Mining Royalties and Taxation, the Chilean Experience

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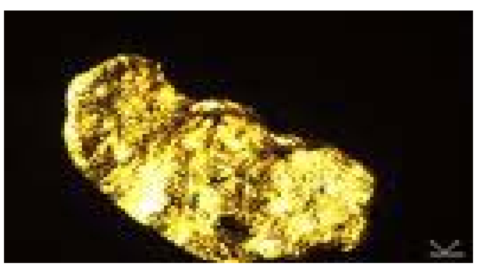
Mining in Chile

Chile, World Class Producer		
Ore	Place	Percentage
Copper	1st	34.2%
Molybdenum	3rd	15.3%
Silver	5th	7.1%
Gold	15th	1.8%



Fuente: Cochilco (2008)

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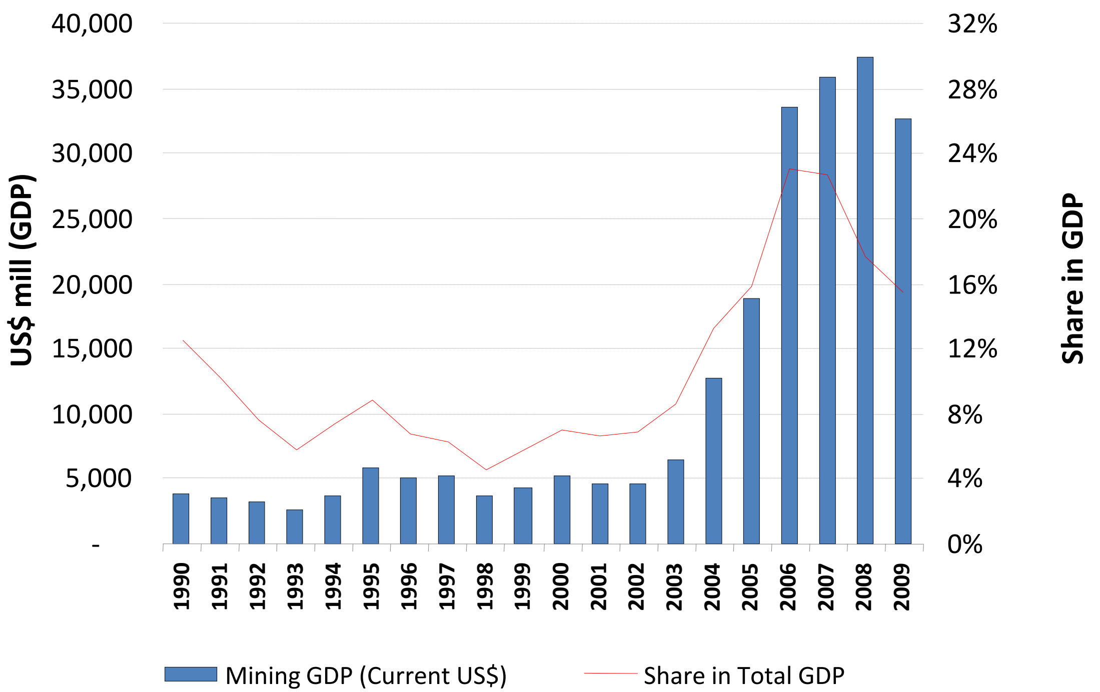
Mining's Share in the GDP

- **Mining is the country's main productive sector.**
- The mining GDP exceeded US$ 30,000 million per year in the period 2006-2009 (measured at current prices).
- In the period 2006-2009, mining represented 19.7% of the total GDP.



Source: Cochilco

Fuente: Gobierno de Chile. Ministerio de Minería.

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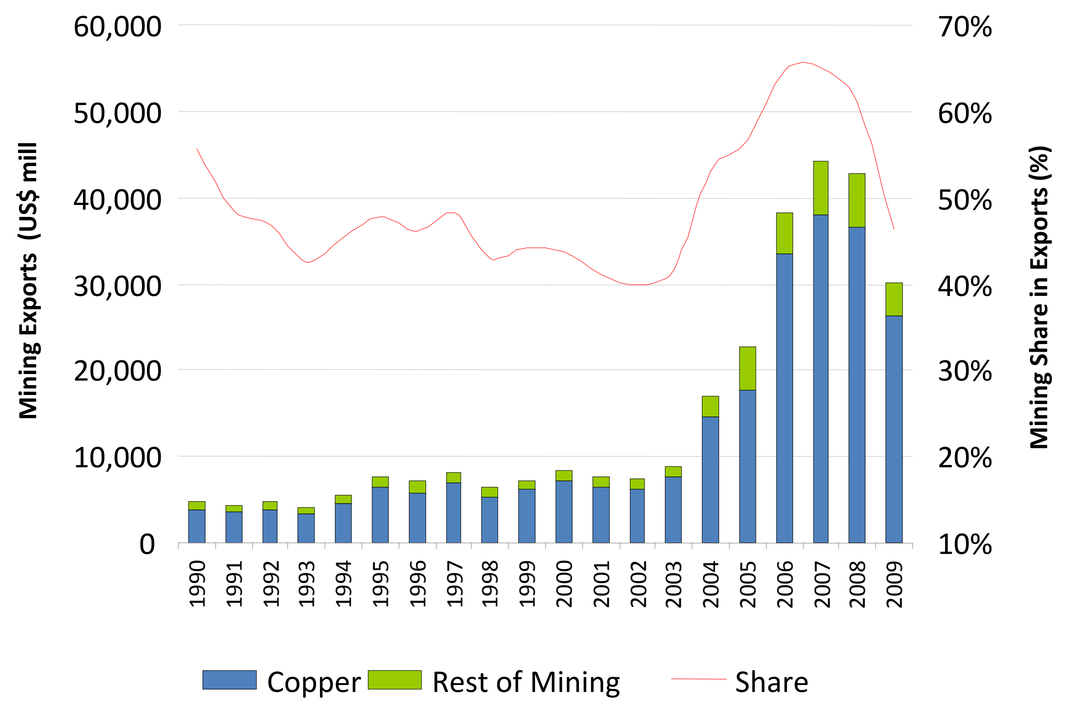
Exports and Mining

- **Mining exports represented 59% of the total amount exported between 2006 and 2009.**

- Copper continues to be the main export, and in the last few years has accounted for approximately 85% of the total mining exports.



Source: Cochilco

Fuente: Gobierno de Chile. Ministerio de Minería.

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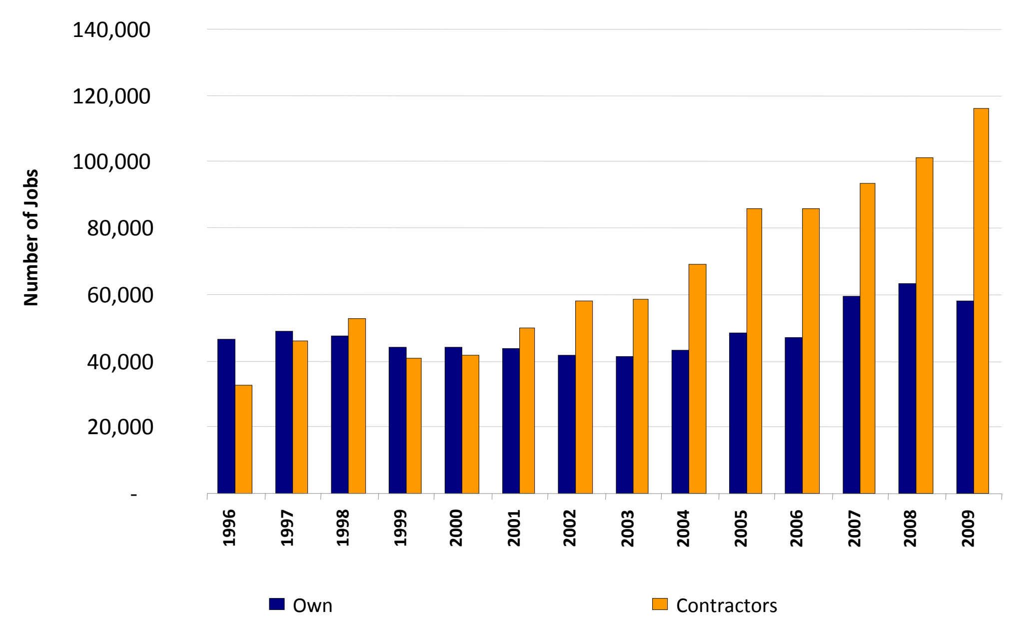
Mining and Employment

Mining does not only contribute from the macroeconomic standpoint: **it has generated more than 95,000 jobs since year 1996**, an increase that has been reflected both in the employment of own workers and of contractor workers.



Source: Cochilco

Fuente: Gobierno de Chile. Ministerio de Minería.

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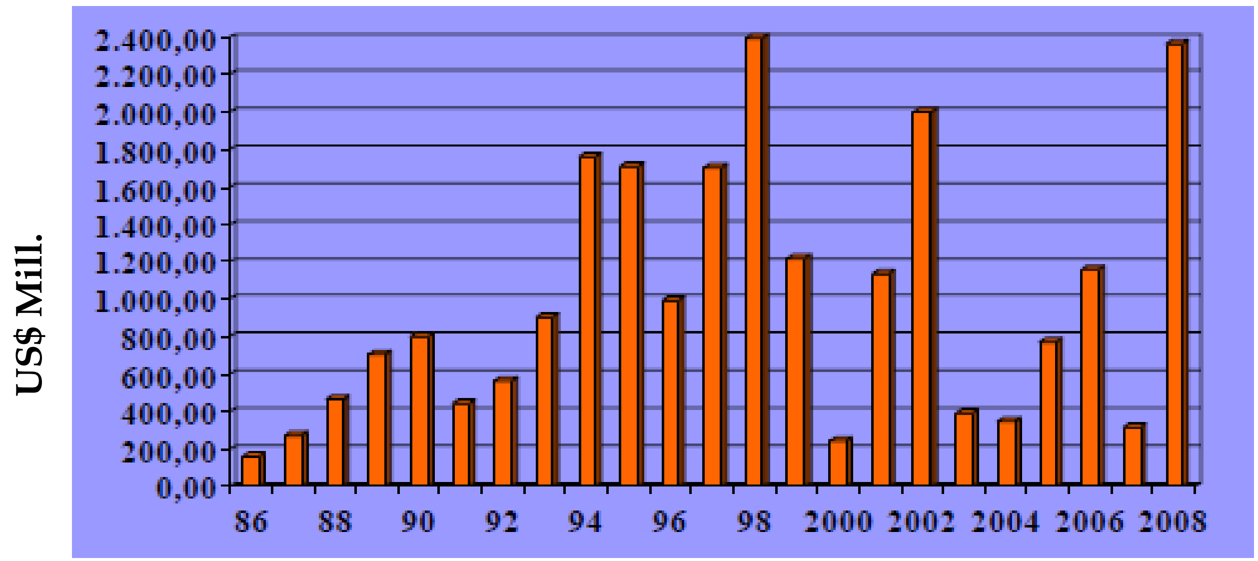
Foreign Investment in Mining Projects



Source: Cochilco

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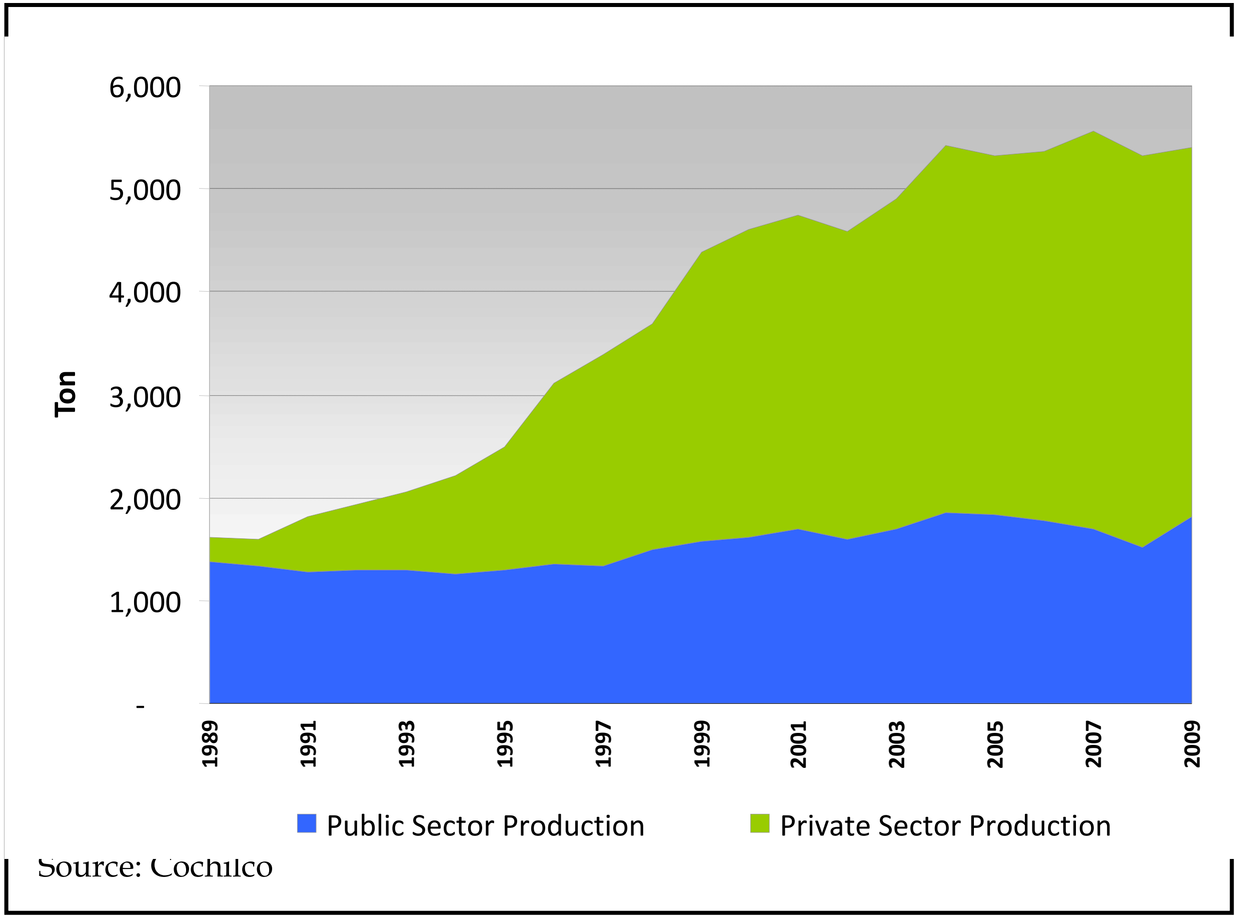
Participation of the Public and Private Sectors in Production

The private sector has been a key element in the increases in copper production during the last decade.



Fuente: Gobierno de Chile. Ministerio de Minería.

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Royalty Modalities

- **Ad valorem Royalty or ad valorem tax**

  The charging of a simple percentage of the sales value. This type of tax does not consider the difference in production costs between companies, which grants the asset an economic value that can be greater or smaller and therefore, the amount to be paid therefore cannot be the same.

- **Charge on the sales value, after deducting certain costs only**

  Discourages the use of inputs the cost of which is not deducted; obstructs supervision and affects mining, production and prospecting.

- **Specific Tax on Mining Activities (Chilean Case)**

  A charge on the sales value after deducting the direct costs and expenses associated with said sales.

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The Nitrate Experience in Chile

- By the end of the 19th Century, the nitrate wealth generated an unusual shift in economy that helped modernize Chile's previously precarious infrastructure.

- Starting in 1880, the Chilean State began charging a tax on nitrate exports equivalent to one third of production.

- During the following decades, local economy experienced sustained growth and other kinds of taxes, such as income taxes or taxes on property and inheritances, were abolished.

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The Disputada case

- Halfway through 2002, Exxon Mobil Mineral tried to sell the Disputada de Las Condes Mine to Anglo American for US$ 1,300 million. The problem was that the sale of the mine was planned through the sale of companies incorporated in tax havens, which sales were not subject to taxes in Chile.

- The Chilean Government became aware of the transaction and initiated a campaign against mining companies because, in its judgment, they paid too few taxes in Chile.

- The Government gradually modified the law so that mining companies would pay higher taxes. The main modifications were:

  - The sale of foreign companies which directly or indirectly control more than 10% of Chilean companies is subject to tax in Chile.

  - Accelerated depreciation was eliminated for the purposes of the Additional Tax.

  - Royalty.

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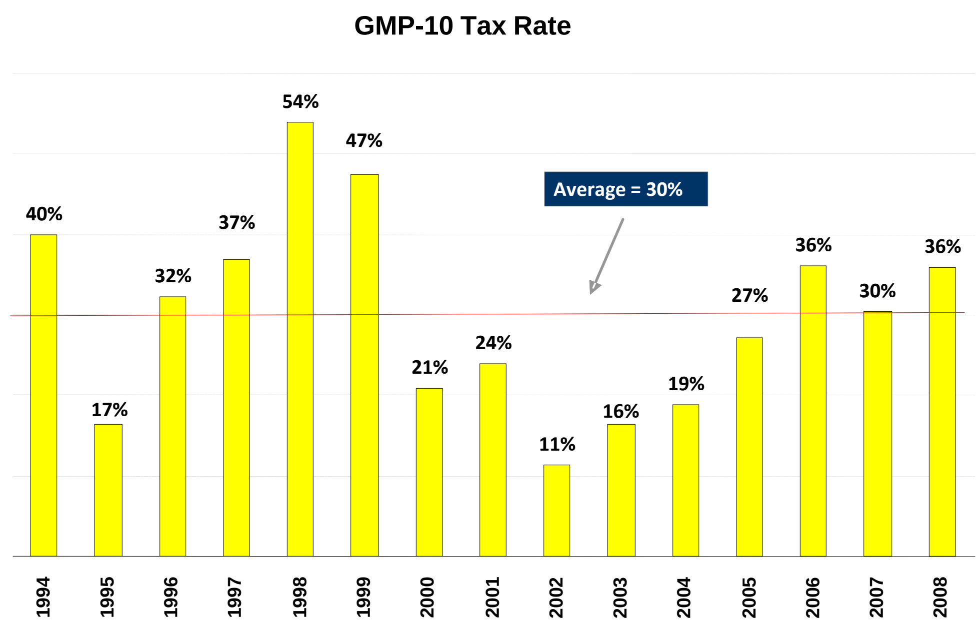
Taxes: Mining Contribution

The effective tax rate of mining companies in the last 15 years has been approximately 30% (considering all transfers to the Tax Authorities)



Source: Cochilco

Fuente: Gobierno de Chile. Ministerio de Minería.

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General Tax Regime prior to January 1st, 2006

- First Category Tax
  - Charged on profits accrued or received during the business year.
  - Costs and expenses such as the following are deducted from income:
    - Interest
    - Losses from previous periods
    - Normal or accelerated depreciation of fixed assets (physical goods)
    - Organization and start-up expenses
  - The rate is 17% (Draft Bill: 20% in 2011 and 18.5% in 2012).

- Additional Tax
  - Charged on profit remittances abroad. (Dividends)
  - The rate of this tax is 35%.
  - The First Category Tax is credited against the Additional Tax.

- Mining Licenses
  - Prospecting license: US$ 1.45 p.a. per hectare.
  - Operating license: US$ 7.23 p.a. per hectare.

Specific Tax on Mining Activities

- This tax came into force on January 1st, 2006.

- Its assessment base is calculated as follows:

	Net Taxable Income of the First Category Tax
+/-	**Income and expenses alien to the sale of products**
+	**Interest accrued by credits of any nature**
+	**Losses from previous periods**
+	**Difference between accelerated depreciation and normal depreciation**
+	**Organization and start-up expenses amortization difference (6 years)**
=	**Mining Operating Taxable Income**

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Specific Tax on Mining Activities (Royalty)

- The rate of the Specific Tax on Mining (**IEM**, for its acronym in Spanish) is determined on the basis of the following structure:

Annual Sales of Fine Copper Equivalent	Tax Rate
? 12,000 metric tons	0%
> 12,000 ? 15.000 metric tons	0.5%
> 15,000 ? 20.000 metric tons	1%
> 20,000 ? 25.000 metric tons	1.5%
> 25,000 ? 30.000 metric tons	2%
> 30,000 ? 35.000 metric tons	2.5%
> 35,000 ? 40.000 metric tons	3%
> 40,000 ? 50.000 metric tons	4.5%
> 50,000 metric tons	Single rate of 5%

- Large-scale Mining is subject to a single rate of 5%.

- The value of the metric ton of fine copper is determined on an annual basis by the Comisión Chilena del Cobre (Chilean Copper Commission) according to the average value of Grade A Copper during the respective period in the London Metal Exchange (US$ 5,611.36 business year 2009).

International Double Taxation Agreements (CDTIs, for their acronym in Spanish)

- Chile has entered into CDTIs under the OECD's model with a large number of countries (Brazil, Colombia, Perú, Canada, United Kingdom, Spain, among others).
- Under these agreements, the profits distributed to foreign partners or shareholders are subject to the Additional Tax.
- Pursuant to provisions set forth in the CDTIs, foreign investors who are the beneficiaries of the profits are entitled to credit the taxes paid in Chile against the taxes they are required to pay in their country of residence, according to the laws in effect in such country.
- Consequently, the Additional Tax and the IEM (Royalty) may be deducted as a credit by foreign investors residing in countries with which Chile has a CDTI in effect.

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Example

- If the mining project generates tax profits in the amount of US$ 100,000 and profits subject to the specific tax on mining for US$ 115,000, the foreign investor will receive US$ 59,250.

- If the foreign investor is domiciled in a country with which we have a CDTI in effect, it may credit the IEM and the Additional Tax paid in Chile, which in this case total US$40,750, against the taxes required to be paid in its country.

Taxation of Mining Project	
Gross Income Chilean Mining Project	100.000
Mining Income with Royalty	115.000
Royalty (5%)	5.750
Gross Income Chilean Mining Project	100.000
Royalty (tax expense)	-5.750
Tax Net Income	94.250
First Category Tax (17%)	-16.023
Cash Availability Chilean Mining Project	78.228
Net Income	78.228
Net Income Foreign Investor	78.228
Plus: First Category Tax	16.023
Plus: Royalty	5.750
Gross Income Foreign Investor	100.000
Withholding Tax Foreign Investor (35%)	35.000
Tax Credit: Royalty	0
Tax Credit: First Category Tax	-16.023
Withholding Tax paid by Foreign Investor	18.978
Gross Income Foreign Investor	100.000
Minus: First Category Tax	-16.023
Minus: Royalty	-5.750
Minus: Withholding Tax	-18.978
Net Income Foreign Investor	**59.250**

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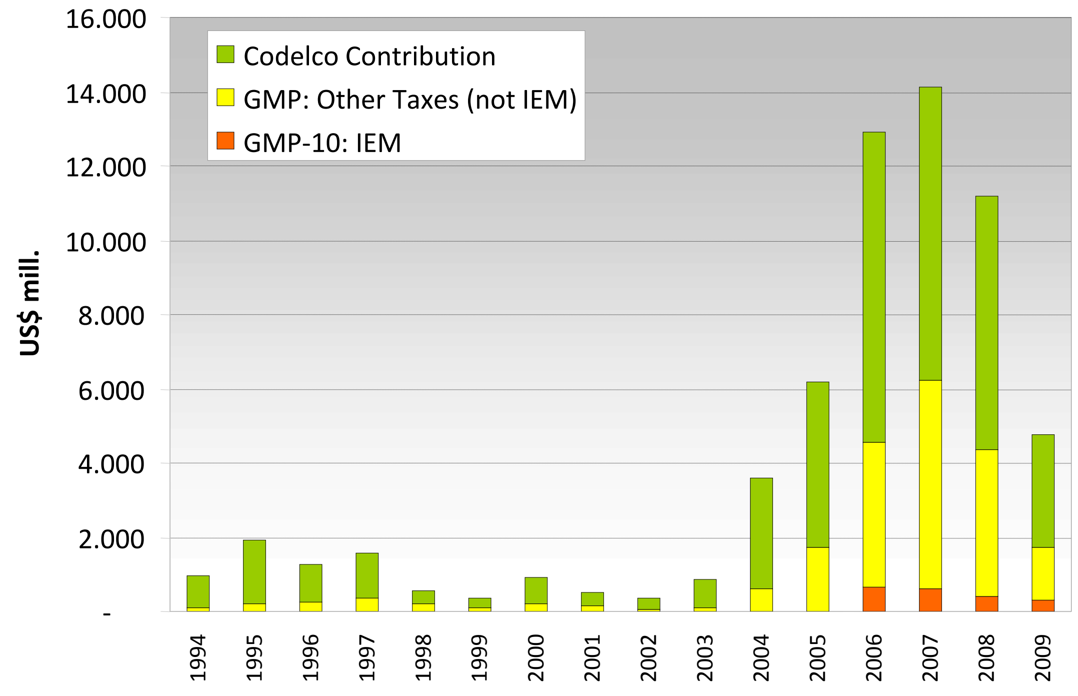
IEM Collection Effectiveness

- The IEM was established in 2005 with structural price scenarios of 93 ¢/lb.
- The collection expectation was US$ 143 million per year.
- Average effective collection 2006-2008:
  ~ US$ 570 million, due to the strong increase in the price of copper and in the performance of mining companies.



Fuente: Gobierno de Chile. Ministerio de Minería.

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Effectiveness of the IEM as against Foreign Investment Contracts

- Foreign investors may bring capital into the country under DL 600 foreign investment mechanism by executing a Foreign Investment Contract with the Chilean State (contract-law).

- Article 7 of DL 600 establishes tax invariability for 10 years as from the project's start-up. Article 11 bis of DL 600 establishes tax invariability for 20 years for industrial or mining projects in amounts equal to or greater than US$ 50,000,000.

- Tax invariability and IEM incompatibility.

- The law recognized the binding force of the contract-law, establishing that the IEM cannot be applied on foreign investors entitled to tax invariability under Foreign Investment Contracts entered into before December 1st, 2004.

- The legislator offered incentives for foreign investors to change their tax invariability regimes, becoming subject to the IEM as from January 1st, 2006, with certain guarantees (ex.: large-scale mining is entitled to a rate of 4% until 2017).

Incentives to Modify Investment Contracts

- Taxpayers exempted from the IEM due to an effective tax invariability were entitled, under certain conditions and until November 30, 2005, to change to the invariability regime established in article 11 ter of DL 600, with certain additional requirements and guarantees, such as:

- Additional Requirements:
  - Waiver of the tax invariability regime.

- Additional Guarantees of Art. 11 ter:
  - Accelerated asset depreciation until December 31, 2007.
  - Invariability for 12 years counted as from the signing of the modification of the foreign investment contract.
  - The rate for producers of over 50,000 metric tons was fixed at 4%.
  - For those investors with contracts signed after December 1st, 2004 and until June 16, 2005, the invariability will be effective for 15 years, and the rate will be 5%.

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Current status of the IEM

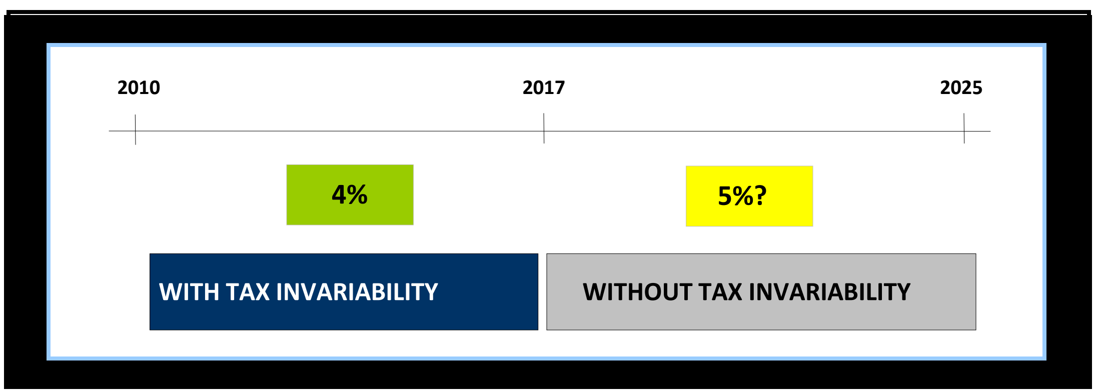
- The rate of the IEM is 5% for large-scale mining. Notwithstanding the foregoing, those companies that had tax invariability were offered a period with a 4% rate and the possibility of resorting to a new invariability period.

- At present, the IEM (for most of the large mining companies that resorted to the previously described invariability scheme) is calculated as follows:

$$\text{IEM} = 4\,\% \times \text{Mining Operating Income}$$

- What is currently being discussed are alternatives to determine the rate, which at present is 4% and will, according to the law, increase to 5% as from year 2018.

- The basis on which the IEM rate is applied (Mining Operating Income) remains unchanged.



Source: Chilean Government. Ministry of Mining.

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Invariability for Other Investors

- Companies which were not recipients of foreign investment under DL 600 were able to resort to tax invariability under the following conditions:
  - Invariability term: 12 years as from the submission of the application to the Ministry of Economy, Development and Reconstruction.
  - The maximum guaranteed IEM rate is 4%.

Draft Bill for the Financing of the Country's Reconstruction
Modifications to the IEM in Legislative Discussion

- A modification of the rate of the Specific Tax on Mining applicable to Large-scale Mining is proposed to the effect that it may be calculated on an annual basis according to a table based on the operating margin of each company.

- The new rate calculation formula seeks to associate the amount of the tax with the industry's cycle: the greater the industry's profitability, the greater the payment by the mining companies, and vice/versa.

- The effective rate would start in 3.5%, for scenarios of margins equal to or lower than 35%, while the maximum effective rate would be 9.0% , applicable in scenarios of margins above 75%.

- The taxable rate and the taxation applicable to medium or small-scale mining remain unchanged.

- The reform would be effective as from the results of business period for 2010, for all mining companies without a tax invariability regime in effect.

- Incentives are established for Large-scale Mining companies to modify their tax invariabilities (increasing their tax payments for years 2010 and 2011).

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- The rate of the Specific Tax would be determined according to the following formula:

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> 40,000 ? 50,000 metric tons	4.5%
> 50.000 metric tons	According ton MOM

$$\textbf{MOM} = \frac{\textbf{Mining Operating Taxable Income}}{\textbf{Mining Operating Income}} \times 100$$

Mining Operating Income	Tax Rate
MOM ? 35	3.5%
MOM > 35; ? 40	6.5%
MOM > 40; ? 45	9.5%
MOM > 45; ? 50	12%
MOM > 50; ? 55	13.5%
MOM > 55; ? 60	15%
MOM > 60; ? 65	16.5%
MOM > 65; ? 70	18%
MOM > 70; ? 75	19.5%
MOM > 75	Single rate of 9%

MOM: Margen Operacional Minero.

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Government's Proposal to Large-scale Mining Companies

- Large-scale Mining Companies may remain as they are or voluntarily resort to the new regime.
- What happens when a company with invariability decides to waive it?

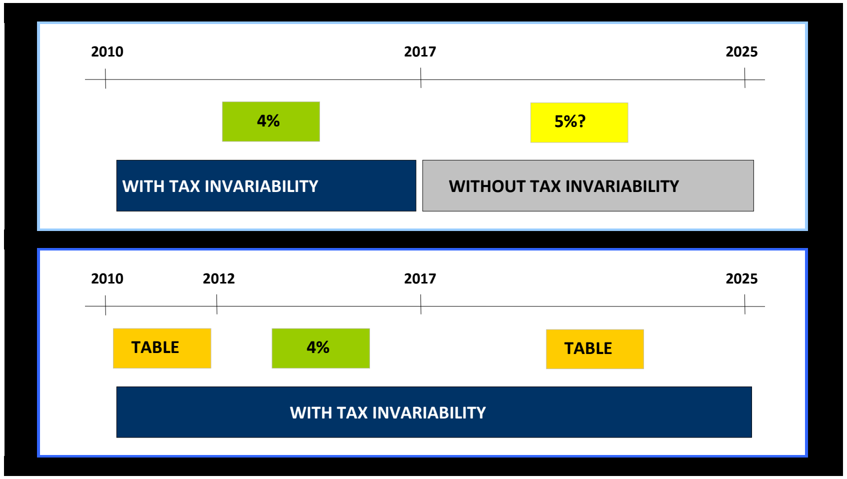
1. The companies will enter into the IEM scheme according to the table during 2010 and 2011, which would generate an increase in receipts for two years;

1. The 4% rate agreed thereby with the State would remain unchanged for the rest of the period during which the original invariability is in effect; and

1. Upon the termination of the invariability period, they will be governed by the new law (variable IEM). In exchange for having resorted to the two year period according to the table, they are granted invariability under the scheme of the new law for eight more years.

Current scheme

Proposal

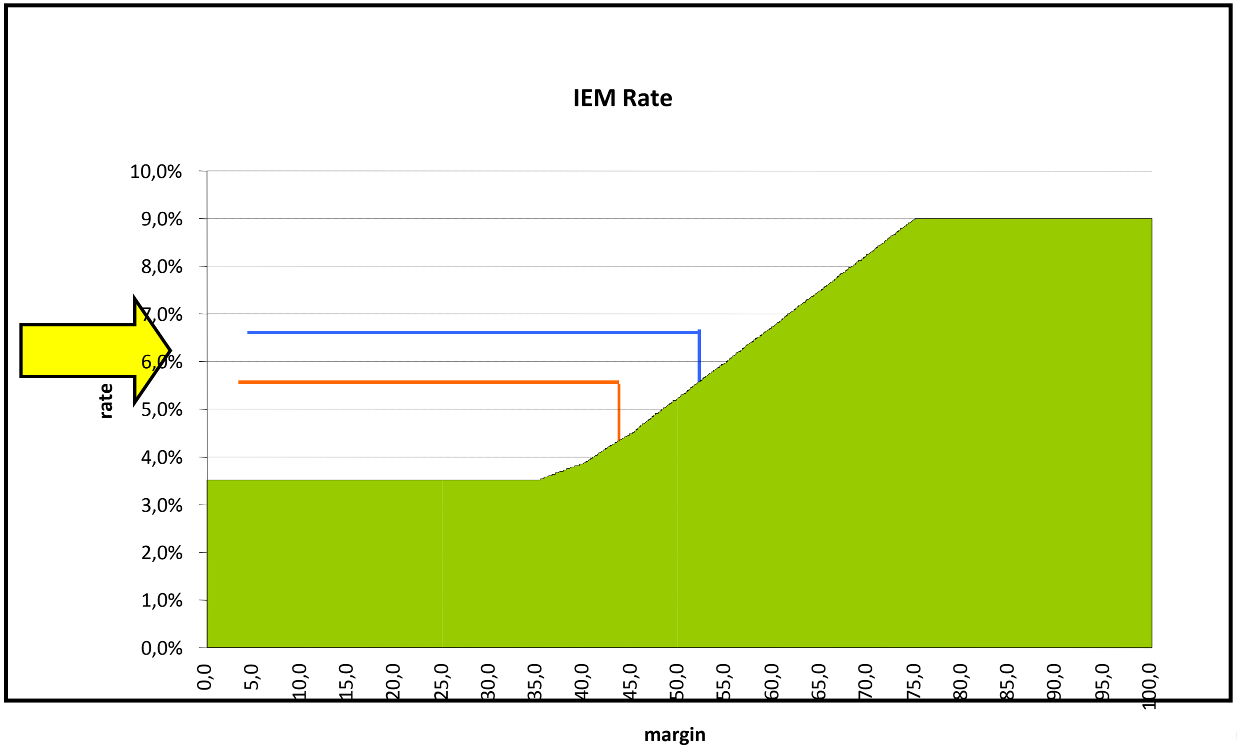


Fuente: Gobierno de Chile. Ministerio de Minería.

Estimated Receipts for the Reconstruction of the Country

- For the period 2010-2011, the table brings net receipts for the Tax Authorities in excess of US$ 700 million (nominal dollars) if the companies resort to the scheme.

- The sector's three major companies (BHP Billiton, Anglo American, and Antofagasta Minerals) would make the greatest contribution.



Source: Chilean Government, Ministry of Mining.

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Conclusions

- Mining is key to the country's economic life.
- It is easy to use demagoguery and attack the mining industry, but it must be recalled that it is a highly cyclical industry that requires very large sums of capital investment.
- **THE GOVERNMENT NEEDS TO BOOST INVESTMENT IN THE SECTOR**: The tax scheme must be stable and should not alter the industry's decisions.