Tax Treaty Design for Resource-Rich Developing Countries

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1. Introduction

**TBD:** What is the practice note about; who is it for; how is it structured.

2. What are tax treaties?

Double Tax Treaties or Double Tax Agreements (DTAs) are international agreements, governed by international law that assign taxing rights between the two contracting countries on income from cross-border transactions, preventing the same income being taxed twice. DTAs determine which country can tax the activities of foreign-owned companies, between their place of operation (source), headquarters (residence) and any intermediary jurisdictions that may be involved in the business of the company.

The purpose of DTAs is:
- To encourage cross-border economic activities;
- To prevent taxation of income in more than one state;
- To prevent tax avoidance and evasion by instilling “arm’s length” bases for transactions and exchanging information;
- To eliminate discrimination against foreign nationals and non-residents.

**Tax Treaties and Domestic Law**

DTAs are overlaid onto domestic tax law but cannot create new tax liabilities. Therefore, each country’s domestic law should be sufficiently comprehensive and robust so that a DTA can be implemented into legislation as complementary provisions to apply to cross-border transactions with the treaty partner only. In these instances, the DTA is the prevailing law, but it does not modify the domestic law towards non-treating states. Conversely, changes to domestic law do not ordinarily modify DTAs. Therefore, the implementation of new tax laws and amendments to DTAs must be considered in tandem.

**Model Tax Conventions**

Model Tax Conventions (MTCs) are commonly used as the basis for negotiating a DTA. The main MTCs are the OECD model and the UN model. There are also regional treaty models such as the one provided by the African Tax Administration Forum (ATAF). While there are similarities between all three texts, the UN and ATAF Models tend to favour the economic interests of developing countries who are net capital importers, as it maintains source taxing rights with greater rights to tax the business income of non-residents, and it does not prevent the source country imposing tax on royalties paid by one of its residents. The OECD Model is notable for favouring developed countries and it determines that the source country has to forgo taxing certain income derived by residents of the treaty partner country. Across these models, double taxation is prevented by provisions which either determine which one country taxes certain income types or agree how to share the income - this is usually done by exemptions or credits.
Multilateral Instrument

While one of the purposes of DTAs is to minimise taxation of income in both countries, the complex structures available to extractives businesses across different jurisdictions can lead to potential abuse of DTAs, for example through shifting profits into jurisdictions to take advantage of preferable treaty provisions, or using loopholes in treaties to create non-taxable income.

To mitigate against this, the Multilateral Convention to Implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting, known as the Multilateral Instrument (MLI) was agreed upon to offer concrete solutions for governments to close loopholes in DTAs and allows signatory governments to modify existing bilateral tax treaties in a synchronised and efficient manner to implement the tax treaty measures developed during the OECD’s BEPS Project, without the need to expend resources renegotiating each treaty bilaterally. It transposes the results of the BEPS Project onto bilateral tax treaties, allowing governments to implement agreed minimum standards to counter treaty abuse and improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies.

3. Policy Considerations

General Issues

TBD: This section will set out some of the general macro-economic factors that developing countries may wish to consider when deciding whether to enter into a DTA. For example, the direction of capital flows; the effectiveness of tax treaties at attracting investment; and the risks of treaty shopping. There will be an overview of recent empirical studies on the costs and benefits of DTAs for developing countries, as well as some examples of treaty shopping, including options to limit abuse.

TBD: Pre-conditions for DTAs – This section will include a list of legislative measures, capabilities, and institutional arrangements that should be in place before countries enter into treaties. E.g. comprehensive transfer pricing rules; other anti-avoidance measures; human resources and financial capacity; good governance; inter-agency coordination etc.

Resource-related considerations

This section will set out some of the unique features of the extractive industries, and their relevance to treaty policy. For example, the location specific nature of the resource may mean that tax competition, including tax treaties, are a less significant factor in investment decision-making. However, the focus of this section will be on the interaction between DTAs, and Mineral Concession Agreements (MCAs), which are common in the mining sector, especially in African countries. The reason for this emphasis is that MCAs may limit the relevance of DTAs in attracting mining investment, particularly where more generous fiscal terms are locked in through stabilisation provisions.
Interaction between Mining Concession Agreements and Double Taxation Agreements

The relation of the fiscal regime of a country rich in mineral resources to an international investor making an investment in a host-country mining project may be affected not only by the provisions of a DTA, but by at least one and often two other critical legal agreements.

1) Mineral Concession Agreement (MCA): An MCA is between a host government and a mining investor (specifically, the entity (or entities) investing in and developing the resource). While MCAs are common across the sector, particularly in African countries, this is not always true for Latin American countries, and virtually unheard of in OECD countries. Moreover, MCAs do not always address tax issues, instead these may be dealt with in the primary law. Finally, policy-makers should be aware that non-transparent negotiations and processes raise concerns and that substantive provisions (such as stabilization clauses) can limit the regulatory powers of the host-country and trigger international obligations under BITs. However, for states that do use MCAs, the interaction with DTAs will be very important.

2) Bilateral Investment Treaty (BIT): A BIT is between the host-country and the country of the investor. Unlike an MCA or DTA, a BIT does not define taxing rights, but may be used as an avenue for dispute resolution in the event of expropriation via excessive taxation.

Table X. Key Features of MCAs, DTAs, and BITs

<table>
<thead>
<tr>
<th>Purpose and scope</th>
<th>MCA</th>
<th>BIT</th>
<th>DTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Some conditions of the mining investment and the rights and obligations of the host-country and the mining investor</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>May include fiscal provisions that modify the application of host-country tax law to the mining investor</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Provides certain guarantees to an investor, including fair and equitable treatment, most-favored nation treatment, protection from expropriation, free transfer of investment-related funds, and full protection and security.</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>The primary purpose of tax treaties is the avoidance of double taxation of income arising from cross-border transactions.</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

1 For a database of publicly disclosed mining (and oil and gas) MCAs, see [https://resourcecontracts.org/](https://resourcecontracts.org/). This database is sponsored by: The Natural Resource Governance Institute, the Columbia Center for Sustainable Investment, The World Bank and Open Oil, working with a number of country partners. This practice note will use as an example of an MCA an Amended and Restated Development Agreement between The Government of the Republic of Zambia and Konkola Copper Mines PLC dated 2004 (the “KCM Agreement”), available at [https://resourcecontracts.org/search?q=&country%5B0%5D=ZM&order=asc&sortby=contract_type](https://resourcecontracts.org/search?q=&country%5B0%5D=ZM&order=asc&sortby=contract_type) (last viewed July 10, 2019).
This next section will briefly describe how each such agreement may affect taxation of income from a mining project and then will review how these agreements intersect with a DTA. This discussion is not intended to be comprehensive but is designed to alert policymakers to important interactions between DTAs and other legal instruments other than domestic law. An MCA, in particular, normally is long-lived (for the life of the project) and may play an outsized role in host-country taxation of a mining investment. The applicability of a BIT may provide an investor rights not generally accorded to taxpayers. There are hundreds—if not thousands—of these two types of agreements in place, so any discussion of DTAs does not write on a clean slate. This section is intended to flag for policymakers the effects of a “cohabitation” of these

| Legal form | - a contract between the host-country and investor | - Agreement between two or more sovereign states | - Agreement between two or more sovereign states |
| Legal status | - may enter into an MCA by legislation or regulation; - or, the MCA may itself be adopted by the legislature. | - Agreement under international law | - Agreement under international law – takes precedence over domestic law, unless there is a treaty override. |
| Dispute resolution | - generally, arbitration in domestic courts, or in a forum outside of the host-country’s judicial system. | - arbitration of claims, which takes disputes outside the judicial system of the host-country | - Mutual agreement procedure: government-to-government |

2 See U.S. Model BIT, Art. 21 (except as provided in the article, treaty does not impose obligations in respect of taxation measures).
4 More recently, MCAs may also include provisions for mediation.
different agreements, their respective effects, and their relative necessity (or lack thereof) from a host-country tax perspective.

**Scope of Substantive Tax Reliefs**

Whether an MCA’s fiscal provisions are affected by a DTA will depend initially on whether the DTA applies to the investor and to the income in question. A DTA would require that several conditions be satisfied before it even would apply. For example:

i. Is the entity resident in the DTA partner country?
ii. Is the entity eligible for the benefit of the DTA under any applicable limitation on benefits provision?
iii. Is the tax in question a covered tax (Art. 2)? Generally, a VAT and sometimes local and regional taxes are not covered by the DTA.
iv. Are the DTA’s substantive provisions more favorable than the tax provisions available through the MCA? For example, do the DTA’s substantive limits on withholding tax in its dividends, interest and royalty articles, or its exemption from host-country tax under a business profits article, provide a more favorable rate than available under the MCA?

States that operate under MCAs that contain fiscal terms, may provide the same or better benefits to an investor than under a DTA, rendering the DTA largely irrelevant for an investor’s decision whether to invest. Indeed, most MCAs are drafted with the country’s DTA policy firmly in mind and therefore rates are sought in the MCA that are as or more favorable than would be available under a relevant treaty. With reference to the questions noted above, an MCA can (i) apply to entities regardless of their residency, (ii) impose fewer (or no) eligibility requirements, (iii) cover all taxes, (iv) and offer more favorable substantive provisions. As an illustration, Table 1 at Appendix A uses an actual MCA to compare the local law taxation provisions of the host-country, the corresponding provision of the MCA and the protections of the OECD and UN Model DTAs.

Where a relevant tax rate under a DTA is more favorable to the investor than under an MCA, most MCAs would allow the investor to claim the more favorable benefit of the treaty. As a consequence, though DTAs may be seen as an added avenue for beneficial treatment of the investor, DTAs are an avenue that may not be a necessary inducement to investment, particularly if the investment is under an existing MCA or a new investment is made under an MCA with comparably favorable taxation relief.

**Legal status**

A DTA has only state-parties and is an international agreement under domestic and international law. As a result, the negotiation and conclusion of a DTA is subject to the rigors and scrutiny of the state-parties’ legislative processes, and the text of the DTA and its drafting history is public. By contrast, as discussed above, an MCA may vary in its legal status, it may not be subject to legislative review, and its terms may not be made public.

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5 A DTA entered into after an investment has been made also obviously is irrelevant to that investment decision, but may nonetheless benefit the investor.
Dispute resolution

The remaining potential benefit of a DTA for an investor is that the mutual agreement procedure of a DTA can provide an additional dispute resolution opportunity. If the investor believes that taxation by the host-country is inconsistent with the treaty, it may request competent authority relief under the mutual agreement article of the treaty. This procedure involves government-to-government, really tax authority-to-tax authority, discussion of the case. The taxpayer does not have a direct role, but it often has the advantage of its home government arguing for its relief. There generally is no requirement for governments to reach an agreement, though an increasing number of treaties (so far mostly involving developed countries) include mandatory binding arbitration provisions that would assure resolution of the case.

A mining investor may, if the proposed host-country taxation is inconsistent with the MCA, make an arbitration claim under an MCA. By comparison with a mutual agreement case, the investor must make and prosecute the claim. This distinction may not be as great as it first appears, since an investor seeking mutual agreement relief normally will already have pursued an objection to the proposed host-country taxation.

In addition to arbitrating a loss claim resulting from taxation inconsistent with the MCA, an investor’s rights under the MCA also may be eligible for protection under a BIT or other international agreement (e.g., the Energy Charter Treaty (ECT)). The ability to bring such a claim depends on the individual’s or entity’s distinct status as an eligible investor and the scope of the protection of a particular treaty, as certain treaties specifically carve out issues of taxation. As in the case of arbitrating under an MCA, the investor, rather than its representative country, would initiate a BIT claim. In effect, therefore, a BIT or international agreement could become an additional mechanism to enforce the benefits of the MCA and therefore provide a remedy that might otherwise be denied through other dispute resolution processes.

In summary, the provisions of a DTA operate alongside other domestic and international agreements, including MCAs and BITs, and the presence of these agreements may affect the impact of a DTA. If a mining investor is operating under an MCA that covers fiscal terms, a DTA may offer limited additional benefit to the investor that it has not already achieved under an MCA. Favorable provisions under the DTA likely are included in the MCA which in some cases are negotiated on the basis of and with the objective to be more advantageous to the investor than an existing DTA framework. Therefore, it is important for policy-makers in countries with pre-existing MCAs, to consider the benefits of a DTA. If a state already has a network of MCAs, it is possible that a DTA will provide tax benefits without increasing mining investment.

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6 This assumes that the MCA provides for arbitration.
4. Tax Treaty Design for Resource-Rich Countries

This section will go through each of the treaty articles that are most relevant for the mining sector. For each article, the discussion will be structured as follows:

a) the relevance of the Article for the mining sector;
b) any key differences between the MTCs;
c) resource-related treaty practice (i.e. deviations from the MTCs by resource-rich countries);
d) recommendations.
Article 5: Permanent Establishment

Permanent establishment (PE) is one of the primary building blocks of international taxation. It is used to determine the right of a State to tax the profits of an enterprise of the other State. Specifically, the profits of an enterprise of one State are taxable in the other State only if the enterprise maintains a PE in the latter State and only to the extent that the profits are attributable to the PE. The definition of what constitutes a PE – the subject of Article 5 – is, therefore, critical.

According to Article 5(1) of both Model Tax Convention (MTCs), a PE means:

“a fixed place of business through which the business of an enterprise is wholly or partly carried on.”

An illustrative list in Article 5(2) specifies kinds of operations that prima facie come within Article 5(1) (the “general rule”), followed by certain deeming rules in paragraphs 4 to 6 that exclude or include certain activities. According to the illustrative list, a PE includes:

“a mine, an oil or gas well, quarry or any other place of extraction of natural resources.”

While it is very likely that a mine will constitute a PE, the fact that it is included in paragraph 5 does not guarantee this. The OECD Commentary is clear that the general rule must be satisfied before a PE exists. The UN MTC is silent on this point. To avoid any ambiguity, resource-rich countries may wish to clarify this point, to ensure that certain activities – notably exploration – are within scope.

The next section discusses the PE issues that may arise at different stages of a mining project.

a) Production

As far as the extraction (production) of minerals is concerned, there is little doubt that the activity is permanent, and therefore constitutes a PE. A mine is linked to a specific geographical point, making it a “fixed place of business.” The main PE issue during the development and production stage will be the use of sub-contractors who are often hired to perform short-term work relating to the mine; this is a particular issue for mining activities taking place offshore.

Deep Sea Mining

Deep sea mining is a relatively new industry. It is the proposed extraction of metallic and non-metallic mineral resources from the ocean floor at water depths greater than 200 meters. It is done mainly by dredging, which involves lifting minerals from the seafloor to the sea surface. Exploration is happening primarily in the Pacific Ocean – territorial waters of Papua New Guinea (PNG) are particularly rich with sulphide concentrate deposits.

According to the OECD Commentaries, the term “any other place of extraction of natural resources” should be interpreted broadly to include all places of extraction of hydrocarbons.
whether on or offshore. The reference to hydrocarbons reflects the prevalence of offshore oil and gas exploration compared to deep sea mining. Regardless, a license holder engaged in deep sea mining will generally have a PE, provided the domestic tax law includes a right to tax resident companies operating within a state’s territorial waters and Continental Shelf.

However, there may be subcontractors – both independent and related entities – that are not resident in the source country and can more readily structure their activities to avoid exceeding the time required to trigger a PE (six months and 12 months for the UN and OECD MTCs respectively). Because the activities are taking place offshore, tax authorities have difficulty monitoring such arrangements.

The same challenges arise with respect to offshore oil and gas exploration. Some countries have sought to address this by inserting a separate Article as a special offshore rule in their DTAs. In such cases, a PE is deemed in respect of offshore activities once 30 days in aggregate is exceeded. Where the activities are carried out by related parties as part of the same project, the time spent by each party may be added together for the purpose of meeting the threshold. The merits of “deeming” a PE are briefly explored in Table X – these apply generally.

Table X. Advantages and disadvantages of deeming a PE

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| • Preserve source taxing rights  
  o This is particularly justified in the case of natural resources  
  • Remove any uncertainty with respect to tax treatment. Source states be able to stretch the notion of PE, but in doing so cause uncertainty for business regarding what is in scope. As such, it may be preferable to deem a PE so that investors at least know they are taxable | • Deviation from the MTC  
  • Resident state may refuse to give relief – could result in double taxation. Less likely to arise with other resource-rich countries that adopt similar deviations but may arise with non-resource rich treaty partners. |

Following the experience from the oil and gas sector, states with the potential for deep sea mining should (1) establish a domestic right to tax non-resident companies operating offshore; (2) ensure that the Continental Shelf is explicitly in scope of DTAs; and (3) deem a PE for offshore activities relating to deep-sea mining that exceed 30 days in aggregate.

7 Committee on Fiscal Affairs, supra n. 1, art. 5, para 17.
8 See Netherlands-United States (1992), Norway-Canada (2002)
9 TBD: this point needs further unpacking. Interestingly, countries such as Norway and the UK that have had offshore rules for some time, lack the right to tax non-resident companies that are operating offshore. This is creating issues for taxation of offshore wind farms in the UK, for example.
10 Papua New Guinea expressly includes its Continental Shelf, sea bed and subsoil in the geographical scope of its treaties. However, it does not deem a PE in the case of offshore activities. In a recent treaty with New Zealand,
Countries that already have a standalone rule for offshore activities should also have the right to tax deep-sea mining, unless the offshore provision relates exclusively to hydrocarbons. These same issues arise in the context of mineral exploration activities, which are discussed in the next section.

**b) Exploration**

From a PE perspective, exploration is more problematic than production. First, there is no provision in the OECD, UN or ATAF MTCs that expressly addresses exploration, although the ATAF MTC is broader in that it refers to “any other place of extraction or exploitation”. Under the OECD and UN MTCs, whether there is a PE will depend on exploration satisfying the general rule, which it will in many cases: generally done on-land; involving a physical attachment to the soil, and for a long period of time.

Notwithstanding, even if exploration satisfies the general rule, it may still be excluded under Article 5(4) if it is considered “preparatory”. “Preparatory” is a relative concept: exploration that is undertaken by the same mining company that intends to develop the resource is likely to be considered “preparatory”, whereas exploration by an foreign service provider may be core business, in which case these activities form a PE, provided that they also satisfy the general rule.

Before considering how best to address this gap, it is worth considering whether it is material if exploration triggers a PE or not. During the exploration phase there is generally no revenue to tax. Furthermore, it may be in government’s interest to avoid a PE arising, to prevent the mining company from offsetting its exploration expenses against future revenue. On the other hand, if the exploration license or permit is transferred, there may be considerable income that would not be subject to tax if there is no PE. Finally, having a PE at exploration, may prevent debate with the investor about when a PE comes into existence once production starts, as well as deem a PE to exist for subcontractors.

**TBD Box X. Example of transfer of exploration license**

Many resource-rich countries have found the arguments in favour of inferring a PE compelling. This has led them to insert their own provisions relating to exploration. Two distinct approaches have formed. The most common is to include exploration within the meaning of a PE (a). The second, and more reliable approach is to deem a PE to exist in the case of exploration (b).

PNG does deem a PE for resource-related activities exceeding 90 days, however this is substantially longer than the usual 30-day period for offshore activities.

11 The Netherlands-United States treaty “offshore activities” means activities which are carried on offshore in connection with the exploration or exploitation of the seabed and its sub-soil and their natural resources, situated in one of the States.
i) Adding exploration to Article 5(2), or in a separate paragraph

Some countries have added exploration to the list in Article 5(2); others have gone further and included drilling rigs or ships. The latter has typically been more relevant for oil and gas than for mining, however, it may be a consideration for countries with the potential for deep sea mining.

Canada-Kazakhstan (1996)

a mine, an oil or gas well, a quarry or any other place relating to the exploration for or the exploitation of natural resources.

China-Kazakhstan (2001)

an installation, drilling rig or ship used for the exploration or exploitation of natural resources.

Other countries have chosen to include exploration in a separate paragraph. Both approaches seek to extend the meaning of PE to include exploration. However, this does not guarantee that exploration activities will satisfy the general rule. They may not be “fixed”, for example.

ii) Deeming a PE

The only way to guarantee that exploration activities will be considered a PE irrespective of the general rule, is to deem a PE to exist. The Australia-Ireland treaty deems a PE to exist in the case of exploration and deems exploration to be carried on through a PE. This effectively displaces the general rule, thereby avoiding any interpretation issues.

Australia-Ireland (1983)

4(a) An enterprise shall be deemed to have a permanent establishment in one of the Contracting States and to carry on business through that permanent establishment if:

4(b) it carries on activities in that State in connection with the exploration or exploitation of the sea-bed, subsoil or their natural resources in that State.

Subcontractors

Traditional mining businesses tend to keep a large part of the core business operations within their own control. However, it is becoming more common for mine operations to be outsourced to subcontractors (known as ‘contract mining’). In addition, there is substantial use of subcontractors in the industry, especially at the start of the mining project where a service provider may be used for engineering and construction of the mine (open cut or underground), processing plant and equipment, and down-stream infrastructure such as rail and port facilities, particularly in developing countries where such infrastructure may not be in existing. Closure and rehabilitation of the mine site is important in the mining industry and this often involves the use of subcontractors.
There are two main PE issues for subcontractors:

i) Scope of PE

Activities undertaken by mining subcontractors will generally be covered by Article 5(3). However, as in the case of exploration activities, it is unclear whether this is a stand-alone provision, or if the general rule must also be satisfied. To avoid any ambiguity, some countries have chosen to deem a PE in the case of construction activities. Table X sets out the default approach under the OECD and UN MTCs, and a deemed approach used in the Canada-PNG treaty.

There is an additional policy choice whether to include supervisory activities. “Supervisory activities” might include planning the construction of a mine, as distinct from actually building a mine, for example. Although the OECD MTC does not include supervisory activities, the Commentary is clear that if such activities are performed by a building contractor or by anyone on site in relation to a building site or construction or installation project, a PE is deemed to exist for the on-site supervising party. Nonetheless, to resolve any ambiguity, some resource-rich countries, Canada and PNG, for example deem a PE in the case of supervisory activities.

Table X. Modifying the construction clause

<table>
<thead>
<tr>
<th>Default Approach</th>
<th>Deeming a PE</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD MTC: “A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.”</td>
<td>Canada-PNG (1987) An enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if: it carries on supervisory activities in that State for more than three months in connection with a building site, or a construction, installation or assembly project which is being undertaken in that State.</td>
</tr>
<tr>
<td>UN MTC: The term PE also encompasses: “A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.”</td>
<td></td>
</tr>
</tbody>
</table>

ii) Applicable Time Test for a PE

Unlike a mine, which will constitute a PE irrespective of the duration, activities performed by a subcontractor may only give rise to a PE after a certain period of time (six months and 12 months for the UN and OECD MTCs respectively). This gives rise to two risks:

\[12\] Brown, pg. 9
• To avoid triggering a PE, and paying taxes at source, subcontractors may agree to perform their services in a shorter time period (e.g. five-months rather than the 6-months limit for a PE).

• A mining company may also be incentivised to use a closely related subcontractor to perform part of the operations, in order to avoid the threshold, and shift profit that would otherwise be taxed at source.

Box X. Example of splitting-up of contracts in mining sector

TBD

These risks raise two important questions:

• Should there be a time limit at all?

The argument against setting a time limit is that it removes any incentive for taxpayers to split contracts to avoid triggering a PE. The Australia-Ireland treaty does not include a minimum period, for example.

• If yes, what should the time limit be?

A number of countries claim reservations to the OECD MTC with respect to the time period, favouring a six-month period. The ATAF MTC leaves it open for contracting states to determine an appropriate duration in the case of exploration specifically – three months is common. This can be useful if States want to maintain a more generous time period for other non-extractives related investments. The downside is increased administrative complexity due to the need to differentiate between the purpose of construction activities.

Setting a higher threshold (e.g. three months) lowers the risk of abuse, but there is still a possibility that companies will split contracts. Consequently, some countries allow for the aggregation of time spent.

Examples include:

• Canada-PNG treaty – a PE will arise where the exploration activities continue for a period exceeding, in the aggregate, 30 days in any 12-month period.

• Nigeria-Singapore – treaty it is 60 days in any 12-month period.

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13 Australia, Chile, Greece, Korea, New Zealand, Portugal. Australia reserved to include a 183-day test.
14 Article 5(3)(d) “an installation or structure used in the exploration for natural resources provided that the installation or structure continues for a period of not less than …….days”.

Intergovernmental Forum on Mining (IGF) and International Senior Lawyers Project (ISLP)
This approach has been adopted in Article 14 of the MLI. Interestingly, two resource-rich countries, Norway and Australia, have reserved against Article 14. This is most likely because Article 14 is based on the normal PE concept, which requires that business activities exceed 12 months; the treaty between Norway and Australia deviates from this with respect to offshore activities.  

**Box X. Article 14 of the MLI**

Article 14 of the MLI addresses the problem of splitting-up of contracts:

1. A PE arises when:
   
a) activities performed at a building site, construction project, installation project or other specific project identified under the relevant treaty continue for a period exceeding, in aggregate, 30 days in the period referred to in the Covered Tax Agreement;

b) connected activities performed at a building site, construction project, installation project or other specific project identified under the relevant treaty during different periods of time, each exceeding 30 days, by one or more closely related companies.

2. States reserve the right for the entirety of this Article not to apply with respect to provisions of its Covered Tax Agreements relating to the exploration for or exploitation of natural resources.  

The test for “closely related” is:

- 50 per cent of the beneficial interest;
- In the case of a company: more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company.

**Substantial equipment**

Some States have found it useful to extend PE to enterprises using substantial equipment in relation to exploration or exploitation of natural resources. Substantial equipment would include, for example, earth moving equipment, or a drilling rig. This is a long-standing provision in Australia’s treaties that is intended to protect its right to tax its natural resources specifically. It is mainly meant to apply to foreign companies providing services to offshore oil and gas projects. It may also apply to activities happening on land, but there is less substantial equipment in such cases.

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15 TBD: clarifying with Australia whether it is just the treaty with Norway that is carved out, and Art 14 applies to existing DTAs without existing anti-spliiting rules.

16 This is the only mention to natural resources in the MLI.
Under the OECD MTC, a PE only arises after a certain time threshold is exceeded. However, in this case, as soon as an enterprise uses substantial equipment in the context of exploration and exploitation, it is deemed to have a PE in the contracting state and to carry on business through that PE if substantial equipment is being used in that state. In this regard, it is a much faster source taxing right.

In some cases, the provision deems a PE when the equipment belongs to a subcontractor, irrespective of whether it is being used by the subcontractor (see Australia-Canada treaty). Consequently, the use of equipment by a lessee, for example, would appear to be sufficient to deem the lessor to have a PE in the host country. This goes beyond the normal PE rules.  

Australia-Switzerland (2013)  
4(b) carries on activities (including the operation of substantial equipment) in the other State in the exploration for or exploitation of natural resources situated in that other State for an aggregate period of at least 6 months in any 24-month period; or  
4(c) operates substantial equipment in the other State (including as provided in subparagraph b)) for a period exceeding 12-month.

Australia-Canada (Amending Protocol 2002)  
4(b) substantial equipment is being used in that State by, for or under contract with the enterprise other than in connection with a building site or construction, installation or assembly project of the enterprise.

Marketing of Mineral Products

It is common for mining companies to sell their mineral production via a dependent agent. The agent (or broker) will typically have authority to negotiate contracts between the producer and third-party customers. They may even conclude the contract depending on powers the producer has delegated to them. However, unlike other models, for example, where a marketing off-taker buys the mineral from the producer, an agent does not take title to the goods.

According to both the UN and OECD MTCs, a PE is deemed to exist if a dependent agent exercises the authority to enter into contracts on behalf of the resident of the other contracting state. There is no need for the non-resident mining company, in this instance, to have a fixed placed of business in the source state. The result is that the country where the mining company is located, may have the right to tax the income of the agent.

18 This is different to the original treaty dated 1980 which limited the duration to 12 months.  
19 This is different to the original treaty dated 1980 which limited the duration to 12 months.
The UN MTC offers a broader definition of the dependent agent, which has subsequently been adopted in Article 12 of the MLI. Under the UN MTC, a PE is triggered even where the agent does not conclude the contract, or modify it materially, but plays a leading role up to that point. Consequently, in the example on Box X, the income of the marketing agent that is attributable to the property in the source state may be taxed at source.

Box X. Example of marketing hub downgraded from fully-fledged offtaker to agent

TBD

Recommendations (TBD)

- To avoid any ambiguity, resource-rich countries should include a separate paragraph in Article 5 that adopts a specific deeming provision in the case of exploration activities.
  - E.g. “An enterprise shall be deemed to have a PE...if it carries on activities that consist of, or that are connected with, the exploration for or exploitation of natural resources situated in that State.”

- If countries opt for a duration test for exploration activities, this should allow for aggregation of time spent in similar projects.
  - E.g. “30 days in aggregate in any [six or 12-month] period”
Article 6: Income from Immoveable Property

Where income from immoveable property is not derived through a PE, Article 6 secures the right of the source state to tax income from immoveable property where the assets are located. The justification is the close economic connection between the source of this income and the State of source. It would seem antithetical, for example, if the income from the sale of a mineral deposit was not taxable in the State where the resource is located. The main challenge is the definition of “immoveable property”.

Definition of “Immoveable Property”

Both the UN and OECD MTCs state in Article 6(2) that the term “immoveable property” shall have the meaning that it has under the domestic law of the State where the property is situated. Consequently, the first issue for States is to ensure that they have a comprehensive definition of immoveable property in their domestic law that explicitly includes the right to explore, and to mine. Canada and Australia both have treaty overrides with respect to the definition of immoveable property; this means that any existing or future DTAs will be subject to the definition of immoveable property in the domestic law.

Canada’s definition is broader than Australia’s and includes an important innovation: any “right to an amount computed by reference to production, or the value of production from mineral deposits.” This provision recognises that there are other ways that taxpayers may derive income from mineral deposits that do not include having the right to explore or exploit. Arrangements that are caught by this include production royalties, both levied on gross and net value.

Box X. Definition of immoveable property in Australia and Canada

**Australia**

“Real property” encompasses interests in land and fixtures or structures upon the land”. A “taxable Australian property” includes:

- a direct interest in real property situated in Australia
- a mining, quarrying or prospecting right to minerals, petroleum or quarry materials situated in Australia

Taxable Australian property also includes an option or right over one of the above.

**Canada** (Income Tax Conventions Interpretation Act. R.S.C., 1985, c. I-4)

“Immovable property and real property, with respect to property in Canada, are hereby declared to include:

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20 OECD Commentary 1 Art.6 (1)
a) any right to explore for or exploit mineral deposits and sources in Canada and other natural resources in Canada, and

b) any right to an amount computed by reference to the production, including profit, from, or to the value of production from, mineral deposits and sources in Canada and other natural resources in Canada; *(biens immobiliers et biens immeubles)*.

Notwithstanding the definition in domestic law, Article 6(2) of the UN and OECD MTCs assumes that “immoveable property” will include:

“rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources.”

The only difference between the MTCs is that the UN includes income from immoveable property used for the performance of independent personal services. This is because of Article 14 of the UN MTC which deals with Independent Personal Services (see Section X - TBD). The ATAF Model follows the OECD, except that it also excludes boats, as well as ships and aircrafts.

There are two modifications to Article 6 that may be relevant for resource-rich countries. The first is the inclusion of exploration assets or rights as immoveable property; and the second is specifying that the right is situated where the underlying asset is located in the source country.

a) Exploration assets or rights may not qualify as immoveable property

If read narrowly, “the working of” or the “right to work” may be taken to mean that only assets or rights relating to mineral production or exploitation qualify as immoveable property. Consequently, income derived by a non-resident from exploration activities would not be subject to tax in the source state, including the capital gains from a future sale of an exploration license.

To avoid any ambiguity, some resource-rich countries have clarified in their DTAs that immoveable property covers both the “right to explore”, and the “right to mine”, as well as the right to receive income from the “right to explore for or exploit” natural resources (see Box x).

PNG-Singapore (1992)

6(2)(a) a lease of land and any other interest in or over land including a **right to explore** for mineral, oil or gas deposits or other natural resources, and a **right to mine** such deposits or resources; and

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6(2)(b) a right to receive variable or fixed payments either as consideration for or in respect of the exploitation of, or the right to explore for or exploit, mineral, oil or gas deposits, quarries or other places of extraction or exploitation of natural resources.

Australia-SA 1999

6(2)(a) a lease of land and any other interest in or over land, whether improved or not, including a right to explore for mineral, oil or gas deposits or other natural resources, and a right to mine those deposits or resources;

b) The right or asset is situated where the immoveable property is located

Many resource-rich countries specify that the right referred to in the definition of immovable property 6(2) “shall be regarded as situated where the land, mineral, oil or gas deposits or sources, quarries or natural resources, as the case may be, are situated or where the exploration may take place.” This is particularly common in Australia’s DTAs. It puts beyond doubt that income from the sale of a mining or exploration right is subject to tax in Australia, which is particularly relevant where the right is indirectly owned (and potentially sold) by a foreign company (section on Article 13).

Australia-UK 2003

Any interest or right referred to in paragraph 2 shall be regarded as situated where the land, mineral, oil or gas deposits, quarries or natural resources, as the case may be, are situated or where the exploration may take place.

UN commentaries raise this as a potential issue. However, they leave countries to decide on whether shares should be included under Article 6 or Article 22 (other income). This is particularly important for mining where the resident company may own shares in a company that owns the mining license.

Recommendations

TBD
Article 11: Interest

Mining is extremely capital-intensive. Over the life of a mine, hundreds of millions of dollars may be spent on constructing the mine, facilities to process the ore, and infrastructure such as roads and power generation. Mining companies have a choice whether to fund projects using equity or debt. Debt generates interest payments, which are tax deductible, and usually subject to withholding tax in the source country.\(^{22}\)

Article 11 deals with the cross-border treatment of withholding tax on interest expense. It allocates the right to tax interest to both the source and residence countries, although in the case of the source country, the OECD Model limits this right to 10 percent of the gross amount. The UN Model, and subsequently the ATAF Model, do not impose a limit. The flexibility to set a higher rate may be preferable for developing countries that rely on withholding taxes as a reliable source of revenue, and to protect against base erosion and profit shifting.

One of the factors that larger multinational mining companies will look at when deciding how to finance a mine, is the tax treaty networks of the source country. They may choose to structure entities to take advantage of treaties that provide reduced rates of withholding tax on interest. Depending on the size of the investment, and the debt-loading, the tax forgone under the treaty may be substantial (Box X). If countries choose to offer a lower rate of withholding tax in their treaties, they should adopt an anti-abuse provision – see Article 7 of the MLI – Preventing Treaty Abuse.

**BOX X. Revenue forgone from lower rate of withholding tax on interest**

Located in the Southern Gobi region of Mongolia, Oyu Tolgoi is one of the world’s largest copper and gold deposits. The Oyu Tolgoi mine (OT) is jointly owned by the government of Mongolia (34%), and Turquoise Hill Resources (66%). The latter is a Canadian subsidiary of Rio Tinto (51%) listed on the Toronto and New York Stock Exchanges. The OT project combines an open pit and an underground mine producing copper concentrate, which is then transported by rail to China for processing.

Since OT began in 2010, construction of the mine has cost $10 billion in capital expenditure. Phase 1 was the construction of the open pit mine, which was financed by shareholder debt from Rio Tinto, and Phase 2 is the construction of the underground mine, which is being funded by external project finance. The finance from Phase 1 came via loans from a related party in the Netherlands, which was subject to a Double Tax Agreement (DTA) between the GoM and the Netherlands. Amongst other tax concessions, the treaty stipulated a WHT rate of 10% on interest, reduced from 20% in Mongolian law.

The result, according to a report issued by the Centre for Research on Multinational Corporations (SOMO), was $173 million in forgone tax revenue so far (i.e. difference between 10% and 20% WHT). Open Oil’s financial model estimates that the lower rate will cost the government $700 million in potential tax revenue over life-of-mine. Recognising the risk to revenue, the GoM annulled the Dutch treaty in 2014. However, the lower rate continues to apply because of the fiscal stabilization provisions in Rio’s Investment Agreement.

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\(^{22}\) See IGF-OECD Practice Note Limiting the Impact of Excessive Interest Deductions on Mining Revenues for a more detailed discussion.
Variation in Withholding Tax on Interest

TBD: Analysis of withholding tax rates from review of DTAs

Alternative Sources of Financing

Article 11 covers interest arising from “debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits.” It is clear that cross-border interest payments arising from traditional sources of debt finance such as banks loans and internal funds satisfy this definition.

However, since the global financial crisis, both debt and equity financing have become harder for mining companies to obtain. Alternative sources of financing have emerged as a result. Some of these sources of finance include metal streaming and royalty agreements.

- **Streaming agreements**: payments to a financier based on the sale of mine production to the financier at discounted prices.
- **Private royalty agreements**: payment to a financier calculated as, for example, a percentage of the value of mine production.

Whether these arrangements constitute debt, will depend on the legal rights and obligations that flow from the transactions. In the case of streaming transactions, credit rating agencies S&P and Moody’s may treat these as debt depending on the facts and circumstances in Box X. It is less clear whether tax authorities would consider streaming or royalty arrangements to be debt-claims. These arrangements may have other implications outside of DTAs. A heavily discounted, fixed sale price may significantly reduce the mine’s tax base. Depending on how states characterise these payments (i.e. as debt or equity), there may be mismatches in tax treatment and opportunities for arbitrage. These issues will be further developed in a forthcoming practice from IGF-OECD on Metals Streaming.

Box X. Criteria for treating streaming transactions as debt

S&P

- If they are done in lieu of borrowing;
- If the upfront payment is repayable in cash in the event that insufficient product is delivered to the streaming company;
- If the streaming company has recourse to the mining company or a guarantor in the case of an insolvency event;

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23 Australia reserve the right to widen the definition of interest which include income which is subjected under its domestic law to the same taxation treatment as income from money lent
24 TBD: Spoke to the Canadian Treasury – no publicly available documents on this. Yet to discuss with the ATO.
• If the repayment of the upfront payment can be accelerated upon an event of default;
• If there is a high level of overcollateralization or security to production coverage or some other mechanism that provides greater certainty of repayment.

Moody’s

1. Length of agreement
   • the likelihood that the mining company will be required to repay the upfront payment to the streaming company as a result of insufficient quantities of metal being delivered to the streaming company during the term of the agreement.
   • the shorter the term of the agreement, the more likely that a portion of the upfront payment will need to be repaid.

2. Completion Guarantees
   • likelihood that the mining company is required to repay the upfront payment in the event that it fails to meet a construction or production milestone.

3. Security Package
   • streaming company is given priority over project financing lenders or other creditors.

4. Fixed Delivery Amounts
   • the requirement to deliver pre-determined quantities of metal, indexed to the price of the relevant metal.

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**TBD:** A separate finding to be included - Mexico reserves the right to include a provision regarding the treatment of interest derived from back to back loans as a safeguard against abuse.

**Recommendations**

**TBD**
Article 12: Royalties

A royalty payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, copyright, or intellectual property are ordinarily classified as royalties. This should not be confused with a “mineral production royalty” – a charge on the value or volume of mineral production – which is not usually covered by a DTA. Under domestic law, tax is usually required to be withheld on the payment of royalties from the entity in the source State. This is addressed in Article 12 of the MTCs.

The Relevance of Royalties for the ‘Mine of the Future’

Compared to other sectors such as Information Communications Technology, mining has primarily been a ‘bricks and mortar’ business with limited use of intangibles. However, there are major changes underway to increase automation in the mining sector, which is leading to a growth in new technologies (see Box X). These technologies are being licensed out to mines for limited use, in return for remuneration i.e. royalty payments.

Box X. Some examples of technological advances driving automation in the mining sector

- **Autonomous haul trucks and loaders**: One person alone can already remotely operate a small fleet of these autonomous trucks. Improvements in software are likely to allow this to be performed even more efficiently by algorithm-driven computer programs.
- **Autonomous long-distance haul trains**: Technologies are being piloted that allow long-haul trains carrying bulk commodities to run fully automated from the mine to the port.
- **Geographic information systems (GIS) and Global Positioning Systems**: GIS is now commonly used in almost all aspects of mining, from initial exploration to geological analysis, production, sustainability and regulatory compliance.

Source: IISD (2016) ‘Mining a Mirage’

These technological developments may mean that royalties become a larger component of outbound payments in the mining sector. With this comes the risk of profit shifting as intangible assets such as patents, trademarks, and intellectual property, are more easily relocated – to countries with lower rates of withholding tax, for example – and harder for tax authorities to value. Consequently, retaining the right to tax royalties in DTAs may be a more important source of mining revenues, as well as a deterrent against profit shifting. On the last point, Chile includes a specific anti-avoidance provision in Article 12, which has since been adopted by the OECD more broadly in the form of the “principle purpose test” (see Box X).

Box X. Chile’s Anti-Avoidance Provision in Article 12

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26 DTAs exclusively cover taxes on income or capital. With the exception of some countries, that calculate royalties with reference to profit (e.g. Chile levies a royalty on operating profit margin), royalties would not be considered within scope of a DTA.

27 Note the role of marketing intangibles in recent years.

“The provisions of this Article shall not apply if the principal purpose or one of the principal purposes of any person connected with the creation or attribution of rights in respect of which royalties are paid is to take advantage of this Article by such creation or attribution”.

Countries that have not yet signed the MLI may wish to follow Chile’s approach and incorporate a “principle purpose test” into their treaties. For those that have joined the MLI, these issues should be resolved by Article 7 – Prevention of Treaty Abuse, which is mandatory for Covered Tax Agreements.

There are three main considerations with respect to the design of Article 12. The first and third issues are not specific to the mining sector – there are – who gets the right to tax royalties, and where the rate should be set, bearing in the potential for profit shifting. The second issue relates to the types of payments that are in scope, and the modifications that may be important for mining countries.

a) Allocation of Taxing Rights

A general issue for developing countries is whether they retain the right to tax royalty payments under their tax treaties. This will depend on which MTC they follow (see Figure X). It is relevant that developed resource-rich countries such as Australia and Chile reserve the right to tax at source.

<table>
<thead>
<tr>
<th>Residence</th>
<th>Source and Residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD MTC – assigns the right to tax royalties to the residence state exclusively.</td>
<td>UN and ATAF MTC - also gives the right to the source country, provided that the rate of tax does not exceed the level agreed in the DTA.</td>
</tr>
</tbody>
</table>

b) Scope of Royalty Payments

Assuming the State has the right to tax royalties, the scope of this right will depend on Article 12(3). For resource-rich countries, the most relevant aspect of Article 12(3) is: “the use or right to use information concerning industrial, commercial or scientific experience.” This would cover geological studies, for example.

In addition to information relating to industrial, commercial or scientific experience, the UN MTC adds “the use or right to use “industrial, commercial or scientific equipment.” This approach may be preferable for resource-rich countries as it captures both information (e.g. geological studies), as well as equipment (e.g. an automated drilling system, or a tele-remote ship-loader). It is relevant that Canada and Chile, for example, follow the UN approach, and reserve the right to add royalty payments arising from equipment to Article 12. It is generally
understood that the right to use equipment also includes leases, which is important given the demand for operational leases, or short-term equipment rentals in the mining sector.\textsuperscript{29}

\textit{c) Withholding Tax Rate}

**TBD:** Analysis of withholding tax rates from review of DTAs

\textit{Recommendations}

**TBD**

\textsuperscript{29} New Zealand specifically reserves the right to tax at source income from the leasing of industrial, commercial or scientific equipment.
Article 13: Capital Gains Tax

When a right to a mining or exploration assets is sold, the source country will generally have jurisdiction to levy a capital gains tax on the sale, both under domestic law and international treaty. This is called taxation of a “direct” transfer of a mining or exploration right.

However, taxation becomes increasingly complicated when a company located offshore owns the right. Further difficulties arise when the right is held by a chain of corporations located in low-tax countries. An “indirect” transfer occurs when the shares of the domestic subsidiary, the shares of the foreign company with a branch in the country, or the shares of the holding company are sold, instead of the right itself. As an example, the offshore company that owns the subsidiary that owns the mine, disposes of 55% of its shares, leading to a change of ownership of the subsidiary, and subsequently the mine. Because the transfer has taken place offshore, the source State may not have the right to tax the gain.

The right to tax the sale of mineral rights or shares of companies that possess is covered by Article 13:

“Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.”

However, as with all treaty obligations, the operation of Article 13 depends on domestic law. First, the definition of immovable property must include mineral rights (see the discussion in Article 6). Second, a treaty cannot create a right to tax indirect transfers, this must be in the domestic law, and it is currently lacking in many countries, both developed and developing. This is the main focus of the next section.

a) Establishing a domestic right to tax indirect transfers

Australia’s Experience

Establishing a domestic right to tax indirect transfers is not always straightforward. A relatively advanced country such as Australia only introduced this right in 2017, as a response to a gap in its treaty network that was identified in a court case against Lamesa Holdings in 1997 (see Box X). Under the DTA with the Netherlands, Australia was limited to taxing the transfer of direct interests in land. This was upheld by the court. Australia fixed this by introducing a treaty override with respect to indirect transfers of real property (see Box X). This was driven specifically by the need to protect Australia’s right to tax income from the sale of mining rights. The issue has now been addressed through Article 9 of the MLI (see Box X) which Australia played an instrumental role in bringing about.

Box X. FC of T v Lamesa Holdings B.V. (1997) 36 ATR 589.

30 Of the treaties we sampled, more than 60% make an explicit reference to the definition of immovable property in Article 6, in Article 13.
Lamesa was a Dutch company, resident of the Netherlands, held by a US limited partnership with US limited partners. It owned a chain of Australian resident companies of which the bottom company held a number of gold mining leases. The top Australian company was floated on the stock exchange and Lamesa sold all its shares in that company for a considerable profit. The Australian tax authorities tried to tax the sale, however the courts ruled that Australia had no taxing rights over Lamesa. The authorities tried to argue that they have an indirect interest under the DTA with the Netherlands, but the court disagreed.

**TBD**

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**Box. Right to tax indirect transfers in Australia**

Australian Income Tax Law 855 30(4)

- **an indirect interest in Australian real property** – you and your associates hold 10% or more of an entity, including a foreign entity, and the value of your interest is principally attributable to Australian real property.

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This is not just a concern for Australia, but for many developing countries. **TBD**: This next section will explore the issues faced by Uganda in relation to Heritage Oil, and Kenya’s recent decision to nullify its DTA with Mauritius due.

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**Box X. Article 9 – Capital Gains from the Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property 1.**

Provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction (or provided that more than a certain part of the property of the entity consists of such immovable property (real property)):

a) shall apply if the relevant value threshold is met at any time during the 365 days preceding the alienation; and

b) shall apply to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions.
2. The period provided in subparagraph a) of paragraph 1 shall apply in place of or in the absence of a time period for determining whether the relevant value threshold in provisions of a Covered Tax Agreement described in paragraph 1 was met.

3. A Party may also choose to apply paragraph 4 with respect to its Covered Tax Agreements.

3. For purposes of a Covered Tax Agreement, gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting Jurisdiction if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction ...”.

b) Gains from the transfer of shares and other interests in immovable property

Article 13(4) of the OECD and UN MTC include the right to tax gains from an alienation of shares that derive their value from the immovable property in the source state. However, in addition to shares, the UN MTC also covers an alienation of comparable interests such as a partnership or trust. This approach has been adopted by the MLI and subsequently the OECD MTC. This is relevant because --.

Roughly 60% of the DTAs sampled for this practice note included shares and other similar rights or interests. In most cases, this was expressed as “shares or other similar rights”. Some DTAs adopted the precise wording from the UN MTC. Others referred to “shares plus other rights in the capital of a company or other legal person.” The UN approach, and the last variation are more prescriptive, putting beyond doubt the application of Article 13 to indirect transfers. 31 See an example from the Canada-PNG treaty below.

Canada-PNG (1987)

Income or gains from the alienation or disposition of: ...

a) any share or comparable interest in a company or association (including a partnership) whose assets consist wholly or principally of real property so situated or of rights to exploit or explore for, natural resources in that State

C) Threshold for indirect transfers

Both the UN and OECD MTCs limit the application of paragraph 4 to entities that derive 50% of more of their value from their interest in the immovable property in the jurisdiction. If the

31 TBD: more analysis of the breakdown of countries and treaty partners using different approaches.
50% threshold is satisfied, the whole gain is taxable. If the value is lower than 50%, then the gain is exempt.

Arguably, 50% may be too high given that natural resources are publicly owned, and the revenue arising from a sale is likely to be significant. Many of the DTAs sampled for this practice note referred to the “principal” or “main” value, rather than set a specific percentage (see the Canada-Australia treaty below). While this approach allows greater flexibility, it also introduces greater subjectivity, and will require interpretation by the courts, as a result.

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**Canada-Australia (1973)**

13(4) Income, profits or gains derived by a resident of a Contracting State from the alienation of any shares or other interests in a company, or of an interest of any kind in a partnership, trust or other entity, where the value of the assets of such entity is derived principally, whether directly or indirectly (including through one or more interposed entities, such as, for example, through a chain of companies), from real property situated in the other Contracting State, may be taxed in that other State.

Some DTAs specifically state that Article 13 will apply as long as the alienator has held shares or other rights in the immovable property at some point over the 12 months preceding the sale. This is an anti-avoidance measure designed to ensure that a taxpayer cannot escape source taxation by selling off multiple small parcels of shares that together form a substantial holding. It is to prevent the value being “watered down” prior to the transfer of ownership. See the Chile-UK treaty as an example.

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**Chile-UK (2005)**

4 Gains derived by a resident of a Contracting State, from the alienation of shares or other rights representing the capital of a company that is a resident of the other Contracting State or from the alienation of an interest in a partnership or trust established under the laws of either the United Kingdom or Chile, may be taxed in the other Contracting State if,

a the alienator at any time during the twelve-month period preceding such alienation owned, directly or indirectly, shares or other rights representing 20 per cent or more of the capital of that company, or

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32 TBD: There is also a question of how the threshold for Article 13 relates to the threshold for beneficial ownership in the extractive sector
33 TBD: further analysis of the trends e.g. Canada-Luxembourg sets a very low rate of 10% - we need to see if this is true generally of treaties with low-tax countries.
34 UN Manual p.134
(b) the gains derive more than 50 per cent. of their value directly or indirectly from immovable property referred to in Article 6 of this Convention situated in that other Contracting State.

Practical Challenges of Collecting Tax on Indirect Transfers

TBD: This section will include some high-level guidance on valuing mineral licenses for the purpose of capital gains tax, and enforcement mechanisms.

Recommendations

TBD

6. Conclusion