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Taxation of Extractive Industries

Permanent Establishment and Other Income Issues for the Extractives Sector

Summary

This paper CRP.38 is presented to the Tax Committee at its Twenty-seventh Session **for discussion and review of the attached guidance as a first read.** The comments, suggestions, and guidance will serve to improve the paper, with the view to submitting a final draft at the Twenty-eighth Session for approval.

This paper CRP.38 is the outcome of work on Permanent Establishment (PE) and other income issues related to taxation of the extractive industries with the view to proposing key changes to the UN Model update, an endeavour entrusted to the Subcommittee on the UN Model Update. The goal for this workstream for the Subcommittee on Taxation of Extractive Industries is to protect the tax base within the extractive industries for developing countries while dealing with issues related to PE.

The paper describes how the current UN Model addresses extractive PE and other income issues. It presents different Articles that has some links to taxation of income as they related to PE determination. Such Articles include Article 3 on Contracting State, Article 5 on PE, Article 6 on Income from Immovable Property, Article 8 on Shipping Income, Articles 12A and 12B on Fees for Services Income, Article 13 on Capital Gain, Article 15 on Income from Employment. After a review of some deviations from some of the Articles in dealing with taxation of the extractive industries, the paper presents some key considerations for the design of a standalone Article encompassing most of those issues.

At this stage the draft can serve as a basis for continued discussion with the Subcommittee on the UN Model Update on main issues to consider when drafting a new Article on PE in the extractive industries. A meeting between the two Subcommittees is scheduled for early November and will consider, inter alia, comments and suggestion from the Twenty-seventh Session.

Permanent Establishment and Other Income Issues for the Extractives Sector: A Briefing Paper for the UN Committee on Updates to the UN Model Convention

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1. Background

1. The United Nations (UN) Committee of Experts on International Cooperation in Tax Matters ("the Committee") is in the process of updating the UN Model Double Tax Convention. As part of these updates, the Committee plans to explore how the Model Convention could more comprehensively address permanent establishment (PE) and other income issues in the extractives sector. The Committee has requested input on this matter from the UN Subcommittee on Extractive Industries Taxation Issues ("the Subcommittee").

2. Specifically, the Committee wishes to better understand PE and other income issues in the context of the extractives sector, to what extent the Model addresses these issues, any gaps or challenges in the Model, and recommendations for how to improve it. The recommendations should include examples of how resource-rich countries have adapted their domestic laws, and tax treaties, to protect their right to tax extractive industry income, through an Offshore Article, as one example.

3. This paper should be read together with Chapters 2 and 3 of the UN Handbook on Extractive Industry Taxation, the Intergovernmental Forum on Mining's (IGF) guidance on tax treaties for resource-rich countries, and the IMF book on International Taxation and the Extractive Industries.

2. Defining the "Extractive Industries"

4. For the purpose of this document, we define the "extractive industries" to mean the economic activity concerned with the exploration and exploitation of non-renewable resources such as oil, gas and minerals – located underground or the seabed. The extractive industries value chain is elaborated in Table 1. Any extractives-related update to the UN Model should preferably take account of all the stages involved from exploration through to closure and decommissioning.

Table 1 – Main features of the extractive industries value chain

Stage	Activities	Timeframe
Acquisition and Exploration	- Market research - Reconnaissance and prospecting activities to determine the existence of economically viable mineral, oil or gas deposits. - Geological surveys or seismic activities (sometimes arranged with local subcontractors) - Drilling to define the ore, oil or gas body. - Upon discovery, feasibility studies to determine commercial viability.	Offshore oil exploration activities can be quite short – ranging from days to a few months. For mining, time frames can range from 3 to 10 years (sometimes longer) depending on commodity prices and technical risk.
Construction and Development	- Continued studies to plan for minimizing environment and community impact. - Commence construction of mine or oil and gas wells and infrastructure, including processing facilities, utilities such as power and water supplies, and transportation facilities such as roads, rails, and ports. - Visits by overseas employees	For large-scale mines, there can be several years from when construction commences to reach production. Once production commences, production volumes will tend to increase gradually over time.
Exploitation and Transportation	- Physical extraction and processing of the ore, oil and gas - Managing of waste and tailings - Transportation of ore or upgraded products or oil and gas. - Export to global markets - Business support/ commercial hubs are generally established outside of the jurisdiction of extraction to support with logistics, marketing and other aspects to meet business objectives and optimize processes and costs.	Production periods are dependent on the mine life and can last 50 years or longer. Expansions occur during this time.
Closure/Decommissioning	- Removal, closing or conversion of infrastructure and rehabilitation of land. - Stabilization of open pit or underground workings (foundations, mine shafts, buried pipelines, etc.) - Rehabilitation of tailings, rock stockpiles, etc - Post-decommissioning monitoring to ensure that potential environmental issues are effectively managed. - Transfer of liability, e.g., reversion of ownership to the state or because of repurposing of land to its next use	Closure/decommissioning is a complex multi-disciplined process with an overall timescale normally last several years.

5. We limit our analysis for the UN Model Update to the extractive industries – mining, oil and gas, to be specific. We recognise other important renewable natural resources such as wind, water, fisheries, agriculture may merit special consideration, however, it is beyond the expertise of this Subcommittee to comment on what this might look like. The views with respect to renewable energy resources are also not yet sufficiently crystalized to be able to draw conclusions in terms of PE, although some features have more generally been addressed in the UN MC 2021, like Art. 13(6) on the sale of government licenses. We also take the view that non-renewable resources such as mining, oil and gas have unique features that justify special treatment by the UN Model, as is typically the case in tax policy design in domestic law in resource-rich countries.

6. Resource taxation has evolved largely distinct from business taxation more generally. What makes the extractive industries different is first and foremost that the resource is a public asset. The national constitutions of most countries vest natural resources, including oil, gas, and minerals located within their jurisdictions, in the state. This arrangement creates a relationship where the state, acting as a fiduciary, manages the resource wealth for the benefit of its citizens. Mineral resources are also finite and non-renewable. These features set the sector apart, and as is apparent in many countries, necessitates a different approach to fiscal policy at the domestic law-level, and potentially in international tax instruments such as double tax agreements – the subject of this paper.

7. Finally, there is the potential to generate substantial economic rents. When investors are awarded the exclusive right to extract resources, they are often able to sell those resources above their cost of extraction (including a normal, risk-adjusted return on the investment) (Baunsgaard & Devlin, 2021). Most governments expect to be able to tax close to 100% of the associated economic rents without distorting investment decisions (Daniel et al., 2010).[1] This goal may not be realized if there are DTAs that are poorly designed, or that fail to take account of the specificities of the sector. For these reasons, it is necessary to consider how the UN Model could be improved to better protect resource-rich countries right to tax mining, and oil and gas income.

3. PE and other Income Issues in the Extractives Industries

8. This section offers a high-level summary of the three main PE and other income concerns for resource-rich countries discussed in Chapter 2 of the UN Handbook.

3.1 Taxation of subcontractors

9. The main PE risk for the extractives sector is the right to tax subcontractors. Some subcontractors have a higher capacity to avoid having a PE than the exploration or mining/oil licence holder. They can more easily structure their activities to avoid exceeding the degree of permanency requirement and, where relevant, the specific time threshold.

[1] Resource rent is typically defined as excess profits over and above the investor's minimum rate of return.

10. The risk is higher during exploration that involves shorter periods. For example, vessels used to undertake seismic surveys move continuously within the area being explored.[2] Subcontractors may also carry out supervisory activities (e.g., planning and managing construction of a mine) that do not necessarily trigger a PE, at least according to the OECD Model, although the Commentaries do state that an "on-site supervising party" will have a PE.

11. An emerging issue is that some subcontractor services are increasingly managed remotely. For example, through remote operation and servicing of mine sites or oil blocks. Some mines/ wells are already being monitored by control rooms overseas. Technology companies will also play a bigger role in servicing mining and oil projects. In these scenarios, the licence holder will continue to have a PE regardless of whether workers are physically present at the mine or block site. This is because the mine/block itself is a fixed place of business, satisfying the general rule. However, subcontractors, including technology companies that remotely service the mine or block, are even less likely to have a PE in the source state. The question becomes how remote services are taxed (e.g., through withholding tax), and the pricing of such arrangements where services are provided by related parties.

12. It is important to note that not all subcontractors present a PE risk. Large subcontractors typically have a significant presence in a jurisdiction for an extended period of time (for example a subcontractor constructing a mine or gas facility, which takes many years to complete). There are also trade-offs between increasing the number of PEs in the sector, and the added compliance burden. Shorter time thresholds, for instance, might create additional work for the source state to monitor short-term activities with limited revenue-generation potential. It will be important to balance these factors when determining the approach to PE for the sector.

[2] *PGS Geophysical AS (Norwegian Supreme Court) 2004*

Table 2 – PE Issues for License Holders and Subcontractors

Stage	License holders	Subcontractors
Acquisition and Exploration	License holders are very likely to have a PE during exploration.	Subcontractors are generally more mobile and operate for shorter periods of time meaning they are less likely to result in a PE. Timing thresholds in the applicable treaty or domestic law become more relevant: • In-country services may be captured by a "services PE" clause provided the time threshold is exceeded (e.g., in Article 5(3)(b) of the UN Model Convention the time threshold is "183 days in any twelve-month period"); • The splitting of contracts (for various reasons) may cause the relevant timing thresholds that determine whether a PE exists to be avoided.
Construction and Development	License holders are very likely to have a PE. The use of substantial equipment, undertaking of construction activities and a higher degree of permanence from significant capital investment are all likely indicators of a PE.	Subcontractors providing construction services are likely to be captured under "construction PE" clause where the time threshold is exceeded. Mines take multiple years to build, other forms of construction and installation may not be covered by the current PE time threshold.
Exploitation and Transportation	There is no doubt that an extractive company will have a PE during the production stage given the fixed character of in-country operations.	Subcontractors that perform activities at the site may have a PE depending on their specific facts and circumstances. PE may arise in selling location if they are involved in marketing.
Closure/Decommissioning	License holders are unlikely to have income during the closure stage making a PE less relevant for revenue collection purposes. However, it may be important for ensuring legal responsibility for clean-up.	For subcontractors hired to perform rehabilitation work, a PE may arise under the same "construction PE" clause noted above provided the applicable time threshold in the clause is exceeded.

Table 3 – Income Generation for license holders and subcontractors

Stage	License holders	Subcontractors
Acquisition and Exploration	Nil	Subcontractors are remunerated by the resource company based on the services provided: • Compensation to professional firms providing support during negotiations is generally on a fixed fee basis (possibly with an additional performance-based component) • Contracts for services during the initial stages may be split up into an onshore and offshore component e.g., where engineering design is carried out in a foreign office of the subcontractor and construction is conducted onshore
Construction and Development	Project value likely to increase once a commercial discovery realized – sale of interests in mining licence or other assets likely to give rise to capital gains at this stage.	Subcontractors might provide construction services. Construction contracts are often used for the delivery of large-scale projects in the resource sector. Remuneration is generally broken down into several sequential stages based on completion of each milestone.
Exploitation and Transportation	Income is generated from the sale of extractive products or upgraded products to the market.	Subcontractors are remunerated based on the services provided during production.
Closure/Decommissioning	Nil	Subcontractors are remunerated based on the rehabilitation services provided.

3.2 Taxation of extractive industry service providers and personnel

13. Mining, oil and gas subsidiaries may access technical services from a parent company or dedicated related-party services company or from unrelated service companies, making fees for technical services a potentially significant source of outbound payments from the sector. Developing countries may have difficulty proving that a PE exists, particularly where services are provided in person for short periods of time and especially if performed remotely. Gross taxation may be possible under Article 12A (or 12B), but that is not full taxation on the total income.

14. The PE notion is also of importance to employee taxation in the case of short-term activities where the 183-day rule of Article 15 of the Models is not met. In such cases, employment income may still be taxed in the source state if the salaries were borne by a PE of their employer in that source state. Employee income can be very significant in the extractives sector considering the specialised expertise often required.

3.3 Taxation of offshore indirect transfers of extractive industry assets

15. The direct or indirect sale or transfer of a mining, oil or gas licence or any other right, interest, or asset related to extractive industry activities may generate considerable capital gains. The country where the mine is located may expect to share in those gains, typically through the general corporate income tax or a specific capital gains tax, which can be very significant.[3] It is also important because a mine, or oil and gas asset typically changes hands several times during the lifetime of the resource, potentially resulting in numerous capital gains tax events.

16. Depending on how they are designed, tax treaties may prevent source states from taxing profits from the sale of shares or comparable interests in extractive industry assets located in their country. Research by the Platform for Collaboration on Tax (PCT) suggests that only 35% of all tax treaties include the right to tax indirect transfers. It is even less likely where one party is a low-income, resource-rich country, by about six percentage points (PCT, 2020a, p. 33). In practice, countries often assert capital gains taxing rights even where they do not exist in the relevant treaty. This clearly indicates that they would like the outcome to be different. However, investors cannot elect to pay capital gains tax where it is not due in law or treaty. Therefore, it is vital that resource-rich countries that wish to tax capital gains specify this in their domestic law, and likewise their tax treaties.

3.4 Shipping and air transport

17. There may be income derived by certain movements made with ships or airplanes, helicopters (and potentially drones), between the mainland and an offshore exploration/ exploitation area which would not fall under Article 8 and thus be taxable in the source state only if the enterprise is a resident of such state or has a PE in that state. International shipping and air transport would be covered by Article 8. An issue may be which activities (type of vessels) are covered by Art. 8 and which are not.

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[3] *MIL Investments v. The Queen* [2006]. For a detailed discussion of the taxation of offshore indirect transfers, refer to Chapter 4 of the UN Handbook on Extractive Industry Taxation.

3.5 Marketing activities

18. The main PE issue that companies face in extractives is PE created from the marketing activity itself (i.e., concluding sales contracts). This could create a risk of double taxation for companies. However, it is a matter of profit attribution, rather than tax treaty design – the focus of this note. Source countries may need to monitor whether such PEs abroad exist and if so which part of the profits on the sales of the extracted materials can be attributed to these.

19. To conclude, this is a high-level summary of the main PE and other income issues facing resource-rich developing countries. Readers can find a more detailed discussion these issues in the UN Extractive Industry Taxation Handbook, and IGF's guidance on tax treaties for resource-rich countries.

4. How the UN Model Addresses Extractive PE and Other Income Issues

20. In this section we describe the extent to which the current UN Model and Commentary address the PE and other income issues raised in Section 3. In doing so, we highlight some of the areas that could be improved in the update to the UN Model that would better protect the right of resource-rich countries to tax extractive industry income at all stages along the value chain.

4.1 Contracting State, Article 3 – General Definitions

21. Article 3 of the UN Model does not make any specific reference to the extractive industries. The parties of a treaty are left to agree bilaterally a definition of 'a Contracting State', and 'the other Contracting State'. Paragraph 3 of the UN Commentary suggests that countries may wish to include their continental shelves in the definition of a Contracting State. This is particularly necessary for the understanding and application of the standalone article (see Section Six). This is because a standalone article is intended to cover any area outside the territorial sea of the Contracting State where the latter can exercise its rights with respect to the seabed and subsoil and their natural resources.

4.2 Permanent Establishment, Article 5 – Permanent Establishment

22. Article 5 of the UN Model is based on Article 5 of the OECD Model but contains significant differences. In both models, for a non-resident to have a permanent establishment, the requirements in Table 4 must be met. These are referred to as the "general rule" in Article 5(1) of the models.

Table 4 – The general PE rule

Permanent Establishment Requirement	Description
Having a place of business at their disposal	Having the effective power to use that location for a sufficient duration. Does not have to be under constant control, e.g., use of subsidiary's office by a supervisor from the parent company
Having a fixed place of business	Two conditions must be met to be considered a fixed place: a certain degree of permanency ("time threshold") and a specific geographical spot ("location test").
The business should be carried on through the permanent establishment	Any situation where business activities are (wholly or partly) carried on at a particular location at the disposal of the enterprise for that purpose.

Table 5. Comparing Article 5 of the OECD and UN models in relation to the extractive industries

	General description of the provision	UN Model	OECD Model
Para 2 Illustrative list of permanent establishments	Operations that are: • Prima facie a PE • Still subject to general rule • Not exhaustive	A mine, an oil or gas well, a quarry or any other place of extraction of natural resources	Identical
Para 3	Construction PE • Construction/installation projects • Has its own time threshold, which may be shorter than the general rule.	6 months Explicitly includes supervisory activities	12 months The Commentaries suggest that supervisory activities are also covered
	Services PE • Services furnished in the source country (including consultancy services)	More than 183 days in any 12-month period.	Not included
Para 4	Preparatory or auxiliary activities, e.g., transportation of crude oil.	Delivery of goods is NOT considered a preparatory or auxiliary activity	Delivery of goods is considered a preparatory or auxiliary activity

23. According to the OECD Commentary to Article 5(2), the term 'any other place of extraction of natural resources' should be interpreted broadly, therefore it includes, for example, all places of extraction of hydrocarbons whether on or offshore.[4] However, it does not mention the exploration of such resources, whether onshore or offshore.[5] The main issue with relying on Article 5(2) of the OECD and UN models is that is still subject to the general rule which may be hard to satisfy in the case of some extractive industry subcontractors. Article 5(3) of the OECD and UN models do not explicitly refer to the extractive sector although non-residents activities may trigger Construction and Services PEs provided that all conditions are met.

24. Overall, the UN Model is more favourable to source states, particularly the lower time threshold required to trigger a PE, making it more likely that they will be able to tax extractive industry subcontractors. Notwithstanding, some resource-rich countries have sought to deviate from the models by adopting more demanding permanent establishment rules for the extractives sector as explained in Section Six.

4.3 Immovable Property, Article 6 – Income from Immovable Property

25. Immovable property generally refers to land and fixtures or structures upon the land (e.g., a mineral deposit). It may also include equipment or accessories to the immovable property (e.g., an oil rig). Article 6 of the models gives the right to tax income from immovable property to the country where the property is located, regardless of whether the activities constitute a permanent establishment. This is justified by the close economic connection between the source of the income and the country where the assets are located. Article 6 also states that the term "immovable property" shall have the meaning it has under the domestic law of the state where the property is situated. Notwithstanding, it also lists assets and rights that shall, in any case, be regarded as immovable property. The includes "rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources." "Working a resource" is generally understood as meaning removing the resource from the landed property.

26. However, other sources of extractive income may not be taxable in the resource-rich country unless expressly included in the definition of immovable property in the domestic law—for example, income from the sale of the right to explore, depreciable assets (e.g., plant and machinery), seismic surveys, and other non-public information related to immovable property. Furthermore, rights to payments not from the sale of a mineral right or tangible property but computed by reference to the value of the mineral or oil deposit may not be taxable. The objective for resource-rich countries should, therefore, be to adopt a domestic law definition of immovable property that is broad enough to capture income arising from all activities and assets along the mining value chain or broaden the scope of the definition of immovable property when negotiating Article 6, ideally both.

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[4] Paragraph 47
[5] Paragraph 48

4.4 International Shipping and Air Transport, Article 8 – Shipping Income

27. The midstream stage includes the transport of natural resources which is commonly undertaken by pipeline or shipping companies. According to Article 8 of the OECD Model, only the residence country has the right to tax profits from the international operation of ships or aircrafts (domestic transportation is not covered by Article 8 but by the provisions of Articles 5 and 7). The UN Model has two alternative versions including the possibility for the source state to tax where shipping activities are more than casual.

28. There is no reference to extractives-related international shipping, a common activity in offshore oil and gas. Where no adjustment to the scope of the definition of permanent establishment is made, a reference to extractives-related international shipping might be needed to grant the source state the right to tax these revenues. There may also be a need to further specify what kind of activities/ types of vessels are covered by Article 8. For example, vessels designed to do firefighting, hook-up activities and tugging, versus vessels purely designed and used for transportation of goods or personnel.

4.5 Royalties, Article 12(A), and Article 12(B) – Fees for Services Income

29. As explained in Section Three, extractive subsidiaries may access administrative and technical services from their parent company or a dedicated related-party services company or a non-related-party services company. Management and technical services fees are a major source of outbound payments in the extractives sector, and in the context of related party transactions, have been found to have eroded the basis of taxation of license holders.[6] This is why the right to tax management and technical services is important for resource-rich developing countries.

30. Article 12-A was added to the UN Model to allow the source State to tax fees for certain technical services paid to a resident of other Contracting State (something some countries have intended to do expanding the definition of royalties in Article 12(3)). One of the reasons behind this addition was that it is possible for an enterprise resident in one State to be substantially involved in another State's economy without a PE, or substantial physical presence there. As explained in Section Three, remote operations and servicing of mine sites or oil blocks without any physical presence in the source country is becoming more common. In the absence of a PE, the source State where the mine/oil block is located should be able to tax revenues derived from these services.

31. Article 12B allows source states to charge a withholding tax on "income from automated digital services." The term *digital services* refer to any service provided on the Internet or an electronic network requiring minimal human involvement from the service provider. It does not include payments qualifying as "fees for technical services" under Article 12A.

32. Both 12-A and 12-B go some way towards addressing the challenge of source states being able to tax fees for services, including in the extractive industries. The challenge is that developing countries may find these articles difficult to negotiate. Many developed countries are reluctant to accept Article 12A in a general policy sense although they may be more willing if it is limited to extractives, considering the unique features of this sector. Countries

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[6] See case of Paladin Energy in Malawi

participating in the Inclusive Framework may see 12B from a broader policy perspective as being in conflict with the planned Pillar 1.

4.6 Taxation of capital gains, Article 13(4), (6), and (7)

33. The OECD and UN models, as well as the Multilateral Instrument (MLI), set the sourcing rule at 50% in Article 13(4). This means the shares that are sold must derive 50% or more of their value from assets (immovable property) in the source state. If this threshold is met, the gain is taxable in the source state. If not, the gain is exempt in the source state. The implication of setting the sourcing rule at 50% is that source countries whose assets do not meet the threshold will not have the right to tax capital gains on their extractive assets. For example, if the threshold is 50% and yet the shares transferred offshore derive only 40% of their value from an extractive asset, the source state loses the right to tax.

34. Some countries may find this sourcing threshold too restrictive and instead want the flexibility to tax any capital gains on their extractive assets, regardless of the percentage that this represents in the multinational company's portfolio. The lower threshold is typically offset by pro rata taxation to ensure that only the proportion of the gain that relates to the resource is subject to tax. The application of this paragraph relies on a robust definition of immovable property in the domestic law, or, alternatively, in Article 6(2).

35. Article 13(6) of the UN Model allows a State to tax gains from the direct alienation of rights granted under the law of the source State provided that these rights allow the use of resources that are naturally present in the source State, and that are under the jurisdiction of that State. According to Paragraph 31 of the UN Commentaries to Article 13(6), '*the common features of these rights are that they allow the commercial exploitation of resources that are inextricably linked to the territory of a State and that the value of these rights consists of what are recognizably location-specific rents deriving from some government-issued license'.* They add that this article will cover the sale of rights such as '*the rights to explore part of a territory of the State for oil, gas or minerals*. It seems likely that extractive industry rights and assets would be covered, however there is no explicit reference in the Model. This could be beneficial for some countries yet to include extractive industry rights and assets in their domestic law definition of immoveable property.

36. Article 13(7) extends the source country's right to tax capital gains arising from indirect transfers. An "indirect transfer" is for instance where the shares in a mine or a right covered in Article 13(6), or shares in the foreign company that owns the mine, or the right are sold. The right to tax such indirect transfers is the primary objective for resource-rich countries with respect to Article 13. Yet, despite the significant tax at stake, only 35 percent of all tax treaties include the right to tax indirect transfers. It is even less likely where one party is a low-income resource-rich country, by about six percentage points (PCT Toolkit, 2020, The taxation of offshore indirect transfers). It is critically important that resource-rich countries have the right to tax indirect transfers in their law and retain this right in their treaties.

4.7 Income from employment related to the extractive industries, Article 15

37. Many people are directly and indirectly employed in the extractives sector. Most of the jobs occur during the development or construction stage (i.e., installation of drilling rigs) or closure. In case of physical presence, the 183-day rule or the existence of a (deemed) PE of their employer is decisive whether the source state is allowed to tax their salaries. There are however some jobs where the employment is not directly exercised in the source state, are short-term, but are related to the exploration, and or exploitation of natural resources, i.e., highly skilled jobs during the exploration of resources.

38. According to Article 15 of the OECD Model, the income from employment is taxable in the state where the employment is exercised. Article 15 of the UN Model is the same as OECD Model, although a reference to fixed based is made. The reference to 'exercised' may be challenging for source states to prove. Instead, the article should be clear that salaries, wages and other similar remuneration derived by a resident of a Contracting State with respect to employment connected with onshore or offshore activities is taxable by the source State, notwithstanding a time threshold.

***Concluding summary*:**

39. The main issues that could be considered as part of the UN Model update include:

Table 6. Gaps or weaknesses in the UN Model with respect to the extractive industries

Article	Gap or weakness in the UN Model
Contracting State, Article 3	Lack of definition of Contracting State referring to continental shelves
Permanent Establishment, Article 5	Lack of specific reference to exploration activities in Article 5, and more generally the time threshold and conditions for triggering an extractives PE.
International Shipping and Air Transport, Article 8	The right to tax income derived from the transport of natural resources by the source state is not sufficiently guaranteed under Article 8 - International Shipping and Air Transport and uncertainty may arise as regards which shipping and air activities (and maybe which types of vessels) are covered by Art.8
Royalties, Article 12(A), (B)	The right to tax extractive industry income derived from administrative and technical services by the source state. Generally applicable Articles 12A and 12B may be difficult for some countries to negotiate.
Taxation of capital gains, Article 13(4), (6) and (7)	The sourcing rule of 50% in Article 13(4) may be too restrictive for the extractive industries. Some countries may want the flexibility to tax any capital gains on their extractive

	assets, regardless of the percentage that this represents in the multinational company's portfolio. There is no explicit reference to extractive rights in Article 13(6). This could be important for some resource-rich countries yet to include extractive industry rights in their domestic law definition of immovable property. A generally applicable Article 13(7) to secure source taxing rights with respect to any type of government licenses and other assets covered by that provision may be difficult to negotiate. But it is a fact that a license for exploitation may change hands several times before actual extraction begins.
Income from employment related to the extractive industries, Article 15	The right to tax employment (direct and indirect) income derived from extractives activities by the source state is considered not to be sufficiently guaranteed under Article 15 - Income from Employment.

5. Treaty Practice addressing Extractives PE and Other Income Issues in Resource-rich Countries

40. This section explores how some resource-rich countries have deviated from the UN and OECD Model Conventions to better protect their right to tax extractive industry income. Specifically, it analyses a standalone article (also known as an offshore article or hydrocarbons article), as well as deviations to Articles 5, 6 and 12. These examples of treaty practice provide some guidance on how the UN Model could be updated to address the PE and other income issues pertaining to the extractives sector that were highlighted in Section Four.

5.1 Standalone Extractive Industries Articles

41. The term "standalone article" refers to a special clause that deals primarily with PE issues in the extractives sector. It may also include other items of income, such as capital gains arising from the alienation of extractive industry assets and employment income. This is a treaty practice of major oil producing countries, including Norway and Mexico. It emerged as a response to the unique working conditions in offshore oil and gas, as well as monitoring difficulties. These issues have been less significant for mining, which is largely land-based. However, the emergence of deep-sea mining poses similar issues to offshore oil and gas, making it important to consider mining as part of any standalone extractive industries article.

42. There are two types of standalone articles identified in treaty practice – the offshore article (Box 1), and the hydrocarbons article (Box 2). The main difference between the two is that the hydrocarbons article covers both offshore and onshore activities, whereas the offshore article is exclusive to offshore oil and gas activities.

BOX 1 – Summary of an 'offshore article' – Article 21 of Norway–United Kingdom (2013)

Article 21. Miscellaneous rules applicable to certain offshore activities (selected provisions)

2. Offshore activities are carried on offshore in connection with the exploration or exploitation of the seabed and subsoil and their natural resources situated in that state.

3. An enterprise carrying on offshore activities in the other contracting state is deemed to have a permanent establishment except under paragraphs 4 and 5.

4. Paragraph 3 shall not apply:

a) Offshore activities must be carried on for a period or periods less than 30 days in aggregate over any 12-month period. For the purposes of this sub-paragraph:

i) Where two associated enterprises carry out substantially similar offshore activities in the contracting state, the time spent by each enterprise will be added together to compute the time threshold. This is an anti-avoidance rule.

ii) Enterprises are associated if one participates directly or indirectly in the management, control, or capital of the other or if the same person or persons participate directly or indirectly in the management, control, or capital of both enterprises.

5. Profits derived in connection with the offshore activities of ships or aircraft designed primarily for the purpose of transporting supplies or personnel, or for towing or anchor handling, shall be taxable only in the resident state.

6. Salaries, wages, and other similar remuneration received in respect of employment connected with offshore activities may, to the extent that the duties are performed offshore in the source state, be taxed in that other contracting state.

7. Gains derived by a resident of a contracting state from the alienation of exploration and exploitation rights, property situated in the other contracting state and used in connection with offshore activities, or shares deriving their value or the greater part of their value directly or indirectly from such rights or such property or from such rights and such property taken together, may be taxed in that other state.

BOX 2 - Summary of a 'hydrocarbons article' - Article 21 of Mexico–Argentina (2015)

Article 21 – Hydrocarbons

2. An enterprise that carries on activities which consist of or are connected with the exploration, production, refining, processing, transportation, distribution, storage, or commercialization of hydrocarbons for a period or periods exceeding in the aggregate 30 days in any 12-month period shall be deemed to have a permanent establishment.

3. Where two associated enterprises carry on identical or substantially similar activities, or these activities are part of the same project, all activities will be considered for computing the limit. "Associated enterprises" is given meaning under the domestic law where the activities are carried on.

4. Salaries, wages, and other similar remuneration received in respect of employment connected with the exploration, production, refining, processing, transportation, distribution, storage, or commercialization of hydrocarbons may be taxed in the state where the activities are performed. However, such remunerations shall be taxable only in the resident state if the employment is performed for an employer who is not a resident of the other state and provided that the employment is performed for a period that, in aggregate, does not exceed 30 days in any 12-month period.

43. The benefits of a standalone article include –

a. It gives primacy to non-renewable natural resources, which are finite and non-renewable. It also limits deviations from the generally applicable rules to this sensitive, non-renewable sector.
b. It can cover multiple items of income, for example, business profits, capital gains, and employment income. In this sense, a standalone article may be more comprehensive than the other approaches listed in this section.
c. It covers offshore activities that may be less likely to trigger a PE under Article 5 due to weather circumstances etc and considering the monitoring difficulties for host states. This includes offshore mining (often referred to as "deep-sea mining") and oil and gas activities within a state's territorial waters and continental shelf.
d. It reduces uncertainties for governments and investors with respect to interpreting the PE notion in case of shorter term and mobile activities.

The challenges include –

a. It widens the scope for source taxation.
b. It may be challenging to determine when an activity is "sufficiently connected" and thus take in.
   activities/services which are not specifically related to extractives (e.g., catering) and might be treated differently if provided outside the extractives industries – see Section Seven.

5.2 Deviations to Article 5, Permanent Establishment

44. This subsection describes further treaty practices which deviate from Article 5.

a. Self-standing "Extractives PE" in Article 5

45. A self-standing Extractives PE deems a PE to exist in the case of any exploration and exploitation activities, regardless of whether these take place onshore or offshore (see the example of Australia–Germany, 2015 in Box 3). This approach may be easier to negotiate compared to a standalone article. The downside is that these deviations only cover one item of income—business profits.

BOX 3 - Article 5(4) of Australia–Germany (2015)

"(4) Notwithstanding the preceding provisions of this Article, where an enterprise of a Contracting State:

(b) carries on activities (including the operation of substantial equipment) in the other State in the exploration for or exploitation of natural resources situated in that other State for a period or periods exceeding in the aggregate 90 days in any 12-month period; or

...., such activities shall be deemed to be carried on through a permanent establishment that the enterprise has in that other State, unless the activities are limited to those mentioned in paragraph 6 and are, in relation to the enterprise, of a preparatory or auxiliary character."

46. The benefits of a self-standing Extractives PE include –

a. It effectively displaces the general rule (included in Article 5(1) – fixed place of business) providing a faster taxing right for the source state.
b. There is no limit to what resource-rich countries could include in a self-standing Extractives PE. It may include exploration and exploitation. Exploration is not included in the positive list of permanent establishments in Article 5(2) of their of the models.
c. There is also no requirement to set a time threshold for triggering an Extractives PE, although countries typically do, adopting a lower threshold than the general rule. Those countries that do opt to include a duration test will typically use a lower threshold than the general rule (e.g., 90 days in any 12-month period, as is the case in Australia's tax treaties).
d. It reduces the risk of companies structuring their activities to avoid triggering a permanent establishment.

47. The challenges include –

a. Deeming a PE can increase the risk of double taxation if the residence state does not give corresponding relief via an exemption or a credit, e.g., due to a different interpretation of the notion of substantial equipment.
b. It may lead to disputes regarding the attribution of profits to the PE.

b. Extractives PE in Article 5(3)

48. The African Tax Administration Forum (ATAF) recommends this option in its Model Tax Agreement (See Box 4). It is largely the same as a self-standing Extractives PE except that it must include a time threshold. Twenty percent of the treaties surveyed by IGF included a dedicated extractives provision in Article 5(3). There is a growing number of countries using this approach.[7]

BOX 4 - Article 5(3) ATAF Model

"(3) The term "permanent establishment" shall be deemed to include:

(d) an installation or structure used in a Contracting State in the exploration for natural resources provided that the installation or structure continues for a period of not less than ……. days within any twelve-month period commencing or ending in the fiscal year concerned.

49. The benefits of having an Extractives PE in Article 5(3) include –

a. There is no limit to what resource-rich countries could include in such a provision. It should provide the most coverage of the sector possible. From IGF's tax treaty survey, some countries also included a reference to an installation, drilling rig, or ship, presumably to bring offshore activities within scope. Others chose to deem a permanent establishment where a non-resident leases equipment and machinery to be used for

[7] This is seventeen out of 86 treaties.

extractive industry activities or where an enterprise uses substantial equipment in connection with resource extraction. Both variations are likely to catch subcontractors.

b. Unlike a self-standing provision, an Extractives PE in Article 5(3) must include a time threshold. However, this can be different from the time threshold in the general rule, creating some leeway to set a lower threshold for extractives. From IGF's tax treaty survey, most of the sampled treaties that included a dedicated mining provision in Article 5(3) set a threshold of 6 months or less. Those that only mention exploration in Article 5(3) typically used 3 months, reflecting a shorter period of operation for subcontractors during exploration. There is a trend toward lower thresholds in recent treaties.

The risks of an Extractives PE in Article 5(3) are the same as for a self-standing Extractives PE.

5.3 Deviations to Article 6, Immovable Property

50. This subsection describes further treaty practice which deviates from Article 6.

51. Resource-rich countries require a robust definition of immovable property in their domestic law. The right to explore is particularly important. If read narrowly, the reference to the "right to work mineral deposits" in Article 6 may be taken to mean that only assets or rights relating to mineral production or exploitation qualify as immovable property. Consequently, income derived by a non-resident from exploration activities may not be subject to tax in the source state.

52. To avoid any ambiguity with respect to exploration, some resource-rich countries include the right to explore in Article 6(2) of their treaties (see the example from New Zealand–Papua New Guinea, 2012, in Box 5). Only 4% of tax treaties samples by IGF include the right to explore in the definition of immovable property. All these tax treaties include China as a contracting state, most likely because Chinese domestic law includes the right to explore in its definition of real property and thus via the reference in Article 6 to the definition of immovable property in domestic law covers also exploration licenses. In other treaties it is, for the sake of clarity, explicitly regulated (see Article 21(7) in Box 1, or maybe otherwise (like in a protocol) observed that it is understood that exploration (and exploitation) licenses are considered immovable property for the purposes of Article 6.

BOX 5 - Treaty Practice: inclusion of exploration assets or activities in article 6(2)

New Zealand—Papua New Guinea (2012)

"6(2) The term 'immovable property'…. shall in any case include …, rights to explore for or exploit natural resources (including mineral deposits, oil or gas deposits or quarries) …, and rights to variable or fixed payments either as consideration for or in respect of the exploitation of, or the right to explore for or exploit natural resources (including mineral deposits, oil or gas deposits or quarries) …"

53. Some resource-rich countries also specify in their tax treaties that the right referred to in the definition of immovable property "shall be regarded as situated where the land, mineral, oil or gas deposits or sources, quarries or natural resources, as the case may be, are situated or where the exploration may take place" (see the example from China–New Zealand, 2019, in Box 6). This is particularly common in Australia's tax treaties. It puts beyond doubt that income from the sale of a mining or exploration right is subject to tax in Australia (provided the threshold is met).

5.4 Deviations to Article 12, Royalties

54. Article 12 gives source states the right to charge a withholding tax on royalty payments for the use of or the right to use intellectual property, equipment, or know-how—for example, payments for the use of trademarks, trade names, copyright, or intellectual property. Some countries have expanded the definition of royalties to include fees for technical services. Most importantly, they include technical services as a separate source of royalty payments, rather than embed them in other services for which royalties are due (see Argentina–Chile, 2015, in

Box 7 - Treaty practice: Inclusion of Technical Services in Article 12

Summary of Article 12 of Argentina–Chile (2015)

3. The term "royalties" means payments of any kind received as a consideration for the use of, or the right to use, news, any copyright of literary, artistic or scientific work (including cinematograph films), or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience, and payments for the rendering of technical assistance.

Box 8 - Treaty practice: embedded technical services in article 12

Summary of Article 12 of India–United States (1989)

5. Definition of the term "Royalties" covers "fees for included services," specifically, payments for the rendering of any technical or consultancy services, if such services: a. Are ancillary and subsidiary to the right, property, or information b. Make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

55. Box 9)— as ancillary and subsidiary to the use of property, rights, equipment, and information, for instance (see India–US, 1989, in Box 10). While this may cover situations where a non-resident provides technical services to a mine as part of assisting it to use equipment provided under Article 12(3)(b), most services are unlikely to qualify, leaving the source state unable to tax the associated payments.

Concluding summary:

56. The tax treaty experience of resource-rich countries shows that there are different approaches to address the PE and other income issues in the extractives sector. The key findings are as follows:

Table 7. Treaty practice in resource-rich countries

Article	Treaty practice
General	The standalone article is the most significant deviation from the UN Model. It is a special clause that deals primarily with PE issues in the extractives sector, but may also include other items of income, such as capital gains arising from the alienation of extractive industry assets and employment income. The primary benefit is that it singles out this specific sector and grants a more source taxation approach which may be better acceptable for countries not prepared to accept broader source taxing rights more generally.
Permanent Establishment, Article 5	There are two common deviations to Article 5: • A self-standing "Extractives PE" in Article 5 which deems a PE to exist in the case of any exploration and exploitation activities, regardless of whether these take place onshore or offshore. • An Extractives PE in Article 5(3), which is largely the same as a self-standing Extractives PE except that it must include a time threshold and goes together with PE Construction and PE Services. There are different benefits and challenges with regards both options.
Immoveable Property, Article 6	Some resource-rich countries include the right to explore in Article 6(2) of their treaties.
Royalties, Article 12	Some countries have expanded the definition of royalties to include fees for technical services, and others have included Article 12(A) of the UN Model. These deviations apply generally but have relevance for the extractives sector considering the reliance on foreign, specialised services.

6. Considerations for Designing a Standalone Extractive Industries Article

57. The UN Committee of Tax Experts has expressed particular interest to explore the potential to include a standalone article in the Model Update. This is a practice adopted by some resource-rich countries as illustrated in the previous section of this briefing paper. This section considers several design issues for a standalone article.

6.1 Types of Income

58. Standalone articles can cover multiple types of income, for example, business profits, capital gains, and employment income. It is appropriate from the perspective that source countries should be able to fully tax profits related to income earned from the extraction of their non-renewable resources that an article dedicated to the extractive industries should be comprehensive, covering the most relevant items of income, particularly those that warrant special treatment relative to other sectors.

- Business profits, and subsequently profit-based taxes, are typically intended to be the primary share of government revenues from the mining sector. Financial benefit/ production sharing models are more varied in the oil and gas sector, but profit-based taxes still play an important role in many jurisdictions.
- Capital gains arising from the sale or transfer of extractive industry assets have the potential to be highly material for resource-rich countries.
- Employment income is also significant considering the specialised non-resident personnel typically required to develop and operate mining, and oil and gas operations.
- Income from management and technical services provided remotely could also be included in a standalone article. While this type of income has not been observed in standalone articles so far, developing countries may be in a better position to negotiate taxing rights over this source of income (compared to Articles 12A and 12B) if confined to the extractives sector.

59. Lower thresholds and greater coverage of licenses is justified for all four items of extractive industry income, in which case it makes sense to address them in the same article. The logic is that any departure from the Model that is justified on the basis that it relates to extractives can be found in one place in the UN Model. It separates the treatment of extractives income from the provisions generally applicable to other sectors. It also makes it easier to see the interaction between the rules for the different sources of extractive income. Finally, a standalone article forces treaty partners to have a thorough discussion, and flesh out various issues pertaining to the tax treatment of extractives-related income.

6.2 Geographical scope – onshore and offshore activities

60. Standalone articles have typically targeted extractive industry activities taking place offshore. This is because of the difficulty of working conditions and of monitoring PEs offshore, plus a narrow scope means it is less likely to interfere with other treaty articles. Mexico has pioneered the onshore option for hydrocarbons, and in relation to the entire value chain.

61. Triggering an offshore PE is likely to remain more difficult than an onshore PE due to the monitoring challenge highlighted above. However, even onshore PEs may be at risk considering the emergence of remote operating technologies may mean that some subcontractors avoid having a physical presence altogether. Both offshore and onshore activities should be included for completeness and consistent treatment of the non-renewable sector.

62. The main implementation challenge of an onshore provision will be determining which activities trigger a PE particularly in the case of subcontractors. For an activity to be a PE, it must be carried out "in connection with the exploration or exploitation of the seabed and subsoil and their natural resources situated in that State." Establishing a connection is less of an issue for offshore activities simply for practical reasons—there are fewer activities taking place. This is more challenging onshore—for example, a catering firm that provides services to a mine or oil block.

63. The Commentary could elaborate on the types of activities that would be considered sufficiently connected to be caught by a standalone article. Table 8 includes the types of activities typically undertaken by subcontractors that would most likely satisfy the connection test). Ultimately it would be up to the Competent Authorities to resolve differences of interpretation in the event of a dispute.

Table 8 – Activities undertaken by subcontractors along the extractive industry value chain

Stage	Activities typically undertaken by subcontractors
Acquisition and Exploration	• Technical and economic analysis • Mine planning, platform design services • Geological mapping and surveys • Sampling and drilling • Excavation services • Feasibility studies • Testing, maintenance, catering, logistics, and health, safety and environment services. • Seismic and casing services • Professional services firms or business development partners advising on negotiations or providing technical support in acquiring/ maintaining a concession.
Construction and Development	• Procurement • Engineering • Construction drilling services (located onshore or offshore), • Project management including Engineering, Procurement, Construction and Management - may establish office
Exploitation and Transportation	• Operation of the mine/ infrastructure • Expansion of the existing operations • Transportation • Ancillary services e.g., aviation, logistics, catering, health and safety, road construction, habitat relocation, marketing.
Closure/Decommissioning	• Removal of the structures and rehabilitation of the extraction site.

6.3 Delineation of extractive industries value chain

64. Offshore articles cover activities in connection with the exploration and exploitation of natural resources. Mexico's hydrocarbons article is explicit that it covers exploration, production, refining, processing, transportation, distribution, storage, or commercialization. In general, the objective should be to include the entire value chain to avoid the risk of fragmentation. However, being exhaustive, as in the case of Mexico, potentially runs the risk of accidently excluding a stage or activity that may be relevant now, or in the future. There is also a risk that separate treatment of extractives becomes less acceptable the further the activities are from upstream extraction. Implementation also gets more complex, determining whether activities are sufficiently connected. Therefore, keeping it at the level of exploration and exploitation may be sufficient, provided that guidance is given on what activities are considered sufficiently connected to extraction.

6.4 Time thresholds

65. Standalone articles – offshore and hydrocarbons articles – typically include thresholds of more than 30 days in aggregate in any 12-month period to trigger a permanent establishment in the case of activities carried on by a non-resident enterprise in connection with the exploration and exploitation of natural resources in the source state. This would extend to employment income or might even go beyond 30 days as is the treaty practice of some countries (see Article 21(6) in Box 1).

6.5 Sourcing threshold for capital gains taxation

66. Assuming that capital gains tax is included in a standalone article, there could be an option for countries to agree a lower sourcing threshold, giving the source state the right to tax more transactions involving the sale and transfer of extractive industry assets. This could be offset by pro rata taxation, limiting the source state to taxation of the proportion of the gain related to the extractive industry asset. This option is discussed in the PCT toolkit on offshore indirect transfers.

7. Conclusion

67. The extractive industries involve the exploitation of finite, non-renewable, and often publicly owned, natural resources. Countries that host such resources only get one chance to tax the income arising from their extraction. This fact, and the prevalence of investment from foreign multinationals, makes the impact of tax treaties on extractive industry revenue collection critically important to resource-rich developing countries. Unless tax treaties are designed with this sector in mind, and considering the potential impact on revenue collection, governments may end up collecting substantially less than they expected from extractive industry investments. In addition, tax treaties could be inappropriately used by investors to reduce or avoid paying taxes.

68. The UN Model Update represents an important opportunity to strengthen source taxation of extractives-related income. The Subcommittee on Extractive Industry Taxation has identified several PE and other income issues that are pertinent to the extractives sector that

could be better addressed in the UN Model. These include: (1) the taxation of subcontractors; (2) the taxation of fees for technical and management services; and (3) the taxation of offshore indirect transfers of mining assets.

69. A standalone extractive industries article is not the only way to address these issues. Resource-rich countries themselves have taken different pathways. However, the Subcommittee considers that a standalone article is likely to be the most comprehensive and efficient route towards ensuring source taxation of extractives-related income. A standalone article can cover multiple items of income – business profits, capital gains, employment income, and potentially fees for technical services for the extractives sector specifically. It also gives countries the flexibility to set a lower time threshold to be able to tax subcontractors and potentially a lower sourcing rule to be able to tax more transactions involving the sale or transfer of mining, oil and gas licenses. Importantly, a standalone article limits deviations from the generally applicable rules to this sensitive, non-renewable sector, making this approach easier to justify and certain provisions easier for developing countries to negotiate.

70. Bringing onshore mining, oil and gas activities in scope of a standalone article is an important step towards ensuring consistent treatment within the non-renewable sector. The risk of subcontractors not triggering a PE, or monitoring difficulties, may not be as great onshore as with offshore. However, the extractives sector is changing, particularly the use of technology, including remote operation of mine sites, for example. In this regard, including offshore and onshore extractive activities can be seen as 'future proofing' a standalone article. Guidance would be needed to help parties determine when onshore activities are sufficiently connected to exploration and exploration, but this is no different to the experience offshore where parties have also had to turn to the courts to consider this question.[8]

71. Finally, we would like to extend our thanks to the Subcommittee on the UN Model for inviting the Subcommittee on Extractive Industry Taxation to contribute its sector-specific expertise to this important process. We remain committed to supporting the Model Update throughout this process.

[8] See two court cases from Norway that considered whether the subcontractors' activities were "in connection with" the exploration and extraction of petroleum: Teekay, 2013, and Retstidende 2001/512.