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**Committee of Experts on International Cooperation in Tax Matters**

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**SECRETARIAT REPORT ON THE EXPERT GROUP MEETING ON EXTRACTIVE  
INDUSTRIES TAXATION,**





Some helpful elements in guiding contractors could include the IMF Code of Good Practices on Fiscal Transparency and the Extractive Industries Transparency Initiative (EITI) Standard promoting transparency. Ms. Yapur described two EIT



In the face of such external influences and domestic constraints, Mr. Nshindano considered that civil society can play a critical role in raising awareness to promote domestic revenue mobilization. He also suggested a reform of tax policy and tax administration, with targeted research, public advocacy at both domestic and international levels, and international cooperation among tax authorities. Finally, he called on governments to be more receptive to civil society advocacy.

In his presentation **Charles Ziemba**, Assistant General Tax Counsel, Chevron Corporation, started with an overview on the importance of affordable energy in the development process and the projection of energy demand in the next 30 years. He pointed out that oil exploitation can benefit resource-rich countries in turn leading to more affordable energy, wealth creation, and better living condition for their populations. For this to happen, he continued, governments and MNEs active in natural resource exploitation have to forge a better partnership that benefits both sides.

Mr. Ziemba also remarked that beyond profit from extraction, the oil industry can positively influence local living conditions and the business environment through promotion of fair competition, transparency, and the rule of law as well as more cooperative approaches. Some social investments in partnership with foundations and international organizations in the areas of health, education, and other sectors also contribute to improving living standards in developing countries.

In comparing governments' expectations with those of investors, Mr. Ziemba insisted that "it is not all about tax rates". Investors also want their investment to be safe, a long-term involvement, avoidance of double taxation, and minimizing political and fiscal risks in general. While designing a tax regime, he recommended, that countries should obtain a fair share of the benefits from resources exploitation but that they should also ensure they do not distort investment decisions by over-taxing some sectors and over-subsidizing others. Any good tax regime should be "clear, enforceable, and non-discriminatory".

He concluded by addressing some key factors that investors tend to consider when deciding on an investment. These include stability, transparency and impartiality in the resolution of issues, efficient tax administrations, a competitive tax regime, and the existence of relevant tax treaties. On the role of fiscal incentives, Mr.

Resource-endowed countries tend to compete for fore





parties performed which function ranging from financing and procurement to management and, when doing so, should discern which party bore the risks involved and which party made use of its assets. According to Ms. van Herksen, the key questions are: What is critical for the success or failure of the business? What are the value drivers for the business? Where in the process is the value added? Accordingly, remuneration should be aligned closely to the functions performed and the risks borne.

Applying these concepts to the extractive industries, key challenges include that natural resources are inherently local and cannot be moved to less expensive places to extract, extraction is very capital intensive and financing is thus a major issue, extracted resources need to be processed to be valuable, often involving many different functions and the use of many assets. Marketing activities, which tend to be



example, deploying the procurement service without paying a fee for it would give the joint venture partner a “free ride”. In a situation where a fee is being charged, the joint venture partner would want to make sure that the amount is being calculated correctly, which in turn



Mr. McLean reiterated that it is important to understand the business context of an industry. He added that it is important that all countries have some form of transfer pricing policies or guidelines and that these should be based on the arm's length principle.

The oil and gas industry is a simple business consisting of upstream activities, essentially focused on extracting resources and downstream activities, i.e. turning resources into an end product that consumers will want to purchase. However, the industry exhibits some distinct characteristics. Firstly, the amounts of investment that are needed are enormous and the time

Using the hard minerals industry as an example, Mr. Durst discussed which kind of disputes may arise. He described one possible fiscal regime; namely, the combination of an ad valorem royalty on the value of mineral produced and sold, which is usually considered to be the government's compensation for the natural resource, plus an income tax on the extractor's net earning from the sales of the product. He found two potential sources of dispute: the pricing of the product and income tax deductions. The first sale is typically from an in-country subsidiary to a related party, which might be located in a low tax country. Hence, there is the need to determine the arm's length price using transfer pricing compliance/enforcement techniques. The valuation of the product at first sale is important for purposes of royalty and income tax.

While the product pricing is typically based on an index price, difficult adjustments have to be made for such a price based on physical attributes of the mineral, distance to market, etc.

arising through off-take arrangements. Enough stability would be provided if agreement could be found on an approach or system to make these kinds of adjustments.

A further **participant from the private sector** noted that his company already concluded concession agreements in which they agree to be taxed with reference to the prevailing oil price. Ultimately, the company decides on a case-by-case basis if a fiscal regime proposed by a government is of interest to them. Some governments want to be fully exposed to the oil price volatility while other governments try to shield themselves from it.

According to **Mr. Durst** the second half of such a concession agreement would have to cover the deductibility of related expenses. His proposal

the respective country. According to Mr. Keen, the IMF has a comparative advantage as compared to other development actors as they address the full range of fiscal management in relation to the extractive industries including macro-economic policies and transparency issues and hold broad dialogues with countries on their fiscal development. The perspective that the IMF takes is focused on the medium-term and quantification plays a crucial role in designing and guiding advice. Mr. Keen stated that the IMF is not directly involved in negotiations between governments and the extractive industries but tries to maintain strong links with all stakeholders during this crucial process. Another key element is that the work of the IMF is driven by research while, in turn, informing future work.

Mr. Keen gave a short overview about the Fund's activities in the extractive industries sector, including around 30 missions per year to countries dealing with extractive industries issues, regional events in Latin America, Africa and Asia, technical workshops and publications. He noted that while core funding ensures flexibility, technical assistance has doubled since the start of the Managing Natural Resource Wealth Topic

negotiations. Another problem is associated to the increased interest in the issues which oftentimes leads to multiple donors being involved in turn raising issues of coordination. Moreover, the extractive industries are often governed by multiple government agencies which are not always cooperating with each other th

She then identified several areas where assistance in the realm of tax policy is needed: Uganda operates production sharing agreements under which oil is shared between the contractor and the government. Uganda is also looking for support on how to effectively perform cost recovery audits. Ms. Rubagumya added that assistance on how to tax complex international transactions between related parties as well as mid-stream activities (i.e. transportation, storage and wholesale marketing) is needed. Another area that deserves attention is the financial analysis of investment in oil and gas projects to ensure proper taxation. There is also a need for assistance in enhancing legislative drafting skills relating to the taxation of the oil and gas industry. Moreover, designing a fiscal system for gas and a value-added tax system along the petroleum value chain is challenging.

Ms. Rubagumya then summarized Uganda's lessons learned in setting up transfer pricing capabilities. She concluded that specific transfer pricing laws are needed. Prior to 2011, Uganda made use of their general anti-avoidance tax provisions but found that there were many tax disputes with taxpayers about applicability and the choice of methods. As transfer pricing is a complex subject, it requires adequate planning and preparation. Issues such as human resources and accessibility to international databases to search for comparables are important. Intensive training of staff to be deployed in a transfer pricing unit is critical. Auditors should be trained in-house if possible. Moreover, engagement with the taxpayer is helpful to have a common understanding of transfer pricing regulations.

Building on Uganda's experience, Ms. Rubagumya divided support which is likely to be effective into short, medium and long term support. Short term support includes training such as in-house training and experts working with auditors. Over the medium term, benchmarking with more experienced tax administrations was identified as helpful. Long term support should focus on advanced training in critical areas and secondment of staff to other revenue authorities. Moreover, she mentioned the possibility of Memoranda of Understanding with more experienced tax administrations with regard to the exchange of information.

Ms. Rubagumya also discussed the role that non-governmental organizations can play and found that they can highlight problem areas, lobby for positive change and organize public debate between the government, public and taxpayers. Next to complying with the law, the role of taxpayers was described as seeking engagement with tax administrations to discuss problematic areas and propose ways of improving tax laws and their administration. Moreover, taxpayers should attend stakeholder meetings organized by the tax administration.

**Mansor Hassan**, Director, Inland Revenue Board of Malaysia, Malaysia focused in his presentation on the lessons learned in setting up a tax administrations' transfer pricing capability. Before doing so, he postulated that a critical look at the availability of human

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based in headquarters and reporting to the Director of the Compliance Department. Later, and with help from headquarters, auditors in other Malaysian states took up transfer pricing functions. Throughout the process, the auditors received training from various organizations

OECD-level – both in working groups as observer and as part of an advisory group for non-OECD economies.

**Marlies de Ruiter**, Head of Tax Treaties, Transfer Pricing and Financ

**Thomas Neale**, Head of Unit, Company Taxation Initiatives, DG Taxation and Customs Union, European Commission, presented lessons learned in building capacity in resource tax policy. Over the last three years, the European Commission (EC) has worked on those issues – though not purely by focusing on the extractive industries. Mr. Neale structured his talk around the formal policies, the research, partners and experience gained in this process.

The formal policies that underpin the EC's work on capacity developing in taxation are those favouring transparency, exchange of information and fair tax competition. When looking for partners, the EC seeks to work with those sharing these principles. According to Mr. Neale, the EC sees itself as an ally for developing countries in the quest to raise domestic resources. In fact, the Commission aims to assist countries in raising their capacity to increase their tax revenues, to tackle tax avoidance and evasion and ultimately, to design efficient tax systems. While the EC is the largest donor globally, little direct assistance is provided on taxation issues. It is thus pivotal that such money is spent in the best way possible.

Mr. Neale stressed the need to substantiate the assistance that was and is being provided. The EC thus commissioned a consultancy firm to research what a specific sample of countries needed in terms of assistance in transfer pricing. The main recommendations were that countries need to broaden their treaty network, that finding good comparables is hard and might need cooperation between countries, that training and staffing posed a challenge and lastly that risk-based audits are especially helpful. On the last point, Mr. Neale concluded that there might be a trade-off involved if a tax administration is not reasonably advanced in conducting such audits. The study made use of an inclusive process involving official representatives as well as non-governmental organizations and civil society and resulted in a shared concept which now forms the basis of how the EC progresses in their work.

The partners that the EC works with in capacity building are developing countries, non-governmental organizations and donors. In fact, the EC is actively involved in the OECD's Taskforce on Tax and Development, which brings together developing and developed countries and industry representatives. The International Tax Dialogue brings the World Bank Group, the IMF, the OECD and the EC together. Moreover, the EC is a member of the core group of the International Tax Compact and holds regular tripartite consultations with the WBG and the OECD. Clearly, the focus is on cooperation in order to ensure that there is as little duplication of effort as possible and thus that resources are put to best use.

In terms of experiences, Mr. Neale explained that the EC does not provide technical assistance directly in this area. Instead, the Commission funds conferences and training programmes and cooperates with other agencies providing such assistance. The EC provided some funding for the editorial process of the UN Transfer Pricing Manual. Additionally, delegations of the European Commission to various countries may provide limited funding. In their country-specific efforts, the EC focuses on five countries; namely Ghana, Tanzania, Vietnam, Colombia and Rwanda. He stressed that follow-up to assistance was necessary to ensure the effectiveness of such assistance.

**Matthew Genasci**, Head of Legal/Economics, Revenue Watch Institute (RWI), described RWI as a not for profit policy organization that promotes good governance in oil, gas and mining revenues for the public good by funding training and technical assistance in over 30 countries. In the tax area, the focus of RWI is on tax policy though approaches consistent with the administrative capacity of a country are promot

response to the so-called “resources curse”. Mr. Genasci noted that RWI has since shied away from this phrase as it has recognized that resources are not themselves a curse. Instead, policy choices matter. Resources can be an engine for development as can be seen in many countries but there are very real and unique challenges that must be addressed. Taxation is one of these challenges as the primary benefit of extraction is likely to be the potential tax revenue they can generate. However, taxation is not only a revenue issue; it is also a development issue. Not only can revenues be used to fund development activities, in low capacity countries building up the tax administration is an important part of the state building process. On the other side of the coin, corruption or poor performance in negotiations of extraction contracts and related fiscal regimes as well as in the administration of tax policy can extend to other areas and have negative repercussions beyond the lo

RWI also provides technical assistance and training on mining and tax policy as well as negotiation support to governments. Mr. Genasci mentioned a project undertaken in cooperation with UNDP and the International Senior Lawyers Project in Sierra Leone related to contract issues. A unique feature was that in addition to international experts, local civil society organizations were incorporated in the project design. Going forward, he identified that data analysis will be a key role for NGOs. Moreover, there is the need to continue to push for greater transparency, for example by building on the recently strengthened EITI rules. Lastly, contract transparency continues to be of crucial importance.

In closing, Mr. Genasci noted that it is important to distinguish between different actors. Smaller exploration companies backed by high risk capital are looking for major pay-offs over a short time horizon and thus pose very different policy challenges as compared with larger and more established extractive industries companies.

**Mr. Msiska** commented on the discussions from the perspective of a developing country from Africa. He noted that assistance given to developing countries often focuses on capacity building in revenue authorities. However, the responsibility for tax policy design lies often with the Ministry of Finance, where, to his mind, the cost of the administration of tax policies was often not analyzed. In the area of transfer pricing, he mentioned the difficulties in retaining trained staff given the potential of significantly higher earnings in the private sector. Norway's support to the Zambian Revenue Authority in financial terms and through joint audits was positively highlighted. Concerning international cooperation, Mr. Msiska recommended that the African Tax Administration Forum (ATAF) should collaborate with international organizations in finding areas of common interest, thereby minimizing

and make decisions based on their projections and by weighing long and short term benefits and personal preferences. The decision to nevertheless change the terms of a contract might, however, still be in order under very exceptional circumstances. A **government representative** agreed with this stance and added that there is the perception that in the past some of the governments negotiating contracts with the extractive industries have not done so in good faith and in the interest of their countries. He noted that contracts should thus have some flexibility with regard to changing circumstances. **Another private sector representative** responded to Mr. Msiska's question by noting that that some debt investors make investment decisions based on cash flow predictions. If the underlying fiscal regime changes this also changes the cash flows and thus might put those investors in a difficult position. Moreover, high prices in commodities often go hand in hand with exponential increases in operating and investment costs. A **further private sector representative** added

