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**Committee of Experts on
International Cooperation in Tax
Twenty-second Session**

Virtual Meeting – 21 April 2021, 8:00 – 9:30 am, 9:45 – 11:00 am; and 22 April 2021, 8:00 – 8:30 am (NY Time)

Item 3(e) of the 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 22nd Session.

The purpose of the note is to inform the Committee on the state of the work within the Subcommittee as the current membership draws to a close. With suggestions and guidance from the Committee during this session the subcommittee intends to finish the Updated Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries by end of the term of the current membership at end of June 2021.

Since the last session in October 2020 the Subcommittee had three formal (online) meetings, one from 7 to 9 December 2020, the second on 1 and 2 March 2021, and last on 19 March 2021. The Subcommittee had a series of technical meetings among topic drafters. Considering comments from the last session, Subcommittee worked on the following documents presented at this session for DISCUSSION and APPROVAL: 1) CRP11: Tax treatment of decommissioning (update); CRP12: Issues and best practices in auditing oil, gas and mining Activities; CRP13: Transfer Pricing Issues in Extractives (update); and CRP10: Overview - Chapter 1.

The two chapters on Tax treatment of decommissioning, an updated text from current Handbook, on Issues and best practices in Auditing, a new chapter, were presented at the 21st session. The chapters on Transfer pricing issues in extractives, and Overview, both updates from the current Handbook, will be seen only once.

This is a brief report of the work of the Subcommittee on Handbook on Issues for Taxation of Extractive Industries. At its inception, and based on its mandate, the Subcommittee first worked on new chapters to be added to the Handbook. The Issues and Best Practices in Auditing (CRP.12) is the last new chapter to be presented to the Committee for discussion and approval. The work followed on a few more chapters that needed to be updated to keep them consistent with the new additions and with other updated materials within the Committee such as the Transfer Pricing Issues in Extractive Industries (CRP.13). Other updated chapters are: Overview chapter (CRP.10), and the tax treatment of decommissioning (CRP.11).

1. Overview Chapter (CRP.10)

The current text for the Overview Chapter is an update of the text in the previous version of the Handbook rendered necessary by the addition of new chapters on: (i) Tax Incentives; (ii) Tax Treatment of Subcontractors and Service Providers; (iii) Production Sharing Contracts; (iv) Tax Treatment of Financial Transactions in the Extractive Industries; and v) Issues and Best Practices in Auditing Extractive Industries. Furthermore, two existing chapters, Transfer Pricing Issues in Extractive Industries, and Decommissioning, were updated in part to align with the new chapters.

Covid-19 has become not only a global pandemic, but also a global economic and social crisis with devastation not seen since the World War II. In that context a substantial redraft of the section dealing with extractive industries data ensured in part to take into account the current situation and to adjust assumptions for future production as well.

2. Tax treatment of decommissioning (CRP.11)

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. This is a necessary task to mitigate the negative impact on the environment often caused by the extractive activities.

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 investor involved with the extractive activity. The update to the previous text was done based on the following key principles: importance of tax certainty; risk of unintended consequences; ensuring funds are available when the rehabilitation begins; and keeping local tax relief effective. Decommissioning is a needed exercise that needs to be part of the whole project planning with the focus to keep the environmental damage minimal and pay for rehabilitation that takes place after the mine or oil and gas field has closed.

3. Issues and best practices in auditing oil, gas and mining Activities

The chapter discusses the entire audit process, preparation, planning, execution and finalization and discusses the intricacies of the extractive sector audits. The issues discussed are not intended

to be exhaustive and will require detailed and extensive analysis in practice given the specific nature of the extractive industry.

The aim of this chapter is to provide developing countries with an overview of the issues that are typically encountered during planning and execution of tax audits in the extractive industry. The chapter also provides insights on administrative practices that can be used by tax officials in countries when auditing the extractive sector.

The issues discussed in this chapter are at a high level and are not intended to be exhaustive and will require detailed and extensive analysis in practice given the complex nature of the extractive industry.

Although the Chapter predominately focusses on domestic audit practices, Section [6] describes bilateral and multilateral audit approaches in recognition of the growing international use of joint audits and simultaneous audits. Section 6 further describes audit capacity building programs, such as Tax Inspectors Without Borders (TIWB) , that is available for developing countries.

At the 21st session, the Subcommittee informed the Committee of its intention to work on Trade Mispricing as a part of the Auditing chapter as time was running out to study trade mispricing in depth and make it a new chapter. The Committee approved the proposal.

4. Transfer Pricing Issues in Extractives (update)

The present text is an update to the same topic part of the first version of the Handbook. The update was rendered necessary in part by the publication of a new update to the Transfer Pricing Manual, referenced throughout this text. The new text also seize upon new topics included in this Handbook update, particularly the chapter on Financial Transactions on which a couple of new practical cases are built.

Progress and steps going forward.

The Subcommittee worked diligently to present the committee the current texts (the 4 CRPs) in a form we think is improved enough for approval by the Committee for the chapter already presented at the 21st session. For the text seen by the Committee for the first time, including the Audit and the overview, we also seek approval as this is the last session of this current membership.

After this session closes the subcommittee, especially the Co-coordinators, will continue to follow the progress on any comment made by the Committee. With the Secretariat's assistance we will follow up with the editor to make sure the text is in printable form. The editorial work should start by 1 May, 2021 and last until June 30.