

**A LEGAL PERSPECTIVE  
OF TAXATION IN THE ZAMBIAN COPPER MINING INDUSTRY  
FOLLOWING THE PRIVATISATION PROGRAMME**

**BY**

**CLARE MUSONDA**

**UNZA**

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## Declaration

I, Clare Musonda, do solemnly declare that this dissertation represents my own work which has not previously been submitted at this or another University.

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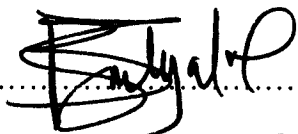
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## Approval

This dissertation of Clare Musonda is approved as fulfilling the requirements for the award of the Bachelor of Laws Degree.

Signed

Date



14/04/2010

DR. N. SIMBYAKULA

## Abstract

The study's main objective was to explore whether or not the tax system in the mining sector in Zambia prior to and in the aftermath of the privatisation of the sector has contributed to making the fiscal landscape in Zambia more or less equitable and shed light on the major tax concessions offered to the new mining investors in the wake of the privatisation programme.

While mining is the largest single economic activity in Zambia and has enjoyed increasingly higher earnings in the post-privatisation era on account not only of increased production levels but also soaring international metal prices, there has been a lingering view that its contribution to tax revenue in the years following the privatisation programme has been inordinately low. Additionally, the secrecy surrounding the development agreements signed between the government and the new mining investors has led to considerable suspicion and speculation as to the contents therein and the reasons behind such substantial tax concessions. As a result, the rest of the Zambian taxpayers have had to shoulder the tax burden while the mining conglomerates have been allowed to freely externalise their earnings. Hence the fiscal regime in Zambia and in the mining industry in particular, has been seen as contributing to the heightening inequality and poverty and promoting corruption, among other things.

This study traced the legislative changes in the taxation of the mining sector for the period 1995 to 2009 in order to get a clear picture with regard to taxation in the sector, as well as the sector's earnings and taxes paid over the period under review, in addition to the provisions of the development agreements. An effort was also made to review available documents on the taxation of extractive sectors in jurisdictions other than Zambia. It emerged through the study that the increases in the earnings of the mining sector in Zambia have not been matched by corresponding increases in the tax contributions of the sector. In light of the findings of the study, various recommendations are made with regard to how this issue could be addressed both at domestic level as well as the role that can be played by various international players in this matter.

## **Dedication**

This study is dedicated to my children, Mushinka and Chipo, for their sacrifice and unwavering support throughout my studies, and for the encouragement they have given me despite their being of tender age. To my husband and my extended family, particularly my siblings and my parents, I will forever remain indebted to you for your unfailing understanding even when things were very difficult.

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## Table of Statutes

Mines and Minerals Act of 1972-----	Page 13
Mines and Minerals Development Act of 1995-----	Page 13
Mineral Royalty Tax Act-----	Page 15
Income Tax Act, Chapter 323-----	Page 19

## Table of Contents

### CHAPTER ONE

<b>1.0</b>	<b>INTRODUCTION</b>	Page 1
1.1	Background Information	Page 2
1.2	Statement of the Problem	Page 7
1.3	Purpose of the Study	Page 8
1.4	Objectives of the Study	Page 8
1.5	Hypothesis	Page 8
1.6	Research Questions	Page 8
1.7	Significance of the Study	Page 10
1.8	Operational Definition of Terms	Page 11
1.9	Methodology	Page 12
1.10	Research Lay Out	Page 12

### CHAPTER TWO

<b>2.0</b>	<b>TAXATION OF THE MINING INDUSTRY IN ZAMBIA – 1995 to 2009</b>	Page 13
2.1	Historical Background: From Nationalisation to Privatisation	Page 13
2.2	Taxation of the Mining Industry during the Privatisation and Post Privatisation Period	Page 15
2.3	Legislative Changes	Page 16
2.4	Mining Sector Earnings and Taxes Paid by the Sector During the period 1995 to 2009	Page 20

## **CHAPTER THREE**

### **3.0 TAXATION OF EXTRACTIVE INDUSTRIES IN SOME JURISDICTIONS OTHER THAN ZAMBIA**

3.1	Introduction-----	Page 25
3.2	Chile-----	Page 26
3.3	Peru-----	Page 27
3.4	Tanzania-----	Page 28
3.5	Ghana-----	Page 30

## **CHAPTER FOUR**

4.0	RESEARCH FINDINGS AND ANALYSIS-----	Page 31
-----	-------------------------------------	---------

## **CHAPTER FIVE**

5.0	RECOMMENDATIONS AND CONCLUSION-----	Page 34
5.1	Recommendations-----	Page 34
5.1.1	Need for Systemic Changes-----	Page 34
5.1.2	Need for Increased Transparency-----	Page 34
5.1.3	Domestic Legislative Measures-----	Page 35
5.1.4	Measures at International Level-----	Page 35
5.1.5	Role to be Played by International Donors-----	Page 35
5.2	Conclusion-----	Page 36

	BIBLIOGRAPHY-----	Page 37
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# CHAPTER ONE

## 1.0 INTRODUCTION

The government budget is the government's plan for the collection and distribution of revenues. In Zambia, government revenues are principally derived from taxation. Taxation, whether direct or indirect, is a legislated burden imposed upon individuals and entities to raise money to support government operations. One of the core principles of taxation is the principle of equity. Governments use fiscal policies to partially redistribute wealth from the rich to the poor and in this way, the budget's taxation and expenditure mechanisms can be used to achieve equity. Under this principle, each taxpayer should contribute his or her fair share to the cost of government. One way of determining a fair share is by using the benefits a taxpayer derives from the government. Whilst this is the most equitable method, it is difficult to determine and measure the benefits a taxpayer enjoys from the government. Another way to ensure equity of taxation is for persons with equal capacity to pay the same (horizontal equity) while people with greater capacity pay more (vertical equity). This method is easier to use and is based on the income levels of the individual or organisation<sup>1</sup>. To achieve this, a progressive taxation system is used, one where the marginal rate of taxation is greater than the average rate of taxation. This means that the higher income households,

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<sup>1</sup> M D Kamanga and C Mulolani Income Taxation in Zambia, Zambia Centre for Accountancy Studies, Lusaka, 2008, p. 8.

individuals or entities not only pay more absolute tax bills but also pay a greater proportion of their income and wealth in taxation<sup>2</sup>.

In recent years, there have been increasing demands in Zambia for the government to increase public expenditure, and the government has, therefore, been compelled to increase the revenue yield. A key issue in this regard has for a long time been how to broaden the tax base without compromising equity. At the same time, in the quest to create an enabling environment to attract foreign direct investment, the government has lost revenue through the granting of generous tax incentives, concessions, rebates, breaks and holidays<sup>3</sup> to foreign investors in general. This has resulted in a serious mismatch between available resources and the expenditure plans of the government. Since it has been difficult to increase internal or external borrowing and no new tax or non tax revenue sources have been identified, government's response to the fiscal squeeze has been to keep on increasing taxes.

## **1.1 Background Information**

The Zambian copper mining industry was nationalised in the late 1960s and it was re-privatised between 1997 and 2000. From the outset, it is important to note that the copper mining industry has traditionally been the backbone of Zambia's economy. In fact, some experts estimate that copper has for many years contributed 90 per cent of the

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<sup>2</sup> Kamanga et al, *Income Taxation in Zambia*, p. 6-7.

<sup>3</sup> Kamanga et al, *Income Taxation in Zambia*, p. 109.

country's foreign exchange earnings<sup>4</sup>. In this regard, it is notable that, backed by high international commodity (and specifically copper) prices, Zambia's gross domestic product in 1969 exceeded that of South Korea and Brazil<sup>5</sup>. In the early 1970s, revenue from all copper mining operations, run by the state-owned Zambia Consolidated Copper Mines Company (ZCCM), provided two-thirds of government revenue<sup>6</sup>, funding the provision of health and education services for all, as well as investment in development of the agricultural and other sectors. However, for almost two decades prior to its privatisation, the sector's position deteriorated precipitously, with the cost of production of copper escalating significantly, largely due to lack of capitalisation of the assets. By March, 1996, ZCCM was diagnosed to be in need of life sustaining injection of about US\$2 billion<sup>7</sup> to avoid complete collapse, and its privatisation became a national emergency.

As part of the privatisation process, the Zambian Government entered into development agreements with the buyers of the mining assets, offering, among other things, fiscal incentives in an effort to encourage the mobilisation and entry of fresh capital into the sector. It was felt that a favourable tax climate was essential in order to avoid overburdening the cost structure of the (new) privately owned companies that would invest in copper mining under the privatisation programme. The justification for a shift to lower tax rates and other tax concessions offered to foreign mining companies was that

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<sup>4</sup> Chamber of Mines, Survey of the Zambian Mining Industry, 1995 to 2004.

<sup>5</sup> Kato Lambrechts (Editor), *Breaking the Curse: How Transparent Taxation and Fair Taxes Can Turn Africa's Mineral Wealth into Development*, Open Society Institute of Southern Africa, Johannesburg, March, 2009, p 6.

<sup>6</sup> Ibid.

<sup>7</sup> Francis Kaunda, *Selling the Family Silver: The Zambian Copper Mines Story*, Interpak Books, KwaZulu-Natal, 2002, p 37.

capital for mining was scarce, given low international metal prices; therefore, Zambia had to compete with other mining countries to attract high risk capital by developing a competitive tax regime. According to this strategy, investors required competitive terms and conditions and iron clad assurances that the investment environment would be stable and that the rules of the game would not change<sup>8</sup>. The result of this strategy was that the mining sector has been characterised by incentives negotiated on a case-by-case basis by companies that purchased the privatised entities from ZCCM. The crux of the matter, however, is that mining contributions to total tax revenues has been extremely small since the privatisation of the sector<sup>9</sup>.

Against the background of soaring international metal prices following the privatisation of the copper mining industry, many Zambians waited with bated breath for the mining industry to begin to contribute to the economic turn around of their country through an improved contribution to national revenues in view of the recapitalisation of the sector after the completion of the privatisation process. This expectation was brought into sharper focus in light of the fact that the new mining investors imported most of their mining equipment, as well as the technical, financial and managerial services needed to run the mines since most of these were not locally available. Further, industrial mining companies created very little forward or backward linkages into the local economy that would stimulate more private sector development and job creation since once extracted, raw ore was exported for further refinement or processing elsewhere. Furthermore, given

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<sup>8</sup> Kato Lambrechts, *Breaking the Curse: How Transparent Taxation and Fair Taxes Can Turn Africa's Mineral Wealth into Development*, p 7

<sup>9</sup> Peter Langmead et al (Editors), *Sectoral Study of the Effective Tax Burden*, in *Tax Policy Issues in Zambia: Selected Papers*, Foreign Investment Advisory Service, a Cooperation between the International Finance Corporation and The World Bank, Langmead and Baker Limited, Lusaka, 2006, p55

the capital intensive nature of industrial mining, these companies created very few jobs relative to the abundant labour supply in the country. In fact, these expectations of the Zambian populace were not entirely misplaced, with consensus among the United Nations Commission on Trade and Development (UNCTAD), the United Nations Economic Commission for Africa (UNECA) and the International Monetary Fund (IMF) that the paramount development benefit of mining in Africa is the potential to generate public revenue through a transparent tax and budget system. As UNCTAD states in a 2007 report, the potentially most important contribution from mineral extraction is the rise in host-country income<sup>10</sup>. In addition, Zambians have not forgotten that they were assured prior to the privatisation process by the government through the then Minister of Finance, Ronald Penza, not to fear that when foreign investors took over the running of ZCCM, they would externalise the money as Zambia would benefit from taxes paid by the mines<sup>11</sup>.

In light of the foregoing, a cross section of Zambians expressed serious concern over the fact that mining companies received what they considered to be tax subsidies by paying lower tax rates than other companies; reducing their tax base through special allowances; and being exempt from paying certain types of taxes. In fact, one study found that the sector was enjoying a Marginal Effective Tax Rate (METR) of zero percent in 2006. In particular, with expensing of many equipment purchases, and moderately accelerated depreciated deductions for the rest, the METR on machinery at the time of the study

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<sup>10</sup> World Investment Report 2007: Transnational Corporations, Extractive Industries and Development, UNCTAD, 2007.

<sup>11</sup> Francis Kaunda, *Selling the Family Silver*, p 37

reflected the largest subsidy (-18.3 per cent) received in any sector for any asset<sup>12</sup>. These concerns were somewhat echoed by Derek Webbstock, former Chief Executive of Luanshya Copper Mines Plc, in an interview<sup>13</sup> when he said, “You must never forget that, anywhere in the world, the wealth in the ground belongs to every citizen. Now that’s a bit mushy for a hard-nosed businessman, but that’s the reality and that’s where the expectations arise.” Similarly, in the political arena, the “subsidies” offered to the mining companies have attracted considerable comment. On one hand, the opposition Patriotic Front campaigned against the ruling Movement for Multiparty Democracy during the run up to the 2006 general elections on the platform that, among other things, it would increase corporate taxes, particularly in the mining sector. Patriotic Front leader and presidential candidate, Michael Sata, stated at an election campaign rally in Mandevu, in Lusaka on 27 September, 2006 (the eve of the election) that, “After tomorrow, you must say no to poverty. After tomorrow you must say no to unemployment. What we want is Zambia for Zambians. People are making money over our heads”<sup>14</sup>. On the other hand, it is notable that even statements by very senior members of the Zambian government reflected these concerns. The then Minister of Finance and National Planning, Ng’andu Magande, is quoted as having publicly stated that “As the prices of copper and other metals continue to boom on the world market, the country needs to benefit as well.”<sup>15</sup> Additionally, acknowledging the rejection of the government’s mining tax policy by a large proportion of voters in the 2006 general elections, the then Republican President,

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<sup>12</sup>Peter Langmead et al (Editors), Sectoral Study of the Effective Tax Burden, p55.

<sup>13</sup>Alastair Fraser and John Lungu, For Whom the Windfalls? Winners and Losers in the Privatisation of Zambia’s Copper Mines’, Zambia Civil Society Trade Network and Catholic Centre for Justice Development and Peace) (CCJDP, now Caritas), 2006, p1.

<sup>14</sup> Ibid.

<sup>15</sup> Mining Companies Must Pay, Mail and Guardian, South Africa 16<sup>th</sup> October, 2006.

Levy P Mwanawasa, in his first address to the National Assembly following the election, in which his party lost all urban parliamentary seats in the Copperbelt region to the opposition Patriotic Front, said, “Zambians spoke clearly and loudly and we will reflect seriously on their concerns...whilst we have made important macroeconomic gains, admittedly the standard of living of the majority of Zambians remains poor.”<sup>16</sup>

## **1.2 Statement of the Problem**

Since the conclusion of the privatisation of the copper mining industry, there has been a lingering perception among different sections of Zambian society that the sector received so many fiscal incentives that it would not contribute its fair share to government revenues. It has not escaped notice that while mining is the largest single economic activity in the country and has enjoyed increasingly higher earnings on account of soaring international metal prices, its contribution to tax revenue in the years following the privatisation programme has been low. This has strengthened the argument that the mining sector fiscal regime has compromised the ability of the sector to contribute to the development of the country, thus making the Zambian tax system inequitable. This view has been heightened by the fact that information relating to the terms of the development agreements has been difficult to access, giving rise to speculation about the actual terms of the sale of the mines with regard to, among other things, fiscal incentives, among many Zambians.

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<sup>16</sup> Official Opening Address by President Levy P Mwanawasa, SC, to the First Session of the Tenth National Assembly, 28 October, 2006

### **1.3 Purpose of the Study**

The purpose of this study is to contribute to the availability of accurate information with regard to the taxation of the copper mining industry before and after its privatisation. The study is also expected to produce a chronology of the levels of taxation in the sector and its contribution to tax revenues before and after conclusion of the privatisation programme. In the process, it is expected that it will become apparent as to whether or not the tax regime imposed on the copper mining industry following its privatisation has contributed to making the Zambian fiscal landscape more or less equitable.

### **1.4 Objectives of the Study**

The specific objectives of the study are:

- to trace the trends in the taxation of the copper mining sector before privatisation;
- to contribute to the availability of accurate and full information on the fiscal incentives offered to the new mining investors as part of the privatisation of the copper mining industry in Zambia;
- to ascertain the current tax contribution by players in the copper mining industry in Zambia;

- to examine the taxation trends in the extractive industries in jurisdictions other than Zambia; and
- to evaluate whether or not the post privatisation tax regime in the copper mining sector has contributed to making the Zambian fiscal landscape more or less equitable.

## **1.5 Hypothesis**

The following hypotheses are made:

- The incentives offered to the copper mining sector have led to a reduction in the contribution of the copper mining sector to tax revenues after privatisation of the sector; and
- The Zambian fiscal landscape has become less equitable on account of the fiscal incentives offered to the buyers of the mines during the privatisation of the sector.

## **1.6 Research Questions**

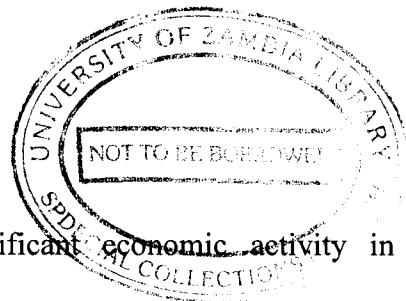
The following are the key questions that the study seeks to answer:

- What was the level of contributions in terms of taxes paid by the mining industry prior to the privatisation of the industry?

- What were the fiscal terms offered to the new investors in the mining industry as part of the privatisation process?
- What has been the level of contributions, in terms of taxes, of the mining industry to national revenues since the privatisation of the industry?
- Have the fiscal terms offered to the new investors in the mining industry resulted in the industry contributing more or less to national revenue?
- Have the fiscal terms offered to the new investors in the mining industry enhanced or undermined equity on the Zambian fiscal landscape?

### 1.7 Significance of the Study

Copper mining, being the single most significant economic activity in Zambia, understandably attracts vivid interest from most Zambians, who have expressed serious concern at various fora, not only about the lack of accurate and full information regarding the fiscal incentives offered to the buyers of the country's mining assets, but also with regard to the perceived low contribution of the sector to national revenues, let alone the country's development efforts. It has, therefore, been averred that the Zambian tax system is inequitable because it is one in which the highest earning sector is among the lowest contributors in terms of taxes. However, most such arguments have been based on speculation and conjecture and not on full and accurate information about the fiscal



regime governing the sector as such information has simply not been readily available. Therefore, this study is significant as it is aimed at addressing this lack of clear, accurate and full information. The study also seeks to help clarify and clear up any misconceptions that might exist with regard to the actual fiscal terms agreed with the new mine owners after the privatisation programme. The study is also important because its findings will act as an advocacy tool for those, be they public officials or otherwise, who seek to push for the possible review of the mining sector fiscal regime in order to enhance the equity of the Zambian fiscal landscape, or indeed those who seek to defend the *status quo*.

## 1.8 Operational Definition of Terms

The following key terms and words will be used in the study as outlined below:

- **Equity** – this term is used in the study to mean fairness in the tax system, that is to say that those who earn higher incomes are subjected to higher taxes.
- **Marginal Tax Rate** – In this study, this refers to the tax rate charged on any incremental earnings by a taxpayer.
- **Mining sector or mining industry** – In this study this will be used to mean the copper mining sector whose privatisation was undertaken by the government between 1997 and 2000.

## **1.9 Methodology**

This proposed study will essentially rely on primary sources such as interviews of key players in the mining and taxation industries. Secondary sources such as Acts of Parliament, mining development agreements, parliamentary debates and reports, books, periodicals, journals, internet sources, newspaper articles and reports will also be consulted.

## **1.10 Research Lay Out**

This report begins with an Introduction in Chapter One, followed by an outline of key issues relating to taxation of the mining sector in Zambia during the period 1995 to 2009 in Chapter Two. Chapter Three traces the taxation systems relating to extractive industries in some jurisdictions other than Zambia. Chapter Four will present the main findings of the study and a brief analysis of the findings. The Recommendations and Conclusion are presented in Chapter Five.

## CHAPTER TWO

### 2.0 TAXATION OF THE MINING INDUSTRY IN ZAMBIA – 1995 to 2009

#### 2.1 Historical Background: From Nationalisation to Privatisation

When Zambia won her political independence in 1964, the country's first President, Kenneth Kaunda and his United National Independence Party (UNIP) inspired great hopes for development. Central to the Government's plans was the growth of the copper industry, driven by favourable world prices through the late 1960s and early 1970s. Mining transformed the Copperbelt into a dynamic urban and industrial region, and the country was seen as the model for a continent moving rapidly towards political and economic independence, industrialisation and an end to poverty<sup>17</sup>. In 1969, Zambia was classified as a middle-income country, with one of the highest GDPs in Africa, three times that of Kenya, twice that of Egypt, higher than Brazil, Malaysia, Turkey and South Korea<sup>18</sup>. However, in 1968, President Kaunda raised concerns that from independence, the two companies that owned the mines had invested little new money in the operations. The companies claimed that the royalty system by which they were taxed dissuaded investment. The Government responded in 1969 by announcing the nationalisation of the mines. The two nationalised companies were combined in 1982 to form the Zambia Consolidated Copper Mines (ZCCM) Limited. It is notable that during the years of good international copper prices, mining contributed over 50 per cent of the country's foreign exchange and two-thirds of the central government revenue<sup>19</sup>.

Although major progress was made in the first decade of independence, developments slowed down when the price of copper collapsed after the first oil crisis in 1974, forcing Zambia to borrow in order to sustain the provision of social services. After the second oil crisis in 1979, interest rates shot up and Zambia was thrown into a severe debt crisis. For

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<sup>17</sup> Alistair Fraser et al, 'For Whom the Windfalls?' p. 7

<sup>18</sup> James Ferguson, *Expectations of Modernity: Myths and Meanings of Urban Life on the Zambian Copperbelt*, University of California Press, Berkeley and Los Angeles, California, 1999, p.6.

<sup>19</sup> Central Statistical Office, *Living Conditions Monitoring Survey 2004, 2005*.

twenty years, the economy collapsed at an internationally unprecedented rate as copper prices continued to fall relative to the price of imports. Between 1974 and 1994, per capita income declined by 50 per cent, leaving Zambia the twenty fifth poorest country in the world<sup>20</sup> Throughout this economic crisis, ZCCM continued to be treated as a 'cash cow', milked without corresponding investment in machinery and prospecting ventures, and the mines suffered from little investment, as had been the case before 1969. With little investment in exploration and drilling, and a lack of spares in equipment and machinery, no new mines were opened after 1979. As the ore bodies within the existing mines were found deeper and deeper, the cost of production shot up. ZCCM production collapsed from a high of 750,000 tonnes in 1973 to 257,000 tonnes in 2000<sup>21</sup>.

The mounting debt to the international financial institutions (the World Bank and the International Monetary Fund (IMF)), coupled with the Zambian Government's inability to fund government expenditures from mining income provided leverage to the international financial institutions to push the country to adopt their economic liberalisation policies, which were tightly policed by these international institutions. Hence in 1983, Zambia embarked on her first structural adjustment programmes (SAPs), which resulted in austerity measures, making the UNIP government highly unpopular. Facing popular unrest, the Zambian government tried to disengage from the SAP, but almost all of Zambia's donors collectively starved the country of much needed assistance, and the country was forced to return to the IMF programme. However, by then a change of government had become inevitable. By October 1991, UNIP was compelled to hold early general elections, which ushered in a new government under the newly formed Movement for Multiparty Democracy (MMD)<sup>22</sup>. The MMD ran on a manifesto that promised to liberalise the economy, and privatise publicly owned enterprises, and encourage fresh investment into the economy. Concomitantly, the MMD enjoyed massive donor support as aid money poured in, and the Zambian budget became over 40

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<sup>20</sup>James Ferguson, *Expectations of Modernity: Myths and Meanings of Urban Life on the Zambian Copperbelt* 1999, p.6

<sup>21</sup> Chamber of Mines of Zambia, *Survey of the Zambian Mining Industry 1995 to 2004*, October, 2005, p.8.

<sup>22</sup>Fraser A et al, 'For Whom the Windfalls?' p 9.

per cent donor dependent<sup>23</sup>. As part of this aid boom, Zambia contracted loans with a huge range of economic conditions attached. Many of these conditions related to the privatisation of 280 parastatal companies. The privatisation programme kicked off in 1992, and by June 1996, 137 companies had been sold<sup>24</sup>.

From the start, the crown jewels of the privatisation process were understood to be the copper mines. As early as 1993, Zambia's second Privatisation and Industrial Reform Credit (PIRC II) from the World Bank required that the Government study options for privatising ZCCM. After repeated demands by both the IMF and the World Bank for the privatisation of ZCCM, and considerable procrastination by the government for technical and political reasons, the issue became a sticking point in the relations with donors, with repeated accusations of bad faith on either side<sup>25</sup>. Eventually, the pressure by the donors was brought to bear, and in 1995, the Mines and Minerals Act of 1972 was repealed to give way to the Mines and Minerals Development Act of 1995, which provided for various incentives for investors in mining. While not specifying the amounts of these forms of relief, the Act permitted the government to enter into development agreements, under which they may extend more incentives than the Act granted.

## **2.2 Taxation of the Mining Industry during the Privatisation and Post Privatisation Period**

From the time the Government made the decision to privatise ZCCM, a series of fiscal measures were put in place in an effort to encourage prospective buyers to invest in the Zambian mines. In an effort to elucidate these measures, this paragraph traces the developments on the Zambian fiscal landscape with specific reference to mining sector during the period 1995 to 2009.

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<sup>23</sup> Gretchen Bauer and Scott D Taylor, *Politics in Southern Africa: State and Society in Transition*, Lynn Reine, Boulder, Colorado, 2005, p70

<sup>24</sup> Fraser A et al, 'For Whom the Windfalls?' p 10.

<sup>25</sup> Lishala C Situmbeko and Jack Jones Zulu, *Zambia: Condemned to Debt: How the World Bank have Undermined Development*, World Development Movement, London, 2004, p19.

### 2.3 Legislative Changes

While no specific fiscal incentives for the mining sector were introduced in 1995, the Minister of Finance and Economic Development, as he was then designated, did allude even at that early stage generally to the Government's intention to improve the investment climate significantly through reduction of Government participation in the economy, reduction in trade taxes and encouragement of competition in the industrial sector in particular<sup>26</sup>.

In 1996, the Government expected mining to make a major contribution to economic growth, export earnings and tax revenue. In line with this expectation, the Government introduced taxation of small scale mining operations, while reducing duty on productive machinery for mining (and agriculture) from 20 per cent to zero per cent. The Government also removed the Value Added Tax exemption on copper and cobalt with effect from 1<sup>st</sup> April 1996. At that time, ZCCM paid VAT on both its domestic purchases and imports. By removing the exemption, exports of copper and cobalt were zero-rated, hence this measure was meant to put ZCCM on the same footing as other manufacturers. There was also an effort to align the income tax provisions of the Mines and Minerals Act with those of the Income Tax Act by abolishing the super tax on large scale mining enterprises<sup>27</sup>.

In 1997, no major changes were effected as the changes made were merely administrative, mainly involving the shifting of the levying of taxes under the Mines and Minerals Act shift from the Minister of Mines and Mineral Development to the Minister of Finance and Economic Development in line with the existing legal provisions. The other change was the incorporation of the taxation provisions in the Mineral Royalty Tax Act, as a consequence of which that Act was repealed<sup>28</sup>.

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<sup>26</sup> 1995 National Budget Speech.

<sup>27</sup> 1996 National Budget Speech.

<sup>28</sup> 1997 National Budget Speech.

In the 1998 Budget Speech, the Minister of Finance and Economic Development reiterated the fact that the mining industry remained the back bone of the Zambian economy and also that the sector required substantial recapitalisation in order to restore high levels of production as well as reduce costs. He announced that, therefore, after protracted negotiations with the successor companies of ZCCM, Government had agreed to some significant concessions. Firstly, the Mineral Royalty Tax rate was to be reduced from 3 per cent to 2 per cent while the withholding tax rate on interest and dividends would be reduced from 15 per cent to 10 per cent. Further, the restrictions of offsetting losses against profits which was limited to 20 per cent for mines which had a common owner, but were geographically not adjacent was removed, so that henceforth 100 per cent of losses could be offset<sup>29</sup>. No major changes to the fiscal landscape in the mining sector were introduced in 1999.

The final and most important stage of privatisation was the negotiation and signing of development agreements with each of the companies. These documents established the terms under which the mines were sold, and the rights and responsibilities of the Zambian state and the new mining companies. The original agreements were negotiated between 1997 and 2000. In 2000, the Government legislated tax concessions to support the privatisation of the remaining major assets of ZCCM Limited. Government at that time also agreed to extend to the new mining companies the concessions to successor companies of ZCCM, namely Konkola Copper Mines Plc (KCM) and Mopani Copper Mines (MCM)<sup>30</sup>. While it is difficult to access copies of all the development agreements, it is possible to identify the key trends as they are all very similar. The agreements contained fiscal clauses, stability clauses as well as clauses that made the agreements override the Zambian tax laws<sup>31</sup>.

The major concessions granted in the agreements included the reduction of Mineral Royalty rate from 3 per cent to 0.6 per cent of gross value; the reduction of Corporate

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<sup>29</sup>1998 National Budget Speech.

<sup>30</sup>Report of the Secretary to the Treasury on Mining Taxation Issues presented to the Expanded Committee on Estimates, Lusaka, 2008, p.2.

<sup>31</sup>Presentation by Peter Phiri, Assistant Director, Zambia Revenue Authority to the Tax Sensitisation Workshop for Members of Parliament, National Assembly, Lusaka, 2008.

Tax rate from 35 per cent to 25 per cent and increase in the period for loss carry forward for KCM to twenty years from ten years. With respect to withholding tax on interest, dividends, royalties and management fees paid to shareholders and affiliates, these were reduced from 15 per cent to zero per cent. Further, the mines were deemed '1975 new mines' in order to allow for the deduction of 100 per cent of capital expenditure in the year the expenditure was incurred<sup>32</sup>. It is significant to note that at the time the Zambian Government was negotiating and legislating these concessions, the financial position of ZCCM was critical as the company was in fact being subsidised by the state.

In 2002, the Government realised that there was an uneven playing field in the taxation of mining companies as KCM and MCM enjoyed a more favourable taxation regime than that applicable to other mining companies. As an initial step towards leveling the playing field, the Government extended the above tax concessions to other mining companies involved in copper and cobalt production<sup>33</sup>. No major changes to the sector's fiscal regime were introduced between 2003 and 2005.

In addition to the above incentives, the Government in 2006 decided that all the tax incentives that applied to the mining of copper and cobalt under the *Income Tax Act* and the *Mines and Minerals Development Act of 1995* be extended to all other base metals. This was in recognition of the fact that the country engaged in exploitation of base metals other than copper and cobalt,<sup>34</sup>.

In 2007, the Government realised that metal prices on the international markets had reached unprecedented high levels and continued their upward trend and also that the nation needed to begin to enjoy the benefits accruing from the higher earnings resulting from exploitation of its mineral resources. In light of this, the Zambian Government decided to review the incentives offered to the mining companies prior to and shortly after the privatisation process.

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<sup>32</sup>Secretary to the Treasury, Report on Mining Taxation Issues, p2.

<sup>33</sup>Ibid.

<sup>34</sup>Ibid.

In light of the foregoing, the Government effected an increase in company income tax for the mining sector from 25 to 30 per cent while the Mineral Royalty rate was increased from 0.6 per cent to 3 per cent of gross value for base metals. Furthermore, withholding tax on dividends, interests, royalties, management fees and payments to affiliates or subcontractors in the mining sector at the standard rate of 15 per cent was re-introduced<sup>35</sup>. At the same time, section 9 of the Mines and Minerals Development Act of 1995 was reviewed with the aim of ensuring that development agreements were subordinate to the law and binding only to the extent and confines of the law. The Government also sought to explicitly provide that there shall be no fiscal term or tax schedule provided in the development agreements and that all fiscal matters should be provided for in the respective tax codes and only cross referenced in the development agreements. This was aimed at preventing any attempts to provide for or negotiate any fiscal terms outside the Zambian tax laws<sup>36</sup>.

In 2008, the Zambian government introduced a new fiscal and regulatory framework for the mining sector. The main features of this new fiscal regime were a revised corporate tax rate of 30 per cent; a mineral royalty rate (on base metals) of 3 per cent of gross value; withholding tax on interest, royalties, management fees and payment to affiliates or subcontractors in the mining sector at the rate of 15 per cent; and withholding tax on dividends at zero percent. Other measures introduced were a variable profit tax of up to 15 per cent on taxable income which was above 8 per cent of the gross income; a windfall tax to be triggered at different price levels for different base metals: for copper the windfall tax was to be 25 per cent at the copper price of US\$2.50 per pound but below US\$3.00 per pound, 50 per cent of the price for the next 50 cents increase in price and 75 per cent for prices above US\$ 3.50 per pound; capital allowance that was a depreciation of capital equipment would be reduced from 100 per cent to 25 per cent per year; capital expenditures on new projects would henceforth be ring-fenced and only become deductible when the projects started production<sup>37</sup>.

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<sup>35</sup>Ng'andu Peter Magande, Minister of Finance and National planning, 2007 National Budget Speech

<sup>36</sup>Ibid.

<sup>37</sup>Ng'andu Peter Magande, Minister of Finance and National Planning, 2008 National Budget Speech.

In addition to these, the new regime provided that hedging as a risk management mechanism was to be treated as a separate activity from mining and a reference price which would be the deemed arms length price was introduced for the purpose of assessing mineral royalties and any transactions for the sale of base metals, gemstones or precious metals between related or associated parties. The reference price would be the price tenable at London metal exchange, metal bulletin or any other commodity exchange market recognised by the Commissioner General of the Zambia Revenue Authority<sup>38</sup>.

The new fiscal regime in the mining sector introduced in the 2008 fiscal year was short-lived, however, and was effectively reversed early in 2009 when the newly appointed Minister of Finance and National Planning announced a number of fiscal measures “in order to support this vital industry and enhance its competitiveness in the world market.”<sup>39</sup> The revision involved the removal of the windfall tax while the variable profits tax was retained. The Minister believed that the variable profits tax would still capture any windfall gains that may arise in the mining sector. Further, all hedging income was to be treated as part of mining income for tax purposes and the capital was increased to 100 per cent as an investment incentive<sup>40</sup>. It must be noted that all the changes proposed by the Minister of Finance during this period were effected through relevant amendments to the Income Tax Act, Cap 323 of the Laws of Zambia in each fiscal year, respectively.

## **2.4 Mining Sector Earnings and Taxes Paid by the Sector during the period 1995 to 2009**

In order to fully appreciate the effects of the above legislative changes on the earnings of the mining sector and relate these earnings to the taxes paid by the sector during the period under review, it is necessary to trace the trends of these variables during that period.

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<sup>38</sup>Ibid.

<sup>39</sup>Dr Situmbeko Musokotwane, Minister of Finance and National Planning, 2009 National Budget Speech.

<sup>40</sup>Ibid.

Low production levels coupled with low international metal prices meant that in the years immediately prior to privatisation, the earnings of the mining sector were relatively low, as were the sector's contributions to the treasury in terms of taxes. This trend changed a few years after the end of the privatisation process, both because the production levels improved in the sector and also because metal prices on the international market rose dramatically. It was the unprecedented rise in international metal prices that compelled the Zambian Government to review the taxation system under the development agreements on the basis that the prevailing regime could not offer the Government a meaningful revenue contribution, was grossly unbalanced and inequitable<sup>41</sup>. In 1995, mining sector export earnings totaled US\$1,038,950.01<sup>42</sup>. In that year, the sector contributed a total of K37.14 billion or a proportion of 7 per cent of national tax revenues<sup>43</sup>. By the close of 1996, Zambian mineral exports recorded reduced earnings of US\$813,267.49<sup>44</sup> while the mining sector contributed K16.71 billion or 2 per cent in taxes to the treasury<sup>45</sup>. At the end of the following year, 1997, mining sector export earnings amounted to US\$ 855,975.24<sup>46</sup>, with the sector contributing K19.05 billion or 2 per cent of total tax revenue<sup>47</sup>. By end of the 1998 fiscal year, the mining sector earned US\$562,141.92 from its mining exports, and paid K17.47 billion in taxes, translating into 1.6 per cent of the national tax revenues. In 1999, the mining sector earned US\$468,177.74 from its exports during that year and paid K13.71 billion, or 1 per cent of national revenues, in taxes.

In 2000, the sector earned US\$634,194.88 while in 2001 it earned US\$727,052.24, contributing K5.42 billion and K8.89 billion (or 0.3 per cent and 0.4 per cent) to tax revenues respectively during that period. In 2002, the sector earned US\$668,483.42 and paid K3.36 billion or 0.18 per cent of total national taxes. The sector's earnings rose consistently from US\$796,107.59 in 2003 to US\$1,371,081.50 in 2004 and

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<sup>41</sup>Secretary to the Treasury, Report on Mining Taxation Issues, p3.

<sup>42</sup>Bank of Zambia, Economics Department, Annual Mineral Export Earnings in Zambia (1995 to 2009), 2010

<sup>43</sup>Zambia Revenue Authority Research Department Report, 2010

<sup>44</sup>Bank of Zambia, Annual Mineral Export Earnings in Zambia, 2010

<sup>45</sup>Zambia Revenue Authority Research Department Report, 2010

<sup>46</sup>Bank of Zambia, Annual Mineral Export Earnings in Zambia, 2010

<sup>47</sup>Zambia Revenue Authority, Research Department Report, 2010

US\$1,680,767.13 in 2005. In terms of tax contributions, the sector paid K8.88 billion or 0.25 per cent in 2003, K6.20 billion or 0.14 per cent in 2004 and K35.32 billion or 0.64 per cent in 2005 to total national revenues respectively.

As international metal prices continued to improve, the sector realised US\$3, 181,217.73 in export earnings in 2006 and contributed K218.92 billion or a total of 3.46 per cent of total tax revenue. In the 2007 fiscal year, the mining sector earned US\$3,667,722.98 from its exports and contributed a total amount of K670.13 billion or 8.18 per cent to national tax revenue. In 2008, the mining industry exported US\$4,004,004.98 worth of output and contributed K1,027.27 billion or 10.63 per cent of total tax revenue. Preliminary export earnings in the mining sector in 2009 amounted to US\$3,283,852.11 with tax contributions totaling K636.1 billion or 6.6 per cent of national tax revenues.

In the interest of clarity, the figures quoted above are presented in tabular form below.

YEAR	EXPORT EARNINGS (US\$ '000)	PERCENTAGE CHANGE IN EARNINGS OVER PREVIOUS YEAR	TAX PAID (K'Billions)	MINING REVENUE/TOTAL ECONOMY REVENUE RATIO	PERCENTAGE CHANGE IN MINING REVENUE/TOTAL ECONOMY REVENUE RATIO OVER PREVIOUS YEAR
1995	1,038,950.01	-	37.14	7%	-
1996	813,267.49	-21.72%	16.71	2%	-5%
1997	855,975.24	5.25%	19.05	2%	0
1998	562,141.92	-34.32%	17.47	1.6%	-0.4%
1999	468,177.74	-16.71%	13.71	1%	-0.6%
2000	634,194.88	35.46%	5.42	0.3%	-0.7%
2001	727,052.24	14.64%	8.89	0.4%	0.1%
2002	668,483.42	-8.05%	3.36	0.18%	-0.22%
2003	796,107.59	19.09%	8.88	0.25%	0.07%
2004	1,371,081.50	72.22%	6.2	0.14%	-0.11%
2005	1,680,767.13	22.59%	35.32	0.64%	0.46%
2006	3,181,217.73	89.27%	218.92	3.46%	2.82%
2007	3,667,722.98	15.29%	670.13	8.18%	4.72%
2008	4,004,004.98	9.17%	1,027.27	10.63%	2.45%
2009	3,283,852.11	-17.99%	636.1	6.57%	-38.07%

The table above shows that the proportion of total national taxes contributed by the mining sector has not increased in proportion to increases in the sector's earnings. While in some fiscal years the sector's earnings have increased significantly, the level of increase of tax contributions has been minimal or even negative. A good example of this is the situation in 2004 when the earnings of the sector increased by 72.22 per cent compared to the earnings in 2003. In the same period, the ratio of sector's tax revenue contribution to national revenues reduced by 0.11 per cent. Between 2004 and 2005, the increase in the sector's earnings was 22.59 per cent, while the increase in the sector's tax contribution in comparison to total economic revenues was a mere 0.46 percent. This trend is observable in almost all the years in the post privatisation period. Of particular interest is the period from 2006 when it became apparent that the metal prices on the

international market were reaching unprecedented levels and the sector's earnings steadily and significantly increased. Notably, the significant increases recorded in the earnings of the sector during this period were not matched by a corresponding increase in contributions in terms of taxes by the mining sector to the treasury. In fact, even in 2008 when the windfall tax was introduced, there was little change in this trend, largely because of resistance by most of the mining companies to pay the windfall tax. There was a marked reduction of 6.5 per cent in the earnings of the sector in 2009; and this can ostensibly be accounted for by the problems that rocked the international economy as a whole in relation to the world economic recession. It is, however, notable that the contribution of the sector to tax revenue reduced by 38.07 per cent, which is totally disproportionate to the reduction in its earnings.

According to the Zambian Government, the trend depicted above came about because the development agreement fiscal regime represented an average Effective Tax Rate (before 2007), of 31.7 per cent for mining companies which was by far the lowest in the world<sup>48</sup>. The problem was compounded by perceived transfer pricing practices by most mining companies in that there were indications that some mining companies quoted lower prices than those prevailing at the London Metal Exchange<sup>49</sup> and lack of capacity by the Zambian tax authorities to undertake tax audits of the mining companies. In this regard, it was not possible to verify, monitor and audit various claims by the mining companies relating to their earnings through effective tax compliance audits. Considering the complexities of mining operations, this lack of capacity created room for mining companies to evade tax through cost escalation, management fees, shareholder loans and, as earlier stated, transfer pricing. This situation was found to be unacceptable, hence the fiscal changes introduced in 2007 and 2008.

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<sup>48</sup>Secretary to the Treasury Report on Mining Taxation Issues, p4

<sup>49</sup>Ibid.

## CHAPTER THREE

### 3.0 TAXATION OF EXTRACTIVE INDUSTRIES IN SOME JURISDICTIONS OTHER THAN ZAMBIA

#### 3.1 Introduction

The mining sector is important in a wide range of economies providing, for example, a source of export revenue as well as government revenue through minerals taxation arrangements. The aim in minerals taxation policy is to enable governments to collect a reasonable return from the extraction of the community's mineral resources, while ensuring that industry outcomes remain efficient and administrative costs are not excessive.

To illustrate the importance of minerals as a source of export earnings and taxation revenue in a wide range of countries, a review of United Nations trade data shows that world exports of selected major mineral resources — including coal, iron ore, base metals, bauxite, alumina and aluminium, and tin — were valued at US\$448 billion in 2006 comprising US\$49 billion for coal, US\$108 billion for ores and concentrates and US\$291 billion for metals<sup>50</sup>. Developed economies accounted for 51 per cent of world exports of these commodities (40 per cent for ores and concentrates). Mineral taxation revenue accounts for a significant share of total fiscal revenue in several countries — most notably, over the period 2000-05, this share was 62.5 per cent in Botswana, 17.9 per cent in Papua New Guinea, 17.8 per cent in Guinea, 9.4 per cent in Chile, 8.2 per cent in Mongolia and 5.9 per cent in Namibia<sup>51</sup>

From an economic perspective, mineral deposits are a natural form of wealth that generate a resource rent following mineral extraction. The resource rent represents a return on the mineral resource. This resource rent provides the economic justification for

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<sup>50</sup>United Nations Commodity Trade Statistics Yearbook 2006 (available at <http://comtrade.un.org/pb/>).

<sup>51</sup>International Monetary Fund Report, 2007.

governments to consider introducing some form of minerals taxation. While specific arrangements vary between countries, mineral resources in the ground may generally be considered to be owned by the community and the government, on behalf of the community, transfers exploration and production rights to companies in the mining sector in return for a minerals taxation payment (or resource royalty payment). This Chapter briefly explores the taxation arrangements of some countries whose economies are dependent on their extractive industries.

### **3.2 Chile**

In Chile, copper accounts for around 16 per cent of fiscal income (some 10 per cent from the sales of the Corporacion Nacional del Cobre de Chile (CODELCO), the state copper producer, and the remainder from taxation of private mining companies). Through its Structural Balance Policy, the Government of Chile recognises that the behaviour of the country's effective GDP is not the only important source of cyclical variations in fiscal income in Chile. The Chilean Government also recognises the fact that the fiscal income from copper is a direct function of the copper price, the behaviour of which is highly cyclical. Therefore, there is a direct correlation between the fiscal income received from copper mining and the prevailing international metal prices. An overview of the mining sector in Chile reveals, for example, that in 1994 the international price of copper averaged 100 US Cents, the fiscal income earned from copper by the Chilean Government was about 1.7 million Chilean Pesos, while in 2003, the international price of copper averaged 80 US Cents and the Chilean government earned about 1.5 million Chilean Pesos from copper mining. In keeping with this trend, in 2006 when international metal prices took a sharp upward turn, the international price of copper averaged 300 US Cents and the Chilean Government earned about 5.2 million Chilean

Pesos from the copper mining industry<sup>52</sup>. Similarly, a sharp increase in the price of molybdenum, a by-product of copper marketed by CODELCO, meant that this mineral, which had previously been insignificant as regards fiscal income, also became a relevant factor as from 2005, accounting for close to 6 per cent of total fiscal income. As a result, cyclical adjustment of fiscal income from molybdenum also became necessary since there is an important correlation between its price and the income that the central government receives from the sales of CODELCO<sup>53</sup>.

### 3.3 Peru

In Peru, there has been some controversy over how the mining sector ought to be taxed. Tax breaks as well as tax stability agreements obtained by large mining companies during the rule of former president Alberto Fujimori (1990-2000) meant that companies paid lower income taxes on their profits. According to Peruvian economist Juan Aste Daffós, between 1998 and 2003, income tax paid by mining companies in Peru totaled, on average, 2.7 per cent of the total tax revenue received by the Peruvian state in this period. On the other hand, Peruvian miners claimed that they paid a lot of taxes. For example, Peruvian mining businessman Augusto Baertl maintained that mining was the economic activity that paid the most income tax in the country. He stated that in 2003, for example, mining companies paid around \$300 million, which was 23 per cent of total income tax revenues. On the contrary, Aste Daffós argued that mineral prices were cyclical and for this reason a long period should be considered in order to establish the average of taxes paid rather than taking a year of high international prices like 2003 as a reference<sup>54</sup>.

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<sup>52</sup>Jorge Rodr guez C, Carla Tokman R Alejandra Vega C, Structural Balance Policy in Chile in Studies In Public Finance, December 2007, p7

<sup>53</sup>Ibid., p.8

<sup>54</sup>Chile, Peru - How Much do Mining Companies Contribute?  
[http://www.fsa.ulaval.ca/rdip/cal/lectures/aff\\_actualites/chile\\_peru\\_-\\_how\\_much\\_do\\_.htm](http://www.fsa.ulaval.ca/rdip/cal/lectures/aff_actualites/chile_peru_-_how_much_do_.htm)

For a number of years, the issue of royalties and the mining canon law generated heated debate in Peru. In 2002, Congress modified the mining canon law, increasing income tax from 20 percent to 50 per cent. Although the measure seemed positive, the mining canon was small, reaching just 0.7 per cent of mining exports. The Peruvian mining canon was also very small compared with income generated by sales. For example, in the 1993-2002 period, the canon paid by Minera Yanacocha, Latin America's biggest gold producer, was just 3 per cent of its mineral sales<sup>55</sup>.

In June 2004, Peru's Congress approved the royalties law, which applied a charge of 1 per cent on sales of \$60 million, 2 per cent for sales of \$60-\$120 million and of 3 percent for sales over \$120 million. Even though the bill was signed into law by the Peruvian President a month later, debate on the issue continued. One of the points in discussion was the proposal that the royalties should be linked to the level of international metal prices. In 2009, the legislature in Peru sought to pass a law to oblige mining companies to make larger economic contributions by paying royalties. It was estimated the state would receive around \$40 million in revenues in royalties in that year<sup>56</sup>.

### **3.4 Tanzania**

The Mineral Policy of the United Republic of Tanzania was promulgated in 1997. As part of the policy, the Government undertook to formulate and implement a mining taxation regime which would be conducive to investment in exploration and mining development. The tax package was envisaged to recognise the investor's need to recover exploration and development outlays, to achieve a rate of return commensurate with risk, to repatriate dividends and to meet financial obligations with creditors and suppliers. In formulating the fiscal regime, the Government would aim to balance the country's

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<sup>55</sup>Ibid.

<sup>56</sup>Ibid.

interest with those of investors by ensuring that the mining taxation regime was equitable, stable and predictable, non-distortionary and internationally competitive<sup>57</sup>.

In 2006, following the promulgation of the policy, the Tanzanian Minister for Energy and Minerals stated that Tanzania's mining fiscal regime included corporate tax at 30 per cent, mineral royalty at the rate of 3 per cent for gold; 5 per cent for diamond; and zero per cent for cut gemstone. No import duties were chargeable on capital goods for exploration and mine development, with a cap of 5 per cent after the first anniversary of commercial operation. Mining investors were also offered special relief on value added tax, withholding taxes on dividends, paid out profits, and on technical services. Further, no ring fencing was allowed around the mining sector: losses in one mine could be offset against profits in another. Other incentives included 100 per cent depreciation with an additional 15 per cent allowance and unlimited loss carry forward provision. Subsequent to this, the country had experienced increased royalties revenue from \$707,000 in 1997 to \$21 million in 2004<sup>58</sup>. It is notable, however, that no mining company, other than AngloGold Ashanti, had paid corporate income tax by the end of 2008 – ten years after industrial mining began in the country. AngloGold Ashanti paid US\$1 million in 2007. Between 2002 and 2006, mining companies exported around US\$2.9 billion worth of gold. During that time, the Government earned around US\$17.4 million in royalties, charged at 3 per cent of the market value minus transport and transaction costs. If royalties were charged at 5 per cent as had since been recommended by a Presidential Commission, government revenue would have increased US\$145 million over these five years<sup>59</sup>. Consequently, the Minister noted that by 2006, Tanzania was yet to realise the expected equitable fiscal benefits from its mineral resources. He added that it had, therefore, become necessary to review the mining sector fiscal regime, particularly in view of the change in conditions affecting the sector. These conditions included positive macroeconomic conditions, key among which was the high prices of certain minerals and

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<sup>57</sup>The Mineral Policy of Tanzania, Ministry of Energy and Minerals, October, 1997, p 14-15

<sup>58</sup>Hon. Dr. Ibrahim S. Msabaha (MP), Minister for Energy and Minerals, The United Republic of Tanzania, Tanzanian Mineral Sector Performance, Fiscal Benefits And Challenges, Presentation to World Bank Fiscal Issues Workshop, Washington DC, October, 2006.

<sup>59</sup>ActionAid, Mining Companies Deprive Africa of Millions in Lost Revenue, Wednesday 25th March 2009, <http://www.actionaid.org/>

a booming international mining industry,<sup>60</sup> which resulted in increased earnings for the mining sector.

### 3.5 Ghana

In Ghana, where gold accounts for 90 per cent of exports, the Minerals and Mining Act of 2006 charges royalties on a sliding scale of 3-6 per cent of gross sales value, replacing a 1986 Act which set a top royalty rate of 12 per cent. In reality, no company had ever paid more than 3 per cent in royalties because of tax allowances and lack of expertise in the revenue collection authority. Between 1990 and 2007, this cost the country US\$1.163 billion (if royalties had been paid at 12 per cent) and US\$387.74 million (if royalties had been paid at 6 per cent).

In a nutshell, taxation of mining is not a new phenomenon. Minerals have been mined for thousands of years and rulers and governments throughout history have taxed mines to share in the created wealth. The key tax policy question in terms of meeting the objective of raising revenues is: how great a tax burden should be placed on a mine? Given that a high tax burden may mean lower investor profit, governments are placed in a position of balancing their fiscal take with a firm's willingness to invest. They have to take account of the fact that if taxes are too high, investors may invest elsewhere, but if taxes are too low, government may needlessly forgo fiscal revenue. Most governments try to strike a balance between government and investor revenue needs by implementing a fair and equitable system. However, it is difficult to determine what an ideal fair and equitable system is. What is certain is that, as a matter of principle, those entities that earn higher revenues must pay more taxes as they have a greater capacity to contribute to the development of their host countries. Mining companies should, in this regard, not be exempt from this rule.

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<sup>60</sup>Dr. Ibrahim S. Msabaha (MP), Tanzanian Mineral Sector Performance, Fiscal Benefits And Challenges

## CHAPTER FOUR

### 4.0 RESEARCH FINDINGS AND ANALYSIS

The privatisation of the mines in Zambia has meant that any income to the state from the sector is not directly from sales and profits, but rather from taxes that can be levied on the sales and profits from the mines such as value added tax paid on purchases by the mines, taxes on imports and exports, corporate taxes, and mineral royalties. However, the mining companies managed to negotiate exemptions from paying most of these taxes. Additionally, because the mining companies are able to carry losses from previous years forward and write off profits that would otherwise have been taxable, the mining sector barely contributes to national tax revenues at all, even despite the massive increases in the international prices of copper which have occurred in the last few years. It is notable that, going by the admission of the Secretary to the Treasury in 2008, the tax rate agreed upon by the Zambian authorities in the development agreements of close to 32 per cent was approximately 8 percentage points below the second lowest country in the world, Peru, while other countries had an average fiscal tax rate of approximately 40 to 53 per cent.

Another issue that clearly emerged from this study was that the development agreements were one-sided in the sense that they had no provision for clawing back excess profits or windfall gains when the prices were high. As a result, all the windfall gains arising from the high metal prices have entirely accrued to the mining companies, while Zambia's copper reserves have been getting depleted. The agreements which gave rise to these concessions were not, and many still are not, accessible to relevant wings of government such as Members of Parliament and local authorities, including other properly interested parties such as labour unions. In light of this, there has been little, if any, monitoring of the implementation of the provisions of the agreements, aside from assurances given by the mining companies themselves and in some cases by government officials. Consequently, the agreements have given rise to speculation and innuendo, and in many

cases, the motives of the government officials involved in their negotiations have been questioned.

In other words, Zambia, like in most other African governments, has failed to collect significant budget revenue from mining, despite higher production by the sector and escalating international metal prices, for two main reasons: excessive tax concessions to mining companies, amounting to tax subsidies, and aggressive tax avoidance by mining companies, primarily by insisting on tax breaks in secret mining contracts and possible transfer pricing. This situation has meant that despite being the single largest economic sector in Zambia, mining has not contributed significantly to the development efforts of the country following the conclusion of the privatisation process. In fact, from the available information, it may be stated that not only has the sector denied the Zambian Government revenue that could have been utilised for development programmes, but it has also enjoyed benefits (such as public infrastructure) provided through fiscal income earned from other sectors, notably from personal income tax, which continues to be the single biggest source of income for the Zambian Government. In other words, it is clear that, going by one of the key principles of taxation, the mining sector has not contributed equitably to national revenues following the privatisation process, since the increase in the sector's earnings have not been matched by a corresponding increase in its contribution to national tax revenues. Therefore, it may be deduced that the taxation of the mining sector in Zambia following the privatisation of the mines has not contributed to making the fiscal landscape more equitable. In fact, evidence emerging from this study suggests that the contrary is the case because the significant increases in the sector's earnings have not been matched by corresponding increases in the sector's tax contributions.

At the same time, the experiences of other countries could provide valuable lessons for the Zambian Government. For example, in the quest to encourage foreign direct investment, the Tanzanian Government offered significant tax incentives to the mining sector consequent upon the promulgation of the Mineral Policy in 1997. By 2006, it was reported that Tanzania and the Tanzanian people had not achieved the envisaged

equitable benefits from the country's mineral resources and it was necessary to review the fiscal regime for the mining sector in this regard. The situation in Ghana has not been much different, with none of the mining companies paying more than 3 per cent in royalties since the introduction of the Minerals and Mining Act of 2006. This was attributed to tax allowances and lack of expertise in the revenue collection authority. The losses suffered by the Ghanaian treasury as a result of these factors were estimated to run into hundreds of millions of dollars. Outside Africa, Peru has experienced problems in relation to the minimal contribution to national taxes by the mining sector as a result of the generous concessions offered to the sector during the period 1990 to 2000. Accordingly, the tax system has been perceived to be unfair and inequitable and has been the subject of considerable debate and reform even as recently as 2009.

One country that appears to have struck a reasonable level of benefit from its mining sector through the tax system is Chile. Predicated on the Chilean Government's Structural Balance Policy, the mining sector fiscal regime takes account of changes in the earnings of the sector. Through this system, the tax contributions by the sector vary in line with its earnings from year to year. There is, therefore, a direct relationship between the earnings of the sector and its tax liability. This correlation is a critical ingredient in the taxation principle of equity. As a result of the equitable nature of the sector's contributions, the mining sector fiscal regime in Chile has been relatively stable, with little need for constant review and reform. The regime has also generated little speculation and innuendo because it has been developed openly through the relevant government policy and legislation rather than in secret agreements whose details are known only to a privileged few.

## **CHAPTER FIVE**

### **5.0 RECOMMENDATIONS AND CONCLUSION**

#### **5.1 Recommendations**

##### **5.1.1 Need for Systemic Changes**

It must be recognised that systemic solutions are needed to increase mining revenue and transparency in the fiscal operations of the mining sector in Zambia, and make the fiscal regimes more equitable. This assertion is borne out by the fact that despite the political opposition having successfully exerted pressure on the Zambian Government to review the mining sector fiscal regime in 2008, this attempt at reform was short-lived and was effectively reversed barely a year later. It is, therefore, clear that there is need to change the way the Zambian Government does business with regard to committing the whole nation to such agreements. Many African governments, Zambia included, are still unwilling to open up the tax agreements they enter into and tax receipts from mining companies to public and parliamentary scrutiny. If possible, the system should require that such agreements be reviewed by other stakeholders prior to the government signing them.

##### **5.1.2 Need for Increased Transparency**

It is also necessary that the process of creating tax regimes and mechanisms of tax payment be made more transparent. This transparency requires opportunities for citizens to monitor payments, receipts and utilisation of mineral tax revenues. Currently, many multinational mining companies are still pushing for tax exemptions and fail to report what they earn and what they remit to governments in each jurisdiction where they operate. The situation may be compounded by the credit crunch and its impact of a reduction in finance available for mining investment. Unfortunately for many developing

countries, the crunch may also provide mining companies the moral instrument to demand more exemptions.

### **5.1.3 Domestic Legislative Measures**

It is important for the Zambian Parliament to pass laws that require mining development agreements to be ratified by the legislature, and made public. In addition, the Zambian legislature is well placed to enhance its oversight function to monitor the mining tax regime to ensure that the applicable rules are enforced at all times. The legislature can also add its strong voice to those advocating for the establishment of a new international accounting standard that would compel mining companies to report on their profits, expenditures, and taxes, fees and community grants paid in each financial year in each country in which such companies operate. In this way, the mining companies would be forced to contribute equitably to national taxes in their various countries of operation.

### **5.1.4 Measures at International Level**

At international level, a new international financial reporting standard is needed, which all companies registered on international stock exchanges will need to implement. It should require them to report on their financial operations and remittances to government and other structures on a country-by-country basis. This will allow citizens and parliaments to monitor the financial flows between parent companies and subsidiaries, and detect tax avoidance practices which promote the inequitable system currently in existence.

### **5.1.5 Role to be Played by International Donors**

International donors could play a critical positive role in the quest for a more equitable taxation system for the mining sector by scaling up their financial assistance to the Zambian Government to improve its capacity to monitor and audit the accounts of mining companies, and to review its mining tax regime comprehensively. The donors should

allow the *Zambian Government* to use such finances to purchase legal and other technical assistance from any service provider of its choice.

## **5.2 Conclusion**

Zambian citizens, who should be the ultimate beneficiaries of the country's natural resources, are increasingly putting political elites in the country under pressure to tax resource rents transparently and distribute the revenue equitably based on the development goals shared by all members of the *Zambian society*. In this light, it is the quality of national legislative and policy processes, state institutions and individual political leadership that will determine whether potential wealth goes towards financing national development or lining the pockets of political and business elites. To optimise tax revenue for development, the *Zambian government* needs to stop subsidising foreign mining companies through tax concessions, put in place a mining tax scheme that is consistent with the overall industrial strategy, outlaw the use of confidential contracts to negotiate tax breaks which help companies to avoid making tax payments and reduce the contribution by mining companies to national revenue for development programmes. This would also help make the fiscal landscape in the country more equitable.

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