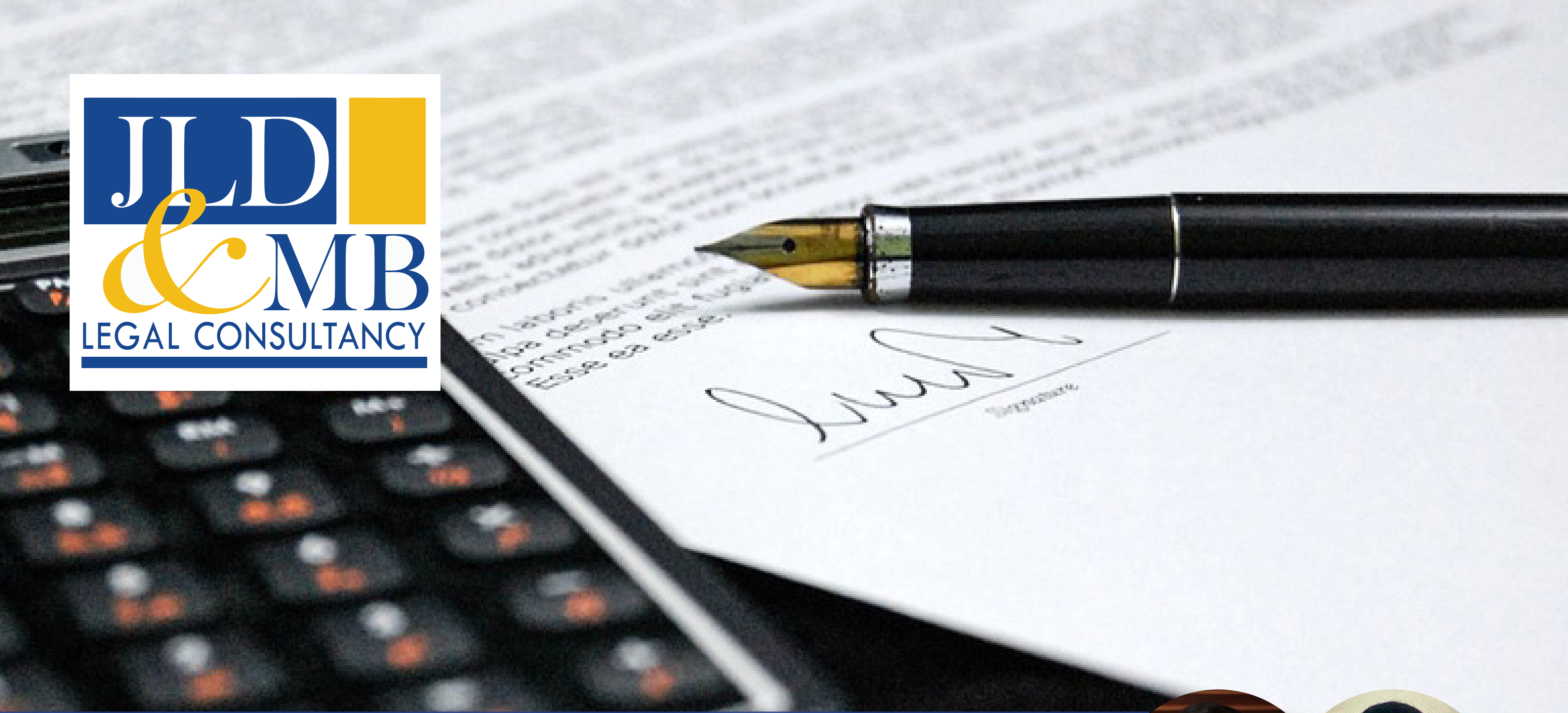
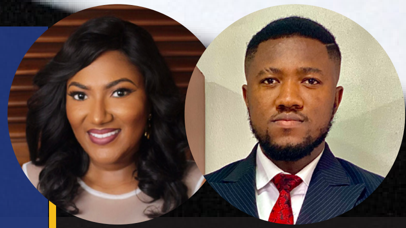


Are development agreements worth the fuss? The Pros and the Cons



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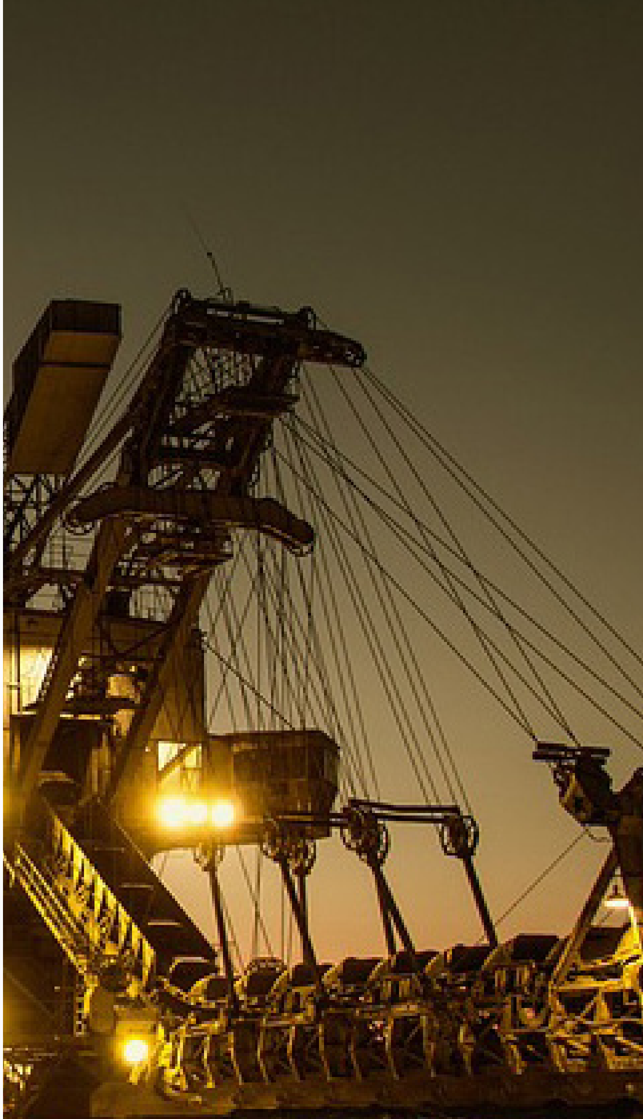
Introduction

The mining industry is a significant contributor to the economic growth of Ghana contributing over five percent (5%) of the annual Gross Domestic Product (GDP) of the country. As is usual with most extractives, mining is a capital-intensive industry. This translates both in operational costs as well as regulatory costs.

Financial obligations of mining companies in Ghana include, amongst others:

- Corporate income tax of thirty-five percent (35%);
- Annual mineral right fees;
- Royalties;
- Annual ground rent;
- Indirect taxes;
- Permit fees;
- Reclamation bonds.

Despite all these costs, the mining industry continues to attract a large number of investors, both local and foreign because it is a hugely profitable industry for both the mining companies and the Government of Ghana ("GoG"). It is therefore not unusual for the GoG to provide incentives to increase participation in the industry. One such initiative is a development agreement ("Development Agreement").



What is a Development Agreement?

Section 49 of the Minerals and Mining Act, 2006 (Act 703)(as amended) (the "Mining Act"), provides that the Minister of Lands and Natural Resources, on the advice of the Minerals Commission may enter into a development agreement under a mining lease where the proposed investment by the person will exceed five hundred million United States Dollars (USD500,000,000).

Development agreements are subject to ratification by Parliament.

Development Agreements usually contain stability clauses, tax concession clauses as well as dispute resolution clauses which are more detailed than the clauses provided in the mining leases. Upon a simple reading of the provisions, it appears the agreements are skewed towards the mining companies with the GoG standing to gain little if any benefit from entering into any such agreement.

What are the benefits of a Development Agreement?

A review of existing Development Agreements between the Government and some major mining companies in Ghana revealed similar stability provisions and corporate income tax concessions.

In these agreements, the applicable corporate income tax rate is thirty-two point five percent (32.5%) in comparison to the corporate income tax rate of thirty-five percent (35%) applicable to all other entities under the Income Tax Act, 2015 (Act 896) as amended. Importantly, in calculating the taxable income of such companies, fees for management and technical services provided by an

Affiliate in the annual aggregate amount of two-point two five percent (2.25%) of total revenues from production or other operations are deductible.

The companies also enjoy an initial stability period of about ten (10) years with the option to extend for a further five (5) years. This extension of the initial stability period is conditional upon the promise of additional investments in mining projects, projected to result in increased mine life and/or gold production and/or increased employment of Ghanaians.

Other tax reliefs/ benefits include:

- Exemption from taxes and duties on the import of plant, machinery, equipment, spare parts, fuels, and petroleum products, supplies and accessories (including spare parts), as well as other items listed in the Mining List[1] which are imported specifically and exclusively for operations;
- A rate of royalty which varies depending on the international price of gold published by the London Bullion Market Association. Generally, the sliding scale starts at a floor of three percent (3%) where gold price is below one thousand three hundred United States Dollars (USD1300) per ounce, and ends at a ceiling of about five percent (5%) where the gold price is not less than two thousand three hundred United States Dollars (USD2,300) per ounce.
- Gold exports are zero rated for VAT purposes.

[1] Mining List means the catalogue of mining machinery, equipment and consumables agreed upon by the Minerals Commission, Ghana Revenue Authority, Value Added Tax Service and the Ghana Chamber of Mines to be exempted or charged concessionary rate for customs import duties and value added tax.

Issues to consider prior to entering into a Development Agreement?

From the above, it appears that the benefits under the Development Agreements are in favour of the mining companies; however, there are some aspects of a Development Agreement which need to be considered carefully. A few of these include:

- The investment of at least five hundred million United States Dollars (USD500,000,000) in the development of the mineral resource. We note that these development costs must be expended prior to consideration for entry into a Development Agreement. It's not sufficient to show that the Company intends to make this investment in the future. This means that companies who want to enjoy these benefits will have to spend more on the completion of the mine, invest more in infrastructure, road network to and from the mine, environmental protection measures, better tailings facilities among others;

- The request for a further investment of at least three hundred million United States Dollars (USD300,000,000) at the end of the initial stability period for mining companies to extend the stability period;

- The right of GoG to request for payment of royalties in gold rather than cash;

- Advance payments on the free carried interest of the GoG. In practice, this free carried interest is usually a participation in the dividends of the company. This means that in a year where dividends are not declared, the GoG will be entitled to no revenue from its interest in the mining operation. However, a number of the Development Agreements contain a clause that gives the GoG the right to request advance payment of their free carried interest. This is then deducted from subsequent years when the company does declare dividends; and

- The companies are not exempt from changes made to the procurement list. This safeguards local content and participation by Ghanaians in the mining services industry and helps retain a significant amount of mining expenditure which hitherto was paid to foreigners.

Conclusion

In conclusion, Development Agreements are a key component of our mining infrastructure. Both the mining companies and the GoG stand to gain considerable benefit from these agreements.

Any investor looking to invest five hundred million United States Dollars (USD500,000,000) or more in a mining lease should consider entering into a Development Agreement with the Government.

It is also important for investors to ensure that prior to entering into a Development Agreement, they employ the services of local legal counsel to assist with legal advisory services and assistance in negotiations with the Government to secure the best possible terms.

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