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**Committee of Experts on International
Cooperation in Tax Matters
Tenth Session**

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Item 3 (b) (iii) of the provisional agenda*

Taxation of the extractive industries

**Subcommittee on Extractive Industries Taxation Issues
for Developing Countries**

Report of the Coordinator

Mandate of the Subcommittee on Extractive Industries Taxation Issues

After initial discussions commenced in 2012, the new Membership of the United Nations Committee of Experts on International Tax Cooperation (“the Committee”) decided to form a Subcommittee on Extractive Industries Taxation Issues for Developing Countries (“the Subcommittee”) at their 2013 annual session.

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 The Subcommittee is mandated to consider, report on and propose draft guidance on extractive industries taxation issues for developing countries on the basis that it shall:

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- provide draft guidance on such issues as are approved by the Committee at its annual sessions.

The Subcommittee is comprised of representatives from tax administrations with wide and varied experience in dealing with the extractive industries, academia, regional and other

international organizations as well as representatives from the private sector, including from petroleum and mining companies.

Subcommittee Membership

3. The members of the Subcommittee and their affiliations at the time of writing (although membership is in a personal capacity) are:

Members of the Committee who are also Subcommittee Members

- Mr. Mohammed Baina
- Mr. Johan de la Rey
- Mr. El Hadji Ibrahima Diop
- Ms. Liselott Kana
- Mr. Enrico Martino
- Mr. Ignatius Kawaza Mvula
- Ms. Carmel Peters
- Ms. Pragya Saksena
- Mr. Stig Sollund
- Ms. Ingela Willfors
- Mr. Ulvi Yusifov

Other Members

- Mr. Charles Bajungu (Tanzania Revenue Authority – TRA)
- Ms. Nara Monkam (African Tax Administration Forum – ATAF)
- Mr. Miguel Pecho (Inter-American Center of Tax Administrations – CIAT)
- Mr. Michael Keen (International Monetary Fund – IMF)
- Mr. Richard Stern (World Bank Group – WBG)
- Mr. Jan de Goede (International Bureau of Fiscal Documentation – IBFD)
- Mr. Michael Kobetsky (University of Melbourne)
- Mr. Tomas Balco (KIMEP University, Kazakhstan)
- Ms. An Theeuwes (Shell International)
- Mr. Alvaro de Juan Ledesma (Repsol)
- Mr. Charles Ziemba (Chevron)/Mr. Tim Raymond (ExxonMobil)¹
- Ms. Nana Okoh (Gold Fields Ghana Ltd)
- Mr. Renaud Fossard (Financial Transparency Coalition)
- Mr. Michael Durst (Attorney)

Issues

4. While policy discussions often focus on the macro-economic effects of resource extraction, less attention is paid to the fiscal systems governing the sector. The extractive industries are or will become an important sector and thus a potentially important revenue

¹ One seat on the Subcommittee is currently shared by Mr. Charles Ziemba and Mr. Tim Raymond under the auspices of the United States Council for International Business (USCIB).

base in many developing countries and emerging economies. This means that the taxation rules that apply to the extractive industries will be crucial in developing countries' efforts to mobilize domestic resources for development. Governments seek to balance creating or sustaining a supportive environment for large investment with the need for revenue streams that can be applied to their development efforts.

5. The extractives industries are special in many ways: The sector is shaped by high sunk costs in the form of substantial investments that cannot be recovered if a project is terminated, fluctuating prices beyond the control of the investor that in turn influence the profitability of exploration and extraction, volatile demand, heavily vertically integrated structures and long production periods. At the same time, companies active in the extractive industries have the potential of substantial earnings in excess of a minimum return on investment and substantial market power as they often drive the exploration process.

6. In other respects, the extractive industries are similar to other sectors that are dominated by multinational companies: The rapid advances in technology, transportation and communication in connection with highly mobile capital and taxation rules that have not kept up with all of these transformative changes have increased the possibilities for tax evasion and avoidance by means of treaty shopping, transfer mis-pricing and hybrid mismatch arrangements.

7. While these challenges are the same for all countries, under-resourced and overstretched tax administrations in developing countries are often not as well equipped to deal with them. The *information* and *knowledge* that is needed to design and administer appropriate tax rules governing the extractive industries is often lacking or is very thinly spread. Coordination between different parts of the government often proves challenging. Specialist *information* and *expertise* is often very asymmetrically held as between multinational companies and developing countries as well as between developed and developing countries.

Subcommittee Meetings and Special Meeting of ECOSOC

First Meeting: Johannesburg

8. Hosted by the South African Revenue Service, the Subcommittee met in May 2014 for initial discussions in Johannesburg. The main outcome of the first meeting was agreement to focus on areas where the UN can add special value. It was agreed that this could best be achieved by publishing an overview note on issues in this area as well as more detailed policy and administrative guidance notes that focus on specific taxation and governance aspects of the extractive industries.

Special Meeting of ECOSOC

9. During the Special Meeting of ECOSOC on International Cooperation in Tax Matters in June 2014 an interactive discussion focused on "Extractive Industries Taxation Issues for Developing Countries". The panel discussion provided representatives of governments and international organizations the opportunity to contribute their views to the debate and to discuss new developments in this area. Ms. Liselott Kana focused on the Chilean experience with mineral taxation drawing conclusions of wider relevance for developing countries. In

her deliberations she scrutinized the Chilean legal framework governing the extractive industries. Her insights were followed by a presentation by Mr. Stig Sollund, who talked about the Norwegian experience with oil and gas taxation and the long-term perspective and the inter-generational aspects of resource wealth that is inherent in extractive industries taxation. Ms. Victoria Perry from the IMF shed light on the IMF's work in supporting developing countries to set up efficient tax rules governing the extractive sector. The last presentation was given by myself, Mr. Eric Mensah, in my role as the Coordinator of the UN Subcommittee on Extractive Industries Taxation Issues for Developing Countries. The presentation focused on the value that the UN Tax Committee can add in this important area, working cooperatively with others and mobilizing the UN convening power and universality on a key tax and development issue for many countries.

Second Meeting: Arusha

10. The outcome of the first meeting of the Subcommittee as well as the lessons learned from the panel discussion at the Special Meeting of ECOSOC set the stage for the second meeting of the Subcommittee that was hosted by the Tanzania Revenue Authority in August 2014 in Arusha. During the meeting, presentations on capital gains taxation including offshore "indirect" sales of local assets, tax treaty issues, certain VAT issues and tax issues of environmental reclamation of extractive sites were given and first drafts of guidance notes and a framework of the overview note were discussed. The Subcommittee decided at that meeting to submit the attached draft papers for comments to Committee members and observers.

Ongoing Work Plan

11. The following notes are submitted for comments:

- Overview note: The note at Attachment A gives a framework for what will be an overview of many issues in the extractive industries and how they are related.
- Capital gains taxation: The draft guidance note at Attachment B describes how capital gains taxation can potentially affect extractive industries taxation including the issues of overseas indirect sales.
- Value added taxation: The draft framework of a guidance note at Attachment C focuses on VAT and how it influences the extractive industries including issues of local content requirements. The note will be elaborated over the course of 2015.
- Tax treatment of the decommissioning of extractive facilities: At the end of the life cycle of an extractive facility, such facility would have to be decommissioned in a way that avoids environmental damage and adverse effects on local populations. An outline of the issues and possible taxation issues that are involved in provisioning for this are described in this draft guidance note at Attachment D.

- Tax treaty issues as they relate to the extractive industries: Various tax treaty issues are relevant to the taxation of the extractive industries and the draft framework of a guidance note at Attachment E seeks to note them for further elaboration in the final note.

12. For next year, the Subcommittee proposes to work further on the various notes attached to this paper and present them for finalization at the Committee's 2015 Annual Session. That process will take into account comments from the Committee and other stakeholders and further deliberations by the Subcommittee. The Subcommittee also proposes to commence work on the following subjects:

- Effective review of invoicing and costs: This note would include issues that are often referred to as "trade mis-pricing".
- Permanent establishment issues for the extractive industries: A special focus on Article 5 and how this article can influence the taxation of the extractive industries would be the subject of this guidance notes that could potentially form part of the abovementioned note on tax treaty issues.
- Kinds of government "take": The different forms of government taxation and participation and their likely impact in various scenarios would be described in this guidance note.
- Negotiation and re-negotiation of contracts in terms of their fiscal aspects: The different fiscal issues that are involved should a contract between a government and a private investor be negotiated, and possibly re-negotiated, would be the topic of this note. This note may include a checklist of issues that may arise in such situations.

13. The work plan for future years will potentially include other issues that are mentioned in the overview note in accordance with the Subcommittee's mandate but will seek guidance from the Committee in doing so. The Subcommittee notes the important role of international and regional organizations in this area as evidenced by the presence of the IMF, WBG, ATAF and CIAT on the Subcommittee and recognizes the possibilities for valuable cooperation between the UN and such organizations.

14. The Subcommittee would like to thank the governments of South Africa and Tanzania for their generosity in hosting the first two meetings of the Subcommittee and encourages other governments to consider hosting the third and following meetings. A lack of funding continues to be an issue and the Subcommittee will proceed to seek support for the work that it is undertaking including to enable Subcommittee members from developing countries and the Secretariat to participate at upcoming meetings.

15. With this note, the Subcommittee seeks approval of its work plan as noted in the previous paragraphs and invites comments to, and input into, finalizing the draft papers attached to this note.
