Submission to the draft ISG Policy Framework report on Africa's mineral regimes

tax justice network — Africa

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The Tax Justice Network – Africa (TJN-A)[1]

TJN-A welcomes the UNECA/AUC initiative towards developing a pan-African mining framework and we have read with interest the ISG's draft framework report. We believe that the development of mining guidelines would be a positive step towards supporting African governments and institutions to transform existing mining tax regimes on the continent to benefit and support socio-economic development.

Our comments and recommendations on the draft document are centred upon u fiscal policy section of the ISG Report covering 'equitable, efficient and transparent collection, sharing and management of revenue'. Our focus is on tax because there is a broad consensus that **revenue raised through taxation is the most important benefit to be gained from industrial mining**, given the lack of other contributions to the host economy. The extractive sector generally fails to create linkages into the local or national economy that would stimulate more private sector development and related employment. Moreover, given the capital-intensive nature of industrial mining these companies create relatively few jobs. This is why there is consensus among UNCTAD, UNECA and the IMF that the paramount development benefit of mining in Africa is the potential to generate public revenue through a transparent tax and budget system. UNCTAD has stated that 'the potentially most important contribution from mineral extraction is the rise in the host-country income'.

Despite the potential of mining revenue to significantly contribute to national income, we are in agreement with the draft ISG report, which recognises that **this potential has largely failed to materialise**. The ISG report rightly states that there has been a failure of generous tax incentives to result in tangible benefits to African economies and that

[1] Tax Justice Network-Africa (TJN-A) is a Pan-African initiative established in 2007 and a member of the global Tax Justice Network. TJN-A seeks to promote socially just, democratic and progressive taxation systems in Africa. We advocate pro-poor taxation and the strengthening of tax regimes to promote domestic resource mobilization. TJN-A aims to challenge harmful tax policies and practices that favour the wealthy and aggravate and perpetuate inequality.

there remains a need for host governments to be adequately compensated for the exploitation of their non-renewable resources. As also noted by the draft report, even during the mineral prices boom, which resulted in increased profitability for mining companies, 'the benefits to African governments were limited due mainly to the generous mineral policy regimes in existence in most countries'.

Research into the mining regimes in seven African countries, conducted by TJN-A and partners and published in our report Breaking the Curse (2009), has clearly demonstrated the scale of this problem: for example, in Ghana, South Africa and Tanzania, lower royalty rates as a result of tax breaks have cost or will cost treasuries up to US$68m, US$359m and US$30m a year respectively. In Malawi and Sierra Leone, tax breaks granted in mining contracts have cost or will cost treasuries up to US$16.8m and US$8m a year respectively. These measurements do not take into account the further very significant losses to treasuries that can arise through companies' under-reporting of profits and tax liability, through transfer mispricing and other forms of tax avoidance.

So, we share much of the ISG report's description of the problem. However, we would like to make a number of recommendations that we believe would strengthen the report, in terms of the mechanisms that are needed to address the problem.

The current draft report seems to refer primarily to the EITI framework, as the primary mechanism for increasing transparency of revenues. While we support the EITI's aims of promoting transparency and accountability in the extractives sector, we welcome the key role it has played in increasing awareness and engagement in these issues among key stakeholders in mineral rich countries and we would encourage more African governments to join the initiative, we also believe that there is a need to develop stronger mechanisms that go beyond this initiative. The EITI is limited by its voluntary status and because its transparency obligations only extend as far as the national border and vary between participating countries. This means that the EITI does not generate the type of information that is needed to spot tax avoidance through transfer mis-pricing.

<u>Key recommendations</u>

Addressing tax competition and un-transparent development agreements

Excessive tax concessions to mining companies amount to a form of hidden subsidy or budget expenditure. The costs associated with these subsidies and with aggressive tax avoidance through mining companies' insistence on tax breaks in secret mining contract have robbed African economies from millions of dollars in public revenue that could have been used to finance equitable development for its citizens. Mining companies and government advisors, for example, are putting increasing pressure on governments to abolish or lower value-based royalties.

We call for the continental guidelines to:

Mandate national governments to reform their mining taxes in compliance with an agreed continental standard. Such a standard should minimize the current competition among African countries for mining investment by offering ever-lower tax rates in the false belief that low taxes are the main factor determining investment decisions by natural resource seeking companies.

Stipulate that development agreements must conform to national laws. The current ISG draft mentions development agreements, but only to state that 'development agreements should stipulate the prices to be used in determining revenues'. The report should go further to call for stronger mechanisms that would increase transparency, improve revenues and ensure that **development agreements conform to national laws**. Mining taxes should be decided and approved by elected parliaments, and not in **secret mining** contracts between companies and senior politicians or government officials. All mining tax rates and terms should be legislated in the substantive law and merely confirmed in mining development agreements.

Addressing the manipulation of the tax base

The draft report points out that the 'determination of revenues can be a challenge'. It also notes that royalties are often calculated 'on the basis of the profits from the mining operation', yet this poses a problem when governments lack the information or capacity to verify a companies' declared profits and companies have ways of manipulating them through practices such as **transfer mis-pricing**. Therefore, we welcome the reference to 'mechanisms for obligatory, regular and open reporting both of revenues received by public bodies and of payments made by each entity engaged in such operations to public institutions and officials'. However, the mechanisms for this need to be more clearly spelled out.

We call for the continental guidelines to:

Express support for a Country-by-Country reporting standard.
The guidelines should call for an international accounting standard requiring all multinational companies operating in Africa to report publicly on their remittances to governments, and their profit and expenditures in each of the countries where they operate.

The call for such a standard is getting louder amongst key players, including the OECD (who have agreed to include a form of the standard in their Guidelines for Multinational

Enterprises), the European Commission (which has called for further investigation into such a standard) and the US (which recently passed an Act requiring energy and mining companies registered in the US to disclose how much they pay to foreign countries and the US government for oil, gas and minerals. The US government has also committed to working with other countries to ensure the implementation of similar disclosure requirements in other financial markets.)

Set a clear framework to calculate mineral reference prices based on value rather than profit-based royalties given that the latter allows for the manipulation of the tax base to reduce declared profits. This framework should include a mechanism that would protect government revenue when royalties are lowered or profit-based royalties introduced. Royalty payments are easier to monitor and collect than tax payments given the present inability of many tax authorities in Africa to cross-check and audit the declared profits of multinational mining companies' complex accounting structures and the ability of these companies to hide profits through transfer mis-pricing.

Continental guidelines should oblige African governments to revise their company acts to require subsidiaries of multinational mining companies incorporated offshore and in foreign jurisdictions to publish the financial information required by the Extractive Industry Transparency Initiative (EITI). National company acts should also require companies registered on African stock exchanges report on their financial operations and remittances to governments and other structures on a country-by-country basis and privately or state-owned mining companies to publish their profits and losses, and remittances to government and other structures. This will allow citizens and parliamentarians to monitor the financial flows between parent companies and subsidiaries, and detect tax avoidance practices.

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