POLICY BRIEF

Mining tax in Zambia

Based on the ZIPAR's *A Guide to Mining Tax in Zambia* by David Manley

With some of the worst poverty statistics in Africa, Zambia appears to have little to show for a century of mining. But given good policies, the country's considerable mineral wealth clearly represents a real opportunity to grow the economy and tackle poverty. Following the recovery of the mining industry since privatisation, and with booming world copper prices, there has been considerable public debate over how to ensure that an appropriate share of mineral resource revenues accrues to the government. Debate is healthy and should lead to better policy, but only if it is well informed. While technical terms such as "windfall tax" are frequently used by participants in the debate, there is no common understanding of the term. The full-length guide upon which this brief is based has been written to address this information gap and to inform one of the most important debates in Zambia.

Objectives of mineral policy

Mining brings many benefits: employment, local infrastructure, linkages to other sectors, foreign exchange earnings, and government revenues. But the most important of these – the one that all Zambians share in – is tax revenues.

Given this, the principal objective of mining policy should be **to maximise government revenue from the mining sector over time.**

The second part of the objective – "over time" – is important. It may be possible to collect more tax today, but what about tomorrow? If mines are "over-taxed" today this may discourage future exploration, investment and production, which will mean lower tax payments in future.

Four broad mineral policy guidelines help here:

1. **Compensate the state for a loss of subsoil wealth**. The right level of compensation for each unit of mineral extracted should be the value the country could have got by leaving extraction for another day.
2. **Be reasonably attractive to investors.** Subject to the first principle, the tax regime should be reasonably attractive to investors, given the other investment conditions in the country. That is to say, an investor should expect a reasonable return from risking her capital – but no more than a reasonable return.
3. **Be flexible to changes in (true) profits**. The tax regime should still be flexible to changing profitability. When conditions are poor, the tax regime should allow mining companies to remain in business – subject to the country receiving sufficient compensation for each unit of the extracted resource. Conversely, when conditions are good, the tax regime should be flexible enough to tax as much of the surplus profits as possible.
4. **Be administratively feasible**. No matter how well a tax regime follows the first three principles, if it is too complex for the tax authority to administer mining companies can avoid paying it. The tax regime should balance the need to follow the previous principles with the need to minimise the challenges of administering and enforcing them.

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Table 1. Details of the four post-privatisation tax regimes

	DA	2008	2009	2012
PROFIT-BASED TAXES				
Company Income Tax rate	25%	30%	30%	30%
Variable Profit Tax in effect?	No	Yes	Yes	Yes
Profit tax base details				
Capital Depreciation Allowance	100%	25%	100%	100%
Loss carry forward (max. years)	15 to 20 years	10 years	10 years	10 years
Allowed Debt to Equity ratio	2:1	3:1	2:1	2:1
REVENUE-BASED TAXES				
Mineral Royalty	0.6%	3%	3%	6%
Windfall Tax	No	Yes	No	No
OTHER TAX TYPES				
Customs Duty	Exempt in most cases	Customs apply, but rebate, refund or remission of the duty payable in respect of plant, machinery, or equipment.		
Export duty (on copper anodes)	No	15% (but with some waivers)	15% (but with some waivers)	10% (but with some waivers)
Withholding profit tax	0%	15% on services, 0% on other payments		

Comparability of tax regimes

It is often debated whether mining tax regimes are "competitive" enough to attract investment. But comparing different tax regimes is not straightforward. For one thing, in the real world, there are only a limited number of opportunities for firms to exploit mineral deposits. This limits the degree of choice over where to invest. For another, as well as the *level* of tax rates, the *predictability* of tax rates (and any other significant part of the regulatory, legislative and contractual systems) is very important for investors. Investors need to know what tax rates they will face when forecasting profits. If the tax regime is unstable, this will make forecasting difficult.

Finally, a competitive tax regime will not attract investment if other investment criteria are neglected. In Zambia, non-tax factors may be more significant than tax in investment decisions: lack of skills, opaque regulation, and infrastructural bottlenecks.

Zambia's mining tax regimes

Since the privatisation of Zambia's mining industry, four tax regimes have applied (also see Table 1):

1. The Development Agreements negotiated with individual mines at privatisation
2. The "2008 regime" (April 2008 to March 2009)
3. The "2009 regime" (April 2009 to March 2012)
4. The "2012 regime" (since April 2012).

Development Agreements were made between the Zambian government and each company. These have never been made publicly available by the Zambian government. Leaked documents show that the tax rates and other details for each company differed. In 2003 it was agreed that all mining companies operating former ZCCM assets would pay the same rates for company income tax and mineral royalty. The details in Table 1 relate to the tax regime that mining companies faced after 2003. The agreements represented a stable tax burden that arguably encouraged investment, but one which was below the global average.

With mining tax revenues failing to rise in line with copper prices and production, tax reforms were introduced in **2008**. The fiscal stability clauses in the Development Agreements were ended and the Windfall Tax introduced.

The Windfall Tax was criticised for being too onerous, compounded by the fact that due to a technical error in its design, windfall tax payments could not be deducted from profits for income tax purposes, which could have increased the overall tax burden to an unacceptably high level.

Imposing tax reforms that increased the tax burden on the mining companies which held Development Agreements was illegal and gave the mining companies the right to seek financial damages. Ultimately, no case was actually taken to arbitration by the industry, but the government's actions did shake investor confidence in Zambia.

A brief guide to mining tax instruments

Here we look briefly at some of the different kinds of taxation applied to the mining sector around the world. Taxes are either direct or indirect (see figure below), and only the direct ones are described below.

DIRECT TAXES				INDIRECT TAXES	
Profit-based		Revenue-based			
Company income tax	Excess of variable profit tax	Mineral royalties	Windfall tax	VAT	Customs and import duty

Corporate income tax

Company income tax is usually applied to all businesses, but it is a complex tax. This is because the taxable profits which the base on which the tax rate is applied can be defined in numerous ways with many additional provisions that can be used to alter the amount of tax that is payable.

Excess (or variable) profits tax

Such taxes are based on the concept of a "resource rent tax" – a tax designed to extract the maximum possible revenue from a mining company without damaging the incentives for investors, thus preserving the long-term viability of the industry. They have at least two advantages. First, they do not significantly affect the incentive to invest. Second, they are widely perceived by the public as being "fair" as they extract a share of exceptionally high profits.

Mineral royalties

Mineral royalties – levied as a fixed percentage of the value of a company's sales of a particular mineral – have three main advantages for governments. First, since they are charged on the value of the mineral extracted, they are well suited as a charge for compensating the resource owner for the loss of wealth as a result of extraction. Second, royalties are a more reliable revenue source than profit-based taxes, as some revenue will be collected as soon as production commences. Third, royalties are relatively easy to administer because usually the only information required is the sales volume of the mineral and the unit price.

Windfall tax (variable rate royalty)

A variable rate royalty can be a useful tax instrument that provides some of the advantages of a standard fixed rate royalty while avoiding some of the disadvantages. To avoid a regressive tax regime, it is a good idea to have a low royalty rate and levy a profit-based tax. However, if the capacity of the tax authority for levying profit-based taxes is low, alternative solution is to use a royalty whose rate varies according to the market price of the mineral. With such a rule, a variable-rate royalty can be made to be less regressive than a fixed-rate royalty: if the price falls, the royalty rate also falls; conversely, when prices rise, the royalty rate rises. As the base is still revenue, rather than costs, a variable rate royalty still shares other characteristics with a fixed-rate royalty. On the plus side it is comparatively easy to administer. However, it is still not as progressive as a profit-based tax.

Adjustments to the tax base

Tax regimes often include measures to fine-tune the characteristics of a tax regime to meet certain objectives. Four types are explained in the full-length version of this guide: depreciation allowances; loss carry-forward provisions; ring-fencing; and tax holidays.

Fiscal stability contracts

Fiscal stability clauses are agreements by the host government not to increase the tax burden for participating mining companies over a period of years. They are a way to balance investors' need for predictability in the amount of tax they will pay with governments' freedom to adjust tax policy over time. Some options for doing this are presented in full-length guide.

The full-length guide also explains some key problems for tax administrators to deal with: transfer pricing abuse; the reported value of production; debt payments; and hedging.

Table 2. Direct tax revenue from the mining industry, 2000–2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Company tax	2	2	1	0	0	1	160	603	464	401	1,244	2,632
Withholding tax	0	-	-	1	2	3	-	-	-	-		
Mineral royalty	4	7	3	8	4	*39*	59	68	*238*	235	412	891
Export duty	-	-	-	-	-	-	-	-	178	15		
Windfall	-	-	-	-	-	-	-	-	126	-		
Total	5	9	3	9	6	43	219	670	1,006	651	1,656	3,524

The 2008 regime lasted only a year. In response to the global financial crisis, falling copper prices and mines refusing to pay the taxes, the tax regime was reformed in **2009**. Windfall tax was abolished and other provisions were reversed.

Following general elections in September 2011 and the resulting change of government, further reforms were made to the mining tax regime in the **2012** Budget. The headline change was an increase in mineral royalties to 6%.

Comments on the 2012 regime

Table 2 shows that from privatisation in 2000 until 2005 tax and royalty revenues from mining companies were particularly poor. Since 2005, revenues have grown considerably. There are five principle drivers that could explain this:

1. Rise in copper and cobalt prices
2. Rise in production
3. Depletion of mining companies' loss carry forward provisions
4. Increase in tax rates
5. Smaller tax gap from better tax administration procedures and better tax instruments.

This suggests that the recent rise in tax revenues is not *necessarily* a result of the tax regime's performance. Revenue statistics cannot tell us how well the tax regime has performed against the objective of capturing the maximum value of the extracted mineral over the long term. Even though revenues have increased significantly, this has been at the expense of depleting close to 5.6 million tonnes of Zambia copper reserves. The question to ask is: has Zambia been sufficiently compensated for this depletion?

The answer requires a more detailed analysis than can be provided in this guide, but it is important to at least be aware of this question when reporting on revenue performances in the mining sector.

No estimate of the Average Effective Tax Rate for Zambia's current mining tax regime has been undertaken, but it is probably close to the upper end of the normal range for mineral tax regimes (40–50%). It is likely that non-tax problems have a more significant effect on Zambia's **attractiveness** to investors.

The 2012 regime is less **flexible** than the 2009 one owing to the increase in the royalty rate, which could pose problems for mines' commercial viability in the vent of falling copper prices. A variable rate royalty should be considered to address this.

The need for flexibility must also be balanced with the need for **stability**. The current tax regime provides no contracted or legislated stability clauses. While such assurances are not needed for large mining companies already in Zambia, stability periods could be considered specifically for attracting new investment.

The **feasibility** of the tax system is a function of both the design of the tax types used and the capacity of the tax authority. In recent years, the Zambia Revenue Authority has made efforts to improve mining tax administration. The 2012 reform to separate hedging income from other mining income is also designed to reduce the burden of administration. However there is still work to be done to improve the administrative details of Zambia's tax regime.

Notes:

For full references and sources refer to the full-length paper: *A guide to mining tax in Zambia by David Manley*

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