CREATING AND CAPTURING MINERAL WEALTH - GOVERNMENT PERSPECTIVES

BY

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INTERNATIONAL INSTITUTE FOR ENVIRONMENT AND DEVELOPMENT - IIED

MINING, MINERALS AND SUSTAINABLE DEVELOPMENT PROJECT - MMSD

WORKSHOP ON MANAGING MINERAL WEALTH

"How can the Minerals Sector Support the Development of Mineral Economies and Contribute to Building Sustainable Communities, Especially in the Poorest Countries?"

August 15 - 17, 2001

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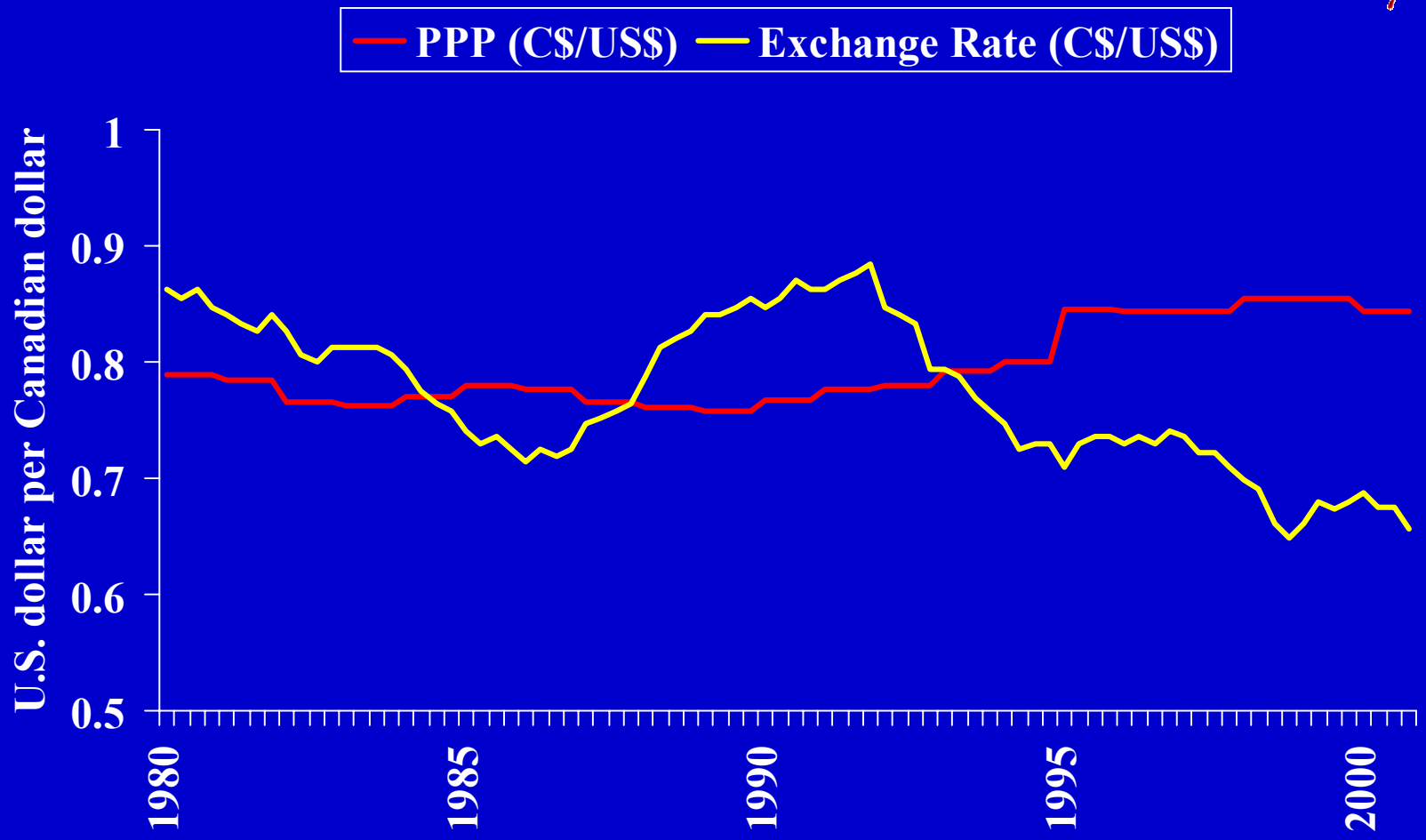
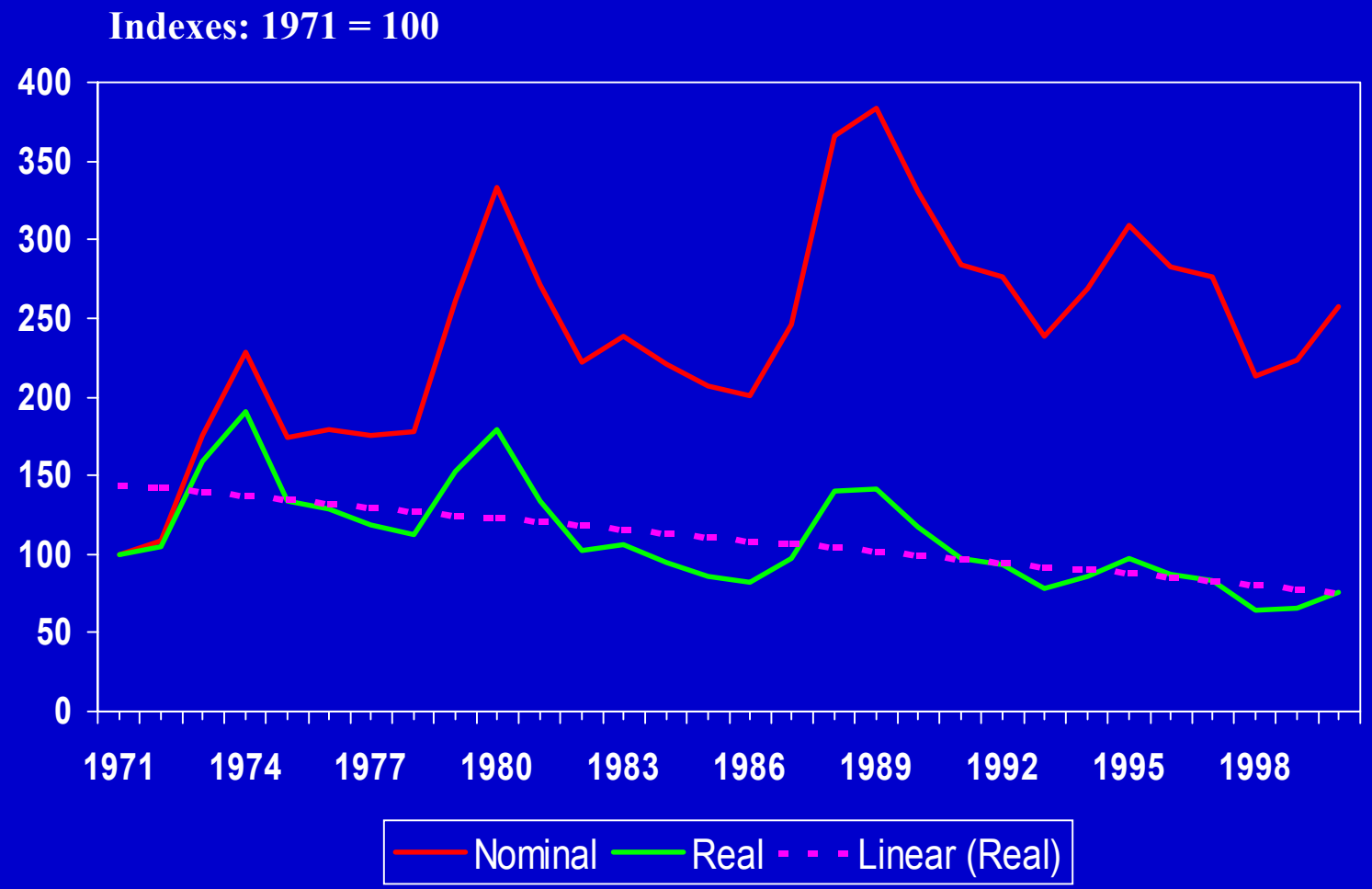
- **Macro Economic Foundation**
- Needs of Private Sector Investment
- Options for Taxation of Mineral Production
- Other types of Mineral Tax Measures
- Sharing Mining Taxation Between Levels of Government
- Conclusions

Canada's Macroeconomic Situation



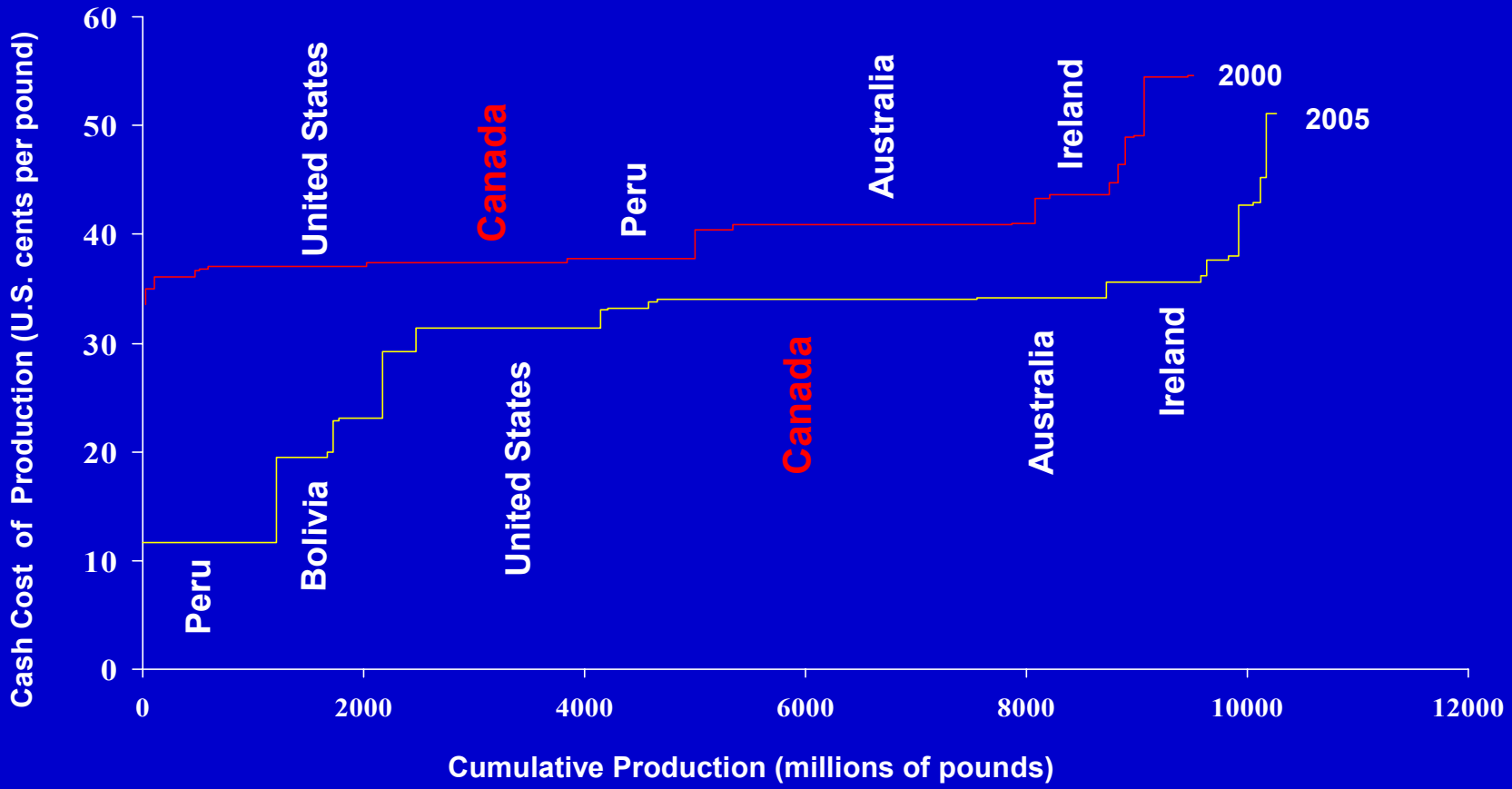
Source: Natural Resources Canada, OECD

Metal Prices 1971-2000



Competitiveness of World Mining

Average Production Cost Estimates of Major Western World Zinc Producing Countries (2000 dollars)



Source: Natural Resources Canada.
Based on data from AME Mineral Economics and used with express permission.

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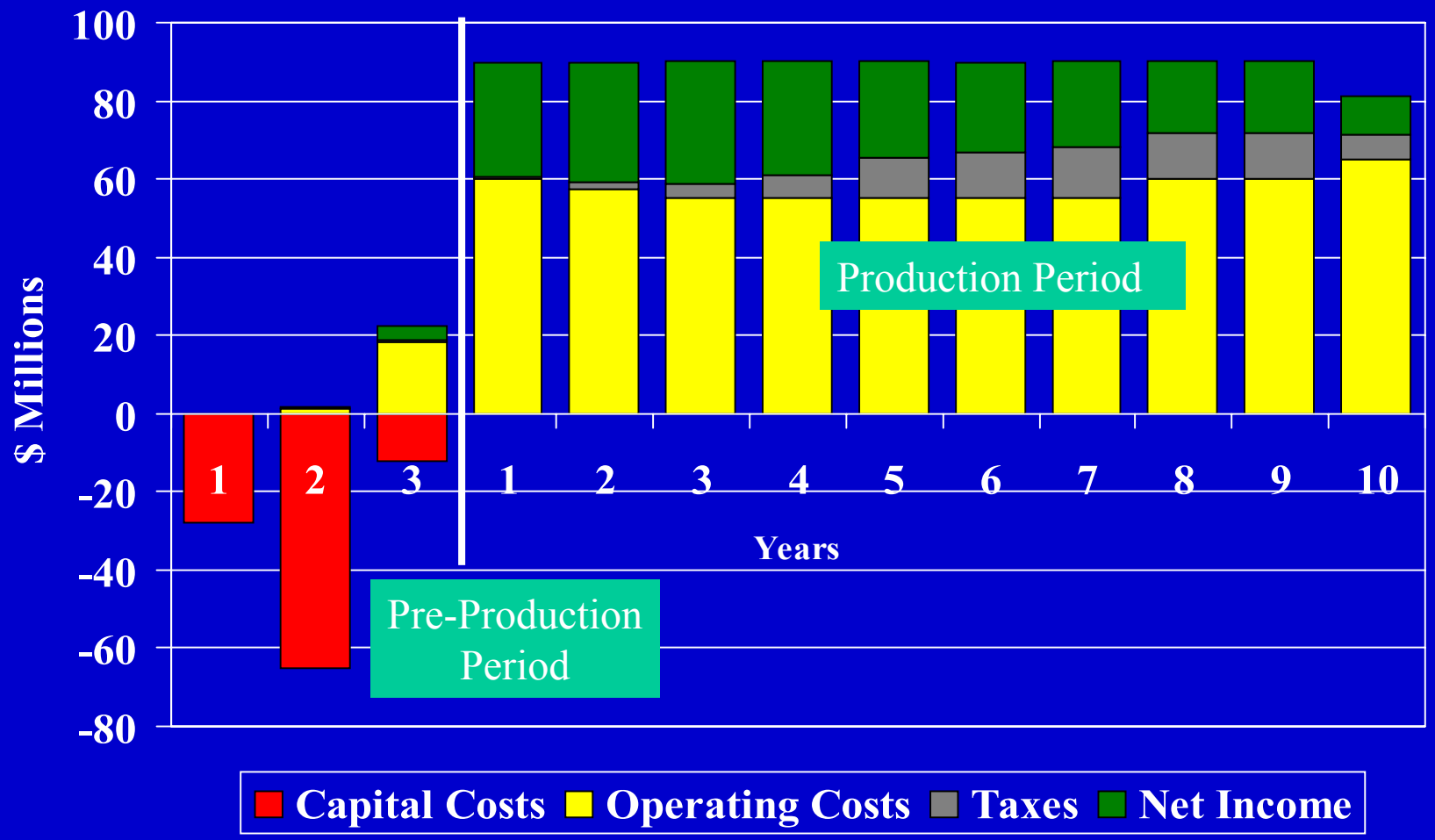
Needs of Private Sector Investors



Needs of Private Sector Investment

- **Private Sector Determines the Pace of Mineral Development**
- **Government Plays a Complementary Role**
- **Rules and Regulations Are Known in Advance**
- **Industry Is Consulted on Proposed Modifications**

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Options for Taxation on Production

- **No Generic Solutions Exist**
- **Range Of Tax Policy Objectives Are Possible**
- **In Designing A New Or Re-designing An Existing Mining Tax Regime**

  - Tax Policy Options

    Rates, Deductions

  - Evaluation Criteria

Tax System Objectives

- **In Designing A Tax System, Objectives May Be:**
  - To maintain existing production capacity
  - To achieve economic growth and long-term job creation
  - To share resources fairly
  - To generate steady revenues
  - To have a simple system and a high degree of compliance
- **Objectives Can Be In Conflict**

Practical Tax Design Options

- **Three Key Parameters**
  - Tax instrument type
    - income tax, production tax, other
  - Tax rate
  - Tax base

- **Designing a Tax System Requires Making Decisions on These Options**

Choosing the Type of Tax Instrument

- **Different Tax Instruments have Different Effects**
- **Production Royalty**
  - steadier revenue stream
  - simpler to administer
  - insensitive to project profitability
- **Income Tax Regime**
  - more acceptable if numerous projects
  - but individual project profitability is variable
- **Ideal System?**

Setting a Competitive Tax Rate

- **Criteria:**
  - rates in international jurisdictions?
  - tax burden on projects?

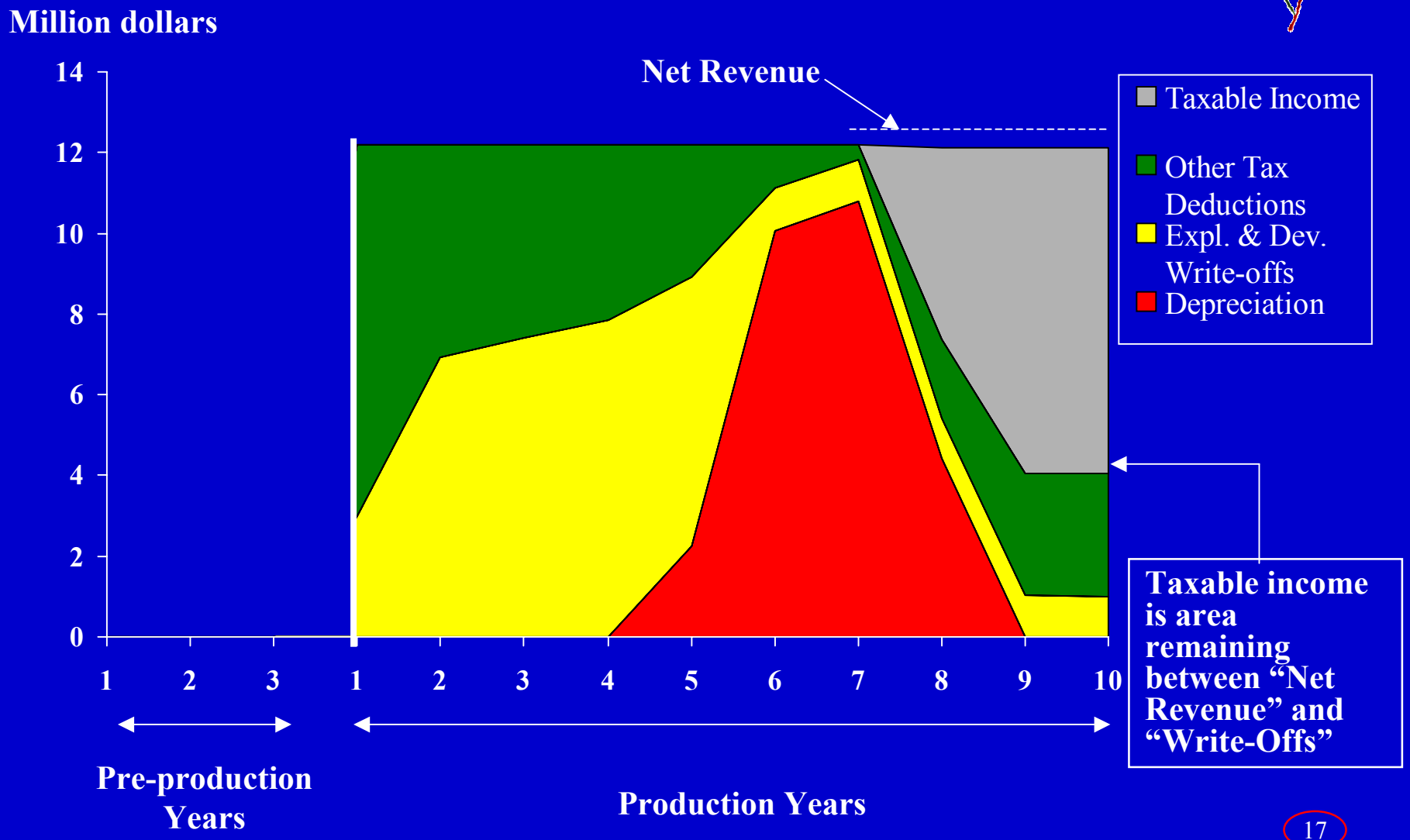
- **Range of World Tax Rates**
  - income tax [15% - 45%, mostly low-30%s]
  - production taxes [0% -15%, mostly 2%-5%)

Designing the Tax Base

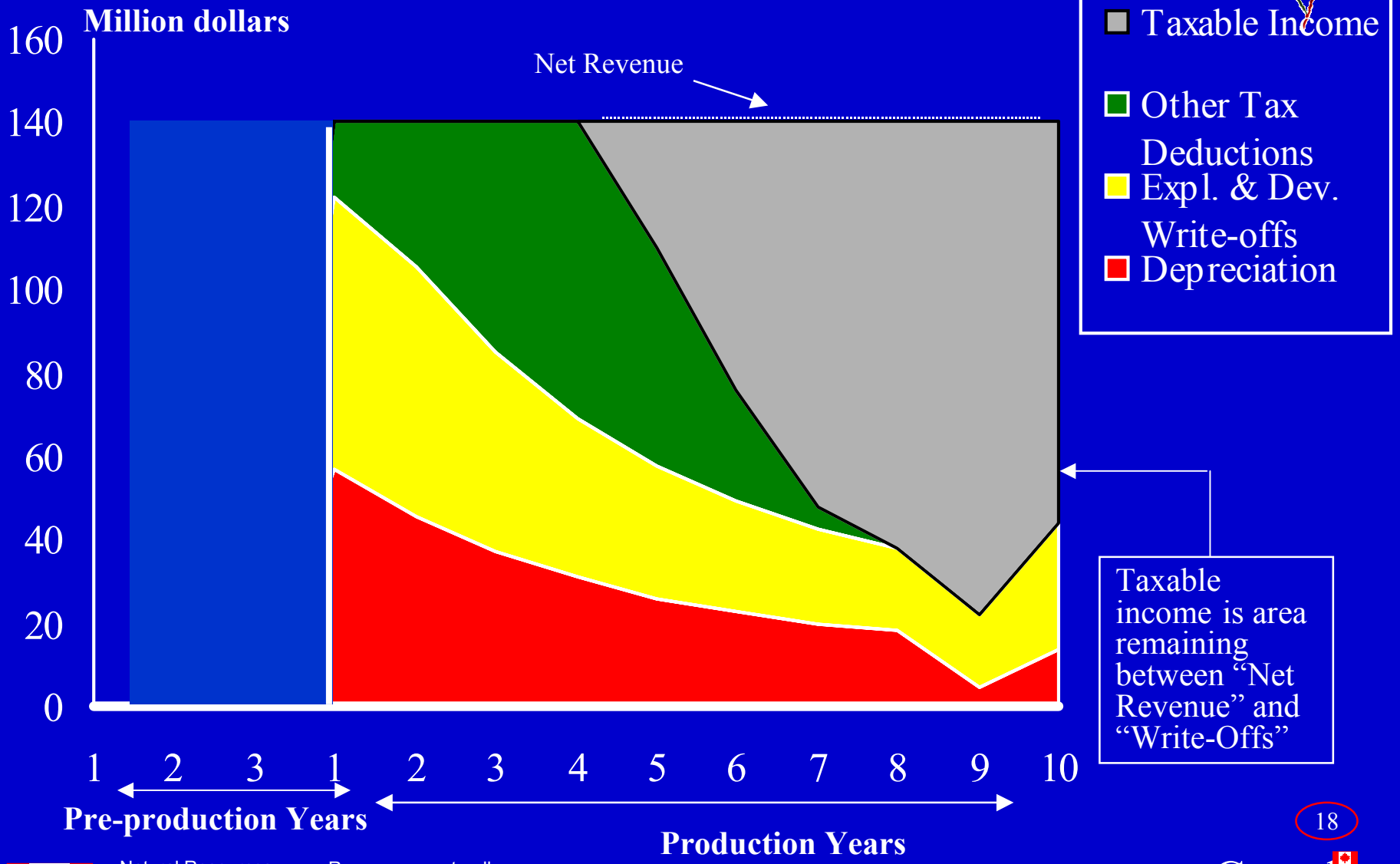
- **Adjusting the Tax Base is a Very Crucial Step**

- **Deductions:**
  - exploration and development
  - rates of depreciation of capital assets
  - operating costs
  - other (interest costs, recognition of mining taxes)

Impact of Deductions on the Tax Base: Project with 10 Percent Internal Rate of Return in Ontario



Impact of Deductions on the Tax Base: Project with 10 Percent Internal Rate of Return in Indonesia



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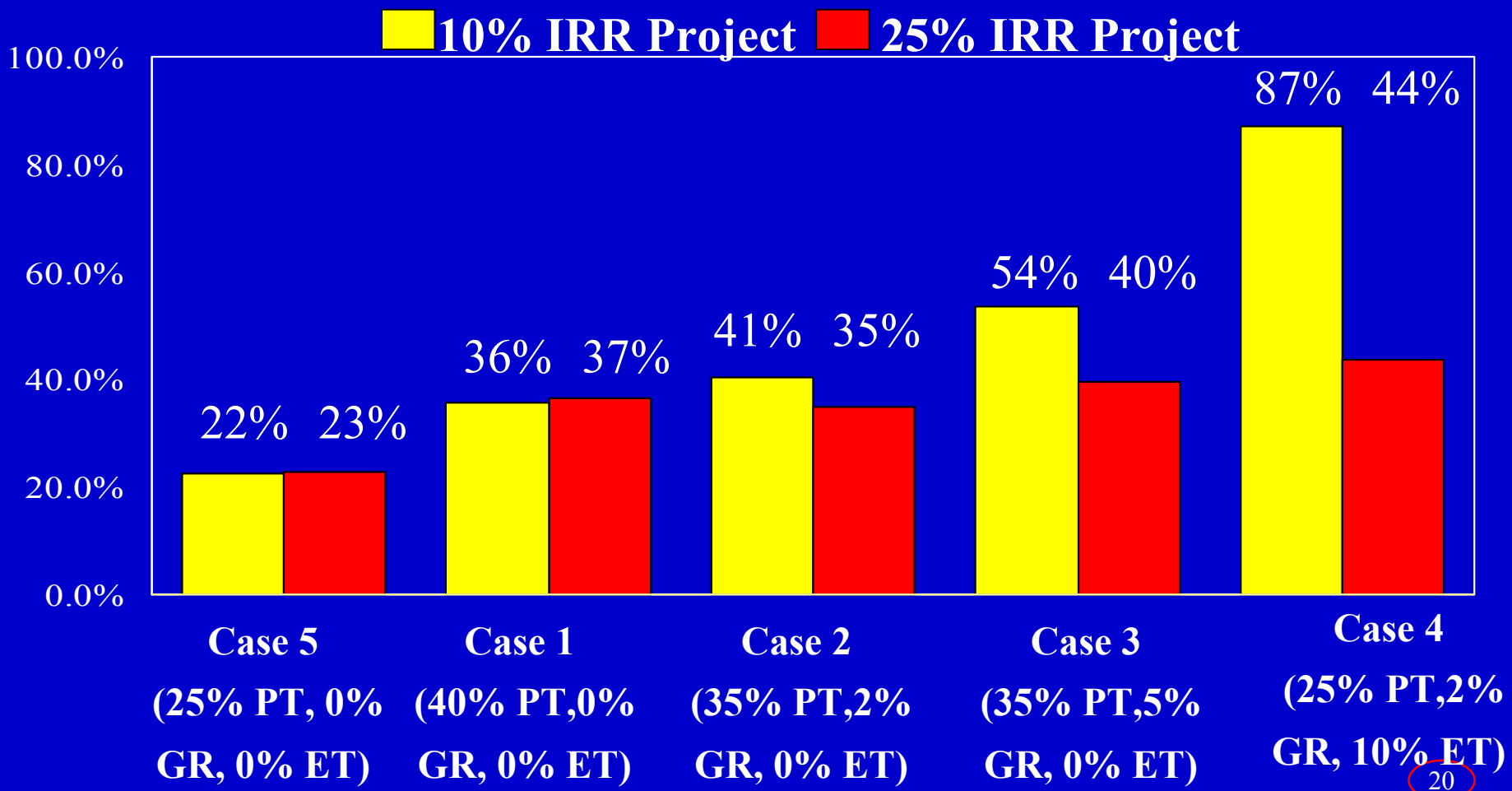
Analyzing Tax Choices

Combinations of Taxes: 5 Cases

Model	Profit Tax	Gross Mining Royalty	Export Tax
Case 1	40%	0%	0%
Case 2	35%	2%	0%
Case 3	35%	5%	0%
Case 4	25%	2%	10%
Case 5	25%	0%	0%

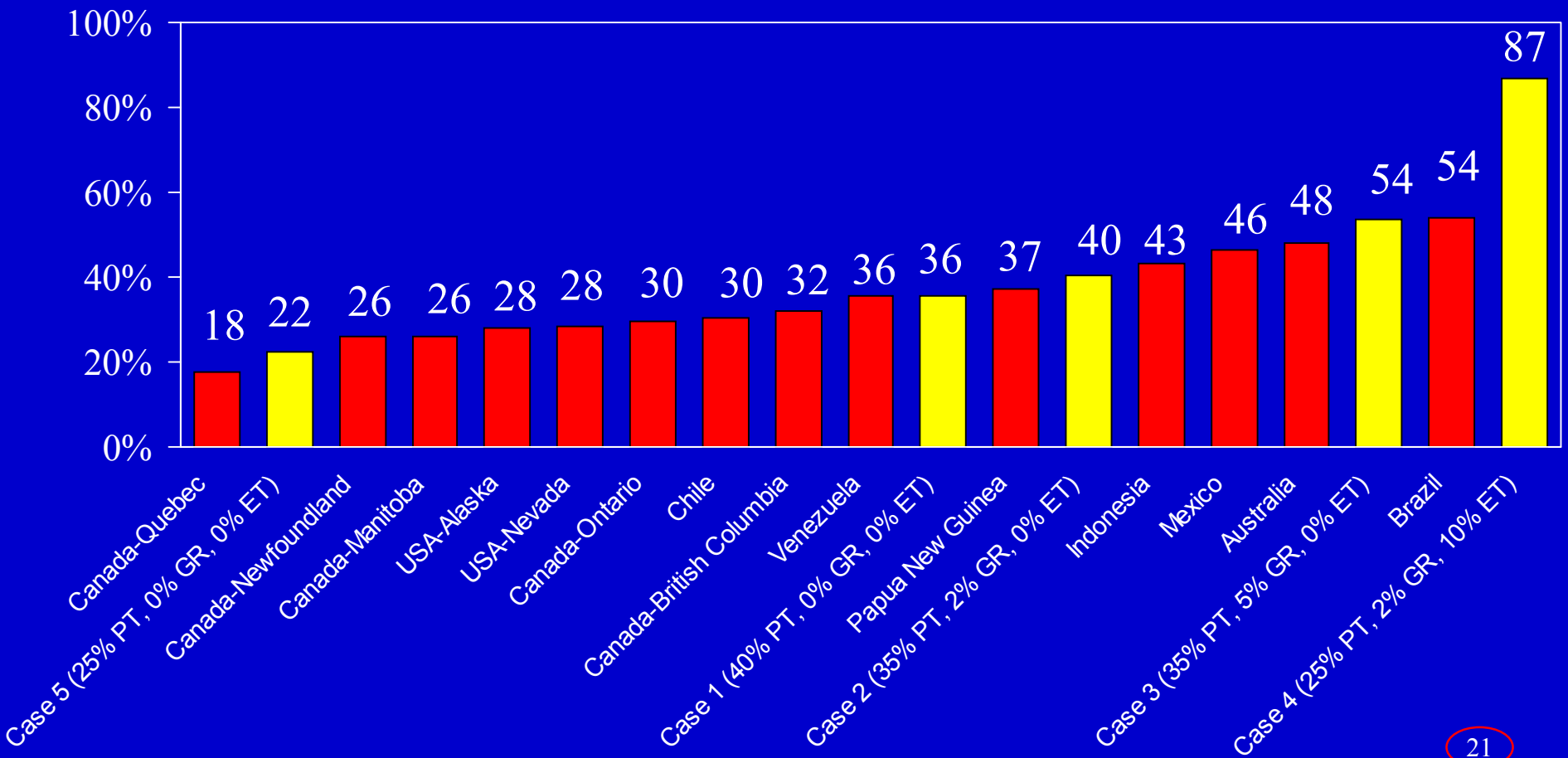
Calculation of Average Tax Rates for the Five Cases

(PT - profit tax rate, GR - gross royalty rate, ET - export tax rate)



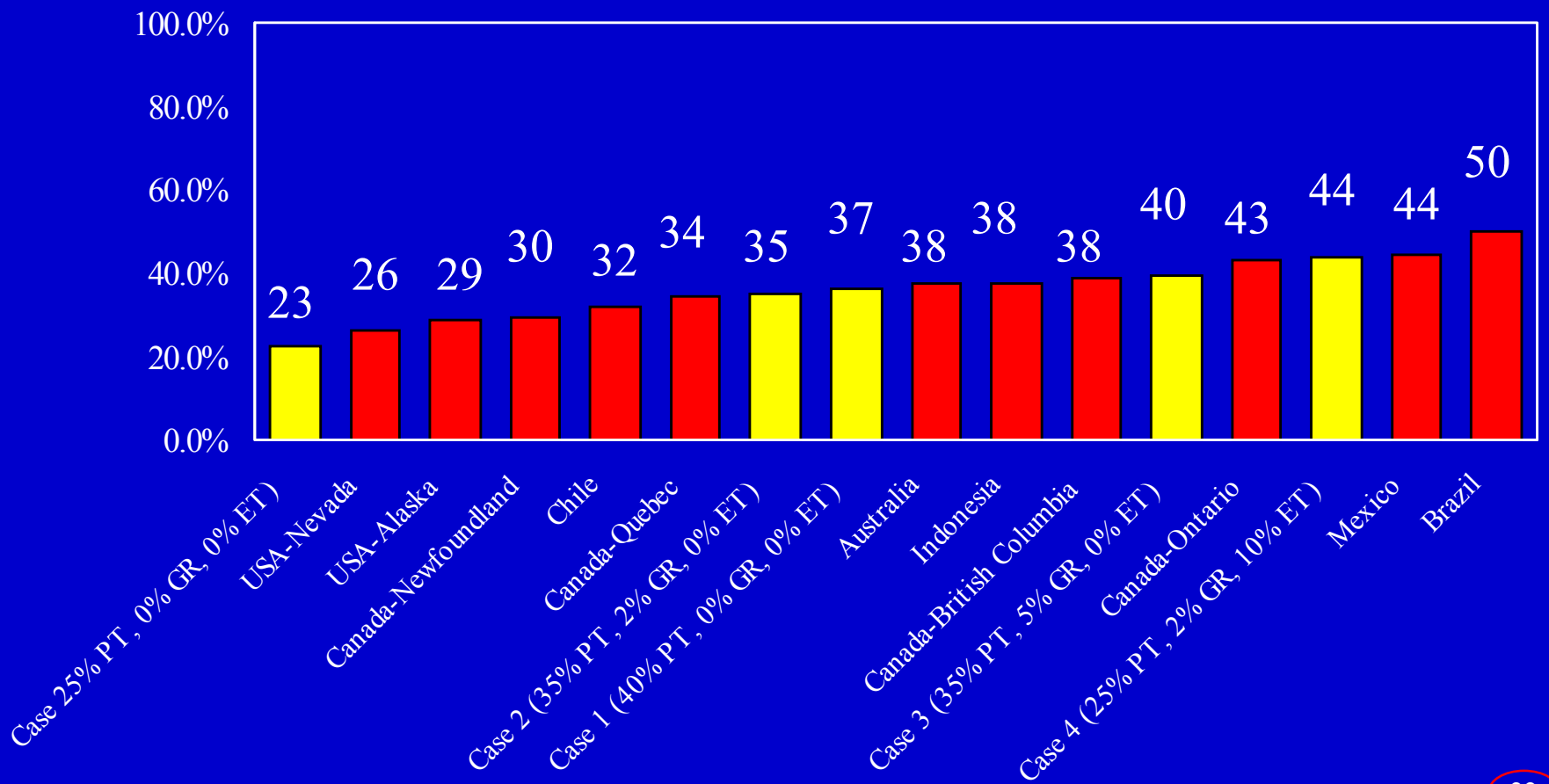
Average Effective Tax Rates for Project with 10% IRR

(PT - profit tax rate, GR - gross royalty rate, ET - export tax rate)



Average Effective Tax Rates for Project with 25% IRR

(PT - profit tax rate, GR - gross royalty rate, ET - export tax rate)



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Lessons from the Canadian Experience

- Global Shortage is of Good Projects, not Finance
- Countries Compete on Geology/Investment climate
- Private Sector Property Rights have to be Secure
- Tax System Recognises Public Good/Social Aspects
- Government Share is Taken by Means of Taxation
- Taxation Rules as Simple as Possible, Stable
- Clearly Explain Taxation Regime to Investors
- Agree Taxation between Levels of Government
- Do Not Impede the Cross Border Flow of Capital
- Companies Negotiate Agreements with Communities

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CANADIAN EXPERIENCE IN MINERAL TAXATION

END