The Future of Resource Taxation

Consultation Webinar: December 8, 2022

IGF

AFRICAN TAX ADMINISTRATION FORUM
FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

Agenda

00.00 - 00.05 Welcome and introductions

00.05 - 00.20 Presentation of 3 policy papers
- State owned mining companies
- Profit split
- Variable rate royalties

00.20 – 00.40 Feedback session

00.40 – 00.55 Presentation of 3 policy papers
- Production sharing contracts
- Sixth methods
- Carbon taxes

00.55 – 01.15 Feedback session

01.15 – 01.30 Presentation of 3 policy papers
- Development turnover tax
- Competitive bidding
- IT monitoring

01.30 – 01.50 Feedback session

01.50 – 02.00 Conclusion

1. Increasing Fiscal Benefits through Commercial State-Owned Enterprises in the Mining Sector

Authors: IGF and ATAF

Potential Benefits of Establishing a SOE for Mining

Greater control over strategic minerals and energy security

- E.g., Mexico has legislated for the state to exclusively mine lithium through its lithium SOE
- E.g., Bolivia’s state-owned lithium company Yacimientos de Bolivianos (YLB)
- Similar plans underway in Chile and Peru

Increase mining revenues

- Government can collect not only taxes and royalties but also dividends from SOEs.
- If state becomes the only investor, all benefits are channelled to the state
- Less risk for tax base erosion and profit shifting

Alternative to private investment

- Especially where there is less appetite to invest because of economic and political reasons

Gather market power

- Morocco’s OCP dominates the international phosphate market
- China has established SOEs to consolidate control of rare earth minerals and influence prices

Key Considerations for Implementing SOEs in the Mining Sector

Clear objectives

- SOEs should have clear, well- defined objectives set out in the laws and regulations

Adequate technical capacity

- Can explore joint partnerships with private sector to gain expertise
    - E.g., government of Botswana and De Beers Group

Sustainable financing structure

- Explore funding from the financial market

Independent and professional board

Regular audits

Maintain transparency and accountability

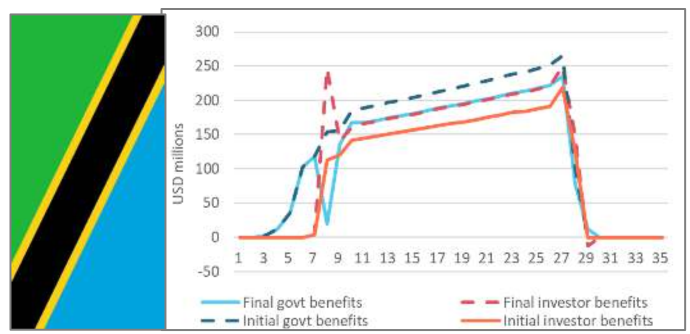
2. A Guaranteed Profit Share for Government: As good as it sounds?

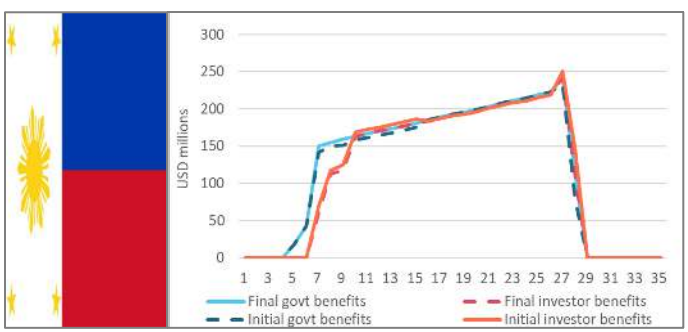
Authors: Thomas Scurfield, Economic Analyst, Natural Resource Governance Institute (NRGI)

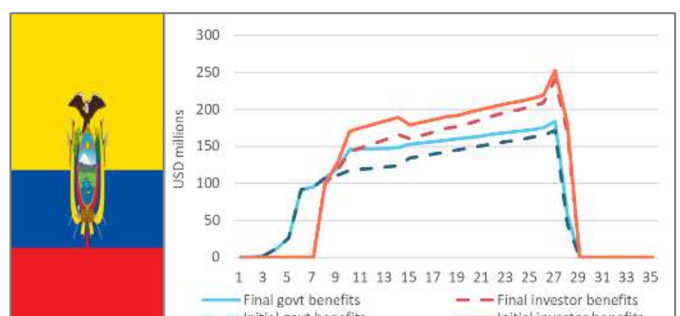
- Several countries require an additional payment if the government share of profits is below a stipulated % after payment of typical revenue streams such as royalty and corporate income tax.

- Could provide slightly more certainty to government and engender public trust and policy predictability.

Modeled sharing of profits across lifetime of average gold mine







Modeling by Natural Resource Governance Institute

Three lessons for other countries:

- Set a floor but not a ceiling on the government share
- Allow investor to earn its required return before sharing is triggered and then base sharing on cumulative benefits
- Don't forget benefits of simpler instruments and building administrative capacity for reducing tax avoidance risks – additional payments are based on profit

A guaranteed profit share for government may be a useful addition, but it does not change the fundamental challenges of fiscal regime design

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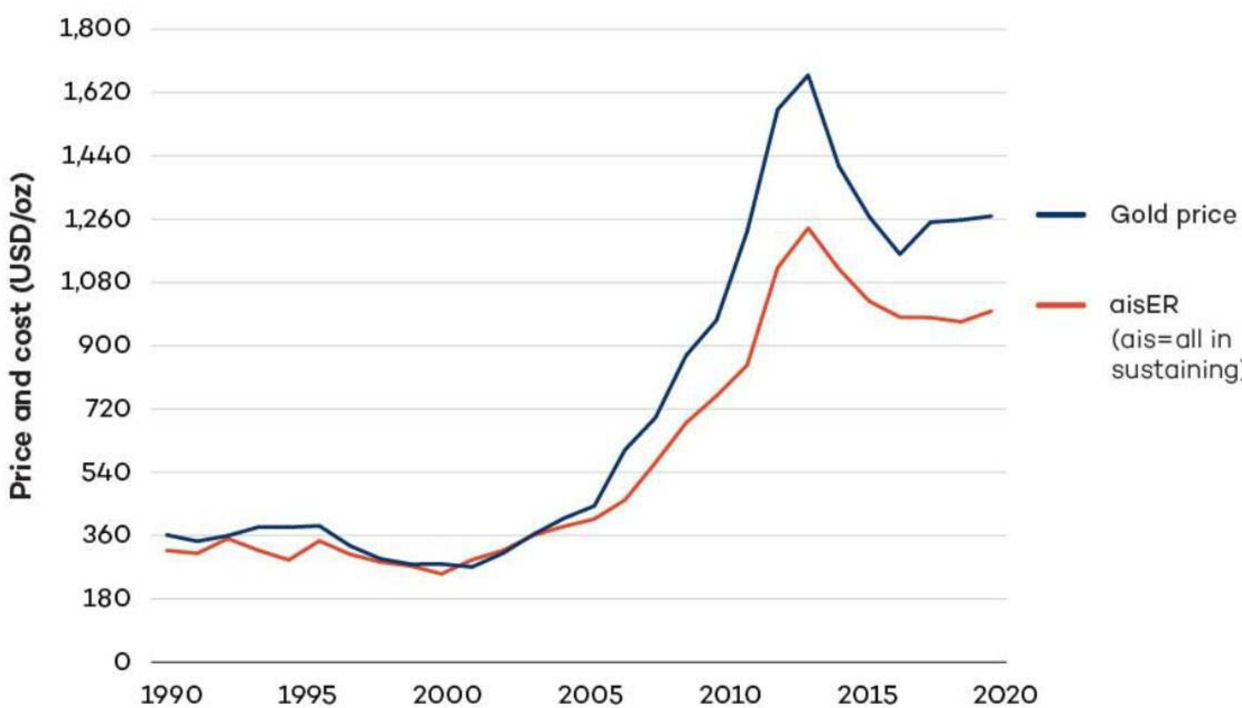
3. Variable Royalties: An answer to volatile mineral prices

Authors: Anna Fleming (NRGI), David Manley, Lead Economic Analyst (NRGI) and Thomas Lassourd (IGF)

An Assessment

- Variable royalties can improve revenue collection
- Variable royalties can accommodate mining investment
- Variable royalties need to consider mining costs



Implementation: Variable royalties around the world

		Royalty base	
		Gross revenue	Net revenue
Variable-rate structure	Mineral prices	**Category 1.** Bolivia, Burkina Faso, Cote d'Ivoire, Guinea gold contract, Kyrgyzstan, Mauritania, Mongolia, Myanmar, Queensland, Zambia.	
	Profitability	**Category 2.** Niger, South Africa.	**Category 3.** Chile, Peru, Nevada.

Politics of Reform

Design

- Design choice 1: Tax base category: gross or net revenues
- Design question 2: Tax rate category: marginal, incremental or based on a formula
- Design question 3: Future adjustments
- Design question 4: Calibration

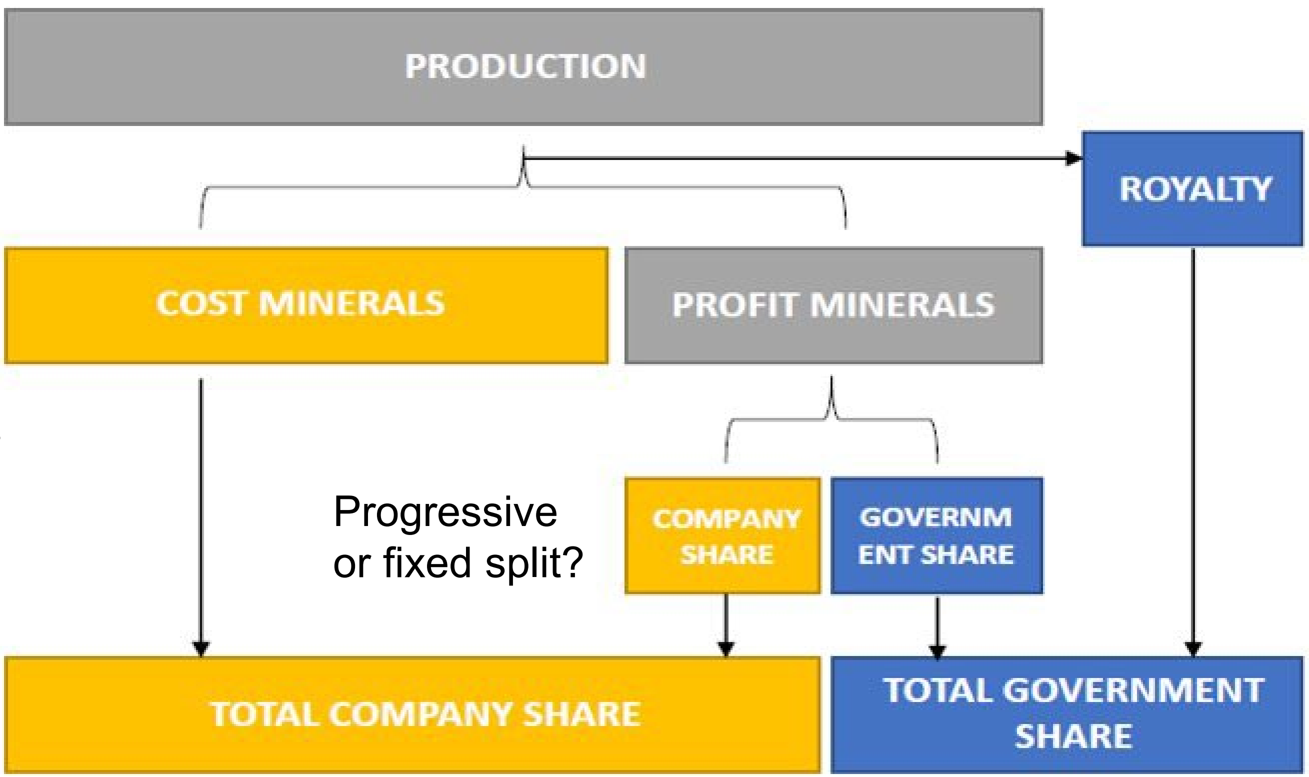
Design features of different categories of sliding royalties

	Reliability at low profit levels	Progressivity as profits change	Tax base simplicity	Variable-rate structure simplicity	Need to update the variable-rate structure periodically
Category 1	Good	Poor	Good	Good	Yes
Category 2	Poor/fair	Fair	Good	Fair	No
Category 3	Poor	Good	Poor	Poor	No

4. Designing and Implementing Production Sharing Contracts in the Mining Sector

Authors: IGF and ATAF with input from the Senegal and Gabon

Emerging Practice from Senegal, Uganda, Gabon and others



Necessary?

Where to set the cap?

Finance costs generally not allowed; uplift instead

Corporate income tax on company’s share or included in the government’s share?

Benefits	Risks
• Reduces the impact of potential under-pricing on sales revenue • Guaranteed revenues as soon as production starts • Cap on cost recovery limits impact on government revenues in each time period, but overall impact depends on carry forwards • Opportunity for state to build marketing expertise	• Cost recovery limit may be too low for investor to meet IRR • Investor may find it harder to secure finance • Government unable to sell its share

5. Using the Sixth Method to Simplify the Pricing of Related Party Mineral Sales and Safeguard Mining Revenues

Authors: IGF and ATAF with inputs from the Government of Ecuador and the Government of Zambia.

- Sixth Method approach developed by resource rich countries in Latin America to address abusive tax planning schemes, e.g., abuse transfer pricing in commodity transactions

- Endorsed by OECD: use of publicly quoted prices when applying the Comparable Uncontrolled Price (CUP) method

- Difference: extent to which taxpayers are required to adjust quoted price – 6th method typically requires limited or no comparability adjustments (Zambia case study)

- Use of quoted price ensures transparency and less open to manipulation (underpricing of sales); simplifies administration; provides tax certainty, improves compliance and limits disputes

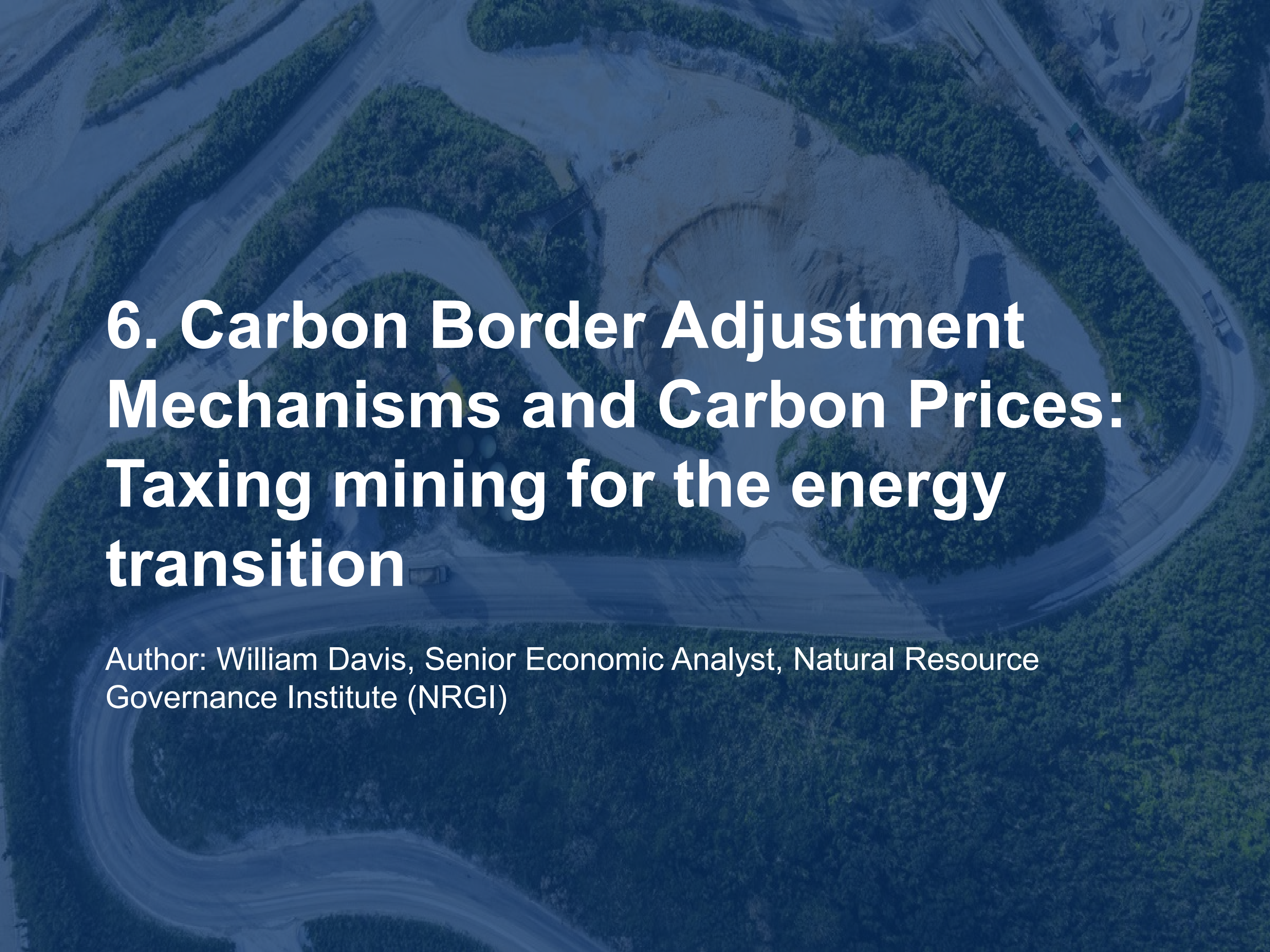
- May be challenged since it (1) can be viewed as not one of the traditional transfer pricing methods; (2) not provided for in double taxation agreements,

- Challenges can be addressed by aligning method more closely to arms length price (by allowing a range of comparability adjustments) or by classifying the method as a domestic anti-abuse rule

- **Different Legal/Regulatory approaches** to: pricing date; foreign intermediaries and comparability adjustments

- **Lessons learnt**:
    - Determining value (access to information/expertise; inter-agency cooperation)
    - Lack of benchmark prices
    - Application depends on type of mineral product
    - Intermediate product pricing (verifying adjustments)
    - Verifying discounts for marketing

- **Alternative approaches to pricing**:
    - Administrative pricing (government determines pricing and first mover advantage)
    - Safe harbour approach (shifts burden of proof)



6. Carbon Border Adjustment Mechanisms and Carbon Prices: Taxing mining for the energy transition

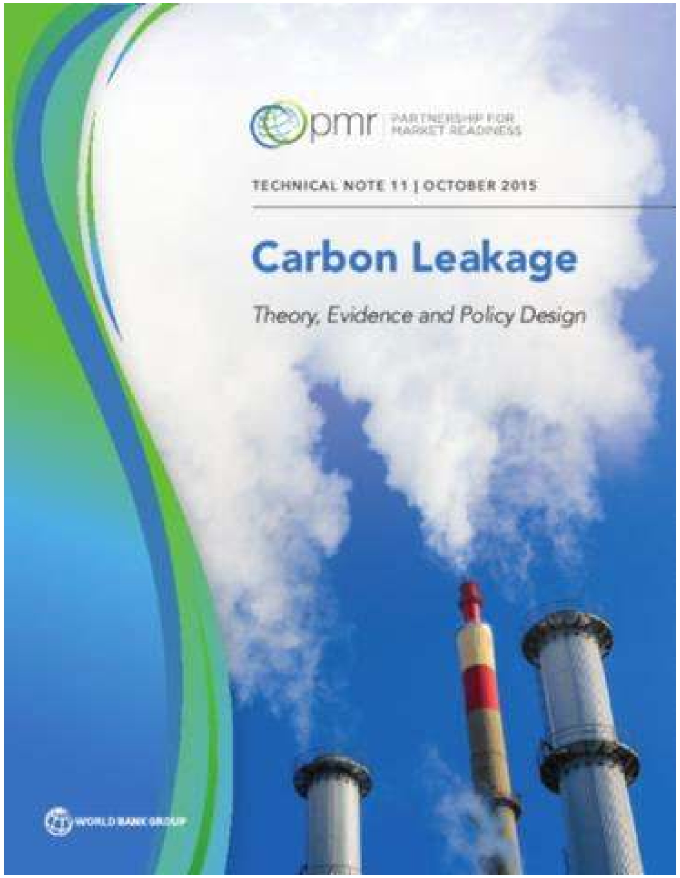
Author: William Davis, Senior Economic Analyst, Natural Resource Governance Institute (NRGI)

How to manage CBAM impacts?

Carbon Border Adjustment Mechanisms (CBAM) – proposed EU import tax on direct emissions for certain imports

Consider lobbying the EU for:

- **Green investments** to help developing countries
- **Exemptions** if this is not forthcoming



Carbon Pricing

Carbon taxes, not emissions trading

"Upstream" taxes on inputs + "downstream" on fugitive methane

Accompanying policies key:

- Adjust fiscal regime
- Industrial policies
- Consider impacts on households

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7. Development Turnover Tax

Authors: Alison Futter, University of Cape Town

- Governments have a responsibility to fulfil the needs of their citizens
  - E.g. Education, safeguarding the environment, ensuring accessibility to free quality health care
  - It is also essential to economic growth that governments invest in public shared infrastructure and new technologies

- It is proposed that Governments implement a Development Turnover Tax at a modest rate of 0.5%-3%

- The tax would compel private mining companies to invest in public shared infrastructure or other certified public benefit activities such as education, health care, welfare to uplift the local communities impacted by the allocation of mineral rights in a licence area.

- In the absence of such investments, the national revenue authority would collect the Development Turnover Tax from mines to be applied to a government-administered mining development fund with similar spending priorities.

Advantages

- It is easy to calculate, audit and administer for collecting revenue authority
  - It is modest in its pricing at 0.5%-3% of gross revenue
  - Consider using the average indexed approximate commodity pricing to avoid manipulation of the tax base
  - Consider monthly payments to promote government cash flow

- It encourages mineral rights holders to invest for the upliftment of the citizens in the source country
- It provides flexibility to the mineral rights holder to choose from the certified public benefit investments in a manner that is mutually beneficial to the community and its operations in the source country
- The implementation needs to follow a consultative process with all stakeholders
  - Where fiscal stability agreements are at play, negotiation for voluntary adoption particularly where the development turnover tax is packaged as positively legislating an ESG obligation.
  - The development turnover tax should not be seen as exonerating government from its own obligation toward its citizens and so the government should continue to play an oversight role, prescribing activities and auditing the expenditure and outcomes claimed for offset against the tax liability.

8. Competitive Bidding for Mining Licenses

Authors: IGF and ATAF with contributions from Thomas Pogge (Yale University) and the ministries of mines in Colombia and India.

Benefits	Risks
• Bridge informational asymmetry • Increase government revenues and investment • Reduce the risk of corruption • Discourage concession sitting	• Collusion: Bidders can conspire to fix the winning bid • Corruption: If the process is not transparent and individual government officials hold discretionary powers • Low participation from junior companies who may be outbid by large companies who are equally competent • Low competition resulting in a less efficient outcome

Key Consideration for Implementing Competitive Bidding

Availability of geological information

- Investors assess the quality of resource using the geological information provided as part of the bid package
- Limited geological information will discourage potential investors from participating in the bid
- Government should invest in collecting data on the unexplored areas

Terms of the bid

- If government sets the minimum bidding criteria too high, few companies will participate in the bid
- If the bid proceeds and the winning bid is overly optimistic, it creates inefficiencies also known as “ winner’s curse”
- Auctions with multiple bidding criteria may be complex to administer

Independent auction house

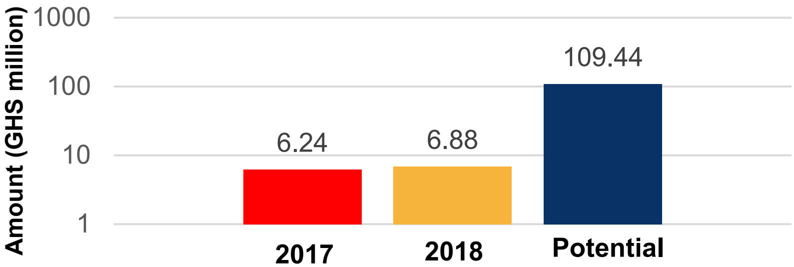
- Neutralize any capacity deficit on government’s side
- Improve transparency of the process

9. Improving the Monitoring of Quarry Production with Remote Monitoring Technologies

Author: Africa Centre for Energy Policy

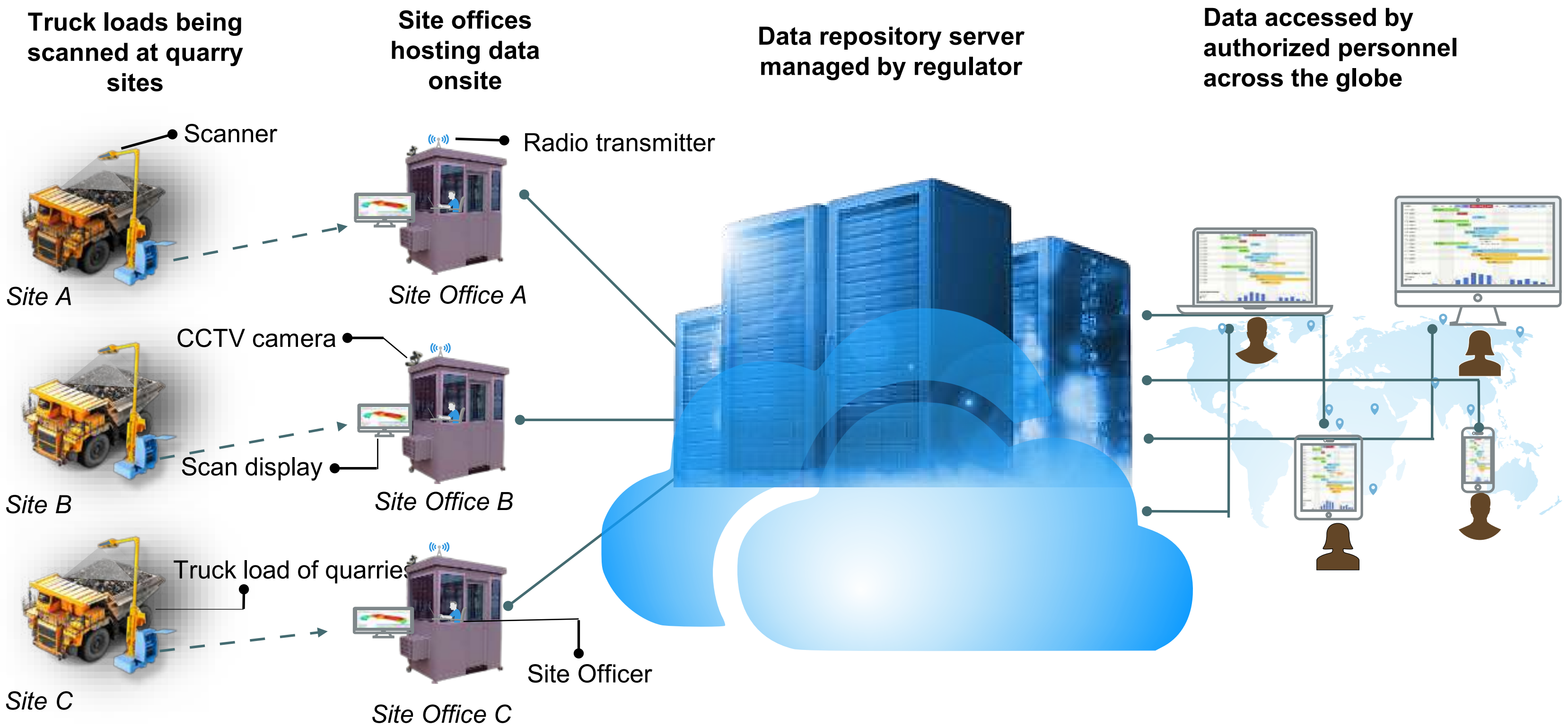
The Problem Identified

- Disparity between the revenue potential of the quarry sector and actual revenue receipt



Source: Boakye et al, 2021

The Idea: A remote monitoring technology



How Do We Benefit From This?

- Increased tax revenue
- Operational efficiency of mining companies
- Improved trust between companies and clients
- Fair competition

Risk: Companies might resort to unapproved routes to evade monitoring.

- Video surveillance tools such as CCTV cameras can augment the technology and enforce utilisation.

Legislative Requirements:

- Specifying the form of reporting requirement for industrial minerals as invoices from a government approved remote monitoring system.
- Where stabilisation clauses in existing leases hinder enforcement, contract renegotiations may be required.

Financing Options:

- Government financing
- Companies financing with tax incentives for cost recovery

We need your feedback!

Our new policy papers outline innovative ways for governments to increase mining revenues.

CONSULTATION IS OPEN

The Future of Resource Taxation

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