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INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development



International Senior
Lawyers Project

Tax Treaties and the Mining Sector: identifying the issues and coordinating responses

Notes of a roundtable discussion held at Simmons & Simmons, 5 Boulevard de la Madeleine, 75001 Paris, France on 25 June 2018 at 5.00pm (CEST) / 4:00pm (BST)

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This note is intended to reflect and record issues raised at the roundtable. Except where necessary in context it does not attribute remarks to individuals, nor are points noted here necessarily consensus or even majority views of the participants.

The aim of the meeting was to begin to answer the following three questions:

1. What specific issues and challenges do bilateral tax treaties raise in the context of the mining sector?
2. How do recent international and regional initiatives address treaty issues relevant to the mining sector?
3. How can we best respond to the treaty issues, challenges, and initiatives we have identified as priorities in the mining sector context?

A range of issues were raised during the discussions concerning various aspects of the relationship of mining to DTA's. Among these were:

What's Different about DTAs in Relation to the Extractives Sector?

- Long term projects crave certainty: There is a heavy importance placed on certainty as more often than not the projects are long term, and the investor will want to know the detail of disputes procedures and what will happen in certain situations.
- Large value, complex deals: With significant values at stake, the licensing and bulk of the fiscal regime is often negotiated on project-by-project basis. This can give rise to complexity within individual projects and as compared with other projects in a country across time. Some degree of consistency and planning across different projects and fiscal instruments, including DTAs and domestic legislation, becomes important.
- DTAs and governance: this complexity underlines the need for good governance and coordination between government agencies in managing the extractives sector. Participants indicated that this does not always happen well.
- Contractual fiscal regimes: Mining fiscal regimes are often at least partially governed by contracts. It is important that government ministries are actually aware of what has happened with regards to DTAs (including withholding taxes, stabilisation, and dispute resolution) and consider the costs and benefits of any further incentives beyond the limits imposed by the treaty.
- Consider how DTAs interact with taxes on economic rent, which is more prevalent in extractives regimes. What is a fair division of profit? Should investors get a reasonable return and governments the rest?
- Mining has a different kind of impact on developing countries to other economic activities. It exploits a non-renewable resource and impacts on environment and people differently to other sectors. The fiscal regime should take into account the risks borne by a country where resources are extracted.
- How important are DTAs in attracting investment in mining projects? There is no empirical evidence either way regarding the role of DTAs in attracting investment. DTAs may not be that important in less heavily negotiated regimes. Or do they form an important baseline? (NB. Norway study of DTA network)

Building on BEPS

Use the BEPS agenda: It was argued by some that DTAs are as good or as bad as you make them: but currently, the political pendulum has swung in the favour of the developing countries. The BEPS agenda has given developing countries a whole set of tools to develop DTAs that may better reflect their interests. In order to combat the challenges and issues surrounding DTAs, one must still be innovative. There are 15 BEPS Actions. Prioritise amongst them. There are tools on the table, and the political wind is working with the developing countries.

But BEPS hasn't resolved everything. For example:

- **Source vs residency argument** about the appropriate balancing of allocation of taxing rights. There is not yet international consensus on this issue. This is significant in mining where source taxation rights are important for resource rich developing countries.
- **Taxation of management fees:** this remains a controversial subject both in terms of taxing rights and enforcement.
- **Collection of tax:** is not sufficiently addressed by international cooperation initiatives at present. It is vital, along with information powers and enforcement that support it.
- **Beyond corporate income tax:** Although there is a current focus on corporate income tax, there also needs to be an increased appreciation and focus on labour taxes, VAT and import taxes (most DTAs don't deal with VAT).

And BEPS is still a specialist subject: For example, within Mongolia, there has been an expression of interest to join the BEPS program and a desire to know more about the potential fiscal and administrative costs, burdens, and benefits of doing so. Currently Mongolia has 30+ DTAs already signed. Mongolia has recently revoked a treaty with the Netherlands. Importantly, some of the non-fiscal benefits of attracting investment in the country were discussed, including significant employment and skills-building opportunities.

Evaluating DTAs is a complex endeavour

A bad treaty may be worse than no treaty at all: Much may depend on context as well as treaty terms. Treaty partner selection is important. The decision to start negotiations (including noting the point it becomes public) should not be taken lightly. Existing DTAs should be reviewed regularly. Use of updated models such as the UN model can provide a helpful guide. Bad DTAs should be re-negotiated. If that is not possible, consideration should be given to terminating DTAs. Although the group noted that to stop negotiating DTAs is also a very public move.

Context is vital in evaluating DTAs: In each treaty case it is important to ask: what issues is the treaty intended to resolve? The answer to that question will help to inform discussions, rather than focusing too tightly on models and precedents taken out of context. Developing countries are often under the impression that DTAs are the only way to get tax information from other jurisdictions. However, a Tax Information Exchange Agreement may achieve the same outcome without giving away taxing rights.

DTAs as a platform for dialogue: DTAs may be used to promote dialogue or to enable communications and conversations with authorities and investors, however one country participant argued that this does not always manifest itself in practice. The communication is not regular, and there is very little knowledge about how much information the country can access, or what information is released.

Cost/benefit Analysis: Modelling

Financial modelling of DTAs: Whilst it would be difficult to model the impact of DTAs on the mining sector as a whole, it could be feasible to model the effects on selected mines. Are DTA provisions included in existing modelling exercises e.g. FARI? If not, can they be?

Cost/ benefit analysis of DTAs: Need to bear in mind the costs and benefits to the economy as a whole. A DTA might be disadvantageous to the mining tax base in certain circumstances, but make up for it in attracting more mobile investment e.g. manufacturing. There is need to explore how to measure the costs and benefits of DTAs.

Reviewing Existing DTAs and how to Upgrade Existing Treaty Networks

There are far too many out of date DTAs. Three quarters of all DTAs are more than ten years old. These old DTAs need to be updated as they do not evolve with legislation and economic developments. New DTAs tend to be better. However, this is a huge undertaking. There may only be one person or a very small team responsible for managing DTAs, so bilateral re-negotiations may be a daunting task. What are the options?

- Signing up to the Multilateral Legal Instrument (MLI) – see discussion notes below.
- Groups of countries may agree to update DTAs based on example of the post-Soviet Baltic states' initiative.
- It may be useful to explore simpler mechanisms to modify DTAs. Note: John Avery Jones and Philip Baker paper of 2010.
- Re-negotiation – note that developed and developing countries may have different priorities in a re-negotiation. Is a balanced re-negotiation realistic? If so, developing countries should be careful not to end up worse off.
- Cancellation – one country participant related an issue they had with use of a treaty by an investor to remove withholding taxes. The treaty in question was subsequently terminated. Interesting to note that Mongolia did not try to renegotiate its DTA with the Netherlands, it went straight to cancellation. Why? What were the factors influencing this decision?
- Updating domestic law to ensure DTAs are effective. Also explore linkages between DTAs and bilateral investment treaties.

The MLI:

- The MLI works to modify existing treaties to include the BEPS minimum standards, particularly anti-treaty shopping provisions (most importantly the “principle purpose test”).
- At a legal level, the MLI is complex, but more and more countries are signing.
- Importantly, some major treaty shopping hubs were the first to sign up.
- Developing countries interested in signing up will need to consider carefully. It may be valuable to assist countries with this process. (OECD provide some training.)
- The MLI is mainly self-executing, not requiring new bilateral protocols, impacting directly on the existing treaty network.
- It offers flexibility in terms of BEPS optional provisions. This means that many BEPS recommendations will likely not be introduced by the MLI to many DTAs in practice.
- On the other hand, countries' approaches to these optional provisions are at least transparent and public under the MLI framework.
- 80 countries will have signed up by the end of the week of the roundtable.

Negotiating New DTAs

Which country partners make sense? Analyse priorities. Look at particular taxpayers and investors.

What are the criteria for a good treaty? What should the objectives be?

Cost benefit balancing: DTAs need to balance attracting investment from the right investors and protecting public finances. Consider: How does a developing country decide who their investors should be?

Put in place policies, red lines, national models, strong negotiation teams. Develop a specific national model treaty. Use it as a baseline. Ensure that the negotiators are good and well-trained, technically, in negotiation skills, politically. Make the economic case to governments regarding investment in tax policy and administration

Develop tax authority/taxpayer relationships: corporate compliance is better than conflict where possible, adopting a risk-based approach to taxpayer relations.

International support: Country representatives said that treaty negotiators and administrators need knowledge and capacity building support.

Use of withholding tax: developing countries may wish to make more use of positive withholding taxes as a last line of defence against BEPS.

Treaty Politics

Political challenges surrounding tax DTAs. One country participant pointed to opacity in the treaty making process and limited knowledge of the impact of DTAs in mining. The country had itself experienced significant revenue loss resulting from treaty provisions. It can be difficult to plot the political processes that influence treaty policy. A specific example was also raised in which the government had ended up considerably worse off in respect to a project than expected, only realising that when it was too late to act.

The power of high government lobbying from the extractives sector including around DTAs was emphasised. There must be a reason! One participant said that extractive companies have shaped the DTA regime.

DTAs Set the Commercial Baseline

According to one participant, the extractive sector (and airlines) have led the promotion of DTAs. Clearly extractive companies see major value in them. Why? What are their goals?

Despite the previous observation, from the perspective of legal practitioners working in the African mining sector, disputes regarding DTAs rarely arise. That may be because DTAs are taken as an *acquis* in any negotiation process. They are not reviewed. This brings us back to the first point, what is in them that is so important to the sector?

How can the concept of “stability with flexibility” be used to improve the way DTAs operate? Be creative! What does flexibility mean for enforcement?

Opportunities for Further Work

Empirical research:

- How significant are DTAs in attracting mining investment?
- Modelling DTA impacts on selected mining projects
- Comparative analysis of DTAs across mining countries, using the ActionAid Tax Treaties Dataset (developed by Martin Hearson).

Guidance:

- A framework for cost benefit analysis of DTAs in mining (bearing in mind the impact on economy as a whole). When is no treaty better than a bad treaty?
- Criteria for a ‘good’ DTA for the mining sector – review of MLI, various DTA models; assessing different options for common provisions
- Review impacts of MLI treaty modifications on resource-rich developing countries

Outreach:

- Awareness raising amongst mining officials of DTAs and the potential impact on mining, giving them the tools to engage in relevant policy discussions led by finance ministries
- Awareness raising amongst treaty negotiators of the impact of DTAs on mining