

Note on Tax Treaty Issues

Overview

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MINISTRY OF FINANCE
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Contributors

- **Subcommittee Members**
 - Meetings in Arusha (Tanzania), NY (UN) and Bratislava (Slovakia)
- **Special Thanks to Subcommittee Members**
 - Jan de Goede,
 - Nana A. Okoh and
 - Susana Bokobo Moiche
- **Special Thanks to Secretariat**
 - Michael, Ilke and Victoria

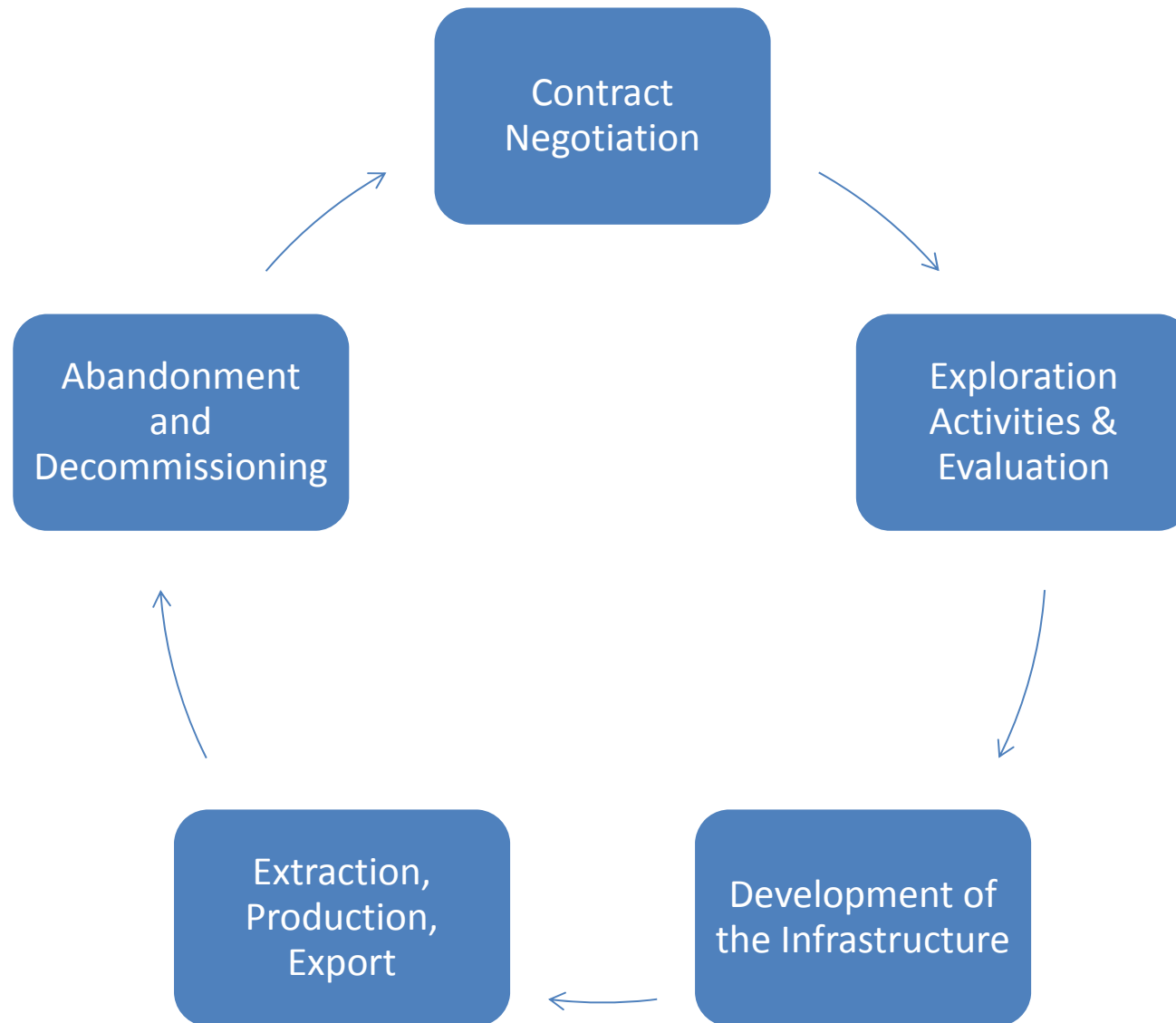
Objectives

- Provide overview of
 - special issues arising in Extractive industries
 - in relation to application to Tax Treaties
 - Special Articles in the tax treaties
- Provide guidance to tax treaty negotiators
 - Implications for taxing rights
 - Implications for elimination of double taxation
- Followed by detailed and specific topical notes
 - – e.g. Capital Gains, Permanent Establishments

Approach and Structure

- Background
- Overview of Business Cycle
- Special focus
 - Personal Scope
 - Substantive Scope
 - Selected Articles addressed
 - Emphasis of Extractive Industry Issues
 - Emphasis of differences between UN MTC and OECD MTC
- Examples of Real Life Treaties

Lifecycle of Extractive Industry Project



Stages, Activities, Actors, Issues

Stages	Key Activities	Actors	Domestic Tax Issues	International Tax Issues
Contract Negotiation and Signature	Extractive company may get engaged in competitive bidding or contract negotiation with assistance of advisers and lawyers	Extractive Company, Consortium members, Advisers, Lawyers, Financiers	Obligatory (tax) payments, such as Signature Bonus, Payments to advisers and WHT consideration	Are Signature Bonus payments covered by scope of DTT? Taxation of income to advisers? Is DTT applicable?
Exploration Activities & Evaluation	Exploration activities in different form take place – geological studies, drilling, and seismic tests, sample taking and analyzes, Evaluation of potential for further extraction	Extractive Company, Subcontractors specializing on the exploration activities (on-shore and off-shore), analyzes	Obligatory (tax) payments, such as Discovery Bonus, Payments to subcontractors and the relevant tax considerations (WHT)	Are Discovery Bonus payments covered by the scope of DTT? Taxation of income to subcontractors? Existence of Permanent Establishment?
Development of the Infrastructure	Development of extractive (mining pits, extraction wells) and supportive infrastructure including transportation (roads, railway, pipelines) and accommodation and office units	Extractive Company, Subcontractors – Construction, Installation and Drilling Companies	Obligatory (tax) payments, such as development Bonus (unusual) Payments to subcontractors and the relevant tax considerations (WHT)	Are development bonus payments covered by scope of DTT? Existence of PE of subcontractors?

Stages	Key Activities	Actors	Domestic Tax Issues	International Tax Issues
Extraction, Production, Export	Extractive activities take place on commercial scale, Resource is processed and/or Transported/ Exported	Extraction Company Subcontractors – processing, transportation, other services	<p>Extraction Taxes (Royalties, Share from PSA, Hydrocarbon Taxes, Corporate Income Tax, Hydrocarbon tax), Export Related taxes (Excise, Export Customs Duty, Export Rent Taxes and other)</p> <p>Payments to subcontractors and the relevant tax considerations (WHT)</p>	<p>Are extraction type of taxes covered by scope of DTT?</p> <p>Existence of PE of subcontractors?</p>
Abandonment and Decommissioning	Extractive activities are seized and are replaced by decommissioning activities, clean up of pollution and removal of infrastructure	Extraction Company, Subcontractors specializing on decommissioning and environmental cleanup activities	<p>Special allowance or reserve created during the life of the project – considerations with deductibility and subsequent taxation of excess reserve.</p> <p>Payments to subcontractors and the relevant tax considerations (WHT)</p>	<p>Is taxation of excess reserve taxable in accordance with tax treaty?</p> <p>Existence of PE of subcontractors?</p>

Personal Scope (Article 1)

- Extractive projects may be carried out either through a resident legal entity
 - Incorporated in the country of extraction, or
 - Via non-resident entities or Joint Ventures
 - Often forming non-incorporated consortium
 - Not constituting separate legal person
 - » Application of tax treaty possible at the level of the partners in consortium, assuming they are resident in tax treaty country

Substantive Scope

Article 2 – Taxes covered

- Relevance of inclusion of particular types of taxes into the scope of the treaty
 - Potential limit on taxing rights, and
 - Obligation of country of residence to eliminate DT
- Benefits of inclusion of taxes, which are of profit/income and capital nature
 - Reduction of the overall tax burden on the investor
 - The Credit (Elimination of Double Taxation) is equally important

Types of Taxation Models

- Profit Tax Model (Norway)
 - Standard CIT of 27% with Special Petroleum Tax of 51% leading to 78%
- Royalty Model
 - Combination with other instruments
 - Bonuses, CIT, Excess Profit Tax, Export Duties
- Production Sharing Agreement
 - Sharing production (cash or in kind) in lieu of tax payment

Stages	Type of Taxes and Obligatory Payments to Governments	Typical Characteristic	Covered by Scope of DTT
Contract Negotiation and Signature	Signature Bonus	A payment in form of % (usually – e.g. 1% of expected value of natural resources) or a fixed amount	Usually not (unless the payment is designed in a way that it can be credited against the CIT)
Exploration Activities & Evaluation	Exploration Bonus	Similar to Signature Bonus	Usually not
	Rent Payments	Payments for the use of land	Usually not
	Tax Levied on Employees	Income Taxes	Yes (taxpayer-individual)
	Tax Levied on Service Providers	Income Taxes	Yes (taxpayer-subcontractor)
Development of the Infrastructure	Bonuses and Rentals	Same as above	Same as above
	Taxes on Employees and Subcontractors	Same as above	Same as above
	Import duties and levies, VAT	Indirect taxes and levies	No
Extraction, Production, Export	Royalties	Payment on the volume or value of extracted resource	Usually not
	Bonuses and Rentals	Same as above	Same as above
	Production Sharing payments	% of production paid to state	Usually not, unless designed as % of profit
	Profit Taxes + Excess Profit Tax	Tax on income/profit	Yes
	Export Duties and Export Levies	Tax on value of exported resource	No
Abandonment and Decommissioning	Environmental Fees or Penalties	Fines or penalties for pollution	No
	Taxes on Employees and Subcontractors	Same as above	Same as above

Territorial Scope

Article 3

- Definition of Contracting states
 - Notions of territory and territorial waters, but also continental shelf and exclusive economic zone, within which the states may exercise the taxing rights in accordance with international law
 - Will omission limit the taxing rights?
 - Sub-committee position – omission of part of territory or area from the scope means the tax treaty does not apply to this territory, therefore the tax treaty may not limit the taxing rights of the country of source
 - » And country of residence may not be obliged to grant credit

Business Profits and Permanent Establishment Issues

Articles 5 and 7

- Profit Attribution 7 UN vs. 7 OECD
 - 7/1 Force of Attraction, 7/2 Limitation to deduction
 - 7/5 Purchasing activities
- Permanent Establishment Issues
 - Exploration activities
 - Reference to OECD Commentary
 - Policy options in respect of exploration activities
 - » Not PE, PE, PE after time period
- Other PE issues
 - Construction/Installation Project
 - Service PE
 - Emphasis on Subcontractors and Issues arising

Service Providers and Tax Considerations

- Who are the service providers?
 - Consultants in the initial stage (Legal, Financial, Other)
 - Exploration activities
 - Drilling,
 - Sample testing,
 - Geological studies
 - Infrastructure development
 - Field and Mine development
 - Extraction stage
 - Transportation (ground transport and pipelines)
 - Decommissioning service providers

Services – Tax Treaty Policy Options

- Wider or narrower PE definitions
 - Thresholds – as short as 30 days
 - Link to Article 15 – taxation of employees
- Technical Services Article
 - Scope of Services covered by the special article

Special Articles Focus

- Article 6 – Immovable Property
- Article 8 – International Transport
- Article 9 – Transfer Pricing Issues
- Articles 10, 11, 12 – Interest and Royalty Considerations
- Article 13 – Capital Gains
 - Highlight Issues – refer to Special Note
- Articles 15, 16, 21, 22, 24 - Highlights

Thank you...

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