IGF GUIDANCE FOR GOVERNMENTS: COUNTERING TAX BASE EROSION AND PROFIT SHIFTING IN THE MINING SECTOR

For many resource-rich developing countries, mineral resources present an unparallelled economic opportunity to increase government revenue. Tax base erosion and profit shifting (BEPS) and weak tax administration in developing countries threaten this prospect.

The International Monetary Fund (IMF) estimates that developing countries' BEPS revenue losses exceed USD 200 billion annually.

With a long list of Sustainable Development Goals (SDGs) to finance, and the end of the commodities super cycle, it is now more important than ever that resource-rich developing country governments ensure that existing mining projects contribute their full share to government budgets.

In 2016, IGF member country governments identified BEPS as their primary collective concern.

IGF believes that equipping developing country governments with the knowledge, skills and tools to build and administer mining tax systems that are robust enough to address BEPS is central to improving domestic revenue mobilization and enabling countries to achieve full implementation of the SDGs.

To deliver the best results for its members, IGF has partnered with the Organisation for Economic Co-operation and Development (OECD) Centre for Tax Policy and Administration, combining its mining expertise with the OECD's knowledge of taxation to design sector-specific solutions to some of the most pressing base erosion challenges facing developing countries.

IGF member countries will be involved in the program throughout, providing guidance, input and feedback to ensure solutions are responsive, practical and capable of being implemented in resource-constrained environments.

WORK HAS ALREADY BEGUN

The forthcoming **IGF Technical Workshop on Tax Base Erosion and Profit** Shifting, presented in collaboration with the OECD during the IGF's Annual General Meeting (October 20, 2017, in Geneva), provides a forum to discuss these challenges:

- Transfer pricing
- Mineral product pricing
- Excessive interest deductions (use of debt)
- Tax incentives
- Investment treaties and stability agreements.

TRAINING ON TRANSFER PRICING RISK ASSESSMENT FOR THE MINING INDUSTRY

IGF is providing training to help African tax authorities address transfer mispricing in the mining sector. Workshops are being developed for the Government of Côte d'Ivoire in October 2017 and Liberia in February 2018. Governments interested in training may contact project lead Alexandra Readhead at alexandra.readhead@iisd.org for more information.

This training will be based upon a new toolkit aimed at helping African tax authorities address transfer mispricing in the mining sector published by the African Tax Administration Forum (ATAF) with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ).

The *Toolkit for Transfer Pricing Risk Assessment for the African Mining Industry* helps to determine whether particular high-risk, related-party transactions should be selected for a transfer pricing audit. IGF was invited to be the toolkit's official training partner.

A MENU OF ISSUES

More than 100 countries are working together to address tax base erosion and profit shifting through the G20/OECD BEPS initiative. The Inclusive Framework on BEPS aims to address significant gaps in existing national and international tax rules that are exploited by multinational corporations. The initiative has outlined 15 BEPS Actions that arm governments with the tools to combat aggressive tax planning and tax avoidance by multinational corporations.

This program builds on the OECD BEPS actions to include other causes of revenue loss in the mining sector, such as the use of harmful tax incentives, abusive hedging arrangements and metals streaming.

The program will cover the following issues:

1. **Excessive Interest Deductions:** Companies may use related-party debt to shift profit away from mineral-producing countries via excessive interest payments to related entities.
2. **Transfer Mispricing:** Transfer pricing is a business practice that consists of setting a price for the purchase of a good or service between two "related parties." Transfer mispricing is when the related parties distort the price of a transaction to reduce their taxable income.
3. **Undervaluation of Mineral Exports:** A feature of transfer mispricing specific to mining: companies may sell mineral products to a related entity at prices below market rates, thereby moving sales revenue and profits offshore, to take advantage of lower tax rates.
4. **Harmful Tax Incentives**: Tax incentives are generally used to attract foreign investment. However, they may also erode the tax base and encourage profit shifting, for example, by encouraging companies to abuse tax-exempt entities in ways that were never envisioned by producing countries.
5. **Tax Stabilization:** Tax stabilization clauses, often in association with investment treaties, can be problematic from a tax perspective because they can freeze the fiscal terms in the contract such that changes in tax law (including BEPS-related reforms and updates to international tax standards) may be applicable to existing mines.
6. **International Tax Treaties:** Tax treaties are agreements between states that establish a common framework for the taxation of cross-border activity. There are potential tax treaty issues arising from mining that resource-rich countries should consider when designing tax treaty policy. Treaty shopping (companies structuring their investment to obtain benefits not intended by parties to the treaty) also presents BEPS challenges.
7. **Indirect Transfer of Mining Assets:** Sale of ownership of mine assets (or the companies themselves) can generate significant income, which many countries seek to tax as capital gains. However, indirect sales that take place offshore may be harder to tax, potentially resulting in hundreds of millions of tax dollars foregone.
8. **Metals Streaming:** Metals streaming involves mining companies selling a certain percentage of production at a fixed cost to a financier in return for funds for mine development and construction. Companies may agree to lower sale prices for long periods of time, thereby reducing royalty and tax collection.
9. **Abusive Hedging Arrangements:** Hedging means locking in a future selling price to manage risks of price fluctuations. A problem arises when companies enter hedging contracts with related parties to set an artificially low sale price for production, reducing the mine's taxable income.

10 **Inadequate Ring-fencing:** Ring-fencing is one way of limiting income consolidation for tax purposes; however, getting the design right is critical to securing tax revenues while continuing to attract further investment.

The full workplan is available here.

OUR MODEL

PHASE 1:
For each of the topics listed above, we will develop a combination of policy and administrative tools for use by resource-rich developing country governments. The precise nature of these products will vary from issue to issue depending on need, as well as work being done by other international and non-governmental organizations.

There are three overarching principles that guide the program:

1. **Adapt existing guidance on international tax issues to be mining-sector specific.** We are taking tax issues experienced by a range of sectors in the economy (such as double taxation treaties) and developing a framework by which governments of resource-rich countries can analyze the impact of treaty provisions on taxes imposed on the mining sector, as well as possible strategies to protect the mining tax base against specific treaty risks.
2. **Fill vital gaps in the available resources.** We are developing new practical guidance and tools that specify the precise legal, administrative, organizational and technical means required for tax authorities and mining regulatory agencies to address the tax issue. For example, we look at "metals streaming," a financing arrangement that may reduce the tax base of resource-producing countries, for which there is virtually no guidance.
3. **Keep administrative capacity front of mind.** We are delivering practical tools capable of being implemented by developing country tax authorities. Mining tax law is only as effective as the administrative capacity of the tax authority responsible for enforcing it. Developing country tax authorities face a range of challenges that impede tax administration, including limited resources, technical expertise and access to tax information. All products will be designed to address these specific challenges.

All results from the program will be publicly available via a dedicated website that will offer users a holistic view of how different mining tax issues interact, and the potential policy trade-offs. The site will be an up-to-date centre of expertise on international tax policy design and administration in mining, and a home to the guidance and tools that will be developed over the next two years.

PHASE 2:
IGF will deliver a menu of training options for member country governments based on the work produced in Phase 1. It will be a mix of annual training events on BEPS issues, as well as country-specific training and direct advisory services.

With support from GIZ, the IGF will develop a diagnostic tool that countries can use to identify the specific BEPS risks they need help with. The IGF will then gather the relevant policy guidance and tools to provide a tailored package of support.

OUR EXPERTS

- **Alexandra Readhead** is Technical Advisor to the IGF on Tax Base Erosion and Profit Shifting. She is a specialist in international taxation and the extractive industries.
- **Dan Devlin** is the Senior Economist in Natural Resource Taxation at the OECD. He is also a technical adviser to the OECD-UNDP Tax Inspectors Without Borders project on mining in Liberia.
- **Howard Mann** is an Associate & Senior International Law Advisor to IISD and IGF. He is a specialist in international investment and sustainable development law, as well as mining contract negotiations.

WANT TO GET INVOLVED?

We recognize that there are many governments, organizations and individuals with significant expertise in mineral tax policy and administration, and we are keen to leverage this wherever we can. Current collaborators include: the International Monetary Fund, United Nations Tax Committee, the World Bank Group, the African Development Bank, the African Mining for Development Centre, the International Senior Lawyers Project, and the International Council on Mining and Metals.

Please get in touch if you or your organization would like to know more about the program, or have something to contribute or suggestions for us.

For more information, please contact project leads Alexandra Readhead at alexandra.readhead@iisd.org and Howard Mann at hmann@iisd.ca.

FUNDING

The program has initial funding from Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) and the Canadian government.

More funds are still required.

If your organization is interested in helping fund the IGF BEPS in Mining Program please contact Alexandra Readhead at alexandra.readhead@iisd.org or Howard Mann at hmann@iisd.ca.