BRITISH COLUMBIA

MINISTRY OF ENERGY AND MINES

INFORMATION LETTER **MTA14**

RESOURCE REVENUE BRANCH
MINERAL TAXATION SECTION

SUBJECT: INVENTORIES

BACKGROUND

The purpose of this information letter is to summarize the provisions of the *Mineral Tax Act* relating to inventories and to explain Resource Revenue Branch policy regarding inventory valuation and the characterization of inventory costs as current or capital for Mineral Tax purposes.

THE LAW

Section 7 of the *Mineral Tax Act* sets out the calculation of Net Current Proceeds. The costs that are allowable in this calculation are referred to as "current operating costs". Capital costs are not deductible in the calculation of Net Current Proceeds.

Mining, processing and distribution costs of a current nature are allowed under section 2 of the *Mineral Tax Costs and Expenditures Regulation,* which states:

> 2. (1) . . . the prescribed costs and expenses, to the extent reasonable, incurred for the purposes of earning gross revenue from the operation of a particular mine shall be:
>
> f) the current costs incurred in the operation of the mine including, for greater certainty, those administrative or corporate costs, including management fees, that are directly related to the operation of a particular mine,
>
> g) the current costs incurred for the operation of processing facilities used to process minerals extracted or obtained from the mine,
>
> h) the current costs of distribution of the mineral product of the mine including marketing expenses and related sales commissions.

Under section 3(f) of the *Mineral Tax Costs and Expenditures Regulation* the cost of inventories is considered to be on account of capital:

> 3. . . . the following costs and expenditures must be included in costs that are prescribed to be on account of capital and may not be included in the current costs and expenditures:
>
> f) the cost of inventories of parts, supplies and products.

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INTERPRETATION

The legislation requires that the costs of inventories be reported as capital additions as incurred, rather than current operating costs. These costs are then allowed as current operating costs in the fiscal year of the mine when the related mineral product is sold. For the most part, the valuation of inventories and the cost of mineral product sold is consistent with generally accepted accounting principles. However, the legislation places some restrictions on the types of costs that may be included in inventory and when the costs may be claimed as current operating costs.

MINERAL PRODUCT INVENTORIES

The Mineral Tax cost of mineral product inventories should reflect the actual costs incurred to produce the inventory and should be determined on a consistent basis from year to year. Generally, a first-in, first-out method of costing is preferable. For example, where there are 2 months of production remaining in inventories, the inventory cost for Mineral Tax purposes should reflect the 2 months of costs required to produce those inventories. Other methods, such as average cost for the year, may be acceptable if costs of production remain relatively stable throughout the year.

Typical costs included in inventories are mining, milling, processing and transportation costs. The following are some of the specific costs that may not be included in mineral product inventories:

- reserves, contingencies and allowances, such as provisions for reclamation, amortization and depreciation
- accrued costs to be incurred at a later date, such as shipping costs to be incurred once port inventory is loaded on board vessels
- other capital costs such as exploration, pre-production development and the cost of capital assets
- interest and other financing costs

Mineral product inventory costs are allowed as current operating costs in the fiscal year of the mine in which the related mineral product is sold. Write-downs of mineral product inventories below cost are not allowed as current operating costs.

For Mineral Tax purposes, revenue must be recognized when mineral product is sold, and mineral product inventory must be valued at cost. Some mines recognize revenue at the time the mineral product is produced, and value mineral product inventory at net realizable value. If this is the case, adjustments to revenue, cost of goods sold and the costs of opening and closing mineral product inventory are required to remove unrealized profits for Mineral Tax reporting.

SUPPLIES INVENTORIES

Supplies inventories must also be valued at cost for Mineral Tax purposes. The costs of supplies inventories become production costs when the supplies are used in the production of minerals. They are then allowed as current operating costs when the related mineral product is sold.

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If supplies inventories are sold without being used in the production of minerals, the related costs may be included in current operating costs. Proceeds from the sale must also be reported in gross revenue, as a recovery of operating costs.

Provisions for shrinkage and obsolescence are not allowable for Mineral Tax purposes; however, write-downs of specific items in supplies inventories will be allowed as current operating costs only when all of the following conditions are met:

i. the items of inventory are specifically identifiable and there is evidence that they have been damaged, destroyed or no longer of any use in the operation of the mine

ii. the items have been physically removed from inventories and the related costs have been removed from the inventory records, and

iii. proceeds from the sale of items previously written-off are identified and included in gross revenues as recoveries of operating costs.

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