



FIGHTING GLOBAL POVERTY

# Extracting minerals, extracting wealth

How Zambia is losing  
\$3 billion a year from  
corporate tax dodging





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**Zambia, one of the poorest countries in the world, is haemorrhaging wealth that could support vital public services and anti-poverty programmes, as a result of tax dodging by multinational mining companies. The new research in this report calculates that a staggering sum – up to \$3 billion a year – is lost by the people of Zambia to tax avoidance and tax evasion by multinationals. Overly generous tax incentives provided to companies by the Zambian government have also played a role. Attempts by the Zambian government to reform their tax system have met opposition from powerful mining companies and international organisations supported by Northern countries where the multinationals concerned are based.**

The revenue lost is a truly enormous sum in a country where 74% of the population live on less than \$1.25 a day and six million people – 43% of the population – are undernourished.

Zambia is, on the face of it, extremely wealthy. For many years the largest producer of copper in Africa, and the seventh largest in the world, Zambia achieved record production (over 800,000 tonnes per year) spurred by growth in demand for metals in Asia. There are many foreign copper mining companies operating in the country, with the largest including Glencore (a Swiss-based company listed on the London Stock Exchange), British-Indian company Vedanta and Canadian companies First Quantum and African Barrick Gold.

Translating Zambia's natural wealth into revenues for the Zambian people requires equitable tax policies to ensure the government receives a fair proportion of the earnings from mining. Although the copper mines are producing ever larger amounts of copper, many companies are paying no corporate income tax because they are declaring no profits. The country is being drained of resources by the ability of multinational companies to avoid paying tax, sometimes facilitated by the global structure of tax havens.

War on Want has long been committed to the fight for tax justice, as a means of guaranteeing an equitable distribution of the revenues from natural resources and of providing democratic control over national finances. We have run a three-year programme with trade union partners across Europe, funded by the European Union, to highlight the social and economic costs of tax dodging by multinational corporations, and to demonstrate the need for a radical transformation in tax policies so as to end the scandal of tax dodging once and for all. We present this report as one further indication of the damage done to the poorest countries by corporate tax dodging, and we encourage all readers to join the campaign for tax justice in all countries, whether in the global North or South.



John Hilary  
Executive Director

# Contents

02

Extracting minerals, extracting wealth How Zambia is losing \$3 billion a year from corporate tax dodging

	<b>Executive Summary</b>	<b>03</b>
<b>1.</b>	<b>Zambia: revenues from mining</b>	<b>04</b>
<b>2.</b>	<b>Corporate tax avoidance</b>	<b>06</b>
	<b>2.1 Glencore</b>	<b>07</b>
	<b>2.2 Vedanta</b>	<b>10</b>
	<b>2.3 Associated British Foods</b>	<b>12</b>
<b>3.</b>	<b>Tax evasion</b>	<b>13</b>
<b>4.</b>	<b>Tax incentives</b>	<b>14</b>
<b>5.</b>	<b>Zambia's lost revenues</b>	<b>16</b>
<b>6.</b>	<b>Clamping down on tax avoidance</b>	<b>18</b>
<b>7.</b>	<b>Conclusions &amp; recommendations</b>	<b>21</b>



**Copper Mine, Zambia**



# Executive Summary

**Zambia has abundant natural resources – including minerals and agriculture – yet gains little tax revenue from the extraction of its resources, leading to lost opportunities to invest in public services such as education and health which are essential in tackling poverty.**

This report reveals how multinationals are able to dodge paying their fair share of tax. In 2012 it was calculated that the amount avoided by companies in Zambia was around \$2 billion a year – representing 10% of Zambia's GDP. Looking at three companies with operations in Zambia: Glencore, Vedanta, and Associated British Foods, the report examines the details of such tax avoidance including use of complex corporate structures and mispricing. All these companies are based in the UK or are listed on the London Stock Exchange.

The report also describes other ways in which Zambia loses out on tax revenue, including illegal tax evasion by companies based in Zambia which adds a further \$264 million; and \$752 million lost in tax incentives agreed by the government.

One aspect of tax avoidance is the lack of access by government officials to information on company operations, production and pricing. Combating tax dodging strategies will require adequate government capacity and expertise which currently does not exist. The report describes a total of \$3 billion being lost to the Zambian exchequer - money which could be spent on essential public services such as health

and education. Recovering Zambia's lost tax revenues could nearly double spending on schools and health care.

Public outcry over lost tax revenue led to government attempts in 2014 to address how mining companies in particular avoided tax. These attempts to reform the tax system were powerfully opposed by mining corporations. They threatened to cut thousands of jobs and billions of dollars of investment. The IMF also expressed concern at the impact of the measures and the impact of lower global commodity prices on government revenues. This pressure all had an effect and the government rolled back on the proposed new measures.

Looking forward, Zambia continues to face enormous challenges in addressing the \$3 billion shortfall, yet without international support its position is weak.

War on Want calls on Northern governments, including the UK, to address the ways in which the international tax system they support undermines Zambia's ability to raise a fair share of tax from multinationals operating in Zambia.

The UK government should:

- Close down tax havens
- Ensure UK tax rules do not allow companies to avoid tax in developing countries
- Support the establishment of a UN body to lead the re-writing of global tax rules
- Launch an investigation into UK multinationals' corporate tax practices in Zambia.



# Zambia: revenues from mining

04

Extracting minerals, extracting wealth How Zambia is losing \$3 billion a year from corporate tax dodging

Zambia is notorious for earning very little from mining. A string of NGO, media and academic reports in recent years have highlighted how mining companies, while producing a large amount of copper, have been paying few taxes to the government.

The latest detailed figures, contained in a recent report for the Extractive Industries Transparency Initiative (EITI), are shown in table 1. In 2010, Zambia produced \$5.7 billion worth of copper but earned revenues from mining of just \$633 million (excluding the payments made by employees of the mining companies in the form of Pay As You Earn (PAYE)).<sup>1</sup>

In 2011, government revenues rose significantly: this was due to tax changes brought in by the government that increased corporation tax and the royalty rate and

introduced a variable profit tax and a windfall tax. Thus in 2011, the Zambian government earned \$1.35 billion in revenues from mining, based on copper production worth \$7.23 billion.

Although government revenues in 2011 were greater than before, they should have been much higher. The EITI report shows that in 2011, over half of all government revenues from mining came from just one company: Kansanshi Mining Plc, jointly owned by First Quantum (80%) and the Zambian government (20%). Of the other five mines, two – owned by Glencore and African Barrick Gold – paid no corporation tax at all, while another, owned by Vedanta, paid only a token amount. Excluding Kansanshi, the other five companies produced copper worth \$4.28 billion but paid a total of only \$310 million in taxes to the government. The taxes paid were mainly windfall taxes, royalties and VAT on imports.

Table 1

## Copper production and government revenues

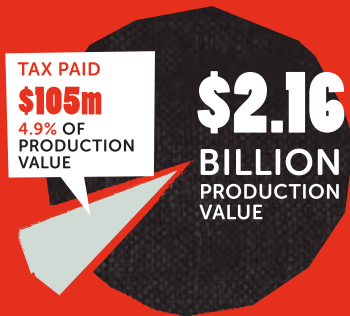


	2010	2011
Mining company copper production	762,521 tonnes	819,574 tonnes
Value of production	\$5.74 billion	\$7.23 billion
Total tax payments by mining companies (all commodities not just copper)	\$789 million	\$1.55 billion
Tax payments minus PAYE	\$633 million	\$1.35 billion
Tax payments minus PAYE as % of production	11%	19%

**Sources:** Moore Stephens, *Zambia Extractive Industries Transparency Initiative (ZEITI): Reconciliation report for the year 2011*, February 2014, Annex 8; US Geological Survey Minerals Information: Copper, 2012 report, <http://minerals.usgs.gov/minerals/pubs/commodity/copper/>. Exchange rate used: ZK4.86/\$ as used in the EITI report.

## PRODUCTION AND TAX AT THE FIVE LARGEST COPPER MINES

Konkola Copper Mine  
(Vedanta)



Kansanshi Mining Plc  
(First Quantum)



Mopani Copper Mines  
(Glencore)



Lumwana Mining Company  
(African Barrick Gold)



NFC Africa Mining Plc  
(CNMC Luanshya Copper Mines)



Based on 2011 figures.

**Sources:** Moore Stephens, *Zambia Extractive Industries Transparency Initiative (ZEITI): Reconciliation report for the year 2011*, February 2014, Annex 8; US Geological Survey Minerals Information: *Copper*, 2012 report, <http://minerals.usgs.gov/minerals/pubs/commodity/copper/>. This is the average price on the London Metal Exchange for 2011. Exchange rate used ZK4.86/\$ as used in the EITI report.



# 2 Corporate tax avoidance

06

Extracting minerals, extracting wealth **How Zambia is losing \$3 billion a year from corporate tax dodging**

**There are various reasons why copper mining companies are paying lower taxes than they should, but one major reason is corporate tax avoidance.**

In November 2012, Zambia's Deputy Finance Minister Miles Sampa made the extraordinary announcement that Zambia was losing \$2 billion a year in tax avoidance, with the mining industry identified as the biggest culprit. This figure amounts to almost 10% of Zambia's GDP. Only one or two mining operations were actually declaring positive earnings, Sampa told reporters in Lusaka, adding:

“The other mines for one reason or another, some genuine, some not, are always making losses. Most of it is due to transfer pricing or tax avoidance. We're looking at developing a law that will criminalise false reporting.”<sup>2</sup>

Sampa noted that companies were avoiding paying tax by means of two methods. One was through transfer pricing – the widespread practice whereby parts of the same company trade with each other at artificial prices determined by themselves, to minimise taxes. The other was that, according to Sampa some parent companies were loaning money to subsidiaries at interest rates higher than market rates, in order to inflate costs and reduce taxable income.<sup>3</sup>

In Zambia, companies are presented with a variety of ways to avoid paying tax, including over-reporting of costs and under-reporting of production. Allegations concerning tax avoidance have recently been made against three high-profile companies: Glencore, Vedanta and Associated British Foods.



**In 2012, Zambia was losing \$2 billion a year through tax avoidance**







**Glencore's headquarters in Baar, Switzerland. Glencore is a public company, listed in London and Hong Kong, registered in Jersey**



## 2.1 Glencore

Mining giant Glencore, which is based in Switzerland, registered in Jersey and listed on the London Stock Exchange, is one of the world's largest extractive companies, and a producer and marketer of over 90 commodities worldwide.<sup>4</sup>

*The Guardian* has reported analysts in the City of London to be 'astonished' to learn that Glencore controls 60% of the world's traded zinc market and 50% of copper.<sup>5</sup> Glencore had revenues of \$233 billion in 2013<sup>6</sup> almost 10 times greater than Zambia's GDP.

In Zambia, Glencore manages Mopani Copper Mines, which consists of four underground copper and cobalt mines, a concentrator and a cobalt plant in the town of Kitwe and an underground mine, concentrator, smelter and refinery in the town of Mufulira; both in the Copperbelt area of north-central Zambia

that is home to Zambia's copper's industry.<sup>7</sup> Mopani employs around 20,000 people and is majority owned by Glencore, with other stakes held by Canadian mining company First Quantum and by the Zambian government, which holds a 10% stake.

Glencore has become one of the most criticised companies in the world for tax avoidance, among other issues, and its Zambia operations are no exception.<sup>8</sup> In 2011, a report written by accountants Grant Thornton and consulting firm Econ Pöyry, which was commissioned by the Zambia Revenue Authority, was leaked in Zambia. The report, an audit of Mopani Copper Mines, contained a number of explosive findings, notably that Mopani's operations included tax planning strategies "equal to moving taxable revenue out of the country". It alleged that there had been an inexplicable increase in Mopani's declared costs between 2006 and 2008, and inconsistencies in the production volumes declared.

In addition, the audit alleged that Glencore was engaging in transfer pricing activities and that its sales of copper to related parties were “not in accordance with the agreement disclosed” by not being at arm’s length. Rather, the audit suggested that Mopani sold copper at artificially low prices to Glencore in Switzerland under a deal struck with the firm’s UK subsidiary. The metal was then sold on, allowing Glencore to take advantage of Switzerland’s ultra-low tax regime. The audit concluded that “the Mopani cost structure cannot be trusted to represent the true nature of the costs of the Mopani mining operation”. In addition, the audit alleged that Mopani had “resisted the pilot audit at every stage”.<sup>9</sup>

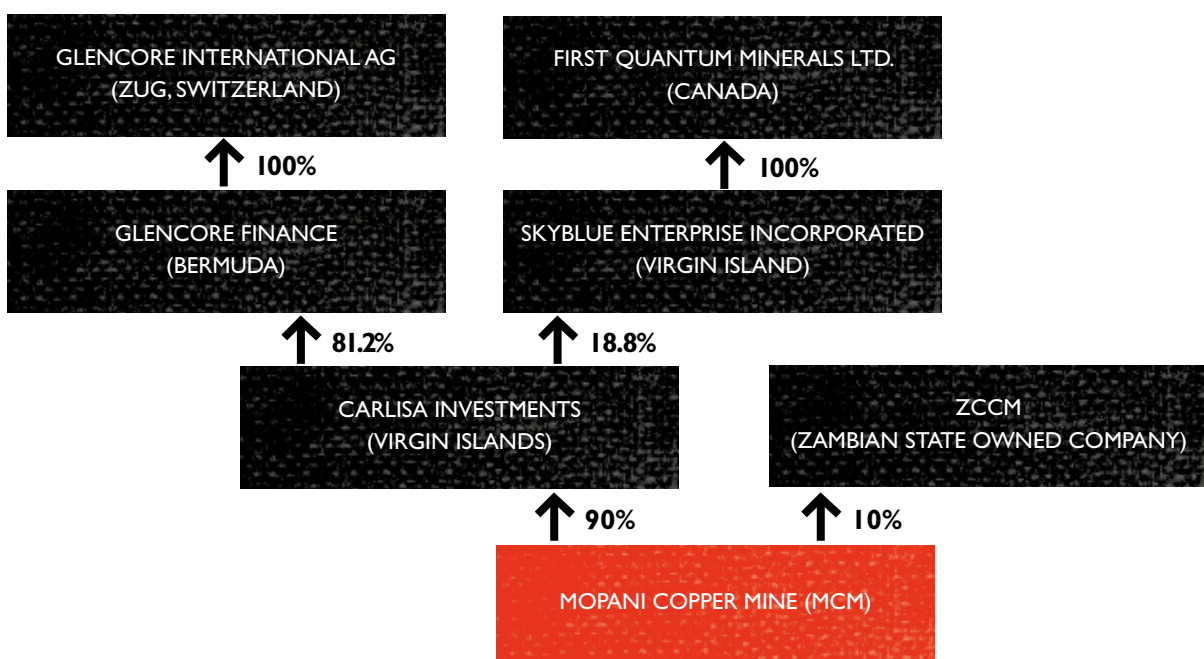
Glencore responded to the allegations in the audit report, saying: “We refute the conclusions of this draft report and we question the reasons for the manner in which it was leaked. This draft report

contains factual errors and inaccuracies. It is based on broad and flawed statistical analysis and assumptions.”<sup>10</sup> Glencore also claimed that the auditors had failed to factor in rising fuel and labour costs over the period, and that all transactions were conducted at an arm’s-length basis and at internationally agreed prices.<sup>11</sup>

The leaked report caused a storm in Zambia, as well as considerable international attention. In 2011, five NGOs filed a complaint to the Organisation for Economic Cooperation and Development (OECD) against Mopani, claiming that Glencore’s activities were violating the OECD’s Guidelines for Multinational Enterprises.<sup>12</sup> Yet the OECD’s final ruling was inconclusive, simply concluding that the two sets of parties agreed to disagree.<sup>13</sup>

The risk of tax avoidance in the case of Mopani is heightened by the fact that the

### Structure of Mopani copper mine





mine's ownership structure is mainly located in secrecy jurisdictions. Mopani is 90% owned by a company registered in the British Virgin Islands, which in turn is majority owned by Glencore Finance, registered in Bermuda.

War on Want's analysis of Mopani's annual financial reports raises serious concerns as to whether the mine is declaring accurate sales prices for its copper production. In the five years 2007-11, for example, Mopani's annual reports suggest that it produced \$4.3 billion worth of copper. Using copper prices given by the US Geological Survey, however, this production would have been worth \$6.8 billion – a difference of \$2.5 billion. The discrepancy may be accounted for by Mopani's 'third party tolling', i.e. supplying other parties with its copper production, meaning that its own sales figures are reduced. This requires further investigation by Zambian authorities, given the possibility of mining companies' under-reporting sales in order to reduce their taxable income.

As noted above (see page 5), Mopani produced 101,000 tonnes of copper in 2011,<sup>14</sup> when average copper prices on the London market were \$8.813 per tonne;<sup>15</sup> thus its production was worth around \$890 million before costs. Yet Mopani paid the government just ZK 374 million (\$77 million) in taxes overall, which included no corporate income tax at all, and ZK 140 million (\$28.8 million) in royalties.<sup>16</sup> Glencore stated in 2012 that Mopani had paid \$425.1 million in taxes and royalties to Zambia since Glencore bought its 73.1% stake in the operation in 2000.<sup>17</sup>

## The role of the European Investment Bank

The European Investment Bank (EIB), which is owned by EU member states, is also implicated in Glencore's alleged tax avoidance.

In 2005, the EIB loaned Mopani \$50 million for the renovation of a smelter to reduce sulphur dioxide emissions. After the 2011 audit report was made public, the EIB launched an investigation into Mopani. But in July 2014, the EIB announced that it would not make public the findings of its investigation.<sup>18</sup> It argues that since Glencore has repaid its loan "and that these matters concern MCM/Glencore's relations with the Zambian authorities, the Bank has not taken any further view on this and considers this case as closed".<sup>19</sup>

Swiss-based commodity traders such as Glencore are the subject of particular scrutiny when it comes to tax avoidance because of the role Switzerland plays in global commodity trade. 'Swissploitation' highlighted this Swiss role and the mystery of where Zambia's copper exports actually go, and at what price. Research undertaken in 2013 showed that in previous years up to half of Zambia's copper exports had been destined for Switzerland, according to Zambian customs, but according to Swiss import data, most never arrived. In addition, exports of copper from Switzerland have much higher declared prices than those from Zambia. If Zambia had secured the same price for its copper exports as Switzerland in 2008, for example, the value would have been nearly six times higher, adding £11.4 billion to Zambia's GDP.<sup>20</sup> The suggestion is that 'Swissploitation' is resulting in countries losing billions as a result of the way that commodities are priced.



© Wikimedia Commons/ Bluesailo

## 2.2 Vedanta

Vedanta – registered in London with a head office in Mumbai, India – manages three copper mines in Zambia, notably Konkola Copper Mines, Zambia’s largest and one of the largest high-grade copper ore-bodies in the world.<sup>21</sup> Vedanta, and specifically the Konkola operation, has long been the target of international campaigns over the company’s environmental and labour impacts, and the generous tax terms under which it operates. In 2014, protesters at the Zambian High Commission in London called on Vedanta to pay a fine of \$2 million served by the Zambian courts in compensation to people poisoned by water pollution near the Konkola mine. At the same time, 400 non-unionised Konkola workers protested against their unfair pay and lack of contracts at labour offices in Kitwe, Zambia.<sup>22</sup>

Vedanta is also accused of tax dodging through transfer mispricing. *The Post* newspaper in Zambia reported that “Vedanta Resources-owned Konkola Copper Mines is cheating on its copper exports prices by under-pricing and selling it through subsidiaries in Dubai”.<sup>23</sup> The article refers to an arbitration hearing in the London High Court of Justice that heard how Vedanta had allegedly used a Dubai-based subsidiary, Fujairah Gold, to buy under-valued copper from Konkola and thus hide its profits.<sup>24</sup> Lawyers argued that “copper was being sold by KCM [Konkola] to Fujairah Gold... in such a way as to result in an underpricing of metal sold to a related company in a manner which was not at arms’ length”.<sup>25</sup> A Konkola spokesman denied the allegations, saying: “All copper exports done by KCM are at market terms and absolutely at arm’s length.”<sup>26</sup>



Vedanta's corporate structure includes numerous subsidiaries in secrecy jurisdictions; its Annual Report for 2014 lists 29 subsidiaries in the tax havens of Mauritius, the Netherlands, British Virgin Islands and Jersey.<sup>27</sup>

One might think that Vedanta hardly needs to engage in tax avoidance, given that it has been granted such generous fiscal terms by the Zambian government. The secret mining agreement negotiated with Vedanta after it took over Konkola from Anglo American in 2000 gave it a 0.6% fixed royalty rate along with the ability to offset 100% of capital expenditures against tax and to carry forward losses.<sup>28</sup> These generous tax terms mean that Vedanta pays very little corporate income tax, as noted above. While Vedanta paid only ZK 54,000 (\$11,111) in corporation tax in 2011, its Annual Report states that its Zambia operations (which include two mines in

addition to Konkola) generated \$1.7 billion in revenues and an operating profit of \$221 million in 2011/12.<sup>29</sup>

In May 2014, a video posted on the internet caused further controversy for Vedanta, apparently showing Anil Agarwal, Vedanta's founder and chairman, mocking the Zambian government for selling Konkola for the knock-down price of \$25 million; the mine's asking price at the time was \$400 million. The video also shows Agarwal saying that the mine brings in profits of \$500 million a year, a figure that does not exactly square with Vedanta's annual report stating that the company made a loss of \$6.3 million in the year ending March 2013. The media reported that the Zambia Revenue Authority was investigating to establish whether these claims as to profits were at variance with profits declared.<sup>30</sup>



## Protester at the Zambia High Commission, London







© Flickr: Worldfish Nixon Chisonga

### 2.3 Associated British Foods

It is not only mining companies in Zambia that are accused of tax avoidance. British company Associated British Foods (ABF), the owner of Silver Spoon sugar, Ryvita and Primark, has also been the subject of research alleging tax avoidance in Zambia. In 2013, a detailed report, the result of a 12-month investigation, revealed that ABF's subsidiary, Zambia Sugar, had generated profits of \$123 million but paid virtually no corporation tax in Zambia. Rather, it had found legal ways to siphon \$83.7 million (\$13 million a year) – a third of pre-tax profits – out of Zambia into tax havens including Ireland, Mauritius and the Netherlands.

The research found that the ABF group was using a variety of tax avoidance techniques:

- Since ABF bought out Zambia Sugar in 2007, it had paid its Irish arm over \$47.6 million for 'management fees', despite the company accounts stating it has no employees.

The company says this was an error, but in any case Zambia lost an estimated \$7.4 million in corporate and withholding taxes as a result.

- In November 2007 Zambia Sugar took out a bank loan of \$70 million, which on paper was routed through Ireland to avoid Zambian tax on the interest charges. This cost Zambia an estimated \$3 million in withholding taxes.
- By shuffling the ownership of Zambia Sugar between the tax havens of Ireland, the Netherlands and Mauritius, the company reduced the withholding tax it pays on dividends in Zambia by an estimated \$7.4 million since 2007.

The report estimated that Zambian public services lost around \$27 million as a result of the company's tax avoidance schemes and special tax breaks, enough money to put 48,000 children in school. The revenue lost to tax havens is 10 times larger than the amount the UK gives Zambia in aid for education each year.<sup>31</sup> ABF denied the allegations.<sup>32</sup>



**“The big global mining companies are robbing the opportunities for the countries to advance.”**

Dev Kar, Economist  
at Global Financial Integrity.<sup>33</sup>

In addition to legal methods of tax avoidance, Zambia is losing more revenues from illegal tax evasion. US-based organisation Global Financial Integrity, which has pioneered recent research into illicit financial flows, estimates that \$8.8 billion left Zambia from the proceeds of crime, corruption and tax evasion in the 10 years between 2001 and

2010 – an average of \$880 million a year.<sup>34</sup> If this money were taxed at the prevailing corporation tax rate of 30%, Zambia would increase its revenues by around \$264 million a year. These illicit outflows are in addition to the \$2 billion outflows from corporate tax avoidance noted by the government.<sup>35</sup>

Of the \$8.8 billion figure, \$4.9 billion is attributed to trade misinvoicing, a process that deliberately misreports the value of a commercial transaction on an invoice submitted to customs. This form of trade-based money laundering is the largest component of illicit financial outflows measured by Global Financial Integrity. Some \$786 billion left the countries of the global South in 2011 as a result of such trade misinvoicing.<sup>36</sup>



**Global financial services are at the heart of largescale corruption in Zambia**



# 4 Tax incentives

14

Extracting minerals, extracting wealth How Zambia is losing \$3 billion a year from corporate tax dodging

**“Our current tax incentive regime remains one of the most generous in the region but this generosity has not translated into creation of decent employment opportunities for our people”**

Finance Minister Alexander Chikwanda,  
October 2012<sup>37</sup>

Tax incentives given by the government to companies, especially in the mining sector, are another cause of Zambia’s lost revenues. The Zambian government offers an array of tax incentives to domestic and foreign

companies. For example, companies investing over \$500,000 in the Multi Facility Economic Zones pay no taxes on profits for the first five years, along with no import duties on raw materials, capital goods, machinery including trucks and specialised motor vehicles. Mining companies are entitled to 100% capital reductions on mining equipment and production capital expenditure, the ability to carry forward losses and offset them against tax, and a rebate on import duties for certain mining equipment.

In addition, all companies investing over \$10 million are “entitled to negotiation with the government for additional incentives”; thus all mining companies have been given special tax deals. This is a major reason why many mining companies are consistently declaring tax losses.

In individual mining agreements signed in the early 2000s, the government typically reduced corporate income tax from 30% to 25%,



**President Banda and Mopani Copper Mines (Glencore)  
CEO Emmanuel Mutati**



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## Zambeef, one of Zambia's largest agribusiness, benefits from secret tax incentives.

15



© Flickr/ BBC World Service

lowered copper royalty rates from 3% to 0.6%, and sealed these through 10-year tax stability clauses.<sup>38</sup> For example, Canadian company African Barrick Gold, which manages the Lumwana copper mine, signed a mining agreement in 2005 providing a 10 year 'stability period' for these corporate income tax and royalty concessions in a deal which also enables it to defer payment of various customs and excise duties.<sup>39</sup>

An example of a non-mining company that appears to benefit from tax incentives is Zambeef, one of the largest agribusinesses in Zambia. The company had revenues of \$255 million in 2012<sup>40</sup> by producing, processing and retailing meat, dairy products, eggs, oils and bread.<sup>41</sup> Details of the tax incentives given to Zambeef are not publicly available, but the company's low tax payments are likely explained by its ability to write off against tax large capital expenditures and depreciation allowances:

- In 2011, for example, Zambeef declared a profit before tax of \$10.6 million, on which it actually paid tax of only \$244,000 – a rate of 2.3%, compared to the standard rate for agribusiness of 15%.<sup>42</sup> Deducted from the tax charge was around \$2.5 million in capital and depreciation allowances.<sup>43</sup>
- Similarly, in 2010, Zambeef made a profit before tax of \$3.3 million, yet company accounts record income recovered (not paid) of \$401,000.<sup>44</sup>

In 2010, tax incentives on VAT and excise duty were given to Varun Beverages Ltd, part of Indian company RKJ Group, which manufactures and markets Pepsi brand beverages in Zambia.<sup>45</sup> The incentives were reportedly worth ZK 15 billion (\$1.8 million).<sup>46</sup> Yet they were withdrawn by the following government and a Commission of Enquiry into the Zambia Revenue Authority found in 2011 that the tax concessions given to the company on VAT and excise were 'illegal' since they were outside the legislation and constitution.<sup>47</sup>

# 5 Zambia's lost revenues

16

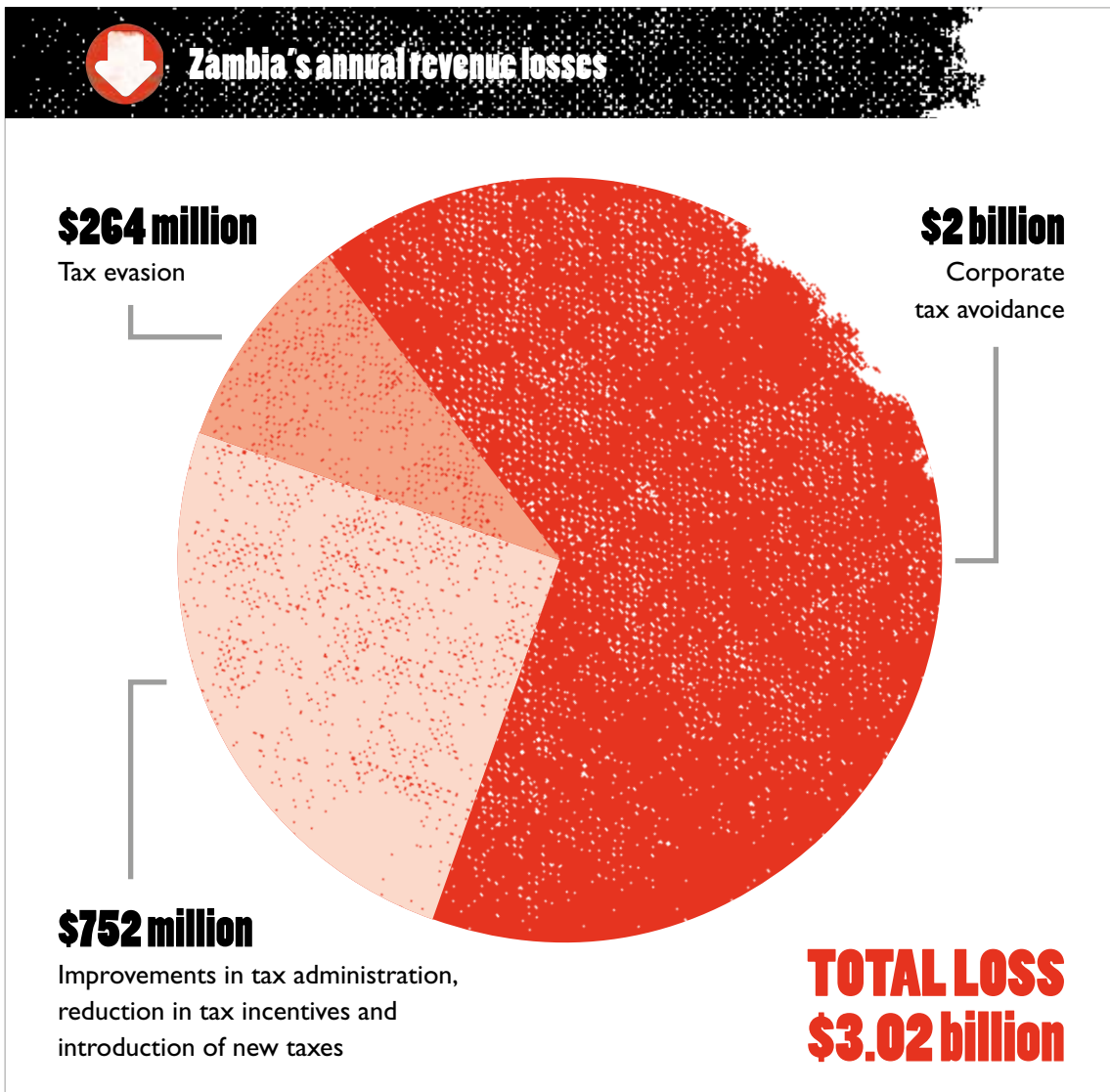
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This report has so far noted that Zambia is every year losing around \$2 billion in corporate tax avoidance, \$264 million in tax evasion and an unspecified amount in tax incentives.

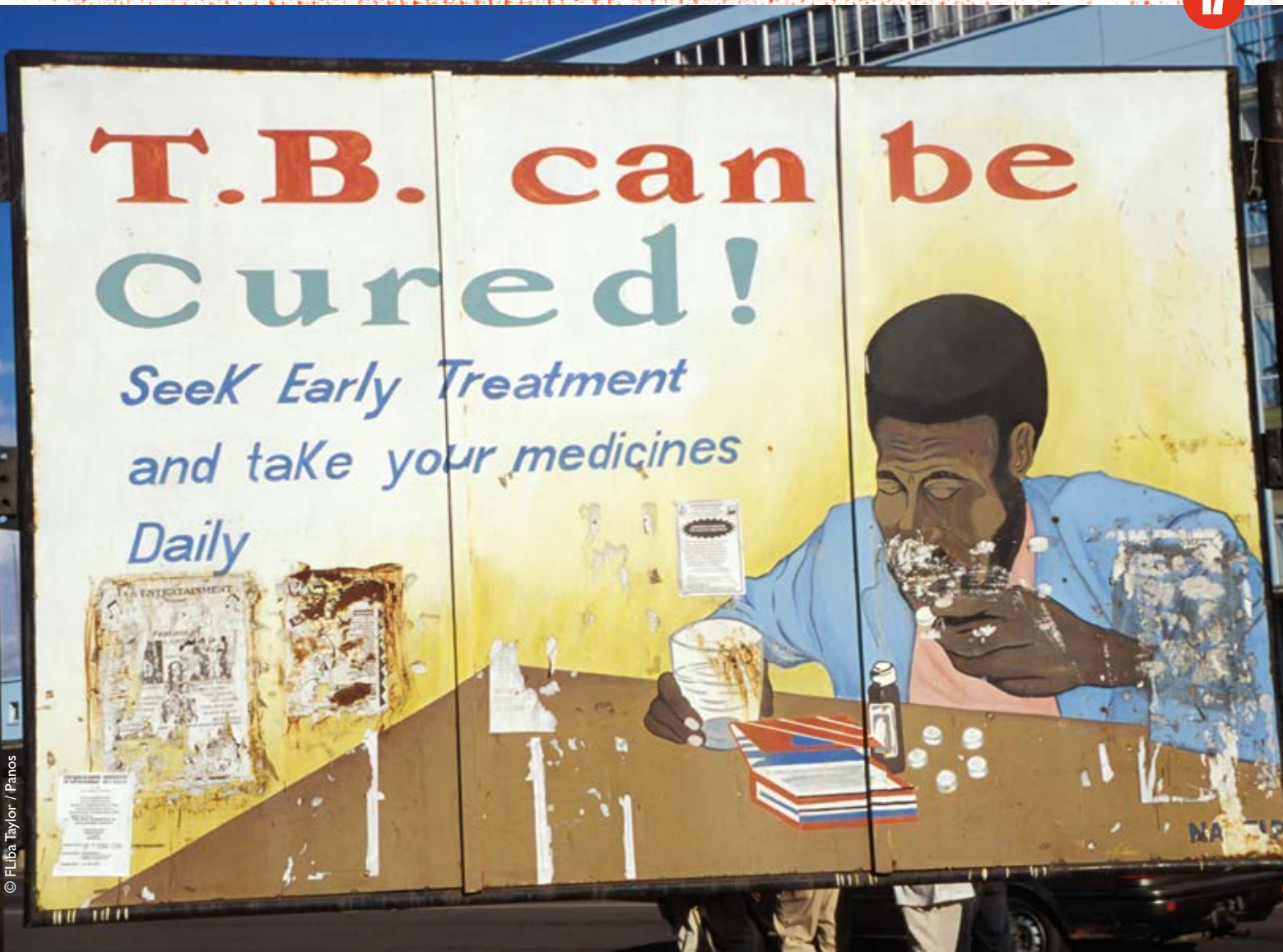
Previous analysis by the International Monetary Fund (IMF) noted that a combination of improvements in Zambia's tax administration, the introduction of new taxes and a reduction in tax incentives would

together increase Zambian government revenues by 4% of GDP.<sup>48</sup> This would mean an increase in revenues of around \$752 million a year.<sup>49</sup> These figures are combined in the chart below.

There may be some double-counting in these figures; for example, improvements in tax administration could reduce the amount of revenues lost through tax evasion. But the overall figure for annual revenue losses would still be around \$3 billion.







The loss of \$3 billion is equivalent to nearly half of Zambia's entire annual government budget of ZK 32.2 billion (\$5.9 billion) in 2013. It is also equivalent to nearly twice Zambia's combined spending on health and education (of ZK 9.26 billion, or \$1.69 billion).<sup>50</sup> Thus recovering Zambia's lost tax revenues could nearly double spending on schools and health care.

The last decade has seen sustained economic growth in Zambia, but this has been accompanied by rising inequality and continuing poor public services.<sup>51</sup> Thus plugging the huge gap in Zambia's revenue

collections could play a significant role in promoting social development in Zambia.

Whilst there is much the Zambian government can do to address this revenue gap, the following chapter demonstrates the resistance and obstacles it faces when trying to ensure multinationals that operate in its country pay a fair amount of tax.

# 6 Clamping down on tax avoidance

18

Extracting minerals, extracting wealth How Zambia is losing \$3 billion a year from corporate tax dodging

**Companies seeking to avoid paying tax in Zambia can use a number of different strategies. The key is for the Zambian authorities to stop them doing so. Officials face problems with four key tax avoidance strategies.<sup>52</sup>**

The first is transfer pricing abuse, in light of the fact that the global mining industry is dominated by multinational companies trading between different operating units in different countries. Companies can reduce their overall tax payments by selling goods and services from an operating unit in a low tax jurisdiction to one in a higher tax jurisdiction at a relatively high price, transferring income away from the high tax jurisdiction.

The second is by under-reporting production values, whereby mines report to the tax authority that their production is less than its market value. Mines can under-report the volume of production or the grade of the mineral. A problem for the government is to check the quality and content of all production, which requires an understanding of the geology of the area being mined and of the processing technology, and thus requires close cooperation between the mine and the tax authority. The process is further complicated by the often complex value chain involved in large-scale copper mining, where some refining and/or smelting is often carried out by separate or associated companies and elements of the potential tax base can be transferred.<sup>53</sup>

A third corporate tax avoidance strategy relates to interest payments on debt, which can be deducted from profits when determining taxable income. This creates an incentive for a company to lend funds to a subsidiary at a high interest rate in order to reduce the subsidiary's taxable profits. Fourth, mining companies, which face volatile prices for their products, can

purchase derivative contracts (similar to futures and options) to guarantee a specific price for their output in the future. This 'hedging', which acts as an insurance against a fall in the copper price, is a legitimate business activity but can also be used to shift income out of high tax jurisdictions: firms can deliberately trade in order to lose money in a subsidiary facing a high tax rate and to gain in another subsidiary facing a lower tax rate.

Combating these policies clearly requires adequate government capacity, which currently does not exist. David Manley, a former senior economist at the Zambia Revenue Authority, notes that no one, except the mining companies themselves, knows what the costs of production really are and that "it is not possible to determine how much return the mining companies make".<sup>54</sup> A recent analysis by the campaign group Foil Vedanta notes that lack of resources and efforts by mining companies to hide data and manage perceptions leave the Zambian state with virtually no information on the operations or production of the mining companies.<sup>55</sup>

Greater capacity and expertise is needed not only to monitor the mines' production and accounts but also to propose different tax designs during the course of negotiations with companies. There is some support from donors to increase Zambia's tax capacity – in 2011, for example, a cooperative programme between the IMF, the Norwegian government and the Zambia Revenue Authority was established. However, as Manley notes, it will take some time before Zambia's lack of capacity stops being a constraint on its fiscal choices.<sup>56</sup>

Over the past several years the government has repeatedly given signals of its intention to clamp down on tax avoidance. In 2012, it





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announced reductions in capital allowances for mining companies.<sup>57</sup> 2013 saw it announce a forensic audit of Vedanta's Konkola operation in response to exposure of Anil Anarwal's comments on YouTube.<sup>58</sup> It also introduced a new law that allows the Bank of Zambia to regulate and monitor foreign exchange flows in a bid to curb tax avoidance. However, it is unclear how effective this will be in monitoring and clamping down on multinationals' tax avoidance.<sup>59</sup> It was also mooted that the mining regime might be amended to enable the government to raise taxes again and implement a 35% minimum ownership threshold for state shareholding in mining projects.<sup>60</sup>

In late 2014, the Zambian government, faced with a downturn in copper prices, attempted again to address the way in which mining companies pay taxes. In January 2015 it abandoned corporate tax rates, claiming they were illusory as only two companies had been paying them, and tripled royalties

to 20% for open pit mines and 8% for underground mines.

International mining firms reacted strongly, saying the changes would threaten 12,000 jobs and stop capital investment in mining. However, some of the scaling back of planned investments they threatened may well have been due to the falling price of copper which led global mining companies to plan to cut back an estimated \$20 billion of investment mainly focused on Africa.<sup>61</sup>

The disagreement over tax rates took place against a backdrop of a dispute between mining companies and the Zambia Revenue Authority over VAT, where mining companies claimed they were owed \$600 million in VAT refunds; the Zambian government claimed the mining companies have been unable to provide the necessary documentation to support their claims. With the companies protesting the proposed changes to the mining taxes, the government faced enormous



pressure to back down over its proposed changes. Glencore suspended its operations before the budget in late 2014.

During the election campaign in January 2015, facing pressure, Edgar Lungu, the presidential candidate for the ruling party, said he would look again at the taxes, something welcomed by the IMF. Following the election he set up a technical committee in March to look at revisions to the new tax regime. The changes were rolled back from 1 July 2015 returning to lower royalty rates: 20% to 9% for opencast and 8% to 6% for underground mines; a corporate income tax level of 30%; a variable profit tax of up to 15% for mining operations and seeking to limit the deduction of losses for mining operations to 50% of taxable profit.

With mining companies suspending operations, delaying investments, and lower global copper prices all impacting on Zambian

government revenues, the government faced a budget deficit, raising the concern and involvement of the IMF. The IMF supported the return to income tax based measures. The Zambian government also gave into mining companies and relaxed documentation rules for VAT refunds and started to pay VAT refunds to mining companies dating from February 2015.

As these attempts demonstrate, introducing a tax regime which can recoup a fairer share of taxes from mining depends on the degree to which the political will of the Zambian government matches the pressure the mining industry and foreign donors can bring to bear to prevent them.

The ability of companies to get away with tax dodging globally depends on the willingness of governments around the world – especially those presiding over tax havens – to allow them to do it.



## Campaigners highlight the role of tax havens undermining the tax base of developing countries





# 7 Conclusions & recommendations

**“Zambia has the natural resource wealth to dig (literally and figuratively) its way out of poverty, but only if the West acts at the same time. Zambia can’t do this alone. The extra money could be siphoned off to the offshore bank accounts of corrupt public officials, or companies could find new ways to legally pretend that their profits were made elsewhere...”**

**The global shadow financial system – a network of secrecy laws, tax havens, shell corporations, and banks like HSBC without real money laundering controls – facilitates both illicit financial flows and pernicious corporate tax avoidance. We need to break this system down. We can start by reforming international customs and trade protocols to detect and curtail trade misinvoicing and requiring the country-by-country reporting of sales, profits and taxes paid by multinational companies.”**

Sarah Freitas, EconoGlobal Financial Integrity<sup>62</sup>

The extraction of wealth from Zambia is truly a scandal. Yet whilst significant pressure from mining companies, and international organisations such as the IMF can be brought to bear on southern countries such as Zambia, there is little policy space available for Zambia to address the issue unilaterally. As well as being faced with these pressures, current attempts to write the global rules needed for tax are taking place through the OECD, a rich nation’s club. For fair international tax rules to be established,

developing countries must have an equal seat at the table.

For Northern governments’ actions to be credible, they must stop supporting rules that enable multinationals, based or listed in their countries, to avoid tax wherever they operate, such as the continuing existence of tax havens. Multinationals must be held to account for their tax dodging and southern countries should be able to participate as equals in the development of international tax rules.

## **The UK Government must:**

- **Close down tax havens**
- **Ensure UK tax rules do not allow companies to avoid tax in developing countries**
- **Support the establishment of a UN body to lead the re-writing of global tax rules**
- **Launch an investigation into UK multinationals’ corporate tax practices in Zambia.**

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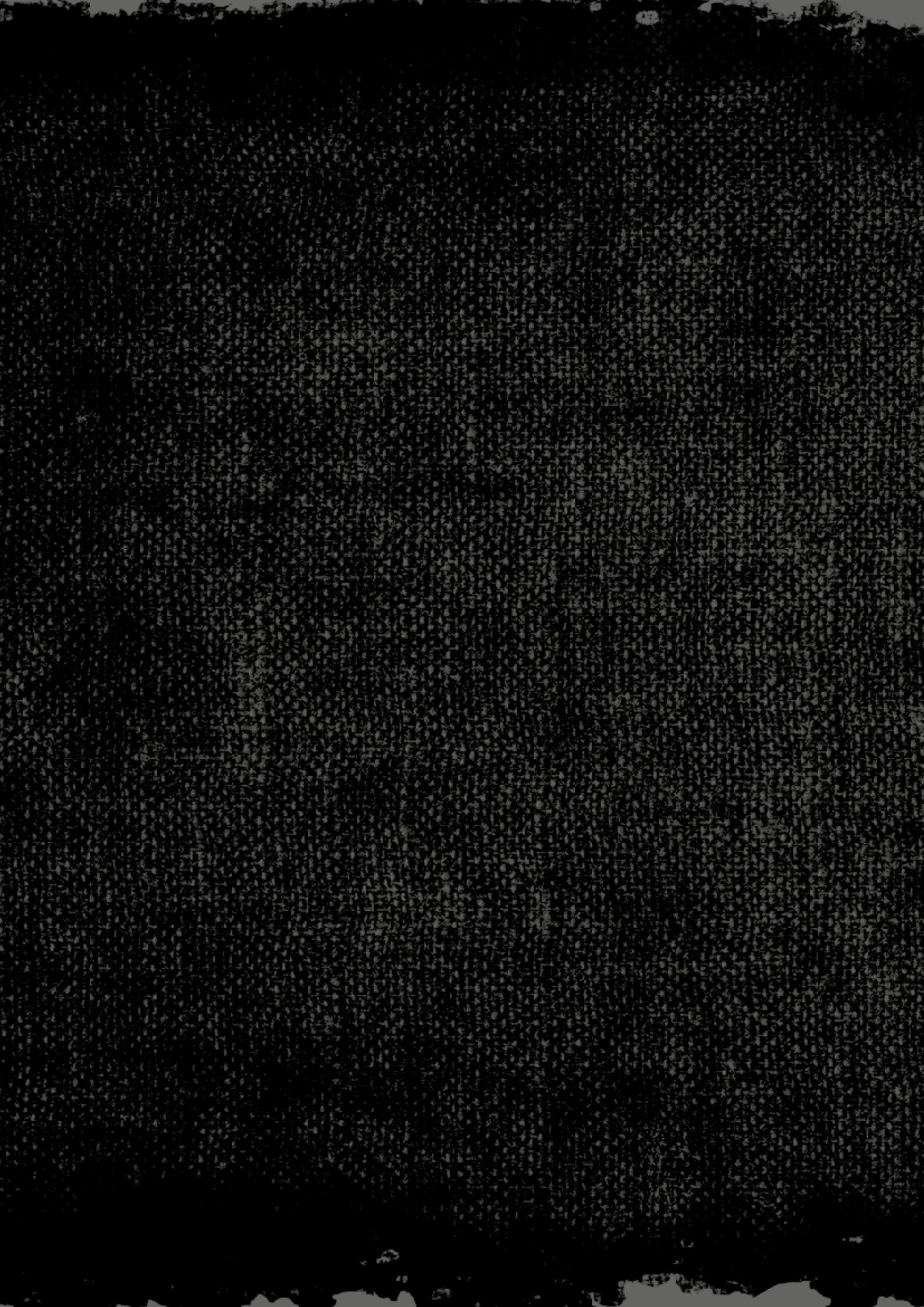
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**Published: October 2015**

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Cover picture: Hagai Sichone, of Konkola Copper  
Mines PLC, works underground in Nchanga mine in  
Cingola, Zambia. © Reuters

Design by [www.wave.coop](http://www.wave.coop)

Printed on recycled paper

This report has been produced with the assistance  
of the European Union – DCI-NSAED/2011/247.

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