THE
CARTER CENTER

Improving Governance of Revenues from the Mining Industry

Cross-cutting lessons from fiscal and parafiscal analyses of five mining projects in the D.R. Congo

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INTRODUCTION

In partnership with local civil society organizations (CSOs), government agencies, mining companies, and international institutions, the Carter Center, over the past seven years, has been working to improve transparency and accountability in the industrial mining sector of the Democratic Republic of Congo (DRC).

The Carter Center aims to strengthen the skills of civil society actors to better equip them in research, analysis and advocacy on natural resource management issues. Mining taxation is one of the areas where its contribution has been most remarkable in the Democratic Republic of Congo.

Although progress in disclosing fiscal revenues data has been made through the Extractive Industries Transparency Initiative (EITI), there remain major challenges in the payment, collection and management of revenues from the extractive sector. While disclosure of fiscal information is a prerequisite for transparency and accountability, the information obtained is only useful when the public has the technical capacity and the ability to use that information to improve mechanisms of payment, collection and redistribution of revenues from the exploitation of extractive resources.

With financial support from the Swedish International Development Agency (SIDA), the Fiscal Transparency Innovation Fund (FTIF) of the US Department of State and the US Agency for International Development (USAID), and the British Department for International Development (DfID), the Carter Center has implemented a series of training modules for Congolese civil society organizations. The training offered by the Carter Center on revenues analysis aims to equip civil society actors with knowledge about the tax regime applicable to the extractive sector, the sources of fiscal and para-fiscal obligations, and how to calculate the various flows and related risks, so that they are able to carry out technical advocacy actions.

As part of this training, the Carter Center has supported six civil society organizations and networks in Haut-Katanga, Ituri, Lualaba and South Kivu Provinces in conducting research on the analysis of fiscal and para-fiscal revenue flows and their impact on the state budget and contributions to improving the living conditions of adjacent communities. Lessons learned include five mining projects: Kibali Goldmines (Randgold Resources), Twangiza Mining (Banro Corporation), Frontier SA (Eurasian Resources Group and First Quantum Minerals), Kamoto Copper Company (Glencore) and Mutanda Mining (Glencore). These analyses were carried out by civil society organizations that received training from the Carter Center on mining revenues in the Democratic Republic of Congo, including: the *Cadre de Concertation de la société civile de l'Ituri sur les Ressources Naturelles* (CDC\RN) , the *Maison des Mines du Kivu* (MMKI), *Action pour la Défense des Droits Humains* (ADDH), the *Initiative Bonne Gouvernance et Droits Humains* (IBGDH) and the collaboration between the *Comité de Suivi pour la Contribution des Communautés et Eglises à la Transformation Humaine* (COSCCET) and *Détectives-Experts pour les Droits au Quotidien* (DEDQ). Their reports on these five projects are available on www.congomines.org.

At the end of these various studies, major revenues problems and risks presented by the mining projects were revealed. It was noted that some of the identified problems and risks were specific to each of the projects and others were cross-cutting. These cross-cutting issues and risks deserve particular attention in order to improve the policies and practices in the governance of the revenues generated by the extractive industries.

ANALYSIS

The purpose of this paper is to present the cross-cutting lessons drawn from the findings of the above-mentioned case studies. The spirit of this note is not to present all the problems and risks identified on all the analyzed flows, but rather some that are cross-cutting. Of these five reports, there are certain transversal lessons, including the non-retrocession of the mining royalty by the Congolese government in accordance with article 242 of the Mining Code, the non-payment of significant profit tax to the Congolese state by mining companies, failure by mining companies to publish their financial statements, undervaluation of mining assets sold by state-owned Enterprises (SOEs) in the mining sector without public tenders, the lack of transparency in the management of revenues by SOEs, and the incomplete publication of contracts, annexes, and amendments to mining projects by the government.

Lesson 1: The retrocession of the mining royalty by the central government to the decentralized provinces and territorial entities does not conform with article 242 of the Mining Code; and this deprives subnational governments of substantial revenues.

The mining royalty to the state is a legal obligation in accordance with Mining Code articles 240, 241 and 242, which determine the royalty's base, rate and distribution between the central and provincial governments and the local entity where the mining project is located. According to article 242, the mining royalty also aims to contribute to the improvement of the living conditions of the populations of the zone in which the mining project operates through the construction of basic socio-economic infrastructures. The distribution of this tax is fixed by article 242 of the Mining Code at a 60% rate to the central government, 25% to the province and 15% to the Decentralized Territorial Entity (*Entité Territoriale Décentralisée* - ETD) on which the mining project is based.

This distribution key is not respected despite the law. According to the findings of the studies, the provinces and local entities did not actually receive their share of the mining royalty paid to the public treasury by the five studied companies. This deprives provinces and local entities of income that would allow to respond with development actions that directly affect communities.

For example, as part of the analysis of the KCC project, it emerged that for the years 2009 to 2014, the former Katanga province should have received a total of US$28,633,742 from the total amount of US$54,791,867 of royalties paid by the company to the national treasury, of which US$17,896,089 to the capital of the province, and US$10,737,653 to the entity concerned by the project. Unfortunately, provinces do not generally receive what they should receive: "out of a total of US$160 million declared to have been received by the DGRAD from the companies installed in the Katanga Province only US$12,223,746 were paid by the Ministry of Finance to the province of Katanga and confirmed by the province, an equivalent of 8% which is far below the 25% provided for by the Law "[1].

Corrective Action:

- *The central government should ensure compliance with the regulations in force, in particular with respect to the application of Article 242 of the Mining Code, by assuring that 25% of the revenue from the mining royalty be allocated to the province and that 15% be allocated to the Decentralized Territorial Entity (ETD).*

Lesson 2: Profit tax payments to the Congolese state are minimized by mining companies, and thus the profit tax does not regularly appear amongst the largest revenue flows of the sector.

The profit tax is a tax flow paid by the mining title-holder to the state on the basis of profits made during the previous financial year, at a rate of 30%, in accordance with the Mining Code, Article 247.

In the event of a negative result or loss, Article 92 of the Tax Code (*Code général des impôts*) requires that the company be subject to an alternative minimum tax of 1/1000 of the declared turnover. This rate has been revised to 1/100 by the 2014 Finance Law (*Loi des Finances de 2014*) in its article 10.

From the cross-cutting lessons of the studies on KCC, Twangiza, Kibali Gold mines, MuMi and Frontier, the perception of this very important flow often remains hypothetical, or even almost zero. The tax base of this revenue flow is net income and, in practice, mining companies could use the strategy of minimizing the tax base by, on the one hand, overestimating fixed assets, increasing operating expenses, and borrowings from subsidiary companies to the parent company, and on the other hand by relying on accelerated depreciation at a 60%[2] rate in the first year.

The conclusions of the case study on the Frontier project show that the net results for the years 2013, 2014 and 2015 were negative, respectively: US$11,413,216, US$351,674,377 and US$271,039,137. Hence the profit tax paid by this company is limited to: US$198,769 in 2013 and US$6,206,723 in 2014. These figures correspond to a minimum profit tax calculated at the rate of 1/100 of the turnover in accordance with the Tax Code. These payments of a minimum profit tax were made only a few years after Frontier was the mining company contributing the most to the state in terms of profit tax, but this distinction was lost after the titles were withdrawn by the state.

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[1] EITI-DRC Report 2014, p.98

[2] Article 249 of the Mining Code

Corrective actions:

Parliament should adopt regulations which set out:

- *A minimum equity investment threshold for investors in mining projects;*
- *The payback period for depreciation of fixed assets for mining projects;*
- *Stricter limits on the manipulation of transfer pricing.*

More,

- *The Congolese state should prioritize the retention of permits for companies that are already making a significant IBP contribution.*

Lesson 3: Non-publication by mining companies of their financial statements prevents the public from monitoring the sector, and analysts from understanding whether mining activities are beneficial to the state and the Congolese people.

The financial statements are a structured financial representation of events affecting a business, and transactions carried out by it. They are intended to provide information on the financial situation, assets, liabilities, and cash flows of a company. This information is useful for NGOs working in the field but also for citizens in general. The financial statements are used to compare the performance of a company over time with its financial capacity.

The findings of these studies have shown that it is not easy to access the financial statements of mining companies operating in the DRC, which makes monitoring of mining revenues difficult. Sometimes financial reports from parent companies have to be used, and they often do not provide detailed, actual information on mining projects in the DRC. Several examples can be put forward, but for illustrative purposes, the financial statements of Glencore from 2011 to 2014 show that there are profits generated by the Mutanda project[3]; whereas it is not clear if this is the situation at the level of the Mutanda Mining project in the DRC.

Corrective Action:

- *The government should advocate a regulation (law, decree) requiring the publication of the financial statements of mining companies, as is the case for the publication of contracts, so that companies comply with the OHADA uniform act on disclosure of business activity reports and financial statements.*

Lesson 4: The mining assets of the state and state-owned enterprises are often sold without a public tender or a good valuation, which may lead to lost potential revenues.

A public company or state-owned enterprise (SOE) is a company in which the state or other local or regional authorities directly or indirectly exercise a dominant influence as a result of their participation in the share capital. The dominant influence is presumed when the public

[3] Glencore, Annual Report 2015, p174-175

authorities directly or indirectly hold a majority of the company's subscribed capital or hold a majority of the votes attached to the shares issued by the company, or may designate more than half of the members of the company administrative, management or supervisory body.

The results of the different above-mentioned reports have shown that there are many problems in the management of the mining sector SOE revenues. These problems are at several levels, such as the lack of valuation of mining assets prior to the sale and the lack of public tenders.

The IBGDH report “Mutanda Mining: A Withdrawal that Benefits the Giant” highlights that losses in received revenues may have been caused by the undervaluation of mining assets sold by the mining SOE, the *Générale des Carrières et des Mines* (Gécamines). No tender process was announced, so it is not clear if Gécamines tried to maximize the value of these assets that were part of Congolese heritage. Estimates made by IBGDH suggest that the royalties that could have been earned by Gécamines between 2011 and 2016 far outweigh the compensation for the sale of assets in the Mutanda and Kansuki project in 2011.

According to the 2013 report of the Africa Progress Panel[4] in only six cases of asset sales by Gécamines and the state-owned enterprise *Société de Développement Industriel et Minier au Congo* (SODIMICO) between 2010-2012, "the DRC lost at least US$1.36 billion in revenues from the underpricing of mining assets that were sold to offshore companies.” The report pointed out that in 2011 Gécamines sold 20% of its shares in the Mutanda mines to Rowny Assets Limited, a company registered in the Virgin Islands, and 25% of its shares in the Kansuki mines to Biko Invest Corp., also registered in the Virgin Islands. Two companies registered in the Democratic Republic of Congo, Mutanda Mining and Kansuki Mining, on behalf of their partners in the Virgin Islands, disclosed in the EITI reports the payment of US$189 million to Gécamines for the acquisition of these assets in 2011.[5] Another US$20 million payment to Gécamines was made in 2012 for the assets sale for a total sum of US$209 million.[6] But today, Mutanda produces more copper than almost any other mining company in the DRC, and more cobalt than any other country in the world except Chile.

Another example is the case of Twangiza Mining, studied by the MMKi. For this project, the government granted several permits to the Canadian investor, Banro, to explore and exploit the sites in South-Kivu and Maniema, with a nearly total exemption from taxes.[7] So far, civil society researchers have found no evidence that any valuation of these assets or exemptions was made before the agreement was signed.

Corrective actions:

- *State-owned enterprises should conduct preliminary valuations of mining assets prior to sale;*
- *The Ministry of the Portfolio should subject the sale of state-owned enterprises mining assets to a competitive bidding process;*

[4] https://eiti.org/fr/news/generer-retombees-en-rdc
[5] EITI-DRC Report 2011
[6] EITI-DRC Report 2012
[7] Banro Convention, as amended.

- *Parliament should put in place measures sanctioning public agents who sell the assets of state-owned enterprises without a prior valuation.*

Lesson 5: The lack of transparency in the management of the revenues generated by mining state-owned enterprises jeopardizes the confidence of the general public in the ability of the Congolese people to benefit from this income.

State-owned enterprises generate significant revenues. They receive revenues from their partnerships through flows such as signature bonuses, royalties, lease payments, and asset sales, amongst others.

According to the different case studies analyzed, despite the income received by the state-owned enterprises from their partnerships, none of them has succeeded in securing a viable financial situation. This can be seen through a number of factors, including low production, decaying infrastructure, non-payment of workers, and excessive debt, amongst others.

In practice, two major problems arise: the procedure for sharing this income between the state and the SOE is not always clear or respected; and the allocations and apportionments of these incomes still do not seem to be in the interest of the company, nor of its sole shareholder, the state.

The debate around the distribution of the signature bonus between SOKIMO and the Congolese state can serve as an illustration. Indeed, the CdC\RN report entitled "Short Term Win, Long Term Loss: Analysis Report of the Fiscal and Parafiscal Revenues from Kibali Goldmines SA" points out that the fair distribution of the US$4,500,000 signature bonus between the state and SOKIMO in 2009 was not justified, because the state was neither shareholder nor party to the contract. There was no legal or contractual instrument during this particular time supporting this distribution. It is only in August 2014 that a regulatory basis was drafted for that distribution through an interministerial decree[8]. Moreover, despite the fact that SOKIMO was entitled to receive, in principle, more than $US100 million from the Kibali project since the start of the joint venture, the company always refers to the lack of funds as justification for the non-payment of wages and other obligations, which suggests that the money collected is not always allocated effectively for the welfare of the company, its workers, and its sole shareholder, the Congolese state.

<u>*Corrective actions:*</u>

- *The Ministry of the Portfolio should require publication of the financial statements of state-owned enterprises;*
- *The government and the EITI-DRC should explain how the revenues received by mining state-owned enterprises are distributed between these companies and the state itself, according to law and practice;*

[8] Arrêté interministériel n° 0349/CAB/MIN/MINES/01/2014 ET N°/CAB/MIN/FINANCES/2014/149 DU 18 AUG 2014 PORTANT FIXATION DES TAUX DES DROITS , TAXES ET REDEVANCES A PERCEVOIR A L'INITIATIVE DU MINISTERE DES MINES/SECRETARIAT GENERAL

- *State-owned enterprises should disclose details of their quasi-fiscal expenditures in the EITI-DRC process;*
- *The government should improve the management of state-owned enterprises (e.g. by strengthening the capacity of the boards of directors and senior officials).*

Lesson 6: The publication of contracts, annexes, and amendments by the Ministry of Mines is neither complete nor up to date, which hinders the monitoring and follow-up on the obligations of mining companies.

Congolese legislation[9] provides for the publication of any contract concluded between the state or a state-owned enterprises and a private investor on natural resources. This publication shall be made within 60 days of its signature. The contract includes not only the main legal document but also the annexes.

The results of the projects analyzed show that there is an incomplete publication of contracts. In particular, it should be noted that amendments to contracts are rarely published, which hinders the ability of civil society to analyze the various agreements between the Congolese state, SOEs and private investors. This absence results in less transparency and a weaker governance of the extractive sector. On this subject, the Carter Center is in constant exchange with the Technical Secretariat of the EITI-DRC to reach a situation of real transparency, where all the contracts and their amendments would be published, and accessible to all.

Corrective Action:

- *The Ministry of Mines should publish all contracts, annexes, and amendments of mining projects on the Ministry of Mines website and add all new contracts, annexes and amendments as soon as possible.*

CONCLUSION

In conclusion, the various studies provide a general overview of the challenges facing the mining sector in the DRC: the non-retrocession of the mining royalty by the Congolese government in accordance with article 242 of the Mining Code, minimization of profit tax payments to the Congolese state by mining companies, non-publication by mining companies of their financial statements, undervaluation of mining assets sold by mining SOEs without a public tender, lack of transparency on the management of the revenues generated by the SOEs, and the incomplete publication of contracts, annexes, and amendments of mining projects by the Ministry of Mines.

But as we noted, every problem has its own solutions, and the various stakeholders in the extractive sector all have their part to play in improving the situation. A mining sector governed by the rules of good governance is an extractive sector where cooperation is constant between

[9] Décret n°011/26 du 20 mai 2011 portant obligation de publier tout contrat ayant pour objet les ressources naturelles

the state, mining state-owned enterprises, private investors and civil society. And only the right collaboration can today enable us to meet these challenges.