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# International Taxation Issues for EI

*Natural Resource Charter Annual Conference*

*Oxford: June 12, 2014*

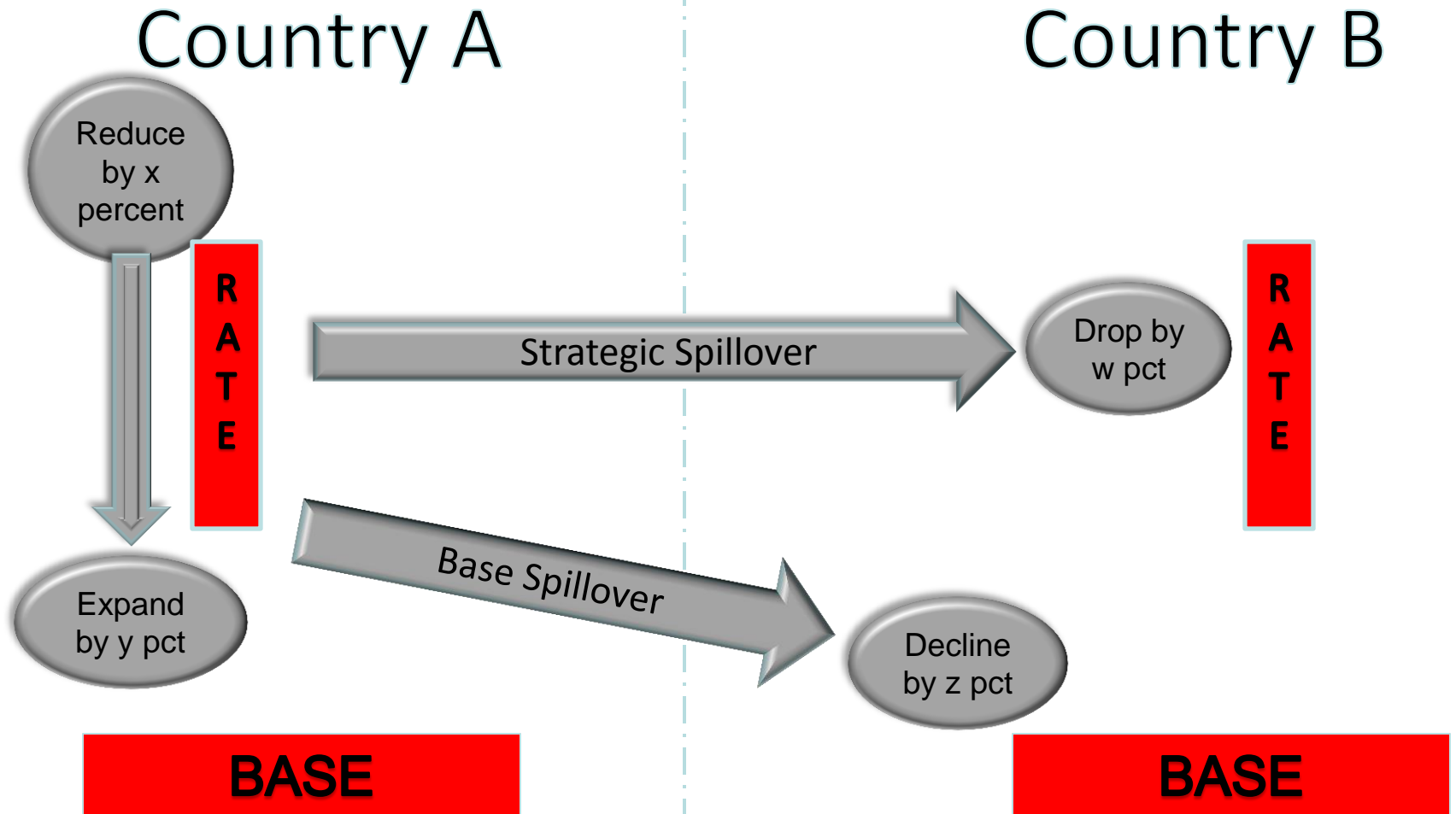
# Overview

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- International tax hits international agenda: G8, OECD/G20 BEPS Project
- An aspect of macro-economic “spillovers”
- Focus today on corporate tax issues for EI (but many other issues remain)
- Issues with tax treaties and the international corporate tax framework
- Transfer pricing risks
- These issues loom large in taxation of resource projects
- Are there some defensive steps that host governments can take?

# “Base” and “rate” spillovers



# Spillovers

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- One country's tax policy can affect others' CIT bases by affecting either real activities or shifting paper profits
- “Base” and “rate” spillovers have significant effects
- Spillovers are especially marked and important for developing countries
- Limiting adverse effects requires not only capacity-building, but changes in domestic law and international arrangements



# Bilateral tax treaties (BTTs)

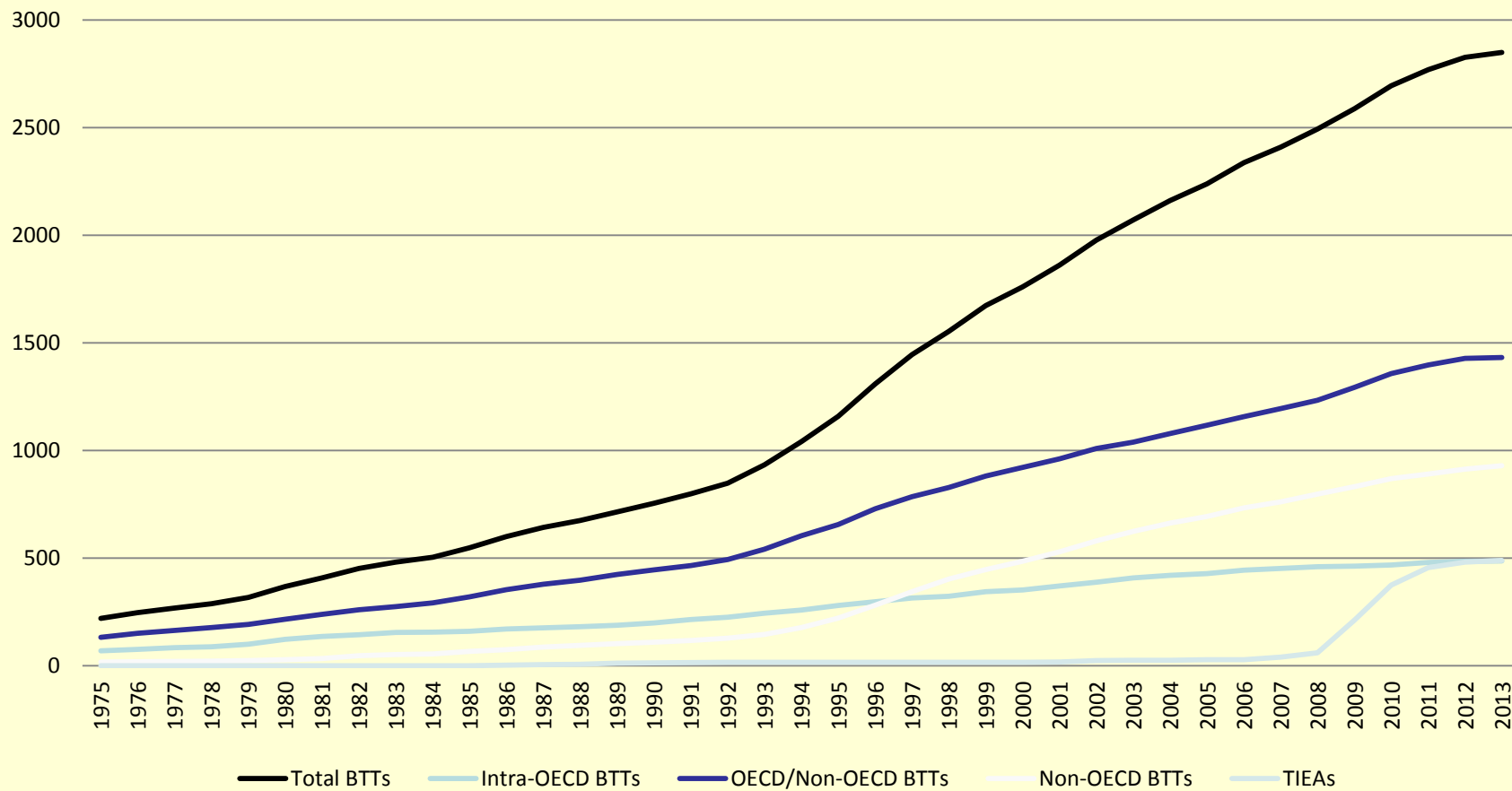
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- Proliferation of tax treaties a part of the international corporate tax framework
- Imposition of withholding taxes (base erosion)
- Treaty shopping
- Taxation of gains on transfers of interest, direct or indirect, in mineral rights
- Exclusions of tax through narrow definitions of real property, or broad definitions of business profits



# Numbers of BTTs and TIEAs, 1975–2013

(Source: IBFD)



# Aims and provisions

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## General aims:

- Avoid double taxation (why, by the way?)
- Avoid no taxation—or at least counter evasion

## Key provisions:

- Clarify who can tax (and get a credit) for what
- Set maximum withholding tax rates
- Provide for information exchange
- Provide for dispute resolution (e.g. on transfer prices)

# Why BTTs?

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- Bilateralism seems highly inefficient (and each treaty is a treaty with the world)
  - Full coverage among 34 OECD countries would require 561 agreements (there are around 280)
  - But only 33 needed for all pairs to be linked; more means multiple presumably non-equivalent routes
- Do they encourage FDI? Causality unclear intuitively, evidence mixed
- What can BTTs achieve that cannot be achieved by some mix of unilateral measures, tax information exchange agreements (TIEAs), investment agreements? (1988 Convention on Mutual Administrative Assistance in Tax Matters)
- Presumably something to do with either signaling and/or credibility?
- High sunk costs mean this is especially important for EIs.



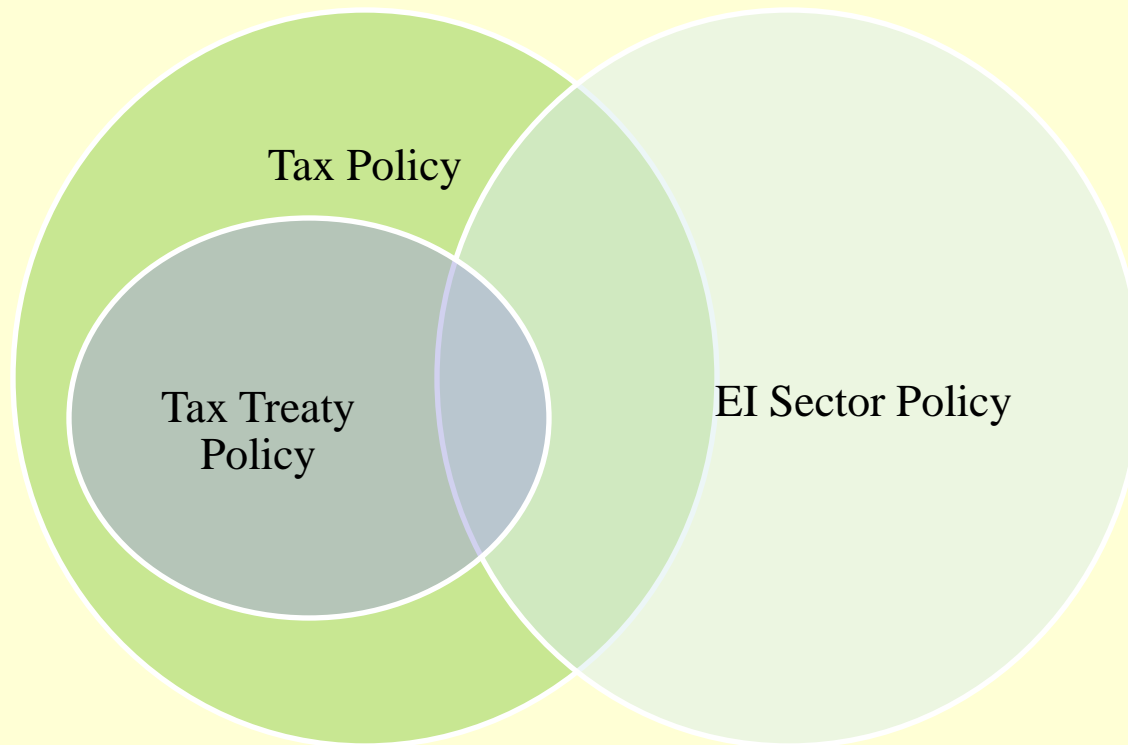


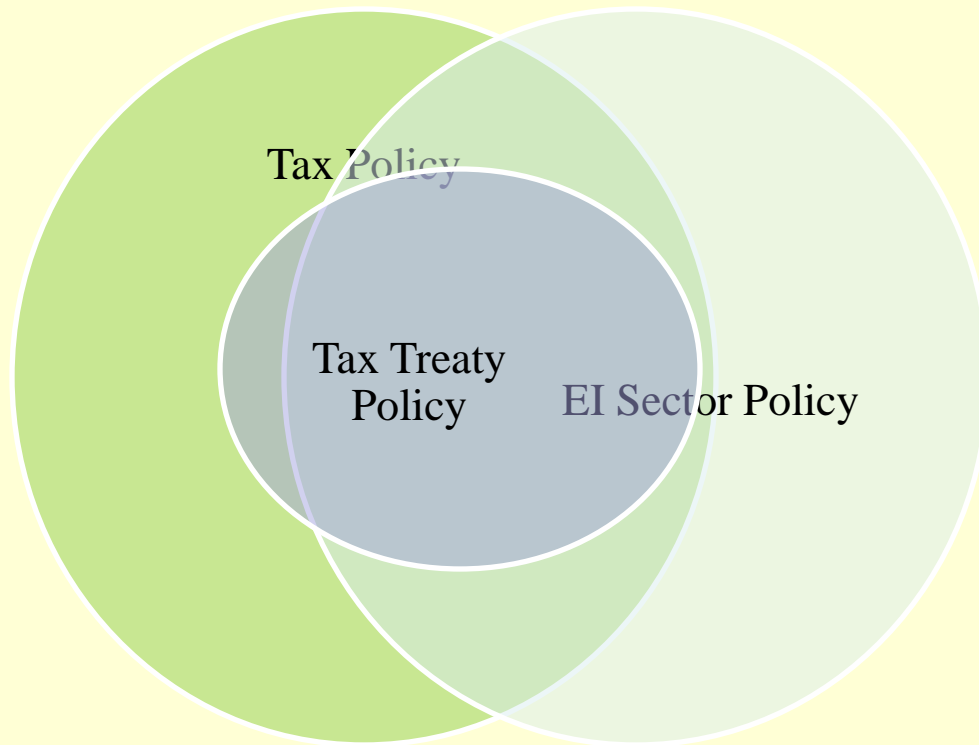
# Does a country need tax treaties?

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Unilateral strategy is possible:

- Limit withholding tax rates to rates that would typically be allowed by treaty, and refrain from overbroad imposition of withholding (for example “all services”).
- Define PE similar to UN Model. Generally tax nonresidents only in those situations where treaties would allow you to. Adopt transfer pricing rules that are consistent with arm’s-length principle.
- Stability through practice or agreements.
- Creditability of corporate income tax through careful tax design.





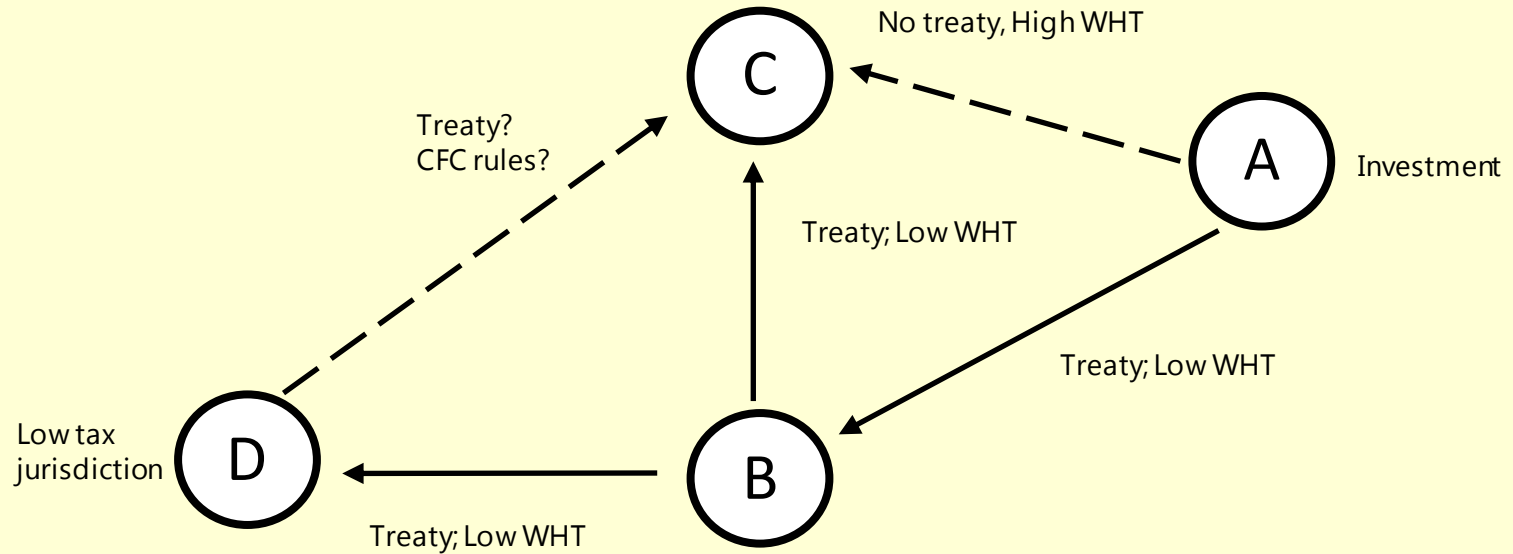
# Base erosion: border withholding

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- Limitations on withholding taxes (WHT) on dividends, interest, royalties, management fees and technical service payments
- Discriminates among sources of capital but often used in securing an individual investment.
- Network of treaties may encourage “treaty shopping”

# Treaty shopping



# Country A (201x)

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- 11 ratified and effective DTAs
- Important mineral producer
- Limitations on WHTs on dividends, interest, royalties, differ country to country
- Technical service payments WHT mentioned in only 3 treaties – limit different in each case
  - Channel investment through France or Sweden to minimize dividend tax
  - Same locations for loan capital disbursement
  - When licensing technology, know-how or patents, channel payments through Mauritius, Romania, Russia, Malaysia, or Sweden
  - Minimize capital gains issues by using a French subsidiary
  - Supply technical services from Malaysia or India
  - In summary: capital from France, know-how from Malaysia.



# Taxation of Transfers of Interest

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- Understood to be exempt in Norway, subject to conditions – BUT a big issue in developing countries. (Uganda, Ghana, Mozambique – and telecoms in India)
- Needs inclusion of EI rights and information in domestic law as “immovable property” making gains taxable under CIT for companies – and not to be over-ridden by treaties
- The amount included in the income of a transferor should be the consideration received - reduced by the undeducted cost of the transferred right
- The transferee is entitled to deduct the consideration paid for the right (there is a step up in cost) – rules differ on treatment of deduction
- Some countries retain non-final withholding as a prepayment of the tax payable on the gain.



# Farm Outs

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- Income tax law can provide that any initial amount paid under a deferred interest farm-out is income when the amount is received.
- If the right is transferred only the additional consideration, if any, is included in income at the time of the transfer.
- The rules on farm-outs can apply to both mining and petroleum operations.



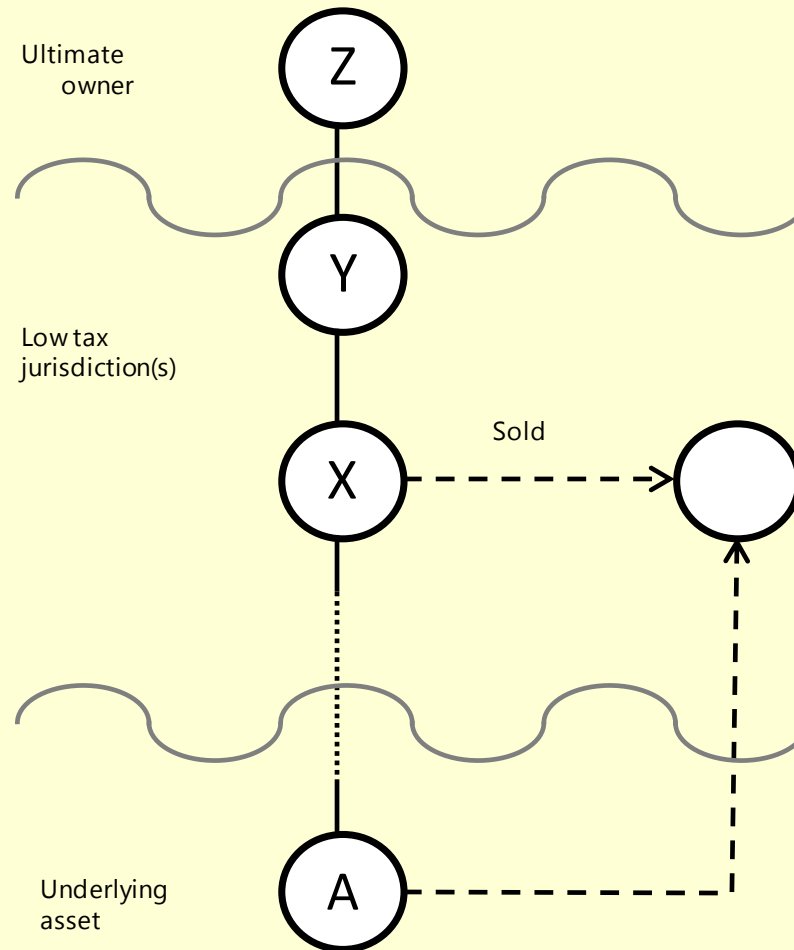


# Indirect Transfers of Interest

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- Deal separately with direct transfers of interest.
- Need specific reference to indirect transfers of interest to include mining and petroleum rights and information in the definition of immovable property for ITA purposes.
- Include a reporting mechanism under which the relevant Ministry informs the Revenue Authority of any substantial change in ownership of contractors or rights-holders.
- Deem the local entity to be agent of the non-resident for payment of the tax due in respect of an indirect transfer of interest.
- Again – need to ensure that treaties do not over-rule.

# Indirect Transfers of Interest





# Other risk areas

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- Intra-company debt shifting
- Thin capitalization (excess debt) usually with affiliated parties
- Inversions
- Location of intangible assets
- Narrow definitions of source, or of business profits



# NR Transfer Pricing Risks

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- Special incentive

- Higher/special taxes on NR upstream
- (So TP risk from cross border and domestic transactions)

- Special opportunity

- International business
- MNEs often vertically integrated (upstream + downstream activities)
- Use of tax havens common

- Other factors reduce TP risks

- Physical operations
- Standard outputs/measures/prices
- Joint venture structure (petroleum)



# What can be done?

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- Avoid negotiating a treaty simply because another country asks to do so , and integrate treaty-making with tax policy-making
- Limit new treaties with potential intermediary countries, or countries with special holding company regimes
- Seek review of unfavorable treaties, especially where created by inheritance from very old treaties
- Include a LOB provision in domestic tax law preventing “treaty shopping”
- Ensure that treaties enshrine the broad right to levy WHT on payments to non-residents and, where relevant, ensure these are creditable in the partner country



# What can be done?

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- Aim for consistency in WHT provisions
- Where this is not possible (and especially for resource companies) consider taxing the underlying business profits at a higher rate and forget about WHT
- Minimum taxation
- Targeting some rules on tax havens.
- Ensure a broad definition of real property, and the right to tax gains on transactions in companies that directly or indirectly hold real property in the host country
- Ensure that royalties, management fees, technical service payments do not get lost in “business profits” articles that exclude WHT by the host.