

# TOPICS TO CONSIDER FOR THE **CONTROL OF THE INCOME TAX** IN THE MINING SECTOR

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## SYNOPSIS

This paper presents a review of the corporate income tax risks that can be faced regarding the management of medium and large companies in the mining sector. The document describes the transversal and specific risks that must be taken into account in both the *risk assessment* process and for *review purposes* during a tax audit. It

offers management suggestions that can serve as a basis for the administration strategies regarding these risks, including clarifications in the legal framework that are necessary. The present work seeks to contribute to the process of understanding the mining activity by the tax administrations.

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## INTRODUCTION

During the last two decades, the countries of Latin America and the Caribbean (henceforth LAC) have received strong investments in activities related to mining. This investment, mainly of foreign source, has promoted a significant growth in mineral exports, which have generated an increase in the taxes derived from this new level of activity and encouraged by higher international prices.

This bonanza situation was not maintained over time, and many tax administrations have been facing the fact that, contrary to expectations, the new level of operation and the higher price of mining products did not translate into higher *corporate income tax* (henceforth CIT) payments.

Furthermore, in some cases, it was observed that revenues of mining companies decreased significantly, sometimes because of the restructuring of operations caused by profit shifting.

The concern about the issue of income tax erosion in the mining sector becomes more important since currently, in a period of “low quotation” of the mineral prices, the decrease in collection from the mining affects significantly the countries’ budgets. In many cases, the increase in collection from other activities does not compensate this decrease in collection and therefore generates the need to assume more debt.

While there are now important reasons for this reduction in revenue (the fall in the price of metals), we must not forget that the main risk about medium and large mining groups, from the perspective of tax administrations, are risks associated to the *veracity gap*.

## 1. SOME TRANSVERSAL RISKS OF THE MINING ACTIVITY

At the 2014 Conference in Brussels, CIAT<sup>1</sup> presented a paper on the mining activity among its member countries and its importance in terms of GDP and tax revenues. The paper also showed a summary of the problems that CIAT member countries had reported.

These problems, transversal to most countries, were related to difficulties, such as: valuation of natural resources, the rules of transfer pricing in terms of their application to extractive activity, the treatment of costs and expenditure on exploration and development, expenditure on social infrastructure. They also relate to the treatment of reserves and provisions, the transfer of interests, customs duties and preferential treatments with respect to VAT on imports, sub-capitalization, the treatment of hybrid financial instruments, the management commissions, among others.

The presentation by CIAT was intended to transfer the risks reported by the member countries and to show the problems faced by the tax administrations, risks that must be managed in order to reduce the negative impacts that they could generate.

## 2. WHAT IS REQUIRED TO DEFINE A CONTROL STRATEGY IN THE MINING SECTOR?

The way forward in order to achieve better control of the extractive activity, in general, should include the revision of the tax policy design in order to achieve an ad-hoc treatment and a robust legal framework. It should include anti-evasion rules (specific or general); an in-depth understanding of today’s business conditions and the problems related to international taxation<sup>2</sup>; the development of capacities in the tax administration, including the optimization of their implicit and/or explicit control models.

1 View presentation in the following link: [http://www.taxcompact.net/activities-events/2014/EC-ITC-WB-Conference-Brussels\\_Sep.html](http://www.taxcompact.net/activities-events/2014/EC-ITC-WB-Conference-Brussels_Sep.html), session 2

2 The mitigation of these risks includes having robust transfer pricing rules and the possibility of making effective exchanges of information between tax administrations. The general recommendation to have in the legislation the possibility of signing Anticipated Pricing Agreements (APAs) completes the set of treatments that have been developed and that have been reported as useful mechanisms.

The foregoing without losing sight of the need to try to keep low (or as far as possible, to reduce) the administrative costs of tax enforcement and compliance costs, in order to prevent affecting the competitiveness of the country.

The development of capacity building in the tax administration should include developing (or mastering skills and knowledge) that allows performing operational audits to reduce the risks that incorrect practices may generate in the payment of taxes. It also requires access to reliable information on the prices agreed for transactions in international markets as a requirement to avoid reducing the tax base of the countries by using “improper adjustments”.

Given the importance of the mining industry in the collection of many countries, addressing these challenges requires the development of a comprehensive compliance strategy consistent with the government's objectives. It should include all aspects related to the management of the sector, the identification of the units involved as well as their responsibilities and goals.

It is clear that the activity control exceeds the taxation framework and requires effective cooperation with other government agencies to exchange information, the adoption of a risk management framework to effectively control and provide the services needed by the taxpayers to comply correctly, the development of a mechanism for a faster and impartial dispute resolution. It also requires the development of control capacities of diverse types in the various public agencies involved.

The risk management of the activity requires the use of treatment instruments involving the participation and

collaboration of many public actors and the development of an effective sectorial tax regulation coordinated and coherent, with optimized processes that generate low compliance costs.

By taking into consideration the above-mentioned elements, we can conclude that the development of an optimal control strategy exceeds an approach centered only on tax issues and on the Tax Administration's capacity.

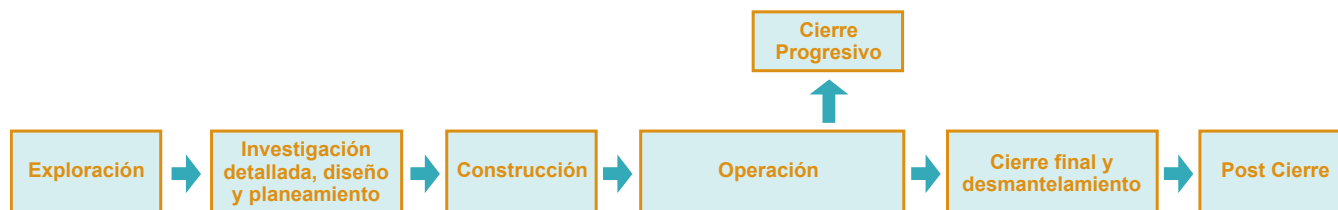
### 3. THE LIFE CYCLE OF A MINING PROJECT

The mining production process presupposes a sequence of stages that must be carried out before benefitting from the mineral resources. The different stages in the activity usually have a variable period of maturation. This period depends on the magnitude of the mining project, its location, the services available in the area of exploitation, the type of deposit and mineral to be exploited, the capital available, among other factors.

Regarding this plurality of stages, before starting to produce, these stages are mandatory that is to say, that one cannot advance to a next stage until having completed the previous one, without prejudice of the fact that all these stages are not always carried out and/or executed directly by the companies. The stages can be outlined, as proposed by SNMPE<sup>3</sup> (2015, 33) as follows:

3 The National Society of Mining, Oil and Energy (Spanish name Sociedad Nacional de Minería Petróleo y Energía, or SNMPE) is a non-profit organization that brings together the main mining companies operating in Peru. See: <http://www.snmpe.org.pe/>

**Figure N° 1**  
**Scheme of the life cycle of a mine and**  
**the phases of the closing plan**



Source: National Society of Mining, Oil and Energy

Each of these stages includes carrying out a series of operations with tax interest and among which we can identify risks that should be managed by the tax administrations.

#### **4. RISKS OF THE MINING ACTIVITY WITH RESPECT TO THE INCOME TAX**

In the following points, we will present a series of risks that are particular to the mining activity. We have not intended to present a complete inventory of all the risks.

We must remember that the process of identification of risks requires as a starting point a framework of reference established by the country where we carry out the identification of risks. In this case, for Peru, we must take into account the legal factors, the environment, the strengths and weaknesses of the public administration, among other elements, as detailed in the best practices of risk management.

##### **4.1 Risks associated with exploration expenditures**

Since there is usually a legislation providing early recognition benefits to such expenditure, the risks arising with respect to this issue are two: 1) To consider unduly capital disbursements as current expenditures in order to report losses and (2) to report a double deduction of the expenditure.

The second risk materializes when expenses that are capitalizable under tax laws are deducted as soon as

they are incurred. This treatment differs from what is set out by the accounting rules (International Financial Reporting Standards – henceforth IFRS); in attention to these rules, these disbursements must be capitalized and amortized in the future.

This difference in time, given the long term of the project and if there is a deficient control, could be deducted more than once, the first time to take advantage of the favorable promotional treatment provided by the tax rules. The second time, as a correct financial amortization, which when not adjusted by the taxpayer and not detected by the administration, could generate a double deduction.

In order to avoid this, it is advisable that in the mining industry and due to its large maturation period, the expenses of this type should be reviewed before the deadlines for revision even if there is no short-term collection interest, and a good control of the *Deferred tax liabilities (IRD in Spanish)* is required.

Another important issue is that, at this stage, highly specialized services and goods are often used, whose market value reference is not always known. These goods and services are usually channelled to the project through related companies. This topic calls for a double attention, first to make sure that the good and service was actually used in the project, and then to make sure that the transaction prices follow the transfer pricing rules.

## 4.2 Risks associated with development and construction expenditures

Mining companies -as in many sectors- usually make disbursements that can be considered as *assets* or *expenses*. In the mining sector, in order to distinguish what concept we are facing and to distinguish between the two, the phases of the mining project are often taken into account; this makes somehow easier to identify which of these disbursements should be treated as assets and which must be treated as expenses.

It is at the stage of development and construction that the largest investments in fixed assets are made. To reach this stage, pre-feasibility and feasibility studies must have been completed and the optimal mining method must have been defined, that is to say, whether the exploitation will take place underground or in open pit mining.

A document that for the purposes of auditing could help us to distinguish between assets and expenses and to establish at what stage we find ourselves is the **final engineering project** that is usually accompanies the feasibility study.

The general recommendation is that we should keep an eye on the company's practices with regard to the treatment of disbursements at this stage. Sometimes these collide and/or have special treatments in each country regarding the general rules of CIT.

In general, the Peruvian mining companies, as stated in SNMPE (2015), usually consider as *intangible* the costs of development incurred before starting production, these costs are then amortized following the method of production units based on the proven and probable reserves (pp. 71-73).

Mining companies generally consider that the *development* costs relate to areas under exploitation, and which are consequently contributing to the current production of the mining unit, must affect the operational result and should not be activated.

To consider these disbursements as *cost* or *expense* is in some cases a decision of the accounting policy of each company. During the audit, the auditor in charge of the case should have this in mind because it could conflict with the accrual of these expenditures.

There are issues that require a more careful analysis such as the *disbursements related to the stripping* of the work area. The most accepted accounting practice is that the disbursements by this concept during the construction and development stage are considered part of the cost of the project and therefore capitalized and treated as an intangible, subject to amortization during the operating life of the mine.

This practice changes when the production stage starts<sup>4</sup>, at this stage the cost of the stripping is considered as production cost, which is recorded as current expense or controlled as a deferred expense with a fixed impact within the production costs of the associated stage. To precipitate the expense by not following this practice for tax purposes, unless explicit acceptance by the tax standard, has a significant impact on the results of the project to be controlled.

Another issue to consider is the *development costs* of areas *different* from those currently in exploitation. The practice in this case is that the disbursements for these concepts are evaluated annually in order to determine if it is correct to keep capitalizing them. If it is decided that the area where these disbursements are made is not economically viable, the accumulated costs previously activated are charged in their entirety to the operational results. This is another point of focus during an audit because it can precipitate expenses that should have been deferred.

On the other hand, the *assets that are bought to build the project* are capitalized and their depreciation is activated as part of the costs of the project. In this case, when the project begins its production stage, the depreciation is recorded as part of the production cost.

Here the analysis of the costs eligible to be activated is critical, especially due to the high amounts associated with the mining, the engineering works, procurement, administration and construction-assembly works that

<sup>4</sup> It is considered in mining practice that a mine is in its "production phase" when the saleable mineral is extracted, and has already reached its "projected minimum production".

are associated to this stage must be carefully reviewed in order to avoid overvaluations. At this stage, it is essential to analyze the “allocated” expenses that are capitalized on the value of the assets that are being developed.

Finally, the *treatment of distribution of indirect costs* usually assumes that at the end of the construction stage, part of the indirect costs are assigned the areas or units that qualify as elements of property, plant or equipment (fixed asset in the Peruvian tax terminology). The assignment is made in attention to reasonable criteria. Remember that these indirect costs are usually assigned taking the direct costs as a reference.

With regard to the *costs of temporary constructions*<sup>5</sup>, these are assumed by the project if they are only used for the construction stage and are demolished or removed later. However, if they will later be used in the project (as usually happens) they are capitalized and then their depreciation is recorded as part of the production cost. The same attention is needed if their withdrawal was initially anticipated, but subsequently it was decided to use them.

An additional issue is that referred to the *agreements of transfer of rights*. While development and construction costs are often very important, it is normal for taxpayers to sign agreements to involve other partners. These agreements are normally carried out through *agreements of transfer of rights*, by means of which the part incorporated into the project acquires a participation in the project, which can take as a reference fixed or variable expenses amounts and/or referents of capital.

During the life of the project, especially if it is an important project, several *agreements of transfer of rights* may

be concluded, which must be reviewed. Agreements of transfer of rights may have more beneficial tax treatments, since depending on the definition of what is considered *capital gains*, situations could occur where these gains are not taxed.

On the other hand, the conditions of the agreement must be reviewed in order to establish whether the obligations assumed by the new partner of the project have been fulfilled. They must determine whether these expenses and/or investments, have been carried out effectively in order to give the right and admit – when applicable – the deduction of expenses and/or the amortization of the assets provided, and especially determine if they correspond to the mining project.

#### 4.3 Risks associated with the treatment of disbursements related to the concession

SNMPE (2015, p. 45) defines the mining concession in the following terms:

“It is the administrative act by which the State confers to a person or entity a real right for the exploration and exploitation of mineral resources within a granted land surface area and the property on mineral resources to be extracted in accordance with the provisions of the concession title”

In some countries, the mining concession constitutes a different right, i.e. separate and independent from the rights on the land where it is located. It is also common that rights on the superficies are not included.<sup>6</sup>

There are several contracts, by which the right of exploration/exploitation of a concession can be obtained, such as *Transfer contracts*<sup>7</sup>, *Option contracts*<sup>8</sup>, and *Mining Transfer contracts*<sup>9</sup>, *Mortgage contracts*, among

5 We refer to canteens, offices or dwellings

6 In some countries, the natural resources are property of the owner the land where they are located, in other cases, as in the case of Peru (see article 66 of the Political Constitution) natural resources are considered national assets. The license is the mechanism that enables the beneficiary to operate and the act conferring the respective exploitation right.

7 It is a typical contract from which the holder of the mining concession permanently transfers his ownership to a third party in exchange for a financial or in-kind consideration.

8 SNMPE (2015, pp.) 45-46) consider that: It is a typical preparatory contract, linked to a transfer or assignment; through these contracts, the holder of a concession can hold in the future contracts on concessions of which it is titular. Through the transfer option, the transferor gives the transferee the possibility of obtaining the ownership of the concession, in exchange for a consideration. As a reflection of this contract, the transferee acquires the possibility of acquiring the ownership of the mining activity by means of transfer. It is usually given the treatment of an intangible asset.

9 SNMPE (2015, pp.) 45-46) consider that the contracts of transfer allow: ... the concessionaire – “assignor” – to transfer to a third party – “Assignee” – the temporary ownership of the mining concession, in return for which he receives a remuneration called compensation, which may consist of a sum of money, in a amount of ore extracted or benefited, or at a percentage of its value. This being produced, the assignee replaces the assignor in all his rights and obligations.

others, through which this right can be transferred temporarily or permanently.

The type of contract and the general or specific legal framework will determine the accounting treatment given to the concession, and the tax effects referring to the cost and amortization could be derived from there.

The normal practice of mining is that *mining concessions* are classified as *intangible assets*, after which they are amortized based on the method of production units or under the straight-line method. The amortization of mining concessions starts from the production stage using the *production unit method* under the reference of *proven and probable reserves*. If the project is abandoned or if the expiration of the concession occurs, the associated costs must be recognized immediately in the income statement, the same policy must be followed if no exploitable mineral body is found.

In their initial recognition, the mining concessions are counted at the cost of acquisition, if the concession is considered an intangible asset this value is adjusted adding the cost of voluntary revaluations. Valuations should be carried out by independent experts taking into account the fair value at the date of appraisal minus their accumulated depreciation. The values attributed to the concession must be reviewed periodically, recognizing the changes in the net worth or the results of the period in case they exceed the assessed value.

These accounting practices may conflict with the tax rules of the different countries and are themselves a source of differences and possibilities of execution of tax planning, so they must be a matter to review in terms of their effects, according to the laws of the country.

The marketing and/or concessions rights contributions made directly and indirectly also generate tax planning options, generating increases in the value of the asset that later affect the production cost, if the profit on the asset commercialized and/or provided is made in a country of low or no taxation.

A mechanism used by companies, when the legislation of a country permits it, is to reframe a transaction of purchase of a mining concession as a payment for the transfer of a royalty contract.

This operation is done in order to make the purchaser deduct in a single exercise the price paid for the acquisition of a mining concession rather than in several periods according to the expected life of the project, as following its exploitation pattern.

Here again a robust legislation is seen as a more appropriate solution to an issue that is debatable. Although the administration can argue that in application of the principle of correlation between income and expenditure (which is usually implicit or explicit in the income tax legislation), the payments for this concept cannot be deducted in a single exercise. These must be amortized throughout the life of the project, and if the legislation does not help, this issue would be debatable.

#### 4.4 Risks associated to revenues

In the mining industry, normally the product obtained from an exploitation is the *ore concentrate*, an intermediate product that can be marketed, obtained from various *metallurgical processes* to recover the greatest possible amount of metal content.

Concentrates are named taking into account the largest metal they contain; this is copper concentrate, lead concentrate, etc. The concentrates must pass through a process of smelting and refining in order to become metals and obtain the degree of purity of 99.99%, which is the standard for their final sale in the form of bars, ingots, sheets or cathodes.

In the mining industry, the sale is normally recognized in application of IAS 18, when the risks and benefits of the seller are transferred to the buyer, the opportunity of how the transfer is to be made is established in advance in the sales contract.

SNMPE (2015) considers that a reasoned examination of the circumstances of the transaction is required to determine when the transfer of the significant risks and advantages to the buyer takes place, involving the property. In most cases, the transfer of the risks and benefits of the property will coincide with the transfer of the legal ownership or the transfer of the possession to the buyer of the concentrate.

The sales can take place in the country or abroad. In local sales the risk transfer usually occurs when the seller delivers the concentrate at the buyer's warehouses. In the case of sales abroad, the transfer of the risk takes place usually on the boarding date when the concentrate is located at the exit port and is ready to be delivered at the place of destination (pp. 163-184).

The sales of concentrate that are made to a local client- usually a trader- include all the deliveries that have been made in a period (month or other agreed period). At the end of the period all these deliveries accumulate in a single liquidation. The mining practice considers that at the time of the final settlement, only one recent sale is considered, however for accounting effects (and normally tax effects), the transfer of the risk happens to the extent that the batches are delivered and the income should be considered executed when these deliveries are made.

For the case of sales abroad, usually different shipments are accumulated in a warehouse near a port to complete the batch exported, in this case, the conditions of these deliveries should be analyzed - as in the previous case- in order to establish what time must be considered for the completion of the sale.

Some types of contracts used by mining companies have tax effects that are not necessarily stated for the purposes pursued by the contractors. Some of the contracts that can generate this type of conflict are the *Holding Certificated* and the *Warehouse Certificate*. As long as the legislation of the countries does not regulate this type of documents (or similar) in order to establish what their tax effects are, we must analyze in each case if the transfer of property occurs or not in the country.

Another type of practice that generates adjustments to the export value is the *Rollback deduction*. The controversy usually generated in these cases is focused on establishing if it is acceptable that mining companies that have referenced their operations to CIF value, deduce the freight and insurance when they claim that the operation is actually done at FOB value. This must be revised in order to avoid an undue deduction especially when we are facing transactions with related companies.

Mining companies establish the *concentrate value* by taking into reference the value of the metal content of

minerals found in the concentrate. With the weight data in metric tonnes of the batch of concentrate, the humidity percentage, the "mineral law", the penalizing elements (such as sulphur content), the costs of refining or "maquila" and its variation, and the international quotation of the metal.

The content of the mineral payable will only be established at the time of the refining of the concentrate, a situation that usually occurs a few months after the delivery of the concentrate, the normal practice of the activity is to make a provisional settlement with the best possible estimates. This first settlement justifies the issuance of an invoice and is usually charged 90% of the value of the mineral.

The period of quotation, an important fact to be established in the sale of the minerals, is normally fixed between the first and until the six months after the delivery of the concentrate. At the end of each month, the adjustment to be made is estimated by comparing the final settlement versus the provisional settlement.

When the *international quotation* is used, the price is of fine mineral in the international market. Some minerals that are commodities are bought and sold in what is known as basic products stock market. For Latin America, the London Metal Exchange (LME) is one of the stock market whose prices are mostly taken as a reference.

Subsequently, when all the variables involved in determining the final price are known, the definitive calculation of the concentrate is made and then we proceed to issue the final settlement, the difference between the two settlements is recorded as sale and the price value of the concentrate is adjusted

Given the volatility of prices, some companies, especially those that are linked to international groups- usually carry out hedging operations to minimize the prices risks, sometimes the main contract is acquired by the matrix and allocated proportionately to companies that benefit from the coverage.

Normally these contracts are made with foreign banks. According to accounting rules, hedging contracts are recorded at fair value in the financial statements, the effects of subsequent measurements are recognized in the profit and loss statement, or in assets as appropriate.



These rules are another point that should be assessed to establish the tax effects according to the laws of each country.

To control the adjustments on the quality and the elements contained in the mineral, a good practice is obtaining samples that can be used for checking the adjustments made to batches of exported minerals. This process can be managed by both the tax authority and/or customs and independent laboratories that report these results to the authority in charge of the control.

The signing of agreements of marketing and sales is a normal topic in the mining industry, if these are made with related companies, the possibilities of manipulating the prices and moving the profits from a tax jurisdiction to others is very high.

The control of transfer pricing, in relation to income-related transactions, is necessary in order to prevent the profits generated by the mining activity from being transferred to other jurisdictions without any business reasons or assumed risk to justify this situation.

On the other hand, some investment and/or financing agreements in the mining projects can add more complexity to the issue of determining the income of the project. Some of these contracts offer to attract investment by offering the investor a royalty on the deposit of minerals in payment of regular interests, or offer an investor an interest in the company if it is committed to buy a fixed amount of resources at fixed or variable price. There are also agreements by which investors commit to sell their ore share at the door of the mine to acquire it again later, after a process of concentration and/or refinement, among others.

#### 4.5 Risks associated with operational expenses

In the exploitation phase of a mining project, the production costs will be the most important; these include the costs of depreciation and amortization of long-term assets as we have mentioned before.

The costs at this stage will vary in attention to the type of mining that has been decided, whether underground

mining, open pit or mixed, they have different costs. On the other hand, the costs of removing the sterile or low-grade ore increase the operating costs. Understanding how the mine is exploited is a basic requirement to reach an adequate control.

The exploitation stage involves a series of processes -which can be considered as cost drivers- and on which there is an interest on the part of the administration to carry out a correct control; in all the stages mentioned above, documental reporting and custody obligations are important, but it is in the exploitation stage where the control of these documents becomes essential.

Ignorance by officials in charge of control may affect the Administration and the Administered, if they do not know how this process is executed, they may run an excess of audit procedures that increase the costs of compliance for the companies without benefit for the treasury.

Without prejudice to the need to know how mining is organized, there are some relevant issues that must be dealt with correctly, and on which the policies chosen by the companies could have significant impacts on the results of the exercise, one of these topics is corresponding to the *low-grade ores*.

Mining companies normally accumulate low-grade ore, which is not processed because their low concentration is not profitable when taking into account current prices, the same situation happens as the mining company decides to prioritize the processing of high-grade ores. Sometimes these low-grade minerals may not be processed for several years until quotations or mineral extraction technology improve or until there is no longer a high-grade ore available.

Deciding in this situation whether or not to recognize them as an asset is a sensitive subject, defined in accounting by the conceptual framework of the IFRS "assets" are the resources controlled by the entity as a result of a past event and of which it is expected to obtain economic benefits in the future. This being said, if the tax administration has evidence that a "mineralized waste" is liable to be processed to obtain mineral, it may require its recognition as an asset.

## 4.6 Risks associated with loans and interest expenses

Financing costs in a mining project include costs incurred in financing an entity's operations, and are conformed by interest and other costs generated and linked to the loans.

The International Accounting Standard N° 23- Borrowing Costs- prescribes the accounting treatment of the financing costs.<sup>10</sup> According to IAS, as long as they are directly attributable to the acquisition, construction or production of assets that fulfil the conditions for their denomination as "qualified assets"<sup>11</sup>, these must be part of the cost of such assets. The same standard stipulates that other borrowing costs must be recognized as expenses.

In view of the regulation of each country, these costs have a similar or different treatment for the tax effects; in any case, the auditor must be vigilant in order to establish that the treatment admitted by the legislation of the country has been followed.

The auditors must be attentive to these differences to avoid that the accounting option allow obtaining tax advantages not included within the norm. The main risks related to the financing costs lies in that they may not be a consequence of a real liability and/or that these exceed the market values and/or the recognition of a financing cost that reduces the taxable base of the income tax before it is pertinent.

It should be remembered that the accounting standard establishes conditions for the commencement of capitalization of financing costs as part of the cost of qualified assets. They also indicates that it should start when the expenditures are incurred for the asset, incurred in the financing costs, or when the activities necessary to prepare the asset for use or sale are initiated.

The capitalization must consider the period in which the physical construction of the asset was carried out, the technical and administrative work before the commencement of construction, including, if any, the

activities related to obtaining permits. Capitalization ends when all the necessary activities to prepare the qualified asset for its planned use or sale are completed.

Remember that the accounting standard states that if the construction is carried out in stages and each stage is suitable to be used while the next one will be built, the capitalization of the financing costs must cease with respect to that which begins to be used. The rules of IAS 23 will not always be harmonized with tax rules, so it is necessary to analyze how the accounting treatment and the corresponding tax adjustments have been carried out.

Special care must be taken with the debt instruments convertible in capital instruments, *hybrid instruments* to which the action 2 and 4 of the BEPS initiative *extensively refer*<sup>12</sup>. These mechanisms are widely used in this sector.

*Streaming financing contracts*<sup>13</sup> and in general how companies in the sector finance their investments must be fully reviewed in order to avoid abuse. Action 4 of BEPS Project describes some financing mechanisms that generate opportunities for tax planning, and there is a basic need for a re-evaluation of the legal framework applicable to financing and the clarity of the effects obtained with the different instruments involved.

Many countries have specific anti-avoidance rules linked to financing costs, so for example Peru limits borrowing with related parties, and some countries have considered that loan-related interests will not be deductible if they exceeds 3 times the taxpayer's net patrimony.

When countries have incorporated these rules of under-capitalization (or thin capitalization), they must ensure that the statements submitted by taxpayers are sufficiently complete to be able to control the rules. Also, remember that in the process of auditing, not only balances should be reviewed, but also the way the debt evolved in the financial year to sure that the rule is not spurned.

10 Financing costs are usually the interests and other costs incurred by a company in obtaining loans, such as interest in short-term and long-term loans, interest in bank overdrafts, financial burdens derived by contracts of financial leasing recognised in accordance with IAS 17, foreign-currency exchange-rate differences corresponding to interest adjustments.

11 "Qualified assets" are considered as those that necessarily require a substantial period before they are ready for use to which they are intended or for sale. The IAS exemplifies that manufacturing plants, hydroelectric, investment properties and specialized machinery, among others, can be qualified assets

12 BEPS is the acronym for Base Erosion and Profit Shifting, see: <https://www.oecd.org/ctp/10-preguntas-sobre-beps.pdf>

13 See: <https://www.imf.org/external/spanish/np/seminars/2015/andean/pdf/sesion3-tenaille.pdf>

In cases where a substantial acquired debt exist, the disbursements related to the debt are usually carried out progressively, however in spite of this, these disbursements can be of such magnitude that they are not absorbed immediately by the project, generating this the existence of major balances not used.

These “idle” amounts, while not required by the project, are usually profitable by temporarily placing the funds in financial instruments and/or consigning them to companies of the group. If it is the case, we have to be attentive to the existence of interest income that should be considered, as is the interest expense, for the determination of the income. If market interests have not been agreed for loans to related companies, the application of transfer pricing rules is compulsory.

To ensure the use of money in the project in the case of MNE that generate significant debts to manage their investments around the world, is an even more complicated challenge, because in this case the matrix will “attribute” the portion of interest and additional expenses to be supported by the local company.<sup>14</sup> Here, as in many cases of attributed expenditure, clear rules of accreditation and documentation of operations, as well as transfer-pricing studies are required for a correct control.

Other rules limit the cost of financing – in whole or in part – in the case of indebtedness with residents of countries or territories of low or zero taxation. In addition, for permanent establishments situated or established in countries or territories of low or zero taxation; those obtained from subjects who receive profits, revenue or income through a country or territory of low or zero taxation; etc.

In some cases, this standard is moderated by accepting that the costs will be deductible if the price or amount of

the consideration is the same as one that would be agreed by independent parties in comparable transactions.

Thus the use of financial hybrids, taking advantage of the corporate structure of the economic group, and its localization in different territories, can be used by companies that seek their investors to obtain yields without paying taxes, disguising the transactions associated with capital as if they were debt transactions.

The case may be even more serious financial services are simulated, such as coverages, and these coverages were not effectively received and/or the amount assignable to the local company exceeds what would correspond to it in a normal market situation.

In the Peruvian tax legislation, the income generated by derivative financial instruments can be considered yields from economic activities or profits and losses of assets. This treatment is done taking into account the purpose of the operation with derivatives.<sup>15</sup>

Thus, if the derivative instruments seek to cover a risk on an element affecting the business activity and therefore cover<sup>16</sup> elements of the assets or liabilities, the income obtained will have the consideration of yields from economic activities and therefore their effects (gains or losses) can be considered for the determination of the income tax<sup>17</sup>.

Likewise, in the mining practice, some types of contracts subscribed may be considered *Implicit Derivatives*<sup>18</sup>, such as the sale of ore whose final settlement is carried out in later periods.

It is common to use derivatives to hedge cash flows, interest rates, exchange rates, investments abroad, thus,

14 One of the advantages previously mentioned in the MNEs is, when operating in global markets, they have the ability to leverage significantly lower interest rates than could obtain a local entity. This advantage is not always “transferred” to the local company. There is a strong tendency to increase even these charges in order to withdraw a greater portion of profits of the project via the payment of interest. Let’s remind that in many cases the income tax rates that correspond to payments for financial expenses tend to be lower than regular rates, thus generating a strong incentive to generate “debt instruments” when it is appropriate to “use” capital instruments. In aggressive cases, companies in the financial system may agree to circumvent the rules indebtedness with related parties.

15 The problem is the operational treatment during the period from the beginning of the contract until before the expiration of the deadline; this problem exceeds the strictly fiscal scope.

16 It is generally accepted that a derivative coverage ends when it aims to reduce the effect of future fluctuations in prices or market rates, on the results of the major economic activities

17 With the only restriction of the necessary presence of causality of the position that is intended to be protected, with the generation of gains within the scope of the tax to be compensated.

18 An implicit derivative is understood as a component of a hybrid financial instrument that also includes a non-derivative main contract (host). This one generates that some of the cash flows of the combined instrument vary in a similar way to the derivative, considered independently causing any or all of the cash flows of a contract to be modified in accordance with an underlying or variable.

many contracts executed by mining companies can comply with the definition of a derivative instrument. On the other hand, some long-term sale contracts of commodities or long-term contracts to buy electricity or fuel-critical inputs from mining activity depending on their characteristics could be classified as derivative financial instruments and/or have characteristics of implicit derivatives that should be evaluated and recognized for accounting purposes.

To recognize the differences between accounting and taxation with respect to this subject becomes critical in order to be able to control adequately the tax effects of the transactions involved.

#### 4.7 Risks associated with the amortization of long-term capitalized assets

Depreciation or amortization<sup>19</sup> of: (1) capitalized costs<sup>20</sup> of the plant property and equipment elements associated with the project, 2) construction and development costs, 3) financing costs and 4) the amortization of intangibles are usually the main concepts that affect the results of the period in a mining company.

For purposes of depreciation of tangible assets, from the financial perspective, the cost of acquiring an asset should be included and other expenses necessary to be able to use the asset. It should also include the cost of dismantling and removing the equipment at the end of its useful life<sup>21</sup> and the restoration of the place where it was installed, this in line with the provisions of IAS 16.

The use of various depreciation methods is permitted; these include straight line, decreasing depreciation,

production units, among others. When an asset depreciation basis has been chosen for the life of the mine<sup>22</sup>, it is necessary to determine the proven and probable reserves<sup>23</sup>, the mine production plans and plant capacity<sup>24</sup> and the calculation of the mine's useful life<sup>25</sup>.

In the mining industry, it is admitted that the method of production units is the most appropriate for the activities of the industry, however it is common for the company to decide that a group of assets or all assets depreciate and/or are amortized, if applicable, following the straight-line method, which is simple and easy to apply.

In these cases, it is to be expected that if the machine or equipment is fully used during its useful life, it could generate significant differences compared with that of production units. Usually, the estimated useful life of the assets when using this method assumes that the production levels do not fluctuate considerably from one period to another.

In SNMPE (2015, pp. 107-116) some common practices of mining activity are collected.

- In the case of amortization of the capitalized development costs, it is carried out according to the useful life of the mine, in some cases, the development investments of certain (independent) sectors that have a useful life lower than the mine, are amortized depending on their own useful lives.
- The practice of the industry is to avoid including in the depreciation the cost of dismantling and removal at the end of the useful life of the asset,

19 The depreciation and amortization understood as the systematic allocation of the capitalized and depreciable amount of an asset throughout its respective useful life.

20 The capitalized amount subject to depreciation is defined in the IFRS as the cost of a tangible or intangible asset, minus its residual value in case this applies and is significant. The residual value is understood as the best estimate of the amount that the entity could obtain on the date of estimation by the disposition of the asset, after deducting the expenses that causes such provision, if the asset had reached the antiquity and the other conditions expected at the end of its useful life (IAS 16).

21 The useful life is considered as the period during which the entity will normally use the asset, or the number of production units or similar ones expected to be obtained from the entity (IAS 16).

22 This is very common in the case of permanent constructions or investments in development

23 The quantity – expressed in metric tonnes – of mineral, which has been measured and expected to be exploited in the future under economic conditions

24 I.e. the forecast of the annual amount of ore to be extracted from the mine from the proven and probable reserves, which will subsequently benefit the treatment plant. Remember that mine production programs are based on plant capacity (tonnes treated per day), so that all extracted ore is benefited.

25 The useful life of the mine is calculated by establishing the proven and probable reserves and the annual programs of mining and mineral benefit, with this data the mine's useful life mine can be established by dividing the ore amount included between tested and probable reserves in the annual production of the mine.

as well as the restoration costs of the place where it was installed since these are normally treated within the costs of mines closures.

- It is frequent that the useful life of some assets is fixed by the expectations of the useful life of the mine, instead of the economic life of the asset, this occurs especially at the end of the exploitation of the mines, when the useful life of the mine is lower than that of the asset.
- The general practice is that lands are not depreciated because the value tends to increase or because their life is unlimited, however this is not entirely true in the case of a mining company. While these could acquire a land to supplement their operations or with geological resources, in which case its value could depreciate depending on the life of the mine, even the price paid may exceed the commercial value of the land when the mine closure takes place, this in the event that something could be recovered.

A general practice of the sector is that estimates of the remaining useful life are frequently re-evaluated (at least once a year). Among others, the following situations are considered: (i) the discovery of additional reserves/resources that could extend the size of the mine and its useful life, ii) economic changes in the recovery of resources that imply significant changes in costs or recoveries, iii) significant changes in the mine plan including the decisions to pass from open pit to underground exploitation, iv) The technological development that involves anticipating the replacement of assets allocated to the mine or plant, etc.

Careful consideration should be given to the fact that most mining companies take into account proven and probable reserves when calculating the depreciation of mining assets, in this practice the inferred resources are excluded. This conservative position is acceptable, however in certain situations, if one has the expectation that in the future the indicated and measured mining

deposits can be classified as reserves, this would not be reasonable.

These industry practices, as already indicated, may have a different tax treatment, the risks therefore in the activity with respect to the correct control of these charges implies that the tax administration is aware of these differences and elaborate controls that enable them to address adequately the deviations.

In the mining industry, it is often necessary to build a series of assets that will be later transferred to the state or to populations surrounding the project. Many of these constructions, negotiated at the beginning of the project, may involve a series of initial disbursements and/or subsequent commitment to their maintenance. Assets that must be transferred to the state include water-conduction systems, reservoirs, bridges, roads, schools, or hospitals.

In some cases, these assets and/or acquired equipment may be purchased by a group of companies whose operation in the scope of influence of the project can lead them to associate, or share the assets. In such cases, clear rules of allocation and definition of assets are required, as well as their recovery via amortization or consideration as an expense, and what to do in cases of transfer, contributions, abandonment, among other operations that can generate different tax effects.

The legislation must be very clear in the treatment of these disbursements in order to avoid unnecessary conflicts with regard to their tax treatment. The considerations regarding income tax<sup>26</sup>, customs duties<sup>27</sup> and VAT, and the mechanisms of early recovery and/or refund in case of export, must be clear, otherwise the conflicts of interpretation will be exhausting, for the state as well as for the taxpayer.

#### 4.8 Risks associated with attributed expenditures

Large business groups tend to take advantage of their market position and the fact of working simultaneously

26 Depending on the definitions of the tax and sectoral legislation these disbursements could (among other options) be considered "donations", "expenses" or "other amortizable assets", each option has a special effect.

27 Many legislations permit the suspension of customs duties and/or exemption from payment in the case of special assets used in the area of influence of the project for its own purposes, the doubt surges about the later destination of the goods and/or eventually on their use in other places other than the area initially determined.

in multiple jurisdictions to displace the incomes to non-resident group entities that are taxed in privileged regimes<sup>28</sup>.

This can be done within the same jurisdiction when, for reasons of tax policy, there are areas and/or activities with privileged tax treatment.

The presence of recurrent losses in a company related to a business group and the fact that the parent or the related companies operating with the domiciled company obtain profits, allows the tax administration to suspect that the losses reported in the jurisdiction are the result of an incorrect *transfer pricing policy*. Unless companies can satisfactorily<sup>29</sup> justify such losses, for a reasonable period, are due to penetration into a new market or the need to expand the market share of a product.

The problem of taxation on the income of local business groups can be reduced by consolidating the income taxation, but even if this option is feasible and compulsory, there will always be doubts about the operations conducted with non-domiciled companies and if transfer pricing regulations are applied properly.<sup>30</sup>

It must be understood that the problem cannot be solved entirely by conducting audits. The transfer pricing audits are usually intensive in the use of highly specialized audit resources, time-consuming regarding their conclusion, and extremely conflictive since the company often questions in all instances the results that are imputed.

It is in the attention of the above-mentioned reasons that *lawmakers* in most countries, intending to avoid further complications, restrict the compensation of losses from transactions with related companies.

Given the volume of the assets attached to the mining projects, it is normal for the project owners to administer the risks associated with them by partly transferring them to insurance companies. When the project is conducted by a multinational company (MNE), the insurance policies are taken at the central level and their expenses are redistributed among all the beneficiary companies according to criteria that are not necessarily clarified.

Although in principle it is accepted that these expenses are assumed, the lack of clarity of the assets and/or risks covered by the policy when it is acquired by the multinational group and then redistributed to its member units is a permanent concern.

The administrations must be oriented to analyze the position by applying the filters of effective implementation of the expenditure, the causality of the disbursement with the protection of risks, the rationality of the amount allocated to the unit and the market value.

An additional issue to consider is that in some cases insurance policies may be covering risks linked to labor issues that could be considered as higher remuneration and/or acts of liberality within the framework of specific legislation. Here again, the application of the Accounting Standards<sup>31</sup> can be helpful to identify how these disbursements should be treated.

#### 4.9 Impairment of capitalized long-term assets

The mining industry uses long-term assets whose importance is high within the company's assets. The loss of value of these assets is usually evident when the recoverable value of an asset or a cash-generating unit is compared to its book value and it is observed that the recoverable value is lower.

28 As a reminder, the most common mechanisms to achieve the foregoing are often associated to, among others: exchange of securities to circumvent restrictions of the exemption method, those relating to losses. Contribution between entities of the group to generate losses by reference to a market value controlled by the group itself, creation of a goodwill in non-resident entities relating to resident entities to determine provisionable losses arising from the amortization of such goodwill. Intra-group transmissions to raise the value of shares, which can subsequently generate loss of value by currency depreciation or stock exchange. Participatory structures to take advantage of the exemption on profits and loss calculation. Creation of losses in subsidiaries constituted abroad, through amortizations of goodwill that will be provisioned.

29 It is obvious that related companies, as well as independents, can have genuine losses. However, an independent company would not be prepared to tolerate losses indefinitely

30 Even if there is the possibility of determining consolidated results, and that the country as a result of information exchange agreements between tax administrations or as part of the commitments made by the countries in double agreements Imposition can access the confirmation of other tax administrations there will always be a high risk of admitting non-real losses.

31 IAS 19 and IFRS 2

Assets that may deteriorate<sup>32</sup> include: *installations, plants, machinery, equipment; real estate investments with recognizable cost; biological assets; land; goodwill; Intangible assets*; among others.

There are several reasons for the deterioration of an asset, so the assets can suffer physical damage that will prevent them from operating at their normal capacity<sup>33</sup>. Another reason is the fact that the market in which the entity develops can fall significantly, so that the asset loses total or part of its value in the active market where it was marketed.

Accounting procedures admit that in the mining industry there are facts and circumstances that are indicative of the need to verify the deterioration of the value of assets for exploration and evaluation – for example it is the case when the right to explore expires (or will expire) in an area and the right is not expected to be renewed. A deterioration must be recognized in this case.

Deterioration should also be recognized in cases where the exploration and evaluation of mineral resources in a specific area does not reveal mineral resources that are useful to extract. Nor in cases where it has been decided to interrupt the exploration and evaluation activities in the area or in cases where the amount in the books of the asset recognized in an area because of the activation of exploration and evaluation can be fully recovered through the successful development or through its sale.

The execution of this type of assessment implies that if signs of deterioration are determined, the entity must make a provision for deterioration of value; these provisions are normally not accepted by the income tax regulations, since as provisions they are estimates

of expenses that may vary and do not necessarily materialize, and yet can be used.

#### 4.10 Risks associated with the assessment and measurement of inventories

The exploitation in the mine seeks to obtain the mineral in the form appropriate to be sold, the finished products in a mining are the ultimate purpose of the activity, and however these are not the only inventory assets that a mining company manage.

If we remember the provisions of IAS 2 inventories, these are considered to be "... assets possessed to be sold in the normal course of operation;" in production process with a view to that sale; or in the form of materials or supplies, to be consumed in the production process, or in the provision of services. Thus defined, within the framework of the mining activity we can recognize four types of inventories: *raw material, supplies and packaging*<sup>34</sup>, *merchandise*<sup>35</sup>, *products in process*<sup>36</sup> and *finished products*<sup>37</sup>.

Mining companies generate stocks of mining products not only for their own production, in some cases, companies acquire inventories to sell them in the near future and generate profits from fluctuations in price or in a marketing margin.

The companies also acquire mining products to mix with their own production and generate an improvement in the quality of their product. Also, when they have an idle capacity installed in their plants of concentration and refining, as consequence of temporary decreases in production, or because they built their plants from the outset considering their production and the eventual transformation of the production of mining farms

32 It is recommended to review the accounting standard 36 – Impairment of assets. We recommend also revising IFRS 6 “mineral Resource Exploration and evaluation”, which provides specific guidelines for evaluating deterioration to be followed in the evaluation process for both assets in the stage of exploration and assets transferred from exploration to the development phase.

33 The damage can also result from errors in the installation of the equipment that prevent their adequate operation.

34 It includes all those tangible elements that are used during the process of making a product, for the purposes of mining the fuel, explosives, chemical reagents, grinding balls, spare parts, etc., would qualify within this section.

35 In the case of the mining activity, the goods bought to another entity and that are available to commercialize are represented here, this item is not usual in mining companies. However, in some mining operations, products are acquired to be provided to the mining contractors via sale or to be placed to the workers by means of a mercantile, and in these cases if it is correct to consider that we are in front of a merchandise.

36 For a mining operation, this item includes the goods in production process, i.e. mineral crushing, mineral in leaching fields, mineral concentrate (in case of refineries), cathodes in cells, etc.

37 In the case of mining companies, these would be ore concentrate, copper cathodes, gold or silver ingots, etc.

around the plant to improve their production costs by the economy of scale of the plant.

Mining companies usually apply IAS 2, and therefore carry their inventories at the cost or net realizable value. When the inventories that they maintain are measured by their net realizable value (NRV) The companies make adjustments that reduce the book value the assets (charged to income) precipitating – from the fiscal perspective- losses before they actually occur, if they finally occur, so this accounting policy could have tax consequences.

In accordance with the aforementioned accounting standards the cost of inventories shall comprise all costs arising from their acquisition and processing, as well as other costs incurred to give them their status and location.

Thus, the cost of acquiring inventories must include the purchase price, import tariffs and other taxes which are not subsequently recoverable from the tax authorities and the costs of transport, storage and other costs directly attributable to the purchase of goods, materials or services to be used in the production process. The above amount must be reduced from commercial discounts, promotional sales and other similar items for which the company acquires the right to apply.

In addition, the costs of transforming inventories will include those costs directly related to the produced units, such as the consumption of raw materials and production supplies, as well as the cost of direct labor. They will also include systematic allocation of indirect, variable or fixed costs<sup>38</sup>, incurred to transform raw materials into finished products (IAS 2).

Whenever the recovery of the mineral contained in low-grade ore materials during the mining process is decided (leachable material), it is correct that this material stored in leaching dumps will be considered

as an asset and therefore activated. This adds to the value of this asset the cost of loading and crushing the material that has been deposited in the fields, in this case the amortization of this asset should be made based on the period of depletion of the leaching dumps.

There are some concepts that IAS 2 requires excluding from the cost of inventories and be recognized as current expenses. For example: abnormal amounts of waste materials, labor or other production costs, the costs of storage unless necessary in the production process prior to a further elaboration process, indirect costs of administration that have not contributed to inventories in their current condition and location, exploration costs, recoverable taxes, expenses related to the environment, sales costs, etc.

Not all concepts previously referred to have a symmetrical treatment in the legislation of the income tax. Therefore here again we recommend to have a thorough knowledge of the policies and accounting practices of the mining entity in review and the understanding of how these practices differ from the tax provisions regulating this type of assets to avoid undue use of deductions.

#### 4.11 Agreements to share risks and costs: joint ventures

In most countries, businesses can be carried out by commercial companies as well as through trusts and contract of partnership in participation. These legal figures are types of contracts that are not normally regarded as mercantile societies and<sup>39</sup> are known in the tax doctrine as *transparent entities*<sup>40</sup>.

Some countries treat companies, trusts and other legal entities or contracts as transparent, taxing their associates or beneficiaries according to their holding of shares or shareholdings in the entity on their income, without taxing the entity in itself, while other countries

38 The accounting practice recognizes that fixed indirect costs that remain relatively constant, irrespective of production volume, whereas variable indirect costs vary directly or almost directly with the volume produced, such as materials and indirect labor

39 Legal or moral entities, according to the terminology that a country can adopt.

40 An issue with transparent entities is that their treatment tend to be different in each country, which in some cases leads to double taxation or that in some cases some monetary flows are not subject to levy.



consider them as taxable entities, taxing societies or entities as different taxpayers.

The diversity of treatments that can be granted forces the *lawmaker* to establish appropriate rules for each situation in particular, whatever the country's options regarding to the treatments and restrictions that have been developed previously.

This type of commercial agreements or strategic alliances of temporary character, are frequent in the mining activity, they are characterized by allowing the participating parties to make a joint investment without losing their independence and without that this necessarily gives rise to the creation of a new entity (company, society or other entity).

In these contracts, the associated parties share the risks and costs of the economic activity to be developed, the parties of the joint venture take control of their investment and obtain the part of the income that is generated as a product of the economic activities of the contract according to the terms agreed.

It should be understood that although each partner or venture retains its legal personality and independence, it does not imply that they cease to be responsible for the business as a whole.

Another issue to consider is that the responsibility does not necessarily lie on a proportional basis between the participants. It is possible that one of them assumes greater responsibilities within the business, without implying greater participation in the results necessarily, however we should ask if in this case the remuneration obtained by each venturer correlate with the assets contributed and/or or the risks supported, among other factors that normally independent parties evaluate at the time of negotiate. In addition, the *contract term* can be determined or undetermined.

The tax effects of the transactions made by the participants of these contracts and the one carried out between them<sup>41</sup> must be analyzed within the framework of the law in force in the different countries to establish correctly their tax effects.<sup>42</sup>

#### 4.12 Treatment of compulsory procurement agreements with suppliers and service providers

Given the location of the mining project, the compliance standards required from suppliers and the need for uninterrupted services, mining companies tend to hire third parties with a "mandatory buy and pay" clause. Under this clause, the project is compelled to pay a provider for the services received, whether or not the service is provided and the income that corresponds to these services is received, in cases of fortuitous event or force majeure attributable to the mining project.

These contracts also include important punitive clauses to the supplier if the provision of services is breached; this way the relationship between supplier and client becomes somehow symmetrical, allowing the flow of production of the mining project to be kept uninterrupted except for cases-as already mentioned-of fortuitous events or "acts of God".

These services can also be provided by related companies, in which case, the risk of the transaction between related companies is resurfacing. Even in the case of independent companies, the treatments that could be given to these events could be discussed. For example in some legislations with a very strict definition of causal expenses, the amounts paid that are not related to the benefit of services and which can be considered penalties could be rejected, on the other hand for either party, these income could be considered unaffected by the tax, since they are not ordinary incomes.

41 Unless otherwise agreed, the contributions in goods do not carry transfer of ownership but their usufruct.

42 For example, in Peru, the General Law of Companies has not regulated the business model joint venture or shared business, having regulated other associative models such as the contract of association in participation and the contract of consortium. Without prejudice to this, in the Unique Ordered Text of the income tax law, some specific rules for the joint venture have been considered.

To reduce the conflicts of interpretation and make predictable to both parties (administration and administered) the appropriate tax treatment, it is essential to provide clear delimitations on the treatment that should be given to these operations.

## 5. CONCLUSIONS

The management of the compliance risks is a process to identify, analyze, prioritize and mitigate the taxpayers' compliance risks; and it should be used in a structured manner by the tax administrations.

The adoption of risk management practices in the segment of medium and large mining is critical for many tax administrations in Latin America and the Caribbean.

This document has presented a sample of the critical issues in the mining industry; although not exhaustive, it allows characterizing the activity and point out elements of attention to those responsible for the control at both the central and operational levels of the administrations.

The importance the existence of a robust legal framework for the mitigation process should not be forgotten, as well as the promotion of standards that

in many instances eliminate and/or control a risk. The administrations therefore should devote a time to analyze and review the functioning of the tax system in order to improve it, and this document has shown points where clear definitions would reduce the conflict between the administration and the taxpayer.

From the previous summary, the key areas of control include precise definitions of the definition of the project, both its income and its expenses, and rules for defining the expenses eligible to be deducted. In addition, it requires definitions on the treatment of expenditure for each phase and rules of apportionment or allocation, to which must be added the amortization rules of the expenses incurred and/or capitalized corresponding to a previous stage.

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