



*cutting through complexity*

KPMG GLOBAL MINING INSTITUTE

# Trends in taxation

**Coping with transparency,  
mining royalties and  
volatility**

[kpmg.com/mining](http://kpmg.com/mining)

KPMG INTERNATIONAL



The dramatic fall in global mining commodity prices, along with high national deficits and a slow climb out of recession in most economies, has elicited a strong reaction from governments. The shift towards indirect taxes and fees reflect governments' efforts to guarantee revenues, striking a balance between a sustainable return on natural resources and a reasonable profit to the mining companies.

On top of this, the burden of proving that companies are paying the right amount of tax no longer rests solely with the taxing authorities. In more and more countries, mining firms may soon be forced to fully disclose all revenues and taxes generated globally, on a country-by-country basis. Such disclosure will put the spotlight on companies' attempts to negotiate or structure into tax efficient operating models.

In this latest paper from KPMG's Global Mining Institute, we take a deeper look at the global movement towards tax transparency, and the steps companies should consider in order to comply with pending disclosure requirements. As this new operating environment exposes tax postures to tax authorities and, in many cases, to the general public, we discuss how mining firms can manage these challenges.

The paper also traces the global trend towards resource nationalization and the resulting volatility in tax policies applied to the extractive industries. Our analysis of recent events in several countries covers issues such as Mexico's new 2014 mining fees, and the repeal of Australia's Minerals Resource Rent Tax after a heated debate on its effectiveness and market impact. Other markets covered in some depth include South Africa and Papua New Guinea.

We hope to release our next edition in the spring of 2015, highlighting people and change management issues, as mining companies continue to cut headcount, cope with the retirement of qualified workers and manage expansion into less industrialized markets.



**Darice Henritze**  
Global Mining  
Leader, Tax

# Content



Future trends in tax transparency **04**



Mining taxation and royalty regimes **10**



Country profiles **17**

KPMG's Global Mining practice

22

KPMG – mining service offerings

23

# Future trends in tax transparency

Although full exchange of information has not yet arrived, more and more mining companies are preparing for such an eventuality.



“  
The push to generate tax revenues is driven by growing pressure on public budgets in a tough economic climate, and the need to reduce government deficits. ”

In August 2014, 44 members of the Organization for Economic Co-operation and Development (OECD), including several developed nations in Europe and Latin America and many tax havens such as the British Virgin Islands, issued a joint statement calling for a global standard for the automatic exchange of information (AEoI) between tax authorities. These early adopters believe that such exchanges can help to clamp down on tax evasion, and shift the burden of proof from tax authorities (who must currently identify tax evaders) to taxpayers, who would have to defend their structures. The group – which did not include the US – also broadcast an invite to additional countries to join the AEoI initiative.

The push to generate tax revenues is driven by growing pressure on public budgets in a tough economic climate, and the need to reduce government deficits. At the same time, investors, civil society organizations, the media and the wider public are demanding that companies and individuals pay their fair share of tax, and are urging increased transparency of tax payments.

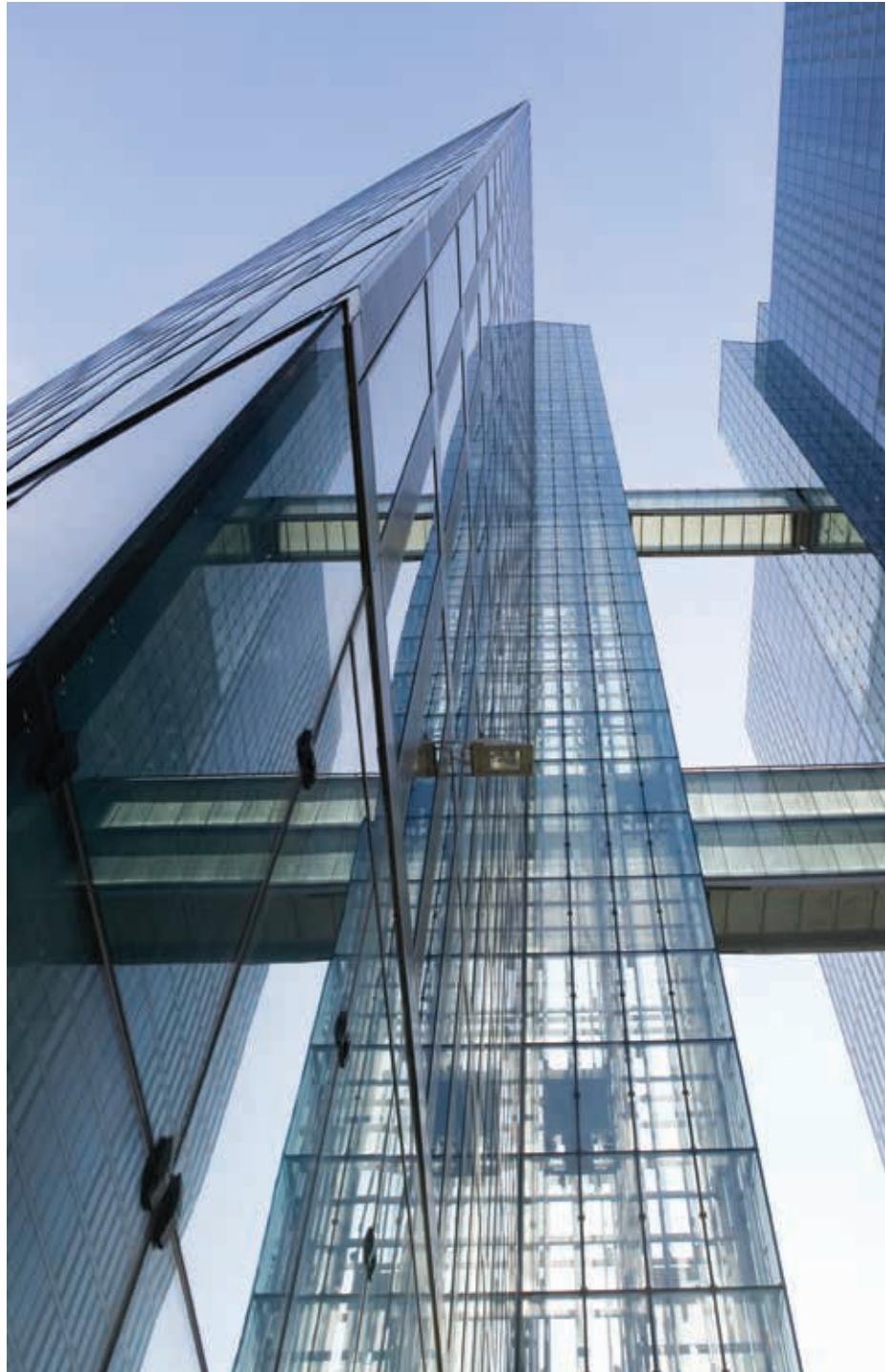
Historically, financial institutions and individual taxpayers were the main targets. The Foreign Account Tax Compliance Act (FATCA) was passed in the US primarily as a response to the 2009 UBS offshore banking scandal, where many Americans were found to hold large financial accounts with Swiss banks, without reporting or paying US taxes on the associated income. FATCA requires foreign financial institutions

to provide information to the US Internal Revenue Service about any of their assets held by US persons. This focus has seemingly shifted to corporate taxpayers, as a lively debate continues over the use of tax planning to avoid taxes.

Although there is no single, global tax reporting standard for multinational companies, a number of compulsory and voluntary initiatives have been introduced in recent years, including the US Dodd-Frank Act of 2010. This act requires any mining company that is listed on a recognized US stock exchange to disclose payments made to foreign governments. However, after a challenge from taxpayers, a 2013 court ruling dismissed this requirement, and instructed the US Securities and Exchange Commission (SEC) to think about a new version that respected any country laws prohibiting disclosure of payments, and considered the potential impacts of including certain proprietary information for public release. At the time of publication, the SEC had not issued any new rules to replace Dodd Frank, and the initial appeal reflected the difficulty in obliging companies to publicly disclose sensitive information about their global structures, although tax authorities may have a greater chance of pushing through such legislation if the information is passed to them only. But, recently, the US Court of Appeals said it will permit the SEC to file a supplemental brief, setting the stage for reconsideration of an April 2014 decision that scaled back conflict minerals disclosure demands amidst First Amendment concerns.

Despite these setbacks, the flood gates are well and truly open, and it is no longer a question of 'if' some form of disclosure is required, but of 'how much' must be disclosed and to whom. This move towards transparency is nothing new for mining companies, having already experienced the Extractive Industries Transparency Initiative (EITI) which passed in 2003, and which calls for certain disclosure of payment and revenues. The group behind EITI, which included government and business participants, established certain minimum requirements for transparency in managing resources in oil, gas and mining. Although compliance is voluntary, early adopters like Royal Dutch Shell and Tullow Oil have complied with the initiative since 2011 in anticipation of more onerous and formal laws on country-by-country reporting. Even the country of Norway produces an annual EITI report disclosing revenues from the extraction of its natural resources, while also requiring that Norwegian companies state their taxes and other payments. This information is subsequently reconciled by the national tax authorities.

Such examples demonstrate a proactive stance towards tax disclosure from many global mining companies, suggesting the industry is ahead of the curve.





## Preparing for a more transparent world

Country-by-country reporting is a more recent trend. Motivated by political interest in a number of countries, in 2013 the OECD began a collaboration to address those international rules that enable profit shifting, allow 'double non-taxation' and erode domestic tax bases. Its September 2014 draft recommended revised standards for transfer pricing documentation, with multinationals required to annually report revenue, profits, income taxes paid and/or accrued, the number of employees, stated capital and retained earnings, and tangible assets for each country in which they do business. Additionally, companies would have to identify each entity within the group that operates in a particular tax system, and indicate the nature of its business. Although the OECD has no power to

force any member to adopt such rules, governments clearly recognize the benefits of taxpayer disclosure over government/auditing agent searches.

There is evidence that national authorities will adopt transparency rules; in 2014 the UK government invited views on proposals for UK reporting requirements in the extractive industries. After considering responses, the EU issued a new set of rules under its Accounting Directive that gives member states until July 2015 to comply. These new rules require full disclosure of all information by project, by government and by country of all taxes levied on income, production or profits, dividends and/or royalties paid, license fees, rental fees, production entitlements, signature, discovery and production bonuses, and any payments made for infrastructure improvements. Mining companies, therefore, now have to explain in detail what taxes they pay.



The industry's major players are very concerned about the incompatibility of various reporting standards and the challenge of acquiring data at an entity level. In preparing for future obligations, companies should be aware of the significant time and cost of gathering and coordinating data and the huge risk of inaccurate or incomplete disclosures. Given the size, diversity and geographical spread of many organizations, it may be a good time to review and modify IT systems and recommend modifications or additions to improve compliance. Ultimately, all mining companies will need a comprehensive data extraction, storage and retention strategy, with appropriate systems support.

With regulators likely to pay close attention to future reporting, organizations should consider the risks of disclosure for countries where

their tax payments are low. They should also retain appropriate transfer pricing documentation to support intercompany transactions with these locations, and have a clear explanation for any enquiring tax inspectors.

Any required disclosure that includes payments to foreign persons may increase the risk of scrutiny by anti-fraud regulators, especially regarding semi-legal payments to public officials for transport permits and other essential tools of business. Mining companies should review their global structures for the existence of any non-tax related payments and formal payments supported with appropriate documentation.

“

In preparing for future obligations, companies should be aware of the significant time and cost of gathering and coordinating data and the huge risk of inaccurate or incomplete disclosures. ”



**By Darice Henritze**  
Global Mining Leader, Tax  
T: +1 303 382 7019  
E: [dhenritze@kpmg.com](mailto:dhenritze@kpmg.com)

Darice has more than 23 years of experience advising mining, data/telecommunications, wire transfer, high technology, and manufacturing clients on all aspects of domestic and international taxation, mergers and acquisitions, and financial management.

# Mining taxation and royalty regimes

Mining royalties and taxation are important to the future of the mining industry, just as they are vital for the growth and development of many resource-rich countries.



## Resource nationalism versus paying a fair share

Royalties represent the price the industry pays to governments and communities for the natural resources extracted and companies will factor in this price when conducting financial modeling to support their decision to invest in a new mine in a new country.

Globally, there are many types of mining taxes, subject to continual change as governments review their regimes and new mining provinces open up for development.

National mining tax policies attempt to determine the 'right price' for extracted resources, striking a balance between a sustainable return for the government and a 'reasonable' profit for the mining company, bearing in mind its long-term capital investment, risk levels, skills and degree of efforts. Consequently, the rates, type of tax and collection methods can vary significantly between countries and commodities.

An effective mining tax policy, well communicated, and developed in consultation with the mining industry in advance of implementation and investment decisions, often produces a win-win result for all stakeholders.

An effective mining tax policy, well communicated, and developed in consultation with the mining industry in advance of implementation and investment decisions, often produces a win-win result for all stakeholders.

This section looks at global developments in mining taxation drawing from recent examples of minerals taxation in Australia; principles that can apply across many other countries.

## Lessons learnt from Australia's short-lived Minerals Resource Rent Tax

In 2009 the Australian government started to question whether the various state mining royalties had yielded a sufficient return for their respective communities, especially in light of the so-called 'super profits' arising from the surge in commodity prices. Following more than 2 years of intense debate between industry and government, the Minerals Resource Rent Tax (MRRT) was introduced but lasted for only 2 years, netting very little for the Federal Government. The tax has now been repealed, with the new national government announcing that Australia is "open for business" and looking to attract increased foreign investment into mining and other industries.

This experience shows that:

- MRRT was over-complex, subject to too many different interpretations, valuations and detailed calculations. This imposed a heavy cost of compliance on industry and created uncertainties over future MRRT liabilities, making it hard to plan for future financial reporting
- resource royalties are, by contrast, relatively simple and effective
- early and ongoing consultation between government and industry is essential
- transitional tax relief helps mitigate sovereign risk and prevents the flight of capital
- federal, state and national policies need to be harmonized; in Australia's case, state government mining royalties competed with the federal government's MRRT regime

- early preparation and consultation with the tax administrator is highly beneficial
- mining companies – and the industry as a whole – should have a communication strategy to show stakeholders and the public that they pay their fair share of taxes.

## Navigating the royalty maze

As the table below shows, royalty rates can differ between countries and commodities, as can taxation methods, tax base factors and stability.

There is often no common pattern and the final rate may well be determined through discussions between the mining company and the government or, in the absence of an agreed rate, will be simply based upon how much the market will bear.

The Western Australian government's current review of royalties seeks to lay ground rules for determining royalty rates, which should provide some interesting benchmarks for other regions and countries. The terms of reference dictate a benchmark of 10 percent of mine head value of extracted resources, and a three-tiered structure of 2.5 percent to metals, 5 percent to concentrate and 7.5 percent to crushed and screened products, based on the level of processing required, to determine the ad valorem rate for selected minerals. The government stated that:

*"The three rates reflect a standardized response to different levels of value added processing after the ore is mined. Lower rates apply to more processed products to allow for the increasing costs of converting the ore into semi-processed, concentrate or metal"*

## Corporate income tax (CIT) and mining royalty rate comparison

Country	CIT	Mining taxes and royalties				
		Method	Coal	Gold	Copper	Iron ore
Australia	30%	R	2.75%–15%	2.5%–5%	2.5%–5%	5.35%–7.5%
Brazil	25%	R	2%	1%	2%	2%
Canada	25%–31%	P	2%–16%	2%–16%	2%–16%	2%–16%
Chile	20%	P	0–14%	0–14%	0–20%	0–14%
China	25%	R	0.5%–4%	0.5%–4%	0.5%–4%	0.5%–4%
Ghana	25%	R	5.00%	5.00%	5.00%	5.00%
Indonesia	25%	R	3–7%	3.75%	4.00%	3.00%
Mexico	30%	P	7.5%	8.0%	7.5%	7.5%
Mongolia	10–25%	R	2.5%–7.5%	5%–7.5%	5%–30%	5%–7.5%
Peru	30%	P	1%–12%	6%–21.5%	6%–21.5%	6%–21.5%
South Africa	28%	R	0.5%–7.0%	0.5%–7.0%	0.5%–7.0%	0.5%–7.0%
US	40%	P/R	8%–12.5%	4%–10%	4%–10%	4%–10%
<b>Global average 2014</b>	<b>23.57 %</b>					

Key

R Royalty basis

P Profit or net basis

Source: Mining Tax Databook, KGS, August 2014

*form as it is transformed through the value chain. The resource value of a commodity is a smaller percentage of the sale price of a highly processed mineral than one subject to minimal processing."*

Although mining royalties are a relatively simple form of collecting mining taxation, they can be indiscriminate, leading to perceptions of unfairness between different royalty payers. In the Australian state of New South Wales (NSW), for example, the coal royalty rate is applied to the value of the extracted ore, which is typically the free on board (FOB), arm's length export sale price of the coal at port. Three alternative royalty rates are used: 6.2 percent for deep underground mines (coal extracted below 400 meters), 7.2 percent for underground mines and 8.2 percent for open cut mines. These variations reflect the higher cost of bringing ore to the surface from a deep

mine – especially as the final FOB sale price at port may be the same as coal from an open cut mine.

However, royalty rates do not acknowledge other costs that may vary significantly between mines, such as distance from ports. The rate for an open cut mine more than 500 kilometers from port is the same as for a similar mine that is much closer to port, meaning that the former's transport costs will result in a lower net return.

Countries and states are competing for capital to develop mineral resources – an argument voiced vocally during the early planning stages of the MRRT. Any country contemplating changing royalty rates for existing or planned projects should be aware of the significant risk of capital being withdrawn, due to perceptions of sovereign risk. As the mining boom subsides and commodity prices return to

## Schemes and mechanisms for taxing resources – Comparative example

### Mining royalty vs. RRT comparison

Example: Coal royalty rate of 8 percent and RRT rate of 22.5 percent

Scenario 1: Coal price AUD\$100	Royalty	RRT
Revenue	\$100	\$100
Allowable deductions	\$5	\$40
Value of mineral for royalty / RRT	\$95	\$60
Royalty / tax payable	\$7.6	\$13.5
Operating profit (pre-tax)	\$30	\$30
Royalty / RRT percentage of operating profit	25%	45%

Scenario 2: Coal price AUD\$150	Royalty	RRT
Revenue	\$150	\$150
Allowable deductions	\$5	\$40
Value of mineral for royalty / RRT purposes	\$145	\$110
Royalty / tax payable	\$11.6	\$25
Operating profit (pre-tax)	\$80	\$80
Royalty / RRT percentage of operating profit	14.5%	31%

Source: KPMG International 2014

historically average levels, governments are carefully reviewing royalty rates to ensure that they support the future mining industries and the associated economic development.

## Choosing the most appropriate mining tax method

Mining tax methods vary significantly and tend to fall into three categories:

**1** Royalties: applied to either the value of the resource extracted or to a tonnage or other measure

**2** Profit-based royalties or resource rent taxes (RRT): a higher rate is usually applied to a net return or profit calculation that recognizes project development and operating costs

**3** State participation: with greater public ownership of resources, the state takes a share of the output from the extraction activity as the community's share of the resources.

Given the significant impact of different tax methods on both the government and the mining company, any royalty mechanism must be appropriate to the commodity, the method of extraction, and help to enable a sustainable mining industry in that country.

In the example on the previous page, a mining royalty is compared with a RRT regime similar to the Australian MRRT:

The comparison highlights a number of notable findings:

- as project profitability increases, royalties collect a declining share of the return from resources (a 50 percent price increase results in a 53 percent rise in the amount of royalty paid)
- RRTs, however, collect a greater share of the return from a profitable resource

project (a 50 percent price increase results in an 85 percent jump in the amount of RRT paid)

- royalties collect a return from loss-making projects (potentially contributing to mine closures for marginal projects)
- where the profitability of a project decreases, collections under a RRT regime also decrease (e.g. the MRRT returned minimal tax collections)
- the International Monetary Fund (IMF) is in favor of combining a royalty and RRT along with corporate income tax (however, as Australia's MRRT experience showed, overlapping taxes can lack harmonization and lead to inefficiencies and uncertainties).

Ultimately, the appropriate method of mining taxation will depend on many factors. From a policy perspective, the principles of equity, fairness and neutrality are commonly used to describe a 'good' or 'bad' tax. A 'tax neutral' mining tax regime is one where the tax rate should not influence any decision to proceed with a mine development.

Over many years, in Australia, the most common mining tax method has been 'ad valorem' mining royalties based on the value of extracted resources. This has provided a largely stable fiscal environment in which miners have made development decisions, and contributed to a growing and viable mining industry that gives returns to government to fund public programs and services. From time to time, tensions have arisen when royalty rates have been increased with minimal industry consultation; open and transparent consultation between industry and governments has worked best and led to optimal outcomes.

“

Given the significant impact of different tax methods on both the government and the mining company, any royalty mechanism must be appropriate to the commodity, the method of extraction, and help to enable a sustainable mining industry in that country. ”

“

Companies can also help themselves by being more transparent about their total tax burden, to show that they are paying their fair share of taxes and earning their social license to operate. ”



### Rod Henderson

Tax Partner – Energy & Natural Resources  
KPMG Australia

T: +61 2 9335 8787  
E: [rbhenderson@kpmg.com.au](mailto:rbhenderson@kpmg.com.au)

With more than 25 years of tax consulting experience, Rod leads KPMG Energy & Natural Resources network in the Asia Pacific region. Based in Sydney, Rod assists many global clients in the mining sector and has participated in many of significant M&A transactions across the Energy & Natural Resources industry.

## Global volatility in mining taxation regimes

As outlined elsewhere in greater detail in this report, there are continuous changes, updates, disputes and issues arising in the world of mining taxation. Here is a recent snapshot of developments in four countries:

- **Western Australia:** in a report due in late 2014, the government is reviewing resource ad valorem royalties, including the benchmark rate of 10 percent of mine head value
- **South Africa:** the State Intervention in the Mining Sector (SIMS) report of 2012 canvased views on a RRT to ensure “people are getting a fair share.” The DavisTax Committee is currently reviewing the current mining tax regime, with a report also due late 2014
- **Ghana:** the corporate tax rate for mining companies was increased from 25 percent to 35 percent in 2012, with a proposed 10 percent windfall profits tax stalled, due to pressure from mining companies. The mineral royalty changed from a range of 3–6 percent to a fixed rate of 5 percent
- **Mexico:** new mining taxes took effect from 1 January 2014, with a 7.5 percent royalty charged as a percentage of ‘profits,’ and an additional levy of 0.5 percent for gold and silver extraction. Recent energy sector reforms should increase investment in Mexico’s mining industry, to take advantage of new opportunities to exploit mineral resources to generate energy.

These and other changes highlight the essential volatility of mining taxation at a time when the industry is seeking certainty and stability, to underpin decisions to invest in new countries and mining development projects.

Companies are looking for certainty. This will involve a range of measures ranging from stakeholder communication of total

taxes paid to forging closer relations with tax authorities. Companies are using tools such as advanced compliance agreements, ruling requests and tax policy submissions to government policy makers. When investing into new projects, companies are using advanced pricing agreements, bilateral investment treaties and fiscal stability agreements to obtain certainty around key tax variables underlying their investment decisions.

Companies can also help themselves by being more transparent about their total tax burden, to show that they are paying their fair share of taxes and earning their social license to operate.

## Towards globally consistent mining taxation

The changes in mining tax in recent years suggest that, on a global basis, best practice can be achieved through:

- a well designed tax regime that does not distort investment and production decisions
- transparency of natural resources revenues, administration and reporting in order to improve stability and credibility
- well constructed tax rules; conversely, poorly thought-out regimes rules can undermine a country’s revenue potential
- administration of mining taxation rules by tax authorities; which is essential to ensure the ongoing integrity and trust in the system ongoing integrity and trust in the system
- early and ongoing consultation between government and industry.

By meeting these goals, the stakeholders can together determine a fair price that rewards the community for the value of the extracted resources while providing a fair return to the mining company over the long life of a project.

# Country profiles

In the following chapter, we provide you with an overview of recent trends in mining taxation in Mexico, Papua New Guinea, South Africa and Australia.





# Australia



Craig has over 30 years corporate tax experience including 20 years as a tax partner with KPMG Australia's Perth office. He provides tax advice to a wide range of international and Australian mining, oil and gas, and mining services clients on structuring inbound and outbound investments, financing and joint ventures. He is a Chartered Tax Advisor and Fellow of the Institute of Chartered Accountants in Australia. Craig is extensively involved in mining industry tax issues and policy developments in his role as Chairman of the Tax Committee for the Association of Mining and Exploration Companies Inc.

**Craig Yaxley**  
Partner, Tax, Energy & Natural Resources  
KPMG Australia  
**T:** +61 8 9263 7127  
**E:** [cyaxley@kpmg.com.au](mailto:cyaxley@kpmg.com.au)

As the mining boom recedes, the Minerals Resource Rent Tax (MRRT) has been swept out. Legislation to repeal the tax was passed with effect from 1 October 2014. This follows the recent repeal of Australia's carbon tax with effect from 1 July 2014.

## Federal MRRT repeal

The MRRT is a profits-based rent tax applied to coal and iron ore projects at a rate of 30 percent. Introduced during a time of high commodity prices in 2012, the tax has netted less than AUD\$500 million (US\$470 million), hence the government's decision to repeal the MRRT to reduce the regulatory and compliance burden on the Australian mining industry.

## An end to carbon tax

Australia's so-called carbon tax has suffered a similar fate to MRRT, although emitters, including coal miners, oil and gas producers, liquid natural gas (LNG) facilities and power generators are still required to report emissions and energy usage, through National Greenhouse and Energy Reporting requirements. The government remains committed to reducing greenhouse gas emissions by 5 percent from 2000 to 2020, at the lowest cost.

## Mining royalties under review

Mining royalties are imposed by the states and territories, which take priority over federal mining taxes. State royalties vary across the different commodities and geographies. In Western Australia, a significant mining region, the state government is reviewing royalties, with a decision due by the end of 2014.

## Tax transparency

Australia recently introduced a tax transparency disclosure regime where the income tax, MRRT and petroleum rent tax paid by larger companies is publicly disclosed by the federal government. Given the high capital investment and expenditure by the mining industry, significant tax deductions – in the form of exploration deductions, mining capital allowances and tax depreciation – can reduce the tax paid by a mining project until production is well and truly ramped

up. Such allowances could lead to public scrutiny over the industry's tax burden, and any mining companies covered by this disclosure should have a robust communications plan, to explain their overall tax payments and contributions to communities.

## Exploration deductions on acquisition

The government is developing legislation to remove the immediate deduction for the cost of mining, quarrying or prospecting rights, or information first used for exploration or prospecting. There will be limited exceptions, such as qualifying farm-in arrangements. Deductions for the cost of such rights or information, if first used for exploration, will instead be available over the shorter of 15 years or the project's effective life. Ongoing qualifying exploration expenditure continues to be immediately deductible.

## Exploration Development Incentive

A new Exploration Development Incentive (EDI) took effect from July 2014, to promote investment in greenfield mineral exploration in Australia. The EDI is similar to the Canadian Flow Through Share Scheme, whereby an exploration company relinquishes tax losses to pass tax benefits to its shareholders. However, the EDI involves a refundable tax offset (at the corporate tax rate proposed to be reduced to 28.5 percent) in the year after the exploration expenditure is incurred. The scheme has a cap of AUD\$100 million (US\$94 million) of tax credits over the 2015-17 tax years.

## Exploration interpretation

The Australian Taxation Office is expected to release its long-awaited public tax ruling on the interpretation of 'exploration.' This has been a highly contentious issue in recent years, and key issues to be addressed include the tax treatment of feasibility and scoping studies, and the factors determining when a company ceases exploration activities and commences development. From this cut off, capital expenditure moves from being immediately deductible to a depreciation write off over the effective life of the mining project.



# Mexico

Mario's area of expertise include the mining and manufacturing industry and foreign investment in Mexico where is he is responsible for tax services including corporate tax, transfer pricing and trade and customs.

Eduardo is the mining leader in KPMG Mexico with experience in US GAAP, PCAOB and IFRS reporting for multinational companies.



**Eduardo Salgado**  
Partner, Audit, Mining  
KPMG in Mexico  
**T:** +52 55 52468833  
**E:** salgado.eduardo@kpmg.com.mx



**Mario A. Hernández**  
Partner, Tax, Mining  
KPMG in Mexico  
**T:** +52 656 9623616  
**E:** m hernandez1@kpmg.com.mx

## Exciting opportunities and a more investor-friendly environment

With vast mineral reserves – many of them unexploited – Mexico is at the heart of the global mining industry and a hotbed for foreign and domestic investment, ranking only behind the US, Canada and Australia in terms of attractiveness. Mexico is among the world's largest silver producers and in the top ten for gold, copper, fluorite, bismuth, sodium, lead, molybdenum, diatomite, cadmium, graphite, salt, gypsum, manganese, zinc and others.

The country's business environment has greatly improved in recent years, thanks to access to the US market, an increasing global network of free trade agreements, and growing domestic demand from an emerging middle class. Since the 1980s, the shackles of protectionism have been loosened somewhat, to create conditions more conducive to foreign investors, with private capital now the driving force behind the Mexican economy, and no restrictions on foreign ownership of Mexican mining companies.

Although mining-specific royalties and taxes were revoked in the 1990s, a number of new mining taxes were introduced in 2014. All mining companies that explore and exploit minerals must be incorporated under Mexican laws and be domiciled within Mexico. The country retains ownership of all mineral resources and the government grants concessions to private mining companies for exploration and extraction.

## Taxation

Tax treatment of mining companies in Mexico is the same as for other sectors. Corporate income tax is 30 percent, and a new 2014 withholding tax of 10 percent applies to dividends paid out of post-2013 earnings. Given Mexico's extensive network of double tax treaties, a lower withholding tax rate may be available, depending on the country of residence of the recipient of the dividends.

In addition to these taxes, Mexican legal entities with employees must distribute 10 percent of their taxable income to employees as profit sharing. Many mining firms hire foreign entities to construct or develop their projects, and, despite not

being residents, these workers could be subject to income tax on their earnings in Mexico.

Mining companies pay a duty on mining concessions, based on the hectares covered, varying for 2014 from approximately US\$0.44 to US\$9.50 per hectare on a bi-annual basis, depending on the period of ownership of the concessions. This amount can be increased if the concession owner is not carrying out exploration or exploitation work on this land.

2014 also saw two new fees or duties:

- A special fee is payable, based upon the "positive difference" between the adjusted taxable income and the allowed deductions and a rate of 7.5 percent. Inflation, interest paid and gains and deductions for investments in fixed assets (i.e. depreciation) are not included in this difference, although exploration expenses are included.
- Extraordinary fees of 0.5 percent are payable on gross sales of gold, silver and platinum.

Mining companies can also benefit from some incentives, notably tax regulations adjusted to international standards, access to capital sources through lines of credit, and efficient processing of exploration and development claims. In addition, the 16 percent value added tax (VAT) has been eliminated for all stages of gold commercialization, although it is still payable on other transactions such as the acquisition of goods or services. This tax is generally creditable and/or recoverable by mining businesses.

## Doing business in Mexico: some tips for investors

Recently approved energy sector reforms may open up investment in those minerals that generate power. However, given the prominence of trades unions, mining companies should strive to establish strong labor relationships.

A further consideration is payments to 'ejidos' (rural communities) for the temporary use of land in order to access areas covered by mining concessions. Ejidos are common rural organizations governing land designated for communal use for agriculture, livestock, fishing and other primary activities. In some instances, a condition of the land use includes the employment of ejidos members.



# Papua New Guinea



Michael is a Tax Director based in Brisbane who is a PNG Tax Specialist working with both Australian and PNG KPMG member firms. Michael assists ENR companies operating in PNG and has also advised on the tax structuring and due diligence on various mining and oil and gas transactions.

**Michael Frazer**  
Tax Director, Energy & Natural Resources,  
KPMG Australia  
**T:** +61 7 3233 3115  
**E:** [mfrazer@kpmg.com.au](mailto:mfrazer@kpmg.com.au)

## Ongoing reviews to a complex tax system

Blessed with an abundance of resources, Papua New Guinea can now add nickel to its list of projects, in addition to the traditional gold and copper mines. Heavy investment in oil and gas resulted in a two-train gas complex coming on stream in 2014, with further expansions to follow, along with exploration in mineral sands.

### Resource taxation

The country's complex resources tax system means that companies pay varying rates for mining and, oil and gas, with some old projects taxed at 50 percent compared to the current corporate tax rate of 30 percent.

Revenues from particular projects are ring-fenced for tax purposes, while there is an allowance to write off short- and long-term capital expenditure against tax. Resource related tax issues include a rent tax i.e. additional profits tax (APT) that applies only to designated gas projects and:

- interest is only deductible post exploration phase, on issue of a development license, which can make funding more expensive in the earlier stages
- thin capitalization rules permit a maximum a debt:equity ratio of 3:1. Any interest charged on debt that exceeds this ratio will not be deductible for corporate tax purposes.

### Taxation review

During 2014 the entire fiscal regime was under review, covering personal and corporate tax, excise and customs, mining and petroleum and tax administration. The Taxation Review Panel is considering a range of issues for mining and petroleum tax, including exploration, aligning income taxes, design of resource rent tax, royalty and development levy, tax incentives, and international factors.

The Mining and Petroleum Issues Paper lists initial responses, with opportunities for further input. Submissions for a second issues paper for corporate and international taxation were accepted up to August 2014, with further papers forthcoming from the panel.

### Next steps

The taxation review is unlikely to be finalized until 2015 and until then it is difficult to predict whether there will be substantive changes to the current tax system.

Although the country's liquid natural gas (LNG) project has entered the production phase, volatile economic conditions have restricted exploration and development in the mining sector. Resource companies can therefore expect amendments to correct various technical tax issues, but it is uncertain whether more fundamental change is forthcoming.



# South Africa



Muhammad is a Partner and Head of Corporate Tax based at KPMG in South Africa's Johannesburg office, specializing in Mining Taxation. He has also worked on entities with various energy and natural resources in the tax service line.

**Muhammad Saloojee**  
Partner, Corporate Tax  
KPMG in South Africa  
**T:** +27783391454  
**E:** muhammad.saloojee@kpmg.co.za

## A mining tax regime ripe for reform

As the country's largest employer and biggest contributor to gross domestic product (GDP), mining is the backbone of the South African economy. The industry faces a period of uncertainty due to labor disruptions, declining commodity prices, rising costs and a poor economic outlook, as well as concerns over new shareholding rules. Falling productivity has reduced mining tax income, prompting a widespread review of tax in the sector.

## Outdated and complex legislation

Despite a patchwork of additions, the 1962 Income Tax Act 58 has failed to keep pace with the times, with no chapter dedicated to mining and only a handful of specific provisions. For example, provisions for capital expenditure (capex) cover shaft sinking but not open cast mining – which makes up a sizeable proportion of the country's mines. Furthermore, in order to qualify for a tax deduction, rehabilitation expenditure must be paid to a registered rehabilitation trust. Such trusts can typically be accessed only on mine closure, making it harder to perform rehabilitation activities during care and maintenance phases.

Another area lacking clarity is beneficiation, where mining crosses over into manufacturing. Mining capex can only be used to off-set against mining income. Once the process crosses into manufacturing, taxpayers must apply internal transfer prices to qualify as capex, yet there are no rules distinguishing mining from manufacturing, nor specifying how mining income must be computed in companies carrying out mining and manufacturing. Current tax laws also discriminate against start-up companies and discourage prospecting, as prospecting expenditure is only deductible once the taxpayer starts to gain income from mining operations.

Capex may not be deducted against any non-mining income, yet the distinction between mining and non-mining income is often unclear, making it hard to interpret the law. A second provision adds further complexity, limiting any capex deductions to taxable income derived from a specific mine.

## Black Economic Empowerment (BEE) shareholders

The 2004 Mineral and Petroleum Resources Development Act (MPRDA) insists that all mining companies have a minimum 26 percent shareholding by BEE shareholders, as part of a strategy

to transform the industry and redress economic imbalances. However, South Africa's tax legislation does not cover the many tax consequences of implementing BEE transactions.

## Royalties

In recognition of the importance of South Africa's resources, the 2010 Mineral and Petroleum Resources Royalty Act (the Royalty Act) imposes royalties on gross sales of extracted materials. The royalty percentage varies according to the extractor's profitability, ranging from 0.5 percent to 5 percent or 7 percent, depending on whether the mineral is 'refined' or 'unrefined.' One recent amendment is designed to increase royalty contributions by coal mining companies.

## The rising cost of tax compliance

New tax obligations are coming thick and fast. In addition to income tax, VAT filings and diesel refunds, mining companies must now also submit royalty returns. A 2012 Tax Administration Act increases tax queries and tax processes, while the introduction in 2014 of dividend withholding tax adds a further burden for mining companies declaring dividends. On top of this, two new withholding taxes on interest and service fees, will come into effect from 1 March 2015 and 1 January 2016 respectively.

## Additional taxes for foreign investors

A recently introduced 15 percent tax on dividends will be followed on 1 March 2015 by a new 15 percent tax on foreign debt funding, along with new limits on interest payments to foreign debt providers. These additional taxes are expected to deter foreign investment into South Africa, especially in the mining sector, which is highly dependent on shareholder and vendor funding. From 1 January 2016, foreign suppliers of mining services into South Africa will face a 15 percent tax on services, which is likely to be borne by the local buyer of the service through a tax gross-up.

## Reforming tax for the mining industry

Through the appointment of a mining sub-committee, the Davis Tax Committee is assessing the current tax regime's impact upon growth and job creation in the sector. Industry stakeholders hope that the findings – due in late 2014 – will bring much-needed tax reforms to help boost the industry and restore investor confidence in mining, while addressing technical tax inefficiencies.

# KPMG's Global Mining practice

## **KPMG Global Mining Centers**

KPMG member firms offer global connectivity through our 14 dedicated Mining Centers in key locations around the world. By working together seamlessly, we help member firm clients adapt and respond to a rapidly-evolving mining environment.

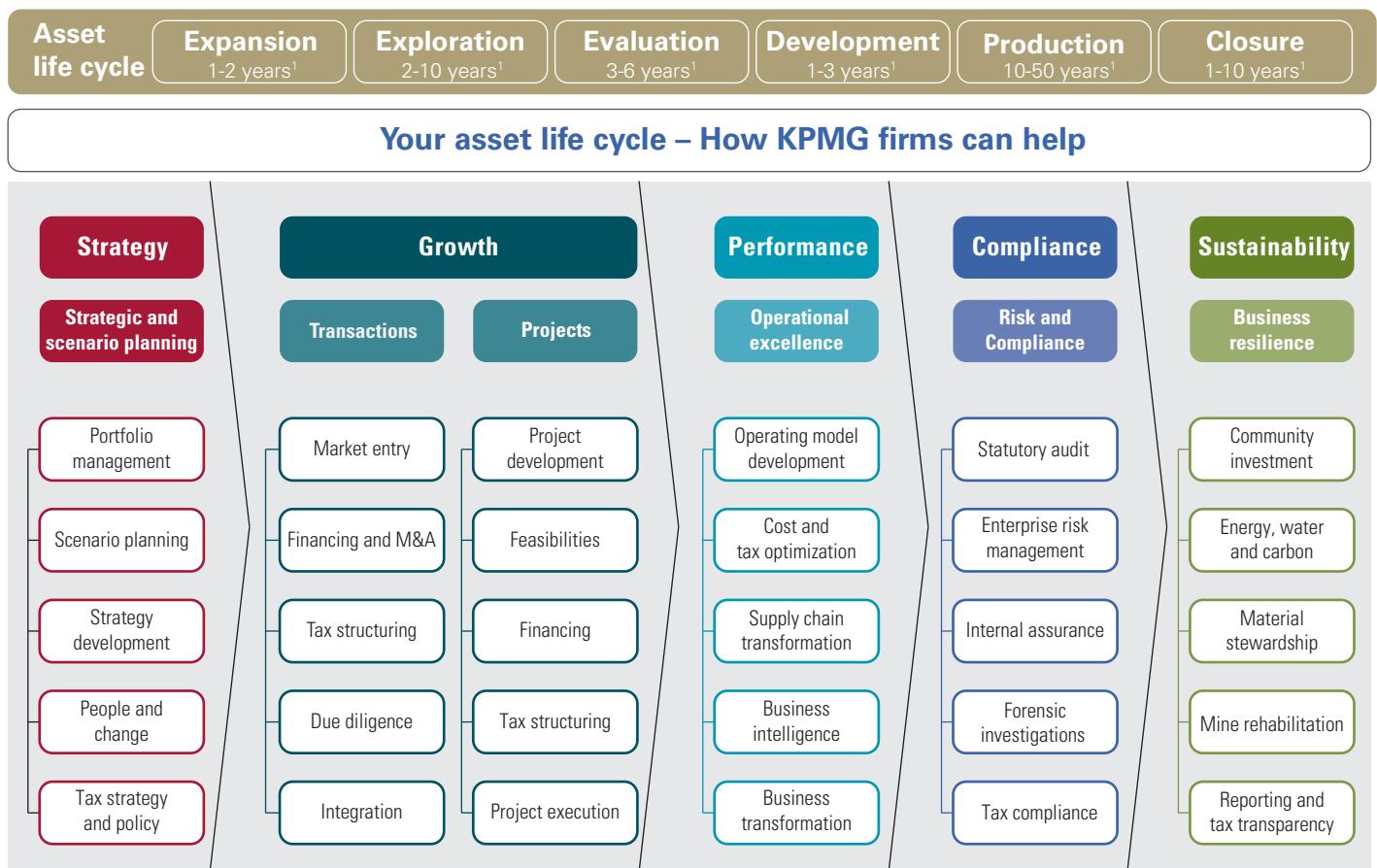
Our centers are located in or near areas with high levels of mining activity: Beijing, Brisbane, Denver, Johannesburg, London, Melbourne, Moscow, Mumbai, Perth, Rio de Janeiro, Santiago, Singapore, Toronto, and Vancouver.

Each center is composed of professionals with extensive practical experience in the mining industry who work together to share information, thought leadership, training, and support. As a client, you will get access to the latest industry thinking, skills, resources, and technical development from a team that has local knowledge, backed up by in-depth global expertise. Our firms are continually building our understanding of global trends and developments by sharing observations and insights with you.

For more information, visit [kpmg.com/mining](http://kpmg.com/mining)



# KPMG – mining service offerings



Source: KPMG International 2012

<sup>1</sup>Estimated duration of stage in the mining asset life cycle

## KPMG Mining Contacts

### Mining Leadership contacts

#### Michiel Soeting

##### Global Chair, Energy & Natural Resources

T: +44 20 7311 1000

E: michiel.soeting@kpmg.co.uk

#### Jimmy Daboo

##### Global Head of Mining

T: +44 20 7311 8350

E: jimmy.daboo@kpmg.co.uk

#### Darice Henritze

##### Global Mining Leader – Tax

T: +1 303 382 7019

E: dhenritze@kpmg.com

#### Hiran Bhadra

##### Global Mining Leader – Operational Excellence

T: +1 214 840 2291

E: hbhadra@kpmg.com

#### Lee Hodgkinson

##### Global Mining Leader – External Assurance

T: +1 416 777 3414

E: lhodgkinson@kpmg.ca

#### Dane Ashe

##### Global Mining Leader – Internal Assurance

T: +27 828 284 812

E: dane.ashe@kpmg.co.za

#### Rohitesh Dhawan

##### Global Mining Leader – Sustainability

T: +27 827 196 114

E: rohitesh.dhawan@kpmg.co.za

### Country contacts

#### Carl Adams

##### KPMG Australia

T: +61 8 9263 7780

E: carladams@kpmg.com.au

#### Alejandro Cerdá

##### KPMG in Chile

T: +56 2279 81501

E: acerda@kpmg.com

#### Anthony Crasto

##### KPMG in India

T: +91 22 3090 1976

E: acrasto@kpmg.com

#### Jacques Erasmus

##### KPMG in South Africa

T: +27 827 190 305

E: jacques.erasmus@kpmg.co.za

#### Pieter Van Dijk

##### KPMG in Brazil

T: +55 213 515 9424

E: pdijk@kpmg.com.br

#### Melvin Guen

##### KPMG China

T: +86 10 8508 7019

E: melvin.guen@kpmg.com

#### Lydia Petrasheva

##### KPMG in Russia

T: +7 49 5937 2975

E: lydiapetrasheva@kpmg.ru

#### Bob Seale

##### KPMG in the UK

T: +44 20 7311 2025

E: bob.seale@kpmg.co.uk

#### Lee Hodgkinson

##### KPMG in Canada

T: +1 416 777 3414

E: lhodgkinson@kpmg.ca

#### Alexis Majnoni d'Intignano

##### KPMG in Francophone Africa (Gabon)

T: +24 10 406 0806

E: amajnoni@kpmg.com

#### Hak Bin Pek

##### KPMG in Singapore

T: +65 6411 8138

E: pekhb@kpmg.com.sg

#### Hiran Bhadra

##### KPMG in the US

T: +1 214 840 2291

E: hbhadra@kpmg.com

For a list of upcoming webcasts, recent thought leadership and our KPMG mining specialists, please visit [kpmg.com/mining](http://kpmg.com/mining)

[kpmg.com/socialmedia](http://kpmg.com/socialmedia)



[kpmg.com/app](http://kpmg.com/app)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Designed by Evalueserve.

Publication name: Trends in taxation Coping with transparency, mining royalties and volatility

Publication number: 131948

Publication date: June 2015