IGF INTERGOVERNMENTAL FORUM on Mining, Minerals, Metals and Sustainable Development

PROTECTING THE RIGHT TO TAX MINING INCOME:

TAX TREATY PRACTICE IN MINING COUNTRIES

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This practice note has been prepared under the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) program to address some of the challenges developing countries are facing in raising revenue from their mining sectors. It complements action by the Platform for Collaboration on Tax and others to produce practice notes on top-priority tax issues facing developing countries.

This draft is for member and public consultation. External feedback has been received from the IGF BEPS in Mining Advisory Group, which comprises representatives of Oxfam; the Natural Resource Governance Institute; the International Monetary Fund; the International Centre for Tax and Development; the Inter-American Centre for Tax Administrations; the African Tax Administration Forum; the Centre for Energy, Petroleum, and Mineral Law and Policy; the International Council for Mining and Minerals; the UK's Foreign, Commonwealth and Development Office; and the Government of Senegal. Interviews were generously given by former and current government officials involved in tax treaty negotiations: Lutando Mvovo (South Africa), Liselott Kana (Chile), and Greg Wood (Australia).

The IGF program to address tax base erosion and profit shifting in mining (the BEPS in Mining program) builds on the Organisation for Economic Co-operation and Development (OECD) BEPS Actions to include other causes of revenue loss in the mining sector.

The program covers the following issues:

1. Excessive Interest Deductions
2. Abusive Transfer Pricing
3. Undervaluation of Mineral Exports
4. Tax Incentives
5. Tax Stabilization
6. International Tax Treaties
7. Offshore Indirect Transfers of Mining Assets
8. Metals Streaming
9. Abusive Hedging Arrangements
10. Inadequate Ring-Fencing

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The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) supports more than 75 nations committed to leveraging mining for sustainable development to ensure negative impacts are limited and financial benefits are shared. It is devoted to optimizing the benefits of mining to achieve poverty reduction, inclusive growth, social development, and environmental stewardship.

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The IGF is focused on improving resource governance and decision making by governments working in the sector. It provides a number of services to members including: in-country assessments; capacity-building and individualized technical assistance; and guidance documents and conferences which explore good international practices and provide an opportunity to engage with industry and civil society.

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Acronyms

ATAF	African Tax Administration Forum
BEPS	tax base erosion and profit shifting
BIT	bilateral investment treaty
DFR	Diamond Field Resources
FDI	foreign direct investment
HMRC	HM Revenue and Customs
ICTD	International Centre for Tax and Development
IMF	International Monetary Fund
MAP	Mutual Agreement Procedure
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument)
Models	Model Tax Conventions
OECD	Organisation for Economic Co-operation and Development
PCT	Platform for Collaboration on Tax
PE	Permanent Establishment
RBC	Royal Bank of Canada
UN	United Nations

Introduction

Large-scale mining in developing countries is often undertaken by investors, licence holders, service providers, and suppliers who are not residents in the country. This is reflective of the significant foreign direct investment (FDI) often required to develop and operate mining projects. However, this context also gives rise to a range of cross-border transactions between the company where the mine is located and foreign companies in other jurisdictions. These transactions might include but are not limited to offshore indirect sales of mining assets or licences, interest payments on foreign loans, or intra-group services.

A key question that emerges is which country should tax what proportion of the income from these transactions to avoid the same income being taxed twice. Double Taxation Agreements, or "tax treaties," as they are referred to in this practice note, aim to resolve this question by allocating taxing rights between two contracting countries on income from cross-border transactions. Consequently, tax treaties may significantly impact how much tax governments collect from transactions involving foreign companies.

Mining involves a finite, non-renewable resource. Countries that host such resources only get one chance to tax the income arising from their extraction. This fact, and the prevalence of investment from foreign multinationals, makes the impact of tax treaties on mining revenue collection of critical importance to resource-rich developing countries. Unless treaties designed with this sector in mind consider the impacts on revenue collection, governments may end up collecting substantially less revenue from mining compared to what they would under domestic law. In addition, tax treaties could be inappropriately used by companies to reduce or avoid paying taxes.

About This Practice Note

This practice note has been written for governments of resource-rich developing countries that are considering negotiating or renegotiating a tax treaty. Governments should not infer from this note that tax treaties are either necessary or advisable in all cases. There are risks and benefits to tax treaties. Countries should consider these carefully when deciding whether to enter a treaty, including in relation to economically significant sectors. In the mining sector, for instance, tax treaties may be less relevant to attracting investment because of the location-specific nature of the resource. Having said that, tax treaties apply to all sectors, not just mining, and may be relevant to investors in terms of added tax certainty and dispute resolution.

Governments of resource-rich developing countries that decide that they would benefit from entering tax treaties must consider the implications for the mining sector to avoid giving up more revenue than necessary. There have been many instances of resource-rich developing countries losing vital mining revenues because of tax treaties.[1] This practice note serves as a guide for governments on how to avoid similar occurrences from happening again. The goal is to equip governments of resource-rich developing countries to decide if tax treaties are necessary and, if they are, to design them in a way that safeguards their right to tax mining income at all stages of the mining value chain.

[1] See Loeprick, J. & Beer, S. (2018).

The practice note is divided into five parts:

1. Introduction
2. Part One: Tax Treaties Are Agreements Between States that Assign Taxing Rights
3. Part Two: The Benefits and Costs of Tax Treaties in a Mining Context
4. Part three: Negotiating Tax Treaties That Protect the Right to Tax Mining Income
5. Part Four: Recommendations

Who is This Practice Note For?

The practice note is primarily intended for use by government tax treaty negotiators and other policy-makers. It aims to generate informed, well-grounded decisions, particularly with respect to tax treaty design. It may also be used by tax administrators to identify potential risks to the mining tax base because of tax treaties and shape tax audit priorities as a result. Finally, the practice note may help international organizations to advise resource-rich developing countries on tax treaty issues and civil society to examine tax treaties to strengthen government accountability.

What Gap Is This Practice Note Filling?

Information is available on tax treaties and the extractives sector. Readers should refer to David et al. (2017), *International Taxation and the Extractive Industries* (2017) and the United Nations (UN) *Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries* (2017). In addition, there is guidance on tax treaty design and negotiation more broadly, notably, the Platform for Collaboration on Tax (PCT) *Toolkit on Tax Treaty Negotiations* (2020) and the International Centre for Tax and Development (ICTD) tax treaties dataset (2021), including the working paper prepared by Martin Hearson (2016) that sets out conclusions from descriptive work using the dataset.

This practice note seeks to address two gaps identified in the literature. The first gap is guidance for government officials in resource-rich developing countries on the design and implementation of specific tax treaty articles that may otherwise limit their ability to collect mining revenues. The second gap was insights into what resource-rich countries do in practice—how they modify or adapt their tax treaties to better protect their right to tax mining income. Much of the guidance that exists is based on the OECD (2019) and United Nations (2018) Model Conventions. This practice note goes beyond these models, analyzing over 80 tax treaties and, in some cases, domestic law to provide concrete examples of tax treaty practice among resource-rich countries that may be particularly instructive for resource-rich developing countries. The methodology for determining “tax treaty practice” is described below.

Box 1. The IGF's tax treaty database: Determining tax treaty practice in the extractives sector

The IGF's survey of tax treaty practice—how resource-rich countries, developed and developing, have modified their treaties to better protect their right to tax mining income—is the primary contribution of this practice note. It is the basis for the analysis and guidance given in Part 3 of the practice note.

The survey included 86 tax treaties signed by resource-rich countries. They were selected to achieve a mix of countries and treaties based on the following parameters: resource-rich and non-resource-rich; high income and low income; high tax and low tax; and geography. The goal was to have a broad cross-section of countries and treaties to identify any trends correlating with these factors.

Once the treaties were selected (hereafter referred to as "sampled treaties"), the text of the articles most relevant to extractives (Articles 5, 6, 13 in the OECD and UN models) was transferred into a word document. Any extractives-related language in the sampled treaties was highlighted and compared with the corresponding articles in the OECD, UN, and African Tax Administration Forum (ATAF) Models. Language in the treaties that deviated from the Models was analyzed and sorted into the various treaty practices described in this practice note.

Readers can clearly see the different approaches that resource-rich countries have adopted, which of these are more common, and to what extent they deviate from the Models. This provides a strong empirical basis for other resource-rich countries to consider similar options when negotiating treaties.

Part One: Tax Treaties Are Agreements Between States that Assign Taxing Rights

Tax treaties are international agreements governed by the Vienna Convention on the Law of Treaties that assign taxing rights between two contracting states on income from cross-border transactions. They limit the abilities of the source state to tax income earned/sourced by non-residents within their jurisdiction and of the residence state to tax its residents on their worldwide income.

- The "**source state"** is where the investment is made (e.g., the location of the mine).
    - Capital-importing countries are typically source states. These are countries that are net importers of capital. Often, they are developing countries.
- The "**residence state"** is where the investor is headquartered (or tax resident).
    - Capital exporting countries are typically residence states. These are countries that are net exporters of capital (i.e., developed and emerging economies).

Tax treaties generally cannot create tax liabilities that do not exist in domestic law.[2] This means that if, for example, a country does not establish the domestic right to tax interest expenses on loan sources from abroad, it generally cannot introduce this right through its tax treaties. However, a treaty can reduce the rate of the withholding tax on interest expenses compared to domestic law.

Once a tax treaty is established, it becomes the prevailing law in relation to cross-border transactions involving that treaty partner. Any subsequent changes to a country's tax law generally will not modify existing tax treaties unless they are renegotiated bilaterally or through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (known as the Multilateral Instrument) (see the section Renegotiating a Tax Treaty). The exception is a tax treaty override, which subjects a specific aspect of existing or future treaties to domestic law.

Tax Treaty Models

Countries often use the Model Tax Conventions (the "Models") as the basis for negotiating a tax treaty. The main models are the Organisation for Economic Co-operation and Development (OECD, 2019) model ("OECD Model") and the UN model (2018) ("UN Model"). However, there are a number of regional models, such as the ATAF Model Tax Agreement (n.d.) ("ATAF Model"). The Models include articles supplemented by commentaries.

There are similarities between these three texts. However, the OECD Model was drafted exclusively for developed countries, whose priorities were eliminating double taxation and reducing source country taxation. The UN Model, which came later, agreed with the OECD's first objective but not the second. Consequently, the UN and ATAF Models represent a limited compromise between the economic interests of developed and developing countries, as they leave intact more taxing rights

[2] There are some limited exceptions. Australia and France, for example, follow the practice that tax treaties may establish a tax liability (UN, 2017, p. 38).

for the source state (Whittaker, 2016). Table 1 sets out the differences between the three Models that are most relevant to the mining sector.

Table 1. Risks to mining revenue collection stemming from tax treaties

Article	OECD Model	UN Model	ATAF Model
Article 5 – Permanent Establishment (PE)	The source state has the right to tax a building or construction project 12 months after it begins.	…6 months after construction begins. The source state has the right to tax a non-resident that performs services in their territory over a defined period ("Services PE").	Time period agreed between states. On Services PE, same as the UN Model.
Article 12 – Royalties	Only the residence country has the right to tax royalties paid to non-residents.[3]	Right to tax royalties is shared between both countries. Definition of royalties is wider; it includes payments for the use of or the right to use industrial, commercial, or scientific equipment.	Same as UN Model.
Article 12A - Fees for Technical Services	Not included.	Right to tax fees for technical services shared between countries.	Same as UN Model.
Article 12B – Income from Automated Digital Services	Not included.	Right to tax income from automated digital services shared between countries.	Not included.
Article 13 – Capital Gains	Only the residence country can tax gains derived from the sale of shares, except when the value of the shares is derived from immovable property in the source state.	Source state has the right to tax the sale of shares if over an agreed threshold (substantial shareholdings).	Same as UN Model.
Article 21 – Other Income	Source country does not have the right to tax other income.	Right to tax other income is shared between both countries.	Same as UN Model.

Many countries have their own tax treaty models or positions that reflect their policy objectives. The model or position is used as an initial basis for negotiating tax treaties. It could deviate from the OECD or UN Models to reflect the specificities of that jurisdiction. For instance, resource-rich countries may modify or adapt the Models to better protect their right to tax their mineral resources. Box 2 describes Colombia's process for updating its tax treaty model from the perspective of the extractives industry.

[3] Royalty refers to payment for the use of intellectual property, not mineral royalties.

Box 2. Colombia reviews its tax treaty model from the perspective of the mining, oil, and gas industries.

Extractive industries contribute approximately 5% of total government revenues in Colombia. With support from the IGF, the National Directorate of Taxes and Customs (DIAN) reviewed its tax treaty model from an extractives perspective.

1. First, it looked at the role of tax treaties in attracting investment in extractives in Colombia.
2. Second, it considered the extractive industry value chain in Colombia and any tax treaty issues arising as a result (e.g., the role of subcontractors in the offshore oil and gas sector).
3. Finally, it compared the treaty articles most likely to impact the extractives sector—Article 5, Article 6, Article 12, and Article 13—to tax treaty practice in other resource-rich countries.

This process enabled the National Directorate of Taxes and Customs to better understand the extractives industry and the impact of tax treaty provisions in order to update its treaty model to better protect Colombia's right to tax its resources.

Renegotiating a Tax Treaty

Countries may choose to renegotiate their tax treaties bilaterally. They may also update their treaties via the Multilateral Instrument (MLI). The MLI is an output of the OECD Base Erosion and Profit Shifting (BEPS) project—a global action plan to limit corporate tax avoidance. Among other things, the MLI aims to limit the risk of treaty shopping. Countries that sign the MLI are agreeing to automatically update their existing tax treaties with other countries also party to the MLI to reflect the BEPS minimum standards.

Whether countries choose to address the risk of treaty abuse and other BEPS issues by renegotiating bilaterally or signing the MLI will depend on each country's situation and the positions of its treaty partners. Countries with a large treaty network may find it convenient to join the MLI, whereas those with fewer (and old) treaties may prefer to renegotiate bilaterally. Another consideration is the causes of BEPS they wish to address. For instance, the MLI does not address maximum withholding tax rates, other core aspects of the PE definition, and provisions covering technical service fees, which can only be modified through a comprehensive renegotiation.

For more guidance on whether developing countries should sign the MLI, see the Centre for Global Development (Oguttu, 2018), *Should Developing Countries Sign the OECD Multilateral Instruments to Address Treaty Related Base Erosion and Profit Shifting Measures?* and the United Nations University Series on Regionalism Vol. 19 (Arias Esteban & Calderoni, 2021), *The Suitability of BEPS in Developing Countries (Emphasis on Latin America and the Caribbean).*

Terminating a Tax Treaty

Sometimes the source state may choose to terminate a tax treaty. The reduction in source taxation may be too great—for example, according to the Senegalese government, it lost USD 257 million over 17 years because of its treaty with Mauritius (Fitzgibbon, 2020). If a treaty partner is unwilling to modify or replace the existing treaty, the source state may be left with no choice but to terminate unilaterally. There has been a recent spate of terminations by resource-rich developing countries, such as Argentina, Kenya, Mongolia, Senegal, and Zambia. Some developed countries are also

following suit—Russia, for example. While this approach may have worked for some countries, it should be a last resort. If done too often, countries risk discouraging foreign investors who value a stable investment environment.

Part Two: The Benefits and Costs of Tax Treaties in a Mining Context

There are benefits and costs associated with entering a tax treaty. On the one hand, tax treaties will generally reduce the amount of tax a source state can charge non-residents compared to its domestic law. In addition, tax treaties may exacerbate or create new profit shifting risks, particularly where a treaty is with a low-tax jurisdiction. On the other hand, countries can access information and receive assistance from treaty partner countries that will improve compliance. From an investor's perspective, the benefits include less risk of double taxation, increased tax certainty, and measures to resolve treaty-related disputes. It is important to consider the benefits and costs before entering a tax treaty.

Table 2. Comparing the benefits and costs of entering a tax treaty

BENEFITS	COSTS
1. Reduces the risk of double taxation, which **may** increase FDI, although the impact on mining is likely to be limited due to the location-specific nature of the resource. 2. Prevention and resolution of disputes where two countries assert taxing rights to the same income, although developing countries may lack the resources to apply the Mutual Agreement Procedure (MAP). 3. Access to taxpayer information from treaty partner countries.	1. Loss of tax revenues: restrictions on source taxation may result in a direct loss compared to domestic law. Whether the loss is necessary to attract investment will depend on a cost-benefit analysis. 2. Tax treaties may be inappropriately used for tax planning; this risk is especially high where the treaty is with a low-tax jurisdiction. 3. Costly to negotiate and administer, and difficult to modify, replace, or terminate.

Developing countries that depend on natural resources for revenue and other economic and social benefits should consider the costs and benefits of tax treaties in the context of the extractives sector. Some of these include attracting FDI, resolving cross-border disputes, loss of tax revenues, and tax avoidance.

Discussion of Selected Benefits

1. Attracting FDI

Many developing countries have used tax treaties with the aim of attracting FDI to boost economic development. The evidence for that is mixed.[4] Academic studies before 2009 show the positive, neutral, or, in some instances, negative effects of tax treaties on investments. Since then, studies using more comprehensive and granular data have found more positive effects.[5] Nevertheless, it remains unclear overall whether tax treaties have generated new investment in developing countries. What is clear, however, are the risks of concluding tax treaties. The decision to enter a treaty, therefore, is a trade-off between certain risks and uncertain benefits regarding investment.

[4] For a summary of the empirical discussion see Appendix 5 of IMF, 2014.
[5] See Barthel et al., 2010; Castillo-Murciego & López-Laborda, 2018; Davies et al., 2009; Millimet. & Abdullah, 2007; Neumayer, 2007 ; Quak & Timmis, 2018.

The role of tax treaties in attracting investment in the mining sector is particularly unclear. Mining is location specific. This means that tax competition, including the effect of tax treaties, which may reduce the level of source taxation, is likely to be a less significant factor in mining investment decisions than in more mobile sectors such as manufacturing and the location of intellectual property rights. According to mining investor surveys, geology accounts for 60% of investment decisions, while policies and other measures, of which tax treaties are a small part, form 40% (Fraser Institute, 2019)—unless there are policies in place that are extremely harmful to potential investors. Of course, investors will take the impact of tax treaties into account, in particular, lower rates of source taxation, which may reduce the cost of investing. However, overall, tax rates, including tax treaties, remain a secondary concern for mining investors compared to the quality of the resource (Fraser Institute, 2019).

2. Resolving Cross-Border Disputes

As globalization continues, the number of cross-border transactions and the potential for disputes between governments with respect to their right to tax international trade and investments under tax treaties are likely to increase in number and scope. Governments and foreign investors are rightly concerned about the need for clear and timely dispute resolution mechanisms.

Tax treaties contain a bilateral mechanism for resolving tax treaty-related disputes. Mining investors, however, may have additional options for dispute resolution under investment agreements, bilateral investment treaties (BITs), or other international agreements (e.g., the Energy Charter Treaty). Consequently, tax treaties may be less critical for mining investors specifically, at least from a dispute resolution perspective. The options are compared in Table 3.

Table 3. Comparing the benefits and costs of entering a tax treaty

	Mining Investment Agreement	Tax Treaty	BIT
Who initiates the claim	The investor makes and prosecutes the claim against the government, but governments can also initiate claims against the investor (e.g., for non-payment of taxes). This distinction may not be as great as it first appears since an investor seeking MAP relief normally will already have pursued an objection to the proposed host country taxation.	An investor can request a MAP; however, it is their home tax administration that will argue for its tax relief. Many developing countries have little or no MAP experience, so this is clearly not a route regularly used by investors in those countries.	The investor makes and prosecutes the claim, provided it is an eligible investor under the BIT, and the scope of the treaty includes taxation or the claim otherwise can be covered. Certain BITs specifically carve out issues of taxation.
Scope of dispute	Domestic laws (i.e., taxes not covered by tax treaties such as mineral royalties), the investment agreement, and international tax treaties.	Tax treaty-related disputes.	Investment treaty-related disputes, domestic law, and/or investment agreements.

Alternative Ways to Achieve Other Tax Treaty Benefits

There may be ways to achieve tax treaty benefits through other instruments or by negotiating a "light treaty" limited to (i) information exchange, (ii) commitment to transfer pricing principles, and (iii) dispute resolution procedures. For more information on alternative ways to achieve tax treaty policy objectives, see Section A.3 of the PCT *Toolkit on Tax Treaty Negotiations* (PCT, 2020b).

Discussion of Selected Costs

1. Loss of Tax Revenues

There are several risks to mining revenue collection, depending on how tax treaties are designed. Three of the most material risks are described in Table 4. They are ranked in order of materiality based on the cases included in Table 5. They also provide the structure for Part 3.

Table 4. Risks to mining revenue collection stemming from tax treaties

Risk to Revenue	Solution (Part 3)
1. Unable to tax the offshore indirect sale of mining assets Tax treaties may limit the ability of source states to tax the profits arising from offshore indirect sales of mining assets located in their country. An indirect sale or transfer is where shares in the foreign company that owns the mine in the source state are sold, rather than the mining or exploration right itself. The sale of a mining interest has the potential to generate significant tax revenue in the source state if it has the right to tax it, both in its domestic law and under its applicable tax treaties.	Establish and retain the right to tax indirect transfers of mining assets Provide an exhaustive definition of immovable property
2. Unable to tax income earned by mining subcontractors Tax treaties typically set a time threshold for the period a non-resident company must spend in a source state before it is required to pay tax on income earned there. This threshold is usually 6–12 months. However, mining subcontractors are often hired to perform short-term work and can more readily structure their activities to avoid exceeding the time period required to trigger a tax liability, thus avoiding paying tax in the source state. The tax at stake is significant, with resource companies spending, on average, just under USD 1 trillion a year on subcontractors between 2008 and 2017.[6]	Design broad rules on a permanent establishment (PE)
3. Reduced withholding tax on revenue earned by foreign companies providing goods, services, loans, or intellectual property rights to the mine. This may exacerbate profit shifting risks. Tax treaties may lower or exempt tax on passive income earned by non-residents from intellectual property, services, or financing provided to mining operations in source states, or income earned by shareholders from dividend payments, which may be significant in the extractives sector.[7] States that lower or exempt withholding tax in their treaties not only forgo vital tax revenue but also run the risk that companies increase outbound payments to strip profit out of the mine, transferring it offshore, often to a low-tax country. For more guidance on the use of debt finance in the mining sector, see IGF & OECD, 2018.	Retain the right to tax income from the provision of technical and management services

[6] The figure is for all upstream suppliers, local and foreign. The figure includes asset/site/project level spending, while spending by headquarters that was not allocated to specific projects is not included (Pittman & Toroskainen, 2020, p. 4).
[7] Researchers suggest that Uganda may have forgone between USD 8 million and USD 24 million in withholding tax on dividends under its treaty with the Netherlands (Hearson & Kangave, 2016).

The risks mentioned in this section are not hypothetical. Table 5 shows that there are millions of dollars at stake if resource-rich countries, developed and developing, fail to anticipate the risks to extractives industry revenues when they negotiate tax treaties, draft domestic law, or sign investment agreements. These examples underscore how critical it is that resource-rich countries consider the implications for extractives when they negotiate tax treaties to avoid giving up revenue unnecessarily.

Table 5. Revenue at stake from tax treaty disputes in the extractives sector over the last 20 years

	Court case/Public report	Revenue at stake	Result for govt.
Risk 1: Unable to tax offshore indirect sales	Heritage Oil and Gas Company (2010) (Uganda–Mauritius)	USD 405 million	Won
	ConocoPhillips, Perenco (2017) (Vietnam–United Kingdom)	USD 179 million	TBD
	MIL Investments (2006) (Canada–Luxembourg)	USD 425 million	Lost
	Alta Energy (2020) (Canada–Luxembourg)	USD 380 million	Lost
	Resource Capital Fund III LP (2014) (Australia–United States)	USD 58 million*	Lost
	Royal Bank of Canada (2020) (Canada–United Kingdom)	USD 12.8 million	Won
Risk 2: Unable o tax subcontractors	PGS Geophysical AS (2004) (Norway–Ivory Coast)	USD 2.5 million	Lost
	Fugro Engineers BV (2008) (India–Netherlands)	USD 1.6 million*	Won
	Clough Projects Intl. Pvt. Ltd. (2010) (India–Australia)	USD 21.4 million*	Lost
	GIL Mauritius Holdings Ltd. (2018) (India–Mauritius)	USD 1.8 million *	Lost
	Adams Challenge (UK) Ltd. (2021) (United States–United Kingdom)	USD 24 million	Won
	BHP Minerals Intl. Exploration Inc. (2007) (India–United States)	USD 2.6 million	Lost
Risk 3: Reduced withholding tax	Paladin Energy (Malawi–Netherlands, renegotiated 2015)	USD 27.5 million	N/A
	Oyu Tolgoi (2021) (Mongolia–Netherlands)	USD 288 million[8]	N/A

Note: An asterisk (*) means that the figure refers to the total profits or gains rather than the capital gains tax due.

[8] A range of issues is covered by the amended assessments. One of them relates to withholding tax and is therefore impacted by tax treaties.

2. Treaty Shopping

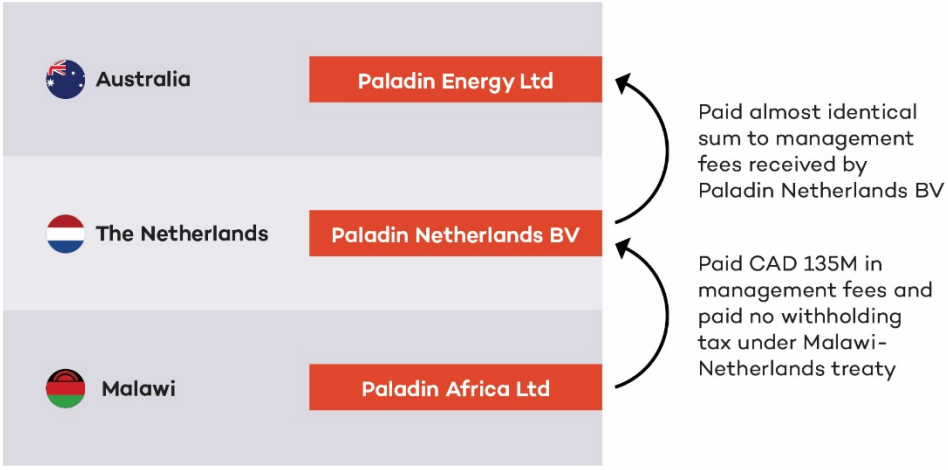
"Treaty shopping" is where investors use tax treaties to reroute investment and income flows, potentially increasing the risk of profit shifting. For example, Paladin, an Australian mining company, took advantage of Malawi's tax treaty with the Netherlands by routing payments via a Dutch company to avoid paying a withholding tax in Malawi (Box 3). The case in Malawi is not an isolated incident. An IMF study of tax treaties between sub-Saharan Africa countries and investment hubs (often referred to as tax havens because they reduce or eliminate taxes on many transactions) suggests that not only do treaties not increase FDI, but they may result in non-negligible revenue losses in source countries (Loeprick & Beer, 2018). Therefore, in addition to conferring certain tax benefits on investors, tax treaties and treaty shopping may also help facilitate tax avoidance. While the MLI has the potential to resolve some aspects of treaty shopping, not all countries have signed up, and not all treaties are covered by agreements, making this risk still very relevant today.

Box 3. Malawi forgoes USD 20 million in withholding tax due to its treaty with the Netherlands

In 2007, the Government of Malawi granted a mining licence to Paladin, an Australian company, to exploit uranium. Between 2009 and 2014, Paladin Africa Ltd paid management fees of USD 134.55 million to related company Paladin Netherlands BV. Paladin Netherlands BV, in turn, paid an almost identical sum of money as management fees back to the parent company in Australia, Paladin Energy Ltd.

Normally, an intra-company management fee payment out of Malawi would incur a 15% withholding tax in Malawi. However, because the transaction was subject to the tax treaty between Malawi and the Netherlands, there was zero withholding tax on services. The routing of the fees via the Netherlands facilitated this tax reduction in Malawi. The tax treaty did not have any anti-abuse measures that might decrease the risk of treaty shopping.

Figure 1. The case of Paladin Energy in Malawi



Source: Actionaid, 2015.

The Stabilization of Tax Treaties

There is the added risk in the mining sector that any loss of tax revenue from a tax treaty will be locked in by stabilization. Many developing countries have signed contracts with mining investors containing specific fiscal terms that are stabilized, meaning that they are frozen at the time of signing a contract. In some cases, this includes the stabilization of tax treaty benefits, which continue to apply to the investor even if the source state renegotiates or terminates the relevant treaty.

In Mongolia, for example, the investment agreement for the Oyu Tolgoi copper mine stabilizes the tax treaties in force at the date of the agreement. Mongolia has since terminated its tax treaties with the United Arab Emirates and Kuwait in 2015, as well as its treaties with Luxembourg and the Netherlands in 2014, due to the potential for certain treaties to give rise to tax planning and reduced revenue collection. For example, the Luxembourg and Netherlands treaties impose zero withholding tax on dividends. This would impact future dividends from the Oyu Tolgoi project in Mongolia, where the investment agreement stabilizes tax treaties in force at the date of the agreement. The Mongolian Tax Authorities have issued Oyu Tolgoi with amended assessments in relation to a range of issues, one of which is withholding tax, which is impacted by the stabilization of the tax treaty. Resource-rich countries should be careful to limit the time and scope of stabilization provisions in domestic law and investment agreements to avoid locking in financially unsustainable tax benefits arising from tax treaties.

Part Three: Negotiating Tax Treaties That Protect the Right to Tax Mining Income

Countries that depend on mining to contribute taxes and generate economic growth should carefully consider the characteristics of the industry, including potential international tax risks when designing and negotiating tax treaties. In too many cases, countries have only come to fully appreciate the impact of tax treaties on mining revenue collection after the treaty has been signed, and in some cases, stabilized in mining contracts. By this time, it is generally too late or too difficult to make a change to the tax treaty, in which case the country may end up forgoing significant revenue. To avoid these occurrences happening in future, resource-rich countries should consider safeguarding mining revenues when negotiating tax treaties.

This section provides guidance to governments on how to design certain tax treaty articles to protect against the most material risks to mining revenues. It is structured as follows:

- Establish and retain the right to levy capital gains on indirect transfers of mining assets.
- Provide an exhaustive definition of immovable property.
- Design broad rules on a PE.
- Retain the right to tax income from management and technical services.

Establish and Retain the Right to Levy Capital Gains Tax on Indirect Transfers of Mining Assets

What Is Capital Gains Tax?

When a company sells or transfers an asset, it makes a capital gain. The gain is the full amount received from the sale or transfer, minus the purchase price. There are two ways to tax capital gains. One is through a separate tax on capital gains, and the other is by incorporating the gain into taxable income that is subject to corporate income tax. These options are discussed in the UN (2017) Handbook.

Why Is Capital Gains Tax Important to Mining?

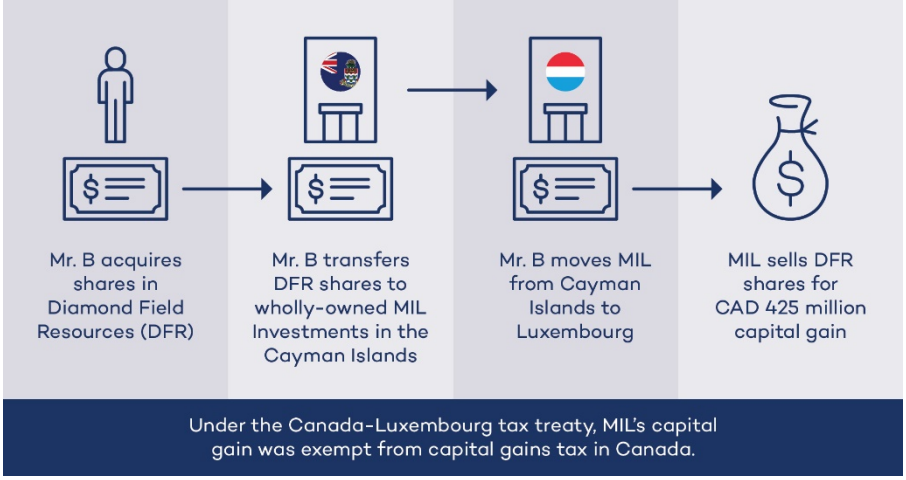
The direct or indirect sale or transfer of a mining licence is likely to generate considerable capital gains. The country where the mine is located is entitled to share in those gains, typically through capital gains tax, which is often very significant (See MIL Investments v. The Queen (2006) in Box 4). It is also important because a mine typically changes hands several times during the lifetime of the resource.

Box 4. MIL Investments v. The Queen (2006)

Mr. B, a resident of Monaco, acquired a 29.4% shareholding in Diamond Field Resources (DFR), a Canadian company engaged in mining exploration. In 1993, Mr. B transferred his shares in DFR to MIL Investments, a company in the Cayman Islands, wholly owned by Mr. B.

In 1995, MIL exchanged shares of DFR for shares of Inco Limited (Inco), another company in Canada, leaving MIL with less than 10% of DFR. Mr. B moved MIL from the Cayman Islands to Luxembourg, which had a tax treaty with Canada that exempted capital gains tax. In 1996, Inco purchased MIL's remaining shares in DFR. MIL realized a gain of CAD 425 million for its shares. MIL claimed that this gain was exempt from Canadian tax under the treaty.

Figure 2. MIL Investments v. The Queen (2006)



The Canadian Revenue Agency argued that the benefit obtained by MIL was an abuse of the treaty that should be disallowed under Canada's General Anti-Avoidance Rule (GAAR). However, the court found no evidence of abuse. It was clear that MIL's stake in DFR was exempt from tax under the treaty.

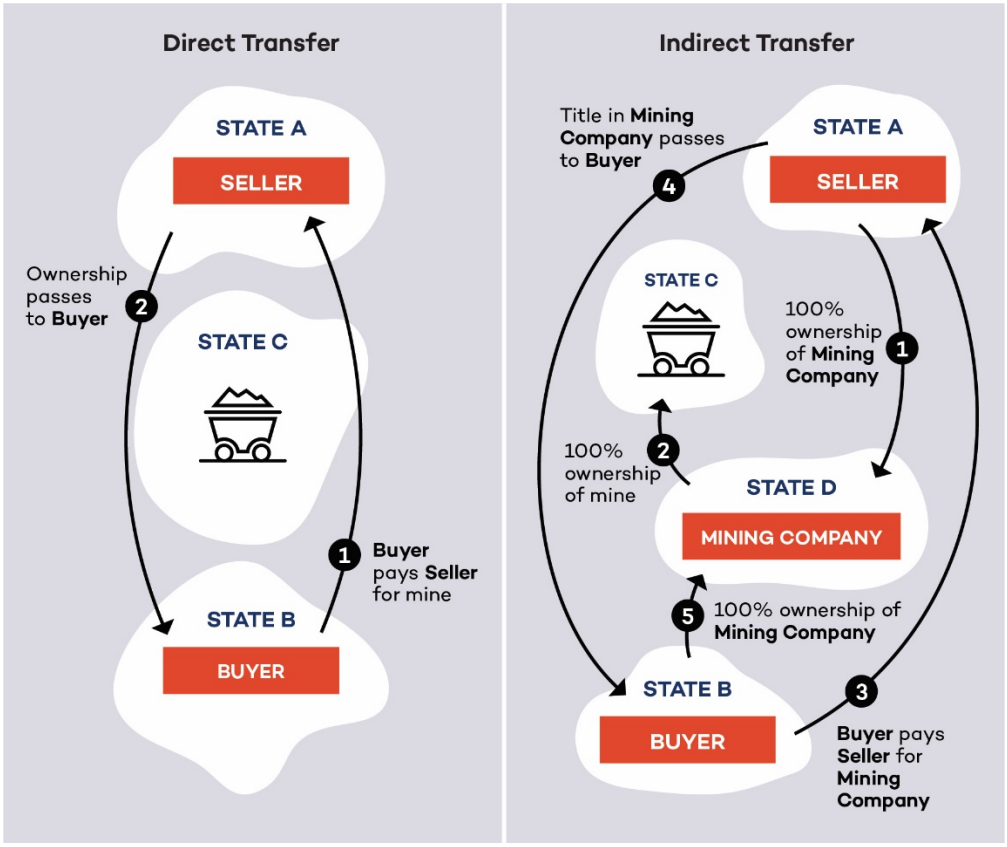
For more examples of indirect sales, see Toledano et al., 2017.

What Are the Risks That Resource-Rich Countries Should Consider When Negotiating Article 13?

When a local mining asset or licence relating to that asset is sold, the country where the resource is located will generally have the right to collect capital gains tax on the sale, under both its domestic law and tax treaties. This is a "direct transfer."

Where the situation becomes more complex is if the asset or licence is sold indirectly through a chain of ownership. An "indirect transfer" is where the shares in the mine or shares in the foreign company that owns the mine are sold. The sale takes place offshore, often without the knowledge of the resource-rich country. See Figure 3 for a depiction of a direct versus an indirect transfer.

Figure 3. Comparing direct and indirect transfers



The right to tax indirect transfers is the primary objective for resource-rich countries with respect to Article 13 of their tax treaties. Yet, despite the significant tax at stake, only 35% of all tax treaties include the right to tax indirect transfers. It is even less likely where one party is a low-income, resource-rich country, by about six percentage points (PCT, 2020a, p. 33). It is critically important to ensure that resource-rich countries (a) have the right to tax indirect transfers in their domestic law and b) retain this right in their tax treaties.

The taxation of indirect transfers also raises several practical questions for tax administrations—for example, how to calculate the value of the underlying licence or asset. These implementation issues, as well as some design considerations, are addressed in a forthcoming practice note from IGF and the OECD on *The Taxation of Offshore Indirect Transfers in the Mining Sector.*

How Can Resource-Rich Countries Address These Risks?

1. Establish a comprehensive definition of immovable property in domestic law and Article 6.

A source state only has the right to tax offshore indirect transfers if the underlying asset or right is considered immovable property in its domestic law and tax treaties. Article 13(1) of the Models states that "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." It is critical, therefore, that resource-rich countries have a comprehensive definition of immovable property in their domestic law and tax treaties. Otherwise, they risk not being able to tax the gains from the sale of certain assets or rights that are out of scope (see the previous discussion on immovable property).

2. Establish the right to tax indirect transfers in the domestic law

A tax treaty cannot create a right to tax indirect transfers; this must exist in domestic law. There are three models for establishing the right to tax indirect transfers in domestic legislation:[9]

Table 6. Different models for including the right to tax indirect transfer in the domestic law

Model	Description
Model 1: deem a direct sale by a resident	This model taxes the indirect transfer as though a direct sale of assets had occurred. Specifically, the source state treats the local entity that directly owns the asset in question as having disposed of and reacquired its assets for their market value.
Model 2: source the gain in the country where the immovable property is located	This model taxes the non-resident seller on a transfer of shares or comparable interest in a source state company. It does this either directly or implicitly by a source of income rule, which provides that a gain is sourced in the location country when the value of the interest disposed of is derived, directly or indirectly, principally from immovable property located in that country.
A combination of both models with different thresholds and an ordering rule	These two models can be combined, with Model 1 applying over a percentage change of ownership and Model 2 to transactions under that threshold.

Having established the right to tax indirect transfers, countries must also determine what percentage or value of the gain must be derived from source state assets for the tax to be triggered and what proportion of the gain should be taxed. These issues are discussed below.

[9] For a detailed discussion of the advantages and disadvantages of each model, see PCT, 2020 and Oxfam, 2020.

i. Determine the threshold for a gain to be taxable in the source state ("sourcing rule")

The OECD and UN Models set the percentage of the value of the shares that are sold that must be derived from assets in the source state at 50%. If this percentage is met, the gain is taxable in the source state. If not, the gain is exempt in the source state.

However, the outcome may not be fair, as it would prevent source countries whose assets do not meet the 50% threshold (or sourcing rule) from taxing capital gains on their mining assets. Many developing countries may want to tax any capital gains on their mining assets, regardless of the percentage that the value of their mining assets represents in the multinational company's portfolio.

The alternative is to adopt a lower threshold (e.g., 20%) but only impose a tax on the proportion of the gain derived from the asset in the source state (discussed in point (ii). Kenya has adopted this approach for extractives.

ii Determine the proportion of a gain to be taxed in the source state

Provided the threshold is met, general practice is for the source state to tax all the gains regardless of whether the offshore company also holds assets in other jurisdictions. In other words, a transfer of shares in an offshore company that holds a 50% interest in a mine in the source state will be subject to tax on the entire gain, even if the company has other assets elsewhere.

Alternatively, if countries decide to adopt a lower threshold for the indirect transfer of mining assets (mentioned above), it may be appropriate to only tax the proportion of the gain attributable to assets located in the source state. This balances the interest of the source state to collect capital gains tax on a greater number of indirect transfers and the risk of double taxation. However, while this might be considered a fairer application of the tax, it introduces the complexity of having to split the gain, which may be difficult in the absence of full information.

3. Maintain the right to tax indirect transfers in tax treaties

Once resource-rich countries have established the right to tax indirect transfers in their domestic law, they should maintain this right in their tax treaties, otherwise, they open themselves up to the risk of treaty shopping. This can be achieved through Article 13 or a standalone extractive industries article.

i Negotiate Article 13 to include the right to tax indirect sales

Countries should negotiate Article 13 to include the following:

- The source state has the right to tax gains from the sale of "shares or comparable interests." Roughly 60% of the tax treaties sampled for this practice note included shares and other similar rights or interests.
- The period during which the shares derive their value principally from immovable property in the source state can be any time during the 365 days prior to alienation. 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 from being "watered down" prior to the transfer of ownership.

Countries with existing treaties that lack these provisions could sign the MLI that has updated the OECD Model to follow the UN approach or try to renegotiate bilaterally.

Finally, countries could consider deviating from the Models by adopting a lower threshold for mining assets as per the discussion in 2(i) and (ii).

ii Negotiate a standalone extractive industry article

Some countries have chosen to rely on a standalone article on extractives to secure their right to tax indirect transfers. The benefit of a standalone article is that it includes an explicit reference to the transfer of extractive assets, including clear definitions of exploration or exploitation rights (see an example from the Norway–Serbia treaty in Box 5). For a detailed discussion of the advantages and disadvantages of a standalone article, see the section on PE.

Box 5. Treaty practice: Right to tax indirect transfer of extractives assets through a standalone article

Norway–Serbia, 2015. Article 21

"6. Gains derived by a resident of a Contracting State from the alienation of:

1) exploration or exploitation rights; or
2) property situated in the other Contracting State and used in connection with the exploration or exploitation of the seabed or subsoil or their natural resources situated in that other State; or
3) shares or comparable interest of any kind deriving their value or the greater part of their value directly or indirectly from such rights or such property or from such rights and such property taken together, may be taxed in that other State.

In this paragraph, the term "exploration or exploitation rights" means rights to assets to be produced by the exploration or exploitation of the seabed or subsoil or their natural resources in the other Contracting State, including rights to interests in or to the benefit of such assets."

Recommendations

1. Resource-rich countries should adopt a comprehensive definition of immovable property in their domestic law; see the recommendations on immovable property in the previous section.
2. Resource-rich countries should establish the right to tax indirect transfers in their domestic law. Countries with limited enforcement capacity may prefer Model 1 in Table 6 (the local entity is deemed to have sold the right or asset), bearing in mind the risk of double taxation.
3. Resource-rich countries should negotiate the right to tax indirect sales, as well as an anti-abuse rule, in their tax treaties. They could also consider a lower threshold for the percentage of the value of the shares that are sold that must be derived from mining assets in the source state. They could combine this with pro rata taxation of the gain to limit the risk of double taxation.
4. In addition, resource-rich countries could consider adopting a standalone extractive industries article that includes the right to tax indirect transfers in the extractives sector specifically.

Provide an Exhaustive Definition of Immovable Property

What Is Immovable Property?

Immovable property generally refers to land and fixtures or structures upon the land (e.g., a mineral deposit). It may also include equipment or accessories to the immovable property (e.g., a drilling rig). Article 6 of the Models gives the right to tax income from immovable property to the country where the property is located, regardless of whether the activities constitute a PE. This is justified by the close economic connection between the source of the income and the country where the assets are located.[10]

Why Is Immovable Property Important for Mining?

Immovable property is important for two reasons:

1. The ability of the resource-rich country to collect capital gains tax from the transfer of mining or exploration licences depends on the definition of immovable property in Article 6. Article 13 grants the state where the property is located the right to tax gains arising from the alienation of immovable property referred to in Article 6. If the definition of immovable property is too narrow, the resource-rich country may miss out on significant tax revenue.
2. Article 6 is a backstop to Article 5 if the resource-rich country is unable to prove that extractive activities give rise to a PE. Provided that the income derived by a non-resident is from an operation related to immovable property, it is subject to taxation in the country where the extractive activities are located, regardless of whether it has a PE.

What Risks Should Resource-Rich Countries Consider When Defining Immovable Property?

The definition of immovable property in Article 6(2) of the OECD and UN Models includes “rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources.” “Working a resource” means removing the resource from the landed property. As such, resource-rich countries should be able to tax income from extraction.

However, other sources of mining income may not be taxable in the resource-rich country unless expressly included in the definition of immovable property—for example, income from the sale of the right to explore, depreciable assets (e.g., plant and machinery), seismic surveys, and other non-public information related to immovable property. Furthermore, rights to payments not from the sale of a mineral right or tangible property but computed by reference to the value of the mineral deposit may not be taxable (see Royal Bank of Canada v. HMRC in Box 6).

The objective for resource-rich countries should, therefore, be to define immovable property broadly enough to capture income arising from all activities and assets along the mining value chain. This definition of immovable property must be in the domestic law, as well as in any tax treaties.

[10] OECD Commentary 1 Art.6 (1)

Box 6. Royal Bank of Canada v. HMRC (2020)

The Royal Bank of Canada (RBC) loaned funds to a Canadian oil and gas company, Sulpetro Limited, to help fund the exploration and extraction of oil in the United Kingdom sector of the North Sea. Sulpetro later had financial difficulties and sold its interest in the oilfield to the BP group. The consideration for the sale included an entitlement to royalty payments based on the value of production from the oil field.

Sulpetro ultimately went into receivership. After the remainder of its assets were sold, it still owed RBC about CAD 185 million, and its rights to all future production royalty payments were formally assigned to the bank with the approval of the Canadian courts.

The British tax authority, HM Revenue and Customs (HMRC), argued that the royalty payments were related to immovable property situated in the United Kingdom and should therefore be subject to tax in the United Kingdom. The court upheld HMRC's view, claiming that there was no reason to limit the scope of Article 6(2) of the United Kingdom–Canada treaty to cover only payments that are made directly to the owner of the rights in exchange for the grant of a right to exploit them. They said, "it would be irrational and inconsistent with the apparent purpose of the provision if it were possible to avoid local taxation on that profit simply by interposing an assignment of the royalty rights (possibly even to an associated company resident in a low-tax jurisdiction) after they had been granted." HMRC collected USD 12.8 million in tax.

How Can Resource-Rich Countries Address These Risks?

In line with Article 6(2) of the Models, resource-rich countries should start by establishing a robust definition of immovable property in their domestic law.[11] Having done this, resource-rich countries should replicate the definition in their tax treaties. Both steps are necessary and should be pursued in parallel.

1. Include exploration assets or rights as immovable property

The definition of immovable property should include the right to explore and to mine, including:

- The physical mine (i.e., the land on which a deposit is situated)
- Any buildings, or part of a building, including machinery, plant, etc.
- The right to mine (i.e., the licence)
- The right to explore.

The right to explore is particularly important. If read narrowly, the definition of immovable property in Article 6, specifically the reference to the "right to work mineral deposits," may be taken to mean that only assets or rights relating to mineral production or exploitation qualify as immovable property. Consequently, income derived by a non-resident from exploration activities would not be subject to tax in the source state.

To avoid any ambiguity, resource-rich countries should clarify in their domestic law that immovable property covers both the "right to explore" and the "right to mine," as well as the right to receive

[11] Article 6(2) ("domestic law") refers to the entire law rather than only tax law (Vogel, 1997, p. 376).

income from the "right to explore for or exploit" natural resources. For example, in Australia, Taxable Australian Property includes "a mining, quarrying or prospecting right to minerals, petroleum or quarry materials in Australia" (Australian Taxation Office, n.d.). Similarly, in Chile, the definition includes exploration and exploitation rights, plus buildings, facilities, and other objects attached.

Countries should also include the right to explore in Article 6(2) of their treaties (see the example from New Zealand–Papua New Guinea, 2012, in Box 7). It is extremely concerning that only 4% of the sampled tax treaties include the right to explore in the definition of immovable property. All these tax treaties include China as a contracting state.[12] This is probably because Chinese domestic law includes the right to explore in its definition of real property.

Box 7. Treaty practice: Inclusion of exploration assets or activities in Article 6(2)

New Zealand-–Papua New Guinea (2012)

"6(2) The term 'immovable property'…. shall in any case include …, **rights to explore** for or exploit natural resources (including mineral deposits, oil or gas deposits or quarries) …, and rights to variable or fixed payments either as consideration for or in respect of the exploitation of, or **the right to explore for** or exploit natural resources (including mineral deposits, oil or gas deposits or quarries) …"

2. Include other payments calculated by reference to mineral production

Some countries may choose to adopt an even broader definition of immovable property that includes payments calculated by reference to the value of mineral production. See Canada's definition in Box 8.

Box 8. Definition of immovable property in Canada

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

"*Immovable property* and *real property*, …. are hereby declared to include:

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*)".

Canada's definition recognizes that there are multiple ways to derive income from mineral deposits that are not limited to the right to explore or to mine, such as royalty financing arrangements. This is a recent financing mechanism in the mining sector that gives the lender the right to a production royalty, often in perpetuity, in return for an upfront payment to the mine. Under Canada's definition, the lender would be subject to tax on the production royalty it receives from the mine in

[12] Three out of 86 tax treaties

Canada. These arrangements are becoming increasingly common, making it important for resource-rich countries to consider adopting a broad definition similar to Canada's.

3. Specify that the right or asset is situated where the immovable property is located

Some resource-rich countries also specify that the right referred to in the definition of immovable property "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" (China–New Zealand, 2019). This is particularly common in Australia's tax treaties. 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 (see Article 13 of the Models).

Box 9. Treaty practice: Situate the right to explore or exploit where the resource is located

China–New Zealand 2019

Article 6 – Income from Immovable Property

"Any right referred to in paragraph 2 of this Article shall be regarded as **situated where the property to which it relates is situated or where the exploration or exploitation may take place**."

Option to Include a Treaty Override

A "treaty override" means a specific aspect of existing or future tax treaties will be subject to a change in the domestic law. Australia and Canada have a treaty override with respect to immovable property. This means any changes they make to their domestic law definition of immovable property will apply to their tax treaty network.

Countries considering this option should be mindful that treaty partners may retaliate by similarly restricting treaty benefits they grant to citizens of those countries or the foreign entities in which they own a significant interest. This risk is less significant for predominantly capital-importing countries.

An alternative is for countries to accept the current definition of immovable property in existing treaties and provide additional interpretative guidance to the courts on how to apply the definition. While treaty partners may be less likely to object to this approach than a treaty override, it potentially limits the scope of what the government can do to achieve a change of results.

Recommendations

1. Resource-rich countries should include the following items in their domestic law definition of immovable property:
    i. Any right to explore mineral deposits in the source state
    ii. Any right to an amount computed by reference to the production, including profit, from or to the value of production from mineral deposits in the source state
    iii. Specify that the resource-related asset or right is situated where the immovable property is located. This avoids any doubt about the source state's right to tax income derived from extractive activities or assets linked to immovable property.
2. Provided their domestic law definition of immovable property is comprehensive, resource-rich countries should replicate this definition in their tax treaties. Alternatively, countries that are yet to update their domestic law definition of immovable property could negotiate a broader definition in their tax treaties, as long as it does not constrain the law or void it.

Design Broad Rules on a PE

What Is a PE?

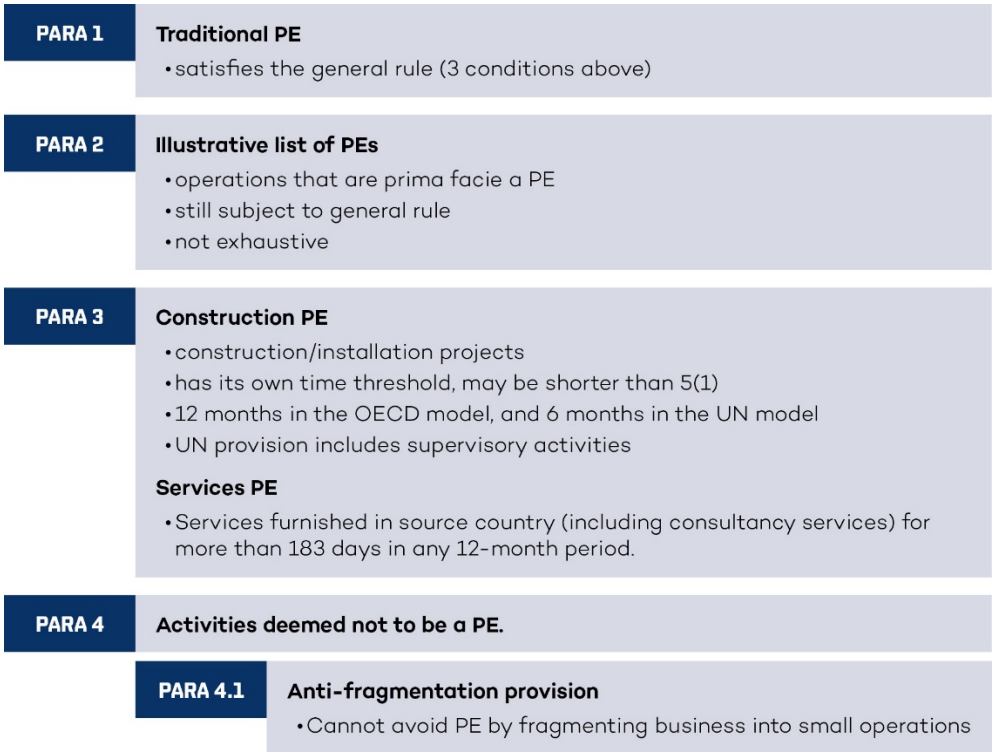
The business profits of an enterprise resident in Country A are only taxable in Country B if the enterprise has a PE in Country B, and only to the extent that the profits are attributable to that PE. For it to have a PE, the requirements in Table 7 must be met. These are referred to as the "general rule" in Article 5(1) of the Models.

Table 7. Requirements of the general rule of a PE

	PE Requirement	Description
(i)	Having a place of business at their disposal	Having the effective power to use that location for a sufficient duration. Does not have to be under constant control, e.g., use of subsidiary's office by a supervisor from the parent company.
(ii)	Having a fixed place of business	Two conditions must be met to be considered a fixed place: a certain degree of permanency ("time threshold") and a specific geographical spot ("location test").
(iii)	The business should be carried on through the PE	Any situation where business activities are (wholly or partly) carried on at a particular location at the disposal of the enterprise for that purpose.

The rules relating to PE are found in Article 5 of the Models. Figure 4 provides a quick tour of the most relevant provisions of Article 5 and how they relate to one another.

Figure 4. Overview of Article 5 (PE)



Why Is a PE Important For Mining?

The complexity and specialization required by the extractive industries mean that foreign enterprises will frequently be part of the extractive process where the mine or oil and gas well is located. It will therefore be important to the source state that it has the right to tax business profits earned directly by foreign companies arising from activities related to the exploration and exploitation of its location-specific, non-renewable natural resources.

What Are the Risks That Countries Should Consider When Designing PE Provisions for the Mining Sector?

An exploration or mining licence holder will generally have a PE in the source state. In both cases, the activity is linked to a specific geographical point (a "fixed place of business") and typically lasts longer than 6 months,[13] thus satisfying the general rule.

Right to Tax Subcontractors

The main PE risk for the mining sector is the right to tax subcontractors. This is because subcontractors are more able to avoid having a PE, and hence paying tax in the source state, than an exploration or mining licence holder.

- Compared to licence holders, subcontractors can more easily structure their activities to avoid exceeding the time threshold and thus triggering a PE. The risk is higher during exploration that involves shorter periods (see PGS Geophysical AS 2004 in Box 10).
- Subcontractors are more likely to move locations, especially within the exploration phase. For example, vessels used to undertake seismic surveys move continuously within the area being explored.
- Subcontractors may carry out supervisory activities (e.g., planning and managing construction of a mine) that do not necessarily trigger a PE, at least according to the OECD Model, which is silent on whether supervisory activities trigger a PE, although the Model commentaries do state that an "on-site supervising party" will have a PE.

The ease with which subcontractors can avoid triggering a PE may create an incentive for mining companies to use related-party subcontractors located in low-tax jurisdictions to perform part of the operations, and in doing so, transfer profits offshore.

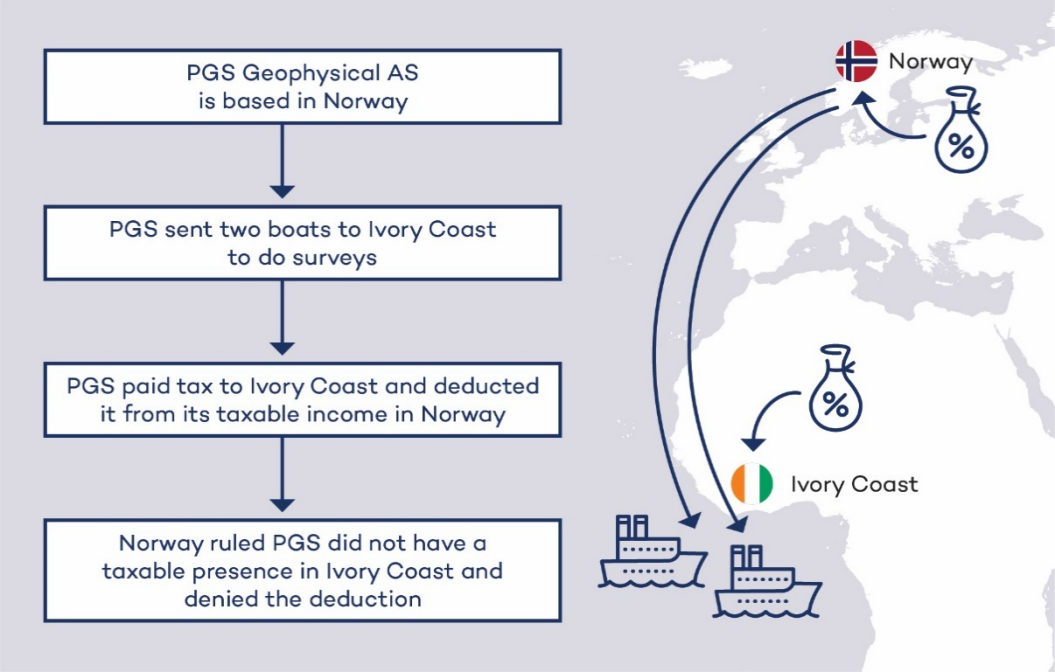
[13] In Africa, the average duration of a mining exploration license is 3 years (Gajigo et al., 2012).

Box 10. Subcontractors avoid paying taxes on income earned in the source state

PGS Geophysical AS (Norwegian Supreme Court) 2004

PGS Geophysical AS (PGS), a Norwegian company, performed seismic surveys for two foreign companies on the continental shelf of the Ivory Coast. One vessel carried out seismic surveys in a contractual area of 561 km^2. Another vessel performed seismic surveys in an area of 1,100 km^2. The missions took 25 days and 41 days, respectively.

Figure 5. PGS Geophysical in the Ivory Coast



PGS assumed that each vessel had a taxable presence in the Ivory Coast and paid taxes accordingly. It credited the tax paid in the Ivory Coast against its income in Norway, reducing the tax paid there. The Norwegian Tax Authority denied the deductions, arguing that PGS did not have a taxable presence in the Ivory Coast.

The Norwegian Supreme Court upheld the tax authority's position, deciding that PGS's activities on the Ivorian continental shelf were too short to trigger a tax liability in Ivory Coast under the Norway–Ivory Coast treaty. The deductions were denied, and PGS was forced to pay tax on its income to Norway from its activities in Ivory Coast.

Remote Operations: The mine of the future

An emerging PE risk is the remote operation and servicing of mine sites. In the future, it is likely that some mines will be almost entirely operated by control rooms overseas. Technology companies will also play a bigger role in servicing mining projects. Under this scenario, the licence holder will continue to have a PE regardless of whether workers are physically present at the mine site. This is because the mine itself is a fixed place of business, satisfying the general rule. However, subcontractors, including technology companies that remotely service the mine, are less likely to have a PE in the source state.

The definition of PE will need to evolve to include businesses selling goods and services digitally. A shift is already starting to occur under the OECD/G20 Inclusive Framework initiative to address the challenges arising from taxing the digital economy (OECD, 2020b). Additionally, countries may choose to adopt Article 12B of the UN Model, recently introduced to allow source states to charge a withholding tax on payments for automated digitalized services provided by a non-resident.

For more information on the impacts of new technology on the mining sector and potential impacts on revenue collection, see the IGF report *New Tech, New Deal: Technology Impacts Review* (2019), and the IISD report, *Mining a Mirage: Reassessing the Shared Benefit Paradigm in Light of the Technological Advances in the Mining Sector* (2017).

How Can Resource-Rich Countries Address These Risks?

Table 8 compares the four approaches to PE in the mining sector that have emerged.[14] How a country chooses to approach PE will have implications for other treaty articles. Figure 6 on shows how the different PE approaches interact with other articles covered in this practice note.

[14] Some treaties have more than one approach. For example, some treaties must have both a reference to exploration in Art. 5(2) and an Extractives PE in Article 5(3), or one of the other approaches.

Table 8. Comparing the four approaches to PE in the extractives sector

Article	Does it increase the likelihood that the source state will have the right to tax mining income?	Easy to negotiate with treaty partners?	What stages in the mining value chain does it cover?	What part of treaty practice (% of sampled treaties)?
Standalone article	Very likely	Challenging because it is an entirely new article. It will depend on each negotiation	Exploration to sales	6% (5 treaties)
Self-standing PE in Article 5	Likely	Easier than a standalone, as it is still within Article 5; however, it will depend on each negotiation	Typically, exploration and exploitation	7% (6 treaties)
Extractives PE in Article 5(3)	Likely, because it does not have to satisfy the time threshold, although other aspects of the general rule must be met	Easier, although it depends on various factors, i.e., threshold	Typically, exploration and exploitation	20% (17 treaties)
Reference to exploration in Article 5(2)	Unlikely, as it must satisfy the entire general rule	Easy to negotiate	Typically, exploration and extraction	33% (28 treaties)

1. Deem a PE to Exist in a Standalone Extractive Industries Article

The best option for resource-rich countries to safeguard their right to tax income arising at all stages of the mining value chain is to include a standalone article covering offshore and onshore mining as well as oil and gas activities. While standalone articles have typically targeted offshore activities in the oil and gas sector, there is no reason why this approach cannot be extended to onshore and offshore mining.

The benefits of a standalone article are:

- It gives primacy to non-renewable natural resources. This may be appealing for resource-rich countries particularly concerned with maintaining their source taxing rights with respect to this sector.
- It covers PE, the right to tax the indirect transfer of assets, and employment income. In this sense, a standalone article may be more comprehensive than the other approaches.
- It can explicitly cover offshore activities, which are harder to prove have a PE under Article 5.

The risks of including a standalone article are:

- It may be hard to convince some treaty partners, particularly developed countries, to accept a wider scope for source taxation. One way to make this proposal more acceptable is to clearly limit the extent of source taxation (e.g., extractive industry activities or offshore activities). Regardless, if a standalone article is not feasible, the second option—a self-standing provision in Article 5 (and other modifications to Articles 6, 13, and 15)—may be a good fallback. It can achieve the same result within the confines of the Models.
- Standalone articles have typically been limited to extractive industry activities taking place offshore. This is because of the difficulty of monitoring PEs offshore, and the narrow scope of the standalone article makes it less likely to interfere with other treaty articles. Extending it to include onshore activities (necessary for mining) may create some challenges. Specifically, the activity must be "connected with" exploration, exploitation, etc., for the article to apply. Determining a connection is less of an issue for offshore activities simply for practical reasons—there are fewer activities taking place. This is more challenging onshore—for example, is a catering firm that provides services to mining and other businesses subject to the standalone article? Determining whether there is a sufficient connection may create uncertainty for taxpayers.

Standalone articles on extractives are not common. Only 6% of the sampled tax treaties include a standalone article. However, the countries that have pioneered this approach are major resource producers—Norway, the United Kingdom, and Mexico. Two types of approaches have emerged:

a) An **"Offshore Article"** enables the source states to collect revenue from extractive operations performed by non-residents operating offshore. It was first introduced by Norway and the United Kingdom (see Box 11). The focus on offshore activities specifically was due to the difficulty of meeting the fixed place test under Article 5. Such articles typically include a lower threshold than in Article 5—for example, 30 days in any 12-month period.

An **"Onshore/Offshore Article"** enables source states to collect revenue from hydrocarbon operations performed by non-residents operating onshore and offshore. To our knowledge, this approach is only used by Mexico, in its treaties with Jamaica and Argentina (See Box 12). It covers a range of activities related to the exploration, production, refining, processing, transport, distribution, storage, and marketing of hydrocarbons. Note that this excludes decommissioning—the risk of an exhaustive approach is that certain activities are overlooked.

Box 11. Treaty practice: Offshore article

Norway–United Kingdom (2013)

Article 21. Miscellaneous rules applicable to certain offshore activities (selected provisions)

2. "Offshore activities" are carried on offshore "in connection with the exploration or exploitation of the seabed and subsoil and their natural resources situated in that State".

3. An enterprise carrying on offshore activities is deemed to have a PE except under para 4 and 5.

4.

- Offshore activities must be carried on for a period or periods less than 30 days in aggregate over any twelve-month period.
- Where two associated enterprises carry out substantially similar offshore activities in the Contracting State, the time spent by each enterprise will be added together to compute the time threshold. This is an anti-avoidance rule.
- Enterprises are associated "if one participates directly or indirectly in the management, control or capital of the other or if the same person or persons participate directly or indirectly in the management, control or capital of both enterprises".

5. Where two Contracting States have entered into an Agreement to the joint exploitation of an oil and gas field, paragraph 3 does not apply.

Box 12. Treaty practice: Onshore/Offshore Article

Mexico–Argentina (2015)

Article 21 – Hydrocarbons

2. "An enterprise that carries on activities which consist or are connected with the exploration, production, refining, processing, transportation, distribution, storage or commercialization of hydrocarbons for a period or periods exceeding in the aggregate 30 days in any 12-month period; shall be deemed to have a PE.

3. Where two associated enterprises carry on identical or substantially similar activities, or these activities are part of the same project, all activities will be considered for the purposes of computing the limit. 'Associated enterprises' is given the meaning under the domestic law where the activities are carried on."

Although establishing a link between the activity and the extractives sector may be more challenging in the case of onshore activities, Mexico's Hydrocarbons Article is a good model, covering offshore and onshore, albeit limited to oil and gas.

Countries that wish to negotiate a standalone article should make sure it covers enterprises:

- Carrying on activities onshore and offshore
- Connected with the exploration, production, refining, processing, transportation, distribution, storage, commercialization, or decommissioning of non-renewable natural resources situated in the source state, including non-renewable natural resources in the seabed or subsoil
- Are deemed to be carrying on business in the source state through a PE.

2. Deem a PE to Exist in the Case of Exploration and Exploitation Activities in Article 5

The next best option is to establish a self-standing provision in Article 5 that deems a PE to exist in the case of any exploration and exploitation activities, regardless of whether these take place onshore or offshore. Compared to a standalone article, a self-standing provision in Article 5 may be easier to negotiate. The downside is that it may be less comprehensive. See Box 13 for an example.

Box 13. Treaty Practice: Self-standing provisions in Article 5

Australia–Germany (2015)

"(4) Notwithstanding the preceding provisions of this Article, where an enterprise of a Contracting State:

(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 a period or periods exceeding in the aggregate 90 days in any 12-month period; or

....,such activities shall be deemed to be carried on through a permanent establishment that the enterprise has in that other State, unless the activities are limited to those mentioned in paragraph 6 and are, in relation to the enterprise, of a preparatory or auxiliary character."

In general, the advantages of a self-standing provision are that it:

- Effectively displaces the general rule
- Provides a faster taxing right for the source state
- Eliminates the risk of companies structuring their activities to avoid triggering a PE.

Some potential treaty partners may be reluctant to agree to such a provision, arguing that:

- Deeming a PE can increase the risk of double taxation if the residence state does not give a corresponding deduction.
- It may lead to disputes regarding the attribution of profits to the PE.

Potential counterarguments include:

- Resource-rich countries such as Australia have pursued such a treaty strategy for many years without significant opposition from treaty partners.
- PE provisions in international tax treaties have also become more source-based over time, which means that recent treaties expand the circumstances in which source states can tax foreign companies' profits within their borders.

Self-standing provisions are relatively uncommon. Only 7%[15] of the sampled treaties adopted this approach. However, the countries that do use a self-standing provision, Canada and Australia in particular, are major resource producers. Therefore, although this practice is not widespread, it is extremely worthwhile for resource-rich developing countries to consider adopting it. When designing a self-standing provision, countries should consider its scope and time period, if any.

Scope of a Self-Standing Provision

There is no limit to what resource-rich countries could include in a self-standing provision. The OECD Commentary envisages a self-standing provision specifically for exploration; however, as in the case of the Australia–Germany treaty, this could be extended to include exploitation and extraction as well. A self-standing provision would typically cover subcontractors as well as licence holders, provided subcontractors are carrying on activities in connection with exploration and exploitation.

Time Threshold (if any)

There is no requirement to set a time threshold for a self-standing provision. Countries such as Australia deem a PE regardless of the duration of exploration and exploitation activities, whereas some others include a time period (see discussion on page 34). Countries should consider that activities caught by a self-standing provision, for example, those performed by subcontractors, may also trigger a Construction PE or Services PE. If there is no time threshold or a lower threshold for the self-standing provision, subcontractors may be incentivized to claim a Construction PE to potentially avoid a tax liability if a priority rule is not stated. Countries could limit this risk by harmonizing all time thresholds in Article 5; however, this would undermine the objective of having a stricter self-standing provision on extractives. Alternatively, countries could include a priority rule for the mining threshold if the self-standing provision is stricter. The latter is preferable.

3. Include a reference to mining-related activities in Article 5(3)

The next best option for resource-rich countries is to include mining-related activities in Article 5(3). The limitation, compared to previous approaches, is that some aspects of the general rule must still be met. There is no certainty that all activities at all stages of the value chain will have a PE under Article 5(3)—for example, subcontractors hired during the exploration. Notwithstanding the limitations, there is a growing number of countries that are using this approach. Twenty percent of the sample included a dedicated extractives provision in Article 5(3).[16]

[15] Seven percent equates to six out of 86 tax treaties.
[16] Seventeen out of 86 treaties.

Scope of Article 5(3)

There is no limit to what resource-rich countries could include in such a provision. It should provide as wide a coverage of the sector as possible. Exploration and exploitation/extraction were included in virtually all examples of a dedicated provision in Article 5(3). Some countries also included a reference to an installation, drilling rig, or ship, presumably to bring offshore activities within scope. Others chose to deem a PE where a non-resident leases equipment and machinery to be used for extractive industry activities or where an enterprise uses substantial equipment in connection with resource extraction. Both variations are likely to catch subcontractors. Box 14 contains some examples.

Box 14. Treaty Practice: Including a dedicated extractives provision in Article 5(3)

Peru–Japan (2021)

3. The term "PE" shall also include: "activities carried on in a Contracting State in connection with the exploration or exploitation of natural resources situated in that Contracting State, but only if such activities last more than six months."

Chile–United States (2010)

"(3) A permanent establishment likewise encompasses:

(a) an installation used for the on-land exploration of natural resources only if it lasts or the activity continues for more than three months;

(b) a building site or construction or installation project and the supervisory activities in connection therewith, or a drilling rig or ship used for the exploration of natural resources not referred to in subparagraph (a) only if it lasts or the activity continues for more than six months; and..."

Cameroon–South Africa (2015)

"Where an enterprise provides services or supplies equipment and machinery on hire, or to be used in exploration, extraction or exploitation of mineral resources."

Time Threshold

Unlike a self-standing provision, a dedicated mining provision in Article 5(3) must include a time threshold. However, this can be different from the time threshold in the general rule, creating some leeway to set a lower threshold for extractives. Most of the sampled treaties that included a dedicated mining provision in Article 5(3) set a threshold of 6 months or less. Those that only mention exploration in Article 5(3), typically used 3 months, reflecting a shorter period of operation for subcontractors during exploration. There is a trend toward lower thresholds in recent treaties.

The choice of where to set a time threshold (or whether to set a time threshold at all in the case of a self-standing provision) will depend on a cost-benefit analysis:

- Does the potential additional tax revenue (and related risk of revenue loss) from triggering more short-term PEs outweigh the increased administration of having to identify and monitor those PEs?
- Would it be easier and more reliable to collect revenue through a withholding tax on gross revenue through Articles 10, 11, and 12, or a separate article on technical services?

Answers to these questions will vary based on countries' domestic laws and administrative capacities. In general, however, a lower time threshold better protects resource-rich countries' right to tax mining income, subcontractors particularly.

The MLI also addresses the risk of splitting up contracts. According to Article 14, where an enterprise carries on activities at a building site in the source state for more than 30 days and connected activities are carried on at the same building site by one or more closely related enterprises, each for more than 30 days, then those closely related enterprises' time will be added to the time of the first enterprise to determine its total time at the building site. To benefit from Article 14, countries can sign and ratify the MLI. Alternatively, they can negotiate a similar provision on a bilateral basis.

4. Include a reference to mining-related activities in the illustrative list of PEs in Article 5(2)

At a minimum, resource-rich countries should include exploration in the positive list of PEs in Article 5(2)—for example, "a mine, oil or gas well, a quarry or any other place of extraction or exploration of natural resources." While this does not guarantee that exploration activities will be considered a PE (they must still satisfy the general rule, according to the OECD and UN commentaries), it is more likely than if the treaty were to remain silent on exploration.

Most countries still follow the OECD and UN Models, only including a "place of extraction" in Article 5(2) of their tax treaties.[17] However, considering the importance of triggering a PE in the case of exploration, a growing number of resource-rich countries are including an explicit reference to a place of, or relating to, exploration in Article 5(2), specifically in 33% of treaties sampled by the IGF.[18]

Recommendations

1. The best option for resource-rich countries seeking to protect their right to tax all activities at all stages of the mining value chain is to adopt a standalone extractive industry article. It should cover the whole mining value chain. The definition of "contracting state" in Article 3 of the treaty should cover the seabed and its sub-soil over which the contracting state has sovereign rights.
2. Alternatively, resource-rich countries that do not wish to adopt a standalone article or are unable to negotiate one should consider the following modifications to Article 5 (in order of priority):
    i. Deem a PE to exist in the case of exploration and exploitation of non-renewable natural resources. A self-standing PE provision would not be subordinate to the general rule in Article 5(1). This provision could include a time threshold or not. Adding a time threshold is a key policy decision for each country and depends on a cost-benefit analysis. Not including a time threshold creates a faster, more reliable

[17] Fifty-two out of 86 treaties.
[18] Twenty-eight out of 86 treaties.

source taxing right; however, there may be other considerations, such as the compliance cost of monitoring more PEs, in which case countries may prefer to apply a withholding tax on outbound payments.

ii. Include a reference to exploration and exploitation of natural resources or resource-related structures or installation used for the exploration and exploitation of natural resources in Article 5(3). Article 5(3) does not have to follow the time threshold.

iii. Adopt a lower threshold in the general rule (e.g., 3 months or less).

3. All resource-rich countries should at least include exploration activities in the positive list in Article 5(2). This will make it more likely that exploration activities trigger a PE, although this still depends on the general rule in Article 5(1) being satisfied.

Retain the Right to Tax Income from Management and Technical Services

What Are Management and Technical Services Fees?

Mining subsidiaries may access administrative and technical services from their parent company or a dedicated related-party services company. Management services are typically administrative (e.g., accounting or legal), whereas technical services involve specialized support to the mining operation (e.g., geological testing). The parent or services company usually charges the subsidiary a fee for service, which it can deduct from its taxable income, reducing the tax base of the source state.

Why Is the Right to Tax Management and Technical Services Important for Mining?

Management and technical services fees are a major source of outbound payments in the mining sector. Such fees are normally subject to a withholding tax in the country where the mine is located, providing a reliable and predictable source of government revenue. Countries that relinquish the right to tax services under their domestic law or tax treaties not only forgo revenue but potentially incentivize companies to inflate these payments to strip profits out of the mine and transfer them offshore, usually to a low-tax jurisdiction.[19] See the Paladin Case in Box 3.

What Are the Risks That Resource-Rich Countries Should Consider When Negotiating the Right to Tax Fees for Management and Technical Services?

Source states have the primary right to tax fees for services on a gross basis under their tax treaties. The benefit of this approach is that source countries can collect a withholding tax on income from services without the need for a PE to be triggered. This reduces the risk that companies restructure their activities to avoid having a PE in the source state and lowers the administrative costs of having to monitor numerous PEs.

How Can Resource-Rich Countries Address These Risks?

Countries should explicitly refer to management and technical services payments in their tax treaties. The most reliable solution is to include a standalone article on fees for technical services, same as Article 12A of the UN Model. Alternatively, some countries have expanded the definition of royalties in Article 12 to include technical services, although this excludes management services. Others have sought to include a Services PE in Article 5(3) or fallback on Article 21 (Other Income). Table 9 briefly compares these approaches, which are covered in detail below.[20]

[19] OECD's *Measuring and Monitoring BEPS, Action 11—2015 Final Report*, supra note 23, 157, recognizes that withholding taxes "can influence cross-border tax planning opportunities" and can "discourage profit shifting via strategic allocation of debt and intangible assets."

[20] Some treaties have more than one approach. For example, some treaties must have both a reference to technical services in Article 12 (Royalties) and Services PE/Extractives PE in Article 5.

Table 9. Comparing the three approaches to taxing management and technical services fees

Article	Covers a broad range of services	Requires the service provider to have a PE in the source state	Easy to negotiate	Part of treaty practice (% of sampled treaties)
Standalone Fees for Technical Services Article	Yes	No	Standalone article	7% (6 treaties)
Services PE and Extractives PE in Article 5	Yes	Must satisfy the general rule, except duration	Depends on various factors, i.e., time threshold	62% (53 treaties)
Technical services included in Article 12 (Royalties)	Interpreted narrowly, excludes administrative services	No	Still within Article 12	19% (16 treaties)[21]

1. Adopt a Standalone Fees for Technical Services Article

The most reliable option is to adopt a standalone "fees for technical services" article. This approach was introduced by the UN Model (2017) in response to concerns from developing countries regarding their ability to tax technical services fees. It gives the source state the primary right to tax fees for services on a gross basis, provided it has this right under its domestic law. See an example from the Cameroon–South Africa (2017) treaty in Box 15.

Box 15. Cameroon–South Africa (2017)

Article 14 – Technical Fees (summarized)

1. Shared taxation on technical fees between both the source and the residence states.
2. Tax on technical fees should not exceed 10% of the gross amount.
3. "Fees for technical services" means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a technical, managerial or consultancy nature.
4. The abovementioned fees do not apply if the beneficial owner of the technical fees carries on business through a PE in the source state, and the services are connected to that PE.

The standalone article is a recent innovation. Therefore, it is not surprising that only 7% of the tax treaties sampled for this practice note followed this approach.[22] The benefits are significant, however, and resource-rich developing countries are encouraged to consider this option.

[21] This approach is more common than a standalone article because it is what was practical before the UN introduced Article 12A in 2017, not because it is more comprehensive or reliable.
[22] Six out of 86 tax treaties.

Table 10. Benefits and risks of a standalone technical services article

Benefits	Risks
Source countries can collect a withholding tax on income from services without the need for a PE. This reduces the risk that companies can structure their activities to avoid having a tax liability and lowers the administrative costs of having to identify and monitor PEs. Article 12A has primacy over Article 7. This means that fees for services will not constitute a business profit under Article 7 (taxed on a net basis) if they are dealt with in Article 12 (taxed on gross). The only exception is if the company providing the services has a PE in the source state and the services are connected to that PE, in which case Article 7 has priority.	The term "services" is not defined, potentially creating interpretation challenges. Some OECD countries may be reluctant to agree to a new article that deviates from the OECD Model without concessions on other matters.

Finally, Article 12A allows the contracting states to negotiate the rate of tax to be levied on services income. The rate should be the same as in domestic law to avoid the risk of treaty shopping.

2. Include an Extractives PE or a Services PE in Article 5

The next best option to a standalone article is for countries to adopt an "Extractives PE" in Article 5. An Extractives PE deems a PE to exist in the case of exploration and exploitation activities. The main advantage is that it displaces the general rule, thereby reducing the risk that non-resident entities can restructure their activities to avoid having a PE in the source state.

However, an Extractives PE is not common practice. Instead, countries are increasingly including a "Services PE" in their tax treaties. This option is in Article 5(3) of the UN and ATAF Models. It was found in 62% of the tax treaties sampled for this practice note.[23]

The benefit of a Services PE is that the source state's right to tax the non-resident service provider is deemed. However, unlike an Extractives PE, which displaces the general rule, a Services PE must still satisfy the time threshold. Consequently, the risks of relying on a Services PE compared to an Extractives PE or standalone article on fees for technical service are the following:

- The non-resident will only have a PE in the source state if it meets the time threshold, which is typically 6 months in any 12-month or, less often, 24-month period.
- It is increasingly possible for an enterprise resident in one state to provide services to an enterprise in another state without having a physical presence. This risk has been addressed by Article 12B of the UN Model, which gives the source state the right to charge a withholding tax on income from automated, digitized services provided by a non-resident.

[23] Fifty-three out of 86 tax treaties.

- The term “services” may be poorly defined in the tax treaty. Countries relying on a Services PE should provide a comprehensive definition of the term—for example, “services, including technical, management or consultancy services.”

Countries could include both a Services PE and an Extractives PE in their tax treaties. However, they must clarify that the Extractives PE takes precedence where services are provided to a resident involved in the exploration or extraction of natural resources. Otherwise, non-residents may try to argue for a Services PE on the basis that it is subject to a time threshold, which can be manipulated to avoid paying tax in the source state.

Finally, countries that choose to rely on Article 5 to tax management and technical services should adopt additional measures to help with identifying PEs. For example, South Africa requires a resident that is or will be the recipient of services to report this arrangement to the South African Revenue Service (SARS) within 45 days of reaching an agreement with a non-resident. Failure to disclose can result in a penalty of ZAR 50,000 (approximately USD 4,000) for the participant and ZAR 100,000 for the promoter each month that the failure continues, up to a maximum of 12 months. The amount of the penalties is doubled if the anticipated tax benefit achieved by the arrangement exceeds ZAR 5 million (approximately USD 35,000) and is tripled if the benefit exceeds ZAR 10 million.

3. Expand the Definition of Royalties in Article 12(3) to Include Payments for Technical Services

Article 12 gives source countries the right to charge a withholding tax on royalty payments for the use of or the right to use intellectual property, equipment, or know-how—for example, payments for the use of trademarks, trade names, copyright, or intellectual property.

Some countries have expanded the definition of royalties to also include fees for services that are ancillary to the use of property, rights, equipment, and knowledge for which royalties are owed (see the India–United States treaty in Box 16). This would cover situations where a non-resident company provides services to a mine in the resource-rich country as a means of assisting it to use equipment provided under Article 12(3)(b). The major limitation is that “technical services” is likely to be interpreted very narrowly, covering only those services that are associated with the transmission of “know-how.” Most services are unlikely to qualify, leaving the source state unable to tax the associated payments.

Box 16. Treaty practice: Inclusion of technical services in Article 12

Summary of Article 12 of India–United States (1989)

5. Definition of the term "Royalties" … covers "fees for included services," specifically, payments for the rendering of any technical or consultancy services, if such services:

a. Are ancillary and subsidiary to the right, property or information

b. Make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

Fallback Option – Article 21 (Other Income)

Countries with existing treaties that do not contain any of the three options already discussed may argue their right to tax services payments under Article 21. Three conditions must be met:

- Services income is not dealt with elsewhere in the treaty.
- The source state has the right to tax other income.
- The income has its source in the source state.

The benefits of relying on Article 21 are that:

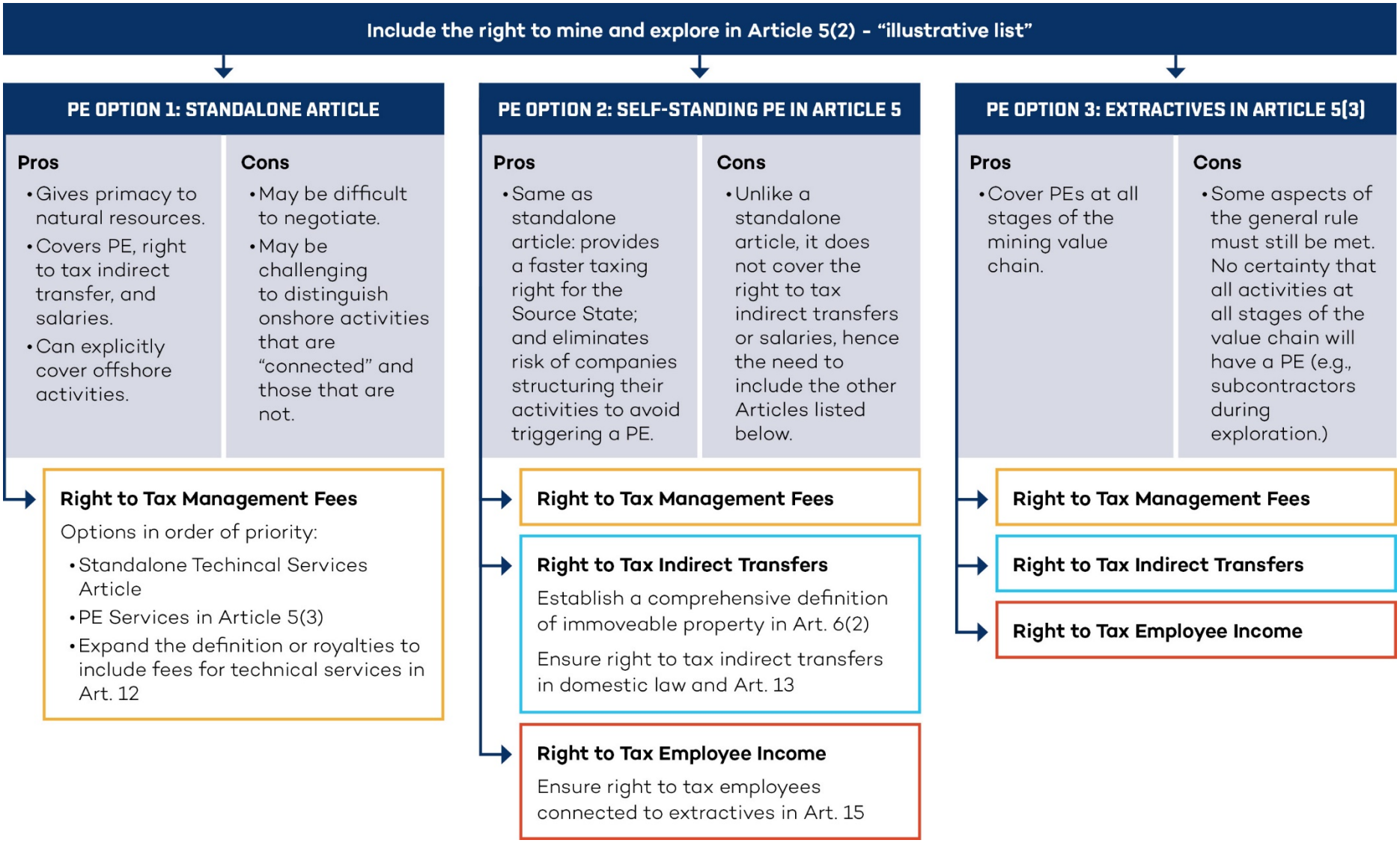
- There is no need to prove that the non-resident has a PE in the Source State.
- Other income is broader than royalties in Article 12, making it more likely the source state can tax both management and technical services.

However, there is no guarantee that management and technical services will be caught by Article 21. Quite the opposite. It is highly uncertain how "other income" may be interpreted under the treaty and domestic law. Taxpayers may argue that services income is, in fact, a "business profit" under Article 7, in which case there is no tax due in the resource-rich country unless the non-resident is found to have a PE. The outcome will depend on how services income and business profits are defined in the domestic law of both states. While some countries have been successful in relying on Article 21 to tax management fees, it is a risky option (see *Copesul v. Brazilian Tax Authority, STJ, 2012*).

Recommendations

1. Resource-rich developing countries should adopt a standalone article on fees for technical services similar to Article 12-A of the UN Model. The main advantage of this option is that source states can collect a withholding tax on income derived from technical services without the need for a PE to be triggered, reducing the risk of tax avoidance and overlaps with other articles (i.e., Articles 5 and 7) and lowering collection costs.
2. Alternatively, resource-rich countries that do not wish to adopt a standalone article or are unable to negotiate one should consider the following options:
    i. Include an Extractives PE and/or a Services PE in Article 5. An Extractives PE is preferable because it displaces the general rule, making it harder for non-residents to avoid tax in the source state. Countries could include both options but make it clear that the Extractives PE takes priority where services are provided to residents involved in the exploration and extraction of natural resources.
    ii. In addition, countries could adopt Article 12B of the UN Model, giving them the right to tax income arising from digitized services in particular. This will become increasingly important in the mines of the future.
    iii. In addition, countries could expand the definition of royalties in Article 12 to include payments for technical services. In very narrow circumstances, this provision may enable source states to tax services associated with the transfer of know-how.

Figure 6. Mapping the interaction between different approaches to PE and other treaty articles



Part Four: Recommendations

General Recommendations

1. Tax treaty negotiators in resource-rich countries should carefully analyze the costs and benefits of entering a tax treaty, including in the context of the mining sector specifically. They should also consider whether tax treaty policy objectives could be achieved through other means.
2. Tax treaty negotiators should review their tax treaty models from the perspective of the mining sector, considering the articles that are most likely to impact revenue collection.
3. Tax treaty negotiators might wish to map cross-border transactions along the mining value chain, identifying key international tax risks that can be reduced through careful tax treaty design.
4. Resource-rich countries should limit the time and scope of fiscal stabilization provisions in domestic law, as well as in mining investment agreements. In particular, the adoption of bona fide anti-avoidance measures or the interpretation of existing laws by host governments to protect the revenue base against BEPS consistent with internationally recognized tax practices should not be considered a change in law constrained by stabilization.

Establish and Retain the Right to Tax Gains From the Indirect Transfer of Mining Assets

5. Resource-rich countries should adopt a comprehensive definition of immovable property in their domestic law. See recommendations on immovable property in the previous section.
6. Resource-rich countries should establish the right to tax indirect transfers in their domestic law. Countries with limited enforcement capacity may prefer Model 1 in Table 6 (the local entity is deemed to have sold the right or asset), bearing in mind the risk of double taxation.
7. Resource-rich countries should negotiate the right to tax indirect sales, as well as an anti-abuse rule, in their tax treaties. They could also consider a lower threshold for the percentage of the value of the shares that are sold that must be derived from mining assets in the source state. They could combine this with pro rata taxation of the gain to limit the risk of double taxation.
8. In addition, resource-rich countries could consider adopting a standalone extractive industries article that includes the right to tax indirect transfers in the extractives sector specifically.

Provide an Exhaustive Definition of Immovable Property

9. Resource-rich countries should include the following items in their domestic law definition of immovable property:
    i. Any right to explore mineral deposits in the source state
    ii. Any right to an amount computed by reference to the production, including profit from or to the value of production from, mineral deposits in the source state
    iii. Specify that the resource-related asset or right is situated where the immovable property is located. This avoids any doubt that the source state's right to tax income derived from extractive activities or assets linked to immovable property is in the source state.

10. Provided their domestic law definition of immovable property is comprehensive, resource-rich countries should replicate this definition in their tax treaties. Alternatively, countries that are yet to update their domestic law definition of immovable property could negotiate a broader definition in their tax treaties, as long as it does not constrain the domestic law or void it.

Design Broad Rules on PE

11. The best option for resource-rich countries seeking to protect their right to tax all activities at all stages of the mining value chain is to adopt a standalone "Extractive Industry Article." It should cover the whole mining value chain. The definition of "contracting state" in Article 3 of the treaty should cover the seabed and its sub-soil over which the contracting state has sovereign rights.
12. Alternatively, resource-rich countries that do not wish to adopt a standalone article or are unable to negotiate one should consider the following modifications to Article 5 (in order of priority):
    i. Deem a PE to exist in the case of exploration and exploitation of non-renewable natural resources. A self-standing PE provision would not be subordinate to the general rule in Article 5(1). This provision could include a time threshold or not. Adding a time threshold is a key policy decision for each country and depends on a cost-benefit analysis. Not including a time threshold creates a faster, more reliable source taxing right; however, there may be other considerations, such as the compliance cost of monitoring more PEs, in which case, countries may prefer to apply a withholding tax on outbound payments.
    ii. Include a reference to exploration and exploitation of natural resources or resource-related structures or installations used for the exploration and exploitation of natural resources in Article 5(3). Article 5(3) does not have to follow the time threshold in the general rule, in which case resource-rich countries should consider adopting a lower threshold (e.g., 3 months or less).
13. All resource-rich countries should at least include exploration activities in the illustrative list of PEs in Article 5(2). This will make it more likely that exploration activities trigger a PE, although this still depends on the general rule in Article 5(1) being met.

Retain the Right to Tax Income from Technical and Management Services

14. Resource-rich developing countries should adopt a standalone article on fees for technical services similar to Article 12A of the UN Model. The main advantage of this option is that source states can collect a withholding tax on income derived from technical services without the need for a PE to be triggered, reducing the risk of tax avoidance and overlaps with other articles (i.e. Articles 5 and 7) and lowering collection costs.
15. Alternatively, resource-rich countries that do not wish to adopt a standalone article or are unable to negotiate one should consider the following options:
    i. Include an Extractives PE and/or Services PE in Article 5. An Extractives PE is preferable because it displaces the general rule, making it harder for non-residents to avoid tax in the source state. Countries could include both options but make it clear that the Extractives PE takes priority where services are provided to residents involved in the exploration and extraction of natural resources.

ii. In addition, countries could adopt Article 12B of the UN Model, giving them the right to tax income arising from digitized services in particular. This will become increasingly important in the mine of the future.

iii. In addition, countries could expand the definition of royalties in Article 12(3) to include payments for technical services. In very narrow circumstances, this provision may enable source states to tax services associated with the transfer of know-how.

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