

Distr.: General
14 October 2013

Original: English

Committee of Experts on International Cooperation in Tax Matters

Ninth session

Geneva, 21-25 October 2013

**SECRETARIAT REPORT ON THE EXPERT GROUP MEETING ON EXTRACTIVE
INDUSTRIES TAXATION,**

UNITED NATIONS, NEW YORK, 28 MAY 2013

Summary

The Financing for Development Office (FfDO) of UN-DESA organized a one-day expert group meeting on 28 May 2013 with a view to inputting into the new agenda item on extractive industries taxation of the Committee of Experts on International Cooperation in Tax Matters.

Discussions focused on issues that developing countries face when designing and administering an extractive industries fiscal regime with a view to ensuring that the UN tax cooperation work can further support developing countries in this important area of development. During the meeting, discussants from national tax authorities, international organizations, the non-governmental and the private sector considered questions of international tax cooperation in the extractive industries sector, including institutional arrangements to promote such cooperation.

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After an opening speech and a keynote address, panellists presented and subsequently discussed three broad topics, with participation from the floor. The first panel was on the impact of natural resource riches on national and international tax policy and administration followed by a panel on transfer prices in the extractive industries. Lastly, a discussion on lessons learned in building capability in resource tax policy and administration took place.

I. Opening

Alexander Trepelkov, Director, Financing for Development Office, UN-DESA, welcomed the participants to the Expert Group Meeting and acknowledged the interest and participation shown by all stakeholders.

He then highlighted that discussions about extractive industries often focus on the macro-economic effects of resource extraction or the governance side of such issues but rarely on taxation effects. However, one very important aspect of natural resource extraction – both for the government and its citizens as well as for the private sector – is the taxation thereof. The extractive industries are important sectors in at least 60 developing countries and emerging economies. For many developing and middle-income countries, revenues from the extractive industries already present an important source of income or will do so in the near future. Mr. Trepelkov added that new discoveries of natural resources in many developing and middle-income countries in the last years lend new urgency to this topic.

On the other hand, he noted that the revenue potential also bears some risks. While taxation of the extractive industries may raise government income, excessive reliance on this revenue narrows a country's tax base. Relying on income from the extractive industries additionally makes it difficult to plan budgets confidently due to the volatility of commodity prices.

Mr. Trepelkov recognized that, for the private sector, investments in the extractive sector are not only capital-intensive but additionally risky and oriented towards the long term due to high initial costs. Those companies engaged in the extractive industries are thus looking for political stability, sound governance and, last but not least, stable fiscal regimes.

As the supply of oil, gas and minerals will not last indefinitely, Mr. Trepelkov concluded that it is important that countries are supported in their efforts to benefit from the exploitation of

their resources. Clearly, an efficient and well-functioning fiscal regime for the extractive industries can contribute to sustainable domestic resource mobilization thereby enhancing a country's fiscal space to pursue development.

II. Keynote Address

In her keynote speech **Germania Montas Yapur**, a partner of Consultores Para el Desarrollo (Consultants for Development), former Deputy Director and Interim Director, International Revenue Tax Service, Dominican Republic and also Global Foundation for Democracy and Development (GFDD/FUNGLODE) Collaborator, remarked that natural resources are limited in volume and therefore will not last forever. There is, therefore, a need to utilize the revenue from exploitation of such resources very responsibly and to plan for the future. Such revenue, she said, could be put to use for social spending and other investments and to unburden less productive sectors.

For this to happen, she continued, governments need to put in place necessary conditions for a win-win situation for both them and investors. Such conditions include: a legal system that is fair, transparent, and efficiently managed, a taxation regime that is easy to understand and to monitor as it expands to all potential taxpayers, labour regulation and employment agreements that do not lead to regular interruption of work but instead foster the availability of skilled workers, political stability, and security for all citizens.

In relation to individual concession contracts, Ms. Yapur suggested that, beyond the need for a tax on gross income, profits or extraordinary gains, it is essential to clearly define those elements that impact on the settlement of these, such as:

- i. The form of compensation for losses generated in the first exercise.
- ii. The method for determining depreciation of assets acquired by private investment but also those that the State has given.
- iii. The methods and practices recommended for the calculation or use of comparable cases for transactions between entities, etc.
- iv. The scope and powers for audits, in this case of the tax administration, the possibilities for running a risk analysis as a prelude to an audit.
- v. The definition of obligations to report information to the tax administration.
- vi. The treatment of future sales, for their impact on the calculation of a return on the investment and the need to analyze the relationship with the buyer.
- vii. The rules for sub-capitalization or capitalization to avoid excessive debt charges that penalize earnings.

Ms. Yapur continued that all of these provisions on procedures that impact the assessment of taxes under the contract become decisive when quantifying the tax payable. She added that two other very important aspects are those concerning norms for transfer prices and regulations regarding the use of the International Accounting Standards and sufficient financial reporting. She considered it especially important that the contracts drawn up provide the tax authorities broad powers of supervision to implement policies to address transfer pricing issues. Or better yet, that the contracts are subject to such provisions applicable to taxpayers generally under explicit Tax Code provisions.

Some helpful elements in guiding contractors could include the IMF Code of Good Practices on Fiscal Transparency and the Extractive Industries Transparency Initiative (EITI) Standard promoting transparency. Ms. Yapur described two EITI principles as particularly notable because they provide support to claims from citizens to their governments and tax administrations, contract negotiators and mining companies:

1. “We affirm that it is within the domain of sovereign governments to proceed with the administration of wealth from natural resources for the benefit of the citizens of their countries, so as to promote the interests of their national development.” She noted that this principle recognizes that there is a commitment to obtain and utilize the resources that come from the mining industry.

2. “We believe we need a broadly consistent and workable approach to the disclosure of payments and revenues, which is easy to introduce and to implement.” Ms. Yapur found that this type of approach is based on a referral of information – usually electronic – with the aim to effectively exercise fiscal powers used by tax administrations.

She considered that, although voluntary, these principles can make a difference in the treasury-taxpayer relationship in this type of activity.

Reflecting on the case of the Dominican Republic, Ms. Yapur concluded on the necessity for transparency in the mining sector, the need to base any concessions on tax regulations and procedures, and the need for clear and enforceable mechanisms. She noted issues such as contracts that lacked sufficient tax control procedures to allow effective tax management, and regimes varying between contracts, which generated additional tax complexity for stretched tax administrations.

Having a regulatory framework should be a priority, as it should ensure the fulfillment of the vision and objectives of the state and citizens, which, in her view, are achieved through a tax system that facilitates control, creates transparency and strengthens institutions.

III. Panel Discussion: The Impact of Natural Resource Riches on National and International Tax Policy and Administration

The discussion on “The Impact of Natural Resource Riches on National and International Tax Policy and Administration” was moderated by **Armando Lara Yaffar**, Chairperson of the Committee and Director-General for International Affairs, Ministry of Finance and Public Credit, Mexico.

Mr. Lara introduced the topic by noting the breadth and the depth of the topic. He remarked that the panel may not cover all aspects of the topic but expressed the hope that at least some of the concerns expressed by countries in the extractive industries could be discussed, particularly issues related to tax policy and tax administration for a more efficient revenue mobilization. He noted that in the UN Model Double Taxation Convention issues relating to resource exploitation are dealt with, although summarily, mainly in two Articles, Article 5 on permanent establishment and Article 6 income from immovable property such as mines. Mr. Lara also remarked that some countries have developed specific policies to deal with the

sector and that a meeting of experts like this could provide some insight on what has worked and what may need to be adjusted. He then passed the floor to the panel.

Eric Mensah, Chief Inspector of Taxes, Revenue Authority, Ghana, gave a brief history of the Ghanaian mining industry, its contribution to the national economy through tax revenue and employment, the legal issues related to its taxation and its shortcomings, as well as the expectations of the local communities in mining areas.

Since the beginning of the economic recovery programme in 1986, he said, the mining industry had been one of the major pillars of that programme. Major assets in the hands of the government were privatized and a new Petroleum Act was enacted in 1988. The Mining Act of 1986 was subsequently replaced by a new Mining Act in 2006.

The new policy and legislation contained among other measures, generous tax incentives, tax holidays, accelerated depreciation, lower corporate tax, and carry-forward losses. It was recognized that the new environment yielded some encouraging results. After attracting over \$7 billion in the mining sector since 2002, the job growth in the sector has averaged 4 per cent per year and government revenue increase as the industry currently represents 37 per cent of company tax collected in 2012. Royalties paid to government have increased tenfold between 2003 and 2011.

In spite of this positive impact, Mr. Mensah identified a number of shortcomings that the government would need to address if it were to take full advantage of its resource endowment. He noted that the world price increase in extractive resources is not reflected in government revenue and that there has been a lack of transparency and over-generous tax incentives in negotiating contract with extractive companies. The issue of environmental degradation, the negative impact of tax competition with other African countries to woo foreign direct investment (FDI) and lower than optimum social and economic investment in local communities were noted as well.

Kryticous Nshindano, Actionaid Zambia, remarked on the extreme poverty in which many local communities live despite billions of dollars in natural resource exports from their countries. As an example, he pointed out that Zambia's copper exports were valued at US\$ 10 billion while generating only 2.4 per cent of that amount in government revenue. At the same time, he continued, the poverty level was estimated at 64 per cent of the population.

Mr. Nshindano lamented the often unjustified tax incentives given to multinational enterprises (MNEs) and the promise of financial secrecy governments have resorted to in order to attract FDI. He also expressed the view that some international financial institutions had at one time pushed for excessive tax incentives for the mining industry, although he noted that many have changed their stance on the issue of tax incentives since those times.

Mr. Nshindano also pointed out some domestic constraints that hinder effective tax collection in the mining industry. In most developing countries, there are few resources devoted to tax auditing, with limited staff which can result in limited capacity to prevent or redress cases of profit-shifting. In many cases, he said, MNEs declare losses in order to avoid paying tax on what are in reality profits. Furthermore, cases of VAT evasion and export mis-pricing to evade royalties are common in Southern African countries.

In the face of such external influences and domestic constraints, Mr. Nshindano considered that civil society can play a critical role in raising awareness to promote domestic revenue mobilization. He also suggested a reform of tax policy and tax administration, with targeted research, public advocacy at both domestic and international levels, and international cooperation among tax authorities. Finally, he called on governments to be more receptive to civil society advocacy.

In his presentation **Charles Ziemba**, Assistant General Tax Counsel, Chevron Corporation, started with an overview on the importance of affordable energy in the development process and the projection of energy demand in the next 30 years. He pointed out that oil exploitation can benefit resource-rich countries in turn leading to more affordable energy, wealth creation, and better living condition for their populations. For this to happen, he continued, governments and MNEs active in natural resource exploitation have to forge a better partnership that benefits both sides.

Mr. Ziemba also remarked that beyond profit from extraction, the oil industry can positively influence local living conditions and the business environment through promotion of fair competition, transparency, and the rule of law as well as more cooperative approaches. Some social investments in partnership with foundations and international organizations in the areas of health, education, and other sectors also contribute to improving living standards in developing countries.

In comparing governments' expectations with those of investors, Mr. Ziemba insisted that "it is not all about tax rates". Investors also want their investment to be safe, a long-term involvement, avoidance of double taxation, and minimizing political and fiscal risks in general. While designing a tax regime, he recommended, that countries should obtain a fair share of the benefits from resources exploitation but that they should also ensure they do not distort investment decisions by over-taxing some sectors and over-subsidizing others. Any good tax regime should be "clear, enforceable, and non-discriminatory".

He concluded by addressing some key factors that investors tend to consider when deciding on an investment. These include stability, transparency and impartiality in the resolution of issues, efficient tax administrations, a competitive tax regime, and the existence of relevant tax treaties. On the role of fiscal incentives, Mr. Ziemba advised on being very selective and targeting a few key sectors while being transparent and non-discretionary. He also recognized that the costs and benefits of tax incentives are not easy to evaluate.

Sheila Killian, Kemmy Business School, University of Limerick, Ireland, spoke of the difficulties in taxing the extractive industries in developing countries and addressed the issue of how to achieve this. The difficulties result from the fact that there are few firms in the sector and most of them are foreign MNEs. The sector is also prone to corruption, inadequacies in infrastructure, lack of transparency and limited technical expertise of many local officials. In many cases the industry is taxed through royalties, windfall taxes on profits and withholding taxes. The role of tax policies is to help raise revenue, affect behaviour, distribute risk, and address issues such as energy security, Ms. Killian said. She also remarked that given the importance of the sector in many developing countries, taxation policy will significantly affect tax compliance and may create dependency if policy makers do not factor in issues of accountability and mid-term or long-term horizons in relation to limited natural resources.

Resource-endowed countries tend to compete for foreign direct investment for their positive spill-over effects and the know-how they are supposed to generate. Ms. Killian cautioned that while seeking such advantages, countries should strive for fairer tax treaties, transparency in dealings and contracts providing a stronger position and better returns from exploitation.

Matthias Witt, Programme Head Good Financial Governance Africa, German International Cooperation (GIZ), South Africa, presented his agency's contribution to extractive resource governance and the long-term support provided to governments and the extractive industries in developing countries in Africa and Latin America in particular.

Mr. Witt argued that each country presents a specific case when it comes to setting up tax policy for the extractive industries. These are sectors in which the interests of different parties such as the governments, companies, and local communities, tend to be divided and to diverge over the long term. It is therefore important that any solution includes all actors and is country-specific.

Tax policies and investment promotion policies present challenges to many governments in developing countries as they often involve several government agencies that do not necessarily act in concert. In addition, governments' capacities to regulate and enforce the law are, in most cases, limited and as the extractive industry requires very large investments with potentially very large returns over a long period of time, the temptation for corruption is also high.

Some of the tools for government to take advantage of the natural resources of their countries include royalties, corporate income taxes, production sharing agreements, tariffs and licensing fees. Mr. Witt recommended a number of solutions including: (i) international cooperation in developing standards and reforming tax incentives; (ii) domestic coordination at country level for regulatory reforms and supervisory functions; (iii) the need for the private sector to develop environmentally friendly techniques in concert with local communities to mitigate adverse consequences; and (iv) civil society involvement in enhancing negotiation and representation capacity.

In the end, Mr. Witt outlined the German government's experience in supporting 19 national EITI initiatives at the national and regional levels. In some specific cases such as in relation to Ghana's petroleum resource management, GIZ has helped in the drafting of key legislation and guidelines for oil and gas revenue management.

In the discussion that followed, Ms. Montes made the point that countries should be given incentives to create their own regulatory framework to allow them to negotiate better but taking into account each country's specific legal system. This framework should also incorporate general guidelines in order to deal with taxation in the mining industry. In this context, good and bad national practices and practical examples from different countries would be helpful. She considered that the framework could also include principles that will guarantee transparency in the industrial operations and in the use of governmental income. This, in turn, would enhance the legitimacy and the acceptance of contracts, among citizens, and would generate greater stability.

In his presentation **Francisco Bataller-Martin**, Coordinator for Public Finance and Development Matters, Section Economic Analysis, Public Finance, Budget Support, DEVCO, European Commission, emphasized economic governance as a cornerstone in the management and taxation of the natural resource industry. He said that citizens in developing countries are becoming more aware of their rights and are initiating more actions in defending their natural resources. As development ownership becomes a key issue on the development agenda, fiscal transparency is taking a central role in this area, he noted.

Mr. Bataller-Martin noted that many organizations and initiatives including the IMF and the Public Expenditure and Accountability (PEFA) Programme, are developing new ways of integrating a natural resource dimension in their respective sets of indicators. Other initiatives also are taking shape across the globe, particularly the recent indications from the UK, US and France of their willingness to be members of the EITI. He also noted the US and the EU decisions requiring companies to report any payment made to governments in countries in which they operate in the natural resource/extractive industries. This is an effort to render payments in the industry more transparent and therefore increase accountability.

On this last issue, however, some concerns were expressed in case companies from other regions are not required to report payments, in which case such legislation may negatively affect the companies bound to meet the reporting requirements. This is particularly true for countries where such reporting on payments they receive may be illegal.

Ulvi Yusifov, Head of International Treaties, Ministry of Taxes, Azerbaijan, made a presentation on the tax regime of his country where revenues from the oil and gas industry generate 45 per cent of the government revenue and is governed by separate tax legislation. In such a case, most tax treaties do not have a significant influence on the taxation of the oil and gas sector.

In the open discussions that followed, some of the topics that were most discussed included: (i) the dilemma faced by developing countries choosing between achieving a sufficiently high amount of taxation on the one hand and attracting investment on the other; (ii) transparency issues including reporting on payments and how to monitor contracts and (iii) the limited capacity of countries in natural resource taxation policy vis-à-vis multinationals companies with broad and long experience in the sector.

Other interventions centred on how to improve tax compliance in the natural resource sector with more harmonized tax policy including fewer distortions among different national economic sectors. During the discussions, participants exchanged views on the role the UN Tax Committee should play and what articles of the UN Model should be updated to take into account some of the concerns raised, as well as the extent to which consideration should extend beyond any UN Model issues.

In conclusion, Mr. Lara remarked that the presentations have raised many issues including the imbalance in expertise between tax officials and companies as most multinationals have been involved in the extractive industries for a very long time and have developed expertise and understanding unmatched by their counterparts in the government. Other key issues raised included transparency in government operations and government dealings with extractive companies. Some propositions now being discussed include legislations that require companies to disclose payments made to government and government officials.

He noted that such measures, however, also raise the issue of ensuring a level playing field where companies in all part of the world, according to many participants, should be subjected to similar legislation. Otherwise such reporting requirements could potentially put companies at a disadvantage in securing contracts in some countries, where such reporting may be prohibited.

Mr. Lara then expressed the view that given the importance of the issue the Committee should look into how to deal with it and advise governments accordingly. The taxation of the extractive industry has two sides to it; at the international and the national level. The international aspect could be dealt with the Committee during its regular meetings and the national aspect can also be discussed so as to provide advice to countries for national policies.

IV. Panel Discussion: The Nexus between Transfer Prices and the Taxation of the Extractive Industry – the Relevance of Transfer Pricing Approaches, but also their Limits

The discussion on “The nexus between transfer prices and the taxation of the extractive industry – the relevance of transfer pricing approaches, but also their limits” was moderated by **Stig Sollund**, Director-General, Ministry of Finance, Norway, who introduced the topic. He stressed that extractive industries differ from one another and are characterized by different regulatory frameworks and tax regimes, which in turn pose specific challenges for transfer pricing.

Monique van Herksen, Partner, Ernst and Young, Netherlands, gave an introduction into transfer pricing issues generally and as they relate to the extractive industries. She defined transfer pricing as the application of the arm’s length principle, i.e. transactions between associated enterprises take place at the same conditions as between those of unrelated parties. The legal basis of this principle is Article 9 of the UN Model Convention and the OECD Model Convention as well as domestic law.

Ms. van Herksen stressed that avoiding under-reporting or over-reporting of taxable income is the rationale behind the arm’s length principle and noted the importance of comparability analysis to compare transactions between unrelated parties, to find a comparable and then to properly apply an appropriate transfer pricing method as part of the procedure to arrive at an arm’s length transfer price.

Ms. van Herksen noted that comparability analysis involves the broad based analysis of the taxpayer’s facts and circumstances, a review of the so called “controlled” transactions between related parties and subsequently choosing comparables and applying the most appropriate transfer pricing method. In choosing comparables, Ms. van Herksen emphasized that the property or service has to be comparable or should there be differences, they should not affect the open market price and/or they should be such that reasonable adjustments can be made.

This consideration of comparability includes examining the contractual terms of the transaction, economic circumstances and should take into account the business strategy used by the parties involved. Moreover, the functional analysis should determine which of the

parties performed which function ranging from financing and procurement to management and, when doing so, should discern which party bore the risks involved and which party made use of its assets. According to Ms. van Herksen, the key questions are: What is critical for the success or failure of the business? What are the value drivers for the business? Where in the process is the value added? Accordingly, remuneration should be aligned closely to the functions performed and the risks borne.

Applying these concepts to the extractive industries, key challenges include that natural resources are inherently local and cannot be moved to less expensive places to extract, extraction is very capital intensive and financing is thus a major issue, extracted resources need to be processed to be valuable, often involving many different functions and the use of many assets. Marketing activities, which tend to be centralized, also require an arm's length return. Finding comparables is a major challenge especially regarding non-publicly traded extractives such as iron ore.

Lastly, Ms. van Herksen mentioned that guidance is needed in applying the Comparable Uncontrolled Price (CUP) Method, because of difficulties in finding suitable comparables for "off-take pricing". This is where a producer of a resource and a buyer of that resource agree to sale terms prior to the construction of a mine in order to secure a market for the future output of the facility – thereby making financing its building easier. Pricing issues relating to trading on the London Metal Exchange (LME) also cause difficulties in applying the CUP Method.

Stig Sollund explained the Norwegian fiscal regime applying to the oil and gas industry with a resource rent tax of 50 per cent and an additional income tax rate of 28 per cent. The relatively high tax rates put pressure on the transfer pricing regime as there are strong incentives to reduce gross income and to exaggerate costs elements arising from intra-group trade of goods and services. Mr. Sollund concluded that administering transfer pricing is difficult but manageable with a strong tax administration and that dealing with transfer pricing is crucial in the oil and gas sector.

Marcos Valadão, Tax Auditor, Federal Revenue Secretariat, Brazil, noted that the Brazilian Constitution specifies that, according to the law, proceeds from the extraction of natural resources such as petroleum, gas and other minerals as well as hydric resources for generation of electric power, accrues to the States, Federal District and the municipalities as well as the administrative agencies of the Union, albeit the Constitution also states that these resources are property of the Union. Mr. Valadão indicated that the revenue from royalties is shared between the Federal Government, States and Municipalities according to where the resources are located and/or which entity is affected by the exploitation. In the oil and gas sector, royalty rates range between five and ten per cent depending on where the extraction takes place. There is also a "special participation rate" for large fields that may reach 40 per cent of revenue depending on the volume, location, depth and age of the field concerned. For 2011, total royalties and special participation revenue amounted to US\$ 13 billion (around 0.62 per cent of GDP). In the mining sector, royalty rates are between 0.2 to 3 per cent depending on the type of mineral involved. Water exploitation for energy generation is taxed with a royalty rate of up to 6.75 per cent.

Mr. Valadão then explained the two different consumption taxes: Imposto sobre Circulação de Mercadorias e Serviços (ICMS), which is levied by the Brazilian States and the Contribution to the Social Integration Programme (Programa de Integração Social [PIS]) and Social

Contribution on Billing (Contribuição para o Financiamento da Seguridade Social [COFINS]). PIS and COFINS are administrated by the federal government. Those taxes are levied only in internal transactions. Exports are exempted from consumption taxes.

Companies operating in Brazil are also subject to corporate income tax, which is a federal tax. Income tax imposed on companies in the extractive industries that have internal transactions raises the issue of potential transfer mis-pricing, mostly when the transactions are performed with affiliates and related companies abroad. Mr. Valadão emphasized that transfer pricing practices that result in mis-pricing are a tremendous source of base erosion and profit shifting. As a consequence, resource-rich countries have to consider how to address such mis-pricing very carefully.

The Brazilian methodology for transfer pricing regarding natural resources, that are tradable commodities, states that for exploitation of natural resources the price deemed to be the arm's length price is the price of the commodity in recognized mercantile and futures exchanges. The rules used are the Price under Quotation Method for Imports (PCI) and the Price under Quotation Method for Exports (PECEX) where the price is defined as the average daily price of goods or rights subject to public prices in commodities futures and internationally recognized exchange markets. In both cases, the law allows for adjustments of the price regarding the market premium at the date of the transaction. When there is no transaction in the organized market for a specific date, the price to be taken into consideration is the last price information available in the market. Mr. Valadão emphasized that this simplified Comparable Uncontrolled Price Method is very useful and saves time spent on searching for comparable transactions when there is a defined and stable organized market that globally sets the price for certain type of goods.

Janine Juggins, Global Head of Tax, Rio Tinto, stated that her presentation sought to give a practical rather than a theoretical perspective and explained that Rio Tinto voluntarily provides information about what taxes it pays and where and to what level of government they are transferred. Ms. Juggins explained where transfer pricing is relevant to a mining operation. Transfer pricing concerns arise where there are transactions between related parties or affiliates. The value of services, capital equipment or the sale of production that is transacted with a foreign entity that is not a related party are assumed to be correctly priced because there is no incentive for the parties to agree on a price that is not the market price. The objective of transfer pricing rules, in turn, is to ensure that the taxable profit is in line with the activities carried out and the risks assumed and that it is not artificially reduced or inflated.

According to Ms. Juggins, large international mining companies can achieve economies of scale and skill by centralizing certain activities. For example, centralized procurement can result in volume discounts and preferred customer treatment in times of supply chain disruptions. Thus, having a good procurement function is essential as it potentially means the difference between being able to successfully operate the business or not. If no fee is charged for these kinds of savings or the security of supply it means that the company is getting a "free ride" as it is taking advantage of a service but is not paying for it.

Applying the arm's length principle to calculate a procurement fee puts the mine in the same position as if it was not part of the international group. As Ms. Juggins pointed out, mines are often operated with joint venture partners who are not related. Using procurement as an

example, deploying the procurement service without paying a fee for it would give the joint venture partner a “free ride”. In a situation where a fee is being charged, the joint venture partner would want to make sure that the amount is being calculated correctly, which in turn could be helpful for tax authorities as a basis for their tax risk assessment.

Ms. Juggins also mentioned other types of cross-border related party transactions such as finance provided or guaranteed by a foreign affiliate, the cost of employees seconded from foreign affiliates or the price paid for production of minerals that are processed or marketed by a foreign affiliates and concluded that in each case it should be possible to reconcile between the price charged and the observable market price for the same product/service, in order to assess the risk that something has not been correctly priced.

When advising tax authorities on how to build capacities in the realm of transfer pricing, Ms. Juggins emphasized that understanding how the mining sector operates, including how mines are being financed, and the pricing of the end product in the market, are essential. In the case of financing of a mine, a starting point could be the government cost of borrowing to which adjustment would have to be made. In the case of an unrefined product, a net-back approach could be used, i.e. the price of the refined product would be discounted for processing and transportation costs.

Commenting on the transfer pricing practice in the mineral sector in Brazil, Ms. Juggins stated that if one wants to simplify the pricing of resources as Brazil is doing by using the price at which a resource is traded regardless of actual revenue, one is trading off simplicity with equity. If simplicity is chosen over equity, Ms. Juggins recommends using a different tax rate.

In the mining sector, smaller mines are often financed through off-take contracts, i.e. a key customer is providing finance up front in order to secure a supply of a percentage of a mines’ production. Sometimes this could be treated as security of supply and the production could be priced at the exchange traded price or by reference to it. Alternatively, it could be priced by reference to a fixed price. In this latter scenario, the financing is embedded in the sale contract. Knowing the difference between these two is important in judging if the transfer price charged is fairly priced.

Transfer pricing is generally thought of as cross-border issue but can also apply in a domestic context. If a company operates a mine and a processing facility in the same country, transportation may be a significant factor in delivering the mineral product to a recognized market. Some royalty and most resource rent taxes apply to the value of the mineral at the point of extraction – the mouth of the mine. To calculate the value at extraction, the notion is to split the business into two. One business that covers the extraction, and the second for everything that happens after. Transfer pricing principles are often used to determine the price of the mineral at the mouth of the mine in this type of situation. A further example can arise when a company operates several mines in one country and where there is no concept of a tax group so that each mine is taxed separately. A company might want to centralize some support functions and will need to charge each of its separate taxpayer operations for this purpose.

A further example is where one or more mines are operated as a single economic unit, perhaps sharing mining equipment and infrastructure. In this case, there is the need to allocate the cost

of the shared infrastructure and transfer pricing methods can be used. In other words: There is domestic transfer pricing as well as cross-border transfer pricing.

Ms. Juggins elaborated on practical steps to ensure that the right amount of tax is collected by a developing country with a large extractive sector. She underlined that a good knowledge of how the mineral sector works is important. That includes insights into pricing, financing, capital needs, key value drivers, risks and how to mitigate that risk. In the mineral sector, the volatility of commodity prices is a risk and tax administrations should know how companies manage that risk. Ms. Juggins argued for an integrated approach to tax policy and economic management for the mineral sector that builds upon that kind of knowledge, which in turn helps to sustain a tax base.

To add to this knowledge of the industry, Ms. Juggins proposed that tax administrations collect some basic information from businesses – to be provided as part of their annual tax filings on related party transactions. Such information should include a short description of how the business operates globally and in the concerned country. Additional information should then be included for different types of transactions, the related parties and the transfer pricing method used. In essence, this could function as a risk assessment tool for the tax authorities. Ms. Juggins also provided an example of the potential role of business in building this knowledge. Rio Tinto, in collaboration with the OECD, provided training for the tax authority in Colombia on how the mining sector works.

On the issue of transfer pricing documentation, Ms. Juggins indicated that it would be much more efficient if there was global standard for some basic documentation to be filed with tax returns – with more detailed documents only being prepared upon request from the tax authority concerned after a risk assessment has been made.

Ms. Juggins described “cooperative compliance” as a carrot and stick scenario. Carrots, in this context, would be the clear and consistent administration of transfer pricing legislation and the involvement of experts at an early stage of dispute resolution. Sticks, on the other hand, would include penalties, full access to exchange of information and appropriate support from those tax authorities on the other side of the transaction.

She welcomed the current opportunities to update transfer pricing methods to make them fit for purpose. Overall, however, she concluded that the current transfer pricing framework was working adequately for the extractive sector.

Stig Sollund noticed the similarities in some of the main themes of Ms. Juggins presentation to the approach taken in the UN Practical Manual on Transfer Pricing, which advises tax officials to know as much as possible about the industry that they are active in. Moreover, he noticed that the proposals that Ms. Juggins made with regard to documentation aligned with OECD efforts to address this issue.

Alan McLean, Executive Vice President Taxation and Corporate Structure, Royal Dutch Shell Plc, focussed on the practical aspects of transfer pricing in the oil and gas industry. He noticed that there is a problem of perception in the sense that the public sometimes has, to his mind, a distorted and very negative view of taxation issues in that industry. By focusing on the practical aspects, he hopes to inform the debate.

Mr. McLean reiterated that it is important to understand the business context of an industry. He added that it is important that all countries have some form of transfer pricing policies or guidelines and that these should be based on the arm's length principle.

The oil and gas industry is a simple business consisting of upstream activities, essentially focused on extracting resources and downstream activities, i.e. turning resources into an end product that consumers will want to purchase. However, the industry exhibits some distinct characteristics. Firstly, the amounts of investment that are needed are enormous and the time frame after which a company realizes profits is very long.

Shell, for example, invests 30 to 40 billion US\$ every year in order to produce energy and for the business to grow. In fact, Shell's profits are invested, almost in its entirety, in the business. He noted that the markets in which oil products are traded are highly liquid and transparent from a transfer pricing perspective. The amount of tax Shell pays is roughly equivalent to their profits. Profits are thus roughly shared between the business and government. This of course depends on the country in which Shell operates and on the activity performed.

Another characteristic is the reliance on technology, which involves bearing high risks in R&D that does not always turn out to be successful. The scale of investments required and risks inherent in the oil and gas industry imply that most upstream activities are not handled by one company, but by a joint venture of business partners, often including the government or a state-owned oil company. To facilitate the free-flow of technology, knowledge and expertise and to spread the risks of technology development and benefit from economies of scale, cost sharing agreements within oil and gas companies, including Shell, and with joint venture parties are the industry norm. The sharing of benefits and costs are an area of great focus in transfer pricing, as tax administrations have difficulty in understanding the complexity of cost sharing agreements.

Stig Sollund thanked Alan McLean for furthering the understanding of the oil and gas industry. He underlined that while the industry might be straight forward in terms of transfer pricing issues, the business involves highly sophisticated technology.

Michael Durst, Columnist for "Tax Notes" and former Director of the Advance Pricing Agreement (APA) Programme of the US Internal Revenue Service started his presentation by stating that despite the fact that the hard mineral and oil and gas industry might be described as relatively simple industries, it is actually difficult in both developed and developing countries to conduct a fair and comprehensive transfer pricing examination of them after the fact.

According to Mr. Durst, it takes too long and requires too much factual information and resources that the government typically does not have. This includes but is not limited to specialized and trained personnel needed to conduct these examinations. Moreover, in developing countries where often a few powerful companies are present, the adversarial posture needed to pursue tax disputes appropriately might not be possible and the judicial infrastructure might not be adequate to resolve tax issues. Mr. Durst thus finds that it would be better if countries could develop ways to eliminate ex-post facto conflict through pre-agreements between tax payer and government.

Using the hard minerals industry as an example, Mr. Durst discussed which kind of disputes may arise. He described one possible fiscal regime; namely, the combination of an ad valorem royalty on the value of mineral produced and sold, which is usually considered to be the governments compensation for the natural resource, plus an income tax on the extractor's net earning from the sales of the product. He found two potential sources of dispute: the pricing of the product and income tax deductions. The first sale is typically from an in-country subsidiary to a related party, which might be located in a low tax country. Hence, there is the need to determine the arm's length price using transfer pricing compliance/enforcement techniques. The valuation of the product at first sale is important for purposes of royalty and income tax.

While the product pricing is typically based on an index price, difficult adjustments have to be made for such a price based on physical attributes of the mineral, distance to market, etc. According to Mr. Durst, tax administrations spend comparatively little time on the examination of income tax deductions. Those include related party fees, including fees for technical services, costs related to materials purchased from related parties and interest deductions. Estimation of the proper arm's length deductions can be extremely difficult, depend heavily on judgement and very easily be subject to disagreement. He finds that the estimations can be done with a relatively high degree of precision but that it is extraordinarily difficult in a tax examination, especially in the context of under-resourced tax administrations.

Mr. Durst stressed that if there was a way to resolve these issues in advance this would be helpful to governments by not only achieving compliance but additionally demonstrating such compliance to its citizenry. Greater predictability on a company's tax burden has the additional benefit of making company earnings more plan-able and government budgets more stable. However, resolving these issues in advance is not easy, especially in industries where technology changes rapidly over time and if prices are volatile.

He proposed for consideration by the panel, that at the earliest possible stage of the development of a mining project, a concession agreement would be reached between the involved parties. After the facts are established, both parties could hire an engineer to come up with a pricing regime for the product.

One **participant from the private sector** replied that everybody likes the idea of a stable investment regime because most large investments are made by appraising the net present value of your investment, which involves selecting a discount rate. Discount rates are higher if more uncertainty is involved, which is also part of the reason why developed countries can sustain higher tax rates. In a developing country context those agreements are entered into to provide stability to deliver some benefits. The problem is that over time, things change, conceptions change and thus the validity of such an agreement is called into question

Mr. Durst added that a concession agreement could involve a self-adjusting price also accounting for the changes that may take place which make extraction harder and thus more expensive.

Another **participant from the private sector** added that while an APA or any other agreement is very attractive, consistency would be an issue. Ultimately, business is looking for guidance on how to make adjustments to commodity prices and how to calculate discounts

arising through off-take arrangements. Enough stability would be provided if agreement could be found on an approach or system to make these kinds of adjustments.

A further **participant from the private sector** noted that his company already concluded concession agreements in which they agree to be taxed with reference to the prevailing oil price. Ultimately, the company decides on a case-by-case basis if a fiscal regime proposed by a government is of interest to them. Some governments want to be fully exposed to the oil price volatility while other governments try to shield themselves from it.

According to **Mr. Durst** the second half of such a concession agreement would have to cover the deductibility of related expenses. His proposal would be to design a system under which related expenses up to a maximum amount per measuring unit chosen can be deducted with adjustments for producer price inflation. This might be perceived as a highly approximate measure but would provide certainty and a practically fair result. Mr. Durst deliberated whether it could be possible to design APAs with said concessions and maximum amounts.

One **participant from the private sector** noted that he was not overly enthusiastic about the way in which Mr. Durst proposes to minimize disputes on income tax deductions.

In the ensuing discussion, a **participant from a developing country tax administration** stated that his country has had transfer pricing legislation for some time. The participant added that developing countries need more support in how to administer such laws, especially in terms of training staff and added that on-the-job training such as joint audits are particularly helpful. According to the participant, the bigger challenges lay in finding appropriate comparables, making the right adjustments and addressing how to deal with transparency and providing information. Moreover, particular complexities with related companies arise when intermediate companies are used in the transaction and guidance was needed on how to deal with those situations.

An **additional participant from the private sector** added that the latter situations are those for which the private sector is also looking for more guidance.

In closing, **Stig Sollund** mentioned the Norwegian oil for development programme, which provides on-the-job training for officials from developing countries. He thanked all panellists and discussants for their participation.

V. Panel Discussion: Lessons Learned in Building Capability in Resource Tax Policy and Administration

The discussion on “Lessons Learned in Building Capability in Resource Tax Policy and Administration” was moderated by **Berlin Msiska**, Commissioner General, Revenue Administration, Zambia, who introduced the topic and the speakers.

Michael Keen, Deputy Director of Fiscal Policy, Fiscal Affairs Department, IMF, noted that receipts from natural resources including from the mining and oil and gas industry are a key revenue for many countries and that the number of such countries is increasing. He then mentioned the key elements of the IMF approach in assisting such countries, which include that the assistance given is demand-driven, i.e. a request for assistance has to be submitted by

the respective country. According to Mr. Keen, the IMF has a comparative advantage as compared to other development actors as they address the full range of fiscal management in relation to the extractive industries including macro-economic policies and transparency issues and hold broad dialogues with countries on their fiscal development. The perspective that the IMF takes is focused on the medium-term and quantification plays a crucial role in designing and guiding advice. Mr. Keen stated that the IMF is not directly involved in negotiations between governments and the extractive industries but tries to maintain strong links with all stakeholders during this crucial process. Another key element is that the work of the IMF is driven by research while, in turn, informing future work.

Mr. Keen gave a short overview about the Fund's activities in the extractive industries sector, including around 30 missions per year to countries dealing with extractive industries issues, regional events in Latin America, Africa and Asia, technical workshops and publications. He noted that while core funding ensures flexibility, technical assistance has doubled since the start of the Managing Natural Resource Wealth Topical Trust Fund and thanked donors for their contributions.

Mr. Keen then addressed issues that the IMF encounters. One key issue is to find the proper balance between royalties and rent taxes. Taxing rents, i.e. taxing the return in excess of the minimum required by the investor, is in principle the most efficient. Economic theory however does not say who should get the rent, in particular how rents should be split between the company and the government, which he portrayed as an equity issue. Royalties have disadvantages in terms of the potential of distortion of extraction decisions but can also play an important role in assuring revenue for the government from the very beginning of extraction and avoid over-extraction when the contract period is short. Moreover, rents may be hard to observe. Other issues include those relating to corporate income tax, value-added taxes, customs, state participation, auctions and environmental aspects of resource extraction.

Another subset of difficulties is linked to the notion of progressivity (increased tax being due to the government as, for example, relevant resource prices went up). According to Mr. Keen, the concept is not very clear as the progressivity (and increased tax take) could be linked to higher prices, higher profits or the lifetime project return. He considered, however, that in the context of many developing countries companies are actually better equipped to bear the risks associated with the extractive industries than the government and thus less progressive fiscal regimes might be in order. On the other hand, political pressure may make progressive systems more credible in the eyes of a country's citizens and thus more stable. In evaluating fiscal regimes and tracking rates of return under alternative fiscal regimes, Mr. Keen finds that details matter. Modelling frameworks should include not only royalty rates but should also focus on indirect taxes, ring fencing, thin capitalization and depreciation rules.

Concerning the administration of fiscal regimes for the extractive industries, Mr. Keen concluded that commodity prices are readily observable and that, overall, the extractive industry is not harder to tax than, for example, the banking sector. It is important to do simple things first and in this respect royalties may not be as easy to administer as they seem and rents might not be as hard to tax as sometimes appears.

All areas of tax face similar problems; namely the lack of political commitment as well as a lack of technical capacity. Additionally, in the taxation of the extractive industries the issue of timing is much more crucial, i.e. interventions are more beneficial if they take place before

negotiations. Another problem is associated to the increased interest in the issues which oftentimes leads to multiple donors being involved in turn raising issues of coordination. Moreover, the extractive industries are often governed by multiple government agencies which are not always cooperating with each other thus making technical assistance difficult. Lastly, unconventional energy sources might become problematic as does the prevalence of negotiated terms rather than having a single framework that applies to everyone.

Richard Stern, Global Program Manager, International Finance Corporation (IFC), World Bank Group, stated that his organization is involved in a lot of work in the mining sector but particularly focuses on the issue of transparency in the mining sector. He then explained that the World Bank Group consists of two sectors, a public sector side and a private sector side. The public sector side helps developing countries to develop their mining sector, advises on related macro-economic and transparency issues. The World Bank Group is also a partner organization of the Extractive Industries Transparency Initiative (EITI). The private sector side of the World Bank Group, on the other hand, holds equity positions in mines.

The Tax Group at the Bank focuses on transfer pricing and incentives as part of their tax transparency work. As part of the IFC's policy on Environmental and Social Sustainability, IFC requires from client companies the public disclosure of contracts or a summary of key terms. This includes disclosing the tax regime that is agreed upon between the company and the government. According to Mr. Stern, some of the most important work of the WBG is to push for transparency in the contracting phase of an investment.

Mr. Stern stressed that it is extremely important for governments to have a transfer pricing regime that applies to the mining sector. The WBG uses transfer pricing diagnostics to identify and quantify (in as far as possible) transfer pricing issues. This forms the basis for a needs assessment. If needed, the WBG assists in legislative reform including design of legislation as well as guidance notes with a view to limiting compliance costs, avoiding instances of double taxation and increasing certainty for tax payers. This might include re-negotiating of concession agreements to include reference to transfer pricing and the arm's length principle. Capacity building efforts focus on teaching sector-specific knowledge and transfer pricing techniques. Moreover, the WBG supports risk-based assessments, i.e. training auditors to identify transfer pricing risks and thus helping tax administrations to manage their scarce resources. Overall, Mr. Stern considered that everybody benefits if solid transfer pricing legislation is in place. Governments can protect their tax base and companies increase certainty as long as the rules are known, fair and stable.

An example was given of work undertaken by the WBG in the Solomon Islands, where assistance was provided in establishing a transfer pricing regime for the extractive sector. As audit capability was weak, the WBG focused on enhancing such audit skills, especially for the extractive sector. After only 1.5 years the tax administration has already handled a few cases and there are domestic service providers that are now bidding for mining-related service contracts.

Patience T. Rubagumya, Assistant Commissioner, Revenue Authority, Uganda, began her presentation by stating that Uganda has discovered oil and gas in recent years but that the country is still in the early stages of extraction and is currently focussing on upstream activities. There is potential for more discoveries in the future. Transfer pricing legislation was enacted in 2011 and the country has a new law governing the upstream sector.

She then identified several areas where assistance in the realm of tax policy is needed: Uganda operates production sharing agreements under which oil is shared between the contractor and the government. Uganda is also looking for support on how to effectively perform cost recovery audits. Ms. Rubagumya added that assistance on how to tax complex international transactions between related parties as well as mid-stream activities (i.e. transportation, storage and wholesale marketing) is needed. Another area that deserves attention is the financial analysis of investment in oil and gas projects to ensure proper taxation. There is also a need for assistance in enhancing legislative drafting skills relating to the taxation of the oil and gas industry. Moreover, designing a fiscal system for gas and a value-added tax system along the petroleum value chain is challenging.

Ms. Rubagumya then summarized Uganda's lessons learned in setting up transfer pricing capabilities. She concluded that specific transfer pricing laws are needed. Prior to 2011, Uganda made use of their general anti-avoidance tax provisions but found that there were many tax disputes with taxpayers about applicability and the choice of methods. As transfer pricing is a complex subject, it requires adequate planning and preparation. Issues such as human resources and accessibility to international databases to search for comparables are important. Intensive training of staff to be deployed in a transfer pricing unit is critical. Auditors should be trained in-house if possible. Moreover, engagement with the taxpayer is helpful to have a common understanding of transfer pricing regulations.

Building on Uganda's experience, Ms. Rubagumya divided support which is likely to be effective into short, medium and long term support. Short term support includes training such as in-house training and experts working with auditors. Over the medium term, benchmarking with more experienced tax administrations was identified as helpful. Long term support should focus on advanced training in critical areas and secondment of staff to other revenue authorities. Moreover, she mentioned the possibility of Memoranda of Understanding with more experienced tax administrations with regard to the exchange of information.

Ms. Rubagumya also discussed the role that non-governmental organizations can play and found that they can highlight problem areas, lobby for positive change and organize public debate between the government, public and taxpayers. Next to complying with the law, the role of taxpayers was described as seeking engagement with tax administrations to discuss problematic areas and propose ways of improving tax laws and their administration. Moreover, taxpayers should attend stakeholder meetings organized by the tax administration.

Mansor Hassan, Director, Inland Revenue Board of Malaysia, Malaysia focused in his presentation on the lessons learned in setting up a tax administrations' transfer pricing capability. Before doing so, he postulated that a critical look at the availability of human resources was needed as well as extensive training. Enacting policies without the necessary resources to make sure that they are applied is useless. Looking at the experience of other countries is also particularly helpful. He also found that mutual understanding between the tax administration and taxpayers prevents disputes, so such meetings were very important.

The Inland Revenue Board of Malaysia (IRBM) has had a special unit dedicated to transfer pricing since 1 August 2003, with responsibility for audit and investigation for cross-border related transactions. As it was found that the IRBM officers lacked the necessary skills, the intention of the unit was to build up such skills. In the beginning the unit had five officers

based in headquarters and reporting to the Director of the Compliance Department. Later, and with help from headquarters, auditors in other Malaysian states took up transfer pricing functions. Throughout the process, the auditors received training from various organizations such as the OECD, the Japan International Cooperation Agency (JICA) and the International Bureau of Fiscal Documentation (IBFD).

At the end of 2007, as the number of multinationals active in Malaysia had increased and despite the fact that the transfer pricing unit now had twelve officers, it was felt that transfer pricing audits needed to be centralized. Even though a special transfer pricing unit was in existence, other units had taken up such issues leading to different methods and approaches being used. In order to ensure a uniform practice, it was decided to set up a dedicated department.

This new department, which is now separated from the Compliance Department and is called the Multinational Tax Department, came into existence on 1 March 2009. It comprises four units; a policy unit dealing with methods and procedures, a multinational audit unit performing transfer pricing audits, a compliance unit monitoring compliance cases and a separate unit dedicated to Advance Pricing Agreements (APAs). Mr. Hassan stated that the intention of the relatively small Department was to build up skills and then later disseminate such knowledge throughout the IRBM.

The legal transfer pricing framework that Malaysia is using and that was enacted in 2003 is based on the OECD Transfer Pricing Guidelines including the arm's length principle. General anti-avoidance rules are included. In 2009, amendments were made and transfer pricing legislation now also covers domestic transactions. Moreover, thin capitalization rules were added as well as rules covering APAs. Such agreements provide certainty to the taxpayer and allow IRBM to better manage their resources. Currently, Malaysia makes use of unilateral, bilateral and multilateral APAs covering between three and five years. In terms of implementation of transfer pricing rules, Mr. Hassan specified that they only apply above a threshold value of income and total related party transactions and that a simplified procedure exists for smaller businesses. As of now, regulations are largely based on the OECD Guidelines, with some adaptation to the local environment. In the future, relevant issues from the UN Transfer Pricing Manual and the latest developments at the OECD-level will be incorporated.

Mr. Hassan addressed some external and internal issues and challenges. He noted that taxpayers exhibit a low compliance level – due, amongst other reasons, to the complexity of the subject matter and a limited numbers of tax agents who are well-versed in transfer pricing. As a result, transfer pricing documentation is often of poor quality. Greater audit coverage is needed to increase visibility and improve compliance. Moreover, the IRBM is holding seminars to explain their rules and guidelines and aims for appropriate application of penalties.

Another issue is that of finding appropriate comparables. He also addressed the issue of human resources and skills retention. It is hard to find appropriate officers and to train them sufficiently. The IRBM is currently building capacity through in-house training at the Malaysian Tax Academy as well as through international seminars and conferences and on-the-job training. In terms of international involvement, Mr. Hassan concluded that Malaysia is well established in the region and involved as observers in transfer pricing related work at the

OECD-level – both in working groups as observer and as part of an advisory group for non-OECD economies.

Marlies de Ruyter, Head of Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD Centre for Tax Policy and Administration, began her presentation by noting that the OECD had just recently started to work on building capacity in resource tax policy and administration. The first annual meeting of the Global Forum on Transfer Pricing took place in March 2011 and brought together between 90 and 100 countries and 200 delegates to discuss cutting-edge transfer pricing issues and subsequently feed into the policy development process at the OECD-level. Moreover, a Steering Committee on Transfer Pricing was installed consisting of ten OECD member countries and twelve non-OECD economies. This Committee named four priority areas; namely, risk assessment, documentation requirements, financial transactions including thin capitalization and transfer pricing in the extractive industries.

The OECD was already working on risk assessments and documentation requirements in other contexts and projects at that point. A secondment from Australia with expertise in the extractive industries then made it possible for the OECD to focus on transfer pricing in that context. The intention was to develop a training course with accompanying materials. Currently, this course focuses mainly on the mining sector and less on the oil and gas industry and thus needs to be further developed.

Ms. de Ruyter indicated that during the second annual meeting of the Global Forum on Transfer Pricing a session on the extractive industries materials took place and in April 2013 the training was held for the first time in Malaysia. The course tries to convey an understanding of energy and resource project profitability, drivers and measures of effectiveness. A part of the training focuses on understanding the multinational group and on financial aspects of extractive operations.

Ms. de Ruyter underlined the importance of understanding how a business functions by giving an example of a project undertaken jointly by Rio Tinto and the OECD in Colombia. An expert provided by Rio Tinto gave insights into the value drivers of the mining industry to tax officers, thus providing important cues to perform the functional analysis, which form the basis of transfer pricing. The OECD transfer pricing training also includes analysis of the local operations, teaches how to undertake a transfer pricing analysis and provides case studies. Overall, it was very well received by the participants. In fact, interest in the course was expressed by developed, emerging and developing economies thus showing that expertise in the field is limited. She found that transfer pricing issues in the extractive industries are not only relevant in relation to corporate tax issues but also for the taxation of rents and to evaluate joint venture structures. While there is a great deal of theory on transfer pricing in the extractive industries, practical experience is rarely being conveyed. The question of the accessibility of specialized knowledge and experience in this field to governments and other interested parties arises.

In closing, Ms. de Ruyter concluded that the OECD has only worked on these issues for a little over a year but hopes to gain more experience over time. She concluded that the OECD can help countries to gain control over transfer pricing issues.

Thomas Neale, Head of Unit, Company Taxation Initiatives, DG Taxation and Customs Union, European Commission, presented lessons learned in building capacity in resource tax policy. Over the last three years, the European Commission (EC) has worked on those issues – though not purely by focusing on the extractive industries. Mr. Neale structured his talk around the formal policies, the research, partners and experience gained in this process.

The formal policies that underpin the EC's work on capacity developing in taxation are those favouring transparency, exchange of information and fair tax competition. When looking for partners, the EC seeks to work with those sharing these principles. According to Mr. Neale, the EC sees itself as an ally for developing countries in the quest to raise domestic resources. In fact, the Commission aims to assist countries in raising their capacity to increase their tax revenues, to tackle tax avoidance and evasion and ultimately, to design efficient tax systems. While the EC is the largest donor globally, little direct assistance is provided on taxation issues. It is thus pivotal that such money is spent in the best way possible.

Mr. Neale stressed the need to substantiate the assistance that was and is being provided. The EC thus commissioned a consultancy firm to research what a specific sample of countries needed in terms of assistance in transfer pricing. The main recommendations were that countries need to broaden their treaty network, that finding good comparables is hard and might need cooperation between countries, that training and staffing posed a challenge and lastly that risk-based audits are especially helpful. On the last point, Mr. Neale concluded that there might be a trade-off involved if a tax administration is not reasonably advanced in conducting such audits. The study made use of an inclusive process involving official representatives as well as non-governmental organizations and civil society and resulted in a shared concept which now forms the basis of how the EC progresses in their work.

The partners that the EC works with in capacity building are developing countries, non-governmental organizations and donors. In fact, the EC is actively involved in the OECD's Taskforce on Tax and Development, which brings together developing and developed countries and industry representatives. The International Tax Dialogue brings the World Bank Group, the IMF, the OECD and the EC together. Moreover, the EC is a member of the core group of the International Tax Compact and holds regular tripartite consultations with the WBG and the OECD. Clearly, the focus is on cooperation in order to ensure that there is as little duplication of effort as possible and thus that resources are put to best use.

In terms of experiences, Mr. Neale explained that the EC does not provide technical assistance directly in this area. Instead, the Commission funds conferences and training programmes and cooperates with other agencies providing such assistance. The EC provided some funding for the editorial process of the UN Transfer Pricing Manual. Additionally, delegations of the European Commission to various countries may provide limited funding. In their country-specific efforts, the EC focuses on five countries; namely Ghana, Tanzania, Vietnam, Colombia and Rwanda. He stressed that follow-up to assistance was necessary to ensure the effectiveness of such assistance.

Matthew Genasci, Head of Legal/Economics, Revenue Watch Institute (RWI), described RWI as a not for profit policy organization that promotes good governance in oil, gas and mining revenues for the public good by funding training and technical assistance in over 30 countries. In the tax area, the focus of RWI is on tax policy though approaches consistent with the administrative capacity of a country are promoted. RWI was founded eight years ago in

response to the so-called “resources curse”. Mr. Genasci noted that RWI has since shied away from this phrase as it has recognized that resources are not themselves a curse. Instead, policy choices matter. Resources can be an engine for development as can be seen in many countries but there are very real and unique challenges that must be addressed. Taxation is one of these challenges as the primary benefit of extraction is likely to be the potential tax revenue they can generate. However, taxation is not only a revenue issue; it is also a development issue. Not only can revenues be used to fund development activities, in low capacity countries building up the tax administration is an important part of the state building process. On the other side of the coin, corruption or poor performance in negotiations of extraction contracts and related fiscal regimes as well as in the administration of tax policy can extend to other areas and have negative repercussions beyond the lost revenue.

According to Mr. Genasci, the objective of governments in setting fiscal policy should be to create a fiscal system that provides strong returns for their resources, provides a reasonable timeline for receipts, takes proper account of trade-offs between risk and reward and at the same time attracts sought-after investment. In doing so, countries have to take into account their legal traditions and constitutional constraints which influence particular patterns of ownership. Fiscal regimes that fulfil these requirements are likely to make use of a range of tools, for example a combination of royalties and taxes on economic rents. Understanding the interactions between different tools is essential to making informed decisions.

Mr. Genasci underlined that fiscal regimes should be based on transparency, robustness and uniformity. Greater tax transparency helps to ensure investors that tax treatment is non-discriminatory and thus reduces the demand for special treatment which in turn helps the administration thereof. Robustness refers to the ability of a fiscal regime to stand up to changing circumstances, reducing calls for renegotiating of contracts. Mechanisms to capture a share of the economic rents are perceived as fair and in turn provide predictability. Stabilization agreements have often actually exacerbated tensions in cases where they have been conceived too broadly. Lastly, uniformity of tax regimes should be something that countries and international organizations, such as the UN, should strive for. In too many countries, tax regimes in the extractive sector are treated as fully negotiable during contract negotiations. The proliferation of such “bespoke agreements” puts further stress on the often limited resources and capacities of tax administrations in developing countries. Facing all of these challenges requires multi-stakeholder solutions that involve the home and host governments of the extractive industries, international and national NGOs and the private sector.

Mr. Genasci identified the core activities of non-governmental organizations in this field as advocacy, research and the promotion of international cooperation. RWI’s advocacy work is focused on transparency issues such as those related to the EITI, home country disclosure rules and international accounting standards. Promoting international cooperation is done by building the capacity of local civil society organizations to engage in effective participation.

Through the provision of funding and technical assistance, RWI helps civil society to understand general principles of the extractive sector, tax regimes and their impact on the government. Those activities have expanded into assisting media and parliaments given the important oversight role they place in a country’s governance system. In the research area, the organization tries to distil lessons and international practice as well as providing tools on a range of topics related to the extractive industry including taxation. Uniquely for a non-profit,

RWI also provides technical assistance and training on mining and tax policy as well as negotiation support to governments. Mr. Genasci mentioned a project undertaken in cooperation with UNDP and the International Senior Lawyers Project in Sierra Leone related to contract issues. A unique feature was that in addition to international experts, local civil society organizations were incorporated in the project design. Going forward, he identified that data analysis will be a key role for NGOs. Moreover, there is the need to continue to push for greater transparency, for example by building on the recently strengthened EITI rules. Lastly, contract transparency continues to be of crucial importance.

In closing, Mr. Genasci noted that it is important to distinguish between different actors. Smaller exploration companies backed by high risk capital are looking for major pay-offs over a short time horizon and thus pose very different policy challenges as compared with larger and more established extractive industries companies.

Mr. Msiska commented on the discussions from the perspective of a developing country from Africa. He noted that assistance given to developing countries often focuses on capacity building in revenue authorities. However, the responsibility for tax policy design lies often with the Ministry of Finance, where, to his mind, the cost of the administration of tax policies was often not analyzed. In the area of transfer pricing, he mentioned the difficulties in retaining trained staff given the potential of significantly higher earnings in the private sector. Norway's support to the Zambian Revenue Authority in financial terms and through joint audits was positively highlighted. Concerning international cooperation, Mr. Msiska recommended that the African Tax Administration Forum (ATAF) should collaborate with international organizations in finding areas of common interest, thereby minimizing fragmentation.

During the discussion, risk based audits were discussed. A **representative from the private sector** underlined the importance of these kinds of audits in order to ensure that resources are not wasted. **Another participant** agreed on the importance for simplification measures that respect the arm's length principle, which in turn let tax administrations focus on situations and exceptions that are deemed as risky. **Marlies de Ruiter** invited participants to comment on the OECD's work on risk-based approaches and mentioned training materials on risk assessments that are being developed and which are available free of charge to those interested. **Michael Keen** noted that while risk-based auditing is important, and in fact has been part of technical assistance efforts by the IMF for a long time, the taxation of the extractive industries is for many countries just one source of income with other taxes having more potential for revenue.

Other topics that were discussed included APAs, which according to **Michael Durst** should play a role. He proposed a regime where difficult questions are referred to unbiased third party experts, which agree on behalf of the government and the private sector. Concerning a lack of compliance in transfer pricing, a **participant** stressed the importance of understanding why companies are non-compliant and then focussing resources on addressing such issues.

Mr. Msiska then asked the representatives of the private sector whether they think changing circumstances, such as rising commodity prices, should press multinational companies operating in developing countries to give something back. One such **representative** responded that companies are in need of long-term relationships that are stable and offer some sense of predictability. During negotiations governments and companies assess the situation

and make decisions based on their projections and by weighing long and short term benefits and personal preferences. The decision to nevertheless change the terms of a contract might, however, still be in order under very exceptional circumstances. A **government representative** agreed with this stance and added that there is the perception that in the past some of the governments negotiating contracts with the extractive industries have not done so in good faith and in the interest of their countries. He noted that contracts should thus have some flexibility with regard to changing circumstances. **Another private sector representative** responded to Mr. Msiska's question by noting that that some debt investors make investment decisions based on cash flow predictions. If the underlying fiscal regime changes this also changes the cash flows and thus might put those investors in a difficult position. Moreover, high prices in commodities often go hand in hand with exponential increases in operating and investment costs. A **further private sector representative** added that flexibility is good but it has to be known by the investors before the investment takes place. Long term investments need stability and thus the fiscal regime needs to be known to the investor. In response, an NGO representative mentioned an example from one African country in which companies resisted the introduction of a windfall tax in response to rising copper prices on the one hand but are currently laying off workers as prices for copper have fallen.

VI. Conclusion

At the end of the meeting, **Michael Lennard, Olivier Munyaneza and Ilka Ritter** of the Financing for Development Office summarized some of the key issues emerging from the meeting. It was also noted that discussion on taxation of the extractive industries within the UN Committee of Experts on International Cooperation in Tax Matters had only been brief so far, and the Committee had important decisions about the scope and focus of this work to make at its annual session in October. The report of this meeting would be an important contribution to this discussion.

Just as with other expert group meetings on issues such as transfer pricing and on the UN Model Tax Convention this meeting would no doubt help the Committee and any relevant Subcommittee in focussing on where the UN tax work could compliment what was usefully being done by other actors. A key focus would be on which areas the Committee's work could add special value by assisting its developing (and especially least developed) countries to harness resource riches for development.

It was noted that there was a legitimate call, with so many actors involved in providing policy and administrative guidance in this area, to avoid duplication. This was an important consideration for the UN tax work, in view of the very limited resources available for that work. There needed to be strong efforts made to work collaboratively with others in the field, as developing and developed countries, business and civil society would all expect, but there was also sometimes value in developing countries having access to different approaches, different analyses and what amounted to second opinions on these central issues, especially from an organization with the universality and legitimacy of the United Nations.

It was commented that the Secretariat had no set view at this stage on recommending what aspects of the taxation of resource extraction would best benefit from the involvement of the Committee. A multi-stakeholder event such as this, conducted in a candid, respectful atmosphere that recognized there were many equally legitimate perspectives on such complex

issues would best equip the Committee (drawing upon its own experience and understanding of developing country needs and priorities also) to give an initial direction to that work.

Participants were thanked for their willingness to give freely of their knowledge and experience and the Secretariat expressed the wish that as many as possible would continue to be engaged in such ongoing work as the Committee chose to work further on the taxation of the extractive industries.
