



Taxation and Extractive Industries (Breakout Group)

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*Presentation for Taxation & Developing Countries
(a PEAKS training course)*

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Dirk Willem te Velde (Overseas Development Institute)



- Tax receipts form key part of overall benefits of extractive industries
- Discuss interactively what makes taxing extractives different
- Discuss interactively tax instruments available to government
- Discuss complexity and challenges (e.g. investment allowance in taxes)
- Summary: What are the key policy challenges?



Special Features of Extractive Industries

- Large rents, but volatile and uncertain
- The extraction and operation of mineral resources requires large upfront investment, but revenues occur over time. Problem of “hold-up” and low investment
- EIs depend on a few private actors, involving asymmetric information, weak state capacities and market power
- Involves multinationals who can use international operations to shift the tax base
- Resources are scarce and non-renewable

→ Policy issue: How to manage these features and trade-offs?



Tax Instruments for EIs (Zambia Mining as Example)

Type of tax	Zambian rates	Base	Comment
Pay- As-You-Earn	25%-35%	Gross salaries, based on income bracket	Based on income bracket of employees. Payable by all formal sector employers.
Indirect taxes (VAT)	Standard VAT rate of 16%	Gross value	Import VAT and VAT (non-refundable) payable on equipment and inputs
Mineral Royalty	6%	Gross value	Increased from 0.6% to 3.0% in 2008, and from 3% to 6% in 2012
Corporate Profit Tax	30%	Gross Profits calculated on accrual basis	General rate of 35% for non-mining companies. Special rates for investments under Zambia Development Agency Act (0% first 5 years, 50% reduced rate years 6-8, 25% reduced rate years 9 and 10)
Import Duty	Variable depending on degree of value	Customs value	A 15% export duty on copper concentrates was imposed in 2008 but later repealed
Withholding Taxes	15% on interest payments, and payments for services of non-residents	Gross income	0% on dividend payments (15% on dividends for non-mining firms). Statutory rates might be modified by country-to-country treaties
Excise Duty	Variable	Excisable value (=customs value + customs duty)	Applied to some products such as fuel
Variable Profit Tax	Introduced in 2009	Gross Profits calculated on accrual basis	In effect when ratio of net-of-tax profits to total sales exceeds 8%



Fiscal Receipts from Zambian Mining

Type of tax	Rev's collected in 2009	
	Kw m	USD m
Pay- As-You-Earn	564,822	113.4
Indirect taxes	463,809	93.2
Mineral Royalty	242,192	48.6
Company Income Tax	209,721	42.1
Import Duty	114,219	22.9
Withholding Taxes	59,010	11.9
Excise Duty	1,113	0.2
Variable Profit Tax	0	0.0
Total	1,654,886	332

Cited in Haglund (2013)



Direct Tax Revenue from Mining (2001-2011)

	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

Source: Zambia Revenue Authority

Source (Manley, 2013)



Example of Complexities in Taxes

Effects over time of accelerated depreciation allowances

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	Year 1	Year 2	Year 3	Year 4
<i>100% depreciation allowance</i>				
Revenue	80	80	80	80
Capital costs	80	0	0	0
Accounting cost depreciated	80	0	0	0
Operating profit	0	80	80	80
Tax paid	0	24	24	24
After tax profit	0	56	56	56
Cumulative profits	0	56	112	168
<i>25% depreciation allowance</i>				
Revenue	80	80	80	80
Capital costs	80	0	0	0
Accounting cost depreciated	20	20	20	20
Operating profit	60	60	60	60
Tax paid	18	18	18	18
After tax profit	-18	62	62	62
Cumulative profits	-18	44	106	168



Consideration of OECD/G8/G20 Issues *transfer pricing*

- Tax administrators face further challenges
 - Transfer pricing abuse,
 - Unreported value of production,
 - Shifting of debt payments and
 - Hedging of risks
- Transfer pricing abuse; how to detect?
 - Over-invoicing imports
 - Under invoicing exports
 - Comparator – arms-length trade)
 - Zambia misses out on US\$2 bn

Exports reported by Zambia 2011 compared with imports from Zambia reported by other countries

Source:	UN COMTRADE database, downloaded 20 May 2013.	
PartnerName	Zambia's reported exports (US\$ 000) - FOB values	Partner's reported imports from Zambia (US\$ 000) - most, if not all, CIF values
All reported partners (incl)	9,000,528	6,260,560
Switzerland	4,402,850	213
China	1,504,569	2,775,940
South Africa	838,359	369,893
Congo, Dem. Rep.	584,111	
United Kingdom	333,058	46,631



Recap - What are the policy issues?

- Manage state-business relations in EIs. How?
- Tailor the type of taxes to the situation. How?
- Address transfer pricing abuse. How?