# Tax Expenditures in the Extractive Sector

**PRESENTATION BY** *Melusi Tshuma*

*Principal Economist*

*REVENUE & TAX POLICY DEPARTMENT,* **MINISTRY OF FINANCE & ECONOMIC DEVELOPMENT**

# Outline

- Introduction
- Rationale for Tax Expenditures
- Overview of the Mining Fiscal Regime
- Tax Expenditure Regime
- Implications of Tax Expenditures
- Conclusion

# Introduction

- Zimbabwe's mining sector is highly diversified, with close to 40 different minerals with huge reserves of ***platinum, gold, coal, diamond and lithium***.
- The mineral resource has attracted a substantial flow of capital into the mining sector, thus raising economic contributions to the fiscus expectations of both Government and citizens.
- The table on the following slide shows the country's estimated mineral reserves:

# Estimated Mineral Reserves

| Mineral | Estimated Resource (Tons) | Current Annual Extraction Rate (tons) |
|---|---|---|
| Gold | 13 Million | 20 |
| Platinum | 2.8 Billion | 2.4 million |
| Chromite | 930 Million | 700,000 |
| Nickel | 4.5 Million | 9,000 |
| Coal | 26 Billion | 4.8 million |
| Diamonds | 16.5 Million Carats | Unspecified |
| Iron Ore | 30 Billion | 300,000 |
| Copper | 5.2 Million | 6,200 |
| Coal Bed Methane | Largest known reserve in Southern Africa | None |

# The use tax incentives

- For decades, tax incentives have been a major policy tool to spur economic development and attract foreign direct investment (FDI).
- Tax incentives tend to attract efficiency-seeking FDI motivated by lowering production costs than other types of investment.
- In recent years, however, these incentives have come under heightened scrutiny from the public, with growing concerns over lost tax revenue and fiscal health.
- Government availed a number of tax incentives in the form of *reduced tax rates, tax exemptions, lower or zero customs duty rates* on imported raw materials and capital goods.
- The tax incentives are offered to both local and foreign investors.
- The cumulative revenue forgone from tax incentives amounted to *ZW$3.19 billion or 2% of GDP in 2019*.

# Rationale for offering IE tax incentives

## Economic Impacts of the Extractive Sector

The main economic impacts of extractive industries are reflected on:

- Contribution to GDP;
- Foreign Currency Earnings (Exports);
- Employment Creation;
- Revenue to the fiscus;
- Value Addition (through Beneficiation & Procurement); and
- Bringing economic and social benefits to mining communities.

# Sector Contribution to GDP, 2014-2020

| Sector | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| Agriculture, Hunting and Fishing | 12% | 11% | 9% | 9% | 12% | 11% | 8% |
| Mining and Quarrying | 9% | 7% | 7% | 6% | 10% | 13% | 11% |
| Manufacturing | 10% | 10% | 13% | 12% | 8% | 17% | 20% |
| Electricity and Water | 3% | 4% | 3% | 2% | 2% | 3% | 3% |
| Construction | 3% | 3% | 2% | 3% | 3% | 4% | 4% |
| Finance and Insurance | 8% | 8% | 6% | 6% | 8% | 7% | 8% |
| Real Estate | 2% | 3% | 2% | 2% | 1% | 0.3% | 0.3% |
| Distribution, Hotels and Restaurants | 12% | 14% | 13% | 13% | 13% | 12% | 14% |
| Transport and Communication | 11% | 11% | 11% | 11% | 11% | 11% | 11% |
| Public Administration | 3% | 3% | 3% | 3% | 3% | 3% | 3% |
| Education | 6% | 8% | 10% | 11% | 7% | 4% | 3% |
| Health | 1% | 1% | 2% | 2% | 1% | 1% | 2% |
| Other Services | 3% | 3% | 1% | 1% | 1% | 3% | 2% |

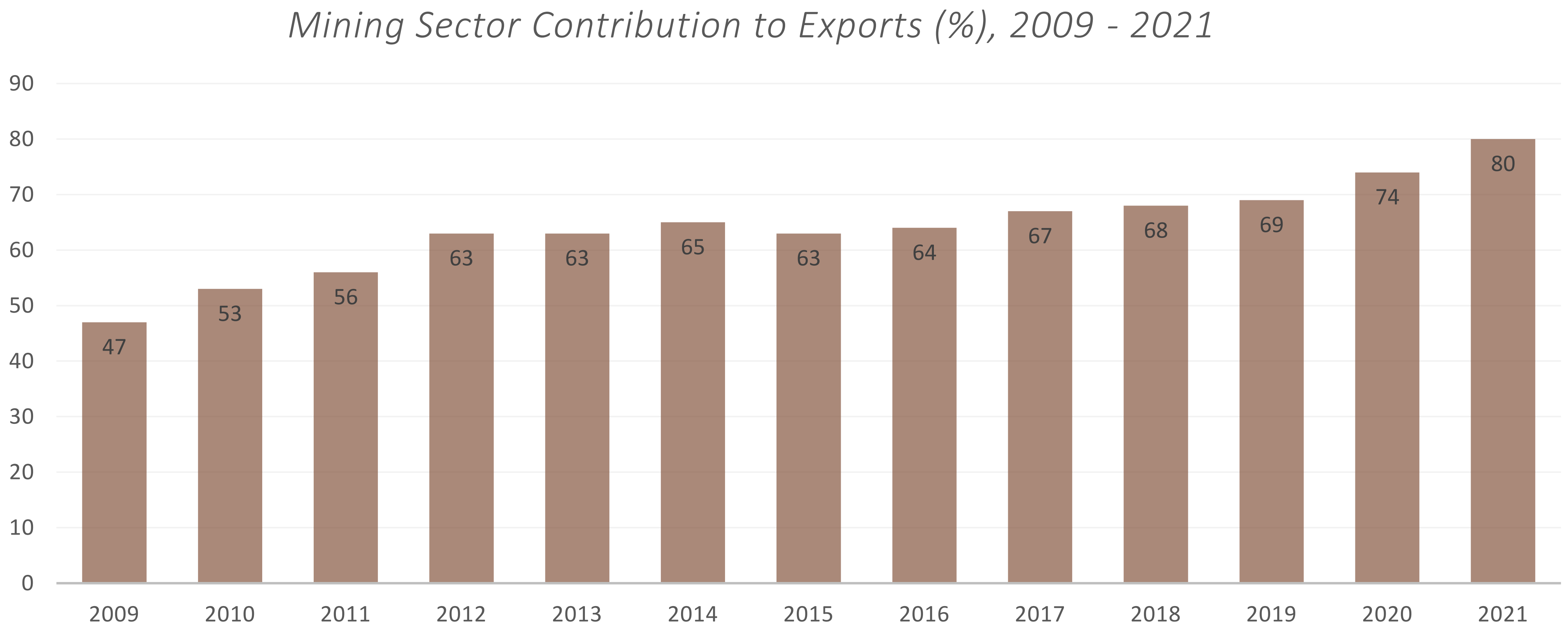
# Contribution to GDP

- As shown on the previous slide, the mining sector has been contributing an average of 9% to GDP between 2014 and 2020.
- The highest contribution of 13% to GDP was recorded in 2019.
- Prospects to maintain the average contribution to GDP have, however, been enhanced, due to firming international prices of minerals.
- The mining sector growth prospects remain strong and is projected to grow by 8% in 2022.

# Contribution to Exports

- The mining sector is the biggest contributor to export earnings.
- The contribution of the mining sector to total exports increased from 47% in 2009 to about 80% in 2021.
- In 2020 exports were dominated by gold, platinum, palladium, diamonds, nickel, coal and copper.
- The sector has potential to contribute much higher, more so, if leakages are minimised.
- The contribution of the mining sector to exports is shown in the graph on the next slide:

# Contribution to Exports (Earning Foreign Currency)



# Employment

- In general, extractive industries are capital intensive and make a limited direct contribution to employment.
- Employment in the mining sector grew from 36,100 in 2010 and reached a peak of 43,000 in 2012.
- Employment has, however, gradually declined from the 2012 level.
- The number of employees who are formally registered with the National Employment Council (NEC) for the mining industry was estimated at 37,321 in 2021.
- Furthermore, It estimated half a million (500,000) artisanal gold small-scale miners (ASGM) spread across the country.
- The Graph on the following slide shows the number of employees in the mining sector from 2010.

# Revenue Contribution to the Fiscus

- Extractive industries raise government revenues mainly through: taxation (corporate income, value added tax, royalties, personal income tax, customs duties and withholding taxes) and direct ownership (with State-owned companies or joint ventures).
- It is important to note that low revenue performance negatively affects Government's ability to invest in infrastructure projects as well as provision of social protection services.
- Revenue contribution from the mining sector, however, has remained depressed.

# Revenue Contribution to the Fiscus

- The sector's contribution to the fiscus was recorded at 9,2%to total Government revenue in 2014, but has, however, declined over the years with a huge bump experienced beginning 2019 to reach a high of14,5% in 2020.
- In Botswana, revenue from the mining sector contributes substantially to the economy with an average of 24% of GDP in 2015/16. Diamonds contributed about 99% of the mineral revenue to Government.
- The tables on the following slides show the Total Revenue from the Mining Sector and Mining Revenue as a share of GDP for the period 2009 to 2015:

# Mining Sector Revenue Share (in % of Total Tax Revenue), 2014 to 2020

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| Royalties | 5.1 | -0.6 | 1.9 | 2.5 | 2.1 | 2.5 | 3.4 |
| Corporate Income Tax | 1.7 | 2.8 | 1.2 | 2.2 | 1.5 | 3.4 | 7.6 |
| Withholding Tax on Tenders | 0.8 | 0.2 | 0.2 | 0.5 | 0.4 | 0.4 | 0.5 |
| VAT | -0.8 | -2.0 | -3.5 | -1.5 | -0.5 | 0.7 | -0.4 |
| Customs Duty | 0.3 | 0.3 | 0.2 | 0.2 | 0.3 | 0.4 | 0.1 |
| Other Taxes | 0.0 | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 | 1.1 |
| **Mining Revenue Share (%)** | **9.2** | **2.9** | **2.3** | **6.2** | **5.4** | **11.3** | **14.5** |

# Mining Sector Revenue Share (in % of GDP), 2014 to 2020

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| Royalties | 0.9 | -0.1 | 0.3 | 0.4 | 0.3 | 0.3 | 0.5 |
| Corporate Income Tax | 0.3 | 0.5 | 0.2 | 0.4 | 0.2 | 0.4 | 1.1 |
| Withholding Tax on Tenders | 0.1 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 |
| VAT | -0.2 | -0.4 | -0.5 | -0.3 | -0.1 | 0.1 | -0.1 |
| Customs Duty | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 |
| Other Taxes | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 |
| **Mining Revenue Share (%)** | **1.7** | **0.5** | **0.4** | **1.1** | **0.7** | **1.4** | **2.2** |

# Accountable governance of tax incentives

- The use of accountable governance is in its infancy because of data constraints, insufficient human and financial resources, and restrictive statutes.
  - ***Transparency:*** *how much are we spending? Who is receiving incentives?*
  - ***Accountability:*** *What are we getting? Are we achieving our goals?*
- Tax incentives are currently provided through tax laws (e.g., income tax act), but are also provided:
  - through laws governing investment, Special Economic Zones (ZIDA)
  - and in other cases, through agreements (Ministry of Mines & Mining Development).
    - ✓ Granting of Special Mining Leases
    - ✓ Tax Incentives Locked in Stabilisation Clauses Under Investment Agreements or Laws

# Current Mining Fiscal Regime

| | ML | SML |
|---|---|---|
| Royalty | • Various rates on gross market value | • Simplified net-back for PGM |
| Price royalty | • For gold 5% above 1,200 /oz & 3% below 1,200 /oz | For gold 5% above 1,200 /oz & 3% below 1,200 /oz |
| Corporate Income tax | • 24% + 3% (24.72%)<br>• Immediate expensing exploration<br>• Immediate expensing for capital | • 15%<br>• 4-year SL for capital<br>• Immediate expensing exploration |
| Additional Profits Tax | • Not applicable | • 2-tier<br>• 31.12% above 15% real IRR<br>• 27.8% above 20% real IRR |
| WHT (technical fees, remittances, royalties, dividends, interest), | • DWT 15% (5% under DTA)<br>• IWT 0%<br>• SWHT 15% (10% under DTA) | • Not applicable |
| VAT | VAT 14%; VAT deferral scheme | VAT 14%; VAT deferral scheme |
| State participation | Not standard part of generally applicable terms | Not standard part of generally applicable terms |
| Customs Duty | Lower to zero rates on capital equipment | Lower to zero rates on capital equipment |
| CGT | Various rates (20% of the net gain and 5% property *abf* 22 February 2019). | Various rates (20% of the net gain and 5% property *abf* 22 February 2019). |

# Tax Incentives Available

- The extractive sector is capital intensive and has a long gestation period. In order to improve the value proposition of investment in mining; the following incentives are available: -

**Incentives for Holders of a Mining Lease**

*Allowable Deductions/ Expenditure*

- All capital expenditure on exploration, development, and operations incurred wholly and exclusively for any mining operations is allowed in full (under ML).

*Assessed Losses*

- Indefinite Carry-over of losses: There is no restriction on carryover of tax losses; these can be carried forward for an indefinite period.

*VAT Deferment*

- Value Added Tax deferment which is granted to mining companies on capital equipment imported for a period of ninety days subject to the conditions set by the Commissioner-General.

# Tax Incentives Available (Cont'd)

**Incentives for Holders of a Special Mining Lease**

- A Special Mining Lease is issued to a holder of one or more contiguous registered mining locations intending to invest in excess of US$100 million principally for export.
- Over and above the tax incentives available to holders of a general mining lease, holders of Special Mining leases may be eligible to benefit from the following tax incentives: -

*Tax Rate*

- Corporate income is taxed at a special rate of 15% ( + 2 tier APT)

*Exemption from Certain Taxes*

- Non-resident's shareholders tax;
- Non-Residents tax on Fees;
- Non-Residents tax on Remittances;
- Non-Residents tax on Royalties

# Tax Incentives Available (Cont'd)

**Customs Duty Rebates**

The following rebates are also available to mining companies operating in Zimbabwe:

- Rebate of duty on goods for the prospecting and search for mineral deposits;
- Rebate of duty on goods for use in petroleum exploration or production;
- Rebate of duty on goods imported in terms of an agreement entered pursuant to a special mining lease; and
- Suspension of duty on goods imported for specific mine development operations.

# Tax Incentives Available (Cont'd)

***VAT Deferment Facility***

- VAT deferment is granted on capital equipment imported for a period not exceeding 180 days, subject to the conditions set by the Commissioner-General of the Zimbabwe Revenue Authority in terms of Section 12A of the VAT Act [23:12].
- This Facility is intended to provide cashflow relief to companies, in view of the huge capital outlays required in the importation of capital equipment.

| Value of equipment (US$) | Deferment Period |
|---|---|
| 100,000 – 1,000,000 | 90 |
| 1,000,001 – 10,000,000 | 120 |
| 10,000,001 and above | 180 |

# Tax Incentives Available (Cont'd)

**Special Economic Zones:**

There are special incentives that are afforded to investors, these include:

- Corporate Income Tax;
  - 0% 1st 5 years & 15% thereafter
- Rebate of Duty On Capital Equipment;
- Special Initial Allowance;
- Employees Tax;
- Exempt from permits requirements for import & export of goods
- Tax Exemption (0%) on:
  - Non-residents Withholding Tax On Fees;
  - Non-resident Withholding Tax on Dividends;
  - Non-resident Withholding Tax on Remittances;
  - Non-residents Withholding Tax On Royalties.

# Tax Incentives Available (Cont'd)

**Tax Treaties:**

Tax treaties sometimes erode the tax base of EI projects:

- They frequently reduce permitted levels of border WHTs (***a number of them at 5%***) or even eliminate them altogether:
  - Non-residents Withholding Tax On Fees;
  - Non-residents Withholding Tax on Remittances;
  - Non-residents Withholding Tax On Royalties; and
  - Non-residents Withholding Tax On Dividends.
- Zimbabwe has existing treaties with Botswana, ***Canada, China***, France, Germany, Malaysia, Mauritius, Netherlands, Norway, Poland, Serbia, ***South Africa***, Sweden, Switzerland, ***United Kingdom*** & Zambia.

# Tax Incentives for Small Scale Miners

*Interest on loans*

- Exemption of interest income earned by financial institutions on loans advanced to small scale miners.

*Small-Scale Miners' Presumptive Tax*

- With effect from 1st October 2014 Small Scale Miners Presumptive tax was reduced from 2% of the gross amount payable to 0%, therefore, no Presumptive tax will be collected from Small Scale Miners.

# Implications of Tax Incentives

- Tax incentives such as low CIT rates have the potential to positively affect FDI inflows into the extractive sector.
- Tax incentives can also stimulate unintended economic distortions and create opportunities for tax evasion and avoidance.
- Tax incentives undermine tax revenue inflows to the fiscus.




# Conclusion

- Extractive industries are an important wealth creating instrument for Zimbabwe, thus, the granting of TEs to the sector.
- Zimbabwe offer various incentives in the hope of attracting investors and fostering economic growth.
- There is a significant regional competitiveness dimension too, as the government may perceive a threat of investors choosing neighbouring countries, triggering "***a race to the bottom***" that make countries in a region collectively worse off.
- The granting of tax incentives for investment is often done using the country's tax laws and administration.
- Govt has began the process of identifying the cost of TEs, measuring & reporting so as to measure their benefits to the economy, and the cost of these tax incentives in terms of foregone revenue.

Thank You!