

EAMIC 2006

Mining Taxation - Where to from here?

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Background - Global

PricewaterhouseCoopers mine* 2006 report (www.pwc.com/mining)

Mine: Let the Good Times Roll
Review of global trends in the mining industry in 2005
June 2006

The mining sector has delivered another spectacular increase in profits during 2005, on the back of a further strengthening in commodity prices. This is one of the key findings of 'mine let the good times roll', the third annual review of global trends in the mining industry by PricewaterhouseCoopers.

The 40 mining companies included in the analysis, which represent over 80% of the total global industry by market capitalisation, reported a 59% increase in aggregate net profits for 2005, up from \$28bn to \$45bn. This compares to aggregate profits of just \$5bn in 2002. These results have prompted the companies to increase the amount returned to shareholders to \$16bn in 2005 with further distributions and buy-backs announced in the early part of 2006.

The report shows that investor confidence in the mining industry and its prospects have continued to strengthen: over the last two years mining stocks have outperformed both the S&P 500 and the Dow Jones Industrial Average by over 300%, and in 2005 alone the industry's market capitalisation increased by 72% to \$791bn.

[download form - 1744 kb](#)

- 3rd annual review by PricewaterhouseCoopers of global trends in mining industry
- 40 mining companies included in the analysis representing 80% of total global industry by market capitalisation
- Report highlights:
 - Exceptional financial results
 - Strengthened investor confidence

PricewaterhouseCoopers mine* 2006 report confirms spectacular results for the global mining sector in 2005

- 59% increase in aggregate net profits for 2005, up from \$28bn to \$45bn. This compares to aggregate profits of just \$5bn in 2002.
- Other financial highlights:
 - Revenue increased by 25% to \$222bn
 - Net profit margin improved to 20% from 16% in 2004
 - Net cash inflow from operations increased by 34% to \$58bn
 - Capital expenditure increased by 31% to \$31bn
 - Exploration expenditure increased by 29% to \$2bn
 - Gearing down to just 16% with year-end cash balances totalling \$32bn
 - Return on equity up from less than 7% in 2002 to 25% in 2005
- Core driver: commodity price increases

PricewaterhouseCoopers mine* 2006 report notes that it will be a challenge to maintain margins should commodity prices fall

- Substantial increases in operating costs have occurred in 2004 and 2005
- CEOs sounded a note of caution on the impact of investment funds that have been investing directly in commodities and could exacerbate price volatility

PricewaterhouseCoopers mine* 2006 report notes a need for attractive new developments or acquisitions

- Investors will demand higher distributions in absence of attractive new development or acquisition opportunities
- 40 companies surveyed have continued to increase their exploration expenditure
- Junior companies now spend more than 50% of global exploration budget and their importance looks set to grow

Background – Tanzania

Significant investment following fiscal and legal reforms

- Prior to 1997: Sector dormant for many years
- 1997: New fiscal regime
- 1998: New Mining Act
- 1998: Mining and Engine of Growth conference
- 1998 to 2005: \$2.5bn new investment
- Gold production: 1998 (2 tonnes), 2005 (50 tonnes)
- Significant non-gold prospects: nickel, platinum, uranium

Aside from taxes, significant macroeconomic benefits

- Multiplier effect as an “Engine of Growth” – see TBL statement →
- Significant export revenues
 - 2005: \$645m (2004: \$553m)
- Contribution to GDP
 - 2005: 3.5% (2004: 3.2%)
- 2005: \$69m in taxes including \$23.6m in royalties



TBL: “Sales grew by 13%
Volume growth benefited during the first half of the year from higher disposable income levels, resulting from good cash crops and the multiplier effect from increased mining activities”

But public perception of the sector is very negative

'Review foreigners' mining contracts'
 By Guardianah
 Reporte Docoma
 14/11/04
 Abdulla Lutavi, said Tanzania has given out minerals to
 of 2003
 only the government about its failure to pay terminal benefits of regions with farm inputs. The challenged the

THE RAPE OF TANZANIA'S MINERALS WEALTH
Avoid making the same mess with petroleum
 By Karl Lyimo
 I SHUDDERED the other day to read in the local press that Tanzania is about to enter the contributions as the training of Tanzanians in mining (\$2.4 million in 2002) - employment (3,853 jobs) - as well as it is that Tanzania and Tanzania benefited to the tune of \$113.69 million in total over the five years, leaving the

THE CITIZEN
 Dar es Salaam, Tuesday, 4 October, 2005

Revision of legislation on mining long overdue
 BY PETER NYANJE
 THE CITIZEN 12/6/05
This mining raw deal is the price we have to pay for ignoring history

If there is nothing dubious about these contracts, why won't they be made public?

Gold price escalates as US dollar weakens
 ● *Tanzania no more than a looker-on!*
 By Hassan Mghenyi
 THE price of gold at the world in the big gold-digging international firms currently operating in the According to a recent report by the Bank of Tanzania, gold 'contributed'

Time to revisit mining policy
 OFFICIALS of Pangea Minerals Limited last week boasted of having around world-class gold-mining small the amount sounds to be

THE CITIZEN 12/6/05

.....and Government is now reviewing the mining regime



Objectives, types, and best practices of mining regimes

What is “mineral taxation”?

- Likely answer from Government official: *“income taxes and Government royalties”*
- Likely answer from Industry representative: *“that portion of the mining project’s total revenues that ends up in the Government’s hands”*

Objectives of the mineral taxation regime

- Fair participation by state
- Stable over time
- Transparent and provides even playing field for all
- Easy to understand and administer
- Internationally competitive

Need to recognise unique characteristics of mining industry

- High risk
- Price taker
- Cyclical profits
- Finite life
- Capital intensive
- Remote locations
- Restoration and reclamation
- Reliance on subcontractors

Tax regime can recognise relatively high risk

- Permit the mining enterprise to reap a reward commensurate with the risk
- Mineral prices set by global market place and cyclical → regime more attractive if minimises taxes not based on profits, and provides adequate / indefinite loss carry forward
- Provide certainty of tax rules
- Avoid front-loading the tax costs

Tax regime can recognise capital intensive nature

- Allow the enterprise to generate sufficient after tax cash flow in the early years of production to service project debt, thereby reducing lender's project risk
- Minimise imposition of customs duties, VAT and similar upfront costs that are a function of capital investment
- Avoid the imposition of taxes on capital

Royalties – a double edged sword

- Historically the most important instrument for taxing mineral extraction
- Attractive to Government as ensures up-front revenue stream
- If too high
 - Can deter investment by increasing marginal cost
 - Risk making it unprofitable to develop marginal reserves

Other considerations

- Remote location → need generous tax depreciation for infrastructure costs
- Restoration & reclamation → tax relief for funds put aside for purposes of mine reclamation and closure

Overview of key features of tax regime in Tanzania

Key features of Tanzania mining fiscal regime:

Royalties	3% standard; 5% diamonds; 0% polished & cut stones
Customs duty	Exemption on supplies for mine up to 1st anniversary of commencement of production; thereafter a cap of 5%.
VAT	Relief from VAT for supplies to mining companies
Income Tax	<ul style="list-style-type: none"> • Standard income tax rate 30% • Standard withholding tax on dividends 10% • US\$ accounting • 100% capital deduction for exploration / development • Indefinite carry forward of tax losses • Ability to provide for future environmental costs
Fiscal stability	Mining development agreements include guarantee

A number of reliefs have been withdrawn since 1997

- 2001: removal of ability to defer payment of royalty when cash operating margin negative
- 2001: removal of 15% additional capital deduction on unrecovered development expenditure
- 2004: removal of withholding tax reliefs (eg for interest)
- Depending on terms of mining development agreements, existing investors protected from these changes

Comparison with other African mining countries and East Africa

Royalties

Established mining countries:

Botswana	3% (precious stones: 10%, precious metals: 5%)
DRC	0.5% - 4%
Ghana	3% - 6% (in practice has always been paid at 3% rate)
Zambia	0.6% (base metals), 2% (other large scale miners), 5% (small scale miners, gemstones)

East Africa:

Kenya*	Higher of (a) 2.5% on gross sales (FOB), and (b) sliding scale of 0% to 20% of “profit” (as defined) – can be subject to negotiation
Tanzania	3% (diamonds: 5%, polished & cut stones: 0%)
Uganda**	Mining Act provides for royalties, but does not stipulate rate.

* Kenya – new Mining code proposes standard royalty of 3%, but precious minerals 4% & diamonds 5%; there have also been suggestions that part of the chargeable royalty be passed to local authorities.

**Uganda - royalty split: central government (80%), local government (17%) land owners/lawful occupiers (3%)

Income Tax Rate & Non-resident Dividend Withholding Tax

Established mining countries:

	Income Tax Rate - Mining	Dividend (NR)
Botswana	25%** (formula* → higher if profitability > 33.3%)	5% (net of ACT)
DRC	30% (lower than standard rate of 40%)	10%
Ghana	25% (= standard corporate tax rate)	10%
Zambia	25% (base metals), 35% (other metals)	0% base metals, 15% other

East Africa:

Kenya	30%, but agreement may provide lower rate	10%
Tanzania	30%	10%
Uganda	25% (formula* → higher if profitability > 33.3%)	15%

*formula in Botswana and Uganda is $70 - 1,500/X$ (where X = profitability ratio); maximum possible rate in Botswana is 55% (including 10% ACT) and in Uganda is 45%;

**in Botswana, tax rate of 25% made comprises company tax at standard rate 15% and additional company tax (ACT) 10%. The ACT (10%) is creditable against withholding tax on dividends (15%).

Capital deductions, \$ accounting, loss carry forward

Established mining countries:

	Capital deductions	US\$ tax filing	Loss c/f
Botswana	100%	No	Unlimited
DRC	As per accounts	Yes	Unlimited for "R&D", otherwise 5 years
Ghana	80%, then 50% reducing balance	Yes	5 yrs, but in practice no limit on capital deductions
Zambia	100% (P&E)	Yes	Base metals – 10 yrs, Some mining companies – 20 yrs

East Africa:

Kenya	40%, balance 10% straight line	No	Unlimited
Tanzania	100% (E&D)	Yes	Unlimited
Uganda	100% (P&E), otherwise normal	No	Unlimited

Customs duty

Established mining countries:

Botswana*	0% on mining equipment
DRC	2% during exploration, 5% thereafter; 3% petroleum
Ghana	0% for assets on the mining list
Zambia	Holder of mining right can apply for rebate, refund or remission of whole or part of duty

East Africa:

Kenya**	No automatic exemption, however mining agreement may grant
Tanzania	0% up to 1st anniversary of production, thereafter 5% cap
Uganda**	No automatic exemption, however mining agreement may grant

* Note that imports from South Africa to Botswana are free of customs duty as part of common customs union

** EAC CET automatically provides for 0% duty on capital goods and raw materials

VAT / Sales Tax - Purchases

Established mining countries:

Botswana	VAT	No relief – but VAT rate is low at 10%
DRC	Sales Tax	No sales tax on mining imports
Ghana	VAT	No VAT on assets on mining list
Zambia	VAT	Deferment of VAT on imported mining equipment

East Africa:

Kenya	VAT	No special provision, but mining agreement likely to provide for VAT relief for certain mining equipment
Tanzania	VAT	No VAT on supplies to mining company
Uganda	VAT	No special provision but VAT deferment on imports should apply to most plant and machinery imported. The VAT deferred on import can later be waived.

Conclusion on comparisons

- Tanzania:
 - tax regime not dissimilar to other mining jurisdictions
- East Africa:
 - Fiscal regimes in the 3 countries quite different
 - In Kenya and Uganda a number of fiscal terms are subject to negotiation (in contrast to Tanzania where a standard framework applies)

Overview of recent Tanzania Government proposals for change

Government Stakeholders Consultative Meeting – 1 July 2006 – summary of some of the recommendations relevant to taxation

- Windfall tax based on price of gold
- Royalty on “gross value” instead of “netback value”
- EAC Common External Tariff to apply to mining
- Ring-fencing of mining losses (to specific projects?)

International perceptions of mining taxation in Tanzania

Fraser Institute – Annual Survey of Mining Companies 2004/05

The screenshot shows a Microsoft Internet Explorer browser window displaying the Fraser Institute website. The address bar shows the URL: <http://www.fraserinstitute.ca/shared/readmore.asp?sNav=pb&id=738>. The website header features the Fraser Institute logo and the text "WELCOME TO THE FRASER INSTITUTE". Below the header is a navigation menu with links for "Student Centre", "Teacher Centre", "About the Institute", and "Be a Supporter". The main content area is titled "PUBLICATIONS" and features a sidebar on the left with two categories: "BY TYPE" (News Releases, Commentaries, Publications, Events) and "BY RESEARCH AREA" (Economic Freedom, Education, Environment & Risk, Fiscal Policy, Governance, Health, Law and Markets, Non-profit Studies, Pharmaceutical Policy, Regulatory, School Report). The main content area displays the title "Annual Survey of Mining Companies 2004/2005" with the following details: Publication Date: March 2005, Publication Format: Survey, Author(s): Fred McMahon, Director, Centre for Trade & Globalization Studies, The Fraser Institute, Email: fredm@fraserinstitute.ca, Telephone: (416) 363-6575 ext 226. An "Executive Summary" follows, stating: "Since 1997, The Fraser Institute has conducted an annual survey of metal mining and exploration companies to assess how mineral endowments and public policy factors such as taxation and regulation affect exploration investment. Survey results represent the opinions of exploration managers in mining and mining consulting companies operating around the world. As the popularity of the survey has grown, we have expanded it to include more jurisdictions."

Survey coverage:

- Sent to 1,121 exploration, development, and mining consulting companies
- Responses from 259 companies (23% response rate) representing
 - \$575 million in exploration spending in 2004 or 15% of total global spending according to Metals Economics Group,
 - \$798 million of expected spending in 2005

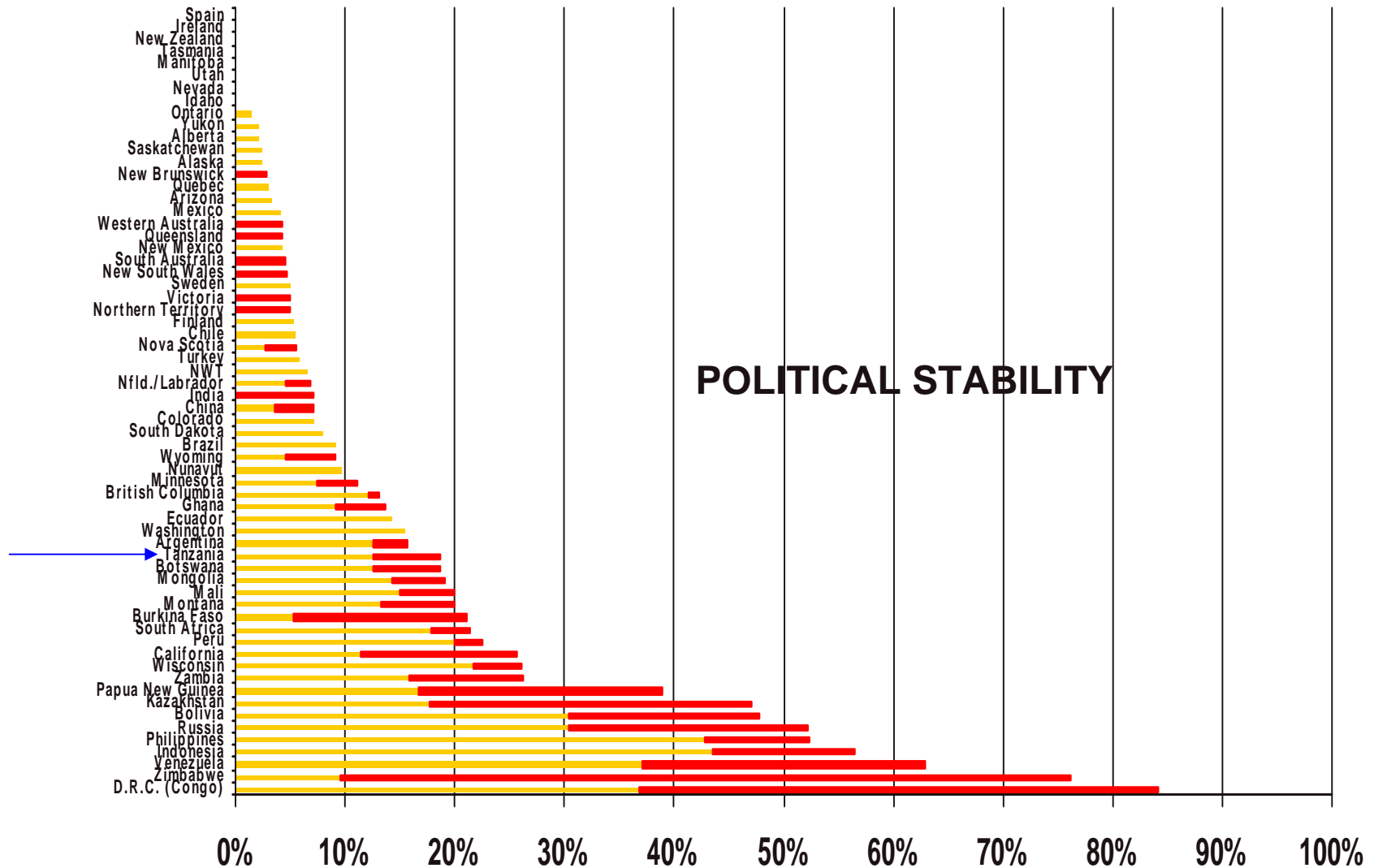
Survey asks questions about:

- geological endowment
- policy endowment including the laws and the process of their implementation

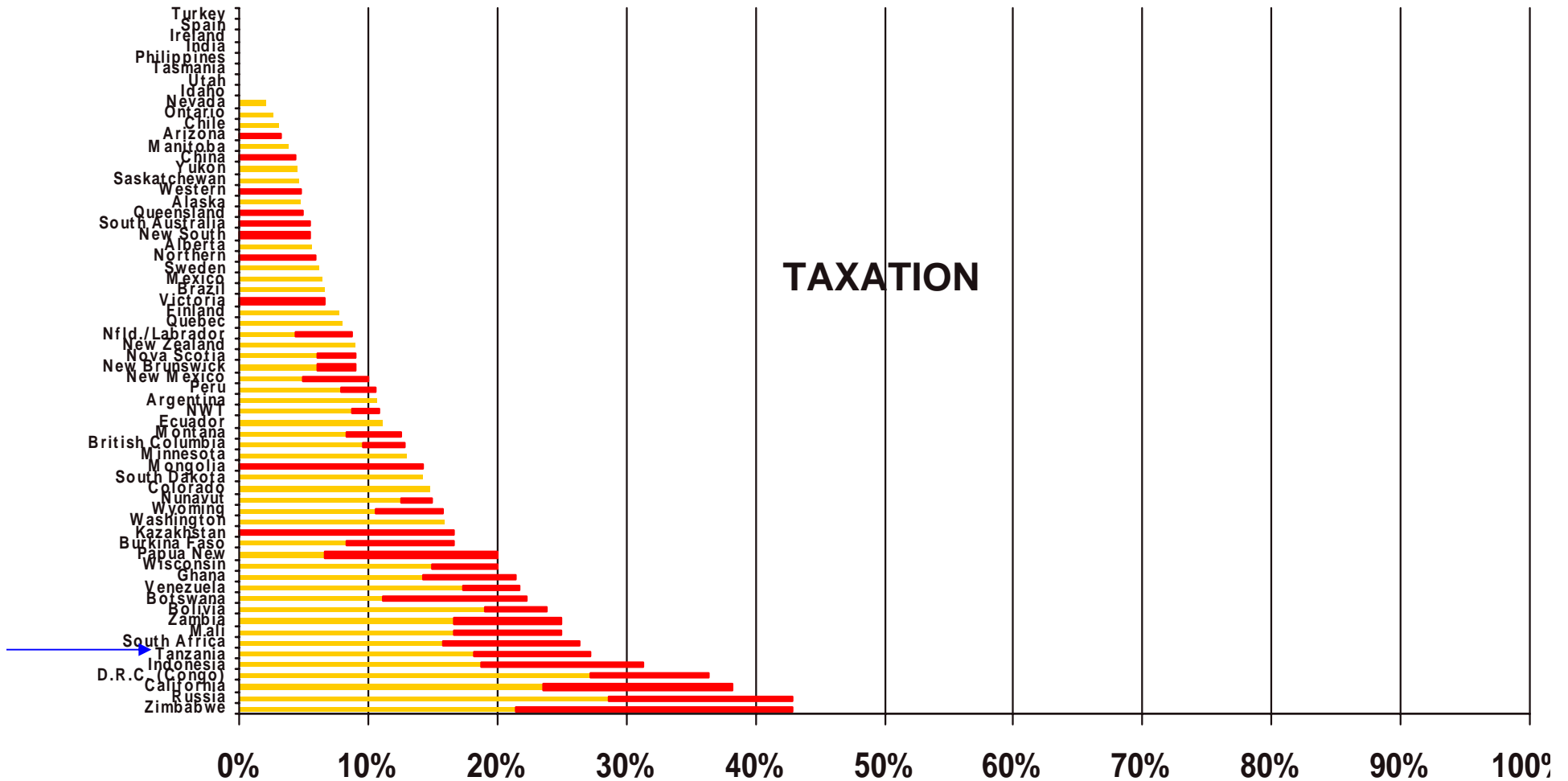
Policy Endowment Indicators – Fraser Institute asked mining companies, “*are you deterred from investing because of*”

- Uncertainty on existing regulations
- Environmental regulations
- Taxation regime
- Uncertainty on native land claims
- Uncertainty on protected areas
- Regulatory duplication and inconsistencies
- Infrastructure
- Socioeconomic agreements
- Political stability
- Labour regulation
- Geological database
- Security

Tanzania comes out reasonably well on political stability but



..when looking at taxation, Tanzania comes within bottom 5 together with countries such as Indonesia, Russia, Zimbabwe



Tax incentives, changes in tax regime and mining investment

Attracting investments

- In times of record profitability, seemingly no need for countries to provide tax incentives to draw investors
- However, evidence indicates that countries like Mali and Ghana that provided preferential investment environments in leaner mining years are reaping the benefits now
- Canada has also shown a positive impact on mining exploration of specific and targeted tax incentives

Impact of uncertainty – the Indonesia example

- Negative publicity around changes in tax regime (coupled with other political factors) have led to a reduction in investment levels over the past decade (despite the country's exceptional mineral potential)
- Total exploration expenditure declined from an annual average of \$134m in the mid 1990s to an annual average of only \$33m in the first part of this decade
- Compounding this decline has been a 68% reduction in development and fixed asset expenditure

Reaping the benefits

- Despite tax incentives, mines are generally a great source of tax revenues for countries
- Need for infrastructural development = hidden “tax”
- Local community normally derives a number of indirect benefits. However, direct financial benefits do not necessarily benefit local community: challenge is to strike right balance between utilising benefits for the whole country and for the specific affected community.

Conclusion

Fiscal regimes for mining in East Africa currently quite disparate, why not have greater harmonisation?

- Current position
 - Mining tax regimes in the 3 countries quite different
 - Lack of standardised policy means that in Kenya and Uganda a number of fiscal terms are subject to negotiation (in contrast to Tanzania where a standard framework applies)
- Benefits of greater harmonization:
 - Sends a stronger message as to likely future stability / consistency of fiscal treatment in the region
 - Deals with any inconsistencies with Common External Tariff
 - Revenue Authorities might be able to have economies of scale in terms of knowledge sharing if dealing with similar legislation

Any change in Tanzania needs to be very carefully considered

- Mining regime introduced in 1997
 - Has been subject to significant modification since 1997
 - As currently constituted, appears to be in line with international practice
- For existing investors with the original 1997 fiscal regime
 - What message will re-opening of contracts send?
 - Let us not forget these were the pioneers who got the industry going
- A key challenge: to strike the right balance between utilising benefits for the whole country and for the specific affected local community.
- Need to ensure that any changes made do not deter future investment

Tanzania is in principle well placed to benefit from the global mining boom.

However, the ongoing debate in relation to mining needs balance.

Any perception of significant uncertainty, especially as to the tax regime, could discourage investment.