New mining tax regime in Zambia: Policy, legal and practical issues – a Private Practice View

IBFD

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# Agenda

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Impact of 2008 financial crisis and global trends
The 2008 Financial Crisis Stunned China;
China’s reaction (over-reaction) caused massive overspending, and acceleration of construction;
Mining industry responded by ramping up production, capex & exploration;
Costs increase;
China realized it was heading for a very bad ending;
New Government Changed Course – China’s Third Plenum:
- **More trade liberalization, policies to spur innovation, factor price reform that weaken State Owned Enterprises, reduction of administrative interference in economy, 5 year plan to combat corruption...**;
- Effectively moving towards a market led economy;
- Lower growth forecasts down to 7.5% vs double digit growth.


Global trends 2008 onwards

- Previously Chinese govt over-reacted to the 2008 financial crisis
- Significant overspend and expansionary policy
- Demand for Cu between 2000 and 2014 grew by 1154% (actual growth 132%)
- Since 2012 metal prices (excluding zinc) have fallen between 29%-59%
- Capex amongst senior miners rose 947%
- Companies have been slow to react to price moves
- Oversupply
Copper price movements

![Copper Price Chart](source: www.tradingeconomics.com | LME)
Shareholder expectations

• Post 2008, Chinese demand and high capex expenditure resulted in lower shareholder returns;
• Mining industry performance lagged behind other industries;
• Shareholders demanded better performance;
• Result:
  - cost cutting measures to improve free cash flow events
  - exploration and capex strategy re-aligned
  - appetite for risk reduces - selection of projects / investment refined to minimize political risk and uncertainty.
Unique features of the life cycle of a mine and taxation
Unique features of the life cycle of a mine and taxation

Phase 1 Exploration:
- Substantial cost phase with no income
- Highly risky
- Tax loss relief critical

Phase 2: Mine Development:
- High cost phase
- Purchase of capital inputs which need to be imported
- Require accelerated capital allowances
- Require import duty relief

Phase 3: Production:
- Only phase where revenue is earned from sale of minerals
- Susceptible to price fluctuations

Phase 4: Post mining
- No income, but significant rehabilitation costs
- Tax deductibility for rehabilitation provisions critical
Aligning needs of public & investors

Ultimate goal of Government – ensure greatest possible benefit to public while simultaneously encouraging investment:

- Careful balancing act;
- Imposing right type of taxes and right measures;
- Timing of taxes important – higher taxes in short term could deter long term investment & exploration;
- Progressive & efficient tax system.
Section 2 – Unique features of the life cycle of a mine and taxation

Critical investment selection criteria

- Tax stability & predictability – tax incentives less important
- Stable socio-political environment
- Relief for capex and costs
- Lower costs (including taxes)
- Cash returns for mining investors
- Transparency & institutional framework for addressing needs of business, government & social interest groups
Summary of recent changes
Brief history of mining industry

1960s and 1970s   mining industry was at its peak
1969   mines nationalized
1973 - 74   oil crisis – metal prices start to fall
1980s   copper prices slump
1970 onwards – lack of investment and development
1990s   Government trying to attract mining houses
1999   first privatization with entrance of Anglo American at KCM
2000   2008 others follow and develop/ acquire mines
2005   Kansanshi starts operations
2008   Lumwana commissioned
2008   Copper prices peak – public dissatisfied with lack of returns to country
2009   Copper prices plummet
Mining cycles and taxation policy

Pre 2008 CIT 25%-35%, development agreements, WHT & import duty concessions

2008 Introduction of windfall tax; increase in mineral royalties to 3%, introduction of variable profits tax and reduction of capital allowances;

2009 Windfall taxes removed;

2012 Mineral royalty increases from 3% to 6%, hedging income taxed separately;

2013 Property transfer tax of 10% on transfer of mining rights;

2014 Export duty on semi processed minerals 10% and customs duty on copper blisters etc. 15%;

1 Jan – 30 June 2015 Single tier regime for mining companies - MRT for open pit mines 20%, MRT for underground mines 8%, CIT for mineral processing and tolling operations at 30%;

1 July 2015 9% MRT, 30% CIT for mining operations, 35% for processing [Yet to be finalised].
2014 Tax regime

- 6% mineral royalty on gross sales – LME prices;
- 30% Corporate income tax for mining operations;
- Variable profits tax of up to 15% where taxable income exceeds 8% of gross income;
- Reduced rate of capital allowance of 25%;
- Carry forward of tax losses:
  - 10 years generally for mining cos
  - 5 years for exploration cos.
C1 Costs & Effective tax rates

- The 2014 tax regime already represented one of the highest effective tax rates in the world. ETR was approximately 48%
- Already challenging fiscal environment
- NB: 2014 mining regime had 6% MRT, 30%CIT & VPT of up to 15%
## Mining Tax Regimes of Comparable Economies

<table>
<thead>
<tr>
<th>Country</th>
<th>CIT</th>
<th>Mineral Royalty (Copper and Base Metals)</th>
<th>Basis of Mineral Royalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zambia (1 Jan – 30 June 2015)</td>
<td>Nil</td>
<td>8% - Underground Mining 20% - Open Cast Mining</td>
<td>Norm Value/ LME/ Gross value</td>
</tr>
<tr>
<td>Zambia (proposed)</td>
<td>Basic Rate - 30% Variable Rate - Up to 15%</td>
<td>9%</td>
<td>Norm Value/ LME/ Gross value</td>
</tr>
<tr>
<td>Botswana</td>
<td>Variable rate</td>
<td>3%</td>
<td>Gross Value</td>
</tr>
<tr>
<td>Congo, Republic of</td>
<td>30%</td>
<td>3%</td>
<td>Market Value</td>
</tr>
<tr>
<td>Democratic Republic of Congo</td>
<td>35%</td>
<td>2.0%</td>
<td>Adjusted Revenue*</td>
</tr>
<tr>
<td>Ghana</td>
<td>35%</td>
<td>5%</td>
<td>Gross Value</td>
</tr>
<tr>
<td>Tanzania</td>
<td>30%</td>
<td>4%</td>
<td>Market Value</td>
</tr>
<tr>
<td>Mozambique</td>
<td>32%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>25%</td>
<td>2%</td>
<td>Invoice Value</td>
</tr>
<tr>
<td>Chile</td>
<td>18.5%</td>
<td>Variable (0% - 14%)</td>
<td>Taxable income</td>
</tr>
</tbody>
</table>
### Comparative analysis of tax regimes of BRICS

<table>
<thead>
<tr>
<th>Country</th>
<th>CIT</th>
<th>Mineral Royalty (Copper and Base Metals)</th>
<th>Basis of Mineral Royalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>34%</td>
<td>2%</td>
<td>Adjusted Revenue*</td>
</tr>
<tr>
<td>China</td>
<td>25%</td>
<td>Variable (0.5 %– 4%)</td>
<td>Units Produced, Revenues, Mining Area</td>
</tr>
<tr>
<td>India</td>
<td>32.5% (Indian) and 42% (Foreign)</td>
<td>4.2%</td>
<td>Units Produced, Area of Mine</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>20%</td>
<td>8%</td>
<td>Values or Quantity of Extracted Mineral Resources</td>
</tr>
<tr>
<td>South Africa</td>
<td>28%</td>
<td>Variable (Max 5% refined ores and 7% Unrefined ores)</td>
<td>Adjusted Revenue**</td>
</tr>
</tbody>
</table>

* Mineral sales revenue less taxes levied on revenue, insurance and freight costs

** Gross sales * royalty percentage rate
Corporate and variable taxes for mining companies abolished
Replaced by:
• 8% mineral royalty tax rate for **underground** mining operations;
• 20% mineral royalty for **open cast** mining operations.

**Tolling activities**
CIT at 30% on income earned from tolling.

**Processing mineral ores and concentrates**
CIT at 30% on income earned from the processing of purchased mineral ores, concentrate and any other semi processed minerals currently taxed as income from mining operations.
Impact of proposed new regime - effective 1 July 2015
Proposed regime – effective 1 July 2015

- Mineral royalty tax rate for open cast mining operations will be pegged at 9 percent;
- Mineral royalty for underground mines to be pegged at 6%;
- Corporate income tax on income earned from mining operations will be 30 percent;
- Corporate income tax on income earned from mineral processing will be 35 percent;
- Variable profit tax on income earned from mining operations will be 15 percent when taxable income exceeds 8 percent of the gross sales;
- Deduction of tax losses carried forward to be limited to 50 percent of taxable profits;
- Stiffening of penalties for tax offenders; and
- Zambia Revenue Authority will introduce stringent enforcement mechanisms to effectively monitor mining activities and ensure greater transparency among mining companies when reporting revenue and expenditure.
Key issues with new proposed mining regime

MRT rate still very high given our cost of doing business and ore concentrate

MRT still taxed on sales – no account of whether or not operations are profitable

Assumption that open pit mines have lower costs cf to underground mines is invalid. Mining costs depend on:

• ore concentrate or ore content;
• ore strip ratio;
• Waste content – often higher for open cast;
• Transportation costs – transporting unprocessed ores from mine to processing facility, tyres, dump trucks, shovels, etc – often higher for open cast;
• Other unresolved matters creating uncertainty - energy and fuel costs;
• Change will require two sets of financial statements, tax returns, etc.
Key issues with new proposed mining regime

Underground mines may be worse off:

- Now subject to CIT of 30%;
- Plus variable profits tax of up to 15%;
- Mineral royalty although lower than 8% still payable on gross sales;
- Significant mine costs – pumping water, ventilation, maintain underground shaft, etc.
### Back of envelope calculations – MRT 9% open pit mines

<table>
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<tr>
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<th>High cost $</th>
<th>Av cost $</th>
<th>Low cost $</th>
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<tbody>
<tr>
<td>Current Cu price</td>
<td>5,888</td>
<td>5,888</td>
<td>5,888</td>
</tr>
<tr>
<td>C1 cost (2.80, 2.17, 1.55/lb)</td>
<td>(6,173)</td>
<td>(4,784)</td>
<td>(3,417)</td>
</tr>
<tr>
<td>Net cash</td>
<td>(285)</td>
<td>1,104</td>
<td>2,471</td>
</tr>
<tr>
<td>Mineral royalty at 9%</td>
<td>(530)</td>
<td>(530)</td>
<td>(530)</td>
</tr>
<tr>
<td>Net cash income C1 costs</td>
<td>(815)</td>
<td>574</td>
<td>1,941</td>
</tr>
</tbody>
</table>

Current C3 costs ex MRT  
(0.51, 0.54, .46/lb)  
Net income after C3 & MRT  
(1,947) (626) 927

NB C1 excludes amortization & depletion costs, interest charges, corporate overheads, corporate income tax, etc.

NB: above costs are derived from various reports and do not represent any specific company costs
Back of envelope calculations – MRT 6% underground mines

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<td>2,471</td>
</tr>
<tr>
<td>Mineral royalty at 6%</td>
<td>(353)</td>
<td>(353)</td>
<td>(353)</td>
</tr>
<tr>
<td>Net cash income</td>
<td>(638)</td>
<td>751</td>
<td>2,118</td>
</tr>
<tr>
<td>Current C3 costs ex MRT</td>
<td>1,132</td>
<td>1,200</td>
<td>1,014</td>
</tr>
<tr>
<td>(0.51, 0.54, .46/lb)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income after C3 &amp; MRT</td>
<td>(1,770)</td>
<td>(449)</td>
<td>1,104</td>
</tr>
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NB C1 excludes amortization & depletion costs, interest charges, corporate overheads, corporate income tax, etc.

NB: above costs are derived from various reports and do not represent any specific company costs.
Suggested way forward
End Game

It's not necessarily about tax avoidance, treasury coffers or super profits & super taxes

It's about stakeholder interests

Shareholders
  • need sufficient return for capital invested;

Governments
  • need sufficient revenues for development, social services,
  • REAL job creation

Employees
  • Fair wage commensurate with effort and investment, job security

Civil society, public organizations
  • equality, justice, freedom, environmental sustainability
Section 5 – Suggested way forward

**Suggested way forward**

- Institutionalize process for addressing all stake-holder concerns;
- Improve trust and co-operation;
- Adopt longer term perspective;
- Monitor global developments & trends & assess impact on local industry/economy;
- Undertake economic impact assessment of proposed tax policy changes.
"Whosoever desires constant success must change his conduct with the times."

Niccolo Machiavelli