IGF-OECD Program on Tax Base Erosion and Profit Shifting in the Mining Sector

Introduction: Needs and Challenges

For many resource-rich developing countries, mineral resources present an unparalleled economic opportunity to increase government revenue and national economic activity. However, the unfortunate reality is that most developing countries have struggled to maximize the expected revenues from the sector due to a range of internal and external challenges. The end of the commodity super cycle has placed further financial pressure on many resource-rich countries, making it even more important to ensure that existing mining projects contribute their full share to government budgets.

At the same time, the broader issue of domestic resource mobilization to finance development has taken on a greater focus since 2015. The Sustainable Development Goals (SDGs) have set out the new sustainable development agenda for the next 15 years. Subsequent analysis has developed the linkages between this agenda and the mining sector in some detail. Of particular relevance for this program is SDG 17, which includes the objective of supporting developing countries to increase domestic revenue mobilization through taxation and management of revenue from natural resources. Domestic revenue mobilization is central to countries achieving full implementation of all SDGs. However, this ambitious agenda is under threat because of various combinations of aggressive tax planning, tax evasion, weaknesses in tax regimes, use of certain tax incentives and other related issues. This program will help developing countries overcome challenges to domestic revenue mobilization to achieve the SDGs.

In 2016, the member country governments of the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) identified tax base erosion and profit shifting (BEPS) as their collective primary concern. This is indicative of the risk that BEPS poses to mining revenues. In addition, many tax authorities of resource-rich developing countries lack the sector-specific knowledge and technical expertise, as well as appropriate tax law, to respond to BEPS affecting mining revenue collection. This program will identify the reforms and mechanisms necessary to counter BEPS in the mining sector.

How will we meet this challenge?

In 2015, the G20/OECD delivered the BEPS project, which has sought to address significant gaps in existing national and international tax rules to tackle tax avoidance and aggressive tax planning by multinational corporations. The BEPS Actions will provide a major underpinning for the IGF program. Other areas, such as the use of aggressive tax incentives and the role of tax treaties in the mining sector, will be the subject of additional studies to identify options for tax policy design to reduce BEPS.

The program aims to provide developing country tax authorities and mining regulatory agencies with practical guidance and tools to address a range of BEPS issues affecting mining revenue collection. These materials will cover the following issues:

1) Excessive interest deductions
2) Transfer mispricing (i.e., under-invoicing of mineral sales to related parties, and over-invoicing of goods, services, and assets received)
3) Undervaluation of mineral exports
4) Harmful tax incentives
5) Tax stabilization
6) International tax treaties
7) Indirect transfer of mining assets
8) Metals Streaming
9) Abusive hedging arrangements
10) Inadequate ring-fencing

For each of these issues, we will provide analysis that is specific to the mining context, propose specific legal language, identify required administrative processes, and indicate the capacity and information requirements to enable implementation.

How will we do this?

By producing practical guidance and tools to counter base erosion and profit shifting in the mining sector in developing countries, we will accomplish the following tasks:

- **Building on actions such as the OECD/G20-led Actions on BEPS**, we will adapt existing guidance on international tax issues to be mining sector-specific. We will take tax issues experienced by a range of sectors in the economy (such as double taxation treaties) and develop a framework by which governments of resource-rich countries can analyze the impact of tax treaty provisions on taxes imposed on the mining sector, as well as possible strategies to protect the mining tax base against specific treaty risks.
- **Filling vital gaps in the available resources**, we will develop new practical guidance and tools that specify the precise legal, administrative, organizational, and technical means required for tax authorities and mining regulatory agencies to address the tax issue. For example, we will look at "metals streaming," a financing arrangement that may reduce the tax base of resource-producing countries, for which there is virtually no guidance.
- **Keeping administrative capacity front of mind**, we will deliver practical tools capable of being implemented by developing country tax authorities. Mining tax law is only as effective as the administrative capacity of the tax authority responsible for enforcing it. Developing country tax authorities face a range of challenges that impede tax administration, including limited resources, technical expertise and access to tax information. All products will be designed to address these specific challenges.

- **Creating a "one-stop shop" website** for developing country tax authorities seeking support on tackling BEPS issues in the mining sector. The website will be an up-to-date centre of expertise on international tax policy design and administration in mining, and a home to the guidance and tools that will be developed over the next two years. Presenting the results of the program on a website, side-by-side, will offer users a holistic view of how different mining tax issues interact, and the potential policy trade-offs.

IGF will deliver the program in collaboration with the OECD Centre for Tax Policy and Administration. The African Mineral Development Centre (AMDC) is also a committed partner to the IGF program, helping to ensure strong participation from African governments. IGF plans to seek out partnerships with various regional tax bodies, for example, the African Tax Administration Forum (ATAF), and the Inter-American Center of Tax Administrations (CIAT).

To ensure that the IGF program is informed by, and responsive to, the needs of developing countries, a technical working group will be established, with representatives drawn from tax authorities and mining regulatory agencies. There may also be scope to involve academics, international agencies, non-governmental agencies and industry. Technical working group meetings have been built into the schedule: at the IGF's Annual General Meeting, the OECD's twice-yearly Natural Resources Policy Dialogue, and dedicated events in Africa (location to be determined). The website for the program will be used to stimulate other public input opportunities. Stakeholder engagement is a critical to ensuring a responsive, comprehensive and sustainable end-product.

IGF considers the next two years as the first stage of a longer-term intervention on BEPS in the mining sector. The first stage is primarily focused on designing the necessary tools and guidance, although, there will be some capacity building of government officials at IGF Annual General Meetings. The second stage will focus on supporting governments to implement the guidance, and will be designed later in 2018.

IGF-OECD Work Plan (2017–2019)

Tax Base Erosion and Profit Shifting in the Mining Sector in Developing Countries

IMPLEMENTATION PLAN

Issue 1	Excessive Interest Deductions					
Challenge: Companies may use related-party debt to shift profit offshore via excessive interest payments to related entities. "Debt shifting" is not unique to mining, but it is particularly significant for mining projects that require high levels of capital investment not directly obtainable from third parties, making substantial related-party borrowing a frequent practice.						
Activities		**2017**				**Lead partner**
		Q1	**Q2**	**Q3**	**Q4**	
1.1	Prepare a policy briefing on the impact of BEPS Action 4 (interest deductions) on the mining sector in developing countries, including the main problems/structures countries are seeing.	**x**	**x**			**OECD**
1.2	Prepare guidance for developing countries on options for addressing these difficulties in the mining sector specifically.		**x**			**OECD**

Issue 2	Transfer Mispricing in Mining							
Challenge: Transfer pricing occurs when one company sells a good or service to another related company. Because these transactions are internal, they are not subject to market pricing and can be used by multinationals to shift profits to low-tax jurisdictions. Related-party transactions in mining can be broadly grouped into two categories: (1) the sale of minerals and/or mineral rights to related parties; and (2) the purchase or acquisition of various goods, services and assets from related parties. Developing countries require sector-specific expertise to detect and mitigate transfer mispricing in the mining sector.								
Activities		**2017-2018**						**Lead Partner**
		Q3	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	
2.1	Design and deliver trainings for African tax authorities on transfer pricing risk assessment in the mining sector. A partnership with GIZ.	**x**	**x**	**x**	**x**	**x**	**x**	**IGF**

2.2	Half-day workshop on transfer pricing in mining to IGF member country representatives at the October 2017 IGF Annual General Meeting.		**x**					**IGF/ OECD**
2.3	Establish a high-level working group to produce a report on the future of transfer pricing in mining, specifically, options for alternative tax policy rules to supplement the arm's length principle.			**x**	**x**	**x**	**x**	**IGF**

Issue 3	**Undervaluation of Mineral Exports**						
Challenge: Profit shifting via the pricing of mineral products sold to related parties is a major concern for many mineral exporting countries. For developing countries, these risks are elevated where government agencies lack the mineral-testing facilities required to verify the grade and quality of mineral exports, as well as detailed sector-specific knowledge of the mining transformation process and mineral product pricing.							
Activities		**2017-2018**					**Lead Partner**
		Q3	**Q4**	**Q1**	**Q2**	**Q3**	
3.1	Prepare a report that evaluates different country approaches to establishing hard mineral-testing capabilities, for example, an independent mineral audit agency, outsourcing to the private sector, shared regional facilities.		**x**	**x**	**x**		**IGF**
3.2	Based on 1.1, prepare a roadmap for developing countries on how to establish or strengthen mineral-testing capabilities for specific minerals.					**x**	**IGF**
3.3	Pilot [OECD mineral product pricing case studies]() with select countries. The first pilot will be bauxite; countries may include Jamaica, Guinea and Australia. The purpose of the pilot is to test the pricing methodology to verify its utility for developing countries, and to deliver a new case study of bauxite.	**x**	**x**	**x**			**OECD**
3.4	Support IGF member countries in implementing the OECD mineral product pricing methodology via partnerships with regional tax administration bodies, and mining groups.			**x**	**x**	**x**	**IGF**
3.5	Half-day workshop on mineral product pricing to IGF member country representatives at the October 2017 IGF Annual General Meeting.		**x**				**IGF/OECD**

<table>
<tr><td colspan="2">Issue 4</td><td colspan="5">Harmful Tax Incentives</td></tr>
<tr><td colspan="7">Challenge: Mining and exploration tax incentives are common in developing countries. While tax incentives could encourage expansion of the sector, they may also lead to excess transfers of the gains from countries. It is unrealistic to expect that developing countries will forego incentives entirely due to the pressures of attracting investment. However, it is important that countries understand when tax incentives may be appropriate, how companies are likely to respond to incentives, and the distinction between tax incentives that permanently reduce taxes and from provisions affecting timing impacts.</td></tr>
<tr><td colspan="2" rowspan="2">Activities</td><td colspan="4">2017-2018</td><td rowspan="2">Lead Partner</td></tr>
<tr><td>Q3</td><td>Q4</td><td>Q1</td><td>Q2</td></tr>
<tr><td>4.1</td><td>Prepare a short guide to mining tax incentives. This will include:
- A typology of mining-specific tax incentives
- Examples of how these incentives are used in different countries
- Explanation of the particular behavioural response the incentive is likely to elicit from taxpayers (e.g., time-based tax holiday may increase rate of extraction of high-grade ore)
- Guidance on appropriate design and use of mining-specific tax incentives.</td><td>x</td><td>x</td><td></td><td></td><td>IGF</td></tr>
<tr><td>4.2</td><td>Develop an interactive financial model that demonstrates the effects of mining tax incentives on tax revenue for different mines (e.g., iron ore, copper, coal, gold, bauxite).</td><td>x</td><td>x</td><td></td><td></td><td>IGF</td></tr>
<tr><td>4.3</td><td>Possible activity for 2018:
Conduct a short study of tax competition in the mining sector in developing countries. This would involve a comparative analysis of specific fiscal terms, as well as the Average Effective Tax Rate (AETR).</td><td>-</td><td>-</td><td>-</td><td>-</td><td>IGF/OECD</td></tr>
<tr><td>4.4</td><td>Possible half-day workshop on tax incentives in mining to IGF member country representatives at the October 2017 IGF Annual General Meeting.</td><td></td><td>x</td><td></td><td></td><td></td></tr>
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Issue 5	Tax Stabilization					
Challenge: Fiscal stabilization clauses are problematic from a tax perspective because they can freeze the fiscal terms in the contract such that changes in tax law may not be applicable to existing mines, foregoing significant government revenue.						
Activities		**2017 - 2018**				**Lead partner**
		Q3	**Q4**	**Q1**	**Q2**	
5.1	Report on forms of stabilization provisions, and their potential impacts on taxation strategies, and a means to address BEPS+ issues.	**x**	**x**			**IGF**
5.2	Recommendations on use of stabilization provisions.	**x**	**x**			**IGF**

Issue 6	International Tax Treaties					
Challenge: Developing countries consistently raise concerns about tax treaty abuse. Countries with abundant mineral resources need particular assistance in this area, considering how treaty provisions might have a significant impact on taxes imposed on the mining sector.						
Activities		**2017- 2018**				**Lead partner**
		Q3	**Q4**	**Q1**	**Q2**	
6.1	Prepare a policy briefing on tax treaty strategy and the implications for mining taxation: - Specific risk areas for mining (e.g., withholding tax, capital gains) - Examples of where treaties can undermine mining tax policy - Comparison of different tax treaty models and their impact on mining - Corresponding strategies to protect the mining tax base against specific treaty risks; alternatives to tax treaties (domestic law).			**x**	**x**	**IGF**

Issue 7	**Indirect Transfer of Mining Assets**
Challenge: Transfers of ownership of company assets (or the companies themselves) can generate significant income, which many countries seek to tax as capital gains. Transactions may be structured to fall outside the mining country's tax base by selling shares in an offshore company holding the asset, without notifying tax authorities in the country where the asset/company is located.	

Activities		**2018**				**Lead partner**
		Q1	**Q2**	**Q3**	**Q4**	
7.1	TBD following launch of OECD toolkit on indirect transfers in May 2017.		**x**	**x**		**OECD**
7.2	Prepare a series of short case studies that explore the design and implementation of indirect transfer rules through specific country experiences.		**x**	**x**		**IGF**

Issue 8	**Metals Streaming**
Challenge: Metals streaming involves mining companies selling a certain percentage of their production at a fixed cost to a financier in return for funds for partial or complete mine development and construction. Since the amount of financing provided is linked to the discounted mineral price, companies have strong incentives to agree to lower fixed prices to increase the up-front finance available. Streaming reduces the tax base of resource-producing countries, where royalties and income tax use sales revenue as part of calculations. There is virtually no guidance on these arrangements in the mining tax literature.	

Activities		**2018-2019**				**Lead partner**
		Q3	**Q4**	**Q1**	**Q2**	
8.1	Survey of IGF countries on prevalence of metals-streaming arrangements.			**x**	**x**	**IGF**
8.2	Prepare a report on metals streaming that will answer the following questions: - How widespread is metals streaming? - Are metals-streaming arrangements increasing? - What should the legal response be to metals streaming?			**x**	**x**	**IGF/ OECD**
8.3	Prepare a policy briefing on what countries can do to combat metals-streaming arrangements, and how to do it.			**x**		**IGF/OECD**

Issue 9	Abusive Hedging Arrangements					
Challenge: Hedging is a legitimate business practice in many commodity markets. It consists of locking in a future-selling price in order for both parties to the transaction to plan their commercial operations with predictability. A problem arises when companies engage in abusive hedging with related parties. They use hedging contracts to set an artificially low sale price for production and therefore record systematic hedging losses, reducing their taxable income.						
Activities		**2018-2019**				**Lead partner**
		Q3	**Q4**	**Q1**	**Q2**	
9.1	Prepare a policy briefing that (i) describes in detail the exact abuses that countries are seeing, ii) evaluates the various legislative approaches to dealing with hedging arrangements through specific country experiences, (ii) provides recommendations on the approach best suited to developing countries, and (iii) offers a step-by-step guide to enacting and implementing the relevant legislation.			**x**	**x**	**IGF**

Issue 10	Inadequate Ring-fencing					
Challenge: It is possible that mining companies will have multiple activities within a country, creating opportunities to use losses incurred in one project (e.g., during exploration for a new mine), to offset profits earned in another project, thereby delaying payment of corporate income tax. Ring-fencing is one way of limiting income consolidation for tax purposes; however, getting the design right is critical to securing tax revenues while attracting further investment.						
Activities		**2018**				**Lead partner**
		Q1	**Q2**	**Q3**	**Q4**	
10.1	Prepare a policy briefing on ring-fencing that covers: - Different countries' approaches to defining the ring-fenced area - Risks/trade-offs associated with different approaches (e.g., shared facilities, economics of different projects and cross subsidies) - Methods for cost allocation - How to manage domestic transfer pricing risks associated with ring-fencing - Checklist for designing and implementing ring-fencing rules.			**x**	**x**	**IGF**