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POLICY ADVICE DIVISION

Tax policy report: Specified Mineral Mining Review

Date:	1 March 2013	**Priority:**	Medium
Security Level:		**Report No:**	T2013/450 PAD2013/22

Action sought

	Action Sought	**Deadline**
Minister of Finance	**Agree** to recommendations	6 March 2013
Minister of Revenue	**Agree** to recommendations	6 March 2013

Contact for telephone discussion (if required)

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1 March 2013

Minister of Finance
Minister of Revenue

Specified Mineral Mining Review

Executive summary

In Budget 2012, the Government announced its intention to review the tax treatment of specified mineral mining as part of its on-going commitment to ensuring fairness across the tax system. There are 50 specified minerals, of which gold, silver and iron sands are the most commonly mined.

Ministers and Cabinet agreed to the release of officials' issues paper, *Taxation of specified mineral mining,* in October 2012 (T2012/2284 / PAD2012/224 and EGI Min (12) 24/1 refers). The issues paper suggested repealing the current concessionary specified mineral mining rules and replacing it with rules that are more aligned with general tax principles.

A total of 39 submissions were received on the issue paper, of which 26 were in a standard form prepared by Minerals West Coast. The majority of submitters understood that the current specified mining rules are concessionary, however, thought that the concessionary rules were necessary to attract off-shore investment into the industry and maintain a viable mining community. Submitters also thought that some aspects of the proposals could add compliance costs onto the industry.

Following consideration of submissions, and discussion with many submitters and their advisors, officials have modified some of the proposals contained in the issues paper to deal with concerns raised. The rules suggested in this report are still designed to bring the tax treatment of mineral mining into alignment with more general tax rules. However, we suggest changes to the original proposals where we consider either they could have resulted in undue compliance costs or where issues specific to mineral mining may have resulted in the general rules providing inappropriate outcomes.

The recommendations for the specified mineral mining tax rules are:

1. "Prospecting expenditure" and "exploration expenditure" should be immediately deductible, subject to the claw-back rule discussed in point 3, below.

2. "Development expenditure" should be capitalised and deducted over the life of the mine.

3. "Exploration expenditure" on items later used for the extraction of minerals should be added back as income in the year the mine becomes operational and deducted over the life of the mine as if it were development expenditure.

4. The "life of the mine" should be self-assessed by taxpayers based on their expected activities in a particular permit area, but should not be less than the expected life of the mine used for accounting purposes. A mine would have a maximum life for tax purposes of 25 years.

5. "Mining expenditure" should be subject to the ordinary capital/revenue distinction that applies to other businesses.

6. "Rehabilitation expenditure" should be deductible in the year it is spent, but a refundable credit should be generated if a loss is incurred in that year to provide for the fact that the expenditure may be after income-earning activity has ceased.

7. Land should be treated as revenue account property of a mining company, meaning income or a deduction is accounted for in the year of disposal. As with rehabilitation expenditure, if a loss is incurred in the year of a land sale, a refundable credit should be generated (again, this is to recognise the fact that selling the land might be the final act of a mining operation and no income may be available to offset any loss).

8. The existing loss rules for mining companies should remain. That is they should continue to be able to carry losses forward through a continuity breach, but only be able to offset those losses against income from the same permit area. To prevent this loss continuity rule being manipulated, mineral mining companies should still only be allowed to form tax groups with other mining companies. This is consistent with the current mineral mining rules, but differs from the rules that apply more generally.

9. The rules that allow mineral miners to appropriate income for future expenditure should be repealed. To account for the fact that the repeal of this rule may result in unexpected tax liabilities for miners, it is recommended that they be allowed to spread any income tax liability over the two years following effective date.

10. When a "farm-out" of mining rights takes place, the consideration received should be treated as income in the year the rights pass and the consideration paid should be deducted over the expected life of the mine (or be immediately deductible if the mine is still in the prospecting or explorations phases).

11. The normal tax rules should apply in respect of insurance receipts and bad debt/bad debt recovery.

The proposals that differ from those set out in the issues paper are numbers 4, 6, 7, 8 and 9.

The amendments from the proposals set out in the issues paper are not expected to significantly affect the revenue positive nature of the overall reform, with an estimated gain of approximately $30 million per year. However, this estimate is heavily dependent on future gold prices and levels of production. Officials understand that this $30 million per year is to be used as a savings item in Budget 2013.

We recommend that these proposals be included in the next omnibus taxation bill, currently scheduled for introduction in April 2013, with an effective date of the 2014/15 income year.

In order to meet the timetable for inclusion in the April bill (and Budget 2013 timetables more generally), the matter will need to be considered by the Cabinet Economic, Growth and Infrastructure Committee on 20 March 2013. Given the planned absences of the Minister of Revenue, we also recommend that the final Cabinet Paper and Regulatory Impact Statement be signed by the Minister of Finance (on behalf of both Ministers) in the week commencing 11 March.

On the assumption that the recommendations in this report are agreed to and the policy approved by EGI, we also recommend that officials be given permission to discuss the details of the proposed rules with key industry representatives immediately prior to the introduction of the April bill. It is anticipated this will assist in constructive debate at the time the rules are publically announced.

Recommended action

We recommend that you:

1. **Agree** that revised tax rules for specified mineral mining be introduced that have the following features:

(a) "Prospecting expenditure" is immediately deductible.

Agreed/Not agreed   Agreed/Not Agreed

(b) "Exploration expenditure" is immediately deductible, subject to the claw-back rule recommended in (d), below.

Agreed/Not agreed   Agreed/Not Agreed

(c) "Development expenditure" is capitalised and deducted over the life of the mine.

Agreed/Not agreed   Agreed/Not Agreed

(d) “Exploration expenditure” on items later used for the extraction of minerals is added back as income in the year the mine becomes operation and deducted over the life of the mine.

Agreed/Not agreed Agreed/Not Agreed

(e) The “life of the mine” is self-assessed by taxpayers, based on their expected activities in a particular permit area, but this “life” cannot be less than the expected life of the mine used for accounting purposes, subject to a 25 year cap.

Agreed/Not agreed Agreed/Not Agreed

(f) “Mining expenditure” which is expenditure independent of the mine is subject to the ordinary capital/revenue rules.

Agreed/Not agreed Agreed/Not Agreed

(g) “Rehabilitation expenditure” is deductible in the year it is spent, but a refundable credit is generated if a loss is incurred in that year.

Agreed/Not agreed Agreed/Not Agreed

(h) Land will be treated as revenue account property of a mining company, but a refundable credit is generated if a loss is incurred in the year that the land is disposed of.

Agreed/Not agreed Agreed/Not Agreed

(i) That the existing loss rules for mining companies remain so that losses can be grouped against other mining income and can survive a continuity breach but only be offset against income from the same permit area.

Agreed/Not agreed Agreed/Not Agreed

(j) The rules that allow mineral miners to appropriate income for future expenditure are repealed, with any resulting tax liability able to be spread over the two years following effective date.

Agreed/Not agreed Agreed/Not Agreed

(k) When a “farm-out” of mining rights takes place, the consideration received is treated as income in the year the rights pass and the consideration paid deducted over the expected life of the mine (or be immediately deductible if the mine is still in the prospecting or explorations phases).

Agreed/Not agreed Agreed/Not Agreed

(l) The normal tax rules will apply in respect of insurance receipts and bad debt/bad debt recovery.

Agreed/Not agreed Agreed/Not Agreed

2. **Agree** that the revised rules should take effect from the start of the 2014/15 income year.

Agreed/Not agreed Agreed/Not Agreed

3. **Note** that officials estimate that the proposed rules will be revenue-positive by around $30 million per year.

Noted Noted

4. **Agree** that the positive revenue impact of an estimated $30 million per annum should be used as a savings item in Budget 2013.

Agreed/Not agreed Agreed/Not Agreed

5. **Agree** that the proposed rules be included in the first omnibus tax bill of 2013, currently scheduled for introduction in April.

Agreed/Not agreed Agreed/Not Agreed

6. **Agree** that the Cabinet Paper and Regulatory Impact Statement outlining the proposed rules be signed by the Minister of Finance (on behalf of both Ministers) for consideration by EGI on 20 March.

Agreed/Not agreed Agreed/Not Agreed

7. **Agree** that if the recommendations in this report are agreed to and the policy approved by EGI, officials can discuss the details of the proposed rules with key industry representatives immediately prior to the introduction of the April bill.

Agreed/Not agreed Agreed/Not Agreed

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Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Revenue

Background

1. The Income Tax Act 2007 differentiates between specified minerals (including gold, silver and iron sands) and other minerals (including oil, gas and coal). The current tax rules that apply to a specified mineral miner allow an immediate tax deduction for:

- prospecting, exploration and development expenditure, including expenditure on capital items such as plant, machinery and production facilities, and
- an amount set aside (appropriated) for mining exploration or mining development, if it will be applied for these purposes within the next two years. The amount that can be appropriated is limited to the company's net income for the year.

2. These immediate deductions for capital expenditure and expenditure yet to be incurred make the tax rules for specified mining very concessionary compared to most sectors, including petroleum mining, which also have concessionary rules. Under general tax principles, deductions for such expenditure should be deferred and allowed over the economic life of the asset that is being created (i.e. a productive mine).

3. The objective of the current review is to create a more neutral tax treatment for specified mineral miners by aligning it with more orthodox tax approaches. Consequently, the suggested rules would make the tax treatment of specified minerals broadly consistent with the rules that apply to other business activities. From a tax perspective, this would make domestic investment decisions more efficient.

Issues Paper

4. In Budget 2012, the Government announced its intention to review the tax treatment of specified mineral mining as part of its on-going commitment to ensuring fairness across the tax system. Ministers and Cabinet agreed to the release of officials' issues paper, *Taxation of specified mineral mining,* in October 2012 (T2012/2284 / PAD2012/224 and EGI Min (12) 24/1 refers).

5. The issues paper was released for public consultation on 31 October 2012. It contained the following key suggested changes:

- Prospecting expenditure: The majority of prospecting expenditure would remain deductible in the year that it is incurred. The only exclusion would be land acquired for mining.
- Exploration expenditure: Most exploration expenditure would also remain deductible in the year that it is incurred (with the exception of land acquired for mining). However, on the establishment of an operational mine, exploration expenditure on items used for the

extraction of minerals would be clawed back and would be deductible over the life of the mine.

- Development expenditure: Development expenditure would be deferred (capitalised) and allowed as a deduction over the life of the mine, commencing in the first year of commercial production.
- Mining expenditure: Other expenditure incurred in the mining phase would be treated according to normal tax principles.
- "Life of the mine": This concept should be based on the estimated reserves of minerals in the permit area at the beginning of the year. The amount of deductions should be aligned with the amount of mineral extracted during the year as a percentage of the total estimated reserves (known as a unit of production basis).
- Rehabilitation expenditure: A deduction should be allowed for payments made to Inland Revenue for expected rehabilitation expenditure. These payments will be held on account for the mining company and can be withdrawn when these liabilities fall due. This is consistent with the current environmental restoration account rules.
- Land: Land acquired directly for prospecting, exploration or mining development would be treated as "revenue account property". This means that the sale proceeds would be taxable, and the cost of acquiring and disposing of the land would be deductible in the year of sale.
- Continuity and grouping: The normal rules for continuity and grouping should apply, meaning that mining companies should be allowed to join groups with other commonly owned companies, but losses would not be able to be carried through a change in shareholding. However existing losses would continue to be quarantined to the mining permit area.

Submissions

6. A total of 39 submissions were received from a mix of accounting firms representing clients, mining firms, and mining industry representatives. Twenty-six of the submissions received were standard form submissions from West Coast alluvial gold miners, with the assistance of Minerals West Coast.

7. The points raised in the submissions were relatively consistent across all of the submissions. The following summarises the main points made:

i. Although submitters generally accepted that the current specified mining rules are concessionary, they thought that these concessions were necessary to attract off-shore investment into the industry. Submissions were that mining investment decisions are made on a global level, not domestically. If mining concessions are removed, mining investors will be more likely to look offshore to more favourable jurisdictions. Submissions also suggested that removal of the existing tax treatment would impact

heavily on rural areas where mining is prevalent (the West Coast of the South Island in particular).

ii. The claw-back of some exploration expenditure was not supported. Submitters thought that it will create uncertainty and compliance costs. It was argued that, in most cases, the dividing line between exploration and development expenditure was clear-cut, so no claw-back rule was necessary. It was also suggested that legislation should be used to clearly define the boundary between exploration and development expenditure.

iii. Requiring expenditure to be spread over the life of the mine (on a unit of production basis) was not supported. It was submitted that, for a number of miners, it is difficult to measure mineral reserves accurately. Significant costs may be incurred in estimating reserves, and some miners may have a number of permits with different life of mines. Many submitters suggested spreading deductions over a fixed time scale (similar to the petroleum rules).

iv. The use of standard depreciation rates was not supported. Submitters claimed that mining puts unusually high demands on equipment and as a result it depreciates more quickly than the same equipment used in other industries. Therefore, the use of standard depreciation rates will not reflect the realities of the mining environment. Submitters suggest reviewing the depreciation rates for mining equipment.

v. Implementing standard shareholder continuity rules was not supported. Submitters claimed that due to high upfront investment large losses can accumulate at the early stages of a mining project and further investment is often required. Because of the high-risk nature of mining, it was submitted that debt funding was not readily available to mining operators. Some submitters suggested that miners should have a choice as to claiming immediate deductions for prospecting and exploration, or delaying these deductions until mining operations start (similar to rules that currently exist for some R&D expenditure).

vi. The use of the rehabilitation account rules was not supported, instead submitters thought that the treatment rehabilitation expenditure be aligned with accounting standards, which would allow deductions when the expenditure is "incurred" (that is, when the legal obligation to incur it arises).

vii. Submitters were concerned about the proposal to put land on revenue account, as capital gains may be taxed. Submitters also did not support the deferment of deductions for the purchase of land until the land is sold, as it may result in a loss at the end of a mines life which cannot be used. Submitters suggested isolating the value of the land which relates to the minerals (similar to forestry revenue account rules) and allowing a deduction for loss of land value over the life of the mine.

viii. Submitters thought that the new rules should be grandparented for existing mining projects, or at the very least any deductions taken in advance or income deferred under the current concessionary rules should not be unwound until they run their course (the timeframe granted by the current rules).

Further consultation

8. After receiving submissions officials met with submitters to get a better understanding of the submissions and the mineral mining industry.

Revised Proposal

The rules in general

9. The key consistent submission was that the proposals should not go ahead, and the current rules should stay substantially in place. Officials recommend that this submission be rejected. The current rules are highly concessionary. They effectively allow a tax deduction for capital expenditure in the year the expenditure is incurred, and, in certain circumstances, allow expenditure to be deducted in anticipation of it being incurred.

10. Tax concessions for specific industries are inconsistent with the Government's broad-base, low-rate tax policy framework. Concessions reduce the Government's tax base and the productivity of capital.

11. A concessionary tax system subsidises investment in specified minerals. This can result in more investments being made in specified mineral mining, instead of into alternative investments with higher pre-tax rates of return. In particular, there are other capital intensive industries that do not benefit from concessionary tax rules. Although officials are concerned to ensure that proposed changes do not place mineral mining at a disadvantage compared with other comparable industries, there appears to be little justification for concessionary treatment to remain in place.

12. Although the tax rules may have some bearing on the sustainability of mineral mining businesses, officials do not consider this in itself justifies the current rules retention. It appears that other external factors – the market price of the relevant mineral in particular – has more influence on whether or not a mine remains operational.

Depreciation

13. Officials understand the concerns of submitters regarding the depreciation of assets that are not tied to the life of the mine. Setting appropriate depreciation rates for industries is an administrative function of Inland Revenue, and policy officials recognise that part of reforming the tax rules for the mining industry should include ensuring that tax depreciation rates accurately reflect the economic useful life of the asset in question.

Specific design features

14. The table on the following page sets out a number of specific issues covered in the issues paper, restates the treatment proposed by the issues paper and, if the recommendations in this paper are different from those in the issues paper, what has changed and why:

Item/Issue	Issues paper proposal	Final recommendation
Prospecting expenditure: Expenditure during the initial stage of the mining process. This phase involves the preliminary search for, and the identification of, an ore body. The techniques vary, but typically have a low impact on the land. Currently immediately deductible.	Immediate deduction allowed, but this would not include costs of plant and machinery which would be depreciated. Land would be specifically excluded from this expenditure category.	As per issues paper.
Exploration expenditure: Expenditure incurred during the phase that involves the use of more intensive methods to define the extent, location and value of the ore body. This leads to a quantitative estimate of the size and grade of any deposits identified. This estimate is used to determine whether it is economic to recover deposits in the permit area. Currently immediately deductible.	Immediate deduction allowed which would not include costs of plant and machinery. Land would be specifically excluded from this expenditure category. Such deductions would be subject to a claw-back rule – discussed below.	As per issues paper.
Development expenditure: Expenditure incurred once the analysis that determines an ore body is worth recovering. This will allow access to the ore body and involves the construction of mine buildings and processing plants, and the sourcing of the necessary equipment. Currently immediately deductible.	Capitalised and depreciated over the life of the mine (once the mine is operational).	As per issues paper.

Claw-back rule: Given that exploration expenditure would be immediately deductible and development expenditure would have to be capitalised, there are incentives to re-characterise development expenditure as exploration expenditure in order to access those deductions.	Any item treated as exploration expenditure that is used for mineral extraction is clawed back and then depreciated over the life of the mine (effectively treating it as development expenditure).	As per issues paper. Some submissions on this subject suggested that the boundary between exploration and development expenditure are almost always clear, so the claw-back rule is unnecessary. However, officials consider that this will not always be the case and the claw-back rule will provide a useful buttress between the two types of expenditure. This is particularly the case when, at the time expenditure is incurred, it may not be clear whether the item in question (a road, for example) will later be useful for the extraction of minerals. In any event, if the boundary is always clear then taxpayers will be able to account for expenditure in a way that ensures the claw-back rule never operates in practice.
Mining expenditure: Expenditure incurred during the phase the minerals are extracted from the ground or seabed. Mining to recover the minerals continues as long as it is economical.	Subject to ordinary rules and treated as capital/revenue as appropriate. Assets with an estimated useful life dependent on the life of the mine would be depreciated over that period. For assets with an estimate useful life independent of the mine, the standard depreciation rates would apply. Other direct costs of mining would be deductible.	As per issues paper.

Rehabilitation/restoration expenditure: Expenditure necessary to restore the mined land to the condition required by the relevant mining permit.	Deductions given for grossed-up sum of money paid into special Inland Revenue account – similar to environmental restoration account rules in subpart EK of the Income Tax Act 2007. So, if a taxpayer wished to access a deduction, they would put $28 into an Inland Revenue account in order to obtain a $100 deduction (effectively a pre-payment of tax).	Deductions should be allowed in the year that rehabilitation expenditure is actually spent. This is the treatment given to similar expenditure under the petroleum mining rules. Under the petroleum rules, if a loss is incurred in the year of such a deduction, it can be carried back and offset against previous years' income. This treatment is designed to recognise that rehabilitation expenditure is more likely to be incurred only after income-earning activity has ceased. To only allow the deduction in the relevant year creates the possibility that there might be no income to offset that deduction against (effectively creating black-hole expenditure). Officials propose a rule similar in effect to the petroleum mining rules for mineral mining. However, to recognise the fact that reopening and adjusting prior years' returns involves significant compliance and administration costs, we consider it would be preferable to allow a refundable credit to be generated in the relevant period. This credit would be limited in value to the amount of tax that the miner has paid in respect of mining operations in the relevant permit area. Submitters have argued that mineral miners should be able to use the provisioning allowed by IFRS accounting as a basis for deductions. This would result in deductions being available in the year that the miner committed to incurring the expenditure (being the period when the relevant damage to land took place), discounted and then claimed over the period between that date and actual

		expenditure. Deductions would therefore be able to be taken earlier than under the proposed rules. Officials can see the force in this argument, but do not consider this is something that can be addressed solely in the mineral mining context. A broad review of the tax treatment of future expenditure would seem more appropriate. In the meantime, we do consider it would be preferable to introduce rules more favourable than those that currently apply to petroleum mining.
Land expenditure: Land purchased by a miner for the purposes of their mining operations. Currently fully deductible.	Treat land as revenue account property, with gains being taxable and losses deductible in the year of sale.	As per the issues paper. Submissions suggested that the proposed treatment would result in a de facto capital gains tax on mineral miners. It was submitted that rules similar to those that exists for forestry be considered. Under the forestry rules, the land is separated from the standing timber, with the latter being given revenue account treatment. Again, officials can see the force in this argument, but consider such a solution unworkable in the mineral mining context. Unlike timber, which is easily identifiable, mineral deposits under the surface are extremely difficult to accurately estimate in advance. This is confirmed by submissions that suggested that the life of mines is constantly being re-evaluated as more deposits are discovered and some prove to be less profitable that had originally been estimated. In any event, the 'revenue account' rule is designed to be concessionary in that it recognises that mineral miners will

		likely be paying a substantial premium for land when the existing landowner realises that they have commercially viable mineral deposits. The land being sold at the end of the mining project will have been devalued by the extraction of the minerals, so a deduction for the loss in value should be available to the miner. To recognise the fact that selling of the land will likely be the final act of a mining project, officials consider that, as with rehabilitation expenditure, losses attributable to the sale of land should be available as a refundable credit, up to the value of tax paid in respect of the relevant permit area.
Life of the mine: The life of the mine is an important concept, because it sets the timeframe for depreciation of all assets that are tied to the life of the mine, including development expenditure.	Using "proven" plus "probable" reserves, with deductions being based on the proportion of those reserves extracted in any given year.	Submissions suggested that the "proven" plus "probable" method would be difficult to operate in practice, particularly for smaller mining operators that may not be required to produce such information for the purposes of their accounts. Officials therefore consider that a self-assessment model could be introduced for determining the life of the mine, provided the timeframe used for tax purposes is not less than the one used for the purposes of the company's accounts. Officials understand that miners that produce IFRS accounts are required to determine the estimated useful life of a mine on a unit of production basis, largely similar to that proposed in the issues paper. However, a self-assessment model gives smaller operators the opportunity to estimate the life of their operations without the need to incur significant compliance costs. Some mines, particularly iron sand mines, have very long

		estimated lives. To create some certainty for these long-life mines, officials propose a cap on the "life of mine" concept of 25 years. This would also recognise the fact that most assets created would need to be replaced during such a timeframe. For these purposes, officials consider that the "mine" in question should be the permit area. Submissions suggested that sometimes several mines exist in one permit area. However, the ability to split permit areas into discrete operations could be used to manipulate the proposed self-assessment rule, and using the entire permit area as a proxy for a "mine" would provide greater certainty. One submission suggested that a set of depreciation rules should be introduced to cater for circumstances where an operation is "mothballed" for commercial reasons. To the extent that the existing depreciation rules do not cater for such events, officials do not consider this is an issue unique to mineral mining and, as such, do not recommend introducing special rules as part of this review.
Loss continuity and grouping: Under the current rules, a mining company can carry losses through a breach in shareholder continuity (subject to losses from one permit area being ring-fenced to future profits from the same area), but cannot belong to a group of companies unless all group members are also mining companies.	The general rules would apply, meaning that a breach in continuity would result in losses no longer being available and mining companies could form groups with any other commonly owned companies. Existing losses, however, would	Submissions favoured either the retention of the existing loss rules or the introduction of rules similar to that which exist for some R&D expenditure. The R&D rues allow deductions to be deferred until a later year. In practice, this is similar to allowing losses to survive a continuity breach because the company can defer deductions until after a breach has taken place.

	continue to be quarantined to the mining permit area.	It was suggested that mineral mining companies were more susceptible to continuity breaches because of the nature of their business. Mining is a capital intensive industry that requires significant upfront investment. This is a level of investment that can be beyond the means of founding shareholders. However, it was submitted that, unlike other industries, mining companies do not have the option of debt financing because of the high-risk nature of the business. Thus with additional equity financing and the associated change in shareholding, they are more at risk of continuity breaches than companies in other industries. Officials agree that the nature of the business means that mineral mining is somewhat unique in this regard and therefore recommend that the existing loss-continuity rules remain in place. This would mean that losses from a permit area can be carried though a continuity breach, but will always be to be ring-fenced to income derived from the same permit area. It also means that mining companies should only be allowed to form tax groups with other mining companies. Such an approach would be consistent with the current mineral mining rules, but inconsistent with the rules that apply to taxpayers more generally. Officials consider that the nature of the mining industry justify these departures and also note that they appear to be consistent with submissions made by the industry.

		As a final point, the claw-back rule mentioned above should apply to all relevant expenditure irrespective of whether it was incurred before or after a continuity breach. This is because the benefit of any losses will pass to the new owner, so that owner should account for any resulting income.
Appropriation of income: Under the current rules, a specified mining company can deduct an amount of income appropriated towards mining exploration or development expenditure. The deduction is allowed in the year that the appropriation is made.	That the normal rules apply and no special appropriation be permitted.	As per the issues paper. However, submissions have pointed out that the removal of these rules will result in a significant "income spike" for affected companies, with cash-flow consequences. Officials agree that this may create difficulties for some companies and therefore recommend that any tax liability that arises as a result of the removal of these rules in the 2014/15 income year be able to spread evenly over that year and the 2015/16 year.
Insurance proceeds: The current rules treat compensation received for the loss, damage or destruction of mining assets as income of the miner.	That the normal tax treatment of insurance receipts applies. If the compensation is for the loss of trading profits the payment is generally taxable. If the compensation relates to the damage to an asset, the compensation is generally a non-assessable capital receipt.	As per the issues paper.

Farm-out arrangements: A farm-out arrangement is a contractual agreement where a mineral rights owner or lessee (the vendor) assigns a working interest to another party (the purchaser) who will become responsible for specific exploration, development or production activities.	That the consideration received by the vendor, less any costs that the vendor has not already claimed and losses carried forward, would be taxable in the year of sale. The purchaser should capitalise the purchase price and deduct it over the life of the mine, unless the purchase was made during the prospecting and exploration phase, in which case the purchaser should be able to claim an immediate deduction for the purchase cost.	As per the issues paper.
Mining loans: Currently, a New Zealand company that holds shares in a mining company may claim a deduction for amounts written off in respect of loans, excluding interest, made to the mining company to fund its exploring, searching or mining activities. Should this amount be recovered, the Commissioner of Inland Revenue has the power, at any time, to reopen the assessments on the holding company and disallow the deductions.	That the general rules for bad debt and bad debt recovery should apply.	As per issues paper.

Effective date

9. Officials recommend an effective date for all of the proposed changes of the 2014/15 income year.

Fiscal and administration costs

10. The recommendations in this report are expected to be revenue-positive by around $30 million per annum.

11. This estimate is based on the current production volume and price of gold, and is highly sensitive to changes in future gold production and price. For example, if gold production remains the same as the 2010 level, a 50% fall in gold prices from its 2011 level would mean that the estimated annual revenue gain would decrease to $10 million.

	$m increase (decrease)				
	2012/13	**2013/14**	**2014/15**	**2015/16**	**2016/17 & out-years**
Tax Revenue	-	3.000	27.000	30.000	30.000

12. Officials understand that this $30 million per year is to be used as a savings item in Budget 2013.

13. The new rules proposed in this report should not have significant systems implications for Inland Revenue, as most of the changes will impact on the self-assessed tax returns provided by taxpayers. To the extent that systems changes are required, they are able to be funded through existing baselines.

Timeline

14. If you agree to the introduction of new tax rules for specified mineral miners in accordance with the recommendations in this report, the next steps would be:

- A Cabinet paper and Regulatory Impact Statement being sent to the Cabinet Economic Growth and Infrastructure Committee for consideration at its meeting on 20 March.
- The Cabinet paper and RIS being considered by Cabinet at its meeting on 25 March.
- Inclusion of the necessary changes in the first omnibus tax bill of 2013, currently set down for introduction in April.

- Revenue figure included as a savings item in Budget 2013.

15. Because of the absence of the Minister of Revenue in week commencing 11 March and the timeframes necessary for this item to be included in the April bill, officials recommend that the Cabinet Paper and Regulatory Impact Statement be referred to EGI by the Minister of Finance.