Presentation Outline

• Discuss key international issues:
  – Transfer pricing
  – Thin Capitalization
  – Treaties
  – Withholding Taxes
  – Transfers of Interests

• Recent international tax developments (i.e., Base Erosion and Profit Shifting Project – BEPS)
Part 1

KEY INTERNATIONAL TAX ISSUES FOR THE EXTRACTIVES SECTOR
Transfer Pricing

- Sector is vulnerable to transfer pricing (TP) abuse:
  - Special regimes ... higher/special taxes on EI upstream (so TP risk from cross border and domestic transactions)
  - Nature of EI company structures
    - International businesses
    - MNEs often vertically integrated (upstream + downstream activities)
    - Use of tax havens
- ... but other factors reduce TP risks:
  - Physical operations
  - Standards outputs/measure/prices
  - Joint venture structures (usually in petroleum)
Transfer Pricing – What to do?

• Important to have clear guidelines (preferably based on OECD guidelines) to provide certainty for investors and tax administrators
  – Draw on expertise of other tax administrations
• Use of advance pricing agreements can provide certainty
Thin Capitalization

• Many countries limit deductions for interest expenses due to concerns that profits are stripped from a country via interest deductions
  – Recent trend to tighten limitations to protect the revenue base

• Usual methods are:
  – Thin capitalization rules that limit deductions if the debt to equity ratio is higher than a certain percentage (e.g., Canada 1.5:1)
  – Earnings stripping rules (e.g., Germany limits deductions to 30% of Earnings before interest, tax, depreciation and amortization (EBITDA))
Bilateral Tax Treaties (BTT) - Aims and Provisions

General aims:

• Avoid double taxation

• 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)
BTTs - Recent Proliferation

Numbers of BTTs and TIEAs, 1975–2013 (Source: IBFD)
Why BTTs?

• Bilateralism seems highly inefficient (and each treaty is a treaty with the world)

• Do they encourage FDI? Evidence is mixed

• What can BTTs achieve that cannot be achieved by some mix of unilateral measures, tax information exchange agreements (TIEAs), investment agreements?

• Presumably something to do with either signaling and/or credibility?
  
  – High sunk costs mean this may be important for EIs
BTT Concerns

• Treaty shopping

• Erosion of withholding tax on dividends, interest, royalties, management fees and technical service payments – especially an issue for developing countries

• Exclusions of tax through narrow definitions of real property, or broad definitions of business profits
BTTs - What can be done?

• Avoid negotiating a treaty simply because another country asks to do so, and integrate treaty-making with tax policy-making

• Limit new BTTs with potential intermediary countries, or countries with special holding company regimes

• Seek review of unfavorable BTTs, especially where created by inheritance from very old treaties

• Include a limitation of benefits (LOB) provision in domestic tax law preventing “treaty shopping”
• Ensure BTTs enshrine the broad right to levy WHT on payments to non-residents and, where relevant, ensure these are creditable in the partner country

• Aim for consistency in WHT provisions

• If this is not possible (and especially for resource companies) consider taxing the underlying business profits at a higher rate and forget about WHT

• Target some rules on tax havens

• Ensure that royalties, management fees, technical service payments do not get lost in “business profits” articles that exclude WHT by the host
Taxation of Transfers of Interest

• Taxation of transfers of interest in resource projects has become a big issue (Uganda, Ghana, Mozambique)
  – Different ways for indirect transfers of interests: domestic share sales; offshore share sales; farm outs

• Gains on transfers of real property usually taxable (whether separate capital gains tax (CGT) or general corporate tax)

• What happens when real property is an asset held by foreign companies who sell shares to other non-residents?
  – CGT then very difficult to enforce (and sometimes excluded by treaties)
Indirect Transfers of Interest

- Ultimate owner: Z
- Low tax jurisdiction(s): Y
- Sold: X
- Underlying asset: A
Taxation of Transfers of Interest – What to do?

• Include 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

• Tax the consideration received for the transfer - reduced by the undeducted cost of the transferred right

• Allow the acquirer to deduct the consideration paid for the right – rules differ on treatment of deduction
• To ensure payment of tax:
  – Some countries retain non-final withholding as a prepayment of the tax payable on the gain
  – Other countries deem the local entity to be the agent of the non-resident for payment of the tax due

• To ensure notification of the transfer:
  – Include a reporting mechanism under which the relevant Ministry informs the Revenue Authority of any substantial change in ownership (direct or indirect) of contractors or rights-holders
Part 2
RECENT DEVELOPMENTS IN INTERNATIONAL TAX - BEPS
BEPS – What is it?

• Base Erosion and Profit Shifting (BEPs) initiative – G20-OECD project to address major avoidance opportunities arising under international tax arrangements

• BEPs Action Plan 2013 – aim to make progress on 15 key areas by latter part of 2015

• Coverage includes:
  – Taxation of digital economy;
  – Strengthening domestic and BTT rules re: hybrid mismatches, CFCs, interest deductions, transfer pricing, permanent establishments, treaty abuse and BTT dispute resolution;
  – Disclosure of aggressive tax planning;
  – Consideration of multilateral instrument.
BEPS – Possible outcomes?

• Still too early to determine final outcomes of BEPs process and whether it will adequately address EI international tax concerns ... the impact on MNEs is also uncertain

• Strengthening domestic and BTT rules on transfer pricing etc. may have a significant impact for EI companies

... although disclosure rules may be less of an issue as EI companies already have major reporting obligations with EI transparency initiatives

• Question as to whether BEPs adequately covers interests of developing countries?