

# Chiadzwa Diamond Revenue Distribution: The Devil Lies in the Mining Contracts and the Tax Regime

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We have been following the debate around the sale of the Chiadzwa diamonds two weeks ago and the speculation around the distribution of the revenue thereof with particular interest. We were equally puzzled by the confusing and mixed projections and signals made by government officials on revenue generated and payments to be made from the diamond sale. Firstly, different figures on the amount of carats sold were thrown around in the press quoting government officials; earlier reports had put the figure at 900 000 carats, while more recent reports quoting the Minister of Mines put the figure at 1 124 655,19 carats. Secondly, different figures of revenue realized in total and to be earned by the state were also tossed around. Originally it was reported that sale had generated \$72 million, then a few days later it was reported to be \$45 million before it was again reported to be US\$56 476 194,04. The same applies to what is expected to go into the Consolidated Revenue Fund from the sale which was first reported to be \$30 million, then later reported to be \$15 million. Then there are reports that the government through the Ministry of Mines, Ministry of Finance and Home Affairs and other stakeholders are still working on what will go to the state.

The above confusing reports about earnings from mining are symptomatic of a state in which there is limited space for effective and efficient disclosure of revenue and payments from the mining sector. Yet quick and comprehensive disclosure of mining payments and revenue may promote transparency and accountability, thus eliminate speculation and the spreading of false information, a label often used against civil society organizations and the media. The wild figures being thrown around have not failed to raise great expectations amongst the population especially the underpaid civil servants and farmers.

However, the point that Zimbabweans should be aware of is that although the Ministries of Mines, Finance, Home Affairs and the other stakeholders are busy and more likely *painfully* reconciling the figures, the ultimate figures in terms of revenue that will go to the State and to mining companies depend on two important issues; firstly, the mining agreements (contracts) and the shareholders agreement signed between Grandwell Holdings and Marange Resources Private Limited (to form Mbada) and Core Mining and Minerals Limited and Marange Resources Private Limited (to form Canadile); and secondly, on the current mining taxation legal regime in Zimbabwe. *We used the term painfully because often you realize after the money is available that you entered into a bad deal or contract and you are struggling to explain this to an over expectant population.* At the outset we should explain that in most cases States get mining revenue

and payments either from mining taxes or through active participation in mining for example by acquiring shares in mining companies like Marange Resources Private Limited which holds 50% of the shares in Canadile and Mbada on behalf of the Zimbabwe Mining Development Corporation which is State owned.

Therefore, the centerpiece of this analysis is to inform Zimbabweans about the curves of mining revenue generation and distribution and why most governments fail to realize enough revenue from mining. On the one hand, a mining contract or agreement establishes the rights and obligations between the state and the foreign or local investor. On the other hand, a shareholders agreement between a State company and an investor sets out the shareholding structure, the sharing of profits and dividends, the distribution of management fees and the marketing arrangements in a new mining company and the duties and rights of the parties thereof. Consequently, unless if the revenue and profit distribution structure envisaged in the mining contracts and shareholders agreements between the State companies and the investors are fair and in the interest of the nation, the State may not get enough money from the diamond revenue as expected by many people. This then gets us to the point that ideally mining contracts and shareholding agreements entered into between government and foreign investors should be disclosed or made public so that people are aware of the revenue and payment distribution structure and not raise wild expectations. However, the major hindrance are the often wide claims of confidentiality by the State and investors over the mining agreements and shareholders agreements which scupper the practical application of the concept of transparency and accountability, but in turn result in raising a lot of speculation and suspicion of corruption and mismanagement of natural resources wealth amongst the people.

In the current scenario, the question is whether the terms and conditions contained in the diamond mining contracts and shareholding agreements between government through Marange Resources Private Limited and the investors (Grandwell Holdings and Core Mining and Minerals Limited) will eventually result in substantial revenue and payments from the recent sale going into the Consolidated Revenue Fund and whether the mining agreements are in the national interest as contemplated by Section 22 (b) of the Zimbabwe Mining Development Corporation Act (Chapter 21:08). This is partly where we should place all the speculation about how much money the national fiscus will effectively get from the diamond sales in addition to royalties. In that context people should be aware that before the State receives the profits and the dividends are declared to the state companies there are a number of expenses that should be paid to the investors in line with the shareholders agreement and the mining contracts.

In particular, the reconciliations by the relevant government departments are aimed at looking at offsetting the capital injection by the investors and paying the management fees. A resource depletion fee may be paid to Marange Resources on behalf of government. The problem however lies in the negotiation of these contracts. If the negotiators of the rather confidential mining contracts and shareholders' agreements did not do a good job people should not expect so much from the sale, as they may have negotiated and settled for high management fees to be paid to the investors while a low percentage is payable as the resource depletion fee. The foreign companies may be

racking more as management fees or even equating management fees to resource depletion fees which will be fundamentally flawed, unjust and not in the economic interests of the country as natural resources are more valuable and diamonds are finite. Therefore, people should be aware that despite the high figures being projected the management fees and investment expenses should be paid first to the investor. The remaining profit will then be shared or divided between the shareholders in this case the investors and Marange Resources Private Limited. The foreign investor will therefore benefit at two levels; by taking management fees from the gross profits and then sharing dividends at par with government as a shareholder.

Having considered how the profits and dividends will be shared between the foreign investors and the state owned companies, the responsible government officials who are reconciling the figures will again crack their heads to solve the equation of how to unlock the jigsaw and minefield around the multiple state institutions whose hands are dipped in the diamond mining issue. The question is how to make sure the money from profits or dividends and the resource depletion fees reaches the State coffers without going through multiple leaking and porous accounts. People should understand that the shareholding agreements were signed between Marange Resources Private Limited and the investors in a 50% each shareholding structure. Marange Resources Private Limited is an investment vehicle of the Zimbabwe Mining Development Corporation (ZMDC). In turn, ZMDC is the government arm in the mining sector. On the other hand, the Mineral Marketing Corporation of Zimbabwe (MMCZ) is another government company responsible for marketing minerals. In this matrix, it is more probable that the profits or dividends will be paid to Marange Resources Private Limited first. Then Marange Resources will pay dividends to ZMDC. In turn ZMDC will pay dividends to its sole shareholder which is the State. If MMCZ played a role in the sale of diamonds it will also claim some share of the revenue. What may happen at every turn is that each institution will subtract from the dividend and resource depletion fees some monies to pay for operations and management costs before the revenue reaches the Consolidated Revenue Fund. It is obvious there are cost implications to this multi-layered system which may not be proper for a struggling economy and an empty Consolidated Revenue Fund. This long chain of institutional involvement exposes the revenue to potential leakages and further deductions that will result in the state receiving less revenue than people expect.

In addition to sharing profits and dividends, the State can also realize revenue from the sale of diamonds through mining taxation. There are various taxes that constitute revenue streams and resource rents in the mining sector. The following revenue streams are always important sources of money for the government; royalties, corporate tax, exploration fees, local authority levies, and environmental fees among many others normally levied on mining operations by different government departments. Of all these royalties paid by mining companies constitute a significant contribution to state coffers but this depends on the levels or percentages of the royalties. The tax regime in Zimbabwe is set out by law and in particular the Mines and Minerals Act in respect of royalties and corporate tax in terms of the Income Tax Act and other taxes and levies administered by different government departments. However, as acknowledged by the Minister of Finance during his Mid-Term Fiscal Policy Review Statement in July 2010,

the mining tax regime is not very satisfactory and is unsustainable. It has been reported that the royalties paid to government by mining companies for diamonds is 10% and this may not be enough for a country struggling to balance the books due to lack of revenue.

The other taxes and levies paid by mining companies are normally absorbed by other government departments and do not go to the Consolidated Revenue Fund. An example is the environmental fee which is paid to the Environmental Management Agency and goes to the Environment Fund while levies charged by local authorities are used by those local authorities from which a resource is being extracted. What this means is that the royalties from diamonds may not be enough to contribute to significantly to the immediate needs of the country as people expected. Therefore, people should not expect a huge windfall that will soak away all our financial troubles in the short-term. Hence the responsible government authorities must be struggling with this fact, yet there is an expectant populace believing the country made a killing from the sale of diamonds. However, what is important in designing a mining tax regime is to ensure that some tradeoffs are made between different objectives such as the desire to attract investment, maximize government revenue and enhance developmental impact of mining. A balance is needed because if mining taxes are too high the investors may not come and if taxes are too low, the state may not get enough revenue from mining operations.

From the above analysis, it is vital at this point to make some recommendations that should trigger further debate around contract negotiation and mineral taxation. Firstly, we recommend that mining agreements should be disclosed for public debate and parliament should effectively debate the contracts before they are concluded or signed. This is to ensure that parliament plays a role in assessing the potential economic benefit of the mining agreements to the country. In the same vein, Parliament should play an oversight role over the use and distribution of revenue from diamond mining by the state. Further, in order to ensure that government companies enter into profitable ventures and get better deals it is important to engage the right people to negotiate the contracts. There is nothing as frustrating for a nation as signing a bad deal that may result in mortgaging finite natural resources like diamonds. Many African countries lack the expertise to negotiate good contracts and end up reversing them years later after realizing it was a bad deal and after failing to realize enough revenue. Conversely, foreign mining companies do a lot of research and have capacity and experts on contract negotiation and they realize the value by managing to negotiate favourable and profitable deals. Therefore, if the State decides to go into business it should negotiate from a business and professional perspective as well. Those who negotiate mining contracts should be fully capacitated, skilled and resourced to do so.

In the interim we encourage the Ministry of Mines, Ministry of Finance and the mining companies to issue and widely disseminate an official joint statement outlining the revenue generated and how the funds were disbursed. Further, government should ensure that all material future revenue and payments from mining are published to the public in a publicly accessible, comprehensive and comprehensible manner. Moreso, the results of ongoing audits and reconciliations in the diamond mining sector should be published. The current sales should also be subject to a credible and independent audit. In the above

context, claims of confidentiality as may be provided for in the mining contracts and shareholders' agreements should be disregarded in the public interest as the issue has caused high expectations and panic amongst the population especially the civil servants, farmers and the generality of the people. Therefore, we are calling government and mining companies to publish what they pay and what they earn respectively. This will reduce speculation and engender trust. This will also be in line with the principles of the Extractive Industries Transparency Initiative (EITI) that we are encouraging the government and mining companies in Zimbabwe to join.

In order to ensure that the Kimberly Process Certification Scheme further allows more sales of diamonds after the proposed second sale in September 2010, government should religiously implement the Joint Work Plan adopted in Swakopmund, Namibia in 2009. Further, the local focal point from civil society who will help the KP monitor should be allowed to do his work to monitor the implementation of the Joint Work Plan without any hindrance. It is further recommended that Zimbabweans should establish a permanent multi-stakeholder group that will ensure compliance with the KP standards composed of local independent and competent people whose function will be to promote transparency and accountability through monitoring the diamond mining activities around Marange especially the issue of smuggling, human rights violations and small scale mining among others. This structure can act as a permanent solution than relying on the KP monitor who is not resident in Zimbabwe.

We are also fully supportive of the passage of a Diamond Act and amendment of the Zimbabwe Mining Development Corporation Act as proposed by the Minister of Finance which should incorporate some of the recommendations above. We are also calling on government to ensure that the resource depletion fee to be paid from the diamond revenue be paid directly to the national fiscus before the establishment of the Diamond Fund. Additionally, people should not lose focus of the need to ensure that the Constitution of Zimbabwe includes as one of its founding principles the aspect of transparency and accountability in the management of natural resources revenue and payments. Further, the Constitution should guarantee the right of communities living in natural resource rich areas to derive economic, social and cultural benefits from natural resources. In that context, it will not be prudent for us to conclude without making reference to the people of Chiadzwa who have been and will be relocated to make way for diamond mining. The people should be adequately compensated and provided with adequate shelter and other social amenities as government and mining companies made an undertaking that they will do that once the revenue from diamonds start coming in.