



Polish tax policy - its impact on the mineral sector



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ARTICLE INFO

Keywords:

Tax policy
Taxation
Mineral industry
Raw materials
Economic development

ABSTRACT

Nowadays, an increase in the overall tax burden on mining companies is being observed as a global trend. The governments of many countries view mining companies as quite profitable, therefore they would like to participate in the revenue arising from the exploitation of natural resources by, for example, taxing the activity. Currently the share of taxes and charges in the cost structure of the mining sector in Poland is at relatively high level, amounting to 7% of total production costs. The main factors affecting this situation are obligatory fees, such as (a) geological and mining taxes and fees, (b) taxes and fees for environmental use, (c) taxes and fees associated with employees and business, and (d) a new tax on the extraction of certain types of mineral which has been levied in Poland since 2012. The overall level of tax, including new taxes and royalties, has a positive impact on public and local finances, however higher taxation levels are likely to reduce mining companies' incentives to invest. It has to be underlined that the anticipation of taxation during the various stages of a project is a crucial factor for investors. If an investor thinks that the tax system will be unfavourable to him during the production period, there is a risk that he will not make his investment (hold-up risk). However, if the tax system is changed after investments are made, the investor no longer has any choice (Laporte & Quatrebarbes 2015). And the latter was the case in Poland for KGHM Polska Miedź SA which has been mining in Poland for over 50 years and has sufficient resources for a further 30 years and more. Therefore tax has a significant impact, both on ongoing operations and on the development of new mineral resources in Poland. It has created additional challenges as the new tax on the extraction of certain types of mineral has a non-linear character, it is several times higher than other taxes, and is only levied on copper and silver. By diminishing the profits limit it can not only decrease exploration activity, but also cause some new investment in Poland to be cancelled. The aim of this paper is to analyse the effects of taxation on resource valuation in Polish copper existing mines, and to assess the implications both from an investor's and the Government's point of view from the medium to long-term perspective.

1. Introduction

Between 1985 and 2005 more than one hundred countries introduced new regulations in the form of mining laws. Most of these are focused on reforms of fiscal systems, including taxation (Mitchell, 2009). As mineral wealth plays a substantial role in many national economies, resource taxation has increased in importance in recent decades (Smith, 2013). Taxes in many countries increased following the financial crisis and global recession in 2008. Analysis of the impact of royalty-type taxes on the situation in the companies concerned is basically limited to the financial sphere. According to the global mining industry report on "Corporate income taxes, mining royalties and other mining taxes" a number of governments are considering raising tax revenue from the mining industry. These new tax laws or tax proposals

being considered may have an impact on current and future mining investments (www.pwc.com). Moreover, transparency and data availability on the amount of taxes paid is becoming more widespread (www.kpmg.com) due to the development of Corporate Social Responsibility (CSR) and other initiatives.

Presently, there are many consulting firms evaluating and comparing the amount of taxes and other financial burdens, including mining fees, in different countries and estimating their impact on the competitiveness and profitability of mining. Detailed information is available in many publications and specialised reports prepared by these companies (Global Mining Taxation, 2000). However, the relationship between mining taxes and the level of mining reserves for ongoing operations is not the subject of much research, a fact which becomes evident on an examination of national and foreign literature.

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In their article P. van der Zwan and P. Nel studied the effects of implementing a tax on the mineral and oil extraction industries in the Republic of South Africa. They focused mainly on the impact of additional burdens on corporate profits. Diminishing profits limit a company's ability to conduct exploration work (Van der Zwan and Nel, 2010). A similar analysis in the context of tax in the Republic of South Africa was carried out by F.T. Cawood, who focused on the additional budget revenues, which may be even greater than would appear to be the case judging by the rules of equitable distribution (Cawood, 2011). It should also be noted that there are specific taxes and duties levied on mining in almost every country.

When it comes to Polish sources, one can come across a statement that the new tax on certain types of mineral, is a factor negatively reflecting on the financial situation of the companies to which it applies. In Poland there is only one such company, the copper producing KGHM which had to optimise the mining system to the new fiscal regime and assess the profitability of new investment in Poland (Kulczycka et al., 2015). The subject of the present article is the issue of taxes, including non-linear ones, in the Polish mining industry. The impact of tax law on the availability of the resource base and rational economic management of the deposit was described and analysed from the medium to long-term perspective taking into account realistic mining production from domestic resources or from imports..

2. The role of the raw material sector in social and economic development

The utilisation of and access to natural resources is a foundation of social and economic development (Helbig et al., 2016). The utilisation of raw materials is an indicator of the status of development in historical times - that is why eras are named after them: stone, iron, bronze. The same can be said about the contemporary economy, where the development of each country is associated with a growing demand for natural resources (Isham et al., 2005). Increasing levels of demand for coal, iron, copper, aluminium and oil are particularly visible during the dynamic growth of economies which are considered rising or developing (ICSG World Copper Factbook, 2014). Over the past few years, there has been a boom in demand for raw materials, which has resulted in a sharp rise in their prices. The key determinant in this was the development of China and the countries of South and East Asia, where the need for infrastructure development and growth of industrial production destined for export and internal markets has resulted in a significant increase in the demand for raw materials. The increase in demand for raw materials in recent centuries and decades is also associated with an increase in world population and the progressive advance of manufactured products. Along with the development of technology, there is an increasing demand for raw materials which are useful in IT and the electronic and telecommunication industries. Silver and copper are the best conductors of electricity, reaching a conductivity respectively 47.8% and 40.5%, higher than gold (www.mains-cables-r-us.co.uk). Due to economic and market reasons, that is a comparison of the price of raw materials per unit weight, copper is currently the most popular electrical conductor.

Responding to a growing demand for raw materials, including copper, the volumes extracted have increased and the development of the mining trade has accelerated and needed to adapt to the new market conditions. The mining industry needed to adapt technologically to new challenges, which meant developing methods to use increasingly deep deposits, improving the reliability, scope and scale of operations of mining equipment, whilst at the same time ensuring the safety of its employees. High demand and the resulting high prices of raw materials meant that the sector developed to such an extent that it became a foundation of the economies of individual countries and one of the most important sectors, employing millions of people worldwide (Wirth et al., 2016). Moreover, the mining industry not

only creates direct jobs (Söderholm and Svahn, 2015), but also generates employment by stimulating demand for goods and services (Mutti et al., 2012). Mines often spend hundreds of millions of dollars on equipment, maintenance traffic, transport, mining services, and engineering and other services, which benefit both global and local suppliers. The risk related to working in the mining industry generally translates into higher wages compared to the average salary in the country, which in turn results in a higher purchasing power of people employed in the sector. Individual mining projects can even determine the strength of a country's economy. It is estimated that the Oyu Tolgoi project, after the process of increasing capacity and achieving the target scale of production, may account for up to 33% of the gross domestic product of Mongolia (www.valuewalk.com). Moreover, the income from mining taxes is often an important source of revenue for mining countries which presumably want to use their mineral wealth to promote the welfare of their citizens. Research on the optimal level of tax has shown that increases in the tax rate will cause companies to cut their exploration for new deposits, stop developing new mines, and eventually, if the tax rate is pushed high enough, to close their existing mines (Tilton, 2004).

3. The security of raw materials

A couple of decades ago, the mining industry in Europe was still regarded as an end-stage industry by many politicians. It had been considered that when it comes to the global economy (Jenkins and Yakovleva, 2006), access to raw materials at affordable prices will be unlimited. However, the accumulation of many raw materials by a single company or country has resulted in the fact that some raw materials, including those necessary for the production of modern technological (high-tech) devices, are obtainable only from single suppliers (quasi-monopoly), mainly from Asian countries (China). Therefore in recent years the security of raw materials has become one of the basic problems of the developed countries, especially those in Europe. There is thus a need to initiate an active search for new deposits (including fiscal policy on minerals) as well as to promote the recovery and recycling of raw materials from waste (i.e. urban mining).

For more than 30 years, there has been no development of integrated strategies for the identification of the raw materials base and no long-term development of the extraction and use of resources in the economy of non-renewable raw materials in Poland, and the recognition and documentation of deposits was only carried out for the current needs of the mining industry. The possibility of looking for and exploiting mineral deposits is made extremely difficult by competing land uses and a highly regulated environmental protection regime, as well as by technological factors limiting access to deposits. The easily available deposits have already been well researched and exploited. There is a need to explore and develop deposits lying deep underground and to search for non-conflicting methods of exploitation, as well as finding proper uses for the potential raw materials in the mineral waste resource, which requires the implementation of proper regulations and the proposing of solutions to the many issues that stimulate the development of this activity (anthropogenic deposits), as well as greater use of recycling (Uberman, 2009). One of the important factors in stimulating long-term investment in the mining industry is the stability of the legislation including those laws governing the system of taxes and fees. The introduction of the tax on certain types of mineral in mid-2012 and the adopting of the law on the special hydrocarbons tax in mid-2014 (the payment of which will start in 2020) reintroduced extensive discussion on the burden on and subsidies for the domestic mining industry (www.bip.kprm.gov.pl) including its international dimension (www.senat.gov.pl) relating to countries with significant mineral resources. A comparison of the actual level of taxation of mining activities in different countries should include a number of elements, such as the method of calculating the base income tax relief, rebates, the amount of

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