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Taxation of the Extractive Industries

Tax incentives and the global minimum tax in the extractive industries: Interaction with investor and other tax regimes (proposed Supplement to Chapter 5 of the Handbook on Taxation of the Extractive Industries)

Summary

This paper is presented to the UN Tax Committee at its Twenty-ninth Session **for a first reading** and seeks the Committee's suggestions and guidance with the view to revising it for discussion and approval at the Thirtieth Session.

The first version of this paper was presented at the 27th session, and comments were made on how to improve it to ensure that it is a balanced paper which seeks to inform countries on the implications of OECD and Inclusive Framework's Pillar 2 implementation.

A technical meeting was convened at the end of May 2024 to discuss how best the new draft could address comments and concerns from the Committee. It was recalled that the objective of the paper was to alert resource-rich countries, especially developing ones, to the risk that their incentives may be compromised because the tax not being collected could be picked up by other countries implementing the global minimum tax. The paper seeks to provide some guidance and to assist in addressing the new feature of the global minimum tax, as it is designed to impact all countries once implemented, regardless of their participation in the Inclusive Framework or their implementation of Pillar 2.

At the conclusion of the meeting, it was suggested that an updated version be prepared of the existing chapter on tax incentives in the UN Handbook on Selected Issues for Taxation of the Extractives Industries by Developing Countries (2021), to account for the developments of the Global Minimum Tax. The attached paper is therefore proposed as updated guidance to complement Chapter 5 of the Handbook.

Attachment – Supplement to Chapter 5 Tax Incentives

Interaction with investor and other tax regimes: Tax incentives and the global minimum tax in the extractive industries

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1. Introduction / Background

1.1. A brief introduction to Pillar Two

In October 2021, 138 members of the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) agreed to a statement on the operational model of the Global Anti Base Erosion (GloBE) rules. The GloBE rules form part of a broader project by the OECD/G20 that builds on the 2013 project on Base Erosion and Profit Shifting. This work culminated in a proposed "two-pillar solution" aimed at addressing the tax challenges arising from the digitization of the economy, with the global minimum tax being the hallmark of Pillar Two.

Whilst the implementation of Pillar Two is not compulsory for all IF members, members of the IF may voluntarily choose to adopt the GloBE rules, and where such a choice is made, those electing members commit to administer and implement the model rules in a manner that is consistent with the overall aims of the framework. Members of the IF also agree to provide information to enable others to apply the GloBE rules if they wish to implement them.

In essence, the GloBE rules include an Income Inclusion Rule (IIR), which operates in a similar manner to the existing controlled foreign company rules, seeking to impose a minimum tax rate on the profits of companies controlled by multinationals. It is complemented by an Under Taxed Profit Rule (UTPR), which acts as backstop in cases where headquarters jurisdictions do not implement an IIR. There are, however, significant differences in practice, including the fact that the calculation of profit under the IIR and UTPR is based on the financial statements (with some adjustments) rather than on the taxable profit, as well as an exemption for a level of profit determined in relation to the amount of substance, as measured by employment and assets.

The impact of this on tax incentives is to impose a "top up tax" at the headquarters level where the effective rate of tax (ETR) in a subsidiary is below 15% of accounting profit. This ETR is the ratio of a multinational group's taxes paid or that are due on GloBE income in a specific jurisdiction, called "covered taxes" under Pillar Two, divided by the multinational's GloBE income from that jurisdiction.

This means governments may need to rethink the type of tax incentives that they extend to companies covered by the GloBE rules even where they are not a part of the IF. Tax incentives which lower the ETR below 15% of accounting profit could lead to additional tax payable at the headquarter level. To avoid this outcome, the country of the low taxed subsidiary may choose to reshape the incentive to capture the benefit of the additional tax locally; or design an incentive that does not lead to top up tax being payable at all.

Pillar Two also includes a Subject to Tax Rule (STTR), which is a treaty-based rule that applies to intragroup payments (interest, royalties and a defined set of other payments) from source jurisdictions (i.e., the jurisdiction in which the income arises) that are subject to tax rates below 9% in the payee's jurisdiction of residence. The STTR allocates to the source country a limited and conditional taxing right to ensure a minimum level of taxation. The STTR takes priority over the GloBE rules. It is not discussed in detail in this annex except to the extent it interacts with the IIR.

The main body of this annex assumes a familiarity with the GloBE rules. References are provided for readers who may wish to review GloBE rules and their implementation status.

1.2. Why is Pillar Two important to the extractive industries?

Whilst the extractive industries are expected to be mostly excluded from Pillar One, they are very much in scope of Pillar Two. These industries could be sensitive to the operation of Pillar Two, because of their economic characteristics, and the number and type of tax incentives that they benefit from.

Companies operating in the extractive sector are often subject to high sunk costs in the form of substantial capital inputs. These costs cannot be recouped when a project is unsuccessful. Significant investment in exploration and development is often sourced from the private sector. The long lead times from the initial investment to project start-up and profitability as well as the relatively long project lives, which can span beyond 30 years, expose the sector to economic risks (fluctuating commodity prices and volatility of demand) and adverse changes in the legal and regulatory framework. The cost of environmental responsibilities, including untimely decommissioning as well as reclamation activities, may further be identified as inherent factors that distinguish the sector.[1]

These characteristics of the sector are the rationale for certain differential tax treatments of extractive companies. In many jurisdictions, a special regime or incentives are applied to the extractive industries to balance domestic resource mobilization with the need to promote investment by partially reducing the high costs and project related risks. The most used tax incentives in the sector include longer loss carry forward rules, accelerated depreciation rules, preferential treatment of long-term capital gains, incentives that encourage local procurement, and, in some jurisdictions, tax holidays and reduced corporate income tax (CIT) rates.[2]

GloBE rules will potentially impact the effectiveness of many profit-based tax incentives that serve to lower a company's ETR. This invites countries to consider changing their local tax laws to capture the additional tax payable, in effect ensuring additional tax payable as a result of Pillar Two is collected locally. This may involve removing or adapting incentives that would otherwise lead to top-up tax, or introducing a domestic minimum tax. Countries that continue to extend ETR-reducing tax incentives to extractive companies covered by the rules may risk forgoing taxes for no benefit to the jurisdiction or the extractive companies covered by the rules, as those taxes would then be paid (through the operation of the IIR or UTPR) to tax authorities in the residence jurisdictions of multinational corporations.[3]

However, the introduction of the GloBE rules will not affect all companies, all low-taxed income, or all tax incentives.

- First, the GloBE rules will only apply to in-scope companies that are members of a multinational group of companies with an annual turnover of €750 million or above.
- Second, the rules allow for a substance based carve out which excludes from the GloBE tax base a certain amount of income calculated by reference to a fixed return on assets and payroll expenses in each jurisdiction and which reduces over time. As payroll and tangible assets constitute a significant portion of many extractive companies' financial activities, it is significant to the sector that tax incentives that reduce taxes on routine returns from investment in substantive activities will not trigger additional GloBE top-up tax. The use of payroll and tangible assets as indicators of substantive activities is based on the principle that

[1] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries; page 15.
[2] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries; page 15.
[3] Infra note 8.

these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions.

- Furthermore, not all tax incentives will have the same ETR reducing impacts and may continue to be extended to companies operating within the industry with moderate to lower risks of triggering a top up tax.

Finally, extractive industries benefit from "stabilized" fiscal regimes in many developing economies. Stabilization provisions are clauses in laws or contracts that either freeze in time the fiscal regime agreed at the outset, or require economic equilibrium where changes are made, can hinder future amendments to the fiscal regime. This might be a constraint for governments seeking to adapt their fiscal policy to the introduction of a global minimum tax, especially for pre-existing investments.

This annex explores the possible impacts of the GloBE rules on the taxation of the extractive industries. It assesses the impact of GloBE on the most used tax incentives within the sector, to assist policy makers in determining which incentives will no longer provide the same tax benefits to extractive companies under the GloBE rules. The annex also considers the impact of stabilization clauses on the application of GloBE rules with specific attention on the interaction of the rules with existing stabilized agreements. It then offers some policy options for resource-rich economies wishing to optimize their extractive revenue within the context of GloBE Pillar Two through changes to their domestic fiscal policy.

2. The impact of GloBE on extractive industries

2.1. Which companies and extractive projects are affected?

The global minimum tax can apply to investments in countries that are not part of the IF, or which choose not to implement Pillar Two themselves. This would be the likely result of an IIR imposed in a shareholder jurisdiction, or a UTPR imposed from a third country within the group.

Not all investments will be subject to Pillar Two. Investors which do not meet the requisite annual group turnover threshold of €750m, some investment funds and equity accounted investments are generally not within the Scope of Pillar Two (apart from certain joint ventures and partially owned parent companies subject to specific rules). In considering the impact of Pillar Two, governments may want to start by identifying which investors in extractive projects in their countries are likely to be in scope. It is possible large MNEs may have certain investments out of scope, because equity accounted investments are outside of the scope of Pillar Two. For example, if a large extractive group has a minority interest in an extractive project that is equity accounted, without control, the profits from that investment will not be subject to Pillar Two.

2.2 Which fiscal instruments commonly used in the extractive industries are considered "Covered Taxes", and which ones are not?

Different types of taxes have different treatments under Pillar Two. Certain taxes will not be 'Covered Taxes' i.e., not count towards the Pillar Two ETR calculation. This section reviews the "Covered Tax" definition of the GloBE rules and compares it with the typical fiscal instruments levied on extractive industries, as set out in the "fiscal take" chapter of the Handbook. It draws

conclusions on how fiscal regime design for extractive industries could be impacted by GloBE Rules.

Information required for the Pillar Two ETR to determine Covered Taxes will generally be sourced from MNE's financial statements. However, extractive companies not only report income taxes in country-by-country reports (CBCRs), but many also file so-called "'payments-to-governments annual reports" to stock exchange regulators in Canada, the European Union and the UK, which contain additional information on payments beyond corporate income taxes – some of them Covered Taxes.

Generally, taxes on income, profits, and distributions are Covered Taxes for Pillar Two purposes (e.g., corporate income tax payments recorded in the financial accounts are Covered Taxes). In contrast, a tax imposed on gross income, revenue, or another basis may not qualify as Covered Taxes under the GloBE Rules (e.g., a royalty based on production or gross revenue). That being said, the definition of Covered Tax is broader than simply income taxes. In determining whether a Tax is a Covered Tax, the focus is on the underlying character of the tax.

The table below shows whether commonly used fiscal instruments in the extractive industries are likely to qualify for Covered Taxes for Pillar Two purposes. They include bonus payments, royalties, income taxes, resource rent taxes, state equity, and indirect payments, fees and duties.

Mechanism	**Description**	**Covered tax: yes/no**	**Notes**
Signature bonus	Up-front payment for acquiring exploration rights	No	1
Production Bonus	Fixed payment on achieving certain cumulative production or production rate	No	1
Royalties	Specific (amount per unit of volume produced)	No	2
	Ad-valorem (percentage of product value)	No	2
	Ad-valorem progressive with price	No	2
	Ad-valorem progressive with production	No	2
	Ad-valorem progressive with operating ratio/profit	No	2
	Profits based royalty	Yes	2
State, provincial, and/or local CIT	Rate of corporate income tax at the state, provincial, or local level in addition to federal level	Yes	3
Variable income tax	CIT where the tax rates increase with the ratio of taxable income to revenue, between an upper and lower bound	Yes	4
Resource rent	Cash flow with accumulation rate/uplift. Can be assessed before or after CIT	Yes	5
	Cash flow with limited uplift on losses (UK) (Surcharge tax on cash flow)	Yes	5

Windfall taxes	Profits based	Yes	6
Other additional income taxes	Other profit taxation mechanisms that do not fall under any of the categories above	Yes	7
Production sharing	Under production sharing agreements – commonly used in the oil & gas industry – a contractor shares its profits with the government after deducting an amount equal to its capital and operational costs. The profits can be split on a fixed share of production basis or a sliding scale basis (e.g., the government's share of profit increases as total cumulative production increases).	Depends	8
State participation	Free equity: government receives percentage of dividends without payment of any costs	No	9
	Carried equity: government contributions met by investor and recovered from dividends with interest	No	9
Social investments/ infrastructure	Resource companies build infrastructure or make other social investments (hospitals, schools, etc.) or other payments in kind	No	10
Indirect taxes	Custom duties, payroll taxes, stamp duties and other input taxes	No	11
Controlled Foreign Company Taxes	Taxes paid in shareholder countries in relation to profits in the source country.	Yes	12
Pillar One tax	Pillar One Tax under the GloBE Rules	Yes	13
Withholding tax	Withholding tax on dividend, interest	Yes	14
"STTR" Tax	Tax arising under the "Subject to Tax Rule"	Yes	15

Note**s**

(1) Signature and production bonus are single lump-sum payments triggered by events, which can be legislated, negotiable or biddable. They are not charged based on income or profits and are not qualified as Covered Taxes for GloBE Model Rules purposes under Article 4.2.1.

(2) Royalties imposed on a fixed basis or on the quantity, volume or value of the resources extracted rather than on net income or profits would not be treated as Covered Taxes under Article 4.2.1 (a) unless they are imposed in lieu of generally applicable income taxes. However, royalties paid on net profit where some relevant costs are deducted from income could fall within the definition of Covered Tax as its tax base is net profit under Article 4.2.1 (a). Whilst not determinative, royalties that are recorded as income tax in the accounts would be more likely to be a Covered Tax, whereas royalties recorded as an expense before tax would less likely be a Covered Tax.

(3) State, provincial, and/or local corporate income taxes charged based on net income would likely be treated as Covered Taxes under Article 4.2.1 (a).

(4) Variable income tax is a profit-based tax and is treated Covered Tax under Article 4.2.1 (a).

(5) If the resource rent tax is a profit-related tax, which is based on net income (i.e., gross revenue from the resource development minus certain expenses incurred in connection with deriving the income), it should be treated as Covered Tax under Article 4.2.1 (a).

(6) If windfall taxes are imposed on profits, they should be treated as Covered Tax irrespective of whether they are in addition to a generally applicable income tax under Article 4.2.1 (a).

(7) Other additional income taxes could be treated as Covered Taxes if they fall within the definition of Covered Taxes under Article 4.2.1.

(8) Under a production sharing agreement, payments made to the Government could be a mixture of profit related payments (corporate income taxes, resource rent etc.) or payments subject to production levels (e.g., production bonus, royalties). Some countries (Egypt and Trinidad for example) have the concept where the Government takes an amount of the production of the oil or gas rather than receiving tax (and a cash payment for the tax). This is often known as "tax barrels" (as the Government get oil instead of cash for its tax). In simplistic terms this is accounted for as a double entry for the company as debit tax, credit turnover. On this basis "tax barrels" would be treated as a Covered Tax under Article 4.2.1 (a) and (c) as it is included in the income tax of the company's Income Statement, and it is a payment in kind made to the government as a substitute for a generally applicable income tax.

Where the payment made to the government is taxed on a profit basis or is included, it is more likely to be treated as Covered Tax under Article 4.2.1. However, if the payment made to the government is not profit-related tax or is not tax in lieu of a generally applicable income tax under Article 4.2.1, it is unlikely to be treated as Covered Tax. It should be considered on a case-by-case basis to determine if the definition of Covered Taxes is met under Article 4.2.1.

(9) Under a state participation agreement, the host government could receive corporation income tax, withholding taxes, or distribution of profits generated from an extractive entity due to their free, carried or paid equity interest. Covered Taxes include taxes on a distribution of profits under Article 4.2.1 (a) and taxes on distributed profits imposed under an Eligible Distribution Tax System are Covered Taxes under Article 4.2.1 (b). However, if the payment made to the government does not have any underlying characteristics of taxes, it is unlikely to be treated as Covered Tax for Pillar Two purposes. E.g., providing the government a free carried equity stake with rights to dividends would not be considered a Covered Tax. It should be considered on a case-by-case basis to determine if the definition of Covered Taxes is met under Article 4.2.1.

(10) Social investment / infrastructure are contributions made by resource companies to resource-holding countries, which do not qualify as Taxes for Pillar Two purposes.

(11) Indirect taxes do not generally fall within the definition of Covered Tax as they are imposed on transactional basis rather than on income or equity basis and are not taxes in lieu of an income tax under Article 4.2.1. However, it will always be necessary to check the precise nature of the tax to draw conclusions e.g., the HMRC has confirmed the US Federal Excise Tax will be treated as Covered Taxes for Pillar Two purposes.

(12) For the purposes of the IIR, a Controlled Foreign Company ("CFC") Tax is Covered Tax as under Article 4.2.1 (a) as it is based on a share of part, or all of the income earned by the CFC. The CFC Tax incurred by a Constituent Entity's owners are allocated to the Constituent Entity under Article 4.3.2(c), subject to the limitations on the "push-down" of Taxes under Article 4.3.3.

Importantly, under a QDMTT, CFC taxes incurred by the Constituent Entity's owners are not eligible to be included as a covered tax if the DMTT is to be "qualifying". This is a key intended distinction between the calculation of top-up tax under an IIR and a QDMTT.

(13) Tax on net income of a Constituent Entity under Amount A of Pillar One would be treated as a Covered Tax under the GloBE Rules as a tax with respect to income or profits under Article 4.2.1 (a). The Pillar One tax should be allocated to the Constituent Entity that takes into account the income associated with such tax for calculating its GloBE Income or Losses.

(14) Withholding taxes on interest, dividends would be treated as Covered Taxes provided such taxes are imposed in substitution for a generally applicable income tax. Importantly, for the purpose of determining the ETR under Pillar Two, dividend withholding tax is allocated to the Constituent Entity making the distribution under Article 4.3.1 (e). Whereas interest withholding taxes are allocated to the Constituent Entity incurring those taxes (i.e., the entity that receives the interest income).

(15) The Subject to Tax Rule ("STTR") is a treaty-based rule that applies to intragroup payments (interest, royalties and a defined set of other payments) from source jurisdictions (i.e., the jurisdiction in which the income arises) that are subject to tax rates below 9% in the payee's jurisdiction of residence. The STTR takes priority over the GloBE Rules and is creditable as a covered tax.

2.3. Which incentives commonly used in the extractive industries are affected, or not, by GloBE?

This section examines the potential impact of GloBE rules on tax incentives commonly offered to extractive industries. Sections 2.4 and 3 below will further discuss the case where incentives exist within stability agreements.

Incentives that create a permanent tax reduction (i.e., a permanent difference between accounting profits and taxable profits, referred to as a "book-tax difference") will likely be more affected than incentives that create timing differences between recognition of accounting and taxable profits, such as accelerating deductions ahead of accounting expenses that defer the tax payment into the future. Nevertheless, the actual impact of GloBE on a specific incentive depends on several other factors, such as the scope limitations, the magnitude of the benefit, the weight of its tax base on the GloBE income, and the particularities of the MNE and its group in the relevant jurisdiction (e.g., the jurisdictional blending and substance based income exclusion (SBIE) mitigation effects).

Incentives can be provided separately or as part of special economic zones (SEZ), such as an export processing zone (EPZ), which is an industrial zone that provides companies with special incentives to attract (mostly foreign) investment for export production. Under these zones, countries offer a variety of incentives, such as corporate income tax holidays, duty-free export and import, value-added tax (VAT) incentives, and free repatriation of profits.[4] The impact of GloBE on SEZs[5] and EPZs depends on which incentives are offered to companies, since many

[4] Committee of Experts on International Cooperation in Tax Matters; (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, pp. 17-18. Also, Readhead A, *Tax incentives in mining: minimizing risks to revenue*. IGF-OECD (2018), p. 32.

[5] https://www.iisd.org/publications/brief/global-minimum-tax-special-economic-zones

of the incentives generally granted under special status, such as VAT incentives, will not be affected by GloBE.

As GloBE treats various types of incentives similarly, the analysis categorizes them into profit-based and cost-based incentives. A summary of this assessment is presented in the table below.

Profit-based incentives

Income or profit-based incentives generally reduce the tax liability once the project is profitable, e.g., through exemptions or reduced tax rates. They usually provide a permanent difference between the tax that would have been paid on those profits without the incentive and that with the incentive, as the reduction in the amount of tax paid is not reversed over time.[6] Common types of profit-based incentives offered to extractive industries are tax holidays, withholding tax relief on income remitted abroad, or a combination of incentives under EPZs.

i. Income tax holiday

An income tax holiday is a temporary reduction or an elimination of corporate income taxes (e.g. a reduction of tax on corporate profits). In the extractive sector, the duration of such tax-free period can vary from one year to the full term of the project and can take many forms, ranging from a complete exemption to a reduced rate.[7]

The impact of GloBE on a tax incentive depends on whether a specific adjustment is prescribed in the rules to neutralize its effect on the GloBE ETR. Based on this rationale, income tax holidays which reduce the tax rate below 15% are likely to be affected by the application of GloBE as they will be treated as a reduction of covered taxes, and no adjustment is prescribed to ensure a neutral effect on the ETR. In other words, while the tax holiday will decrease the covered taxes (the numerator of the ETR), the corresponding untaxed income remains included in the GloBE income (the denominator). However, the degree of the impact depends on the magnitude of the benefit. For instance, a tax holiday providing a total exemption may be more affected than one that offers a partial exemption (e.g., a rate of at least 15% with limited permanent benefits provided). It also depends "on the length of relief and the treatment of other tax provisions such as depreciation allowances during the period of the holiday",[8] as well as on whether and how much profits are generated during the tax holiday.

ii. Withholding taxes on income remitted abroad

Another income-based tax incentive commonly used in the extractive sector is a withholding tax (WHT) relief in respect of outbound payments, including services, interest, royalties, management fees, and shareholder dividends.[9] Such relief usually takes the form of an exemption or a reduced WHT rate. The impact of GloBE on WHT incentives varies in relation to the nature of the relevant income to which it applies.

[6] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, p. 15.
[7] Ibid., p. 16.
[8] Ibid., para. 14.
[9] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, pp. 15 and 16. Also, Readhead. A., *Tax incentives in mining: minimizing risks to revenue*. IGF-OECD (2018), p. 25.

- WHT on interest, royalties, services and portfolio dividends

  Withholding taxes on interest, services, royalties and portfolio dividends are attributed to the recipient entity's jurisdiction for calculating the GloBE ETR. Thus, whether such incentives are impacted by the GloBE rules will depend on the tax profile of recipient entities. For in scope MNEs, it can be assumed that profits from such payments will be taxed at a minimum rate of 15%. As with all incentives, if a WHT exemption leads only to additional tax payable upon receipt, the incentive will be ineffective.

  STTR Tax: Importantly, intragroup payments for defined categories of income, such as services, interest and royalties, may be captured by the STTR, which would be akin to WHT. The STTR is a treaty-based rule that supplements the GloBE rules, reinstating the source taxing rights where certain intragroup payments are not subject to a minimum rate of 9% in the recipient's residence jurisdiction.[10] Accordingly, where relief from WHT has already been granted on payments covered by STTR, the STTR recaptures the relief up to a maximum tax cost of 9% on the gross income.

- Dividend WHT

  Withholding tax on non-portfolio dividends is attributed to the source (i.e., the "dividend paying") jurisdiction for the purpose of calculating the ETR. The rationale behind this is that such tax represents an additional tax on the income of the distributing entity that has been included in the OECD GloBE.[11] Since the underlying income from which the dividends are paid was included in the distributing entity's GloBE income, any tax paid on such dividends is assigned to the jurisdiction of the constituent entity that originally earned the underlying income for the GloBE purposes.[12] Therefore, while WHT on dividend distributions is a legal liability (and tax expense) of the recipient shareholder, it is included in the covered taxes of the distributing entity. The impact of GloBE on WHT exemptions or reductions on dividends depends on the ETR for the distributing entity's jurisdiction – i.e., if above 15%, the incentive will not be impacted, but if below, it may be partially or totally offset by the top-up tax levied by another jurisdiction.

Cost-based incentives

Cost-based incentives are widely offered across resource-rich countries, allowing taxpayers to recoup their investment faster through special deductions from their taxable income or directly from the amount of taxes to be paid. This defers tax payments to later stages in a project's life, thus not reducing cash flows to companies in the initial years.[13] The most common types of cost-

[10] In September 2023, the Inclusive Framework concluded negotiations on the Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule (the STTR MLI). The STTR is intended to help developing countries, notably those with lower administrative capacities, to protect their tax base. *See* OECD (2023), *Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule.*

[11] Commentary on the OECD GloBE Model Rules, *Article 4.1.3.*, para. 11.

[12] Commentary on the GloBE Model Rules, *Article 4.3.2.*, paras 60-61.

[13] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, p. 15. Also, Readhead. A, *Tax incentives in mining: minimizing risks to revenue*. IGF-OECD (2018), p. 28.

based incentives offered to extractive industries are investment allowances and credits, accelerated depreciation and loss carry forward.

i. Accelerated depreciation, immediate expensing, and loss carry forward

Some of the most common types of incentives offered to the extractive sector and beyond are accelerated depreciation and immediate expensing of business assets. Accelerated depreciation allows the cost of an asset to be written off at a faster rate than the accounting rate of depreciation. Immediate expensing allows the entire cost of an asset to be deducted for tax purposes in the first year of investment. Both lower the taxable profits of firms for the years they apply, leading to a deferral of taxation to later stages in a project's life and thus a timing benefit. These are referred to as "timing differences" because the tax rules allow for deductions at different points compared to when amounts are recognized as expenses for accounting purposes.

GloBE relies on financial accounts to compute the tax base and does not take into account the beneficial tax treatment of depreciation and the timing benefits of incentives like accelerated depreciation and immediate expensing. As these incentives simply create a 'temporary' difference, where the payment of the tax is not reduced but deferred into the future, failing to address them under GloBE would lead to over-taxation, especially for capital-intensive businesses such as the extractives industries. Recognizing this, GloBE rules incorporate deferred tax accounting adjustments in the calculation of covered taxes to avoid the imposition of the top-up tax as a result of timing differences. GloBE allows the deferred tax liability accrued in the financial accounts at the minimum rate to be added in the adjusted covered taxes computation, neutralizing the timing difference effect in the ETR. As such, in principle, these incentives would not be affected by the GloBE rules.

However, GloBE only allows a deferral for a maximum period of five years, where if the book-tax difference is not reversed within this period, the top-up tax needs to be recaptured. This means that the MNE has to recalculate the amount of covered taxes for the year when the deferred tax liability was originally credited under GloBE, regularizing the amount of top-up tax that should have been paid if no adjustment had been made for the timing difference.

The five-year recapture rule has exceptions that allow the extractive sector to continue benefiting fully from many cost-based incentives, such as accelerated depreciation and immediate expensing in relation to tangible assets.[14] The Recapture Exception Accrual Rule (REAR)[15] includes a list of categories of deferred tax liabilities such as cost recovery allowances on tangible assets that do not need to be monitored for recapture, even if the temporary difference they create is not reversed within five years. Tangible assets under GloBE not only consist of assets classified as property, plant, and equipment or stockpiles for financial accounting purposes, but also include natural resources, such as mineral deposits, timber, oil and gas reserves, and exploration and evaluation assets. Timing differences in relation to de-commissioning and rehabilitation expenses, research and development, foreign exchange gains and losses, and fair value accounting on unrealized net gains are also allowed under REAR. In addition, REAR applies to the cost of a license or similar arrangement from the government, such as a lease or concession for the exploitation of natural resources, where this entails significant investment in tangible assets, as well as to de-commissioning and remediation expenses.

[14] OECD (2022). *Tax incentives and the Global Minimum Corporate Tax: Reconsidering tax incentives after the GloBE rules,* para. 62.

[15] Article 4.4.5. (b) and (d) of the GloBE Model Rules and Commentary on the GloBE Model Rules, *Article 4.4.5.*, paras 96 and 98-101.

The same deferred tax accounting adjustment applies to deferred tax assets from loss carry-forward regimes. Domestic tax rules may permit taxpayers to carry losses forward until they have been completely offset against future tax liabilities. This creates timing differences, where GloBE allows deferred tax adjustments, reducing the amount of covered taxes in the year in which the deferred tax asset is recognized and increasing it as the loss is utilized, neutralizing the deferred tax asset's effect on the ETR. Thus, loss carry-forward regimes generally remain unaffected by the GloBE rules. [16]

However, where a deferred tax liability adjustment is allowed under GloBE (and no recapture applies), the deferred tax arising from timing differences is only recognized in the ETR at the minimum rate. If the tax rate applicable is below 15%, the tax amount will have to be paid in the year when the income is recognized in the financial accounts, meaning that the deferral would not be applicable for GloBE purposes. Thus, even in relation to cases where recapture would not be needed in relation to incentives for immediate expensing or accelerated asset cost recovery, these may still be affected by the top-up tax if the tax rate applicable is below 15%.

ii. Investment allowances and credits

Investment allowances and credits are tax reliefs based on the capital expenditure on qualifying investments, providing benefits beyond the value of depreciation of an asset. The impact of GloBE on these incentives differs.

In relation to investment allowances, the GloBE's impact will depend on whether they give companies the right to deduct up to or more than 100% of the value of the acquisition cost or depreciation expense of the asset to which it relates.

An investment allowance giving the right to a deduction up to 100% of the actual investment cost will not give rise to additional tax liability under GloBE (provided the REAR applies), because it only leads to a timing benefit. As indicated above in relation to accelerated depreciation and immediate expensing, the GloBE rules prescribe certain adjustments to the ETR calculation to neutralize its effects on timing differences from such incentives. Therefore, as long as the investment allowance produces the same effect as an immediate expensing, where the amount allowed to be written off in advance does not exceed the actual investment cost, the same deferred tax adjustments under GloBE apply.

Enhanced investment allowances, such as a capital allowance uplift, which entitle the taxpayer to deduct an amount that exceeds the actual expenditure incurred, are more likely to be affected by the top-up tax.[17] Under GloBE, the grant of enhanced deductions may give rise to a top-up tax even where the MNE group has no GloBE income in a jurisdiction. This can occur where a permanent book-tax difference arises as the domestic tax rules allow, e.g., a deduction that is in

[16] However, deferred tax accounting for carry-forward tax credits, such as foreign tax credits, is not permitted under GloBE and can result in top-up tax.

[17] As described by the OECD, if, for example, the "taxpayer is entitled to depreciate 120% of the acquisition cost of the asset, then the additional 20% is considered a tax allowance", which may be affected by the GloBE rules provided the ETR for the jurisdiction is below 15%. This is because such enhanced investment allowances will reduce the covered taxes (numerator) in the GloBE ETR calculation, where no specific adjustment is made to this nor to the GloBE income (denominator) to neutralize their effects, thereby contributing to the reduction of the ETR and potentially being offset if the ETR falls below 15%. *See* supra fn. 14

excess of the amount that would be allowed for financial accounting purposes, and that is not reversed over time. In this situation, the local tax loss will be greater than the loss recognized under GloBE, resulting in an excess benefit. To address this, Article 4.1.5 of the Globe Rules imposes an additional current top-up tax on the excess benefit in the year in which the permanent difference is created at the minimum rate. This may impact how countries will grant deductions in excess of the economic cost of assets, because even where the company has a loss for GloBE purposes, the top-up tax may be charged on the excess benefit created.

Investment credits allow a reduction of the amount of tax payable, rather than the taxable income, by a portion of the taxpayer's investment expenditure in the first year. A credit allows a percentage of the investment to directly reduce the amount of taxes to be paid in a period, where if the taxes owed are lower than the taxpayer's entitlement to a credit, resulting in a negative tax liability, such negative balance can be paid back to the investor by the government, carried forward to offset future tax liabilities, or expire. The impact of GloBE on tax credits depends primarily on whether they are qualified refundable or non-qualified refundable credits and, subordinately, on whether they can be transferable at a marketable price.

First, the GloBE rules provide for an adjustment for "Qualified Refundable Tax Credit" (QRTC) in the ETR. GloBE follows general financial accounting standards by treating refundable tax credits as income rather than a reduction in the firm's tax expense, as is the case with grants. Thus, the rules adjust the GloBE income for QRTC, where the credit will be treated as income in the ETR, rather than a reduction in covered taxes. A QRTC under GloBE is a credit refundable within four years from the date when the conditions for it are met and is either payable as cash or cash equivalent. Where the QRTC is recorded in the firm's financial accounts as a reduction to current tax expense in the year it is refunded, an adjustment will be made to add the amount of credit to the covered taxes, in addition to including such amount in the GloBE income.

All other refundable credits (i.e., refundable for more than four years) are deemed "Non-Qualified Refundable Tax Credits" (non-QRTCs) under GloBE. In principle, non-QRTCs and non-refundable tax credits will be excluded from the computation of GloBE income and be treated as a reduction to adjusted covered taxes. However, if it is a transferable tax credit, although considered a non-refundable credit or a non-QRTC, it can still qualify as a "Marketable Transferable Tax Credit" (MTTC) and be treated as income in the ETR computation, in a similar way to QRTCs. To qualify as a MTTC, the credit must be a tax credit that can be used by the credit holder to reduce its liability for a covered tax in the jurisdiction that issued the credit and that meets both the legal transferability standard and the marketability standard in the hands of the holder (the originator or the purchaser of the tax credit).[18]

If the tax credit does not meet the refundability criteria (to qualify as a QRTC) or the transferability criteria (to be considered a MTTC), it will be treated as a reduction of covered taxes under GloBE. This will be the case for "Non-Marketable Transferable Tax Credits" (non-MTTCs) - those that are transferable but not considered MTTCs -, or "Other Tax Credits" (OTCs), which are non-refundable and non-transferable credits that can only be used to offset the originator's liability for a covered tax.

In conclusion, the QRTCs and MTTCs increase GloBE income while non-MTTCs and OTCs reduce GloBE covered taxes. In any ratio, reducing the numerator has a larger impact on the ratio

[18] Broadly, the legal transferability standard is met if the credit can be transferred by the originator or purchaser to an unrelated party. The marketability standard is met if the credit is transferred by the originator or from the purchaser at a price of at least 80% of the net present value of the credit (the "Marketable Price Floor").

than increasing the denominator by the same amount. Therefore, the QRTCs and MTTCs are less likely to reduce ETRs below 15% and create top up tax liabilities than non-MTTCs and OTCs.

In this context, jurisdictions may wish to consider the benefits of aligning their tax credit regimes to the QRTC and MTTC definitions under GloBE. However, countries opting to offer these incentives will need to make a payment (in cash or in cash equivalent) to investors within four years if the credit exceeds the liability, amounts of which can be significant. Such a requirement can make this instrument a less viable option, especially for developing and emerging economies.

iii. Customs duty reductions or exemptions

Customs or import duty relief is also commonly offered to the extractive sector, allowing investors to import goods such as equipment, plant, fuel and construction material duty-free.[19] Since, in general, import tax or customs duty is levied on the value of the imported goods, it will not qualify as a covered tax under GloBE. As noted above, the definition of covered taxes under the GloBE rules (broadly) means income-based taxes,[20] and the import tax is a tax based on the value of the good rather than on a measure of income. In addition, the "in lieu" test set out in the rules to regard a tax as a tax imposed in lieu of a generally applicable CIT is unlikely to be satisfied to include custom duties or import duties as covered taxes.[21] Therefore, any custom duty or import tax relief will not be affected by Pillar Two.

iv. VAT exemptions on imports

Many resource-rich countries exempt imported inputs used in oil and gas operations from VAT to avoid the complexities of refunding VAT paid on inputs by export-oriented extractive industries, which do not pay VAT on exports. This practice aims to eliminate or reduce issues related to VAT imposition and immediate refund requirements.[22] However, the GloBE rules explicitly exclude VAT from the definition of Covered Taxes, as VAT is "calculated by reference to the consideration for a defined supply and are not Taxes on the net income or equity of a taxpayer".[23] Thus, while the effectiveness of adopting a VAT exemption may be debated, any incentives offered under the VAT regime will not be affected by the GloBE rules.

v. Production royalty-based incentives

Royalties are an "obligatory payment made by the operator of the extraction project to the country as a compensation for the extraction rights."[24] Typically calculated as a percentage of the gross volume or value of the production and/or by reference to the type, quantity, and quality of the extracted mineral resource, royalties are due upon commencement of production rather than when the project is profitable, and are usually charged at a constant rate, imposing a fixed cost on the

[19] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries p. 19. Also, Readhead. A., *Tax incentives in mining: minimizing risks to revenue*. IGF-OECD (2018), p. 35.

[20] Article 4.2.1 of the GloBE Model Rules. Also, Commentary on the GloBE Model Rules, *Article 4.2.1*, para. 25.

[21] Article 4.2.1(c) of the GloBE Model Rules. Also, Commentary on the GloBE Model Rules, *Article 4.2.1*, paras 31-32.

[22] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, p. 20.

[23] Commentary on the GloBE Model Rules, *Article 4.2.1*, para. 36a.

[24] Handbook on Taxation of the Extractive Industries, p. 475.

investor irrespective of profitability. Governments offer production royalty-based incentives to reduce the burden on the project during the initial phase until sunk costs are recovered, encourage new entrants, and prevent early termination of production as resources approach depletion.[25] These include: (i) royalty holidays that reduce or eliminate payments for a period; (ii) royalty deferrals that postpone payments; and (iii) sliding scales, where rates vary based on sales, production, price or costs.

Production royalties are not considered covered taxes under GloBE. The Commentary clarifies that "natural resource levies closely linked to extractions (for example, those that are imposed on a fixed basis or on the quantity, volume or value of the resources extracted rather than on net income or profits) would not be treated as Covered Taxes except where these levies satisfy the "in lieu of" test" [26]. Thus, incentives granted to production royalties, which are charged "ad valorem" and not in lieu of income taxes, are not affected by the GloBE rules. However, royalties imposed on profits similar to income taxes may be impacted.

Summary

The following table summarizes the incentives discussed above, and the likelihood of these incentives leading to top-up tax being payable in a headquarter jurisdiction as a result of Pillar Two GloBE rules.

Nature	**Type**	**Intensity of effect**
Profit-based incentives	Income Tax holiday	More likely – where effect is to reduce local ETR below 15%
	Withholding taxes on income remitted abroad as:	
	Interest and royalties	More likely (to impact recipient jurisdiction, not source state)
	Dividends (non-portfolio)	More likely (to impact source state) if local ETR is already below 15%
	Export processing zone (EPZ)	Depends
Cost-based incentives	Accelerated depreciation and immediate expensing (including rehabilitation and remediation (decommissioning) costs on:	
	Tangible assets and resource rights	Unaffected – Pillar Two allows deferred taxes for intangible assets to be included in ETR at 15%
	Short-lived intangible-assets	Less likely – Pillar Two allows deferred taxes for intangible assets to be included in ETR at 15%, as long as the timing difference reverses within 5 years
	Other intangible assets	More likely – deferred taxes for intangible assets are subject to a recapture rule if timing differences do not reverse within 5 years

[25] Committee of Experts on International Cooperation in Tax Matters; Nineteenth Session (2019), Update of the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries, p. 21. Also, Readhead. A., *Tax incentives in mining: minimizing risks to revenue*. IGF-OECD (2018), p. 39.

[26] Commentary on the GloBE Model Rules, *Article 4.2.1*, para. 28.

	Loss carry forward	Unaffected – deferred taxes in relation to carried forward losses, on their own do not adversely impact the ETR
	Investment allowances for tangible assets:	
	More than 100% of actual cost	More likely – potential to lead to a permanent tax benefit which reduces the ETR below 15%
	100% or less than actual cost	Less likely – see comments above on cost-based incentives for tangible assets
	Investment credits:	
	Qualified refundable credits	Less likely – these credits are included in GloBE income rather than reducing Covered Tax so are less likely to reduce the ETR below 15%
	Marketable transferable tax credits	Less likely – as above
	Other tax credits (non-refundable and non-transferable)	More likely – these credits reduce Covered Tax so a more likely to reduce the ETR
	Customs duty reductions or exemptions	Unaffected – Customs duty is not a Covered Tax
	VAT exemptions on imports	Unaffected – VAT is not a Covered Tax
	Production royalty-based incentives	Unaffected – Production based royalty is not a Covered Tax
Note: "More likely" means that the incentive has a strong potential to bring the ETR below 15% and as such is more likely to result in top-up tax payable under Pillar Two. Should the ETR in the jurisdiction be above 15%, there is still a chance that these incentives will remain effective.		

2.4. What could be the impact of stabilization provisions and what options are available to governments in relation to existing stabilized agreements?

As a consequence of GloBE rules, source countries may consider changes to domestic tax policy to ensure any additional top-up tax payable by MNEs in respect of activity in those countries, is paid in those source countries rather than in shareholder jurisdictions. For developing economies, this requires consideration of the applicable fiscal terms that govern operations in their jurisdiction and their interaction with the GloBE rules, including where there are investment contracts or agreements covered by stabilization clauses - stabilized agreements. Under many stabilized agreements, changes to domestic tax legislation will not apply to the stabilized projects/entities, or will only apply if they do not increase the overall tax burden[27].

Stabilized agreements can be considered in two categories:

i. In most cases, extractive industry companies' ETR will be higher than 15%, or companies will be out of the scope of Pillar Two (i.e., junior companies and mid-cap). There will be no impact on those agreements.
ii. In-scope companies with jurisdiction-level GloBE ETR below 15% will be subject to the GloBE rules, typically in the form of an IIR imposed by countries in which the parent

[27] Stabilized agreements can take various forms and are discussed in more detail in Chapter 2 of this Handbook

company or intermediate shareholders are located, regardless of stabilization provisions in host jurisdictions. In this case, an existing stabilized agreement focused on host taxation is unlikely to cover the top-up tax paid by the parent. The host jurisdiction may wish to raise taxes by an equivalent amount to ensure tax remains in the host jurisdiction. However, because the tax regime applicable in the host jurisdiction has been stabilized, any imposition of additional local taxes in the host jurisdiction in response to the GloBE rules is not possible without mutual agreement. While changes to the existing arrangements should be feasible, several commercial and legal issues need to be considered as stabilization provisions operate within existing legal regimes, and they are likely to cover a range of issues beyond taxation.

This section considers whether there are practical ways to amend tax stabilization provisions while reducing complexity for governments and investors. An important consideration will be ensuring that any additional tax paid locally is in fact a Covered Tax which is taken into account for the purposes of the GloBE rules.

Pillar Two Interaction with Existing Stabilized agreements

Any changes to domestic tax policy will need to take into consideration stabilized agreements. In this regard, the term ‘stabilized agreement’ is used to refer to any agreement that sets the tax regime for a project and limits the application of changes in domestic tax law to the project. This may be done in several ways:

- The agreement may ‘freeze’ taxation law in force at a particular date so that future changes to domestic law are not applicable to the investment.
- The agreement may set out the tax regime in relation to the project (in a manner that differs from the general domestic tax regime).
- The agreement may provide for equalization of the value-sharing arrangements, or compensation to be paid to an investor where there are changes to the taxation regime.
- In some cases, the agreement may provide for a combination of the above.

The common feature of such an arrangement is that it is not generally possible to amend the fiscal regime for a project simply through changes to the general domestic tax rules. Importantly, stabilized agreements in relation to taxation are generally part of a wider framework of agreements governing project investment. These agreements cover a wide range of commercial matters beyond taxation, e.g., the legal regime governing the project and construction, state participation where relevant and dispute resolution. These agreements may be documented in the form of investment agreements, production sharing contracts, conventions and framework agreements (among others).

Stabilization clauses however vary in many respects, notably in nature, scope, and time period. This lack of consistency makes it difficult to generalize about the potential interaction between such clauses and changes to the domestic tax regime. Those interactions will depend on a case-by-case reading of the precise wording of the fiscal stabilization provision. There are at least three things to consider when reviewing a stabilization clause in this context, namely: what tax it covers and in particular if this is considered a covered tax; secondly the duration of the stabilization provision; and lastly whether it is a freezing or economic equilibrium clause. It will be important for a government to ascertain that relevant stabilization clauses are still in force as it is common for such clauses to be time bound or to be linked to the company reaching certain production volumes.

To the extent the GloBE rules result in additional top-up tax payable in relation to projects (usually at the level of the parent company or intermediate companies, under an IIR), host governments will likely have an objective to ensure that tax is instead paid locally. In many cases investors may have a similar objective to the host country. That is a preference to pay additional tax in the source jurisdiction of operations, if the GloBE rules would otherwise result in additional top-up tax being paid in a shareholder jurisdiction.[28]

Where mutually agreed between the parties, it may be possible to amend the tax regime for projects that are governed by stabilized agreements. Two potential approaches and issues to consider are set out below.

1. Amend tax clauses of existing stabilized agreements.
2. Implement a side agreement or a waiver outside the stabilized agreement.

Option 1 – Amend Tax Clauses of existing stabilized agreements

Amending stabilized agreements through mutual agreement would involve a renegotiation of tax clauses embedded within stabilized agreements. This approach would provide a number of benefits:

- This would provide the highest degree of certainty to governments and investors in relation to the tax regime for the project.
- Modifications to the stabilized agreement would enshrine the way corporate tax rules apply regardless of the evolution of the GloBE rules and how they are implemented by the relevant shareholder country. This would ensure stability and certainty for both parties – as the government would not be dependent on how the GloBE rules are imposed by shareholder countries, ongoing progression on the interpretation of the GloBE rules (including subsequent releases of administrative guidance by the OECD), or whether Pillar Two tax is payable by new investors. Different investors can have different Pillar Two outcomes and there can be different outcomes for jointly owned projects – linking local tax payments to different investor positions would be extremely challenging and potentially lead to inequitable outcomes depending on the characteristics of an investor.
- This approach enables the tailoring of arrangements for specific projects to meet government and investor objectives. This may include, for example, removing corporate tax holidays or other incentives that are ineffective under the GloBE rules, and replacing them with a higher corporate tax rate along with more effective tax incentives such as accelerated tax depreciation or immediate expensing. If agreed, it would be possible to neutralize the effect

[28] As noted in the Administrative Guidance released by the OECD in July 2023, if a jurisdiction does not impose the QDMTT due to a stabilization agreement, that QDMTT will not be treated as "payable". Consequently, it will not reduce the top-up tax to zero in other states. This implies that the top-up tax may be levied by another jurisdiction under IIR or UTPR, irrespective of the terms of the stabilization agreement. *See* OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf, at paras. 73-81.

of top-up tax arising under the GloBE rules for investors while also benefiting local governments, by changing the mix of taxation applicable to the project, or the timing of tax collections for governments.

- Many tax incentives operate with the effect of minimizing tax payments during the earlier stages of operations. Replacing these incentives which are likely to give rise to top-up tax are expected to accelerate tax revenues for host jurisdictions.
- Where stabilized agreements are published, this provides transparency in relation to the tax regime for the project and provides the highest level of certainty for investors.
- This would ensure that any additional tax which is payable is in fact required to be paid by law, as voluntary payments are unlikely to be considered 'Covered Tax' for the purpose of Pillar Two.

Amending or adjusting tax clauses within stabilized agreements may be complex and risky for governments and investors, given the potential to trigger renegotiation of issues wider than tax. In addition, renegotiation can take many months. One way to address this complexity would be to provide the option of a simplified approach for importing a simplified domestic minimum tax into stabilized agreements.

Option 2 – Implement a side agreement or a waiver outside the stabilized agreement

Instead of directly amending a stabilized agreement through mutual agreement between investors and host government, a side agreement may be entered into. A side agreement generally comprises an agreement outside of the stabilized agreement that has the effect of amending certain clauses of the original agreement. Similarly, an investor may agree to 'waive' certain clauses in the stabilized agreement, enabling a host government to introduce new fiscal terms in response to the GloBE rules.

This approach may reduce the complexity and limit the scope of amendments that can be made to the existing stabilized agreement, thus limiting risks associated with opening wider issues outside of the tax regime for a project. In these circumstances, investors are likely to insist on clarity of what is being agreed to and on dispute resolution processes in the event of disagreement as to the interpretation of the side agreement or waiver. Where this approach is adopted, it will be necessary to ensure the existing stabilization clauses and applicable laws permit variation, and that the agreement relates only to tax. It may also require consideration of the legal standing of the side agreement or waiver, in comparison to the stability agreement itself. For example, a stability agreement may have been ratified by Parliament. The legal effect of side agreements or waivers would need to be considered based on laws and regulations in the relevant country.

As for option 1, it would be necessary to ensure any additional taxes are in fact legally payable and an alternative would be to provide pro-forma agreements or interpretative guidelines to be followed when implementing a side agreement.

3. Tax policy responses

3.1. What are the possible domestic policy responses of resource-rich countries?

Where countries project that the implementation of GloBE will result in the imposition of a top-up tax in another jurisdiction, either through the mechanics of the IIR or UTPR, they may consider enacting domestic policy responses that serve to preserve their primary taxing rights. Various domestic policy responses will be available to resource-rich countries subject to some

potential legal barriers within their domestic or international legislative regime that could limit the scope of reforms.

Resource-rich countries will not be impacted by GloBE in a uniform manner and so the proposed responses and their varying complexity will need to be weighed against any projected revenue losses, as well as other domestic fiscal priorities. Each country will accordingly need to determine which policy reforms best meet its national interest and which are most practicable within its administrative capacity constraints. Where a resource-rich country establishes that it hosts only a few constituent entities (with predictably low profits) of in-scope MNEs within its jurisdiction, or that the constituent entities, on the whole, are subject to an ETR higher than 15%, maintaining the status quo may be the easiest course of action, as there is no or little revenue loss at stake and there can be considerable complexity in introducing new tax provisions. Those countries may still wish to reflect on the effectiveness, use, and mix of tax incentives that they avail to companies operating in the sector.

This section considers the most viable policy responses for resource-rich countries. Given the extensive use of tax incentives as an investment promotion tool, a key response is likely to be the revision of the tax incentives regime and specific consideration of stabilization provisions if applicable (as discussed above). Countries may also implement broader reforms that ensure that any possible top-up taxes are retained domestically, such as by implementing a Domestic Minimum Tax (DMT). A QDMTT is one version of DMT that is consistent with GloBE rules and would only apply to MNEs that are in scope of the GloBE rules[29]. A QDMTT would qualify for the QDMTT Safe Harbour (discussed further below). A country may also choose to adopt these two domestic measures in a concurrent manner particularly in light of the complexities of unwinding the tax incentive regime applied to extractive companies. This section considers the impact of these two response measures in turn.

For projects that have existing stabilization agreements, this section should be considered in conjunction with Section 2 - in other words, the first step would be to consider which revisions to existing tax incentives are possible under stabilized agreements, and which revisions require amendments to the stabilized agreements.

3.2. Review the use of tax incentives

Given that the GloBE rules are likely to nullify benefits that investors derived from the use of some types of tax incentives, it is recommended that countries review the effectiveness of the existing set of tax incentives, following recommendations from the main body of this chapter, with a view to considering optimizing their use in the new environment. This review will need to take into account the nuances of the GloBE rules, including the fact that the Substance Based Income Exclusion will result in some profits not being subject to a top up tax. Furthermore, taxes imposed by other jurisdictions on in-scope MNEs may further impact the overall effectiveness of tax incentives granted to the industry under the GloBE rules.

The governance structure of the extractive industries may serve to complicate the evaluation of tax incentives within the sector. Although good practice suggests tax incentives should be

[29] Alternatively, based on the latest Administrative Guidance released by the OECD on 2 February 2023, an implementing jurisdiction has flexibility to expand the application of their QDMTT to a broader scope than the GloBE rules.

provided for in general tax legislation, in practice, tax incentives can be located in the following sources:

1. Corporate income tax laws
2. Investment promotion laws
3. Sector-specific laws (e.g. petroleum, mining, agriculture, fisheries, forestry, manufacturing, telecoms, etc.)
4. Laws governing special economic zones.
5. Special statutory provisions or decrees
6. Bilateral investment treaties (BITs)
7. Investment agreements, including concession agreements or production-sharing contracts for extractive industries (including stabilized agreements as discussed above)
8. Free Trade Agreements - regional or inter-regional
9. Ad hoc government acts (e.g., decrees)

When countries decide to change certain tax incentives, they will need to firstly map out the exact source of tax incentives for in-scope MNE's. Next, countries will need to ascertain the interaction of the specific incentives or the combination of several incentives with the GloBE rules. Then they will need to assess the legal constraints that may impede the withdrawal of impacted tax incentives with special attention to the stabilization provisions whose risks have been assessed above. Countries will then have to ensure that the reform process is carried out in a comprehensive and consistent manner by amending the tax incentive regime in both the domestic and international sources that have been identified above. Whilst reviewing tax incentives is the most targeted manner to retain domestically any possible top up tax, depending on a country's legislative framework, it may prove to be a time and resource consuming exercise. The risks of renegotiating contracts to extend tax incentives must also be balanced against the overall revenue implications of exploring other options of domestic revenue retention under the GloBE rules.

Rather than entirely unwind the use of tax incentives, countries may seek to revisit the mix of tax incentives granted to extractive companies. As the impacts of tax incentives on the GloBE ETR vary, countries and companies may wish to replace profit-based tax incentives with measures such as certain tax deferrals and investment allowances, for example. Given the capital-intensive nature of extractive projects, cost-based tax incentives such as these have been found to be more appropriate relief measures. Care should be taken to ensure that any resulting incentives represent value for money to the country, as discussed more widely in the main body of chapter 5.

Reviewing tax incentives may be carried out in parallel with other response measures such as the adoption of a broader domestic tax or a qualified domestic minimum top-up tax which may be implemented sooner.

3.3.Adopt a Qualified Domestic Minimum Top-Up Tax (QDMTT)

The GloBE rules provide specific treatment where a jurisdiction introduces a QDMTT. This response measure is, however, not industry specific and must be implemented across all industries. Applying a QDMTT to extractive companies only could be perceived to be inherently discriminatory in nature and open a country to various domestic and international challenges. It would also mean the regime does not meet the scoping requirements under the GloBE rules, causing the DMT to not be recognized as having a "qualified" status. [30]

[30] OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), OECD/G20 Inclusive Framework on BEPS, OECD, Paris. www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two.pdf.

A country has the choice to:

- introduce a Qualified Domestic Minimum Top-up Tax (QDMTT) to ensure that the "top up tax" is paid locally rather than at the headquarters level; or
- implement a "relaxed" QDMTT that operates as a credit against any IIR payable.

Adopting a QDMTT as prescribed by the OECD has the advantage of aligning with the top-up taxes that would be collected under IIR or UTPR. A QDMTT further presents a targeted response to the GloBE model rules and so it will not impact out of scope companies, which may be an important consideration for host countries. It also ensures that the benefit of the substance can be provided to investors, without leading to additional top up tax in shareholder jurisdictions (as discussed further below). A QDMTT takes priority to the IIR and UTPR and also ranks before controlled foreign company (CFC) taxes.

On the other hand, a QDMTT essentially requires implementation of rules and administration that mirror Pillar Two and would therefore be complex to administer and would require significant additional capacity for many countries' tax authorities – at the very least, specialist knowledge of international accounting standards, the Pillar Two Model rules and their commentary

In February and July 2023, the OECD published guidance that provides further insights into the scope and nature of QDMTTs, including that it can be more restrictive in scope than the GloBE rules in order to preserve consistency with local tax rules. Countries are not compelled to provide adjustments to the computation of a QDMTT that are not consistent with the domestic tax system. The application of a QDMTT may be extended to constituent entities whose UPE is located in a country but fall outside the revenue scope of the GloBE rules. It can even apply to purely domestic companies.

While this annex is not intended to cover in detail every aspect involved in a QDMTT achieving qualified status, the main considerations for a host country are outlined below. The requirements are described in detail in the GloBE rules and the 2023 guidance.

The GloBE rules currently define a QDMTT as a domestic minimum tax which presents the following characteristics:

1. Determines the excess profits of Constituent Entities located in the country (domestic excess profits) in a manner that is equivalent to the GloBE rules.

2. Increases the domestic tax liability with respect to domestic excess profits to the minimum rate for the country and Constituent Entities for a fiscal year.

3. Is implemented and administered in a way that is consistent with the GloBE rules and the commentary, so long as the adopting country does not provide any benefits that are related to such rules.

<u>GloBE Rules</u>

In order for a DMT to be a QDMTT, i.e., achieve "qualified status, an implementing country will need to use substantially similar methods to the model rules towards calculating the ETR of in-scope companies as well as any resulting top-up tax. Each jurisdiction will invariably have to

customize a QDMTT to its local circumstances, which the IF recognizes. However, any deviation from the model rules will need to be justifiable within the context of the domestic tax system and will need to result in outcomes consistent with the purpose of the rules.

An assessment of the viability of a QDMTT will need to be conducted in a case-by-case manner, taking into account existing outcomes under a country's domestic law. There are, however, two main principles for qualifying as a QDMTT:

a. The minimum tax must be consistent with the design of the GloBE Rules; and

b. The minimum tax must provide for outcomes that are consistent with the GloBE Rules.

QDMTT Safe Harbor
In order to qualify for the safe harbor, a QDMTT should meet three specific standards: 1. The accounting standard: QDMTT legislation should adopt either a provision that requires QDMTT calculations to be based on the accounting principles set out in the Model Rules, using constituent entity-level accounts based on the financial accounting standard of the UPE's consolidated financial statements, except where not reasonably practicable, or the locally applicable financial accounting standard rules. 2. The consistency standard: the rule computations must be the same as required under the Globe Rules. 3. The administration standard: the QDMTT implementing jurisdiction must meet the ongoing monitoring process requirements applicable to the GloBE Rules, which includes a review of the information collection and reporting requirements to ensure consistency with the equivalent requirements under the GloBE Rules and the approach set out in the Global Information Return standards.

Despite the stated benefits of applying a QDMTT, such adoption is likely to be a burdensome undertaking, particularly within the context of limited tax administration and enforcement capacities. Countries may opt to first monitor the extent to which top-up taxes attributable to entities within their country are enforced elsewhere; then, only in the event of significant revenue loss, decide to adopt a QDMTT. This "wait and see" approach will however rely on efficient information sharing processes and may present less legal and revenue certainty for governments.

A country's QDMTT will not exist in a vacuum. The qualification of a minimum tax as a QDMTT depends on its interaction with the existing tax system and whether it achieves outcomes consistent with the GloBE Framework. Therefore, if a country extends tax incentives that undercut the aims of GloBE, it will not be considered a valid QDMTT. Further, incentives, refundable credits or subsidies introduced by a country that are designed to compensate for the introduction of a QDMTT will result in the DMT not meeting qualifying status.

The IF has further developed a multilateral review process that will assess whether a country's domestic minimum tax produces outcomes that are consistent with the GloBE rules and if it should be treated as a QDMTT. In July 2023 the IF published administrative guidance, including examples, to clarify the interpretation and operation of the OECD model rules.

<u>QDMTTs and substance based carve-outs</u>

Although a QDMTT is not compelled to include a substance-based carve-out, if the aim is to mirror the impact of the IIR and UTPR, then countries may wish to provide investors with the benefit of the SBIE. The model rules restrict any such carve-out to the substance factors set out in the model rules, so that they may not go beyond the scope of exclusions for only tangible assets and payroll. The QDMTT could however provide for an applicable percentage lower than the GloBE rules and a country may decide not to adopt any transitional allowances in the percentages of the carve-out.

Given the high level of investment in tangible assets for developing economies, the quantum of the substance based carve out is likely to be significant and most relevant where corporate tax rates are 15% or lower. For a $1billion capital investment, the carve-out would be equal to $10.5m for a single year ($1billion asset base x 7.5% x 15%). As noted, the benefit of providing this carve out needs to be weighed against the complexity of administering a QDMTT for tax authorities and companies. For DMTs that do not qualify as QDMTTs, the value of the carve-out would be partially eroded.

3.4. Adopt a Simplified Domestic Minimum Tax

To preserve domestically any possible top up taxes, a country may adopt a domestic minimum tax (DMT) that achieves the same objectives as a qualified minimum tax but is simpler to design and implement. Like the QDMTT, this tax would need to be levied at a minimum rate of at least 15%.

To ensure the creditability of a domestic tax in foreign jurisdictions, countries will need to ensure that it is recognized as a covered tax. Under the GloBE rules, a covered tax is defined as "any tax on an entity's income or profits (including a tax on distributed profits), and includes any taxes imposed in lieu of a generally applicable income tax[31]." The tax must further be compulsory and unreciprocated. This threshold is easier to meet than the onerous threshold of a QDMTT, which may make this approach a more viable option for countries with limited administrative resources. As long as it is based on the profits of local constituent entities of MNEs, it should qualify as a Covered Tax. Where it is not considered a Covered Tax, for example if the simplified domestic tax is based on companies' gross revenue, it may risk adding an additional tax burden to a company that continues to face a GloBE top-up tax in another jurisdiction.

A domestic minimum tax can thus be implemented in various ways. This tax could apply broadly to all large corporate taxpayers, to all domestic MNE's or, similar to a QDMTT, be designed to apply only if a domestic constituent entity would be liable for a top up tax in another jurisdiction under the GloBE framework. The main difference between a simplified domestic minimum tax and a GloBE compliant QDMTT is in cases where the low taxed constituent entity is not anticipated to be liable for a top-up tax in a foreign jurisdiction. It would then be subject to a simplified domestic minimum tax, but not a QDMTT. A simplified domestic minimum tax thus risks increasing the tax liability of all MNE's operating in a jurisdiction indiscriminately. Simplified domestic minimum taxes will further not benefit from the safe harbor rules.

[31] Organisation for Economic Co-operation and Development. (2021). *FAQs on model GloBE rules.* p. 3. https://www. oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf

In theory, a DMT could enable countries to design a DMT that reduced the potential application of top up taxes but did so in a way that was significantly less burdensome than a QDMTT. However, care is needed to ensure that such a tax would qualify as both a Covered Tax for the GloBE purposes and as creditable tax for treaty obligations.

4. Conclusion

Many resource-rich countries will be impacted by GloBE rules as jurisdictions implement them domestically. As a result, each country should assess the likely impact of GloBE on its tax revenue base, and the implications for its tax incentive regime. This annexure has explored the three main domestic options that a resource-rich country may seek to implement in order to retain the "excess profits" of an extractive company domestically. Each response measure must however be assessed within the context of a country's overall policy framework and administrative capacity.

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