

## Tracking tax trends within the current commodity cycle

“Tax is in the headlines in a manner few could have predicted – even a year or two ago. This has led to a range of issues for businesses to consider, including the OECD’s Base Erosion and Profit Shifting project.”

In addition to low commodity prices and poor economic news from around the globe, tax concerns are confronting the mining industry. Mining companies are finding themselves in territory not seen since the 2008/2009 global recession. The consequence of the current cycle is an increased scrutiny by management on costs, capital expenditure programs, exploration related prospects and current mining operations to ensure that shareholder value is retained and optimised.

Governments in the traditional resource rich countries which host mining companies are certainly not isolated from the global economic outlook prevailing in the mining industry. These governments are facing challenges due to mining companies declaring less profits which is putting pressure on the revenue collections across the spectrum of collection methods. Unfortunately, this position often leads to rather sudden tax policy changes or announcements of pending changes. In these circumstances, mining companies may also experience increased scrutiny.

In our experience, tax-related queries and the increased focus of revenue authorities require a company to ensure that the policy framework within which it deals with its tax affairs, often across various jurisdictions, is up to date. The tax policies adopted by mining companies as part of its governance structures often hold the key to dealing with tax related matters in a succinct and effective manner. A mining company’s current tax policy should take the following tax trends into consideration.





1

## Doing the right thing locally – balancing competing interests

“Alternative Mining Indaba calls for inclusion of communities”  
– News from the recent Cape Town mining event.

Mining companies have made significant strides to ensure constructive and meaningful engagement with local communities. It is becoming increasingly apparent that the stakeholders in mining companies include shareholders, employees, local communities, governments and arguably the revenue authorities. In certain mining jurisdictions, the actual form of the engagement with local communities may require the mining company to provide real tangible economic interest in the actual mining property to the local community. For example, local communities may act as the landlord, provide services or goods to the mine, or be the first choice for sourcing employees. In other mining jurisdictions, governments may require the mining company to obtain the mining permit/license from local communities by way of a license or tariff payment. In certain situations, a mining company may be confronted by a combination of these requirements.

The issues related to the implementation of these structures present real tax challenges. A free carry of a mining interest, in terms of which a community is not required to actually pay for the economic interest, might be free, yet we have often found that the local jurisdiction's tax laws do not always cater for such a free carry.

In other instances, stakeholders in the form of communities and/or governments in resource rich jurisdictions are questioning the amount “taxes” paid in respect of mining revenue. There is also the ongoing debate with regards to typical social and labour plan expenditures which often leads to the discussion as to whether there is more to taxes than simply the statutory rates.

In addition to the debate as to what is taxed, a number of structural tax issues related to community participation may bring mining companies into discussions with revenue authorities. These challenges arise as a result of the fact that local revenue authorities apply the tax laws as they are written with no transitional relief. Revenue authorities often adopt the approach of “there is no equity in tax”.

In our experience, the tax-related issues associated with community participation must be managed from the outset to ensure that the anticipated consequences flow from the adopted community participation method.

In the current commodity cycle, we anticipate that mining companies may face additional challenges as revenue authorities scrutinize how the community and stakeholder participation is structured.





# 2

## Moving people around the world to deliver projects

The tax and immigration landscape for movement of people across borders is changing. In addition, revenue authority attitudes towards business travellers and employer compliance obligations appear to be tightening. Many programs have been established to track business travellers and therefore, the revenue authorities are becoming less tolerant with non-compliance amidst expectations that data are available to human resources and tax departments to enable full disclosure.

Resource rich jurisdictions are also taking a look at what the people movements mean for tax filings and immigration compliance. Mining companies are not immune to business travellers and employer compliance obligations and may face significant issues if this operational aspect is not dealt with correctly.



# 3

## Attracting the investment and tapping the wealth – government’s arsenal in good times and bad times

The tables below reflect how governments in mining jurisdictions often attract the investment in an ever increasing competitive environment. It further reflects how governments may actually extract their participation in the mining industry. Companies should note that the incentives and participation methods are two sides of the same sword during resource cycles.

### Investment incentives

Governments around the world have a range of significant incentives that they can choose to employ to attract foreign investment into their domestic mining sector. They certainly adopt these measures to some degree when the resource cycle is reflective of low commodity prices.

This table outlines tax incentives that may be available to mining companies.

Incentive	Description
Stability agreements	Stability agreements between governments and mining companies set the tax regime that will be applicable to the miner for a specified number of years, usually fixing the tax regime in existence at the time of investment. This certainty allows the miner to properly appraise investment decisions in the knowledge that returns should not be eroded by changes to the country’s tax regime over the period of the agreement. However, these agreements are now more difficult to negotiate or renegotiate.
Tax holidays/concessions	Governments may offer mining companies periods of exemption from corporate taxes or concessionary rates over certain periods. These usually cover the early years of a mine’s development and operation. However, in some cases, the mining companies are able to elect exactly when to trigger the start of an exempt or concessionary period.
Tax free zones	Governments may offer mining companies tax exemptions or concessions for operations in certain less developed regions of a country – for instance, to establish smelting or beneficiation processes in areas which will most benefit from the related infrastructure or employment.
Accelerated tax depreciation	Many mining jurisdictions offer generous upfront tax allowances for the capital costs of developing and equipping a mine. These allowances can generally be carried forward to offset future taxable income once mine production is underway and profitable.
Tax credits	Tax credits are available in some jurisdictions, varying from resource credits to manufacturing and processing credits. Credits can be available on a national or provincial/state level, depending on the nature of the tax system.
Research and development (R&D) incentives	R&D tax incentives generally allow an enhanced deduction (e.g., 150%) and/or tax credits for qualifying R&D expenditures. Some tax regimes also permit losses to be surrendered for payable tax credits, effectively subsidizing R&D expenditures.

### Taxation and other government payments

The tax regime is one of the main methods available to governments to extract value from mining investment in their jurisdiction. A number of countries supplement their general corporate tax regime with a special mining tax regime, comprising of royalties, duties or other payments specific to the mining sector.

In addition to tax, some administrations impose other requirements which ultimately result in investment returns flowing to governments or government-supported bodies rather than shareholders. Governments in jurisdictions with coveted resources may apply a variety of methods, detailed in the table below, to ensure that the governments receive their perceived fair share of the mining investment. We note that the use of these methods often differs between governments and certainly differs between jurisdictions.

Method	Description
Corporate tax	Mining companies will generally be subject to the same corporate tax rate on profits as other businesses within the country.
Secondary taxes/ withholding taxes	While not specific to mining, significant incremental taxes can be levied on cross-border flows of dividends in the form of secondary and withholding taxes. Broadly, secondary taxes are the liability of the dividend payer while withholding taxes are the liability of the recipient and may be reduced by double tax treaties. A developing trend is the increase in the application of withholding taxes, particularly towards dividend and interest withholding taxes while certain jurisdictions, typically in resource rich countries, are considering various withholding taxes on certain types of services.
Mining royalties	Mining royalties can take many forms and are one of the main methods employed by governments to vary the taxation of mining companies relative to other sectors. Royalties may be chargeable as a percentage of turnover or some measure of taxable income, or they may be payable as fixed amounts per standard volume of mineral extraction or sale. They may apply to all mining activity or only be triggered above a certain threshold of revenue, profitability or extraction volume. They may also apply at tiered rates, according to certain thresholds being exceeded or based on the type of commodity.
Superprofits taxes	Superprofits taxes, such as Excess Profits Tax (EPT) in Kazakhstan, generally apply to mining companies once their profitability exceeds a certain threshold. In the case of EPT, the rate applicable can be up to 60%.
Transfer pricing	Although transfer pricing is not an exclusive concept to mining, tax authorities in mining jurisdictions may focus closely on the cross-border intragroup pricing of transactions, especially where highly profitable sales and marketing or beneficiation operations are located abroad. The Organisation of Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) debate will have a fundamental impact on the approach to transfer pricing in the mining environment on various levels.
Discovery bonus	These constitute fees payable to the government upon the discovery of mineral reserves by a company. For example, in Kazakhstan, a commercial discovery bonus of 0.1% of the value of recoverable reserves is payable based on commodity prices.



Resource rents	Mining companies may be required to pay a land rent to the government according to the area held under licence.
Licence fees/ signature bonus	These constitute fees payable upon agreeing to a mining licence with a government. In Kazakhstan, for example, a signature bonus may be payable on concluding a subsurface use contract, depending on the type of contract and commodity.
Taxation of non-resident capital gains	Some governments impose tax on non-residents who realize capital gains on assets physically located in their jurisdiction or on shareholdings whose value is mainly derived from such assets. Although not a specific mining tax, this form of taxation often affects mining groups disproportionately since double tax treaties often do not provide relief where the capital gain is in relation to so-called immovable property – which mining assets invariably are.
Export duties	These are generally payable as a percentage of the value of commodities exported. They are increasingly being used by certain countries to curb the export of natural resources to safeguard domestic supplies for the future.
Government shareholdings	In some mining jurisdictions, it is not possible for a foreign investor to own 100% of a local mining company; a certain percentage ownership must be lodged with the government or a government-controlled industry body. Examples currently include Botswana, Namibia and, more recently, Tanzania. Although governments taking such stakes may compensate the foreign investor, future dividend flows to the investor are permanently diminished.
Indigenisation schemes	In broad terms, indigenisation schemes require mining groups to cede a percentage of shareholdings in the local mining subsidiary to a body established for the benefit of indigenous or economically-disadvantaged groups. South Africa's Black Economic Empowerment rules are one example, but other countries may follow suit, and ongoing changes continue to occur in various resource rich jurisdictions. As with government shareholdings, the mining group may be compensated when shareholdings are ceded.
Provincial/state mining taxes	Mining taxes or royalties may be levied at a state or provincial level in addition to national taxes. In some cases, local taxes may be creditable against national tax, but often the burden is incremental. Canada, Australia and Argentina impose mining taxes or royalties at regional levels.
Stability agreement renegotiation	Historically, governments have been known to deny or challenge tax stability agreements in order to increase the tax burden of mining companies. Alternatively, governments may offer new stability agreements on altered terms. Invariably, mining companies rely on good government relations to operate smoothly; for instance, to renew mining licences or grant environmental permits. Therefore, commercially and politically, mining groups may have little option other than to accept new tax stability terms.
Environmental taxes	Environmental taxes are increasingly coming to the fore of government agendas. While unlikely to be targeted directly at mining companies, the sector's high energy requirements would typically result in a significant tax burden.
Expropriation	The most extreme form of government intervention for mining companies is the expropriation of their mines. This may be justified by governments in terms of a breach of mining licence conditions. Within a resource or commodity cycle the use of expropriation by governments may differ vastly.





# 4

## Investing in mines in a foreign country

Resource rich countries are often not the home country for the mining company's shareholders or parent company. Therefore, it is not uncommon for mining companies to use various investment structures to enter resource rich jurisdictions. These investment structures have been a focus over the past decade for various reasons. In the last year, discussions of tax reform and the OECD's Action Plan on BEPS have dominated the tax forums. Since September 2014, the OECD has released its papers on several of the BEPS Actions, and with some 900+ pages of recommendations, we have highlighted below certain themes which may relate to the mining industry. The ultimate application to the mining industry will certainly be a discussion topic going forward.

### Treaty Shopping:

Action 6 proposes to change the OECD Model Tax Convention to prevent treaty shopping and suggests a limitation on benefits clause, a principal purposes test or a combination of the two. Mining companies would be particularly vulnerable to these proposals because of the reliance on holding companies in their structures. Increased attention has been placed on demonstrating and maintaining substance in holding jurisdictions. The topic of substance in the context of treaty shopping and tax avoidance has become an important focus of the OECD's BEPS agenda, as well as that of individual foreign jurisdictions that have traditional holding company regimes (i.e. the Netherlands). Substance requirements should be reviewed and maintained in order to ensure compliance with new rules.

### Transfer Pricing Documentation:

The OECD released a three-tier approach to transfer pricing documentation that includes: (1) country-by-country reporting; (2) a master file, which includes the company's global transfer pricing policies; and (3) the local file, which includes information to support intercompany transactions that the local company engages in. These recommendations are most likely to be adopted by the global tax community and will substantially increase the compliance burden on mining companies, particularly on those that have subsidiaries in multiple jurisdictions. As a result, it may be prudent to begin establishing the files now so as to ease the transition (and burden) once the guidelines are formally adopted.

### Interest Deductibility:

Action 4 introduces the concept of group-wide tests with the aim to match net interest expense within a group to economic activity, so that the aggregate tax deductions do not exceed the group's actual third party interest expense. These proposals would have a significant impact on companies that use debt to finance their operations and could significantly increase the level of disallowed interest within a group. Close attention must be paid to the release of the final proposals to assess their impact on intragroup financing arrangements.

The OECD's BEPS initiative is a formidable and ambitious undertaking. Once the Action Plans are finalized, getting all countries to implement them will be a challenge. Even though not all Action Plans will be implemented by all countries as proposed by the OECD, the tax environment is changing and will change as the pendulum swings towards greater transparency and more co-operation between jurisdictions.

The mining industry will undoubtedly face changes as resource rich jurisdictions adopt some, if not all, of the recommendations.



# 5

## Innovating in the mining industry

Innovation in the mining industry is currently a topic drawing significant attention to improve cost management. Mining companies that have invested in technologies such as remote mining, autonomous equipment, and driverless trucks and trains have been able to reduce costs while driving up productivity.

The governments of countries typically hosting mining companies have realized that this innovation is valuable to its economy if performed domestically. Thus, a number of jurisdictions encourage on-shore innovation either by way of R&D tax incentives or grants. The way in which these incentives are approached requires careful management since there are often conflicts between competing jurisdictions.

Companies should consider the impact of these opportunities at all levels within the organizational structure.







# Taxation trends – what now?

Mining companies are not unfamiliar with commodity cycles. In some respects, the current commodity cycle is rather unique in the sense that the tax world is also seeing a major OECD initiative with regards to BEPS. Mining companies will not be isolated from BEPS and in some respect may be at the coal face of the proposed changes being debated. We anticipate that various jurisdictions, particularly the resource rich jurisdictions, may adopt various forms of legislation to implement BEPS related measures. We believe that the desire of governments in resource rich jurisdictions will be to protect the local tax base and to sustain or increase revenue from mining activities in the respective jurisdictions to further the economic growth within those jurisdictions.

Although our discussion regarding tax trends is in no way comprehensive, we do believe that the evolving tax world within a complex commodity cycle requires strategic tax management.



# At Deloitte we are poised to provide insight into the mining jurisdiction regimes.

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