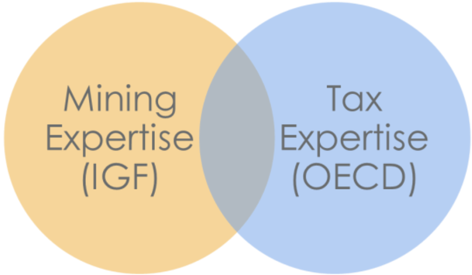


IGF-OECD BEPS in Mining Program

AN UPDATE

OECD Policy Dialogue on NR-Based Development
31 January 2018

The ‘BEPS in Mining Program’

A program to equip developing country governments with the knowledge, skills and tools to build and administer mining tax systems that help reduce and eliminate tax base erosion and profit shifting by investors.

- In 2015, IGF member countries identified transfer pricing, base erosion, and illicit financial flows as top priorities;
- BEPS are a particular risk to developing countries given their reliance on corporate income tax;
- Many resource-rich developing countries lack the sector-specific expertise to respond to BEPS issues in mining;
- The OECD BEPS Actions cut across sectors; hence, there is value in adapting them to be mining specific.

What the Program Will Deliver

Phase 1:

- Produce practical guidance and tools to counter BEPS in mining;
- Build on the OECD/G20-led Actions on BEPS;
- Fill vital gaps in the available resources by addressing all key issues;
- Keep administrative capacity front of mind (practical and implementable);
- Create a 'one-stop shop' website that includes for all the issues:
    - Key background documents
    - Original research and analysis
    - Guidance document
    - Training and implementation needs

What the Program Will Deliver

Phase 2:

- Training opportunities for countries, plus direct advisory services
- Has already begun:
    - Training countries on transfer pricing risk assessment in mining has already begun
    - And on mineral valuation
    - June 2018: training for UEMOA states on overall BEPS in mining
- Develop a diagnostic tool to help identify main causes of BEPS on a country-by-country basis to establish priorities for support.

The BEPS in Mining Issues We Will Address

The IGF-OECD program delivers policy and administrative tools to address:

1. **Excessive interest deductions***
2. **Abusive transfer pricing***
3. **Undervaluation of mineral exports***
4. **Harmful tax incentives***
5. **Tax stabilization and investment trreaties***
6. *International tax treaties*
7. *Metals Streaming*
8. *Abusive Hedging arrangements*
9. Indirect transfer of mining assets
10. Inadequate ring-fencing

*Work has begun on these topics.

BASE EROSION VIA INTEREST DEDUCTIONS

Implementing BEPS Action 4 in Mining Sector

OECD
BETTER POLICIES FOR BETTER LIVES

Base erosion via interest deductions

- *"Cross-country differences in rates of [corporate income tax] create opportunities for tax planning within multinational groups, by*
  - *lending from low tax countries to related entities in high tax countries or*
  - *locating external borrowings in high tax countries."*
- Can be quantity, price, or a combination of both
- Incentive for all industries, but aim is to examine whether there are particular issues in mining.

What mining MNE structures have we seen?

- Interest rate mark-ups on related party loans
- Mine asset purchases (e.g. machinery) that embed a financing component
- Debt-funded mine purchases where debt is "pushed down" to the host country
- Use of hybrid financial instruments
- Arrangements contingent on features of host country tax system
- Use of working capital to generate interest expenses

BEPS Action 4

- Ensures that an entity’s <u>net</u> interest deductions are directly linked to the taxable income generated by its economic activities, based on taxable earnings
  - before deducting net interest expense, depreciation and amortisation (“EBITDA”)
- The approach under Action 4 includes three parts:
  - a fixed ratio rule based on a benchmark net interest/EBITDA ratio (set between 10-30 percent);
  - *a group ratio rule which allows an entity to deduct more interest expense in certain circumstances, based on the position of its worldwide group; and
  - *targeted rules to address specific risks.

    * = optional

Call for assistance

We are looking for:

- real-world examples of structures that are base eroding
- evidence of levels of debt used in developing countries.

The Hidden Cost of Tax Incentives

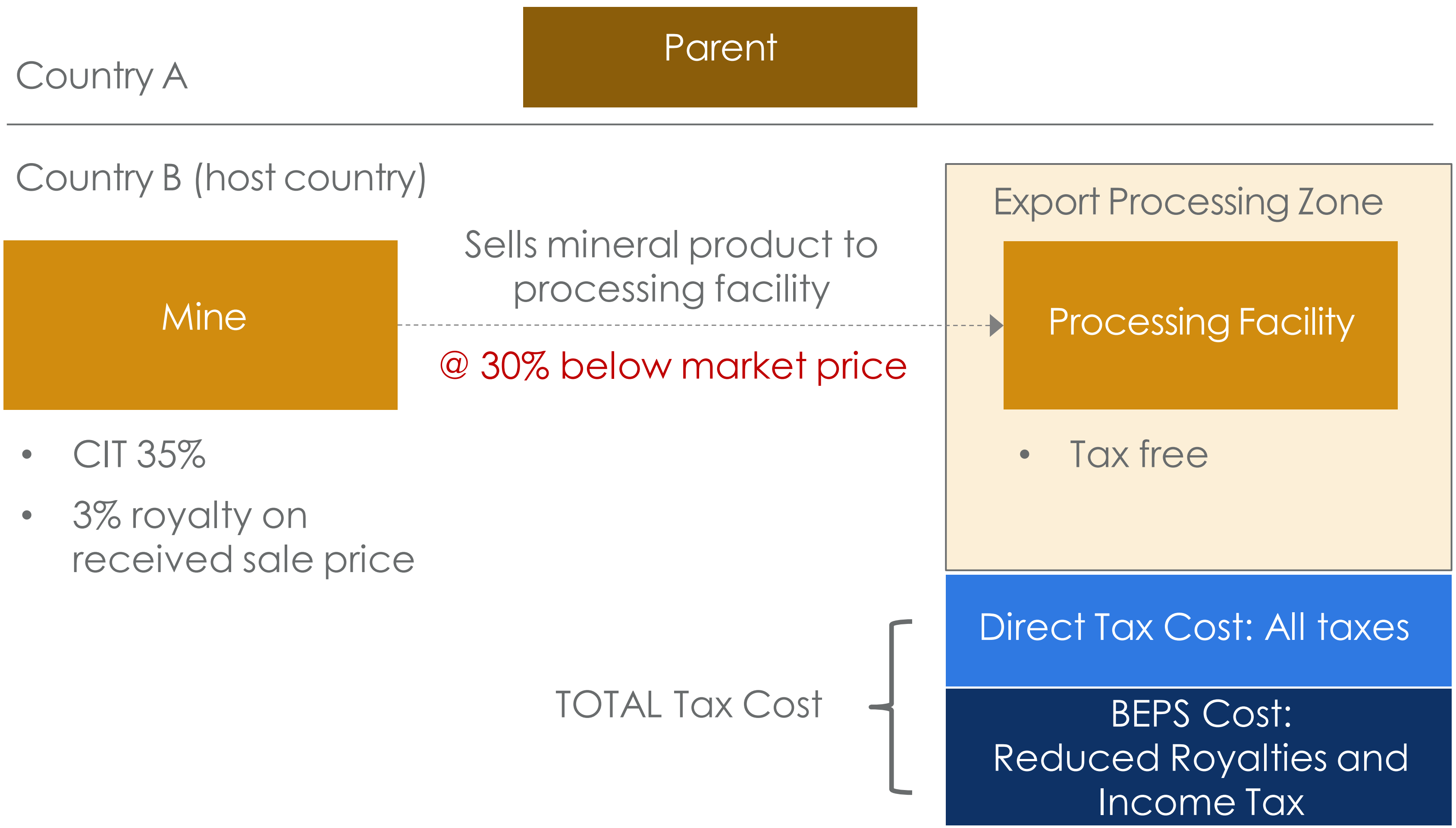
The Hidden Cost of Tax Incentives

Draft guidance for governments includes:

a) Catalogue of mining tax incentives;
b) New empirical research on the prevalence of tax incentives in contracts
   a) first tranche: 54 contracts from 10 countries,
   b) Second thranche, doubling this, French and Spanish contracts to be include;
   c) Including domestic law based incentives (not just contracts)
c) Discussion of investor's behavioural responses to incentives ("BEPS impact");
d) Guidance on use of financial models to estimate the cost of tax incentives;
e) Lessons for the design and use of tax incentives.

The "BEPS Impact"

Example: Economic Processing Zone (EPZ)



Monitoring the Value of Mineral Exports: Policy Options for Governments

With thanks to GIZ, the National Minerals Agency, Sierra Leone, the Ministry of Mines and Geology, Guinea, and Cotecna

The Mineral Valuation Process

Sampling e.g. extracting a representative sample of the ore body;

Sample preparation e.g. crushing and pulverizing the sample for testing;

Analytical testing e.g. fire assay, XRF analysis.

Policy Options for Gov't Mineral Valuation

	Pro's	Con's
1. Direct measurement of mineral quality	• Independent analysis of mineral exports.	• Costly; • Time intensive (2 yrs to set up ISO lab); • Difficult to get accredited; • Duplication.
2. Monitoring companies' own valuation processes	• Cheaper; • More efficient (less duplication); • Proportionate to risk.	• Relying on company valuation processes; • Less self sufficient.

Implementation: Private, Public, or Both?

a) Government Does it All

Key considerations:
- Which gov't authority?
- Is there competence in sampling, and testing, or must this be built?

c) Public Private Partnership

Key considerations:
- Is it a BOT (i.e. Third-party finances/ acquires/ builds testing facility)?
- How should remuneration be structured e.g. company pays fee directly, or government funded?

b) Government Contracts Third-Party

Key considerations:
- Should gov't outsource all aspects of valuation, or only sampling, for example?

d) Shared Regional Testing Facility

Key considerations:
- Which countries? What are their production volumes?
- What funds and staff could gov'ts contribute?

Discussion:

1 How big is the risk of companies deliberately undervaluing mineral exports? Can countries point to specific examples of this happening?

2 What mineral valuation controls do governments have in place?

3 Of the policy options proposed, which do countries prefer, and why?

Where to from here?

- Expert reviews of first three papers in progress
- Government consultation process on first three reports to begin soon.
- Work on next round of products begins.
- Indaba 2018: