Analysing the extractive industry fiscal policies in sub-Saharan Africa

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ANALYSING THE EXTRACTIVE INDUSTRY FISCAL POLICIES IN SUB-SAHARAN AFRICA

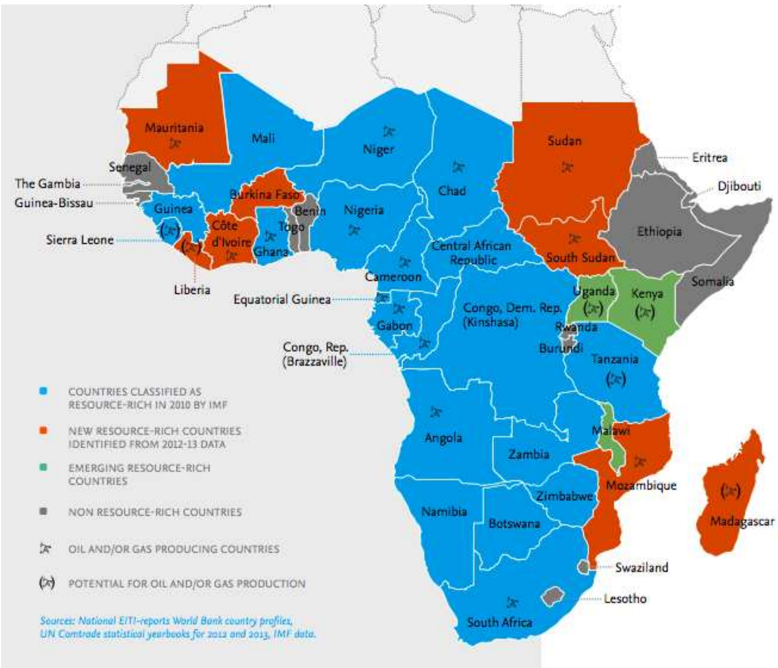
KEY FINDINGS

- Sub-Saharan Africa (SSA) is a region abundant in natural resources, with 20 of its countries having natural resources account for more than 25% of their total exports. As a result, mining is an important sector in the region.
- Recently, a number of countries across the region have introduced various legal and regulatory changes in the mining sector to generate more revenues and improve community engagement/ participation in mining projects to further popularise this sector
- However, this vast abundance of natural resources and the various measures put in place to tax the mining sector in SSA hasn't necessarily translated into social gains for the host countries

INTRODUCTION

Buried beneath the surface of sub-Saharan Africa (SSA) is an abundance of valuable and extractable natural resources, making its mining industry one of the most important in the world (Garside, 2020). Out of the 54 countries in Africa, 20 are considered by the International Monetary Fund (IMF) to be rich in natural resources i.e., countries whose natural resources account for more than 25 per cent of total exports. All 20 of these countries are situated in SSA and, as such, the significant weight of the extractive sector in these states raises the question of the taxation of these natural resources, which are non-renewable, in the region (Figure 1) (Bouterige et al., 2020).

Figure 1: Natural Resource Map of sub-Saharan Africa



Source: (Thorborg and Blomqvist, 2015)

Various sub-Saharan countries, in recent years, have been introducing legal and regulatory changes with the aim to increase the revenues from mining and improve community engagement/ participation in mining projects to further popularise this sector (Poustie et al., 2019). Following an increase in commodity prices in the 2000s and recent natural reserve discoveries in the region, many countries in SSA reformed their mining acts to shift the onus of taxation onto the mining companies. As such, increase in mining royalty rates, reappearance of mineral resource rent taxes and of free equity for the State have been observed throughout the region (Bouterige et al., 2020).

For example, the Democratic Republic of Congo (DRC) published a new mining code on 28 March 2018 to increase royalty payments as well as increase taxes by 2-10%. It also introduced a new "super profits" tax of 50% on profits exceeding 25% of the forecasted value. Furthermore, it introduced an obligation for 0.3% of turnover to be contributed to development projects and that 10% of the capital of mining companies to be held by Congolese citizens. Similarly, Zambia has recently taken steps to deal with dwindling foreign currency reserves and increasing public debt. These include an increase in the country's sliding scale for mining royalties in September 2019 (including a new 10% tax when the price of copper exceeds $7,500 per tonne), an announcement in October 2018 that mines will have to pay royalties in dollars to help stabilise the Kwacha, introduction of new mining duties and a new sales tax in December 2018; and the introduction of a new 5% copper import duty (Poustie et al., 2019).

However, this vast abundance of natural resources and the various measures put in place to tax the mining sector in SSA doesn't necessarily translate to social gains for the countries in this region (Maroun et al., 2019). Despite being rich in resources and having a lot of investors, countries in SSA still tend to lose out on revenue from the extractive sector. Inadequate legal and regulatory frameworks, ineffective administrative systems and widespread tax evasion by mining companies are often cited as the main culprits for this loss in tax revenues. Lack of access to information required to impose the right amount of taxes, monitor compliance and audit mining companies often prevents revenue administrations from employing even their basic frameworks and systems. As a result, the region loses out annually on mining taxes accounting up to 6% of African GDP (Linder, 2019).

TAXING THE MINING SECTOR ACROSS SUB-SAHARAN AFRICA

Mining companies are subject to varied tax treatment across the world and are justified usually on the grounds that their operations are either different from other economic activities or give rise to material, social and environmental impacts which justify an additional charge by the state. The imposition of a type of extraction-linked tax has also been defended on the basis that mineral resources belong to a country's citizens and as such, mining companies should be required to pay for mineral extraction as part of a long-term contribution to society. For many SSA governments, this view is linked to the fact that the colonial system dispossessed indigenous people of their mineral wealth. In this context, taxes on the mining sector become part of socio-political policies designed to address the effects of colonialism in addition to being seen as a source of national income (Maroun et al., 2019).

Governments use various instruments to generate revenue from this sector. These include but are not limited to mining royalty[1], mineral resource rent tax[2], corporate income tax and minimum tax[3] as well as free equity of the state[4] (Bouterige et al., 2020). Additionally, different countries also introduce various personalised taxes to better suit their circumstances. These include imposing customs and excise duty, value-added taxes (VAT), withholding taxes and environmental taxes. These are treated as supplementary taxes because they are not based on mining companies' access to and extraction of minerals or profits generated from core operations (Maroun et al., 2019).

Some countries charge mining companies for a licence to commence and conduct their operations (PKF, 2017). Alternatively, a surface tax based on the area in which exploration or extraction is taking place is applied. In Angola, for example, the surface tax is calculated based on the area awarded to the taxpayer for mining purposes but only applies during the exploration phase (Maroun et al., 2019). Benin and Kenya make use of fix rights and area taxes that are, in substance, similar to a surface tax (PKF, 2017). Only Benin, DRC and Senegal charge a license fee in addition to a surface or fix rights and area tax. Côte d'Ivoire and Mozambique levy VAT on

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[1] The mining royalty is an ad valorem tax that taxes the value of the ore when it is sold or exported. In principle, the mining royalty is the counterpart of the exploitation of the resource.
[2] The purpose of the mineral resource rent tax is to directly tax the rent, i.e., the net cash flow. Some countries are trying or have tried to introduce levies similar to a mineral resource rent tax. Also called additional profit tax, these levies specific to the mining sector are mainly aimed at capturing a larger share of the rent.
[3] Corporate income tax is an income tax that taxes the profits of companies. It may be accompanied by a minimum tax which is based on a company's turnover.
[4] States may require equity investment in mining companies. Generally, mining acts provide that the holder of the mining right must create a company under national law in which the State participates, free of charge, usually to 10 per cent. This free shareholding may not be diluted, even in the event of a capital increase. Additional participation of the State is possible, but this is then acquired under normal conditions, i.e., in cash.

mineral and metal exports while Tanzania imposes an inspection fee of 1% of the value of all mineral exports (Murphy, 2017).

Local surcharges are additional taxes on specific items and include, for example, the Tanzanian service levy surcharge special import levies in Ghana. In Mozambique, a 20% windfall profits tax is levied where the pre-corporate income tax net return is in excess of 18% (Maroun et al., 2019). Pollution and carbon emission taxes are levied on mining companies to reduce adverse environmental impacts and include, for example, the Namibian carbon tax and the Zambian environmental vehicle tax. Mine rehabilitation fees are also payable in countries like Botswana to provide for the cost of the rehabilitation of mines at the end of their useful lives (Maroun et al., 2019). Additionally, some countries also require mining companies to make education and corporate social responsibility related contributions. In countries South Africa requires mining companies to make investments in community development as part of the country's broader social agenda (PKF, 2017). Table 1 below gives a clear and comprehensive idea of mining taxes in select countries of SSA.

Table 1: Mining taxes in select sub-Saharan African countries

Angola	- A royalty regime is in place, with the maximum rate of 5% applying to strategic minerals and stones - Construction materials of mining origin and other minerals not falling in a defined category attract royalties at the lowest rate of 2%
Botswana	- Mining profits are taxed according to a formula resulting in a minimum tax charge of 22% - The rate increases in proportion to the ratio of taxable income to gross income - Royalties are levied at 10% for precious stones, 5% for precious metals and 3% for other minerals
Côte d'Ivoire	- Gold attracts royalties at between 3% and 6%, while other substances are subject to royalties of between 1% and 5%
The Democratic Republic of Congo	- Mining royalties are levied at 4% for precious stones, 2.5% for precious metals, 2% for nonferrous metals, 1% for coal and 0.5% for iron and other ferrous metals
Ghana	- The corporate income tax rate is 35% for mining companies while the general rate is 25% for other industries - Royalties are charged at a fixed rate of 5% on revenue
Kenya	- Mining companies are taxed at 30% unless they are a branch of a foreign company in which case the tax rate is 37.5% - Mining royalties are also payable o The maximum rate (12%) applies to diamonds o Gemstones and other precious metals (such as gold and silver) are subject to royalties at 5% o A rate of 8% applies to coal and the lowest rate (1%) applies to industrial minerals
South Africa	- Mining companies are taxed at a rate of 28% - The royalty rate applied to each mineral is determined according to a formula, with the range as follows: o For refined mineral resources: 0.5% to 5% o For unrefined mineral resources: 0.5% to 7%
Tanzania	- Mining royalties are charged at between 3% and 6% - An 'inspection fee' of 1% of the value of all mineral exports has also been imposed
Zimbabwe	- A mining royalty system is in place:

- The maximum rate applies to diamonds (15%), while the lowest rate is levied on coal (1%)
- A rate of 10% applies to platinum and precious stones, while 5% applies to gold and 4% to copper and other precious metals

(Source: Adapted from Maroun et al., 2019)

SHORTCOMINGS OF THE MINING TAXATION IN SUB-SAHARAN AFRICA

Given the vast scale and impact of mining in SSA, its efficient and effective taxation has the potential to really contribute positively to the host nation – both socially and monetarily. In practice however, the sector is taxed inefficiently, and is very much under-taxed. It is estimated that, during the 2000-10 natural resource supercycle, while turnover in the mining sector increased globally by a factor of 4.6, tax revenues earned by African governments increased only by a factor of 1.15 (Chuhan-Pole et al., 2017).

Improvements in the taxation of mining are likely to be slow and difficult. There are a set of structural characteristics of mining, especially pronounced in Africa, that result in mining projects and mining taxation typically becoming highly politicised and enmeshed in controversy, confrontation, uncertainty, large-scale rent-taking and a range of illicit practices (Moore and Lundstøl, 2016).

These structural characteristics include very large 'rents' (super-profits) which can be earned from control of mineral resources. This creates incentives for politicians, criminals and businessmen to find ways to obtain a share of these rents and for all the parties involved to give, seek and take bribes of various kinds (Lundstol et al., 2013). A British-Swiss commodity trading and mining company, Glencore, was embroiled in a US Department of Justice corruption probe over its operations in the DRC.[5] Between 2010 and 2012, the DRC reportedly lost over US$1.36 billion from the under-pricing of mining assets that were sold to offshore companies linked to Gertler. Similarly, in Australia, several mining companies are currently under investigation for bribing high-ranking officials to win mining licenses in Sierra Leone (2016) and the Republic of Congo (2006-07) (Africa billions) (Transparency International, 2019b).

Most mining projects are developed and operated by large transnational companies and they have a considerable scope to reduce their tax bills through the use of transfer mispricing and other tax avoidance practices. When negotiating mining contracts, these large transnational companies also have much more relevant geological, economic and financial information and expertise than host governments. Mining projects also often require major supporting infrastructure investments. Governments may agree to reduce companies' tax liabilities if they take responsibility for providing (and operating) this infrastructure – while typically having little accurate information on the real cost of the infrastructure or the distribution of the benefits between the company and the public (Moore and Lundstøl, 2016). This is clearly seen in the case of Sierra Leone where the tax breaks provided to the six largest foreign mining companies add up to 59 per cent of the total budget of the country or eight times the country's health budget (Oxfam International, 2015).

Finally, there is the question of tax evasion by mining multinational companies in the region. Multinational companies involved in mineral resource extraction are particularly effective at paying only a small share of the taxes that they owe and are responsible for much of the tax evasion in SSA, accounting for total annual losses of up to 6% of African GDP in the region as mentioned above (Linder, 2019). We have an example here, once again from Sierra Leone, in the case of Koidu mine. Koidu is the richest diamond mine in the country but is registered in the British Virgin Islands by Mossack Fonseca, the Panamanian law firm at the centre of the Panama Papers scandal. It is owned by holding company OCTÉA Limited, which is chaired by Jan Joubert. In 2016, Sierra Leone's high court ruled that, despite being the largest diamond mining company in the country, OCTÉA is not required to pay tax because its parent company – the Beny Steinmetz Group Resources (BSGR) – is not registered for business in Sierra Leone. Koidu Limited was also ruled to be exempt from paying taxes to the local community, for the same reason (Transparency International, 2019a).

CONCLUSION

[5] Israeli billionaire Dan Gertler, who partnered with Glencore in the DRC and invested in two of their mining projects in the country, was sanctioned by the US Department of the Treasury under the Global Magnitsky Act in 2017. According to the Treasury, Gertler used his close friendship with President Joseph Kabila to act as a middleman in mining asset sales. In 2018, the Treasury also designated 14 companied affiliated with Gertler.

The mining sector is of primary importance to the SSA states given the scale and impact of operations in this sector. As such, the significant weight of the extractive sector in these states raises the question of the taxation of these natural resources, which are non-renewable, in the region (Bouterige et al., 2020). The fundamental reason for the importance of taxation of mining is that mining entails extracting subsoil assets and transforming these into financial assets. These assets have varying degrees of value added, depending on the refining and product development needed. What is left after costs of production and marketing are deducted (including normal dividend to investment) is defined as economic rent. In principle, for a non-renewable resource such as minerals, such rent should be appropriated by the government on behalf of the country. It is not feasible to accomplish this 100% without negatively affecting the private incentive to invest in mineral production. Therefore, countries try to balance the competing interests and achieve as high a percentage as possible for the government, often mainly through taxation or direct financial interest. As such, each country has a mining tax regime that is unique to its circumstances and needs (Lundstol et al., 2013).

Given the vast scale and impact of mining in SSA, its efficient and effective taxation has the potential to really contribute positively to the host nation – both socially and monetarily. However, this is far from true and the mining sector in SSA is essentially undertaxed for a variety of reasons – including political economy, contract structures, widespread tax evasion, inadequate legal and regulatory frameworks and lack of deep sector knowledge among the policymakers. There is also the question of not scaring away foreign investors with strict and large taxes and as such, governments may end up giving large discounts to private mining companies and essentially lose out on a large amount of mining tax revenue (Moore and Lundstøl, 2016).

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