

## **Attachment A:**

### **Draft Outline of Overview Note on Extractive Industries Taxation Issues<sup>1</sup>**

#### **Executive Summary/Purpose**

The purpose of this note is to give an overview of some of the issues for extractive industries taxation in developing countries including possible cluster of such issues and the interactions between them, options available and the likely effect of taking such options in particular circumstances. This is intended to help policy makers and administrators but also to give guidance to taxpayers operating in developing countries. A series of guidance notes will accompany this overview note. These notes will deal with some of the issues identified in this overview note in more detail.

#### **Status of the Note**

This note is [currently only a discussion draft and even in final form it will be] for guidance only. It is intended to address the issues of taxation of the extractive industries in short form and to help build awareness of them, as well as to help put those faced with these issues in a position to make policy and administration decisions in relation to them.

#### **Terms Used**

"Extractives" - non-renewable natural resources such as crude oil, natural gas and mining products

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<sup>1</sup> This guidance note was prepared by the Secretariat of the Committee of Experts with input from other Committee Members.

## **Introduction/Industry Background**

Similarities between extractive industries and other industries:

- Need for foreign investment
- Dominated by MNEs

Differences between extractive industries and other industries:

- Need for large up-front investment
- Investment isn't as "footloose"
- Uncertainty - regarding price development and exploration possibilities
- Long production period
- Larger environmental concerns
- Possibility of "economic rents"

Differences between different types of extractive industries:

- Industry structure
- Market structure
- Financing structures

Challenges for governments:

- Balance:
  - The need to attract foreign direct investment
  - Ensure that the government receives a fair share of revenues
  - Timing issues in relation to receipt of revenue
  - Environmental issues
  - Transparency and confidentiality

**Possible Types of Fiscal Instruments and their Characteristics** (a specific guidance note may be drafted beginning in 2015 if the issue cannot adequately be dealt with in the overview note)

- Royalties
- Income taxes
- Withholding taxes
- VAT (GST)
- Rent-based taxes
- State participation
- Others
  - Auction bids
  - Surface rent
  - Bonuses
  - Minimum taxes

Taxation of output-based versus profit based fiscal instruments:

- Blended options
- Suitable options in various situations
- Possible changes over time

Location of fiscal provisions:

- Specific tax legislation
  - Income tax provisions
  - Capital gains taxation
  - Value added tax
  - Other taxes
- Part of an Extractive Industries Act
- Part of Sector Legislation
- Interaction with contracts

## Some Specific Issues

Policy and legal issues:

- Predominantly domestic policy and legal issues
  - Capital gains taxation of assets in the extractive industries (*guidance note currently being drafted*)
  - Tax treatment of environmental reclamation and rehabilitation (*guidance note on decommissioning currently being drafted*)
  - VAT issues (*guidance note on certain VAT and local content issues currently being drafted*)
    - Ring-fencing VAT due to/from the mining industry
    - Local content issues
  - Ring fencing issues
  - Setting prices for tax purposes/tax issues related to price fluctuations
  - Tax incentive issues and management
  - Windfall taxes
  - Taxation of service providers to the extractive industries (contract mining)
  - Treatment of exploration and development expenditure for tax purposes
  - Tax treatment of non-resident subcontractors
  - Transfer of interests
  - Sale of exploration/development rights
  - Farm-outs and farm-ins
  - Tax treatment of production sharing
- International policy and legal issues
  - Double taxation treaty issues
    - Relevant double tax treaty provisions and options
    - Permanent establishment issues in the extractive industries (*guidance note will be drafted beginning 2015*)
    - Treaty limitations on domestic source taxation

- Avoidance of double taxation and creditability issues under treaties
- Exchange of information
- Dispute resolution (incl. mutual agreement procedure)
- Overriding royalties
- Effective review of invoicing and costs under treaties (*guidance note to be drafted commencing in 2015*)

Other international issues:

- International tax issues in the absence of tax treaties
- Public international law relevant to taxation of the extractive industries (e.g. decommissioning)
- Avoidance of double taxation and creditability issues in the absence of tax treaties
- Effective review of invoicing and costs in the absence of tax treaties

Some domestic and international tax planning issues:

- Hedging
- Thin capitalization
- Treaty shopping
- Finance leases
- Transfer pricing<sup>2</sup>

Organization and procedures:

- General approach to mining tax legislation
- Tax assessments
- Possible organizational models for extractive industries capability in revenue

<sup>2</sup> Secretariat Note: Transfer Pricing issues come under the mandate of the *Subcommittee on Article 9 (Associated Enterprises) – Transfer Pricing Issues*, though it is within the mandate of the Subcommittee on extractive industries to suggest possible issues for consideration by the Transfer Pricing Subcommittee and the two subcommittees could, for example, embark on a joint guidance note on transfer pricing issues in the extractive industries if they saw fit.

authorities

- Access to and effective use of information

Capability building:

- Addressing knowledge gap issues
- Addressing information gap issues including accessing information and using it effectively

Contract issues – tax aspects:

- Negotiation and re-negotiation of extraction rights/contracts
- Fiscal stability clauses
- Relationship to investment protection treaties – to the extent they address tax issues