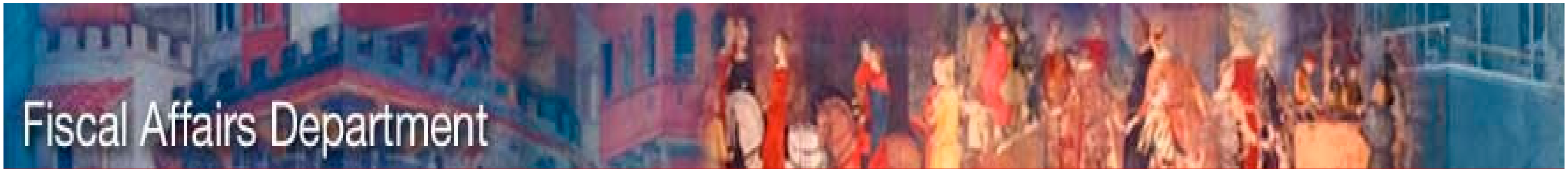

International Tax Issues and the Extractive Industries

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International Taxation: Opportunities and Risk

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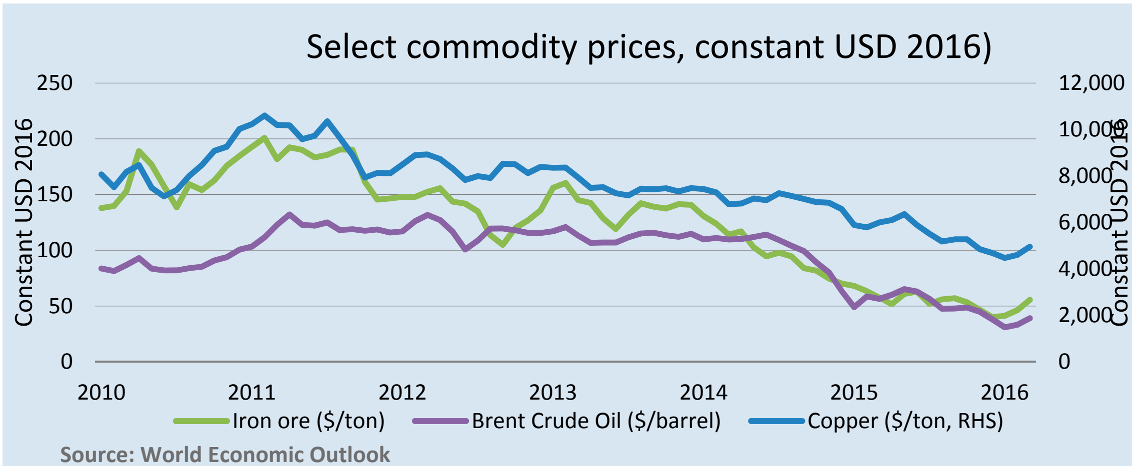
Current Challenges

- Low commodity prices



… leading to lower government revenues

– e.g., oil exporters' revenue ratio has fallen by 5.8 percentage points of GDP (*Fiscal Monitor, April 2016*)

… and pressure on governments to provide relief to EI producers

… while concerns with MNE international tax planning

International Tax Planning

- EI sector is vulnerable to international tax planning similar to other sectors, but also particular concerns
  - Special regimes (e.g., higher taxes on EI upstream) create a transfer pricing (TP) risk from cross border and domestic transactions

  … but other EI factors reduce TP risks: physical operations; standard price benchmarks; joint venture structures

  - High-value transfers of interest are common (or at least get more attention) for the EI sector
  - Inadequate coverage of the EI sector in treaties can cause problems (e.g., PE rules and special taxes)
  - Complexities arising from unique EI arrangements: cross-border projects/pipelines; joint development zones

EI Fiscal Instruments

Different fiscal instruments (e.g., royalty, income tax, production share, rent tax) are used to achieve the prime objective of an EI fiscal regime – that is, ***ensure the State as resource owner gets an 'appropriate' share*** while ***remaining attractive to investors***

… but which fiscal instrument or combination of instruments can achieve this objective while limiting opportunities for tax planning?

Which Fiscal Instruments?

- Royalties
  - Considered less vulnerable to profit shifting: no or limited deduction for costs; price benchmarks are often available; perceived as easier to administer

  … but can distort extraction—and exploration—decisions, so if set too high can make projects unviable, especially when prices are low
- Income tax
  - Potential for various mispricing and treaty abuses
- Production share/rent taxes
  - Similar vulnerabilities for mispricing as income tax
  - If progressive rates, then potential for 'gold-plating' (bring forward costs/overspend to avoid progressive taxes)

International Experience

- Some countries have tried to address TP (and fiscal) concerns with significant increases in taxes on gross revenues (e.g., royalties)

  … but has been viewed negatively by investors

- This suggests that a ***fiscal package*** of instruments (mix of low royalty, income tax and rent tax/production share) is still appropriate

  …with reliance on other policy and administration measures to mitigate profit shifting

  … but recognizing that taxes on gross revenue could play a greater role, especially if other mitigating measures are not effective

Publications and Tools

- In deciding on reform of a fiscal regime, evaluation of the implications of a reform for government and investors is essential
  - IMF's FARI model (now public) is available as an evaluation tool http://www.imf.org/external/np/fad/fari/
- EI international tax issues addressed in forthcoming book:

  International Taxation and the Extractive Industries due for release in 2016