HARMONY™

30 May 2014

Head of Secretariat
Tax Review Secretariat
C/- Department of Treasury
PO Box 542, Waigani
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By email: papers@taxreview.gov.pg

Dear Sir / Madam

RE: HARMONY GOLD – SUBMISSION TO TAX REVIEW COMMITTE

Attached please find the Harmony Gold submission to the PNG Tax Review Committee, in response to the Committee's *Issues Paper No. 1: Mining and Petroleum Taxation* released in March 2014.

Although we had input into the submission made by the PNG Chamber of Mines and support the positions taken and suggestions made in that submission, this submission addresses the issues of particular relevance and concern to Harmony Gold as an investor and operator in mining and minerals exploration in PNG.

Our submission is not intended to replicate the Chamber's paper but rather to expand on those issues in respect of which Harmony believes it is able to make specific and relevant additional comment.

We are available, and would welcome, the opportunity to discuss any of the issues raised in our submission in more detail with the Secretariat or the Committee.

Yours faithfully

Aubrey Testa
Chief Financial Officer

Mary McKinlay
Taxation Manager

Papua New Guinea Taxation Review (2013 – 2015) Issues Paper 1 Submission by Harmony Gold

Introduction

Harmony Gold Mining Company Limited is a listed South African mining company, which owns and operates various mines in the Republic of South Africa. We have been active in PNG since 2003, and are 50:50 participants with Newcrest Mining Limited in various joint ventures in Morobe Province, PNG, including:

- Hidden Valley Joint Venture (HVJV) – Hidden Valley mine operating since 2010
- Morobe Exploration Joint Venture (MEJV) - regional exploration in Morobe Province
- Wafi Golpu Joint Venture (WGJV) – Wafi-Golpu project.

We also have a 100% interest in a number of smaller exploration projects elsewhere in PNG.

This document has been prepared by Harmony Gold in response to the invitation of the PNG Tax Review Committee (TRC) to Mining and Petroleum Taxpayers (MPT) to make submissions for consideration by the TRC.

The Papua New Guinea Chamber of Mines & Petroleum ("Chamber") has separately made a submission in relation to Issues Paper No 1 ("Issues Paper"). Harmony Gold has read and is in agreement with the contents of the submission to the TRC prepared by PwC on behalf of the Chamber. We are also in agreement with the detailed responses to the TRC's questions in its report, prepared by the Chamber.

The purpose of this individual submission is to address some of the points raised in the Issues Paper that are of particular concern to Harmony Gold and on which we feel qualified to add additional comments pertinent to our specific circumstances. Accordingly, what follows is Harmony Gold's particular view of the PNG Mining tax regime.

It is hoped that our comments will be of assistance to the TRC in its endeavours to improve the competitiveness, efficiency, fairness and simplicity of PNG's taxation system, and to fulfil PNG's aspiration to be a competitive middle-income nation in the Asian century.

Overview of Fiscal Policy - Harmony's perspective

Mining makes a very significant contribution to the PNG economy. In 2012 gold contributed 15% of PNG's GDP, the largest of any gold producing country in the world, and PNG's gold exports accounted for 26% of PNG's total exports (second only to Tanzania). Given the extent of this contribution, any process of reform of taxation and equity participation in respect of mining potentially has very far-reaching consequences.

Clearly, the objective is the long-term best interest of the PNG economy and Papua New Guineans. However, this objective cannot be pursued in isolation, and consideration must be given to the interests and objectives of other participants in the industry also.

In the opinion of Harmony Gold, the long term interests of the nation and its citizens will best be served, and optimal outcomes achieved, only when they are balanced against the long-term interests of mine developers, appropriately taking account of the latter's duty to their stakeholders to ensure that sustainable and acceptable levels of profitability, commensurate with the risks assumed by them and competing investment opportunities forgone by them elsewhere, are achieved and maintained.

As correctly noted by the TRC in its Issues Paper, taxation and equity participation are critical financial considerations and are central to any evaluation of a prospective mining investment. Fiscal stability is a further very important consideration, given the high levels of capital expenditure and long time periods from the first commitment to build a mine to production typical of mine development projects. Consequently, a tax regime which is subject to frequent or fundamental changes, or a tax or participation outcome which disproportionately skews the allocation of project benefits in favour of one particular stakeholder or group of stakeholders to the detriment of another, renders it extremely difficult for investors to commit to such projects.

These are, of course, not the only factors to be taken into account when evaluating a project. For instance, the Issues Paper references geological attractiveness and notes that PNG rates very highly in world rankings in that regard.

However, the fiscal regime remains of critical importance, in which regard it is noted that, in a recent study by GMP Securities LLP of taxation trends in the mining industry, PNG rates particularly poorly, being 53rd out of 55 countries ranked on favourability of tax regime. This is largely due to the existence in PNG of a compulsory State Equity (perceived as a tax) and high in-country operating costs. These factors have significant cost and risk implications which impact on profitability and, ultimately, the investment decision.

PNG's poor ranking suggests that there is an urgent need for reform. However, care must be taken to ensure that these reforms will render the country more – not less – attractive to investors. If PNG is to achieve its objective of being internationally competitive and an attractive investment destination, fair and balanced fiscal policies must be adopted, and fiscal stability maintained.

Overview of PNG Mining Sector – Harmony's perspective

The Issues Paper states that the investment climate for mining is more positive now than ten years ago.

Whereas that observation may be correct for the period 2003 -2012 (due to the global boom in commodity prices), it is not correct for 2014. Since 2012, there has been a dramatic decline in the performance of the global resources sector. Commodity prices (in particular gold, but also copper) and productivity have fallen, and at the same time capital and operating costs have increased.

The immediate and obvious consequence of this has been reduced revenue and declining tax and royalty receipts.

More significantly in the context of fiscal regime design, however, is a profoundly changed global economic climate, a significant deterioration in investment sentiment and capital markets less inclined to support projects with long-term horizons.. Investors and capital markets demand returns over growth, and are increasingly risk-averse (including sovereign risk). Exploration and development expenditure has been reduced and mega-projects stopped or downsized, with the focus on lower cost operations with shorter payback periods.

To Harmony Gold's knowledge, these developments have adversely affected a number of the projects and operations cited by the TRC in the Issues Paper.

As for its own projects and operations in PNG, Harmony Gold has invested significantly since it first acquired its interests in the early 2000s. Its cumulative cash investment in exploration up to 30 June 2013 is over 800 million kina and its 50% share of Hidden Valley is 1.6 billion kina.

However, due to the dramatic drop in gold prices from the start of 2013, combined with the high-cost operating environment in PNG, the market value of Harmony Gold's assets in PNG was lower than the cost of building them. As a result Harmony's gold mining assets in PNG were written down in the 2013 financial year by over 430 million kina, which represents a loss of more than 25% on the investment made by Harmony's shareholders in PNG mining assets.

Obviously, this had an impact on the Company's share price and its shareholders' view of large scale investments. However, these recent developments, and their very adverse effects, are nowhere referenced or acknowledged in the Issues Paper.

Similarly, the Issues Paper does not accurately reflect the current situation in exploration. As at March 2014, the MRA tenement update contained a total of only 443 licences, including 177 Current ELs, 108 Renewal ELs, and 158 Application ELs. The 3 year trend shows tenement applications to be in decline (estimated to be by approximately 33% over the period January 2011 to March 2014).

Consequently, contrary to the rosy outlook set forth in the Issues Paper, in Harmony Gold's opinion PNG's resources sector is presently going through its most difficult period since the commencement of the commodity boom in 2003.

Mineral Endowment not the only Investment Criterion

There is no question that PNG is highly geologically prospective. However, care must be taken not to attach overbearing weight to this advantageous attribute. It is by no means the only - or even the predominant - investment criterion and, important though it is, must be weighed against other considerations also associated with the natural attributes of the country.

PNG is a difficult country in which to conduct business. This is mainly due to its very rugged topography and poor level of physical and administrative infrastructure, which poses significant access challenges. Roads and other means of access and communication are often entirely absent, and there is a lack of well-developed social support services, such as health and education. In addition, certain areas of the country pose law and order challenges impacting on site security and non-exclusivity of mining access to tenemented land.

These difficulties impose additional – and sometimes very significant - cost burdens on projects, when developers are required to independently provide infrastructure, community programs and related support services which are – in other countries - provided by the State at the cost of the State.

If the fiscal regime does not adequately recognise the burden borne by developers in this regard, the attractiveness of an investment opportunity flowing from these abundant natural attributes will be rapidly offset against the costs of turning the opportunity to account.

Fiscal Regime for the Mining Sector

Tax policy is tax law and practice as it is, and tax reform looks at how to change the current law and practice. The Issues Paper is not merely remedial (i.e. designed to fix anomalies and problems associated with applying existing law and practice), but evidences a wide-ranging review intended to identify and recommend changes to the tax system as a whole.

The fiscal review coincides with a similarly wide-ranging review of PNG mining legislation and regulations, the outcome of which could itself have a detrimental impact on the climate of investment in the country. Mooted initiatives include possible changes in the quantum and funding of State Equity participation in mining development projects, the increase of non-developer ownership by a further 20%, compulsory on-shore processing of up to 70% of mine production and the prohibition on Fly-in Fly-out workers and a requirement to establish sustainable residential townships.

The implementation of a combination of wide-ranging reform initiatives on a critical employment sector and source of State revenues could have unintended adverse consequences for PNG, especially when undertaken (as it is) against a background of global economic conservatism.

Investors in PNG resource projects already need to take into account the mandatory right of the State to secure up to 30% equity in a project on a de-risked basis. This may appear to be beneficial for PNG – especially in relation to projects that proceed - but in reality it constitutes an economic hurdle that makes investing in PNG less attractive than most other resource countries.

Policies which result in significant financial burdens being imposed on a developer, which delay developer payback or which materially reduce developer returns are ultimately antagonistic to PNG mining investment. Any move to increase the level of equity held by the State or other non-developer third parties, whether acquired at sunk cost or on commercial terms, should be considered in this light.

The greater the non-developer equity participation, the less the aggregate returns for the developer from the project and the more difficult it becomes for the developer to justify to its shareholders and financiers the investment of its capital and other resources. Eventually, this will result in a project not proceeding and the redirection of the developer's resources to some other, more attractive jurisdiction.

The currently proposed policy initiatives are significant by any measure and (if implemented) will, in a profound and fundamental way, impact the way investors view mining project investment in PNG. Therefore, it is critical that detailed, comprehensive and meaningful consultation takes place with industry, and more broadly within the Government, on the implications of the combination of fiscal, mining policy and legislative reforms being contemplated, and that the review and reform processes are not conducted in isolation or independently of one another.

Fiscal Package Design

Any review of the fiscal regime which fails to take all applicable laws and policies into account risks establishing or endorsing a fiscal and regulatory package with unintended adverse outcomes which may take decades to repair.

The Issues Paper declares that:

> "Although they are concessionary rates with regard to the general taxation provisions for PNG, the rates for company income tax and dividend withholding tax are, apart from the level of royalties, broadly in line with those of other mining countries"

If correct, this would suggest that the existing PNG tax regime is comparable to that of other resource rich countries and that the mineral industry in PNG already pays an appropriate amount of tax. Especial care, then, must be exercised to ensure that the current fiscal reforms do not reduce PNG's competitiveness.

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The Issues Paper correctly identifies the fundamental challenge of fiscal regime design – namely, the need for the Government to ensure that the overall investment climate does not impose undue barriers to attracting necessary capital and expertise, while at the same time seeking to maximise the economic benefits to the citizens of the country.

Although it is technically correct, the TRC's observation (on page 15 of the Issues Paper) that:

> *"Their [PNG's mineral and petroleum resources] extraction permanently depletes PNG's inventory of resources, and the right to extract them allows private firms to potentially gain surplus revenues in excess of all costs of production. Accordingly, PNG needs to manage and ensure that the exploitation of these non-renewable resources is done in a way that maximises the economic benefits to the citizens of the country"*

seems not to recognise that investment is returns driven. As previously stated, the economic interests of PNG's citizens cannot be pursued in isolation, and the "maximisation" of those interests is a delicate balancing act. No investment would take place at all were developers not to have the expectation that they will enjoy "surplus revenues" above breakeven, which is to say, profit. Absent extraordinary circumstances, unless developers are confident that they will not only break even but that they will recover sufficient "surplus revenues" to afford them a rate of return at least comparable to other investment opportunities available to them, they will not proceed with a project.

The TRC's observation is especially concerning, since the concept of "normal profit" is raised later in the Issues Paper in the context of resource rents. In Harmony Gold's view, this concept must embrace a competitive return on investment comparable at least to the returns on investment available elsewhere or in some other pursuit, and commensurate with the risks peculiar to the project in question to be assumed by the developer.

Harmony supports the ongoing fiscal differentiation between oil and gas and other minerals. These commodities operate under very different economic and commercial conditions and constraints. Mineral resources are far less economically resilient than oil and gas – and policies like free carries and export quotas are ultimately counterproductive to mineral resource development.

The Issues Paper comments (later on page 15) that a survey has concluded that:

> "the fiscal regime – described as 'method and level of tax levies' – rates only 16th in order of importance for exploration decisions, and 13th in order of importance for mining decisions. Of greater importance are those factors related to geology, profitability, and stability – uncertainty and risk are major deterrents to the attractiveness of a country as an investment destination for mining and petroleum"

We have already cautioned against undue importance being attached to the geological factor. As to the comment above, Harmony Gold considers that the TRC fails to attach sufficient weight to the high (3rd) ranking attaching to 'measure of profitability' in the same survey. A valuation of a project will include the cost of taxes, so we are confident that the measure of profitability cited in the survey included an assessment of the fiscal regime among the range of cost factors.

If reference is to be made to survey findings, it is noted, by contrast, that PNG ranks in the lowest quartile in the Policy Perception Index produced by the Fraser Institute in its recent 'Survey of Mining Companies 2013'. This survey is 'an attempt to assess how mineral endowments and public policy factors such as taxation and regulatory uncertainty affect exploration investment'. The Policy Perception Index (PPI) is a composite index, measuring the overall policy attractiveness of the 112 jurisdictions in the survey, drawn from survey responses to such policy factors affecting investment decisions as uncertainty concerning the administration of current regulations, environmental regulations, regulatory duplication, the legal system and the taxation regime.

The PPI is normalized to a maximum score of 100, and over the period 2009/10 to 2012/13, PNG has declined from a rank of 56/112 [PPI 31.2] to 84/112 [PPI 24.7].

As stated in the Survey report:

> "The effects of policy on deterring exploration investment may not be immediately apparent due to the lag time between when policy changes are implemented and when economic activity is impeded and job losses occur. Many regions around the world have attractive geology and competitive policies, allowing exploration investment to be shifted away from jurisdictions with unattractive policies".

Resource Rent vs State Equity

The TRC has expressly requested feedback on its view that State Equity should be replaced by a Resource Rent of some kind. Harmony agrees - in theory - with the economic analysis presented in the Issues Paper regarding the advantages of a Resource Rent over State Equity, and understands the risk aspects to the Government that are presented in the Paper.

Harmony Gold is in little doubt that the existence of a compulsory State Equity is a significant hurdle to investment in PNG, and is a factor weighing against it as a desirable investment destination. Not many of its competitors have such a requirement, and where that requirement has been introduced, mining investment has reduced.

Moreover, in Harmony Gold's view, there are compelling economic reasons why the State should not be the holder of equity in a project, not least among them being the very real risk of an absence of dividends, exposure to project losses and further unexpected contribution demands, failing which equity participation will be diluted. These are the risks of ownership assumed by every investor, namely that a project may not be as profitable as may have been originally contemplated or hoped. Whether such risks ought to be assumed by Government, and whether the State should forgo the steady and reliable annuity of a fixed or variable royalty for the potential hazards of investment, are profound and far-reaching questions.

However, we will not seek to answer them here.

Rather, Harmony considers that the current State Equity arrangements should be retained for reasons which are entirely pragmatic, namely that the current political climate in PNG is not conducive to or aligned with a reduction or abolition of State Equity. Until the politics surrounding the calls for increased equity participation are resolved and Government is aligned to a particular policy, no changes should be made to the existing system. And then only with great circumspection.

Suffice it to state, for present purposes, that if the introduction of a resource rent is to be considered in the future, Harmony Gold considers that the outcome must be either a State Equity or a Resource Rent, and most certainly not a 'both/and' outcome. In this context, there is no difference between a State Equity acquired by the State as a condition of the exploration tenement and an equity acquired by landowners pursuant to some other law or process – compulsory equity participations and resource rents cannot co-exist without materially adversely affecting project economics.

Moreover, there must be a process of "give and take" in respect of other components of the tax package, if the aggregate fiscal package is not to be unfairly skewed.

Given that there is no 'both/and' option, and given that the current political climate in PNG is not ready for the abolition of State Equity, Harmony Gold recommends that a Resources Rent Tax should not be contemplated at this time.

Resource Rent Taxes – Some General Observations

Notwithstanding the position adopted by Harmony Gold above, we wish to make the following general observations regarding resource rents.

Harmony agrees that a tax system that is efficient, competitive, broad-based and simple to use would be ideal. However, we do not believe that all of the proposals in the Issues Paper will necessarily achieve these outcomes.

A "successful" tax is efficient and fair. Efficiency is about raising the required revenue at the least cost, including the costs of administering and complying. "Fairness" goes to the distortionary costs of misallocation of resources due to tax induced changes in the cost of investing. Harmony Gold agrees with the view expressed by the TRC that variability in fiscal settings gives rise to instability, and that, to that extent, the use of a progressive fiscal regime would arguably improve the country's reputation as a stable destination for investment.

However, much turns on the practical outcomes of the alternative model envisaged by the TRC – namely:

> "*a fiscal package that automatically responds to prevailing commodity prices to enable collection of a greater share of revenues when times are good, and a smaller share when times are bad*".

Commodity cycles are cyclical and volatile, responding to economic events beyond the capacity of any individual miner to control. Very few miners have the capacity to influence their markets, and are generally price-takers. Consequently, while in theory a "resource rent" would appear to be a good solution for mining operations, in practice it is not suited for the uncertain economic environment of global mining or for the current political climate in PNG.

Moreover, the introduction of resource rents is fraught with difficulties and they have rarely been successfully implemented.

Wherever in the world Governments have tried to introduce Resource Rent Taxes, they have encountered significant resistance, and not from the mining industry only. The economic ramifications of such a tax are wide-ranging, and potentially affect businesses seemingly far-removed from mining involvement. Frequently, they have the opposite outcome to that intended, not only failing to achieve their stated objectives but instead becoming themselves barriers to investment. One only needs to consider the poor revenue-raising performance of the Australian "Resources Super Profits Tax" and the adverse impact of such policy on projects in Australia.

In Harmony Gold's opinion, the introduction of such a tax in PNG would be generally counterproductive to the stated aim of PNG becoming a "competitive middle income nation in the Asian century".

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Royalties

Harmony Gold shares the TRC's concerns regarding the imposition of royalties, and agrees that a conceptual argument can be made to shift from a revenue-based system to a profits-based system, provided the correct design can be formulated to properly share risk and reward between government and miners.

However, Harmony does not support the introduction of a profits based sliding scale royalty as a quasi-Resource Rent and would instead prefer to see it introduced as a separate change to the existing royalty regime.

State Equity Participation

The TRC Report states that:

> "*As funds used to finance its share of the project could have been used to generate returns in an alternative project, the State is only better off by the amount of the dividends that exceeds what the State could have obtained in an alternative investment. This excess is roughly a share of the resource rent equivalent to the State's share in the project*".

Firstly, this observation is correct only insofar as the definition of "normal profit" excludes any premium for the risk of mining, which issue is dealt with above.

Secondly, the TRC's somewhat cavalier treatment of sunk costs in the developer's investment decision overlooks the very important fact that, <u>in aggregate</u>, mining companies must recover their sunk capital. The "loss" which the TRC calculates will be suffered by the State in the example it provides in the Issues Paper will equally be suffered by the developer, as its recoveries will not exceed its expenditures in the aggregate.

Sunk costs must eventually be recouped, or else the developer will go out of business.

The TRC is quite correct in its analysis that the State as an equity participant will share in the risks as well as the rewards of the mining operation. As we suggested above, this is precisely why equity is not nearly as attractive an alternative as a risk-free entitlement to profits under a Resource Rent. Moreover, whereas equity does confer "ownership" benefits going to participation in the governance of the project -which addresses to some extent the "political" aspirations attaching to ownership of minerals – these benefits and the levels of participation in governance are proportional only and do not necessarily represent "control". Minority interests exercising operational vetos would be a further, very significant, barrier to investment.

Summary

In summary, whatever form the resource rent takes, it comes at a cost to the developer. If it takes the form of a tax, it reduces the returns from the project. If it comes in the form of equity participation, it reduces the upfront value uplift of the project to the developer (since the State will take up its equity at actual sunk cost, rather than on the basis of the value of the de–risked project itself) and proportionately diminishes its future returns from the project.

At some equity level, the returns available to the developer will not be sufficient to justify the investment of capital and human resources in the project.

This means that:

1. Very few projects can sustain the burden of both a resource rent in the form of a tax on "surplus profit" together with equity participation. It must be one or the other;

2. The combination of a State-held equity and an entitlement for landowners to take up a further landowner-held equity may reduce the mining companies' proportion of ownership to a level which renders the project economically and operationally unattractive, especially if more than one mining company is involved (as in the Morobe Mining Joint Venture).

3. Any change to the equity participation arrangements currently in place which has the effect that the State will not be required to immediately reimburse the mining company for its pro rata

share of sunk costs will impose a significant further financial burden on the developer, delay payback on its capital investment and constitute a disincentive to mining investment in PNG.

Exploration

Harmony Gold agrees with the observations of the TRC that there is a significant backlog and delay in processing of licence applications and renewals.

However, we consider that this backlog is the result of an unusually high number of historical applications, which trend has subsequently reduced significantly with the global financial crisis and the end of the commodities boom. That is not to say that the capacity of the department should not be increased in any event, in order to cope with the administrative burden upon it.

The existing Mining legislation anticipates “land banking”, and has made provision to prevent it.

Harmony does not consider that the mooted cash bidding system is an appropriate means of allocating exploration licences, nor that its introduction will alleviate the backlog or lead to a speedier turnover of licence applications. On the contrary, its sole outcome will be to generate some little revenue for the State (should the bid require payment to be made to the State over and above work performed on the land), but at the price of discouraging exploration.

Exploration is inherently risky and the proportion of failed projects is high. Consequently, it is the first activity to be cut back in times of financial hardship. Therefore, this endeavour should not be further burdened by a cash component which rewards deep pockets and a taste for the gamble over such other, more valuable criteria as technical capacity, experience and a genuine and demonstrated commitment to responsible exploration and development.

An additional danger is that the greater the “bid”, the less the “spend” on the work program. Mining companies do not have unlimited funds for exploration, and to divert money to up-front cash tenders is to diminish actual exploration by the same amount. It is in PNG’s interest that the maximum amount is expended on actual exploration activities, since it is these that unlock the resource and produce enduring revenue generation.

Double Deduction for Exploration Expenditure

The issues paper refers to the history surrounding the introduction of the section 155N double deduction for exploration expenditure and notes that it was introduced in the early 2000s to address low levels of exploration. The TRC poses the question whether this incentive is still required.

Harmony is strongly of the view that this deduction is very much required and should not be abolished.

As noted above, the TRC’s assumption that there is a boom in exploration activity is no longer correct. In times of financial hardship, exploration expenditure is always the first to be cut, and exploration activity in PNG is declining.

Consequently, Harmony Gold considers that it would be extremely detrimental to mineral exploration if PNG to abolish the double deduction incentive at this time, especially if exploration project modelling has been completed on the basis that it will be available.

Aligning Income Taxes

Harmony Gold is concerned that the TRC, by its statement (on page 27 of the Issues Paper) that:

> " *with high metal prices, the income tax applicable to mining projects is no longer in itself likely to capture a fair share of resource rents for PNG*",

fails to sufficiently take into account the other, non-fiscal benefits which flow to PNG and citizens under the provisions of Mining Development Contracts negotiated with the State. Although they do not take the form of a direct tax, these benefits nevertheless represent material cashflows from the miner to the community which are financed from the exploitation of the resource.

As pointed out above and in the submission prepared by PricewaterhouseCoopers Papua New Guinea (PwC) on behalf of the Chamber, PNG is already one of the most difficult countries in the world in which to do business.

It is critical that any fiscal regime design takes these significant, additional costs into account, if PNG is to retain its competitive edge.

Conclusion

Harmony Gold considers that, whereas there are areas within PNG's current tax regime that could be improved, it is fundamentally competitive and efficient in its present form.

As a company committed to investment in PNG, with a track record of exploration and mine development in the country and keen to bring new mining projects to fruition, Harmony Gold considers that significant changes to the existing fiscal framework will jeopardise the creditable advances made by the country as a desirable investment destination, and will not be in the best interests of the country generally, or the development of its mineral resources in particular.

We thank you for providing us with the opportunity to respond to the Issues Paper, and hope that the comments and observations contained herein will assist the TRC and Government to frame a stable and competitive fiscal policy which will serve PNG and its citizens well in the years ahead.

Schedule One

Harmony's response to specific consultation questions in the Issues Paper

Exploration

Question 4.1 – Do stakeholders consider that the current process of awarding exploration licenses in PNG is appropriate? Why or why not?

Harmony Gold considers that the current exploration licence application process (for minerals) is transparent and fair, and provides a clear path for maintaining title through to mine development and operation. This is critical for maintaining investor participation in the mining industry in PNG. The system is "country specific", in that the applicant's capacity and history in PNG, and the local community's views, are taken into account.

However, the selected statistics in the discussion paper do not reflect the current situation. There are not 2200 exploration licences presently issued. As at March 2014 the MRA tenement update contained a total of 443 licences including 177 Current ELs, 108 Renewal ELs, and 158 Application ELs.

The 3 year trend shows that the number of current exploration licences and new tenement application area is in decline. Total area under tenure in PNG has declined 33% from 510,000 sq km in January 2011 to the current 342,000 sq km (March 2014).

Without the burst in coal related title in the Western and Madang provinces, the decline in exploration tenure would be much more severe. It is anticipated that the MRA will confirm these trends, with the number of new applications dramatically reduced from previous year levels.

A highest bidder system;

- is susceptible to corruption and undermines confidence in the ability to maintain title over major resource discoveries which require multi-million dollar exploration drill programs to develop
- does not guarantee that the bidding company has the financial and technical capacity to undertake the work;
- limits the ability of individuals to peg title and test innovative new exploration concepts
- shifts the goal posts in favour of major companies which are not recognised within the industry as the most successful explorers;
- requires a whole new administrative system to ensure honesty and transparency, and to differentiate genuine bids from those of speculators.

Question 4.2 – In principle, should PNG consider moving towards a competitive tendering process based upon cash bidding? If so, should this process be applied to outstanding applications, with a moratorium introduced for the issuing of new applications until such a process is put in place?

An upfront cash bid is a disincentive to take up exploration rights, and does not promote real "in-ground" expenditure:

- Expected revenue under such a scheme is questionable, as its highly unlikely mining companies will pay large amounts of cash to undertake greenfield activities
- Exploration is a major expense to shareholders, and the pool of capital available to undertake such activities is limited (especially in the current climate);

The consequence of the above is fewer discoveries and less economic development.

In the current economic climate, a moratorium and application of a new system to outstanding and future applications in minerals exploration will destabilise and deter investors, and will also make it difficult to finance existing major projects.

Finally, these questions and the discussion paper circulated appear to be compiled in isolation of the current Mining act revision and overlook the long term economic benefit derived from exploration.

Question 4.3 – Is the double deduction still required as an incentive to promote exploration, given the changes in PNG since it was first introduced?

Harmony Gold is strongly of the opinion that the double deduction is an important incentive to exploration. It is a significant contributor to the economic feasibility of projects, without which certain of them might not go ahead.

While the deduction is called a “double” deduction, given the very low number of successful mines that arise from greenfields exploration expenditure and given the significant investment in exploration in PNG Harmony, its existence is a very important component of the investment evaluation.

Question 5.6 – in addition to the piercing of the ring fence, should taxpayers be allowed to make contributions to a mine closure trust to bring forward deductions for decommissioning expenses into the income producing phase of a ring fenced project?

Mine Closure costs are difficult from a tax perspective in that the substantial costs occur at the end of a project when there is generally little revenue.

While the piercing of the ring fence is welcome, it only helps if there is more than one project.

Harmony would like to see the option of making deductions when provisions are made to the Mine Closure Provision, provided that there is an agreed formula for such provisions (eg percentage of ore mined or some similar formula from an approved mine plan).

If deductions are only permitted for cash contributions, Harmony Gold would prefer that a Trust be set up by the investor , subject of course to Government Regulation regarding the amounts to be contributed and rules for withdrawals.

An alternative would be to provide for a tax credit carry-back if at the end of the project there is insufficient income to offset the expenditure. This occurs in Australia for the Minerals Resource Rent Tax, which is also a project based tax. To the extent deductions exceed income, a credit of previously paid tax is allowed (capped at the amount of tax paid.)

Question 6.1 – Do stakeholders agree with the pros and cons of State equity participation as described? What other factors might be relevant when considering the benefits of State participation?

See below

Question 6.2 – What are stakeholders' views on the value of the State having a carried interest in a project?

See below

Question 6.3 – As a general principle, do stakeholders agree that the State should focus on ensuring it collects a proportion of any resource rents in new projects through an appropriately framed fiscal instrument rather than through State participation?

Refer to the discussion in the main body of our paper. Given the current review of the Mining Act and the calls for increased non-developer ownership, Harmony recommends that the Government resolves its position on direct State and landowner equity participation (already, effectively, a "tax") before considering any additional resource rent type taxes.

As noted above, the introduction of resource rents is universally considered to be a disincentive to investment and there are no examples of successful implementation among resource rich countries.

Royalty and Development Levy

Question 7.1 – do stakeholders agree that royalty rates should be maintained, with a focus instead on developing an appropriately framed resource rent tax?

As noted above we do not want to see a Resource Rent tax introduced while State Equity exists. However, a Sliding Royalty allowing for a lower rate for marginal mines would be preferable with a higher rate for extremely profitable mines. South Africa has a system that provides for royalty rates for gold to range from 0.5% to 5% depending on the profitability of the project.