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**Committee of Experts on International
Cooperation in Tax Matters
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Agenda Item 3 b (ii)

Taxation of the extractive industries

**Subcommittee on Extractive Industries Taxation Issues
for Developing Countries
(Report of the Coordinator, Mr Eric Mensah)**

**Mandate of the Subcommittee on Extractive Industries Taxation Issues for Developing
Countries**

The Subcommittee's mandate is as follows:

The Subcommittee is mandated to consider, report on and propose draft guidance on extractive industries taxation issues for developing countries on the basis that it shall:

- identify and consider the most pressing issues where guidance from the Committee may most usefully assist developing countries in this area and report to the Committee on such at its tenth annual session in 2014;
- provide a work program to the Committee at its tenth annual session that identifies and prioritizes such issues on a preliminary basis and includes proposals providing policy and administrative guidance for developing countries at a very practical level; and
- provide draft guidance on such issues as are approved by the Committee at its annual sessions.

In undertaking its work, the Subcommittee shall seek to engage with other organizations active in the field. The Subcommittee shall report on its work at each annual session.

Recent Work

During the eleventh session of the Committee in October 2015, The Subcommittee presented a progress report on its work and a series of guidance notes to the Committee seeking its approval.

After discussion and amendment where necessary, the approved notes were: (a) an **overview note** on taxation issues in the extractive industries; (b) a guidance note on **selected tax treaty issues** in relation to the extractive industries; and (c) a guidance note on **capital gains taxation and the taxation of indirect asset transfers**. These are currently being further edited, with some extra examples added, consistent with the Committee decision.

The guidance note on tax treatment of **decommissioning** for the extractive industries was also presented and initially discussed. Afterwards, it was decided to revise the note, including providing more examples and scenarios. An updated version of that note for Committee consideration is at **Attachment A**. Taking stock of the discussions during the eleventh session of the Committee, the present note reviews several decommissioning models that are available as well as the implications for each of them. The models include: no tax deduction, tax relief upon expenditure, tax deduction upon accrual, tax deduction upon pre-funding. The note also examines key questions concerning the measuring of costs for decommissioning. Furthermore, the paper provides a case study on the issue based on the Zambian experience.

At the eleventh session in 2015, I presented, as coordinator of the Subcommittee, a new program of work for the next 12 months which was approved by the Committee. The main tasks included producing guidance notes on: (a) **value added tax** in relation to the extractive industries (a draft of which is at **Attachment B**); (b) the tax aspects of the **negotiation and renegotiation** of extractive industry contracts (at **Attachment C**); (c) **permanent establishment issues** in the extractive industries (**Attachment D**); (d) kinds of “**government fiscal take**” (**Attachment E**); and (e) revision of the note on tax treatment of decommissioning already referred to.

The Subcommittee met twice during the last 12 months; in Livingstone, Zambia and in New York, USA. The hosting of the first meeting by the Zambia Revenue Authority is gratefully acknowledged, as is the support of the European Commission's Directorate-General for International Cooperation and Development (DG DEVCO). The meetings were extremely important in developing the current texts.

(a) value added tax in relation to the extractive industries (Attachment B):

The VAT issue is raised in the context of taxation of extractive industries because of its payment and refund timing, the amount involved for the imports and initial investment to start production, and its spill over effect on other economic activities in the concerned country as well. The VAT issue is present in the all phases of the life cycle of an extractive investment from exploration to decommissioning activities. The paper discusses and offers guidance of the most pressing issues for the government receiving the investment and for the company investing in extractive industry in the that country.

(b) the tax aspects of the negotiation and renegotiation of extractive industry contracts (Attachment C):

This guidance note provides an overview of different issues faced by developing countries and other stakeholders during the negotiations and renegotiations of contracts in extractives industries. The note identifies several key tax and fiscal issues to address during the negotiations. Issues discussed include, balancing investment attractiveness and tax resources, establishing a fiscal regime whether as

a statutory approach or by ad hoc contract, involving all stakeholders (internal and external), coordination among different government entities (different Ministries and tax administrations). A particular attention is paid to provisions related to government take, such as royalties, income and additional profit taxes, withholding taxes, VAT, export taxes, etc. Contract provisions on tax implications of the “after-project” such as decommissioning and rehabilitation are also discussed for proper inclusion in contracts.

(c) permanent establishment issues in the extractive industries:

The guidance note discusses the concept of permanent establishment (PE) as it relates to the extractive industries, a sector which tends to employ a vast array of contractors and sub-contracts and thus leading to several considerations as to when/whether a PE occurs in the sense of treaties based upon the UN Model Convention (2011), the OECD Model Convention (2014), or other models. Although the paper focusses particularly on the oil and gas industry, it is applicable to the mining sector as well. It touches upon issues such as territorial regimes, joint operating agreement, and different kind of contracts or fiscal regimes.

(d) Note on government fiscal take:

This note addresses the various types of "fiscal take" available to governments, and the consequences of each in the short and longer terms.

Action requested

The **Committee is requested to approve the release of the final guidance note on decommissioning**, subject to further purely editorial work (including possible further examples) under the Coordinator's guidance. It is further **requested to approve release of the guidance note on permanent establishments** subject to the same sorts of editorial work. The Committee is asked to **make comments on the notes on VAT and on fiscal take**, with a view to their finalisation by the thirteenth session of the Committee and release, along with the other guidance notes, in the form of a handbook on selected issues for taxation of the extractive industries by developing countries before the end of June 2017. It is noted that every effort needs to be made to translate such a handbook into the official UN working languages as quickly as possible, especially French and Spanish.

The Subcommittee has also considered the possibility of useful work that might be done in terms of **reviewing invoicing and costs**. It considers that the possibility of such guidance assisting developing in situations other than transfer pricing (dealt with by a separate subcommittee), might be a useful area of consideration by the next membership of the Committee, as might further joint work on transfer pricing related issues in the extractives sector.