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**Committee of Experts on International
Cooperation in Tax Matters
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Item 3 (f) of the provisional agenda

Taxation of Extractive Industries

Co-Coordinator's Report

Summary

This paper is *for approval* and proposes three workstreams for the Subcommittee on Extractive Industries Taxation. The workstreams will stem from three identified key topics: (i) Energy transition from fossil fuel to renewable sources of energy; (ii) Trade mispricing and undervaluation of natural resources; and (iii) Tax incentives and permanent establishment (PE).

Workstream A – Energy Transition: The subcommittee will develop guidelines to assist primarily developing countries endowed in oil and gas. The issue of energy access for economic development and the need to curb carbon emission will be discussed.

Workstream B – Trade mispricing and undervaluation of natural resources: Trade mispricing can lead to host of issues, including tax (direct and indirect) evasion and tax avoidance. The subcommittee will limit its work only to tax related issues. It will come up with guidelines to assist countries collect the right amount of tax in extractive industries.

Workstream C – Tax incentives and PE: The subcommittee will work on tax incentives and permanent establishment (PE) in parallel with the view to producing two separate guidelines. For the tax incentives issue, the work will focus on its interaction with pillar 2 of the OECD Inclusive Framework, and to a less extent with pillar 1. The work on PEs will focus on extractive activities issues related to permanent establishment and the need for appropriate update in the UN Model.

The Subcommittee seeks *the Committee's views on the issues raised in this note and its approval* of the proposed course of action.

Background and Subcommittee Mandate

1. At its 23rd session the Committee was briefed on the work on extractive industries taxation carried out by the previous membership. Reference is made to the note E/C.18/2021/CRP.25. The work has resulted in the update of the United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries.
2. The Committee agreed to establish a Subcommittee on Extractive Industries Taxation, with Nana Akua Mensah as Coordinator, and with the following mandate:

Bearing in mind the mandates of other Subcommittees and working closely with them as necessary, as well as taking stock of the work done by the previous Subcommittee on the United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, the Subcommittee shall:

- Work on tax policy guidelines to curb trade mispricing and undervaluation of resources in extractive industries
- Work on tax issues related to tax incentives and permanent establishment, with the view to minimizing tax losses and contraction of the tax base
- In collaboration with the Subcommittee on Environmental Taxation, review and reflect on adequate tax policies that can assist countries in transitioning from fossil fuel energy to renewable and environmentally friendly sources
- Work on any other tax matters that may arise in the extractive industries as directed by the Committee

Subsequently, and to assure continuity in the work undertaken in the previous Committee, Mr. Ignatius Mvula, a former Member of the Committee and Co-coordinator of the previous work on extractive industries taxation, has taken on the role as Co-Coordinator, on an ad hoc basis.

Composition of the Subcommittee

3. Taking stock of the Committee's recommendation to have a multi-stakeholders' group including government officials, private sector, other international organizations, academia and other members of the civil society, the Co-Coordination invited active participants of the previous subcommittee for two meetings in January and March 2022. An invitation was extended to a few renowned experts on the field so as to have a more balanced group. The Co-Coordination will present the list of proposed participants in the subcommittee and seek the Committee's approval.
4. As it stands now the list comprises 35 participants. This is over the recommended maximum size of 30 participants, but given the broad range of topics to work on and the required expertise in 3 to 4 different clusters, the Co-Coordination are confident the group will produce results.

Workstreams

5. To fulfill its mandate, the subcommittee proposes to organize its work in 3 main workstreams. The key issues to be discussed in each workstream are raised below and form the outline for each expected product.

Workstream A: Energy transition from fossil fuel to renewable sources of energy

6. The points discussed, which would be the framework for the outline on the subject, include:
 - *Short term revenue loss for countries*: on this issue, it was observed that it is not only short term but could be a substantial ongoing loss for countries endowed in oil and gas. Developing countries depending on oil and gas for government revenue will be hit hard. In that respect the pace of transition will be country-specific, taking into account a host of different situations and sometimes calling for external funding. The subcommittee

will review the consequences and spillover effects from energy policies implemented by one country, say an energy-consumer country, to an energy-producing country, and possible adequate measures to mitigate the negative impact especially on revenue.

- *Need to differentiate sources of energy as their polluting effects are different*: For example, the combustion of coal emits more CO₂ than natural gas.
- *Targeted short-term tax incentives*: to encourage the switch from fossil fuel to clean sources of energy. Transitional tax incentives regarding energy transition, early decommissioning, renewables, mining, and new technologies such as carbon capture and storage technology, a new and innovative way to store carbon would help reduce the cost of these new technologies.
- *The issue of energy access*: for economic development and the need to curb carbon emission will be discussed with the view to producing guidelines for countries confronted with that difficult equation especially countries producing oil and gas. Energy provision and energy availability is a constant concern for the majority of developing countries. It is important to keep that in mind when proposing transitional solutions.
- *The fiscal mitigating measures*: which can accompany countries' policies for energy transition will be discussed but limited to the scope of the mandate, i.e. tax policy measures in the extractive industries and geared towards energy transition.
- *The international spillover effects and impacts of/on cross-border emission permit trading*.
- *The aspect of Emission Trading Certificates (CERs)*: which are CO₂ Certificates is being examined by the subcommittee on Transfer Pricing for dealings between related parties. It was proposed to have a coordination meeting among TP, Extractive Industries taxation, and Environmental taxation subcommittees to determine areas to delineate the work of each subcommittee and establish ways of collaborating. The meeting would be scheduled after the 24th session. The Secretariat will work on the meeting planning with Co-Coordinators.
- *The pace of the transition*: should the transition be gradual, commencing by eliminating the sources most pollutant while others such as natural gas can serve as an intermediary solution?
- *Tax stability clause and other ad hoc clauses*: the implementation of energy transition policies will have an impact on extractive industries, on the production/extraction structure and on cost of production. This may affect the tax stability clauses which are found in many extractive contracts as well as production sharing contracts. The subcommittee will need to look at this aspect of contracts.

Workstream B: Trade mispricing and undervaluation of natural resources

7. The purpose of the guideline will be to assist countries in designing policies and setting up measures to curb trade mispricing.
8. The paper would review different definitions used by various entities and come up with a practical one that will be easy to use to curb tax evasion and tax avoidance due to trade mispricing.
9. The possibility of using administrative pricing would be discussed taking stock of country examples that may help developing countries make an informed and cost-effective decision. In this respect, data sources that can be used to set up an administrative price as well as for detecting possible abuse will be discussed. The Norwegian pricing method for crude oil is a practical country example that can be developed in this publication. Peru's practice of requiring companies involved in extraction and export of minerals such as gold and copper, to report sales prices to both related and non-related entities buying the mineral would also be developed. The issue of governance in tax administration was also mentioned.
10. Techniques usually used in this area such as market quotation reference prices, administrative determined prices for tax purposes, advance pricing agreements, as well as case studies and country examples would also be part of the output.
11. The need for capacity building in the area of trade mispricing, especially the evaluation of mineral content will be reviewed. The subcommittee plans to identify and invite experts such as engineers to discuss the issue in the near future in one of its meetings.
12. To fully apprehend the problem and identify the real need for developing countries, the subcommittee will seek to consult with tax administration officials in those countries as well as with other entities working on tax collection issues such as Tax Inspectors Without Borders. The private sector will also be invited to provide input.
13. Furthermore, the subcommittee intends to take advantage of DESA-organized workshops and other capacity-building activities to collect relevant information from participants' feedbacks on the needs from their respective countries. In Subcommittee will seek to draw from experience from regional entities such as ATAF or CIAT.

Workstream C: Tax incentives and Permanent Establishment

14. The subcommittee proposes to work on tax incentives and permanent establishment in parallel and in two different clusters.
 - a) Tax incentives:
15. The issue to command the most attention from the subgroup will be the interaction between Pillar 2, with its global minimum tax rule, and countries' tax incentives that might be negated by the Pillar 2 implementation. The subcommittee would study different rules contained in Pillar 2 with the view to pointing out challenges that developing countries may face in implementing the Pillar 2. There are countries that are not part of the Inclusive Framework but that may be affected by the global minimum tax. Such cases would also be reviewed with the aim to produce adequate guidance.

16. In implementing the global minimum tax measures, the guidance will include situations relative to production sharing contracts, income inclusion rule, domestic minimum tax, ring fencing situations, etc. There is also a need to consider license holders and subcontractors when implementing the pillar 2 and its global minimum tax rule. Some countries are considering introducing a domestic minimum tax in the countries of source, the subcommittee would discuss the impact and effectiveness of such a measure.
 17. The Covid-19 pandemic has devastated the global economy. Various countries have implemented temporary economic and social measures, including tax incentives, aiming at rehabilitating the economy as quickly as possible. The subcommittee would review those incentive measures to come up with “lessons learned” and draft some guidance that may be used in extractive industries sector to mitigate the negative impacts from other eventual emergencies resulting from various types of devastating situations.
- b) Permanent Establishment:
18. The permanent establishment (PE) issue is linked with the Article 5 of the UN Model. The Subcommittee noted the need to update the Article. In particular, the application of permanent establishment concept in relation to offshore activities in extractive industries needs be clarified. It was agreed that the subgroup would identify key issues in the extractive industries warranting revision in Article 5 and convey them to the Subcommittee working on the Model update.
 19. While working on the PE issue, the Subcommittee would also pay attention to the application of pillar 1 to extractive industries in the context of reallocation of income and exclusion of incentives in extractive industries. It was pointed out that there is discussion to exclude extractive industries profits from pillar one. Once the final rules are made public, the subcommittee would review them accordingly. In some instances, extractive companies also perform non-extractive activities as part of the agreement with the State granting the licenses. further rules are expected about the way the extractive industry activities can be defined and how the pure extractive activities could be separated from other activities carried on by the same extractive companies.

Matters for Decision and Next Steps

20. The Subcommittee submits the proposed key issues by workstream for the Committee’s approval. It also invites the Committee Members for inputs for any relevant issue not mentioned in the paper. For the 25th session the Subcommittee would produce a detailed outline for each workstream with tentative timeline.