



ARTICLE

# Mining Royalties, Elections and the Constitution in Chile

Chile is now considering new taxes for its mining industry, which could dramatically impact the supply of minerals that are critical for the world's industrialization and energy transition. In particular, we estimate that, if the new taxes are approved, Chilean copper mining companies could see their tax rates increase to as much as 80% and profit margins drop by more than 50% at current copper prices. With this change, Chile would become the nation with the highest tax burden on copper mining, forcing companies to revisit the viability of their current and future investments.

The Chilean Senate is currently reviewing a proposed *Mining Royalties Law* which would impose new taxes on copper and lithium sales.<sup>1</sup> Chile is the world's largest copper producer, so its decisions have an outsized impact on copper supply and prices worldwide.<sup>2</sup> It is also the world's second largest producer of lithium.

Chile has been trending left politically over the past several years. Elections in May 2021 helped non-traditional parties take several seats in the Constituent Assembly in charge of overseeing the drafting of a new and likely more socially conscious constitution, which would favor increased

taxation on mining. The views of the newly elected members of the Assembly differ markedly from those of current President Sebastián Piñera<sup>3</sup> and it appears that in the upcoming presidential elections in November, Chile could well choose a president who also favors higher levels of taxation.

Thus, the passage of the proposed *Mining Royalties Law*, the rewriting of the Chilean constitution, and the results of the presidential elections, will all be critical in determining the future of foreign investment in Chile, as well as having an inordinate impact on the global mining sector.

<sup>1</sup> <https://www.df.cl/noticias/empresas/energia/royalty-minero-senado-calcula-que-el-debate-se-extendera-por-un-mes-en/2021-06-16/195606.html>

<sup>2</sup> <https://consejominero.cl/wp-content/uploads/2021/05/Cifras-Actualizadas-de-la-Mineria-2021-Mayo.pdf>

<sup>3</sup> <https://www.bbc.com/mundo/noticias-america-latina-57139669>

## The Mining Sector in Chile and its Importance for the World Economy

Mining has historically been one of Chile's most important economic sectors with copper representing the lion's share of the sector's contribution to gross domestic product.<sup>4,5</sup>

More broadly, Chile is also the world's largest copper producer, accounting for approximately 28% of global production in 2020.<sup>6</sup>

While Chile's share of global copper production is expected to diminish from 34% in 2010 to about 24% by 2030, the country is projected to remain an irreplaceable source of copper over the next decade.<sup>7</sup>

Copper is a critical mineral for the world's continuing industrialization and, like lithium, is expected to play a key role in the transition towards carbon neutrality. The sharp recovery in demand and relatively tight supply for copper during the Covid-19 pandemic created conditions for a strong rebound in prices in 2021. In February 2021, the price of copper on the London Metal Exchange<sup>8</sup> ("LME") had its most significant daily increase in almost a year and in May 2021 hit a record high at USD 4.6 per pound.<sup>9</sup>

While demand is set to rise, supply of copper will likely remain constrained due to the limited number of large-scale quality mining projects. Increasingly strict sustainability criteria will also affect both the probability and timing of development for greenfield projects. Therefore, any drastic regulatory changes, such as the proposed new royalty in Chile, affecting the costs and returns on mining investments would likely have a major impact on the supply and prices of copper. This would reverberate across the value chains in several key industries globally.



## Political and Social Context of Chile's Proposed Tax Reform

### Chile's unstable political and social context today

Since the protests of 2019 (known in Chile as the *Estallido Social*), swelling social activism has demanded addressing historical inequality in the country.

Following the social unrest, the opposition has dominated Congress,<sup>10</sup> challenging the current government's mandate with a series of initiatives that they claim are intended to help ordinary Chileans recover from the Covid-19 pandemic.<sup>11</sup>

Social unrest, combined with the severe financial impacts of Covid-19 and the contemporaneous rise in copper prices at the start of 2021, prompted members of the National Congress of Chile to consider new tax proposals for the mining industry.<sup>12</sup>

In this context, in March 2021, the National Congress opened debates on the *Mining Royalties Law (Ley de Regalías Mineras)* (the "Bill"), which seeks to introduce a new tax on copper and lithium sales.<sup>13</sup>

<sup>4</sup> The mining sector accounted for 14% of Chile's gross domestic product in the first quarter of 2021

<sup>5</sup> <https://consejominero.cl/wp-content/uploads/2021/05/Cifras-Actualizadas-de-la-Mineria-2021-Mayo.pdf>

<sup>6</sup> <https://consejominero.cl/wp-content/uploads/2021/05/Cifras-Actualizadas-de-la-Mineria-2021-Mayo.pdf>

<sup>7</sup> [https://www.fitchsolutions.com/commodities/global-copper-mining-outlook-29-06-2021?fsWebArticleValidation=true&mkt\\_tok=NzMyLUNLSC03NjcAAAF-JaUcFC9MoskwMhqOkM6MZecoEYfxg\\_o2DHmQZqxqBmihawcER0bzVcmPOxrXNUFcI6MrtRz79Jb\\_jDpu-vxJh0ALA6x4ZQwpVgch3CR-k-xQUBep](https://www.fitchsolutions.com/commodities/global-copper-mining-outlook-29-06-2021?fsWebArticleValidation=true&mkt_tok=NzMyLUNLSC03NjcAAAF-JaUcFC9MoskwMhqOkM6MZecoEYfxg_o2DHmQZqxqBmihawcER0bzVcmPOxrXNUFcI6MrtRz79Jb_jDpu-vxJh0ALA6x4ZQwpVgch3CR-k-xQUBep)

<sup>8</sup> "The London Metal Exchange (LME) is the world's largest and oldest futures and options exchange for trading industrial metals, including aluminium, copper, nickel and zinc." <https://capital.com/london-metal-exchange-definition>

<sup>9</sup> <https://www.nuevamineria.com/revista/alza-del-cobre-diputado-jackson-propone-reforma-tributaria-expres-e-industria-pide-que-debate-no-responda-a-variaciones-en-el-precio/>

<sup>10</sup> The Opposition in Chile has been led by several parties including: Federación Regionalista Verde Social, Partido Comunista de Chile, Partido Socialista de Chile, Democracia Cristiana and Partidol Partido Radical.

<sup>11</sup> <https://www.mining.com/proposed-new-royalty-unsettles-miners-in-chile/>

<sup>12</sup> <https://www.nuevamineria.com/revista/alza-del-cobre-diputado-jackson-propone-reforma-tributaria-expres-e-industria-pide-que-debate-no-responda-a-variaciones-en-el-precio/>

<sup>13</sup> <https://www.bnamericas.com/es/noticias/diputados-chilenos-votaran-proyecto-de-regalias-mineras-esta-semana>



**Proposed Mining Tax Bill approved by the Lower House of Chile’s National Congress**

The Bill was approved in the Lower House (*Cámara Baja*) of the National Congress on May 6, 2021 with 78 votes in favor and 55 votes against.<sup>14</sup> As explained by the Minister of Mines and Energy, Juan Carlos Jobet (“Jobet”), “companies would pay up to 75% in royalties and taxes on sales exceeding 12,000t/y of copper and 50,000t/y of lithium.”<sup>15</sup> The Upper House has since been debating and is expected to vote on the final Bill after July 30, 2021.<sup>16</sup> The Bill requires a two-third majority in the Senate to be approved.<sup>17</sup>

The Bill has come at a complicated time for the country, as Chile is expected to define the constitutional framework that would govern the mining sector. This framework aims to modify and add articles to the Constitution that would be expected to remain the law for at least the next decade.<sup>18</sup>

**What would change if the Mining Royalties Law was passed?**

To understand the Bill, it is vital to compare it with the current legislation. At present, the specific tax on mining activity (*Impuesto Específico a la Actividad Minera-“IEAM”*) “establishes in a progressive manner and in tranches, taxes on the operating margin.”<sup>19</sup> For copper miners, royalty rates vary depending on sales volumes as described in Table 1 below.

*Table 1: IEAM Rate in Chile<sup>20</sup>*

SIZE OF MINING OPERATION	SALES IN METRIC TONNES	ROYALTY RATES
Large	Sales over 50,000 metric tonnes of fine copper <sup>21</sup>	5% to 14%
Medium	Sales between 12,000 and 50,000 metric tonnes of fine copper	0.5% to 1.93%
Small	Sales of less than 12,000 metric tonnes of fine copper	Exempt

<sup>14</sup> <https://www.bloomberg.com/news/articles/2021-05-06/in-top-copper-nation-chile-a-giant-tax-hike-moves-a-step-closer>

<sup>15</sup> <https://www.bnamericas.com/es/noticias/lo-que-pagarian-las-mineras-en-chile-con-la-ley-de-regalias> (translated by the authors)

<sup>16</sup> <https://senado.cl/mineria-verde-para-el-siglo-xxi-aportes-para-la-discusion-sobre-el/senado/2021-07-19/123744.html>

<sup>17</sup> <https://www.mining.com/proposed-new-royalty-unsettles-miners-in-chile/>

<sup>18</sup> <https://camiper.com/tiempominero-noticias-en-mineria-para-el-peru-y-el-mundo/ministro-de-chile-no-respaldara-ley-de-regalias-mineras/>

<sup>19</sup> [https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#\\_ftn2](https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#_ftn2) (translated by the authors)

<sup>20</sup> *Ibid*

<sup>21</sup> “The value of one metric tonne of fine copper is determined according to the Grade A copper spot price average value for the respective fiscal year on the London Metal Exchange. This is published by the Chilean Copper Commission (Comisión Chilena del Cobre) (Cochilco) within the first 30 days of each year (for the rest of the year).” [https://uk.practicallaw.thomsonreuters.com/w-020-5636?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/w-020-5636?transitionType=Default&contextData=(sc.Default)&firstPage=true)

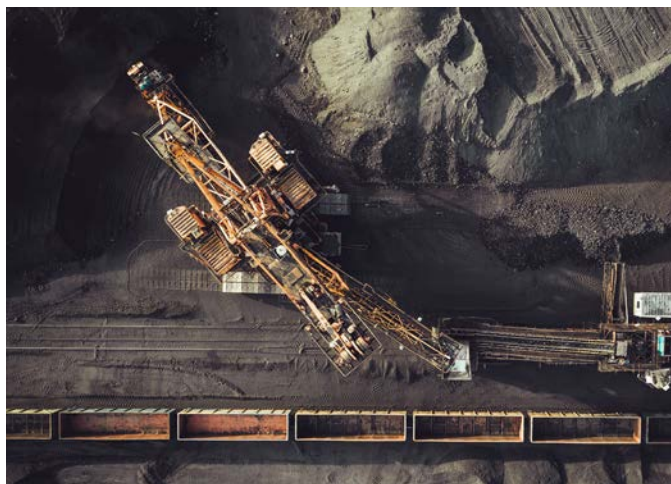
With the existing mechanism, according to sources within Chile’s Ministry of Mining, “most large copper miners in Chile currently pay a flat, or invariable rate regardless of the price of the red metal, under agreements that run through 2023.”<sup>22</sup>

In contrast, the new Bill proposes a basic ad-valorem royalty rate of 3% levied on gross sales of companies with annual production exceeding 12,000 tonnes for copper together with an escalation mechanism depending on the annual average copper price set on the LME, as described in Table 2 below.<sup>23,24</sup> As a result, the 3% rate would only be a ‘floor’ and additional rates would apply as copper prices on the LME exceed certain thresholds.

The Bill also establishes rebates off marginal rates depending on the degree of processing for mined products. Thus, rebates would increase if, for example, smelting and refining of copper occurs in Chile.<sup>25</sup>

Table 2: The Mining Royalties Law Proposed Rate<sup>26</sup>

PRICE PER POUND	MARGINAL RATES OF PROPOSED ROYALTY REGIME
When copper prices are below USD 2.0	3% of revenues
When copper prices are USD 2.0	15% on additional profits generated by the market price
When copper prices reach USD 2.5	35% on additional profits generated by the market price
When copper prices reach USD 3.0	50% on additional profits generated by the market price
When copper prices reach USD 3.5	60% on additional profits generated by the market price
When copper prices reach USD 4.0	75% on additional profits generated by the market price



### Effect of the Bill on the Mining Sector

#### Consequences on Chilean Mining Companies’ Viability

The main argument of the supporters of the new Bill is that it would help address shortfalls in the State’s budget in the face of the Covid-19 pandemic. However, the new royalty would not end when the effects of the pandemic subside.

The result of the proposed new law would be a sharp increase of the miners’ overall tax burden, from 14% to more than 80% for large copper miners according to the Chilean government estimates.<sup>27,28</sup>

We estimate that, as a result, average profit margins for copper mining companies in Chile would drop by more than 55% at copper prices of USD 4 per pound.<sup>29</sup>

The proposed royalty would affect not only private companies but also the state-owned and world’s largest copper mining company, Codelco,<sup>30</sup> and potentially stress financially all mining companies in Chile by increasing their tax burden.

Therefore, with the additional royalty burden, some speculate that a number of Chile’s largest mines could be forced to curtail production or close.

<sup>22</sup> <https://www.reuters.com/world/americas/chile-copper-miners-cry-foul-royalty-bill-advances-senate-2021-05-06/>

<sup>23</sup> <https://www.bnamericas.com/es/noticias/diputados-chilenos-votaran-proyecto-de-regalias-mineras-esta-semana>

<sup>24</sup> The threshold would be 50,000 tonnes for lithium

<sup>25</sup> [https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#\\_ftn2](https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#_ftn2)

<sup>26</sup> <https://www.bnamericas.com/en/news/heres-how-much-miners-would-pay-under-chiles-royalty-bill>

<sup>27</sup> [https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#\\_ftn2](https://www.ciperchile.cl/2021/05/12/el-royalty-acabara-con-la-inversion-minera-una-respuesta-desde-los-ciclos-de-precio/#_ftn2)

<sup>28</sup> <https://www.bloomberg.com/news/articles/2021-05-06/in-top-copper-nation-chile-a-giant-tax-hike-moves-a-step-closer>

<sup>29</sup> On a weighted average basis

<sup>30</sup> <https://mase.lmneuquen.com/chile/chile-debate-un-proyecto-reforma-las-regalias-mineras-n794568>

## Medium to long term impact on investments in Chile

More than half of the foreign-owned copper mines in Chile have agreements that should insulate them from higher royalties until about 2023.<sup>31</sup> However, they and any new investors would be impacted by the new royalty regime starting in 2024.

If the Bill is passed, international mining players could begin to invest in other countries. Wood Mackenzie, an independent industry research firm, noted that *“there is a clear risk that the amendments could compromise the continued appetite for long-term, large-scale investment in the Chilean copper sector.”*<sup>32</sup> The royalty could push the Chilean tax system into pseudo-expropriation territory, and inhibit resource developments and investments, both short and long term.<sup>33</sup>

The mining industry in Chile is alarmed. This comes at a time of growing copper demand worldwide, driven partly by the shift towards a greater share of electric vehicles and renewable energies.<sup>34</sup>

The royalty rates proposed in the Bill are markedly higher than those in other jurisdictions. For example, the average tax burden in South Australia for mining companies is about 44.6%; in Mexico 41.6%; in Peru 40.7% and in British Columbia 40.1%,<sup>35</sup> while the Bill in Chile proposes a royalty that could range from 75% to 80%. Jobet has warned that a tax of this proportion would be higher than that of other competing mineral producing countries such as Peru, Canada, Australia and Mexico, thereby making Chile less competitive than other important mining countries.<sup>36</sup> He quoted Cochilco which indicated that, with the new royalty and a price of copper of USD 4.80 per pound, the overall tax rate for a copper mining company producing 150,000 tons



per year would be 100% of its annual profit.<sup>37</sup> Other critics of the Bill argue that its passage could immediately deter investment, and when the royalty scheme comes into effect in 2024, it could lead to a permanent drop in new investments.<sup>38</sup>

Internationally, we have seen a number of other controversial tax proposals abandoned. For example, in 2014, Australia discontinued the *Mineral Resources Rent Tax (MRRT)*, “a tax levied on super profits of Australian coal and iron ore miners which came into force on 1 July 2012.”<sup>39</sup> It was highly criticized by business leaders who *“called it a ‘sovereign risk’ which was damaging to Australia’s investment reputation.”*<sup>40</sup> The Australian parliament voted to abolish it to preserve the country’s reputation as a good place to invest.

## Political Evolving Landscape in Chile

### Uncertainties concerning the Bill’s passage in the Chilean Senate

The Chilean Senate Mining and Energy Committee is currently reviewing the Bill and the entire Senate is expected to vote on the proposed law after July 30, 2021.<sup>41</sup>

<sup>31</sup> <https://www.reuters.com/article/mineria-chile-goldmansachs-idLTAKCN2D82IB>

<sup>32</sup> <https://elperiodicodelaenergia.com/la-reforma-de-las-regalias-mineras-podria-frenar-el-apetito-de-los-inversores-por-el-sector-del-cobre-chileno/> (translated by the authors)

<sup>33</sup> <https://www.bnamericas.com/es/noticias/diputados-chilenos-votaran-proyecto-de-regalias-mineras-esta-semana>

<sup>34</sup> <https://www.metalbulletin.com/Article/3726147/FORECAST-EV-copper-demand-to-rise-9-fold-by-2027.html#:~:text=The%20growing%20market%20for%20electric,by%20the%20International%20Copper%20Assn.>

<sup>35</sup> <https://www.bnamericas.com/es/noticias/lo-que-pagarian-las-mineras-en-chile-con-la-ley-de-regalias> This tax estimate includes local income taxes plus royalties specific to mining activity. At this moment in Chile, for example, the income tax is 27% and the mining royalty reaches 15%.

<sup>36</sup> <https://www.bnamericas.com/es/noticias/lo-que-pagarian-las-mineras-en-chile-con-la-ley-de-regalias>

<sup>37</sup> *ibid*

<sup>38</sup> *ibid*

<sup>39</sup> <https://www.allenoverly.com/en-gb/global/news-and-insights/publications/australian-government-repeals-controversial-super-profits-mining-tax>

<sup>40</sup> *ibid*

<sup>41</sup> <https://www.senado.cl/royalty-minero-la-dificil-tarea-de-equilibrar-recaudacion-y-desarrollo/senado/2021-07-13/161227.html>

To be sure, the future of the Bill remains uncertain. Considering the current makeup of the Chilean Senate, where the conservative coalition, *Chile Vamos*, has 18 of 43 seats (42%), the passage of the Bill remains a possibility as it could get the two-third majority required.<sup>42</sup> Furthermore, the Senate may introduce modifications influenced by political considerations due to the upcoming elections. Moreover, several critics have questioned the constitutionality of the Bill.

The executive director of the Mining Suppliers Association (*Asociación de Proveedores de la Minería -APRIMIN*), Sergio Hernández (“Hernández”), has openly criticized the Bill during the Senate’s hearings. He has argued that the Bill is unconstitutional, stating that “*we are facing an unconstitutional project because it proposes an unjustified and unfair tax.*”<sup>43</sup> Hernández described the Bill as a serious mistake for the Chilean mining sector, affirming that “*in Chile there has been a mining royalty since 2015, which is the specific tax on mining activity. This new norm does not repeal this tax; therefore, we would end up with a tax rate of almost 80%.*”<sup>44</sup>

## 2021 Elections

The debate and review of the Bill coincides with political turmoil in Chile. In May 2021, the country elected the 155 delegates of the Constituent Assembly who will oversee the drafting of a new constitution. Most of the elected members belong to current opposition parties (53) and non-traditional parties (66).<sup>45</sup>

*The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals. FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm.*

<sup>42</sup> <https://www.duna.cl/media/2017/11/INFORME-FINAL-Candidaturas-Chile-20NOV-.pdf>

<sup>43</sup> <https://www.senado.cl/royalty-minero-la-dificil-tarea-de-equilibrar-recaudacion-y-desarrollo/senado/2021-07-13/161227.html> (Translated by the authors)

<sup>44</sup> [Ibid](#)

<sup>45</sup> <https://www.bbc.com/mundo/noticias-america-latina-57140964>

<sup>46</sup> <https://theglobalamericans.org/2021/05/pinera-stumbles-as-chile-elects-its-constitutional-convention/>

<sup>47</sup> <https://www.bbc.com/mundo/noticias-america-latina-57140964>

<sup>48</sup> <https://www.t13.cl/noticia/elecciones-2021/politica/complicada-parlamentaria-chile-vamos-15-07-2021>

Piñera’s coalition, *Chile Vamos*, received 37 seats, fewer than one third of the seats that are required for his coalition to block proposed laws.<sup>46</sup> The results of this recent election indicate that a large part of the Chilean population does not support, at least today, the current government, and would prefer a shift towards a party with a robust social program and a president from a non-traditional party.<sup>47</sup> This may also influence the Senate’s vote on the Bill. Chile is holding congressional elections in November 2021 and since the Chilean population is looking for a change in government, Senators running for reelection may vote in favor of the Bill to gather their constituents’ support.<sup>48</sup>

We believe it is likely we will see a complete shift in the political orientation of the Chilean government by the end of the year. The Constitutional Assembly election and the presidential primaries indicated that Chile is part of the current *pink tide* trend gaining momentum in Latin America, as seen with the election of Castillo in Peru.

Mining companies and investors around the world will be monitoring closely the upcoming events in Chile. The passage of the Bill, the results of the presidential and congressional elections, as well as the rewriting of the constitution are all critical for the future of foreign investment in Chile and that of the mining industry worldwide.

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