18 March 2021

Media Release

Southern Africa Resource Watch (SARW) Report
The Mineral Sector of Namibia: A nuanced overview of selected key aspects

Chamber of Mines (CoM) observations on Inaccuracies, Faulty Assumptions & Allegations in the Report

The SARW commissioned a research paper that investigates certain aspects of Namibia's mineral legislative and policy framework. According to the research, the mining sector is guilty of wide- spread illicit financial flows, tax-base erosion and price manipulation. These allegations, however, are based on flawed assumptions and inaccuracies.

The authors of the report use the allegations to suggest that Namibia's mining tax policy is inefficient, and that Government has forfeited revenue from the mining sector and suggest changes to Namibia's mining taxation regime. In this brief, the Chamber has extracted each of such allegations and provided responses as to why we believe they are incorrect and inaccurate. There is a risk that such allegations could be incorrectly interpreted by stakeholders and Government, who in response to this report, may consider changes to Namibia's mining tax regime that could have serious unintended consequences to the country's economy.

The following allegations are made by the report, with responses to each allegation provided by the Chamber of Mines;

1) **Tax policy inefficient**

SARW Report
"There are no mechanisms or provisions in place in the tax code or other legislation to address commodity price volatility. The mineral legal and policy framework does not have windfall tax that enables the government to mobilise optimal resources commensurate with production on the ground when world commodity prices are high." – *pg.4*

CoM Response
The fact that most metals and minerals are taxed at a rate of 3%+1% (export levy and royalty rate) = 4% on gross sales, is the very mechanism that provides for price volatility and windfall taxation applied to any particular mining company. When prices are high, revenues are high and GRN benefits accordingly, regardless of the profitability of the operation. When prices are low, the company pays less royalties and export levies, and will necessarily pay less Corporate tax as well, as profits will be lower. To apply an additional variable windfall/super-profits tax to certain commodities would mean that the buffer built up by the company during boom times, which partially protects the company during lean times in the product pricing cycle, is eliminated or minimised.

An example of this is the Navachab gold mine. Had there been a risk of super tax beyond predictable levels, Navachab would not have embarked on their additional investment programme and their life of mine would have been very short. The ability to build reserves offered by the bullish gold market, supported by an equitable tax regime, has offered the mine a new lease on life. By applying a consistent tax regime, the mine was partially protected, which could recover from times of low product pricing and avoid mine closure. The mine is now able to benefit from the upside of the gold price cycle. Navachab needed a long-term investment and the company shareholders appreciated that policy remained consistent.

Independent studies have shown that the combination of revenue-based taxes and corporate (profit) based taxes is extremely high by international standards. However, owing to Namibia's low risk profile, the total effective taxation regime for non-diamond mining was considered to be optimal insofar as it strikes a balance between maximising revenue to the treasury and attracting FDI in exploration. The 2011 study by Prof. James Otto further warned that any increase to the total effective taxation rate in Namibia beyond the total effective taxation rate in force at the time of his study, would result in a steep decline in revenue to the treasury. Since then, the country has increased its revenue-based taxes through the addition of a variable export levy capped at 2%, excluding dimension stone.

SARW Report

"The Chamber is wrong in its argument that disallowing the tax deductibility of royalties is unfavourable. This argument is self-serving because currently royalty, export levy and corporate tax (to be used) as tools for resource mobilisation for the government from non-diamond mining companies are inefficient (as clearly demonstrated in this report)." Pg.18 – 19

CoM Response

The above statement indicates that the concept of non-deductibility is not properly understood. To tax the top line (revenue) and then require that the tax paid on revenue is reintroduced below the EBITDA line so that it can also be taxed at the Corporate rate, amounts to double taxation. Even the harshest tax regimes in Africa have realised the harmful and counter-productive nature of this form of taxation, which they have reversed (e.g., Zimbabwe).

SARW Report

On pages 34 and 35, the report provides evidence that the diamond mining sector is the majority contributor to Government revenue, as compared to the non-diamond sector. It uses this finding as a basis to argue that the tax policy for mining in Namibia is inefficient.

CoM Response

GRN realised that diamond mining was far more profitable than non-diamond mining and as such, it was able to afford a higher level of royalties and Corporate taxes. If non-diamond mining were to be taxed at the same rate as diamond mines (10% royalty and 55% Corporate tax), there would be no non-diamond mining operations in Namibia. As mentioned above, the non-diamond mining taxation regime is considered to be at the higher end of the total effective taxation rates for mining jurisdictions globally. Any attempt to increase that would result in a reduction of revenue to the treasury, according to the 2011 report by James Otto.

2) <u>Corporate tax rates are too high</u>

<u>SARW report</u>

"The mining industry considers the corporate tax levied on their profits too high; 55 percent for diamond mining companies and 37.5 per cent for companies mining other minerals, compared to an average of 20.8 per cent in Asia. As a result of the high corporate tax, ***there is a high risk of transfer pricing manipulation by mining companies in the country****. The country is not collecting enough revenue from the extractive sector due to possible illicit financial flows, tax evasion, and avoidance practices" pg.5*

<u>CoM Response</u>

As discussed above, the taxation rate of 37.5% for non-diamond mining operations was considered to be high, but reasonable, when the total effective taxation rate is calculated (including other taxes such as royalties and export levies), given Namibia's low risk profile. The total effective taxation rate for mines in Namibia was seen to derive maximum benefit to GRN by establishing the optimum level of taxation. In fact, the James Otto report praised GRN for having found the optimal position (sweet spot), but warned that any further taxation would result in a reduction in FDI and hence revenue to the treasury.

<u>SARW report</u>

The report asserts that due to the high corporate tax rate in Namibia, **tax avoidance and illicit financial flows** are taking place. It also states that **price manipulation** is taking place.

<u>CoM Response</u>

All large mines in Namibia are required to undergo internal and external audits, and most are required to comply with stock exchange rules, which are explicit and harsh in their handling of audit and tax fraud issues. It is extremely unlikely that any large mines are guilty of tax avoidance or evasion. This is very easy for GRN to establish, as audit reports from external auditors are available for GRN to view.

The report does not acknowledge that most mines in the non-diamond mining sector have at times declared losses in recent years, due to lower commodity prices and other economic factors. Thus, owing to the cyclic nature of metals and minerals, many operations in the non-diamond mining sector have, at times, not been in a position to pay corporate tax but continue to pay royalties and export levies even when they are in a loss-making position. Accordingly, many mines have shut down owing to the lack of profitability (notably all copper mines in Namibia). Furthermore, new mines will not be in a corporate tax paying position for the first few years of their operation, owing to the fact that they will recoup their initial capital and exploration expenditure during the early years, as per the Income Tax Act. This is why the CoM has always supported a reasonable revenue-based taxation rate (royalties/export levies), so that GRN continues to benefit from the country's mineral endowment even during times of low commodity pricing or during times of recoupment of capital and exploration expenditure.

As far as the allegation that mines are guilty of price manipulation is concerned, once again, this is very easy for GRN to establish as each of the large operations must clearly report on their prices received and if there are any deviations from international prices that cannot be justified through long term contractual arrangements, or FOB transportation prices etc., GRN should question this.

In fact, exactly the opposite is true for the Uranium sector as GRN benefits from the high price of long-term contracts (well above spot prices for Uranium) negotiated before the fall in Uranium prices in response to the Fukushima disaster.

<u>SARW Report</u>

The report uses diamond mining's majority contribution to Government revenue (pg.35) as a basis to argue that the tax rate for non-diamond companies is too high, and as such, non-diamond mining companies have engaged in ***'activities that lower their tax liabilities'***.

<u>CoM Response</u>

As explained above, the report does not acknowledge that many non-diamond mines have made losses or have had to close down in recent years, due to low commodity prices. However, those mines that have survived in spite of the losses they incur, have continued contributing to Government revenue through the payment of royalties and export levies, which are revenue-based taxes.

It is true that the taxation rate for land-based diamonds is too high. This would have resulted in the early closure of the Namdeb land-based operations. However, GRN has recently had the foresight to accommodate the taxation regime for land-based diamond mining operations, thus extending the Life of Mine of these operations by decades.

3) **<u>Royalties & Export levies too low</u>**

<u>SARW Report</u>

"Royalties paid by mining companies (3 per cent) are way too low compared to other mining jurisdictions, such as South Africa, Canada, and Australia. Export levies charged by the Namibian government are way too low, at less than 2 per cent average for the 18 different mineral commodities it exports." – pg. 5

<u>CoM response</u>

The report ignores the fact that the entire taxation regime and not just the royalties, should be viewed in terms of its attractiveness to FDI by serious exploration companies. Whereas the authors refer to higher royalty rates in other mining jurisdictions, they mention nothing about the prevailing total effective taxation rates in those jurisdictions. As an example, the South African Corporate tax rate for non-diamond mining is far lower than the Namibian rate (26% vs. 37.5%). The attractiveness to the investor is a function of the total effective taxation rate, which as explained earlier, is high by international standards.

It is noteworthy that minerals exported with little local value addition, such as dimension stone, attract a much higher export levy, of 15%, to destinations outside the European Union, compared to those with higher levels of local value addition (0 – 2%).


Highest Royalty Tax Rate
0,00%
5,00%
10,00%
15,00%
20,00%
25,00%
30,00%
35,00%
40,00%
Netherlands
Norway
Switzerland
PNG
Argentina
Brazil
Mali
Angola
Ghana
Mongolia
Nigeria
Senegal
Coite D'Ivoire
Philippines
Tanzania
Zimbabwe
South Africa
Mexico
Burkino Faso
Ecuador
Mozambique
Ukraine
Vietnam
Botswana
DRC
Laos
Namibia
Pakistan
Singapore
Colombia
Peru
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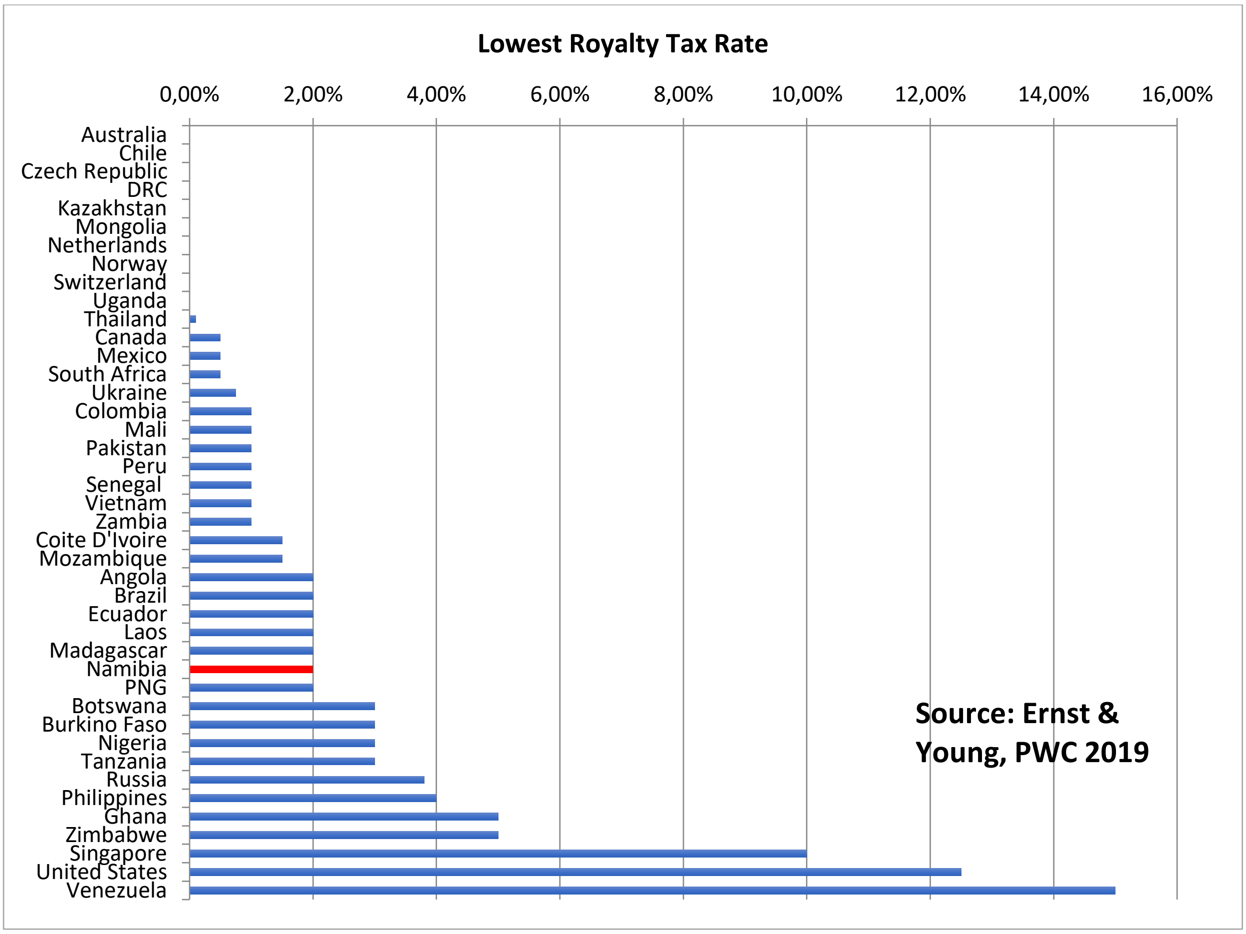
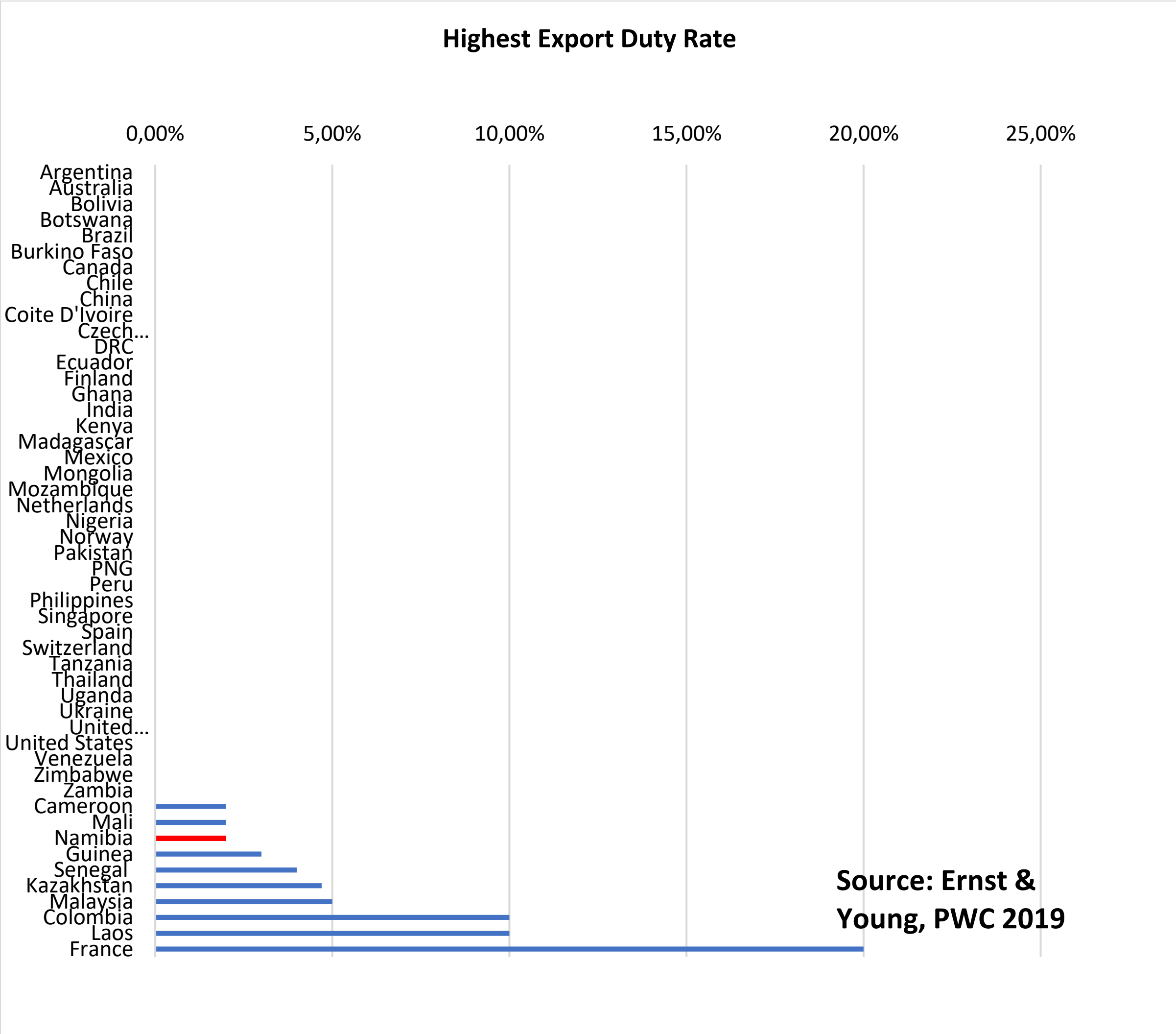
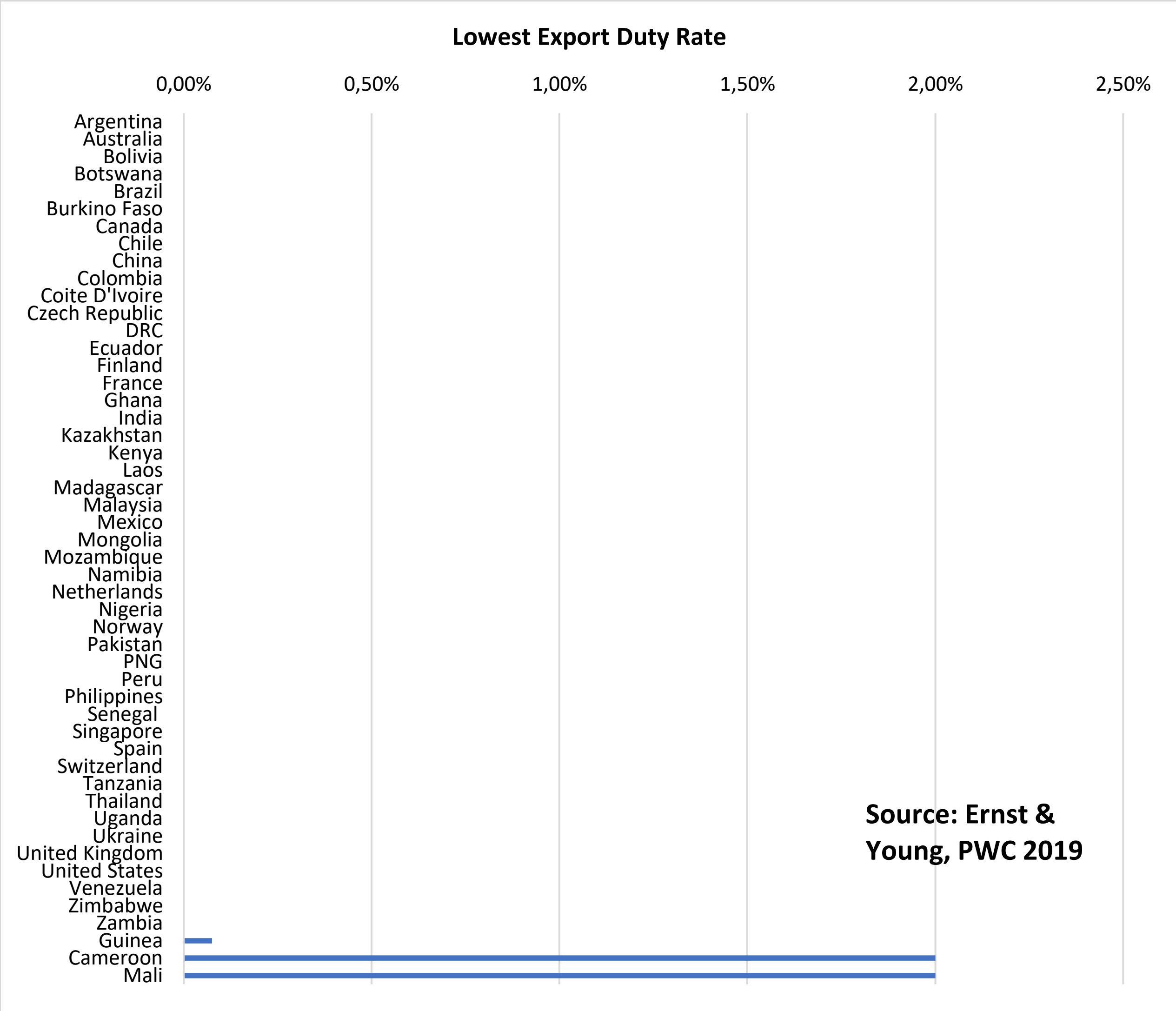
Russia
Kazakhstan
United States
Thailand
Uganda
Venezuela
Czech Republic
Source: Ernst & Young, PWC 2019


Lowest Royalty Tax Rate
0,00%
2,00%
4,00%
6,00%
8,00%
10,00%
12,00%
14,00%
16,00%
Australia
Chile
Czech Republic
DRC
Kazakhstan
Mongolia
Netherlands
Norway
Switzerland
Uganda
Thailand
Canada
Mexico
South Africa
Ukraine
Colombia
Mali
Pakistan
Peru
Senegal
Vietnam
Zambia
Coite D'Ivoire
Mozambique
Angola
Brazil
Ecuador
Laos
Madagascar
Namibia
PNG
Botswana
Burkino Faso
Nigeria
Tanzania
Russia
Philippines
Ghana
Zimbabwe
Singapore
United States
Venezuela
Source: Ernst & Young, PWC 2019

Benchmark studies have also shown that Namibia is one of the few countries globally that actually impose an export levy on mining products. The graphs below depict that this is not common practice.





4) <u>Transfer Mispricing/ Price Manipulation & Tax Base Erosion</u>

<u>SARW Report</u>

*"**Price manipulation is widespread** in the mineral sector in Namibia and is carried out in many different ways. **Mining companies inflate their investment expenditure, in order to offset profits and avoid paying corporate taxes. This tax avoidance practice is rampant throughout the entire extractive sector**." Pg. 5- 6*

<u>CoM response</u>

This is a very serious allegation and most damaging to the Namibian mining industry, for which there has been no evidence provided in the report. The Chamber of Mines entirely refutes this defamatory allegation and reserves its rights in this connection. The authors were also requested to present such evidence to CoM in a face-to-face meeting, but failed to do so. Refer to our comments on page 2.

SARW report

*"There is **excessive leveraging by multi-national companies in the sector that causes major domestic tax base erosion**. The incentives given to foreign mining companies to attract foreign direct investment (FDI) into the sector do not make economic sense.*

CoM response

GRN has repealed the EPZ taxation holidays from 31 December 2020 and provided a five-year transition period for current EPZ holders. The CoM has always supported the notion that the burden of taxation should be borne equitably by all mines.

SARW report

*"Companies that pay taxes may **continually record losses because they are selling unprocessed ore to sister companies** at a discount." Pg. 6*

CoM response

This is a libellous and baseless accusation for which the Chamber reserves its rights. Refer to comments above.

SARW Report

The report accuses the entire mining sector of **transfer mis-pricing practices** (transfer pricing malpractices), but does not provide concrete evidence of this occurring in all companies.

CoM Response

No evidence has been provided for transfer pricing malpractices. As mentioned earlier, all large mines carry out external audits in compliance with stock exchange and fiduciary requirements. Transfer pricing irregularities could easily be uncovered by GRN. When the authors were requested to substantiate these allegations, they were unable to do so. In this vein, the CoM welcomes the establishment of the Namibia Revenue Authority (NAMRA) which will allow closer vigilance of all businesses in Namibia and would be able to detect any malpractices.

SARW report

The report refers to an example on page. 36 to illustrate a scenario whereby **a precious metals company inflated investment expenditure to receive a tax credit of N$1 billion, and a grader that was purchased with a market value of N$2 million, however, was valued at N$10 million**.

CoM response

Once again, this is a baseless and libellous allegation. All investment expenditure is subject to audit controls and accordingly, the gold mining company concerned will not have inflated its investment expenditure as this is tantamount to fraud. The example of a grader at a market value of N$2 million is incorrect, as the large graders purchased by the company concerned are far more expensive than this figure.

SARW Report

The report refers to a vertically integrated **nuclear fuels company which is mining uranium for sale to its sister company at a loss. This implies that the revenue from further value addition and sales of the value-added product in another country, is forfeited by Namibia**.

CoM response

In this particular scenario, the findings are not factual as the same entity enriches the uranium produced from its mine in Namibia and uses it to generate electricity in their home country, and not to sell it on for a value 30 times greater than the value for which it was sold in Namibia, as the report cites. The concept of Uranium enrichment in Namibia has been dealt with time and time again through the Value Addition Committee under the leadership of MME. It is not economically viable to establish Uranium enrichment facilities in Namibia. Hence, transfer pricing and local value addition is not an issue in this context. The report uses baseless references to potential value addition of 30 X (Uranium) and 1,000 X (diamonds), which further undermines the findings and the credibility of SARW.

SARW report

"While mining companies publish their financials in the annual Chamber of Mines review reports, ***traceability revenues generated from the sector stop once the funds enter the national coffers****." Pg. 6*

CoM response

A detailed break-down of financial information for each mining operation is provided in the Chamber Annual Reviews, which are publicly accessible, and in the audited financial statements, which are available to Government.

Conclusion

The SARW report is largely based on unfounded and libellous allegations that are damaging to the image of the industry. It has the potential to derail Namibia's successful mining industry and repeat the mistakes of neighbouring countries that have largely destroyed their mining industry through the promulgation of damaging legislation that has thwarted FDI into exploration and mining in those countries.

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