

Distr.: General  
23 03 2023

Original: English

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**Committee of Experts on International  
Cooperation in Tax Matters  
Twenty-sixth Session**

27-30 March 2023

Item 5 (f) of the provisional agenda

**Taxation of Extractive Industries**

**Co-Coordinators' Report**

***Summary***

This paper is for discussion and comment. It reports on the progress of work by the Subcommittee on Taxation of Extractive Industries (EI SC) since the last Session. Following the Committee's recommendation the Subcommittee has organised technical meetings in conjunction with other concerned Subcommittees, namely the Subcommittee on Transfer Pricing (TP SC), and the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries (UNM SC).

The draft papers on Tax Incentives and on Permanent Establishment are well advanced. The former is held off waiting a formal decision by OECD&IF on the will Pillar 2 which addresses tax challenges arising from the digitalization of the economy and the extractive sector. It will soon be finalized and readied for Committee discussion at its next Session in October. For the later a preliminary draft has been shared with the UNM SC for comments and will be discussed by the two Subcommittees this May.

A detailed outline on trade mispricing and valuation of natural resources has been drafted and shared with the TP SC which has just provided its comments. A draft will follow with the view to presenting a first draft to the Committee in October.

As for the Energy Transition workstream, the Subcommittee is working on a detailed outline centered on the following key issues: i) transition challenges for developed and developing countries; ii) transition challenges for the current extractive industries; iii) tax regime for renewable energy; and cross border tax issues. The outline will first be discussed with the Environmental Taxation Subcommittee and then presented to the Committee in October.

## **1. Introduction**

Following the Committee's recommendation at the Twenty-fifth Session, the Subcommittee has organised technical meetings in conjunction with other concerned Subcommittees, namely the Subcommittee on Transfer Pricing (TP SC) and the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries (UNM SC). This time the Subcommittee did not have a formal meeting with the Subcommittee on Environmental Taxation; rather, the two took advantage of common participants in both Subcommittees to learn about the progress in each and to make sure there was no duplication. Although the work on PE and the draft on tax incentives are part of the same workstream, the two activities have progressed in parallel tracks.

Since the last Session, the Subcommittee had two meetings, one on 17 and 18 November 2022 and the second from 1 to 3 March 2023. In between the two meetings of the Subcommittee, several smaller technical meetings on each workstream were also organized in addition to consultations between the EI SC and the UNM SC or the TP SC.

## **2. The Permanent Establishment (PE) Workstream**

The Co-Coordiators of the UNM SC were invited to take part at the Permanent Establishment (PE) workstream segment of the EI SC meetings. Their participation was in line with the recommendation of the Twenty-fifth Session of the Committee for close collaboration between the EI SC and the UNM on the workstream related to permanent establishment in EI. Subsequently, the UNM SC also invited the EI SC to participate at its meeting.

At the Twenty-fifth Session the Committee discussed the PE issue in relation to the extractive industry activities. Some of the key points discussed included, among others, the profit allocation, force of attraction. The offshore activities were also recognized as an urgent issue for developing countries needing more guidance during tax treaty negotiations. It was suggested that EI SC work on PE issues and implications across several Articles of the UN Model as regard the extractive industries. The EI SC would also propose to the UNM SC for consideration, drafting language for Article(s) or commentaries.

During the EI SC meeting, the Co-Coordiators for the UNM SC informed participants of their intention to not only work on offshore issues related to PE but also on its onshore aspects. They also mentioned that the UNM SC intended to consider both onshore and offshore PE issues in the extractive industries, including minerals and renewable energy sectors. Thus, the need for an article that considers both aspects of offshore and onshore activities. Some offshore activities will be examined carefully, especially in relation to existing thresholds for a deemed PE. For instance, some remote activities may require a high turnover of personnel/subcontractors such that no one stays long enough to pay tax on income, especially in extreme weather conditions.

Instead of working on different PE provisions in various Articles, the meeting participants reflected on the possibility of a self-standing broad Article encompassing key points raised in different Articles when practical. The uniqueness of the EI regarding PE provision was

emphasized, particularly for exploration activities and involvement with subcontractors. From the UMU point of view, PE is an issue that goes beyond extractives sector. However, the EI SC's mandate is limited to extractive industries.

Some elements to be considered for the self-standing Article included attribution of rights, service PE, attribution of profits (Article 7), and Article 8 on international traffic. It is also of relevance to examine PE issues through Article 6, especially in relation to real estate and extractive activities. The tricky issue of two similar activities attending to two different sectors needs also to be discussed. For instance, how to treat a catering business subcontracted by an EI company and similar catering activities attending to companies operating in a different sector. The UNM SC will explore possible options for more taxing rights for developing countries in the face of the changing global economy and international trade.

A guiding principle will be to have a new PE Article that ensures that each PE situation leads to creation or expansion of new taxing rights, otherwise a PE without taxing rights attached to it would be just a complication of tax administration processes.

On a question on the issue of profit allocation for the self-standing Article and if/how it would deviate from Article 9, it was stated that the new Article would not deviate from Article 9 on transfer pricing and whenever the SC on the Model gets into issues in relation with allocation of profits and transfer pricing the SC seeks to coordinate with the SC on TP. The UNM SC seeks possible options for more taxing rights for developing countries in the face of change in the global economy and international trade.

Discussing the broader perspective of the new Article, there was an exchange of ideas on service provisions currently found in 5.3, 12.A, and 12B. Further, any issue related to taxation or non taxation in the EI has to be examined considering the government take on natural resources. The income tax should be treated along with a range of issues such as VAT, the use of administrative pricing, profit sharing, seismic surveys, capital gains,...

The value of a seismic survey as an activity that may involve or warrant some type of profit allocation computation, was discussed. It appeared that a seismic survey may be of monetary value even when considered separately from drilling activities.

The two SCs discussed how broad the new Article would be and the challenges of including all points raised in one Article. The new Article could be drafted to be in accordance with the Article 12A dealing with fees for technical services. However, it may be counterproductive to completely align it with 12B whose full impact and replications are still being assessed by several countries.

Finally, it was made clear that beyond extraction of non-renewable resources some activities on renewable sources of energy may call for PE discussion. However renewable sources of energy such as wind, solar, hydro, and thermo-power, may be outside the traditional extractive industries.

At present a detailed outline of the Subcommittee's paper on PE has been drafted and presented to the UNM SC for comments. A meeting is planned in early May between the two Subcommittees. Thereafter the EI SC will prepare a draft of the paper for the Committee for a first read at its Twenty-seventh Session in October.

### **3. Tax Incentives**

In working on this topic, the Subcommittee kept in mind Committee members' concern that tax incentives may lead to tax competition among countries and result in the race to the bottom. Tax incentives in the Extractive Industries has been examined in its various aspects, including political and economic and accounting for tax administration purposes. A whole chapter on the topic is published in the updated [United Nations Handbook on Selected Issues for Taxation of the Extractive Industries, 2021](#).

This paper focuses on key issues related to Pillar 2 of the OECD Inclusive Framework on BEPS' Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy and the Extractives Sector. This includes consideration of the impact on incentives in the sector, especially in developing countries.

As constructed and designed today, GloBE rules would impact resource-rich countries in an inconsistent manner. As a result, each country must assess the likely impact of GloBE on its tax revenue base on a case-by-case manner. Various aspects and interaction between tax incentives and Pillar 2 are examined using practical examples to help explain some key concepts with possible options for countries to consider.

It is important however, to point out that no formal decision regarding Pillar 2 has been adopted by the OECD and IF. The Subcommittee has discussed the issue in its different angles as it is currently proposed by the OECD. But it appeared wise to hold on to this topic until a formal decision is communicated.

### **4. Trade mispricing and product content**

Some of the recommendations from the Twenty-fifth Session centered on the collaboration and coordination with the SC on Transfer Pricing. The TP SC intended to launch a survey and its Co-Coordinator wondered if there could be collaboration and launch one questionnaire to collect data to be used by both SCs. At a meeting between the two Subcommittees, it was pointed out that the two are looking for different types of information and therefore each will use different sources to get the data needed. Further, it was established that whenever a TP issue arises during the trade mispricing work, the [TP Manual](#) will be referenced.

At its November 2022 meeting the EI SC discussed different forms of trade mispricing and how it occurs. On substantive issues it was remarked that trade mispricing can be between associated entities and non-associated companies. The EI SC will aim at bringing some clarity on how to do valuation of product especially on the content of minerals. Further, it will look at how countries use administrative approach and how to avoid dispute between taxpayers and tax administrations.

The Subcommittee has discussed the tax loss due to underreporting the price or underreporting the content (grading of minerals). The grading system is a very specialized area and at first look such expertise is lacking within the Subcommittee. However, in addressing the issue the Subcommittee requested assistance from organizations participating in the Subcommittee. Participants from IGF, OECD, Rio Tinto (a private company which has participated in the Subcommittee's activities for a long time) and the Zambian Revenue Authority, provided experts for a one-day presentation to help the Subcommittee understand the process.

The valuation of extracted product is important to taxpayers and tax administrations alike, both for addressing routine but often difficult disagreements regarding transfer pricing, and also for addressing instances of the intentional misstatement of price for illicit purposes, as in cases of deliberate mis-invoicing or the falsification of minerals appraisal data.

The valuation of mineral product involves a number of different steps, all of which need to be addressed effectively if the valuation is to be accurate and persuasive. Although each mineral product may have its particularities, it is understood that there are key steps that are important to almost all minerals. The EI SC will look at those key steps with the view to developing a detailed understanding of the valuation practices based on a number of country cases, especially countries producing large quantities of the relevant minerals.

The draft outline is intended to (i) illustrate the importance of robust and comprehensive product valuation to the protection of revenues and (ii) illustrate the kinds of adjustments to posted product prices, for various product-quality and economic factors, that are needed to produce reliable valuations.

While the draft outline at its current stage is well advanced, the Subcommittee elected to share it with the TP Subcommittee for comment before submitting the document to the Committee. After considering comments from the TP Subcommittee, a new draft will be produced and put before the Committee at its Twenty-seventh Session.

## **5. Energy transition**

At the Twenty-fifth Session the Committee raised the following main points on energy transition: (i) the cost of energy transition and energy access and proper funding for developing countries; and (ii) the enabling environment and de-risking investment in renewable sources and how to make sure that taxation is not a barrier for the development of renewable sources of energy.

The Subcommittee is working on this topic keeping in mind the points mentioned above. Some of the issues currently being discussed include: i) transition challenges for developed and developing countries; ii) transition challenges for the current extractive industries; iii) tax regime for renewable energy; and iv) cross border tax issues. The Subcommittee continues to work on the draft outline for this workstream as it exchanges views with the Subcommittee on Environmental Taxation, which is dealing with the same issue from the consumption side. The Subcommittee intends to draw from existing country experiences by selecting a very limited

number of cases and documenting them, such that policy-makers from other countries may learn from those cases.

## 6. Conclusion

The Subcommittee is working on several workstreams as stated in the mandate. The collaboration with other Subcommittees to feed off each other's work and avoid duplication is a constant throughout all the workstreams. In fact the work done may not reported in details as we preferred to exchange drafts with other subcommittees, namely the TP and the UNM SCs. This will not only help improve the draft guidance produced but also make it easier for the Committee as a whole to review the drafts submitted for its consideration. Finally, to give the Committee an overall picture of the work ahead, a tentative program of work from the Twenty-sixth Session up to the last Session of the current membership is produced below.

### Program of work April 2023 - April 2025

Dates/workstream	Energy Transition	Trade Mispricing	PE and UN Model	Tax Incentives
March 2023				
October 2023		1 <sup>st</sup> read	1 <sup>st</sup> read	1 <sup>st</sup> read
April 2024	1 <sup>st</sup> read		2 <sup>nd</sup> read	2 <sup>nd</sup> read
October 2024	2 <sup>nd</sup> read	2 <sup>nd</sup> read		
April 2025				