AMLA

African Mining Legislation Atlas

African Mining Legislation Atlas (AMLA)

TOOLKIT FOR MINERAL TAXATION IN MINING PROJECTS

November 2024

ALSF
AFRICAN LEGAL SUPPORT FACILITY · FACILITÉ AFRICAINE DE SOUTIEN JURIDIQUE

WORLD BANK GROUP

ISLP International Senior Lawyers Project

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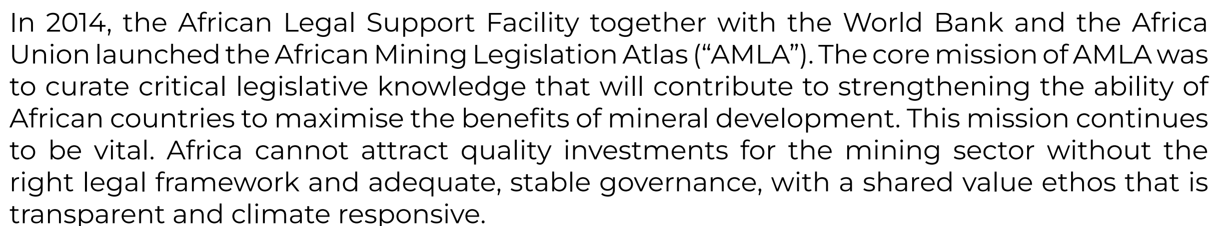
Foreword



In 2014, the African Legal Support Facility together with the World Bank and the Africa Union launched the African Mining Legislation Atlas ("AMLA"). The core mission of AMLA was to curate critical legislative knowledge that will contribute to strengthening the ability of African countries to maximise the benefits of mineral development. This mission continues to be vital. Africa cannot attract quality investments for the mining sector without the right legal framework and adequate, stable governance, with a shared value ethos that is transparent and climate responsive.

AMLA has developed useful knowledge instruments designed to bridge information gaps and build the capacity of African governments and mining professionals on critical legislative and policy issues. This includes the flagship AMLA Platform and the AMLA Guiding Template.

The AMLA Platform is a tool that African governments and legislative drafters may utilise in developing legislation, or which may serve as an educational device for parliamentarians, mining sector regulatory bodies and civil society to better understand some of the possible legal solutions or systems for regulating the mining sector. The Guiding Template represents an enhanced starting point for its users by providing a clear and practical foundation on which they can thoroughly consider topical issues supported by sample drafting language as they develop, modify, or simply assess mining legislative frameworks that fit each country's unique context. The various toolkits developed to complement the AMLA Platform and the Guiding Template provide enhanced analyses, references and practical guidance on addressing specific mining legal issues. Accordingly, this toolkit on mineral taxation is intended to consider recent developments and challenges in designing and implementing an effective mining fiscal regime and to provide practical and innovative solutions to ensure that the African countries obtain optimal benefits from the mining sector.

The development of the toolkit will also provide African countries with specific guidance on setting continental standards for maximising government revenue from mineral resources, including ways of increasing compliance and limiting loopholes enabling illicit financial outflows among others.

Consistent with the partnership approach that runs through the AMLA project, the toolkit has been developed in collaboration with the International Senior Lawyers Project, under the management oversight of the African Legal Support Facility.

We would like to sincerely thank the authors and peer reviewers (who contributed valuable time and expertise, on a pro bono basis) for their commitment to the development of this toolkit. The process of creating this toolkit benefited enormously from their experience, dedication and healthy debate.

Toolkit for Mineral Taxation

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Glossary

Abbreviations

BEPS	Base Erosion and Profit Shifting
CbC	Country-by-Country
CIT	Corporate Income Tax
CUP	Comparable Uncontrolled Price
DEMPE	Development, Enhancement, Maintenance, Protection and Exploitation of intangibles - a standard developed by the OECD as part of the BEPS project to determine whether a taxpayer is entitled to earn non-routine profits from an intangible asset
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortisation - a metric used for a variety of limitations on tax deductions
EITI	Extractive Industries Transparency Initiative
EPZ	Export Processing Zone
ETR	Effective Tax Rate
EU	European Union
EUR	Euro, the official currency of the EU
HMA	Hybrid Mismatch Arrangement
HTVI	Hard-To-Value Intangibles
IGF	Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development
IIR	Income Inclusion Rule
MDA	Mine Development Agreement
MMDA	Model Mine Development Agreement
MNE	Multinational Enterprise
OECD	Organisation for Economic Cooperation and Development
PSA	Production Sharing Agreement
QDMT	Qualified Domestic Minimum Top-up Tax
SBIE	Substance-Based Income Exclusion
SOE	State-Owned Enterprise
TPSM	Transactional Profit Split Method
USD	United States Dollar
UTPR	Under-Taxed Profits Rule
VAT	Value-Added Tax
WHT	Withholding Tax
ZRA	Zambia Revenue Authority

Definitions

Term	Definition
Amortisation	means the process of gradually writing off the initial cost of an intangible asset over its useful life, typically using a systematic and rational method
BEPS Action 4 Report	means the OECD final report on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
Bonus	means a payment made by a Mining Company to the Host Government, typically at the time of signing a contract or upon achieving a specific milestone, such as resource discovery or the commencement of production
Carryback	means the ability to apply a net operating loss, credit or other tax attribute to a previous tax period
Carryforward	means the ability to apply a net operating loss, credit or other tax attribute to a future tax period
Concession	means a legal grant by a Host Government to a Mining Company, allowing the exclusive right to explore, extract, and sell specified mineral resources within a defined area
Concession Agreement	means a formal contract between the Host Government and a Mining Company that sets out the terms and conditions under which the concession is granted, including rights, obligations, and fiscal terms
Contracting State	means a Host Country that is a party to a bilateral or multilateral agreement governing mining operations, taxation, or other related aspects
Controlled Transaction	means a transaction between two related parties
Cost Recovery	means the process by which a Mining Company recovers its exploration and development costs from revenues generated by the mining project before calculating Profits for taxation or sharing
Depletion	means an accounting method used to allocate the cost of extracting natural resources such as minerals or fossil fuels over the period of their extraction, reflecting their gradual consumption
Depreciation	means the systematic allocation of the cost of a tangible asset over its useful life, reflecting wear and tear, obsolescence, or usage
Fixed Ratio rule	means a limitation on the deduction of interest expenses for tax purposes, calculated as a fixed percentage of a company's EBITDA
Group	means companies within a corporate group structure
Group Ratio rule	means a rule that allows a company to deduct interest expenses based on the net interest-to-EBITDA ratio of its global Group, often used to address circumstances where companies have high third-party debt
Host Country	means a mineral producing country
Host Government	means the government of a Host Country
Hybrid Mismatch Arrangement	means an arrangement that is used to exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation

Definitions

Intangibles	mean non-physical assets such as intellectual property, licenses, or rights that hold value for a Mining Company and are often crucial for operations
Joint Venture	means a cooperative arrangement where the parties share the costs of and profits from mine development
License	means an official permit granted by the Host Government to a Mining Company to explore, extract, or process minerals within a designated area, typically subject to conditions and fees
Mining Company	means a company investing or operating in the mining industry in a Host Country
Mine Development Agreement	means a contractual framework for the process of exploring for and developing minerals
Permanent Establishment	means a fixed place of business through which the business of an enterprise is wholly or partly carried on within a sovereign jurisdiction
Production Sharing Agreement	means a contractual arrangement where a Mining Company invests in exploration and development and shares the resulting production profits with the Host Government, often after recovering costs
Profit	means the financial gain realised when the revenues generated from mining operations exceed the associated costs, including exploration, extraction, and processing expenses
R-Factor	means revenue divided by cost
Related Parties	means where one company controls, or is in common control with, another (either directly, indirectly, through the holding of shares, through the possession of voting rights or via some other means)
Ring-Fencing	means the concept by which taxable income or loss of a certain industry (e.g., mining) is calculated and imposed separately from other businesses of the taxpayer
Royalty	means a payment made by the Mining Company to the Host Government, calculated as a percentage of revenue or production value, as compensation for the extraction of natural resources
Service Contract	means an agreement in which the Host Government hires a service company to perform its mining operations
Special Purpose Entity	means a business entity formed to hold mining rights, allowing its owners to jointly develop the mining project and share risks and returned through the corporate form, sometimes called a special purpose vehicle
State Owned Enterprise	means a company that is wholly or partially owned by the State
Transfer Pricing	refers to the means of establishing an appropriate price for tax purposes (an arm's length amount) where transactions are entered into between related parties
Uncontrolled Transaction	means a transaction between independent parties

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1. Overview of Mining Project Structures

Both Host Governments and Mining Companies can use different legal, regulatory and commercial tools to structure successful mining projects. These structures balance risk allocation and economic returns in different ways, which determine the effect of taxes on the mining projects. The key mining project structures include:

- Service Contracts
- Licenses and Concessions
- Joint Ventures
- Production Sharing
- Mine Development Agreements

1.1. Service Contract

Summary: State retains ownership of the resource. Company provides services to the State in return for a payment, often a cost-plus arrangement.

1.1.1. A Service Contract, which may also be referred to as "work contract" or "operations agreement," refers to an agreement in which the Host Government hires a service company to perform its mining operations.[1] These types of agreements were common in the post-colonial era as newly independent countries nationalised industries like mining, which were previously dominated by other foreign states or companies.[2]

1.1.2. A distinctive feature of the Service Contract is that the title to the mineral ore remains with the Host Government until it is extracted.[3] A Service Contract implies a different relationship between the Host Government and the Mining Company than would be found in a Concession Agreement.[4] The Mining Company is considered as a contractor or service provider for the Host Government.[5] These arrangements were common in energy industry projects, where the service provider would provide the technical know-how and services as the general contractor.

1. *Natural Resources Contracts as a Tool for Managing the Mining Sector, Federal Ministry for Economic Cooperation and Development, at p. 17 (Service Agreement).*
2. *Id.*
3. *See* Smith, David Nathan and Wells, Louis T., *Mineral agreement in developing countries: Structures and substance, AMERICAN JOURNAL OF INTERNATIONAL LAW, vol. 69, pp. 560-590 (1975).*
4.See discussion *infra* at Section 1.2
5. *Id.* at 585.

1.1.3. The Mining Company may be paid for its services in cash or in-kind.[6] The payment could be based on a fixed fee (for example, quarterly or annually); however, the Mining Company may receive reimbursement for actual costs, plus a payment based on profits.[7]

1.1.4. Most Service Contracts require the Mining Company to bear the risk of exploration. The Host Government may agree that a certain amount of the production profits could be used to cover initial development expenses.[8]

For example, the 2015 Service Agreement between the Democratic Republic of Congo and the CNRMEDEA SA (a Mining Company), it provides that "*The parties agree that all costs inherent in the activities and works to be carried out under this Agreement shall be borne exclusively by CNRMEDEA SA and in the event that the Agreement …is concluded between the parties, the said costs shall be recoverable with the mining of the gold.*" [9]

1.1.5. With regard to tax provisions in Service Contracts, there are a number of technical issues that may be addressed in the negotiation of equity sharing arrangements between the Host Government and the Mining Company. These arrangements defer to the Host Government's specific laws for the tax framework. Often, the Host Government recognises that the financial benefit to itself and the area surrounding the project will result primarily from the effective collection of taxes due to it in accordance with the relevant legislation.[10] The Host Government, however, may use its discretion to allow certain tax incentives or exemptions than applicable by law (i.e. tax credits and allowances).[11]

1.1.6 One related example is the petroleum service contract for oil in South Lake Maracaibo between Corporacion Venezuela de Petroleo and Shell Oil Company, in which the financing was to be provided by Shell as the contractor.[12] Under the terms the contract, Shell would retain 90% of the oil with the remainder going to the SOE. [13] In addition, Shell would pay the Venezuelan government a Royalty of 16% and an income tax of 60% based on an agreed upon price.[14] Then, the SOE would receive 5% of the Royalty going to the Venezuelan government as well as a certain portion of Shell's after-tax Profit.[15] As shown, a Host Government can be creative in setting up appropriate tax incentive structures in service contracts, and therefore the actual terms may differ.

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6. See Smith, David Nathan and Wells, Louis T., Mineral agreement in developing countries: Structures and substance, AMERICAN JOURNAL OF INTERNATIONAL LAW at p. 585.
7.Id.
8. For mining example, *see* Confidential Service Agreement between the Government of the Democratic Republic of Congo, Sokimo S.A., and CNRMEDEA (DRC) SA, dated April 29, 2015 (regarding services for the mining of gold).
9. Id. at Section 5.2 (emphasis added)
10. See generally Service Delegation Contract between the DEA Democratic Republic of Province du Lualaba & The Sud South Company S.A.R.L. (October 2021).
11. Bostock, Mark and Harvey, Charles, *Economic Independence and Zambian Copper*, NATURAL RESOURCES JOURNAL, vol 13, Issue 2 (Spring 1973).
12. See Smith, David Nathan and Wells, Louis T., Mineral agreement in developing countries: Structures and substance, AMERICAN JOURNAL OF INTERNATIONAL LAW at p. 586.
13. Id.
14. Id.
15. Id.

1.2. License/Concession

Summary: A License or Concession is a grant by a Host Government to a Mining Company of the exclusive right to develop specified mineral resources in return for a Royalty. The terms of the Concession or License may also include a bonus payment upon award of the Concession or License.

1.2.1. A company that wants to undertake mining activities needs to hold a mineral right, which may be granted either by a contract or by License.

1.2.2. In contract regimes, Host Governments negotiate the terms of the mineral rights for specific projects with each individual Mining Company,[16] which is then captured in a License, or a Concession Agreement signed between the Mining Company and the Host Government. The Concession Agreement is the earliest form of monetisation contract entered into between a mineral rights owner (which is typically the Host Government) and a Mining Company, whereby the Host Government "concedes" rights to national assets. The main right granted under Licenses or Concessions is the exclusive mineral right over a certain mineral, within a defined area, including the right to explore and to exploit and commercialise such mineral.

1.2.3. Under licensing regimes, the process of granting mineral Licenses and all the accompanying rights and obligations in enshrined in legislation. Some commentators believe that Host Governments should move away from mining contracts,[17] others point out that nations with a less developed mining framework tend to rely more on contracts to fill the gaps in the law. Some systems may include a mix of law-based or contract-based mineral rights.[18]

1.2.4. A License or a Concession provides its holder with the exclusive mining right over certain minerals in a defined area, to undertake mining activities in exchange of compensation. Such License or Concession can grant both exploration and exploitation rights; or an exploration right, with an exclusive right to apply for an exploitation license. The License or Concession will have a term which may be extended upon compliance with certain exploration or exploitation parameters. Note that the term Concession has also been used in a broader sense to include Mine Development Agreements. We address Mine Development Agreements separately in section 1.5.

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16. Id. at p. 7. Introduction.
17. See paragraph [...] Mine Development Agreements Section 1.5.
18. Id. at p. 15 to 16. See also "The Law and Governance of Mining and Minerals. A Global Perspective, Ana Elizabeth Bastida, Chapter 5, Contractual Regimes p. 156 ("Most usually countries using mining agreements rely on hybrid of mining laws granting title to conduct exploration, exploitation and ancillary activities, and agreements fixing terms and conditions for large-scale, industrial mining.")

1.2.5. **A key obligation of the Mining Company is the payment of a Royalty to the Host Government and an additional rent or fee, in addition to other rights and obligations. The latest publicly available Licences entered into by the Republic of Ghana[19] cover other additional provisions such as: third party rights to mine a different mineral; the right of the Host Government to exclude certain areas from the license; the working thresholds the Mining Company needs to comply with in order to maintain the license; rights and obligations regarding new discoveries; compliance with environmental standards; knowledge sharing; production of financial records and sharing of technical and geological records; and how to extend the respective License or Concession or surrender the license areas.**

1.2.6. With respect to taxation, the Concession Agreement usually addresses the amount of the Royalty but defers to the Host Government's laws for the specific tax framework. The Ghana Lease agreement includes a Royalty as prescribed by legislation, regulates a certain tax withholding exception as authorised by the Ghana Minerals and Mining Act, 2006 and, save for such exception, establishes that the Mining Company will pay taxes in accordance with the laws of Ghana.[20]

1.2.7. Other forms of mining agreement, even when they recognise that the Host Government's tax regime applies, provide for a more comprehensive tax framework, either by supplementing the tax regime where the Host Government has a sophisticated mining legal system or supplanting the local tax regime where the mining legal system is less developed.

1.3. Joint Ventures

Summary: A Joint Venture ("JV") is a cooperative arrangement where the parties share the costs of and profits from mine development. The JV parties may include a State-Owned Enterprise ("SOE"). The JV can be a contractual arrangement or set up through a company – a "Special Purpose Entity" – held by the JV partners (being the Host Government, the Mining Company and investors in the project). The Special Purpose Entity is often a flow-through entity to allow the JV partners manage their own tax position.

1.3.1. Mining projects require considerable capital for their funding and operation. With public capital markets being relatively difficult to access for Mining Companies, particularly junior mining companies[21], JV are an attractive solution. Advantages of entering into a JV include:

- sharing costs in capital-intensive projects;
- sharing risks in speculative projects;
- gaining access to a partner's technology;
- saving money by sharing research and development expenditure and production costs; and
- taking advantage of new geographic or technical markets.

19. See Mining Lease Agreement between the Government of the Republic of Ghana and Adamus Resources Limited dated April 30, 2019; Mining Lease Agreement between the Government of the Republic of Ghana and Central Ashanti Gold Limited dated December 31, 2019.
20. See Mining Lease Agreement between the Government of the Republic of Ghana and Central Ashanti Gold Limited dated December 31, 2019.
21. See pwc Mine 2023: 20th edition. The era of reinvention

1.3.2. Host Governments may also partner with Mining Companies to have strategic operational stakes on projects in key jurisdictions and access to specific commodities. Examples include:

- the agreement between the United Arab Emirates and the SOE of the Democratic Republic of Congo to develop four mines with Concessions for tin, tantalum, tungsten and gold;[22] and
- the announcement of the Saudi Public Investment Fund to partner with mining companies in Namibia, Guinea and the Democratic Republic of Congo in order to secure critical minerals [23].

1.3.3. The parties to a JV will depend on the size and scope of the project. In early-stage exploration, JV may comprise a junior Mining Company and specialist investor. For the larger projects, the major Mining Companies may partner with international investors, large commercial operators or SOEs. In some jurisdictions, domestic mining law prescribes that the Host Government or an SOE must be given a minority participation in any mining project. **Most recently Mali's government has announced changes to its mining laws that could see its ownership in new projects to 35% in order to share in Profits[24].**

1.3.4. Having established their commercial objectives, JV partners must consider which legal structure is most appropriate to enable them effectively meet their objectives. The chosen structure will be determined by a variety of commercial, legal, tax, regulatory and accounting considerations. These structures include:

- contractual JVs;
- risk and revenue sharing arrangements;
- strategic alliances; and
- JV companies.

1.3.5. Risk and revenue sharing arrangements are an appropriate structure where substantial development expenditure is required. A minority party agrees to make a contribution to the cost of developing the project and the principal party remains responsible for the overall operation. Revenues are then shared after production in agreed proportions.

1.3.6. With strategic alliances, each party takes a small equity shareholding in the other as an expression of mutual interest and to provide a background against which specific business opportunities are discussed and agreed going forward.

1.3.7. Unincorporated and contractual JVs are commonly used for early-stage exploration projects. An unincorporated JV allows greater tax efficiency, as expenditure will be incurred directly by the JV partners rather than through a separate legal entity; privacy, as there is no requirement to file separate accounts with any regulatory authority; and a fewer formalities or expenses in constituting the JV. Due diligence on local law will be required to ensure that issues such as sanctions, government powers and dispute resolution processes would not fetter the success of the project.

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22. Mining Technology article «UAE signs $1.9bn mining deal with the Democratic Republic of Congo»
23. Center for strategic international studies article «Saudi Arabia has a strategic advantage in sourcing critical minerals from Africa»
24. Reuters article «Exclusive: New Mali mining law could boost state, local interest in projects to 35%»

1.3.8. Through the production phase, parties often prefer a JV to be set up as a limited company to ensure that assets and Licences are owned under a corporate structure. Advantages of a JV company include:

- limitation of liability for the JV partners;
- separate legal identity for contracting with third parties;
- owning and holding assets in its own name, giving it the ability to grant security to funders, enabling finance to be raised without recourse to shareholders;
- the share structure of a company can often provide flexibility for investors. For instance, a company can issue preference shares, allowing investors to obtain a priority return on their investments without having any management control over the company. Preference shareholders can be given the right to convert their preference shares into equity shares; and
- a clear structure for internal management, employment, accounting and reporting.

1.3.9. A wide variety of financing options are available for a corporate JVs including:

- subscription for ordinary equity shares (the most common method);
- loan capital, either from funders or the JV partners;
- third parties through methods such as preference share capital, or loan stock convertible into shares;
- consideration for the initial share capital is typically cash, however, there may also be non-cash consideration, such as the transfer of assets to the JV company by the JV partners, or an agreement to provide services and know-how.

1.3.10. The management rights and responsibilities of the JV partners need to be established. Such rights and responsibilities need not necessarily be equal. For example, one party may be given greater rights of management in respect of technical appointments or decisions. One party may be given full day-to-day responsibility through a management agreement with the JV company. It would be typical for major shareholders to have the right to appoint one or more directors to sit on the board of the JV company, to maintain control. JV partners also consider veto rights on strategic matters in management and operation. Governance rules require minimum notice periods for board meetings and the particular location of such meetings, as well as stipulated periods between those meetings.

1.3.11. Where there is disagreement on matters which have been identified as needing unanimous agreement, deadlock provisions must be set out clearly. It is not only in the case of 50:50 splits that a deadlock can arise. The same situation can occur at board level when a minority shareholder exercises its right of veto or even at shareholder level in relation to matters referred to the parent companies by the board pursuant to either the shareholders agreement or the articles of association of the JV company. If a deadlock arises and agreement cannot be reached, the JV company may choose to continue with the business of the JV in an agreed fashion or terminate the arrangement.

A practical solution to deadlock is to refer to the board of the parent shareholders for sensible negotiation. Deadlock at board level may be unlocked by giving the chair a casting vote. A majority shareholder can control the board in this manner and this solution is not likely to work in a 50:50 deadlock. An alternative is a casting vote given to an agreed independent third party. This will be dependent on choosing a suitable third party that is agreeable to both parties.

If the parties cannot resolve the deadlock and termination is the only realistic prospect, then appropriate termination provisions are essential to ensure a suitable commercial result. One option is to let the dissenting party exit the project by permitting it to transfer its shares to a new approved party, which would allow the project to continue.

Alternatively, the parties may pre-agree to a forced sale of shares in the event of such dissent. If neither of these options work the parties may have to consider termination and liquidation of the joint venture.

1.3.12. Depending on the jurisdiction of the project, JV partners will have to consider which governing law will apply to the JV; which courts should have jurisdiction; and whether arbitration would be appropriate for any dispute. Although this may not be a key consideration in set-up phase, it is critical to set out the agreed parameters of any dispute procedure to avoid pitfalls in the event of disagreement.

1.4. Production Sharing

Summary : A Production Sharing Agreement ("PSA") (or production sharing contract) is a form of mining agreement in which a Mining Company provides capital investment in exploration, drilling and construction of infrastructure for a state-owned mining project. In return, the Mining Company receives a share of the Profits from the project. The percentage of Profits allocated to the Mining Company is adjusted over time to reflect the return on capital and the recovery of the mine investment. Taxes are typically paid on the net Profits allocated to the Mining Company.

A Production Sharing Agreement ("PSA") (or production sharing contract) is a form of mining agreement in which a Mining Company provides capital investment in exploration, drilling and construction of infrastructure for a state-owned mining project. A PSA involves several parties including the Host Government, contracting party (the Mining Company), and its affiliates or subcontractors, depending on the size and nature of a mining project. Sometimes, the Host Government may opt to operate the mining project itself – perhaps after discovery is made and mineral reserves are quantified. For ease of explanation, this section will focus on PSAs between a Host Government and a single Mining Company, where the Host Government does not serve in any operational capacity.

1.4.1. A PSA enables a Host Government to retain ownership over and draw Profit from mineral resources while avoiding taking on the significant capital risk required to develop those resources without ensured success.[25] By contracting out services to a domestic or foreign Mining Company, the Host Government opens a path to capitalise on valuable resources without taking on significant financial burdens or giving up ownership in the mineral resources. The Host Government also retains some control over how the work is performed, through contract terms or by offering its own domestic companies for service on the mine. Of course, the Mining Company must be willing to incur the financial risk of developing a mining project without ownership in the mine and related assets. Today, PSAs are more common in the petroleum sector than in the mining sector, however, the structure of petroleum PSAs mirror that of mining PSAs in the basic form.

25. Twenty-Fourth Meeting of the IMF Committee on Balance of Payment Statistics: Production Sharing Agreements, Central Bank of Russia (2011).

1.4.2. Basic PSA Structure

1.4.2.1. In a typical PSA, the Host Government and the Mining Company will specify an area and period for prospecting, exploring, and extracting minerals from the state-owned land. Then, once parties agree, the Mining Company will pay a Bonus to the Host Government for the right to operate in that area. There may be another Bonus imposed when minerals are discovered. The Mining Company will market and sell minerals produced at the site. At the point of actual mineral production, the Host Government takes a Royalty from the sales. A Host Government may impose an additional Bonus at some production milestone, often tied to a tonnage amount. After Royalties are paid out, the gross revenue received from the Mining Company's sale of minerals is allocated to Cost Recovery and Profit. The Cost Recovery amount will cover costs incurred by the Mining Company and can range in its coverage of expenses.[27] Cost Recovery is an important point of negotiation between Host Government and Mining Company, since it assures the Mining Company that its expenses will be paid. A riskier mining project will often yield a Cost Recovery with greater coverage for the Mining Company, especially considering the Mining Company will not receive any Cost Recovery unless there are minerals produced from the project.

1.4.2.2. After the Mining Company takes its Cost Recovery amount, the remainder is Profit. This is the point where the Host Government incurs Profit from production.The Profit is split between the Host Government and Mining Company at an agreed proportion. The Host Government may also impose a tax on the Mining Company's Profit share. This Profit tax is the lion-share tax imposed under PSAs. Other taxes on Mining Company's revenue include export and import taxes. Typically, a Host Government will not impose export duties in relation to PSAs; however, the Host Government will impose import duties, particularly on goods or services imported that are already for purchase available within the Host Country.[28] Import duties are discussed in greater length in Section 3.2.

Due to the complexity and uncertainty involved in a typical mining project, flexible Profit share arrangements are important to balance protecting the Host Government's revenue while still attracting vital capital investment. Thus, a sliding scale for Profit share affords a Host Government and the Mining Company protection against unknown factors. As mineral production increases, the sliding scale tips in the Host Government's favour and the Mining Company receives a progressively smaller share of Profit. That is, the greater the production from a mine, the greater the Profit share allocated to the Host Government. At times, the Host Government will fix the production Royalty rather than use a sliding Royalty, to create more certainty for investors concerned with a sliding Profit-sharing scale.[26]

1.4.2.3. An R-factor can help guide the sliding scale. **Dividing revenue by cost yields the R-factor.**The R-factor will increase as production increases and revenues grow relative to costs. Thus, PSAs balance revenue sharing between costs and profitability.[27]

26. Yassine et al.
27. Energy Law Practice.

1.4.2.4. Typically, the Mining Company's cost revenue will not be sliding, because it is a function of costs not gross revenue. However, the calculation will incorporate the numerous complexities and factors discussed above, to ensure that the Host Government is not overpaying for costs, but the Mining Company is still recovering its expenses. Taxes and production Bonuses are also less likely to be on a sliding scale in PSAs.[28]

1.4.2.5. Other obligations imposed by the Host Government may include local content and domestic market obligations. Local content obligations require the Mining Company to use local goods, services, or employees for the mining project.[29] Domestic market obligations include requiring a percentage of minerals produced by the Mining Company be sold to the Host Government at a discounted price or an agreed international market rate.[30] Domestic market obligations can be used in combination with Royalties or Profit taxes and essentially become a different form of taxing the Mining Company.

1.4.3. Points of Negotiation

1.4.3.1. The Host Government will negotiate the PSA based on its financial goals. For example, it can ensure a revenue stream by demanding a high signing Bonus and Royalty percentage, or demand a higher Profit share under the Profit allocation. The Profit share and Cost Recovery negotiations usually depend on a number of economic and risk factors present at the outset of the agreement. For example:

- the size of the mining field;
- whether there is a known or unknown mineral reserve;
- availability of information related to the geology;
- uncertainty of mineral pricing; and
- risky economic or political environments.[31]

1.4.3.2. The production period is another key point of negotiation. A Host Government may offer a longer production period when there is an unknown reserve presenting a longer opportunity for the Mining Company to reach a profitable production level. Conversely, if a Host Government has proven mineral reserves, it may offer a shorter production period since the Mining Company can reach profitability quicker without roadblocks of expensive exploration and unknown levels of production.[32]

1.4.3.3. Another tool to attract investment in PSAs is by offering a Cost Recovery multiplier, which provides a small cushion on costs to a Mining Company. For instance, a Host Government may allow for a 10% increase of Cost Recovery which creates an added benefit to the Mining Company.[33] Of course, the Cost Recovery itself hinges on the Mining Company producing minerals which incentivises it to actually reach production.

1.4.3.4. Thus, under a PSA, the Host Government can net any combination of Bonuses, Royalties, Profits, taxes and import duties – with added benefits of domestic market obligations and local content obligations. All while the Host Government retains its ownership over the land and related mineral rights.

28. Yassine et al.
29. Yassine et al.
30. Energy Law Practice.
31. Yassine et al.
32. How to Scrutinize a Production Sharing Agreement
33. Yassine et al.

1.5. Mine Development Agreements

Summary: A Mine Development Agreement ("MDA") provides a contractual framework for the process of exploring for and developing minerals. The actual grant of the right to minerals usually occurs under a separate instrument, such as a License or Concession. The MDA includes important commitments and financial provisions that affect the costs incurred by the Mining Company as well as Royalty and Bonus payment obligations and financial returns. The MDA may include exemptions from import and export duties, tax stabilisation or tax holiday provisions, and other terms relevant to the determination of the tax position of the Mining Company.

1.5.1. Many countries use MDAs as an element of their legal regime for the development of minerals. An MDA does not grant the right to mine, that right comes in the form of a License or Concession. The Mining Company that holds the right to mine will negotiate and execute the MDA with the Host Government to determine a clear and equitable basis for the project.

The MDA is a hybrid between a permit to mine (because it will contain some permissions and authorisations for mine development) and a development agreement (because it will include financial provisions and development milestones or benchmarks). The MDA does not typically provide all the permissions required for the mining project, and the Mining Company may need to secure additional permits for specific activities. The MDA sometimes provides a list or schedule of additional permits required as part of the mine development process.

1.5.2. The MDA will include provisions related to key elements of mine development, such as access rights for mine development, rental and Royalty provisions, a structure to facilitate financing of mine operations, a framework for community engagement and community development agreements, dispute resolution provisions, local content requirements, and similar provisions.[34]

1.5.3. Some commentators and policy makers believe that Host Governments should move away from using mining contracts such as MDAs, moving instead "toward investment based on clear legal codes: mining codes, tax codes, environmental laws and other generally applicable legal dispositions that apply equally to all that come."[35] Nonetheless, MDAs remain common, and indeed are being adopted in addition to or in lieu of mining codes.[36]

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34. Id. See also International Bar Association, Model Mine Development Agreement (2011) (MMDA).
35. Carlos Vilhena, Michael J. Bourassa, Luke Danielson, Peter S. G. Leon, The International Bar Association's Model Mining Development Agreement Project, Rocky Mountain Mineral Law Foundation International Mining and Oil & Gas Law, Development, and Investment Paper 9 (2011).
36. Id.

1.5.4. MDAs were a key element of a restructuring and privatizing mining in Zambia after the rise of the Movement for Multiparty Democracy in 1991.[37] These agreements included preferred tax rates as well as tax stability clauses.[38] When copper prices increased, there was a backlash against these agreements[39], and they were ultimately terminated in 2010 to allow the imposition of new higher taxes including a windfall tax. When copper prices fell again, the windfall tax was rescinded.[40]

1.5.5. The International Bar Association published a Model Mine Development Agreement ("MMDA") in 2011. The MMDA provides an outline of the key provisions in an MDA, and examples of clauses from existing MDAs as a template or guide for the negotiation of an agreement.[41] The MMDA provides a useful outline of standard approaches to taxation and other fiscal elements of and MDA.[42]

1.5.6. On taxation, the MMDA recognises that the tax code of the Host Government sets the framework for the tax provisions of an MDA. The representative tax provisions in the MMDA are available only to the extent consistent with the tax code, or as approved by legislation. Some countries require parliamentary approval of MDAs (as well as Concessions and other granting instruments). That approval process may allow more flexibility in designing the tax provisions of an MDA.

1.5.7. Article 7 of the MMDA sets out the potential tax provisions of an MDA. The MMDA acknowledges that the Mining Company is subject to the fiscal policies and legislation of the Host Country, except as otherwise provided in the MDA.[43]

1.5.8. The MMDA anticipates that the Mining Company will negotiate a cap on its income tax rate. Article 7.2(a) of the MMDA provides that the rate applicable to the Mining Company will be the lesser of the applicable tax rate and a percentage to be negotiated between the Mining Company and the Host Government. The income tax provision of the MMDA also assures that income tax is limited to income generated in the Host Country and restricts the ability of the Host Government to impose income tax on entities elsewhere in the Mining Company's corporate structure.[44]

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37. Sangwani Patrick Ng'ambi, Contractual Protections Against the Resource Nationalism Cycle in Zambia, 4 Cardozo Int'l & Comp. L. Rev. 829, 841 (2021).
38. Id., citing Mufulira Mine, Smelter and Refinery and Nkana Mines, Concentrator and Cobalt Plant Development Agreement, https://www.resourcecontracts.org/contract/ocds-591adf-0639959550/view#.
39. Id. at 844.
40. Id.
41. Peter S. G. Leon, The International Bar Association's Model Mining Development Agreement Project, International Mining and Oil & Gas Law, Development, and Investment, 2011 NO. 3 RMMLF-INST PAPER NO. 9B (2011)
42. MMDA Art. 7
43. MMDA 7.1(c)
44. MMDA 7.2

1.5.9. The MMDA also sets out a set of deductions from income tax that are related to the costs of developing and operating a mine. The deductions include:

- Royalties and taxes paid by the Mining Company under the MDA, including payments to local communities;
- exploration costs;
- mine design development and construction;
- mine operations;
- smelting, processing and marketing;
- mine reclamation and rehabilitation;
- interest on loans;
- depreciation of equipment, plants, and other capital expenses, with the right to carry forward any related losses.

1.5.10. The MMDA also includes a provision protecting the Mining Company from increases in local taxes inconsistent with the MDA,[45] as well as a general prohibition against imposing taxes not contemplated by the MDA.[46]

1.5.11. Article 5 of the MMDA addresses customs and import duties. Under the MMDA, "the supplies, goods, materials, fuel, machinery, equipment and consumer goods necessary to properly carry out the project" are free of any customs charges, and any other import duties are reimbursable.[47] The Mining Company may pay a fee to cover the cost of governmental inspection of materials being imported.[48] The export of minerals and related products is equally free from export duties.[49] The MMDA also excludes the Mining Company from any Value-Added Tax ("VAT").[50]

1.5.12. The government of Malawi entered into an MDA with Globe Metals and Mining (Africa) Limited for the Kanyika Niobium project in March 2023.[51] The Kanyika niobium MDA in Malawi adopts some but not all of the taxation approaches set out in the MMDA. It references the Malawi Taxation Act in many provisions, rather than including a provision specific to the MDA. Items such as resource rent, ring fencing, deductible costs and indebtedness, and withholding tax are all governed by the Malawi Taxation Act. Ring-fencing of mining projects was added to the Taxation Act through an amendment in 2016.[52]

1.5.13. The tax rate applicable to companies engaged in mining operations is 30% of taxable income, with an additional tax of 5% of taxable income charged to companies not incorporated in Malawi. Resource rents are an additional 10% of Profits after tax if the Mining Company's rate of return exceeds 20% (see Schedule 11of the Malawi Taxation Act). In addition to other deductions, the Mining Company can treat payment to a mine closure fund as deductions from income, but when those funds are paid out, the distributions are treated as income.[53]

45. MMDA 7.10
46. MMDA 7.9
47. MMDA Art 5.
48. MMDA 5.1.
49. MMDA 5.1(c)
50. MMDA 7.4
51. https://resourcecontracts.org/contract/ocds-591adf-4540340150/view#/pdf.
52. Malawi Revenue Authority, "New Tax Measures for 2016/17 Gazetted (October 7, 2016) (https://www.mra.mw/press-releases/new-tax-measures-for-201617-gazetted)
53. Kanyika MDA 21.4

1.5.14. The Kanyika MDA includes stabilisation based on the current tax law. The stability term is ten years, and the Mining Company can determine when that ten-year period starts.[54]

1.5.15. The Malawi Revenue Authority also provided incentives related to customs, duties, and VAT: "Duty free and VAT free on importation of specialised goods for use in mining, such as machinery plant and exploration equipment." [55] There is no time limit on the exemption from import duties.[56]

54. Kanyika MDA 21.10
55. Malawi Revenue Authority, Malawi Tax Incentives at 9 (June 2022)
56. Kanyika MDA 21.9

African Mining Legislation Atlas (AMLA)

2. Key Taxation Issues

2.1. Income Tax Base

The scope of income tax on a mining project is directly dependent on the structure of the project, summarised in the table 2.1, which identifies the key tax issues associated with different modes of structuring a mining project (there are often overlaps between the various structures):

Form of Mining Project	Resource Ownership	Income Tax Base	Key Income Tax Issues
Service Contract	Host Government	Net profit attributable to performance of services often in the form of a cost-plus return on in-country and potentially offshore services	• Withholding taxes • Transfer Pricing
Licenses and Concessions	Mining Company (during term)	Net Profit from resource extraction (net of Royalty payment to Host Government)	• Capital allowances • Transfer Pricing • Interest Withholding taxes
Production Sharing Agreement	Host Government	Net profit from resource extraction	• Capital allowances • Transfer Pricing • Interest Withholding taxes
Joint venture	Host Government and Mining Company	Net Profit attributable to Mining Company's ownership of JV (depending on form of JV)	• Capital allowances • Interest expense • Withholding taxes
Mine Development Agreements	Host Government (but can vary by contract)	Net Profit from resource extraction/exploitation	• Capital allowances • Transfer Pricing • Interest Withholding taxes

As can be seen from the above table, the tax position of the Mining Company will vary depending on the nature of the project. For example, Transfer Pricing issues (further discussed below) are less pronounced in a JV compared to Licenses, Concessions and PSAs because the Host Government in the JV can act as a third-party buffer to ensure that transactions between the JV entity and the Mining Company are at arm's length.[57]

An important issue impacting the income tax base of a mining project is "Ring-Fencing". Due to the unique nature of the mining industry, in some countries a Mining Company's Profits from its mining projects are Ring-Fenced and taxed separately from its other activities. Host Governments use Ring-Fencing as a means to prevent tax losses from the early stages of a mining project by stopping the Mining Company from offsetting its non-mining Profits other activities in the country. Some countries apply Ring-Fencing on a project-by-project basis to tax each mining project separately, thereby preventing losses from one project from offsetting the Profits of another project.

2.2. Income Tax Rates

The income tax rate applicable to a Mining Company will often be the Corporate Income Tax ("CIT") rate in the relevant country. CIT is applied to the net Profits from the project taking into account available deductions and allowances.

The average CIT rate in Africa is around 27%.[58] In some countries, the income tax rate applicable to a Mining Company will differ from the CIT rate applicable to general business or industry. Alternatively, some countries impose additional mining, windfall or excess Profits taxes on Mining Companies either as a supplement to the general CIT or as an alternative tax regime. These separate or supplemental taxes are designed to account for some of the unique features of the mining industry.

2.3. Withholding Tax

There are numerous outbound flows from a mining project. These include interest incurred on financing the project, royalties for access technology and other intellectual property, fees for services including technical services, and dividends or other repatriations of net Profit.

Withholding taxes are a means of collecting income tax on outbound flows. An outbound flow is subject to withholding tax if it has its "source" in the Host Country. Sourcing rules generally depend on the type of outbound flow. For example, interest is sourced by reference to the location of the borrower. If the borrower is tax resident in a country, an interest payment by that borrower to an offshore lender will be subject to withholding tax.

A royalty is sourced by reference to where the intellectual property is used. For example, if a resident Mining Company is using proprietary exploration technology for a local mining project that is licensed by an offshore party, that royalty would be subject to withholding tax.

Services are sourced at the place of performance of those services. If services are performed in the Host Country, withholding tax could apply to a payment for such services. Some countries take the position that services performed outside the country are subject to withholding tax if the beneficiary of the services is in the Host Country.

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57. Whether a Related Party payment is arm's length is only one issue arising in connection with outbound Related Party payments. Countries may provide additional restrictions on Related Party payments even if those payments are determined to be arm's length.
58. Corporate Tax Rates by Country | Corporate Tax Trends | Tax Foundation

Most countries have statutory withholding tax rates for outbound flows. Income tax treaties can reduce or eliminate withholding taxes on dividends, interest and royalties.

Income tax treaties may restrict withholding taxes on service fees unless the service provider has a taxable nexus (a "Permanent Establishment") in the Host Country. Increasingly, income tax treaties with certain (usually developing) countries have expanded the application of withholding taxes to include "fees for included services" in the definition of a royalty subject to withholding.[59] This is intended to capture and subject to withholding tax technical services that are adjacent to the intellectual property being licensed.

2.4. Capital Allowances

2.4.1. Capital allowances encourage capital investment.[60] Mining projects are heavily capital intensive and tax allowances for capital expenditures enable an investor to spread the cost of capital expenditures over the life of the asset. Capital allowances take the form of Depreciation, Depletion and Amortisation. In addition, countries often allow an immediate deduction of up to 100% of certain capital expenditures to further encourage capital investment.

2.4.2. The amount of a capital allowance generally depends on two factors:

Useful Life: The useful life of the capital asset determines the period in which Depreciation and Amortisation can be taken. Useful lives can be prescribed by reference to asset type, industry or some other measure.

Method: Once the useful life of the capital asset is determined, it is depreciated or amortised over the life of that asset based on a Depreciation or Amortisation method. The two most common methods are the straight-line method and the accelerated depreciation method.

2.4.3. Under the straight-line method , the asset is depreciated on an annual basis over the life of the asset. For example, a mining drill valued at US$10 million (net of residual value) with a useful life of five years would be depreciated on a straight-line basis at US$2 million per year.

Straight-Line Depreciation = (Purchase Price – Salvage Value) / Useful Life
where:

- Purchase Price: The total cost of the asset, including any capital expenditures
- Salvage Value: The estimated value of the asset at the end of its useful life
- Useful Life: The number of years the asset is expected to be useful

2.4.4. Accelerated depreciation enables the taxpayer to claim some multiple of straight-line depreciation (for example 150% or 200% of straight-line depreciation). This has the effect of front-loading the depreciation deductions to the earlier years of the project, thus further encouraging capital investment.

59. See Article 12A of the UN Model Treaty. UN Model_2021.pdf
60. It is worth noting that a substantial portion of capital investment occurs well before a project generates revenue. As a result, capital allowances are inextricably linked with other tax issues included interest expense limitations and net operating loss carryforwards.

2.5. Interest Expense Limitations

2.5.1. Background

The use of interest expense to achieve excessive deductions has been a widespread issue, and has led to the introduction of a set of rules designed to limit the amount of interest that may be deducted for tax purposes. On 19 July, 2013 the Organisation for Economic Cooperation and Development ("OECD") released an Action Plan on Base Erosion and Profit Shifting ("BEPS"). As discussed further in section 4 below, Action 4 of the BEPS Action Plan called for recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense to achieve excessive interest deductions. On 5 October, 2015 the OECD released its final report on "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments", which was later updated in 2016 [61] (the "BEPS Action 4 Report"). The BEPS Action 4 Report broadly provides for two key set of rules: the Fixed Ratio rule; and the Group Ratio rule. Before briefly discussing both rules, it should be noted that in the mining industry the appropriateness of intra-Group financing is commonly regulated through the inclusion of minority investors, JV partners or Host Government equity holders in Group structures.

The Fixed Ratio rule limits a company's net deduction for interest, and any such payments economically equivalent to interest, to a percentage of its earnings before interest, taxes, depreciation and amortisation ("EBITDA"). The recommended ratios by the OECD are between 10% and 30% of a company's EBITDA, which is designed to achieve a balance between tackling BEPS whilst recognising that different jurisdictions hold different positions. The Group Ratio rule was introduced to address circumstances where companies within a corporate group structure are highly leveraged with third party debt for non-tax reasons. The Group Ratio rule allows a company with a net interest expense above a Host Country's fixed ratio to deduct interest up to the level of the net interest/EBITDA ratio of the global Group, and therefore provides a higher threshold whereby only net interest expense that exceeds the global Group Ratio would be disallowed.

Following the publication of the BEPS Action 4 Report, many jurisdictions now have rules which restrict the amount of interest which a company or Group can deduct against its Profits for tax purposes based on a percentage of EBITDA. Having provided a brief introduction regarding Action 4 of the BEPS Action Plan, the focus of the following section is on interest expense limitation in the context of the various mining project structures which were discussed in section 1 above.

2.5.2. Service Contracts

As discussed in section 1.1, a Service Contract in the context of the mining industry refers to an agreement in which the Host Government hires a Mining Company to perform its mining operations as a contractor or service provider. The Mining Company may be paid for its services in cash, however, it will typically receive reimbursement for actual costs and a payment based on Profits. Given that costs incurred by the Mining Company may be reimbursed, and a Host Government is more likely to engage with a Mining Company which is financially stable and capable of funding such mining operations, a Mining Company is likely to be less reliant on external debt funding in the context of this commercial arrangement. However, there is always the risk that intra-Group lending could be used to generate excessive interest deductions. However, there is always the risk that intra-group lending is used to generate excessive interest deductions.

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61. OECD (2016), Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 -2016 Update, OECD Publishing. https://www.oecd-ilibrary.org/deliver/9789264268333-en.pdf?itemId=/content/publication/9789264268333-en&mimeType=pdf

2.5.3. Licenses and Concessions

Concessions and Licenses grant Mining Companies exclusive mining rights over certain minerals in a defined area, including the right to explore, exploit and commercialise such minerals. Payments made by Mining Companies under Concession Agreements and Licenses are not interest payments and are therefore not subject to interest expense limitations. For example, Royalty payments and other fees are not considered interest expense for purposes of the limitations, however ,such payments would reduce pre-tax Profits which may be relevant to the overall interest restriction calculation. Any external loans obtained by the Mining Company to fund payments at this stage of the project would likely bear interest and such interest may be deducted by the Mining Company subject to the limitations and restrictions in the relevant jurisdiction.

Exploration is an essential part of the mining industry, whereby specialist teams analyse country terrain and geology for signs of mineral deposits. This phase is understood to be "high risk, high reward", and Mining Companies find it difficult to borrow from external sources at this stage since no income is being generated. Excessive income deductions are therefore less of a risk in this context. By contrast, during the development and extraction phases, external debt is easier to obtain. This, coupled with heavy financing requirements, can increase the risk of aggressive Profit shifting amongst companies within a Group to achieve excessive interest deductions. However, heavy reliance on debt financing at this stage is a necessary part of the capital structuring and should not be viewed with suspicion. To achieve excessive interest deductions a company with exclusive mining rights would likely rely on external debt to meet its financing requirements. The company may then lend the borrowed amount by making an intra-Group loan to a subsidiary located in a high tax jurisdiction, which will result in the company being able to claim more valuable interest deductions for tax purposes. The company may also charge the subsidiary a higher interest rate than the interest rate charged on the external debt so as to increase the amount of interest deductions available (see section 2.7 (Transfer Pricing)).

It should be noted that the rates of financing achieved by a multinational enterprise ("MNE") Group's central treasury function may be more favourable than those that could be secured in a local market in, for example, an African country. A company hosting a central treasury function may also be more suitable for balancing a portfolio of assets and managing foreign exchange risk. As such, there may be legitimate commercial reasons for a Group to structure its financing in such a manner. However, where such structuring is not driven by genuine commercial reasons, rules limiting a Group's use of interest deductions in the relevant jurisdiction in accordance with Action 4 of the BEPS Action Plan (and discussed in detail in section 4 below), together with Transfer Pricing rules, would otherwise limit the extent to which base erosion could be achieved.

2.5.4. Joint Venture

Joint Ventures in the mining industry are increasingly popular for a number of reasons, including the need to share the risks of the project, as well as the costs. JV partners will typically agree on a funding programme for all mining operations, from initial drilling to full construction.

In the context of JV companies, funding is typically by share capital subscriptions and shareholder loans. Interest on loans can therefore be deducted from Profits for tax purposes, subject to any rules in place in the relevant jurisdiction limiting interest deductions in accordance with Action 4 of BEPS Action Plan.

If a Mining Company is already subject to an interest restriction due to high amounts of interest being payable on external debt, it is unlikely that tax deductions would be available for interest on shareholder debt. It should also be noted that shareholders may extract Profits from the JV company through payments of dividends, including dividends on preference shares which have an economically similar character to interest. Dividends and payments on instruments which have equity-like features are generally not tax-deductible.

It should be noted that for the purpose of the Group Ratio rule, a JV company is included in the consolidated accounts of a controlling JV partner's Group i.e. where one of the JV partners holds a 50% plus 1 share stake in the JV company. However, where no JV partner has overall control of a JV company, neither will include the JV company in its consolidated financial statements using equity accounting. The effect of there being no controlling JV partner and therefore the JV being treated as a separate entity would likely result in a lower net interest/EBITDA Group Ratio and therefore a lower threshold for the purpose of limiting interest deductions in relating to loans that the JV may obtain in order to finance the mining operations.

2.5.5. Production Sharing Agreement

For mining projects using a PSA, external loans may be obtained by the Mining Company in order to carry out the production activities, thereby making interest deductible subject to any limitations in the relevant jurisdiction. However, credit support for the Mining Company's obligations is often required under PSA, given the substantive investments. Where the Mining Company is not itself sufficiently creditworthy, this will take the form of a letter of credit or parent guarantee to the stated value (being the proportion of contracted expenditure over a specified time period) and would typically be adjusted on an annual basis depending on how much capital expenditure has taken place in the relevant period. Separately, it should be noted that the PSA will set out a predetermined share of production to be taken by the Mining Company from which it can recover its exploration and production costs for a particular year. As discussed earlier, the riskier the project, the greater the Cost Recovery for the Mining Company.

2.5.6. Mine Development Agreements

There are a number of conditions that must be met in order for a Mining Company to be able to contract with a Host Government pursuant to an MDA,[62] including confirmation through due diligence that the Mining Company is financially capable to undertake the mining project proposed (for example, in Tanzania capital expenditure of a mining project must be at least US$100 million). However, as most development costs are funded through debt, the risk of base erosion through excessive interest deductions in the context of MDAs is an area of concern.

The MMDA includes a stability provision which protects the Mining Company from increases in local taxes that are inconsistent with the MDA, as well as a general prohibition against the imposition of taxes which are not contemplated by the MDA.[63]

62. MMDA 7.10
63. MMDA 7.9

In this context, should any domestic rules limiting the use of interest deductions come into force following the execution of a MDA which includes such provisions, the Mining Company could be protected from potential increases in tax which result from such restrictions on interest deductions. However, this is subject to the nature of the particular stability provision. Additionally, it is increasingly recognised, including by the International Monetary Fund, that stability clauses should be limited in scope and duration, and in particular, should not limit the applicability of provisions aimed at tackling tax avoidance.

2.6. Net Operating Losses

2.6.1. Most countries allow for a Carryforward (and in some cases a Carryback) of net operating losses to another tax year. The general purpose of a net operating loss deduction is to smooth taxation over a period of significant changes in Profit and loss which is a common phenomenon in the mining industry.

2.6.2. Mining projects will usually produce losses for many years until the mine is developed and producing. Heavy capital expenditure, which is generally financed by debt, results in significant Depreciation, Amortisation and interest expense deductions that naturally result in taxable losses. Net operating loss Carryforwards and Carrybacks represent deferred tax assets that replicate the deductions that would normally arise in years where the mine is producing and generating revenue. Net operating loss carryovers are not tax incentives, they are timing adjustments that neutralise the differences in profitability between various industries.

2.6.3. Net operating loss utilisation varies around the world with respect to the Carryforward period and the amount of taxable income that can be offset by the Carryforward. Many countries have moved toward an indefinite Carryforward period. They have put limits on the amount of taxable income that can be offset by a net operating loss. These limits range from 50%-90% and essentially act as the imposition of a minimum tax.

2.6.4. In principle, there is no difference between a net operating loss Carryback and a net operating loss Carryforward in that they both have the effect of smoothing variations in taxable income and loss. However, many countries have eliminated a net operating loss Carryback in lieu of allowing an indefinite Carryforward. It should be noted that the benefits of a net operating loss Carryback or Carryforward also depend on the stage of the mining project. Net operating loss Carryforwards are more valuable at the beginning of a project whereas net operating loss Carrybacks are generally more valuable at the end of a project's lifecycle.

2.7. Transfer Pricing

2.7.1. An introduction

Transfer Pricing refers to the means of establishing an appropriate price for tax purposes (an arm's length amount) where transactions are entered into between "Related Parties". This captures cases where one company controls another (either directly, indirectly, through the holding of shares, through the possession of voting rights or via some other means). When independent parties enter into a transaction, the commercial terms of that transaction are usually decided by market forces. However, where Related Parties transact with each other, the terms of that transaction may not be impacted by external market forces in the same way as would be the case were they independent of each other. The transaction between the Related Parties is referred to as the "Controlled Transaction". A transaction between independent parties is referred to as an "Uncontrolled Transaction".

Under Transfer Pricing rules, the Profits of Related Parties may be adjusted as required so that Controlled Transactions are treated as happening at "arm's length" i.e. on terms that would have existed had such parties been independent of each other.

Many countries have Transfer Pricing rules which provide for the circumstances in which the actual price charged between Related Parties must be replaced with an arm's length amount, as well as how such arm's length amount is to be calculated. Many of those rules are centered around the "arm's length principle" which comes from the OECD's Transfer Pricing Guidelines, the most recent being published on 20 January 2022.[64]

Transfer Pricing has also been a particular focus of the OECD's BEPS project, specifically Actions 8-10 of the BEPS Action Plan, which is discussed further in section 4. below. In addition to the OECD's Transfer Pricing Guidelines, it is important to also refer to the UN Practical Manual on Transfer Pricing for Developing Countries, which is a useful resource in providing for guidance on the policy and administrative aspects of applying a Transfer Pricing analysis, although the focus of the following sections will be on the OECD's Transfer Pricing Guidelines.

There are five different Transfer Pricing methods described in the OECD's Transfer Pricing Guidelines, namely: the Comparable Uncontrolled Price ("CUP") Method; the Resale Price Method; the Cost-Plus Method; the Transactional Profit Split Method; and the Transactional Net Margin Method. However, before discussing the different Transfer Pricing methods, it is necessary to briefly explore how to delineate the appropriate transaction to which each method may apply.

Accurately delineating a transaction involves assessing the actual behaviour of the Related Parties against the written terms of the transaction contract, to take into account the true contributions of the parties to value creation, as opposed to their contractual obligations which may not reflect the reality. Chapter 1 of the OECD's Transfer Pricing Guidelines makes clear that if the economically relevant characteristics of the transaction are inconsistent with the written contract between Related Parties, then the actual transaction should be delineated for the purposes of the Transfer Pricing analysis in accordance with the characteristics of the transaction as reflected in the conduct of the parties. The guidance further provides that where there are material differences between contractual terms and: the conduct of the Related Parties; the functions they actually perform; the assets they actually use; the risks they actually assume, considered in the context of the contractual terms, these material differences should be used to accurately delineate the transaction. Once the appropriate transaction has been identified, the Transfer Pricing methods can be applied to that transaction in order to establish the arm's length price.

2.7.2. The Comparable Uncontrolled Price Method

The CUP Method compares the price used in the Controlled Transaction with the price used in a comparable Uncontrolled Transaction. Where these are different, then the price in the Uncontrolled Transaction may be substituted for the price in the Controlled Transaction. The CUP Method is considered the most straightforward and accurate Transfer Pricing method subject to availability of appropriate data (that is, appropriate comparable transactions) in order to apply it.

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64. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, OECD Publishing, https://www.oecd.org/tax/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm

2.7.3. The Resale Price Method

The starting point for the Resale Price Method is the price at which a product purchased from a Related Party is resold to a third party (the resale price). The resale price is then reduced by an appropriate gross margin (the resale price margin). The resale price margin is the amount a reseller would charge to make an appropriate profit (taking account of assets used and risks assumed) after deducting its operating costs. This method is likely to be the most appropriate method for establishing the Transfer Pricing of marketing operations.

2.7.4. The Cost-Plus Method

Applying the Cost-Plus Method involves establishing the costs incurred by a supplier of goods or services and adding a percentage to these costs to reflect an appropriate profit for the supplier given the supplier's functions and the market conditions in which it operates. To calculate the Profit, it is necessary to compare the Profits earned by the supplier in comparable transactions with third parties or, if there are no such internal comparables, the supplier can compare the Profit that would have been earned by an independent supplier in a comparable transaction. The OECD's Transfer Pricing Guidelines reflect that the Cost-Plus Method is most helpful in the context of transfers of unfinished goods between Related Parties (in the mining context, this could include the transfer of extracted raw materials for further processing) or where the Controlled Transaction is the provision of services.

2.7.5. The Transactional Profit Split Method

The Transactional Profit Split Method ("TPSM") can be applied in a Transfer Pricing analysis involving highly integrated operations where evaluating transactions separately is complex. The TPSM identifies the relevant Profits to be split by the Related Parties from a Controlled Transaction and then splits those Profits between the Related Parties on an economically valid basis that approximates the division of Profits that would have been agreed at arm's length. Further information on this method is set out below in section 4.4.

2.7.6. The Transactional Net Margin Method

The Transactional Net Margin Method is less commonly used than other methods. The OECD's Transfer Pricing Guidelines provide that this method involves comparing the net margin which the tested party makes from a Controlled Transaction with the net margin it makes from an Uncontrolled Transaction. If there are no transactions with non-Related Parties, then the net margin is one which would have arisen in a comparable transaction between independent parties.

2.7.7. Transfer Pricing and Permanent Establishments

It is worth briefly explaining how the Transfer Pricing principles described above are also relevant in the context of Permanent Establishments and Profit attribution. A Permanent Establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on (as defined by the OECD Model Tax Convention on Income and on Capital (the "OECD Model Tax Convention") and the United Nations Model Double Taxation Convention (the "UN Model Convention")[65]). A Permanent Establishment constitutes a separate taxable presence in the jurisdiction where it is located.

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65. OECD (2017), OECD Model Tax Convention on Income and on Capital, OECD Publishing, https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm

Both the OECD Model Tax Convention and the UN Model Convention definitions of Permanent Establishment include an office, branch or factory. The definitions also include a mine, oil or gas well, quarry or any other place of extraction of natural resources. Therefore, in the context of the mining industry, even in the absence of a legal entity in a particular jurisdiction, the existence of a mine or any other place of extraction of natural resources is likely to constitute a Permanent Establishment, resulting in a taxable presence for a mining Group.

Profits must be attributed to a Permanent Establishment as if it were a separate and independent entity. This means that any transactions between the Permanent Establishment and the legal entity of which it is a part (for example, an entity based in one jurisdiction owning a mine located in another) are treated as happening on an arm's length basis as if between two separate entities. To determine the arm's length pricing of the relevant transaction, it is necessary to apply the applicable domestic law Transfer Pricing principles.

This may also require consideration of the Transfer Pricing methods from the OECD's Transfer Pricing Guidelines described above. As such, mining Groups should bear in mind that it will be necessary to apply Transfer Pricing principles in order to establish any taxable Profits attributable to any Permanent Establishment they may have (for example, a mine located in a territory where such Group may not otherwise have a taxable presence).

2.7.8. Transfer Pricing and Service Contracts

Having provided a brief introduction as to the typical operation of Transfer Pricing rules, the focus of the following sections is on Transfer Pricing in the context of mining and, specifically, Service Contracts.

To the extent that a Service Contract is entered into by a Host Government and a third party Mining Company, such contract will by its nature be between non-Related Parties such that the agreement itself is unlikely to trigger Transfer Pricing considerations. However, certain Service Contracts may also be entered into between Related Parties, and Transfer Pricing will be relevant in the context of those contracts.

As discussed above, Service Contracts will be entered into between the entity owning the mine (usually the Host Government) and a service provider at different stages of the mining project. Some of the services provided under a Service Contract include feasibility studies (to assess the economic viability of a potential mining project), supplying mining equipment and labour costs (to build the mine and undertake the extraction process); and management services.

Under Service Contracts, Related Party transactions are likely to occur in the context of procurement services (where a company purchases mining goods and services on behalf of its subsidiary) and management services (where a subsidiary pays a fee to a Related Party in return for certain administrative, technical and advisory services). The Related Parties will enter into a Service Contract in respect of these services pursuant to which a fee will be charged.

The question becomes: how do mining Groups entering into such intra-Group Service Contracts ensure that the fee charged reflects an arm's length amount, and so mitigate the risk of a tax authority adjusting the amount charged under local Transfer Pricing rules, thus impacting taxable Profits of the Group?

i. Service Contracts: Procurement Services

As noted above, the Cost-Plus Method is useful in establishing an arm's length consideration in the context of Controlled Transactions involving the provision of services. constitutes a separate taxable presence in the jurisdiction where it is located. Many The appropriate Cost-Plus mark-up will depend on whether the entity providing the procurement services possesses real substance: for example, does the Related Party have real procurement expertise (such as having employees sufficiently qualified in the relevant field)?; have other entities in the mining Group ceased to carry on the functions which are now performed by a Related Party?; and does the Related Party assume any risks in procuring the relevant goods or services (such as the risk of late delivery or poor quality goods or services)? In the absence of sufficient substance, a mark-up is unlikely to be appropriate and the Related Party supplier may instead simply pass on to the Related Party recipient any third-party costs incurred by it in providing the relevant intra-Group services.

Assuming the substance test is satisfied, the next stage will be to establish an appropriate Cost-Plus mark-up. This will depend on the level of involvement of the Related Party supplier: for example, the production of bid documents and any involvement by that Related Party in efforts to resolve disputes where goods or services procured are of poor quality, are factors that would attract a higher mark-up. Contrast this with cases where the Related Party involvement is limited to accepting receipt of procured items or providing invoicing services and managing payments for goods and services: such cases would attract a lower mark-up.

ii. Service Contracts: Management Services

Management services in the mining context may involve human resources, accounting and legal services as well as certain technical services. Again, the Cost-Plus Method is likely to be the most appropriate in this context and it will therefore be necessary to identify suitable comparable transactions. In doing so, consideration should be given to the nature of the services and the risks assumed, including whether the management services involve outsourcing to a third party, onward supplying to a Related Party, and passing on the costs of that third party.

In this scenario, no mark-up would be appropriate. Contrast this with technical services involving specialist knowledge such as geology expertise or the use of specialised equipment, for which a higher mark-up can be justified (assuming such services are provided by the Related Party itself and not outsourced to a third party). Services for which a lower mark-up would be expected include HR, legal and accounting services.

2.7.9 Licenses and Concessions

While the License or Concession Agreement is likely to be between the mining Group and a third party (Host Government), it could trigger Transfer Pricing considerations on the basis that, once obtained, the mining Group will need to commence the Exploration stage of the mining project for which external financing is likely needed.

Related Party financial transactions are common within larger mining Groups, who will often arrange such finance centrally through an entity which carries on a Group treasury function. The Group treasury entity will make loans to Related Parties to meet their funding requirements, including at the exploration stage of the mining project.

From a Transfer Pricing perspective, it will be necessary to determine whether the principal sum loaned could have been obtained from a third-party lender, and whether the interest is charged at arm's length. The question is whether the loan would have been made in the absence of the Related Party relationship and, if not, what (if any) amount would have been provided by a third party. Then, assuming a third party would have provided some, if not all, of the principal amount, one should consider the rate of interest that would have been agreed with a third-party lender.

In determining the arm's length price, the CUP Method is appropriate and would be applied in the context of the domestic Transfer Pricing rules of the relevant jurisdiction. The CUP Method involves comparing the cost of debt in a Controlled Transaction to the cost of debt in an Uncontrolled Transaction. Adjustments may need to be made to the arm's length interest amount for particular features of the Controlled Transaction, namely the credit risk of the borrower and the terms and conditions of the intra-Group loan (for example, loan duration, subordination and provision of any security).

Aside from entry into a License or Concession Agreement being a likely trigger for certain funding requirements (including intra-Group funding), given that any such agreements will by their nature be between non-Related Parties (i.e. the Mining Company and the Host Government), the License or Concession Agreement itself is unlikely to give rise to further Transfer Pricing considerations.

2.7.10. Joint Ventures

As noted above, JVs may be set up using different structures including contractual joint ventures (for example, risk and revenue sharing arrangements), strategic alliances, partnerships, JV companies and dual company structures. Where a JV company is formed, the provision of funding and/or services to that JV company by a JV party (being an investor in the JV company) may trigger Transfer Pricing considerations.

The Transfer Pricing rules will apply to the provision of services and/or funding to a JV company where a JV partner is sufficiently connected with the JV company, depending on its ownership interest in the company. The relevant domestic Transfer Pricing rules will determine the sufficient connection point but, broadly, sufficient connection will be established where a JV partner directly controls the JV company (for example, through the holding of shares or the possession of voting rights or through some other means such as powers conferred by the controlled JV company's constitutional documents). Some jurisdictions may apply their Transfer Pricing rules where a JV partner (we shall refer to as "A") supplies services and/or financing to a JV company and meets a particular ownership interest threshold in that vehicle (e.g. 40%) and, together with another JV partner who also meets such minimum ownership interest threshold, A controls the JV company.

Some jurisdictions also apply Transfer Pricing rules in the context of financing transactions between JV companies and their owners where those owners act together with other persons in relation to the financing of the JV company and, taking such persons as a whole, they would be capable of controlling the JV company if their control rights were aggregated. The key point here is that Transfer Pricing rules can apply even where a party does not control the other party.

2.7.11. Production Sharing Agreements

Entry into a PSA may trigger the need for external funding for exploration and construction activities which may be on-lent to Related Parties within the mining Group, thus triggering the requirement for a Transfer Pricing analysis in respect of such intra-Group financing. The PSA itself is unlikely to trigger direct Transfer Pricing considerations given that PSAs are between non-Related Parties, so any fee payable under the PSA would be at arm's length.

However, it is noted that there are indirect Transfer Pricing risks which may impact a Host Government which has entered into a PSA, as any agreements between the Mining Company which is a party to that PSA and its Related Parties, which do not comply with Transfer Pricing principles, are likely to erode the revenue of the Host Government.

2.7.12. Mine Development Agreements

MDAs are long-term investment agreements between Host Governments and Mining Companies for the exploration and development of specific mineral deposits. MDAs are therefore between non-Related Parties and are thus unlikely to trigger Transfer Pricing considerations.

2.8. Customs and Duties

2.8.1. Host Government routinely impose taxes and fees on the importation of goods and materials into the country, and on the export of goods, materials and products from the country. In addition to generating revenue for the Host Government, import and export taxes can be used to incentivise commercial decisions and promote policy goals.

2.8.2. For mining projects, the Mining Company often requires the importation of equipment for mine construction and operations, materials and supplies during mine operation. Contractors and employees of the Mining Company will also need to import both business and personal items if relocating to the Host Country.

2.8.3. The primary impact of export duties will be on the export of products from the mine. In many developing economies, the mine will export cleaned ore and thus the amount of the export duty will reflect the costs incurred to bring the ore to a finished exportable product.

2.8.4. Import Duties

2.8.5. Import duties are taxes paid on imported goods, usually as a percentage of the value of the imported item.[66] As will be further discussed in Section 3, mining projects often receive an exemptions from some import duties.

There is also some variability in the tax treatment of the cost of import duties: sometimes import duties might be deductible as a cost, other times the tax code may not allow the deduction of import duties.

2.8.6. Creation of free trade zones and other treaty arrangements may all affect the application of import duties. For example, the proposed African Continental Free Trade Area would create a pan-African free trade zone, and would reduce tariffs among African countries.[67] The European Union ("EU") is also seeking to enter into a trade agreement with a number of West African countries.[68]

While awaiting final approval of the broader Economic Partnership Agreement, the EU has entered into "stepping stone" agreements with Ghana and Cote d'Ivoire. Under the Ghana stepping stone agreement for example, goods from Ghana may be exported to the EU duty free immediately, while Ghanian import duties will be maintained or eliminated over a 15-year period.[69]

2.8.7. While import duties may be relaxed and waived, this is less common with export duties. Most extracted minerals are exported, usually in the form of ore or an intermediary product, destined for further processing outside the Host Country.

Host Governments recognise the benefits of having minerals processed and beneficiated within the country as doing so generates a more valuable product, creates jobs and economic opportunities, and allows for the growth of manufacturing and other industries that use the beneficiated end product.

2.8.8. While it is common for mining projects to receive some relief from import duties and export taxes, these amounts are still a material element of a Host Country's fiscal regime. In 2019, for example, taxes on Mining Company goods and trade (excises, customs duties, and export taxes) represented over 15% of total payments in Burkina Faso, Guinea, Mali, and Zambia.[70]

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66. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 35 (2018)
67. See World bank, The African Continental Free Trade Area: Economic and Distributional Effects (2022).
68. https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/west-africa_en
69. Summary: Ghana-EU economic partnership agreement (https://eur-lex.europa.eu/legal-content/EN/LSU/?uri=uriserv:OJ.L_.2016.287.01.0003.01.ENG).
70. International Monetary Fund, Tax Avoidance in Sub-Saharan Africa's Mining Sector at 8 (2020). The IMF notes that seeking tax incentives is not in any way illegal, but may nonetheless be a matter of concern.

2.8.9. Zimbabwe attempted to use the export duty on platinum as a way to incentivise in-country beneficiation. Zimbabwe first imposed a 15% export tax on unbeneficiated platinum, but that export duty led platinum producers to curtail their operations.[71] The 15% export tax was reduced to 5%, and then suspended. The tax remains suspended, and the Zimbabwe Chamber of Mines has asked that the 5% tax remains suspended at least through 2025.[72]

2.8.10. Import duties have two key functions. Firstly, the imposition of an import duty can promote the use of local goods. Secondly, import duties are a source of revenue for the Host Government.[73] In 2020, twenty countries in Africa had import duties in excess of 10%, and in five countries – Gambia, Djibouti, the Central African Republic, Chad, and Equatorial Guinea – the import duty was greater than 15%.[74]

71. Cecilia Jamasmie, Zimbabwe platinum export tax shelved for now, mining.com (August 10, 2015)
72. Godfrey Marawanyika, Zimbabwe Platinum Miners Ask Government to Defer Export Tax, Bloomberg (November 14, 2023)
73. Mining Policy and Research, Import Duty on Mining Machinery and Mobile Equipment (January 27 2020)
74. Emmanuel Abara Benson, 20 African countries with the highest import tariffs, Business Insider Africa (July 4, 2022)

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3. Tax Incentive Approaches

3.1. General Discussion

Mining projects are high-risk, capital intensive, long-duration projects requiring finance and technical expertise which may not be available in the Host Country. Host Countries may provide fiscal incentives to attract foreign participation in the project. As discussed below, these incentives take a variety of forms including: tax holidays or tax rate reductions; fiscal incentives designed to target specific investment, for example, incentivised capital allowances; and tax credits to encourage capital investment. Similarly, Host Countries may reduce or eliminate duties or other indirect taxes and charges on the importation of capital equipment to be used on the project.

Assuming a tax incentive is necessary to attract the investment, a tax incentive represents a trade-off between the loss of tax revenue to the Host Government and the potential increase to the Host Country's economy through jobs, investment and (assuming the project is successful) a share in the Profits from the project.

The utility of incentives has been an on-going debate even before the emergence of the OECD's BEPS initiative. As discussed in Section 4, the relationship between tax incentives and BEPS Pillar 2 will only further this debate.

3.2. Income Tax Holidays

3.2.1. A tax holiday is a tax-free period, the duration of which may vary from one year to the entirety of the project, and which may take the form of a complete exemption from profits tax, or a reduced rate, or a combination of the two.[75] A tax holiday may be designed to provide tax relief in the early stages of mine development, when cash is constrained, and then drop away once a mine is operational and generating revenue.

3.2.2. Tax holidays are common in mining projects in developing economies. A 2019 study of 21 countries found that over half offered holidays from corporate income tax for an average span of nine years.[76] Although tax holidays can attract investment, they are also seen as inefficient.While a tax holiday might make a marginal project economic, it has a much greater economic effect on profitable projects as there is more money being generated and not taxed.[77]

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75. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 20 (2018) (citing Zolt, E. (2013). Tax incentives and tax base protection issues. United Nations. Retrieved from http://www.un.org/esa/ffd/wp-content/uploads/2014/10/20140604_Paper3_Zolt.pdf).
76. Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), Tax Holidays Threaten Economic Prosperity in Resource-Rich Developing Countries (July 24, 2019).
77. IGF, Insights on Incentives: Tax Competition in Mining at 8 (2019)

3.2.3. Tax holidays can attract investment, however, they can also create incentives that prevent more durable investment in the broader economy.

3.2.4. Despite their prevalence, tax incentives are not usually the decisive factor in whether an investment proceeds. Where Host Countries offer tax holidays or other investment-based incentives, they increase the risk that all companies—whether they be multinational or domestic—will seek arrangements that make best use of those incentives, which may or may not stimulate the economic activity desired. Where companies in one sector of the economy (e.g. the mining industry) are tax-free, this increases incentives to shift domestic Profits into that sector and away from sectors that are taxed. These incentives also increase competitive tax pressures in the region. [78]

3.2.5. Tax holidays can also incentivise behaviour that reduces the economic value of a mining project to the Host Country. As the term of the tax holiday nears its end, for example, the mine may accelerate production to maximise the benefit of the tax holiday. If mining has proceeded at a standard pace, some of that production would have been tax bearing, and created additional value for the Host Government.[79] A tax holiday can also increase the risk of Transfer Pricing issues, as the Mining Company may allocate costs and revenues to the Related Party with a tax holiday.[80]

3.2.6. To prevent disputes and tax avoidance, a tax holiday should be crafted to achieve the goal of incentivising investment in the mining sector and addressing the front-end capital costs of mine development. Tax holidays may be granted for a term of years, but they can also be tied to a level of production – once that production target is met, then the tax holiday ends. The production target can be defined as "a specific cumulative tonnage extracted at a given grade; or on the basis of a cumulative production expressed in terms of contained metal." [81]

3.3. Accelerated Depletion Depreciation and Amortisation

3.3.1. Capital allowances can be incentivised by accelerating the rate at which the capital asset is depreciated or amortised for example by providing shorter useful lives or allowing for a larger deduction for Depreciation or Amortisation. In many countries, Depreciation can be taken at 150% or 200% of straight-line Depreciation as a means to encourage capital investment.

3.3.2. A further means of encouraging capital investment is to allow an immediate 100% deduction for the purchase of capital assets. This tool is often used to encourage the acquisition of less costly assets which may be manufactured locally, to boost investment in local manufacturing.

78. International Monetary Fund, Tax Avoidance in Sub-Saharan Africa's Mining Sector at 30 (date)
79. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 3, 15 (2018)
80. Id. at 21.
81. Pietro Guj, Boubacar Bocoum, James Limerick, Murray Meaton, and Bryan Maybee, How to Improve Mining Tax Administration and Collection Frameworks: A Sourcebook at 72 (2013)

3.4. Investment Tax Credits

3.4.1. A tax credit allows a full or partial credit against income tax liability for the cost of the asset. Investment tax credits are designed to super-charge capital investment and are often used to target investment in particular industries.

3.4.2. Investment tax credits need not be limited to capital investment. They can be used to encourage investment in particular activities, for example, local research and development, targeted work-force employment or other similar objectives of the Host Country.

3.5. Import and Export Duty Relief

3.5.1. It is common for mining projects to be granted exemptions from import duties.[82] Commonly, import duty exemption applies to the importation of machinery, equipment and supplies for mining operations. The import duty exemption is sometimes extended to the personal property of the employees and contractors working of the Mining Company.[83]

3.5.2. **Relief from import duties is not universal. For example, Zambia Revenue Authority ("ZRA") sought a penalty of almost USD 8 billion dollars against First Quantum Minerals Limited ("First Quantum") for allegedly underpaid import duties. However, only USD150 million were actual unpaid import fees, the remaining being penalties and interest.[84] First Quantum eventually settled the dispute with ZRA, in part through committing to additional investment in the Zambian mining sector.[85]**

3.5.3. Export Duties and Export Processing Zones

Export duties can be an *ad valorem* tax (based on the value of the taxable item), a fixed fee per ton, or other measured unit of production. The *ad valorem* percentage or the fixed fee amount may be scaled to increase or decrease as mine development proceeds.[86] Complete relief from export duties for mining projects is less common than relief from import duties, but it can occur. The MMDA includes a proposed provision providing relief from export duty.[87] An Export Processing Zone ("EPZ") involves the provision of special incentives to attract investment, mostly foreign, for export production, incentives such as tax holidays, duty free export and import, and free repatriation of Profits.[88]

The Tanzania Revenue Authority describes EPZ as a customs area where one is allowed to import plant, machinery, equipment and material for the manufacture of export goods under security, without payment of duty. The imported goods are subject to customs control at importation, through the manufacturing process, to the time of sale/export, or duty payment for home consumption.

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82. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 35 (2018)
83. See, e.g., MMDA § 5.1
84. AfricanNews, Zambia slaps Canadian mining giant with $8bn bill for unpaid import duties (September 12, 2019).
85. Gladys Lwizi, FQM, ZRA mute over US$8 billion tax dispute final settlement deal, Zambian Business Times (August 10, 2019); Sullivan and Cromwell, S&C Advises First Quantum in Resolving Disputes and Expanding Operations in Zambia (June 17 2022)
86. Roberta Piermartini, The Role of Export Taxes in the Field of Primary Commodities, World Trade Organization (2004)
87. MMDA § 5.1(c).
88. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 32 (2018)

Other benefits of operating such enterprises include: free trade conditions, streamlined Government red tape allowing for one stop registration and licensing and also a facility of long term tax concession.[89] A company registered in the Tanzanian EPZ must post a bond if goods are moved out of the EPZ and become subject to tax.[90]

For the mining sector, this structure is designed to promote processing in the Host Country. An EPZ can be especially attractive for a developing economy because infrastructure commitment can be focused on a limited geographic area.[91]

As with other tax incentives, the EPZ can lead to unanticipated tax avoidance through commercial arrangements. For example, if the tax structure for processed materials is more favourable than the tax regime applicable to mined products, the Mining Company might shift Profits to the processed materials.[92]

In Mozambique, a Mining Company was able to transfer its Profits to a tax-exempt Related Party operating in an EPZ. The Mining Company took a loan from the tax-exempt Related Party, thus creating tax deductions for the Mining Company and untaxed interest income for the tax-exempt Related Party in the EPZ.[93]

3.6. Fiscal Stabilisation

3.6.1. Fiscal instability is one of the key risks considered by a mining investor. Changes in the fiscal regime can cause additional risks which may not only affect the investor's return on investment but also its ability to secure funding. To mitigate this risk, Host Governments commit to maintain a stable tax regime for a certain period.

3.6.2. Fiscal stabilisation is often achieved contractually between the Mining Company and the Host Government. In some cases, by including a tax stabilisation clause in the mining agreement, or by entering into a separate legal stability or investment agreement. Although not that common, certain countries provide for fiscal stabilisation in their local laws.

3.6.3. Fiscal stabilisation may take one of two forms. Firstly, a form that exempts the Mining Company from being bound by new laws or regulations that may negatively impact the Mining Company's rights and obligations under the agreement with the Host Government.[97]

89. https://www.tra.go.tz/index.php/export-processing-zones-epz
90. https://www.tra.go.tz/index.php/export-processing-zones-epz
91. Peter L. Watson, Export Processing Zones: Has Africa Missed the Boat? Not Yet, World Bank Africa Region Working Paper Series No. 17 at 9 (2001)
92. IGF and OECD, Tax Incentives in Mining: Minimising Risks to Revenue at 32 (2018)
93. International Monetary Fund, Tax Avoidance in Sub-Saharan Africa's Mining Sector at 30 (2020)
94. Natural Resource Contracts as a Tool for Managing the Mining Sector, Federal Ministry for Economic Cooperation and Development, at p. 21.

A typical example of this type of clause comes from the Basic Convention between the Republic of Guinea and BSG Resources (Guinea Limited) and BSG Resources (Guinea) SARL dated 16 December 2009, for the exploitation of the Zogota/N'zerekore Iron Ore Deposits:

"The government warrants the company from the date of grant of the concession and throughout its full duration the stabilisation of current legislation and of all provisions, particularly fiscal and concerning customs and excise, stipulated in this agreement. Accordingly, all changes to current legislation, particularly fiscal and/or concerning customs and excise, after the date of grant of the concession that would as a result increase, whether directly or indirectly, the company's tax and/or customs and excise charges would not be applicable for it. On the other hand, the company may validly take advantage of such changes if their effect is to reduce its tax and/or customs and excise charges."[95]

3.6.4. Although this first kind of fiscal stabilisation clause will create an incentive for investors, certain Host Governments may consider this as a limit to their ability to make and pass laws.

3.6.5. The second is a type of stabilisation clause which attempts to establish an economic equilibrium. It does not exempt the Mining Company from the application of new laws and regulations, but entitles it to compensation by the Host Government for any materially adverse financial effects suffered as a result.[96]

3.6.6. Stabilisation clauses tie the time of the specific fiscal stabilisation to the time necessary for the Mining Company to meet its financial obligations. This is the case of Guinea which provides for a maximum stabilisation period of the tax and customs regime of 15 years from the date of the grant of the mining right,[97] and Burkina Faso which guarantees fiscal stabilisation to the holder of a mineral right for the life of the mine (as indicated in the feasibility study) up to 20 years.[98]

95. Id, at p. 22.
96. Id, at p. 22.
97. Code Minier de la République de Guinée 2011
98. Code Minier du Burkina Faso. Jo N°44 Du 29 Octobre 2015

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4. Impact of BEPS 1.0

4.1. Background

This Chapter will provide an overview of domestic tax base erosion and profit shifting ("BEPS"), specific BEPS Actions relating to anti-hybrids, debt/equity limitations, Transfer Pricing and country-by-country reporting before setting out how such Actions have impacted the mining industry.

Domestic tax base erosion and profit shifting relates to tax planning strategies that multinational enterprises use to exploit loopholes in tax rules to artificially shift Profits to low or no-tax locations as a way to avoid paying tax[99]. On 19 July, 2013 the OECD released an Action Plan on Base Erosion and Profit Shifting ("BEPS"), which was later endorsed by the leaders of G20 countries in September 2013. The Action Plan identifies 15 specific Actions along the following three pillars:

1. introducing coherence in the domestic rules that affect cross-border activities;
2. reinforcing substance requirements in the existing international standards; and
3. improving transparency as well as certainty.

G20 and OECD countries have since worked on the development of the 15 Actions and have continued to engage developing countries via a number of different mechanisms, including through direct participation in the OECD's Committee on Fiscal Affairs. Regional tax organisations, including the African Tax Administration Forum, the Centre de rencontre des administrations fiscals and the Centro Interamericano de Administraciones Tributarias, have contributed to this project alongside the International Monetary Fund, the World Bank and the United Nations and other international organisations. Following two years of extensive work, the OECD delivered the final package of its comprehensive BEPS Action Plan on 5 October, 2015, representing the first substantial renovation of international tax rules in almost a century.

Tax base erosion and profit shifting is of particular relevance to resource-rich tax jurisdictions. The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development ("IGF") and the OECD recognise that the mining industry faces unique challenges that can prevent effective taxation of the mining sector and shift revenue away from the tax authorities of Host Countries. Therefore, the two institutions have combined their respective mining and tax expertise to deliver the BEPS in Mining Programme which aims to provide mining-specific solutions to the challenges faced by resource-rich countries including (among others) excessive interest deductions and Transfer Pricing. The results of their joint efforts have led to the publication of materials including "Limiting the Impact of Excessive Interest Deductions on Mining Revenue (October 2018)" (the "2018 Report") which is discussed in further detail.

99. Base erosion and profit shifting ("BEPS") https://www.oecd.org/en/topics/base-erosion-and-profit-shifting-beps.html

4.2. BEPS Action 2: Anti-Hybrid Rules

Action 2 of the BEPS Action Plan calls for the development of model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effects of Hybrid Mismatch Arrangements ("HMAs"), which are arrangements that are used in aggressive tax planning to exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation. HMAs can result in a substantial erosion of the taxable bases of the jurisdictions concerned, and were previously a widespread issue. The work conducted by the OECD culminated in the release of its final report on Action 2: Neutralising the Effect of Hybrid Mismatch Arrangements (the "BEPS Action 2 Report"), on 5 October, 2015. The BEPS Action 2 Report, which supersedes the interim report that was released in September 2014, contains recommendations on domestic law rules to address HMAs, as well as proposed changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities are not used to obtain tax treaty benefits.

4.2.1. Hybrid Mismatch Arrangements

A HMA is an arrangement that exploits a difference in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to produce a mismatch in tax outcomes which has the effect of lowering the aggregate tax burden of the parties to the arrangement. The BEPS Action 2 Report focuses on arrangements that exploit differences in the way that cross-border payments are treated for tax purposes in jurisdictions of the payer and payee to the extent that such difference in treatment results in a mismatch. The extent of the mismatch is determined by comparing the tax treatment of the payment under the local laws of each jurisdiction.

The recommended hybrid-mismatch rules set out in the BEPs Action 2 Report are designed to target arrangements that give rise to three outcomes:

i. payments that are deductible under the rules of the payer jurisdiction and not included in the ordinary income of the payee jurisdiction or a related investor jurisdiction (this is known as a Deduction/No Inclusion outcome ("D/NI outcome"));

ii. payments that give rise to duplicate deductions for the same payment (this is known as a Difference-in Differences outcome ("DD outcome")); and

iii. payments that give rise to an indirect D/NI outcome, whereby the effect of the mismatch is shifted into a third jurisdiction (for example, using an ordinary loan).

It should be noted that differences in the valuation of money in each relevant jurisdiction are not within the scope of the hybrid mismatch rules.

Conflicts in the treatment of a hybrid entity generally involve a conflict between different jurisdictions regarding the transparency of the entity for tax purposes with respect to particular payments. This can result in such payments being treated differently for tax purposes in each relevant jurisdiction at the same stage in a project.

There is a difference between arrangements related to an asset where taxpayers in different jurisdictions take incompatible positions on the ownership rights of that asset, and hybrid financial instruments (being instruments that result in taxpayers taking incompatible positions on the treatment of the same payment made under the instrument).

The following example, as set out in the 2018 Report, illustrates how hybrid financial instruments might be used in the mining industry to produce a favourable tax outcome:

- Company A and Company B are Related Parties, and Company B operates a mine in Country B.
- Company A borrows from third-party financiers in Country A with the intention of providing the funds to Company B in Country B. Rather than on-lend to Company B on the same terms as it received from its financiers, Company A creates a hybrid financial product for Company B with debt and equity characteristics.
- Company A has engineered a financial product that is more complex than required by Company B so that Company A may take advantage of differences in treatment of the hybrid instrument in Country A and Country B by way of having the instrument classified as debt in Country B (and therefore with tax deductible interest payments) but as equity in Country A (which may exempt any dividend receipts).

It should be noted that there are numerous ways in which a financial instrument may lead to a mismatch treatment, and characterising each of these would be an extensive task. As such, the BEPS Action 2 Report focuses on aligning the treatment of cross-border payments under a financial instrument so that amounts that are treated as financing expense by the issuer's jurisdiction are treated as ordinary income in the holder's jurisdiction.

Before discussing the recommendations outlined in the BEPS Action 2 Report, it is worth noting that where both the shareholder of a Mining Company and the Mining Company itself apply a deduction, meaning that there is a double deduction, but each pay tax on the same Profits, the double deduction is allowed. This circumstance would arise where the Mining Company is treated as tax transparent in the jurisdiction in which the shareholder is resident, but is treated as opaque in the jurisdiction in which the Mining Company is incorporated.

4.2.2. Recommendations

The hybrid mismatch rules seek to align the tax treatment of an instrument or entity with the tax outcomes in the counterparty jurisdiction, however, the rules do not otherwise disturb the tax or commercial outcomes of the arrangement. The BEPS Action 2 Report divides the rules into a primary response and a defensive response, in order to avoid double taxation and to ensure that the mismatch is eliminated in circumstances where not all of the jurisdictions involved in the relevant arrangement adopt the rules. The defensive rules apply in situations where the payer jurisdiction has not enforced domestic hybrid mismatch rules, or where these rules are not applied to the relevant entity or arrangement.

In circumstances where arrangements have a D/NI outcome, either by way of a payment made under a hybrid financial instrument or by a hybrid entity, the BEPS Action 2 Report recommends that the the deduction in the payer's jurisdiction should be denied. If the payer jurisdiction does not respond to the mismatch, it is recommended that the jurisdictions adopt a defensive rule that requires the payment to be included as ordinary income in the payee's jurisdiction.

In relation to arrangements that give rise to DD outcomes, the BEPS Action 2 Report recommends that the primary response should be to deny the duplicate deduction in the parent jurisdiction, whereas the defensive rule should require that the deduction be denied in the payer jurisdiction (which would, for the avoidance of doubt, apply in circumstances where the parent jurisdiction did not adopt the primary response).

In circumstances where the effect of the D/NI outcome is shifted to a third jurisdiction, the BEPS Action 2 Report recommends that a payer jurisdiction deny a deduction for a payee where that payee sets the payment off against expenditure under a HMA (i.e. the payment is made under an imported mismatch arrangement that results in an indirect D/NI outcome). It should be noted that co-ordination in the implementation and application of the rules amongst different jurisdictions is key to ensuring the sharing of relevant information between jurisdictions, as well as the ability for taxpayers to identify the potential for mismatches and the response required under the hybrid mismatch rules. The rules proposed by the BEPS Action 2 Report seek to minimise the administrative burden for both taxpayers and tax administrations, and in particular, it recognises the need for rules that operate automatically without the need to identify which jurisdiction has lost tax revenue under the relevant HMA.

4.2.3. The OECD Model Tax Convention

Part II of the BEPS Action 2 Report explores several proposed changes to be made to the OECD Model Tax Convention in order to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly. The BEPS Action 2 Report also considers the interaction between the recommended changes to domestic law and the provisions of the OECD Model Tax Convention.

The general concern was that the although the 1999 OECD Report on the Application of the OECD Model Tax Convention to Partnerships (the "Partnership Report") includes an extensive analysis of the application of treaty provisions to partnerships, including circumstances involving a mismatch in the tax treatment of the partnership, it fails to expressly address the application of tax treaties to transparent entities other than partnerships. As such, the BEPS Action 2 Report proposed to include an additional provision in the OECD Model Tax Convention to ensure that the income of transparent entities is treated in accordance with the principles of the Partnership Report, and specifically, that the benefits of tax treaties are granted where appropriate and that such benefits are not granted where neither jurisdiction treats the income of an entity as the income of one of its residents under its domestic law.

The OECD Model Tax Convention was updated in September 2017 to reflect changes that were approved as part of the final package of the BEPS Action Plan. The addition of a new paragraph 2 to Article 1 of the OECD Model Tax Convention, which reflects the changes outlined above as contained in the BEPS Action 2 Report, broadly provides that income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that Contracting State, as income of a resident of that Contracting State. It should also be noted that this position is reflected in paragraph 2 to Article 1 of the UN Model Convention.

Part II of the BEPS Action 2 Report also discusses potential treaty issues that could arise from the recommendations contained in Part I. In particular, the discussion explores whether the recommended rule that provides that the payer jurisdiction should deny a deduction for a payment to the extent it gives rise to a D/NI outcome, could be incompatible with treaty provisions.

The BEPS Action 2 Report raised that apart from Article 7 (Business Profits) and Article 24 (Non-Discrimination) of the OECD Model Tax Convention, the model convention does not govern whether payments are deductible and whether they are effectively taxed, noting that these are considered to be matters of domestic law.

The BEPS Action 2 Report also discusses whether the recommendations in Part I could be incompatible with the provisions of Article 24 (Non-Discrimination) of the OECD Model Tax Convention, which provides that nationals of a Contracting State shall not be subjected to any taxation or any related requirement in the other Contracting State, which is more burdensome than the taxation and the requirements to which nationals of that other Contracting State, in the same circumstances, are subject. However, the BEPS Action 2 Report concluded that, subject to the precise wording of the domestic rules, the Action 2 recommendations do not appear to conflict with the provisions of Article 24.

4.3. Debt/Equity Limitations

This section sets out a high-level overview of Action 4 of the BEPS Action Plan which provides for a set of rules designed to limit base erosion involving interest deductions, together with a discussion of how some of these issues might be relevant in the context of the mining industry.

Action 4 of the BEPS Action Plan called for recommendations regarding best practices in the design of rules to prevent base erosion by using interest expense to achieve excessive interest deductions or to finance the production of exempt income. Multinational Groups may achieve favourable tax results in this context in three scenarios:

1. Groups placing higher levels of third-party debt in subsidiaries located in high tax countries;
2. Groups using intra-Group loans to generate interest deductions in excess of the Group's actual third-party expense; and
3. Groups using third party or intra-Group financing to fund the generation of tax-exempt income.

In order to address these issues, the OECD released its final report on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments ("BEPS Action 4 Report") on 5 October, 2015, as part of the wider package that included final reports on all 15 BEPS Actions. The BEPS Action 4 Report provides a two-pillar approach consisting of a Fixed Ratio rule and a Group Ratio rule, together with certain modifications and enhancements depending on the nature of the Group, as well as industry specific considerations.

It should be noted that an area of focus of the BEPS initiative is the concern that MNEs use debt "excessively" in Host Countries. This area was also identified as a high priority item for developing countries at an informal workshop on domestic resource mobilisation from mining, hosted by the OECD in October 2016. As such, the 2018 Report was prepared under a programme of co-operation between the OECD and the IGF as part of a wider effort to address some of the challenges developing countries are facing in raising revenue from their mining sectors.

The 2018 Report aims to help policy-makers understand how Mining Companies can legitimately use debt finance within corporations, as well as aid the development of an appropriate set of limitations that should be adopted by developing countries in order to mitigate aggressive Profit shifting in the mining sector. In particular, the 2018 Report identifies a number of areas of concern, including the allocation of disproportionately large amounts of debt to the Host Country which then raises questions about their ability to service that debt (and make a Profit locally), and the charging of interest rates between Related Parties that are inconsistent with rates that would be charged between non-Related Parties.

4.3.1. The Fixed Ratio Rule

The Fixed Ratio rule, which the BEPS Action 4 Report recommends that all jurisdictions adopt, limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its EBITDA. The design of the rule is thought to most efficiently link a Group's net interest deductions to its income-producing activities. The application of the Fixed Ratio rule is set out as follows:

1. determination of the relevant entity's EBITDA by calculating the taxable income of the entity as determined under applicable domestic law, adding back net interest expense, net payments equivalent to interest, and Depreciation and Amortisation;
2. determination of the maximum allowable interest expense by applying the statutory benchmark ratio (which is to range between 10% and 30%) to the EBITDA figure;
3. determination of the allowable net interest deduction as the lower of the actual net interest expense or the maximum amount as calculated in (2).

The recommended ratios range between 10% and 30% to ensure that the ratio is low enough to tackle BEPS, whilst also recognising that not all countries are in the same position. In particular, the BEPS Action 4 Report indicates that, based on average figures over the period 2009 to 2013, half of publicly traded multinational Groups with positive EBITDA have an EBITDA ratio of 5% or less, whereas 62% of such Groups are able to deduct all their net third party interest expense at the 10% benchmark and 87% of such Groups are able to do so at the 30% benchmark.

The BEPS Action 4 Report raises that a number of different factors should be considered by a jurisdiction in order to establish an appropriate ratio. For example, jurisdictions that do not also adopt a Group Ratio rule (which is discussed in further detail below), jurisdictions that do not permit entities to carry forward disallowed interest expense and/or unused interest capacity (i.e. where an entity's actual net interest deductions are below the maximum permitted) for future years, and jurisdictions that have a targeted system of rules to address interest-related BEPS activity, should each consider adopting a benchmark ratio at the upper end of the range.

The BEPS Action 4 Report also identifies a few issues with the Fixed Ratio rule, with the key issue being that Group's earnings can be volatile and therefore difficult to predict. In these circumstances, it is recommended that countries consider using an average EBITDA figure between the range of 10% and 30%.

4.3.2. The Group Ratio Rule

The BEPS Action 4 Report recognises that some Groups are highly leveraged with third party debt for non-tax reasons, and therefore offers a Group Ratio rule, alongside the Fixed Ratio rule, which can be adopted by jurisdictions to address these circumstances.

The Group Ratio rule allows an entity with a net interest expense above a country's Fixed Ratio to deduct interest up to the level of the net interest/EBITDA ratio of its worldwide Group, and therefore only net interest expense that exceeds both the benchmark Fixed Ratio and the Group Ratio would be disallowed. The BEPS Action 4 Report advises that consolidated financial statements be used to determine the interest/EBITDA ratio of a worldwide Group. However, as a national tax authority will typically not be in a position to confirm the accuracy of Group financial data, it is recommended that such consolidated financial statements should be audited by an independent regulated accountant.

The BEPS Action 4 Report also recommends that adjustments are made to exclude items that are not properly viewed as interest, including dividends, gains and losses on the disposition of financial instruments, and notional interest amounts. Where a country chooses not to introduce a Group Ratio rule, it should apply the Fixed Ratio rule to entities in multinational and domestic Groups without improper discrimination.

4.3.3. Definition of Interest Expense

It should be noted that jurisdictions should include items economically equivalent to interest within the scope of the Fixed Ratio rule and the Group Ratio rule. Examples of items that might be considered economically equivalent to interest for the purpose of these rules includes Profit participating loans, imputed interest on various instruments such as convertible bonds and zero coupon bonds, amounts payable under alternative financing arrangements, capitalised interest, notional interest under derivative instruments or hedges of an entity's debt, and certain foreign exchange gains and losses on debt instruments. Certain expenses incurred in relation with borrowing should also fall within the scope of the proposed rules, including guarantee fees and debt issuance costs.

4.3.4. Carry Forwards and Carrybacks

The BEPS Action 4 Report recognises that earnings volatility creates a challenge for Groups when planning long-term, whereas the permanent disallowance of interest expense could result in double taxation whereby the relevant lender will likely be taxed on the interest income. As such, the BEPS Action 4 Report recommends that jurisdictions allow entities to Carry forward unused interest capacity and to Carry forward and/or Carryback disallowed interest expense (being interest expense disallowed under the Fixed Ratio and Group Ratio rules, and not pursuant to other targeted rules, on the basis that any disallowance in relation to the latter is presumed to arise from BEPS arrangements).

It should be noted that Carry forwards and Carrybacks are particularly relevant in the context of the mining industry, where projects typically involve initial periods of high investment followed by extended periods of non-profitability through construction and high depreciation to revenue. The BEPS Action 4 Report also suggests that jurisdictions should apply limits to all Carry forwards and Carrybacks, such as in relation to the number of years in which disallowed interest expense has arisen or the amount of unused interest capacity.

4.3.5. Targeted Rules and Special Rules for Certain Industries

The BEPS Action 4 Report recommends that the approach discussed above should be supported by targeted rules to prevent any possible artificial modification of the effect of the Fixed Ratio rule and Group Ratio rule. For example, entities may attempt to convert interest expense into a different form of deductible expense in order to artificially reduce the level of net interest expense. The BEPS Action 4 Report suggests that jurisdictions should consider introducing rules to tackle specific BEPS risks not addressed by the recommended approach, such as to address circumstances in which an entity without net interest expense shelters interest income.

The recommended approach also encourages countries to supplement the Fixed Ratio rule and the Group Ratio rule with other provisions that reduce the impact of the relevant rules on entities or arrangements which pose less BEPS risk. Exclusions from the prescribed approach includes a de *minimis* threshold which carves-out entities which have a low level of net interest expense, noting that in the case of multinational Groups, it is recommended that the threshold is applied to the total net interest expense of the local Group in a particular jurisdiction.

The BEPS Action 4 Report outlines an exclusion for interest paid to third party lenders on loans used to fund public-benefit projects, on the basis that in such circumstances an entity may be highly leveraged, but due to the nature of the projects and the public sector nexus, the BEPS risk is significantly low. However, in order for this exclusion to apply, and for any earnings and related interest expense of the operator and its Group to be excluded from the Fixed Ratio rule and the Group Ratio rule, several conditions must be met:

1. the relevant third-party loan relates to projects where the operator undertakes to provide, operate and/or maintain assets for at least 10 years;
2. there is a general public interest in the project and the operator contracts with a public sector body to provide the relevant goods or services;
3. the loan is non-recourse and the loan is secured only by the project's assets;
4. each of the operator, the interest, the project's assets and the income arising from the project are all in the same jurisdiction; and
5. the third-party debt of the project does not exceed any such third-party debt attributable to other, similar projects undertaken by the operator or its Group.

It should also be noted that the BEPS Action 4 Report acknowledges that the banking and insurance sectors have specific features which should be considered and therefore specific rules that address risks in these sectors will need to be developed. For example, the Fixed Ratio rules and Group Ratio rules may not be effective in the context of bank and insurance companies, given that these entities typically have net interest income rather than net interest expense.

4.3.6. BEPS Action 4 and the Mining Industry

The 2018 Report considers whether a mining-specific rule is needed under the Action 4 of the BEPS Action Plan. It acknowledges that tax policies implemented sector by sector are not typically encouraged, however, where extractive industries are a significant portion of a country's economy, this could justify a special interest limitation rule for the sector (particularly where there is sufficient evidence of acute base erosion occurring). It should also be noted that in many tax jurisdictions Mining Companies face separate fiscal arrangements and ring-fencing, and therefore the decision to apply sectoral rules has already been made.

The application of a specific rule for the mining sector would require certain considerations, including whether additional limitations would apply to each MNE on a project-by-project basis, or instead to the Group of local entities as a whole. Fluctuations in the price of mineral products should also be considered as these can lead to marked changes in the economic position of mining entities within a Group. For example, where the price of mineral products falls, the accounting value of the Mining Company can fall and the level of interest deductions for tax purposes can increase without the MNE Group taking any action to increase its debt levels, whereas, in the case of stronger commodity prices, earnings increase and interest costs can fall, increasing the level of debt that could be allowable. Any prescribed limitations would therefore need to provide for this volatility to ensure that the rules operate effectively long-term.

The 2018 Report also recognises that the fixed ratio prescribed would need to reflect the diversity across mining MNEs and therefore be tailored to the actual structure of the mining sector in each Host Country (as well as consider some of the additional factors discussed above). The report also notes that mining MNEs do not typically have high levels of borrowing with external parties relative to other sectors, and therefore a simplified approach with no Group Ratio rule may be sufficient for developing countries with a substantial mining industry which are facing acute capacity constraints.

The ability to Carryforward excess deductions was recognised as an important measure to ensure that Mining Companies can deduct legitimate expenses for tax purposes. For example, timing mismatches between when a mine is constructed and when production begins (and therefore income is received) can result in entities with negative or no EBITDA, therefore allowing entities to Carryforward excess interest expenses to later years would be the most appropriate response. Additionally, as previously raised, the ability to Carryforward excess deductions addresses any concerns surrounding the fluctuation of Mining Companies' earnings in conjunction with commodity price fluctuations.

Finally, it should be noted that debt financing is an important source of funds to construct mines and finance their operation and expansion, and therefore any limitations enforced by developing countries will need to carefully balance the ability to continue to attract an appropriate level of foreign investment into the Host Country, whilst ensuring that the country's tax base is sufficiently protected.

4.4 Transfer Pricing and DEMPE

This section gives a high-level overview of additional Transfer Pricing guidance provided for by Actions 8-10 of the BEPS Action Plan[100] and sets out the relevance of this issue in the context of the mining industry.

Transfer Pricing principles are relevant in the context of attributing taxable profits to Permanent Establishments. The OECD has released guidance which is relevant to this topic: Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7 (the "Additional Guidance"). The Additional Guidance contains a number of examples illustrating the attribution of profits to Permanent Establishments arising under Article 5 of the OECD Model Tax Convention. In each example, the guidance in the OECD's Transfer Pricing Guidelines is applied by analogy to determine the arm's length pricing of the internal transaction between the Permanent Establishment and its Related Party.

The Additional Guidance will be of particular relevance to mining Groups operating in jurisdictions whose definition of Permanent Establishment closely follows the OECD Model Tax Convention. It will assist such Groups in attributing taxable Profits (and calculating potential tax liabilities) to its Permanent Establishment(s) located in a particular territory.

4.4.1. BEPS Actions 8-10: Transfer Pricing

The aim of Transfer Pricing rules is to determine the conditions, including the price, for transactions within a multinational Group. Transfer Pricing applies the arm's length principle such that transactions between Related Parties must be priced as if those entities were independent and operating at arm's length. Transfer Pricing considers the price that would apply to a Controlled Transaction between Related Parties based on comparable transactions happening under similar conditions and economic circumstances.

100. OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD publishing, https://www.oecd-ilibrary.org/taxation/aligning-transfer-pricing-outcomes-with-value-creation-actions-8-10-2015-final-reports_9789264241244-en

There are many potential Controlled Transactions in the mining sector value chain which may be split into two categories: the sale and purchase of minerals or mineral rights between Related Parties; and the sale and purchase of various goods, services and assets from Related Parties. Examples include:

- Sale of minerals to a Related Party for further processing.
- A parent purchasing mining machinery on behalf of its subsidiary.
- A parent lending money to its subsidiary to finance exploration or development costs.
- A subsidiary paying a fee to a Related Party in exchange for certain support services including administrative and advisory functions.

BEPS Actions 8-10 address Transfer Pricing guidance with a view to ensuring that Transfer Pricing outcomes are better aligned with the value creation of multinational Groups. The following items result from the work of the OECD in relation to Actions 8 through 10 (each of which are discussed separately in further detail below):

i. Revised Guidance on Transactional Profit Split Method

This revised OECD guidance (*Revised Guidance on the Application of the Transactional Profit Split Method*) clarifies and significantly expands the guidance on when a TPSM may be the most appropriate Transfer Pricing method. The guidance describes a TPSM as a method that identifies the relevant Profits to be split for the Related Parties from a Controlled Transaction and then splits those Profits on an economically valid basis that approximates the division of profits that would have been agreed at arm’s length.

However, while there may be circumstances where the TPSM is most appropriate, it is worth emphasising that in many cases it is the CUP Method that is the more appropriate Transfer Pricing method for transactions involving commodities such as minerals, being the most direct and reliable way to apply the arm’s length principle in such a context. This point is made clear in the OECD’s Transfer Pricing Guidelines as well as in guidance published by the OECD and the IGF.[101] As such, in many Related Party transactions entered into by Mining Companies, the CUP Method will be preferred to other methods. This is not to say that other Transfer Pricing methods should be ignored and, in the circumstances set out below, the TPSM may be preferred.

In choosing a Transfer Pricing method, the aim is to find the most appropriate method for the transaction at hand. The OECD sets out non-prescriptive guidance on how to determine whether the TPSM is likely to be the most appropriate method to use. When determining the appropriateness of using the TPSM, the presence of the following indicators are relevant:

- Each party makes unique and valuable contributions (e.g. by contributing unique and valuable intangibles) to the transaction in question. Contributions (for instance functions performed, or assets used or contributed) will be “unique and valuable” in cases where (i) they are not comparable to contributions made by uncontrolled parties in comparable circumstances, and (ii) they represent a key source of actual or potential economic benefits in the business operations.

- The business operations are highly integrated such that the contributions of the parties cannot be reliably evaluated in isolation from each other.

101. OECD/IGF (2023), Determining the Price of Minerals: A Transfer Pricing Framework

A high degree of integration means that the way in which one party to the transaction performs its functions, uses assets and assumes risks are interlinked with, and cannot reliably be evaluated in isolation from, the way in which another party to the transaction performs its functions, uses assets and assumes risks. In some cases, the parties may perform functions jointly, use assets jointly and/or share assumption of risks to such an extent that it is impossible to evaluate their respective contributions in isolation from those of others.

- The parties share the assumption of economically significant risks, or separately assume closely related economically significant risks. A TPSM may be most the appropriate method where each party to the Controlled Transaction shares the assumption of one or more of the economically significant risks in relation to that transaction. The relevance of this factor as an indicator for the TPSM will depend on the extent to which the risks concerned are economically significant such that a share of relevant Profits would be warranted for each party. The economic significance of the risks should be analysed in relation to their importance to the actual or anticipated relevant profits from the Controlled Transaction(s), rather than in respect of their importance to any one of the Related Parties whose business operations may extend beyond those covered by the relevant Profits.

ii. Additional Guidance on the Application of Hard-to-Value Intangibles ("HTVI") Approach (Action 8)

Although HTVIs generally play a smaller role in the mining industry than they do in other industries (for example, the pharmaceutical industry), as noted by the IGF and the African Tax Administration Forum, the mining sector is undergoing a major technological transition, including the use of optimisation tools such as machine learning and artificial intelligence[102]. They discuss how the role of new technologies will lead to a significant increase in the value of mining-related intangible assets such as patents and algorithms as a percentage of the mining value chain[103]. Thus, Mining Companies will be required to pay licensing fees for new intangibles, including to Group companies. Therefore, the following discussion around the approach developed by the OECD for valuing HTVIs will be of relevance to Groups operating in the mining sector.

The guidance for tax administrations on the application of the HTVI approach has been incorporated into the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 at Section D.4 of Chapter VI. The purpose of the guidance is to provide an approach which tax authorities can use to determine if taxpayers' pricing arrangements relating to HTVI are arm's length.

Per the Transfer Pricing Guidelines definition, HTVI are intangibles for which, at the time of their transfer between Related Parties, (i) no reliable comparables exist; and (ii) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate financial success of the intangible at the time of the transfer.

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102. The Future of Resource Taxation: A roadmap (October 2020)
103. Id

The guidance goes on to say that the following are features of a HTVI:

- At the point of transfer, the intangible has only been partially developed.
- It is not expected to be exploited commercially until several years post-transfer.
- Where the intangible does not fall within the definition of HTVI per the Transfer Pricing Guidelines, it is nonetheless key to developing or enhancing other HTVIs which do meet that definition.
- The expectation is for the intangible to be exploited in a novel way and there is no history of development or exploitation of similar intangibles, making projections highly uncertain.
- The HTVI has been transferred to an associated enterprise for a lump sum payment.
- The HTVI is used in connection with or developed under a cost contribution arrangement or similar.

The guidance recognises that for HTVIs there may be significant information asymmetry between the taxpayer and the tax administration. Often it will be difficult for a tax administration to establish whether an arm's length price has been used until years following the transfer i.e. once actual financial outcomes (referred to in the guidance as ex post outcomes) relating to the HTVI are known. In these circumstances, the guidance says tax administrations can consider actual financial outcomes as evidence as to the appropriateness of the projected financial outcomes originally used by the taxpayer to set Transfer Pricing and make an adjustment where appropriate.

A taxpayer can avoid Transfer Pricing adjustments based on ex post financial outcomes by ensuring it takes the following steps:

- providing details of the projections used at the time of the transfer of the HTVI to determine pricing arrangements, including how risks were accounted for when determining the price;
- demonstrating that it appropriately considered the probability of the occurrence of any reasonably foreseeable events and risks; and
- providing evidence that any significant difference between financial projections and actual outcomes is either due to: (i) unforeseeable developments or events occurring after determining the price for the transfer, which could not have been anticipated at the time; or (ii) the occurrence of foreseeable outcomes and the probability of those outcomes occurring was not significantly overestimated or underestimated at the time of the transfer of the HTVI.

iii. Development, Enhancement, Maintenance, Protection and Exploitation of intangibles ("DEMPE")

Intangibles are of increasing relevance for the mining industry given the pervasion of technology-based solutions within the sector. For example, mining know-how developed or exploited during the mine development stage, may give rise to Transfer Pricing considerations regarding charging or being charged fees to Related Parties for the use of this intellectual property or other intangible asset.

There is guidance from the OECD on how to allocate returns between the legal owner of an intangible and other members of its multinational Group. In particular, the OECD BEPS Report on Actions 8 to 10 notes that although the legal owner of an intangible may receive the proceeds from its exploitation, other members of the legal owner's multinational Group may have performed functions, used assets or assumed risks that are expected to contribute to the value of that intangible and must be compensated for those contributions under the arm's length principle.

The allocation of returns derived by a multinational Group from the exploitation of intangibles, and the allocation of related costs, is achieved by compensating Group members for functions performed, assets used, and risks assumed in the development, enhancement, maintenance, protection and exploitation of intangibles ("DEMPE"). In the mining industry, many DEMPE functions are performed by the parent, which then needs to be suitably compensated, applying appropriate Transfer Pricing methods, for undertaking those functions (e.g. developing intangibles) which are then used by their operating subsidiaries.

The BEPS Actions 8–10 Report states that taxpayers should carry out a DEMPE analysis to ensure that they are complying with the OECD BEPS guidance on determining appropriate arm's length compensation for functional contributions towards intangibles. Prior to the introduction of the DEMPE principle, all returns generated by an intangible could be treated as belonging to its legal owner. This enabled multinational Groups operating in high-tax jurisdictions to hold intellectual property in low-tax jurisdictions and charge royalties to other members of the Group in high-tax jurisdictions, thus reducing the taxable Profits in high-tax jurisdictions and shifting those Profits to low-tax jurisdictions through intra-Group payments of royalties, despite the fact that the royalty income was effectively generated in a high-tax jurisdictions.

Now, however, any income that is generated by that intangible is owned by all the parties that perform the DEMPE functions. So, rather than the legal owner of intangible receiving the full amount of the returns generated by the intangible, it will be divided between the relevant parties, in line with each entity's contribution to the value of the intangible. Therefore, although an intangible may be registered in a low-tax jurisdiction, it does not mean that Profits relating to that intangible are treated as located there. Rather, it will depend on the extent of the DEMPE functions (if any) performed in the jurisdiction of the legal owner.

As is made clear in the BEPS Actions 8–10 Report, for Transfer Pricing purposes, legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by the multinational Group from exploiting the intangible, even though returns may initially accrue to the legal owner as a result of its legal and contractual right to exploit the intangible. If the legal owner performs no relevant functions, uses no relevant assets and assumes no relevant risks but acts solely as a title holding entity, it will not be entitled for Transfer Pricing purposes to any portion of the return other than arm's length compensation (if any) for holding title.

iv. New Transfer Pricing Guidance on Financial Transactions (Actions 4 and 8-10)

The OECD published the Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS: Actions 4, 8-10 in February 2020. The report provides guidance for determining whether the conditions of certain financial transactions between Related Parties are consistent with the arm's length principle. However, it is important to note that the report, which is also contained in Chapter X of the OECD Transfer Pricing Guidelines, allows countries to take a different approach under their domestic legislation – they are not required to follow the arm's length principle as described in the report.

The report provides guidance on the application of the principles contained in Section D.1 of Chapter I of the OECD Transfer Pricing Guidelines, including by setting out guidance on whether a loan should be treated as such for Transfer Pricing purposes. The report also addresses specific issues relating to the pricing of financial transactions e.g. treasury functions, intra-Group loans, guarantees and hedging as well as guidance on how to determine a risk-free rate of return and a risk-adjusted rate of return, in each case in the context of Related Party financial transactions.

Related Party financial transactions are common within larger mining Groups, who will often arrange such finance centrally through an entity which carries on a Group treasury function. The Group treasury entity normally establishes any cash pooling arrangements i.e. a centralised short-term cash management arrangement between Group entities which aids in efficient deployment of capital within the Group. Excess cash is regularly transferred to a cash pool so that it can then be deployed by other Group entities on a short-term basis. Cash pooling arrangements are undertaken by an entity that generally performs a co-ordination function that needs to be appropriately remunerated. Other Group entities will deposit cash into the pool or borrow from the pool and will either be receiving or paying an arm's length rate of interest. For each of the Related Party financial transactions mentioned here, the principles described below are of importance in establishing an appropriate arm's length.

As noted above, the OECD report on Actions 4, 8, 9 and 10 sets out how to determine whether a purported loan between associated enterprises should be regarded as a loan for tax purposes. The report makes clear that accurate delineation of financial transactions requires a consideration of specific factors affecting business performance in the industry in which the multinational group operates, for example, the point of the economic or product cycle and the impact of government regulations as well as different capital intensity levels between industries.

The starting point for the accurate delineation of the actual financial transaction is to identify its economically relevant characteristics i.e. contractual terms of the transaction: functions performed, assets used and risks assumed by the parties to the Controlled Transaction; characteristics of the relevant financial instruments; the economic circumstances of the parties and of the market; and the business strategies pursued by the parties.

Having done this, the next step is to consider the conditions that independent parties would have agreed in comparable circumstances. The report notes that in an ideal scenario, comparable financial transactions between independent parties would match the tested transaction in all respects. Where comparables differ from the Controlled Transaction (as is the more likely reality), comparability adjustments must be made to improve the reliability of comparables to the extent that such differences have a material impact on price.

4.5. Country-by-Country Reporting

This section provides a high level overview of country-by-country reporting as provided for by Action 13 of the BEPS Action Plan before setting out the relevance of this issue in the context of the mining sector.

Action 13 of the BEPS Action Plan regarding Country-by-Country ("CbC") reporting and Transfer Pricing documentation provides that the parent company of a multinational Group with consolidated revenues of at least EUR 750 millon should annually file a CbC report on with the tax authority in the jurisdiction in which the parent is tax resident. CbC reporting differs from regular financial reporting in that companies have to publish information for every country in which they do business, as opposed to producing a single set of information at global level i.e. on a consolidated basis.

The following African, Middle Eastern and Latin American countries have introduced a CbC reporting rule for multinational enterprises with consolidated revenues above the relevant threshold: Argentina, Aruba, Bahrain, Belize, Brazil, Cabo Verde, Chile, Colombia, Costa Rica, Côte d'Ivoire, Curaçao, Egypt, Gabon, Israel, Jordan, Mauritius, Mexico, Morocco, Nigeria, Oman, Panama, Peru, Qatar, Saudi Arabia, Senegal, Seychelles, South Africa, Tunisia, United Arab Emirates, Uruguay and Zambia.

The CbC report must give a clear overview of where Profits, sales, employees and assets are located and where taxes are paid. This information must be presented for each jurisdiction in which the multinational Group operates. Entities that are included within the consolidated Group for financial reporting purposes should be included in the CbC report.

The tax authority in the jurisdiction of the parent company will exchange this information with other tax authorities located in territories where the multinational Group carries on its business (provided that Competent Authority Agreement (which is a form of an intergovernmental agreement) is in place between the parent jurisdiction and the recipient tax jurisdiction and certain conditions are met regarding confidentiality, consistency and appropriate use). The idea is that a CbC report assists tax authorities in carrying out Transfer Pricing assessments or tax audits which the OECD has identified as being key areas of difficulty for tax authorities in the context of global businesses.

The CbC reporting requirements has been implemented for fiscal years beginning on or after 1 January, 2016, and annual CbC reporting is a BEPS minimum standard and shall be implemented by all member countries of the OECD/G20 Inclusive Framework on BEPS (including many countries in Africa, the Middle East and Latin America).[104]

4.5.1. CbC Report Template

A template CbC report which is in electronic format is contained in the 2015 Final Report as well as in Appendix C of the OECD Country-by-Country Reporting XML Schema: User Guide for Tax Administrations.

The template CbC report is split into three tables. Table 1 of the template report must include the following information:

- The sum of the Profit (or loss) before income tax for all constituent entities resident for tax purposes in the relevant tax jurisdiction.
- Income tax paid during the relevant tax year by all constituent entities resident for tax purposes in the relevant tax jurisdiction (this includes taxes paid in the residence jurisdiction as well as in other tax jurisdictions) as well as taxes withheld from payments made to the constituent entities.
- Accrued current income tax expense of the year of reporting for all constituent entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year. This should not include deferred taxes or provisions for uncertain tax liabilities.
- Stated capital of all constituent entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year. Stated capital of Permanent Establishments should be reported by the legal entity of which it is a Permanent Establishment unless there is a defined capital requirement in the Permanent Establishment's tax jurisdiction for regulatory purposes.

104. The Inclusive Framework is the name of the group of over 140 countries that have agreed to the BEPS principles.

- Accumulated earnings of all constituent entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year. Accumulated earnings of Permanent Establishments should be reported by the legal entity of which it is a Permanent Establishment.
- Number of employees on a full-time equivalent basis of all constituent entities resident for tax purposes in the relevant jurisdiction. The number of employees may be reported as of year-end, based on average employment levels for the year, or on any other basis as long as it is consistently applied across tax jurisdictions and from year to year. Independent contractors participating in ordinary operating activities of the Related Party may be reported as employees.
- The net book values of tangible assets of all constituent entities resident for tax purposes in the relevant tax jurisdiction. Tangible assets of Permanent Establishments should be reported by reference to the tax jurisdiction in which the Permanent Establishment is situated. Tangible assets do not include cash or cash equivalents, intangibles or financial assets.

Table 2 of the template CbC report must include all the constituent entities of the MNE Group on a tax CbC basis and specify their legal entity names. Permanent Establishments should be listed by reference to the tax jurisdiction in which the Permanent Establishment is situated and the name of the legal entity of which it is a Permanent Establishment should be noted. The report must also include the tax jurisdiction of incorporation of a particular Related Party if it is different from its tax jurisdiction of residence. Finally, table 2 must specify the main business activities for each Related Party by ticking the relevant description from a pre-defined list. The pre-defined list includes research and development, holding or managing intellectual property, purchasing or procurement, and manufacturing or production (among others).

Table 3 of the template CbC report is an optional section that asks for inclusion (in brief) of any further information or explanation considered necessary or that would facilitate the understanding of the compulsory information provided in Tables 1 and 2 of the CbC report. In terms of sourcing the data required to complete a CbC report, the OECD is understanding of the fact that Groups have different financial systems, accounting policies and approaches to tax management and reporting. As such, the OECD permits flexibility when choosing the source of data for the CbC report. While a consistent approach should be followed as between entities and countries, as well as year on year, changes can be made if the reasons and implications for this are explained (for example, an explanation can be included in Table 3). Multinational Groups should decide on the preferred approach in their particular circumstances which may involve a choice between local versus Group generally accepted accounting principles.

While the OECD has provided guidance on what should be included for each piece of data required in a CbC report, the guidance is not detailed, which allows for some flexibility in the preparation of such reports provided any approaches taken (e.g. assumptions made) are clearly documented and data sources are disclosed within the report (in Table 3). Despite an allowance for flexibility, as noted above, there remains an expectation of consistent application of the guidance across data points, countries, and over time.

4.5.2. Relevance of Country-by-Country Reporting for the Mining Industry

One of the implications of CbC reporting for the mining industry is its ability to lay clearly before tax authorities the key Transfer Pricing metrics used by large multinational mining Groups. Action 13 requires such Groups to share information on their global allocation of Profits, earnings, economic activity (including number of employees and net book values of tangibles assets), and income taxes paid among countries to all relevant tax authorities.

The reporting of such information provides tax authorities with a clearer picture of a mining Group's global value chain and highlights any mismatches between income allocation and value creation including, for example, an excessively debt-laden financing structure or an entity which carries on limited back office functions but has excessive Profits and few employees and/or assets. Therefore, the requirement on certain large mining Groups to submit a CbC report puts certain pressure to direct the appropriate amount of resource to assessing their Transfer Pricing risk and compliance positions.

It is worth noting briefly that Action 13 of the BEPS Action Plan is not the only CbC reporting of relevance to the mining sector. The Extractive Industries Transparency Initiative ("EITI") is widely regarded as a key impetus for global transparency for natural resources in the extractives industry. Countries may volunteer to sign up for EITI and over 50 countries have done so thus far, including a number of key mining jurisdictions in Africa and Latin America (for example, Burkina Faso, Peru, Tanzania and Zambia).

EITI comes with a requirement to report payments by mining Groups to Host Governments. The payments to be disclosed are: taxes on Profits, Royalties, dividends and License fees (among others) as well as any other significant payments and material benefits to a Host Government. The Host Government will use this information to publish a report which is made publicly available. While there is some overlap between the information required under EITI and BEPS Action 13, BEPS CbC reporting requires a comparatively greater amount of data sharing than EITI and, as discussed above, has potential implications in terms of a Group's Transfer Pricing compliance given the ability of tax authorities with access to CbC reports to then further scrutinise the Transfer Pricing methodologies used by large mining Groups.

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5. Impact of BEPS 2.0 - Pillar 2

We review below, the hierarchy and mechanics of Pillar Two; the impact of Pillar Two on tax incentives; the role of tax holidays in the post Pillar Two world and we provide preliminary recommendations.

5.1. In a bid to combat BEPS exacerbated by the digitalisation of the economy,[105] the OECD embarked and continues to work on a two-pillar solution to reallocate taxing rights and assure a minimum level of effective taxation for multinational companies.[106] As seen above, Pillar One which would, inter alia, allow market jurisdictions a tax claim on a greater share of a multinational's Profits, has moved at a slower pace to date and remains subject to fundamental debate at the OECD.[107]

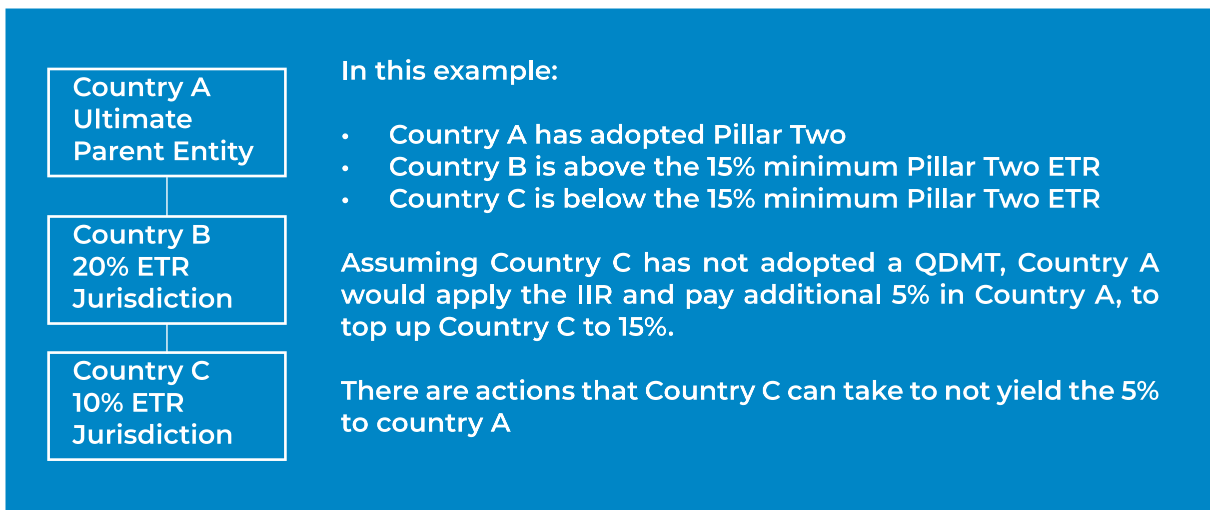
5.2. Pillar Two, which endeavours to provide a minimum level of effective taxation in each jurisdiction, continues to move very fast toward implementation with the major building blocks now agreed upon.[108] Pillar Two has been materialised by several documents including blueprints, model rules, multiple iterations of guidance, and various countries implementing legislations.[109] One of the notable features of Pillar Two is that it presents countries with a unique opportunity to review their tax policy in light of the major shifts it brings to the international tax landscape. Pillar Two arguably brings a new pot of revenues on the table and depending on a country's response, the country may find itself unnecessarily yielding that new pot of revenues to other jurisdictions' tax authorities. In the mining industry specifically, the wide use of tax incentives should be reviewed and reevaluated. Today, any design of policy around mining taxation should thoroughly vet the impact of Pillar Two. The policy design should answer, *ab initio*, how the major shifts brought about by Pillar Two impact the policy.

105. OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en.
106. OECD (2021), Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD Publishing, 8 October, 2021, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.
107. OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/beba0634-en.
108. OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.
109. OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.; OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition: Inclusive Framework on BEPS, OECD Publishing, Paris, https://doi.org/10.1787/1e0e9cd8-en.; OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris,www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf.;

5.3. Pillar Two offers a set of interlocking rules that assign rights to impose top-up tax on low-taxed income of multinational Groups across various jurisdictions according to an operating order of taxing priority. The cornerstone of Pillar Two is the Income Inclusion Rule ("IIR"), which is backstopped with the Under-Taxed Profits Rule ("UTPR"); in turn, both may be pre-empted by a Qualified Domestic Minimum Top-up Tax ("QDMT"). Each rule under Pillar Two is designed to backstop the other in such a way that they collectively bring a multinational Group's jurisdictional Effective Tax Rate ("ETR") to a minimum of 15% on Pillar Two income that exceeds a Substance-Based Income Exclusion ("SBIE"). To apply the minimum tax on a roughly equivalent tax base across countries, Pillar Two income is based on a multinational Group's financial statement income, with adjustments for each Related Party. We discuss the main rules of Pillar Two and their hierarchy below, including some basic examples.

5.4. Income Inclusion Rule

5.4.1. In the Pillar Two design, the IIR is effectively a rule that applies in a top-down manner to assure that the ultimate parent entity pays a top up tax for each and every one of its subsidiaries with an ETR below 15%. Outside of the QDMT (discussed below), the IIR is the first rule to apply to make sure that each jurisdiction in which the multinational company has a presence, is subject to a 15% minimum ETR. The general idea of the IIR is illustrated here:



5.5. Under-Taxed Profits Rule

5.5.1. The UTPR is a backstop rule which only applies where no IIR or QDMT is applicable to achieve the 15% Pillar Two minimum ETR. The UTPR is designed to adjust the income of one or more Related Parties to produce a tax equivalent to the top-up tax amount that was calculated but not collected in respect of a low-taxed Related Party elsewhere in the Group (including if the ultimate parent entity is itself a low-taxed Related Party).

5.5.2. Where more than one jurisdiction hosting a Related Party of the MNE Group adopts a UTPR, each of the countries is designated a portion of the top-up tax amount according to an allocation key based on the number of employees and the net book value of tangible assets in each country. The UTPR amount may be collected from the local Related Party in virtually any manner, including by denying deductions, adding deemed amounts to income, imposing a surcharge or excise, or otherwise. The basic operation of the UTPR is illustrated here.

Country A Ultimate Parent Entity

Country B 20% ETR Jurisdiction

Country C 10% ETR Jurisdiction

In this example:

- Country A has NOT adopted Pillar Two
- Country B has adopted Pillar Two and is above the 15% ETR
- Country C is below the 15% minimum Pillar Two ETR

Assuming Country C has not adopted a QDMT, there would be no IIR because Country A has not adopted Pillar Two. Country B may apply the UTPR and require additional 5% in Country B, to top up Country C to 15%.

There are actions that Country C can take to not yield the 5% to country B

5.6. Qualified Domestic Minimum Top-Up Tax

5.6.1. The Pillar Two design supports the adoption of domestic minimum taxes. A domestic minimum tax preserves the first right of taxation to the source country, thus switching the country collecting the Pillar Two top-up tax from an IIR- or UTPR-imposing country to the country where the income is earned. Importantly, the QDMT is fully creditable against Pillar Two taxes, and the QDMT takes precedence over shareholder taxes including the various controlled foreign corporation taxes imposed in the jurisdiction of the shareholder. The idea of the QDMT is illustrated here.

Country A Ultimate Parent Entity

Country C 10% ETR Jurisdiction

In this example:

- Country A has adopted Pillar Two
- Country C is below the 15% minimum ETR and has adopted QDMT

Because Country C has adopted a QDMT, the 5% differential will be capture under QDMT and will be fully credited against the 5% that would have been required under IIR. As a consequence, no IIR is due. In effect, Country C has topped up itself to the minimum 15% ETR for Pillar Two purposes.

There are actions that Country C can take to not yield the 5% to country A

5.7. Subject to Tax Rule

5.7.1. Pillar Two also adopted the Subject-To-Tax Rule (“STTR”) which modifies the outcome of existing tax treaties by allowing source countries to impose a top-up tax rate in addition to the existing treaty rate where the gross income paid is taxed in the payee’s country at less than 9% statutory rate. As currently proposed, the STTR would apply only to a prescribed set of deductible payments between Related Parties, including interest, royalties, and service fees; and would not alter the rate of tax on other payments such as those in respect of capital gains, or offshore indirect transfers.

5.7.2. Like other withholding taxes, the STTR is imposed on gross payments rather than net income. Under the current design, payments that are already subject to a statutory rate of at least 9% in the recipient country would not be subject to an STTR but would remain subject to other Pillar Two top-up tax if the entity's overall ETR falls below 15%. Accordingly, a jurisdiction adopting an STTR would apply it regardless of whether another jurisdiction has imposed top-up taxes through an IIR or UTPR. Taxes triggered under the STTR are included in the calculation of a jurisdiction's ETR for purposes of determining the application of the other Pillar Two rules.

5.8. Impact of Incentives under the OECD BEPS Pillar Two

5.8.1. Pillar Two applies on a CbC basis and ensures that the multinational company is subject to a minimum ETR of 15% in each jurisdiction where it carries operations. In the design of Pillar Two, the 15% ETR computation is based on the income in the jurisdiction and the taxes paid in relation to that income. In simplified terms, the ETR is the ratio of a multinational Group's taxes paid or accrued on Pillar Two income in a country divided by the multinational's Pillar Two income from that country.

5.8.2. In the mining sector as in many other sectors, there is a wide use of incentives to promote socially useful activities and investment. Importantly, the design of Pillar Two does not specifically take these considerations into account and often, the presence of these incentives leads to a Pillar Two ETR below 15%. Tax incentives and other tax reliefs may therefore present a significant way a country yields revenues to other countries through the mechanics of Pillar Two top up taxes. Specifically, a tax incentive provided under a mining agreement may lead the Mining Company to be deemed low taxed in the jurisdiction where the MDA is operated.

5.8.3. For example, a major multinational Mining Company, X, headquartered in England may enter into an MDA with the country of Cameroon to operate therein. The MDA may provide that company X would enjoy a tax holiday for the first five years of its operations in an attempt to attract investment and spur the development of the mining industry in Cameroon. In the first year of operations, company X generates USD 100 of Profits and is exempt from tax in Cameroon due to the tax incentive. However, from a Pillar Two perspective, company X may be seen to have USD 100 of income and USD 0 of taxes in Cameroon. Therefore, company X may be deemed to have a low taxed entity within its structure and provided England has adopted the Pillar Two rules, the parent company in England would be required to apply the IIR and pay USD 15 of taxes in England, to top up the entity Cameroon, to the minimum Pillar Two ETR of 15%. In effect, and from the perspective of Cameroon, USD 15 of revenues would have unnecessarily been yielded to England and the policy objectives of the incentives would not have been achieved because company X, ultimately would not enjoy the holiday and instead would pay the tax elsewhere (England). From a company X perspective, the incentive is meaningless because the tax is ultimately paid, regardless of the tax holiday provided in the local country (Cameroon).

5.8.4. All incentives do not have the same impact on Pillar Two, however. The table 5.8.4[110] summarises the common incentives and their impact on Pillar Two and an assessment of the level of risk they pose in driving the ETR to below the minimum Pillar Two rate of 15%.

110. CITE TO THE GUIDE BY ISLP AND IISD

Tax incentives	Likely impact of Pillar Two
Profit-based incentives	
Income tax holidays, including in export processing zones	**High:** Will significantly reduce the Pillar Two ETR for periods in which they are applicable and likely lead to the payment of top-up tax, depending on the size of the carve-out for payroll and tangible assets.
Business credits	**Medium to High**: The distinction between refundable and non-refundable tax credits and their differential impact on the calculation of the Pillar Two ETR—as well as the further differentiation of qualified and nonqualified refundable tax credits—will determine the risk of business credits.
Withholding tax (WHT) relief	**Medium to High**: WHT on payments of income (other than distributions to owners) is treated as a Covered Tax in the recipient's country and not the source country, while WHTs on distributions to owners are attributed to the source country. Accordingly, reductions in WHTs imposed by a source country on distributions, as an incentive for investment, are affected by application of Pillar Two in the source country if the reduction in effective rate results in an ETR for the distributing entity below the minimum tax rate.
Cost-based incentives	
Reduced tax rate, additional deductions for qualifying expenses	**Medium:** Will, in many cases, reduce Pillar Two ETR, but the ETR reduction may not always lead to the payment of top-up tax.
Tax deferrals, investment allowances, longer loss carry forward periods, preferential treatment of long-term capital gains	**Limited:** Likely to not reduce Pillar Two ETR and lead to the payment of top-up tax.
Payroll tax incentives, property tax reductions, exemptions from indirect taxes	**No impact:** Payroll taxes and other employment-based taxes, as well as social security contributions, are not Covered Taxes under the Pillar Two rules. Taxes based on ownership of specified items or categories of property are distinguishable from taxes based on a corporation's equity and should not be Covered Taxes under the Pillar Two rules. Consumption taxes, such as sales taxes and value-added taxes, are not Covered Taxes under the Pillar Two rules.

5.9. Role of Tax Holidays Post Pillar Two

5.9.1. It seems unrealistic to believe that Host Governments would simply abandon tax incentives and tax relief altogether due to their negative impact on Pillar Two. It is reasonable to assume that tax incentives will continue because in some instances, they serve as a powerful policy tool available to Host Governments. However, it is reasonable to expect that the use of incentives and the kinds of incentives that are used, may change significantly in the post Pillar Two world.

5.9.2. First, for Groups that have global revenues below the Pillar Two threshold of EUR 750 million, Pillar Two is not applicable and the risk of a low ETR triggering a top up tax simply does not exist. For those Groups therefore, tax incentives may continue unaltered, in the pre-Pillar Two world.

5.9.3. Second, for large companies that are within scope of Pillar Two, negotiation of tax incentives would need to be informed by their impact from a Pillar Two perspective. Multinational companies would rely heavily on modeling to assess the usefulness of incentives offered to them in various source countries. Ultimately, multinational companies would need to get comfortable, based on their overall footprint, that an incentive given in country X would not be clawed back in country Y based on the operation of Pillar Two and specifically the IIR and the UTPR.

5.9.4. Finally, from a domestic perspective, incentives would need to be carefully selected and designed so as to not drive the ETR below the minimum Pillar Two rate of 15%. Host Countries would need to make sure that any tax policy incentive they provide do indeed benefit the investor and that revenues are not otherwise being yielded to external government authorities on income economically earned in the Host Country. Specifically, Host Countries would need to pay close attention to the table of incentives above and carefully assess those incentives that have a high risk of driving ETR to below the minimum Pillar Two rate.

5.9.5. The overall recommendation is that any consideration of a tax incentive in the mining industry should carefully consider and analyse the impact of OECD BEPS Pillar Two. The main question to be answered before establishing or agreeing to a tax incentive is whether it actually provides the favourable treatment desired, or whether it simply serves to yield tax revenues to other countries' tax authorities due to Pillar Two.

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TOOLKIT FOR MINERAL TAXATION IN MINING PROJECTS