment of Environmental Expenditures," Questions and Answers Provided at the Annual Conference of the Tax Executives Institute, (Hull, Quebec, May, 1995), RC document no. 5M0886, July 18, 1995.

[89] *Ibid.*

The discussion of "environmental trust funds" in the 1996 Federal Budget,[90] it appears, is the direct result of this alliance.

In the Budget documents, "environmental trust funds" are broadly described as "funds established by companies to help finance future environmental commitments (i.e., reforestation, waste disposal site clean-ups)."[91] Under current tax rules, the documents explain, "contributions by a taxpayer to environmental trust funds established to finance future reforestation work, waste disposal sites or sand and gravel pits would not qualify for a deduction in computing income for tax purposes because the contribution would only be used in the future to satisfy the taxpayer's obligations."[92] This situation, the Department adds, "is similar to the situation that faced the mining industry prior to the announcement in the 1994 budget."[93] Finally, the Budget announces:

> Given the similarity between environmental trust funds and mine reclamation trust funds, the government will examine the appropriateness of extending the mine reclamation trust rules to other sectors. Reviews will be undertaken on a sector-by-sector basis in consultation with provincial governments.[94]

Among other things, this study is intended to assist in this review process.

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[90] See Department of Finance, *Tax Measures: Supplementary Information*, Federal Budget, March 6, 1996, (Toronto: Carswell) at 4:25-26.
[91] *Ibid.* at 26.
[92] *Ibid.*
[93] *Ibid.*
[94] *Ibid.*

5. Issues in the Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

5.1 Introduction

The current tax treatment of environmental restoration costs and financial assurances involves a number of potential issues for Canadian governments and businesses. The conceptual framework set out in section 2 of this paper helps establish a range of general issues. These include the potential impacts of any tax regime on competitiveness, environmental quality and government revenues, and the use of the tax system to subsidize the costs of environmental restoration.

Several issues become clear after surveying existing Canadian regulatory requirements and tax law. Some issues relate to the uneven application of tax laws across different sectors. Other issues relate to uncertainties in the tax treatment of expenditures on environmental restoration and financial assurances. Still others relate to the definition of an appropriate benchmark for the "neutral" tax treatment of environmental restoration costs and financial assurances in order to determine whether specific tax provisions reflect tax neutrality, a tax penalty or a tax expenditure. Finally, having defined this benchmark, a fourth set of issues are involved in deciding whether or not to depart from this benchmark, and in selecting the specific method, if any, in which such a departure is achieved.

5.2 Uneven Tax Treatment Across Sectors

Although the Federal Government has introduced rules allowing a current deduction for contributions to mining reclamation trusts, these rules are unavailable to other sectors. As a result, as section 4.2 of this paper documents, current deductibility for contributions to similarly constituted trusts in these other sectors is likely to be denied. From a tax policy perspective, the possibility of special treatment for the mining industry alone raises serious issues regarding horizontal equity and economic efficiency.

In the design of a fair tax system, it is a cardinal principle that identical tax rules should apply to all taxpayers who are similarly situated. As section 3 documents, there are many other sectors subject to similar requirements for environmental restoration and financial assurances. As a result, to the extent that the *Income Tax Act* allows current deductions only for contributions to mining reclamation trusts, it violates this basic principle of tax fairness.

Moreover, by providing uneven tax treatment across sectors, the mining trust reclamation rules may bias investment decisions. In particular, by reducing the current cost of carrying out activities in one sector compared to another, the tax treatment of mining reclamation trusts may tend to bias investment decisions in favour of the mining sector over non-mining sectors.

An uneven tax treatment for reclamation trusts can also encourage a higher level of reclamation activity in some sectors than others. If there are no strict requirements to deposit funds into a reclamation trust, but only one sector has access to an up-front deduction, the tax system is likely to encourage a higher level of financial assurance – and, in turn, reclamation activity -- in the sector that receives more generous tax treatment. Under these circumstances, by affecting environmental restoration decisions, the tax system will play a regulatory role which may or may not be desired.

5.3 Uncertainties in the Current Tax Treatment of Environmental Restoration Costs and Financial Assurances

A second issue in the tax treatment of environmental restoration costs and financial assurances involves uncertainties in current legislative, judicial, and administrative standards. For businesses, uncertainty can lead to inefficient investment decisions that ultimately affect profits. For governments, unclear tax treatments may distort revenue and other fiscal projections. In addition, by creating a more risky investment climate, an uncertain tax environment can deter domestic as well as foreign investment in Canada. With millions, and potentially billions, of tax dollars and investments at stake, businesses and governments should ideally be as clear and certain as possible about how the tax system will treat expenditures on environmental reclamation.

The review of the Canadian tax treatment of environmental restoration costs and financial assurances in section 4 of this paper suggests at least three areas of uncertainty. First, although the mining reclamation trust rules have removed the uncertainty surrounding the current deductibility of contributions for these kinds of financial assurances and the tax treatment of trust income both as it accrues and when it is withdrawn, a degree of uncertainty remains for other sectors for which the mining trust reclamation rules are currently unavailable. As section 4.2.4 of this paper documents, the basis of the Federal Court of Appeal decision *Nomad Sand and Gravel* is not entirely clear, and Revenue Canada's stated administrative position may not be entirely justified. Likewise, section 4.2.5 indicates a degree of uncertainty in the treatment of income received by or credited to funds held in trust, depending on the precise character of the trust.

The forestry and aggregates sectors, and to a lesser extent the solid waste and other sectors, are particularly vulnerable to setting cash aside and being denied a deduction until a later date. As explained in section 3.3 of this paper, the forestry industry currently contributes over $100 million to site-specific trusts for reforestation in the Provinces of Saskatchewan, Manitoba and Ontario. The aggregates sector contributes almost $60 million into site-specific trusts in Ontario. Although the solid waste and other sectors (exclusive of mining, forestry and aggregates) contribute minimal cash into trust funds, they post significant financial assurance in other forms that may be converted to cash deposits at some later date. Without clear tax rules for environmental trusts in these sectors, considerable uncertainty remains as to the proper tax treatment both of

contributions to these trusts and of income received by these trusts or credited to contributors when amounts held on deposit are refunded.

Second, as section 4.3.2 of this paper indicates, although Revenue Canada appears to have accepted, as an administrative practice, that expenditures on environmental restoration constitute deductible expenses rather than non-deductible capital outlays, this characterization issue is uncertain as a matter of law. As a result, considerable uncertainty exists in deciding whether expenditures on environmental restoration must be capitalized or may be deducted from business income.[95]

Finally, even if expenditures on environmental restoration are considered to be deductible expenses, a further element of uncertainty persists with respect to the specific taxation year in which these deductions may be claimed. As section 4.3.3 of this paper explains, the degree of certainty required for a future cost to be recognized as an "incurred expense" in advance of payment is itself imprecise. In addition, while the decisions in *Burnco Industries* and *Northwood Pulp and Timber Limited* suggest that current obligations to engage in future environmental restoration are not recognized as deductible "expenses" for the purposes of paragraph 18(1)(a) of the *Income Tax Act*, they do not rule out the possibility that current deductions might be available where contractual or regulatory obligations for environmental restoration require cash payments (as opposed to the actual performance of environmental restoration) in subsequent periods.

5.4 Defining a Benchmark for the Tax Treatment of Environmental Restoration Costs and Financial Assurances

Concerns about uncertainty and unevenness suggest that tax rules for environmental restoration costs and financial assurances should be clear and equally applicable to all industry sectors. However, they say nothing about the specific content which these revised tax rules should take. For this purpose, as section 2.5 suggests, it is necessary to define a benchmark for the neutral income tax treatment of environmental restoration costs and financial assurances, and to evaluate various policy reasons and methods for departing from this benchmark.

This section attempts to define a benchmark for the neutral tax treatment of environmental restoration costs and financial assurances. Section 5.5 discusses relevant policy issues involved in deciding to depart from this benchmark. Section 6 reviews alternative policy options for the tax treatment of environmental restoration costs and financial assurances and recommends specific options based on our definition of the benchmark tax treatment

[95] It is important to emphasize that this uncertainty issue continues to apply to mining companies despite the mining trust reclamation rules. Although these rules allow a deduction for amounts contributed to a mining reclamation trust, they also tax amounts withdrawn from the trust, and do not provide that these amounts are deductible if actually spent on reclamation. As a result, in order to obtain such a deduction, mining companies must depend on general tax principles.

and our analysis of the relevant policy issues involved in choosing to depart from this benchmark.

Based on our review of the current tax system in section 4 of this paper, there appear to be four elements involved in defining an appropriate benchmark for the tax treatment of environmental restoration costs and financial assurances. First, it is necessary to decide whether environmental restoration costs should, in a neutral income tax, be treated as non-deductible capital outlays or deductible expenses in calculating net income. Second, where obligations to perform future environmental restoration are assumed in advance of this restoration, it is essential to set a benchmark for the period, if any, in which the costs of these restoration obligations should be recovered for tax purposes (either as deductible expenses or on account of capital). Third, where financial assurances are provided in respect of these future environmental restoration obligations, a benchmark must be determined for the neutral tax treatment of these financial assurances. Finally, where these financial assurances take the form of deposits into a trust, it is necessary to define an appropriate benchmark for the tax treatment of income accumulated within the trust and the tax treatment of amounts that are withdrawn from the trust for use by a beneficiary.

5.4.1 Tax Treatment of Environmental Restoration Costs when Incurred

The discussion of characterization issues in section 4.2.2 of this paper is helpful in determining a benchmark for the tax treatment of environmental restoration costs when these costs are actually incurred. On the one hand, where restoration obligations are assumed in order to obtain a lease or to acquire real property either of which is necessary to engage in the income-producing activity, the decisions in *Robert Addie & Sons' Collieries Ltd.* and *RTZ Oil Ltd.* suggest that these costs should be regarded as non-deductible capital expenditures. On the other hand, the recent Australian decision in *Associated Minerals Consolidated Ltd.* concludes that environmental restoration costs should be recognized as deductible expenses incurred in gaining or producing income where these expenditures are made "necessary to the conduct of the business" by public pressure or government regulation.

In Canada, industry expenditures on environmental restoration are increasingly demanded by an environmentally conscious public and fiscally strapped governments. In the words of the Australian court in *Associated Minerals Consolidated Ltd.*: "In the late 20th century, part of the recurring costs of mining businesses is expenditure upon the amelioration of any adverse effects upon the environment of the mining activity."[96] The same may be said of other industries (such as aggregates, oil and gas, forestry, and waste management) subject to public pressure and government regulation.

While these costs may be incurred "once and for all" toward the end of the life of the income-producing activity, the extent to which they bring into existence "an asset or an advantage for the enduring benefit of a trade" is limited. Where the obligation is incurred in order to obtain a lease or permit to carry on the activity, the lease or permit comes to an

[96] *Associated Minerals Consolidated Ltd., supra* at 4506.

end with the termination of the activity. Since these "assets" are then likely to be disposed of for little or no consideration, a rule which capitalized the costs of environmental restoration could provide limited recognition for these substantial costs in determining the taxpayer's income tax liability.[97]

For these reasons, we think that it is appropriate to consider expenditures for environmental restoration as deductible expenses in defining the benchmark for their treatment under a neutral income tax.[98] As indicated in section 4.2.2, as an administrative practice, Revenue Canada appears to have accepted this view.

5.4.2 Tax Treatment of Future Environmental Restoration Costs

The review of accounting and tax principles in section 4.2.1 of this paper provides guidance in a discussion of the benchmark tax treatment for future environmental restoration costs. Accounting principles require future liabilities to be matched with current income. As a result, a benchmark based on accounting principles would suggest that estimated costs of future environmental restoration should be deductible on an accrual basis over the life of the project as income is produced.

From the perspective of tax principles, however, which must be concerned with the need to protect the revenue base, an accounting benchmark is highly problematic.[99] Under an accounting benchmark, cash or property need not be specifically set aside for future restoration in order to meet the test for current deductibility. Indeed, since the taxpayer may transfer its restoration obligations to another party (e.g., by selling the business or through a wind-up or merger) an accounting benchmark may allow deductions for environmental restoration cost that may never be incurred. It is for these reasons that a neutral tax system may legitimately deny a current deduction in respect of future environmental restoration costs where expenses are not incurred in the current period or amounts are not explicitly set aside for the purposes of future environmental restoration. Whether the tax system should depart from this benchmark to achieve any of the policy objectives outlined in section 2 of this paper is considered below in section 6.3 of this paper.

[97] Absent the application of any other rule, this approach would appear to result in a capital loss for which limited recognition is available under the Act. See paragraph 38(b) of the Act which limits "allowable" capital losses to three-quarters of the capital loss, paragraph 3(b) of the Act which allows allowable capital losses to be offset only against taxable capital gains, and paragraph 111(1)(a) of the Act which allows a one-year carryforward and a three-year carryback for net capital losses.

[98] Section 6.2 considers whether it makes sense to depart from this benchmark for specific policy objectives.

[99] On the different purposes of accounting and tax definitions of income, see the comments of Iacobucci, J. in *Symes v. Canada*, *supra* at 52. See also Glen E. Cronkwright, "The Dilemma of Conformity: Tax and Financial Reporting -- A Perspective from the Private Sector," in *Current Developments in Measuring Business Income for Tax* Purposes, 1981 Corporate Management Tax Conference, (Toronto: Canadian Tax Foundation, 1982) 22-40.

5.4.3 Tax Treatment of Financial Assurances

While a benchmark that is established in accordance with the distinct purposes of an income tax will certainly produce a less generous result than one developed on the basis of accounting principles, a neutral income tax need not rule out all current period deductions for future environmental restoration costs. On the contrary, where cash or property is actually set aside and dedicated solely for the purpose of future environmental restoration, the reasons identified in the previous section for departing from an accounting benchmark cease to apply, since cash or property is actually set aside for the purpose of environmental restoration and must ultimately be used for this purpose in order to obtain a deduction.

An obvious way to achieve this result would be to allow current deductions for cash or qualifying property contributed to a dedicated trust, from which funds could be withdrawn only for the purposes of environmental restoration.[100] In other words, unlike the current mining reclamation trust provisions, surplus funds could not be withdrawn by a beneficiary for any use other than environmental restoration.[101] Under these circumstances, deductions would never be provided for amounts that might never actually be spent on environmental restoration. As a benchmark for a neutral income tax system, therefore, amounts actually set aside in such a dedicated trust should be deductible in the taxation year in which these contributions are made.[102]

Finally, it is worth noting that the rationale for allowing a current deduction for amounts irrevocably set aside for the purpose of future environmental restoration expenditures does not apply for other kinds of financial assurances, such as letters of credit or performance bonds. Since these constitute a form of security, not an actual outlay or expense, the amount of these financial assurances should not be deductible for income tax purposes. On the other hand, where the taxpayer providing the financial assurance incurs expenses in respect of these assurances, these should be recognized as deductible expense under a neutral income tax.

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[100] In this respect, reference might be made to current income tax provisions with respect to trusts governed by a registered education savings plan (RESP). See subsection 146.1(2) of the Act, which provides that the property of a RESP must be "irrevocably held" for certain purposes specified in the definition of the term "trust" (for the purpose of section 146.1 of the Act) in subsection 146.1(1) of the Act. Except for paragraph (c) of this definition, which (contrary to our suggestion for environmental trusts) allows contributions to a RESP to be refunded to the payor, this definition requires the property of a trust governed by a RESP to be used solely for educational purposes.

[101] On the other hand, where trust funds remain after environmental restoration is completed, beneficiaries might be allowed to sell their beneficial interests, with proceeds of disposition subject to treatment as income rather than capital gains as provided in paragraph 12(1)(z.2) and subparagraph 39(10(a)(v) of the Act. The purchaser, of course, would remain subject to the initial requirement that funds could only be withdrawn for the purposes of environmental restoration.

[102] The Department of Finance appears to reject the idea of a current deduction for these contributions as an appropriate benchmark. See Federal/Provincial Alternative Approach, *supra*, and Testimony to the Standing Committee on Natural Resources by Bob Hamilton, *supra*. This issue is discussed more fully in section 5.4.4.4 of this paper.

While there may be other policy reasons to defer or fully exempt the accrued income of environmental trusts from tax, we cannot accept the view that deferral or exemption should be regarded as the proper benchmark for this income. On the contrary, it is a basic principle of an annual income tax that income should generally be taxed as it accrues.[106] While it is true that the taxation of trust income is deferred in the case of registered pension plans, this approach represents a deliberate departure from the benchmark tax treatment in order to encourage savings for retirement. As a result, while one might consider adopting a similar approach for environmental trusts in order to promote particular policy objectives, this approach should be recognized and evaluated as a tax subsidy or tax expenditure, not as a reflection of the benchmark tax treatment. We return to this issue below in section 6.5 of this paper.

5.4.4.2 Rate of Tax on Trust Income

Having determined that the income of an environmental trust should, for the purposes of defining the benchmark, be taxable as it accrues, a decision must then be made as to the appropriate rate of tax to be applied to this income under a neutral income tax. In general, two alternatives are possible: first, to tax the trust income at the beneficiary's marginal tax rate, on the assumption that this rate establishes the appropriate benchmark for the taxation of the trust income; or second, to tax the trust income at an arbitrary rate which might be set at the highest rate of tax applicable to corporate income.

The current system for taxing the income of mining reclamation trusts is an odd and complex combination of each of these approaches. On the one hand, the trust itself is taxed at the highest rate of tax applicable to corporate income. On the other hand, the beneficiary also pays tax on the annual income of the trust and receives a refundable tax credit equal to the tax paid by the trust on its share of the trust income. The net effect of this refundable credit mechanism, however, is to tax the trust income at the beneficiary's marginal tax rate.[107]

While the mechanism for achieving this result under the mining reclamation trust rules seems unnecessarily complex,[108] the taxation of accrued trust income at the beneficiaries' marginal tax rate seems like the appropriate benchmark for the neutral tax treatment of this accrued income. To the extent that the funds accumulating within the trust are for the purpose of satisfying the beneficiaries' obligations with respect to future environmental restoration, the income retains a sufficient connection with the beneficiaries' business to justify the beneficiaries' marginal tax rate as the appropriate benchmark. Although the *Income Tax Act* taxes *inter* vivos trusts at the top marginal rate for anti-avoidance

[106] See generally the *Report of the Royal Commission on Taxation* (Carter Commission), (Ottawa: Queen's Printer, 1966).

[107] Where the marginal tax rates of the trust and the beneficiaries differ, this refundable credit mechanism also affects the distribution of the tax burden among the trust and the beneficiaries. This issue is examined below in section 5.4.4.3 of this paper.

[108] See the discussion in section 5.4.4.3 of this paper.

reasons,[109] it is by no means obvious that similar anti-avoidance concerns justify a similar approach in the case of environmental trusts.

5.4.4.3 Payment of Tax on Trust Income

Having decided the benchmark rate at which tax should be paid on the accrued income of the trust, a benchmark must also be set to determine whether this tax should be paid by the trust, the beneficiaries, or some combination of both.

Under the current mining reclamation trust provisions, the distribution of this tax burden among the trust and the beneficiaries depends on the relative rates of tax payable by the trust and the beneficiaries. Where these rates are identical, the tax is paid out of income earned by the trust. Where beneficiaries are taxed at a higher marginal rate than the trust, the tax burden is shared among the trust and the beneficiaries. Finally, where beneficiaries are taxed at a lower marginal rate than the trust, the current mining reclamation trust provisions impose an excessive tax burden on the trust and refund the excessive portion of this tax to the beneficiaries in the form of a refundable tax credit. Since these rules also stipulate that mining reclamation trusts are taxable at a rate of tax equal to the highest corporate tax rate, the third of these situations is likely to occur quite often.[110]

While the tax results in the first and second of these circumstances seem unproblematic, the net effect in the third situation is particularly odd. By imposing an excessive tax burden on the trust and refunding the amount of this excessive tax burden to the beneficiary, the current mining reclamation trust provisions may not only impede the rate of accumulation of funds within the trust but, in effect, provide a tax-free distribution of trust funds to all beneficiaries taxable at lower marginal rates than the trust.[111] To the extent that the trust is intended to accumulate funds for future mine reclamation, any artificial reduction in the rate of

[109] See paragraph 117(2)(b) of the Act, which sets the top marginal rate of tax for individuals at 29%, and subsection 122(1) of the Act, which taxes *inter vivos* trusts at a rate of 29%. By taxing *inter vivos* trusts at the top marginal rate, the Act eliminates incentives for income splitting through the establishment of this kind of trust.

[110] The beneficiary's marginal tax rate could be less than the tax rate applicable to income of the trust if it has no net income for the year, can make use of loss carryovers to shelter net income for the year, or any of its income qualifies for specific deductions available under sections 125 (small business deduction) and 125.1 (deduction for manufacturing and processing profits).

[111] Assuming a combined federal and provincial trust tax rate of 44% and a combined federal and provincial corporate tax rate of 22% payable by the beneficiary, a receipt of $100 by the trust would result in an after-tax accumulation of $66 in the trust and a net credit of $22 to the beneficiary -- thereby, in effect, withdrawing $22 from the trust for use by the beneficiary.

accumulation within the trust seems somewhat contradictory.[112] As well, the impact on revenues and equity seems questionable.[113]

As for the determination of an appropriate benchmark, taxation in the hands of the trust is an obvious choice since the trust, not the beneficiary, actually receives the income on which tax must be paid. To require the beneficiary to pay tax on accrued trust income which it does not actually receive could result in cash flow problems which current deductibility for contributions to environmental trusts is in part intended to resolve.

On the other hand, two arguments might be made for requiring the beneficiary to pay the tax despite these cash flow problems. First, where the trust income is taxed at the beneficiaries' marginal rates of tax, payment by the trust is likely to be considerably more complex than payment by the beneficiaries, since beneficiaries will have to determine their tax position before the trust can calculate the amount of tax payable. In addition, where the trust has more than one beneficiary, the trustees will face the administrative burden of having to determine each beneficiary's share of the trust income and calculating tax at an appropriate blended rate.[114] Second, to the extent that trust monies will accumulate more quickly where tax is paid outside the trust, it might be argued that environmental quality could be enhanced by requiring beneficiaries to pay tax on the trust income, rather than the trust.

While the second of these arguments is properly considered in deciding whether or not to depart from a benchmark tax treatment,[115] the complexity issue is a relevant consideration in determining the appropriate benchmark for the distribution of the trust tax burden under a neutral income tax. On balance, we think that these complexities favour an arrangement in which tax on the income of the trust is paid by the beneficiaries, rather than the trust.[116] On the other hand, since cash-flow problems may make it difficult for the beneficiaries to pay the tax, we believe that a neutral tax system would also allow beneficiaries to direct the trustees to pay the tax out of the income of the trust.

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[112] While this outcome can be corrected by increasing the contributions to the trust (e.g., based on the example in the previous footnote, the beneficiary could contribute the $22 net credit back to the trust), the refundable credit mechanism increases both the complexity of the tax system and the number of calculations involved in attempting to determine an appropriate schedule for contributions to the trust. In addition, the beneficiary obtains a further deduction for an amount for which a deduction was already received on the initial contribution to the trust.

[113] To the extent that taxpayers contribute additional funds to the trust in order to compensate for the excessive tax burden, they obtain an additional deduction which reduces tax revenues. Moreover, since this additional deduction is available only to beneficiaries with relatively low marginal rates of tax, it is horizontally inequitable.

[114] Nonetheless, where tax on the accrued trust income is payable by the beneficiaries, the trustees will also have to determine each beneficiary's share of the trust income in order that each beneficiary can determine its own tax position.

[115] See the discussion of this issue below in section 6.5 of this paper.

[116] This approach would be analogous to the taxation of partnership income under subsection 96(1) of the Act.

5.4.4.4 Tax Treatment of Amounts Withdrawn from the Trust

If contributions to environmental trusts are deductible when made, but trust income is taxable as it accrues, funds that are withdrawn from these trusts for the purposes of environmental restoration will include amounts on which income tax has not been paid and amounts on which income tax has been paid by the trust. Of the total value of all property held by the trust at any time, the untaxed portion should be the aggregate amount of deductible contributions made to the trust, while the tax-paid portion should be the difference between the total value of all property held by the trust and the amount of the untaxed portion.

To the extent that a beneficiary's contributions to an environmental trust are deductible when made, it is generally agreed that these amounts should be taxable when they are distributed out of the trust to the beneficiary.[117] This approach seems appropriate from the perspective of a neutral benchmark.

In contrast, where tax has already been paid on amounts that are subsequently withdrawn from the trust, taxation of these amounts would appear to constitute double taxation. Indeed, this very criticism has been leveled against the current mining reclamation trust rules, which require beneficiaries to whom funds are distributed from a mining reclamation trust to pay tax on the entire amount of this distribution, notwithstanding that tax may have been paid on these funds as they accumulated in the trust.[118] Defending the current rules against this double taxation argument, the Department of Finance argues that the mining reclamation trust provisions are neutral in that the present value of the initial deduction and subsequent taxation is equal to the present value of a deduction available at the time that the trust funds are withdrawn and spent on environmental restoration.[119]

As we explain in section 5.4.3 of this paper, we regard a current deduction for contributions to dedicated environmental trusts as the benchmark for a neutral income tax. The Department of Finance, however, appears to reject the idea of a current deduction as an appropriate benchmark . As a result, while its "alternative approach", on which the mining reclamation trust rules are based, allows a current deduction for contributions to a mining reclamation trust, it deliberately taxes income as it accrues within the trust and again when tax-paid amounts are subsequently distributed out of the trust in order to maintain its own benchmark of revenue neutrality.

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[117] Where the terms of the trust require that these funds be spent on environmental restoration, no net tax will be payable provided that expenditures on environmental restoration are recognized as deductible expenses, not non-deductible capital outlays.

[118] See The Mining Association of Canada, *Financial Assurance for Mine Reclamation, Decommissioning and Post-Closure Obligations*, *supra* at 10; and Carson, "Mining Reclamation Trusts," *supra* at 19 and 23.

[119] See Federal/Provincial Alternative Approach, *supra*, and Testimony to the Standing Committee on Natural Resources by Bob Hamilton, *supra*. For the purpose of this paper, we do not examine the mathematical validity of this proposition, but accept it as asserted by the Department of Finance.

In our view, because the Department of Finance has mistaken the relevant benchmark for determining the appropriate tax treatment of contributions to environmental trust funds, the current mining reclamation trust rules impose an unintended tax penalty on the accumulation of funds within a mining reclamation trust by subjecting tax-paid funds to a second burden of taxation when they are withdrawn from the trust. In contrast, we believe, the benchmark would be to recognize the tax that has already been paid on these amounts by allowing a portion of each distribution from the trust to be received free of tax, based on the ratio of the aggregate value of tax-paid funds in the trust to the total value of all property held by the trust. While this allocation rule might be complex to design and administer, it would address a serious double taxation effect embedded in the current mining reclamation trust rules.

5.5 Issues in Departing from the Benchmark Tax Treatment

Beyond the issue of defining a benchmark tax treatment for environmental restoration costs and financial assurances, there are a number of issues that must be confronted in choosing to depart from the benchmark. Governments can depart from the benchmark either by designing a relatively generous tax treatment (tax subsidy or tax expenditure), or a relatively onerous one (tax penalty). The key issues in considering both types of departures from the benchmark tax treatment are impacts on environmental quality, effects on competitiveness and jobs, and impacts on revenue. There are several additional considerations in providing a tax subsidy, as outlined above in Section 2.

A final, and perhaps overriding, issue is whether the objectives in departing from the benchmark tax treatment are better met through a different tax provision or direct subsidy program. We have identified four possible points of departure from the benchmark tax treatment of environmental restoration costs and financial assurance. The tax treatment can depart from the benchmark treatment of environmental restoration costs when incurred; from the tax treatment of future environmental restoration costs; from the tax treatment of financial assurances; and from the tax treatment of trust income. Considerations for revenue, jobs, competitiveness and the environment under any of these cases may become irrelevant if objectives in departing from the benchmark can be achieved through an alternative policy instrument.

6. Policy Options and Recommendations for Tax Treatment of Environmental Restoration Costs and Financial Assurances for Environmental Restoration

6.1 Introduction

Earlier sections of this paper have surveyed the regulation and taxation of environmental restoration costs and financial assurances for environmental restoration in Canada, and have examined the various policy issues that must be considered in order to evaluate alternative policy options for the tax treatment of environmental restoration costs and related financial assurances. In section 5 we set out a benchmark for the neutral tax treatment of environmental restoration costs and related financial assurances and identified the key issues involved in any policy decision to depart from this benchmark tax treatment. We also emphasized, and now recommend, that the tax treatment of environmental restoration costs and financial assurances for environmental restoration should apply equally to all industry sectors.

In this section, we review the key options for the tax treatment of environmental restoration costs and financial assurances, their relationship to the benchmark tax treatment as we have defined it in section 5.4 of this paper, and various ways in which policy makers might choose to depart from this benchmark in order to pursue specific policy objectives. While this paper cannot determine whether any departure from the benchmark tax treatment is warranted, it can and does evaluate alternative avenues of departure from the benchmark in light of the policy objectives that these departures might be intended to promote.

6.2 Options for the Treatment of Environmental Restoration Costs when Incurred

Based on the discussion in sections 4 and 5 of this paper, there are two options for the tax treatment of environmental restoration costs when they are actually incurred: to recognize these expenditures as deductible expenses or to treat them as non-deductible outlays on account of capital.

As in indicated in section 5.4.1 of this paper, we believe that a neutral income tax would allow these expenditures to be deducted against income when actually incurred. Nonetheless, a rule requiring these expenditures to be capitalized might be suggested as a way of increasing government revenues by limiting the recognition of these expenditures for income tax purposes.

As a consequence, of course, such a departure from tax neutrality would impose a substantial cost burden on industries subject to environmental restoration obligations, and establish a tax penalty on expenditures for environmental restoration. Given concerns

about competitiveness and environmental quality, therefore, this method of departing from our stated benchmark seems undesirable.

While Revenue Canada appears to accept the conclusion that environmental restoration costs should be deductible when actually incurred, this position remains uncertain as a matter of law. For this reason, we recommend that the *Income Tax Act* be amended to include a specific provisions stating that environmental restoration costs are deductible when actually incurred.

6.3 Options for the Tax Treatment of Future Environmental Restoration Costs

With respect to the tax treatment of future restoration costs, the two most obvious options are for tax rules to follow the accounting treatment in which estimated future restoration costs are matched against current income, or to retain the existing rule that future restoration costs are not deductible unless they represent a current liability to pay a certain amount.

As indicated in section 5.4.2 of this paper, we consider the current approach, rather than accounting principles, to be consistent with the benchmark for a neutral income tax. As a result, where more generous treatment under accounting principles is recommended as an alternative to the existing rule, this option should be evaluated as a tax subsidy or tax expenditure.

From this perspective, there is little doubt that recognition of the accounting definition of income for the purposes of income taxation would provide a significant subsidy to industries subject to environmental restoration obligations, improving their competitive position and perhaps their level of investment in Canada. On the other hand, by allowing current period deductions irrespective of amounts actually set aside for the purposes of environmental restoration, this form of tax expenditure would provide a subsidy to industry without any guarantee that this subsidy would improve environmental quality by encouraging companies to set aside funds for future environmental restoration or by increasing expenditures on site restoration. As well, given the uncertain and potentially enormous unfunded liabilities in respect of future environmental restoration obligations, the revenues foregone by this kind of tax expenditure are likely to be similarly uncertain and substantial. Finally, as section 6.6 of this paper explains, if it is considered appropriate or necessary to subsidize the impending costs of unfunded environmental restoration liabilities, a refundable tax credit specifically designed for this purpose would be a more direct and cost-effective policy instrument achieve this objective.

For these reasons, we favour the current rule whereby future restoration costs are not deductible unless they represent a current liability to pay a certain amount, and recommend that the accounting treatment whereby estimated future restoration costs may be matched against current income *not* be recognized as the basis for determining income for tax purposes.

6.4 Options for the Tax Treatment of Financial Assurances

Where funds are actually set aside to fund future environmental restoration costs, these amounts may or may not be allowed as current period deductions for the purposes of the income tax. Likewise, where other forms of financial assurance are provided, the economic costs associated with the granting of these assurances may or may not be recognized for income tax purposes.

As indicated in section 5.4.3, we think that a neutral income tax should allow a current period deduction for amounts contributed to a dedicated environmental trust, but should recognize the economic costs associated with other kinds of financial assurance only to the extent that the taxpayer granting the financial assurance incurs expenses in respect of these assurances (e.g., fees or premiums). Consequently, to depart from this benchmark, as does the existing income tax by prohibiting current period deductions for all forms of financial assurance except mining reclamation trusts, is to impose a tax penalty which must be evaluated on the basis of the revenue or regulatory objectives pursued by means of the tax penalty.

Based on our analysis in section 5.4.4.4 of this paper, the apparent policy objective in departing from the benchmark tax treatment of financial assurances for environmental restoration, as we have defined this benchmark, appears to be largely revenue-oriented. As the Department of Finance has indicated, it is a concern with maintaining existing revenues that explains the "double taxation" of income withdrawn from a mining reclamation trust. In addition, however, this restrictive approach may be designed to achieve a regulatory goal, by requiring companies to incur current restoration costs or to assume definite future payment obligations in order to obtain a deduction in the current period.

With respect to the first objective, we are unable to estimate the revenue cost involved in moving from the current restrictive tax treatment to a more generous approach in which current deductions would be allowed for contributions to dedicated environmental trusts. Nonetheless, we believe that even significant revenue costs may be justified where this involves a step in the direction of a neutral benchmark and where other compelling policy reasons favoring a departure from this benchmark appear to be lacking. In the case of the current income tax treatment of financial assurances, we believe that the additional revenue raised by denying a current deduction for contributions to dedicated environmental trusts are unlikely to be sufficient to outweigh the negative impact that this tax penalty is likely to inflict upon affected industries and environmental quality.

As for the regulatory goal of improving environmental quality, it is our view that the current tax rules may actually undermine this objective by discouraging businesses from setting aside funds for future environmental restoration. If all amounts set aside for the purposes of environmental restoration were deductible upfront, an incentive would be created (or a penalty removed) to encourage businesses to set aside funds for future environmental restoration. Moreover, where tax rules specify that environmental trust

funds cannot be withdrawn except for the purpose of environmental restoration, increased contributions to these funds are likely to improve environmental quality.

For all these reasons, therefore, we recommend that amounts set aside in dedicated environmental trusts, prohibited from spending funds on any purpose other than environmental restoration, should be deductible in the taxation year in which contributions are made.

6.5 Options for the Tax Treatment of Environmental Trust Income

With respect to the tax treatment of income received and subsequently distributed by environmental trusts, there appear to be three general alternatives[117]:

(1) the current rules for taxing the income of mining reclamation trusts, which tax the trust income both when it accrues and again when it is withdrawn from the trust;

(2) the mining industry's proposal for RPP-type treatment, according to which tax on the income of the trust would be deferred until amounts are withdrawn from the trust; and

(3) the benchmark tax system, as we have defined it in section 5.4.4 of this paper, according to which the trust income should be taxable as it accrues, and an appropriate portion of each withdrawal (representing the ratio of aggregate tax-paid funds to the total value of property held by the trust at the time of the distribution from the trust) should be received free of tax.

With respect to the first of these options, we have already explained why we consider the additional tax on the tax-paid portion of amounts withdrawn from the trust to be double taxation: to the extent that a neutral tax system would allow an upfront deduction for amounts contributed to a dedicated environmental trust, the "revenue neutral" approach proposed by the Department of Finance, and reflected in the current rules for mining reclamation trusts, amounts to a tax penalty on contributions to these trusts.[118] Likewise, we have also explained why this tax penalty is apt to discourage contributions to

[117] For the purposes of the more general discussion of policy options in this section, we do not reconsider the detailed issues examined in sections 5.4.4.2 and 5.4.4.3 of this paper concerning who should pay the tax and the rate at which it should be paid, but instead simply assume the benchmarks we defined. As noted in these sections of the paper, this benchmark suggests a simpler approach than that contained in the current mining reclamation trust rules, which tax both the trust and the beneficiaries and provide a refundable credit to the beneficiaries. On the contrary, we favour an approach, much like that for the taxation of partnership income, according to which each beneficiary's share of the trust income would be taxed in the hands of the beneficiary, subject to an election to have the resulting tax paid out of the income of the trust.

[118] See sections 5.4.3 and 5.4.4.4 of this paper.

environmental trusts and impede the policy goal of enhancing environmental quality.[119] Alternatively, to the extent that government regulations ensure a comparable standard of environmental quality irrespective of the manner in which the income of mining reclamation trusts is taxed, this tax penalty imposes an additional cost burden on businesses which may lessen their competitiveness. For all these reasons, we reject the first option as an unjustified departure from the benchmark tax treatment of environmental trust income.

With respect to the second of these options, we have already explained why we regard RPP-type treatment as an inappropriate benchmark for the neutral tax treatment of the income of an environmental trust: it is a basic principle of an annual income tax that income should generally be taxed as it accrues, so that registered pension plans represent a deliberate departure from this benchmark for social policy reasons.[120] As a result, any departure from the benchmark by deferring tax on the income of environmental trusts until the accumulated income is withdrawn from the fund should be evaluated as a tax subsidy or tax expenditure.

In this respect, the mining industry has advanced two further arguments in favour of tax deferral. First, it is argued that environmental quality is likely to suffer where the rate of accumulation of funds for future environmental restoration is decreased by the taxation of accrued income in the trust:

> If the earnings of these funds are taxed on an annual basis, either the time necessary to build up the fund to meet financial requirements will increase or the drain on company cash flow will increase. Untaxed compounding would reduce risk to governments and the environment because funds build up more quickly and there would be more money available sooner to cover the necessary reclamation if a company closes ahead of schedule or unexpectedly.[121]

Second, the mining industry argues that it faces a significant financial hurdle related to unfunded future restoration obligations, especially over the next ten years, and that a failure to share this burden with the public could affect "the competitive position of the industry" and could lead to a "loss of jobs and economic activity if mines close prematurely."[122]

In response to these arguments in favour of a tax expenditure delivered in the form of a tax deferral on income accumulated by environmental trusts, two points should be mentioned. First, since there is no guarantee that the benefits of untaxed compounding will be reflected in increased expenditures on environmental restoration, rather than

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[119] See the analysis of "Options for the Tax Treatment of Financial Assurances" in section 6.4 of this paper.

[120] See section 5.4.4.1 of this paper on "Tax Treatment of Trust Income as it Accrues".

[121] *Ibid.* at 10.

[122] *Ibid.* at 11.

reduced contributions to environmental trusts, the connection between this policy instrument and improvements in environmental quality is tenuous. Second, to the extent that governments accept a need to share the costs of environmental restoration with industry, these subsidies can be delivered more directly an with less uncertainty in terms of foregone revenue through a refundable tax credit for environmental restoration or through a direct subsidy for environmental restoration.

For these reasons, we recommend that the benchmark defined in section 5.4.4 of this paper should be the model for the taxation of the income of environmental trusts.

6.6 Additional Tax Options for Departing from the Benchmark

In addition to these various methods of departing from the benchmark tax treatment for environmental restoration costs and financial assurances, it is important to mention two additional tax instruments that might merit more serious investigation.

First, to the extent that a more restrictive tax treatment is desired for revenue or regulatory purposes, an explicit tax penalty on environmentally damaging conduct or activities might be considered. One possibility, which would require considerable further study is the US Superfund legislation, which raises funds for environmental restoration through specific taxes on toxic substances responsible for environmental degradation.

Alternatively, where governments desire to subsidize the costs of environmental restoration, refundable tax credits for amounts actually spent on environmental restoration are likely to be a more cost-effective and targeted method of sharing these costs than tax expenditures directed at the treatment of environmental trust fund income. Of course, the manner in which such a refundable tax credit might be designed and delivered would also require further study.

6.7 Recommendations

It is not our view that the tax treatment of environmental restoration costs and financial assurances for environmental restoration should necessarily follow the neutral benchmark that we have identified. Nonetheless, we believe that the definition of a neutral benchmark crucial to understand the role of specific tax provisions and essential to assess the effectiveness of alternative options to achieve specific policy objectives beyond those involved in raising revenue through a fair and neutral income tax.

In this section, we have evaluated alternative departures from our benchmark and have suggested two preferred approaches if it is considered desirable to establish a more onerous or a more generous tax treatment than that suggested by our benchmark.[123] On the basis of this analysis, we make the following specific recommendations for the tax

[123] See section 6.6 of this paper.

treatment of environmental restoration costs and financial assurances for environmental restoration:

1. That the tax treatment of environmental restoration costs and financial assurances for environmental restoration should apply equally to all industry sectors.

2. That the *Income Tax Act* be amended to include a specific provisions stating that environmental restoration costs are deductible when actually incurred.

3. That the accounting treatment whereby estimated future restoration costs may be matched against current income *not* be recognized as the basis for determining income for tax purposes.

4. That amounts set aside in dedicated environmental trusts, prohibited from spending funds on any purpose other than environmental restoration, should be deductible in the taxation year in which contributions are made.

5. That the income of the trust be subject to tax as it accrues, payable at the marginal rate of each beneficiary and by each beneficiary, subject to an election to have the resulting tax paid out of the income of the trust.

6. That amounts withdrawn from the trust for the purpose of environmental restoration be partly taxable and partly free of tax, with the taxable portion based on the ratio of the aggregate value of deductible amounts contributed to the trust to the total value of all property held by the trust.

7. That further study be devoted to the merits of imposing tax penalties on environmentally damaging conduct or activities, and providing refundable tax credits for amounts spent on environmental restoration.

Appendix A
Regulations for Environmental Restoration and Financial Assurances

Mining

Alberta

Under the *Environmental Protection and Enhancement Act*, mining companies are obliged to conserve and reclaim sites in accordance with regulatory standards, and required to obtain a reclamation certificate in order to surrender a lease.[1] In order to obtain approval to carry out any mining activities, licensees must obtain approval provide security in an amount determined by the Director to be sufficient to ensure the completion of conservation and reclamation based on estimated costs submitted by the operator and any other factors considered relevant by the director.[2] Security may be in any form acceptable to the Director, including cash, cheques and other negotiable instruments payable to the Provincial Treasurer, government-guaranteed bonds, debentures, term deposits, certificates of deposit, trust certificates or investment certificates assigned to the Provincial Treasurer, irrevocable letters of credit, irrevocable letters of guarantee, performance bonds, or surety bonds.[3] This security may be forfeited where the mining operator fails to comply with its conservation and reclamation obligations, or returned to the operator when a reclamation certificate is issued.[4]

The *Environmental Protection and Enhancement Act* establishes two funds for the purposes of conservation and reclamation: an Environmental Protection Security Fund, to which security is deposited in a separate account, and an Environmental Protection and Enhancement Fund, funded by forfeited security and transfers from the Consolidated Revenue Fund.[5]

British Columbia

Before work may commence in, on, or about any mine, including any mechanical disturbance of the ground or excavation or any exploratory drilling, the applicant for a

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[1] *Environmental Protection and Enhancement Act*, SA 1992, c. E-13.3, ss. 122, 123 and 129. See also subparagraph 1(w)(iii) and section 2 of the *Conservation and Reclamation Regulation*, Alta. Reg. 115/93 (May 15, 1993), which provide that a mine is "specified land" for the purposes of Part 5 of the *Environmental Protection and Enhancement Act*, and that: "The objective of conservation and reclamation of specified land is to return the specified land to an equivalent land capability."

[2] On the approval requirement, see sections 58-68 of the *Environmental Protection and Enhancement Act*, *supra*, and paragraph 17(1)(a) of the *Conservation and Reclamation Regulation*, *supra*. On the requirement to obtain security, see paragraph (a) of Division 3 of the *Activities Designation* Regulation, Alta. Reg. 110/93, and subsection 18(1) of the *Conservation and Reclamation Regulation*, *supra*, and section 80 of the *Environmental Protection and Enhancement Act*, *supra*.

[3] *Conservation and Reclamation Regulation*, *supra*, s. 21.

[4] *Ibid.*, ss. 22 and 24.

[5] *Environmental Protection and Enhancement Act*, *supra*, ss. 28 and 30.

permit must file a plan outlining the work and a programme for the protection and reclamation of the land and watercourses affected.[6] As a condition of issuing a permit, the chief inspector of mines may require that security for mine reclamation be provided in a form specified.[7] In addition, he or she may require annual deposits of security so that, together with the initial security deposit and calculated over the life of the mine, funds will be available to fulfill all the conditions of the permit.[8] As well, mining companies may deposit funds with a mine reclamation fund, which maintains a separate account for each mine.[9] Money deposited to this fund may be used to pay for reclamation where it is not carried out, or refunded with "interest earned on it" when in the opinion of the chief inspector, "it is no longer required for mine reclamation and protection of, and mitigation of damage to, land and watercourses affected by the mine".[10]

Manitoba

Under the *Mines and Minerals Act*, mine operators are required to institute and carry out a program for protection of the environment and for rehabilitation of the project site as set out in an approved closure plan.[11] Submission of the closure plan must be accompanied by the provision of security to the Crown for performance of the rehabilitation work.[12]

The Act provides for a "Mine Rehabilitation Fund" to which monies received as security or realized under securities or letters of credit given as security are to be deposited.[13] Securities are to be maintained in the names of the sites to which the funds are related,[14] and are refunded with interest upon completion of the rehabilitation work,[15] or made available for use by the minister in the event of non-compliance.[16] The details of this Fund have yet to be established by regulation.

New Brunswick

Under the *Mining* Act, a prospector, holder of a mining lease or mineral claim, or mine operator planning to do work that may cause damage to or interference with the use and enjoyment of land may be required to submit a reclamation program and security.[17] The security may take the form of money, a negotiable bond, a letter of credit, a bond of an insurance company, or some other form acceptable to the Minister.[18]

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[6] *Mines Act*, SBC 1989, c. 56, s. 10(1).
[7] *Ibid.*, s. 10(4).
[8] *Ibid.*, s. 10(5). See also Barry Barton, *Canadian Law of Mining*, (Calgary: Canadian Institute of Resources Law, 1993) at 18.
[9] *Mines Act*, *supra*, s. 12. See also BC Reg. 287/94 (August 26, 1994).
[10] *Mines Act*, *supra*, s. 12(4).
[11] *Mines and Minerals Act*, SM 1991-92, c. 9 [as amended], s. 188(1).
[12] *Ibid.*, s. 1(1) definition of "closure plan".
[13] *Ibid.*, s. 195(1).
[14] *Ibid.*, s. 195(2).
[15] *Ibid.*, s. 195(3)(b).
[16] *Ibid.*, ss. 195(3)(a) and 193.
[17] *Mining Act*, RSNB 1973, c. M-14.1 [as amended], ss. 109-111.1.
[18] *Ibid.*, s. 111.1(a).

Nova Scotia

Under the *Mineral Resources Act*, the area disturbed by mining operations, including any area upon which waste rock and tailings are deposited, must be reclaimed to the satisfaction of the Minister by the lessee within 12 months of the cessation of production, or such greater time as determined by the Minister.[19] Applicants for a mining permit must post cash, a negotiable bond, or other security in a form satisfactory to the Minister and an amount determined in accordance with regulations.[20]

Ontario

According to the *Mining Act*, before advanced exploration of mine production may commence, a "closure plan" must be filed or submitted for approval by the Director of Mine Rehabilitation.[21] Under the definition of the term "closure plan" in subsection 139(1) of the *Mining Act*, this plan must include provision for financial assurance to the Crown in order to secure performance of the requirements of the closure plan.[22] Financial assurance required as part of a closure plan must be in an amount specified in the closure plan, and may in the form of cash, a letter of credit from a bank named in schedule I to the *Bank Act* (Canada), a bond of a guarantee company approved under the *Guarantee Companies Securities Act*, a mining reclamation trust as defined in the *Income Tax Act*, compliance with a corporate financial test, as prescribed by regulation, or another form of security acceptable to the director including a pledge of assets, a sinking fund, or royalties per tonne.[23]

Quebec

Under recently enacted amendments to the *Mining Act*, persons engaged in mining activities must carry out land rehabilitation and restoration works in accordance with a plan approved by the Minister.[24] Before carrying on mining activities that may affect the environment, mining companies must file for approval a plan for the redevelopment and restoration of the site affected by the mining activities.[25] In addition, to ensure that the work stipulated in the plan will be performed, they must provide a guarantee in an amount determined by the minister.[26]

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[19] *Mineral Resources Act*, SNS 1990, c. 18 [as amended], s. 75.
[20] *Ibid.*, s. 97. See also NS Reg. 30/91 (March 22, 1991).
[21] *Mining Act*, RSO 1990, c. M.14 [as amended], ss. 140-142. On the details of the closure plan, see O. Reg. 114/91 (March 20, 1991).
[22] *Ibid.*, s. 139(1).
[23] *Ibid.*, s. 145(1).
[24] *Mining Act*, RSQ c. M-13.1, s. 232.1. On the recent amendments, see Paul R. Granda and Odette Nadon, "The Mining Industry and the Restoration of the Environment in Quebec" (1995), 18 *Canadian Environmental Law Report* 197.
[25] *Ibid.*, s. 232.2. For specific requirements of the plan, see *ibid.*, s. 232.3.
[26] Ibid., ss. 232.4, 232.5, and 232.7. The amount of the guarantee is specified in the *Regulation Respecting Mineral Substances other than Petroleum, Natural Gas and Brine*, RQ 185/95 (February 8, 1995), s. 96.5.

Pursuant to regulations established under the *Act*, this guarantee may take one or more of the following forms: a cheque made out to the Minister of Finance of Quebec; bonds issued or guaranteed by Quebec or another Canadian province, by Canada or by a municipality in Canada, and having a market value at least equal to the amount of the guarantee payable; guaranteed investment certificates or term deposit certificates, in Canadian dollars, issued on behalf of the Minister of Finance by a bank, a savings and credit union, or a trust company; an irrevocable and unconditional letter of credit issued on behalf of the Government of Quebec by a bank, a savings and credit union, or a trust company; a security or a guarantee policy issued on behalf of the Government of Quebec by a company legally authorized to act in that capacity; a security provided by a third party on behalf of the Government Quebec; and a trust established for the purpose of completing the rehabilitation and restoration of a mine site, constituted in accordance with the provision of the *Civil Code of Quebec* and fulfilling specific requirements set out in the Regulation.[27]

Where the operator fails to comply with the requirements of the rehabilitation and restoration plan, the Minister may cause this work to be performed and may recover the cost of the work out of the guarantee furnished.[28] On the other hand, where the rehabilitation and restoration work is carried out in accordance with the plan, the Minister may release the operator from its guarantee.[29]

Saskatchewan

Under *The Mineral Industry Environmental Protection Regulations, 1996*, persons are prohibited from operating a mine until a decommissioning and reclamation plan for the mine site has been approved by the minister, and an assurance fund to ensure the completion of the decommissioning and reclamation has been proposed, approved by the minister and established to the minister's satisfaction.[30] According to the Regulation, this assurance fund must be in an amount and form approved by the minister and may consist of cash; cheques and other similar negotiable instruments; government bonds, government guaranteed bonds, debentures, term deposits, certificates of deposit, trust certificates or investment certificates; guarantees, irrevocable letters of credit, irrevocable letters of guarantee, performance bonds or surety bonds; security interests in goods, documents of title, securities, chattel papers, instruments, moneys, intangibles of interests that arise from an assignment of accounts that secure the performance of a decommissioning and reclamation plan approved by the minister pursuant to section 14 of the Regulation; any other financial instrument or security that is acceptable to the minister; or any combination of these types of security.[31]

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[27] *Ibid.*, s. 96.8.
[28] *Mining Act, supra*, s. 232.8.
[29] *Ibid.*, s. 232.10.
[30] *The Mineral Industry Environmental Protection Regulations, 1996*, RRS 134/96 (March 5, 1996), s. 12. Detailed requirements for the decommissioning and reclamation plan are set out in subsection 14(2) of the Regulation.
[31] *Ibid.*, s. 15(1).

Under section 19 of the Regulation, security may be realized and used for the purposes of site decommissioning and reclamation where the operator defaults in respect of its obligations.[32] Alternatively, where the operator is released from the requirements of the decommissioning and reclamation plan, the minister is required to release or refund the proportion of the assurance fund that the minister considers proportionate with the degree to which the operator is released from its obligations.[33]

Territories

Under the *Northern Inland Waters Act*, mine operators must obtain a water license, which normally includes the submission of a reclamation plan and may include the provision of security.[34] Under the *Act*, territorial water boards may require a licence applicant to post a refundable bond in the amount of $100,000 or 10% of the estimated capital cost of the work, whichever is greater. The security may be in the form of a bank draft, certified cheque, or performance bond.[35] In 1993, each territory enacted new water legislation under which security may be required to cover all damage and some future damage.[36]

Aggregates

Alberta

Under the *Environmental Protection and Enhancement Act* and the *Activities Designation Regulation* adopted pursuant to this *Act*, companies carrying on aggregates activities are subject to the same requirements for approval, conservation and reclamation, and financial assurance as apply to mining companies.[37]

Manitoba

Under the *Mines and Minerals Act*, a registration certificate is required in order to operate an aggregate quarry.[38] In order to finance future site restoration, operators of aggregate quarries are required to pay an annual rehabilitation levy, as prescribed by regulation.[39] Funds raised by this levy are deposited to a Quarry Rehabilitation Reserve Account

[32] *Ibid.*, s. 19.
[33] *Ibid.*, s. 22.
[34] See the *Northern Inland Waters Act*, RSC 1985, c. N-25, and the *Northern Inland Waters Regulations*, CRC 1978, c. 1234, s. 13.
[35] See Richard Carson, "Mining Reclamation Trusts" in *Report of the Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 14:1-24 at 10.
[36] See the *Northwest Territories Waters Act*, Bill C-51, 3d Sess., 34th Parl., and the *Yukon Waters Act*, Bill C-52, 3d Sess., 34th Parl., s. 17.
[37] See subparagraph 1(w)(iii) of the *Conservation and Reclamation Regulation, supra*, which provides that a pit or quarry is "specified land" for the purposes of Part 5 of the *Environmental Protection and Enhancement Act*, and paragraph (d) of Division 3 and paragraphs 1(5)(1) and (k) of the *Activities Designation Regulation, supra.*
[38] *Mines and Minerals Act, supra*, ss. 196-197.
[39] *Ibid.*, s. 200(1), and Reg. M162-65/92.

established under the Consolidated Fund, from which amounts may be drawn to pay for rehabilitation of lands on which quarries are situated.[40]

Ontario

Holders of licences and permits to carry out aggregates activities are required to perform progressive rehabilitation and final rehabilitation of the site.[41] In addition, aggregates operators are required to pay to the Treasurer security for rehabilitation at times and in an amount and manner prescribed by regulation.[42] Sums are held in separate named accounts, earn interest at a prescribed rate which forms part of the security, and are paid out in accordance with regulations.[43] Upon proof of progressive rehabilitation, operators are entitled to a refund from their rehabilitation security account.[44] Where rehabilitation is not carried out by the operator, the Minister or an authorized person may rehabilitate the site and draw on funds from the rehabilitation security account for this purpose.[45]

Quebec

Under the *Environmental Quality Act*, applicants seeking authorization to carry out activities likely to harm or destroy the surface of the soil must submit a land reclamation plan as well as any guarantee required by regulation.[46]

Oil and Gas

Alberta

Under the *Environmental Protection and Enhancement Act*, operators of oil and gas wells are subject to the same requirements for conservation and reclamation as mining companies.[47] Likewise, these conservation and reclamation obligations apply to oil sands and heavy oil sites.[48] On the other hand, while oil sands and heavy oil operations are

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[40] *Mines and Minerals Act, supra*, s. 200(3) and 200(4).
[41] *Aggregate Resources Act*, RSO 1990 c. A.8, s. 48(1).
[42] *Ibid.*, ss. 50(1) and 51(1). Regulations provide that the amount of security is $0.08 per tonne of aggregate removed from the site during the year, subject to a minimum and maximum, payable by cash, cheque or money order. O. Reg. 702/89, ss. 8 and 11(2).
[43] *Aggregate Resources Act, supra*, s. 52. Pursuant to section 12 of O. Reg. 702/89, the rate of interest on rehabilitation security accounts is the rate of interest paid on deposits in the Province of Ontario Savings Office's regular savings accounts paying interest on the last days of March and September.
[44] *Aggregate Resources Act, supra*, s. 53.
[45] *Ibid.*, s. 56.
[46] *Environmental Quality Act*, RSQ Q.2 [as amended], s. 23.
[47] See subparagraph 1(w)(i) of the *Conservation and Reclamation Regulation, supra*, which provides that a well is "specified land" for the purposes of Part 5 of the *Environmental Protection and Enhancement Act, supra.*
[48] See subparagraph 1(w)(i) of the *Conservation and Reclamation Regulation, supra*, and the definition of "mine" in paragraph 1(kk) of the *Environmental Protection and Enhancement Act, supra.*

subject to the same requirements for financial assurance as mining companies,[49] oil and gas well sites are not subject to these financial assurance requirements, unless so designated by the Minister.[50]

Federal

Under the *Canada Oil and Gas Operators Act*, work or activity related to exploration, drilling, production, processing or transportation of oil and gas cannot be carried on in an area to which the *Act* applies unless a licence is obtained.[51] As a condition for approval of such a licence, operators are required to provide proof of financial responsibility, which must be in an amount satisfactory to the National Energy Board and may take the form of a letter of credit, guarantee or indemnity bond, or any other form satisfactory to the National Energy Board.[52]

Forestry

Alberta

In January 1994, Alberta launched a province-wide Forest Resources Improvement Program (FRIP), which derives revenues from the Environmental Protection and Enhancement Fund, established under the *Environmental Protection and Enhancement Act*.[53] The Fund receives a specified percentage of dues paid on coniferous sawlogs by tenure holders, deposits are accounted for separately, and moneys are allocated on a project-specific basis upon the Minister and the company entering into a master agreement.[54]

British Columbia

As a condition of harvesting timber, applicants for a licence must prepare and obtain approval of a silviculture plan for the area to be harvested and must curing and after harvesting the timber carry our the plan at its own expense and in accordance with the regulations.[55] Under regulations pursuant to section 201 of the *Forest Practices Code of British Columbia*, licence holders may be required to provide "security of any kind, including money, for the performance of the holder's duty to carry out silviculture

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[49] See paragraph (a) of Division 3 of the *Activities Designation Regulation, supra.*

[50] See subsection 17(2) of the *Conservation and Reclamation Regulation, supra.* See also the discussion in Brian O'Ferrall, "The `Conservation and Reclamation' Provisions of the Proposed Environmental Protection and Enhancement Act" (1992), 2 *Journal of Environmental Law and Practice* 1 at 32.

[51] *Canada Oil and Gas Operators Act*, RSC 1985, c. O-7 [as amended], s. 4.

[52] *ibid.*, ss. 5.03 and 27(1).

[53] *Environmental Protection and Enhancement Act, supra*, s. 28(1).

[54] Monique M. Ross, *Forest Management in Canada*, (Calgary: Canadian Institute of Resources Law, 1995) at 182.

[55] *Forest Practices Code of British Columbia*, SBC 1994, c. 41, ss. 22, 70.

obligations."[56] This regulation also provides that this security must be returned promptly when the district manager is "satisfied that there is no further need for the security."[57]

In addition, with the enactment of the *B.C. Forest Renewal Act* in 1994,[58] reforestation is also carried out by a Crown corporation, funded by Crown stumpage and royalty revenues.[59]

Manitoba

Under the *Forest Act*, the holder of a timber cutting right is required to pay to the Crown a forest renewal charge as prescribed by regulations or, if the Minister approves, carry out forest renewal on land that has been harvested by the holder, according to terms prescribed by regulation or set out in the licence, permit or other authorization under which timber is cut.[60] Pursuant to regulations promulgated under the *Forest Act*, the Minister may, before granting a forest management licence to a person, "require and obtain from that person a surety bond, or other security in such amount as is, in his opinion, adequate to secure the faithful performance and observance by that person of the terms and conditions of the licence and the provisions of the Act."[61] According to section 22 of this Regulation, the bond or other security referred to shall:

> (a) be in a form acceptable to the minister;
>
> (b) be maintained in good standing for such period of time as the minister may require;
>
> (c) in the case of a surety bond, be issued by an assurance or bonding company authorized to carry on business in Manitoba; and
>
> (d) be subject to forfeiture in the event of the licensee violating any provisions of the Act, the regulations, or the terms and conditions of his licence.

In addition, since the late 1980s, licence agreements to harvest timber include a requirement that licensees establish a Forest Management and Renewal Fund to be used for reforestation and silvicultural treatments. Contributions to the Fund, maintained by a trust company, are made by the licensee, as well as other operators in the licence area, and the contributions are based on a fixed amount per cubic meter harvested. The trust fund can only be used for forest renewal and stand management, and the licensee must periodically submit reports to the Department.[62]

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[56] *Security for Forest Practice Liabilities Regulation*, s. 1.
[57] *Ibid.*, s. 3(b).
[58] SBC 1994, c. 3.
[59] Ross, *Forest Management in Canada, supra* at 181-82.
[60] RSM c. F150, ss. 34(1.1), (1.2).
[61] Reg. F150-227/88R, ss. 21, 22.
[62] *Ibid.* at 180-81.

New Brunswick

According to the *Crown Lands and Forests Act*, the holder of a timber licence must enter into a forest management agreement with the Minister, pursuant to which the licensee must, among other things, describe the manner in which it will manage the lands with respect to silviculture and the silvicultural treatments to be carried out by the licence holder.[63] Under subsection 38(2) of the Act, the Minister is required to reimburse the licensee for forest management expenses carried out in accordance with the operating plan, including tree planting.

Ontario

Under the *Crown Forest Sustainability Act*, holders of forest resource licences are required to pay forest renewal charges either to the Minister of Finance, to be held in a separate account and paid out for payment or reimbursement of silvicultural expenses, or, where the licence holder is subject to a renewable licence requiring the licensee to carry out renewal and maintenance activities, to a Forest Renewal Trust dedicated to the reimbursement of silvicultural expenses.[64] In addition, holders of forest resource licences are also required to pay forestry futures charges to a Forestry Futures Trust responsible for funding silvicultural expenses for Crown forests killed or damaged by fire or natural causes, subject to a forest resource licence, if the licensee becomes insolvent, or to provide for intensive stand management and pest control.[65]

Quebec

In order to harvest timber, agreement holders are required prepare a general forest management plan, including an undertaking to carryout every year at its own expense, "all silvicultural treatments necessary for the attainment of the annual yield indicated in the agreement" in accordance with regulations established pursuant to section 171 of the Quebec *Forest Act*.[66] At the end of each year, the agreement holder is required to prepare and submit to the Minister a report on its forest management activities for the year.[67] According to the *Forest Act*: "The Minister shall, each year, gratuitously supply the agreement holder with the necessary plants for the reforestation the holder intends to carry out to attain the annual yield indicated in the agreement."[68] As well, each agreement holder is required to pay dues, based on a unit rate established by regulation, which are payable either in cash or by way of silvicultural treatments.[69] Where an agreement holder carries out silvicultural treatments and provides a periodic report to the Minister, the

[63] RSNB 1973 c. 38.1 [as amended], ss. 27-29.
[64] SO 1994, c. 25, ss. 26, 48-50.
[65] *Crown Forest Sustainability Act*, s. 51.
[66] *Forest Act*, SQ. 1986 [as amended], ss. 51, 60.
[67] *Ibid.*, s. 70.
[68] *Ibid.*, s. 64.
[69] *Ibid.*, s. 73.1

Minister may grant a provisional credit against dues otherwise payable, equal to the value of the silvicultural treatments carried out.[70]

Saskatchewan

Under the recently enacted *Forest Resources Management Act*, licensee's are required to obtain approval of a forest management plan prior to harvesting forest products.[71] According to section 27 of this *act*, licensees are required to carry out "renewal activities" in accordance with regulations and the terms of the licensee's licence. In addition, licensees are required to pay renewal fees prescribed by regulation or as provided in a forest management agreement either to the Crown or to a renewal fund established by the licensee or a person designated by the Minister.[72] According to subsection 26(3) of the *Act*: "Licensees or other persons responsible for administering renewal funds established pursuant to this section shall ensure that the fees collected pursuant to this section are used for the purposes of renewal as set out in the regulations and the terms of the licensee's licence."

Waste Disposal

Alberta

Under the *Environmental Protection and Enhancement Act*, waste disposal sites are subject to the same requirements for conservation and reclamation as mining companies.[73] Like oil and gas wells, however, waste disposal sites are not subject to regulatory financial assurance requirements, unless so designated by the minister.[74]

British Columbia

According to the *Waste Management Act*, a manager may issue a permit to introduce waste into the environment or to store special waste subject to requirements for the protection of the environment, and may, in the permit require the permittee to give security in the amount and form and subject to the conditions specified in the permit.[75]

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[70] *Ibid.*, s. 73.2.
[71] s. 37(1).
[72] *Ibid.*, ss. 26-27.
[73] See subparagraph 1(w)(vi) of the *Conservation and Reclamation Regulation*, *supra*, which provides that "the construction, operation or reclamation of a landfill" is "specified land" for the purposes of Part 5 of the *Environmental Protection and Enhancement Act*, *supra*, and paragraph 1(3)(f) of the *Activities Designation Regulation*, *supra*, which defines a "landfill" generally as "a facility at which waste is disposed of by placing it on or in land".
[74] The minister's authority to require a site to satisfy regulatory financial assurance obligations is in the *Conservation and Reclamation Regulation*, *supra*, s. 17(2).
[75] *Waste Management Act*, SBC 1982, c. 41, s. 8.

Newfoundland

According to the *Waste Material Disposal Act*, a person shall not establish, enlarge or extend a waste management system or a waste disposal site unless a certificate has been issued to the owner by the minister.[76] The *Act* also stipulates that a certificate generally shall not be issued to an owner unless the owner has deposited a sum or money, provided a surety bond or provided personal sureties "in the amount and upon conditions that the minister considers adequate to assure satisfactory maintenance of the waste management system or the waste disposal site or the removal of waste from the site where the minister considers the removal necessary."[77]

Nova Scotia

Under the *Environment Act*, any person who seeks approval to carry out an activity or undertaking as defined in the *Act* and regulations,[78] is required to provide financial or other security in respect of the activity or undertaking as required by the Minister or by regulation. According to the *Activities Designation Regulations*, the amount of any security required is to be determined by the Minister or an Administrator to be sufficient to ensure completion or rehabilitation of a site.[79] The security may take the form of cash; cheques and other similar negotiable instruments made payable to the Nova Scotia Department of Finance; Government guaranteed bonds, debentures, term deposits, certificates of deposit, trust certificates or investment certificates assigned to the Nova Scotia Department of Finance; irrevocable letters of credit, irrevocable letters of guarantee, performance bonds or surety bonds in a form acceptable to the Minister or an Administrator; or "any other form of security which provides good and valuable consideration and that is approved in writing by the Minister or an Administrator."[80]

Where the Minister or an Administrator certifies that the rehabilitation has been performed satisfactorily on all or part of the site, all or part of the security may be returned.[81] In contrast, where a person fails to comply with a rehabilitation plan, the Minister or an Administrator may order that all or part of the security be forfeited and used for carry out rehabilitation of the site and other lands on which the activity has had an impact.[82]

Ontario

Under the *Environmental Protection Act*, no person shall use, operate, establish, alter, enlarge or extend a waste management system or a waste disposal site unless a certificate of approval has been issued by the Director and except in accordance with conditions set

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[76] *Waste Material Disposal Act*, RSNS 1990, c. W-4, s. 11.
[77] *Ibid.*, s. 13(1).
[78] Activities requiring approval are set out in the *Activities Designation Regulations*, RNS 95-286 (April 11, 1995), and include, among other things, sewage works and solid waste management facilities.
[79] *Ibid.*, s. 14.
[80] *Ibid.*, s. 17.
[81] *Ibid.*, s. 18.
[82] *Ibid.*, s. 19.

out in the certificate.[83] According to the *Act*, no certificate of approval shall be issued to an applicant other than a municipality unless the applicant has deposited a sum or money, furnished a surety bond or provided personal sureties in an amount and upon conditions prescribed by regulations "to assure satisfactory maintenance of the waste management system or the waste disposal site or the removal of waste from the site if the Director considers the removal necessary."[84] According to Guidelines issued by the Ministry of Environment and Energy, financial assurance is required for:

- private landfill sites for which a hearing is required under section 30 of the *Environmental Protection Act*, or which will accept non-hazardous solid industrial, commercial or domestic wastes and which have a life-time capacity of 40,000 cubic metres or more;
- private transfer stations, which handle "subject wastes" as defined in Regulation 347, waste processing sites for subject wastes and PCB mobile destruction units;
- private transfer stations and waste processing sites for other wastes where there is no identified place or practical method for final disposal in Ontario;
- private waste management (haulage) systems which carry biomedical wastes, PCBs and hazardous subject wastes;
- all unclassified, unregulated sewage systems treating commercial or industrial waste water;
- private communal sewage and water works in unorganized areas where there is no agreement with the Ministry of Municipal Affairs for a local government agency to take over the works in the event of a default; and
- private communal sewage and water works in organized areas without an agreement with the local government agency to take over the system in a default situation.[85]

According to the same document, activities for which financial assurance is discretionary for the director include:

- private landfill sites not mentioned above;
- reclamation or processing operations;
- organic waste disposal sites;
- incineration facilities;

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[83] *Environmental Protection Act*, RSO 1990, c. 86, s. 31.
[84] *Ibid.*, s. 34.
[85] Economic Services Branch, Ontario Ministry of Environment and Energy, *Financial Assurance (Part XII - Ontario Environmental Protection Act): A Guide*, (Toronto: Queen's Printer, May 1996) at 10-11.

• private transfer stations and waste processing sites other than those mentioned above;

• PCB storage sites;

• waste management systems (haulers) which do not handle biomedical wastes, PCBs and hazardous subject wastes;

• class 7 sewage systems

• all sewage systems serving either industrial, commercial or institutional facilities for which financial assurance is not otherwise mandatory;

• class A sewage systems;

• industrial and milling activities that generate tailings, ash or other waster materials subject to section 53 of the *Ontario Water Resources Act*;

• any sewage works in which waste materials that are generated by the sewage works, including sludges, are to be disposed of on the site of the sewage works;

• any sewage works, or any part thereof, that contain waste materials, such as sludges, that are to remain on the site after decommissioning;

• storage of subject wastes from air pollution equipment;

• private undertakings which are likely to reduce the quantity or quality of water supplies of neighbours, and where conditions require remedial measures;

• industrial abatement programs under section 18 of the *Environmental Protection Act*;

• where an industrial or commercial site which is contaminated with hazardous materials is to be decommissioned; and

• operations which store subject wastes on site under Regulation 347 for more than 90 days.[86]

Financial assurance requirements are specified in sections 131 to 136 of the *Environmental Protection Act.* According to section 131, financial assurance may take one or more of the following forms: cash; a letter of credit from a bank; negotiable securities issue or guaranteed by the Government of Ontario or the Government of Canada; a personal bond accompanied by collateral security; a bond of a guarantee company approved under the *Guarantee Companies Securities Act*; a bond of a guarantor, other than a guarantee company, accompanied by collateral security; or an agreement in the form and terms specified in the approval, order or regulations.[87] According to section 133, failure to provide financial assurance is grounds for revocation of the approval.[88] Finally, section 134 provides for the return or release of the financial assurance where the

[86] *Ibid.* at 12-13.
[87] *Environmental Protection Act*, *supra*, s. 313 definition of "financial assurance".
[88] *Ibid.*, s. 133.

Director is satisfied that the assurance is not required in respect of the works, while section 136 provides that the Director may realize on any security and use any cash to require performance of environmental measures where there is reasonable and probable ground to believe that any environmental measure required by the approval or order in respect of which the financial assurance was given has not been or will not be carried out in accordance with the requirement.[89]

[89] *Ibid.*, ss. 134 and 136.

Appendix B
Summary of Financial Assurance Posted in Canadian Provinces

	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Quebec
Waste Sites/Sewer Treatment/Other	between $15 m. and $25 m. in letters of credit[a]	N/A	no financial assurances of any kind[f]	$34.6 m. in various forms of financial assurance – none in trust funds[j]	$49.3 m. in financial assurances – most letters of credit, limited amount in performance bonds and cash[n]	several millions of dollars in various forms[r]
Aggregates	$3.5 m. in assurances – none in trust funds[b]	$8.9 m. in assurances – all letters of credit[d]	no financial assurances of any kind[g]	$1.0-$1.5 m. in trust funds – not site-specific[k]	$1.0 m. in non site-specific trusts; $59.5 m. in site-specific trusts[o]	N/A
Forestry	no financial assurances of any kind[u]	N/A	$6.5 m. in site-specific trust funds[h]	$5 m. in site-specific trust funds[l]	$95 m. in site-specific trusts[p]	no financial assurances of any kind[s]
Mining/Oil and Gas	$4.6 m. in site-specific trust funds; $139.1 m. in other assurances[c]	$156 m. in assurances – all letters of credit[e]	$5.4 m. in total assurance – all in letters of credit[i]	no financial assurances of any kind[m]	$10.1 m. in total financial assurance – 79% letters of credit and up to $2 m. in cash[q]	no financial assurances of any kind[t]

(Notes can be found on the page that follows.)

Notes to Table on Previous Page

[a]amounts pertain to landfill as well as contaminated sites from activities such as wood treatment – source for information is John Ward, Industrial Waste Branch, B.C. Environmental Protection Dept.
[b]source for information is Greg McKillop, Employment and Investment Dept., Province of B.C.
[c]site-specific trust funds for 2 companies (Equity Silver and Golden Bear) most other assurances in the form of letters of credit or other third party agreements with banks– source for information is John Erington, Minerals Branch, Province of B.C.
[d]source of information is Larry Brocke, Director of Reclamation, Alberta Dept. of Environmental Protection.
[e]Amounts include about $34 million for oil sands development and exploration -- source of information is Larry Brocke, Director of Reclamation, Alberta Dept. of Environmental Protection.
[f]source of information is Larry Lechner, Assessment Branch, Environmental and Resource Management Dept., Province of Saskatchewan.
[g]source of information is Len Sinclair, Environment and Resource Management Dept., Province of Saskatchewan.
[h]amounts deposited into site-specific trusts are likely to increase in near future as the 1/3 of companies currently depositing funds for reforestation into the government's consolidated revenue fund are transferred to site-specific fund arrangement -- source of information is Felix Casavant, Environment and Resource Management Dept., Province of Saskatchewan.
[i]source of information is Len Sinclair, Environment and Resource Management Dept., Province of Saskatchewan.
[j]financial assurance for both hazardous and solid waste sites, as well as hazardous waste transportation – source of information is Larry Strachan, Industrial Approvals Branch, Manitoba Department of Environment.
[k]Operators of aggregate sites pay 10 cents per tonne into a rehabilitation account -- source of information is Barry Hatfield, Director of Rehabilitation, Province of Manitoba.
[l]source of information is Richard Westwood, Forestry Branch, Manitoba Ministry of Natural Resources.
[m]source of information is Barry Hatfield, Director of Rehabilitation, Province of Manitoba.
[n]assurance covers activities including solid waste landfill sites, hazardous waste haulage, sewage treatment, waste transfer stations, and others. The Ministry of Environment had 496 financial assurance accounts in March of 1996. About 67% of these accounts are held in letters of credit, 17% are in cash and 16% are in performance bonds – source is Ontario Ministry of Environment and Energy, *Financial Assurance – A Guide* (Toronto: Queen's Printer for Ontario, 1996).
[o]sources of information are Ontario Ministry of Natural Resources, *Mineral Aggregates in Ontario – Overview and Statistical Update* (Toronto: Queen's Printer for Ontario, 1994). And Ray Pichette, Ontario Ministry of Natural Resources.
[p]Represents amounts collected through stumpage and deposited into site-specific accounts for reforestation – source is Jeff Munro, Ontario Ministry of Natural Resources.
[q]source of information is Dick Cowan, Mines Group, Ontario Ministry of Northern Development and Mines.
[r]Financial assurance is posted for activities including solid waste disposal, used tire disposal, waste transport, biomedical waste disposal, and certain pesticide usage – source is Jean Rivet, Industrial Sector, Quebec Ministry of Environment.
[s]source of information is Francois Trottier, Forest Division, Quebec Ministry of Natural Resources.
[t]source of information is Christian Morin, Mines Department, Quebec Ministry of Natural Resources.
[u]source of information is Tim Ebata, British Columbia Ministry of Forests.