



IGF

INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development

Insights on Incentives: Tax competition in mining



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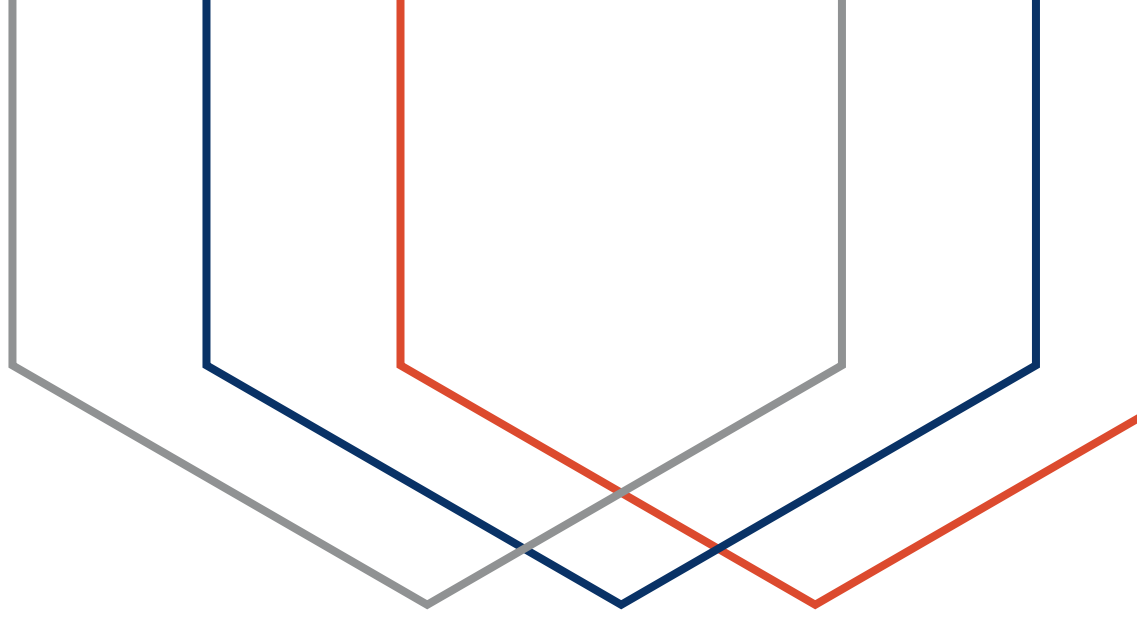


IGF Secretariat funded by:

Canada

Project funded by:





Introduction

This paper highlights key findings from an analysis of the IGF Mining Tax Incentives Database, a collection of files comparing the fiscal regimes of 104 mining projects across 21 countries. The database is the first large-scale, systematic attempt to compile tax incentives used by developing country governments to attract mining investment. It is also the first public effort to bring together incentives granted in mining contracts. This is made possible through greater contract transparency—in particular, the availability of resource contracts compiled by the Natural Resource Governance Institute (NRGI), Colombia Centre for Sustainable Investment (CCSI), the World Bank and Open Oil.

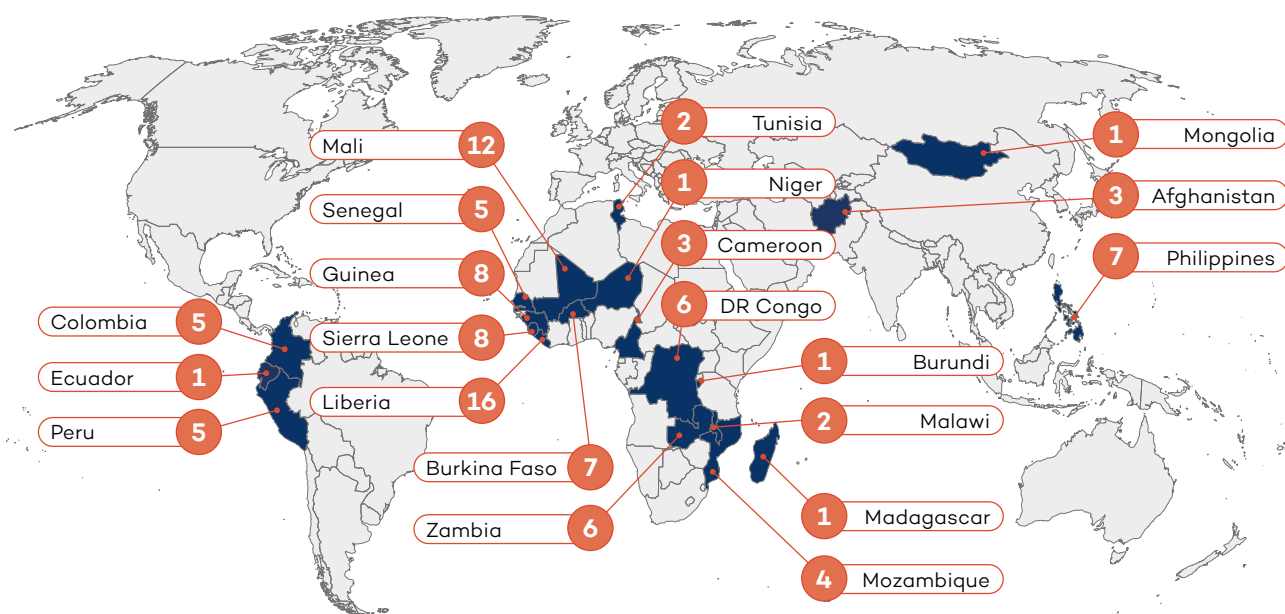
The findings below are by no means exhaustive. It is hoped that further analysis of the database by policy-makers, researchers, international organizations and civil society, will yield additional lessons for the design and use of mining tax incentives. To ensure that the contents remain relevant, and in light of the Extractive Industry Transparency Initiative (EITI) requirement to publish all resource contracts by 2021, IGF is committed to periodically updating the database, and welcomes support from researchers and partner organizations in this task.

The database is part of a series of materials on mining tax incentives. Readers should refer to the IGF-OECD practice note [Tax Incentives in Mining: Mining Risks to Revenue](#), as well as the open-source IGF financial model for estimating the cost of tax incentives.

Data Description and Method

1. Selection of Countries

The database surveys mining tax incentives in 21 countries. These countries were selected based on the public availability of mining contracts on NRGI's webpage [resourcecontracts.org](https://www.nrgi.org/resourcecontracts.org). For most countries, all available mining contracts were coded provided they were available in English, Spanish, French or Portuguese. However, for the Philippines, Guinea, the Democratic Republic of Congo, and Peru only a limited selection of contracts was coded due to the large number of available contracts. A sample was chosen to reflect the different types of minerals mined in each country. Figure 1 outlines the number of contracts coded per country.

Figure 1. Coverage of Database (number of contracts per country)

2. Selection of Mining Tax Incentives

The database adopts the same definition of “tax incentives” as the IGF-OECD practice note—that is, any special tax provision granted to mining investors that provides a favourable deviation from the general tax treatment that applies to all corporate entities. It also captures the same tax incentives defined in Table 1. As in the practice note, the incentives captured in the database are not exhaustive, but include the more typical mining tax incentives.

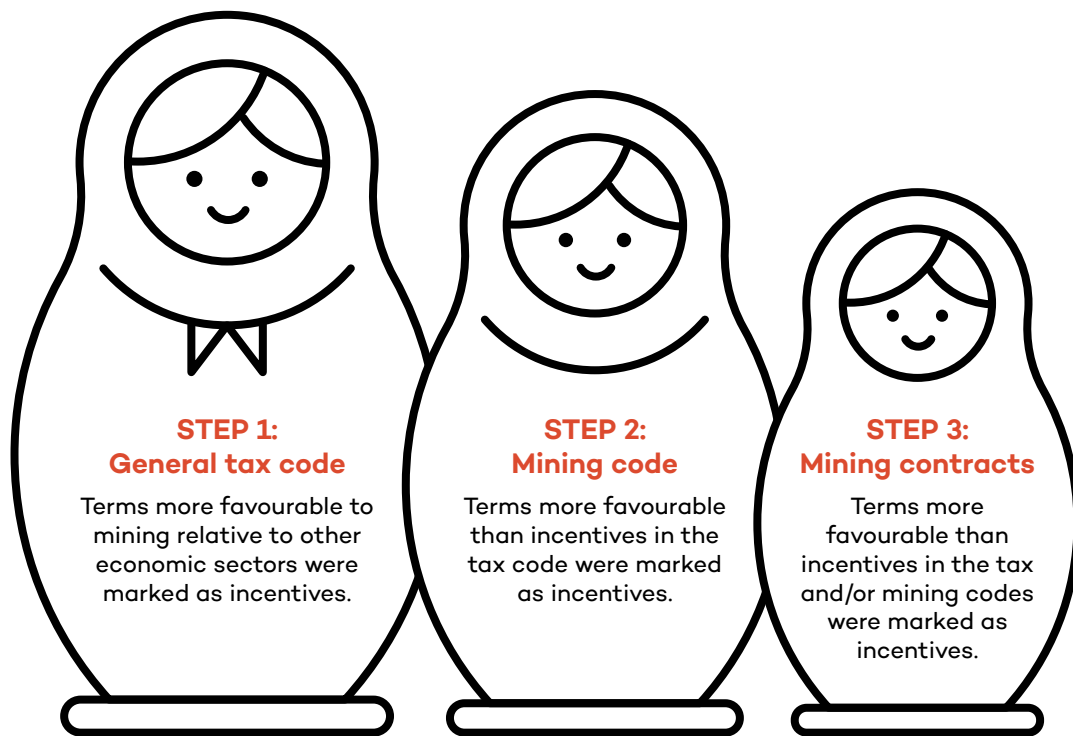
Table 1. Typical mining tax incentives

| Mining fiscal instruments | Corresponding tax incentives |
|--|--|
| Taxes on income (e.g., corporate income tax, resource rent taxes, withholding taxes) | <ul style="list-style-type: none"> Income tax holiday Accelerated depreciation Investment allowance/tax credit Longer loss carry forward Withholding tax relief on interest expense dividends, services (e.g., management fees) |
| Taxes on production (e.g., mineral royalties) | <ul style="list-style-type: none"> Reduced royalties Royalty holidays Sliding-scale royalties |
| Tariffs on imports and exports (e.g., tariffs on import of capital inputs) | <ul style="list-style-type: none"> Import duty relief |
| Others | <ul style="list-style-type: none"> Stabilization of fiscal terms Property tax VAT |

3. Method for Classifying Fiscal Terms as Tax Incentives

Whether a fiscal term is a tax incentive depends on the country's legal framework, in particular the law that applies to all taxpayers by default (the "benchmark fiscal regime"). If the term in question provides a favourable deviation from the benchmark fiscal regime for mining investors it will be deemed an incentive. Thus, in order to identify tax incentives for the purpose of the database, it was necessary to review the general tax code, the mining code, and project-specific contracts, in that order. In some countries, mostly in Anglophone Africa, the mining tax law is included as part of the general tax code rather than as part of the mining code. In these cases, the mining tax law is treated as part of the general tax code. Having identified the relevant fiscal terms, these were copied into a spreadsheet; the terms were translated into English, summarized and analyzed according to the steps below.

Figure 2. Steps in the analysis



(i) **Using the Primary Law Presently in Force**

It was not practical to identify the primary law in force at the time each contract was signed. As such, the tax codes and mining codes included in the database are the most recent versions, which may be different to the primary law when the contract was signed. This is one of the limitations of the database, and government and investors may object to certain terms being deemed incentives that were not incentives according to the benchmark at the time. Notwithstanding, these terms are favourable relative to the most recent tax code and/or mining code and it is reasonable to count them as incentives.

(ii) **Counting Incentives Across Multiple Sources of Law**

It is possible for a country to have an incentive in the law and in the contract, if the contract provides something more generous than the legislation. For example, all mining investors may be subject to a lower corporate tax rate by law; however, one mining company receives

an even lower tax rate in its contract. While it could be argued that the incentive in the law is cancelled out by the more generous incentive in the contract, both are counted in the database. This is because the incentive in the law would still apply to any other investor entering the market as well as to existing investors with less generous contracts. Table 2 provides a stylized example of how incentives were assessed in such cases. On the other hand, if the incentive in the contract is less generous than the incentive in the law, the “incentive” in the contract is not counted as an incentive.

Table 2. Example: When is something defined as an incentive?

| | | | | |
|-------------|------------------|------------------|-----------------------|-------------------------------|
| Tax code | 30% tax rate | 30% tax rate | 30% tax rate | 30% tax rate |
| Mining code | 30% tax rate | 25% tax rate | 30% tax rate | 25% tax rate |
| Contract | According to law | According to law | 25% tax rate | 10% tax rate |
| | No incentive | Incentive in law | Incentive in contract | Incentive in law and contract |

(iii) **Not all Incentives Are Made Equal**

Of course, not all incentives are the same—some are more generous than others. A tax holiday, for example, eliminates all corporate income tax for that period, whereas if the benchmark rate of tax is 30 per cent, and the incentive rate is 25 per cent, government foregoes some tax, but not all. Despite these important differences, the database counts each incentive as one. Thus, a tax holiday and a lower rate of tax are each counted as one incentive although the impact on government revenue may be different. Users should refer to [Tax Incentives in Mining: Mining Risks to Revenue](#) for a detailed discussion of the different risks to revenue of each incentive.

7 Key Findings

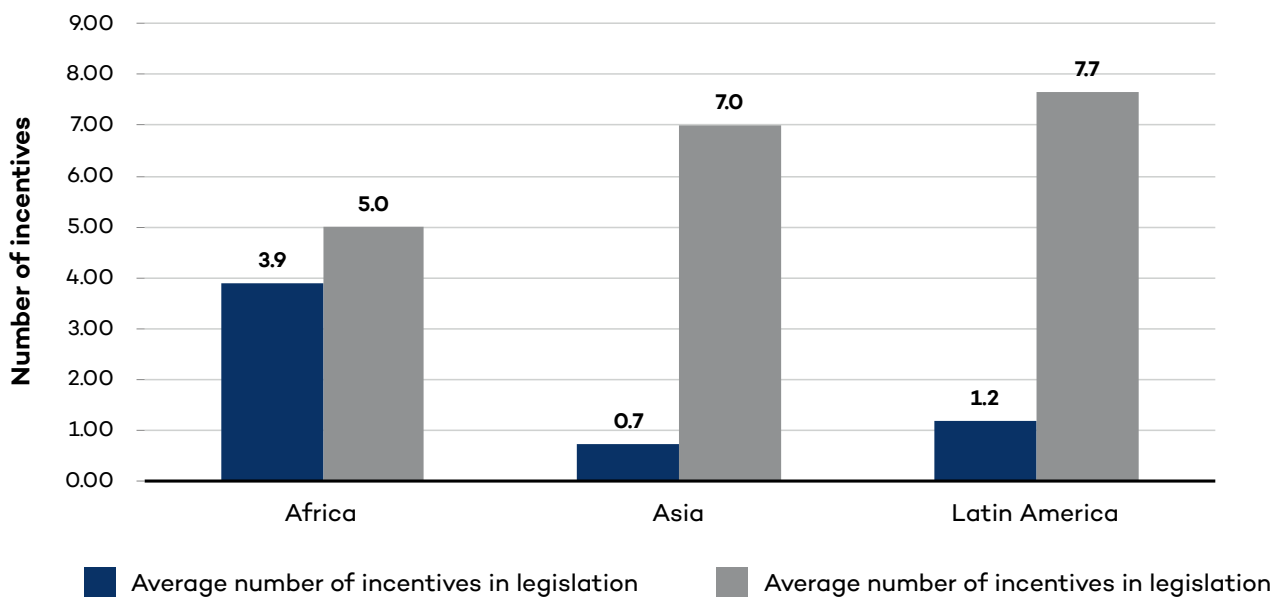
1 It is more common for countries to grant incentives in the primary law than in contracts.

Across the three regions, the average number of incentives granted through law is higher than the number of incentives granted by contract. Without considering the type of incentives, it is positive that a greater proportion are granted in the law, which is public, and subject to legislative review, rather than by contract, which are often discretionary, secret and vulnerable to corruption.

→ See [page 18](#) of the IGF-OECD practice note for a checklist for good governance and tax incentives.

However, there are significant regional differences. In particular, African countries grant more contract-based incentives than their peers in Asia and Latin America. It should be considered that the database coverage of Asia and Latin America is less than Africa, which may impact regional comparisons. Notwithstanding, the finding is still valid given that the results are weighted for number of contracts and number of countries. The average number of incentives in law per region is determined by the combined number of incentives in law divided by the number of countries in that region. Incentives per contract per region are the number of contract-based incentives divided by the number of contracts analyzed. Thus, the comparison is valid, although the results may look different if more Asian and Latin American countries were included in the database (the limitation was the availability of contracts).

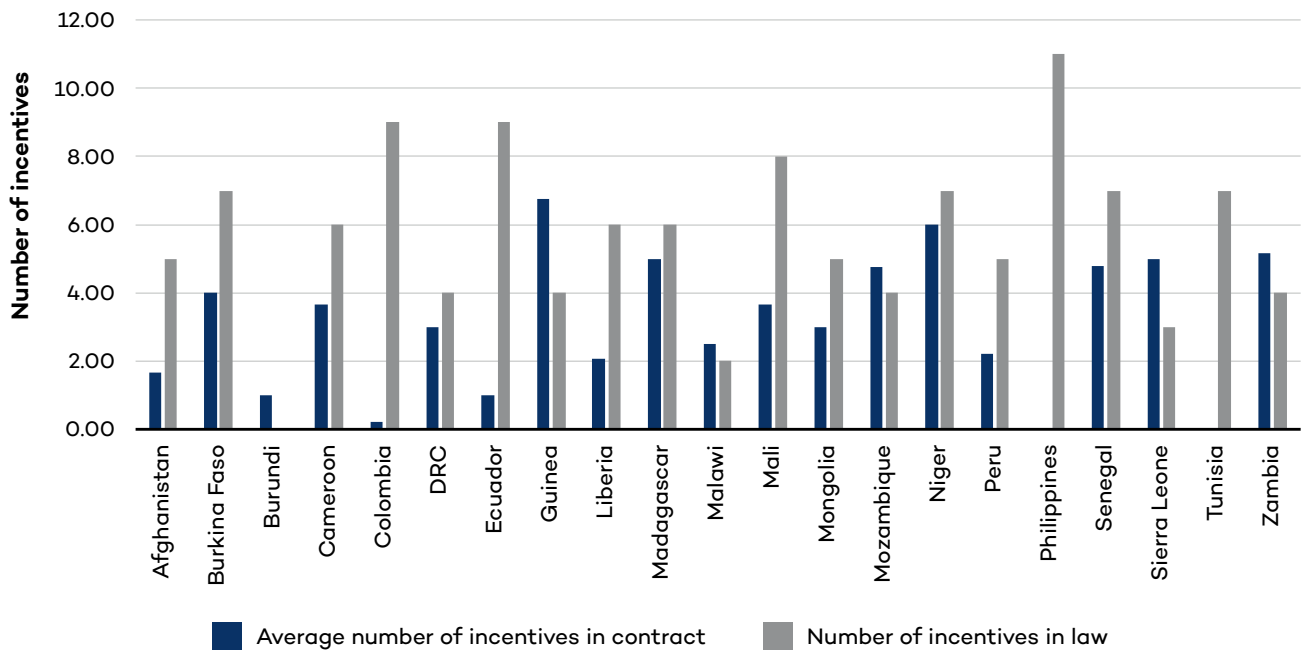
Figure 3. Tax incentives by region





Reading the chart: The “number of incentives in law” is the sum of incentives by type for the primary law; this may include incentives in the general tax code, the mining code, and, in some cases, investment codes. It is not necessary to provide an average here as the chart is per country.

Figure 4. Tax incentives by country



2 Tax stabilization and corporate income tax incentives are the most common incentives. Withholding tax incentives are also common, which is relevant in terms of risk to revenue.

Tax stabilization and corporate income tax incentives are the most common form of incentives across both primary law and mining contracts. They are also two of the most high-risk incentives according to the IGF-OECD practice note. Partial or complete income tax holidays may cause the investor to increase their income during the tax-free period by speeding up the rate of production and shifting the profits offshore. Combining incentives with excessive use of broad and long-term fiscal stability provisions will magnify the adverse impact of tax incentives, including the unintended consequences, by potentially cutting off government’s ability to correct mistakes and unexpectedly large revenue losses.

→ See [pages 42 to 44 of the IGF-OECD practice note](#).

Incentives relating to withholding tax raise particular tax base erosion and profit shifting (BEPS) issues. Withholding tax requires the taxpayer to withhold some income tax on outbound payments. For example, a taxpayer in Country A borrows USD 1,000 from a lender in Country B; the lender requires 10 per cent interest on the loan, which is USD 100. The withholding tax rate in Country A is 5

per cent, meaning the borrower must withhold USD 5 income tax on the USD 100 interest it pays to the lender. However, if countries reduce or exempt withholding tax on interest expense, management fees or royalties, there is an added incentive for investors to increase these payments in order to strip profits out of the mine, transferring them to a foreign affiliate, usually based in a low-tax country.

→ See pages 25 to 27 of the IGF-OECD practice note.

3 Cost-based incentives, in particular investment allowances and tax credits, are uncommon, despite being better suited to mining investments than profit-based incentives.

Only Colombia, Mongolia and the Philippines offer an investment allowance or tax credit in the law. This is surprising given that cost-based incentives are generally better targeted to mining investments. An investment allowance, or tax credit, allows taxpayers to recoup their investment, as well as defer taxes to later stages in a project’s life and hence not eat into cash flows in the early years when capital is most needed. They are also easier to monitor, as the benefit is based on the amount of investment. However, there are some importance differences: Mongolia gives a 10 per cent tax credit, whereas Colombia offers an allowance for investments made in the environment, including the rehabilitation of mine sites. A tax credit will reduce the tax payable, whereas the investment allowance will reduce the taxable income. The effect is different; the tax credit being significantly more generous than the investment allowance.

→ See pages 28 to 30 in the IGF-OECD practice note.

Figure 5. Number of countries with incentives in law

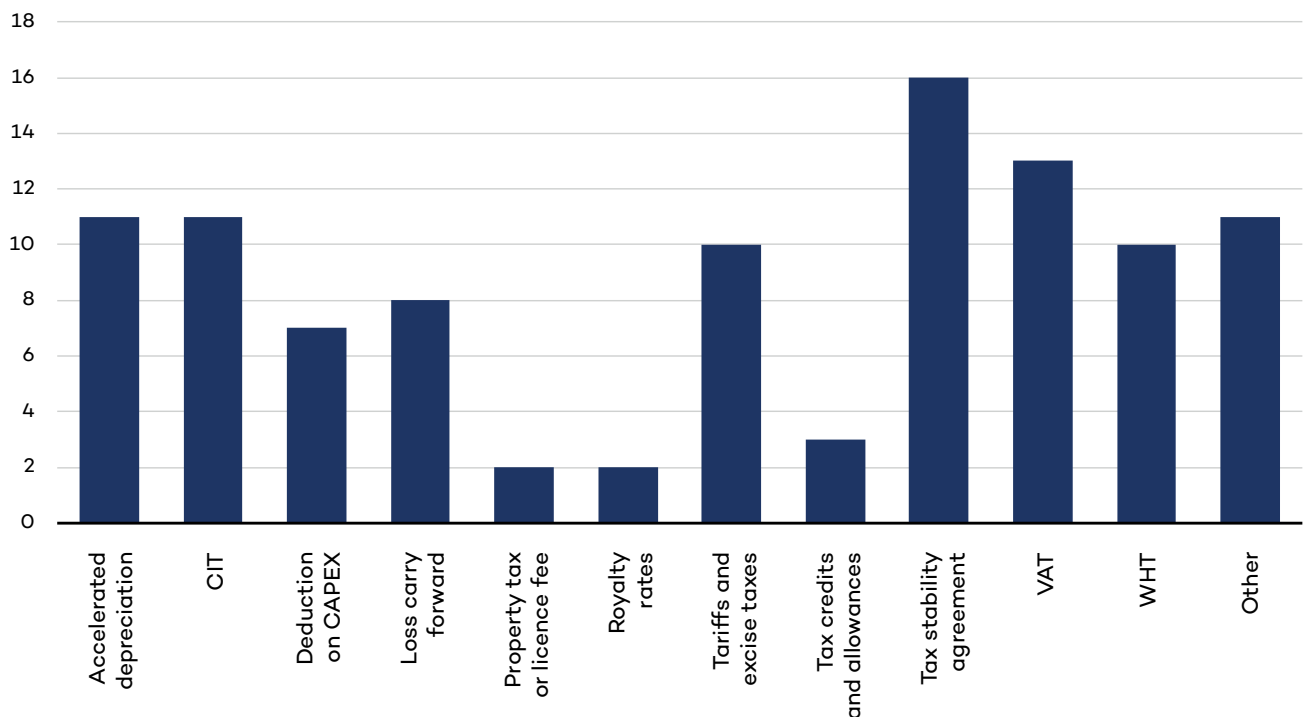
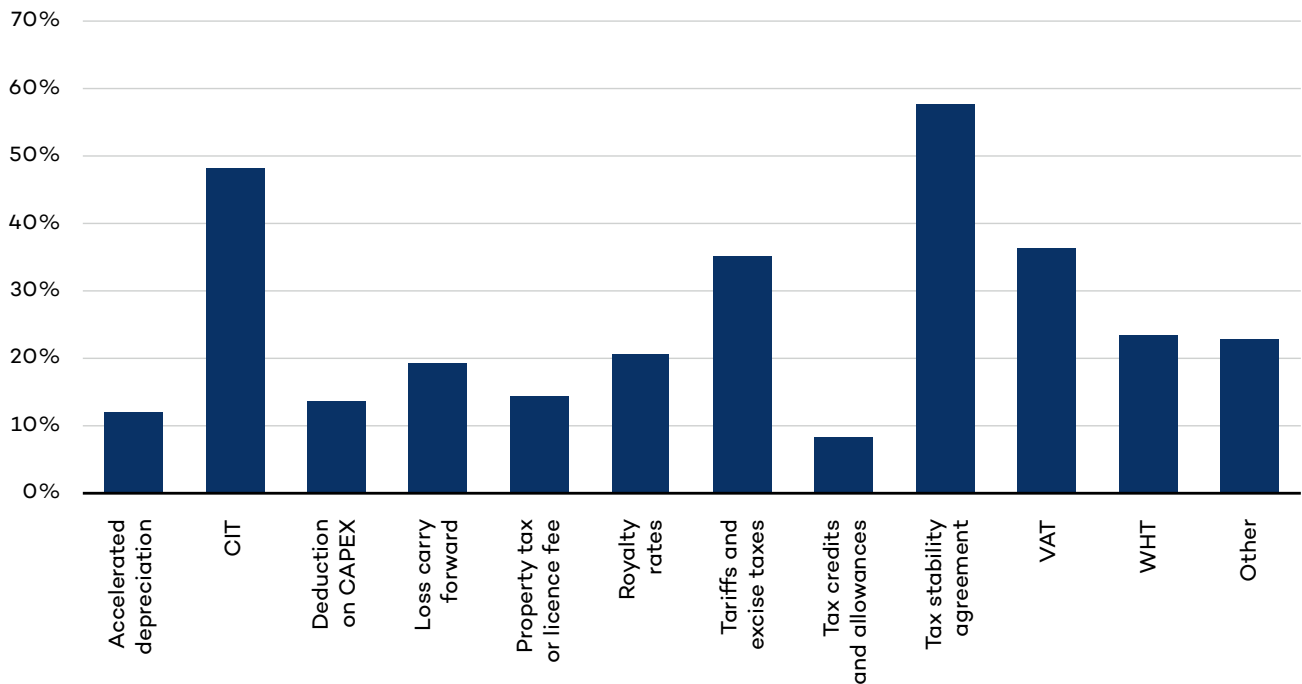


Figure 6. Average proportion of contracts with incentives

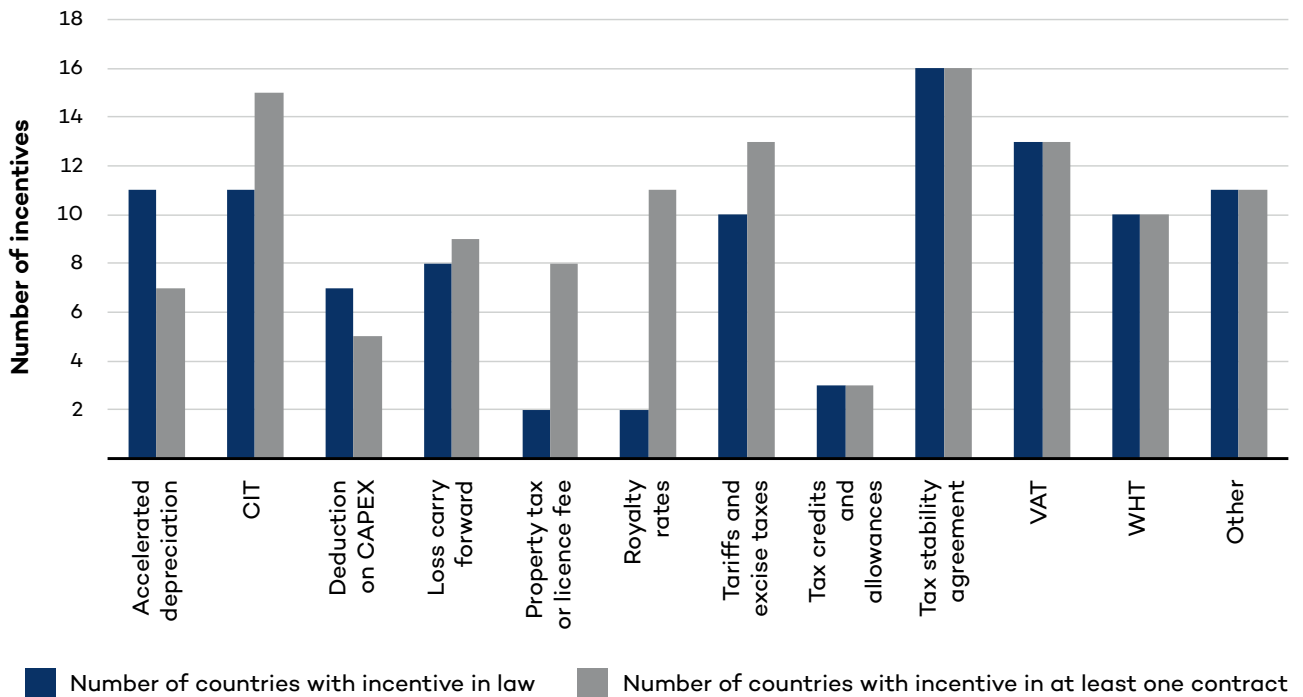


4 Royalty-based incentives feature heavily in contracts but not in the primary law.

Very few countries grant royalty-based incentives in the primary law. Thus, it is particularly striking that many more offer such incentives in contracts. Royalty-based incentives may take the form of reduced or deferred royalties, or variable rate royalties where the benchmark is a flat rate. The extent of royalty-based incentives is concerning for two reasons. First, royalties are intended as payment for the right to extract a publicly owned resource. If government reduces or waives royalties, it foregoes a regular and relatively predictable source of revenue. Secondly, a royalty holiday provides an incentive to shift revenues into the tax-free period, like the response to an income tax holiday. While there may be circumstances in which it is necessary to waive or exempt royalty payments, when cash flows are negative, for example, there should be clear and objective criteria and procedures.

→ See [pages 39 to 41](#) of the IGF-OECD practice note.

Figure 7. Number of countries with incentives



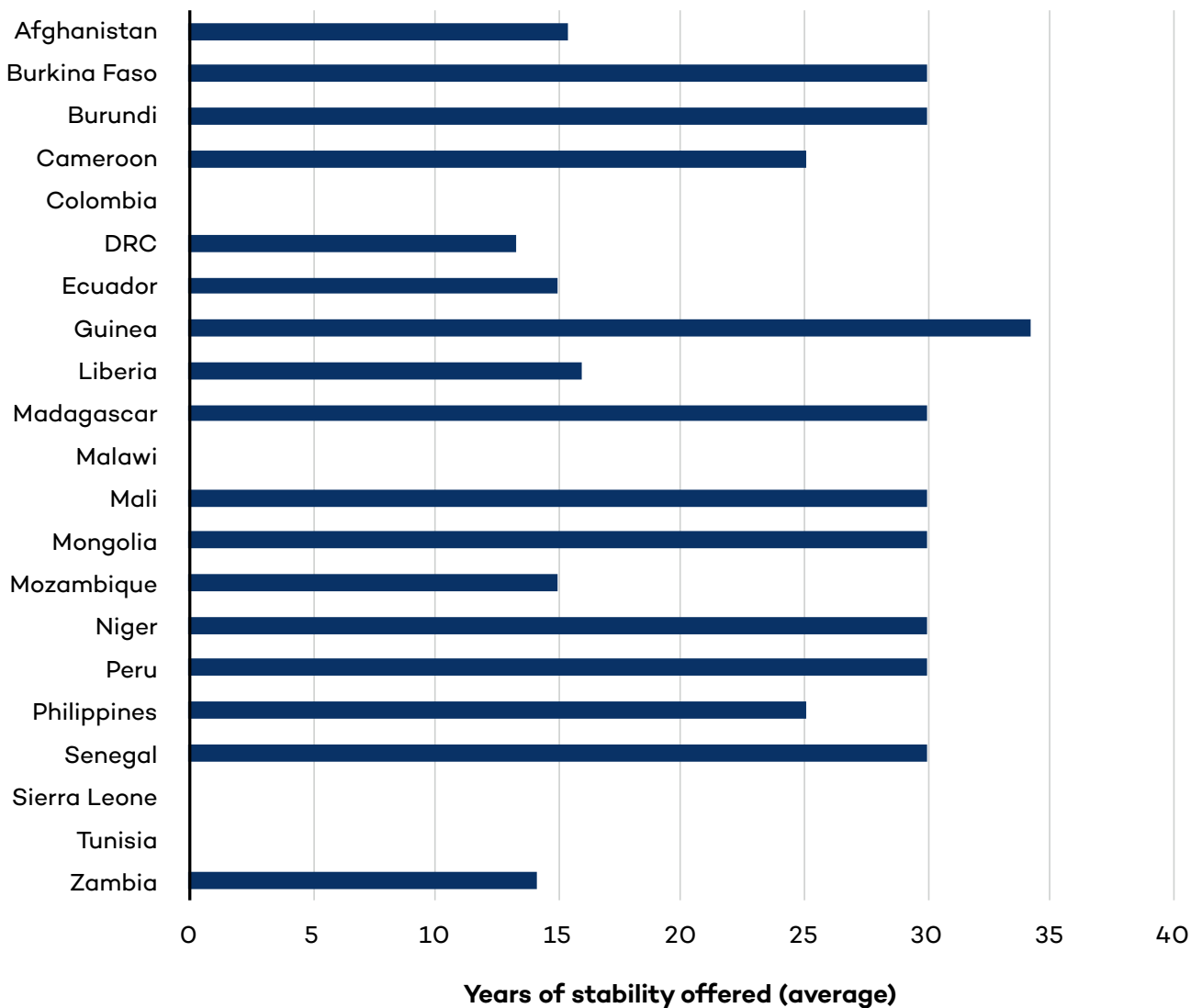
5 Taxes are stabilized for 20 years on average.

Nearly all countries include a tax stability clause either in the primary law or mining contracts. A predictable investment environment is important to ensure the bankability of projects. However, where the period extends well past the financing stages, for example, 30–34 years on average in Guinea, Burkina Faso, Burundi, Madagascar and Mali, stabilization clauses become more akin to rent-seeking tools than necessary financial assurances. Where governments choose to offer fiscal stabilization, they should ensure that the time period and scope are limited, and that there are opportunities for review.

→ See [page 43](#) of the IGF-OECD practice note for recommendations on drafting fiscal stabilization clauses.



Reading the chart: The “average years of stability” are calculated using the number of years offered for each contract. If the contract does not specify a number of years, the number of years specified in legislation is entered. If the offered tax stability is for the entire duration of the project or indefinite, 30 is entered as a benchmark.

Figure 8. Tax stability agreements

6 Tax holidays are nine years long on average.

More than half of the countries surveyed offer a corporate income tax holiday either in the law, or in one or more mining contracts. Statutory tax holidays are provided for in Ecuador, Madagascar, Niger and the Philippines.

Tax holidays are problematic for two reasons: First, income tax holidays are a relatively inefficient and ineffective incentive for mining. They are ineffective because mining is location-specific, making it difficult for investors to move where they are offered better fiscal terms. They are inefficient because profitable projects benefit more from tax holidays than marginal ones whose viability may actually depend on favourable fiscal terms. The second problem is the risk of abuse. Investors are incentivized to increase their income during the tax-free period by speeding up production and shifting the profits offshore, leaving less income to tax after the holiday has ended. In some cases, the tax holidays are more than the average life of the mine, in which case government may never collect income tax.

→ See [pages 20 to 24 of IGF-OECD practice note for a detailed discussion of tax holidays.](#)



Reading the table: Tax holiday is defined as a corporate income tax exemption during the operating phase and is counted as “yes” if either legislation or at least one contract is granted such for at least one year. Tax holiday length is the simple average of the projects with a tax holiday, regardless of whether this comes from law or contract. In one case in the Democratic Republic of Congo, the tax holiday is not time-limited: for this a period of 30 years is used to calculate the average. In Guinea, one contract has a tax holiday "Until full repayment of initial investments." For this case we do not assign a number of years.

Table 3. Mining tax holidays

| Country | Average CIT rate for mining projects | Tax holiday | Average length of tax holiday (years) |
|--------------|--------------------------------------|-------------|---------------------------------------|
| Afghanistan | 20.0 | No | |
| Burkina Faso | 18.9 | No | |
| Burundi | 30.0 | No | |
| Cameroon | 28.3 | Yes | 5 |
| Colombia | 33.0 | No | |
| DRC | 25.0 | Yes | 22.5 |
| Ecuador | 25.0 | Yes | 15 |
| Guinea | 31.3 | Yes | 10 |
| Liberia | 29.5 | Yes | 5 |
| Madagascar | 12.5 | Yes | 5 |
| Malawi | 30.0 | No | |

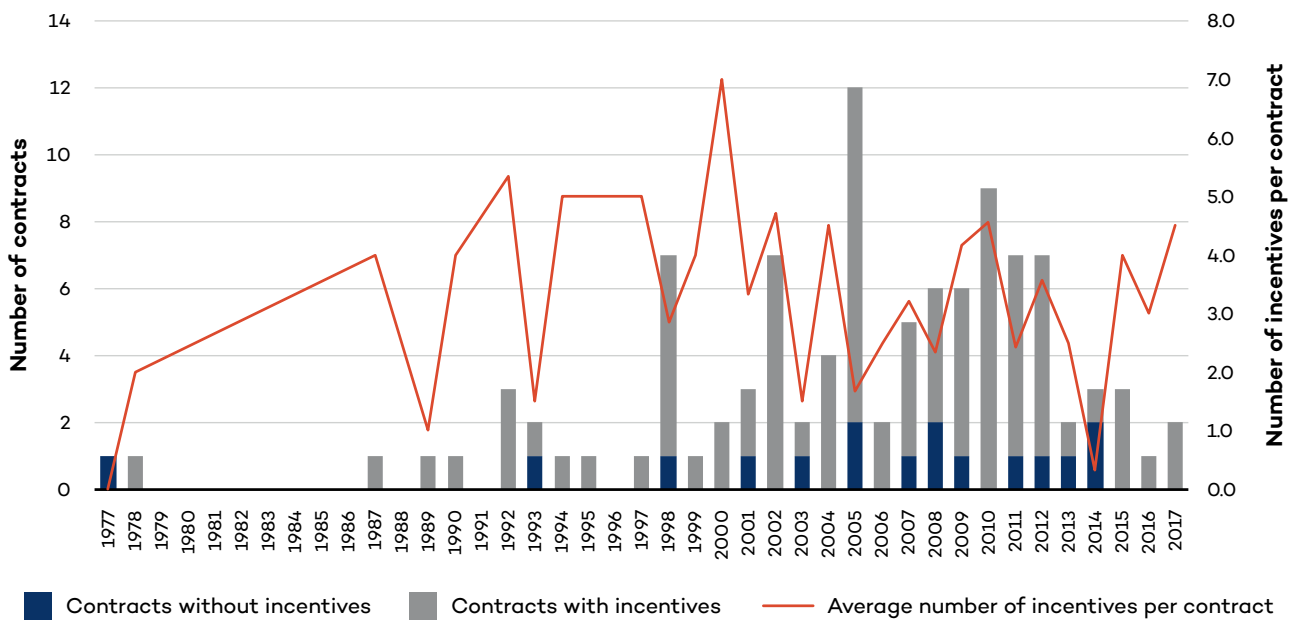
| Country | Average CIT rate for mining projects | Tax holiday | Average length of tax holiday (years) |
|--------------|--------------------------------------|-------------|---------------------------------------|
| Mali | 31.3 | Yes | 4.4 |
| Mongolia | 25.0 | No | |
| Mozambique | 29.3 | No | |
| Niger | 40.5 | Yes | 4 |
| Peru | 27.6 | No | |
| Philippines | 35.0 | Yes | 8 |
| Senegal | 30.0 | Yes | 13.6 |
| Sierra Leone | 26.2 | Yes | 8 |
| Tunisia | 25.0 | Yes | 7.5 |
| Zambia | 27.5 | No | |

7 The use of mining tax incentives rose sharply in the late 1990s, and during the commodity price crash of 2014–2016.

The use of mining tax incentives peaked during the late 1990s, with an average of 4.7 incentives per contract. This coincides with many African countries seeking to attract private investment to develop their mineral resources. Some of the Zambian contracts signed during that period offered 0.6 per cent

royalty rates, for example. The experience was mixed during most of the 2000s. However, there was a sharp decline in incentives from 2010 to 2013, which coincides with high commodity prices. This was followed by a steep increase from 2014 onwards, mirroring the commodity price crash, in which case countries would have been under pressure to offer generous fiscal terms to attract investment. With the exception of these events, countries' motivations for granting incentives seem relatively random, and are more likely determined by particular policy choices, or private sector investors, than global economic conditions.

Figure 9. Incentives in contracts over time



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INTERGOVERNMENTAL FORUM ON MINING, METALS AND SUSTAINABLE DEVELOPMENT

The IGF is a member-driven organization which provides national governments the opportunity to work collectively to achieve their sustainable mining goals. It is devoted to optimizing the benefits of mining to achieve poverty reduction, inclusive growth, social development and environmental stewardship. The IGF serves as a unique global venue for dialogue between its over 70 member country governments, mining companies, industry associations and civil society.

Our Tax Base Erosion and Profit Shifting (BEPS) in Mining Program provides sector-specific guidance and tools on BEPS challenges, as well as capacity building support to developing country governments, with the goal of helping countries capture a fair share of the fiscal benefits from their natural resources. Funding for this program comes from the UK Department for International Development.

Secretariat functions are provided by the International Institute for Sustainable Development, which manages the day-to-day operations of the IGF and provides logistical, administrative and strategic support for its activities. The program is undertaken with the financial support of the Government of Canada provided through Global Affairs Canada.

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