Protecting the Right to Tax Mining Income: Tax Treaty Practice in Resource-Rich Countries

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What is a tax treaty, and how do they work?

Treaties determine how much of the profit each country gets to tax.
Should resource-rich countries sign treaties?

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Reduces double taxation which <strong>may</strong> increase FDI, <strong>but</strong> impact on mining is limited due to location-specific resource and use of Mining Concession Agreements.</td>
<td>1. Loss of tax revenues.</td>
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<td>2. Dispute resolution.</td>
<td>2. Risk of treaty abuse – loss of revenues due to tax planning.</td>
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<td>3. Access to information from treaty partner countries.</td>
<td>3. Costly to negotiate and administer.</td>
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Uncertain benefits, widely recognised risks…
Hundreds of millions of dollars at stake

1. Risk to Revenue: Taxation of offshore indirect transfers of mining assets
   Tax treaties may prevent source states from being able to tax profits from the sale of shares or comparable interests in mining assets located in their country.

   - USD 425 million
     Canada–Luxembourg
   - USD 405 million
     Uganda–Mauritius
   - USD 380 million
     Canada–Luxembourg
   - USD 179 million
     Vietnam–United Kingdom
   - USD 58 million
     Australia–United States
   - USD 14.7 million
     Namibia–Mauritius
   - USD 12.8 million
     Canada–United Kingdom

2. Risk to Revenue: Taxation of mining subcontractors
   Subcontractors may avoid paying taxes in the source state by restructuring their activities to not exceed the time threshold for triggering a taxable presence under the tax treaty.

   - USD 24 million
     United States–United Kingdom
   - USD 21.4 million
     India–Australia
   - USD 2.6 million
     India–United States
   - USD 2.5 million
     Norway–Ivory Coast
   - USD 1.8 million
     India–Mauritius
   - USD 1.6 million
     India–Netherlands

3. Risk to Revenue: Taxation of fees for technical and management services
   Tax treaties may prevent source states from collecting withholding tax on payments a mine makes to foreign companies in return for technical and management services.

   - USD 288 million
     Mongolia–Netherlands
   - USD 27.5 million
     Malawi–Netherlands
Countries that choose to sign treaties – how can they protect mining taxes?

What do resource-rich countries do in practice?

How do they modify the Model Conventions to better protect their right to tax mining income?

What can other resource-rich countries learn from this?

Gap in the guidance
86 tax treaties
18 countries
Articles 5, 6, 13
Africa | LAC | Asia
1. Establish the right to tax indirect transfers

Canada v MIL Investments (2006)

Diagram:
- Mr. B. in Monaco
  - Diamond Field Resources (DFR) in Canada
    - Transfers 29.4% shares in DFR to MIL Investments in Cayman Islands
  - Transfers 10% of shares in DFR to Inco Limited in Canada
    - Inco pays MIL CAD 425 million for remaining shares in DFR. MIL is exempt from tax in Canada under Lux-Canada treaty
  - MIL Investments in Luxembourg
    - Redomiciles

Note: The diagram illustrates the complex financial transactions and the tax implications involved in the case.
Indirect sale or transfer of mining license likely to generate considerable capital gains which should be subject to tax in the source country.

- E.g., MIL Investments v Canada, CAD 425 million

- Definition of immoveable property is too narrow (next section)
- Only 35% of treaties include the right to tax indirect transfers; and only 29% when one party is a low-income, resource-rich country (PCT, 2020).

Recommendations:
1. Establish a robust definition of immoveable property (next section)
2. Establish the right to tax indirect transfers in domestic law –
3. Negotiate Article 13 to include the right to tax indirect transfers; and
4. Negotiate a standalone extractive industry article (e.g. Norway)
2. Adopt an exhaustive definition of immoveable property

The ability to tax indirect transfers depends on Art 6. If the definition is too narrow, the resource-rich country may miss out on significant tax revenue.

- OECD/UN definition “working a resource” does not cover rights to exploration, production, depreciable assets, non-public information.
- Only 4% of sampled treaties include the right to explore.
- E.g., Royal Bank of Canada v HMRC (2020), $12.8mn tax

Recommendations:
1. Include exploration assets or rights as immoveable property
2. Include other payments calculated by reference to mineral production
3. Specify that right/asset is situated where immoveable property is located
3. Design broad rules on Permanent Establishment

General Rule: Profits of a non-resident entity are only taxable in the source country if they have a fixed place of business – location test, time threshold.
3. Design broad rules on Permanent Establishment

Complexity and specialisation required by mining means foreign enterprises will frequently be part of the process. Source country must have right to tax.

- Right to tax subcontractors which are more mobile than license holders
  - E.g., PGS Geophysical (Norway-Ivory Coast)
- Remote mining operations – may not have a physical presence

Recommendations:

Minimum – Include a reference to mining activities in Art 5(2) (33%); PLUS
1. Deem a PE to exist in a standalone extractive industries article (6%); or
2. Deem a PE to exist for exploration and exploitation in Art 5 (7%); or
3. Include a reference to mining related activities in Art 5(3) (20%).
4. Retain right to tax income from management and technical services

The case of Paladin Energy in Malawi

Paladin Energy Ltd
Australia

Paladin Netherlands BV
The Netherlands

Paladin Africa Ltd
Malawi

Paid almost identical sum to management fees received by Paladin Netherlands BV

Paid CAD 135 million in management fees and paid no withholding tax under Malawi-Netherlands treaty
4. Retain right to tax income from management and technical services

Major source of outbound payments in the mining sector.

Countries that relinquish the right to tax management / technical services fees forgo withholding tax and increase the risk of BEPS.

Recommendations:
1. Adopt a standalone fees for technical services article – Art 12A (7%); or
2. Expand definition of royalties in Art 12 to include technical fees (19%); or
3. Include an extractives PE or a Services PE in Art 5 (62%)
   • Extractives PE is preferable – displaces general rule
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A website that allows you to visualise
a new dataset of almost every tax
treaty signed by developing countries

Dec 1st 9:00-11:00 EST
(14:00-16:00 GMT)

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