NOTE
ON
MINING AND THE BURDEN OF TAXATION IN INDIA

(31-07-2017)

Mining has been a crucial component of human existence and development. It is an economic activity which transforms the mineral resources into usable products to support national growth. Mineral taxation plays a key role in tackling the challenge of converting mineral resource wealth into sustainable economic growth and development in the country. Even in the 3rd century BC, Kautilya in the Arthashastra observed that — "*Mines are the source of wealth; from wealth comes the power of the State*". While mining brings employment, government revenues and opportunities for socio-economic growth, the economic viability to mine is greatly influenced by the existing taxation policies.

PRESENT MINING REGIME

2. The existing mining regime is guided by Section 8A Introduced by MMDR (Amendment) Act 2015 effective from 12th January, 2015 which, inter alia, provides

— all new mining leases shall be granted for 50 years.

— all mining leases granted before 12th January, 2015 shall be deemed to have been granted for a period of 50 years.

— on expiry of lease period, the lease shall be put up for auction as per procedure specified.

— the period of the lease granted before 12th January, 2015, where mineral is used for captive purpose, shall be extended and be deemed to have been extended upto a period ending on the 31st March, 2030.

— the period of lease granted before 12th January, 2015, where mineral is used for other than captive purpose, shall be

extended and be deemed to have been extended upto a period ending on 31st March, 2020.

— any holder of a lease granted for captive purpose shall have the right of first refusal at the time of auction held after the expiry of the lease period.

— the period of mining lease, including existing leases of Government companies or Corporations shall be such as may be prescribed by the Central Government.

3. The MMDR (Amendment) Act, 2015 also introduced two new levies, in addition to royalty

— payment to District Mineral Foundation which at present is 30% of royalty for mining lease granted before 12th January, 2015 and 10% for mining lease or prospecting licence-cum-mining lease (PL-cum-ML) acquired through auction on or after 12th January, 2015.

— payment of 2% of royalty to National Mineral Exploration Trust.

AUCTION OF MINING LEASES / COMPOSITE LICENCE (PL-cum-ML) / TRANSFER OF CAPTIVE MINING LEASE

(a) Auction of Mining Leases

Mineral (Auction) Rules, 2015

4. The State Government will initiate an auction process, which shall only be through online electronic auction platform, if the mineral contents in such area has been established as per the provisions of Mineral (Evidence of Mineral Contents) Rules, 2015. Where the State Government reserves a mine or mines for any particular specified end-use, the minerals extracted shall

(i) be utilized solely for the specified end-use; and
(ii) not be sold or transferred or otherwise disposed of, either directly or indirectly. ***(Rule 6 (4)***

5. Bidding parameters include minimum percentage of the value of mineral despatched, which shall be known as the "reserve price" (Rule 8(1). The value of mineral despatched shall be an amount equal to the product of

(i) mineral despatched in a month; and
(ii) sale price of the mineral (grade-wise and state-wise) as published by IBM for such month of dispatch. ***(Rule 8 (2)***

6. As per bidding parameter, for the purpose of payment to the State Government, the bidders shall quote a percentage of value of mineral despatched equal to or above the reserve price. The successful bidder shall pay to the State Government an amount equal to the product of

(i) percentage so quoted; and
(ii) value of mineral despatched. ***(Rule 8(3)***

7. There is an upfront payment for mining lease which is an amount equal to 0.50% of the value of estimated resource in lease area. The upfront payment is payable to the State Government in three instalments of 10%, 10% and 80%. This will be adjusted in full against the amount paid as per Rule 8(3) (para 6 above) within the first five years of commencement of production of a mineral. ***(Rule 11)***

8. The successful bidder shall have to provide a performance security of an amount of 0.50% of the value of estimated resources. The performance security shall be adjusted every year so that it continues to correspond to 0.50% of the reassessed value of estimated resources. The performance security which can be through bank guarantee may be invoked as per provisions of

(i) the Mine Development and Production Agreement; and
(ii) the Mining Lease Deed. ***(Rule 12)***

9. Payments under mining lease include royalties and dead rent as per MMDR Act and rules framed thereunder. The lessee shall also pay applicable amount as per Rule 8 (para 6 above) to be paid on monthly basis and also contribute such amounts as may be required under the MMDR Act towards designated accounts of National Mineral Exploration Trust and District Mineral Foundation. The lessee also pay such other amounts as may be required under any law for the time being in force to the concerned authorities.

(Rule 13)

(b) Auction of Composite Licence (Prospecting licence-cum-mining lease)

10. The auction process for composite licence (prospecting licence-cum-mining lease) will be same as for mining lease, delineated in previous section of this paper (Rule 17). Upon completion of the auction process, the preferred bidder shall submit performance security (Rule 18). An amount of 0.25% of the value of estimated resource shall be payable by the preferred bidder as performance security prior to the issuance of composite licence. The amount of performance security shall be revised, prior to the issuance of the mining lease, to an amount of 0.50% of the value of estimated resources. The performance security shall be adjusted every five years so that it continues to correspond to 0.50% of the reassessed value of estimated resources. This performance security may be worked as per provisions of (i) the Mine Development and Production Agreement; and (ii) the Mining Lease Deed (Rule19).

(c) Transfer of mining leases granted otherwise than through auction (captive leases)

The Minerals (Transfer of Mining Lease Granted Otherwise than through Auction for Captive Purpose) Rules, 2016

11. The holder of a mining lease granted otherwise than through auction which is being used for captive purpose, has to apply to the State Government for transferring the mining lease to the manufacturing unit owned by the lessee (Rule 5(1)). The State Government has to convey its decision

within a period of ninety days, failing which it shall be deemed to have approved transfer (Rule 5(2).

12. Within fifteen days of the approval of transfer, the State Government will raise a demand, based upon an estimate of the value of estimated resources of the mining lease, upon the transferee for making an upfront payment of an amount equal to 0.50 percent of the value of the estimated resources within a period of thirty days (Rule 5(3)) which shall be adjusted in full against the amount payable on signing MDPA (Rule 5(5)). The transferee shall, within fifteen days of making the upfront payment sign the Mine Development and Production Agreement (MDPA) (Rule 5(6)). The transferee shall, within fifteen days of signing the MDPA, provide a performance security in the form of bank guarantee or as a security deposit for an amount equivalent to 0.50 percent of the value of estimated resources which may be invoked by the State Government as per the terms and conditions of MDPA (Rule 5(7)). The performance security shall be adjusted every five years so that it continues to correspond to 0.50 percent of the reassessed value of estimated resources (Rule 5(8)).

13. In addition to royalty or dead rent, the transferee shall make transfer charges which at present are equal to 80% of the royalty paid. In addition, the transferee shall contribute amounts to the designated accounts of National Mineral Exploration Trust and District Mineral Foundation (Rule 6(4)).

BURDEN OF TAXATION

(a) Environment (EC), Forest Clearance (FC)
(b) and Forest Rights Act (FRA)

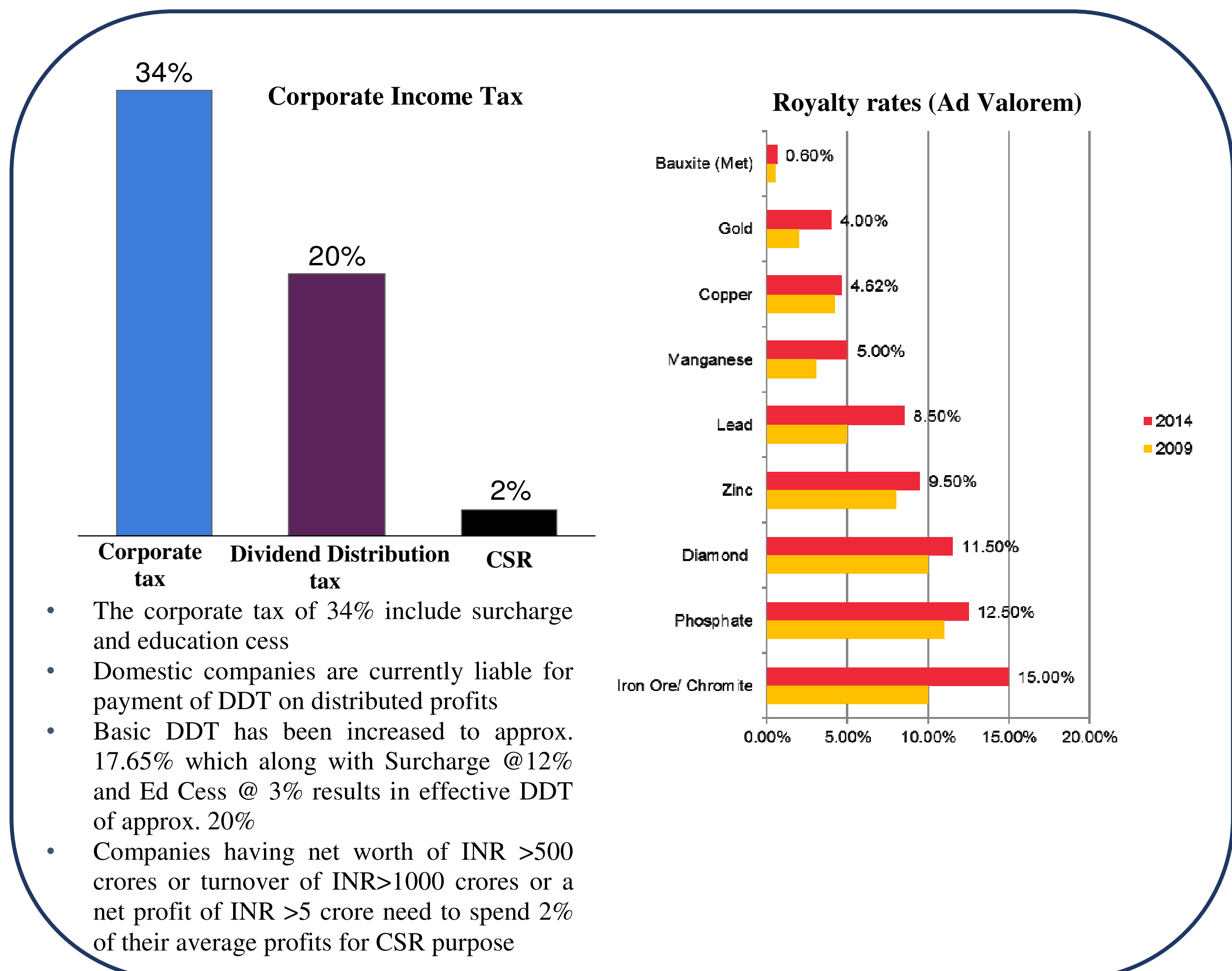
14. The above narration clearly brings out that right from the stage of conceptualization of grant of lease or composite licence through auction by State Government, there is built-in payment of various charges by the prospective entrepreneur. Even after passing various stages, if an entrepreneur is able to get the lease, he has to obtain environmental clearance (EC) under Environment (Protection) Act, 1986 and if the lease

area is under forest, to obtain clearance under Forest (Conservation) Act, 1980 and pay compensatory afforestation (CA) charges and net present value (NPV) depending on the density of the forest (ranging from Rs. 4.38 lakhs to Rs. 10.43 lakhs per hectare). As if this is not enough, an entrepreneur has to obtain clearance under Forest Rights Act (FRA), 2006. All these clearances can take anything between 5-10 years. There is no guarantee that even after that, a lessee will get all the clearances. Even after spending enormous sum, waiting all these years to get all clearances entails monetary burden on the entrepreneur.

(b) Corporate Income Tax and Royalty Regime

15. India has a complex mix of corporate and mining taxes administered by different authorities. The following table brings out the corporate income tax and royalty on some minerals in 2009 and 2015 respectively.

Table-I



16. It would be interesting to note that just as commodity melt-down was starting, India steeply increased royalty rates on all minerals which made the export of some of the commodities like iron ore and chrome ore (which were already reeling under 30% export duty effective from December 2011) unviable.

17. These taxes and royalty rates have to be viewed in the context of international scenario.

Table-II

Navigating the Royalty Maze: International Comparison

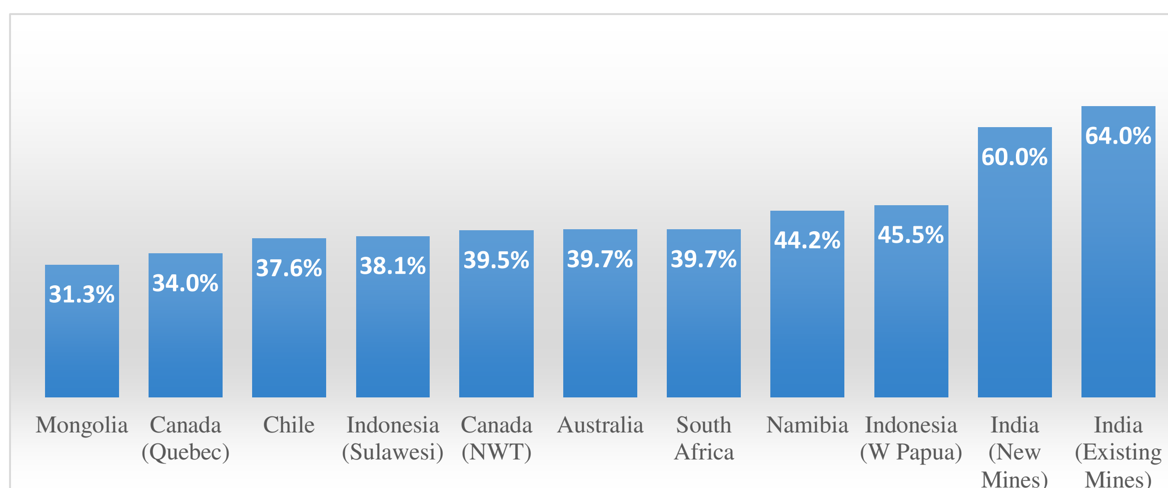
Country	Corporate income tax	Mining taxes and royalties			
		Method	Coal	Gold	Iron ore
Australia	30%	R	2.75%-15%	2.5%-5%	2.5%-5%
Brazil	25%	R	2%	1%	2%
Canada	25%-31%	P	2%-16%	2%-16%	2%-16%
Chile	20%	P	0-14%	0-14%	0-20%
China	25%	R	0.5%-4%	0.5%-4%	0.5%-4%
Ghana	25%	R	5.00%	5.00%	5.00%
Indonesia	25%	R	3-7%	3.75%	4.00%
Mexico	30%	P	7.50%	8.00%	7.50%
Mongolia	10-25%	R	2.5-7.5%	5%-7.5%	5%-30%
Peru	30%	P	1%-12%	6%-21.5%	6%-21.5%
South Africa	28%	R	0.5%-7.0%	0.5%-7.0%	0.5%-7.0%
US	40%	P/R	8%-12.5%	4%-10%	4%-10%
Global average 2014	**23.57%**				

Key R: Royalty basis P: profit or net basis **Source: Mining Tax Databook, KSG, August 2014**

18. The following table brings out the vast gap in effective tax rate in India vis-à-vis other resource-rich countries. The calculations in the following table has been made on an iron ore mine after assuming same capital and operating costs of all countries based on available information on all sorts of taxes.

Table-III

Effective Tax Rate (ETR)



DMF:10% **DMF: 30%**

Notes:

1. Effective Tax Rate = $\frac{\text{Value of all amounts paid to government}}{\text{Total revenue from minerals sales}}$

2. ETR does not cover the following:

- **(i)** Auction price (base price + premium)
- **(ii)** Purchase of land for mining
- **(iii)** GST of 18% of royalty made effective w.e.f. 01.07.2017.
- **(iv)** 10% tax levied by Supreme Court in Goa and Karnataka and FDT levied by Karnataka a swell as highest rate of royalty on iron ore in Orissa.
- **(v)** Net Present Value (NPV) = Rs 4.38 lakhs to Rs 10.43 lakhs per hectare depending on the density of forests
- **(vi)** Compensatory afforestation charges which differs from State to State
- **(vii)** Upfront payment at the time of grant of mining lease = @0.50% of value of estimated resources.
- **(viii)** Performance security = @0.50% of the value of resources

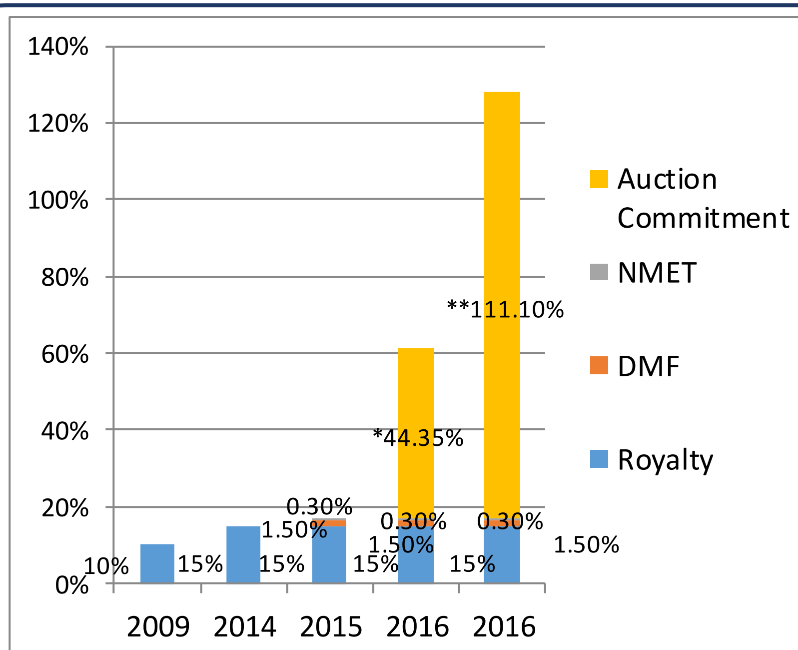
(c) Over-all impact after obtaining mining lease

19. In addition to various taxes / levies detailed above, the existing mines have to give bank guarantee for financial assurance for progressive mine closure plan. These are Rs. 3 lakhs per hectare (minimum Rs. 10 lakhs) for 'A' category mines and Rs. 2 lakh per hectare (minimum Rs. 5 lakhs) for 'B' category mine. No financial assurance is required for leases granted through auctions where Mine Development and Production Agreement (MDPA) has to be signed.

20. The final scenario which emerges as regards royalty and other taxation [post auctions] in a typical case study of iron ore mine is as under:

Table-IV

Royalty and Taxation Scenario post Auctions: Case Study — Iron Ore



DMF @ 10% on Royalty
NMET @ 2% on Royalty
Auction Commitment @ *44.35% of Value of Mineral Dispatched (in case of Ghoraburhani-Sagasai Iron Block, Odisha)
**111.1% of Value of Mineral Dispatched (in case C Category Mines Karnataka)

Note: This table does not include corporate income tax and other taxes / levies imposed by local bodies, etc. as well as net present value (NPV) and compensatory afforestation (CA) charges if the area is under forest.

(d) Transfer of captive mines

21. There is additional financial burden on the buyer of a sick unit or where merger and acquisition (M&A) takes place. The additional financial burden of transferring a captive mine is more than the mine taken on auction. FIMI made two case studies in the case of transfer of mining lease of cement plants in Jharkhand and Chhattisgarh and the limestone mines which were put to auction. A comparison between the operation cost of the captive limestone mines transferred as per MMDR (Amendment) Act, 2016 and the mines which were auctioned brings out that transfer of captive mines will result in additional burden of 4–7% (this will work out to 11–13% if Government takes a view that since these mines were existing prior to 12th January 2015, DMF would be charged @30% of royalty) in Jharkhand and Chhattisgarh in comparison to auctioned mines (Table V). This will have serious repercussions as it will not only affect M&A but nobody will endeavour to buy a sick plant which may result in its closure and job losses.

Table-V

Heads	UOM	In case of Mine Transfer as per ML Transfer Rule		Auction mine - 2 Case Studies	
		Jharkhand	**Chhattisgarh**	**Jharkhand**	**Chhattisgarh**
				PL-cum-ML	**ML**
Operating Cost	Rs / tonne	70	70	70	70
Royalty	Rs/ tonne	80	80	80	80
DMF	Rs/ tonne	8 (10%)	8 (10%)	8 (10%)	8 (10%)
NMET	Rs/ tonne	1.6	1.6	1.6	1.6
Environment Cess	-	-	7.5	-	7.5
Infra Development Cess	-	-	7.5	-	7.5
Entry Tax	-	-	30	-	30
Transfer Charge	80% of Royalty	64	64	-	-
Winning Bid charges as per auction	% of IBM Average Sale Price	-	-	12%	10.15%
	(February,2016-Rs 462/-)	-	-	55.44	46.89
Total Cost		**223.60**	**268.60**	**215.04**	**251.49**
Transfer charges higher by	-	8.56	17.11	-	-
Additional burden % terms	-	4%	7%	-	-

22. The captive mines which were granted prior to enactment of the MMDR (Amendment) Act, 2015, and required to be transferred as per MMDR (Amendment) Act, 2016 will be subjected to additional hefty transfer charges of 80% of the royalty amount despite the fact that for such mines only ownership is getting changed. Further in case of auctioned mines, there is no provision of charging transfer charges. There appears to be intention to fleece the mining industry as much as possible making the cement plants unviable.

REPERCUSSIONS : HIGH COST OF RAW MATERIALS TO AFFECT MINE DEVELOPMENT

23. The main objective behind MMDR (Amendment) Act, 2015 was to ensure that the State Governments get maximum revenue right from the start (cradle) to the closure (grave) of the mining operations. It has to be realised that in this country, the mines are mostly in tribal and forest areas with no infrastructure facilities. Development of a mine with the attendant infrastructure required therefor will directly affect the socio-economic milieu of the people living in those areas. If acquiring a mine and its continuous operations become unviable, no entrepreneur will be encouraged to acquire a mine and the area will remain backward. State will also get no revenue. Instead of earning more revenue from auction and other means, which may never be utilised in these backward and tribal areas, the State should attract more investment in mines in these areas which will provide jobs and lead to socio-economic development.

24. Commodity markets are subject to market fluctuations — sometimes wild and sometimes moderate. In such a situation if it is insisted upon to adhere Mine Development and Production Agreement (MDPA) and to secure performance security, which can be invoked for any breach, it would make a mine unviable since very beginning. The experience of coal mines acquired through auction is a testimony to this; most of the mines could not go into production and had to be surrendered.

25. The performance security of 0.50% of the value of estimated resources which is to be adjusted every year to correspond to 0.50% of the reassessed estimated resources will discourage exploration. A lessee would not like to add to his cost, not only of the exploration expenses but in terms of additional performance security which may result following discovery of more resources. In the case of captive mines, their production from the mines is directly linked to the production of the product to which it is captive. The demand for cement / steel / aluminium is subject to market forces. How can thus one have a static Mine Development and Production Agreement (MDPA)?

26. In a competitive world, it is necessary that what we produce should be economically viable. Mr. Graeme Hancock of World Bank in his report submitted in 2006 has observed that "countries compete for mineral sector investment and generally offer terms of ETR between 40% and 50%". The taxes mentioned above have all the ingredients to make domestic raw materials costly. In present day uncertain commodity market around the world, a time may come when imports would be cheaper than buying raw materials in the domestic market.

27. Further, the high raw materials cost will make finished products unviable and open it to the vagaries of imports. Any safeguards against import of finished products like steel and aluminium and making them costly will hurt down-stream industries, many of whose products are exported. Down-stream industries provide jobs to a large number of people and if the cost of finished products increases, the domestic consumers and exports will get affected.

28. Even if for argument sake, one acquires mining lease through auction route, there are restrictions on market access particularly export and an entrepreneur is not able to realise best unit value for his product(s). Some of the minerals like iron ore, bauxite, ilmenite, chromite are subject to export duty and in the case of chromite and manganese ore, there are ceilings on the quantity to be exported despite being limited domestic demand. Needless

to say that more export realisation adds value and increase GDP. Further, despite adequate resources and capacity to produce, imports are taking place at higher prices resulting closure of more than 80% of the manganese mines and less than optimum production of chrome ore.

CONCLUSION

29. The high taxation on mining in India alongwith inordinate delays in grant and development of mines have already led to several major international players exiting the country. As James Ferguson, Global Mining Tax Leader at Deloitte, observes:

> "This will impel miners to base future investments on three main factors — a country's geology, its political stability, and its tax policy. "

30. While resource-rich nations are competing to attract investors to explore, mine, contribute to socio-economic growth and create new employment opportunities by unlocking their own mineral potential whereas, in India, we are making it difficult for investors with state-of-the-art technologies to invest in exploration and development of mineral resources.

31. In the recently released Survey of Mining Companies by Fraser Institute, India ranks among the 10 least attractive jurisdictions globally (97th among 104) in terms of Investment Attractiveness Index for mining and exploration. It is imperative that the country addresses and fixes these issues to create an attractive legal and fiscal regime for mining. In designing our policies and rules, we must always remember that the Indian mining industry cannot produce minerals in isolation today as their viability is closely dependent on the trends in global commodity prices. It is imperative that policy decisions and Government interventions should closely consider the international dynamics and attractiveness of other mining jurisdictions.

32. This high incidence of taxation especially in mining could possibly be attributed to an erroneous perception that miners continue to make windfall profits even after the global commodity slump. It has to be realised that the

mining sector in India is heavily taxed, not only in comparison to international level but also in comparison to other domestic sectors. The taxation regime for mining in India affects all downstream industries and employment opportunities in the economy, while fuelling the already skewed balance of payment through additional import of minerals. Hence, there is need to rationalize the taxation structure for the mining sector for sustainable development and deriving long-term benefits in terms of sustained raw material security for industries.