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# REFORM IN THE MINING SECTOR

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# CONTENT

**M**

	Page
PROVISIONAL PRESIDENTIAL DECREE 789/17	<b>3</b>
PROVISIONAL PRESIDENTIAL DECREE 790/17	<b>18</b>
PROVISIONAL PRESIDENTIAL DECREE 791/17	<b>22</b>

# PROVISIONAL PRESIDENTIAL DECREE Nº 789/17

IT AMENDS THE PROVISIONS ON FINANCIAL COMPENSATION FOR THE EXPLORATION OF MINERAL RESOURCES (COMPENSAÇÃO FINANCEIRA PELA EXPLORAÇÃO DE RECURSOS MINERAIS - CFEM). ALSO KNOWN AS "MINING ROYALTY", CFEM IS ONE OF THE MAIN REASONS FOR CRITICISM OF THE NEW MODEL PROPOSED BY THE GOVERNMENT.

# 1. EXPANSION OF THE CALCULATION BASIS - GENERAL RULE

MP 789/17 addressed a number of controversial issues with CFEM, and generally clarified them in a manner favorable to the State's position on such issues.

For the event of sale of ore, the calculation basis to be considered was changed: net sales (equivalent to gross revenue, less taxes on the commercialization of the mineral product and expenses with insurance and transport) were replaced by gross revenue from sales of mineral assets, deducting only the taxes levied on the sale. Therefore, the possibility of deducting transport and insurance expenditures was excluded, and there is no indication of any system of credits or debits from previous stages that could minimize the cascading costs indirectly related to the activity.

For the event of internal consumption (by the mining company itself), the calculation basis, which was previously the cost of producing ore, becomes one of the following alternatives, to be defined for each mineral asset after public consultation: current local, regional, national, or international market price, or a reference price defined by the regulatory authority.

## 1. EXPANSION OF THE CALCULATION BASIS - GENERAL RULE

A specific rule was created for export to related legal entities or countries with favorable taxation. This exportation should use transfer pricing rules and consider the price parameter defined by the Brazilian Federal Revenue Service. In the absence of this, the reference price to be defined by the regulatory entity shall be considered.

Acquisitions in public auction received specific treatment, as it was defined that CFEM will apply on the price of the auction. The text does not clarify whether the application of CFEM is discarded when the mineral subject to the public auction has already been subject to collection of CFEM previously. This can become a point of discussion, in that CFEM would be charged in duplicity on the same mineral asset.

In order to eliminate points of contention, the MP also presents a definition of beneficiation that takes into account some litigation brought by companies in the industry in regard to the moment in which beneficiation is considered terminated and industrialization begins. The definition contained in the previous

rule, according to which the beneficiation process could not result in declassification as minerals of the mineral substances, was discarded. The new definition now includes a number of questionable examples in the light of the previous definition, such as pelletizing, sintering, and coking, "even if they require the addition or removal of other substances."

The new regulation clarifies that transfer of ore between establishments of the same company will not be considered a sale transaction. In general, the ore is transferred between establishments of the same company when the operation of the company involves the extraction of ore and its subsequent beneficiation, with value added. Since, in the new rule, CFEM will only be calculated based on the price at the end of the company's operational chain (called the actual sale or consumption in the new regulations), the authority is applying a royalty charge on the value added to the ore, with a tendency, therefore, to increase the amount collected.

## 1. EXPANSION OF THE CALCULATION BASIS - GENERAL RULE

#	GENERAL RULE (ARTICLE 2, I TO V)	SPECIFIC RULE
I	<p><b>For the sale</b>, the basis should be gross revenue from the sale, subtracting taxes levied on its marketing.</p>	<p><b>Paragraph 3</b> Transfer of mineral assets to another establishment of the same owner for beneficiation – the calculation basis should consider the price used in the final sale, deducting taxes levied on the sale.</p> <p><b>Paragraph 4</b> Operations between establishments of the same company or between related companies or the same economic group shall not be considered a sale. In this case, CFEM applies on the ACTUAL consumption or marketing and sale of the mineral assets.</p>
II	<p><b>For consumption</b>, the basis should take into account the current price of the mineral asset, or similar asset, on the local, regional, national, or international market, or the reference price defined by the mining industry regulator.</p>	<p><b>Paragraph 5</b> The calculation basis is applied when there is use, donation, or beneficiation of the mineral asset, in any establishment, even without actual economic use.</p> <p><b>Paragraph 6</b> Act of the regulatory entity, preceded by public consultation, will establish for each mineral asset whether its criterion will be the price in the local, regional, national, or international market or a reference price.</p>

1. EXPANSION OF THE CALCULATION  
BASIS - GENERAL RULE

#	GENERAL RULE (ARTICLE 2, I TO V)	SPECIFIC RULE
III	<b>For exports</b> to related entities or entities domiciled in countries with favorable taxation, the basis should be calculated revenue, considered as the parameter price defined by the Brazilian Federal Revenue Service or, if there is no such parameter price, the reference price of the mining regulatory authority.	<b>Paragraph 3</b> Transfer of mineral assets to another establishment of the same owner for beneficiation – the calculation basis should consider the price parameter of the Brazilian Federal Revenue Service or the industry's authority.
IV	<b>For purchase in public auctions</b> , the basis should be the amount of the winning bid.	
V	<b>For purchase of ore extracted under the prospecting framework</b> , the basis should be the value of the first acquisition of the ore.	

## 2. CHANGE IN RATE

In general, change in rates followed discussions held by the Brazilian legislature to the effect that valuation of mineral assets in which Brazil has a prominence or primacy in global production, such as niobium and iron ore, which had their CFEM rates increased, respectively, from 2% to 3%, and from 2% to one variable percent between 2% to 4%, depending on the international price of the commodity.

Also noteworthy was the increase in the CFEM rate on diamond extraction from 2% to 3% and on carbonates and noble metals from 0.2% to 2%.

The MP creates, however, an additional band to accommodate the 1.5% rate on extraction from rocks, sand, gravel, clay, and other substances for the construction industry. Under the previous framework, the rate was 2%. However, given the significant expansion of the calculation basis, reduction in the taxation of these materials is not certain, since the impact of exclusion of transport and insurance expenses from the CFEM calculation basis should be scaled case by case, depending on the operation of each company, its processes of beneficiation, and marketing structures.



## 2. CHANGE IN RATE

Iron ore suffered the most substantial rate change, previously defined at 2%, and currently variable between 2% and 4%, according to mechanics of tiered values based on the international price of the commodity. With the tiered mechanism, in theory, the government shares some of the risks of the miners, as it reduces collection of royalties in times of low international prices for ore. However, it was found that, in practice, this was in fact a protection for the government itself, which established as floor the same rate as previously collected and, as a ceiling, double the rate previously applied, which shall be enhanced by the changes in the calculation basis.

This new method of calculating CFEM for iron ore brings, unfortunately, uncertainties and operational difficulties that need to be clarified. For example, the rate varies according to the Platts index for iron ore. If, for example, the Platts price is US\$ 72/t and the mining company sells at US\$ 69/t, the applicable rate should be in the range of US\$ 70/t and US\$ 80/t, or 3%.

Another interesting detail is that, at first, the tiered rate applies to the total sale price, not just the "surplus" price in each band. Using an example with the Platts index at US\$ 65/t and sale made at that same value, the 2.5% rate would be about US\$ 65/t. An alternative would be the application of the 2% tax rate up to US\$ 60/t, plus a 2.5% rate over what exceeds the previous ceiling.

Calculation done in this manner leaves companies at the mercy of situations in which it will be more beneficial to have the price of the Platts index a little lower, when close to the change in band. Mainly in long-term contracts, depending on the price negotiation mechanisms agreed upon between the parties, this new rule may stimulate adjustment to determine not only the sale price, but also the time to realize it, in order to seek a more favorable applicable rate.

## 2. CHANGE IN RATE

ORE	OLD RATE
Gold (from mine prospecting)	0,2%
Precious stones	
Rough colored stones	
<b>Carbonates</b>	
<b>Noble Metals</b>	
<hr/>	
<b>Iron</b>	2%
Fertilizer	
Coal	
Other mineral substances	
<hr/>	
Aluminum ore	3%
Manganese	
Rock salt	
Potassium	
<hr/>	

MINÉRIO	ALÍQUOTA NOVA
Gold and <b>diamond</b> (for mine prospecting)	0,2%
Precious stones	
Rough colored stones	
<hr/>	
<b>Rocks</b>	1,5%
<b>Sands</b>	
<b>Pebbles</b>	
<b>Gravel</b>	
<b>Other mineral substances intended for immediate use in civil construction</b>	
<hr/>	
<b>Gold</b>	2%
Other mineral substances	
<hr/>	
<b>Bauxite</b>	3%
<b>Manganese</b>	
<b>Diamond</b>	
<b>Niobium</b>	
<b>Potassium</b>	
<b>Rock salt</b>	
<hr/>	
Iron ore	Variável
<hr/>	

### 3. CFEM SHARING BETWEEN STATES

The provisional presidential decree did not change the current rules related to the CFEM distribution percentage among the states, or the extinction of the National Fund for Scientific and Technological Development (Fundo Nacional de Desenvolvimento Científico e Tecnológico – FNDCT) – the Federal Government continues to retain 12%, the states 23%, and municipalities 65%. Transfer of 10% to the Ministry of Mines and Energy (Ministério de Minas e Energia – MME) is mandatory, and must be sent to the National Department of Mineral Production (Departamento Nacional de Produção Mineral – DNPM).

## 4. PERSON SUBJECT TO OBLIGATION

Two factors in the change to the regulation result in observation of new persons subject to the CFEM payment obligation: (1) the inclusion of new triggering facts, such as acquisition at public auction and export to related legal entities or to a country with favorable taxation; and (2) the legal clarification of joint and several liability of the lessor during the validity of the lease.

The first item adds obvious new persons subject to the obligation: exporters to a related legal entity, although they are not among those listed in the amendment to Law No. 7,990/1989, and purchasers at public auction.

The second item brings as a new person subject to the obligation lessees of mineral rights, which may be charged if the lessee has not fulfilled the obligation, thus altering the previous position of the department that the lessor would only have secondary liability, if tax entry occurred after recording of the lease.

In the case of assignment of mining rights, there was also an apparent revision to what was previously observed by the DNPM. It was determined that both the assignor and the assignee are responsible for the CFEM whose triggering event occurred before the assignment. Until then, the DNPM understood that only the lessor was responsible for the CFEM debts incurred prior to the lease registration.

## 5. PENALTIES

There is no change to the application of fines and interest for non-payment of CFEM, or for incorrect collection. The provisions of Law No. 9,430/1996 apply, with monetary adjustment following the IPCA index rate.

Administrative infractions punishable by a fine were created, to be applied by the mining regulator specifically in cases of (i) provision of untrue declarations or information; (ii) falsification, adulteration, destruction, simulation, or alteration of the records and bookkeeping of books and other documents required for inspection, with both cases subject to a fine of 20% over the amount established by the mining sector regulator for CFEM or R\$ 5,000, whichever is greater; and (iii) unjustified refusal to submit documents requested by the regulatory authority, subject to a fine of 0.33% per day up to a maximum limit of 20% of the amount calculated by the mining regulator for CFEM.

## 5. PENALTIES

Article 2-C allows the authority to require, in a comprehensive manner, submission of documents. Unjustified and repeated refusal to submit them may lead to suspension of mining activities, among other measures. While it seems reasonable that such documentation should be related to calculation of CFEM to be charged, there are no guiding principles expressed in the rule, which may lead the agency to take too rigid a stance on what would be an unjustified refusal. Ultimately, certain documents protected by confidentiality clauses or of a strategic commercial nature may become more vulnerable to exposure because of the broad discretion conferred on the authority.

The new regulation also provides that, in the event of refusal by the person subject to the obligation to submit the documents requested by the agency or in the event of contradictions in the documentation provided, the mining regulator shall use the data submitted that implies the highest CFEM value for each triggering event. If no document is made available or if the data contained in the documents provided are not sufficient

for verification, the mining regulator may reasonably base the CFEM values on the basis of the documents below, in the following order:

- I** – CFEM collection forms;
- II** – data contained in reports submitted by the person subject to the obligation;
- III** – transaction data by the same person with respect to different triggering events;
- IV** – amounts paid by other individuals or legal entities of the same branch in the local market; and
- V** – data set forth in guidelines prepared by the tax agencies or other official technical sources.

## 6. TIMEFRAME

The new regulations attributed to the CFEM the statutory limitations and lapse deadlines established in article 47 of Law No. 9,636/1998. As a result, the MP, without defining (or addressing) the legal nature of the contribution, which has already been much debated, equated it with income from assets, in a maneuver that seeks to favor collection under the decree. As a consequence, the DNPM's theory is unanimous that the limitations term would be ten years to supervise and collect debts and five years to demand them from covered persons.

## 7. JURISDICTION

The new regulation expressly states that "it is the exclusive jurisdiction of the Federal Government, through the mining industry regulator, to regulate, collect, inspect, charge, and distribute the CFEM."

The objective is to eliminate any doubts about the legitimacy of other states to create rules on supervision and collection of the CFEM, such as those already existing in various states and municipalities.



## 8. VALIDITY

MP 789/17 will enter into effect in phases: (i) most of the provisions will enter into force on August 1, 2017, except for (ii) new rates applicable to the CFEM, effective as of November 1, (iii) rules applicable to the new calculation basis for consumption, which enter into force on January 1, 2018, possibly in order to provide the new mining authority with a minimum period for establishing the calculation system.

# PROVISIONAL PRESIDENTIAL DECREE N° 790/17

Among the changes brought in by Provisional Presidential Decree No. 790, published in the Official Federal Gazette on July 26, 2017, we highlight those focused on (i) standardization of practices that had already been adopted by DNPM; (ii) institution of rules to reformulate the procedures for approval of research authorizations and identification of availability of areas; and (iii) revision of the sanctions previously contemplated.

An example of a normalization of practices that were being adopted by the DNPM is the requirement of proof by the interested party of the prior license application to the competent environmental agency at the time of supporting an Economic Utilization Plan (paragraph 2, Article 41). Another example concerns the possibility of carrying out research, upon prior notice, after the end of this phase, through preliminary notice (paragraph 4, article 14), with the clarification that this information cannot be added to the final research plan, but can only serve as additional support for the subsequent phase.

Regarding the new rules for approval of research authorizations and the identification of availability of areas, the changes sought to restrict existing speculation on mining rights still under research, in addition to giving greater dynamism to related activities. For example, from now on, areas released by an act of the DNPM will become available, and no longer free. Likewise, waiver of mining rights will also make areas available. It should also be noted that the deadline for appealing refusal of a research authorization has decreased from 60 to 30 days.

There was also a change in the rules of availability of mining rights. The new wording of article 26, paragraph 5, of the Mining Code, clarified the announcements made by the government in recent months on this issue. From now on, we will have electronic auctions, and the winning bid will be the one with the highest amount offered (previously, the criterion was the best technical offer).

In addition to the changes introduced by MP 790/17 to the research authorization regime, change is proposed for the initial period to two to four years, which was from one to three years. It may be extended for only one new period, except in cases where research has been impacted by problems related to the restriction of access to the area in question, or even the absence of an environmental license (provided that it is proven that these issues were not caused by action or omission of the interested party). In such cases, further extension shall be permitted. The rules proposed by MP 790/17 sought to make it possible to extend the authorization for research in situations in which the interested party submitted the request for a timely extension (article 22, paragraph 7) and to prove that it complied with all diligences and summons sent in the course of the process (in the event of problems with access to the area) or in the course of obtaining the environmental license, as applicable (article 22, paragraph 5, items I and II).

Still in relation to the research phase, the following rules were changed:

**A. EXTENSIONS OF RESEARCH AUTHORIZATION:** a single duly justified extension was defined as a general rule, thus avoiding unwarranted delays by the holder of the mining right;

**B. DEFINITION OF "RESEARCH":** thus far, without clear defined parameters; from now on, should follow international standards, thereby avoiding "positive" reports without proper identification of potential areas and maintenance of mining rights;

**C. REPORTS:** it will be mandatory to submit a biannual report, which will cause the holders to provide information regarding the work performed, even for authorizations of more than two years.

Some of the amendments will necessarily require further regulations. We highlight the entire Chapter II, titled "Mineral Research", which will detail the minimum content and guidelines for preparation of the research report, since declaration of results should follow "international standards." Another point to be detailed involves waiver of the mining rights, which may exempt the holder from presenting the research report without payment of a fine.

In addition, Chapter V, "Sanctions and Nullity", was extensively modified. As a highlight, we have included the possibility of seizure of minerals, goods, and equipment and variation of fines, which will have a limit of R\$ 30 million.

Regarding the proposed changes to Law No. 6,567/1978, with respect to the licensing regime, the limitation of 20 years for license registration is highlighted, as well as the classification of areas as "available" in cases of cancellation of registration, pursuant to the Mining Code.

# PROVISIONAL PRESIDENTIAL DECREE N° 791/17

# 1. THE INSTITUTION AND COMPETENCIES

Provisional Presidential Decree No. 791, of July 25, 2017, creates the National Agency of Mineral Production (Agência Nacional de Mineração – ANM) to replace the DNPM. The objective is to implement national policies for mining industry activities, including standardization, information management, and control of the use of mineral resources in Brazil.

The ANM, as a regulatory agency submitted to an independent industry regulatory regime and linked to the MME, will succeed DNPM in all legal powers, obligations, rights, revenues, and lawsuits. The new agency will have its headquarters and jurisdiction in the Federal District, and may have regional administrative units.

The specific competences of the ANM were defined in order to promote mineral exploration and development of the mining industry in Brazil. Among its competencies, it is worth noting the obligation to implement the national policy for mining activities by establishing rules and standards for the use of mineral resources, and, in accordance with the guidelines of

## 1. THE INSTITUTION AND COMPETENCIES

the MME, define the technical, legal, financial, requirements and economic issues to be met by interested parties in obtaining mining rights, in addition to establishing industry best practices. The ANM must also manage mining rights and titles for the use of mineral resources, thereby regulating, supervising, and charging debts arising from (a) the CFEM; (b) the annual rate per hectare, the TAH; and (c) other fees, including the supervision of mining activities within the competence of the Federal Government.

The ANM must observe and implement guidelines, rules, and policies set forth in the Mining Code and related legislation, as well as those defined by the MME.

Finally, MP 791/17 also sets forth the three competencies that remain with the MME, that is, they will not be assigned to the ANM: (i) granting of mining concessions; (ii) declaration of expiration and nullity of mining concessions and mine manifests; and (iii) granting prior consent to acts of assignment and transfer of mining concessions and mine manifests.



## 2. ORGANIZATIONAL STRUCTURE AND OPERATIONS

Unlike the present structure of the DNPM, the ANM will be managed by a management board composed of a director general and four directors.

The board and its respective members should follow the following criteria:

- (a)** They shall hold office for five years and shall be Brazilian citizens, nominated and appointed by the Brazilian President, after approval by the Federal Senate, in accordance with article 52 of the 1988 Federal Constitution;
- (b)** The board will be defined by decree and will have a Public Prosecutor's Office, Internal Disciplinary Board, Ombudsman's Office, and Audit Committee;
- (c)** They must meet the requirements set forth in paragraph one of article 9 of MP 791/71 (for example, have at least ten years of professional experience in the public or private sector in the field of activity of the regulatory agency or in an area related to it, in an upper management function); and

## 2. ORGANIZATIONAL STRUCTURE AND OPERATIONS

**(d)** They cannot be classified among the scenarios of prohibition for appointment as a member of the board, as provided in article 12 of MP 791/17 (as a nomination of minister of State, secretary of state, municipal secretary, statutory officer of a political party, and mandate holder in the Legislative Power of any state, even if they are former holders of the positions).

ANM's organizational structure is aligned with other existing regulatory agencies.

### 3. REVENUES

The revenue that will enable the operation of ANM already provided for by MP 791/17 will be constituted by TAH, by the fees due as a necessary condition for the acceptance and processing of applications and requests made to ANM, as well as revenues resulting from fines within its competence, for the areas put into availability, from amounts collected under the newly established Mineral Activity Inspection Fee (TFAM), and the amount collected by way of CFEM.

The TFAM, created by MP 791/17, shall be collected by all holders of mining rights under the authorization regimes for research, mining concession, licensing, and mining prospecting permits. The triggering event for the TFAM is the regular exercise of the police power to oversee mining activities by the ANM. The fee must be collected by April 30 of each year.

The TFAM will be charged according to the stage of the administrative process, according to the values below:

### 3. REVENUES

- (a)** authorization of research until delivery of the final report – R\$ 2,000; and after the presentation of the final research report until the granting of the mining concession – R\$ 1,000;
- (b)** mining concession or mine manifest in force – R\$ 5,000;
- (c)** licensing in force – R\$ 3,000;
- (d)** mining prospecting permit in force owned by a cooperative – R\$ 1,000; and
- (e)** mining permit in force owned by an individual – R\$ 500.

Non-payment or untimely payment of the TFAM will be penalized with a fine corresponding to 50% of the principal amount of the debt.

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