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During the fifteenth session of the Committee of Experts on International Cooperation in Tax Matters (Committee), the coordinator of the Subcommittee on Extractive Industries Taxation Issues (Subcommittee), Mr. Eric Mensah, made a recommendation, endorsed by the Committee, to review and expand the Handbook on Extractive Industries Taxation Issues by Developing Countries (Handbook).

The review of the Handbook would be conducted to revise the relevance, for developing countries, of the guidance of topics included therein; the



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- 4.1.1 Description of chapter, from approach and analysis from domestic taxation standpoint. Intention is to not repeat content covered by Chapters 2, 3 and 5 (Treaty, PE and Transfer Pricing), but only to cover issues specific to the tax treatment of Service Providers and subcontractors. Broad definition of these terms, and their usage (e.g. Service Provider would include the major firms like Schlumberger, Halliburton, Bechtel, etc., while subcontractors would be firms that work for those companies. The coverage would be restricted to taxation issues, and local content, training, skill development of partner NOCs, etc. issues could be referred to here only to mention that they would not be covered in the chapter. Benefits for developing country tax administrations from clarity and certainty for business. The chapter will also use case studies to identify practical issues.
- 4.1.2 Contractor and subcontractor issues specific to affiliates should be dealt with at Chapter 6 (Transfer Pricing) with a reference here to 4.2.5.
- 4.1.3 Discussion is on the taxation of the profits of the service providers/subcontractors and the taxation of the salaries of their staff.
- 4.1.4 Standardized definitions
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- 4.2.1 Value chain in the extractive sector and position of contractors/subcontractors
- 4.2.2 Location of services provided
- 4.2.3 Resident and non-resident contractors,
- 4.2.4 Wholly owned contractors and subcontractors of resource sector companies
- 4.2.5 Very short-term Contractors and Individual Contractors/technical engineers
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- 4.3.1 Contract development stage E.g. Consulting and research, Advisory firms
- 4.3.2 Exploration stage E.g. Geological mapping and surveys, Seismic capture/sampling, Analysis, Test drilling/excavation
- 4.3.3 Development Production drilling/facilities, Platforms and mine construction,
- 4.3.4 Production and distribution e.g. Production support, Pipelines and transportation, Byproduct processing

- 4.3.5 Ancillary catering, tugging, anchor handling, firefighting; standby services
- 4.3.6 Decommissioning e.g. Removal of structures and Restoration of land surface
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- 4.4.1 Main tax issues for consideration (at headline level with rationale – e.g. withholding tax, characterization of income, PE issues, other treaty issues,
- 4.4.2 Outline of case studies used. (Process of developing case studies through engagement with government/ tax administrations and companies in services sector)
- 4.4.3 Broad technical issues (Would cover overarching areas such as need to address mismatches, describe challenges around split contracts with reference to the direct and indirect tax components to be discussed in detail under the headings below, upcoming challenges from new technological developments, increased use of intangibles)
- 4.4.4 Tax treatment of depreciation: Issues relating to valuation for tax purposes of movable assets that are transferred into and out of a taxing jurisdiction, e.g. for depreciation, balancing charges or capital gains on deemed realisation.
- 4.4.5 Tax issues arising from unused/stored equipment.
- 4.4.6 Treatment of services rendered by the Head Office of service providers and subcontractors.
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- 4.5.1 Charge to WHT for typical contractor/subcontractor income under domestic law and treaty practices (Interaction of WHT vs business income treatment, possible models for treatment)
- 4.5.2 Characterization of technical service fees and payments to non-resident service providers with reference to case studies used (Should cover impact of contractual terms, including “holds harmless” clauses, royalty treatment; x-ref to clarify that affiliate technical service fees are dealt with in Chapter 6 [transfer pricing issues] of Handbook.)
- 4.5.3 Tax treatment of leased assets and of lease payments
- 4.5.4 Computation issues (Gross up, possibilities of duplication of charge, analysis of service contracts)
- 4.5.5 Treaty issues in technical service fees (Impact of new Article 12A of the UNMC. Application of current treaties without Article 12A inspired language, reference to the limited number of treaties with explicit technical services articles, Treaties with old Art 12 language “for information concerning industrial, commercial or scientific





and the local PE as well as for centralization of certain work at Head Office/Regional Office level.

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- 4.8.1 Risk assessment (Conclusions drawn from case studies, issues thrown up by greater use of intangibles, complications from fragmentation of physical operations and business functions in digital economy, reduced need for physical presence)
- 4.8.2 Transfer pricing challenges (limited text to only refer to guidance in chapter 5 and identify issues specific to contractors/subcontractors)
- 4.8.3 Solutions and risk minimization (Clarity on characterisation of transactions as technical services, and related guidance)
- 4.8.4 Strengthening of permanent establishment provisions: Strengthened PE concepts including the BEPS action 7 as now included in the UN Model, approaches to make these more effective.

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- 4.9.1 Status and characterization of service providers for tax purposes (Industry characterized by layers of contractors, down to individual service companies, examples)
- 4.9.2 Tax issues related to individual service companies (Tax residence and PE status, treating individual subcontractor as an employee for income tax purposes, determining who is the relevant employer in situations of e.g. hiring out of labour (employees), including WHT and social security contributions, etc recharacterizing service providers from independent subcontractors to employees, Management/ personal service companies and anti-avoidance). Possible approaches to solution such as chain responsibility including for instance for wage tax, public and employee social security rules.
- 4.9.3 Tax treaty issues (Application of domestic law in identifying contracts of service, allocation of taxing rights under Art. 15(2)). Address issue of deemed PE on continental shelf which has effects under traditional art.15 application but also special rules not requiring 183-day presence for taxing the salaries. Application of 15(2)(c), remuneration borne by the deemed employer in the host country in absence of presence of legal employer)
- 4.9.4 Administrative and compliance issues (E.g. where subcontractors have left the jurisdiction when queries are raised, liability of contractors as deemed employers, guidelines and good practices)

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money. Trade-based money laundering is a technique where trade mispricing is used to hide or disguise income generated from illegal activity. Trade mispricing is the falsification of the price, quality and quantity values of traded goods for a variety of purposes. These could range from the desire to evade customs duties and domestic levies to the intent to export foreign exchange abroad.

- (d) According to *Global Financial Integrity*: Trade misinvoicing is the deliberate manipulation of the price, quality or quantity (value or volume) of an international commercial transaction of goods or services by at least one party to the transaction.
- (e) According to UNCTAD: Trade misinvoicing consists of either “perverse” discrepancies or “excessive normal” discrepancies in partner trade statistics derived from the comparison of the value of exports as reported by the exporter to the value of imports as reported by the importer. The first case is when the comparison of partner data reveals discrepancies in the “wrong” direction, such as export overinvoicing or import underinvoiced; in the second case, the flow is in the right direction, but there are “excessive normal” discrepancies that exceeds reasonable values; this latter case constitutes capital flight and happens through export underinvoicing or import overinvoicing.

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- 6.4.1 Underinvoicing of imports, not purely related to custom duties. Important to be aware of commentators that argue that the discrepancies in trade data come from statistics shortcomings rather than always manipulations (underinvoicing or overinvoicing); this is relevant to consider when investigating the issue
- 6.4.2 Misinvoicing of services and intangibles such as intra-group loans and intellectual property and management fees may account for an increasing contribution to illicit financial flows, due to change in technology, lack of comparative price information, and share of service in global trade
- 6.4.3 Quantification (quality, quantity, price and other aspects) of actual traded commodities:
  - (a) Tax authorities may lack information on how to evaluate and price commodities in the extractive industries;
  - (b) Also, some developing countries lack the means to verify the quantities of natural resources produced, relying instead on exporter declarations;
  - (c) Some products in the extractive industries, such as precious metals, have a high value and low weight, increasing the risk for smuggling and making it harder to control the transactions;
  - (d) This guidance would be of benefit in both transfer pricing and non-transfer pricing cases.
- 6.4.4 Another relevant issue is that there might not be a system of standardized international pricing for some natural resources and the access to comparables could be difficult. This



(d) However, due to countries' difficulties in monitoring trade operations and generating reliable statistics, the magnitude of trade misinvoicing is difficult to estimate and may be very misleading. Focusing on this will be beneficial, looking to find ways that can lead to better risk assessment, while avoiding pitfalls of exaggerated claims of lost revenues, or missing areas where risks may be higher. ‡

6.5.2 Detecting misinvoicing and recommendations. These difficulties can be addressed by:

- (a) Implementing an efficient digital system in which information from tax authorities and customs can be cross checked;
- (b) Promoting exchange of information among countries, especially between the key trade











national oil companies, and the executive etc). This may lead to duplication of incentives; uncertainty for investors; increased complexity in terms of administration and monitoring.

- (b) There is a potential for conflict of interest in cases where agencies also have performance targets (e.g. attracting investment.)

#### 12.2.2 Joined-up government

- (a) Strategies for better coordination amongst governments with respect to the design, use, and administration of tax incentives in the extractive sector. Linking back to the earlier section on policy objectives, and the need for a common vision for the sector.
- (b) Increased complexity in terms of administering and monitoring relevant policy objectives.

#### 12.3.1 Effectiveness

- (a) Briefly define effectiveness (i.e. the incentive should achieve the relevant policy objective)
- (b) Often incentives are given without clear objectives in mind, or an understanding of the possible alternative ways, other than through tax, to achieve the same aim. This section will encourage governments to (a) find solutions to their policy objectives that do not require tax incentives, (b) consider whether incentives are the most effective way to induce investment in the extractive sector (drawing on empirical evidence), and (c) link incentives to specific policy objectives (e.g. attracting investment, funding the

(iii) Subcontractors: Subcontractors are often entitled to the same tax incentives as the companies responsible for extraction. This section will explore the application of incentives to subcontractors – whether this is necessary and/or appropriate; under what circumstances; and within what limits.

(b) Opportunities for review (sunset clauses).

### 12.3.3 Case studies

The principles outlined above will be used as a framework for evaluating some typical incentives. The aim is to illustrate what works and doesn't work, as well as the various trade-offs policy-makers need to consider. Potential incentives for evaluation include accelerated depreciation; tax holidays; import duties; withholding taxes; and deductions for contributions to environmental funds.

### 12.3.4 Tools

This section will highlight the various tools available to governments to determine whether incentives are necessary (i.e. financial modelling); efficient and effective (i.e. cost benefit analysis, and tax expenditure analysis).

(a) Transparency is necessary to ensure efficient and effective use of tax incentives, and to avoid the possibility of political corruption emerging in the process of granting incentives. This section will explore the options for improving transparency of incentives

(i) Contract disclosure

(ii) Clear measurable policy objectives

(b) Monitoring of incentives

(i) Regular calculation, and reporting of revenue gains and losses attributable to incentives

(ii) Auditing of incentives, not from an efficiency or effectiveness perspective but simply whether the incentives are properly applied.







Special attention would be provided to the exploration phase due to the high risk and uncertainty involved, but also to alternative approaches regarding the design of a structured finance instruments.

Introduction of the tax risks that high non-legitimate corporate debt levels may cause from a base erosion viewpoint and the mechanism available to tackle abuses through the limitation of deductible interest.

#### 13.5.1 Tax issues derived from the use of Debt vs. Equity.

General explanation of how the use of interest may lead to base erosion and profit

Explanation and illustrative examples of country legislation establishing a





country, where the underlying assets lies, as well as the tax treatment in the various residence countries.

13.10.1 Interaction with Fiscal Take – e.g. Petroleum Income Tax

13.10.2 Others?

13.10.3 [to check for Mining special aspects]

13.11.1 Stamp duties

13.11.2 VAT/sales tax treatment

13.11.2.1 For transaction itself

13.11.2.2 For future costs/carry



- 15.3.3 Information and data collection (powers to collect, penalization to mitigate or prevent delays and non - provision of audit information).
- 15.3.4 Risk based approach concepts and their pros and cons.
- 15.3.5 Post audit reporting and conclusions – (including the impact of audits/import reports on share performance of listed MNEs and the knock on thereon).