

THE MINING LAW  
REVIEW

SIXTH EDITION

**Editor**  
Erik Richer La Flèche

THE LAWREVIEWS

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REVIEW

The Mining Law Review

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# CONTENTS

PREFACE.....	vii
<i>Erik Richer La Flèche</i>	
<b>Part I</b>	<b>Mining Law</b>
Chapter 1	AUSTRALIA..... 1
	<i>Jay Leary and Geoff Kerrigan</i>
Chapter 2	BRAZIL..... 14
	<i>William Freire</i>
Chapter 3	BURKINA FASO ..... 27
	<i>Alban Dorin</i>
Chapter 4	CANADA..... 40
	<i>Erik Richer La Flèche, David Massé and Jennifer Honeyman</i>
Chapter 5	CHILE..... 50
	<i>Marcelo Olivares</i>
Chapter 6	COLOMBIA..... 60
	<i>José Vicente Zapata, Daniel Fajardo and María Alejandra Cabrera</i>
Chapter 7	DEMOCRATIC REPUBLIC OF THE CONGO..... 71
	<i>Aimery de Schoutbeete and Thibaut Hollanders</i>
Chapter 8	ECUADOR..... 80
	<i>Rodrigo Borja Calisto</i>
Chapter 9	GUINEA ..... 89
	<i>Stéphane Brabant and Bertrand Montembault</i>

Chapter 10	IVORY COAST ..... <i>Raphaël Wagner</i>	101
Chapter 11	MEXICO ..... <i>Alberto M Vázquez and Rubén Federico García</i>	112
Chapter 12	MONGOLIA..... <i>Sebastian Rosholt</i>	129
Chapter 13	NIGERIA..... <i>Oladotun Alokolaro and George Ukwuoma</i>	146
Chapter 14	PAKISTAN..... <i>Aemen Zulfikar Maluka</i>	158
Chapter 15	PORTUGAL..... <i>Rui Botica Santos and Luis Moreira Cortez</i>	167
Chapter 16	SENEGAL..... <i>Mouhamed Kebe</i>	179
Chapter 17	SOUTH AFRICA ..... <i>Pieter Willem Smit</i>	189
Chapter 18	UNITED STATES ..... <i>Karol L Kaballey, Kristin A Nichols and Robert A Bassett</i>	200
<b>Part II</b>	<b>Capital Markets</b>	
Chapter 19	AUSTRALIA..... <i>Simon Rear, Chris Rosario, Ben Stewart and Michael Van Der Ende</i>	213
Chapter 20	BRAZIL..... <i>Carlos Vilhena and Adriano Drummond C Trindade</i>	225
Chapter 21	CANADA..... <i>Erik Richer La Flèche, David Massé and Jennifer Honeyman</i>	233
Chapter 22	UNITED KINGDOM ..... <i>Kate Ball-Dodd and Connor Cahalane</i>	243

*Contents*

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Appendix 1	ABOUT THE AUTHORS.....	255
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	267

# BRAZIL

*Carlos Vilhena and Adriano Drummond C Trindade<sup>1</sup>*

## I INTRODUCTION

The mining sector is a significant part of the Brazilian economy and accounts for a large proportion of Brazilian exports. According to the Brazilian Mining Association (IBRAM), national mineral production in 2016 was US\$24 billion, which represented a decrease in relation to previous years, but the forecast for 2017 is a slight increase to US\$25 billion. IBRAM further reports that iron ore was the most exported mineral substance in 2016, representing approximately 61.5 per cent of overall mineral exports, followed by gold (13.4 per cent), copper (8.9 per cent) and niobium (6.2 per cent).

Despite those significant figures, the Brazilian capital market for mining activities does not present the same level of sophistication as in other jurisdictions. Apart from a few companies that are listed on the São Paulo stock exchange (e.g., Vale, CSN, Gerdau, Magnesita and Ferbasa), most capital market transactions involving mining assets are structured in other markets through parent companies, which are usually listed on the Toronto Stock Exchange (TSX) or on the Australian Securities Exchange. Juniors and mid-tier exploration and mining companies tend to float in those jurisdictions where exploration and mining markets are more developed. The TMX Group reports that over 40 with assets in Brazil are listed in the TSX or TSX-V. In some cases, the original shareholders are from Brazil and resort to a non-Brazilian, more traditional, market to raise capital.

In addition to the lack of an investment culture in the mining business, other factors may explain the slow development of Brazilian capital markets for mining, compared with other jurisdictions. The first is the economic downturn of the mining sector, which has been experienced worldwide over the past few years. The second reason is attributable to the political crisis that led President Rousseff to be impeached in 2016 and replaced by President Temer. The third reason is the lack of culture of the Brazilian market to invest in stock exchanges in the mining industry.

Those factors might explain the large preference of investors towards investing or floating on the Toronto Stock Exchange. In the past few years, the number of public offerings in the Brazilian market reduced significantly. A handful of mining companies with operations in Brazil postponed or cancelled their listing plans. Likewise, the number of companies that hold mining assets in Brazil listing in other jurisdictions has also fallen significantly as a result of the market conditions of the mining sector. More recently, the interest of companies with

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<sup>1</sup> Carlos Vilhena is a partner and Adriano Drummond C Trindade is a counsel at Pinheiro Neto Advogados.

mining assets in Brazil towards listing in traditional jurisdictions such as in Toronto has started to recover with a few offerings and plans for offering. If confirmed, this change in the market behaviour may confirm to be a trend.

## II CAPITAL RAISING

### i General overview of the legal framework

Capital raising in Brazil in general is subject to federal corporate laws, capital markets laws and regulations issued by the securities commission (CVM).

#### *Listing in Brazil*

There are no specific requirements for raising capital for mining activities in Brazil. Mining companies listed on the São Paulo stock exchange will be subject to the usual requirements in terms of governance and disclosure that are applicable to other industries.

On the other hand, there are no incentives tailored for the mining sector either. Mechanisms such as flow-through shares that may be common in other jurisdictions have no equivalent in Brazil. In terms of incentives for exploration companies, there were studies to create benefits so that the shareholders of listed exploration companies could deduct exploration-qualified expenditure for tax purposes. As the incentive implies a reduction of taxes assessed by the Brazilian government, such studies are still under consideration by the Ministry of Industry, Foreign Trade and Services (MDIC) and the Brazilian Agency for Industrial Development, and the mechanism has not been put in place.

As a consequence, the absence of specific rules considering the particularities of the sector, coupled with high costs in terms of governance and disclosure requirements, discourage exploration companies, juniors and companies with smaller projects or operations from listing in the Brazilian market.

#### *Foreign investment*

Foreign direct investment plays an important role in the Brazilian economy and the legislation imposes few requirements (such as the online registration of the investment within 30 days of the date the funds are converted into Brazilian currency). According to the United Nations Conference on Trade and Development, Brazil was the seventh most popular destination for foreign direct investment in 2016, in the amount of US\$58.7 billion. In terms of the overall investment in Latin America, Brazil was the main destination for 41 per cent of investment in general.

Foreign investors find no legal restrictions on acquiring stakes in Brazilian mining companies, but in the past few years, the government has put forward the interpretation that restrictions on non-Brazilian ownership apply to border areas (i.e., areas within the 150-kilometre wide strip of land parallel to Brazilian borders), as in other countries of the region. Hence, for those companies based in or that have mining assets in the border area, non-Brazilian equity interest is limited to 49 per cent, directly or indirectly.

Likewise, the Brazilian government also establishes that Brazilian companies that are directly or indirectly controlled by non-Brazilians are subject to certain requirements to acquire rural land, such as the prior approval of the National Institute for Colonisation and Agrarian Reform (INCRA). Since access to land is of paramount importance to the mining sector, non-Brazilian investors should bear in mind this element in channelling their investment.

## **Debt**

One of the main sources of funding for mining projects is through debt transactions. The National Bank for Economic and Social Development (BNDES) has played a key role in financing major mining projects at more favourable rates. It operates in strengthening the capital structure of private companies and provides more favourable conditions for financing intended for projects that contribute to social, cultural and technological development. In 2016, the BNDES teamed up with the Funding Authority for Studies and Project (FINEP) to financially support investment in projects that deal with scientific or technological development. This initiative is known as 'Inova Mineral' and approximately US\$400 million was earmarked to be used in the initiative. The support of FINEP covers all stages and dimensions of the scientific and technological development cycle: basic research, applied research and the development and improvement of products, services and processes. Mining companies that fit in one or more of those activities may benefit from favourable conditions for funding.

Brazilian commercial banks also provide finance for projects, but in many cases the internal requirements make it harder for projects at the exploration stage to be funded, particularly considering the economic downturn and the political turmoil. Non-Brazilian-based banks may also provide funding for mining projects and usually do so through pre-export finance mechanisms that ensure more favourable taxation.

### **ii Market overview**

Investment in the Brazilian mining sector comprises both Brazilian nationals and non-Brazilian investors. The number of Brazilian investors in the mining sector is not as high as in other sectors of the economy, but their importance should not be downplayed. Vale accounts for a relevant part of the investment in mining, and so do other mining companies, such as Votorantim. In addition, private equity funds are frequently seen in the market, as well as pension funds and companies in general (for instance, in the past few years, steel companies have also gone into the mining business). Unlike other markets, however, retail investors are not common in the Brazilian market.

Non-Brazilian investors are usually global funds, private equity funds, pension funds or mining companies that seek to reinvest and expand their portfolios, as well as companies that seek to secure the supply of raw materials for their industries.

### **iii Structural considerations**

Given the economic downturn and the market conditions of the mining sector, also influenced by the deteriorating political situation, alternative methods of access to funding have been developed and have become more popular in Brazil.

Royalty transactions are common in Brazil and there are more companies specialising in acquiring royalties. The main hurdle is the fact that Brazilian mining legislation does not provide for the registration of the royalty against title, so the royalty remains a contractual obligation that cannot be imposed on a third-party acquirer of the mining property unless such party expressly acknowledges that it is bound by the royalty. Consequently, a series of legal mechanisms and securities need to be put in place to reduce the exposure and provide more assurances to the royalty creditor.

During the past few years, there have also been a number of streaming transactions in Brazil. Streaming arrangements are contracts for ongoing supply of mineral production under which, upon advance payment of a premium, the buyer agrees to purchase at a fixed

discounted and predetermined price, all or part of the mineral production to be extracted by a mining company during a certain period or even throughout the life of the mine. The mining company receives payment up front, which enables it to develop, construct and operate or expand the mine. This arrangement allows the mining company to capitalise on the basis of proven but still unexplored mineral reserves at a cost usually below that of loans.

These streaming arrangements have been praised by mining companies, as they have access to additional fundraising mechanisms to develop the mineral project, and have a purchaser for all or part of its future production (depending on the agreement). Moreover, contrary to capital investment financing, streaming arrangements avoid debt-financing costs, particularly at times when credit access conditions are unfavourable.

One major difficulty of Brazilian mining companies in raising capital is the gap between reporting requirements under Brazilian mining law and other typical reporting standards adopted by the market. Reporting requirements in Brazil still abide by legislation enacted in the late 1960s, which employs standards and terminology that is not the same as in the current market (e.g., the inadequate use of ‘measured, indicated and inferred reserves’). This means that the reporting obligations to the Brazilian Department of Mines (DNPM) are much less detailed than those required by banks and investors. In some cases, Brazilian companies reach the transitional stage between exploration and mining pursuant to domestic legislation, but still need to undertake further exploration so as to produce the report that provides a resource or reserve that is in compliance with the NI43-101 or JORC standards. In order to bridge that gap, Brazilian mining associations (i.e., the Brazilian Association of Exploration Companies, the Brazilian Agency for the Development of the Mining Industry and IBRAM) joined the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). As a result, a non-binding, voluntary Brazilian Code for Resources and Reserves that follows the international standards was put together and submitted to CRIRSCO, which will also contribute to the formation of qualified persons in Brazil.

More recently (a couple of weeks before this article was concluded), the government enacted changes to the Brazilian Mining Code as part of a reform of the sector to encourage investment. One of the changes made to the Mining Code was the possibility of adopting international standards for reporting and abiding by best international practices, which gives room to more market-oriented reporting requirements. This will be subject to forthcoming regulation to be enacted by the newly-created National Mining Agency (further details below).

In the environmental field, the accident involving the Samarco dam in November 2015 is likely to result in more stringent regulation on environmental issues, and more specifically on the use of dams by mining operations, as well as more severe supervision of environmental authorities and public prosecutors. For instance, new regulations were already issued by the DNPM on tailings dams, which contains more requirements to those companies that operate such dams.

A final comment should be made with regard to the social and environmental liability of financial institutions that provide funds for mining and infrastructure projects in general. Although no legal provisions impose such liability, the trend is that such institutions are deemed increasingly responsible for the use of funds borrowed by companies – particularly those that use environmental resources and could potentially create a social and environmental footprint. In 2015, a National Monetary Council regulation involving the liability of

financial institutions started to be implemented. Such regulation requires that each financial institution to put in place a social and environmental policy. It may result in increasing liabilities to financial institutions in the future.

#### **iv Tax considerations**

Brazilian legislation does not provide for any tax advantages or incentives to persons engaged in mining activities, or their investors and lenders.

As a general comment, Brazilian corporate income tax (IRPJ) is levied at the rate of 15 per cent on the taxable profits. A 10 per cent surcharge is levied on the actual profits, presumed profits, or profits determined by the tax authorities, in excess of 240,000 reais per year. Taxable profits are ascertained by deducting the operating costs and expenses from the gross income originating from the company's core activity and incidental businesses. Some of these costs and expenses are not deductible because of their nature or the amount involved. There are also certain events of tax exemption upon ascertainment of the company's taxable profit.

Moreover, it is worth mentioning that Brazilian legal entities are allowed to carry forward losses indefinitely, which is of paramount importance for companies that undertake exploration, development and later mining activities; however, such losses can only offset 30 per cent of the taxable profits, which can result in deferral of the utilisation of the losses in the event the legal entity happens to have material losses and profits that are not substantial.

In some cases, a legal entity may opt for taxation on presumed profits instead of actual profits. Under the presumed profit regime, the IRPJ's calculation base is determined upon the application of predetermined rates (that may vary depending on the activity carried out), as set out in the applicable law, over revenues derived by the legal entity from the execution of its operational activities. Expenses are not deductible to the Brazilian company when it is taxed under the presumed profit regime and, in order to be taxed under this system, the company cannot have had a gross income over 78 million reais.

As a general rule, the income, capital gains and other earnings paid, credited, delivered, employed or remitted by a Brazilian source to a foreign-based individual or legal entity are subject to withholding tax at a general rate of 15 per cent. As from 1 January 2017, the tax rates on capital gains of Brazilian individuals or non-residents (both individuals and companies) would be: (1) 15 per cent for the part of the gain that does not exceed 5 million reais; (2) 17.5 per cent for the part of the gain that exceeds 5 million reais but does not exceed 10 million reais; (3) 20 per cent for the part of the gain that exceeds 10 million reais but does not exceed 30 million reais; and (4) 22.5 per cent for the part of the gain that exceeds 30 million reais. The rates above may reach 25 per cent for income paid to a person residing in a jurisdiction deemed a tax haven or privileged tax regime for Brazilian tax purposes (i.e., a country or territory where income is not taxed or subject to taxation at a maximum rate lower than 20 per cent, or does not disclose information about the ownership or beneficial owner of the company's income). When it comes to countries and regimes aligned with international standards of fiscal transparency, in accordance with rules established by the Brazilian tax authorities (on a par with OCDE standards), such minimum threshold of 20 per cent is decreased to 17 per cent.

The social contribution on net profits (CSL) applies to Brazilian companies (including financial institutions), and is calculated on the net profits before the allowance for income tax, adjusted by the additions, exclusions and offsets prescribed by tax law. The CSL rate is 9 per cent and the figures paid are not deductible from the income tax base (actual profits).

The profit participation programme contribution (PIS) and the social security financing contribution (COFINS) are levied at the combined rate of 9.25 per cent, assessed over the gross billings of the company.

The tax on financial transactions (IOF) is a tax on foreign exchange, securities, credit, gold and insurance transactions. The Minister of Finance sets the rates of the IOF tax, subject to limits set out by law. The IOF/Exchange is currently imposed on a variety of foreign-exchange transactions. Currently, for most exchange transactions, the rate of IOF/Exchange is 0.38 per cent.

The tax on distribution of goods and services (ICMS) is a state VAT levied on the circulation of goods (thus covering the entire chain of trades from the manufacturer to the end consumer) and on the provision of intrastate and interstate transportation and communications services. Normally, the transaction value serves as the ICMS tax base. The ICMS is paid by the trader or provider of carrier or communications services.

The ICMS is a non-cumulative tax and, as such, generates a tax credit to be offset by the product or service recipient against the tax payable on future transactions. Each Brazilian state is free to establish its own ICMS rates (generally between 17 and 18 per cent). The ICMS tax exemptions, breaks and incentives are granted or cancelled via agreements entered into among the Brazilian states; however, these states often grant ICMS tax breaks and incentives to attract investment without the approval of other states, generating a 'tax war'.

The tax on services (ISS) is assessed on the services provided by a company or independent contractor or professional, in accordance with a list of services attached to a federal supplementary law. This tax is levied by the local municipality at a rate of 2 to 5 per cent on the service value.

Mining activities are subject to a statutory royalty (CFEM), which was increased a few weeks before the finalisation of the article to up to 3 per cent – depending on the substance, but in most of the cases the applicable rate is 2 per cent – of the revenue arising from the sale of the mineral product. In the most dramatic case, the rate for diamonds increased from 0.2 per cent to 3 per cent. Gold had its rate increased from 1 per cent to 2 per cent, and iron ore saw the rate changing from 2 per cent to a sliding scale where the 4 per cent rate can apply when iron ore prices are above US\$100.00 per tonne according to the Platts Iron Ore Index.

The government also enlarged the calculation basis of CFEM so as to restrict deductions only to those taxes that levy on the sale of the products. External transportation and insurance costs are no longer deductible, which will increase significantly the CFEM payable by those producers that have logistics associated to their businesses. For those companies that use the mineral substance in their industrial process to create an industrialised product, the statutory royalty shall be calculated based on current market prices or a reference price, both to be defined by the National Mining Agency.

The recent changes to Brazilian mining laws also introduced a new charge, namely the Mining Activity Inspection Fee to be calculated annually on a 'per-mining title' basis. It ranges from US\$ 300 to US\$ 1500 depending on the stage of the mineral rights.

It is worth noting that, over the past few years, three states (Minas Gerais, Pará and Amapá) also created 'inspection fees'. A close review of these state fees, however, shows that they are actually proportionate to the mine production and are tantamount to an additional royalty.

As a measure to foster regional development, exports and the development of infrastructure, there are a number of tax breaks and incentives that investors should consider. Legislation provides for the reduction of IRPJ for industries that are established in the Amazon region or in the north east of the country as a measure to industrialise those regions.

Exports generally enjoy tax breaks in terms of ICMS and export taxes. Likewise, there are incentives for the import of machinery with no equivalent in the domestic market that will be used in the production of goods for exportation.

Finally, the government has granted tax benefits to ‘infrastructure debentures’ so as to reduce taxation on the income paid from debentures issued by special purpose companies created to invest in infrastructure projects (logistics, transportation, energy, telecommunications, sanitation or irrigation). Since many mining projects require associated logistics, these tax benefits should be taken into account by investors.

### III DEVELOPMENTS

In the fifth edition of *The Mining Law Review*, we stated that ‘any changes to be proposed by [President Temer’s] government will not depart significantly from the current system (as opposed to the bill sent to Congress by Ms Rousseff’s government). So one can expect reforms to the mining sector that are more market-driven, although conversely there will probably be an increase in mining royalties.’ In fact, a couple of weeks prior to the conclusion of this article, the President of the Republic enacted three Provisional Measures to amend existing mining legislation. The first Provisional Measure (MP 789) altered the method to calculate the base value of CFEM – from net income to gross income – and changed applicable rates to different minerals. The second Provisional Measure (MP 790) amended around 30 provisions of the Mining Code seeking to modernise and address regulatory inconsistencies. Finally, the third Provisional Measure (MP 791) created the National Mining Agency (ANM) to replace the DNPM; and instituted an ‘inspection fee’ to be paid annually by holders of mineral rights. Provisional measures are executive orders with immediate effect, but that need to be reviewed by Congress within 120 days. Congress can approve, amend or reject each of the Provisional Measures.

The changes to CFEM enacted through MP 789 did not move towards strengthening the mining sector. The increase of the calculation base and the increase in royalty rates (as described above) augmented significantly the government-take (particularly for some substances e.g., diamonds, gold and iron ore, the latter depending on market prices). Although mineral royalties in Brazil may still be low if compared to other large mining countries – as claimed by the government – the overall tax burden of a mining operation in Brazil shows a higher government-take compared to other mining jurisdictions.

The ‘inspection fee’ described above was clearly created for collection purposes and will probably be used to finance the new National Mining Agency. However, the new Agency would already be feasible had the CFEM share to which the DNPM is already entitled not been withheld by the Treasury, as it has happened in past years – and never actually reached the final recipient, i.e., the DNPM. Instead of solving the contingency issue, the government chose to assign the burden over to the industry by means of the ‘inspection fee’.

The amendments to the Mining Code presented by MP 790 bring some beneficial propositions to the industry. The increase of maximum exploration term from six years to eight years, added by the possibility of continuing exploration after submission of the final exploration report, are useful measures to deal with the transition from exploration to mining.

However, the opportunity has been lost (at least for the time being) to propose developments on important matters, such as measures to facilitate mining finance, mechanisms to regulate access to public and private areas for exploration and mining, recognising mining rights as a property right (*in rem* right or 'real right'), updating the Mining Cadastre, among others matters. In short, the government was very timid in introducing changes and new measures that could actually benefit the investor and the mining sector.

The creation of ANM to replace DNPM, as provided for in MP 791, places the mining industry into the same management model that has been applied to the oil and gas, power and telecommunications sectors for two decades in Brazil. ANM will have a board made up of five members with fixed terms of office in an attempt to reduce political influence and give higher independence to the regulatory agency. The practice adopted for other regulatory bodies – where decisions are made jointly, sessions are public, proposed regulatory changes go through public consultations at which the agency must review and provide its opinions and suggestions, and procedures become more transparent – may bring significant gains for the industry if actually put in place. The key, however, is that ANM does not exclusively represent a name change, but it will be endowed with budgetary funds to implement the new administrative framework and meet the purposes expected from a regulatory body. Creating a new agency with the same low budgets as those of DNPM may mean an aesthetic measure only.

On a final note, it is worth mentioning that the Congress has to review the three Provisional Measures until the end of November 2017 (the deadline is 28 November 2017). Amendments will probably be made and, as of the time of preparation of this article, around 500 suggested amendments had been presented. This means that the second half of 2017 and first half of 2018 will probably be regarded as a transition period into a new model that will have a new mining agency in place, some new rules, and increased charges. The precise rules will only be known once Congress concludes its review and the President of the Republic sanctions (or vetoes) the amendments to be made by Congress. Hence, there is still an opportunity for adjusting the framework laid down by MPs 789, 790 and 791 towards a more attractive environment to mining investment.

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Adriano Drummond Cançado Trindade is a counsel at Brazilian law firm Pinheiro Neto Advogados, where he has devoted his time to providing advice to exploration and mining companies and investors in aspects involving mining projects. He holds an LLB from the Law School of the University of Brasilia and an LLM (distinction) from the Centre for Energy, Petroleum, Mineral Law and Policy from the University of Dundee. Mr Trindade is also a professor of resources law at the University of Brasilia Law School, where he also heads the mining section of the natural resources law research group. He has been continually listed as a top mining lawyer by various international legal guides.

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