

## **MINISTERIAL STATEMENT ON THE STATUS OF MINING TAXATION**

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Mr. Speaker, I wish to thank you for according me this opportunity to brief the House and the Nation at large on the status of mining taxation which of late has generated a lot of interest and debate in the country.

Sir, as this august House may be aware, Government privatized the mines in the year 2000. Prior to this, the mines were Government owned and run by Zambia Consolidated Copper Mines (ZCCM). During the reign of ZCCM, mismanagement set in including the diversion of funds from core mining activities to non-core activities. This resulted in lack of reinvestment in the sector that led to continued fall in production levels. Copper production declined from a peak of 750,000 metric tonnes in 1973 to about 200,000 metric tonnes per annum in 2000. This situation compelled the Treasury to finance the operations of ZCCM at great expense, diverting resources from other needy areas. At this level and given the operational difficulties as a result of lack of recapitalisation, it became apparent that Zambia was reaching the end of its mining life.

Sir, it was therefore, imperative to privatize these mines and save tax payers money which the Government was giving to ZCCM for continued operations. More importantly, the Government had to save the many jobs and lives of people particularly on the Copperbelt, whose livelihood was dependent on mining.

Mr. Speaker, in view of these challenges, the Government, in 2000, privatized the mining industry. The Government had to provide fiscal incentives to the mining companies to facilitate the substantial recapitalization and investment that the sector required. It also had to enter into Development Agreements with the private owners of the mines to:

- (a) protect the jobs of Zambians working in the mines;

(b) secure maximum benefit and adequately contribute to the advancement of the social and economic welfare of the people of Zambia; and

(c) secure an appropriate return on investment for the new mine owners.

Mr. Speaker, this august House will also recall that when the Government provided tax incentives in 2000, which included the reduction of mineral royalty rate from 2 percent to 0.6 percent and company income tax from 35 percent to 25 percent, copper prices on the international market were very depressed, going below US\$1 per pound. The Government had to provide incentives as not doing so meant closing the mines.

By 2006, however, copper prices began to improve and it became apparent that the Zambian mining tax regime was not responsive and could not provide adequate revenues to the Government. There was also a feeling that development agreements were unfair, unjust and that the people were not benefiting from their mineral resources. This led to the formulation of a new fiscal and regulatory regime in 2008, which was intended to ensure that the tax system remains stable and robust but also that it works efficiently and effectively for both high and low metal prices as well as high and low cost operating mines. On the overall the Government's objective was to have an average effective tax rate for the mining sector of 47 percent.

Mr. Speaker, on the regulatory front, the House may recall that in 2008, this House nullified all the Development Agreements that the Government had signed with Mining Companies by repealing the Mines and Minerals Act, cap 213 of the Laws of Zambia. This was replaced by the Mines and Minerals Development Act No 7 of 2008. In the Mines and Minerals Development Act, Section 160 provides that Development Agreements that existed prior to the commencement of this Act would cease to be binding on the

Republic from the date the Act came into force. As a result whatever obligations that existed between the parties were extinguished.

With regard to the fiscal regime, Mr. Speaker, the Government introduced a new fiscal regime with the following features:

- a. The corporate tax rate was increased from 25 percent to 30 percent;
- b. Mineral royalty rate was increased from 0.6 percent to 3 percent;
- c. Withholding tax on interest, royalties, management fees and payments to affiliates or subcontractors in the mining sector was reintroduced at the rate of 15 percent while withholding tax on dividend was at zero percent;
- d. A variable profit tax of up to 15 percent on taxable income, which is above 8 percent of the gross income, was introduced but only applicable if prices were below the windfall tax trigger price;
- e. A windfall tax was introduced which was being triggered at different price levels for different base metals.
- f. Hedging income was treated as a non-mining activity and therefore taxed at different rate of 35 percent;
- g. Capital allowance, that is a depreciation of capital equipment, was reduced from 100 percent to 25 percent per year; and
- h. A reference price, which is the deemed arms length price, was introduced for the purposes of assessing mineral royalties. This was a price tenable at the London Metal Exchange, metal Bulletin or any other commodity exchange market recognised by the Commissioner General.

Mr. Speaker, during the implementation of this tax regime in 2008, windfall tax became problematic due to weaknesses in its design. This resulted in a higher than intended effective tax rate that ranged between 64 and 96 percent for high cost mines and 57 and 64 percent for low cost mines. This clearly was above the intended rate of up to 47 percent. Further, the marginal tax rates, particularly for the high cost mines, were very higher, in some cases even higher than 100 percent. This simply meant that for every 1 dollar increase in the price above the highest trigger level of copper price, a mining company had to pay taxes of more than one dollar. Additionally, the design of the windfall tax in the Zambian case was defective and not consistent with international practice as it was based on revenue as opposed to profit. It therefore did not take into account the cost of production. Sir, in countries with similar taxes, they are always profit based.

Mr. Speaker, as a result of these weaknesses in the 2008 tax regime, this House in 2009 took a bold step to remove the windfall tax as it was onerous on mining companies. Instead the variable profit tax was retained and is being applied to capture extra profits.

Sir, I would like to assure this August House that the current regime is responsive enough to ensure increased revenue collection in times of higher copper prices. The regime also compares well to other resource endowed economies in the region where effective tax rates range from the highest of 52.1 percent and the lowest effective rate of 42.6 percent.

Mr. Speaker, I would like to mention that the nullification of the Development Agreements and the subsequent change of the mining tax regime triggered challenges from mining companies. Some Companies indicated their intention to go for arbitration. However, knowing the importance of stability in this sector, the Government decided to engage the mining companies in discussions to find a lasting solution to the impasse that had arisen from the nullification of the Development Agreements.

Mr. Speaker, I wish to report to this House that the Government has now finalized the discussions with all the mining companies and that these discussions, which have been very positive, were on two fronts.

Firstly, the discussions focussed on the need for the mining companies to pay their tax arrears arising from the changes that were introduced in 2008. I am glad to inform this house that all the mining companies have agreed to pay the tax arrears. It has also been agreed that the windfall tax arrears be re-assessed at 25 percent only to ensure that the assessed total liability does not exceed the 47 percent effective tax rate which was intended.

With this agreement Mr. Speaker, total tax liabilities of mining companies amount to K1,426.16 billion. Of these arrears, the Government expects that K458.5 billion will be paid by the end of 2010 while the balance of K967.6 billion will be settled in 2011. The Government will ensure that all the arrears are paid by 30<sup>th</sup> June 2011.

Mr. Speaker, the Second part of discussions focused on the need for mining companies to accede to the current mining tax regime of 3 percent mineral royalty, 30 percent corporate tax and 15 percent variable profit tax, among others. Once again, I wish to report that all the mining companies have agreed to start paying taxes based on the current tax regime. This, Mr. Speaker, entails that mining tax collection will tremendously increase. In 2011 for example, Mineral royalties will increase by about 60 percent to K651.57 billion from K404.70 billion initial estimates indicated in the 2011 budget while Company Income tax (including variable profit tax) will improve by about 40 percent from K899 billion indicated in the 2011 budget to K1, 258.46 billion.

Sir, with these changes, Government will realise K1,019 billion in 2011 of which K606 billion will be extra revenues from the mining sector based on the current tax regime and K413

billion arrears above the 2011 budget estimate. These extra revenues will, as usual, be presented to this House as supplementary budget and will be targeted towards infrastructure development.

Mr. Speaker, I further wish to inform the House that in view of the higher copper prices, most of the mining companies are expected to extinguish their carry forward losses earlier than projected, some of them as early as 2012. Once the losses are extinguished, the companies will then be in tax paying position and the Treasury projects the taxes from mining companies to further improve. Our calculations show that when most of the mining companies start making tax profits, tax revenue collections from the mining companies, under the current tax regime, will become the major contributor to tax revenues at about 40 percent or 7 percent of GDP.

Mr. Speaker, due to the huge investment cost in the mining sector, investors often want to see a credible signal from the Government that the prevailing terms on which they base their financial models to borrow funds are not changed anyhow. One area where Government often changes terms is in the area of taxation. In this regard, the mining companies have been asking the Government for stability in the tax regime.

Sir, a good tax system is one which is predictable and which provides stability to investors. It has therefore been agreed that a fiscal stability for a period of ten (10) years be given to companies that will accede to the new tax regime. The stability will apply to corporate income tax, capital allowance, mineral royalty and variable profit tax.

In conclusion, the current mining tax regime, which was introduced in 2008 and amended in 2009, will now be fully implemented. With the full implementation, Zambia's Effective Tax Rate will move from 31.2 percent prior to 2008 to 47 percent and will be within the average effective tax rates of other resource endowed countries. Mr. Speaker, I wish to highlight the effective tax rates of some comparable countries;

Angola (52.7 percent), Mozambique (52.1 percent), Botswana (50.6 percent), Namibia (47.9 percent), Tanzania (45 percent), South Africa (42.9 percent) and Chile (42.6 percent).

Mr. Speaker, let me now take this opportunity to thank the mining companies individually and severally for their willingness and cordial manner in which the discussions were conducted.

Mr. Speaker, I thank you.