



Impact of Illicit Financial Flows on **DOMESTIC RESOURCE MOBILIZATION:** Optimizing Revenues from the Mineral Sector in Africa



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United Nations Economic Commission on Africa
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Contents

Abbreviations	vi
Acknowledgements	vii
Executive summary	1
Key findings	3
Policy recommendations	7
1. Evolving context of mineral-led development in Africa	18
2. Importance of good governance for optimizing mineral revenues in Africa	21
Good governance for domestic resource mobilization in the mining sector	21
Towards a conceptual framework of illicit financial flows and domestic resource mobilization	22
Fiscal regimes	26
Mining value chains	30
Mining companies	33
Understanding illicit financial flows	35
Base erosion and profit shifting (BEPS)	37
3. Sustainable development impacts of weak domestic resource mobilization	38
Economic	38
Social	39
Political	40
Environment	42
4. Analysis of policy and regulatory frameworks to combat illicit financial outflows from the mining sector in case-study countries	43
Licensing	43
Beneficial ownership	47
Exploration	47
Capital gains tax	51
Contract negotiations	52
Exploitation	55
Thin capitalization	55

Royalties	57
Corporate income tax	60
Indirect taxes	62
Transfer pricing	63
<i>Transfer pricing methods</i>	65
<i>Anti-avoidance provisions</i>	66
<i>Dispute settlement</i>	67
<i>Comparables</i>	68
<i>Management fees and procurement of capital goods</i>	69
<i>Tax administration and capacity building</i>	70
Transportation and marketing	74
Intangibles	74
Trade misinvoicing	75
Crosscutting issues	76
Double taxation treaties	76
Bilateral investment treaties	76
5. Conclusions and recommendations	78
Conclusions	78
Policy recommendations	80
Annexes	91
A.1 Country summary: Democratic Republic of the Con-go	92
A.2 Country summary: Republic of South Africa	110
A.3 Country summary: United Republic of Tanzania	124
A.4 Country summary: Republic of Zambia	134

Figures, tables and boxes

Figures

Figure 2.1	Conceptualizing impact of illicit financial flows on domestic resource mobilization	23
Figure 4.1	Transactions along the mining value chain	43
Figure 4.2	Average tax revenues as a percentage of GDP across mineral-rich and resource-poor countries in Africa	61

Tables

Table 2.1	Fiscal instruments along the mining value chain	27
Table 2.2	Illicit financial flow practices and risks along the mining value chain	36
Table 4.1	Mining fiscal regimes in selected countries	59

Boxes

Box 2.1	Viable approaches for domestic resource mobilization in mineral-rich Africa	21
Box 2.2	Key objectives for good mineral resource governance	26
Box 2.3	Africa Mining Vision	32
Box. 3.1	Regional and international governance initiatives	41
Box 4.1	Mining taxation capacity building in Zambia	71

Abbreviations

AfDB	African Development Bank
AMV	African Mining Vision
DRM	Domestic Resource Mobilization
DTA	Double Taxation Agreements
ECA	Economic Commission for Africa
EITI	Extractives Industry Transparency Initiative
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFFs	Illicit Financial Flows
IAG	Ibrahim Index of African Governance
IMF	International Monetary Fund
KPCS	Kimberly Process Certificate System
MDG	Millennium Development Goals
MNC	Multinational corporation
NEPAD	New Economic Partnership for Africa's Development
PWYP	Publish What You Pay
SWF	Sovereign Wealth Fund
UNCTAD	United Nations Conference on Trade and Development

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Executive Summary

The recent furor over the massive cache of leaked documents has galvanized global attention on the impact of illicit financial outflows on domestic resource mobilization. However, renewed impetus for change will require complementary analytical and strategic work and effective concerted actions. This report is a follow-up to the landmark Report of the High Level Panel on Illicit Financial Flows from Africa, commissioned by the African Union and the Economic Commission for Africa. Based on four country case studies, this report demonstrates the level of vulnerability of the mining sector of Africa to sophisticated cross-border corporate practices which erode the tax base of its countries.

The report adopts a policy-oriented approach, systematically examining risks points of illicit financial leakages along the mineral value chain. The selected countries –Democratic Republic of the Congo, South Africa, Tanzania and Zambia - reflect an inclusive range of policy, institutional and economic realities. They are all mineral-dependent economies, albeit at different stages of economic development and structural transformation. Their experiences reflect the regional diversity of the continent.

The resource potential of Africa is enormous, confirming that the continent has endless opportunities to finance its development priorities. In fact, mineral endowment represents one of the best assets for mobilizing revenues for growth and structural transformation. Even with collapsed prices and depressed markets, the extractive sector remains a highly significant source of fiscal revenues for many countries, accounting for more than 70 per cent of African exports. The continent continues to occupy an important geostrategic place in the global mining industry. While extensive swathes of its territory remain unexplored, Africa hosts an estimated 30 per cent of the world's mineral reserves and produces an even greater share of key precious and base metals, as well as gemstones, including platinum group metals (54 per cent), diamonds (78 per cent) and chromium (40 per cent). Its subsoil endowments include significant deposits of industrial minerals, such as phosphates, which account for more than 60 per cent of global reserves. Investors also have a positive view of the mineral sector, with the influential Fraser Institute survey recently ranking Africa as one of the most attractive destinations for mining investment just behind Australia, Europe and North America— ahead of Asia, the Caribbean, Latin America and Oceania.

Translating the abundant wealth into sustained riches for all citizens, however, remains a challenge. The proverbial 'paradox of plenty' has been a curse on many countries' development. Management of resource rents through increased social services spending and more productive investment has dominated policy discussions over the past decade. Country

experiences suggest that without specific policies to address key governance challenges, the contribution of the extractive sector to broad-based socio-economic development will remain suboptimal.

However, besides equity and transparency, African countries are facing an even greater challenge of 'fairness'. Mineral-rich countries are not collecting the type of tax revenues from their resources that their production value would suggest. Tax efforts in resource-rich African countries have remained below the African average. Cross-border illicit financial leakages drain away much-needed resources that would otherwise be available to finance development priorities. The case-study countries collectively bear one of the largest burdens of illicit financial flows from the continent. Estimates by ECA show that, over the period 2000-2010, more than half (56.2 per cent) of the IFFs from Africa came from the extractive sector and was highly concentrated in a few countries. The High Level Panel estimates that over \$50 billion leave the continent annually. In fact, according to the Global Financial Integrity, the continent bears the most disproportionate burden of unrecorded cross-border financial outflows as a percentage of gross domestic product (GDP), representing approximately 8.6 per cent of GDP.

Domestic resource mobilization and illicit financial outflows are at opposite ends of the goal to build effective 'developmental State'. Policy and compliance gaps in regulatory regimes along the mineral value chain, create loopholes for illicit financial outflows, undermining countries' potential to mobilize much-needed domestic resources for their development. Illicit financial outflows therefore undermine the emergence of developmental States in Africa.

Good governance is key to mobilize adequate domestic resources and plug loopholes that facilitate illicit financial outflows. It entails the ability to formulate and implement effective strategies, policies, laws and regulations for mobilizing optimal revenues from the mineral sector. At a minimum, this involves minimizing illicit financial flows and, at best, entirely eliminating resource mobilization-inhibiting practices along the mineral value chain. Governance of domestic resource mobilization is also shaped by institutional and political economy factors, at both the national and international levels. Incentives for illicit financial leakages stem from policy and compliance gaps allowing vested foreign and domestic interests to profit from tax evasion and weak state institutions. Corrupt tax administration may also undermine the enforcement of policies to curb illicit capital flows.

Key Findings

Below are some emerging findings from the case-study countries, which could be extrapolated to the continental level.

Illicit financial flows from the mineral sector are increasingly widespread and complex, necessitating a whole-of-government approach.

The report demonstrates that inhibitive practices related to illicit financial flows (IFF) and domestic resource mobilization (DRM) in the mineral sector are increasingly widespread and complex. They are also global in nature. However, design and compliance gaps in countries' institutional frameworks transform tax evasion and avoidance opportunities into harmful cross-border illicit financial flows. The risks vary along the mining value chain, in terms of exploration, exploitation, transportation and marketing. Different minerals face different levels of revenue leakage risk.

Most countries lack a whole-of-government policy consistency framework. While there is increasing awareness of multinational companies' tax avoidance practices in the sector, no comprehensive working definition of illicit financial flows exists in any of the mineral regimes studied. The case-study countries have incorporated various anti-avoidance measures into their policies, laws and regulations targeting specific aspects of illicit financial flows, such as transparency and accountability, as well as corruption and money laundering. Meanwhile, the trade and investment incentives designed to encourage foreign direct investment in the sector are overly generous and misaligned with revenue mobilization objectives. Due to tax exemptions in the sector, tax authorities are losing more than \$1.6 billion a year in foregone tax revenue in Zambia.

Policies and legislation are creating loopholes along the entire mining value chains

Transfer mispricing remains one of the biggest sources of illicit leakages from the mineral sector. Zambia for example, is reported to have lost almost 10 per cent of its gross domestic product (GDP) annually due to corporate tax avoidance practices, including transfer mispricing. However, the scope and effectiveness of policy and legislative frameworks vary from country to country. All case-study countries have some sort of legislation in place to curb transfer mispricing. However, many have yet to formulate specific but complementary regulatory guidance documents. The Democratic Republic of the Congo recently introduced a provision on transfer pricing in its Law No. 004/2003 of 13 March 2003 reforming tax procedures. However, no specific guidelines exist to date for determining the transfer pricing positions of multinational companies. South Africa, Tanzania and Zambia have adopted specific transfer pricing guidelines. With the exception of Tanzania, the penalties imposed by South Africa and Zambia are far lower than those of comparable mining countries like Chile and Australia, where

finances average about 40- 50 per cent plus interest for transfer mispricing arrangements aimed at evading or minimizing tax liabilities.

Excessive leveraging by mining companies is a major source of domestic tax base erosion. However, the anti-avoidance measures adopted are weak and contain the seeds of their own destruction. Since accrued interest from debt is deductible against tax liability, there is a strong tendency for mining companies to borrow internally from their affiliates, rather than raise capital through the sale of their shares. All case-study countries have adopted a ratio-based approach, with a predetermined proportion of equity to debt in the allowable finance mix as per thin capitalization requirements. While the mining industry is not a big consumer of debt financing, countries have adopted average ratios in the range of 2:1 to 3:1, which are higher than the efficient level of debt that the market can bear for the industry. In fact, comparable advanced mineral-rich countries like Canada and Australia have far lower debt-to-equity ratios (1.5:1). With the exception of South Africa, none of the countries have adopted an earnings stripping approach, limiting the amount of deductible interest as a share of earnings before taxable income.

Bridging information gap, particularly regarding geology, remains key to effective compliance

Mineral-rich African countries have yet to leverage key information and knowledge of the sector in a forward-looking manner. All case-study countries recognize the importance of geological information, but fail to integrate its investment and governance dimensions in way that effectively mobilizes revenues and curbs illicit financial flows. Mandatory submission of precompetitive geoscience information by mining companies to governments is often limited by confidentiality clauses, preventing African states from exercising their right of custodianship of geo-scientific data. This is further complicated by the self-limiting practice of incorporating geological information into legislation as records, rather than datasets that could be aggregated and analyzed for effective tracking and monitoring of illicit financial flows. There is little clarity on the use of the terms 'geological information', 'geological knowledge', 'geological data' and 'geological records'. With the exception of South Africa, there is no requirement for precompetitive data submitted to government to be digitalized. Data are often submitted in PDF format, which cannot be aggregated. As a result, African governments are not only losing billions of dollars in undervalued assets, but are also underutilizing a critical tool for attracting investment as well as governing the sector.

The lack of a data management approach extends along the value chain. None of the case-study countries' regulations include provisions for the tax administration to continuously review and update criteria for transfer pricing requirements, including the documentation submitted reflecting the constantly changing practices adopted by mining companies. This means that regulations will likely continue to lag behind mispricing practices, with the risk of significant leakages through information asymmetry.

Balanced mix of tax instruments is key to optimal resource mobilization

Progressivity as a principle for designing optimal tax instruments remains a major challenge. African governments employ a wide range of mechanisms for mobilizing revenues from the sector, including production-based and profit-based taxes. However, efforts to ensure revenue stability, adopt efficient tax instruments and build implementation capacity remain unbalanced. Only South Africa applies a profit-based system to calculate royalty rates for different minerals. Most of the case-study countries apply ad valorem or sales-based royalty systems, which factor in changing market prices. While resource rent taxes are generally recognized as having a neutral impact on investment decisions, none of the case-study countries applies an excess profit tax. Zambia has vacillated with windfall tax reforms, which were first introduced in the 2008 Mineral and Mines Act and later annulled in the face of opposition from the mining industry.

In the face of depressed market conditions, there is continued pressure for mineral-rich Africa to review royalty rates. While there are definitely fears of further alienating investors with upwardly revised rates, the relatively low royalty rates set long ago by the international financial institutions as a way of attracting investment do not seem to have translated into increased tax revenues for African governments. Even with the recent surge in commodity prices, resource taxes, including royalties, fell from 41 per cent in 1980 to 37.1 per cent in 2010 of overall tax revenues.

In truth, geology matters more than tax policies in terms of attracting investors. According to an African Development Bank (AfDB) study, the most significant impact on the cost of operating a gold mine was grade quality, underscoring the influence of geology and geological information. The influential Fraser Institute reports that, according to business executives, only 3.5 per cent of mining companies will not invest in Africa due to tax regimes.

Good governance remains key to domestic resource mobilization

There are no sustainable substitutes for broad-based governance reforms, which are aligned with the African Mining Vision. While contractual regimes are commonly used as stand-alone governance instruments, their design, opacity and content, including stability clauses, are often misaligned with revenue mobilization efforts and heighten the risk of illicit financial outflows. However, case-study countries clearly recognize the importance of establishing solid legal and policy frameworks for governing the sector.

There are encouraging examples of good governance for increased domestic resource mobilization. Zambia has shifted from a contractual regime to a statutory governance model with the recent adoption of its 2015 Mines and Minerals Development Act, which finally confirmed licensing as the primary governance regime for the sector. Section 160(1) of the Act annuls all mineral development agreements entered into before the enforcement of the Act.

Institutional capability for joint action along the mineral value chain remains crippled. While most African countries have demonstrated their commitment to tackle terrorism-linked international money laundering practices, there is an alarming institutional failure to address the commercial components of illicit financial flows. Interagency coordination is weak or absent in the case-study countries, none of which has a dedicated platform to get custom officials, tax authorities, law enforcement agencies, trade and mines departments to systematically share information in order to curb illicit financial flows.

Capacity remains a binding constraint

Apparently, there is a reactive, transactional approach towards curbing cross-border tax dodging practices by mining companies. While this reflects operational and strategic capacity gaps, the lack of a proactive risk management approach may end up stretching the already limited capacity of countries. This situation could get even worse, as the case-study countries tighten up their legislation with more demands for documentary evidence from companies on their tax positions. With the exception of South Africa, it was unclear how tax authorities in the case-study countries decide on which companies to monitor and which risk to audit. It appears that case selection was more discretionary and often based on anecdotal evidence. South Africa has a dedicated Assurance Unit responsible for mining tax administration, as well as a separate risk profiling team focused on the extractive industry. Both teams work closely with the International Tax and Transfer Pricing teams, including employee secondments.

Policy Recommendations

A window of opportunity has opened for formulating targeted policies and systemic approaches to curb illicit financial outflows. An era of unprecedented international cooperation on tax matters is now under way. Mineral-rich African countries must step up their game in terms of adopting emerging international norm-setting processes and seizing opportunities for strengthening critical capacity along the mining value chain.

Curbing illicit financial flows from the extractive sector requires collective action at all levels. Below are some proposals for tackling the complex challenge of corporate tax avoidance, as well as suboptimal domestic resource mobilization in the African mining sector. They are specific to case-study countries, as well as mineral-rich countries as a whole. The recommendations are organized into three levels: global, regional and country.

Global

1. Establish inclusive, transparent global governance frameworks to curb illicit financial flows

- All governments should make concerted efforts to ensure that global governance of illicit financial flows is fit for purpose. Now that IFFs are on the global agenda, it is imperative to expand and strengthen institutional frameworks to address their commercial dimensions in ways that are effective, equitable and sustainable.
- The global community must take firm collective action to increase access to information about beneficial ownership of mining companies along the value chain registered in their countries. The information should be shared through central public registries and made accessible in a timely manner to key agencies and stakeholders, including civil society organizations. International efforts to put political pressure on low-tax jurisdictions that encourage high-level financial opacity, banking secrecy and the registration of shell companies should continue.
- The international community should recognize the particular risks of IFFs faced by the extractive sector in Africa and support ongoing continental and global initiatives to strengthen governance, including the African Mining Vision, the Africa Peer Review Mechanism, the Extractive Industry Transparency Initiative, the US Dodd Frank Act and comparable European Union legislation.
- The United Nations should promote and strengthen inclusive intergovernmental approaches to tax transparency. The United Nations Tax Committee should step up efforts to formulate specific norms to curb cross-border tax avoidance in the extractive sector, a priority area for domestic resource mobilization in Africa which continues to

be inadequately addressed by current global reform initiatives. Targeted, consistent efforts should be made to support African countries in addressing key priority risk areas which are not yet part of the global reform agenda of the Organization for Economic Cooperation and Development (OECD), including trade mispricing, comparables for the mining sector, tax incentives and transfer of indirect assets.

- The United Nations should establish a global mechanism for the repatriation of proceeds from tax evasion and tax avoidance to the source countries. The mechanism could be modelled along the lines of existing international asset recovery initiatives, including the upgrading of the United Nations Convention against Corruption (UNCAC) to tackle the commercial dimension of illicit financial flows.
- The European Union, G20, G8 and the United States of America and the United Kingdom of Great Britain and Northern Ireland, including the wider international community, should work towards ensuring the accountability of jurisdictions, corporations and individuals that facilitate cross-border tax evasion and avoidance. They should also support efforts to integrate the activities of commodity trading companies presenting high risks of trade mispricing into their existing extractive sector reporting initiative.
- International financial institutions should include stronger mandatory disclosure requirements as part of their support of public-private partnerships in the extractive sector, including contract and tax transparency.
- International standard-setting bodies, such as the International Accounting Standard Board, should strengthen their disclosure framework for corporate taxes. They should complement current reporting, which is based on historic financial data and publicly available tax governance information, with disclosure of unrecognized tax benefits that are uncertain to tax authorities, as well as a code of conduct obliging companies to avoid all forms of practices inconsistent with their tax obligations.

2. Increase technical support for African countries

- The international community should support African countries in implementing key action plans of the OECD-G20 Base Erosion and Profit Shifting Project. While the fifteen recently adopted Action Plans are not binding upon African countries, they will however introduce major normative reforms of key legislation and policies to curb IFFs in countries. Due to capacity challenges, the current participation of African countries in newly established mechanisms remains very low. International partners should support African countries in prioritizing and implementing the international tax reform package according to their owned capacities and priorities.
- Partners must therefore step up efforts to strengthen the capacity of African countries in a targeted and coherent manner. High-priority areas of the adopted action plans include limiting base erosion through interest deductions and other financial payments, preventing treaty abuse and artificial avoidance of permanent establishment status, ensuring that transfer pricing outcomes related to intangibles are in line with value creation and re-examining transfer pricing documentation.

- International partners should support and facilitate south-south, north-south initiatives to share experiences among countries, as well as the work of regional organizations to curb illicit financial outflows and increase domestic resource mobilization. As major consumers of African minerals, the European Union and China could develop and support joint, triangular, cooperation initiatives in targeted capacity needs areas, in order to address cross-border corporate tax avoidance by mining companies operating in Africa.
- Donors should double their technical support for domestic resource mobilization, in accordance with the Addis Ababa Tax Initiative. Partners should leverage their development assistance to provide much-needed technical assistance for curbing illicit financial outflows along the mining value chain. They should do so in ways that are coherent, coordinated and holistic. Despite evidence of the great value for money of technical taxation assistance, only 0.22 per cent of Official Development Assistance (ODA)¹ is spent on building tax administration capacity in countries. The amount allocated for boosting taxation of mineral resources is even negligible. Successful examples of international cooperation through targeted support for effective auditing of IFF risks along the value chain should be encouraged.
- The international community should step up technical assistance to implement the specific goals of the United Nations Agenda 2030 and the Africa Union Agenda 2063 to eliminate all forms of illicit financial flows. The work of ECA and the African Union Commission (AUC) to develop integrated frameworks for implementing both agendas in accordance with the resolution of the 2016 African Union/Economic Commission for Africa Joint Conference of Ministers should be supported. International organizations like the OECD, World Bank and International Monetary Fund (IMF) and United Nations Conference on Trade and Development (UNCTAD) should increase their efforts to develop tools, databases and indicators to monitor and curb illicit financial outflows. Particular effort should be devoted to upgrading existing publicly accessible databases in order to capture trade mispricing, as well as developing new transfer pricing databases.

Regional

3. Establish progressive African leadership to promote international tax cooperation

- African countries must step up their game. The African Union Commission, together with the African Tax Administration Forum, should support countries' strong, proactive commitment to influence emerging global governance frameworks for international tax transparency. The African Union should examine the challenges and opportunities presented by the OECD/ Base Erosion and Profit Shifting (BEPS) project, with a view to coordinated, harmonized African participation in the remaining standard-setting priorities, through the newly endorsed BEPS Associate initiative.

¹ OECD (2015). Examples of Successful Domestic Resource Mobilization Reforms and the Role of International Cooperation. Discussion Paper. Organization of Economic Cooperation and Development, Paris.

- Specialized international and continental organizations should provide specific technical support to mineral-rich African countries, in order to strengthen their participation in the work of the Subcommittee on Extractive Industries Taxation Issues for Developing Countries of the United Nations Tax Committee. The Committee's ongoing work will eventually lead to the revision of the United Nations Model Tax Convention and its effective application of the arm's length principle for regulating transfer mispricing in developing countries. Participation in the setting of global norms to curb cross-border tax avoidance, will allow African countries to ensure that new rules adequately address their needs and capacity, as well as providing long-term benefits.

Figure 1.1 Cumulative illicit financial flows by region, 2004-2013 (As a % of total illicit flows)

Source: Global Financial Integrity

- The African Union Commission should initiate steps for adopting and implementing an effectively unified and consistent continental approach for curbing illicit financial flows, including the mining sector. The African Union should implement the recently adopted Protocol and Statute of the African Court of Justice on Human and People's Rights, which makes provisions for crimes involving the illicit exploitation of natural resources, including corruption, money laundering and corporate complicity. The African Union Convention on Preventing and Combatting Corruption should be updated and expanded to include targeted measures to stem and reduce the commercial component of illicit financial flows. Specifically, the Africa Peer Review Mechanism should be strengthened to include questionnaires on IFFs related to the extractive sector. The African Union Advisory Board of Corruption (AU-ABC) should include IFFs in their annual corruption questionnaire. The normative work of continental organizations like the African Minerals Development Centre and the African Tax Administration Forum should be supported. The efforts of the ATAF Cross Border Taxation Committee should be expanded to include issues related to domestic resource mobilization in the mining sector.
- The ATAF should strengthen its support for African countries so as to focus their limited resources on the recently adopted OECD/G20 BEPS Action Plans that they consider of highest priority. Continental efforts should center more on other base-eroding practices that are of even higher priority to African countries, including mineral taxation, trade mispricing, and application of the arm's length principle including comparables for the extractive sector.
- The African Union should create a continental platform for dialogue that will promote consistency between tax policy, tax legislation and tax administration in the mining sector. The AUC, AMDC and ATAF should therefore jointly organize a high-level regional policy dialogue on illicit financial flows and domestic resource mobilization in the extractive sector. The forum would examine policy gaps and compliance issues along the mining value chain that present risks of illicit financial leakages. The forum will provide opportunity for countries to share their experiences, with a view to developing specific regional and country approaches to curbing illicit financial flows and enhancing domestic resource mobilization in the mining sector. In addition, the

forum would provide concrete recommendations to strengthen fiscal reforms in the mineral sector in ways that guard against ‘race to the bottom’ inspired by a collapse of commodity prices². The outcome of the forum could include a resolution for adoption by the AUC Specialized Technical Committee on Trade, Industry and Minerals.

- The African Union should bolster its support of regional economic communities’ efforts to harmonize the fiscal policies of their Member States in ways that guard against ‘beggar thy neighbor’ policies and align with the African Mining Vision.
- The AMDC, AfDB and World Bank and Global Financial Integrity could form a joint consortium to assess and quantify the exact extent of illicit financial outflows from the mineral sector. For purposes of effective policymaking, the study should disaggregate data according to country and region. The work could be aligned and integrated with the priorities of the recently established African Union Consortium on IFFs.
- The Africa Union should support existing voluntary international and regional multi-stakeholder governance initiatives in the extractive sector aimed at curbing illicit financial flows, including the Extractives Industry Transparency Initiative (EITI), International Conference on the Great Lakes Region and Kimberly Process Certificate System (KPCS). The African Union should develop and implement complementary, targeted mechanisms that can better monitor and stem illicit financial outflows from the extractive sector, including the proposed African Mineral Governance Framework. The African Union should strengthen support to public-private partnerships for domestic resource mobilization in the mining sector, including the development of an Africa Union Compact with the Private Sector.
- The African Union should explore the possibility of establishing a Pan-African Metal and Mineral Exchange to facilitate and improve price discovery, as well as develop the financial infrastructure for mining operations on the continent.

4. Reduce and stem illicit financial flows by consistently enhancing the capacity of African countries

- The African Union should ensure that the African Mining Vision (AMV) framework for ‘transparent, equitable and optimal exploitation of mineral resources to underpin broad-based sustainable growth and socio-economic development’ is a guiding principle for designing and implementing policies to stem illicit financial outflows and enhance domestic resource mobilization.
- The African Union should ensure that international capacity-building initiatives regarding the negotiation of tax treaties and mineral development agreements align closely with the AMV framework. The African Union should promote the sector’s shift from contract to licensing regime, as recently demonstrated by Zambia. While this shift from a narrow, contract-based governance structure to a more broad-based licensing regime is the sector’s ultimate goal, in the interim, countries will need capacity to better negotiate optimal contracts for greater domestic resource mobilization. The

² In 1990, almost 40% of African countries including resource -rich countries offer tax holidays, but in 2005 the proportion went up to 80% (Keen and Mansour, 2009).

AMDC should support countries in developing model contracts that are AMV-compliant and make certain that these contracts are integrated into legislative frameworks. The goal is to ensure that negotiated contracts are consistent with the enhancement of the sector's policy, legal and regulatory frameworks.

- The African Union should support initiatives to build capacity in the region, in order to allow countries to benefit fully from ever-increasing international tax transparency. The efforts of ATAF and other regional organizations to adapt emerging international frameworks to continental realities should be supported, including the Practical Guide on Exchange of Information for Developing Countries, the Agreement on Mutual Assistance in Tax Matters and the Model Double Tax Agreements. The Africa Union and ATAF could also explore opportunities to establish a facility to support Member States in negotiating equitable, transparent and sustainable tax agreements.
- The AMDC, ATAF and RECs should support mineral-rich African countries in pooling their resources, through multi-user licensing schemes for accessing comparable databases that are key to transfer pricing compliance. The AMDC and other relevant institutions should provide guidance for identifying and selecting relevant databases, as well as develop and adapt existing databases to the realities of the extractive sector and promote training on the different databases. The current work of the OECD on the development of a toolkit for assessing transfer prices for some major mineral commodities provides opportunities for partnerships with regional organizations.
- The African Union should facilitate regionally coordinated pooling of expertise and training to curb illicit financial flows. The mandate of the African Mineral Geoscience Centre should be expanded to allow countries with independent laboratory facilities to track and test the quality of ores, in order to monitor and curb the underreporting of minerals in countries. Activities could also include promoting and accrediting national laboratories as centers of excellence for auditing potential mineral leakages along the regional chain. Other important emerging initiatives that should be supported include the ATAF Agreement on Mutual Assistance in Tax Matters (AMATM), a multilateral instrument allowing for the exchange of information, sharing of expertise, joint audits and investigations, and mutual administrative assistance among African countries. The AMATM could be broadened to promote the sharing of experiences between countries in addressing key constraints along the mining value chain. The AMDC could develop a roster of international mineral taxation experts, forensic auditors, lawyers and mineralogists at the continental level, which could be made available to countries on demand. AMDC should partner with ATAF and the World Bank to develop specific training courses and workshops on transfer pricing, mineral taxation and mining value chain auditing, evaluation and analysis.
- The African Union should create a structured platform promoting effective collaboration between customs agencies, tax authorities, law enforcement agencies and the Ministry of Mines on key IFF risks along the mining value chain.
- The African Union should strengthen collective demand-side accountability efforts, including the emergence of effective Pan-African civil society platforms for fighting IFFs, as well as the capacity of media and bar associations in areas related to cross-border illicit financial flows.

Country

5. Ensure policy consistency for effectively stemming illicit financial flows

- As a matter of urgency, mineral-rich countries should formulate a working definition tackling illicit financial outflows. The definition should effectively frame policy interventions and organize instruments and institutions for greater resource mobilization along the mining value chain. The definition endorsed by the African Union/Economic Commission for Africa High Level Panel of ‘money illegally earned, transferred or used’ should guide the adoption of country policies and legislation. It should also take into account both the criminal and commercial dimensions of illicit financial flows. Borderline practices, however, should be identified and made illegal, including earning, transferring or utilizing funds stemming from tax evasion, tax avoidance, trade misinvoicing, abusive transfer pricing, base eroding and profit shifting.
- Given the scale of illicit financial outflows and the inconsistency of domestic resource mobilization strategies, it is imperative for all institutional efforts to be state-centered. An overarching structure is needed to streamline government efforts and promote consistent leadership in creating and implementing fiscal policy along the mining value chain. Depending on the country, this structure may take several forms, including an intergovernmental committee, an inter-agency task force or a memorandum of understanding between relevant agencies.
- Geological information remains key for optimizing mineral revenues, as well as monitoring, tracking and curbing illicit leakages along the value chain. Countries should review their minerals code to ensure that geological information is framed more strategically, in terms of data management rather than record keeping. Governments should put in place regulations governing the management of geological information, making it mandatory for companies to provide precompetitive digital data that can be aggregated with other datasets for analysis, forecasting and monitoring.
- Use the African Mining Vision as the basis for much-needed reforms to ensure greater resource mobilization, transparency, equity and broad-based development in the mining sector. This entails putting in place policies and legislation that establish clear fiscal rules, coherent contractual arrangements and effective regulatory regimes. Mineral-rich countries should stop relying on a patchwork of separately negotiated contracts as sector governance instruments and switch, to a licensing regime based on established, innovative mineral legislation and policy frameworks. Countries should take steps to review their mining development agreements with a view to balancing their revenue mobilization objectives, reducing illicit financial risks and creating an attractive investment climate. Negotiated contracts should align with the AMV principle of transparent, equitable and broad-based development of the mineral sector, which is integrated into legislation. The legislation should include key terms to minimize discretion in contract negotiation, implementation and monitoring. A transparent system of auctions and competitive bidding should be instituted for concessions and licenses. Where there is evidence of significant undervaluation of

concessions, governments should initiate independent investigations to review the evidence in a transparent manner.

- Governments should undertake a cost-benefit analysis of the policy space frequently limiting the revenue mobilization objectives of bilateral investment treaties (BIT). Treaties that are unfit for purpose should be cancelled or renegotiated. Tax concessions such as tax holidays, reduced royalty fees and waived corporate income tax should not be used as instruments for attracting investment. Where tax relief is granted, it should be finite, publicly transparent, subject to legislative oversight and reviewed regularly.
- Mineral-rich countries should avoid relying on easily obtained taxes— flat rate taxes, including production-based taxes. Governments should focus on progressivity and stability in order to optimize domestic resource mobilization. Countries should therefore adopt an appropriate mix of fiscal instruments, including royalties, corporate income tax and value added taxes. For greater resource mobilization, royalties can be increased, made more profit-sensitive and indexed to commodity prices. The progressive rate for royalties should increase, depending on the mineral. Mineral-rich countries should also consider imposing resource rent tax or capital gains tax, which is progressive.
- To clamp down on transfer mispricing, governments should formulate tough transfer pricing legislation based on arm's length principles. The policies should also ensure that taxable profits are clearly aligned with value creation along the mineral value chain. Legislation should include guidelines for applying the arm's length principles modelled along the United Nations or OECD guidance documents, including documentation requirements, penalties and preferences for various methods and dispute settlement mechanisms. The legislation should also broaden the definition of related parties beyond financial and managerial relations to include the actual conduct of the parties. For the sake of pragmatism, governments should consider using administratively determined reference prices when insufficient information is available to assess or determine the transfer pricing position of mining companies. For mineral trading between related parties, countries should use the average monthly quoted price on metal exchange markets as the reference price for tax purposes. It is imperative for mineral-rich countries to set up specialized transfer pricing units for monitoring profitability, reported prices and intra-company trade in minerals, assets and services along the mining value chain.
- To better optimize limited resources, governments should adopt a proactive risk management approach, rather than a reactive transactional approach, in conducting audits. The criteria for selecting cases should be developed in the form of a hierarchy of risks, based on the profile of various transactions and companies along the mineral value chain.
- Governments should adopt effective anti-avoidance rules, including thin capitalization requirements, as a means to curb excessive leveraging by mining companies. They should do so, however, with the understanding that there is more than one way in which profits can be shifted across borders. Poorly targeted legislation may create loopholes elsewhere. Countries should therefore review and tighten their existing thin

capitalization requirements to ensure that the debt-equity ratio is consistent with the industry's relatively low appetite for debt financing and does not inadvertently encourage transfer mispricing within the acceptable limit. The average debt-to-equity ratio in the case studies' legislation is relatively generous, at 3:1 compared to 1.5:1 in advanced mining jurisdictions. Governments should apply transfer pricing audits on a case-by-case basis when there is suspicion of abuse, even within the accepted thin capitalization ratio.

- Countries should limit excessive interest on loans deducted by companies, in order to protect and prevent the erosion of their tax base. The limit should be based on an agreed ratio of assessed Earnings before Income Tax, Depreciation and Amortization. Tax authorities may also limit the maximum amount of interest deducted by setting a fixed rate or using the available local market rate. This means that nationally determined maximum interest rates permissible for deduction remain the reference point. Any interest on intra-company loans held by a mining company above the locally or market determined interest rates will be disallowed for tax deduction or considered as a taxable dividend. In addition, tax authorities may also adopt an administrative approach, judging each excessive interest-deductible transaction between related parties on its merit, based on the arm's length principle. A transfer pricing adjustment is made on the basis of the actual need for the loan, the interest rate of a non-controlled comparable transaction and the ability of the debtor to repay the loan.
- Governments should ring-fence individual extractive projects for tax purposes. The anti-avoidance measure will protect the revenue base by preventing mining companies from transferring operational losses and deductible operational and capital expenditures from one project to another.
- Companies bidding for concession or license should be required to publish their beneficial owners and those of subsidiaries and provide detailed organograms to officials as part of their reporting requirements. In accordance with EITI requirements, they should also report on their profits, disaggregated by project. The beneficial ownership provisions should ensure that the complex chain of ownership information is captured in the reporting requirements and includes all companies along the mining value chain. The ultimate beneficial ownership information should also include politically exposed persons (PEPs). The information gathered should be updated annually, verified and linked to existing license registries or cadasters.
- Review existing Double Taxation Treaties (DTT) signed with various countries in relation to their tax objectives and domestic resource mobilization. Renegotiate or cancel those that are abused, particularly those in countries with low-tax jurisdictions or tax havens. Avoid, where possible, entering into a DTT which will lead to a loss of taxing rights on key revenue streams, including withholding taxes. Countries should include clear anti-avoidance language in their DTT, emphasizing not only the purpose of the treaty, but also what it is not about.
- Mining companies should commit to support governments in the fight against IFFs. It is imperative that they make every effort to be transparent, cooperate with tax authorities and support the implementation of the AMV. They should provide revenue

authorities with requested useful information about their transactions and transfer pricing position. They should also avoid excessive use of offshore centers and shell companies for the purpose of limiting their tax liability.

6. Strengthen capacity to implement an effective, forward-looking approach

- African countries will act in accordance with their own priorities. Countries will have to explore existing and emerging opportunities to build their capacity to participate effectively in international tax governance reform processes, including BEPS. Governments should embrace international initiatives to build capacity for greater exchange of information between different tax authorities. They must make every effort to strengthen their capacity to negotiate AMV-compliant contracts, BITs and DTTs. Countries will also need capacity to negotiate and implement Advance Pricing Agreements and other alternatives to litigation, including collaborative mechanisms to reduce compliance costs. Meanwhile EITI-implementing countries should also explore available opportunities to strengthen their capacity to implement and use information emerging from international tax transparency initiatives, including newly adopted mandatory beneficial ownership disclosure requirements. Efforts should be made to ensure that the disclosed information targets the needs of government agencies for effectively carrying out their mandates to curb IFFs.
- Countries should implement mechanisms that facilitate effective interagency cooperation between tax authorities, custom officials and ministries of mines along the mining value chain.
- Governments should provide tax authorities with greater resources, including well-resourced and specialized transfer pricing units. The units should comprise an appropriate skill mix of accountants, lawyers, geologists/mineralogists, economists, financial analysts and IT specialists.
- Tax authorities should be equipped to undertake systematic audits along the mineral value chain, and be provided with clear criteria based on the individual risk profiles of various transactions.
- Governments should modernize their tax administration with basic IT systems and expand their legislation to promote information sharing across tax jurisdictions.
- Mineral-rich governments should analyze the different options, and select and acquire licenses to access appropriate international comparables databases. They may also want to explore opportunities for partnerships with other countries, in order to acquire multiuser licensing for accessing often expensive databases.
- Governments should also step up their investment in geological information, not only as an important tool for attracting investment, but also as a governance instrument for monitoring and tracking illicit leakages along the mineral value chain.
- Mineral-rich countries should invest further in laboratory facilities, in order to verify the quality of extracted ores. They should also invest in tertiary geoscience training programs, including mineral auditing.

- Governments should support civil society organizations in building their capacity to conduct research, analyze data and engage in dialogue and consensus-building, in order to play a meaningful role in the fight against illicit financial flows.

Chapter 1

Evolving context of mineral-led development in Africa

The mineral sector remains very attractive, offering unparalleled potential to transform and diversify economies through industrialization. The mineral endowment of Africa is rich, varied and spread almost widely across countries and regions. The continent occupies an important geostrategic place in the global mining industry. While extensive swathes of subsoil still remain unexplored, Africa hosts an estimated 30 per cent of the world's mineral reserves. It produces an even greater share of key precious and base metals, as well as gemstones, including platinum group metals (54 per cent), diamonds (78 per cent) and chromium (40 per cent). Its geological endowments also include significant industrial minerals, such as phosphates, accounting for more than 60 per cent of global reserves. The continent will soon become an important source of fossil fuel exports, with new natural resource discoveries projected to substantially impact development outcomes. Investors also have a positive view of the mining sector, with the influential Fraser Institute survey recently ranking Africa as the most attractive destination for mining investment after North America.

Mineral development is a key part of the impressive growth of Africa over the past decade. While commodity booms were among the many growth drivers during this period, the recent demand-driven price surge significantly underpinned growth in mineral-rich countries. From 2000 until 2008, natural resource rents increased six-fold³. The mineral sector contributes more than 20 per cent of African economic output and remains the continent's second-largest category of exports, the highest in the world. Even with collapsed prices, the sector still remains a significant source of fiscal revenues, with 2015 projected growth in mineral-dependent countries averaging 3.9 per cent⁴.

However, translating mineral rents⁵ into sustained riches for all citizens remains an ever-growing challenge. Country experiences suggest that, without specific policies to address key governance challenges, the extractive sector's contribution to broad-based socio-economic development will remain uncertain, at best, and suboptimal, at worst. An even greater challenge is the growing concern that mineral-rich countries are not collecting as much revenue from their natural resources as the production value of those resources would suggest. A growing number of studies show that significant amounts of cross-border financial resources are illicitly leaking out of African economies. The exact figures on illicit financial flows (IFFs) from the mining sector are unavailable, due to data limitations. However, the New Partnership for Africa's Development estimates that plugging holes in mineral regulations could generate a

³ Barma, H.; Kaiser, K; Le, Tuan M; Vinuela, L (2012) Rents to Riches? The Political Economy of Natural Resource-led Development. World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/2381> License: CC BY 3.0 I

⁴ ECA (2015). Industrialization Through Trade. Economic Report for Africa. Economic Commission for Africa

⁵ Rents defined as the difference between production cost and revenues earned from the sector.

substantial amount of additional resources, even more than overseas development aid⁶. Cross-border financial leakages drain away much-needed resources available to African countries for financing their development priorities.

As domestic resource mobilization becomes increasingly important for long-term development, curbing illicit financial flows remains central to the newly adopted post-2015 development agenda. African countries have yet to work out how commitments will translate into actions over the 2016-2030 period. However, United Nations Member States, through the Addis Ababa Action Agenda (AAAA) and the recently adopted ground-breaking Sustainable Development Goals, have committed to “redouble efforts to substantially reduce IFFs by 2030”. Member States also committed, through the AAAA, “to further strengthen the mobilization and effective use of domestic resources”. The OECD is also finalizing its 15-point proposal on Base-Erosion and Profit Shifting (BEPS), so far the most comprehensive attempt at international tax governance reforms since the last century.

Collective efforts to curb the drivers of IFFs have become a global priority. However, even before IFFs topped the international agenda, Africa had already blazed a trail with forward-looking initiatives. Concerned by the disproportionate economic burden of IFFs, in 2012, the 4th Joint African Union/United Nations/Economic Commission for Africa (AU/ECA) Conference of African Ministers of Finance, Planning and Economic Development called for the establishment of a High Level Panel (HLP) on IFFs from Africa. The HLP assessed the volumes and sources of illicit financial outflows; provided deeper insight into how these outflows occur in Africa and presented practical proposals for solving the problem of IFFs on a continental level.

In 2015, the HLP released its globally recognized, ground-breaking report, which estimates that US\$50 billion illicitly leave Africa annually, a large proportion of which from the extractive sector. The loss of funds through IFFs reduces revenues and fiscal benefits from the mineral and other economic sectors. The continent has adopted the African Union Agenda 2063, a long-term vision to accelerate structural transformation of economies through committed priorities including “reversing illicit flows of capital from the continent by 2025”.

Against this backdrop, the Macroeconomic Policy Division (MPD) of ECA and the African Minerals Development Centre (AMDC) have jointly undertaken the present Study on the impact of IFFs on mineral revenue mobilization. The purpose of the study is to give the ECA deeper insight into the challenges of IFFs in mineral-rich Africa. It is also intended to support mineral-exporting African countries in plugging IFF-related policy and compliance gaps. It is envisaged that this work will increase collaboration and cooperation among African countries, Regional Economic Communities (RECs) and external partners in addressing the challenges posed by IFFs.

Given the broad, diverse nature of the extractive sector of Africa, the study focuses mainly on mining, while also drawing on relevant experiences in the oil and gas sector. The choice of mining is strategic. Africa remains a hotspot for global mining investment. Compared with the

⁶ NEPAD (2014) Mobilizing Domestic Financial Resources for Implementing NEPAD National and Regional Programmes and Projects, a report produced by NEPAD and UNECA

energy sector, the African global share of mining and metal investment is greater than that for the energy sector. In spite of the slowdown, mining investment in Africa has held steady at 14 per cent of total global investment, particularly for non-ferrous metals. The overall percentage for the sector is more than double the share of foreign direct investment flowing into the continent as a whole, which stands at 5.7 per cent.⁷

Its relative attractiveness creates potential for development-inhibiting illicit leakages. The thrust of the study is that policy and compliance gaps in regulatory regimes along the mining value chain create loopholes for illicit financial outflows, undermining potential for countries to mobilize much-needed domestic resources for their development. The report assumes that good governance depends on the quality of domestic laws and regulations, as well as their effective implementation and compliance with international best practices. The unit of analysis is the mining value chain. The study takes a policy-relevant approach focusing exclusively on IFFs, rather than capital flight⁸. According to HLP, the adopted term illicit financial flows reflects a much narrower and more focused definition: targeting unrecorded cross-border capital flows from criminal, corrupt (bribery and theft by government officials) and commercial activities”.

To obtain updated empirical data, ECA commissioned four country case studies involving the Democratic Republic of the Congo, South Africa, Tanzania and Zambia. These countries were selected due to the importance of the mineral sector to their economies. The Democratic Republic of the Congo is one of the most mineral-endowed countries in Africa. South Africa and Zambia are among the oldest and most advanced mineral economies on the continent. Tanzania is a mid-level mineral economy. In order to determine the main sources of revenue leakages in the African mineral sector, this study assesses illicit financial flow practices and their impact on domestic resource mobilization in the mining sector of each of the four countries.

The study’s key findings stemmed from primary interviews with the countries’ key officials, as well as reviews of literature and reports. For the primary data, four questionnaires were designed focusing on the illicit financial flow practices of extractive companies, legal and regulatory frameworks, the revenue-generation issues of tax authorities and the reasons for continued IFF data limitations. Indeed, illicit financial outflow estimates remain a serious concern, given the lack of readily available country-specific data. For instance, the data collectors were unable to obtain accurate figures on the extent of IFFs in the four country case studies.

The study is divided into two parts. Part one frames the role of good governance in organizing effective actions to curb IFFs along the mining value chain and thereby improve DRM in countries. Part two uses selected country case studies to examine challenges, as well as identify opportunities for the optimization of mining revenues by African states. The report ends with practical policy recommendations for mineral-rich African countries. The individual country studies are annexed to the report.

⁷ SNL(2015). World Exploration Trends Report 2015. SNL Metals and Mining. <http://go.snl.com/SNL-Metals-Mining-World-Exploration-Trends-WET-Report-2016-Request-MS.html>

⁸ In general, capital flight is understood in a broader fashion: “movement of funds abroad to secure better returns, often in response to an unfavorable business climate in the country of origin”.

Chapter 2

Importance of good governance for optimizing mineral revenues in Africa

2.1 Good governance for domestic resource mobilization in the mining sector

Governance remains key to domestic resource mobilization. Mobilizing adequate and sustained levels of domestic revenues from natural resources is central to achieving countries' long-term development priorities. Domestic resource mobilization is commonly defined as the "generation of savings domestically and their allocation to socially productive investments within the country".⁹

There are many DRM instruments, as shown in box 1. However, taxation remains the principal instrument for mobilizing government revenues. It is an exercise in state-building through governance¹⁰. From a sector perspective, governance involves the exercise of state authority over mineral resource management. For the purpose of this study, good governance for domestic resource mobilization entails the ability to formulate and implement effective strategies, policies, laws and regulations for mobilizing optimal revenues from the mineral sector. At a minimum, this involves minimizing illicit financial flows and, at best, completely eliminating resource mobilization-inhibiting practices along the mining value chain.

Conceptually, three variables mutually interact to determine the scale and quality of domestic resources available from the mining sector: fiscal regimes, mining companies and mineral value chains— as shown in figure 1.

Box 2.1 Viable approaches for domestic resource mobilization in mineral-rich Africa

Taxation is the most popular approach towards mobilizing public domestic resources, but also the most affected by IFF practices. A recent study indicates that an increase in tax-to-GDP ratio by just 0.44% per annum could potentially mobilize additional revenues of USD 22.5 billion. However, only a few mineral-rich African countries have high tax-to-GDP ratios [e.g. Botswana (36%) and South Africa (27%)], whereas most have a tax-to-GDP ratio of less than 10%.

Another way of mobilizing resources in mineral-rich African countries is through domestic savings. Several African countries have made progress in increasing domestic savings. Countries that have successfully managed mineral revenues (e.g. Botswana and South Africa) have taken efficient savings and investment decisions, so as to mitigate the impact of volatile revenue streams on fiscal budgets. However, it is observed that many countries whose natural resource revenues constitute a large share of their Gross National Income (GNI) have negative savings rates (e.g. Angola and Nigeria). It is thus critical for these countries to ensure positive domestic savings in order to sustain investments and growth.

There are also innovative methods for mobilizing resources domestically, which include Sovereign Wealth Funds (SWF). SWFs are structured to eliminate inefficiency in resource wealth management, ensure less political interference and a professional approach to portfolio allocation and performance attribution. At least eleven resource-rich African countries already have SWFs, namely: Algeria, Angola, Botswana, Chad, Equatorial Guinea, Gabon, Ghana, Libya, Nigeria, Sudan, and São Tome and Príncipe.

⁹ AfDB/OECD, 2010. Public Resource Mobilization and Aid in Africa. African Economic Outlook

¹⁰ Brautigam, D., O. H. Fjeldstad, and M. Moore, eds. 2008. Taxation and State Building in Developing Countries: Capacity and Consent. Cambridge, U.K.. Cambridge University Press

A fiscal regime comprises legislation, policy and administration. Successful modern states depend on mobilizing revenues through an effective tax system capable of constraining tax evasion¹¹. However, weak fiscal regimes interact in a vicious manner with illicit and sophisticated tax-avoiding practices of mining companies along the mineral value chain. The outcome is often cross-border illicit financial flows with a net resultant negative impact on domestic resource mobilization. In contrast, good governance creates a virtuous cycle of mutually reinforcing interactions between the three elements outlined, with a resultant increase in domestic resources mobilized.

2.2 Towards a conceptual framework of illicit financial flows and domestic resource mobilization

Fiscal governance is exercised in a multilevel and complex fashion. Illicit financial outflows represent a symptom of fundamental governance weaknesses at the domestic and international levels. While taxation of natural resources remains an act of sovereignty, complex interactions of mineral regimes and international taxation, trade, investment, and finance create gaps and overlaps, with potentially damaging effects on tax collection. International corporate taxation underpins national tax laws with incentives and opportunities for cross-border cooperation to curb IFFs¹². However, the patchwork of diverse national rules and bilateral treaties governing the taxing of multinational companies remains outdated and broken.

The basic architecture of international tax governance dates as far back as the 1920s, when there was a limited understanding of globalization, including its complex dimensions of cross-border trade¹³. The guiding fiscal principles are to avoid double taxation on the same income, as well as prevent double non taxation or no taxation at all¹⁴. Concerted efforts at reforms, however, have been restricted to avoiding double taxation, rather than ensuring that double non-taxation does not take place¹⁵. Corporate income tax regimes have therefore not caught up with increasingly globally integrated operational models and the sophisticated practices of multinational companies. In truth, the gap creates opportunities for translating tax evasion incentives at the national level into cross-border illicit capital outflows. The greater the illicit international capital outflows, the fewer the resources available for domestic taxation, as shown in figure 1.

¹¹ Reuter, P. 2012. Draining Development? Controlling Flows of Illicit Funds from Developing Countries. World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/2242> License: CC BY 3.0 IGO."

¹² IMF(2014) Spillover in International Corporate Taxation, Staff Report International Monetary Fund Washington, D.C. <https://www.imf.org/external/np/pp/eng/2014/050914.pdf>

¹³ The OECD and G20 group of countries have however recently adopted the 15 Action Plans to curb Profit Shifting and Base Erosion practices of multinational companies. The BEPS initiative, is by far the most important reforms in international tax governance since 1920.

¹⁴ Ault, H(2013). Some Reflections on the OECD and Sources of International Tax Principles. Tax Notes International, Vol 70, No 12, June 17.

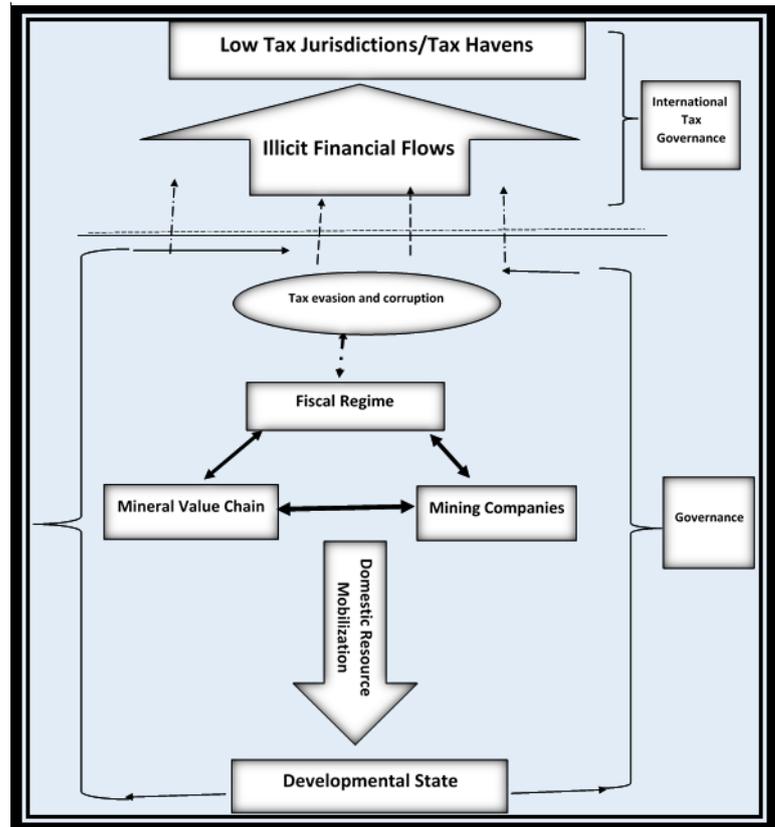
¹⁵ Corwin, M (2014): Sense and Sensibility: The Policy and Politics of BEPS. Tax Notes, October, 6.

The current package of reforms, as embodied by the OECD-led Base Erosion and Profit Shifting (BEPS) action plans, has been endorsed by the G20 countries. The BEPS initiative aims to bring about reforms in a wide range of areas, by ensuring that multinational companies' tax planning becomes a peripheral activity rather than business strategy. However, fundamental weaknesses of the international tax system remain key constraints. First, the allocation of taxing rights between source and resident countries remains arbitrary and based on an obsolete, simplistic distinction between active and passive incomes. The dichotomy favors capital-exporting jurisdictions over importing countries, like mineral-rich African countries. Source countries have taxing rights to

active income, while resident countries can exercise rights to passive income. Active income includes direct income from business activity. The OECD defines passive income as that generated by an activity in which the recipient does not participate. For example, royalties, interest and dividends are passive income. However, where and how income is generated is becoming increasingly complex and overlapping to unpack simply into neat categories of business activity and investment activity respectively¹⁶. Second, the 'independent entity' principle, which assumes that parent and subsidiary companies in a corporate group act like separate legal persons, transacting with one another at arm's length, is not entirely true. The subsidiaries often transact among themselves at non-market prices, with a goal to shift profits to low tax jurisdictions¹⁷.

Incentives for cross-border tax competition remains a core challenge. Tax rate variations between countries with natural resources and those without increase the potential for transfer pricing optimization. Low-tax jurisdictions, offshore financial centers and tax havens create cross-border tax arbitrage with risks of illicit financial outflows. These jurisdictions without natural wealth are seeking to take advantage of resource wealth by offering favorable tax regimes, among other things¹⁸. Competition leads to negative spill overs. Singapore and

Figure 2.1 Conceptualizing impact of illicit financial flows on domestic resource mobilization



¹⁶ Devereux, M. P. and Vella, J. (2014), Are We Heading towards a Corporate Tax System Fit for the 21st Century?. *Fiscal Studies*, 35: 449–475. doi: 10.1111/j.1475-5890.2014.12038.x.

¹⁷ Vella, J (2015). *Corporate Tax Practices and Aggressive Tax Planning in the EU*. Report commissioned by the European Parliament's Committee on Economic and Financial Affairs (ECON).

¹⁸ E&Y(2013). *Global Mining and Metals Tax Survey: From Backroom to Boardroom*. Ernest and Young.

Switzerland, for example, offer tax rates for commodities trading as low as 5 and 10 per cent respectively¹⁹. The low-tax jurisdictions also provide a legally backed veil of secrecy, making it harder to identify beneficiaries²⁰. The high level of secrecy is complemented by the ease with which companies and other legal entities can be registered or established²¹

Mining companies often explore loopholes in international corporate taxation allowing them to artificially shift their taxable profits from mineral-rich countries to offshore jurisdictions where they may be taxed minimally or not at all. These mining companies employ sophisticated cross-border practices that minimize their overall tax liability. In fact, non-cooperative policymaking in the presence of externalities may lead to inefficient outcomes. However, from an individual country perspective, this is a zero sum game. Low-tax jurisdictions gain by attracting mobile assets like profits, while mineral-rich countries lose by not being able to adequately tax income earned from the exploitation of their minerals.

The mutual relationship between politics and economics is of great importance. Governance for domestic resource mobilization is also shaped by institutional and political economy factors, both at the national and international levels. Taxation goes beyond administration to include politics and power. In fact, it includes the way authority is exercised in a country through formal and informal institutions²². Incentives for illicit financial leakages are underpinned by policy and compliance gaps, as well as vested foreign and domestic interests profiting from tax evasion and weak state institutions. Corrupt tax administration may undermine the enforcement of policies to curb illicit capital flows. Weldman identifies three political economies that translate tax evasion into illicit financial outflows: looting, rent-scrapping and dividend collection²³. He describes looting as the systematic theft of public funds, including bribes, while rent-scrapping is political manipulation to produce rents, so that short-term political gains drive illicit financial outflows. For example, the ECA notes that “foreign multinational corporations often capitalize on weak institutional mechanisms in order to bribe state officials and gain unwarranted advantages, including paying little or no taxes, as well as unfair sharing of rents”²⁴. Ndikumana and Boyce reckons that Africa ‘probably loses much more from corruption by multinational companies than from corruption by a multitude of local small and medium enterprises’²⁵.

Khan (2000) defines dividend-collecting incentives as those where the political premium attached to building an effective state is such that there is strong commitment to prevent tax

¹⁹ Ibid

²⁰ Palan, R, Murphy, R and Chavagneux, C (2010). *Tax Havens: How Globalization Really Works*. Cornell Studies in Money. Ithaca, NY: Cornell University Press.

²¹ Gravel, J (2015). *Tax Havens: International Tax Avoidance and Evasion*. Committee Report by the Congressional Research Service, USA <https://www.fas.org/sgp/crs/misc/R40623.pdf>

²² Moore, M(2004). Revenues, State Formation, and the Quality of Governance in Developing Countries *International Political Science Review* (2004), Vol 25, No. 3, 297–319

²³ Weldman, A (1997). Looters, Rent-Scrappers and Dividend-Collectors: Corruption and Growth in Zaire, Sout Korea and the Philippines, *Journal of Developing Areas* 31(4):57-78

²⁴ ECA(2016). *Measuring Corruption in Africa: The International Dimension Matters*. African Governance Report IV. United Nations Economic Commission for Africa, p.22

²⁵ Ndikumana, L and Boyce, J (2012). *Capital Flight from North African Countries*. PERI Research Report. Amherst, Massachusetts: Political Economy Research Institute p. 3.

evasion from translating into illicit financial flows²⁶. Khan associates the dividend-collecting political economy to 'developmental State'.

Illicit financial flows therefore undermine the emergence of developmental States. While no standard definition exists, developmental State, in general, has a fundamentally "developmentalist" orientation, in terms of both 'ideology' and 'structure' of the state²⁷. The state's main concern is to ensure sustained growth and development through domestic resource mobilization, industrialization and structural change²⁸. 'The state also develops capacity to implement economic policies that effectively deliver development, which gives legitimacy²⁹'. While corruption may exist in the 'developmental State' context, it is limited to the extent that it does not translate into significant illicit financial outflows that undermine long-term political survival of ruling elites which is based on a 'social contract' to deliver growth, public goods and services³⁰.

Development-oriented leadership also drives domestic resource mobilization. In this context, governance becomes an exercise to reclaim fiscal policy space along the mining value chain, as shown in fig.1. The International Study Group Report, the foundation document of the African Mining Vision, 'endorses the normative implications of a democratic developmental State. It urges governments to recognize and harness the positive potential of state institutions, while promoting democratic norms³¹'. Specifically, this entails formulating inclusive policies, laws, regulations and institutions that will effectively regulate mining companies' activities in ways that significantly curb illicit financial outflows, while at the same time maximizing opportunities to collect greater revenues for the state.

Good governance for domestic resource mobilization is an exercise in ownership of a country's development agenda. It ensures that resources are not tied to externally driven aid programs with conditionality requirements that are often misaligned with a country's needs³². The reliance on internally generated resources therefore remains crucial for diversifying and transforming mineral-rich African economies. By collecting more taxes, governments will develop their own governance capacity, including spending even more on critical infrastructure for linking mining to the broader economy. 'Taxation therefore reflects the intrinsic legitimacy of the state, based on effectiveness of institutions which is manifested in ensuring actual compliance³³'. An

²⁶ Khan, H, (2000). Rent-Seeking as a Process: Inputs, Rent-Outcomes and Net Effects. In *Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia*, ed. M.H. Khan and K.S. Jomo, 70-104. Cambridge, UK : Cambridge University Press

²⁷ Mkandawire T(2001). Thinking about developmental State in Africa. *Cambridge Journal of Economics*, 25(3): 289-313, May.

²⁸ UNCTAD(2007). Reclaiming Policy Space: Domestic Resource Mobilization in Developmental State. Economic Development in Africa Report. United Nations Conference on Trade and Development, Geneva,

²⁹ Ibid p.60

³⁰ Weldman, A. (1997). Looters, Rent-Scrappers and Dividend-Collectors: Corruption and Growth in Zaire, South Korea and the Philippines, *Journal of Developing Areas* 31(4):57-78

³¹ UNECA (2011). Minerals and Africa's Development: The International Study Group Report. Addis Ababa, ECA and AUC. P. 153

³² ECA (2014). Domestic Resource Mobilization. Issue Paper. Ninth African Development Forum, Economic Commission for Africa http://www.uneca.org/sites/default/files/uploaded-documents/ADF/ADF9/adf_ix-issues_paper_1-domestic_resource_mobilization.pdf

³³ Everest-Phillips, M (2012) The Political Economy of Controlling Tax Evasion and Illicit Financial Flows in Draining Development, Controlling Flows of Illicit Funds from Developing Countries. World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/2242> License: CC BY 3.0 IGO."

effective system for collecting optimal revenues from natural resources solidifies the often weak ‘social contract’ between governments and citizens for equitable delivery of mining benefits.

Governance for resource mobilization therefore translates into effective, accountable public financial management institutions, capable of curbing illicit outflows from the mineral sector. Yet mineral-rich African countries continue to underperform in terms of revenue mobilization. Resource revenues as a share of total taxes collected have increased, particularly during the recent period of exceptionally high commodity prices³⁴. However, tax efforts in resource-rich countries have remained lower than the African average³⁵, suggesting potential for greater resource mobilization. Given the structure of their economies, mineral-rich countries are collecting as little as half of what they would be expected to collect³⁶, which is surprising when compared with resource-scarce countries. While the reason behind the fiscal underperformance remains complex, structural transformation in mineral-rich African countries requires governments to expand and deepen their fiscal space by minimizing cross-border tax avoidance.

Box. 2.2 Key objectives for good mineral resource governance

- Strengthen transparency and access to information at all levels of the MVC
- Provide effective oversight over mineral sector institutions and mining companies.
- Improve public participation in the formulation of national policies, laws and regulations.
- Review mineral regimes in order to optimize revenues
- Build capacity and enhance human resources skills in negotiating fiscal issues and effectively monitoring compliance with tax laws
- Negotiate or re-negotiate mining contracts to optimize revenues
- Build capacity and systems to auction mineral rights where applicable

Source: Extracted from “Action Plan for Implementation of the AMV”, 2011

2.2.1 Fiscal regimes

Regimes are commonly defined as a set of governing arrangements or networks of rules, norms and procedures that constrain behavior and control its effects³⁷. Regimes shape the preferences of multinational companies and provide incentives to source, transfer and use money derived from mining in ways that undermine governments’ strategy to mobilize adequate resources for development. Fiscal regimes for the mining sector comprise policies, legislation and institutions for resource mobilization.

The fiscal regime represents government choices about which tools to use to share revenues with mining companies and other private sector interests along the mining value chain. Tools may be enshrined in legislation or agreed to on project-by-project basis, including contracts. Laws that are specific to the industry, such as mining bills, often set out fiscal tools. General legislation, such as tax laws, may also underpin specific fiscal tools. The total revenue mobilized

³⁴ AfDB (2010) Public Resource Mobilization and Aid: Africa Economic Outlook Report

³⁵ Ndikumana et al (2010) Revenue Mobilization in African Countries: Does Natural Resource Endowment Matter? Africa n Development Review, VOL. 22 No. 3

³⁶ AfDB(2010) Domestic Resource Mobilization across Africa: Trends, Challenges, and Policy Options. Committee of Ten Policy Brief. N02/2010

³⁷ Nye, J (2000) Governance in a Globalizing World, Published by Brookings Institute Press

is calculated by adding up fiscal revenue from each impost. It is not always possible to access comprehensive fiscal information on the sector in some countries, even though, in principle, it is public information. However, information could be found in reports, including transparency motivated initiatives like the Extractive Industry Transparency Initiative.

Just as the mining sector is complex, so too is its fiscal regime, which may vary from a standalone regime to a general fiscal framework. The benefits of having a specific or integrated fiscal framework for all sectors are mixed. Due to the specific features of the sector, most African countries devote special fiscal regimes to mineral development. Specific fiscal aspects are often included in standalone mineral development agreements, with constraining stability clauses. Unlike other sectors, very few taxpayers may be operating in a country. In theory, this should make taxation easy, but the sector is highly specialized, involving complex operations of mining companies including entities within a particular multinational group. The limited number of taxpayers, often the most important and dependable source of fiscal revenue for the government, requires special attention, including minimizing potential risks of revenue leakages and corruption. Mineral resources are finite and require specific resource mobilization tools to compensate for their non-renewable nature. Another important motivation for a separate fiscal regime is that estimating profits is complex and depends on a host of factors, including geological information regarding quality, quantity and production function, as well as international market prices. Together, these factors create information asymmetry between state and mining companies, with potential implications for illicit financial outflows.

Table 2.1 Fiscal instruments along the mining value chain

Stages	Type of taxes and obligatory payments to governments	Typical characteristics
Contract negotiations and signatures	Signature bonus	A payment in form of a certain % (usually -eg. 1% of expected value of natural resources) or fixed amount
Exploration activities and evaluation	Exploration bonus	Similar to signature bonus
	Tax levied on employees	Income and social taxes
	Tax levied on service providers	Income taxes, WHT and also VAT
Development of the infrastructures	Bonuses and rentals	Same as bonuses and rentals above
	Taxes on employees and subcontractors	Income and social taxes, WHT, VAT
	Import duties and levies, VAT	Indirect taxes and levies
Extraction, production, export	Royalties	Payment on the volume or value of extracted resource
	Bonuses and rentals	Same as bonuses and rentals above
	Production and sharing payments	% of production paid to state
	Profit taxes + excess profit tax + repatriation of profit taxes (WHT of Branch profit tax)	Tax on income/profit + WHT
	Export duties and export levies, VAT	Tax on value of exported resource, VAT
Abandoning and decommissioning	Environmental fees or penalties	Fines or penalties for pollution
	Decommissioning reserve	Reserve that the company must create during the period of extraction - part of profit and cash must be allocated for clean-up - relevant for CIT
	Taxes on employees and subcontractors	Income and social taxes, WHT, VAT

Mineral extraction is capital intensive, with long pre-production periods where no revenue is earned. In fact, exploitation requires substantial capital and technological investment that is

beyond the reach of the state and often provided only by private capital from multinational companies. The industry imports capital and technological goods along the value chain. Financing requirements for the sector often require special treatment in tax regimes, with damaging consequences for revenue mobilization. The mineral sector also presents a range of challenges with broader governance implications.

In addressing unique as well as broader development challenges, mineral-dependent countries have to grapple with often mutually incompatible policy objectives underpinning their fiscal framework. While most governments understand the importance of sound policy and legislative framework, their revenue objectives are often inconsistent with their strategies. The tensions and ambiguities could create opportunities for revenue leakages along the value chain. For example, a government may put in place fiscal stability clauses as incentives to attract investment in the sector that end up undermining the sector's future revenue potential in times of price booms. This may lead to public outcry, but only after the revenue-damaging incentives have already been incorporated into fiscal agreements.

Mining fiscal policies attempt to establish the 'right price' for the extracted resource. Policy design often entails balancing the following competing objectives: revenue maximization and adequacy, optimal tax base, economic allocative efficiency, revenue stability, equity, transparency, stability and finally administrative efficiency. Consequently, the tax rate and instruments can vary significantly across countries and commodities. The tax rate is determined by government and, at times, in consultation with mining companies. In extreme cases, the government may set a rate based on how much the market will bear. The rate may also vary along the value chain, decreasing with the level of processing, value addition and transformation of the ores.

To implement revenue policies, two types of instruments are commonly employed along the mining value chain— production-based and profit-based taxes. Production-based taxes are aimed at appropriating a share of mining rents for the government. They are regressive, flat taxes based on the tonnage or value of the extracted resource. Production-based taxes provide a stable source of government revenues from the beginning of the project, but are less effective in maximizing rents in terms of company profits during price booms. Their inherent inflexibility to respond to profit surges may create negative perceptions as well as loopholes for leakages. Examples include royalties, value added taxes and import duties.

From an accounting point of view, production-based taxes are relatively easy to administer. As a consequence, they are the most common type of taxes employed by African countries. However, in terms of efficiency, their dependence on production, irrespective of whether profits are made, may discourage exploitation of lower-grade ores, accelerating the depletion of those of high-quality. In addition to indirect taxes, mineral-rich countries also employ trade-based taxes, including tariffs and fees, which may also be distortionary to trade. Countries are increasingly obligated by their international trade commitments to phase them out. In addition to World Trade Organization imperatives, recent research points to their linkage with IFFs. A Global Financial Integrity study shows a robust correlation between high tariff rates and high levels of IFFs³⁸.

³⁸ Spanjers J & Foss, H (2015) Illicit Financial Flows and Development Indices: 2008-2012, Global Financial Integrity Report

Profit-based taxes are direct taxes levied on the profits of mining companies. They are progressive and neutral in terms of having less impact on investment decisions. In this type of tax, income is the main target of taxation. Examples include Corporate Income Tax, capital gains tax and excess profit tax, including profit-based royalties. Corporate Income Tax is the most common profit-based tax in mineral-rich countries levied at the entity level. Taxable profits are calculated as the difference between the revenues from mineral sales and the corresponding expenses. The expenses stem from the depreciation of production factors, including capital, during the exploration and development stage of mining. The tax rate can be set as flat or progressive, meaning the higher the projected profit, the higher the tax base.

The effective tax collected will depend on the treatment of deductions. What are the allowable deductions and to what extent are losses allowed to be carried forward. How are environmental expenses treated, particularly those related to mine closure? How is the corporate social responsibility expenditure factored in? How much expenditure on community or social activities is permitted as a deduction from gross income for the purposes of determining taxable income?

While profit-based taxes provide governments with an efficient means of capturing a greater share of resource rents, due to their relative complexity, these types of instruments have had marginal results when applied by African countries. The African Development Bank estimates that, in the last decade, direct taxation as a share of GDP has experienced a small increase throughout Africa, mostly in upper and middle-income countries like Botswana, Morocco, South Africa, Tunisia and Zimbabwe. Overall, however, the trend in direct taxation has been flat³⁹.

Meanwhile, as a share of all revenue collected, corporate income tax is more important to developing countries (15 per cent) than to developed countries (9 per cent)⁴⁰. However, when it comes to mining in Africa, the picture is a little different. It is unclear why corporate income tax in mineral-rich countries has remained relatively stable on the continent, despite sustained commodity price booms. The average corporate income tax rate in Africa, which applies to the mining sector, is about 32 per cent, or higher than the world average. However, governments have often decreased the rate at which profits are taxed and increased the number of tax exemptions granted to mining companies (AfDB, 2010d)⁴¹. The trend continues despite evidence pointing in the opposite direction. Contrary to the assumption that tax incentives encourage investment, studies have shown that fiscal consideration is secondary to investment decisions in the mining sector⁴².

The choice of instruments will have to depend on the capacity of the tax administration to implement the selected instruments. While studies consistently show that investment in tax administration yields manifold multiplier effects⁴³, the IMF reckons that most African countries face challenges in designing and implementing effective strategies to combat illicit financial flows.⁴⁴ The revenue collection agencies of most mineral-rich African countries lack technical

³⁹ AfDB (2010) Public Resource Mobilization and Aid: Africa Economic Outlook Report

⁴⁰ International Monetary Fund (2014), IMF Policy Paper: Spillovers in International Corporate

⁴¹ AfDB. (2010d). *African Economic Report*. African Development Bank, United Nations Economic Commission for Africa and OECD.

⁴² *ibid*

⁴³ OECD Task Force on Tax and Development (2014)

⁴⁴ IMF, OECD, UN and World Bank (2011), Supporting the Development of More Effective Tax Systems: A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank, Washington, DC,

expertise. They are thus unable to accurately measure profit levels of mineral extractive companies. A recent report has also shown a very strong correlation between the efficiency of a country's customs department and the volume of illicit outflows⁴⁵. Countries' tax filing systems are often not fully computerized, if at all, which implies inconsistent tax records and additional administrative costs. There is also a lack of expertise in current methods of tax auditing, monitoring, regulation and resource exploitation frameworks to develop the mineral sector connections to the domestic economy.

Administrative weaknesses may result from systemic gaps in policy design. Needlessly complex tax regimes remain a major weak link in the mining value chain. A complicated set of overlapping and at times confusing policy, legal and administrative frameworks, including individually negotiated agreements, may operate at cross purposes and create significant operational challenges. Even for highly competent tax administration, the often tangled mix will make implementation very demanding. Added to the revenue inhibiting mixture is the fragmentation, poor coordination and inconsistency of roles and functions of different agencies across tiers of government mandated to mobilize revenues along the value chain.

2.2.2 Mining value chains

Mining activities occur at different stages. Value is created along the process commonly referred to as the mining value chain. The first stage involves exploration, development and mining. The second stage is process-related and encompasses processing, beneficiation, smelting, refining and other added value activities. Another important activity is mineral transportation and storage,⁴⁶ which includes exportation and sale.

Extraction-related activities involve three stages. Exploration represents the first stage in mining and includes all the activities leading to the discovery of resources. The total cost of the exploration stage may vary from \$20 million to over \$150 million and extend from 3-10 years before feasibility decisions are made.⁴⁷ The development stage follows with the preparation of feasibility studies, including mine development. This stage may involve constructing roads, rails, sewers, waterlines and housing to support operations. The development phase requires the largest investment, ranging from \$100 million to \$3 billion, and may take 2-4 years. The mining stage starts with the commercial exploitation of the mine, including extracting mineral value from the host rock or matrix.⁴⁸

Processing-related activities include beneficiation through the separation of minerals from waste materials, as well as preparing the ores for further refinement. The beneficiation process aims to add greater value to the concentrates mined. Concentrates are shipped to smelters and refineries to further extract and refine the metal, preparing it for final use as well as further incorporation into physical and chemical manufacturing. Further value addition activities

New York and Paris, www.imf.org/external/np/g20/pdf/110311.pdf. Kaldor, N. (1980), "Reports on Taxation", Vol. 1 and 2, Gerald Duckworth, London.

⁴⁵ Spanjers J & Foss, H (2015) Illicit Financial Flows and Development Indices: 2008-2012, Global Financial Integrity Report

⁴⁶ Sigam, Claudine and Leonardo Garcia. 2012. Extractive Industries: Optimizing Value Retention in Host Countries. UNCTAD; Geneva.

⁴⁷ Sigam, Claudine and Leonardo Garcia. 2012. Extractive Industries: Optimizing Value Retention in Host Countries. UNCTAD; Geneva.

⁴⁸ <http://www.miningguide.ca/>

include transforming processed pure metals into highly demanded and commercially traded products such as copper wires.⁴⁹

As mineral deposits can be located in remote places, transport and storage activities play a major role in carrying the minerals from one stage of the value chain to another. Ore and concentrates can be transported by sea, rail and road. Besides location, the transportation decision is also based on the mineral characteristics. Storage is necessary at several points in the mining supply chain. Since minerals are transported mainly in batches, the supply chain must accommodate surges and lulls in demand at the mine. Various stakeholders, including companies (private and public), government agencies, civil society organizations and local communities, are involved in these value chains. Mining companies are often private companies fully integrated as major companies, independent producers or junior mining companies. The entities may operate as independent refiners, pipeline companies, service providers or transport, storage and trading companies. These stakeholders have various expectations and interests during each stage of the mining process, including minimizing tax expenses and maximizing profits.

As value is increased, so too are cross-border opportunities for revenues to be earned and transferred illicitly from economies. IFFs occur throughout the mining value chain, extending from local to international levels and including various actors, as shown in table 3. Each link in the leakage chain depends on opportunity, capacity and power. Illicit outflows originate from five broadly defined sources: development of the regulatory framework, allocation of access, enforcement and compliance with regulations, sale of resources and utilization of revenue⁵⁰ as shown in table 3.

How the mining sector integrates into the global economy is important not only for tracking IFFs, but also for mobilizing domestic resources through the structural transformation of African economies. Greater insertion into the global and regional value chains entails the beneficiation and processing of mineral products within domestic and regional economies. However, the long-standing division of international trade, supported by challenging international trade rules, continue to confine mineral-rich African countries to the lowest rung of the value chain. While Africa is more prominent in the value chains than recognized, particularly the mining sector, the bulk of integration comes from a high degree of forward linkages, driven by exports of raw materials. Africa remains a marginal player in the global trading of value added products. In 2011, the African share was just 2.2 per cent, albeit almost doubling from 1.4 per cent in 1995, which contrasts with the contraction of the manufacturing sector during that period⁵¹.

Africa has taken encouraging steps to integrate into global and regional value chains, although much work is still needed to overcome “staples traps” at the low-value adding rung. From 1999 to 2011, over 90 per cent of African countries increased backward integration to global value chains (GVCs), including mining (UNECA, 2015)⁵². The Southern African region is the most integrated, while West and North Africa participate only marginally in the GVCs and show little backward integration. The Southern African region shows the same strong participation in regional value chains (RVCs), suggesting the strong correlation between regional integration

⁴⁹Sigam, Claudine and Leonardo Garcia. 2012. *Extractive Industries: Optimizing Value Retention in Host Countries*. UNCTAD; Geneva.

⁵⁰Hoogstraten, Julia Van. 2015. *Theoretical Framework for Financial Flows in the Extractive Sector*. New York: PODER.

⁵¹UNECA. (2015). *Industrializing Through Trade: Economic Report on Africa*. United Nations Economic Commission for Africa.

⁵²IBID

and attractiveness to leading firms in the GVCs. However, forward integration, particularly downstream beneficiation, remains very weak.

The African Mining Vision, adopted by all Heads of State in 2009, is the most important continental framework for transforming mining from an enclave sector to one that integrates fully into the local, national, regional and global economies. This vision remains the boldest expression of ambition to turn the mining sector of Africa from ‘norm-taker’ to ‘norm-setter’—employing the continent’s rich mineral endowments to transform and diversify economies through industrialization. It is aimed at ‘creating a knowledge-driven mining sector that is a key component of a diversified, vibrant and globally competitive industrialized African economy.’ The framework is also aimed at obtaining an adequate share of mineral revenues along the value chain and utilizing it equitably. Resource-rich countries have committed to optimize the share of mineral revenue accruing to their economies, through greater value addition.

Insertion into the global and regional value chains is a complex, sophisticated and dynamic process. Upgrading value chains has been globally recognized as a target for developing countries in order to achieve sustainable development through industrialization⁵³. But how power is exercised in creating and accounting for value along the chain remains crucial for tracking and curbing IFFs. While the global value chain increases nodes of interactions and hence risks of illicit financial flows, the net benefit of greater participation and upgrading is far higher in terms of financial resources mobilized for the domestic economy, resilience to price shocks, creation of decent jobs, as well as catalyzing much-needed economic structural change. For example, a study by the Southern African Development Community (SADC) of the value chain for a range of minerals in the region found that the value of processed products was typically 400 times greater than the equivalent unit value by weight of raw material⁵⁴. The mining sector’s modest share of employment dropped

Box 2.3 African Mining Vision (AMV)

The AMV seeks to create a “transparent, equitable and optimal exploitation of Africa’s mineral resources to underpin broad-based sustainable growth and socio-economic development”. As a strategy, the AMV attempts not only to address the sector’s isolation from mainstream social and economic activities but also creates win-win outcomes for all stakeholders.

The AMV’s key tenets integrate the economic, social and environment pillars of sustainable development including knowledge and benefits of finite mineral resources at all levels of mining and for all minerals; harnessing the potential national economy, fostering sustainable development principles based on environmentally and socially responsible mining which is safe and includes communities and all other stakeholders; building human and institutional capacities towards a knowledge economy that supports innovation, research and development; developing a diversified and globally competitive African mineral industry which contributes to broad economic and social growth through the creation of economic linkages; fostering a transparent and accountable mineral sector in which communities and citizens participate in mineral assets and in which there is equity in the distribution of benefits.

The AMV main instruments for implementation are its Action Plan and the Country Mining Vision (CMV). The action plan adopted in 2011 comprises nine program clusters of activities constructed around the key tenets of the vision. The CMV, a handbook developed by the African Minerals Development Centre, provides a practical step-by-step guide, setting out how countries can apply the AMV in their own context. It facilitates that articulation of vision including emergence of a new social contract for the sector that extend beyond political cycles. The CMV remains the main tool used by AMDC and its implementing partners to support countries’ minerals development related activities.

⁵³ <https://sustainabledevelopment.un.org/index.php?page=view&type=400&nr=775&menu=1515>

⁵⁴ UNECA (2011). Minerals and Africa’s Development: The International Study Group Report. Addis Ababa, ECA and AUC

significantly from 1.5 per cent in 1975 to about 0.9 per cent in 2010, despite the last decade of a sustained surge in commodity prices⁵⁵.

Greater participation in global and regional value chains and domestic resource mobilization may operate in a virtuous cycle, mutually reinforcing one another in a way that curbs IFFs. Understanding and engaging in sophisticated, diffused value chains enhances state capacity in terms of knowledge, human resources and reach, thereby plugging IFF gaps. However, the concentration of resource mobilization efforts and participation at the lowest end of the value chain may operate in a vicious cycle. Limited resource mobilization opportunities undermine state capacity to better understand, track and curb IFFs, consequently further restricting much-needed domestically mobilized financial resources.

2.2.3 Mining companies

Mining companies remain key to influencing the structure and evolution of mining value chains. Basically, they extract minerals from the ground and either sell them in contestable markets or transfer them along the value adding chain to their affiliates abroad.

The transaction-intensive process along the value chain creates opportunities for optimizing tax revenues, as well as risks for mineral leakages. The products transacted include crushed ores, raw gems, and refined and smelted metals. The sophistication of the products will depend on the depth of linkages to the broader economy. Where downstream linkages are low, the products are mostly concentrates. When downstream linkages are high, the products will be refined.

As organizations, mining companies are either fully or partially integrated. A fully integrated structure means the company is involved from exploration up to marketing of the refined mineral. Despite the integrated nature of the structures, the company's internal processes and activities are often complex and dynamic. They are often organized into separate entities, transacting among themselves as self-contained entities comprising suppliers and customers engaging in different activities across countries. The transaction process is often between related entities or affiliates, with risks of abusive transfer pricing. It may also take place between unrelated entities, with risks of trade mispricing.

Besides mineral transactions, the internal corporate structure of mining companies is organized so as to provide core services for facilitating the movement and value addition of mineral products along the value chain. The inbound services are provided by different centers located within the different affiliates. The service centers include costs, profits, expenditure, marketing, risks, investment and intellectual property. Each service center has varied levels of decision-making autonomy.

The centers are organized in ways that are efficient for the multinational company as a group. In host countries, mining companies always organize their subsidiaries as profit centers. This structure gives the subsidiaries considerable decision-making autonomy, since they are considered standalone entities. Each mining operation is run as separate company. The

⁵⁵ UNECA (2014). Overview of Recent Economic and Social Development in Africa: Industrialization for Inclusive and Transformative Development in Africa. Addis Ababa, United Nations Economic Commission for Africa

corporate strategy adopted by multinational companies is also consistent with the trend in Africa to ring-fence mining operations as independent taxable entities, thereby preventing losses from one mining operation being carried into another.

Mining companies organize their assets into various categories with tax valuation implications. Allocation of ownership and control of assets remain complex. Based on business and risk management activities, the asset classes include:

- tangible assets,
- intangible assets
- non-intangible premiums.

Tangibles are physical assets that are easily quantified and valued and appear on the company's balance sheet. They include capital goods owned and controlled by the company, as well as mines, company infrastructure, exploitation plants and equipment, ores, concentrates, inventories and stockpiles. These assets are cumulated along the value chain. Identifying the center of decision-making power in the company's overall structure remains central to determining ownership and control of tangible assets.

Intangible assets are non-physical and owned and controlled by the company. However, these assets are often difficult to measure or value. As such, they pose considerable challenges in terms of calculating mining companies' tax liability and, in turn, the government's share of profits. They often lack comparables, making it difficult to assess the appropriate transfer price between related parties in particular transactions. They also occur along the value chain. Examples of intangibles include intellectual property, exploration and mining license rights, engineering design, marketing know-how, specialized supply chain knowledge, product innovation and exploitation techniques.

The Organization for Economic Cooperation and Development (OECD) has developed guidelines for the evaluation of intangibles.⁵⁶ According to these guidelines, ownership and control of intangibles could be demonstrated by relevant patents, as well as the presence in the entity of the necessary professional skills and expertise to perform not only the non-routine asset utilization functions, but also the related maintenance, development, enhancement and exploitation functions. Investment return on intangibles takes the form of royalties, fees or premiums. However, compensation can be questioned in a situation where the 'value creation' attributed to the intangible is not unique.

The non-intangible premium is a location-specific advantage. It is of particular importance to mineral-rich countries. However, it is often not captured by conventional accounting. It involves issues like ready access to minerals, the quality of regulatory regimes in the country and a competent workforce.

⁵⁶ <https://www.oecd.org/tax/revised-discussion-draft-intangibles.pdf>

2.3 Understanding illicit financial flows

There is a lack of clarity around the concept of illicit financial flows, which has been defined in different ways. The confusion in the literature has many dimensions. Illicit financial flows could be classified in terms of their source: legal or illegal. They could also be grouped into activities: commercial, criminal or corrupt. They could involve a range of transfer practices, including mispricing, abusive tax prices, money laundering and bribery. The typology may also include motivation, such as tax avoidance. One major methodological challenge is differentiating between the broader capital flight definition and the narrower illicit financial flows definition. Capital flight is generally understood as the movement of capital abroad, with the purpose of securing better returns. It emphasizes the source country's responsibility, including macroeconomic instability and a discouraging business environment presenting increased risks and costs compared to other investment destinations. Meanwhile, IFFs place the burden on all levels, including destination countries, by demanding shared responsibility for collective action.

This report adopts the definition of the African Union/Economic Commission for Africa Conference of Ministers of Finance, Planning and Economic Development in 2014: "money illegally earned, transferred or used".^{57 58} This definition, which was also endorsed by the High Level Panel, brings together all the different above-mentioned dimensions in a way that provides a working, consistent policy for addressing IFFs. The definition adapts that of Baker (2005): "money that is illegally transferred and illegally utilized".⁵⁹ Baker's definition of IFFs has been adopted by the United Nations, Global Financial Integrity (GFI), World Bank, as well as other organizations.

African countries have yet to develop country-specific working definitions of IFFs with practical application in the mining sector. The High Level Panel's definition provides a useful building block for country- and sector-specific definitions of IFFs. The emphasis on illegality along the leakage chain makes it highly focused, including tracking flows that violate laws in their source countries in terms of the transfer process, as well as motivation and use. The term illicit is flexible enough to strictly accommodate legal aspects and practices that go beyond established norms, including tax avoidance.

Multinational companies are arguably at the heart of cross-border capital movements, with the goal of concealing illegal activities or evading taxes. Baker (2005) estimates that over 60 per cent of total illicit flows stem from legal commercial transactions. Their financialization-based logic may underpin incentives to maximize profits, even at the cost of evading taxes. Motivations for IFFs may also be linked to a country's own internal investment risks, such as the threat of expropriation or confiscation of private property, economic and political uncertainty, financial repression, or devaluation. However, given the volume, Ndikumana (2013) argues that the enormous capital outflows from Africa can no longer be explained by domestic risks

⁵⁷ ECA, 2014. Illicit Financial Flows from Africa: Scale and Development Challenges.

⁵⁸ Report of the High Level Panel on Illicit Financial Flows from Africa. Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development.

⁵⁹ R. W. Baker, 2005. Capitalism's Achilles Heel: Dirty Money and how to renew the free market system

factors. He notes that local investment opportunities sufficiently outweigh the risks of doing business.

Table. 2.2 Illicit financial flow practices and risks along the mining value chain

Mineral Value Chain Stages	Illegal Exploitation	Tax Evasion	International Third Party Effects
Licensing	<ul style="list-style-type: none"> Risk Level: Low Key method: bribery; commissions Loopholes: non-compliance mechanisms; weak law & order enabling trespassing beyond the gazetted areas 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; nepotism Loopholes: weak fiscal regimes; weak capacity of tax administrations, including human resource challenges 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; Loopholes: Unfair bidding & award processes due to interference from third parties
Exploration	<ul style="list-style-type: none"> Risk Level: Low Key method: bribery; commissions Loopholes: non-compliance mechanisms; weak law & order enabling trespassing beyond gazetted areas 	<ul style="list-style-type: none"> Risk Level: High Key method: fraud Loopholes: weak oversight institutions and weak accountability mechanisms 	<ul style="list-style-type: none"> Risk Level: Low Key method: unlawful gifts & commissions Loopholes: Unfair bidding & award processes extortion
Development	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; unlawful gifts and commissions Loopholes: non-compliance with contractual arrangements 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations (e.g. procurement irregularities) 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations (e.g. procurement irregularities; over-invoicing of materials)
Production	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; fraud Loopholes: weak accountability mechanisms which enable underreporting and undervaluing of the minerals 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations allowing for transfer mispricing; over-invoicing... 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; fraud Loopholes: weak accountability mechanisms, which enable underreporting & undervaluing of the minerals
Transport, storage and marketing	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; fraud; racketeering; extortion; smuggling Loopholes: weak accountability & enforcement mechanisms, including customs 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; racketeering; commissions Loopholes: lack of enforcement of mineral sector regulations allowing for transfer mispricing; under-invoicing... 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; racketeering; commissions; smuggling Loopholes: lack of enforcement of mineral sector regulations allowing for transfer mispricing; under-invoicing...
Processing and marketing	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; commissions; fraud; racketeering; extortion; smuggling Loopholes: weak accountability & enforcement mechanisms 	<ul style="list-style-type: none"> Risk Level: High Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations allowing for transfer mispricing; mis-invoicing... 	<ul style="list-style-type: none"> Risk Level: Medium Key method: bribery; racketeering; smuggling Loopholes: lack of enforcement of mineral sector regulations allowing for transfer mispricing; under-invoicing...
Abandonment & Decommissioning	<ul style="list-style-type: none"> Risk level: Low, except for post decommissioning on illegal exploitation Key method: bribery; commissions; fraud; racketeering; extortion; smuggling Loopholes: weak enforcement mechanisms 	<ul style="list-style-type: none"> Risk Level: High, through early exit or fabricated bankruptcy Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations 	<ul style="list-style-type: none"> Risk Level: High, through concealed off-shore transfers of shares amongst foreign MNCs. Key method: fraud, fabricated bankruptcy, bribery Loopholes: lack of enforcement of mineral sector regulations relating to profit repatriation.
Effects on budgetary allocation on mineral rich countries	<ul style="list-style-type: none"> High impact Key method: money-laundering; smuggling Loopholes: political instability; weak non-compliance mechanisms 	<ul style="list-style-type: none"> Very High impact Key method: bribery; kick-backs; commissions; fraud Loopholes: lack of enforcement of mineral sector regulations allowing for under-invoicing of imports 	<ul style="list-style-type: none"> Very High impact Key method: embezzlement; kickbacks; fraud; white-collar crime; insider-trader on commodity exchange markets Loopholes: weak Public Financial Management systems; weak oversight institutions; inadequate accountability mechanisms

Source: Extracted and Adapted from P. Le Billion, 2011. Extractive Sectors and Illicit Financial Flows: What role for revenue governance initiatives, U4 Issue No. 13, U4 Anti-Corruption Resource Centre

2.3.1 Base erosion and profit shifting

Base erosion and profit shifting (BEPS) is a range of loopholes in the international tax system with harmful effects on domestic resource mobilization. These loopholes stem from a patchwork of overlapping national tax laws and bilateral treaties, as well as exploitive practices by multinational companies leading to significant attrition of countries' tax base, including illicit financial flows. Corporate practices resulting in double taxation, minimal taxation or no taxation at all are facilitated by aggressive tax planning aimed at artificially separating taxable income from the activities that generate it. The OECD reckons that multinational companies' aggressive tax planning represents over \$240 billion of lost tax revenues a year⁶⁰.

In order to curb BEPS, the OECD has adopted a package of 15 Action Plans. These legally non-binding targeted reforms constitute the most significant shake-up of multinational taxation since the 1920s, when the current international tax framework was established. The measures include addressing tax challenges in the digital economy, neutralizing the effects of hybrid mismatch arrangements, strengthening controlled foreign company rules (CFC), limiting base erosion through interest deductions and other financial payments, countering harmful tax practices by taking into account transparency and substance, preventing treaty abuse, preventing artificial avoidance of Permanent Establishment status, ensuring that transfer pricing outcomes are in line with value creation, establishing methodologies to collect and analyze BEPS data, requiring taxpayers to disclose their aggressive tax planning arrangements, re-examining transfer pricing documentation, making dispute resolution mechanisms more effective and developing a multilateral instrument.

The effectiveness of the measures remains to be seen. However, as a whole, they do not represent a radical overhaul of international tax governance. Fundamental flaws remain, as explained above. Nevertheless, these measures, which were recently endorsed by the G20 Heads of States, aim to close loopholes facilitating cross-border tax avoidance. While the project was not fully inclusive, the G20 and OECD countries which have already adopted the measures represent more than 80 per cent of global trade. Attempts have been made to ensure universal implementation, including targeted support addressing the specific capacity needs and concerns of developing countries.

Not all the adopted measures are the same. The 15 Action Plans range from new minimum standards to revised existing standards, common approaches which will facilitate convergence of national practices and guidance drawing on best practices⁶¹. For example, the OECD and G20 countries have committed to consistently implement necessary measures related to preventing treaty shopping (Action 6), country-by-country reporting (Action 13), fighting harmful tax practices (Action 5) and improving dispute resolution (Action 14). Existing standards that have been updated will be implemented by countries that choose to adopt them. The standards include OECD Transfer Pricing Guidelines (Action 8-10), Transfer Pricing Documentation (Action 13), Hybrid Mismatch, (Action 2) and Permanent Establishment status (Action 7). Other action plans aim to bring about convergence of tax policies through best practices, including Interest Deductibility (Action 4), Mandatory Disclosure (Action 12), Controlled Foreign Company (Action 3) and Multilateral Instruments (Action 15).

⁶⁰ OECD (2013). Action Plan on Base Erosion and Profit Shifting.

⁶¹ OECD (2016). Frequently Asked Questions. OECD/G20 Base Erosion and Profit Shifting Project. 2015 Final Reports

Chapter 3

Sustainable development impacts of weak domestic resource mobilization

As net resultant impact, the combination of ineffective mineral regimes and illicit financial practices along the mineral value chain undermines resource mobilization, which is key to building an effective, capable state. Corruption and tax evasion may be rampant, but illicit financial flows continue to threaten sustainable development⁶². DRM-damaging financial outflows limit efforts to achieve sustainable development in countries through the following pillars.

3.1 Economic

The status of domestic resource mobilization in Africa is improving, albeit slowly. On the back of sustained economic growth, tax revenues have increased over the past decade. Overall, public revenues mobilized internally grew from 17.5 per cent of GDP in 1980 to 22.3 per cent in 2010⁶³. Africa generates more than \$520 billion annually from domestic taxes⁶⁴. While an important share of tax revenues stemmed from the boom in natural resource prices, the average tax-to-GDP ratio improved to about 20.34 per cent, including in mineral-rich countries. The progress has been underpinned by the improvement of institutions. According to the recent Ibrahim Index of African Governance, public management as an aggregate score increased by 1.5 per cent over the past five years.

This progress, however, masks the damaging institutional impacts of IFFs. African economies bear a disproportionate brunt, with the highest illicit financial flows to GDP ratio, at 5.7 per cent⁶⁵. Illicit practices grew from 3.9 per cent in 2002 to about 7 per cent in 2011. Like a vicious cycle, IFFs erode the tax base of most African countries. Moreover, a weak fiscal base further accelerates illicit practices. The quality of fiscal institutions dropped in the IAG index over the 2011-2014 period. On an actual per capita basis, tax collection has declined across the continent. Excluding South Africa, Africa collected less tax resources per capita in 2010 than it did in the 1980s and much of the 1990s⁶⁶.

While natural resource endowment affords opportunities for fiscal transformation, resource-rich Africa remains unable to take advantage of this wealth. In fact, resource-rich countries have not performed any better than their resource-poor counterparts with regard to revenue

⁶² Khan, H (2005). Markets, States and Democracy: Patron-Client Networks and the Case for Democracy in Developing Countries. *Democratization* 12(5):705-24

⁶³ Mansour M (2014) A Tax Revenue Dataset for Sub-Saharan Africa: 1980-2010, FERDI Working Paper 116.

⁶⁴ AUC&ECA (2014) Mobilizing Domestic Financial Resources for Implementing NEPAD National and Regional Programmes and Project

⁶⁵ Kar D & Leblanc B(2013) Illicit Financial Flows from Developing Countries: 2002-2011, Global Financial Integrity Report

⁶⁶ Mansour M (2014) A Tax Revenue Dataset for Sub-Saharan Africa: 1980-2010, FERDI Working Paper 116.

mobilization⁶⁷. Several reasons may account for the gap, including the damaging effects of illicit financial flows on institutions. Due to limited fiscal revenues, mineral-rich countries are unable to build the type of capacity necessary to negotiate IFF-resilient contracts, formulate effective policies and build a capable tax administration to mobilize fair revenues from their natural resources.

In fact, IFFs are undermining tax efforts, by limiting fiscal space. Mineral-rich Africa is not only collecting less revenue from its natural resources, but is also unable to effectively reach out to other sectors of the economy. A negative correlation is observed between resource revenues and non-resource revenues, even though increased resource revenues may outweigh the loss. For example, the Democratic Republic of the Congo, with an illicit outflow to tax revenue ratio of 373 per cent⁶⁸, experienced an increase in its resource revenue-to-GDP ratio from an average of 17 per cent in the early 1980s to 32 per cent in the late 2000s. During that period, the non-resource revenue ratio dropped from 15 per cent to 7 per cent⁶⁹. Over the same period in Equatorial Guinea, with an illicit outflow to tax revenue ratio of 138 per cent, the resource revenue-to-GDP ratio increased from zero to 35 per cent, while the non-resource revenue ratio dropped from 20 to less than 2 per cent.

Africa will have to mobilize more revenues in taxes than in aid, in order to achieve its development priorities. Significant potential exists for closing the revenue gap. The African Development Bank estimates that African governments can raise an additional \$300 billion in tax revenues yearly⁷⁰. In addition to efforts to curb the over \$50 billion in IFFs leaving the continent, Africa can more than meet its infrastructure needs, a binding constraint to economic growth. McKinsey projects that by targeting readily attainable objectives in terms of modernizing tax administration, governments could generate an additional 50 billion in tax revenues within the next five years. Countries have no other choice but to look inward, making every effort to plug illicit financial flows loopholes as aid levels dwindle and become relatively marginal for meeting the newly adopted seventeen sustainable development goals. It will cost the world over \$4.5 trillion in state spending to meet the endorsed 169 targets⁷¹. This is more than 33 times overall overseas development assistance.

3.2 Social

Africa has made impressive gains in meeting the Millennium Development Goals, even though progress remains mixed. Although overall poverty rates are still hovering around 48 per cent,

⁶⁷ Ndikumana et al (2010) Revenue Mobilization in African Countries: Does Natural Resource Endowment Matter? Africa n Development Review VOL. 22 No. 3

⁶⁸ Spanjers J & Foss H (2015) Illicit Financial Flows and Development Indices: 2008-2012, Global Financial Integrity Report

⁶⁹ ⁶⁹ Ndikumana et al (2010) Revenue Mobilization in African Countries: Does Natural Resource Endowment Matter? Africa n Development Review VOL. 22 No. 3

⁷⁰ African Economic Outlook, World Bank and Mckinsey [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/C-10%20Note%20%20English%20\(final\)_for%20posting%20.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/C-10%20Note%20%20English%20(final)_for%20posting%20.pdf).

⁷¹ http://www.un.org/pga/wp-content/uploads/sites/3/2015/08/120815_outcome-document-of-Summit-for-adoption-of-the-post-2015-development-agenda.pdf

according to recent estimates, most countries have forged ahead on at least one goal⁷². Africa is in the homestretch in terms of achieving the universal primary education enrolment target. Overall, African countries have made substantial progress towards reducing infant mortality. Efforts to combat HIV/AIDS, malaria and tuberculosis have also paid off, with the continent on track to reversing the spread. However, Africa still has the highest maternal mortality ratio in the world, registering 289 maternal deaths per 100,000 live births, compared to the global average of 210 maternal deaths per 100,000 live births in 2013. Only 16 per cent of the continent's population has access to pipe-borne water, the lowest in the world. Resource-rich Equatorial Guinea is among the few African countries that have cut pregnancy related deaths by three quarters, paving the way to meet the Millennium Development Goals (MDG) target.

Africa has met many of the goals, thanks in part to externally mobilized funds. However, moving forward and overcoming the growing challenges to implement the more ambitious sustainable development goals will require tax collection efforts. Without raising adequate revenues, governments will be unable to fulfil their obligation to deliver basic services their citizens. Many studies have pointed to the negative correlation between IFFs and human development. A recent study on the impact of IFFs on development outcomes establishes a statistically significant inverse relationship between IFFs and the Human Development Index⁷³. The negative relationship shows the significant loss in much-needed domestic revenues for providing basic services, including health and education. The study also demonstrates a positive relationship between high income inequality and illicit financial flows, suggesting that the wealthiest 10 per cent may enable DRM-damaging financial outflows.

Besides correlations, some peer-reviewed studies have demonstrated further IFF causal links in Africa. A recent study published in the *Journal of the Royal Society of Medicine* estimates the negative impact of illicit financial outflows on the ability of sub-Saharan States to realize Millennium Development Goal 4, relating to the right to health⁷⁴. Focusing on infant mortality rates in 34 countries in Africa, the study estimates that fifty per cent more countries could reach their target if illicit financial outflows were completely curtailed.

3.3 Political

The relationship between illicit outflows and governance is complex. Illicit financial flows impact both strong and weak states, albeit to varying degrees. There appears to be a weak correlation between levels of illicit financial flows and common governance barometers, including the Fragile States and Corruption Perception Indexes, as well as the World Bank's CPIA⁷⁵.

⁷² ECA (2015) ASSESSING PROGRESS IN AFRICA TOWARD THE MILLENNIUM DEVELOPMENT GOALS, Report by ECA, AUC, AfDB, and UNDP

⁷³ Spanjers J & Foss H (2015) Illicit Financial Flows and Development Indices: 2008-2012, Global Financial Integrity Report

⁷⁴ Ohare B & Makuta I (2015) An analysis of the potential for achieving the fourth millennium development goal in SSA with domestic resources, *Journal of the Royal Society of Medicine* 107(4): 148–156

⁷⁵ Spanjers J & Foss H (2015) Illicit Financial Flows and Development Indices: 2008-2012, Global Financial Integrity Report

Box. 3.1 Regional and International governance initiatives

In order to strengthen good governance and address mineral-specific governance challenges, many mineral-rich African States are members of regional and international initiatives:

- The African Peer Review Mechanism (APRM), as an African-owned mechanism, offers an opportunity to improve Africa's governance standards in the extractives sector. The APRM has made a significant step towards deepening national ownership of mineral resource governance processes, by including a specific chapter on extractive industry governance to its country review questionnaire. The quality and depth of the APRM consultations offer an opportunity to move discussions on governance beyond rhetoric to development-oriented strategies.
- The Extractive Industries Transparency Initiative (EITI) is an international initiative, which provides standards relating to full annual disclosure of payments made by oil, gas and mining companies to governments. The overarching objective is to improve governance in mineral-rich countries, including by promoting transparency and accountability. At present, 24 African countries have joined the EITI, of which only three countries have completed the validation process (Liberia, Nigeria and Ghana).
- The Kimberley Process Certification Scheme (KPCS) was set up to curtail "conflict diamonds" from being traded. To this end, it requires member States to certify that diamonds mined within their borders are conflict-free. Eleven African countries are members of the Process.
- The Publish What You Pay (PWYP) is an initiative, by a coalition of civil society groups, which calls for "the mandatory disclosure of payments made by oil, gas and mining extractive companies to each national government". By encouraging private firms to "publish what they pay" to governments, the initiative enables citizens in resource rich countries to hold their governments accountable. Currently, only three African mineral-rich countries are members of the PWYP (Algeria, Kenya and Tanzania).
- The Open Government Partnership (OGP) seeks to promote transparency, accountability and civic partnership. The eligibility criteria are assessed by an evaluation of a country's performance in four main areas: access to information, fiscal transparency, citizen engagement and public official's asset disclosure. States that score 75% and above in the evaluation are able to join. Only seven mineral-rich African countries have met the minimal OGP requirements

This suggests that illicit financial flows constitute a global problem. Outflows may undermine political governance in both source and destination countries. The illegal transfer of money from mineral-rich countries contributes to the breakdown of law and order and creates an enabling environment for corruption and its damaging impact on domestic resource mobilization institutions. Laundered money often reroutes its way back into the political system, eroding trust in the judicial system, as well as politics. Over 80 per cent of mineral-rich African countries associated with high IFFs underperformed in the areas of rule of law and government effectiveness, according to the recent Natural Resource Governance Index, an accountability and transparency tool for the mining sector.⁷⁶ Additionally, over 50 per cent of the worst performing countries were African.

⁷⁶ NRG(2014) The 2015 Resource Governance Index

3.4 Environmental

The criminal component of IFF practices may result in widespread, systematic degradation of the environment. While it is difficult to establish a clear causation, it is reasonable to assume that the underpricing of African minerals will accelerate their depletion. Underreporting the timber exports of Africa from a country like the Democratic Republic of Congo⁷⁷ accelerates the deforestation of one of the world's critical ecosystems.

In fact, abusive transfer mispricing of minerals may underprice the environmental cost of mine closures, leaving the state to assume the liability, with a lasting impact on the population's health and safety.

⁷⁷ Greenpeace, 2008, Conning Congo, Greenpeace: London, <http://www.greenpeace.org/international/en/publications/reports/conning-the-congo>.

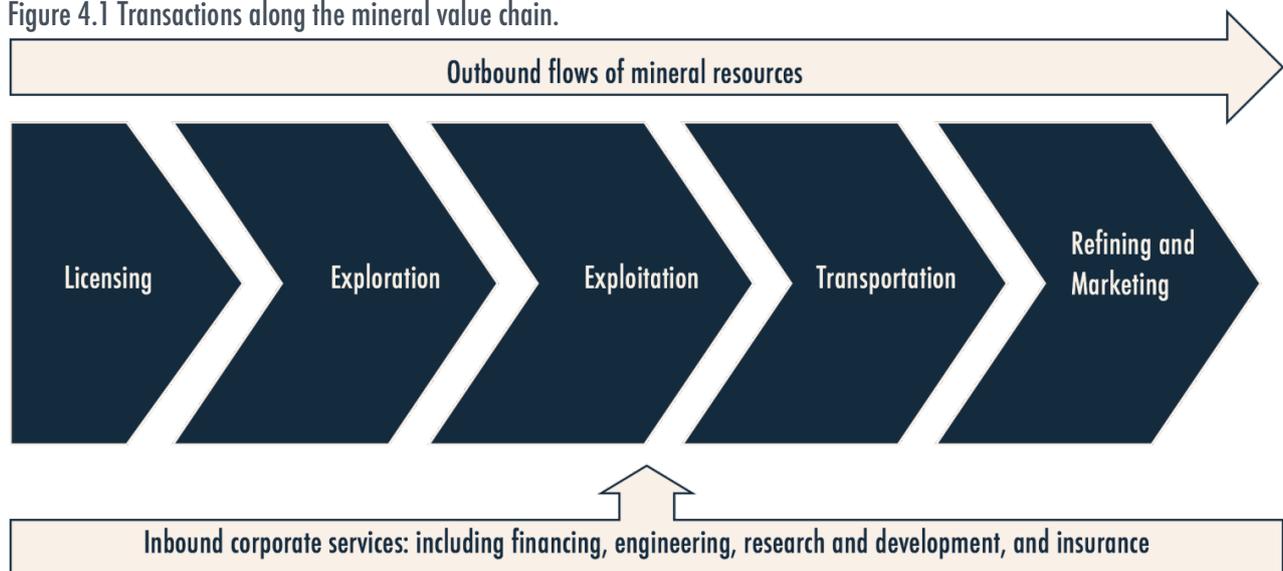
Chapter 4

Analysis of policy and regulatory frameworks to combat financial flows from the mining sector in case-study countries

This chapter analyses existing policy, regulatory and institutional frameworks for combatting IFFs in the mining sector of the four case-study countries. It examines design and compliance gaps along the mining value chain with implications for domestic resource mobilization, as shown in figure 1. It also identifies strengths and opportunities in the policy and regulatory frameworks, which, if effectively utilized, can provide some level of protection against IFF practices at different stages of the mineral value chain.

This section draws on the Africa Mining Vision as a reference guide. While the analysis focuses on the country case studies, it also extrapolates crosscutting issues to the regional level, in order to underline challenges and opportunities for harmonizing mineral regimes to combat IFFs and DRM-inhibiting practices. The section also draws on global experiences and lessons that could promote better policy design and implementation for greater domestic resource mobilization.

Figure 4.1 Transactions along the mineral value chain.



Adapted from the World Bank Unpublished Report

4.1 Licensing

National policies and laws remain the basis for allocating licenses in the mineral sector. The regulatory frameworks in all four case studies were clear on the ultimate responsibility of the State - a key tool for protecting against illicit financial flows. Consistent with most jurisdictions, the custodianship of minerals is vested in governments, rather than mining companies. The public-ownership provisions enshrined in mineral regimes give the state responsibility for

ensuring that optimal revenue is mobilized from the exploration, exploitation, processing and sale of minerals for the benefit of all citizens. The state's ownership of mineral rights is inalienable: it cannot be transferred.⁷⁸ In South Africa, one of the oldest and most advanced mining countries in the continent, the Mineral and Petroleum Resources Development Act (MPRDA) of 2002 underlines in its preamble "that South Africa's minerals and petroleum resources belong to the nation and that the State is the custodian thereof".⁷⁹ In Zambia, the State holds the property rights to all minerals on behalf of the people.⁸⁰ In Tanzania, the entire ownership and control over minerals on, in or under the land is vested in the United Republic.⁸¹ This implies that the state has exclusive power to grant all mining rights to its citizens, public bodies or foreign companies and even to cancel or terminate licenses. The sovereignty of the state over all minerals is recognized as a fundamental principle.

Mining companies do not own the resources by virtue of a license. As custodian of mineral resources, the government may terminate any license for irregularities and protection of public interests. The ownership function entitles the government to mobilize revenues from the resources through licensing, bonus payments, etc. The AMV notes that the state's ability to optimize the leasing of its natural resource assets is concentrated at the outset in the licensing process.⁸² Failure at this stage locks in future processes, inhibiting opportunities for greater resource mobilization, as well as creating significant leakages further down the mining value chain. The type of licensing varies across case-study countries, often organized by business, function or a combination of both. In Zambia the Mines and Minerals Development Act outlines four types of licensing: prospecting, large-scale, small-scale and artisanal mining. The Mining Act of Tanzania includes prospecting, mining and primary mining. The Mining Code of Democratic Republic of the Congo lists research and exploitation licenses⁸³, while in South Africa, the main access rights to mineral resources are reconnaissance prospecting and mining rights.

Meanwhile, beyond maximizing revenues, most case-study countries have also included socio-economic or political objectives as part of the licensing process. In South Africa, the MPRDA empowers the Ministry to facilitate any historically disadvantaged persons to conduct prospecting or mining operations through the relevant permits. The Democratic Republic of the Congo reserves artisanal mining for nationals only, while Tanzania earmarks all gemstone mining permits for its citizens. Given the entrenched informality of the ASM sector, it remains unclear how social empowerment objectives could mitigate against the growth of illicit mineral trading without significant fiscal impacts. A recent USAID report estimates that over eight tons of gold from the ASM sector leaks out of the Democratic Republic of the Congo into the supply

⁷⁸ Muna Ndulo, 2013. Legal and Regulatory Frameworks for Resource Exploration and Extraction-Global Experience, African Development Bank High Level Policy Seminar on Optimizing the Benefits of Coal & Gas in Mozambique (27-28 February, 2013, Maputo, Mozambique) <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/Presentation%20->

⁷⁹ Section 3 (1) Minerals and Petroleum Resources Development Act (MPRDA) 28 of 2002 of South Africa

⁸⁰ Section 3(1) of Zambia's Mines and Minerals Development Act of 2008 vests all rights of ownership in, of searching for, mining and disposing of, minerals are hereby in the president on behalf of the Republic."

⁸¹ Section 5 the Tanzania Mining Act No. 14 of 201.

⁸² The African Mining Vision (2009), pg 17

⁸³ Mining Code Law No. 007/2002 /July/11 and the enabling regulations are encoded in the Mining Regulation No. 038/2003/ March/26.

chains of neighboring Burundi and Uganda. The study reckons that the fiscal cost of such illicit leakage amounts to \$6 million yearly, or about 97 per cent of expected revenues from the gold sector⁸⁴.

The process of granting licenses could offer opportunities for leveraging greater fiscal revenues, while presenting risks of illicit financial leakages and corruption. The AMV aims for a sustainable, well-governed mining sector that “effectively mobilizes and deploys resource rents” (AUC 2009, pV). Tendering, bidding and auctioning remain efficient instruments for optimizing revenues during the licensing process. However, in most case studies, licensing is granted on a first-come, first-served basis, which is not competitive enough to achieve greater resource rents. For example, in the Democratic Republic of the Congo, competitive tendering is an exception, not a rule. Article 33 of the Mining Code states that “if the public interest so requires, the Minister submits to tender, in exceptional cases, open or by invitation, mining and quarry rights relating to a deposit which has been studied, documented or possibly worked on by the State or its entities and which is considered as an asset with considerable known value. In this case, the Minister reserves the mining rights relating to the deposit to be submitted to tender.” It was noted that implementation remains a major challenge in the field case studies. Cases were cited where licensees acquire their license for speculative purposes. Technical and financial evaluation of competencies of license holders or candidates is inadequate. While the Government of the Democratic Republic of the Congo is drafting a new mining code, there were also reports of state-owned companies with many lucrative titles signing joint venture contracts under opaque circumstances⁸⁵. South African licensing, which is granted on a first-come, first-served basis, is also uncompetitive.

Optimally, “governance should aim at reconciling the flexibility and control of government institutions with the demands of transparency and efficiency in ways that improve the quality of decisions and help maximize economic value for the State”⁸⁶. In all case studies, the authority to grant licensing is vested in the Minister of Mines. For large-scale mining, the Minister decides who gets the permit. The Minister’s discretionary powers vary across the case studies and are often subject to broad constitutional and administrative legal principles. For example, in South Africa the Minister is supported by a multi-stakeholder Minerals and Mining Development Board. However, its members are appointed by the minister, as well as representatives from the private sector and organized labor. In the Democratic Republic of the Congo, Article 10 of the Mining Code grants the Minister power to approve as well as refuse and cancel licensing, with the exception of construction minerals. The Minister also appoints members of the Interministerial Committee in charge of selecting bids for exploration of a deposit subject to tender. According to the Tanzanian Mining Act of 2010, the Minister is obliged to seek the advice of the Mining Board before entering into licensing or contractual arrangements with mining companies, including Mineral Development Agreements. This Board

⁸⁴ USAID (2015) Capacity Building for a Responsible Mineral Trade: Working with Producers to Responsibly Source Artisanal Gold in the Democratic Republic of Congo. A report prepared by Tetra Tech/ARD http://www.resolv.org/site-ppa/files/2015/06/GBRMT-Gold-Assessment_REVISSED-FINAL-WITH-COPY-EDIT.pdf

⁸⁵ NRG (2015) Country Strategy Note, The Democratic Republic of Congo October 2015 pdf link

⁸⁶ ECA (2011), Minerals and Africa’s Development: The International Study Group Report on Africa’s Minerals Regimes, pg 136.

also comprises many stakeholders, including representatives from the private sector and the Attorney General's Office.

While there is increasing awareness of illicit revenue mobilization practices in the sector, no comprehensive working definition of illicit financial flows exists in any of the mineral regimes studied. The case-study countries have adopted various measures to combat discrete aspects of IFFs in their policies, laws and regulations. The targeted areas for action are transparency and accountability, as well as corruption and money laundering. For example, the Minerals and Petroleum Resources Development Act of South Africa is aimed at ensuring that mineral resources are developed in a sustainable manner, in order to promote social and economic development. To promote transparency, section 28(2) contains requirements for mining companies to disclose information regarding mining activity records and monthly financial statements to the Director General of the mining authority. Conversely, section 30 gives effect to the public's constitutional right of access to information related to mining activities.

It appears the global security implications of illicit financial flows have given impetus to actions to address the latter. All the case-study countries have anti-money laundering legislation. In 2003, Zambia adopted The Banking and Financial Services Act CAP 387 and Banking and Financial Services Regulations. The country has also adopted specific pieces of legislation, including the Prohibition and Prevention of Money Laundering ACT no 14 of 2001 which led to the Anti-Money Laundering Authority (AMLA), in addition to establishing an Anti-Money Laundering Investigation Unit. In 2006, the government of Tanzania enacted the Anti-Money Laundering Act and signed a Multi-Year Agreement with the Eastern and Southern Africa Anti-Money Laundering Group. In June, 2015, the president of the Democratic Republic of the Congo issued new directives on the enforcement of anti-money laundering laws.

The case-study countries have also adopted pieces of anti-corruption legislation. The Zambia Anti-Corruption Act of 2012 includes a section on corrupt practices by foreign public officers, including businesses. Article 26(3) defines corruption to include a "person who unlawfully promises, offers, or gives to a foreign public official, directly or indirectly, an undue advantage, for the benefit of the foreign public official or another person, in order that the public official may do or forbear to do, in the exercise of the official duties, in order to obtain or retain business or other undue advantage in relation to the conduct of international affairs or business, commits an offence"⁸⁷.

The case-study countries also have institutional mechanisms to address DMR-damaging capital flight. All four countries have set up Financial Investigations Units within their Central Banks to deal with various aspects of illicit financial flows, including risks of cross-border capital flight, as shown in box 2. Zambia has established a special unit within its revenue authority focusing on mining. Aspects of legislation also cover arms-length principles and abusive transfer pricing. However, the lack of a working definition undermines the consistency of policies and legislation, as well as the effectiveness of institutions to combat illicit financial flows. In terms

⁸⁷ The Anti-Corruption Act, No 3 of 2012 <http://www.zambialii.org/files/zm/legislation/act/2012/3/The%20Anti-Corruption%202012.pdf>

of legal and institutional quality, the NRG Index ranks the case-study countries respectively: Zambia, South Africa, the Democratic Republic of the Congo and Tanzania⁸⁸.

4.1.2 Beneficial ownership

Transparency in ownership arrangements for mineral licensing and exploitation remains a weak link, with major risks of corruption and illicit financial flows. Often the identity of license holders or those behind exploration and exploitation activities remains hidden by a chain of unaccountable corporate structures⁸⁹. The opaque nature of company ownership may encourage tax evasion and corruption. It has been estimated that developing countries are losing almost \$1 trillion yearly due to corrupt and illegal deals, including many transactions involving anonymous or shell companies⁹⁰. In 2013, the Africa Progress Panel reckoned that the Democratic Republic of the Congo lost almost \$1.36 billion from five mining deals, masked by a veil of complex corporate structures and secret ownership⁹¹.

Nevertheless, the case-study countries have taken some encouraging steps towards disclosure of beneficial ownership. As part of its requirements for Extractive Industry Transparency Initiative (EITI) compliance status, the Democratic Republic of the Congo started a pilot project on disclosure of beneficial ownership of extractive companies. It was reported that 31 out of 63 privately held mining companies have disclosed their beneficial owners, including nationality, date of birth and residential address. In Tanzania, although the Business Registration and Licensing Authority maintains a publicly accessible register of companies operating in the country, it contains no information on beneficial ownership. However, in 2015, the Tanzania EITI enacted a law requiring all extractive companies to disclose their beneficial owners. Furthermore, as part of its commitment at the recent Anti-Corruption Summit held in London, Tanzania agreed to “ensure beneficial ownership information is publicly available for all companies active in the extractive sector”⁹². Meanwhile, in Zambia, there is no legislation requiring disclosure of beneficial ownership of mining companies. In addition, information about companies incorporated in foreign jurisdictions is difficult to obtain.

4.2 Exploration

Subsoil research and analysis for possible commercial deposits remains a transaction-intensive stage in the mining, value chain. The flow of materials and data presents risks of mineral

⁸⁸<http://www.resourcegovernance.org/resource-governance-index/countries>

⁸⁹ EITI (2016). Beneficial Owners: Revealing Who Stands Behind the Companies. Factsheet https://eiti.org/files/eiti_bo_factsheet_en_final.pdf

⁹⁰ McNair, D; Kraus, J; McKiernan, K and McKay, S (2014). The Trillion Dollar Scandal. ONE Report. https://s3.amazonaws.com/one.org/pdfs/Trillion_Dollar_Scandal_report_EN.pdf

⁹¹ APP (2013) Equity in Extractives : Stewarding Africa's natural resources for all, Africa Progress Panel Report http://africaprogresspanel.org/wpcontent/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf

⁹² Anti-Corruption Summit London 2016. Country Commitments. United Republic of Tanzania. <https://www.gov.uk/government/publications/anti-corruption-summit-country-statements>

leakages, as well as opportunities to combat illicit financial flows. Exploration remains a cornerstone of revenue mobilization, and success, together with an underlying institutional framework, provide the foundation for contract negotiation.

The transfer of samples collected during the exploration phase presents risks of illicit mineral trading. While country case studies include guidelines, regulations vary in terms of quality and effectiveness. The Mineral Act of Tanzania imposes a commercial cap of fifty thousand shillings, above which export samples are subject to royalty payments. However, the law contains no guidelines on transfer frequency or type of mineral. While in the Democratic Republic of the Congo, there is no requirement for royalty payments on samples, the Mining Code obliges exploration companies to document the weight and volume of samples acquired and to seek consent from the Ministry of Mines. In addition, companies must submit duplicate samples to the Ministry, which then become the property of the State. Meanwhile, the samples collected become the property of the licensed holder. Furthermore, the Ministry commits to guarantee confidentiality of information derived from the sampling. The Democratic Republic of the Congo Mining Code also exempts samples from associated custom duties and taxes, regardless of their nature.

Legal loopholes and weak administrative capacity pose significant challenges for ensuring compliance. While exporting commercial quantities is taxable in the Democratic Republic of the Congo, its definition remains unclear. There is no mention in the Mining Code of what quantity of minerals is considered commercial. This opens the door for discretion, with risks of corruption. There were reports in the Democratic Republic of the Congo of multinational companies exporting commercial quantities of ores illegally as samples for analysis abroad, depriving government of much-needed taxable income, including royalties and value-added tax. Due to porous borders in most of the case-study countries, there were also reports of commercial quantities of samples making their way into the supply chains of neighboring states and being exported illegally, without being taxed appropriately or at all. The design and compliance gaps become even more significant in the case of high-value and low-volume minerals like gemstone and gold, for which leakages of even small samples could reach millions of dollars. According to a recent United Nations report, every year gold and other natural resources valued between \$0.7 and \$1.3 billion are exploited and smuggled illegally out of the conflict zone and surrounding areas in eastern Democratic Republic of the Congo.⁹³ The report attributed the illicit flow to transnational organized crime.

Geological information remains a crucial tool for both mobilizing investment and valuing subsoil resources. Exploration, as the first and most important source of geological information, is an extremely risky activity, and countries' access to precompetitive geological data becomes very important. The proportion of exploration targets that eventually evolve into profitable mines approximates 4 per cent for Brownfield projects and ranges from 0.01-0.03 per cent for Greenfield exploration⁹⁴. Exploratory work is carried out by both states and companies. Due to the high capital investment involved, in Africa, the sector is dominated by foreign mining

⁹³ UNEP-MONUSCO-OSESG. 2015. Experts' background report on illegal exploitation and trade in natural resources benefitting organized criminal groups and recommendations on MONUSCO's role in fostering stability and peace in eastern DR Congo. Final report. April 15th 2015 http://postconflict.unep.ch/publications/UNEP_DRCongo_MONUSCO_OSESG_final_report.pdf

⁹⁴ Lord, D., Etheridge, M.A., Willson, M., Hall, G., and Uttley, P.J., 2001. Measuring exploration success: An alternative to the discovery-cost-per-ounce method of quantifying exploration success. *Society of Economic Geologists Newsletter*, v. 45, p. 1 and 10-16.

companies, particularly juniors. Given the very low probability of success, it is often likely that two or more companies will have explored the same area prior to discovery⁹⁵.

All case-study countries recognize the importance of geological information in their mining codes. However, integrating investment and governance dimensions in a way that effectively curbs illicit leakages remains a challenge varying across case studies. For example, Article 8 of the Democratic Republic of the Congo Mining Code states that “the State may through expert organization set up for that purpose, carry out exploration activities of the soil or subsoil with the sole purpose of improving geological knowledge of the national territory or for scientific purposes which do not require mining or quarry rights to be obtained.” The MPRDA of South Africa includes specific requirements for exploration findings. Section 102(3) requires mineral right holders to declare and account for the associated minerals discovered during the exploration process.

While data sourced from exploration is recognized, access to this data is hindered by binding legal and capacity constraints. All case studies include requirements for the geoscience data generated to be submitted to relevant authorities. However, most of them include a confidentiality clause which blocks the collected data from public use and prevents governments from exercising their right of custodianship. It was unclear from the case studies how valuable exploration geoscience information obtained by companies is transferred to governments. While regular data transfer is common practice in most mining countries, including Australia and Canada, the government officials interviewed complained that companies were reluctant to transfer their exploration data, even after their license had expired. For many African countries, the amount of geological data transferred from industry to government remains variable, and corporate geoscience data is largely missing from the geological infrastructure⁹⁶. The World Bank reckons that the transfer of these national datasets to the country’s archives represents an equivalent data acquisition expenditure of over \$1 billion across Africa⁹⁷. As a result, African countries are losing not only money, but also opportunities to attract further investment to their mining sector. Studies also show that, when made available to mineral exploration companies, precompetitive datasets could leverage inward investment of 3:1 to 20:1 for a number of jurisdictions⁹⁸.

Even when information is made available as per legal requirements, the lack of a forward-looking approach towards data management limits governments’ ability to track, analyze and monitor resource flows. There is often no specific protocol for formatting the submitted data. While most of the case-study countries include legislation requiring raw company exploration data, only South Africa included a specific requirement that “data and progress reports be submitted in a prescribed manner and intervals.” However, there is no requirement for the data to be submitted in digital format. In most African countries, the majority of data are submitted in PDF, and associated datasets are generally not provided, even after the mining company has relinquished its permit⁹⁹. In addition to the confidentiality clause, the Zambian Mines and

⁹⁵ Minex Consulting 2014, based on discovery data from RH Sillive 1995

⁹⁶ Harris, E & Miller, J (2015), Company Geodata: Growing African National Archives Via Transfer of Corporate Geoscience Data. International Mining for Development Report

⁹⁷ World Bank. 2014. The African Minerals Geoscience Initiative (AMGI)- The “Billion Dollar Map” Technical Report.

⁹⁸ Scott, M., Jones, M., 2014. Management of Public Geoscience Data. IM4DC Action Research Report.

⁹⁹ Harris, E & Miller, J (2015), Company Geodata: Growing African National Archives Via Transfer of Corporate Geoscience Data. International Mining for Development Report

Minerals Development Act does not specify standard data formats to ensure that datasets from various operations can be integrated and used for robust analysis and tracking.

Legislation may also be ambiguous and self-limiting. In many African countries, there is no distinction made between the terms 'geological knowledge', 'information' and 'records'¹⁰⁰. For example, the Democratic Republic of the Congo uses information instead of data, potentially leading to selective submission by companies. The reports submitted do not constitute geoscientific infrastructure on their own, since they do not include generic datasets that could be readily incorporated into other datasets for access in a digital archive.

The exercise of ownership by African governments through custody of geoscientific information is further limited by investment in geological survey institutions. While the African share of global exploration funding has grown significantly, even when adjusted for the recent collapse in commodity prices, it is largely driven by foreign mining companies. In 2000, the country's share of global exploration approximated 5 per cent¹⁰¹, a sharp contrast to its 2015 share of 14 per cent of the worldwide exploration budget, making it the third most attractive region, even ahead of mining superpowers like Canada and Australia¹⁰². The top destination countries for private exploration capital in Africa include Burkina Faso, Democratic Republic of the Congo, Ghana, South Africa and Zambia.

However, the increase in private exploration capital does not match the scale of mapping needed. It seems that African governments are not meeting their reciprocal responsibility to fund basic geological surveys. As a result, a large proportion of the continent remains unmapped geologically and unexplored in a systematic manner at appropriate scales. Only 14 per cent of Africa is covered by reasonably detailed government-generated geological maps of the scale of 1:200000 or better¹⁰³. The value of known subsoil assets per square kilometer of Africa is barely one quarter that for high-income countries with comparable geological potential¹⁰⁴. In fact, the continent remains the lowest in absolute terms, below \$5 per kilometer square, as compared to \$65 in Canada, Australia¹⁰⁵

The African Mining Vision underscores geological 'knowledge infrastructure' as fundamental to countries, enabling them to optimize their share of resource rents along the mining value chain. It was difficult to get a clear picture of government investment in geoscientific infrastructure in the case-study countries. However, besides those in South Africa, geological survey institutions in the case-study countries reflect the continental trend of neglecting the sector. In its 2008-2012 Strategic Plan, the Ministry of Mines noted that the Geological Survey of Zambia was understaffed, demotivated and failed to cover specialized activities beyond geophysics. In fact, a study on geological survey institutions showed that in Zambia, the last geological maps produced by the government were in 2000.¹⁰⁶ The report further noted that there were no

¹⁰⁰ Ibid

¹⁰¹ UNECA (2011), Minerals and Africa's Development: The International Study Group Report on Africa's Minerals Regimes

¹⁰² SNL (2016) World Wide Exploration Trends, a special Report from SNL Metals and Mining for the PDAC International Convention.

¹⁰³ ACP(2002) Mining Data Bank http://mines.acp.int/html/presentation_en.html

¹⁰⁴ Gelb et al (2012). How Much Does Natural Resource Extraction Really Diminish National Wealth? The Implications of Discovery. Center for Global Development, New York

¹⁰⁵ AfDB (2012). Mining Industry Prospects in Africa, African Development Bank

¹⁰⁶ Scott, M (2013) Developing Effective Mineral Resource Policy for Sustainable Livelihoods through Geoscience, IM4DC Action Research Report.

regional mapping databases. and data were not captured in a structured format, an observational code or consistent terminology.

4.2.1 Capital gains tax

The transition from successful mine exploration to development often involves the transfer of high-value, appreciated capital assets in the form of licenses, concessions and shares. The capital gains on the transactions may involve significant amounts— a potential opportunity for mobilizing pre-production tax revenues. Risk thresholds in the industry vary, “Junior mining companies”, with their comparatively high appetite for extremely risky activities, often hold on to their exploration licenses or concession as a way of building value for eventual resale to major mining companies with the resources and capacity to develop the concession. They may also sell their shares in a concession following its appreciation.

Based on various economic and political reasons, “to tax or not to tax” capital gains remains an open debate.¹⁰⁷ However, irrespective of policy position, it is increasingly not uncommon for governments to explore opportunities to broaden their tax base, including capital gains taxation for the mineral sector.¹⁰⁸ In the mining sector, transactions subject to capital gains taxation (CGT) represent significant revenues¹⁰⁹. Given the often generous incentives provided by governments in exploitation contracts, as well as the widespread perception in Africa that mining companies often understate their tax liability over the course of the development phase¹¹⁰, capital gains taxation remains one of the ways for governments to reverse some of the imbalances undermining optimal domestic revenue mobilization from the sector.

Yet the application of capital gains taxation remains varied and inconsistent across Africa, including the case-study countries. There is no standalone, comprehensive legislation on capital gains taxation in the case studies. Capital gains taxation is treated as part of corporate income tax and subject to the applicable tax rate. For example, the South African capital gains tax provisions were introduced in 2001 as part of the provision of the Eighth Schedule to the Income Tax Act (ITA) 58 of 1962. The Schedule determines the taxable capital gains, with Section 26A providing for the mandatory inclusion of the capital gains in the taxable income. The provision includes specific methods for valuing the gains, which take into consideration length of ownership. In the Democratic Republic of the Congo, capital gains are also treated as taxable income. The seller bears the tax liability.

Mining companies may explore limitations in legal provisions and their implementation, in order to avoid paying capital gains taxes. Most CGT provisions incorporated into the income tax laws assume that the seller is a permanent resident, for tax purposes, and continues to reside in the country. It is not uncommon for a mining company to liquidate its entire assets, including

¹⁰⁷ Watson, A (2012) Mozambique: Reforming the Fiscal Regimes for Mining and Petroleum, IMF Fiscal Affairs Department.

¹⁰⁸ UN(2014) Capital Gains Taxation and Indirect Sales, paper presented at the United Nations Financing for Development Forum 10th session http://www.un.org/esa/ffd/tax/tenthsession/CRP3_%20AttachmentB_CapitalGains.pdf

¹⁰⁹ CIP (2014) Taxing Capital Gains in Mozambique’s Extractive Sector, Policy Brief of the Center for Public Policy Integrity,

¹¹⁰ ECA (2015) Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa, United Economic Commission for Africa.

leases, leaving behind no financial presence in the host country. While there were accessible records of the practice in the case-study countries, applicable examples exist in other African countries. For example, in 2010, Riversdale sold all its stakes to Rio Tinto and left Mozambique without the knowledge of tax authorities. With no leverage over the Australian company, the Mozambican government has tried unsuccessfully to recover the capital gains tax liability from the over \$4 billion transfer of assets.¹¹¹ Some of the case-study countries do not include provisions for indirect sales in their CGT regulations. For example, the Democratic Republic of the Congo does not include income generated by an indirect transfer of assets or shares. As a result, companies may argue that what is being transferred is not directly an appreciated asset in the host country, but rather a subsidiary of the parent company. South Africa exempts intragroup restructuring from capital gains taxation, provided the parent company is a holding company based in the country.

Besides regulatory weaknesses, capacity in most African countries may also limit the implementation of CGT provisions. Enforcement requires that governments know when a transaction with CGT implications occurs. Often tax authorities are not aware of what is going on in companies. Companies do not automatically report their corporate takeovers to tax authorities. As a result, the only source of information is foreign media, which often reports transactions only after they have already occurred. For example, the tax authority in Mozambique only learned about the Riversdale transaction from the media months after it had been finalized¹¹².

4.2.2 Contract negotiations

The AMV identifies negotiation of mineral development agreements as a critical stage in the mining cycle. Contracts stemming from this process remain a key governance tool for domestic resource mobilization in the mineral sector in most African countries. Often concluded between host governments and mining companies, and increasingly communities, contracts are detailed, specific agreements setting out the parameters for the distribution of the risks, costs and benefits of a mining project. Getting the contract right is key to minimizing illicit financial flows and optimizing revenues for the state.

Despite their importance, contracts are at the bottom of legal hierarchy governing the mineral sector, including the constitution, policies and laws, and regulations¹¹³. However, contracts may be negotiated in ways that deviate substantially from existing legal frameworks, including the tax laws of the host country.¹¹⁴ The contracts may take different names: Mineral Development

¹¹¹ CIP(2014) Taxing Capital Gains in Mozambique's Extractive Sector, Policy Brief of the Center for Public Policy Integrity

¹¹² <http://clubofmozambique.com/news/mozambican-tax-authority-capital-gains-being-discussed-with-vale/>

¹¹³ Lorenzo, C (2010) "Investment Contracts and Sustainable Development: How to Make Contracts for Fairer and More Sustainable Natural Resource Investments," IIED, pp. 3 https://lms-sdsn-new-infra.edcastcloud.com/asset-v1:sdsnedu+2379nr+february-2016+type@asset+block/Investment_contracts_and_sustainable_development.pdf

¹¹⁴ NRG(2015) Legal Framework: Navigating the Web of Laws and Contracts Governing the Extractive Industries, Policy Brief of Natural Resource Governance Institute https://lms-sdsn-new-infra.edcastcloud.com/asset-v1:sdsnedu+2379nr+february-2016+type@asset+block/Reader_-_Legal-Framework.pdf

Agreements, Mining Contracts, Mining Concessions and Community Development Agreements. Irrespective of their nomenclature, the contracts signed deal with the same kind of issues. with implications for domestic resource mobilization.

Regulatory regimes in the case studies vary between licensing and contracting. With their advanced legal framework, South Africa and Zambia have opted for licensing regimes. where the adopted pieces of legislation serve as a standalone tool for governing the sector. Licensing reduces the transaction costs of governing a multitude of projects with varied agreements. With a single legislative framework, the licensing regime brings consistency to the governance of the sector. Zambia has shifted to the statutory model with the adoption of its Mines and Minerals Development Act of 2015, which in section 160(1), annuls mineral development agreements entered into before the enforcement of the Act. The recently adopted Mines and Minerals Development Act of 2015 finally confirmed licensing as the primary governance regime for the sector. The new act did not mention contracts or agreements. Prior to its adoption, and following opposition by mining companies over proposed mining tax reforms, the Zambian authorities responded to an IMF Staff Report by stressing their strong commitment to do away with the mine-by-mine agreements as a governance instrument for the sector¹¹⁵.

However, the two remaining case-study countries apply contractual agreements in varied forms as part of the primary framework for governing the sector. The contracts are written in ways that take precedence, filling gaps in relatively less advanced legal and regulatory frameworks. For example, Article 10(1) of the Mining Act of Tanzania states that “the Minister may on behalf of the United Republic of Tanzania and subject to section (3), enter into a development agreement not inconsistent with the Act, with the holder, or applicant for the mineral rights, for which he is the licensing authority relating to the grant of such a mineral right or mineral rights, the conduct of mining license, the grant of the government free carried interest, and state participation in mining and financing of any mining operations under a special license.” Article 10(4) of the Mining Act also insists that the agreement entered into shall conform to the standard model as prescribed in the regulations and may contain provisions binding on the United Republic and the mineral right holder.

For most mineral-rich African countries, contracts remain a substitute for their weak legal and regulatory frameworks. While the ideal option is to move towards a licensing arrangement based on a country’s own legal and regulatory frameworks, which are aligned with the AMV, project-specific contracts remain the only viable approach in the short and medium term. The AMV therefore recommends more effective mining contract, including among other things, provisions on equitable sharing of revenues between host governments and mining companies.

However, unlike Tanzania, there are no specific provisions on the application of MDAs in the Mining Code of the Democratic Republic of the Congo. This loophole opens the way for discretion, which may be inconsistent with the state’s revenue mobilization objective. Contracts may significantly undervalue the mineral asset, robbing the state of much-needed revenues. For example, an African Progress Panel report which reviewed five concession agreements in the Democratic Republic of the Congo between 2010-2012 found that total losses from

¹¹⁵ IMF (2015) Zambia, IMF Country Report No. 15/152, the International Monetary Fund, Washington D.C.

undervaluation of assets almost equaled the combined budget for health and education in 2012.¹¹⁶ In fact, across the five contracts, assets were sold on average at one sixth of their estimated commercial value. The report reckons that assets valued at \$1.63 billion were sold to offshore companies for as low as \$275 million, with a beneficial ownership structure which remains unknown.

Agreements may also contain revenue mobilization inhibiting clauses. All three case-study countries using contractual arrangements include stability clauses, which freeze fiscal laws in time. For example, Article 10(4a) of the Tanzania Mining Act states that mineral agreements may contain binding provisions "... which guarantee the fiscal stability of a long term mining project, by reference to the law in force at the effective date of the agreement, with respect to the range and applicable rates of royalties, taxes, duties and levies and the manner in which liability in respect thereof is calculated and for that purpose and not otherwise, may contain special provisions relating to the payment of any such fiscal impost which shall take effect in the event of change in the applicable law."

The contract negotiating process may also include incentives for greater revenue resource mobilization. The Democratic Republic of the Congo includes "signing bonuses" as part of the finalization of mineral development agreements. The signing bonuses provide government with early revenue streams, before exploitation begins. However, there is no provision in the mining code detailing when the bonuses should be paid. Yet extracting agreed bonuses after the contract has been signed could be quite challenging and lead to costly litigation for the state. It was not clear from the case studies whether signature bonuses paid to state-owned mining companies end up in the public treasury in joint venture arrangements.

However, contract transparency remains a challenge in the case-study countries. Secrecy surrounding the signing bonuses underlines the ever-present risks of corruption. In 2012, the IMF cancelled the final instalments of a half-billion dollar loan program with Democratic Republic of the Congo after Gecamines, the state-owned mining company, failed to publish full details of the sale of a copper mine to Glencore Plc's Mutanda unit the previous year, breaching transparency conditions¹¹⁷. Furthermore, a report reviewing 62 contracts and annexes showed that key amendments were kept away from public scrutiny¹¹⁸.

Nevertheless, disclosure of contractual agreements is becoming increasingly expected by civil society organizations for the industry. The case-study countries revealed some encouraging examples of contract transparency. The Democratic Republic of the Congo passed a law requiring contract transparency in 2011, in the wake of criticism by the international community. As part of an EITI pilot project, "the Democratic Republic of the Congo is among the rare countries that have taken steps to disclose identities of beneficial owners— individuals who ultimately control or profit from a company."¹¹⁹ How these progressive disclosure steps

¹¹⁶ APP(2013) Equity in Extractives : Stewarding Africa's natural resources for all, Africa Progress Panel Report http://africaprogresspanel.org/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf

¹¹⁷ Bloomberg (2015) Gecamines Discloses Congo Mine-Permit Sale to Glencore Unit <http://www.bloomberg.com/news/articles/2015-06-29/congo-s-gecamines-discloses-deal-with-glencore-unit>

¹¹⁸ Carter Center (2015) Qui Cherche, ne Trouve Pas: Transparence des Projets Miniers en Republique Democratique du Congo, http://www.congomines.org/system/attachments/assets/000/000/718/original/Index_Transparence_-_Qui_cherche_ne_trouve_pas_2015-01-19_PDF.pdf?1436879901

¹¹⁹ Lintzer, M(2016) Shedding Light on Real Owners in DRC Mining Sector, <http://www.resourcegovernance.org/blog/shedding-light-real-owners-drc-mining-sector>

translate into action remains to be seen. On the recent 2015 Mo Ibrahim Governance Index, the Democratic Republic of the Congo showed the most improvement in overall access to information during 2011-2014. Over the same period, it also outpaced African countries in the domestic revenue mobilization category, albeit from a low base. In terms of reporting practices, the NRG Index ranks the case-study countries in the following order: Zambia, Tanzania, the Democratic Republic of the Congo and South Africa¹²⁰.

4.3 Exploitation

Mine development remains one of the most transaction-intensive stages in the mining value chain, with implications for illicit financial flows. The locus of transactions is at two levels: outbound and inbound (see figure 1). The exploitation and transfer of mineral ores, as well as the inbound movements of both tangible and intangible assets, create risks as well as opportunities for curbing DRM-inhibiting practices:

4.3.1 Thin capitalization

Methods of financing mining projects are influenced by business, as well as tax considerations. The proportion of debt and equity financing in the capital mix determines how efficient the project is, not only from an industry perspective, but also from a tax liability point of view. Since interest accruing from debts is deductible against tax liability, there is a strong preference for borrowing rather than raising capital through the sale of shares¹²¹. The financing arrangements may be structured in such a way that the interest is received in a jurisdiction that either does not tax the interest income or subjects such interest to a low tax rate. Often, mining companies lend to their affiliates at rates and levels that would normally be considered risky, even by industry standards¹²².

Mineral-rich African countries have formulated regulations to prevent excessive leveraging through the application of thin capitalization rules. Thin capitalization ratios enhance revenue mobilization and stock market development in resource-rich countries. One study estimates that in the presence of thin capitalization rules, one standard deviation increase in windfall revenues leads to an extra 0.35 per cent increase in resource tax revenue, compared to the case where thin capitalization requirements are not present.¹²³ Most mining codes have therefore included a 'safe harbor' of an allowable mix of debt and equity financing for a project. The rules place a ceiling on the maximum amount of debt on which deductible interest payments are allowed.

¹²⁰ <http://www.resourcegovernance.org/resource-governance-index/countries>

¹²¹ IMF (2012) Fiscal Regimes for Extractive Industries: Design and Implementation, <https://www.imf.org/external/np/pp/eng/2012/081512.pdf>

¹²² http://csimarket.com/Industry/industry_Financial_Strength_Ratios.php?ind=108

¹²³ Areki, R; Rota-Graziosi, G and Senbet, L (2014). Natural Resources and Capital Flight: A Role for Policy in Capital Flight from Africa: Causes, Effects, and Policy Issues edited by S. Ibi Ajayi, Léonce Ndikumana. Oxford University Press.

All four countries have adopted a ratio-based approach, expressed in the form of a predetermined proportion of debt to equity in the financing mix. While the range varies across case-study countries, with the exception of Tanzania (7:3), the debt-to-equity ratio is consistent with the average range on the continent of 2:1 to 3:1¹²⁴. The debt-to-equity ratios of the Democratic Republic of the Congo, Zambia and South Africa are 3:1, respectively.

The application of thin capitalization rules may lead to varied outcomes. No agreed international standard exists for determining an appropriate fixed ratio. However, when compared with the industry average debt-to-equity ratio of 0.85¹²⁵, the inflexible thin capitalization ratios appear misaligned with the arm's length range for the mining sector—apparently very excessive, with risks of illicit financial flows. A comparable mineral-rich country like Canada has a far lower thin capitalization ratio of 1.5:1¹²⁶. In an effort to reduce tax dodging by mining companies, Australia has recently tightened its thin capitalization requirements to 1.5:1¹²⁷. This suggests that, far from preventing tax base erosion, the safe-harbor provisions in the case-study countries may instead encourage tax avoidance through excessive leveraging by mining companies. Given the risk profile of the case-study countries, the debt level encouraged by their various pieces of legislation will appear risky and inefficient to the industry. In fact, debt should be a very expensive method of financing operations in these countries.

However, while the exact extent of front-loading debts remains unclear, it was reported during the case studies, that mining companies were relying on excessive leveraging to finance their operations. Yet looking at the evidence, the perceptions reveal a grey line between legal tax avoidance and illicit tax practices. Due to tax advantageous opportunities to borrow from their affiliates, mining companies are maximizing the generous thin-capitalization allowances in the laws to create internal mechanisms for financing their operations almost entirely from debts that will yield deductible interest—thereby minimizing their overall tax liability. One recent study of 76 multinational companies in Australia shows that companies were using illicit practices, including debt-loading, to cut their effective tax rate by almost half¹²⁸.

The case-study countries also lack effective anti-avoidance rules that could prevent thin-capitalization requirements from being abused. While all case-study countries have adopted a ratio-approach, none of them specifies the financial indicator to track the level of allowed leveraging—either average debt level or maximum debt level. The gap poses potential risks of parent companies artificially reducing the level of their domestic affiliate's financial indicators just before the reporting period, including calendar year or month, and then increasing them

¹²⁴ LexAfrica(2015), Guide to Mining in Africa 2015. Personal calculations <http://www.werksmans.com/wp-content/uploads/2015/03/LA-MINING-IN-AFRICA-GUIDE-WEB.pdf>

¹²⁵ http://csimarket.com/Industry/industry_Financial_Strength_Ratios.php?ind=108

¹²⁶ PwC (2013) Canadian Mining Taxation <https://www.pwc.com/ca/en/mining/publications/pwc-canadian-mining-taxation-2013-12-en.pdf>

¹²⁷ Financial Review(2016) Coalition targets tax dodging with thin cap rule change <http://www.afr.com/news/policy/tax/coalition-targets-taxdodging-with-thin-cap-rule-change-20160414-go6yor>

¹²⁸ McClure, et al(2016) Analysis of Tax Avoidance Strategies of Top Foreign Multinationals Operating in Australia: An Expose published by University of Technology Sydney <http://cdn.getup.org.au/1507-Aggressive-Tax-Avoidance-By-Top-Foreign-Multinationals.pdf>

immediately after the financial reporting period. The goal of the DRM-damaging practice is to avoid scrutiny from tax authorities.

While all case-study countries have thin capitalization ratios, with the exception of South Africa, none of them have adopted an earnings stripping approach. There is no limit to deductible interest as a percentage of earnings before tax. The lack of a referenced ratio of deductible interest on earnings may encourage excessive front-loading of debts. In January 2015, the South African Parliament approved legislation changing the thin capitalization rules, effectively limiting the interest deduction to 40 per cent of earnings before income tax depreciation and amortization (EBITDA)¹²⁹. South Africa also employs the earnings stripping approach for risk management, selecting potential thin capitalization cases for further transfer pricing audit.¹³⁰ The South African Revenue Service will consider transactions in which the debt-to-equity EBITDA of the South African taxpayer exceeds 3:1 to be of greater risk.

In addition, thin capitalization may lead to abusive transfer pricing where companies shift profits as untaxed interest deductions abroad to their lending affiliates in low-tax jurisdictions.

4.3.2 Royalties

Governments exercise their stewardship/ownership and fiscal roles by collecting royalties and taxes from mineral development. All case-study countries apply royalties, albeit at different levels. The rates vary by mineral, weight, volume, price and geology/cost.

Royalty rates applied by the case-study countries are consistent with the African average of 3-3.5 per cent¹³¹. None of the case-study countries applies a flat tax on production only, suggesting a strong preference for greater revenue mobilization over stability of public mining revenue. Most of the case-study countries apply ad valorem or sales-based royalties, which factor in changing market prices. This type of royalty instrument is commonly used in Africa. The rates for precious minerals and gemstones are relatively higher. For example, according to Article 240 of the Democratic Republic of the Congo Mining Code, the royalty rates applied include 0.5 per cent for iron and ferrous metals, 2 per cent for nonferrous metals, 2.5 per cent for precious metals, 4 per cent for precious stones, 1 per cent for industrial metals and 0 per cent for standard construction minerals. The value is based on product sales realized, less all costs. The newly adopted Mines and Minerals Act of Zambia¹³² charges mineral royalties based on geology/cost, mineral and price: 9 per cent for open cast mining operations and 6 per cent for underground mining operations. The amount is charged on the norm value for base metals/precious metals and on the gross value for gemstones or energy minerals. For industrial

¹²⁹ OECD and Country Measures to Combat Base Erosion and Profit Shifting: <http://www.bna.com/oecd-country-measures-n17179934459/>

¹³⁰ PwC(2013) South Africa Releases Draft Guidance on Thin Capitalization. African Tax Newsalert. <http://www.pwc.co.za/en/press-room/thin-cap-tax.html>

¹³¹ Gajigo et al (2012) Royalty Rates in African Mining Revisited: Evidence from Gold Mining, the African Development Bank, Africa Economic Brief, Vol 3, Issue 6

¹³² Before the adoption of the new royalty system, Zambia tried unsuccessfully to shift away from a dual royalty and corporate income tax system to a royalty only based system, with higher flat rates of open and underground mines. But due to opposition from the mining industry, the government had to rescind the regressive based only tax system.

minerals, the value is 6 per cent of the gross value of the minerals produced or recoverable under license.

The Mining Act of 2010 instituted the gross value method for exports, which eliminates the possibility of using transfer pricing to overstate costs deductible for royalties, such as transportation costs. Royalties were also revised to 4 per cent from 3 per cent for gold and other metallic minerals. Royalties are assessed on a provisional basis at the time of export by calculating 90 per cent of 4 per cent of the spot value of metals, with the final royalty being assessed once the metal is sold. However, the 90 per cent is an arbitrary amount agreed upon with mining companies, which is intended to reflect smelting and refining losses and transport and other costs deductible from the royalty base “and to ensure the provisional royalty is most likely an underpayment” (Muganyizi 2012, 28)¹³³.

Only South Africa applies a profit-based royalty. South Africa introduced royalties in 2008, following the spectacular rise in commodity prices. The profit-adjusted model ensures greater opportunities for maximizing domestic resources, especially during upturns in commodity prices. South African royalty assessment is based on the profits of the entire mining operation up to the point of first sale. The formula adopted is sophisticated and includes profit-sensitive variables, such as earnings before interest and tax (EBIT) and gross sale value. The royalty calculation is also adjusted for the extent of value addition, with varying allowances for refined and non-refined minerals. In the case of refined minerals, the royalty rates range from 0.5 per cent up to a maximum of 5 per cent, while the minimum royalty rate for unrefined minerals is 0.5 per cent and the maximum is 7 per cent.

Discussions with stakeholders underscore the need for more efficient approaches for collecting royalties. While implementation capacity significantly influences the choice of instrument, the limited use of profit-based models suggests missed opportunities for mobilizing greater domestic revenues from the mineral sector in Africa. Given that royalties constitute the most stable, predictable component of government revenues in the case-study countries, implementing royalty reforms would make it possible to capture a greater share of rents available for structural transformation and economic diversification.

Encouraging examples are emerging from the continent. For example, in 2010, Burkina Faso instituted sliding-scale ad valorem royalty rates that are indexed to gold prices. Specifically, the minimum royalty rate is 3 per cent (ad valorem), which increases to 4 per cent when gold prices are between \$1,000/ounce and \$1,300/ounce, and further to 5 per cent when prices exceed \$1,300/ounce¹³⁴.

Against the depressed market conditions, the scope for mineral-rich Africa to review royalty rates continues to exist. While there are certainly fears of further scaring increasingly hard-to-attract investors with upwardly revised rates,¹³⁵ the relatively low royalty rates, which were set long ago by international financial institutions as a way of attracting investment,¹³⁶ appear not

¹³³Muganyizi, Tonedeus K. 2012. Mining Sector Taxation In Tanzania. International Centre for Tax and Development Research Report 1. Brighton: Institute of Development Studies.

¹³⁴ DLA Piper. (2012). *MINING IN AFRICA: A legal overview*. DLA Piper Law Firm

¹³⁵ E&Y (2015) Business risks facing mining and metals 2015–2016: Moving from the back seat to the driver's seat

[http://www.ey.com/Publication/vwLUAssets/EY-business-risks-in-mining-and-metals-2015-2016/\\$FILE/EY-business-risks-in-mining-and-metals-2015-2016.pdf](http://www.ey.com/Publication/vwLUAssets/EY-business-risks-in-mining-and-metals-2015-2016/$FILE/EY-business-risks-in-mining-and-metals-2015-2016.pdf)

¹³⁶ Otto et al (2006) Mining Royalties: A Global Study of their Impact on Investors, Government and Civil Society, World Bank, Washington DC

to have translated into increased tax revenues for governments in Africa. Even with the recent surge in commodity prices, resource taxes, including royalties, fell from 41 per cent in 1980 to 37.1 per cent of overall tax revenues in 2010¹³⁷. It is unclear whether this suggests broadening of the tax base or indicates failure of countries to properly tax their resource sector¹³⁸.

Far from ‘racing to the bottom’ to attract investors by cutting rates, there is an empirical case for countries to, at a minimum, maintain current royalty rates, or at best, even raise them. A study of gold-producing countries in Africa, (Gajigo et al, 2012), through a multiple regression analysis, shows that an increase in royalty rates has little impact on the profitability of the surveyed gold mines. In fact, the relationship is insignificant, even when controlled for location-specific effects like grade and year.

Furthermore, even when increased royalty is modelled against unit production cost, the relationship remains flat, albeit slightly negative, but with no statistical significance. The most significant impact on cost was mine grade quality, underscoring the influence of geology and geological information. Other recent studies have also emphasized the influence of geology as decisive in attracting investors, rather than the policy environment including tax rates¹³⁹. The influential Fraser Institute reports that, based on the perceptions of business executives, only 3.5 per cent of mining companies will not invest in Africa due to tax regimes¹⁴⁰.

However, increasing rates requires an increase in geological information and financial modelling. Many countries lack the knowledge infrastructure to adjust their fiscal regimes in ways that optimize domestic revenue mobilization from minerals. Some African countries have exercised fiscal sovereignty over their mineral resources, albeit with mixed results. The recent boom saw a wave of reviews of unsustainable fiscal regimes in the sector¹⁴¹. Three of the case-study countries have attempted to revise their fiscal regimes, with varying degrees of success. For example, Zambia was able to secure greater fiscal policy space. Since annulling its constraining development agreement regime, the government of Zambia has steadily revised its royalty rates, with mixed results— from 3 per cent in 2008, to 6 per cent in 2012, and to 8 and 20 per cent (on copper from underground and open-cast mines, respectively) in January 2015— before being revised to 9 per cent in July 2015¹⁴². In South Africa, the Davis Tax Committee, established by the Treasury, also recommended that the government revise its gold mining tax regime upwards, but in a manner that would not jeopardize jobs in the industry¹⁴³.

Table: 4.1 Mining fiscal regimes in selected countries.

Country	Royalty rate applicable to copper %	Corporate income tax
Chile	0-14	20:42
Democratic Republic of Congo	2	30
Indonesia	4	25
Zambia	9 open cast, 6 underground	30 plus variable income tax
South Africa	-	28

Source: country mining codes and FAD database

¹³⁷ Mario Mansour (2010) A Tax Revenue Dataset for Sub-Saharan Africa: 1980-2010*

¹³⁸ Mario Mansour (2010) A Tax Revenue Dataset for Sub-Saharan Africa: 1980-2010*

¹³⁹ Jackson, T & Green, K (2016) The Fraser Institute Annual Survey of Mining Companies 2015

¹⁴⁰ Fraser Institute (2011), Mining Companies, 2005/6 to 2010/2011

¹⁴¹ Stürmer, M. 2010. “Let the good times roll? Raising tax revenues from the extractive sector in sub-Saharan Africa during the commodity price boom”, German Development Institute Discussion Paper

¹⁴² World Bank (2015) Making Mining Work for Zambia: The Economic, Health, and Environmental Nexus of Zambia’s Copper Mining Economy, Zambia Economic Brief, Issue 5

¹⁴³ Reuters(2015) South Africa tax team against windfall taxes in mining sector
<http://af.reuters.com/article/investingNews/idAFKCNQI16A20150813>

4.3.3 Corporate income tax

As a share of all revenues collected, corporate income tax is more important to developing countries (15 per cent) than developed countries (9 per cent)¹⁴⁴. However, when it comes to mining in Africa, the picture appears a little different. It is unclear why corporate income tax in mineral-rich countries has remained relatively stable in the continent, even over a period of sustained commodity price booms. The average corporate income tax rate applied in the African mining sector is about 32 per cent higher than the world average. However, governments have often decreased the rate at which profits are taxed and increased the number of tax exemptions granted to mining companies (AfDB, 2010d)¹⁴⁵. The trend continues, even in the face of evidence pointing in the opposite direction. Contrary to the assumption that tax incentives encourage investment, studies have shown that fiscal considerations are secondary when it comes to making investment decisions in the mining sector¹⁴⁶.

However, mineral-rich African countries have applied a range of tax-base-eroding practices, including exemptions and deductions. All case studies include specific provisions exempting or reducing taxes on particular activities and items. For example, prospecting in Zambia brings income tax deductions on the following expenditures; capital expenditure - allowances of 25 per cent on plant, machinery and commercial vehicle, 20 per cent on non-commercial vehicles and 5 per cent on industrial buildings; prospecting expenditure under special circumstances; mining expenditure under special circumstances; mining expenditure on a non-producing mine; mining expenses incurred by a mine of irregular production close to the end of its life.¹⁴⁷

In Tanzania, the law provides for the cost of all capital equipment (such as machinery or property) incurred in a mining operation to be offset against taxable income. Non-mining companies are entitled to a 100 per cent depreciation allowance only for the first five years of operations. On the other hand, in South Africa, mining companies are able to deduct 100 per cent of many of their capital expenditures against tax, while gold mining companies pay a corporate tax rate based on a formula that keeps government remittances low.

In South Africa, gold mining taxable income is derived from a formula based on the profit-revenue ratio. As profits rise, the state takes a larger proportion in tax; if the company makes no profits (or low profits at around 5 per cent of revenues), the state receives no tax, although shareholders can still receive dividends.¹⁴⁸ For example, companies with a profit-revenue ratio of 15 per cent paid 30 per cent corporate tax in 2005; those with a 30 per cent ratio paid 37.5 per cent corporate tax.¹⁴⁹ Gold mining companies can elect to be taxed with or without paying the secondary tax on companies (STC); the basic tax rate for gold mining companies in 2008 is up to 34 per cent for those paying the STC and up to 43 per cent for those electing to be

¹⁴⁴ International Monetary Fund (2014), IMF Policy Paper: Spillovers in International Corporate

¹⁴⁵ AfDB. (2010d). *African Economic Report*. African Development Bank, United Nations Economic Commission for Africa and OECD.

¹⁴⁶ *ibid*

¹⁴⁷ Available at: <http://zambiamining.com/tax-regime-incentives/> Accessed on 7th January 2015

¹⁴⁸ Chamber of Mines of South Africa, 'Note on mining taxation in South Africa: A presentation by Mzolisi Diliza', 2 June 2008, www.bullion.org.za

¹⁴⁹ Foreign investment advisory service, Sector study of the effective tax burden: South Africa, April 2006, p.33

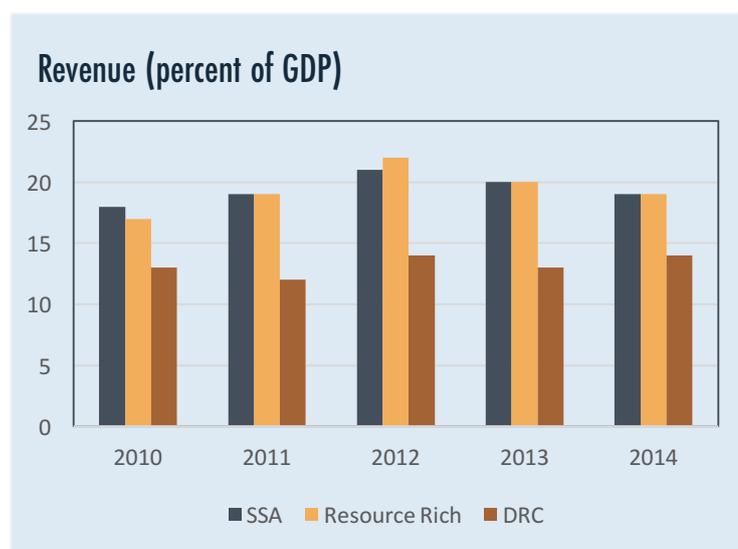
exempt.¹⁵⁰ With the proposed abolition of the STC in 2009, the 43 per cent option will be discontinued.¹⁵¹

However, the possibility of offsetting a wide range of generous capital allowances against taxable income undermines domestic resource mobilization in the sector. In some case-study countries, there were reports of mining companies perpetually declaring losses in ways that enable them to minimize their tax liability or avoid paying corporate income tax at all. Despite the strong contribution of the mining sector to real

GDP growth in the Democratic Republic of the Congo, the IMF reckons that government tax revenues from the sector, were only 3.8 per cent of GDP in 2012, reflecting the generous exemptions in the country's mining code.¹⁵² In fact, the sector has yet to contribute its fair share to government revenues. With taxes constituting 14 per cent of its gross domestic product, the Democratic Republic of the Congo collects one of the lowest amounts of taxes, even lower than the continental average and resource-rich countries (see box 2). In Tanzania, the IMF also observes that, while gold exports increased from around \$500 million to \$1.5 billion over the 2007-2011 period, government revenues remained flat at about \$100 million a year. The report attributed this stagnation to generous provisions including corporate income tax holidays for mining companies. In fact, 'none of the existing gold projects have paid material income tax to date'.¹⁵³ The IMF projects that as a consequence of tax incentives, there is no likelihood of any increase in mining revenues in the near future. An analysis of Zambian mining tax revenue over the years 1998 to 2012 shows that without generous tax exemptions and other leakages, tax authorities would have collected an additional \$1.6 billion yearly from the sector, representing about 3.7 per cent of the GDP¹⁵⁴.

However, some countries have put measures in place to protect their tax base. For example, in 2008, Zambia introduced the Alternative Minimum Tax of 0.3 per cent of turnover, payable when companies declare three consecutive years of tax losses. However, it is likely that revenues from this tax are far lower than the losses caused by the capital allowance.¹⁵⁵

Figure 4.2 Average tax revenues as a percentage of GDP across mineral-rich and resource-poor countries in Africa



Source: IMF (2015)

¹⁵⁰ National Treasury, Media statement, 20 February 2008, www.treasury.gov.za

¹⁵¹ National Treasury, Media statement, 20 February 2008, www.treasury.gov.za

¹⁵² IMF (2015) Democratic Republic of The Congo, Staff Country Report NO 15/280, The International Monetary Fund, Washington D.C

¹⁵³ IMF (2011) United Republic of Tanzania, Staff Report for the 2011 Article IV Consultation and Second Review under the Policy Support Instrument, 21 April 2011, p.17

¹⁵⁴ Simpasa et al (2012) Capturing Mineral Revenue in Zambia: Past Trends and Future Prospects, United Nations Development Programme, New York.

¹⁵⁵ Tax Justice Network, ActionAid International and Policy Forum. 2012. Tax Competition in East Africa. A race to the bottom? Tax Incentives and Revenue Losses in Tanzania, at page 16.

Tanzania has ring-fencing provisions whereby capital expenditure related to a mine is restricted to the taxable income of that mine and cannot be incorporated with other mines owned by the same company. The law, however, gives the Minister of Finance limited discretion to rule that corporate costs can be offset against another mine, although mining companies can then only transfer up to 25 per cent of the capital exemption from unprofitable mines to offset income from profitable mines.¹⁵⁶ In Tanzania, there is a limit on local government taxes of up to \$200,000 a year, which is nonetheless lower than the 0.3 per cent of turnover required by law.¹⁵⁷ In the Democratic Republic of the Congo some of the generous incentives granted to companies, like accelerated amortization, have started expiring, providing an opportunity for greater domestic resource mobilization, through corporate income taxes.

Progressivity remains a core principle for designing effective tax instruments to enhance resource mobilization in the sector. However, its application remains suboptimal. The use of resource rent taxation is increasing, notably in the petroleum and mining sectors¹⁵⁸. Some African countries have made efforts to strengthen their fiscal regimes to gradually adjust to changing business conditions, particularly the profitability of mining companies. 'It is generally recognized that an RRT has the advantage of having a neutral impact on investment decisions'¹⁵⁹. However, none of the case-study countries applies an excess profit tax. Zambia has vacillated with windfall tax reforms, which were first introduced in 2008 in the Mineral and Mines Act and then later annulled in the face of opposition from the mining industry. However, Zambia also applies a variable income tax for mining companies, where rates increase with the ratio of taxable income (see box 2). The Davis Commission in South Africa has advised against additional tax instruments, such as a windfall tax, for the country's mining sector¹⁶⁰.

4.3.4 Indirect taxes

The Value Added Tax (VAT) is a principal source of indirect government tax revenue in Africa, including mineral-rich countries. As a transaction tax, it allows governments to capture value addition along the mining value chain. However, it is vulnerable to leakages, with implications for domestic revenue mobilization. The average VAT rate across the case-study countries is 15 per cent, which is consistent with the continental average.

However, since VAT is a tax on domestic consumption, mining companies can claim a refund on their exported raw and unrefined minerals. For countries that operate an invoice system, there may be abuse, whereby mining companies can claim VAT refunds for goods that were not exported. For example, in Zambia, taxpayers credit the VAT paid on their purchases against the VAT charged on their sales, transferring the net balance to the tax authority. If the balance is negative, then they can claim a refund. However, the system is abused. There were reports

¹⁵⁶ Chamber of Mines of South Africa, 'Note on mining taxation in South Africa: A presentation by Mzolisi Diliza', 2 June 2008, www.bullion.org.za

¹⁵⁷ Tax Justice Network, ActionAid International and Policy Forum. 2012. Tax Competition in East Africa. A race to the bottom? Tax Incentives and Revenue Losses in Tanzania, at page 7.

¹⁵⁸ IMF (2012) Fiscal Regimes for Extractive Industries: Design and Implementation, International Monetary Fund, Washington D.C <https://www.imf.org/external/np/pp/eng/2012/081512.pdf>

¹⁵⁹ UNECA(2011) Minerals and Africa's Development: The International Study Group Report on Africa's Mineral Regimes, United Nations Economic Commission for Africa, Addis Ababa, Ethiopia, pg 94

¹⁶⁰ <http://af.reuters.com/article/investingNews/idAFKCN0Q116A20150813>

of mining companies claiming VAT on equipment that was purchased tax-free, as per individual mineral development agreements. In fact, a World Bank report estimates the outstanding claims¹⁶¹ by mining companies from the government of Zambia at over K5.7 billion, close to 3.7 per cent of the GDP¹⁶². Given the magnitude of VAT leakages, the government has taken measures to reform the VAT rules, including stringent requirements. According to the amended VAT Rule 18, exporters are required to provide documentary evidence proving that payment of goods has been made by the customer into the exporter bank account in Zambia. The government also started enforcing the requirement for copies of import documents, including the certificate of importation into the country of destination provided by customs authorities.

Mining companies also enjoy special exemptions, which may account for significant lost revenues for governments. Mining companies, however, are exempted from the VAT charge on imports in Tanzania. According to the Value Added Tax, Cap 148. Paragraph 11 “The importation by or supply to a registered licensed exploration, prospecting, mineral assaying, drilling or mining company, of goods which if imported would be eligible for relief from duty under Customs Laws, and services for exclusive use in exploration, prospecting, drilling or mining activities”. Under Zambian law, a holder of a mining right is exempt from customs, excise and VAT duties in respect of all machinery and equipment required for exploration or mining activities.¹⁶³ In Tanzania, there is zero import duty on fuel – compared to the standard current levy of TShs 200 per liter. A presidential commission that was set up in Tanzania reported that mining companies had made claims for a government refund related to their fuel levy exemptions of over \$274 million¹⁶⁴

4.3.5 Transfer pricing

The exploitation and development of minerals is a transaction-intensive stage of the mining value chain, with significant implications for transfer pricing. The outbound trade of minerals, as well as the inbound supply of corporate services and goods to mine operations, frequently involves trade among related parties, with risks of transfer mispricing. Companies often fragment the supply chain of their mining operations in a way that is not only economically efficient, but also allows them to minimize their tax liabilities. Mining companies take advantage of complex cross-border structures designed to shift profits across a number of subsidiary entities resident in other generally low-tax jurisdictions¹⁶⁵.

As a management accounting tool, transfer pricing remains an important business practice and legal guide for intra-company trade. It represents the adjusted arm’s length or competitive price

¹⁶¹ The amount includes claims that were a result of delay treatment of genuine VAT refunds.

¹⁶³ Available at: <http://zambiamining.com/tax-regime-incentives/> Accessed on 7th January 2015

¹⁶⁴ Action Aid (2012) Revenue losses owing to tax incentives in the mining sector: policy recommendations, policy brief http://www.policyforum-tz.org/sites/default/files/rtbbriefonmining_0.pdf

¹⁶⁵ Guj et al (2015) Transfer Pricing in Mining: An African Perspective, Interim Information Report, World Bank <http://im4dc.org/wp-content/uploads/2013/07/Transfer-pricing-in-mining-An-African-perspective-A-briefing-note1.pdf>

for which one subsidiary or upstream division of a mining company sells outbound or purchases inbound goods and services from another subsidiary or downstream division. The goods and services include tangible components like mineral ores, machinery and labor. Transfer pricing may also involve intra-company trade in intangibles like intellectual property rights and brand marketing. However, the application of arm's length pricing by mining companies is not an exact science and may yield mixed results. Small mispricing risks may cumulate into significant revenue losses for the tax administration. The risks of mispricing occur when related parties underpay for outbound sales of mineral products and overcharge for inbound services and goods supplied to the mines. Transfer mispricing occurs within the context of related party transactions that may have implication on tax liability and income, including thin capitalization, treaty shopping and exchange controls.

Tax policies and laws remain crucial for allowing the tax administration to identify and address risks of transfer mispricing. While progress has been made, the quality of fiscal regimes in the case-study countries in particular their ability to address abusive transfer mispricing vary both in form and substance. All case-study countries have some sort of legislation in place to address transfer pricing. The legislative frameworks adopted are based on the OECD Guidelines for Multinational Enterprises¹⁶⁶ and Tax Administrations and the United Nations Practical Manual on Transfer Pricing for Developing Countries¹⁶⁷. Although case-study countries rely on both frameworks as primary reference documents, none specify which guidance document should be used in case of inconsistency. For example, the Tanzanian Transfer Pricing regulation, section (2.0) states 'the underlying principle adopted in the guideline has its basis... in the country's tax statutes and the OECD/United Nations guidelines.' However, it is silent on which guidance framework should take precedence in case of conflicts, leading to uncertainty, as both guidance documents differ in certain aspects.

As a consequence, the arm's length principle embodied in both standards is included in the provisions of all case-study countries as the internationally accepted framework for regulating related parties' transactions in the mining value chain. The arm's length principle aims to preserve the neutrality between multinational companies and independent operations, as well as define the tax base upon which countries can exercise their primary taxing right¹⁶⁸. Article 9 of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the OECD Model Tax Convention on Income and Capital both define the arm's length principle as an "international standard that compares the transfer prices charged between related entities with the price of similar transactions carried out between independent entities at arm's length. An adjustment may be made to the extent that profits of a related party differ from those that would be agreed between independent entities in similar circumstances." In Tanzania, Section 33 of the Income Tax Act requires that any arrangement between related parties must be conducted at arm's length. While the income tax regulations remain the primary instrument for regulating transfer pricing, some countries have gone one step further to include the arm's length principle in their mining codes. For example, the arm's length principle of the

¹⁶⁶ <http://www.oecd.org/publications/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm>

¹⁶⁷ http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf

¹⁶⁸ IMF(2014) Spillovers In International Corporate Taxation, IMF Policy Paper.

Zambian Income Tax Act is cross-referenced in Section 89(4) of the new Mines and Minerals Development Act of 2015. The South African Minerals and Petroleum Resources Royalty Bill 2008, subsections (1c) and (2c) states that “transfers arising from exports or consumption, theft, destruction or loss require a hypothetical arm’s length price determination. This arm’s length price will be the hypothetical price that would have been obtained if the mineral resource had been disposed of in the specified condition”.

4.3.5.1 Transfer pricing methods

It appears there is no clear preference for any of the different methods for determining transfer pricing. The absence of preference may give rise to disputes, as transfer pricing determination may involve a range of methods imposing different capacity requirements on tax administration. Some countries suggest a sort of hierarchy of the six Transfer Pricing Methods explained in the previous section. While other regulations indicate no preference, Tanzania for example, recommends traditional methods like the Comparable Uncontrolled Price, Resale Price and Cost Plus methods as preferred methodologies for determining the arm’s length price. The regulation notes that the Transaction Profit Method may be used only when the traditional methods cannot be relied upon or applied at all. There is no methodological preference in the transfer pricing legislation in the Democratic Republic of the Congo and Zambia.

The scope and effectiveness of transfer pricing legislation differ as well. While all the case-study countries have basic legislation in place, many have yet to formulate specific but complementary regulatory guidance documents. The Democratic Republic of the Congo recently introduced a transfer pricing provision in Law No. 004/2003 of March 13, 2003 reforming tax procedures. However, there are no specific guidelines to date for determining transfer pricing positions of multinational companies. However, South Africa, Tanzania and Zambia have adopted specific guidelines for transfer pricing which place the burden of proof on mining companies through mandatory requirements for documentation on their transfer pricing position. While the Democratic Republic of the Congo does not yet have specific guidelines, there is a provision for documentation requirements. Under the provision, companies established in the Democratic Republic of the Congo that are under the control, in law or in fact, of companies or groups of companies located abroad must hold at the disposal of the Tax Administration documentation justifying their pricing policy in the context of transactions of any kind carried out with these companies. None of the case-study countries include provisions for the tax administration to continuously review and update criteria for documentation submitted, particularly that reflecting the constantly changing practices adopted by mining companies. This means that regulations may likely continue to lag behind mispricing practices, with risks of significant leakages through information asymmetry. The statutes of limitation for keeping contemporaneous documentation to justify transfer pricing position ranges from 3 to 6 years in the case-study countries.

Definitions of related parties differ - some are more restrictive, while others are broader. The definition of related parties includes minimum shareholding of 50 per cent in Tanzania, or 20 per cent in South Africa. Related parties are also defined by other factors like financial aspects, which are also vulnerable to risks of abuse. For example, the Zambian Income Tax Act extends the definition of related parties to include both direct and indirect participation in the

management, control or capital of the other party. While transfer pricing is a completely domestic legislative framework, most case-study countries have limited their legislations solely to cross-border transactions, ignoring transfer pricing positions between related domestic affiliates, with significant mispricing risks.

4.3.5.2 Anti-avoidance provisions

Anti-avoidance provisions which are too generic and generous may undermine the application of the arm's length principle. All case-study countries have 'safe harbor' rules for a defined category of sectors and taxpayers, including mining companies. The rules also target specific transactions like financing. Safe harbor rules generally aim to encourage investment, reduce compliance cost for tax administration and ensure stability for mining company investment¹⁶⁹. Thin capitalization rules, with their pre-determined ratios, serve as a safe harbor for determining excessive transfer pricing positions, especially if they are aimed at related party transactions. However, the pre-determined equity-to-debt proportions adopted in the case studies are mining sector-specific.

However, thin capitalization rules left outside the scope of transfer pricing regulations may carry risks of illicit financial flows. It remains unclear whether the fixed ratios adopted in most case-study countries, apply to the overall debt incurred by mining companies with unrelated parties or include lending between affiliates. However, the blanket sector-based thin capitalization rules adopted in case-study countries remain inflexible, with significant risks of revenue leakages. The absence of a needs test may trigger excessive leveraging by mining companies in order to maximize the generous allowance. In fact, it is unclear how effectively the strategies in place can evaluate, monitor and curb abusive debt-induced transfer pricing positions adopted by mining companies. The already very generous finance mix means that companies may be encouraged to incur more debt than usual and purposefully misprice the interest charged for intra-company transactions within defined 'safe harbor' zones. The ring-fenced transactions would likely avoid scrutiny from tax authorities— a significant risk of tax base erosion.

However, South Africa has taken steps to integrate its thin capitalization requirements into its transfer pricing regulations. Thin capitalization rules are only applicable for companies whose assessments date before April 2012. The safe harbor 3:1 debt-equity ratio does not apply to companies established after the tax period. For these companies thin capitalization is dealt with under the general transfer pricing provisions contained in the Income Tax Act (section 31(2))¹⁷⁰. In fact, a South African mining company receiving inbound financial assistance from a foreign related party is required to demonstrate that it could have secured the financial assistance in an arm's length manner. The transfer pricing position in excess of the arm's length interest determined by the tax authority will be disallowed and be deemed to be a loan to the funder.

¹⁶⁹ OECD(2013). Revised Section E On Safe Harbours In Chapter IV of the Transfer Pricing Guidelines, Organization of Economic Cooperation and Development, Paris

¹⁷⁰ Deloitte(2014). M&A Tax Guide— sub-Saharan Africa. Deloitte Development LLC.

Furthermore, stabilization clauses in mining contracts and exemptions may also prevent the application of the arm's length principle on potentially mispriced transactions. For example, due to stability clauses in Article 276 of the Democratic Republic of the Congo Mining Code of 2002, the application of the recently adopted transfer pricing requirements will only come into force on existing mining projects 10 years after the implementation of the new law. In fact, the IMF has described the Democratic Republic of the Congo Mining Code, including its stability requirements, as overly 'generous'¹⁷¹. Meanwhile, a Tax Appeal Tribunal in Tanzania recently found Acacia Mining, a subsidiary of the Barrick Gold Corp, guilty of a "sophisticated tax evasion scheme" which included transfer mispricing and generated losses¹⁷². The company has been ordered to pay the Government of Tanzania about \$41.25 million in unpaid taxes over four years. As part of its defense, Acacia argued that the contractual obligation it signed with the government provided for deductions of its \$3billion capital investment in the three mines operated in the country, leading it to consistently declare no profits¹⁷³.

Stringency of regulations varies too. It seems that the absence of a working definition of IFFs makes it difficult for countries to adopt standalone, stringent transfer pricing regulations—despite the magnitude and disproportionate impact of transfer mispricing on mineral-rich countries. Most case-study countries rely on the general provisions of their income tax act for applicable penalties. Only Tanzanian Income Tax Acts provides for specific, stringent penalties for abuse of transfer pricing legislation. The country's regulations impose harsh penalties for noncompliance. Abuse of the arm's length principle incurs a penalty equal to 100 per cent of the tax underpayment. Additionally, a taxpayer that fails to prepare and maintain transfer pricing documentation commits an offense and is liable on conviction to imprisonment for a term not exceeding six months or a fine not less than TZS 50 million, or both. In Zambia, transfer mispricing tax penalties also include imprisonment not exceeding 12 months and a fine of 17.5 per cent to 35 per cent of incorrect returns. With the exception of Tanzania, the penalties imposed by South Africa and Zambia are far lower than those of comparable mining countries like Chile and Australia, where fines average about 40- 50 per cent plus interest for transfer mispricing arrangements aimed at evading or minimizing tax liabilities.

4.3.5.3 Dispute settlement

There seems to be a shift towards cooperative arrangements as a way of better addressing the complexities of transfer pricing issues, albeit very weak. With the exception of Tanzania, none of the case-study countries include provisions for Advance Pricing Arrangements (APA). According to the Tanzanian Income Tax Regulation of 2014, taxpayers that wish to enter into an APA may apply to the commissioner, providing specific information pertaining to the controlled transactions and proposed transfer prices. The commissioner can accept, reject, or

¹⁷¹ IMF(2015) Democratic Republic of The Congo, Staff Country Report NO 15/280, The International Monetary Fund, Washington D.C pg 20

¹⁷² African Barrick Gold PLC versus Commissioner General, TAX APPEAL NO. 16 OF 2015. Appeal from the judgment of the Tax Revenue Appeals Board in Tax Appeal No. 22 of 2011 (Fikirini, VC) dated 15th May 2011]

¹⁷³ <http://www.theglobeandmail.com/report-on-business/international-business/african-and-mideast-business/barrick-gold-subsi-dary-evaded-tanzanian-taxes-tribunal-rules/article29533858/>

modify the proposal. If accepted, the APA will be in force for a period not exceeding five years. The APA is a forward-looking mechanism promoting collaboration between mining companies and the tax administration to address sticky issues, including transfer pricing adjustments and the use of methodologies and comparables to confirm the arm's length principle in advance. As global tax transparency increases, including the power of tax administrations, mining companies will more and more seek cooperative arrangements, like APA, that could supplement existing administrative and judicial mechanisms¹⁷⁴. Successful APA negotiation requires strong domestic capacity, which remains a critical constraint in Africa, including the case-study countries.

4.3.5.4 Comparables

The application of transfer pricing rules represents a major challenge for African countries, with very high risks of manipulation by mining companies along the mining value chain. The application of the arm's length principle is complex, and remains more an art than a science. According to the arm's length principle, the pricing of uncontrolled transactions should be benchmarked with comparable market prices. But in practice, this is not always the case. All the case-study countries face problems with comparables. Officials interviewed in the case-study countries noted that the problem was particularly acute for the mineral sector. For some inputs used in drilling and mining, there may not be domestic comparables to track illicit transfer pricing practices. There were no databases containing country-specific comparables, in general, and those of the minerals sector. As a result, most countries rely on foreign databases to establish their arm's length prices or the taxable profits of intragroup transactions. Capacity limitation has encouraged countries to explore alternative, complementary options. It was reported that the South African Revenue Service favors a more holistic approach to establish arm's length pricing. Among the favored approaches is analyzing the value chain and business model to map out drivers of value creation, including centers of profits, costs, risks, expenditure and investment. This will enable the authorities to more effectively separate economic substance from form, which is key to protecting the tax base.

It should be noted that implementing transfer pricing rules in the mineral sector is more challenging than in the oil and gas sector. Unlike crude oil, unrefined mineral production varies considerably in quality across countries, and even project areas. All the case studies use benchmark prices for outbound mineral sales, which may vary in quality. Valuation becomes even more difficult due to the lack of comparables for benchmarking the adjusted transfer prices. Even when average prices are used, the risks of manipulation by companies are high. Some minerals may be developed at the same time and not even declared to the tax authorities, in addition to being sold to affiliates at non-arm's length prices. In the absence of a standard benchmark for determining value for gemstones, intra- group pricing may manipulate transactions in a way that is inconsistent with the arm's length principle. Even when alternatives

¹⁷⁴ Chung et al (2016) Global APA Programmes: Get Ready to Apply BEPS Guidance Prospectively, International Tax Review, No 107, Deloitte.

to guard against non-arm's length transactions exist, such as physical inspection, tax authorities may not even have the proper technical expertise to assess the quality of the stone.

4.3.5.5 Management fees and procurement of capital goods

Management fees are an important expenditure item of a typical mining company, with significant implications for transfer mispricing risks. Given mining's major contribution to GDP, mining operations in the case-study countries involve a substantial amount of consumables, including management and engineering services. For most of the case-study countries, these services are provided by affiliates, given the integrated nature of mining operations. For a typical copper mine, common in all case-study countries, management fees may amount to about 11 per cent of capital expenditure (CAPEX)¹⁷⁵. Given the capital-intensive nature of mining operations, the amount of money spent is significant. Since the management fees are collected directly from earnings before tax, small mispricing charges may contribute significantly to tax base erosion.

Excessive management fees remain a major revenue loophole in mineral-rich countries. According to a survey of tax administrators in developing countries, including Africa, 58 per cent identified management and technical service fees as a top transfer pricing enforcement issue¹⁷⁶. Lack of control data for undertaking transfer pricing adjustments makes it even more difficult to apply the arm's length principle against potential abuses. Most of the tax administrations lack even basic capacity to determine whether services provided by the parent company have economic substance or benefit, or whether the service is unique and not a duplication of what the host company is already doing. The economic benefit of the service provided often cannot be measured in actual monetary terms, with the result that tax authorities have to rely on the information and commercial judgement provided by the recipient subsidiary or affiliated mining company. It was mentioned in Zambia that some parent companies even charged fees for the services provided by mine employees who are already drawing a salary for the same services.

In addition, purchases of fixed assets constitute another expenditure area with significant risks of transfer mispricing. Mining operations are capital-intensive, with procurement often centralized in the parent company or an affiliate located in a low-tax jurisdiction. It was difficult to get exact figures from the case-study countries on the extent of transfer mispricing through the purchase of equipment. However, anecdotal evidence indicates its significance. A typical copper mining operation's equipment purchases may average almost 45 per cent of capital

¹⁷⁵ Guj, P; Maybee, B; Cawood, F; Cooper, J, Gosai, N and Huibregtse, S (2015). Interim Information Report on Transfer Pricing a in Mining: An African Perspective. International Mining for Development Center <http://im4dc.org/wp-content/uploads/2013/07/Transfer-pricing-in-mining-An-African-perspective-A-briefing-note1.pdf>

¹⁷⁶ OECD(2014). Transfer Pricing Comparability Data and Developing Countries <https://www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.pdf>

expenditure¹⁷⁷. The parent company may also buy underutilized machinery from subsidiaries, which it later sells to other subsidiaries in Africa. However, assessment of the remaining useful life value of second-hand equipment is subjective and often based on the judgement of the parent company. Furthermore, the interest and loans paid for the second-hand equipment go directly to the parent company and are tax deductible. There were reports in Zambia of a parent company located abroad in countries with double taxation agreements, meaning that no withholding taxes were paid to Zambia.

4.3.5.6 Tax administration capacity building

The capacity to implement transfer pricing regulations remains a critical and binding constraint in resource-rich African countries. Design and compliance gaps are often reinforced like a vicious cycle. Compliance weaknesses are broad and specific along the entire value chain. They encompass systemic, institutional, human and societal challenges to effectively address all dimensions of DRM-inhibiting base erosion and profit shifting practices.

Acute capacity gaps undermine a whole-of-government approach. Incomplete or insufficiently targeted legislation translates into systemic deficits between policymaking and implementation. With no working definition of illicit financial flows, coordination among different enforcement agencies along the mining value chain is poor. While policymaking for domestic resource mobilization resides in different ministries, including finance and trade, it is often divorced from tax administration. It was reported that tax authorities were often not sufficiently involved in negotiations of investment and tax treaties, as well as mineral development agreements. The potentially fiscally-inhibiting agreements undertaken separately by different ministries end up undermining the efforts of tax authorities, as well as the policy feedback loop, to effectively curb illicit financial flows.

The level of collaboration varies across case-study countries, which reveal an insufficient level of cooperation between agencies, thereby preventing tax authorities from getting a full picture of illicit financial flow risks. The deficit is particularly acute between geological survey organizations and tax authorities. Information sharing across enforcement agencies in order to track and monitor illicit leakages along the mining value chain is very weak. Cooperation between the tax and customs authorities, statistics offices and Ministry of Mines remains inadequate. Collaboration between anti-corruption agencies, financial intelligence units and transfer pricing units remains suboptimal. In Zambia, for example, the copper price data published by the Central Statistical Office and Bank of Zambia and Ministry of Mines vary markedly by more than 100 per cent.

Institutional capability to curb illicit financial flows along the value chain remains crippling. While most African countries have demonstrated their commitment to tackle terrorism-inspired international money laundering practices, there is a worrying institutional deficit to tackle the commercial component of illicit financial flows. Yet, according to a recent survey of chief

¹⁷⁷ Guj, P; Maybee, B; Cawood, F; Cooper, J, Gosai, N and Huibregtse, S (2015). Interim Information Report on Transfer Pricing a in Mining: An African Perspective. International Mining for Development Center <http://im4dc.org/wp-content/uploads/2013/07/Transfer-pricing-in-mining-An-African-perspective-A-briefing-note1.pdf>

financial officers of leading multinational companies, including mining, over 42 per cent of these executives could justify corporate misconduct, including sophisticated tax dodging practices, to meet financial targets¹⁷⁸. Zambia, as an example, loses almost \$2 billion annually from corporate tax avoidance, equivalent to 10 per cent of its GDP¹⁷⁹. In fact, the Mbeki Panel's influential report on illicit financial flows observes that only three African countries had transfer pricing units in their internal revenue services¹⁸⁰.

Nonetheless, governance arrangements and capacity gaps of tax authorities vary across the case-study countries. South Africa and Tanzania, with their semi-autonomous tax administrations, have special units dedicated to specific aspects of corporate tax avoidance in particular transfer pricing. Zambia, with its semi-autonomous revenue agency, has recently committed to setting up a special unit focusing on transfer pricing¹⁸¹. However, the Democratic Republic of the Congo has no unit dedicated to transfer pricing in its revenue service.

The operational effectiveness of audit units remains a concern as well.

Specialized technical expertise for auditing mining activities is in short supply in the revenue authorities¹⁸². In fact, forensic auditing is an area where capacity is most lacking in the case-study countries. Auditing capacity varies across case-study countries, in terms of both frequency and quality. According to a recent country study, audits of transfer pricing issues are rarely carried out as part of general audits.¹⁸³ Capacity deficits were consistently confirmed in the

Box 4.1 Mining Taxation Capacity Building in Zambia

Collaboration between the Zambian Revenue Authority (ZRA) <https://www.zra.org.zm/> and the Norwegian Directorate of Taxes started in 2011, with the emphasis on building up a separate mining unit. Short missions by specialists from the Norwegian tax authorities, the IMF and the OECD continue to play an important part. In 2014, the staff of the ZRA were able to undertake more and larger tasks, particularly in the mining sector.

The ZRA has introduced new IT systems, primarily for accounting analysis and tax reporting via the Internet. Improved underlying data have made it easier to select companies for more detailed inspections and audits where the risk of embezzlement is greatest. There is increased exchange of information with the tax authorities of other countries.

Tax audits cover corporate tax, royalty on minerals, personal tax, tax on services and value-added tax. The ZRA has also received training on internal pricing, to make it better able to check whether companies set incorrect internal prices in order to cut tax. The ZRA has revealed such conditions in connection with book audits. A solution to the problem requires the implementation of new rules.

Tax audits with Norwegian support covered 16 mining companies that accounted for 73 per cent of revenue from the mining sector. This resulted in over \$19 million of back taxes being assessed and paid.

Complementing this, is a European Union funded Mineral Production Monitoring Support Project is being carried out under the supervision of the Ministry of Mines, Energy and Water Development (MMEWD) to effectively monitor mining activities and mineral production in Zambia, and to share this information with other relevant Government agencies, in order to facilitate the mobilization of the appropriate levels of domestic revenue.

Sources: Various internet sources

¹⁷⁸ E&Y (2016). Corporate Misconduct— individual consequences. 14th Global Fraud Survey 2016

¹⁷⁹ FT (2013). Zambia's Tax Losses. Financial Times, April 30, 2013

¹⁸⁰ UNECA (2015). Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa. Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development

¹⁸¹ http://www.un.org/esa/ffd/tax/Beps/CommentsZambia_BEPS.pdf

¹⁸² CMI (2011) TOWARDS FISCAL SELF-RELIANCE: Capacity building for domestic revenue enhancement in Mozambique, Tanzania and Zambia. Workshop Report held in Maputo, from 30-31 March 2011 <http://www.cmi.no/publications/file/4002-workshop-report-towards-fiscal-self-reliance.pdf>

¹⁸³ Guj, P; Maybee, B; Cawood, F; Cooper, J, Gosai, N and Huibregtse, S (2015). Interim Information Report on Transfer Pricing a in Mining: An African Perspective. International Mining for Development Center <http://im4dc.org/wp-content/uploads/2013/07/Transfer-pricing-in-mining-An-African-perspective-A-briefing-note1.pdf>

case-study countries. With the exception of South Africa, none of the case-study countries carries out value chain analysis to identify potential risks of leakages in a systematic manner. Nevertheless, there have been some encouraging developments. Over the past couple of years, the South African Revenue Services Transfer Pricing unit has audited more than 30 cases and made transfer pricing adjustments of over R 20 billion, with an income tax impact of R 5 billion.¹⁸⁴ Tanzania has established a Minerals Audit Agency (TMAA) charged with conducting financial and environmental audits, as well as auditing the quality and quantity of minerals produced and exported by mining companies. In a recent National Budget proposal for 2015/2016, the Minister of Finance of Tanzania noted that the Tanzania Revenue Authority will increase the frequency of audits of cross-border transactions with implications for illicit financial flows. The Zambian Revenue Authority has also taken steps to increase its capacity, albeit with donor support (see box 4.1). Concrete evidence exists demonstrating the potential of targeted capacity building technical support. The OECD reckoned that approximately \$15,000 of support for transfer pricing capacity building from the OECD Tax and Development Programme to Colombia increased revenues from \$3.3 million in 2011 to \$5.83 million in 2012 (a 76 per cent increase). In terms of return rates, this translates into \$170 of revenues collected per \$1 spent¹⁸⁵.

The effectiveness of the audits remains unclear. Tax collection efforts in Africa are generally inefficient and very costly, with a comparatively elevated ratio of tax authority budget and total revenue collected, averaging over 2.93—one of the highest in the world¹⁸⁶. While most tax authorities in case-study countries published annual activity reports, little meaningful information on the performance of audit institutions could be gleaned from them. There is little data on the average time or frequency of audits. Also unclear was the percentage of challenged audits settled in favor of governments, as well as the percentage of audits accepted without contest by mining companies. There is a paucity of court proceedings on transfer mispricing and other corporate misconduct in the case-study countries, despite growing alarm and public attention regarding cross-border corporate misconduct.

Tax administrations have to prioritize their focus, since it is costly and inefficient to spread it thinly. In fact, it is impossible to systematically audit all potential leakages along the mining value chain, even for resource-endowed administrations. Besides lack of comparables, auditing may be further limited by structural constraints, including confidentiality clauses and coordination difficulties. Analyzing information gathered in a meaningful manner is equally challenging and demanding. Tax authorities in most of the case-study countries rarely map out illicit financial outflow risks points and audit triggers along the entire mining value chain. No clear strategy exists in case-study countries for prioritizing illicit leakage risks in ways that focus already scarce resources on transactions with the highest risks and significant revenue mobilization returns.

Mining companies adopt varied tactics to frustrate auditing procedures by tax authorities. Gathering information from mining companies is not always seamless. The South African Revenue Service noted that mining companies use creative tactics to circumvent questions from tax authorities. The approach often leads to costly and drawn-out audits. Mining companies

¹⁸⁴ E&Y (2014). Global Tax Alert: South African authorities address transfer pricing and OECD's BEPS Action Plan

¹⁸⁵ OECD(2013). Measuring OECD Responses to the Challenges of Illicit Financial Flows from Developing Countries.

¹⁸⁶ USAID (2013) . "Collecting Taxes." Accessed database United State Agency for International Development <http://egateg.usaid.gov/collecting-taxes>

prefer to use expensive lawyers and advocates to avoid responding to requests for information from tax administration. Companies may also overload tax authorities with operational and transactional details, which slow down the audit process and make it difficult to reach reliable conclusions.

Apparently, there is a reactive and transactional approach towards curbing cross-border tax dodging practices. While this reflects operational and strategic capacity gaps, the lack of a proactive risk management approach will end up spreading the already limited capacity thinly and ineffectively. This may even get worse as the case-study countries tighten up their legislation with more demands for documentary evidence from companies on their tax positions. With the exception of South Africa, it was unclear how tax authorities in the case-study countries decide on which companies to audit. South Africa has a dedicated Assurance Unit responsible for mining tax administration, as well as a separate risk profiling team focused on the extractive industry. Both teams work closely with the International Tax and Transfer Pricing teams, including employee secondment. However, it appears that case selection was more discretionary and often based on anecdotal evidence.

Another equally important challenge is human and financial capacity. Operational performance of tax administrations continues to be very poor on the continent, in general, and in resource-rich countries, in particular. While progress has been made in the case-study countries, tax administrations are chronically understaffed. In fact, according to an estimate, the number of tax and customs officials available for every 1,000 citizens is 0.087 in Tanzania, 0.099 in Zambia and 0.31 in South Africa¹⁸⁷. While the tax staff per population ratio is higher than the continental average of 0.037¹⁸⁸, it is very low when compared to that of similar but advanced mineral-rich countries like Canada 1.12 and Australia 0.98.¹⁸⁹

In terms of both quantity and quality, skill sets remain unfit for purpose. The broad and specialized mix of skills needed to monitor and curb complex, sophisticated corporate tax misconduct is chronically scarce, albeit in varying degrees across countries. In Zambia and Tanzania, it was stressed that auditing expertise in the mining value chain was in short supply, as was capacity to undertake research for audit purposes. The Zambian transfer pricing audit team of 17 specialists includes two metallurgists, but there is no metallurgist in the transfer pricing audit team of 15 specialists in Tanzania. Legal expertise, including economic and financial modelling skills, was also scarce. Attracting and retaining motivated, highly skilled staff in the revenue authorities is an even bigger challenge. While some countries like Zambia and South Africa have made efforts to pay their staff market efficiency wages, others are still constrained by civil service pay rules, which are not competitive with the private sector. Competencies in the rapidly evolving information technology and software sectors are limited. However, most of the case-study countries have made significant efforts to modernize their tax administration system.

¹⁸⁷ Fjeldsø, O and Heggstad, K (2011). The tax systems in Mozambique, Tanzania and Zambia: Capacity Constraints, Chr. Michelsen Institute (CMI) and NORAD.

¹⁸⁸ Africa Development Bank (AfDB). 2010b. Domestic resource mobilization for poverty reduction in East Africa: Tanzania case study. African Development Group: Tunis (17 December 2011)

¹⁸⁹ 189 USAID (2015). "Collecting Taxes." Accessed database May 24, 2015 United State Agency for International Development <http://egateg.usaid.gov/collecting-taxes>

Given the dearth of manpower, training of existing staff remains a quick fix for stepping up capacity. In a recent survey of capacity needs to implement the Base Erosion and Profit Shifting Action Plan, developing countries, including those in Africa, cited training and IT as the most important priorities¹⁹⁰. Capacity on the demand side of accountability is also very weak. While civil society organizations have played an active role in raising awareness on corporate tax evasion, the capacity to unpack the complexities of these practices in a meaningful manner for sensible policymaking is equally weak, as is the capacity of parliamentarians to engage effectively.

4.4 Transportation and marketing

4.4.1 Intangibles

Valuation of intangible assets remains a major auditing challenge. Since intangible assets are often specific and unique, they present transfer mispricing and trade mispricing risks for tax administration. The hard-to-value assets often lead to disputes between mining companies and tax administration. The marketing of gemstones is a highly specialized area. Diamonds produced by all case-study countries are hard to value, with significant pricing challenges, including the enormous variation in the quality of individual stones and the specialized nature of the market. Since the prices are not set in highly transparent markets, tax authorities often do not have comparables to adjust for the transfer prices between related parties.

Other important examples of intangible assets presenting risks of transfer mispricing include research and development services and intellectual property. The intra-company trading of this class of intangibles often lead to artificial separation of where production occurs from where value is created. A report by the Economic Commission for Europe notes that intra-company flows of research and development services, ghost services from intellectual property together as a means of determining economic profit are hardly accessible. The report also cites, among a variety of motives, the incentive to escape any control, including tax evasions.¹⁹¹

Mining companies are increasingly inclined to maximize revenues from their intangible assets in the form of ‘royalties’ on intellectual property rather than production. The practice of artificially separating taxable income from the activities that generate it leads to profit shifting and tax base erosion. A report by E&Y notes that the pursuit of tax incentives on hard-to-measure intangibles like research and development credits contributes significantly to cash flows¹⁹². Through the use of subsidiaries, risks and costs are aligned in a way that minimizes their tax burden. For example, overvaluation of intangibles enables companies to illicitly transfer profits untaxed, or taxed at very low rates, out of countries where production is based

¹⁹⁰ OECD(2016) http://www.step.org/sites/default/files/Events/2014/Asia_2014/Speaker_Notes_Day_One/Automatic-exchange-of-tax-information-and-privacy-monica-bhatia.pdf

¹⁹¹ ECE (2008) conference of European Statisticians, working group on the impact of globalization on national accounts research agenda. Economic Commission for Europe

¹⁹² E&Y(2014) Global Mining Metals Tax Survey: from backroom to board room

on their research and development license subsidiaries located in tax havens abroad. A study carried out in the US points to the substantial migration of intangible assets from the United States to foreign countries¹⁹³. In fact, in a recent survey carried out by the Australian government, patent fielding in the mining industry has increased eightfold since the 1990s, while productivity has halved over the same period¹⁹⁴. Meanwhile, the African Progress Panel estimates that mining companies' profits increased at four times the rate of government revenues over the last decade¹⁹⁵. It remains unclear how much of the discrepancy could be explained by practices linked to illicit financial flows.

4.4.2 Trade misinvoicing

Trade mispricing occurs between two unrelated companies transacting across the globe. It involves manipulating international prices through the overpricing and misinvoicing of mineral exports from African countries. Trade mispricing also includes the overpricing of inputs by mining companies. This involves, for example, charging and invoicing non-existent transactions, that is, contracts concluded with off-shore companies which provide "management", "marketing" or other services, without having the employees or capacity to provide such services. Such flows are facilitated mainly through bank secrecy clauses. Secrecy provisions make it impossible to accurately assess and measure the extent of leakages.

Trade mispricing accounts for the most significant component of illicit financial flows from the mining sector. ECA estimates that the cumulative share of IFFs from Africa attributed to trade mispricing is over 50 per cent¹⁹⁶. Based on sectoral estimates, ECA reckons that more than 56 per cent of all trade mispricing comes from the extractive sector, including oil, precious metals and base metals. The Africa Progress Panel estimates that Africa is losing over 38.4 billion dollars yearly from this practice alone.

Without forward-looking actions, the practice of trade mispricing appears poised to grow even faster. Given the global nature of commodity markets, most mining companies are centralizing their trading practices in one or few locations with risks of mispricing. It is unclear how sustainable trading concentration will become, given the projected prolonged collapse in global commodity prices. However, Switzerland and Singapore are becoming the most attractive locations, given the tax incentives and secrecy protection offered to multinational trading companies. Mineral-rich African countries exposed to trading with these countries are very vulnerable to trade mispricing. For example, Zambian copper exports to Switzerland constitute one of the most significant sources of mispricing of copper in Africa. Based on average copper prices, a forensic audit shows systematic mispricing of the country's copper destined for

¹⁹³ Mutti J (2006), New Development in the Effect of Taxes and Royalties on the Migration of Intangible Assets Abroad, Paper prepare for the NBER/CRIW conference Washington, DC

¹⁹⁴ IP Australia (2015) The Australian Mining Industry: More than Just Shovels and Being the Lucky Country

¹⁹⁵ APP(2013) Africa Progress Panel Report

¹⁹⁶ ECA (2012). Illicit Financial Flows from Africa: Scale and Development Challenges Addis Ababa

Switzerland¹⁹⁷. The study highlights discrepancies between the prices recorded at the point of export by Zambian customs authorities and that declared in Switzerland for subsequent re-export. The report calculates that if Zambia had received prices comparable to what was declared in Switzerland, its GDP would have increased by 80 per cent. While shocking, these results should be interpreted with caution, given the methodological weaknesses in the data. This example also points to the data gaps in tracking IFFs of this nature. While export data from Zambia is readily available, data for imports of copper into Switzerland is inadequate. Filling these data gaps, even within Africa, is crucial, given that mispricing is projected to grow at a real rate of 32.5 per cent, compared to 9.7 per cent in Europe and 7.7 per cent in Asia¹⁹⁸.

4.5 Crosscutting issues

4.5.1 Double taxation treaties (DTTs)

These tax treaties, which are intended to eliminate double taxation, also pose significant risks of illicit financial outflows and domestic resource mobilization constraints. Many of the case-study countries have entered into bilateral taxation treaties that negatively impact their taxing rights in respect of different types of payments, such as service payments, commission payments, financial derivatives transactions, sales of shares or other transactions. This leads to tax base erosion and profit shifting, minimizes DRM capacity and significantly limits the legal framework enabling DRM.

Double taxation treaties negotiated in case-study countries are modelled after the OECD Model Taxation Convention and the United Nations Model Tax Convention. While both models are similar in many respects, the United Nations Model Tax Convention provides more taxing rights to developing countries as source countries.

4.5.2 Bilateral investment treaties

Another major constraint to policy space for domestic resource mobilization are the mushrooming bilateral investment and trade rules signed between African countries and key trade partners, including OECD and emerging countries. While bilateral investment treaties (BITs) remain unproven as decisive in influencing investment decisions, countries still continue to sign them at a rate of 50 per year (Adam, 2012). More than 400 BITs are operating in Africa. With the goal to attract foreign direct investment, many countries have entered into BITs without a coherent, comprehensive strategy or space for promoting value addition.

¹⁹⁷ Cobham et al (2014). Estimating Illicit Financial Flows of Capital via Trade Mispricing: A Forensic Analysis of Data on Switzerland, Center for Global Development

¹⁹⁸ Kar, Dev and Sarah Frietas (2011). Illicit Financial Flows from Developing Countries over the Decade Ending 2009. Washington, DC: Global Financial Integrity

Most BITs lack a development orientation. National development policy has become secondary to the investor's interests. The State-to-State agreements establish how governments handle investors from each other's country, covering fair and equitable treatment, security, and compensation for expropriation etc. Based on an agreed equity in treatment principle, host countries may be prohibited from imposing performance requirements on multinational mining companies to encourage greater domestic content and value addition. For example, some developed countries go as far as seeking pre-establishment privileges for their investors, allowing them to enjoy preferential treatment even before they set up.

The extensive webs of outdated BITs are clearly misaligned with the goals of optimizing mineral revenues. The BITs include stabilization clauses, as well as generous tax provisions, which will likely become a bigger problem in the next boom. Despite the unproven potential of BITs to attract investment, more than 400 of them are operating in Africa¹⁹⁹. Without forward-looking collective action at the continental level, tax holidays will take on a life of their own: in 1980, 40 per cent of sub-Saharan African countries offered tax holidays, while in 2005, 80 per cent did so.²⁰⁰ A study of 12 Western and Central African countries over the 1994-2006 period showed no relationship between tax holidays and investment.²⁰¹ In fact, an IMF assessment of the Eastern Caribbean Monetary Union estimated that forfeited tax revenues as a result of tax incentives ranged between 9.5 per cent and 16 per cent of GDP per year²⁰².

While many developing countries have taken steps to review their BITs, such initiatives remain limited in Africa. Only South Africa has undertaken a comprehensive review. In 2010, the government concluded a three-year review of its BITs to assess the role of foreign investment in South Africa, the levels of protection afforded to investment and the risks and benefits of BITs (Carim, 2013). According to the report, there was no conclusive link between BIT and Foreign Direct Investment (FDI) flows. In addition, some BIT terms violated the country's constitution, existing BITs contained imprecise language and overall BITs constrained government from regulating in the public interest. South Africa has therefore taken encouraging steps. The government will refrain from entering into BITs unless there are compelling political or economic reasons to do so. In addition, it will terminate existing BITs and offer partners the possibility to re-negotiate BITs based on a new model. It will also develop a new Foreign Investment Act that is aligned with the constitution and clarifies typical BIT provisions under South African law, as well as establish an Investment Ministerial Committee to oversee this work. In fact, the country is revising its domestic laws to strengthen investor protection, the kinds of concerns provided in BITs. South Africa is also leading the SADC in designing a model BIT that is compatible with regional development.

¹⁹⁹ Adam, G (2012). Bilateral Investment Treaties Coming Back to Bite, <http://thisisafricaonline.com>

²⁰⁰ Keen, M. and Mansour, M. (2009), Revenue Mobilization in Sub-Saharan Africa: Challenges from Globalization, IMF Working Paper, IMFWP/09/157, IMF Fiscal Affairs Department, Washington, DC, www.imf.org/external/pubs/ft/wp/2009/wp09157.pdf.

²⁰¹ James, S. and Van Parys, S. (2010), The effectiveness of tax incentives in attracting investment: panel data evidence from the CFA Franc zone, *International Tax and Public Finance*, Vol. 17/4, pp 400-429.

²⁰² Chai, J. and Goyal, R. (2008), Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union. IMF Working Paper, IMF WP/08/257, IMF Western Hemisphere Department, Washington, DC, www.imf.org/external/pubs/ft/wp/2008/wp08257.pdf.

Chapter 5

Conclusions and recommendations

5.1 Conclusions

Mineral wealth offers an opportunity for greater domestic revenue mobilization in countries. Yet resource-rich Africa remains unable to take full advantage of the proceeds. Resource revenues as a share of overall taxes collected have increased, particularly during the recent boom in commodity prices. Surprisingly however, tax effort in resource-rich countries continues to remain below the African average—even when compared to their resource-scarce counterparts.

Taxation remains the most predictable instrument for mobilizing government revenues. Structural transformation of resource-rich countries depends strongly on effective tax systems which are capable of reducing tax evasion, as well as avoidance. However, weak fiscal regimes along the mining value chain, interact in a vicious cycle with illicit and sophisticated tax-avoidance practices of mining companies. The outcome is often significant cross-border illicit financial flows, with resultant net negative impact on domestic resource mobilization efforts. The impacts cut across socioeconomic and political fronts, through reduced mineral revenues, increased income inequality and depleted hard-currency reserves.

Illicit financial flow is a complex, multidimensional phenomenon. The report adopts the definition by the 2014 Conference of Ministers: “money illegally earned, transferred or used”. The definition, which was also endorsed by the High Level Panel, brings together all relevant dimensions in a way that provides a consistent and relevant working definition for addressing IFFs. The working definition frames the outflows in terms of origin, motivation, method and destination.

Success requires collective and coordinated actions at the domestic and international levels. Illicit financial flows represent a symptom of fundamental gaps in international tax governance. Taxation of mineral resources continues to remain an act of sovereignty. However, national tax laws in most African countries have yet to keep pace with global corporations’ complex business models. A ‘broken’ international fiscal system creates opportunities for translating incentives for tax evasion in countries into cross-border illicit capital outflows. In fact, complex interactions of mineral regimes and international taxation, trade, investment, and finance create gaps and overlaps, with potentially damaging impacts on tax collection.

Strategic tax competition results in winners and losers. Low-tax jurisdictions or tax havens create cross-border tax arbitrage. Multinational companies take advantage of the loopholes to minimize their overall tax liability, artificially shifting their profits out of mineral-rich countries

to low-tax or no-tax locations, where there is little or no economic activity. The jurisdictions provide a legally backed veil of secrecy, making it harder to determine beneficiaries. The high level of secrecy is complemented by the ease with which companies and other legal entities can be registered or established offshore.

Most IFF practices occur in a grey area of the law: 'legitimate tax planning' and 'tax evasion'. While impacts are discernible, identifying, tracking and curbing IFF practices remains complex and challenging for tax administrators, particularly in resource-constrained settings. The risks are widespread and varied along the mining value chain. Every transaction in the chain presents a set of overlapping and discrete IFF practices, ranging from illegal and fraudulent activities to manipulative tax avoidance schemes by multinational corporations. These are compounded by political economy drivers, including corruption at the highest political levels in the mining industry.

Curbing multinational corporate tax avoidance remains a key development priority. African governments have collectively committed to tackle IFFs in key continental and global policy documents: The African Mining Vision, The African Union Agenda 2063, and The 2030 Agenda for Sustainable Development. Combatting IFFs effectively would raise development revenues for the countries of origin. Sustained and strategic efforts at strengthening institutions would seriously deter the incentive to move profits outside the country of origin. The task for many African countries is to develop mechanisms to detect IFF practices at all stages of the mining value chain, which are triggered by both internal and external players.

Good governance is at the heart of domestic resource mobilization. It entails the ability of governments to formulate and implement effective strategies, policies, laws and regulations for mobilizing optimal revenues from the mineral sector. It is about having a capacitated mineral tax administration to track, stop and repatriate illicit financial outflows. At a minimum, this involves reducing illicit financial flows and, at best, completely eliminating the development-inhibiting practices along the mining value chain.

Mineral-rich countries have made some progress, but challenges remain. While there is increasing awareness of DRM-damaging practices, there are still major gaps in policy, legislative and institutional frameworks. The case-study countries have formulated various regulations to combat some individual drivers associated with IFFs, including corruption, money laundering and tax evasion. However, no comprehensive working definition of illicit financial outflows exists in the mineral regimes of the countries studied. Consequently, the additional standalone actions were limited in their systemic impact.

Illicit financial practices are products of asymmetry of knowledge and power along the value chain. While case studies recognized the importance of geological information in their mining codes, integrating the investment and governance dimensions remain critical.

5.2 Policy recommendations

Curbing illicit financial flows from the extractive sector requires collective action at all levels. Below are some proposals for tackling the complex challenge of corporate tax avoidance, as well as suboptimal domestic resource mobilization in the mineral sector in Africa. They are specific to case-study countries, as well as mineral-rich countries as a whole. The recommendations are organized into three levels: global, regional and country.

Global

1. Establish inclusive, transparent global governance frameworks to curb illicit financial flows

- All governments should make concerted efforts to ensure that global governance of illicit financial outflows is fit for purpose. Now that IFFs are on the global agenda, it is imperative to expand and strengthen institutional frameworks to address their commercial dimensions in ways that are effective, equitable and sustainable.
- The global community must take firm collective action to increase access to information about beneficial ownership of mining companies along the value chain registered in their countries. The information should be shared through central public registries and made accessible in a timely manner to key agencies and stakeholders, including civil society organizations. International efforts to put political pressure on low- tax jurisdictions that encourage high-level financial opacity, banking secrecy and the registration of shell companies should continue.
- The international community should recognize the particular risks of IFFs faced by the extractive sector in Africa and support ongoing continental and global initiatives to strengthen governance, including the African Mining Vision, the Africa Peer Review Mechanism, the Extractive Industry Transparency Initiative, the US Dodd Frank Act and comparable EU legislation.
- The United Nations should promote and strengthen inclusive intergovernmental approaches to tax transparency. The United Nations Tax Committee should step up efforts to formulate specific norms to curb cross-border tax avoidance in the extractive sector, a priority area for domestic resource mobilization in Africa, which continues to be inadequately addressed by current global reform initiatives. Targeted, consistent efforts should be made to support African countries in addressing key priority risk areas which are not yet part of the global reform agenda of the OECD, including trade mispricing, comparables for the mining sector, tax incentives and transfer of indirect assets.
- The United Nations should establish a global mechanism for the repatriation of proceeds from tax evasion and tax avoidance to the source countries. The mechanism could be modelled along the lines of existing international asset recovery initiatives,

including the upgrading of the United Nations Convention Against Corruption (UNCAC) to tackle the commercial dimension of illicit financial flows.

- The EU, G20, G8 and US and UK including the wider international community should work towards ensuring the accountability of jurisdictions, corporations and individuals that facilitate cross-border tax evasion and avoidance. They should also support efforts to integrate the activities of commodity trading companies presenting high risks of trade mispricing into their existing extractive sector reporting initiative.
- International financial institutions should include stronger mandatory disclosure requirements as part of their support of public-private partnerships in the extractive sector including contract and tax transparency.
- International standard-setting bodies, like the International Accounting Standard Board, should strengthen their disclosure framework for corporate taxes. They should complement current reporting, which is based on historic financial data and publicly available tax governance information, with disclosure of unrecognized tax benefits that are uncertain to tax authorities, as well as a code of conduct obliging companies to avoid all forms of practices inconsistent with their tax obligations.

2. Increase technical support for African countries

- The international community should support African countries in implementing key action plans of the OECD-G20 Base Erosion and Profit Shifting Project. While the fifteen recently adopted Action Plans are not binding upon African countries, they will however introduce major normative reforms of key legislation and policies to curb IFFs in countries. Due to capacity challenges, the current participation of African countries in newly established mechanisms remains very low. International partners should support African countries in prioritizing and implementing the international tax reform package according to their owned capacities and priorities.
- Partners must therefore step up efforts to strengthen the capacity of African countries in a targeted and coherent manner. High-priority areas of the adopted action plans include limiting base erosion through interest deductions and other financial payments, preventing treaty abuse and artificial avoidance of permanent establishment status, ensuring that transfer pricing outcomes related to intangibles are in line with value creation and re-examining transfer pricing documentation.
- International partners should support and facilitate south-south, north-south initiatives to share experiences among countries as well as the work of regional organizations to curb illicit financial outflows and increase domestic resource mobilization. As major consumers of African minerals, the European Union and China could develop and support joint triangular cooperation initiatives in targeted capacity needs areas, in order to address cross-border corporate tax avoidance by mining companies operating in Africa.

- Donors should double their technical support for domestic resource mobilization, in accordance with the Addis Ababa Tax Initiative. Partners should leverage their development assistance to provide much-needed technical assistance for curbing illicit financial outflows along the mining value chain. They should do so in ways that are coherent, coordinated and holistic. Despite evidence of the great value for money of technical taxation assistance, only 0.22 per cent of ODA²⁰³ is spent on building tax administration capacity in countries. The amount allocated for boosting taxation of mineral resources is even negligible. Successful examples of international cooperation through targeted support for effective auditing of IFF risks along the value chain should be encouraged.
- The international community should step up technical assistance to implement the specific goals of the United Nations Agenda 2030 and the Africa Union Agenda 2063 to eliminate all forms of illicit financial flows. The work of ECA and AUC to develop integrated frameworks for implementing both agendas in accordance with the resolution of the 2016 African Union/Economic Commission for Africa Joint Conference of Ministers should be supported. International organizations like the OECD, World Bank and IMF and UNCTAD should increase their efforts to develop tools, databases and indicators to monitor and curb illicit financial outflows. Particular efforts should be devoted to upgrading existing publicly accessible databases in order to capture trade mispricing, as well as developing new databases on transfer pricing.

Regional

3. Establish progressive African leadership to promote international tax cooperation

- African countries must step up their game. The African Union Commission, together with the African Tax Administration Forum, should support countries' strong, proactive commitment to influence the emerging global governance frameworks for international tax transparency. The African Union should examine the challenges and opportunities presented by the OECD/BEPS project, with a view to coordinated, harmonized African participation in the remaining standard-setting priorities, through the newly endorsed BEPS Associate initiative.
- Specialized international and continental organizations should provide specific technical support to mineral-rich African countries, in order to strengthen their participation in the work of the Subcommittee on Extractive Industries Taxation Issues for Developing Countries of the United Nations Tax Committee. The Committee's ongoing work will eventually lead to the revision of the United Nations Model Tax Convention and its effective application of the arm's length principle for regulating transfer mispricing in developing countries. Participation in the setting of global norms to curb cross-border tax avoidance, will allow African countries to ensure that new

²⁰³ OECD(2015). Examples of Successful Domestic Resource Mobilization Reforms and the Role of International Cooperation. Discussion Paper. Organization of Economic Cooperation and Development, Paris.

rules adequately address their needs and capacity, as well as providing long-term benefits.

- The African Union Commission should initiate steps for adopting and implementing an effectively unified and consistent continental approach for curbing illicit financial flows including the mining sector. The African Union should implement the recently adopted Protocol and Statute of the African Court of Justice on Human and People's Rights which makes provisions for crimes involving the illicit exploitation of natural resources, including corruption, money laundering and corporate complicity. The African Union Convention on Preventing and Combatting Corruption should be updated and expanded to include targeted measures to stem and reduce the commercial component of illicit financial flows. Specifically, the Africa Peer Review Mechanism should be strengthened to include questionnaires on IFFs related to the extractive sector. The Africa Union Advisory Board of Corruption (AU-ABC) should include IFFs in their annual corruption questionnaire. The normative work of continental organizations like the African Minerals Development Centre and the African Tax Administration Forum should be supported. The efforts of the ATAF Cross Border Taxation Committee should be expanded to include issues related to domestic resource mobilization in the mining sector.
- The ATAF should strengthen its support for African countries so as to focus their limited resources on the recently adopted OECD/G20 BEPS Action Plans that they consider of highest priority. Continental efforts should center more on other base-eroding practices that are of even higher priority to African countries, including minerals taxation, trade mispricing, and application of the arm's length principle including comparables for the extractive sector.
- The African Union should create a continental platform for dialogue that will promote consistency between tax policy, tax legislation and tax administration in the mining sector. The AUC, AMDC and ATAF should therefore jointly organize a high-level regional policy dialogue on illicit financial flows and domestic resource mobilization in the extractive sector in Africa. The forum would examine policy gaps and compliance issues along the mining value chain that present risks of illicit financial leakages. The forum will provide an opportunity for countries to share their experiences, with a view to developing specific regional and country approaches to curbing illicit financial flows and enhancing domestic resource mobilization in the mining sector. In addition, the forum would provide concrete recommendations to strengthen fiscal reforms in the mineral sector in ways that guard against 'race to the bottom' inspired by a collapse of commodity prices²⁰⁴. The outcome of the forum could include a resolution for adoption by the AUC Specialized Technical Committee on Trade, Industry and Minerals.

²⁰⁴ In 1990, almost 40% of African countries including resource rich countries offer tax holidays, but in 2005 the proportion went up to 80% (Keen and Mansour, 2009).

- The African Union should bolster its support of regional economic communities' efforts to harmonize the fiscal policies of their Member States in ways that guard against 'beggar thy neighbor' policies and align with the African Mining Vision.
- The AMDC, AfDB and World Bank and Global Financial Integrity could form a joint consortium to assess and quantify the exact extent of illicit financial outflows from the mining sector in Africa. For the purposes of effective policymaking, the study should disaggregate data according to country and region. The work could be aligned and integrated with the priorities of the recently established African Union Consortium on IFFs.
- The Africa Union should support existing voluntary international and regional multi-stakeholder governance initiatives in the extractive sector aimed at curbing illicit financial flows, including the Extractives Industry Transparency Initiative (EITI), International Conference on the Great Lakes Region and KPCS. The African Union should develop and implement complementary, targeted mechanisms that can better monitor and stem illicit financial outflows from the extractive sector including the proposed African Mineral Governance Framework. The African Union should strengthen support to public-private partnerships for domestic resource mobilization in the mining sector, including the development of an Africa Union Compact with the Private Sector.
- The African Union should explore the possibility of establishing a Pan-African Metal and Mineral Exchange to facilitate and improve price discovery, as well as develop the financial infrastructure for mining operations on the continent.

4. Reduce and stem illicit financial flows by consistently enhancing the capacity of African countries

- The African Union should ensure that the AMV framework for 'transparent, equitable and optimal exploitation of mineral resources to underpin broad-based sustainable growth and socio-economic development' is a guiding principle for designing and implementing policies to stem illicit financial outflows and enhance domestic resource mobilization.
- The African Union should ensure that international capacity building initiatives regarding the negotiation of tax treaties and mineral development agreements align closely with the AMV framework. The African Union should promote the sector's shift from contract to licensing regime, as recently demonstrated by Zambia. While this transformative change from narrow, contract-based governance arrangements to a more broad-based licensing regime is the sector's ultimate goal, in the interim, countries will need capacity to better negotiate optimal contracts for greater domestic resource mobilization. The AMDC should support countries in developing model contracts that are AMV-compliant and make certain that these contracts are integrated into legislative frameworks. The goal is to ensure that negotiated contracts are

consistent with the enhancement of the sector's policy, legal and regulatory frameworks.

- The African Union should support initiatives to build capacity in the region, in order to allow countries to benefit fully from ever-increasing international tax transparency. The efforts of ATAF and other regional organizations to adapt emerging international frameworks to continental realities should be supported, including the Practical Guide on Exchange of Information for Developing Countries, the Agreement on Mutual Assistance in Tax Matters and the Model Double Tax Agreements. The Africa Union and ATAF could also explore opportunities to establish a facility to support Member States in negotiating equitable, transparent and sustainable tax agreements.
- The AMDC, ATAF and RECs should support mineral-rich African countries in pooling their resources, through multiuser licensing schemes for accessing comparable databases that are key to transfer pricing compliance. The AMDC and other relevant institutions should provide guidance for identifying and selecting relevant databases, as well as develop and adapt existing databases to the realities of the extractive sector in Africa and promote training on the different databases. The current work of the OECD on the development of a toolkit for assessing the transfer prices for some major mineral commodities provides opportunities for partnerships with regional organizations.
- The African Union should facilitate regionally coordinated pooling of expertise and training to curb illicit financial flows. The mandate of the African Mineral Geoscience Centre should be expanded to allow countries with independent laboratory facilities to track and test the quality of ores, in order to monitor and curb the underreporting of minerals in countries. Activities could also include promoting and accrediting national laboratories as centers of excellence for auditing potential mineral leakages along the regional chain. Other important emerging initiatives that should be supported include the ATAF Agreement on Mutual Assistance in Tax Matters (AMATM), a multilateral instrument allowing for the exchange of information, sharing of expertise, joint audits and investigations and mutual administrative assistance among African countries. The AMATM could be broadened to promote sharing of experiences across countries in addressing specific key constraints along the mining value chain. The AMDC could develop a roster of international mineral taxation experts, forensic auditors, lawyers and mineralogists at the continental level, which could be made available to countries on demand. AMDC should partner with ATAF and the World Bank to develop specific training courses and workshops on transfer pricing, mineral taxation and mining value chain auditing, evaluation and analysis.
- The African Union should create a structured platform promoting effective collaboration between customs agencies, tax authorities and law enforcement agencies and the Ministry of Mines on key IFF risks along the mining value chain.
- The African Union should strengthen collective demand-side accountability efforts including the emergence of effective Pan-African civil society platforms for fighting

IFFs, as well as the capacity of media and bar associations in areas related to cross-border illicit financial outflows.

Country

5. Ensure policy consistency for effectively stemming illicit financial flows

- As a matter of urgency, mineral-rich countries should formulate a working definition to tackling illicit financial outflows. The definition should effectively frame policy interventions and organize instruments and institutions for greater resource mobilization along the mining value chain. The definition endorsed by the African Union/Economic Commission for Africa High-Level Panel of ‘money illegally earned, transferred or used’ should guide the adoption of country policies and legislation. It should take into account both the criminal and commercial dimensions of illicit financial flows. Borderline practices, however, should be identified and made illegal, including earning, transferring or utilizing funds stemming from tax evasion, tax avoidance, trade misinvoicing, abusive transfer pricing, base eroding and profit shifting.
- Given the scale of illicit financial outflows and the inconsistency of domestic resource mobilization strategies, it is imperative for all institutional efforts to be state-centered. An overarching structure is needed to streamline government efforts and promote consistent leadership in creating and implementing fiscal policy along the mining value chain. Depending on the country, this structure may take several forms including an intergovernmental committee, an inter-agency task force or a memorandum of understanding between relevant agencies.
- Geological information remains key for optimizing mineral revenues as well as monitoring, tracking and curbing illicit leakages along the value chain. Countries should review their minerals code to ensure that geological information is framed more strategically in terms of data management rather than record keeping. Governments should put in place regulations governing the management of geological information, making it mandatory for companies to provide precompetitive digital data that can be aggregated with other datasets for analysis, forecasting and monitoring.
- Use the African Mining Vision as the basis for much-needed reforms to ensure greater resource mobilization, transparency, equity and broad-based development in the mining sector. This entails putting in place policies and legislation that establish clear fiscal rules, coherent contractual arrangements and effective regulatory regimes. Mineral-rich countries should stop relying on a patchwork of separately negotiated contracts as sector governance instruments and switch to a licensing regime based on established, innovative mineral legislation and policy frameworks. Countries should take steps to review their mineral development agreements with a view to balancing their revenue mobilization objectives, reducing illicit financial risks and creating an attractive investment climate. Negotiated contracts should align with the AMV

principle of transparent, equitable and broad-based development of the mineral sector, which is integrated into legislation. The legislations should include key terms to minimize discretion in contract negotiation, implementation and monitoring. A transparent system of auctions and competitive bidding should be instituted for concessions and licenses. Where there is evidence of significant undervaluation of concessions, governments should initiate independent investigations to review the evidence in a transparent manner.

- Governments should undertake a cost-benefit analysis of the policy space frequently limiting the revenue mobilization objectives of bilateral investment treaties (BIT). Treaties that are unfit for purpose should be cancelled or renegotiated. Tax concessions such as tax holidays, reduced royalty fees and waived corporate income tax should not be used as instruments for attracting investment. Where tax relief is granted, it should be finite, publicly transparent, subject to legislative oversight and reviewed regularly.
- Mineral-rich countries should avoid relying on easily obtained taxes— flat rate taxes, including production-based taxes. Governments should focus on progressivity and stability in order to optimize domestic resource mobilization. Countries should therefore adopt an appropriate mix of fiscal instruments, including royalties, corporate income tax and value added taxes. For greater resource mobilization, royalties can be increased. made more profit-sensitive and indexed to commodity prices. The progressive rate for royalties should increase, depending on the mineral. Mineral-rich countries should also consider imposing resource rent tax or capital gains tax, which is progressive.
- To clamp down on transfer mispricing, governments should formulate tough transfer pricing legislation based on arm's length principles. The policies should also ensure that taxable profits are clearly aligned with value creation along the mining value chain. Legislation should include guidelines for applying the arm's length principles modelled along the United Nations or OECD guidance documents including documentation requirements, penalties and preferences for various methods and dispute settlement mechanisms. The legislation should also broaden the definition of related parties beyond financial and managerial relations to include the actual conduct of the parties. For the sake of pragmatism, governments should consider using administratively determined reference prices when insufficient information is available to assess or determine the transfer pricing position of mining companies. In the trade of minerals between related parties, countries should use the average monthly quoted price on metal exchange markets as the reference price for tax purposes. It is imperative for mineral-rich countries to set up specialized transfer pricing units for monitoring profitability, reported prices and intra-company trade in minerals, assets and services along the mining value chain.
- To better optimize limited resources, governments should adopt a proactive risk management approach, rather than a reactive transactional approach, in conducting audits. The criteria for selecting cases should be developed in the form of a hierarchy

of risks based on the profile of various transactions and companies along the mining value chain.

- Governments should adopt effective anti-avoidance rules, including thin capitalization requirements, as a means to curb excessive leveraging by mining companies. They should do so, however, with the understanding that there is more than one way in which profits can be shifted across borders. Poorly targeted legislation may create loopholes elsewhere. Countries should therefore review and tighten their existing thin capitalization requirements to ensure that the debt-equity ratio is consistent with the industry's relatively low appetite for debt financing and does not inadvertently encourage transfer mispricing within the acceptable limit. The average debt-to-equity ratio in the case studies' legislation is relatively generous, at 3:1 compared to 1.5:1 in advanced mining jurisdictions. Governments should apply transfer pricing audits on a case-by-case basis when there is suspicion of abuse, even within the accepted thin capitalization ratio.
- Countries should limit excessive interest on loans deducted by companies, in order to protect and prevent the erosion of their tax base. The limit should be based on an agreed ratio of assessed Earnings Before Income Tax, Depreciation and Amortization (EBITDA). Tax authorities may also limit the maximum amount of interest deducted by setting a fixed rate or using the available local market rate. This means that nationally determined maximum interest rates permissible for deduction remain the reference point. Any interest on intra-company loans held by a mining company above the locally or market-determined interest rates will be disallowed for tax deduction or considered as a taxable dividend. In addition, tax authorities may also adopt an administrative approach, judging each excessive interest-deductible transaction between related parties on its merit, based on the arm's length principle. A transfer pricing adjustment is made on the basis of the actual need for the loan, the interest rate of a non-controlled comparable transaction and the ability of the debtor to repay the loan.
- Governments should ring-fence individual extractive projects for tax purposes. The anti-avoidance measure will protect the revenue base by preventing mining companies from transferring operational losses and deductible operational and capital expenditures from one project to another.
- Companies bidding for concession or license should be required to publish their beneficial owners and those of subsidiaries and provide detailed organograms to officials as part of their reporting requirements. In accordance with EITI requirements, they should also report on their profits, disaggregated by project. The beneficial ownership provisions should ensure that the complex chain of ownership information is captured in the reporting requirements and includes all companies along the mining value chain. The ultimate beneficial ownership information should also include politically exposed persons (PEPs). The information gathered should be updated annually, verified and linked to existing license registries or cadasters.

- Review existing Double Taxation Treaties (DTT) signed with various countries in relation to their tax objectives and domestic resource mobilization. Renegotiate or cancel those that are abused, particularly, those in countries with low-tax jurisdictions or tax havens. Avoid, where possible, entering into a DTT which will lead to a loss of taxing rights on key revenue streams, including withholding taxes. Countries should include clear anti-avoidance language in their DTT, emphasizing not only the purpose of the treaty but also what it is not about.
- Mining companies should commit to support governments in the fight against IFFs. It is imperative that they make every effort to be transparent, cooperate with tax authorities and support the implementation of the AMV. They should provide revenue authorities with requested useful information about their transactions and transfer pricing position. They should also avoid excessive use of offshore centers and shell companies for the purpose of limiting their tax liability.

6. Strengthen capacity to implement an effective, forward-looking approach

- African countries will act in accordance with their own priorities. Countries will have to explore existing and emerging opportunities to build their capacity to participate effectively in international tax governance reform processes, including BEPS. Governments should embrace international initiatives to build capacity for greater exchange of information between different tax authorities. They must make every effort to strengthen their capacity to negotiate AMV-compliant contracts, BITs and DTTs. Countries will also need capacity to negotiate and implement Advance Pricing Agreements and other alternatives to litigation, including collaborative mechanisms to reduce compliance costs. Meanwhile EITI-implementing countries should also explore available opportunities to strengthen their capacity to implement and use information emerging from international tax transparency initiatives, including newly adopted mandatory beneficial ownership disclosure requirements. Efforts should be made to ensure that the disclosed information targets the needs of government agencies for effectively carrying out their mandates to curb IFFs.
- Countries should implement mechanisms that facilitate effective interagency cooperation between tax authorities, custom officials and ministries of mines along the mining value chain.
- Governments should provide tax authorities with greater resources, including well-resourced and specialized transfer pricing units. The units should comprise an appropriate skill mix of accountants, lawyers, geologists/mineralogists, economists, financial analysts and IT specialists.
- Tax authorities should be equipped to undertake systematic audits along the mining value chain and be provided with clear criteria based on the individual risk profiles of various transactions.

- Governments should modernize their tax administration with basic IT systems and expand their legislations to promote information sharing across tax jurisdictions.
- Mineral-rich government should analyze the different options and select and acquire licenses to access appropriate international comparables databases. They may also want to explore opportunities for partnerships with other countries, in order to acquire multiuser licensing for accessing often expensive databases.
- Governments should also step up their investment in geological information, not only as an important tool for attracting investment, but also as a governance instrument for monitoring and tracking illicit leakages along the mineral value chain.
- Mineral-rich countries should invest further in laboratory facilities, in order to verify the quality of extracted ores. They should also invest in tertiary geoscience training programs, including mineral auditing.
- Governments should support civil society organizations in building their capacity to undertake research, analyze data and engage in dialogue and consensus-building, in order to play a meaningful role in the fight against illicit financial flows.

Annexes

A.1 Country Case Study: Democratic Republic of the Congo

I. 1. Introduction and historical background

1.1 Country Demographic (General, Economic and Mining Specific)

La République démocratique du Congo (RDC) est un pays d'Afrique dont la superficie est de 2.345.509 Km² avec une population estimée à 72 millions d'habitants. Par son étendue, elle occupe la troisième place en Afrique après l'Algérie et le Soudan. Elle est limitée au Nord par la République Centre Africaine et le Soudan du sud, à l'Est par l'Ouganda, le Rwanda, le Burundi et la Tanzanie, au Sud par la Zambie et l'Angola et à l'Ouest par l'Océan Atlantique, la province angolaise de Cabinda et la République du Congo. Sa position au cœur de l'Afrique et son étendue font d'elle un pays à la fois de l'Afrique centrale, australe, orientale et occidentale.

Elle²⁰⁵ possède la plus grande étendue de forêt tropicale au monde après le Brésil et 80 millions d'hectares de terres arables. Historiquement, la RDC fut parmi les premiers producteurs de cuivre, de cobalt et d'or mais après des années de négligence et l'absence d'explorations minières, les ressources identifiées sont modestes par rapport au potentiel du pays.

Les grandes évolutions de l'économie congolaise²⁰⁶ peuvent être circonscrites globalement en quatre périodes, à savoir : 1959 à 1973 : Croissance et inflation modérée ; 1974-1988 : Ralentissement de la croissance et inflation ouverte ; 1989-2001 : Déclin de la croissance, Destruction des richesses et hyperinflation ; 2002-2014 : Reprise de la croissance et d'inflation sous contrôle.

1. **Croissance et inflation modéré** : Forte des infrastructures et de l'organisation issue de la colonisation, l'économie congolaise est marquée, au cours de la période de 1960 à 1973 par l'accumulation des richesses intérieures. Caractérisée aussi par des turbulences politiques des cinq premières années de l'Indépendance et les faiblesses au niveau de la gestion des Finances Publiques. Les efforts de redressement économique entrepris entre fin 1967 et fin 1973 ont permis de rehausser la croissance économique qui a coïncidé avec la hausse du cours du Cuivre. Ces éléments ont déterminé les résultats positifs enregistrés a caractérisée par une croissance du PIB réel de 2,7% et une hausse du niveau général des prix de 27% en moyenne annuelle.
2. **Ralentissement de la croissance et inflation ouverte** : Cette période, marquée par une croissance de 0,03% et une inflation de 57,6% en moyenne annuelle, comprend deux phases dont la première (1974 - 1982) est caractérisée par des mauvais choix en matière de politique économique ayant abouti au surendettement du pays dans le cadre de financement des grands travaux (INGA I et II, Centre International de Commerce au Zaïre (CCIZ), la Sidérurgie de Maluku...) sous le sceau de la corruption et de rétro-commissions.

²⁰⁵ Citation : Johannes Herderschee, Kai-Alexander Kaiser et Daniel Mukoko Samba, 2012, "Rapport de Synthèse", dans Johannes Herderschee, Daniel Mukoko Samba et Moïse Tshimenga Tshibangu (éditeurs), Résilience d'un Géant Africain : Accélérer la Croissance et Promouvoir l'emploi en République Démocratique du Congo, Volume I Synthèse, contexte historique et macroéconomique, MÉDIASPAUL, Kinshasa, P 41.

²⁰⁶ Agence Nationale pour la promotion des investissements : profil de l'économie congolaise, 2015 <http://www.investindrc.cd/fr>

Dans un contexte international caractérisé par deux chocs pétroliers (quintuplement et quadruplement du prix du baril respectivement en 1973-1976) et la chute du cours du Cuivre en 1975 (après l'échec de la stratégie mise en œuvre par le Conseil Intergouvernemental des Pays Producteurs et Exportateurs du Cuivre) (CIPEC), les mesures ratées de Zaïrianisation ou nationalisation, de Radicalisation ou Étatisation et enfin de Rétrocession, la gestion peu orthodoxe des Finances Publiques.

La phase de 1983-1989 est celle des efforts d'ajustement de l'économie grâce aux mesures d'assainissement de la politique budgétaire et des réformes entreprises au niveau de la politique monétaire (libéralisation des taux d'intérêt), de la politique de change (adoption du régime des changes flottants et assouplissement de la réglementation de change). Toutefois, ces politiques de gestion de la demande n'ont pas été relayées par des politiques de portée structurelle et des initiatives de développement.

3. Déclin de la croissance, destruction des richesses, hyperinflation et paupérisation généralisée de la population.

La période de 1989 à 2001 est celle du déclin de l'économie et de la société congolaise. La longue transition politique, l'instabilité institutionnelle, les malaises sociaux (événements de Lubumbashi en 1990, conflits interethniques en 1991 et 1992, grèves, contestations populaires, villes mortes...) et économiques (hyperinflation, pillages de l'outil de production et de commercialisation des entreprises en 1991 et 1993, rupture de la coopération bilatérale et multilatérale..).

Le désordre des Finances Publiques est attesté par des déficits insoutenables du trésor financé presque exclusivement par les avances directes de la Banque Centrale avec comme conséquence la dépréciation rapide du taux de change et la hausse vertigineuse des prix intérieurs, respectivement 98% et 9800% en 1994. Les conflits armés, après l'échec de la Conférence Nationale, ont eu des impacts graves tant sur la situation sociale qu'économique. Au cours de cette période, le PIB Réel a reculé de 4,5% en moyenne. La hausse du niveau général des prix a été de près de 2.000 % en moyenne. L'incidence de la pauvreté est établie en moyenne à 80% et le taux de chômage à 84%.

4. Reprise de la croissance et inflation sous contrôle (2001 à nos jours)

Au cours de cette période, coïncidant avec la reprise de la coopération multilatérale et bilatérale, les résultats économiques ont été surtout le fait de l'application des politiques économiques conjoncturelles restrictives et de certaines réformes structurelles de première génération (partenariat dans le secteur minier, guichet unique au Port de Matadi, mise en place de la chaîne la dépense, indépendance de la Banque Centrale, liquidation des banques en difficulté). Ces politiques ont permis de casser l'hyperinflation (hausse du niveau général des prix de 17% en moyenne annuelle, de relancer la croissance économique, de réduire le chômage (passant de 84% à 40 % en moyenne) et la pauvreté de 80% à 63%.

Au cours de ces trois dernières années (2012 à 2014), les résultats économiques de la RDC ont été remarquables au plan de la croissance économique (moyenne de 8,2% contre 5,3% pour l'Afrique Subsaharienne) et de l'inflation (1,6% en moyenne contre 7,1% pour l'Afrique Subsaharienne). Cette croissance demeure résiliente : située à 6,1% en moyenne, cinq ans avant la crise financière de 2009 où elle est tombée à 2,8%, la variation du PIB réel est passée à 7,7%

cinq ans après. Pour l'Afrique au Sud du Sahara, de 7,1% avant la crise où elle a été ramenée à 4,1%, la croissance est établie à 5,3%, cinq ans après. Au regard de l'amélioration de la croissance dans un environnement de faible inflation, le ratio de sacrifice de l'économie congolaise est quasi nul.

Cependant, des faiblesses continuent à caractériser la mobilisation des recettes internes (rapport recettes publiques hors dons de 13,9% en moyenne en pourcentage du PIB contre 21,1% pour l'Afrique Subsaharienne), le niveau des réserves (2 mois d'autonomie pour 5,2 pour l'Afrique), l'accès au marché d'emploi (surtout pour les jeunes et les femmes), la qualité des infrastructures.

1.2 Infrastructures

En RDC, La navigation maritime et fluviale, la gestion du trafic aérien, le transport ferroviaire, et le réseau routier national sont sous l'unique responsabilité du gouvernement central. Le réseau routier il est constitué de 58.385 km de routes nationales, 86.615 km de routes rurales, et 7.400 km de voies urbaines. Selon les estimations, seuls 5 % des 58.000 kilomètres de routes nationales du pays sont revêtus. Le réseau ferroviaire congolais est caractérisé par une vétusté tant des lignes qu'au niveau des machines fonctionnelles. Outre la voie ferré Kinshasa – Matadi à l'ouest (366 km) gérée par la Société Commerciale de Transports et des Ports (SCTP), le réseau ferroviaire de l'est est dominé à l'ouest par de la Société Nationale des Chemins de Fer du C SNCC est largement localisé dans le Sud-Est du pays et couvre nominalelement 3.641 km. Il fait partie du seul réseau ferroviaire intégré en Afrique sub-saharienne. L'interconnexion au réseau zambien permet au bassin minier du Katanga d'avoir accès aux ports de Durban et Dar-es - Salaam. Le trafic actuel sur le réseau de la SNCC (environ 200 millions de tonnes en 2009) est de l'ordre du dixième du tonnage des années soixante-dix.

Le pays possède 15.000 kilomètres de voies navigables sur le fleuve Congo et ses affluents qui relie Kinshasa à Kisangani à l'intérieur du pays. Les barges étaient largement utilisées pour le transport fluvial pendant la période coloniale mais éprouvent d'énormes difficultés de navigation à cause du manque de dragage. Enfin, la RDC possède 270 terrains d'atterrissage, publics et privés, dont quatre aéroports internationaux : Kinshasa, Lubumbashi, Kisangani et Goma dont la majorité ont du mal à fonctionner faute d'entretien et d'équipements.

2. History (General, legal, and mining specific)

2.1 Constitutional law (Mining and tax)

La constitution Congolaise (art. 174) dit « Il ne peut être établi d'impôts que par la loi. La contribution aux charges publiques constitue un devoir pour toute personne vivant en République Démocratique du Congo. Il ne peut être établi d'exemption ou d'allègement fiscal qu'en vertu de la loi ». D'autres lois sectorielles déclinent les différentes impôts et taxes auxquelles contribuables qui sont les personnes physiques et morales à la charge publique.

2.2 Fiscal mining, IFF legislative and policy framework

Il va sans dire que la contribution du secteur minier dans le budget du gouvernement congolais a toujours été considérable pendant les époques précédentes bien qu'en dent de scie variant d'une période à une autre en fonction des contraintes internes et externes basées souvent sous l'effet du marché international.

En 1970, la contribution du secteur minier s'élevait environ à 50% du Produit intérieur brut et à 80% des exportations. Exprimée en valeur pour la même année, la contribution des entreprises minières s'élevait à 44,5% des recettes de l'Etat. « Pour les années, 1978, 1979 et 1980, la contribution des entreprises au budget de l'Etat s'élevait respectivement à 83,7%, 86,8% des recettes en devise de l'Etat ». En 1990, la seule Gécamines représentait 121,4 millions USD de revenus pour l'Etat, soit 14, 8% des recettes totales.

Ainsi qu'il a déjà été relevé, sous l'empire du Code minier de 2002, le secteur des hydrocarbures a généré une contribution au budget de l'Etat plus élevée (14,04%) durant l'année 2011 que celle du secteur minier (13,18%). La rente en faveur de l'Etat ne correspond pas à la reprise de l'activité minière constatée. « [Quelques années après] l'amorce de la réforme du secteur minier congolais, les indices de reprise macro-économique du secteur ne traduisent pas encore les retombées escomptées, malgré une excellente conjoncture mondiale [jusqu'en 2008] ». Et de souligner que le 17 avril 2013, le Congo fut suspendu de l'ITIE.

Dans les pays qui y ont adhééré, cette institution vise à établir les correspondances et divergences entre ce que les entreprises minières prétendent avoir payé comme taxes à l'Etat et celui-ci ce qu'il dit avoir perçu à ce titre. Cette décision intervient à l'issue de la publication du quatrième rapport concernant la RDC. Les informations contenues dans le rapport du Sénat congolais dont l'examen synthétique de la contribution du secteur minier au budget de l'Etat pour une période de quatre ans allant de 2007-2011 présente la situation ci-après :

Tableau : contribution totale du secteur minier au budget de l'Etat.

	2007	2008	2009	2010	2011	Total
Droit sorties	4 521 074 228,00	7 296 316 322, 48	5 370 939 412, 82	3 849 823 713, 08	4 939 518 973, 69	25 977 762 650,07
DGRAD	6 038 601 988,00	41 320 732 738,27	38 282 531 935,56	119 441 622 631,13	126 049 782 092,80	331 133 271 285,76
Impôts exceptionnels	529 716 884,87	967 445 279,69	781 720 809,16	1 254 158 480,84	1 477 566 172,78	5 010 607 627,34
Rémunérations						
Impôts Bénéfices	6 038 601 988, 00	41 320 732 738,27	38 282 531 935,56	119 441 622 631,13	126 049 782 092,80	331 133 271 385,76
Total en CDF	17 127 995 088,87	90 905 227 078,71	82 717 724 093,10	243 987 227 456,18	258 516 649 332,07	693 254 823 048,93
Total en USD	33 142 405,36	170 541 098,38	102 570 183,02	269 019 491,10	281 393 979,90	856 667 157,75
Budget réalisé USD	1 794 181 379,22	2 814 197 185,86	3 260 830 953,59	4 682 219 207,27	3 880 775 841,13	16 432 204 567,07
% du secteur minier	1,85%	6,06%	3,15%	5,75%	7,25%	5,21%

Source : Sénat 2013

Il ressort de ce tableau que la contribution du secteur minier n'est que 5,21% sur la période considérée ce qui est trop faible en rapport avec les espoirs suscités par les ressources minières comme facteur intégrateur de croissance économique. Il y a lieu de mettre en évidence qu'on est en tout cas loin du compte et des espoirs entretenus dans le pays sur les potentialités du secteur minier comme poumon économique de la République démocratique du Congo, et ce juste au moment où les principaux métaux et produits exportés du pays connaissent des prix excessivement élevés tels que jamais enregistrés auparavant dans le monde²⁰⁷. Le taux appliqué pour la période est respectivement pour la période 2007-2012 est de : 1\$\$ = 516 CDF (2007), 553,04 (2008), 806,45(2009), 906,95(2010), 918,70 (2011) et 943,40 (2012).

Malgré l'abondance des produits miniers, le ministère des mines et les autres services publics commis dans la chaîne d'exportation de ces matières a identifié 46 principaux produits marchands exportés régulièrement par les opérateurs. Ces produits ont généré au cours de la période étudiée un chiffre d'affaire 41 millions USD. Ce qui représente juste une goutte d'eau dans ce secteur juteux de l'économie congolaise. En considérant le grand potentiel minier du pays et l'essor de l'industrie minière au vu des résultats des ventes enregistrées les six dernières années de 2007 à 2012, telles que développées dans la présente étude, il y a lieu de noter que le secteur minier, pourtant porteur de croissance, n'apporte pas au budget de l'Etat congolais ce qu'il aurait pu s'il eut été mieux géré.

La contribution réelle de la période 2007-2012 de l'ordre de 1,03 milliards de dollars américains réalisés, représentant seulement 2,51% sur les 41,04 milliards du chiffre d'affaires généré par le secteur, laisse quelque peu perplexe tout esprit doué de bon sens.

En ne contribuant pas de manière équitable et juste au budget de l'Etat, le secteur minier pourrait plutôt être taxé de source d'enrichissement unilatérale et anormal des sociétés minières au détriment du pays entier dont le Budget réalisés de seulement 19,7 milliards de dollars américains ne représenterait que 48,05% du chiffre d'affaires réalisé par lesdites sociétés.

Ainsi, la raison majeure de cette perte sèche en défaveur du compte du Trésor public est imputable au laxisme²⁰⁸ du gouvernement dans la gestion dudit secteur. Ce laxisme pourrait clairement être établi en considérant notamment les aspects suivants :

- Le non prise en compte des différentes recommandations faites au gouvernement et relatives au secteur minier (Sénat, ITIE, FMI, Banque Mondiale, etc.),
- Le non renforcement des capacités des services attitrés (spécialement le service des Mines) pour le suivi et le contrôle de la production, des ventes et des exportations du secteur. Les autorités concernées par la gestion du secteur se contentent généralement des déclarations des opérateurs miniers pour entériner des ventes fictives au lieu de s'en référer aux ventes réelles pourtant renseignés officiellement dans les statistiques qui existent au niveau de différents services de l'Etat. Malheureusement, il faut le noter, pour lesdits services, il y a un manque criant de coordination entre eux et les données ne sont pas partagées pour l'intérêt supérieur du pays ;

²⁰⁷ République démocratique du Congo, Senat. *Etude analytique sur la contribution du secteur minier au budget de l'Etat*, janvier 2013, P24.

²⁰⁸ Etude analytique sur la contribution du secteur minier au budget de l'Etat op cit pp 51-52

- Les mesures populistes visant, soit disant, à attirer et à protéger les investisseurs par des exemptions fiscales intempestives, temporaires et illégales ;
- La vente au rabais du patrimoine minier de l'Etat (titres, gisements, installations minières et métallurgiques) que les acquéreurs revendent de suite à leur profit, à plus de 10 fois voire 30 fois de la valeur d'acquisition ;
- Les recettes de la fiscalité minière non clairement identifiables dans les recettes de la fiscalité globale du pays ;
- Le non-paiement par les sociétés minières des droits, impôts et taxes dus par la dissimulation volontaire des bénéfices réellement réalisés suite au manque de contrôle légal par l'Etat en amont comme en aval du circuit de commercialisation.

Mieux géré tel que démontré par la présente étude analytique, le minimum des recettes à attendre du secteur minier pour le compte du Trésor public devrait se situer au moins à 19,6% du chiffre d'affaires réalisé par les entreprises minières, et ce, calculé avec les taux actuels du Code minier. Ce pourcentage serait beaucoup plus important si le gouvernement décidait enfin de faire appliquer les taux prévus par la loi N° 08/006 du 12 juin 2008 pour les sociétés non détentrices des titres miniers.

La production de la Gécamines de l'époque n'était que de 422,500 tonnes de cuivre, 9, 311 tonnes de cobalt, 54,000 tonnes de zinc, 224 tonnes de cadmium, 25 tonnes d'argent et 11 Kg d'or. Les prix d'alors comparés aux prix actuels sont repris à l'annexe 2 de la présente étude. En conséquence, A titre illustratif, seulement sur quelques impôts et taxes, les métaux de base auraient normalement généré au cours de cette période une redevance minière de 694,9 Millions USD et un impôt professionnel sur les bénéfices de de 5,479,5 millions USD soit au total une contribution au budget de l'Etat de l'ordre de 6,174,4 millions.

2.3 IFF

	2007	2008	2009	2010	2011	2012	Total
Ventes cuivre en millions US \$	1 325,59	2 164,90	1 472,13	3 246,44	4 381,37	4 921,87	17 512,299
Ventes Cobalt en million US \$	3 189,42	4 600,30	1 831,86	3 028,90	3 237,96	2 350,71	18 239,138
Chiffres d'affaires Zn en millions US \$	53,18	67,23	76,31	64,04	88,55	63,79	413,105
Cassité en millions US \$	0,25	2,65	0,00	0,00	0,24	0,96	4,111
Coltan en millions US \$	44,76	188,86	113,47	134,47	107,64	34,40	623,590
Wolframite en millions US \$	3,62	8,40	7,38	4,62	16,31	10,33	50,664
Or en millions US \$	2,15	1,00	6,06	5,90	9,02	103,53	127,657
Vente d'argent en millions US \$	38,67	524,65	244,82	290,66	335,07	266,68	2 275,042
Total en millions US \$	5 278,89	8 781,25	3 754,46	6 912,87	8 277,47	8 031,67	41 036,60

3. Fiscal Mining, IFF Legislative and Policy Framework

3.1 Accounting Rules and Regulations

Les règles comptables sont contenues dans la législation fiscale en vigueur relatives à l'impôt sur le bénéfice destinées aux entreprises industrielles, commerciales, artisanale, agricoles ou immobilières exploitées en sociétés autrement, Le régime de réévaluation de l'actif immobilisé des entreprises régi par l'ordonnance-loi n°89-017 du 18 février 1989, et les dispositions relatives au calcul du prix de transfert souvent inadaptées dans un contexte de dynamique mondiale, lequel la RDC est en retard par rapport aux autres pays du monde tel que les Etats Unis car sous règlementé .

L'article 31 bis de l'ordonnance-loi de 1969 telle que modifiée complété par l'O-L n° 70/086 du 23 décembre 1970 portant impôt sur le revenu dispose « lorsque une entreprise en RDC se trouve directement ou indirectement dans les liens quelconques d'interdépendance à l'égard d'une entreprise établie à l'étranger, tous avantages anormaux ou bénévoles qu'en raisons de ces liens, elle consent à cette dernière ou à des personnes et entreprises ayant avec celle-ci des intérêts communs, sont ajoutés à ses propres bénéfices ²⁰⁹ ». De cette inadéquation du système fiscal congolais, naît des contraintes dans la mobilisation des ressources fiscales capable d'apporter des moyens à l'Etat pour relever les défis du développement socio-économique du pays. De ce constat on note que : le rendement des principaux impôts du secteur à savoir l'impôt sur les bénéfices et la redevance minière, est très faible, à peine 1/3 des recettes totales au cours de la période 2011-2013, la redevance minière est perçue sur une assiette amputée des charges déductibles, après prise en compte de taux d'humidité, en plus de taux d'imposition relativement bas (2,5% pour les métaux non ferreux contre une moyenne de 5% dans la région et de prix de vente des minerais mal maîtrisés . La perspective de collecter l'impôt sur le bénéfice est retardée en raison de la pratique de l'amortissement accélérée, qui se traduit par des pertes fiscales maintes fois reportées. Quelques audits de certification des immobilisations réalisés dans le secteur ont établi des situations flagrantes de surestimation des immobilisations suite notamment à l'imputation des charges indirectes et indirectes non éligibles, les pratiques d'optimisation fiscale , de sous-capitalisation et des prix de transfert aboutissent à l'amenuisement de l'assiette de l'impôt, par le biais de l'augmentation des charges d'exploitation qu'elles induisent ; les différentes exonérations consacrées par le code minier ainsi que les conventions minières se traduisent par des dépenses fiscales assez importantes²¹⁰.

Depuis janvier 2010 la RDC est dans une logique de migration de l'ancien plan comptable élaboré par le Conseil Permanent de la Comptabilité au Congo vers les Normes Internationales d'Informations financières (IAS/IFRS. Ceci est consécutif à l'adhésion de la RDC à l'Organisation

²⁰⁹ République Démocratique du Congo, Ministère des Finances, Codes des Impôts mise à jour 2013, P 63.

²¹⁰

pour l'harmonisation du droit des Affaires en Afrique (OHADA) sanctionnée par une loi le 11 Février 2010.

3.1.1 Mining tax laws and policies

Pour assurer la mobilisation des ressources au profit du trésor public, le gouvernement congolais recourt plusieurs instruments juridiques relatifs aux impôts et taxes légales. Ces législations comprennent : le code des impôts, le code des douanes²¹¹ ainsi que d'autres textes juridiques y afférents tant sur la perception des impôts taxes et redevances dans le secteur minier que dans d'autres secteurs de la vie nationale.

Ces impôts et taxes prévues dans le secteur des ressources naturelles et particulièrement dans le secteur minier sont catégorisés par les trois régies financières existantes à savoir pour la Direction Générale des impôts (DGI) : l'impôt sur les bénéfices et profits, l'impôt mobilier, la taxe sur la valeur ajoutée, l'impôt exceptionnel sur la rémunération, les pénalités fiscales. Pour la Direction Générale des Douanes et Accises (DGDA) : les droits de douane à l'importation, la redevance administrative à l'importation, droits de sortie sur diamant artisanal, droit de sortie sur l'or artisanal, droits de sortie des autres produits miniers. Enfin pour la Direction Générale des Recettes Administratives, Domaniales et de Participation (DGRAD), il y a : la redevance minière, la redevance agrément des comptoirs or et diamant, la redevance pour acheteur supplémentaire, l'autorisation d'export des matières minérales à l'état brut, la caution comptoirs or, diamant et cassitérite, agrément des mandataires des mines et des carrières, autorisation de déminage temporaire, la taxe rémunératoire sur valeur expertisées des substances précieuses, droits superficiels annuels par carré, pénalités et amendes transactionnelles. Cependant, les provinces minières perçoivent aussi certaines impôts et taxes prévues par la loi. La liste exhaustive de la fiscalité /parafiscalité minière est reprise dans les annexes de la présente étude.

²¹¹ La liste des textes juridiques cités sont les suivants:

- L'Ordonnance-loi n° 13/001 du 23 février 2013 fixant la nomenclature des impôts, droits, taxes et redevances des Provinces et des Entités Territoriales Décentralisées ainsi que leurs modalités de répartition,
- L'Ordonnance-loi n° 13/002 du 23 février 2013 fixant la nomenclature des droits, taxes et redevances du Pouvoir Central,
- L'Ordonnance-loi n° 13/003 du 23 février 2013 portant réforme des procédures relatives à l'assiette, au contrôle et aux modalités de recouvrement des recettes non fiscales,
- L'Ordonnance-loi n° 13/004 du 23 février 2013 portant abrogation de certaines dispositions de la loi n° 006/03 du 13 mars 2003 fixant les modalités de calcul et de perception des acomptes et précomptes de l'impôt sur les bénéfices et profits,
- L'Ordonnance-loi n° 13/005 modifiant et complétant certaines dispositions de la Loi n° 004/2003 du 13 mars 2003 portant réforme des procédures fiscales,
- L'Ordonnance-loi n° 13/006 du 23 février 2013 portant régime fiscal applicable aux entreprises de petite taille en matière d'impôt sur les bénéfices et profits,
- Ordonnance-loi n° 13/007 du 23 février 2013 modifiant et complétant certaines dispositions de l'ordonnance-loi n° 10/001 du 20 août 2010 portant institution de la Taxe sur la Valeur Ajoutée,
- L'Ordonnance-loi n° 13/008 du 23 février 2013 modifiant et complétant certaines dispositions de l'ordonnance-loi n° 69/009 du 10 février 1969 relative aux Impôts Cédulaires sur les Revenus,
- L'Ordonnance-loi n° 13/009 du 23 février 2013 modifiant et complétant certaines dispositions de l'ordonnance-loi n° 90-046 du 8 août 1990 portant réglementation du Petit commerce.

3.1.2 IFF Concern

Jusqu'à ce jour, le législateur encore trouvé une définition sur le concept « fuite illicites des capitaux » dans l'arsenal juridique congolais pour identifier ce phénomène. Cependant, Tax Justice Network le définit comme procédé par lequel les riches particuliers et les entreprises déposent leurs fonds ou autres avoirs en dehors du pays de résidence. Les capitaux illicites sont des sommes d'argent gagnées, transférées ou utilisées illégalement²¹². « Il s'agit des fonds qui sont reçus, transférés ou utilisés de façon illégale. Ces fonds proviennent ordinairement de trois sources: l'évasion fiscale commerciale, la falsification des factures dans le commerce international, et des prix de transfert abusifs; des activités criminelles telles que le trafic de drogues, la traite des personnes, les transactions illégales sur les armes, la contrebande, la corruption active et la concussion de fonctionnaires corrompus²¹³. En dépit des publications récentes de Global Financial Integrity (GFI) sur la fuite illicite des capitaux en Afrique, l'action gouvernementale sur les flux illicites des capitaux a été portée la connaissance de l'opinion que dans une période récente.

Par ailleurs, Les nombreuses révélations sur la domination de l'exportation de capitaux illicites de la RDC présentées au jury par une équipe dirigée par le ministre délégué des Finances, Patrice Kitebi Kibol, ont fait mention de seulement 15 pour cent des minerais extraits du pays qui sont déclarés à la douane et les autorités fiscales par les entreprises concernées²¹⁴. Cela veut dire que l'État connaîtrait une perte possible de 85% des revenus. Les autorités congolaises ont déclaré que le gouvernement a vécu un moment difficile à essayer de renverser la tendance en raison du manque d'outils techniques et de capital humain pour contrôler ces fuites, mais aussi en raison de la porosité de vastes frontières du Congo, facilitée par la persistance du conflit dans les régions riches en ressources naturelles du pays. Le problème de la RDC a été aggravé par le phénomène de concentration économique - un système complexe d'oligopoles aidant les entreprises qui travaillent entre elles à frauder le fisc.

Face à ces enjeux, une série de recommandations a été formulée par les intervenants consultés par le Groupe, notamment la nécessité de renforcer la collaboration entre les banques commerciales et les institutions de contrôle financier, de construire un cadre juridique efficace pour répondre aux fuites des capitaux illicites, y compris l'accès à l'information, former les ressources humaines à tous les niveaux pour faire face à la question et leur fournir des outils techniques nécessaires, une campagne d'éthique, lutter contre la corruption, investir dans la transformation industrielle qui encourage la production domestique de ce que les Congolais consomment réellement, stimuler le commerce intra-africain, créer un environnement propice à l'émergence d'une classe moyenne génératrice de richesses, améliorer la sécurité nationale, renforcer la collaboration entre les institutions de l'Etat congolais et promouvoir l'échange d'informations entre Etats africains. Il est plus qu'urgent pour le gouvernement congolais de

²¹² Tax Justice Network - Africa. ; Taxez nous si vous pouvez, Pourquoi l'Afrique doit défendre la justice fiscale, mars 2012, P 85.

²¹³ Commission Economique pour l'Afrique. ; Rapport du Groupe de haut niveau sur les Flux financiers en provenance de l'Afrique, Localisez-les , neutralisez – les, recouvrez – les , P11.

²¹⁴ http://lepotentielonline.com/site2/index.php?option=com_content&view=article&id=2388:flux-financiers-illicites-85-des-exportations-des-minerais-echappent-a-la-douane&catid=85:a-la-une&Itemid=472

renforcer les efforts de lutte anti-corruption par des sanctions judiciaires, chose prometteuse avec la nomination d'un conseiller anticorruption et lutte contre le blanchiment des capitaux au cabinet du Président de la République en mars 2015. Des cas de fraudes douanières et contrebande des minerais ont toujours été considérées comme une des sources principales de la fuite illicite des capitaux pendant une longue période dans ce pays. Que de fois la presse locale a dénoncé la saisie de 180 Kg d'or extrait dans la concession de la firme Kibali Gold mining²¹⁵ d'une valeur estimée à 8 Millions de dollars américains lesquels le trésor public congolais devrait percevoir 3,5 de taxes.

Toujours dans le même chapitre des contrebandes des minerais et fraude fiscale, trois organisations internationales auraient porté plainte contre les entreprises Hussar Services Limited basée à Londres et Hussar Limited dont le siège se trouve à Jersey (une île anglo-normande) pour avoir fondu de l'or pillé entre 2004 et 2005 en Ituri²¹⁶. Des cas de sous évaluations des ressources minières suivi par la minoration de leur valeur pendant la vente des titres miniers par le gouvernement congolais ont démontré à quel niveau le pays devient perdant pendant la signature des conventions minières.

3.1.3 Anti- money laundering and anti-corruption laws.

Depuis 2003, les autorités congolaises ont pris des initiatives louables contribuant à l'assainissement du secteur financier congolais par des mesures visant à lutter contre le blanchiment des capitaux et le financement du terrorisme par la promulgation d'une loi particulière en la matière²¹⁷ qui prend des mesures coercitives, conservatoires et une coopération internationale par l'entraide, l'assistance judiciaire et l'extradition des délinquants présumés coupables ou condamnés aux fins, selon le cas, de procéder aux enquêtes, de les juger ou de leur faire purger les peines prononcées à leur encontre. La loi exige la transparence dans les opérations financières ainsi que la mise en place d'une institution chargée de recueillir et de traiter les renseignements financiers sur les circuits de blanchiment de capitaux et de financement du terrorisme et collabore étroitement avec le ministère de la justice. Outre cette loi spécifique, d'autres mesures ont été prises entre autres :

- La révision de certaines dispositions de la Constitution afin de permettre la mise en œuvre de la poursuite des hauts responsables publics reconnus coupables de la fraude et la corruption,
- La dotation du pays ²¹⁸ des moyens nécessaires au fonctionnement des structures de régulation et de lutte contre la fraude de toutes natures telles que l'Autorité de Régulation

²¹⁵http://www.lepotentielonline.com/index.php?option=com_content&view=article&id=3891:kinshasa-environ-180-kg-d-or-de-la-societe-kibali-goldmines-saisis-au-kenya&catid=90:online-depeches

²¹⁶<http://radiookapi.net/economie/2014/02/13/trois-ong-reclament-des-enquetes-contre-des-societes-britanniques-accusees-davoir-raffine-lor-pille-en-ituri/>

²¹⁷ République démocratique du Congo, loi n° 04/016 du 19 juillet portant lutte contre le blanchiment des capitaux et le financement du terrorisme, Juillet 2004.

²¹⁸ République Démocratique du Congo, Programme Économique du Gouvernement, Mai 2012.

des Marchés Publics (ARMP), l'Inspection Générale des Finances Publiques (IGF) ; la Cours des Comptes, la Cellule Nationale des Renseignements Financiers (CENAREF) et l'Observatoire Congolais d'Ethique Professionnelle (OCEP), assurer leur indépendance.

- L'obligation de publier tout contrat signé entre l'Etat ou une entreprise et un ou plusieurs partenaires nationaux ou étranger, de droit privé ou public, et ayant pour objet la recherche, l'exploration ou l'exploitation des ressources naturelles publier par le ministre en charge de ce secteur²¹⁹ et une série de mesure sur l'amélioration du climat des affaires²²⁰.

Malgré la promulgation de cet arsenal juridique visant à améliorer la gouvernance économique du pays, et d'autres mesures prises par le gouvernement à l'instar de l'opération « Tolérance zéro » ces cinq dernières années, la lutte contre la corruption, le trafic d'influence²²¹ et l'impunité les résultats sont mitigés et loin des répondre aux attentes.

Le Gouvernement est conscient du potentiel indubitable qui peut servir de plateforme au blanchiment des capitaux et au financement du terrorisme dans le pays, du fait de sa sous bancarisation et du caractère informel dominant de son économie. Même si cela n'est pas encore démontré, le risque est cependant grand sur l'impact de ce fléau sur l'environnement des affaires. C'est dans ce cadre que le Gouvernement s'est engagé depuis novembre 2002 dans une stratégie nationale de lutte contre la corruption, le blanchiment des capitaux et la criminalité organisée. Une cellule nationale des Renseignements Financiers et bien d'autres structures citées ci-haut ont été mises en place pour recueillir et traiter les renseignements financiers sur les circuits de blanchiments de capitaux et de financement du terrorisme.

3.1.4 Status of DRM in the country

La mobilisation des ressources financières internes fait des pouvoirs régaliens du pays. La liste des impôts, taxe et redevances perçues pour le compte de l'Etat présentée ci-haut, le régime fiscal, douanier et de change en RDC appelé « régime préférentiel » déroge de celui du droit commun et se caractérise par sa faveur envers les investisseurs étrangers et vise à privilégier la rentabilité des projets miniers. Réputé attractif à cause des taux au rabais, le régime préférentiel constitué des exonérations dans le secteur minier a démontré ses limites et ses faibles du fait que l'Etat congolais est sorti perdant douze ans après la promulgation du nouveau code minier en 2002. L'établissement des exonérations qui constitue, en complément des taux d'imposition très bas, la manifestation de la politique que l'Etat a décidée d'adopter aux fins de relancer cette industrie. En soi la fiscalité minière congolaise est au centre de débat à cause des avantages et largesses accordées auxdits investisseurs n'ont pas permis au peuple congolais de

²¹⁹ République démocratique du Congo, décret n°11/26 du 20 mai 2011 portant obligation de publier tout contrat ayant pour objet les ressources naturelles, mai 2011.

²²⁰ Journal officiel de la République démocratique du Congo, recueil des textes sur l'amélioration du climat des affaires, numéro spécial, mars 2013.

²²¹ Yves-Junior MANZANZA L.; Les manifestations de l'effet Matthieu dans le régime fiscal de la rémunération en République Démocratique du Congo, P19.

se retrouver et de bénéficier des retombées de cette activité. Ce qui constitue une grande lacune du point de vue fiscal²²². Etant tricéphale car il y a un régime fiscal et douanier général des mines, un régime juridique et fiscal des petites mines et un régime juridique et fiscal applicable pour l'exploitation minière artisanale et les comptoirs juridique et fiscal applicable pour l'exploitation minière artisanale et les comptoirs d'achats.

Les taxes et impôts applicables aux activités minières dans le cadre de régime général peuvent être regroupés en 4 grandes catégories : les impôts et taxes qui s'appliquent aux revenus, Les impôts et taxes liés au sol, les impôts et taxes divers et les impôts et taxes liés aux titres miniers. Le constat fait par plus d'expert est que le taux applicable pour les différents impôts sont minimales en plus des exonérations prévues dans le cadre des régimes préférentiels appliqués dans les conventions minières établies entre la RDC représentée souvent par l'entreprise Gécamines et la majorité des filiales des multinationales établies dans ce pays.

Prenons le cas de l'impôt mobilier appelé impôt sur les revenus des capitaux mobiliers qui s'applique : aux revenus d'actions ou parts quelconques et aux revenus d'obligations des sociétés qui ont leur siège social et leur principal établissement administratif au RDC, aux revenus des parts des associés non actifs dans les sociétés autres que par actions, aux revenus, y compris tous intérêts et avantages, des capitaux empruntés à des fins Professionnels par des sociétés ou par des personnes physiques qui ont en RDC, leur établissement, aux tantièmes alloués dans les sociétés de droit national par actions, aux membres du conseil général, aux revenus d'actions ou parts quelconques à charge des sociétés par actions civiles ou commerciales étrangères ayant un établissement permanent ou fixe en RDC, aux tantièmes alloués dans les sociétés étrangères par actions ayant un établissement permanent ou fixe au RDC aux membres du conseil général, aux montants nets des redevances, le terme de redevance désigne les rémunérations de toute nature payées pour l'usage ou la concession de l'usage d'un droit d'auteur sur une œuvre littéraire, artistique ou scientifique, d'un brevet, d'une marque de fabrique ou de commerce.

Le montant des redevances s'entend de leur montant brut diminué des dépenses ou charges exposées en vue de leur acquisition ou de leur conservation par le bénéficiaire. A défaut d'élément probant, les dépenses ou charges sont fixées forfaitairement à 30% du montant brut des redevances. Conformément à l'article 246 du code minier, le bénéficiaire du code minier est redevable de l'impôt sur les revenus mobiliers dans le cadre de la législation de droit commun, à l'exception des revenus mobiliers suivants : les intérêts des emprunts contractés en devises étrangères, Si l'emprunteur est une personne physique. Pour bénéficier de cette exemption le requérant doit apporter la preuve que l'emprunt en cause a été affecté exclusivement aux activités minières. Pour les emprunts intra groupe, en provenance de l'étranger, les intérêts sont déductibles si les conditions de taux et d'autres conditions du prêt sont meilleurs que les taux et conditions que l'emprunteur aurait pu obtenir auprès des bailleurs

²²²Ndela J.; *régime fiscal congolais du secteur minier une approche critique et faiblesse points positifs*, <http://jivetndela.blogspot.com/2012/08/regime-fiscal-congolais-du-secteur.html>

de fonds ne faisant pas partie du groupe de l'emprunteur. Les dividendes versés aux actionnaires ne sont assujettis qu'au taux préférentiel de 10%. Les redevables des revenus mobiliers ont le droit de retenir sur les revenus imposables, l'impôt y afférent et ce nonobstant toute opposition des bénéficiaires quelle que soit la nationalité de ceux-ci. Il est précisé que le montant net de la redevance s'entend de leur montant brut diminué des dépenses ou charges exposées en vue de leur acquisition ou de leur conservation par le bénéficiaire. A défaut d'éléments probants, les dépenses ou charges sont fixées forfaitairement à 30% du montant brut des redevances. Tel qu'il est indiqué ci haut, les dividendes versés aux actionnaires ne sont imposés qu'au taux de 10%, il conviendrait de le porter à 15 ou 20%. Concernant les intérêts des emprunts intra groupe, ces types d'intérêts doivent subir un impôt pour la part excédent le taux d'intérêt applicable par la Banque Centrale. S'agissant des exonérations fiscales et douanières prévues dans le code minier, elles sont souvent liées à l'import et à l'export, aux intérêts d'emprunts et à la rémunération des services rendus. Le code minier accorde un certain nombre d'exonérations dont les plus importantes sont liées à l'exportation, importations, aux intérêts d'emprunts, et à la rémunération des services rendus. L'exportation des échantillons destinés aux analyses et essais industriels sont exonérés de tous droits de douane ou impôts, de quelques natures que ce soit, à la sortie du territoire national.

4. State Institutional Framework

Selon la constitution, le cadre institutionnel de la République Démocratique Congo comprend quatre institutions²²³ : le Président de la République, le Parlement, le Gouvernement et les Cours et Tribunaux. Le Président de la République : Il représente la nation, il est le symbole de l'unité nationale. Il veille au respect de la Constitution. Il assure, par son arbitrage, le fonctionnement régulier des pouvoirs publics et des institutions ainsi que la continuité de l'Etat. Il est le garant de l'indépendance nationale, de l'intégrité du territoire, de la souveraineté nationale et du respect des traités et accords internationaux. Le Parlement : Le pouvoir législatif est exercé par un Parlement composé de deux Chambres : l'Assemblée nationale et le Sénat sont chargées des lois et exercées des contrôles parlementaires au sein du gouvernement, les entreprises et les établissements publics. Le gouvernement définit en concertation avec le Président de la République la politique de la nation et assure la responsabilité. Le pouvoir judiciaire est indépendant du pouvoir législatif et exécutif. La justice est rendue sur l'ensemble du territoire national au nom du peuple. Les arrêts et les jugements ainsi que les ordonnances des cours et tribunaux sont exécutés au nom du Président de la République.

1. **Ministry of Mines** : Depuis l'indépendance du pays en 1960, les secteurs des Mines et des Hydrocarbures étaient régis par un même texte législatif. Il s'agit de l'Ordonnance-Loi n°67-231 du 11 mai 1967, texte abrogé et remplacé par l'Ordonnance-Loi n°81-013 du 02 avril 1981 portant législation générale sur les mines et les hydrocarbures. Actuellement, les mines sont régies par deux textes à savoir la loi n° 007/2002 du 11 juillet 2002 portant Code Minier et le Décret n° 038/2003 du 26 mars 2003 portant Règlement Minier. Ses attributions portent

²²³ République démocratique du Congo, Loi n° 11/002 du 20 janvier 2011 portant révision de certains articles de la Constitution de la République Démocratique du Congo du 18 février 2006, février 2011.

sur l'application de la réglementation, de la gestion du domaine minier, de la cartographie, du contrôle et de la commercialisation des produits miniers jusqu'à la gestion des politiques environnementales.

2. **Ministry of Finance and Treasury** : Ses attributions sont la conduite des politiques monétaire, douanière, fiscale, parafiscale, comptable et des assurances de l'Etat ; les Questions monétaires, banques et organismes de crédit ; la mobilisation des ressources propres de l'Etat et des ressources extérieures et l'encadrement des dépenses publiques ; la politique de gestion de la dette publique directes et indirectes, etc.
3. **Ministry of Trade** : ses attributions sont la promotion du commerce extérieur et étude des propositions sur les orientations générales et sectorielles de la politique du commerce extérieur; Mesures susceptibles de contribuer à la restauration de la compétitivité extérieure des produits congolais exportables notamment en identifiant toutes les entraves structurelles, administratives, financières, tarifaires ou humaines, Contrôle de la quantité, de la qualité et des normes de tous les produits à l'import, à l'export et au transit, la gestion du contentieux.
4. **Central Bank** a pour mission de garder les fonds publics et de sauvegarder la stabilité monétaire, de définir et de mettre en œuvre la politique monétaire et le contrôle de l'ensemble bancaire.
5. **Revenue authority** : La perception des recettes fiscales et parafiscales en RDC est confiée à trois régies financières dépendant du ministère des finances. Les trois sont la DGI, la DGRAD et la DGDA. C'est la Direction Générale des Impôts (DGI) qui exerce dans le cadre des lois et règlements en vigueur, toutes les missions et prérogatives en matière fiscale. Ces missions et prérogatives comprennent notamment celles concernant l'assiette, le contrôle, le recouvrement et le contentieux des impôts, taxes, redevances et prélèvements à caractère fiscal. À cet effet, la Direction générale des impôts est chargée d'étudier et de soumettre à l'autorité compétente les projets de lois, de décrets et d'arrêtés en la matière. Elle doit être consultée pour tout texte ou toute convention à incidence fiscale ou tout agrément d'un projet d'investissement à un régime fiscal dérogatoire. La Direction générale des impôts exerce ses compétences, de manière exclusive sur toute l'étendue du territoire national.
6. **La Direction Générale des recettes administratives et domaniales (DGRAD)** : exerce toutes les missions et prérogatives en matière d'ordonnancement et de recouvrement des recettes administratives, judiciaires, domaniales et de participations émergeant au budget général de l'Etat. En collaboration avec les autres Administrations, elle peut élaborer et soumettre aux autorités compétentes des projets de loi, de décret, d'arrêté, de circulaire et autres instructions dans le domaine de ses attributions.
7. **Direction Générales des Douanes (DGDA)** : Dans les conditions prévues par les lois et règlements, la DGDA exerce sur l'étendue du territoire national toutes les missions et prérogatives relatives à l'application des législations douanière et arcisienne, ainsi qu'à celle de tous autres textes légaux et réglementaires liés à l'importation ou l'exportation, au transit et au séjour des marchandises en entrepôt de douane. A cet effet, elle perçoit les droits, taxes et redevances à caractère douanier et fiscal, présents et à venir, qui sont dus soit du

fait de l'importation ou de l'exportation des marchandises de toute nature, soit du fait de leur transit ou de leur séjour en entrepôt douanier ; la perception des droits d'accises et de consommation présents et à venir ; la classification des marchandises ; la détermination de l'origine des marchandises ; la détermination de la valeur en douane des marchandises à l'importation et à l'exportation ; le contrôle des prix ex-usine des produits soumis aux droits d'accises ; la conception et la mise en œuvre des mesures visant la facilitation et la sécurisation des échanges commerciaux, ainsi que celles relatives à la production locale des produits soumis aux droits d'accises ; le renforcement des capacités du personnel aux techniques modernes de gestion dans le domaine des douanes et accises ; la protection de l'espace économique national en particulier par l'application des normes aux frontières ; l'application des législations connexes aux frontières concernant la protection de l'environnement conformément aux conventions internationales ; la protection de la société par la lutte contre le trafic illicite des marchandises dangereuses et des déchets toxiques, des produits qui appauvrissent la couche d'ozone.

5. The Global Value Chain and Global Wealth Chain Analysis

1. Mineral Discovery and Survey Stage

La RDC est extrêmement riche en minéraux précieux et l'on estime à 24 billions USD les gisements inexploités de minerais bruts que possède le pays, y compris les plus grandes réserves mondiales de cobalt (51 % des réserves connues) et d'importantes quantités de diamants, d'or et de cuivre. En 2009, la part qu'occupait le pays dans la production mondiale de minerais de cobalt s'élevait à 40 %. La part mondiale associée à d'autres minerais durant cette même année est énumérée ci-après : diamant industriel, 31 % ; tantale, 9 % ; diamant de qualité gemme, 6 % ; étain, 4 % ; cuivre, 2 %. Outre les principaux minerais traditionnels cités ci-haut, la RDC regorge plusieurs ressources minérales estimées à 1100 espèces disséminées dans toutes les provinces. Les estimations des différentes ressources minières comprennent les métaux de base dont le fer localisé dans la province orientale et ailleurs estimé à 20.000.000.000 de tonnes de réserves, les métaux non ferreux tels que l'aluminium et le cuivre situé respectivement dans le Bas – Congo et le Katanga compte 62.331.514 tonnes dont les réserves. L'étain, le Plomb et le zinc dont le tonnage estimatif s'élève à 4.055.403 se localisent à Kipushi au Katanga, au Bas – Congo et dans l'ex- Kivu. Les métaux d'alliage dont le chrome – Nickel est identifié dans les deux Kasai sont estimés à 22 ,5 millions de tonnes. Le cobalt dans le Katanga compte 4.920.060 tonnes de réserve. Les métaux stratégiques que sont le Beryllium, la Monazite ((Minerai du Cérium, Lanthane, Thorium, Yttrium) et le Lithium, situés dans les deux Kasai, le Katanga et le Kivu. Le colombo tantalite (coltan) qui constitue la matière base pour la fabrication des téléphones cellulaires et les ordinateurs sont localisés dans le sud Kivu, Maniema et au Katanga dont les réserves sont évaluées à 33.441.300 tonnes de minerai à 2,42 % Nb₂O₃, soit 808.700 tonnes de Nb₂O₃. Pour l'Or, les gisements les plus importants se situent dans les Provinces suivantes : Province Orientale, Maniema, Nord-Kivu et Sud-Kivu. Il existe des indices dans les provinces du Bas Congo, les deux Kasai, l'Equateur et du Bandundu. Le diamant dont les réserves sont estimées à 140.000.000 tonnes dans gisement le plus important se trouve dans le Kasai à Bakwanga.

2. Feasibility Study

Dans la plupart des cas, il n'y a pas d'études indépendantes préalables réalisées par le gouvernement avant l'attribution d'une concession minière en RDC. Cependant le gouvernement se base des anciennes données de l'époque coloniale qui lui permettent de décider sur la valeur d'une mine. En plus, le gouvernement congolais n'a pas l'expertise requise et les moyens pour mener ce genre d'études car souvent couteuses.

3. Corporate Modelling

4. **Les entreprises minières** seules réalisent des études de faisabilité avant l'attribution des titres pour connaître la valeur d'une mine. Cependant, les conclusions de ces études ne sont pas à la portée du public car elles sont couvertes des clauses confidentielles.

5. Development of bilateral and multilateral agreements.

Les conventions minières entre la RDC et les entreprises multinationales établies ont été signées pendant la période des conflits que le pays a traversé ces dernières années. Elles ont été signées de manière précipitée pour financer l'effort de guerre. Bien qu'elles aient été révisées en 2007 sous la pression de la société civile et de la communauté internationale ces conventions n'ont pas respecté les clauses de l'OCDE, sinon le pays n'aurait pas accepté des taux d'impôts et taxes les bas au monde. En plus face aux défis de relance économique, le gouvernement affaibli par plusieurs années de guerre n'avait pas d'autres choix que d'accepter les accords malgré le bradage des ressources minières du pays. « Avec la montée fulgurante des investissements étrangers, perçus de nos jours comme une donnée indispensable pour le développement économique, cet état de choses soulève bien des questions sous l'angle juridique. En tant qu'entité souveraine, l'Etat va-t-il le droit de modifier unilatéralement les termes d'un contrat auxquels il a librement consenti ? Quelle responsabilité pourrait-il encourir à l'égard de l'investisseur étranger ? Le droit des investissements étrangers ayant des racines aussi bien en droit interne qu'en droit international, les réponses à ces questions semblent varier selon que l'on se trouve dans l'ordre juridique national ou international »²²⁴. Malgré la « révisitation » d'une soixantaine des conventions minières le volume des recettes ne répond pas aux attentes du gouvernement. Seules les filiales des multinationales se tapent la part du lion.

6. Stage of mining, tax points and potential of IFF

- Exploration Stage

Sur cette partie les taxes et impôts ciblés sont ceux liés au titre minier. Il s'agit de :

- Les impôts liés à la prospection minière : la requérante paie 25 \$ pour obtenir son attestation de prospection comme frais de constitution du dossier. Cependant ce droit viendra en déduction au cas où le requérant sollicite le permis de recherches ou D'exploitation par la suite. Il conviendra d'établir par exemple le paiement de 30% de droit superficiaires applicable la première année du permis de recherches.
- Les impôts liés aux activités minières de la recherche : payable avant le début de l'exploitation minière, le requérant sollicite le permis de recherches.

²²⁴ <http://www.leganet.cd/Doctrine.textes/Decon/Dcontrats/RevisiondescontratsminiersRDC.pdf>

- Le droit superficiaires annuel par carré lié au permis de recherches : Le requérant au permis de recherches supporte des droits superficiaires annuels par carré. L'objet de ces droits, est la prise en charge des coûts des prestations et de la gestion des droits constatés par les titres miniers. Ces droits sont versés au cadastre minier, qui rétribue une quotité aux services du ministère des mines, chargé de l'administration du code. Il est rappelé que la durée du permis de recherche est de :
 - 4 ans pour les pierres précieuses, renouvelable 2 fois pour 2 ans de chaque Renouvellement.
 - 5 ans pour les autres substances, renouvelable 2 fois pour 5 ans de chaque renouvellement.

Ainsi, les droits superficiaires annuels portant sur la recherche minière sont réglées comme suit :

1. 2,55 \$ US par carré pour chacune des deux premières années de la première période de validité du permis. Soit 0,03 \$ US par hectare,
2. 26,34 \$ US par carré pour chacune des années de la première période de validité après les deux premières années. Soit 0,31 \$ US par hectare, correspondant à 10 fois plus que les deux années précédentes.
3. 43,33 \$ US par carré pour chaque année de la première période de renouvellement, Soit 0,51 \$ US par hectare, correspondant à soit 1,7 fois plus que les années suivantes les deux premières années.
4. 124,03 \$ US par carré pour chaque année de la deuxième période de renouvellement, Soit 1,46 \$ US par hectare correspondant à 2,8 fois plus que les années du premier renouvellement.

Les impôts liés au permis d'exploitation

- Droits fixes liés aux permis d'exploitation : Les frais de dossier liés à l'instruction cadastrale. Toute demande de permis d'exploitation fait l'objet d'un versement de frais de dépôt partiel de dossier afférent à l'instruction cadastrale, équivalent en franc congolais à 500 \$ US. Les frais de dossier liés à l'instruction environnementale. Dès la notification de l'avis cadastral, le requérant paie les frais de dépôt pour l'instruction environnementale de sa demande de permis d'exploitation.
- Les droits superficiaires annuels par carré applicables au permis d'exploitation : Les taux dépendent du type de permis d'exploitation en cause. Pour le permis d'exploitation, le taux est de 424,78 \$ US par carré, soit l'équivalent de 5 \$ US par hectare. Pour le permis d'exploitation de rejets, le taux est de 679,64 \$ US par carré, soit l'équivalent de 8 \$ US par hectare. Pour le permis d'exploitation de petites mines, le taux est de 195,40 \$ US par carré, soit l'équivalent de 2,30 \$ US par hectare.
- Concernant le permis d'exploitation des carrières : Le taux des droits superficiaires annuels par carré pour le permis d'exploitation des produits de carrières est fixé à l'équivalent en Francs congolais à 169,91 \$ US pour chaque année de la validité de l'autorisation sans distinction entre la durée initiale et renouvellement. Soit 2 \$ US par hectare. Ces droits sont calculés et perçus par le cadastre minier qui le reparti comme

suit: cadastre minier centrale :50% direction des mines : 8% direction de géologie : 9% direction chargée de la protection de l'environnement : 6% direction des investigations : 3 cellule technique de coordination et de planification minière (CCTPM) : 3% service d'assistance et d'encadrement du Small scale mining : 6% dont 10% sont destinées au développement des communautés locales de base ou se déroulent les activités minières artisanales et ou à petite échelle. Commission interministérielle d'adjudication : 1,5%, Comité permanent dévaluation : 2%.

6. Recommandations

La lutte contre la fuite des capitaux dans le secteur minier en RDC pour trouver à travers :

1. La réforme en profondeur du système fiscal congolais entre sur les aspects liés au calcul du prix de transfert longtemps considéré comme un case tête entre le gouvernement congolais et les entreprises multinationales basées au Congo. La création d'une direction au sein de la Direction générale des Impôts pour discuter essentiellement de la question serait une voie de sortie pour l'Etat congolais.
2. La réforme du code minier par l'augmentation des taux d'imposition aux différents impôts et taxes permettraient au gouvernement d'augmenter les recettes et d'améliorer la contribution du secteur au budget de l'Etat,
3. Renforcer la coopération internationale par l'entraide judiciaire entre les Etats et L'assistance/ entraide judiciaire entre les Etats et le rapatriement des avoirs volés dans le pays,
4. Le renforcer les mesures pour lutter contre le secret bancaire permettra à l'opinion d'informer sur les entreprises qui excellent dans la fraude fiscale et la dissimulation des bénéfices,
5. La formation du personnel de l'administration fiscale pour lui rendre compétitif, et ainsi lui permettre de traquer les délinquants fiscaux et ainsi combattre les arrangements fiscaux au détriment du trésor public.
6. L'information de l'administration fiscale ?
7. La lutte contre la corruption sous toutes ces formations au sein de l'administration fiscale et dans les douanes.

A.2 Country Case Study: Republic of South Africa

1. Introduction: History of the South African mining sector

The South African economy was built on mining, which has been the backbone of the economy since the 1800s. South Africa is globally recognized as the leading supplier of a variety of minerals and mineral products, which include rich deposits of platinum, gold, diamonds, coal, antimony, chromite, cobalt, copper, iron ore, lead, manganese, nickel, silver, steel, titanium, uranium, vanadium, zinc and zirconium. South Africa is the world's largest producer of gold, platinum group metals and chromium. It is also the fourth-largest producer of diamonds, which were first discovered in 1870 near the town of Kimberley. This was followed by the discovery of gold in the Witwatersrand area in 1886,²²⁵ resulting in the country now being recognized as the world's second-largest gold producer. The mining industry, led by gold and diamonds, continued to grow throughout the twentieth century, generating revenues that drove industrialization in South Africa. The growth of many towns and cities and much of South African infrastructure – road and rail networks in particular – stemmed from the development of the mining industry. In 2000, platinum overtook gold as the country's largest foreign exchange earner. The northern part of South Africa contains most of the world's platinum reserves, making the country the world's largest producer of platinum group metals. South Africa owns about 90 per cent of the globe's platinum metal reserves, 80 per cent of its manganese, 73 per cent of its chrome, 45 per cent of its vanadium and 40 per cent of its gold reserves. South Africa is also a major supplier of coal (world rank 5), iron ore (9), nickel (5) and uranium (5).²²⁶ Many of the world's largest mining companies are South African or have their origins there, notably De Beers, Anglo American, Anglo Platinum, Anglo Gold Ashanti, Gold Fields, Impala Platinum Holdings, Lonmin Plc and Harmony Gold.

Currently, the mining sector's direct contribution to the country's gross domestic product (GDP) is estimated at around 8 per cent of GDP, while mining and related industries contribute up to 18 per cent of GDP. The sector is estimated to contribute between 10 per cent and 20 per cent of all corporate taxes.²²⁷ The sector is an important net generator of foreign exchange and a major attraction for foreign investment inflows. It is a large employer of semi-skilled and skilled workers with high levels of technical and production expertise.²²⁸ It is also a significant driver

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²²⁵ M Curtis "Mining and Tax in South Africa: Costs and benefits" (February 2009) at 4. Available at <http://www.curtisresearch.org/SAfrica.MiningTax.Feb09.Curtis.pdf> accessed 12 January 2015.

²²⁶ Ibid.

²²⁷ Shari Bryan & Barr Hofmann *Transparency and Accountability in South Africa Extractive Industries: The Role of Legislature – South Africa* (2007) at 88.

²²⁸ Muhammad Saloojee, KPMG Press Release "Mining companies seeking certainty on tax issues in the forthcoming 2013 Budget Speech" (27 February 2013). Available at <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/tax-and-legal-publications/pages/tax-issues-in-the-2013-budget-speech.aspx> accessed 12 January 2015.

of economic transformation and the largest contributor to Broad-Based Black Economic Empowerment wealth creation.²²⁹

Although mining has historically been a very important sector to the South African economy, the pace of mineral exploration has fallen off over the years and the mineral base has been depleted, with the result that its relative contribution to GDP has declined. Gold, traditionally the major driver of the economy, has seen a consistent contraction. The number of people employed in the sector has also dropped, mainly due to rising production costs and automation.²³⁰ There are concerns about the government's inability to ensure that mineral wealth translates into sustainable economic development and contributes to revenue mobilization.²³¹ The Chamber of Mines of South Africa contends that the cost of mining in the country is increasing and affecting the viability of the operations, which are also hampered by the fact that the government has placed demands on mining companies to play a big role in corporate social responsibility.²³² Mining companies have also been concerned by the widely reported rhetoric about the nationalization of mines, which has sharply reduced the industry's attractiveness and resulted in billions of dollars in deferred or abandoned investments. However the government has declared that it has no short-term agenda to pursue resource nationalization.²³³ South African mining companies' margins are also under pressure from a combination of stagnant or falling global commodities prices and rising input costs. These matters are forcing mining companies to lay off workers. The mining sector, which relies heavily on electricity, is also facing power problems due to the financial woes of the country's parastatal company Eskom.²³⁴ The mining sector is also affected by labor unrest as a result of the annual "strike season", which is characterized by increasing salary and socioeconomic demands by trade unions and mine workers. This has resulted in jobs losses in certain mining companies or threats of mine closures. Corruption is known to be rife in the extractive sector, which greatly limits the optimization of revenue in this sector.²³⁵

2. State institutional regulatory framework

Previously, ownership of the diamond and gold mines was privately controlled by a few white entrepreneurs known as Randlords. When apartheid ended in 1994, the democratically elected government undertook a review of South African mining policies and legal framework in 1995. This culminated in the Minerals and Petroleum Resources Development Act (MPRDA) 28 of

²²⁹ Shari Bryan & Barr Hofmann (2007) at 88.

²³⁰ Curtis (February 2009) at 6.

²³¹ Muhammad Saloojee, KPMG Press Release "Mining companies seeking certainty on tax issues in the forthcoming 2013 Budget Speech" (27/022013). Available at <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/tax-and-legal-publications/pages/tax-issues-in-the-2013-budget-speech.aspx> accessed 12 January 2015.

²³² Shari Bryan & Barr Hofmann (2007) at 90.

²³³ Muhammad Saloojee, KPMG Press Release (27/02/2013).

²³⁴ UNISA "UNISA experts weigh in on Budget Speech" Available at <http://www.unisa.ac.za/news/index.php/2015/02/unisa-experts-weigh-in-on-budget-speech/> accessed 9 March 2019

²³⁵ Public Protector South Africa "Corruption and Governance Challenges: The South African Experience" (21 January 2010). Available at http://www.publicprotector.org/media_gallery/2010/PP%20Speech%20Nigeria%20Corruption%20and%20Governance%20Challenges%20final.pdf accessed 8 March 2015.

2002, which recognizes state rather than private custodianship over minerals in the country. The preamble to the MPRDA states that the country's natural resources belong to all its citizens, and that the government bears responsibility for ensuring that the benefits from the exploitation of these minerals are shared equally shared by all South Africans.²³⁶ Under the MPRDA, existing mineral rights revert to the government unless companies act within five years to convert "old order" exploration and mining rights into "new order" rights. Section 27 of the MPRDA requires that a natural person or juristic person (resident or non-resident) must apply for a mining permit, which has to be issued by the Minister of Minerals and Energy. The MPRDA recognizes the States' obligation in the Constitution of the Republic of South Africa, 1996 to redress the results of past racial discrimination. Thus section 12 thereof provides that the Minister may facilitate assistance to any historically disadvantaged person to conduct prospecting or mining operations. This is line with the 2002 "Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry".²³⁷ Section 26 of the MPRDA provides that the Minister of Finance may prescribe incentives to promote the beneficiation of minerals in the Republic. The Department of Minerals and Energy (DME) regulates the country's extractive sector and is responsible for overseeing the exploration, development, processing, utilization and management of minerals in South Africa. The DME also plays a central role in overseeing the payment of royalties for license holders and ensuring sustainable mineral exploration and mining, as well as encouraging the involvement of previously disadvantaged communities in the South African mineral industry.

3. Legal taxation framework for the mineral sector

1. **Corporate income tax:** In terms of s 38(2)(g) of the Income Tax 58 of 1962 (ITA), a company whose principal business in South Africa is gold or diamond mining is regarded as a public company for tax purposes and is liable for normal tax on all mining and non-mining income at a rate of 28 per cent. In terms of s 37A of the ITA, companies involved in the environmental rehabilitation of mining areas upon closure are exempt from tax. The ITA provides certain deductions for mining expenditure:
 - Deduction of capital expenditure (s 15(a) read together with s 36 of the ITA): This covers expenditure on shaft sinking, mine equipment, development, general administration and management, as well as on the construction of infrastructure for the use of employees. However, there are limitations to the capital expenditure deduction. Firstly, s 37(7E) limits the deduction of capital expenditure to the "gross mining taxable income" derived by the taxpayer from mining. The excess that is not deductible in that year must be carried forward, and will be deemed to be incurred in the next succeeding year of assessment. Secondly, s 36(7F) limits the deduction of capital expenditure to the "gross mining taxable income" derived by the taxpayer from mining on that particular mine. This ring-fencing provision ensures that capital expenditure in respect of one mine can

²³⁶ South Africa *Mining Laws and Regulations Handbook* Vol 1 (2014, International Business Publication, USA) at 121.

²³⁷ South Africa Department of Mineral Resources, "Amendment of the Broad-Based Black Economic Empowerment Charter for the South African Mining and Minerals Industry," Pretoria, September 2010.

only be set off against the mining income of that mine. If such expenditure exceeds the taxable income of that mine, it shall be carried forward to the succeeding year. However, s 36(7G) offers relief from ring-fencing to a “new mine”, a mine on which mining and operations were commenced by the taxpayer after March 14, 1990. To prevent new mines from being housed temporarily in companies with substantial mining tax bases prior to disposal, there is an exclusion to the application of s 36(7G) which provides that if a new mine is disposed of during the year and the recoupment of capital expenditure does not exceed such unredeemed capital expenditure, the excess capital expenditure may not be set off against the income of the taxpayer’s other mines. The exclusion also ensures that s 36(7G) does not apply where the acquisition of the right to mine in respect of a new mine is financed wholly or partly by the issue of shares, in respect of which any dividend is to be calculated by reference to that portion of the company’s profits which is attributable to the operation of such mine.

- Deduction of expenditure for prospecting operations (s 15(b) of the ITA): This includes expenditure incurred on surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine in the Republic. The capital expenditure under s 15(a) and (b) of the ITA has been criticized, however, for not being favorable to the fiscus, as it allows for the accelerated write-off of mining capital expenditure against taxable mining income. This is a substantial subsidy for investment in equipment in the mining sector.
 - Deduction in respect of environmental treatment and recycling assets, as well as environmental waste disposal assets, is provided under s 37B.
 - Deduction in respect of environmental conservation and maintenance: In terms of s 37C (1) of the ITA, expenditure actually incurred by a taxpayer to conserve or maintain land is deemed to be expenditure incurred in the production of income.
2. **Special tax formula for gold or diamond mining companies:** To encourage investment in these mines, the taxable income derived by a company from mining gold or diamonds is determined based on a formula which takes into account the marginal tax rate, the portion of tax free revenue and the ratio of taxable income to total income.²³⁸ Since the formula depends on the ratio of taxable income to turnover, it substantially lowers the tax rate²³⁹ and the revenue which can be generated from gold and diamond mines. As profits rise, the state takes a larger proportion in tax. If the company makes low or no profits, the state receives no tax. However, shareholders can still receive dividends during this time.
3. **Capital gains tax implications:** CGT is levied under in the eighth schedule to the ITA read with section 26A of the Act. If a non-resident disposes of a mining operation (immovable property located in South Africa), CGT would apply.

²³⁸ Explanatory Memorandum on the Income Tax Bill, 1990.

²³⁹ Curtis (February 2009) at 4.

4. **Withholding taxes:** Since it is difficult to collect income tax on the earnings of non-residents, countries normally levy withholding taxes on their earnings.²⁴⁰ If there is a treaty in place, the withholding tax rate will be limited to the treaty rate.
- Where a non-resident mining company derives royalties from mining operations in South Africa, s 35(1) of the ITA provides for a final withholding tax of 12 per cent on the royalties.
 - In terms of s 35A of the ITA, amounts paid for the disposal of the immovable property (e.g. a mine) of a non-resident are subject to a withholding tax equal to 5 per cent, in the case of an individual, 7.5 per cent for a company, and 10 per cent, in the case of a trust.
 - In terms of s 64D to 64N of the ITA, a dividend withholding tax at a rate of 15 per cent is levied on the shareholder in respect of dividends paid by any company other than a headquarter company. Subject to certain exemptions, the dividend tax is payable by South African resident companies or by non-resident companies listed on a South African exchange.²⁴¹
5. **Royalty tax:** As of 2009, mining operations in South Africa are subject to a royalty tax under the Mineral and Petroleum Resources Royalty Act 28 of 2008 (MPRRA). Before then, royalty payments for privately owned mineral rights were determined by agreement between local chiefs and mining companies.²⁴² Under s 2 of the MPRRA a royalty tax is levied on a mineral resource extracted from the Republic, depending on whether it is a “refined mineral resource” or an “unrefined mineral resource”. The royalty tax is calculated based on a formula provided in s 3(1) of the MPRRA. There are criticisms, however, that the royalty tax formula favors mining companies, since there is an upper cap on the rate that does not allow the State to share in “super profits”.²⁴³ There have been suggestions to replace the royalty regime with a resource rent tax on any super profits which would be triggered after a “normal” return on investment has been achieved. In 2012, the government commissioned the report “Maximizing the Development of the People’s Mineral Assets”²⁴⁴, which recommended the introduction of a resource rent tax of 50 per cent on all profits above a 15 per cent return on capital, as well as the reduction of royalties payable to one per cent.
- **Stabilization clauses:** To ensure the royalty regime is “investor friendly”, s 13 of the MPRDA provides that the Minister of Finance may conclude an agreement with a mineral extractor that guarantees stability of the terms of the agreement for a number of years. Any legislative amendments after the agreement is signed will have no force and effect. Mining companies are entitled to compensation if the state breaches the agreement.

²⁴⁰ B Spitz & G Clarke *Offshore Service* (March 2002) Issue 66 at LEX/26.

²⁴¹ L Olivier & M Honiball *International Tax: A South African Perspective* (2011) at 102.

²⁴² Curtis (February 2009) at 4.

²⁴³ Muhammad Saloojee, KPMG Press Release (27/02/2013)..

²⁴⁴ ANC SIMS Report “Maximising the Development of the People’s Mineral Assets: State Intervention in the Minerals Sector” (SIMS) – 11 June 2012).

6. **Diamond export levy:** To promote the domestic diamond cutting and polishing industry, a diamond export levy at a rate of 5 per cent is imposed on rough diamonds that are exported for processing, as provided in s 3 of the Diamond Export Levy Act 15 of 2007.
7. **Taxation of oil and gas companies:** South Africa is not a major crude oil producer. Its proven reserves amount to 15 million barrels. However, through its Fischer-Tropsch process, the South African Coal, Oil and Gas Corporation (SASOL) is the world's leading oil-from-coal producer. SASOL's Secunda plant is also the world's largest producer of concentrated carbon. South Africa has abundant gas reserves and has the world's largest gas-to-liquid refinery in Mossel Bay on the Cape South Coast.²⁴⁵ Section 26B of the ITA, read together with the Tenth Schedule to this Act, provides for the taxation of oil and gas companies. Section 2 of the Gas Act, 48 of 2001 provides for the imposition of a gas levy, based on the amount of gas, measured in gigajoules, delivered by importers and producers to inlet flanges of transmission or distribution pipelines, on the person holding the title to the gas at the inlet flange.
8. **Value-added tax implications:** Under s 7(3)(a) of the VAT Act 89 of 1991, VAT is levied at the rate of 14 per cent. Section 11 provides for zero rating for all exports. Since most mineral production is exported, mining companies not only pay no VAT on those exports, but are also entitled to a refund for all input taxes paid. This is a major gain for gold and diamond companies, which export virtually all of their production. Zero rating also applies to petroleum and crude oils obtained from bituminous minerals.

3.1 Addressing concerns in the mining sector taxation framework

Taxation of mining companies has been at the forefront of the debate in South Africa as to whether the State derives sufficient revenue from this sector to support public spending. The concerns are that the mining tax regime of South Africa is archaic, complex and out of touch with current economic realities. In the 2013 budget, the Minister of Finance stated that mining taxes would be reviewed as part of a broader investigation into the effectiveness of the nation's tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability. Consequently, the Minister appointed the Davis Tax Committee, whose terms of reference include a review of the South African mining tax regime. In 2015, the Davis Tax Committee issued its interim report for public comment on mining tax in South Africa.

3.2 Measures to address tax avoidance: base erosion and profit shifting

The term "base erosion and profit shifting" (BEPS) refers to the use of tax avoidance schemes by multinational enterprises that manipulate gaps in the interaction of different tax systems, in order

²⁴⁵ T Hughs, Revenue Watch Institute "South Africa a Driver of Change: Increasing Transparency and Change in the Extractive Industries" Working Paper Series 2012 at 13.14. Available at http://www.resourcegovernance.org/sites/default/files/SouthAfrica_TAI.pdf accessed 22 January 2015

to artificially reduce taxable income or shift profits to low-tax jurisdictions featuring little or no economic activity. The tax avoidance schemes they employ involve utilizing loopholes in tax laws and exploiting them, ostensibly within legal parameters, so as to pay less tax.²⁴⁶ In 2013, OECD issued a report²⁴⁷ recommending the actions that countries ought to take to prevent BEPS. In response to this report, in 2014, the Davis Tax Committee of South Africa released a report highlighting BEPS concerns in the country and related recommendations (this includes concerns in the mining sector).²⁴⁸

- **Transfer pricing:** This term describes the process whereby related entities set prices at which they mutually transfer goods or services. It entails a systematic manipulation of prices in order to artificially reduce or increase profits or cause losses and avoid taxes in a specific country.²⁴⁹ Although there are no court cases on transfer pricing in South Africa, there have been allegations of mining companies being involved in transfer pricing schemes. In 2014, media reports²⁵⁰ spotlighted allegations of transfer pricing by the platinum mining company Lonmin (whose parent company is based in the UK), which had been embroiled in a protracted wage dispute by its Marikana rock drillers in 2012. The revelations arose from the information made public in the proceedings of the “Farlam Commission of Inquiry” into the deaths of 34 miners at the Marikana Mine in 2012. Further allegation of transfer pricing in the mining sector were made in a submission before the Portfolio Committee on Trade and Industry by the South African Mining Development Association (SAMDA)²⁵¹, which contended that some mining companies sell commodities to their marketing divisions in low-tax jurisdictions at below-market prices.
- **Thin capitalization:** These schemes entail the use of unusual proportions of loan to equity capital in order to gain a tax advantage.²⁵² SARS has indicated that there are excessive debt deductions through thin capitalization in the mining sector.²⁵³ SAMDA also alleges that mining companies are involved in thin capitalization schemes.²⁵⁴
- South Africa has transfer pricing and thin capitalization is prevented using the arm’s length principle under s 31 of the ITA. With regards to mining, s 11(2) of the MPRRA provides that to the extent that the gross sales differ from those that an extractor would have taken into account if they had been derived from arm’s length transactions, the

²⁴⁶ A Rapakko *Base Company Taxation* (1989) at 39.

²⁴⁷ OECD *Action Plan on Base Erosion and Profit Shifting* (2013) at 19.

²⁴⁸ BizNews.com “Budget 2015: New Income Tax Tables” Available at <http://www.biznews.com/budget/2015/02/25/budget-2015-new-income-tax-tables/> accessed 8 March 2015.

²⁴⁹ Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa ‘Second Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa: Thin Capitalisation Rules’ (1995) para 1.3b.

²⁵⁰ A Crotty “Lonmin’s Failed gag Bid puts spotlight on transfer Pricing” *Business Times* 19 October 2014.

²⁵¹ South African Mining Development Association (SAMDA): Submission to the Portfolio the Committee on Trade and Industry on “Transfer Pricing and Transformation within the Mining Industry” (3 September 2014). Available at <https://www.google.co.za/#q=foreign+owned+mines+in+south+africa+> accessed 8 March 2015.

²⁵² MM Katz (Chairman) Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa *Second Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa: Thin Capitalisation Rules* (1995) in para 1.1.

²⁵³ Nishana Gosai (SARS) “Transfer Pricing in the Mining Industry” (December 2011). Available at [http://www.eisourcebook.org/cms/files/attachments/other/Transfer%20Pricing%20in%20the%20Mining%20Industry%20\(RSA%20view\).pdf](http://www.eisourcebook.org/cms/files/attachments/other/Transfer%20Pricing%20in%20the%20Mining%20Industry%20(RSA%20view).pdf) accessed 3 August 2015.

²⁵⁴ SAMDA: Submissions to the Portfolio Committee on Trade and Industry (3 September 2014).

Commissioner may adjust the gross sales to reflect those that would have been taken into account.

- Tax deferral: If a South African mining company sets up a subsidiary in another country CFC in s 9D of the ITA can prevent deferral of taxes.²⁵⁵ This legislation ensures that the undistributed income of a CFC is not deferred, but is taxed in the hands of its domestic shareholders as and when it is derived.
- Treaty shopping: This term refers to the use of double tax treaties by the residents of a non-treaty country, in order to obtain treaty benefits that are not supposed to be available to them.²⁵⁶ It is often achieved by interposing a corporation in one of the contracting states²⁵⁷ to shift profits out of any of those states. Article 1 of the OECD Model Tax Convention suggests clauses that can be inserted in tax treaties to curb treaty shopping. The one used in South African treaties is the “beneficial ownership” provision with respect to dividends, interest and royalty income.²⁵⁸ However, due to its limitations in curtailing treaty shopping,²⁵⁹ the OECD BEPS Report recommends that countries ensure that the title and preamble of their treaties state that they are not intended for non-taxation and treaty shopping. It further recommends that treaties include a limitation-on-benefits provision and a principal purposes test.²⁶⁰
- General anti-avoidance rules set out in ss 80A-80L of the ITA can curtail impermissible tax avoidance arrangements. Section 12 of the MPRRA also contains a general anti-avoidance provision.
- Common-law anti-avoidance provisions such as the “substance over form doctrine” can be employed to curb tax avoidance that involves sham or simulated transactions.²⁶¹
- Exchange control regulations²⁶² have implications for mining companies, in that they ensure the timeous repatriation into the South African banking system of certain foreign currency acquired by residents of South Africa, whether through transactions of a current or capital nature, and prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa. The regulations aim to control capital movements in and out of the Common Monetary Area that consists of South Africa, Lesotho, Namibia and Swaziland.

²⁵⁵ AW Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* (LLD Dissertation, UNISA 2007) 56; B Arnold & MJ McIntyre *International Tax Primer* (2002) 87.

²⁵⁶ Svan Weeghel *The Improper Use of Tax Treaties with Particular Reference to the Netherlands and The United States* (1998) at 119.

²⁵⁷ FJ Wurm “Treaty Shopping in the 1992 OECD Model Convention” (1992) *Intertax* 658.

²⁵⁸ OECD “The Concept of Beneficial Ownership in Tax Treaties” (2000) 15.

²⁵⁹ As a result of international case such as: *Velcro Canada Inc v Her Majesty The Queen* 2012 TCC 57; *Prévost Car Inc v Her Majesty the Queen* 2006 DTL 330.

²⁶⁰ OECD Base Erosion and Profit Shifting Project “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Action 6” (2014) at 13.

²⁶¹ *Kilburn v Estate Kilburn* 1931 AD 501 at 507; *CIR v Conhage (Pty) Ltd* 61 SATC 391.

²⁶² South African Reserve Bank “Exchange Control Manual” para E.

4. Mining value chain: highlighting areas of potential abuse

- 1. Mining begins with exploration, which involves geochemical analysis and mineral ore characterization:** At this stage, the government awards exploration licenses and production rights. Since the process often follows bidding procedures, it requires proper governance, such as clear legal, regulatory framework and clarity on institutions that award mining licenses. This process is often prone to corruption, thus the need for transparency in awarding licenses. If there are tax incentives to encourage investment, there must be a transparent, legal framework for granting these incentives. To finance the exploration, a mining company may get into financial arrangements involving loans, guarantees and even cash pooling with related companies. Such financial arrangements may involve ongoing, recurrent interest payments and related charges, which are prone to transfer pricing. Since exploration involves major investment, investors are often granted generous deductions for capital expenditure incurred in prospecting.
- 2. Construction and development of the mine:** This requires importing machinery, plants and equipment. If these are bought or leased from related parties, the transactions could be prone to transfer pricing. Mining companies may require valuable intangibles (e.g. know-how, designs, patents, rights) relating to mining technology, which may be bought or leased from a related party. The valuation of the transfer of such intangible is prone to transfer pricing, as it is often difficult to find comparable arm's length transfers of intangibles in the mining sector.
- 3. Actual mining:** Since the government is expected to derive revenue and royalties from the mine, it regulates and monitors operations. The investor is usually granted deductions for capital expenditure on machinery bought or hired to carry out mining operations. Full deductions of capital expenditures that extend throughout the life of the mine can hamper revenue collection. During the actual mining stage, the mining companies often make use of various corporate administrative services, such as management and technical services, research and development services, and financial and insurance services. Transfer pricing is often a concern if such services are provided by related companies. Mining companies also often claim huge deductions for such management services, which can deplete the domestic tax base.
- 4. Sale of mineral products without beneficiation:** Tax has to be levied on the sale of commodities with no or minimal beneficiation. The sale of commodities involves the transportation, trucking and shipping of commodities through customs ports. Tracking the quantity of commodities shipped is often prone to trade mis-pricing at customs. The sale of commodities and mineral concentrates (e.g. base metals, nickel concentrates, precious and base metals - after smelting and refining) to related parties in other jurisdictions for downstream processing of the mineral products is often prone to transfer pricing schemes.
- 5. Smelting and refining the metals extracted:** The government may require beneficiation of the minerals, which entails the smelting or refining of mineral ores to a more finished product, so that it can derive more revenue from its mineral resources. Mining companies may require the transfer of valuable intangible property (e.g. know-how, designs, patents, rights) for the processing technology. When this technology is bought or leased from related

parties, transfer pricing is a concern. The sale or marketing of fully or partially processed mineral products and/or toll smelting and refining services offered by related companies may be prone to transfer pricing schemes.

6. **Closure and environmental protection:** The mining company is usually expected to rehabilitate the mining site. Deductions are granted for expenditure incurred.

5. Impact of illicit financial flows

Global Financial Integrity reports that South Africa has lost out on billions in tax revenue in the past decade, as large corporations, wealthy individuals and criminal syndicates slipped nearly R1-trillion out of the country. The country suffered "illicit financial flows" totalling more than \$122 -billion between 2003 and 2012, and in 2012 alone, \$29.1-billion left the country undetected.²⁶³ Illicit financial flows are particularly prevalent in the extractive and natural resources sector, due to poor governance of this sector.²⁶⁴ However, there is no universally agreed upon definition of "illicit financial flows", and its boundaries are disputed. It generally refers to the movement of money in a way that contravenes the laws or regulations of a country. The money can be a product of illegal activities, such as tax evasion, organized crime, customs fraud, money laundering, terrorist financing and bribery. However, some IFF definitions include certain corporate tax avoidance practices that take advantage of loopholes in countries' tax systems – resulting in BEPS.²⁶⁵ The OECD acknowledges that, although there are cases of illegal abuses (which are the exception rather than the rule), multinational companies engaged in BEPS comply with the legal requirements of the countries involved. The exceptional illegal abuses (which may constitute illicit financial flows) often involve taxpayers concealing their assets and income in low-tax and tax-haven jurisdictions with banking secrecy rules.²⁶⁶ It is difficult to monitor such cases, due to the secrecy involved. Nevertheless, it is important to develop a clear definition of these illicit financial flows, which should not be confused with BEPS, since the solutions for curtailing IFFs differ from those for BEPS. Curtailing BEPS requires closing legal loopholes, which is what the OECD BEPS project is all about. Taxpayers caught contravening the rules must pay the relevant tax and penalties. However, if taxpayers are involved in illegal/illicit activities, criminal sanctions apply. A Global Financial Integrity²⁶⁷ report states that resolving the problem of illicit financial outflows involves distinguishing between licit and illicit capital flight. "Licit capital flight is recorded and can be tracked, significantly lowering the

²⁶³ Kar and Spanjers, Global Financial Integrity. *Illicit Financial Flows from Developing Countries (2003-2012)*. Times Live "Billions of Rands leave SA Under the Radar" Available at <http://www.timeslive.co.za/thetimes/2015/01/11/billions-of-rands-leave-sa-under-the-radar> accessed 9 March 2015.

²⁶⁴ Lincoln Marais, Director African Tax Administration Forum "The Structural Transformation of African Economies: What Role for the G20?" "The Role of Taxation in Africa's Economic Growth" paper presented at 2nd Annual G20 Africa Conference Johannesburg, 11 November 2013.

²⁶⁵ Gene Rowe, Fergus Bolger, Rachel Payne & Esther Shubert (Academic Stand Against Poverty) "Policy Options for Addressing Illicit Financial Flows: Results from a Delphi Study" (2014) at 4.

²⁶⁶ The OECD defines a tax haven as a jurisdiction that actively makes itself available for the avoidance of tax that would have been paid in high-tax countries. OECD *Harmful Tax Competition: An Emerging Global Issue* (1998) at 3.

²⁶⁷ Dev Kar & Joseph Spanjers, Global Financial Integrity "Illicit Financial Flows from Developing Countries: 2003-2012" (December 2014) in para 2. Available at <http://www.gfintegrity.org/wp-content/uploads/2014/12/Illicit-Financial-Flows-from-Developing-Countries-2003-2012.pdf> accessed 22 June 2015

probability that it has a corrupt or criminal source. In contrast, illicit financial flows are by nature unrecorded, and cannot be used as public funds or private investment capital in their country of origin". Clearly exposing both BEPS and illicit financial flows requires international cooperation through exchange of information between countries. Examples of illicit financial flows that impact the mining sector are:

1. Tax evasion: Non-compliance with tax laws is illegal and contributes to illicit financial flows. It includes activities like the deliberate falsification of tax returns and books of account by a taxpayer in order to illegally avoid paying the tax legally imposed on his income. Tax authorities use criminal prosecution to prevent tax evasion.²⁶⁸

2. Trade misinvoicing: This is customs fraud, whereby the value of a commercial transaction is deliberately falsified on an invoice submitted to customs, in order to circumvent the payment of customs duties.²⁶⁹ Trade misinvoicing is estimated to account for nearly 99 per cent of illicit financial outflows from Africa.²⁷⁰ The 2014 UNCTAD Trade and Development Report²⁷¹ notes that illicit flows due to trade misinvoicing is one of the most pressing challenges facing developing countries, since it costs them billions of dollars in revenue. To prevent trade misinvoicing, governments need to implement capital management measures, including capital controls.

- Organized crime, money laundering, terrorist financing and bribery: Research²⁷² shows that crime syndicates operating in South Africa operate illicit trade in gold and diamonds, among other products. Such illicit trade is enabled by the country's busy ports, which are tied to the international economy. Illicit goods are often hidden in contraband containers to take advantage of the authorities' inability to check all containers.²⁷³ Those engaging in illicit transactions use the advanced financial sector in South Africa to "clean" and "unclean" their ill-gotten finances. However, the country has stepped up efforts to enact tough legislation, improve its capacity to fight these crimes and cooperate with global organizations, such as the Financial Action Task Force (FATF), to address this problem.²⁷⁴

Legislative measures to curtail illicit financial flows in South Africa:

- The Financial Intelligence Centre Act, 38 of 2001, which is designed to combat money laundering and the abuse of financial systems.
- The Financial Advisory and Intermediary Services Act 37 of 2002, which, regulates the activities of all financial service providers who provide advice or intermediary services to consumers of certain financial products.

²⁶⁸ D Meyerowitz *Meyerowitz on Income Tax* (2008) in para 29.1.

²⁶⁹ Times Live "Billions of Rands leave SA under the Radar"

²⁷⁰ Kar and Spanjers. Global Financial Integrity "Illicit Financial Flows from Developing Countries".

²⁷¹ UNCTAD "Trade and Development: Global Governance and Policy Space for Development" (2014).

²⁷² Lala Camerer Senior Researcher, Crime and Policing Policy Project, Institute for Security Studies "International Fraud Trends: South Africa at Risk" African Security Review Vol 6 No 2 (1997); A Hübschle: Institute for Security Studies "Organised crime in Southern Africa" First annual review, 2010, <http://www.iss.co.za>.

²⁷³ S Patrick "Weak links: Fragile states, global threats, and international security" (2011) Oxford University Press: Oxford.

²⁷⁴ G Mthembu-Salter "Money laundering in the South African real estate market today" in Goredema, C. (ed.). *Money laundering experiences*. ISS Monograph Series (2006) at 124.

- The Prevention and Combating of Corrupt Activities Act, 2004.
- Prevention of Organized Crime Act, 1998.
- Protected Disclosures Act, 2000, which provides protection to whistle blowers for disclosing unlawful or irregular conduct.
- Promotion of Access to Information Act, 2000, which gives effect to the constitutional right of access to any information held by the state.
- Promotion of Administrative Justice Act, 2000, which promotes transparency and good governance by giving effect to the constitutional right to administrative action that is lawful, reasonable and procedurally fair.
- Witness Protection Act, 2000, which encourages state witnesses to give evidence in trial proceedings and commissions of enquiry by providing protection.
- The Public Finance Management Act, 1999, which promotes the effective and efficient use of resources by departments and constitutional institutions.

Institutions combatting illicit financial flows and corruption in South Africa:

- The Public Protector, which is an Ombudsman office that can be used in combatting corruption and promoting good governance.
- The South African Police Service (SAPS), which carries out criminal investigations.
- The Directorate for Priority Crime Investigation - a division of the SAPS, whose functions are to prevent, combat and investigate national priority offences (serious organized crime, serious commercial crime and serious corruption).
- The Independent Complaints Directorate, which investigates criminal acts and misconduct by members of SAPS and the Municipal Police Service.
- The Asset Forfeiture Unit within the National Prosecuting Authority, which is responsible for confiscation and restraint orders in terms of the Prevention of Organized Crime Act.
- The Witness Protection Unit, which is responsible for Witness Protection under the Witness Protection Act.
- The Auditor General, which audits and reports on the accounts, financial statements and financial management of all national and provincial departments, municipalities or any other institutions required by national legislation to be audited.
- The Anti-Corruption Coordinating Committee - an intergovernmental structure comprising departments and agencies whose functional mandate includes anti-corruption work.
- The Public Service Commission, which manages the Anti-Corruption Hotline.
- The National Prosecuting Authority and Interpol.

In light of the above, it is clear that there are many government institutions and agencies dealing with illicit financial outflows. However, the duplicity of efforts can result in inefficiency. It is important that there is a coordinated effort to address this problem and that a few specified institutions are delegated to address the matter, with the others feeding information to the relevant designated bodies. The problem is exacerbated by the following regulatory loopholes identified by the African Monitor report²⁷⁵: lack of a clear definition of illicit flow; no proper policy mechanism to identify and quantify illicit flows; inadequate clarity of stakeholder roles within current legislation; lack of engagement between stake holders; insufficient monitoring of illicit financial outflows across sectors; limited research on illicit flows in South Africa; inadequate and incomplete statistics on illicit financial outflows; lack of key statistics to submit to prosecution authorities to deal with IFFs; lack of adequate human and financial capacity within various institutions; and inadequate capacity to monitor and enforce compliance.

African Monitor urged the South African government to adopt the following policy recommendations.

- Introduce the concept of illicit financial outflows in the regulatory discourse in South Africa. The FICA Act needs to be amended to strengthen the definition of Illicit Financial Flows in South Africa and include various forms of illicit financial outflows in order to promote targeted efforts to address them.
- Regulatory emphasis must be placed on trade mispricing, which is the most dominant form of illicit financial flows. More attention must be given to money laundering and terrorist financing.
- Improve implementation and monitoring by setting clear performance targets and baseline indicators for each government agency dealing with illicit financial outflows.
- Improve partnerships, collaboration and cohesion by mobilizing all stakeholders to tackle the most dominant forms of illicit financial flows.
- Harness the advocacy potential of civil society organizations.
- Strengthen knowledge base and build technical and human capability to deal with illicit financial outflows, by developing; data collection, IT and research skills.
- Promote collaboration among regional and international bodies. This would include strengthening tax administration and enforcement through better regionally integrated systems, facilitating tax information exchange between governments from developed and developing countries, and increasing global asset recovery capacity.

²⁷⁵ African Monitor "Illicit financial flows (IFF) in South Africa". Available at <http://www.africayouth2015.org/news/illicit-financial-flows-iffs-in-south-africa.html> accessed 9 march 2015.

6. Conclusion

South African mineral resources have tremendous potential to contribute to the long-term development of South Africa. To this end, a number of major steps must be taken. The government needs to address the governance and regulatory concerns highlighted in this paper. To optimize revenue from the mining sector, the generous corporate capital expenditure deductions need to be reconsidered. The royalty tax needs to be replaced by a recourse rent tax. Measures need to be taken to curtail tax base erosion in the mining sector, particularly transfer pricing schemes. Illicit financial flows, especially involving trade mispricing, need to be addressed.

A.3 Country Case Study: United Republic of Tanzania

1. Introduction

1.1 Demographic and fiscal characteristics of Tanzania

Tanzania, officially the United Republic of Tanzania, acquired its name from the union between Tanganyika and Zanzibar that took place in 1964, following the independence of Tanganyika in 1961 and the Zanzibar Revolution in 1964. The country occupies a geographical area of 945,087 square kilometers, with a population of 44.9 million according to a 2012 national census (estimated to reach 48.5 million in October 2015²⁷⁶). Dating back to the pre-colonial era, the mining sector currently contributes less than 4 per cent of GDP (projected to reach 10 per cent in the National Development Vision 2025). Following the country's independence in 1961, the mining sector was put under direct state control, before economic reforms implemented in the mid-1980s shifted the sector towards private sector-led development, with a dependency on foreign investment. In 2008, the World Investment Report of UNCTAD showed that Foreign Direct Investment (FDI) had significantly increased, making Tanzania one of the top non-oil African countries in terms of FDI receipts, which were fueled by the development of the country's mining sector.

1.2 Legal history relevant to the mining sector

Article 24 of the Constitution guarantees the right to own property and to protect in accordance with the law. This indicates full recognition of private property and protection against any non-commercial risks. Article 30 of the Constitution also lays out a principle for protection of "... the exploitation and utilization of minerals." The mining sector is governed mainly by the Mining Policy 2009 and the Mining Act, 2010 and its Regulations. These replaced the Mining Policy 1997 and the Mining Act 1998. The current policy and law reflect the elements of the African Mining Vision (AMV), by including improved provisions in such areas as local content and providing for Mineral Development Agreements (MDAs).

1.3 Infrastructure

Investment in infrastructure is mentioned in the Tanzanian Development Vision 2025 as one of the priority areas. According to the work of the 2008 Africa Infrastructure Country Diagnostic, as quoted in an IMF working paper (IMF 2008), only one third of households have access to an improved water source, while the overwhelming majority lacks access to improved sanitation. Coverage of electricity and road networks in Tanzania is low even by regional standards, with only 11 per cent of households having access to electricity and only 28 per cent of the rural population living within 2 km of an all-weather road²⁷⁷. According to Briceno and Foster (2007),

²⁷⁶ National Bureau of Statistics Report (Tanzania in figures 2012)

²⁷⁷ www.mow.go.tz/uploads/wp08256: viewed on 25th October 2015.

as quoted in the same IMF paper, at \$27 per person, infrastructure spending per capita in Tanzania remains less than one tenth the level found in middle-income countries and is dominated by transport and energy, though spending on water and sanitation has been growing in recent years.

2. Current legal framework

2.1 Constitutional law (mining and tax)

According to Article 138. -(1) of the Constitution of the United Republic of Tanzania, 1977, no tax of any kind shall be imposed, save in accordance with a law enacted by Parliament or pursuant to a procedure lawfully prescribed and having the force of law by virtue of a law enacted by Parliament. Furthermore, Article 99. -(1) of the Tanzania Constitution prohibits the National Assembly from dealing with a Bill "...to levy a tax or to alter taxation otherwise than by reduction", unless the president has proposed that the matter be dealt with by the National Assembly and the proposal has been submitted by a minister.

2.2 Fiscal mining, illicit financial flow legislative and policy framework

2.2.1 Accounting rules and regulations

In the area of accounting, companies operating in the mining sector are subject to a set of standards and regulations. The general regulatory framework of accounting practice in Tanzania is based on the International Financial Reporting Standards (IFRS), which the country adopted whole sale in July 2004. The focus of all these standards is transparency in the affairs of all reporting entities. Disclosure requirements appear also, albeit partially, as the subject of Sections 129 to 131 of the Companies Act 2002. Furthermore, Section 472 of the Companies Act 2002 makes it an offence to willfully make a false statement in any particular material. Section 474 provides for the production and inspection of books where offences are suspected. These provisions are supplemented by the reporting requirements under the Capital Markets and Securities Act, 1994. Specific to the mining sector is Regulation 9 of the Mining (Mineral Rights) Regulations, 2010, which requires holders of prospecting operations to keep accounts with prescribed detail, including all expenditures incurred, supported by receipts, vouchers and other documentary evidence.

2.2.1 Mining tax laws and policies

The policies and legislations applicable to the Industry in Tanzania include: Tanzania Mining Policy of 2009; Mining Act 2010 and its Regulations; The Income Tax Act, Cap 322; The VAT Act (2014); and The East African Customs (Management and Tariff) Act, Cap. 403; and the Petroleum (exploration and production) Act, 1980.

- **Income tax:** The CIT rate for the mining sector is 30 per cent, the same as all other sectors. Companies offering 30 per cent or more equity to the public are taxed at 25 per cent, provided they list on the Dar es Salaam Stock Exchange. In addition, permanent establishments (PEs) are taxed at 10 per cent on deemed repatriated income. The provisions unique to mining include: ring-fencing of mining operations; loss carry forward (an alternative minimum tax is charged to companies with consecutive losses in three years at 0.3 per cent on turnover); and the deductibility of provisions for decommissioning costs, which is subject to conditions which the commissioner is empowered to establish, including setting a date by which actual expenditure must be incurred. Ring-fencing refers to restriction of deductibility of losses to each mining areas and non-transferability to other areas, even if operated by the same company.
- Withholding tax rates are prescribed in Paragraph 4 of the Third Schedule to the Income Tax Act 2004. The rates are as follows: dividends-10 per cent irrespective of residence of the shareholder (reduced to 5 per cent when distributed by companies listed in the Dar es salaam Stock Exchange, interest 10 per cent irrespective of residence of the receiver (save for resident financial institution to which withholding does not apply); royalties-15 per cent irrespective of residence of the receiver; natural resource payments-15 per cent.²⁷⁸ The withholding tax from service fees and contract payments is as follows: management or technical service fees paid by a resident person to another resident person in conducting a mining business-5 per cent; service fees paid to a non-resident person-15 per cent; insurance premium paid to a non-resident -5 per cent.
- **Additional profits tax:** Currently, Additional Profits Tax (APT) does not exist, but is mentioned in Article 17 of the Model Production Sharing Agreement in the oil and gas sub-sector. Discussions seem to point to a special tax regime for the extractives industry. There is therefore possibility for an APT for the industry as a whole.
- **Deductibility of provisions for decommissioning costs:** Section 15 (1) of the Income Tax Act 2004 provides for deduction of decommissioning costs with the condition stated as “ ...the Commissioner shall specify a date by which the expenditure must be incurred...which shall not be more than two years after the date by which resources extraction has substantially ceased...”. Where these conditions are violated by the taxpayer, the commissioner is empowered to make adjustments and to charge interest and penalties.
- **Customs duty:** The EAC provides for zero per cent duty rate on capital goods and raw materials for all importers, including equipment for mining companies.
- **Royalty payments:** According to the Mining Act 2010, every authorized miner shall pay the Government of the United Republic of Tanzania a royalty on the gross value²⁷⁹ of

²⁷⁸ Natural resource payment is defined in the Income Tax Act 2004 a “..any payment, including a premium or like amount, for the right to take natural resources from land or the sea or calculated in whole or part by reference to the quantity or value of natural resources taken from land or the sea”.

²⁷⁹ Note: Gross value for purposes of calculating royalties payable is defined by the Mining Act, 2010 as the market value of minerals at the point of refining or sale

minerals produced under his license at the rate-(a) in the case of uranium, of five per centum;(b) in the case of gemstone and diamond, of five per centum; (c) in the case of metallic minerals such as copper, gold, silver, and platinum group minerals, of four per centum; (d) in the case of gem, of one per centum; and (e) in the case of other minerals, including building materials, salt, all minerals within the industrial minerals group, of three per centum.

2.2.1 Illicit financial flow concerns

This research did not come up with a specific definition of Illicit Financial Flows (IFFs) in Tanzania. The Anti-Money Laundering Act, 2006 only contains a concept of “predicate offence”, which is defined to include “...terrorism, including terrorism financing; corrupt practice; theft; forgery; tax evasion...” In the context of the definition of IFF by the Global Financial Integrity (GFI), also referred to by the Report of the High Level Panel on Illicit Financial Flows from Africa viz., “money illegally earned, transferred or utilized”, the definition of predicate offence can be seen as an attempt at addressing some aspects of IFFs.

2.3 Anti-money laundering and anti-corruption laws

Both Money Laundering and Corruption have been criminalized in Tanzania. The Anti-Money Laundering Act of 2006 (which came into effect in July 2007) is the main law for countering money laundering and related criminal acts. The actors are the Financial Intelligence Unit (FIU) and the Prevention and Combating of Corruption Bureau (PCCB).

2.4 Status of domestic resource mobilization in the country

Domestic Revenue Mobilization (DRM) refers to the generation of savings from domestic sources and their allocation to economically and socially productive investments²⁸⁰. In Tanzania, DRM is a common theme in the annual budget speeches, with the focus in recent years being on reduction of donor-dependency. Performance has shown a positive trend, with donor-dependency estimated at over 6 per cent according to the 2015/2016 budget speech, down from 24 per cent in 2004/2005 and 17 per cent in 2010/2011 (Salum 2015). Tax revenue as a major component (measured as a percentage of GDP) in Tanzania remains low. The 2015/2016 budget speech, for example, notes the current yield as only 12 per cent (projected to reach 13.1 per cent in the year 2015/2016), lower than most neighboring countries. Currently, domestic revenue is collected from just about 2.0 million registered taxpayers. Approximately 70 per cent of domestic tax revenue comes from 450 large taxpayers (80 per cent of which is generated by only 53 per cent of the 450)²⁸¹ the majority of which are subsidiaries of foreign Multinational Enterprises (MNEs).

²⁸⁰ www.oecd.org/site/devaen10/44272298.pdf

²⁸¹ TRA's key performance indicators report for 2014/2015

Table 2.1: Itemized tax revenue as a percentage of total tax revenue (TRA Mainland)

Tax item	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
P.A.Y.E.	13.9%	14.3%	15.6%	14.8%	15.9%	16.3%	17.0%	16.9%	17.4%	16.5%
Corporation tax	9.1%	10.1%	10.2%	10.8%	10.0%	9.2%	9.8%	11.7%	12.9%	15.0%
Individuals	1.5%	1.6%	1.2%	1.0%	1.0%	1.1%	1.1%	1.0%	0.9%	0.9%
Other income taxes	5.8%	5.7%	5.6%	5.3%	5.5%	6.3%	5.8%	7.4%	8.0%	7.8%
Domestic excise duty	6.6%	6.7%	6.7%	6.4%	6.9%	6.6%	6.0%	6.7%	7.0%	7.6%
Domestic VAT	17.1%	16.4%	16.0%	15.8%	16.6%	15.9%	15.1%	14.7%	14.4%	13.3%
Other domestic taxes & charges	1.5%	1.5%	1.4%	2.1%	2.0%	2.1%	2.4%	2.3%	2.4%	2.2%
Import Duty	6.3%	8.8%	9.4%	8.8%	8.8%	8.2%	8.4%	7.6%	7.2%	7.4%
Excise duty on imports	7.6%	6.3%	11.9%	12.7%	11.4%	11.7%	11.3%	8.8%	8.7%	7.7%
VAT on imports	26.0%	24.9%	17.7%	15.9%	15.4%	16.6%	16.6%	16.2%	15.1%	13.5%
Other import charges	4.6%	3.8%	4.2%	6.4%	6.4%	6.0%	6.5%	6.6%	6.0%	8.1%
Total (GROSS)	100.0%									

Source: TRA performance reports

3. State institutional framework

3.1 Ministry of Energy and Minerals

As part of its mandate, the Ministry of Energy and Minerals (MEM) coordinates several other agencies, including the Minerals Audit Agency and State Mining Corporation.

1. **Tanzania Minerals Audit Agency:** Recent work (African Minerals Development Centre [AMDC] 2014) highlighted the need for oversight bodies in the management of the mineral sector. The establishment of the TMAA is consistent with the ideas reflected in the work of AMDC. The role of the TMAA is summarized in its mission, which reads “to conduct financial and environmental audit as well as auditing of quality and quantity of minerals produced and exported by miners in order to maximize benefits to the government from the mining industry for sustainable development of the country”. The challenges faced include inadequate human and financial resources to monitor and audit medium and small-scale mining operations, poor recordkeeping/little awareness of regulatory requirements and delays by some government bodies to take action on audit recommendations.
2. **State Mining Corporation:** The State Mining Corporation (STAMICO) was established under the Ministry of Energy and Minerals. Initially a holding corporation with five subsidiary companies active in the mining sector, the corporation currently oversees government interests in mining ventures. This is in line with the government’s decision, through the Mining Policy 2009 and the Mining Act 2010, to participate in mining investments through its institutions. Shareholding involves both 100 per cent by STAMICO and in joint venture with private companies. This decision is also consistent with the recommendations of the African Minerals Development Centre (AMDC 2014), which include the establishment of a state mining company (SMC) to hold state equity in mining companies.

3. **Ministerial Advisory Board:** In reference to consultative processes with stakeholders, the AMDC (2014) notes the need for a “Minerals Advisory Board” (MAB) comprising government, industry, labor and civics to assist government in assessing applications for exploration rights, developing new laws and regulations, enhancing mineral economic linkages and resolving disputes. No immediate record could be found in Tanzania of an Advisory Board of the nature highlighted by AMDC. There is a “Ministerial Advisory Board”, which appears to be more a part of THE TMAA.

3.2 Ministry of Finance and Treasury

The Ministry of Finance is responsible for revenue management, including mineral revenues. In its role as such, MoF is party to negotiations for Mineral Development Agreements (MDAs).
Financial Intelligence Unit

1. **The Financial Intelligence Unit (FIU)** was established under Section 4 (1) of the Anti-Money Laundering Act, 2006 as an extra-ministerial department under the Ministry of Finance. Its mandate is stated as “...receiving, analyzing and disseminating suspicious transaction reports and other information regarding potential money laundering or terrorist financing received from the reporting persons and other sources from within and outside the United Republic.”
2. **National Multi-Disciplinary Committee on Anti-Money Laundering:** The establishment of the FIU paralleled the establishment, under the same law, of a National Multi-Disciplinary Committee for purposes of the Anti-Money Laundering Act. Its mandate is provided for under section 8 (1) as: formulate, assess and improve the effectiveness of the policies and measures to combat money laundering; advise the Government on legislative, regulatory and policy reforms in respect of anti-money laundering and combating predicate offences; generally, advise the government in relation to such other matters relating to anti-money laundering and predicate offences.

3.3 Central Bank

As indicated earlier, the central bank is represented on the Multi-Disciplinary Committee on Money Laundering.

3.4 Revenue Authority

The Tanzania Revenue Authority (TRA) is responsible for the administration of central government taxes. In addition to routine tax administration functions, TRA has accorded special attention to the challenges posed by MNCs generally and those posed by specialized industries such as extractives. The measures taken in this regard have included the establishment of an International Taxation Unit (ITU) and special teams dealing with mining and oil and gas sectors.

3.5 Tanzania Extractive Industry Transparency Initiative

Tanzania is now a member of the Extractive Industry Transparency Initiative (EITI). This has been accompanied by the creation of Tanzania Extractive Industry Transparency Initiative (TEITI), in keeping with the recommendations of AMDC (2014)

4. Global value chain and global wealth chain analysis

4.1 Mineral discovery and survey stage

Mason (2009) classifies mineral resources into four main groups. The first comprises the basic raw materials for construction and infrastructure. The second is made up of the energy minerals: oil, natural gas, coal and uranium. The third group consists of the industrial minerals. The fourth group comprises precious and semi-precious stones. Tanzania has mineral wealth in each of the four categories.

4.2 Feasibility study and corporate modelling

It could not be established whether the government undertook independent feasibility studies on the mineral values before granting the mining concessions. The information that could be obtained shows the establishment of an agency called Geological Survey of Tanzania in 2005, whose responsibility is stated as acquisition and storage of geological data and information used in the mineral resources sector and other sectors of the economy and promoting mineral exploitation and mining in Tanzania. On the other hand, corporate modelling appears more likely to be undertaken by consultant firms. The modelling reports are not publicly available, but tax auditors are empowered by law to access them during the course of an audit.

4.3 Development of bilateral and multilateral agreements

4.3.1 Mineral Development Agreements

Section 10 (i) of the Mining Act, 2010 empowers the minister to, on behalf of the United Republic of Tanzania, enter into a development agreement with a holder of, or an applicant for, mineral rights for which the minister is the licensing authority. Such agreements may cover the granting of the mineral right(s), the conduct of mining operations under a special mining license,

Table: Confirmed mineral resource wealth of Tanzania

Type of mineral	Quantity
Gold	2,222 (million) tons
Nickel	209 million tons
Copper	13.65 million tons
Iron ore	103.0 million tons
Diamond	50.9 million carats
Tanzanite	12.60 million tons
Limestone	313 million tons
Soda ash	109 million tons
Gypsum	3.0 million tons
Phosphate	577.4 million tons
Coal	911.00 million tons
Uranium	23,000 tons (Mkuju only)
Rare Earth Metals	No data

Source: Zito Kabwe Lecture to National Defence College

the granting of the government free carried interest and state participation in mining, and the financing of any mining operations under a special mining license²⁸².

Table 1: Tax concessions under the Model MDA

Tax aspect	MDA holders	Non-MDA holders
VAT	VAT relief has been granted to both imports and purchases	Only available to Primary Licence holders
Withholding tax on technical fees for residents	3%	5%
Withholding tax on technical fees for non-residents	3%	15%
Withholding tax on management fees-for residents	3% for MDA holders, charged on payments made only if management fee does not exceed 2% of total operating costs. If management fee is greater than 2% of total operating costs, the applicable rate shall not exceed 20% of the gross payments made.	5% charged on payments made
Withholding tax on technical fees for non-residents	3%	15%

Author's reconstruction of data extracted from http://www.tmaa.go.tz/uploads/MPF_IMPLEMENTATION_STATUS_TANZANIA.pdf

4.3.2 Double Taxation Agreements

Currently Tanzania has 11 DTAs. In recent years practice shows that it is the Ministry of Finance that leads the negotiation team which normally includes representatives from TRA and Ministry of Legal and Constitutional Affairs. The DTAs with Canada and South Africa (as the major sources of capital in the sector) are used here as examples to highlight the issues involved: whereas the DTA with Canada is a bit generous to Tanzania, the one with South Africa is not as generous. If we consider, for example taxation of dividends: in the Tanzania/Canada DTA, Tanzania can tax dividends up to 20 per cent where a participating interest is involved and 25 per cent in all other cases, the comparable rates in the DTA with South Africa are 15 per cent and 20 per cent. Likewise, interest can be taxed in Tanzania up to 15 per cent in the Tanzania/Canada DTA and royalties up to 20 per cent. The comparable rates in the Tanzania/South Africa DTA are 10 per cent for both interest and royalties.

4.4 Stages of mining, tax points and illicit financial flow potential

Table 2 shows the stages in the mining process and tax points.

²⁸² A special mining license is defined under Section 4 of the Mining Act, 2010 as a license for large scale mining operation, whose capital investment is not less than \$100,000,000.

Table 2: Stages in the mining process and tax points

Tax/other revenue point	Type of tax	Rates
Prospecting/exploration (Acquisition of mineral rights)	License application fees	\$100
	Licensing Fees	\$500 for initial period, \$2,000 for 1st renewal and 3,000 for 2nd renewal
Importation of equipment	Annual rents for prospecting license	\$40
	Import taxes (Import duty, excise taxation and Value Added Tax)	Exempted under the EAC Customs Management Act 2004 and VAT Act, 2014
Production (including goods purchases and service acquisition)	Royalties	4% for metallic minerals, 5 per cent for gems and 3% for others. For cut diamonds (gem), the rate is 1%
	Withholding taxes	Range from 5 to 15%, as amended by MDAs-details shown above
Sales/export	Corporate Income Tax	30%
	Additional Profit Tax	Currently does not exist-mentioned as possibility
	VAT	Zero-rated
Financing transaction	Withholding taxes	

Source: Author's own construction

4.5 Global wealth chains and illicit financial flow potential

The best starting point in relating global wealth chains (GWCs) to DRM, which is the focus of the report, is the role of Tanzania in the GWC. As is typical of many developing countries, GWC place Tanzania at the receiving end in terms of capital, technology and skills, with the companies operating in the country being mostly subsidiaries of MNEs. In taxation terms, this positions the country as a country of source. Potential for IFFs will therefore depend on the effectiveness of its source taxation and related rules.

4.6 Government service: water electricity infrastructure

Water supplies in Tanzania are basically the responsibility of local government authorities. Therefore, no subsidies are offered to mining companies. In the case of electricity, there are no specific tariffs for mining companies.

4.7 Capacity building and data access

In recognition of the need for capacity-building initiatives, Paragraph 7.2 (iv) of the Mineral Policy, 2009 provides for strengthening cooperation between higher learning and research institutions and investors to foster the development of the mineral sector.

5. Summary and recommendations

Tanzania continues to make considerable efforts towards ensuring equitable sharing of mineral revenues, improved management and use of mineral revenues, as well as a sound competitive position for attracting investment to the mining sector, in line with the African Mining Vision. The existence of a Mineral Development Agreement (Model MDA) and the potential for Additional Profits Tax (APT) reflect the guidelines contained in the AMV. The existing accounting requirements and accession to the Extractive Industry Transparency Initiative with the creation of the Tanzania Extractive Industry Initiative (TEITI) are expected to enhance governance of the mineral sector. Challenges remain, however, in terms of the need for more effective laws and greater capacity to deal with the complexities presented by the industry.

Therefore, moving forward, the focus must be on the following: continued policy and law reforms to target IFFs, in particular; continued investment in capacity building; maintenance of a Tax Treaty Network that is current and sensitive to the risks of IFFs; and continued efforts to expand the TP regime to include specific provisions for services and commissions.

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A.4 Country Case Study: Republic of Zambia

1. Introduction

Zambia is a landlocked country in Southern Africa. It is 752,612 square kilometers'. It has abundant water resources, which account for 45 per cent of the region's water supply. It has some of the largest copper, cobalt and emerald deposits in the world. Zambia gained its independence from Britain on October 24, 1964. Its population was 13.1 m in 2010²⁸³ and is projected to be 14.9m in 2015.²⁸⁴

1.1 History of mining in Zambia.

Mining of copper in Zambia dates back to the early thirteenth century. Copper was used as a medium of exchange. The first commercial copper mine was opened in 1928 by the BSAC. Mining was controlled by private companies. However, in 1969, the Government nationalized all mines and claimed a 51 per cent stake of the shares. It decided to privatize the mines, mainly due to low tax revenues from the mining sector. In 1969, Zambia was classified as a middle-income country. Its GDP was 3 times greater than that of Kenya and exceeded that of South Korea, Brazil, and Malaysia. Its annual copper production was around 750,000 tons per annum. Due to many factors, such as lack of investment, poor management, the 1975 oil crisis and a slump in global copper prices, production fell to 2000 tons in 2000. The government then privatized the mines. Production is currently at 850,000 tons and expected to rise to 1.5m tons by the year 2017.

1.2 Historical law governing the mining sector

The right to prospect and mine was vested in agreements between mining companies and the British Government and, to a lesser extent, agreements between traditional leaders and mining companies. After Zambia gained its independence, prospecting and mining rights were granted by the government via the Mines and Minerals Development Act. The current Act does not recognize Development Agreements. They were abolished in 2008 because the DA provisions were outside the Zambian constitution, the tax rates were too low so the government did not get a fair share of revenues, and each mine company had its own tax regime, making it difficult and costly to administer the extractive taxes.

1.3 Infrastructure

The telecommunication infrastructure of Zambia is very good. The Government has embarked on various projects, such as construction of roads and building of power stations, hospitals and schools, as per our revised Sixth National Development Plan. However, though Zambia is

²⁸³ Living condition monitoring survey of 2010

²⁸⁴ Central Statistics Organisation.

classified as a middle-income country, 62 per cent of the population has access to safe drinking water and one third of the population has access to adequate sanitation²⁸⁵.

2. Policy and legal framework

2.1 Mining policy

Zambia introduced a new mining policy, entitled the Mineral Resources Development Policy, in 2013. The policy objectives are outlined below:

- Attract and encourage local and foreign private sector participation in the exploration and commercial exploitation of Zambian mineral resources;
- Facilitate the empowerment of Zambians to become owners/shareholders in the mining industry;
- Promote the development of a mining sector that is integrated into the domestic economy and promotes local entrepreneurship and increased demand for local goods and services, creates employment for Zambians and promotes value addition;
- Encourage and facilitate orderly and sustainable development of small-scale subsector mines, in order to contribute to economic development and wealth creation of wealth;
- Achieve a socially and internationally acceptable balance between mining and the biophysical environment and ensure acceptable health and safety standards;
- Promote research and development and its application in the mining sector;
- Encourage mining companies to develop a participatory, collaborative approach towards mining, development and decommission, taking into account the needs and concerns of local communities; and
- Ensure transparency and accountability in the management of mineral resources in the country.

2.2 Constitutional law

The Constitution of Zambia (1996) in Article 114(1) states that “.no taxation shall be imposed or altered except by or under an Act of Parliament”. Further in Clause (2) of Article 114 the Constitution provides that “Parliament shall not confer upon any other person or authority power to impose or alter, otherwise than by reduction any taxation”.

2.2.1 Accounting rules and regulations

The Zambia Centre for accountancy has set accounting standards for companies operating in Zambia. In addition, the rules are complemented by International Financial Reporting

Standards. All companies are required to report their income using the accrual method, as provided for in Section 5 of the Income Tax Act.

2.3 Fiscal mining and illicit financial flow legislation

The laws that govern the fiscal mining regime are enshrined in the VAT ACT; Income Tax ACT, Mines and Minerals Development Act and the Property Transfer Tax ACT.

1. **Income tax:** Income from mining operations is taxed as follows

$$Y=30\% + [a - (ab/c)]$$

Where – Y= the tax rate to be applied per annum; a= 15% b= 8%; and c= the percentage ratio of the assessable income to gross sales; income from mineral processing is taxed at 30%, Withholding Tax Rates- 0% for dividends, 20% for management and consultancy fees, 20% for commissions, 20% for royalties and 15% for interest.

To mitigate the effects of transfer pricing, a reference price is used to determine the price of base metals or precious minerals. "Reference price" means:

- The monthly average London Metal Exchange cash price;
- The monthly average Metal Bulletin cash price, to the extent that the base metals or precious metal prices are not quoted on the London Metal Exchange;
- The monthly average cash price of any other metal exchange market as approved by the Commissioner-General, to the extent that the base metal price or precious metal price is not quoted on the London Metal Exchange or Metal Bulletin; or
- The average monthly London Metal Exchange cash price, average monthly metal market exchange cash price approved by the Commissioner-General, less any discounts on account of proof or low quality or grade.

Companies carrying out mining operations can carry the loss for a period of 10 years; however, companies carrying out mineral processing can carry the loss for a period of 5 years. Extractive industry firms are allowed to claim deductions for expenses claimed. There are two types of deductions allowed: general deductions and specific deductions. General deductions include deductions for bad debts, royalties, pensions, research, payments to approved public benefit organizations. Specific deductions for the extractive industry are illustrated in table 1.

2. **Property transfer tax:** Any transfer of a share in a mining company attracts a property

Table 1: Mining deductions

Type of deduction	Tax allowance/rates
Pre-production expenditure	100%
Prospecting expenditure	100%
Capital expenditure	25%
Capital expenditure for non-contiguous mines	25%
Restoration and rehabilitation works	100%
Amounts paid to Environmental Protection Fund	100%
Debt-to-equity ratio allowable interest rate	100% if does not exceed the ratio 3:1
Capital expenditure on change of mine ownership	100%

transfer tax of 10 per cent of the value of the shares. The value of the shares should be at market price or nominal value, whichever is higher. In addition, a transfer of a mining right also attracts a tax of 10 per cent

3. **VAT:** Exports of minerals are zero-rated. In addition, the Commissioner General Rules require exporters to provide documentary evidence that the minerals have reached their final destination by having customs officials certify that the goods were imported. The companies can then access the VAT refund
4. **Customs and Excise Act:** Exports of unprocessed mineral attract a duty of 10 per cent. This is to encourage value addition in the country, as per the African Mining Vision.
5. **Mines and Minerals Development Act:** Provides for the levying of mineral royalties: 9 per cent of norm value of base metal or precious minerals extracted using open cast method; 9 per cent of gross value of gemstones and energy minerals extracted from open cast mining; 6 per cent of gross value of energy and gemstones minerals extracted from underground extraction; 6 per cent of norm value of base metal or precious minerals extracted using underground method of extraction; 6 per cent of gross value of industrial minerals; and 9% for anyone found in possession of minerals without a mining license.

2.4 Illicit financial flows

The laws in Zambia do not include a definition of IFFs. However, the Prohibition and Prevention of Money Laundering Act No14 of 2001 has defined illegal activity and proceeds of crime as follows. "Illegal Activity- means any activity, whenever or wherever carried out which under any written Law in the republic amounts to a crime". A Proceed of crime is defined as "any property, benefit, or advantage within or outside Zambia realized or derived, directly or indirectly from an illegal activity." The definitions are very broad and effective in curbing IFFs in Zambia. even if the act or deed was committed outside the country or in Zambia.

2.5 Anti -money laundering and anti-corruption laws

Efforts to minimize IFFs are championed by the following institutions: The Drug Enforcement Commission, which has an Anti-Money Laundering Unit; the Zambia Revenue Authority; the Bank of Zambia; the Financial Intelligence Centre Anti-Corruption Unit and the Zambia Police Service. An inter-ministerial committee oversees efforts to minimize IFFs and human trafficking.

2.6 Status of domestic resource mobilization in Zambia

Zambia has been classified as a middle-income country. As a result of this classification, donor and grant support to Zambia has been reduced. The reduction in donor support has led to a

budget deficit. The deficit as at December 31, 2015 was 6.9 per cent of GDP²⁸⁶. This has prompted the government to increase borrowing from external markets.

Previously, tax revenues accounted for more than 70 per cent of DRM. With the slump in copper prices and declining production volumes, tax revenues are projected at 57 per cent of DRM in 2016. This has prompted the government to

increase non-tax revenues to boost DRM. In addition, Zambian tax collection as a percentage of GDP is very low for a middle-income country, averaging around 18 per cent of GDP. The country needs to collect around 30 per cent of GDP and, to achieve this ambitious target, the Zambia Revenue Authority is undergoing a modernization process.

Table 2. Domestic resource mobilization in Zambia

Source	2016	2015	2014	2013
Foreign financing	15%	9%	17%	17.3%
Domestic borrowing	5%	9%	8%	5.7%
Non-tax revenues	22%	7%	7%	3.8%
Foreign grants	1%	3%	3%	
Tax revenues	57%	67%	65%	73.2%
Bond proceeds		5%	0	0

Source: Annual budget addresses

Table 2. Tax revenue as a per cent of GDP

	2011	2012	2013	2014
Tax revenue	20.10%	18.70%	18.40%	16.60%
Income tax	10.40%	10.60%	9.20%	7.90%
Mining tax	2.60%	2.40%	0.90%	0.90%
Non-mining tax	1.20%	1.60%	1.40%	1.20%
Mineral royalties	0.90%	1.30%	1.40%	1.10%
Mining tax arrears	1.9%	n/a	n/a	n/a
Excise tax	1.80%	1.40%	1.90%	1.70%
VAT on domestic goods	0%	0.30%	0.90%	1.90%
Trade tax	6.10%	6.40%	6.40%	5%
Vat on import	4.30%	4.50%	4.90%	3.80%
Customs duties	1.80%	1.80%	1.40%	1.20%
Export duties	0%	0%	0%	0%
Export duties on copper	0%	0%	0%	0%
Non-tax revenue	0%	0.10%	0%	0%

Source: Zambia Revenue Authority Annual Reports

3. Institutional framework

3.1 Ministry of Mines and Minerals Development

The Ministry of Mines and Minerals Development (MMMD) is mandated to issue mining rights, mineral processing licenses, mining trading permits and artisan's licenses. The 2015 Mining Act

²⁸⁶ 2016 Zambia national budget address

prohibits foreigners from acquiring small-scale licenses. In addition, the Act provides for mining companies to give preference to Zambian products. The 2015 Mining Act directs mining companies to give preference to Zambian citizens and Zambian-owned companies to provide them with services. Furthermore, the Act provides for Zambian citizens to be given first priority when the mines are employing personnel. These measures are in tandem with the African Minerals Development Centre (AMDC 2014).

The MMMD has 3 departments, namely, the geological department, the mine and safety department and the cadaster department.

1. **Geological Department:** Conducts geological surveys, geological mapping, mineral exploration and laboratory analysis of minerals (Assay).
2. **Mining Cadaster office:** Processes mining rights, mining licenses, mineral processing licenses and mineral trading licenses
3. **Health and Safety Department:** Ensures miner safety and environmental protection
4. **Mining License Committee:** Interministerial committee composed of officials from the MMMD, Ministry of Energy, Ministry of Labor; Ministry of Lands. Ministry of Finance, Ministry of Justice, Zambia Development Agency and non-governmental institution such as the Engineering Institution of Zambia
5. **Mining Appeals Tribunal:** Settles disputes

3.2 Ministry of Finance

It is responsible for setting policy on how revenue is collected from the extractive industry and determines tax rates and fees for mining licenses and permits.

3.3 Zambia Revenue Authority

It is mandated by law to collect revenues such as income tax, PAYE, VAT and customs duty export levies. It also collects property transfer tax on the sale of mining shares or rights in the extractive industry. It collects mineral royalties on behalf of the MMMD. It has a mining unit that specializes in collecting taxes from the mining companies.

3.4 Financial Intelligence Centre

It was formed in 2010 for the sole purpose of providing timely, quality and impartial financial intelligence in combatting money laundering IFFs, terrorism financing and other serious offences, in order to ensure integrity and transparency in the financial system. It collaborates with all security organizations, the Zambia Revenue Authority and the Bank of Zambia.

3.5 Zambia Consolidated Copper Mines-Investment Holdings Plc

This is an investment vehicle for the Zambian Government in the mining sector. ZCCM-IH holds shares in almost all the large-scale mines in Zambia, in keeping with the AMDC 2014. ZCCM-IH shareholding in the mining firms varies from 0 to 100 per cent.

3.6 Industrial Development Corporation

One of the key components of mining policy in Zambia is to “Promote the development of a mining sector that is integrated into the domestic economy and promotes local entrepreneurship and increased demand for local goods and services, creates employment for Zambians and promotes value addition”. IDC is an investment company wholly owned by the Zambian Government which was incorporated in 2014. Its main objective is to promote Zambia industrialization capacity, in order to promote job creation and domesticate wealth creation.

4. Global value chain and global wealth chain analysis

Zambia is a natural resource-rich country. Its linkage to the GVC is that it supplies raw materials. Supplying raw materials does not create much wealth in the country. MNCs provide the capital to explore, exploit and market the minerals. Technology is developed elsewhere and Zambia is an end user of that technology. There are few downward and upward linkages in the local economy. Most services are procured from abroad. The processing of the minerals into final products takes place outside Zambia. In terms of global wealth creation, Zambia is at the very bottom of the wealth creation spectrum.

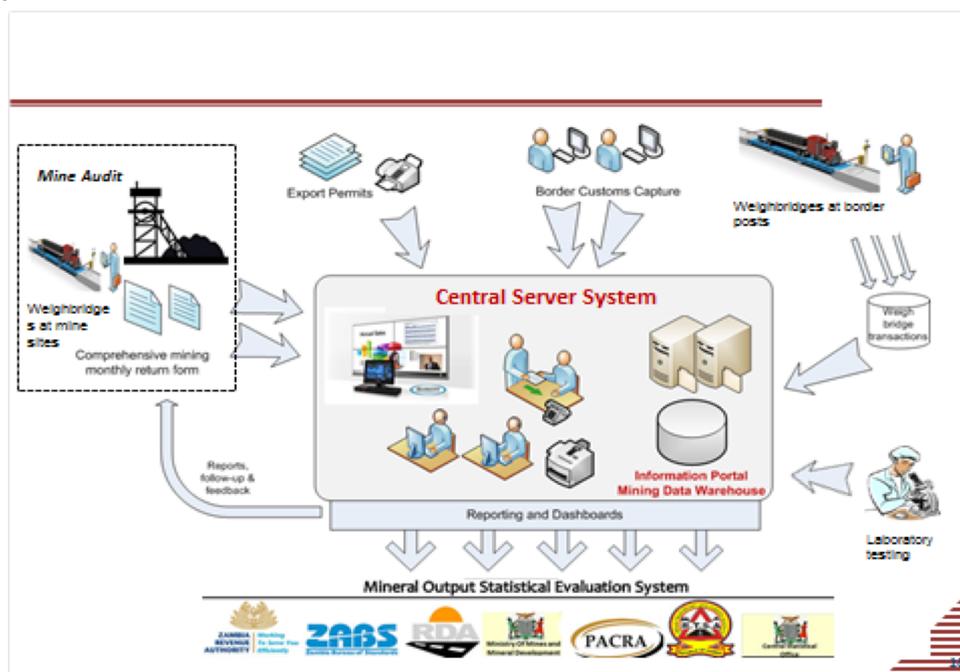
In addition, the little wealth that is created in Zambia is exported through the payment of dividends to non-resident’s shareholders, management fees, head office expenses and commissions, as well as illegally through transfer pricing and trade mispricing. Most multinational corporations are seen as not paying their fair share of mining taxes, which has prompted our government to establish the Mining Value Chain Monitoring project.

4.1 Mining value chain monitoring

The overall objective of mining value chain monitoring is to establish an integrated electronic system to help bridge the information gap in mining operations, specifically to:

- Review mechanisms for monitoring the mineral and mining value chain from exploration to exportation;
- Develop and implement mechanisms for monitoring and facilitating the movement of minerals within and out of Zambia;
- Institutionalize the framework in all relevant government institutions and agencies through effective change management;
- Minimize IFFs at each stage of the mining process

Chart 1 of MVCM



Seven institutions have been incorporated into the MVCM namely, the MMMD, the Zambia Revenue Authority (ZRA), Zambia Bureau of Standards, Central Statistics Organization, Patents Office, Road Development Agency and Road Safety Transport Agency. Most of the minerals in Zambia are transported by road.

With the MVCM, it will be very easy to monitor IFFs, from prospecting to sale or export of commodities. All payments of licenses, taxes and permits shall be accessible to all government departments and units. Payments to overseas suppliers are monitored by the Financial Intelligence Centre and Bank of Zambia. The information shall be readily available to ZRA for use in their tax audits.

The other feature of the MVCM is that all institutions involved shall initiate capacity-building activities to help minimize IFFs. Training and employee secondment to other jurisdictions has begun. Equipment and a state-of-the-art geological laboratory shall be built.

4.2 Development of bilateral and multilateral agreements

1. **Mineral Development Agreements:** Zambia had mineral development agreements; however, in 2007 the government unilaterally revoked the agreements. Some mining companies have taken the government to court. The mining agreements were revoked for the following reasons: each mining company had its own fiscal regime, therefore, it was difficult to administer the mining fiscal regime; the government felt that the terms of the agreements favored the mining companies over the government; the tax rates were very low, which resulted in lost revenue for the government; and the mining development agreements were outside our constitution.

2. **Double taxation agreements, mutual agreements & tax information exchange agreements:** Zambia uses the SADC model treaty agreement, which is a hybrid of the United Nations & OECD model tax conventions. Currently, Zambia has 22 DTA and Mutual Agreements with all SADC Member States and one TIEA with a tax haven. Some Zambian treaties with certain countries were entered into before Zambia attained its independence. Most of these treaties have unfavorable terms. The Government has made it a priority to renegotiate these treaties. For an example, the treaty with Ireland was entered into before independence. The rate of withholding tax on management fees, interest, and dividends is 0 per cent. This prompted many mining companies to set up dummy companies in Ireland, which has led to treaty shopping, tax avoidance, tax evasion and also illicit financial flows. Zambia has negotiated a new treaty with Ireland, which takes effect January 1, 2016.

5.0 Summary and recommendations

The Zambian Government is very keen to maximize DRM from the mining sector and increase its wealth creation. To achieve its objectives, the government has introduced a new mining policy giving preference to Zambian citizens to supply the mines and provide services. Furthermore, it has set up an institution that will help the nation industrialize and be able to supply the mine companies with their capital requirements.

In order to curb IFFs, a MVCM has been put in place. Capacity building has commenced in all institutions and tax treaty networks are being widened.

Recommendations

- Widen its treaty networks
- Renegotiate unfavorable tax treaties
- Continue capacity building in all institutions involved in the MVCM