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**Committee of Experts on
International Cooperation in Tax
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Item 3(e) of the provisional agenda

**Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by
Developing Countries**

Co-coordinators' Report

Summary

This note is presented to the Committee FOR INFORMATION at its 21st Session.

The aim of the note is to inform the Committee on the state of the work within the Subcommittee and its intention on how to carry the work forward with the view to delivering the Updated Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries by end of the term of the current membership.

During the last three months the Subcommittee had one formal (online) meeting from 23 to 25 September 2020, and a series of technical meetings for drafters. Taking into account comments from the last session, Subcommittee worked on documents reviewed during the session to make them ready for a second reading and approval at the 21st session. The following documents are submitted for review and APPROVAL: 1) CRP.49 Tax Incentives; 2) CRP.50 Tax Treatment of Subcontractors and Service Providers; 3) CRP.51 Production Sharing Contracts; and CRP.52 Tax Treatment of Financial Transactions in the Extractive Industries.

The Tax Incentives paper was approved at the 20th Session notwithstanding consideration of Committee's comments regarding OECD pillar 2 and ATAF comments. The issues have addressed in the current draft which the Subcommittee expect the Committee will review on only those two issues.

Two other papers are also submitted for DISCUSSION. CRP.53 on Issues and Best Practices in Auditing Oil, Gas and Mining Activities, and CRP.54 on The tax treatment of decommissioning.

This is a brief report of the work of the Subcommittee on Handbook on Issues for Taxation of Extractive Industries. The Subcommittee has focused on new chapters to be added in the current Handbook. This includes: 1) Tax Incentives; 2) Tax Treatment of Subcontractors and Service Providers; 3) Production Sharing Contracts; 4) Tax Treatment of Financial Transactions in the Extractive Industries; 5) Issues and Best Practices in Auditing Oil, Gas and Mining Activities. Trade mis-pricing was initially thought as a chapter on its own as was Environmental Issues. Because of limited time, the Subcommittee later decided to include Trade mis-pricing in the Audit chapter and Environmental Issues will be part of Decommissioning chapter. The Committee was briefed on that arrangement at its last session.

a. Tax Incentives.

The chapter has already been approved by the Committee at its 20th Session. Nevertheless, the Committee instructed the Subcommittee on work on specific issues and report back to the Committee at its 21st Session. The current version is presented as an update to the previous one on those issues, including a redraft of the section on OECD pillar 2 and a consideration of the African Tax Administration Forum (ATAF) comments. At its 20th Session, the Committee requested that the paper do not go into detail on pillar 2 which was still in discussion at OECD Inclusive Framework. As recommended a number of paragraphs have just been deleted. The current paper also addressed some of ATAF concerns on EU position on harmful tax practices. For easy reference the text is presented in track mode.

b. Production Sharing Contracts (PSCs)

Production Sharing Contracts is among the new topics for the update of the Handbook on Selected Issues for the Taxation of the Extractive Industries by Developing Countries. It is presented to the Committee FOR DISCUSSION and APPROVAL its 21st Session.

The chapter was presented at the 20th Session for discussion. Even as it was presented the Subcommittee knew that the text needed some improvement to present the content in a more balanced manner for the production sharing contracts to be both practical and profitable to government in developing countries and to businesses. After the last Session the Subcommittee worked on improving the text and the content and happy to presented a restructured text with a more in-depth content.

The chapter examines the concept and some of the mechanisms of Production Sharing Contracts or Agreements (PSC or PSA) in detail. PSCs are among the most common types of contractual arrangements for petroleum Exploration and Production (E&P).

PSCs typically relate to the petroleum industry and are rarely seen in the mining industry. This is largely related to the fact that direct participation of government bodies in mining is not as common as in the oil and gas industry. However, some countries, have recently explored the possibility of PSCs in the mining sector. PSCs are used worldwide, and most common in African and Asian countries, as well as in certain countries of South America.

This chapter intends to improve understanding as to what PSCs are, including relevant terminology, what the tax mechanisms of the contracts are and what areas need attention in a

PSC. It intends to discuss aspects of interest to tax administration, investors and other stakeholders.

c. Tax Treatment of Subcontractors and Service Providers

Tax Treatment of Subcontractors and Service Providers is among the new topics for the update of the Handbook on Selected Issues for the Taxation of the Extractive Industries by Developing Countries. It is presented to the Committee FOR DISCUSSION and APPROVAL at its 21st Session.

This chapter considers the taxation issues that arise from the use of subcontractors in the extractive sector. The increased complexity of extractive activities led to specialist businesses that are subcontracted by resource companies. Subcontractors open the market to more competitors, including local companies in developing countries. More competitors increase the number of bidders on projects and allows for new partnerships and operating models.

The common features of subcontracting arrangements include:

- Subcontractors generally provide specialised services at a specific stage of the project. Unlike resource companies, they generally do not invest to derive a return on the resources extracted (rather they earn a fee for services performed).
- Subcontractors supply services to multiple companies, located on different extractive sites.
- Subcontractors and the resource company they provide services to are often tax resident in different jurisdictions. Subcontractors may also not be resident in the country where the extractive site is located.
- Subcontractors services that may be entirely performed remotely in a different jurisdiction from the resource company and/or the extractive site.

This chapter is focussed on a limited range of key tax issues specific to subcontractors engaged directly by resource companies and that are not otherwise covered in the general discussions in this Handbook. General issues applicable to subcontractors but also other industry participants are not discussed.

The use of subcontractors also gives rise to complex tax issues and some countries' tax administrations may have limited experience in administering these challenges. This chapter is focused on a limited range of key tax issues specific to subcontractors engaged directly by resource companies and that are not otherwise covered in the general discussions in this Handbook.

The current version of draft chapter is quite similar to the previous version presented at the 20th Session. However, some revisions have been added to improve the overall flow of the text and to make it consistent with other parts of the Handbook. Some sections including Split Contracts, Subcontractors in the Stages of Resource Extraction, and Characterization of Income to Charge Withholding Taxes, have been substantively redrafted.

d. Tax Treatment of Financial Transactions in the Extractives

The Tax Treatment of Financial Transactions in the Extractive Industries is among the new topics for the update of the Handbook on Selected Issues for the Taxation of the Extractive Industries by Developing Countries. It is presented to the Committee FOR DISCUSSION and APPROVAL at its 21st Session.

It elaborates on different financing approaches commonly used in the mining, and oil and gas sectors and provides guidance on tax-related issues.

There are a lot of crosscutting issues between financial transactions in extractive industries and intragroup transfer pricing within the same MNE. This chapter will focus on tax treatments of financial transactions that are not discussed in the United Nations Practical Manual on Transfer Pricing. The transfer pricing considerations related to the intra-group financial transactions along the value chain are not addressed as such in the United Nations Practical Manual on Transfer Pricing. In addition, because of the importance of intra-group financing in the extractive industries, beyond the market price compliance issues, thin-capitalisation and important financial expenses may constitute a risk of base erosion for local companies. Such issues will be discussed here.

This chapter elaborates on the thin capitalization rule in the extractive industries, reviews current debate on interest limitation issues and provide concrete application examples in developing countries as part of financing mechanisms. Other topics developed include hedging instruments, performance guarantees, and farm-in/farm-out agreements.

The first draft was presented at the 20th Session. Taking stock of the Committee's comments and other inputs from the Subcommittee's members, the new draft is substantively more detailed. New content such as "Extractives industry value chain", or "alternative source of funding" were developed, while other topics such as "tax issues of streaming arrangements" and "Hedge instruments" were redrafted, detailed with practical or country examples.

e. Issues and Best Practices in Auditing Oil, Gas and Mining Activities

This is one of the two new drafts being presented at the 21st Session for the Committee's review and DISCUSSION and seeks the Committee's input and guidance on other crucial issues in the area on audit and mispricing to be included in the Handbook.

The purpose of this chapter is to provide developing countries with an overview of the issues that are encountered during audits and to provide insights on "best" practices that can be used by officials in developing countries when auditing the extractive sector. The chapter will also aim to provide practical examples employed by countries in dealing with issues arising from the audit of the extractive industry.

This text is an outline that does not necessarily follow the sequence the final chapter may have. The chapter will also be drafted to be consistent with and not overlap or duplicate the work of the Sub-committee on Associated Enterprises on Audit and Risk Assessment. The latter is a chapter in the UN Practical Manual on Transfer Pricing for Developing Countries which is being updated as well.

Moreover, to efficiently use the expertise within the Subcommittee with the limited remaining time for this membership of the Committee, the chapter will contain a detailed section on trade mispricing in the extractive industries instead of a separate chapter on trade mispricing.

f. The tax treatment of decommissioning

This chapter covers the tax treatment of rehabilitation/decommissioning costs for mining and oil & gas projects. Such decommissioning may be required under a wide range of domestic laws, international agreements and voluntary guidelines.

In order to consider the tax treatment of decommissioning costs, it is necessary to understand the environment in which those costs will be accrued and incurred. This chapter therefore first addresses the broad principles behind a government's regime for decommissioning and considers the actual work that needs to be done to achieve local, national and international requirements. It then discusses methods by which responsibilities to carry out such work are assigned, and the different contractual and legal frameworks which govern the relationship between the host state/resource owner and the contractor involved with the extractive activity.

This text is an update of the previous same chapter in the previous version and presented to the Committee at the 12st Session for review and DISCUSSION. The draft is in track mode for easy reference.

Progress and steps going forward.

It is the intention of the Subcommittee to finalize these two last chapters with comments and guidance we may receive at the 21st Session, and submit them for discussion and approval at the 22nd Session in April next year. This will be the end of the substantive work save for any requirement the Committee may instruct the Subcommittee to look at during the months of May to July 2020, ending date for the current membership of the Committee. We anticipate the editorial work for the Handbook to continue until end of July as well.