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***Royalties, Taxation And Valuation - Bhp  
Diamond Mine Environmental Assessment  
Panel***

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# **ROYALTIES, TAXATION AND VALUATION**

**Submission to the  
BHP Diamond Mine Environmental Assessment Panel  
Yellowknife, NT**

**Prepared by**

**Government of the Northwest Territories**

**Department of Energy, Mines and Petroleum Resources  
Department of Finance**

**February, 1996**

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## 1.0 ROYALTIES AND TAXATION

The NWT Diamonds Project will generate a significant stream of royalty and taxation revenue. Our calculations indicate that these revenues will, on average, be about \$150 million per year over the first ten years of operation.

However, most of the incremental tax revenues collected by the Government of the Northwest Territories (GNWT), including corporate income tax, personal income tax, and commodity taxes, will substantially be offset by reductions in the grant from Canada. The GNWT also does not currently receive any share of royalties from resource development in the NWT.

Therefore, under current fiscal arrangements, the GNWT will receive little net financial benefit from the considerable government revenues generated by the Project. For every dollar collected and retained by the GNWT from the Project, the federal government will receive over twenty five dollars.

This lack of fiscal benefit from resource development is one of the reasons why the GNWT is seeking to secure northern control over northern resources, and access to resource revenues.

The advantages of diamond mining development will be accompanied by additional demands on already overburdened government resources in areas such as, but not limited to, education, policing, health care and social services. Equitable northern control over resource revenues will help to offset the potential adverse impacts.

## 2.0 VALUATION

Unlike most other commodities, there is no simple, objective method to place a reasonably accurate value on a production of rough uncut diamonds for tax and royalty purposes. There is no standard world price for a carat of diamond. The value of a diamond depends on characteristics such as carat (weight), color, clarity and shape. Small differences within these characteristics can make a significant difference to their value.

**Sales** of specific diamonds, or a parcel of diamonds (an assortment), are very difficult to track and audit. Sales in major trading centers such as **Antwerp** are unregulated and there is a **very** large "black" market. The open market for diamonds operates with little or no paper trail, and sales are often undeclared. In this context, they can be thought of as a form of currency without serial numbers.

Manipulation of sales is pervasive throughout the industry into which the NWT diamond production would be sold. The nature of diamonds, with their very high value to weight and

the difficulty of linking any written documentation, also facilitates tax evasion and smuggling, which are common in the business.

**In response to this problem, diamond producing jurisdictions generally require that there be an independent valuation of their diamond production.** The GNWT believes that the requirement of a valuation to be carried out prior to export, to back up sales reports, is a prudent measure to ensure that the sales returns upon which royalty revenues and corporate income taxes are based, reflect fair market price.

The ability to audit the revenue from a diamond mine is an important consideration in the administration of taxes, which the GNWT has responsibility for, and royalties. Although the GNWT currently does not **have** responsibility for royalties, it is assumed that this responsibility will be transferred in the near future.

The GNWT's opinion on the need for valuation is not a reflection on the integrity of the proponent. We believe, however, that there will be more than one diamond mine in the NWT.

A policy on valuation and auditing of sales should not be designed around a single operator, who in any case is one party to the many sales transactions that will be taking place in unregulated, foreign jurisdictions. Indeed, the GNWT believes that a valuation will protect the interests of the proponent by helping to ensure that fair market values are being realized for their actual production.

The GNWT also believes that the valuation should occur prior to export from the NWT, and as close as possible to the mine itself.

Diamond valuation is often associated with diamond sorting. Sorting involves the grouping of an assortment of rough diamonds into common categories, which adds to the value of the assortment. There are many levels or degrees of sorting and a single diamond could be "sorted" a number of times before it is **finally** cut. Most major diamond producing jurisdictions have established diamond sorting operations, which provide significant additional employment benefits.

Local sorting is feasible in the NWT, but would require a strong commitment from government and a substantial lead time. The GNWT would be interested in pursuing this opportunity in the future, following **devolution**. However, the issues and complexities involved in establishing a sorting operation should not become confused with the much more straightforward process involved in valuation.

The valuation process would involve the appointment of a government valuator or valuers by the government responsible for the collection of royalties. The valuation of actual



production would be based on a representative percentage sample being taken from a production over a fixed time period, such as one month.

The cut-off would then be cleaned and delivered under joint company and government seal to a location where the valuation would be conducted in the presence of representatives of the producer and government. By examining a valid sample of actual production and comparing them to current market sales, valutors are able to place an accurate value on a production of diamonds.

### 3.0 RECOMMENDATION

**We recommend that the federal government, the proponent and the GNWT work together to establish a mutually acceptable system for the valuation of the production from the NWT Diamonds Project, and that the valuation be conducted in the NWT.**