

# Extractive Industries Taxation Issues

ECOSOC Special Meeting on  
International Cooperation in Tax Matters  
New York, 7 April 2017

Presentation by:  
Eric Nii Yarboi Mensah  
Johan de la Rey

# Overview and Process

- In 2013 the Subcommittee was mandated to consider, report on and propose draft guidance on extractive industries taxation issues for developing countries.
- The membership of the Subcommittee included some members of the Tax Committee, representatives of the business sector and government, persons from civil society organisations, academics and other experts.
- Subcommittee meetings were held in Johannesburg, Arusha, New York, Bratislava, Livingstone and Amsterdam (the last was a joint meeting with some members of the Transfer Pricing Subcommittee).
- An overview note and eight guidance notes on various topics were approved by the Tax Committee. The notes deal with issues for both the mining and oil and gas industries.
- It is envisaged that the Handbook on Extractive Industries Taxation Issues for Developing Countries, incorporating the notes prepared by the Subcommittee, will be released in October 2017.

# Overview of Extractive Industries taxation issues

- An overview is given of some of the taxation issues for the extractive industries in developing countries, options available and the effect of deciding on options in particular circumstances.
- Intention is to build awareness of the issues, assist policy makers and administrators in developing countries as well as to provide information to other stakeholders.
- The note gives an overview of the mining and oil and gas industry structures to provide context for designing and administering a tax regime and seeks to provide policy and administrative guidance at a practical level.
- It is acknowledged that extractive industries are unique in many ways and an important revenue base in many developing countries and emerging economies.
- The tax and fiscal system should ensure that the government obtains an adequate and appropriate share of the benefits from the country's resources while providing a return commensurate with the risks borne and functions carried out by the parties.

# Fiscal Take in the Extractive Industries

- The guidance note provides context on how value derived from natural resources can be shared between government and investors, an overview of and discussion of the issues arising for the types of government take available, and the interaction between the tax instruments and with the general tax regime in a country.
- Government's share from the development of natural resources could include profit based income taxes, royalties, other taxes and fees, obligations placed on investors (for example infrastructure investment, employing and training residents, supporting local businesses and contributions to decommissioning and environmental costs).
- Relevant aspects when designing and implementing a fiscal regime are risk/return, predictability, long-term perspective, flexibility, simplicity, clarity and timing of tax revenue collection.
- Considerations that are important from the perspective of resource holders and also investors are discussed.
- Implementation aspects of a fiscal regime such as revenue collection, a dedicated tax office focussing on the extractive industry, monitoring and auditing should be considered at an early stage.

# Tax aspects of Negotiation and Renegotiation of Contracts

- In many developing countries without laws governing investment and the fiscal terms of natural resource activities, the terms are negotiated and reflected in a contractual agreement between investor and government.
- The guidance note provides an overview of tax and fiscal related issues developing countries face in the negotiation and sometimes renegotiation of long term natural resource contracts.
- Country and investor perspectives are highlighted (for example, balancing investment attractiveness with obtaining resource value, involvement of internal and external stakeholders, forecast models, long term relationships and stability clauses) and options, concerns, approaches and practical aspects of successfully negotiating contracts are discussed.
- Contracts that are flexible enough to self adjust as circumstances change may obviate the need for renegotiation to occur.
- When negotiating contracts it is key that tax authorities are involved and be present to ensure consistency with sound tax policy and administration.

# Transfer Pricing issues in Extractive Industries

- The guidance note identifies issues that may arise in the extractive industries during consecutive stages of the extractive industries' value chain and provides suggested solutions for addressing the issues.
- Generic case examples, with findings and considerations, are presented on–
  - a marketing hub,
  - information challenges, and
  - management services.
- The value chains of mining and mineral extraction, and production of oil and natural gas are described.
- Mining specific case examples, with findings and considerations, are presented on–
  - the export of low value minerals to an intermediary distribution company,
  - coal group marketing activities,
  - price fluctuations and intermediary sales of uranium,
  - market off-taker function,
  - buying and selling of iron ore,
  - intercompany financing,
  - copper joint venture, and
  - sale and leaseback of equipment.

# Transfer Pricing issues in Extractive Industries (continued)

- Oil and gas specific case examples, with findings and considerations, are presented on–
  - oil acquired from related companies,
  - structure and operations of a petroleum industry company,
  - market volatility,
  - financing costs,
  - horizontal ring fencing,
  - cost sharing agreement,
  - intercompany charges at cost, and
  - parent company guarantees.

# Selected Tax Treaty Issues for the Extractive Industries

- International tax issues arise as extractive activities often include cross border elements which impact on taxes payable by extractive industries.
- The guidance note reviews the relevant tax treaty articles and highlights the issues that developing countries may consider in the process of designing their tax treaty policy and in applying their tax treaties with other jurisdictions.
- The UN Model Convention (also OECD Model) contains only a few provisions specifically addressing issues arising in extractive industries and therefore the general provisions are applicable.
- Several countries have included specific provisions affecting extractive industries in their tax treaties.
- In designing domestic tax law and negotiating tax treaties countries should ensure that the interaction between them should not impact negatively on taxing rights over extractive industry income, capital and tax revenue.
- An overview of the extractive industries life cycle is given and key activities with domestic and international tax considerations are highlighted.
- Taxes on income are dealt with under tax treaties, However, the characteristics of special tax instruments that are designed differently should be analysed to determine whether they are covered by the scope of the relevant tax treaties.



# Permanent Establishment issues for Extractive Industries

- The permanent establishment (PE) concept is one of the pillars for the international taxation of business profits , involves both fixed and mobile activities, applies and is interpreted differently for purposes of establishing whether it exists, and is used in treaties with different thresholds.
- The purpose of the guidance note is to provide an overview of PE tax aspects and focuses on the main taxation issues and implications of recognising the presence of a PE, taking into account the provisions and Commentaries of the UN Model Convention and the OECD Model Convention and specific provisions of tax treaties countries have entered into regarding extractive industries.
- The note deals mainly with PEs in the oil and gas industry and discusses the issues raised by the practical application of the concept as reflected by case law, tax disputes and articles on the subject.
- Service PEs, construction or installation PEs, the geographical and commercial coherence test, the application of the PE concept to the different phases of a project life cycle and the attribution of profits to a PE are also discussed.

# Value Added Tax issues in Extractive Industries

- Due the predominantly export nature of extractive industries, governments should not expect large amounts of VAT revenue.
- The VAT treatment of extractive industries and specifically refund policy is critical and could be a barrier to investment due to its impact on cash flow and costs to the industry.
- The majority of issues regarding VAT refunds are administrative and are associated with compliance cost of claims, administrative cost of auditing, budgeting for refunds by the fiscal authorities and delays in the payment of refunds.
- The guidance note provides an overview of VAT policy options (highlighting pros and cons) and administration measures over the life cycle of the typical extractive industry activities that countries could consider.
- It is concluded that the ideal tax policy approach is that full VAT taxation (based on the destination principle) should apply to extractive industries.

# Taxation of Indirect Asset Transfers

- Extractive assets of a company could be sold indirectly by the transfer of shares or ownership interests in the company. Shareholders and the company may not be tax residents of the mining or oil and gas country.
- The guidance note discusses and provides options (with pros and cons) for policy makers and administrators.
- A sequence of policy questions are whether a country should tax–
  - the direct transfer of capital assets
  - the indirect transfer of capital assets
  - all types of transfers of capital assets (special treatment of extractive industries and corporate restructuring)?
- The question is how to effectively implement tax on indirect asset transfers (identification of transactions, the entity to be taxed and tax collection)?
- Applicable tax treaties impact on the taxing rights over indirect transfers and interact with domestic law – domestic tax law and tax treaty aspects are discussed, referring to a number of country examples.
- Symmetry issues arise regarding the taxation of the seller's gains and the tax deductions that may be claimed by the purchaser and the mining/oil and gas company.

# Tax treatment of Decommissioning in Extractive Industries

- The guidance note addresses the broad principles behind a government's regime for decommissioning and the work that needs to be done to achieve local, national and international legal requirements.
- It is intended to raise awareness of potential challenges and the range of policy options available, and to assist in the making of good policy (including tax legislative design) and administrative decisions.
- Decommissioning is a complex multi-disciplined process with political, community and environmental impact and requires financial and technical planning over a long period of time.
- The three key models for funding decommissioning work and their tax treatment are examined, potential distortions are identified and methods to address the distortions are discussed. The three models for providing a tax deduction are upon:
  - Incurral of expenditure (cash basis)
  - Accrual (based on a provision for future expenditure)
  - Pre-funding (into a dedicated and protected fund).