



IGF

INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development

GLOBAL DIGITAL TAX REFORMS: HIGHLIGHTING POTENTIAL IMPACT FOR MINING COUNTRIES

Since 2018, the Organisation for Economic Co-operation and Development (OECD) has led a global initiative to address the tax challenges arising from a digitalized economy. The primary objective of this initiative, under the responsibility of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, is to ensure that digitalized companies carrying out business in places where they do not have a physical presence pay tax in these jurisdictions. However, the proposals are, in fact, much broader, with potential implications for mining. Resource-rich countries need to ensure that the reforms do not undermine their right to collect revenues from the mining sector.

When the initial 2019 two-pillar tax reform agenda was shared, it was clear that mining was not exempt from the global digital tax reforms¹ and that there was potentially a lot of revenue at stake for resource-rich countries should the reforms go ahead. Since then, the Inclusive Framework has further developed the proposals.

¹ Readhead, A., & Lassourd, T. (2020). *What is at stake for the mining sector in the global digital tax reforms?* International Institute for Sustainable Development. <https://www.iisd.org/articles/what-stake-mining-sector-global-digital-tax-reforms>

Pillar One² (228 pages) and Pillar Two³ (250 pages) were published in October 2020, along with an economic impact assessment⁴ of the proposals (284 pages). The OECD also collected and published comments from a range of stakeholders.⁵ On January 14 and 15, 2021, the OECD held a public consultation⁶ on the latest Pillar One and Pillar Two Blueprints.

² Organisation for Economic Co-operation and Development (OECD). (2020c). *Tax challenges arising from digitalisation – Report on Pillar One Blueprint*. <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm>

³ Organisation for Economic Co-operation and Development. (2020d). *Tax challenges arising from digitalisation – Report on Pillar Two Blueprint*. <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm>

⁴ Organisation for Economic Co-operation and Development. (2020b). *Tax challenges arising from Digitalisation – Economic impact assessment*. <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-economic-impact-assessment-Oe3cc2d4-en.htm>

⁵ Organisation for Economic Co-operation and Development. (2020a). *Tax and digital: OECD/G20 Inclusive Framework on BEPS invites public input on the Pillar One and Pillar Two Blueprints*. <https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm>

⁶ Organisation for Economic Co-operation and Development. (2020). *Tax and digital: Public consultation meeting on the Pillar One and Pillar Two Blueprints*. <https://www.oecd.org/tax/beps/public-consultation-meeting-reports-on-the-pillar-one-and-pillar-two-blueprints.htm>



What do these recent developments mean for the taxation of the mining sector? This briefing note considers the extent to which the latest blueprints address concerns about taxing rights and domestic revenue for resource-rich countries, as well as new issues that have emerged. It also signals important points of discussion for Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) member countries ahead of a more detailed briefing on specific aspects of the reform proposal in the coming months.

Overall, the reform follows the approach outlined in 2019. Despite significant criticisms⁷ saying the proposal is both too complex and insufficiently bold, the OECD Secretariat maintains the two-pillar approach. Pillar One creates a new taxing right for businesses selling goods and services digitally in countries where their users or consumers are physically located (“market countries”). Pillar Two addresses tax competition and profit shifting in all economic sectors through rules to ensure all global profits of multinational enterprises are taxed at least at a minimum effective tax rate. Thus, despite being labelled as digital tax reform, this initiative is, in fact, much broader and requires the attention of the mining sector.

PILLAR ONE - THE ALLOCATION OF TAXING RIGHTS TO THE MARKET COUNTRY

“AMOUNT A” - A NEW TAXING RIGHT IN THE MARKET COUNTRY

The first draft of Pillar One, what was then called the “Unified Approach,”⁸ indicated that some sectors (extractives, for example) might be carved out of Amount A—the proposed new taxing right that would allocate a share of multinationals’ global profits to market countries. The latest Pillar One blueprint specifically excludes “non-renewable resources,” defined to include minerals and hydrocarbons, from “Amount A.” This is appropriate given that minerals are generic goods that are sold and priced on the basis of their inherent characteristics rather than on other factors such as marketing. The primary taxing right correctly resides with the resource-producing country, a position the OECD agrees with, which has led to the whole mining value chain being carved out of the reform. The one possible exception to this carve-out is gemstones, which may benefit from marketing.



Thus, despite being labelled as digital tax reform, this initiative is, in fact, much broader and requires the attention of the mining sector.

⁷ Independent Commission for the Reform of International Corporate Taxation (ICRICT). (2020). *ICRICT response to the OECD consultation on the Pillar One and Pillar Two Blueprints*. <https://www.icrict.com/press-release/2020/12/16/oecd-response-to-the-oecd-consultation-on-the-review-of-country-by-country-reporting-beps-action-13>

⁸ Organisation for Economic Co-operation and Development. (2019). *Secretariat proposal for a “Unified Approach” under Pillar One* [Public consultation document]. <https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>



“AMOUNT B” – A FIXED RETURN TO MARKETING ACTIVITIES IN THE MARKET COUNTRY

Amount B allocates a fixed return on sales to related entities that already have a physical, taxable presence in the market country and that carry out basic activities to market their goods and services in that jurisdiction. So far, there is no carve-out for mining. While there are advantages to formulaic approaches, a fixed return on sales is not appropriate for marketing services in the mining sector.

Marketing plays a limited role in the sale of mineral products. According to the International Council on Mining and Metals, “minerals and metals are physical assets with limited value generated from marketing intangibles”.⁹ Either extractives should be carved out of the fixed return on sales, or an industry-specific rule should be developed.

Ideally, an industry-specific rule would also include marketing hubs in low-tax jurisdictions—a major source of profit shifting in the mining sector.¹⁰ The rule would allocate all profits from the sale of minerals to the resource-producing country, except to the extent that the marketing entity could prove that it contributed additional sales value above a nominal percentage of group revenues, in which case it would get a fixed return on operating costs. This combines the formulaic and simplification aspects of the proposed Amount B but with a focus on countering tax abuse in the mining sector specifically.

⁹ International Council on Mining and Metals (ICMM). (2020). *Submission to the OECD/G20 Inclusive Framework on BEPS on the Pillar One and Pillar Two blueprints*. <https://www.oecd.org/tax/beps/public-comments-received-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm>

¹⁰ Khadem, N. (2020). *BHP loses tax case over Singapore marketing hub, hit with \$125 million bill*. ABC News. <https://www.abc.net.au/news/2020-03-11/bhp-loses-tax-case-over-singapore-marketing-hub/12045610>

“AMOUNT C” – A PROCESS FOR RESOLVING DISPUTES ARISING FROM AMOUNT B

While this section has now been renamed “Tax Certainty,” it nevertheless continues to put much emphasis on mandatory binding dispute resolution. While mandatory binding arbitration is no longer the only option for dispute resolution—a dispute-prevention process has been added—it now applies to “all disputes related to transfer pricing and permanent establishment adjustments,” not just disputes arising from the allocation of profits to the market country. This puts international tax disputes outside domestic law, potentially undermining national sovereignty.





PILLAR TWO - A GLOBAL MINIMUM EFFECTIVE TAX RATE

The blueprint of Pillar Two provides a lot of important details on the reform proposal. The main elements are summarized below and will be addressed in a dedicated briefing note.

The objective of Pillar Two is now clear: to remove incentives for multinational companies to shift profits away from their countries of operation or residence to low-tax countries and investment centres. It therefore creates a minimum tax that will be triggered whenever a multinational company pays less tax, as a proportion of its profits, in a single country and in a single year than the agreed minimum tax rate. The difference can then be collected by the tax authority of the country where the company is headquartered.

Under the current proposal, companies will have little incentive to keep using tax loopholes that depend on tax havens. This would help mineral-rich countries combat aggressive tax avoidance practices such as in cases where mining companies shift profits to offshore marketing hubs or route their intercompany loans¹¹ through empty shell companies in low-tax jurisdictions. But there are several elements of the proposal that could be problematic for developing countries:

- The threshold for companies to be included in Pillar Two is set at EUR 750 million of global consolidated annual gross revenue, which is likely to exclude many smaller but significant companies operating in developing countries.



- The way that taxes and profits will be assessed to calculate an effective tax rate by country and by year will be different from local tax rules, which typically allow a faster depreciation of exploration and development expenses, which are significant in the mining sector. Most mining projects in cost-recovery periods therefore declare profits on their financial statements but no taxable profit, a situation that reverses over time. During this period, it may look as if the mine's effective tax rate is under the minimum, which would require the mine to pay taxes to a foreign jurisdiction before the resource-owning country and increase its overall tax burden.
- Because of their design, Pillar Two rules would create more direct revenues for richer and larger countries—where mining companies are headquartered—than for developing countries.

¹¹ Jefferis, J. (2015). *Chevron loses multi-million dollar transfer pricing court case*. *International Tax Review*. <https://www.internationaltaxreview.com/article/b1fygbv548c6jt/chevron-loses-multi-million-dollar-transfer-pricing-court-case>



Resource-rich developing countries have a lot to gain from Pillar Two. Under the right design, a minimum tax could ease downward pressure on tax rates not only by addressing tax competition from small states acting as tax havens, but also by reducing pressure to offer overly generous investment incentives.¹² But the current proposal may be skewed toward the interests of wealthier countries and fall short of expectations in developing countries. For instance, illustrative examples in the blueprint and the economic impact assessment use rates ranging from 7.5% to 17.5%. These rates are too low to prevent downward pressures on the statutory rates in the mining sector, typically 30%.

WHAT CAN THE GOVERNMENTS OF RESOURCE-RICH COUNTRIES DO?

As the reform progresses on the international agenda, it is important that governments develop positions that defend their current and future right to tax their natural resources. Beyond the team of international tax negotiators participating in the OECD's Inclusive Framework (in most cases from ministries of finance), governments may benefit from involving other relevant departments in the tax administration or the ministry of mines. The OECD Secretariat has shared a country-specific economic impact assessment of the reform blueprints with each country's government. These assessments warrant government scrutiny across agencies. Countries with similar interests could strengthen their positions by using regional or international platforms to form coalitions, for example, through forums such as the African Tax Administration Forum (ATAF) or

IGF, as recommended by the International Centre for Tax and Development.

Inevitably, there will be mining sector-specific profit-shifting risks that cannot be addressed by the international tax reform package. These risks, along with other revenue collection challenges, will be considered as part of the Future of Resource Taxation,¹³ a joint project with the IGF and ATAF to identify and popularize innovative tax and revenue-generating policies in the mining sector.

¹³ Agyiri Danso, I., Lassourd, T., Readhead, A., Taqiri, J., Monkam, N., & Madzivanyika, E. (2020). *The Future of Resource Taxation: A roadmap*. The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development. <https://www.iisd.org/publications/future-resource-taxation-roadmap>

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March 2021

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¹² The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF). (n.d.). *Minimizing the risks of tax incentives in mining*. <https://www.igfmining.org/tax-incentives-mining/>