TAX JUSTICE NETWORK AFRICA

Assessing the Fiscal Aspects of Extractive Industry Contracts

A Toolkit for Members of Parliament and Civil Society Organizations

May 2024

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Foreword

Acknowledgements

This Toolkit was prepared by the International Lawyers Project for Tax Justice Network Africa (TJNA's) policy advocacy work with the African Parliamentary Network on Illicit Financial Flows and Taxation (APNIFFT). The toolkit was written by John Bush and Mary Ongore, with extensive input from Michael Durst, Howie Man, Alexandra Readhead, and Mukupa Nsenduluka.

Intended Use

This Toolkit is for use by African parliamentarians and Civil Society Organizations (CSOs) to examine and assess the fiscal aspects of extractive industry contracts and monitor the tax, royalty, and Product Sharing Agreements (PSA) revenue earned under such contracts. It is intended to give an overview of the fiscal issues involved and is designed for persons interested in this focus area without a technical background.

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List of Abbreviations

AMGF	African Minerals Governance Framework
AMV	African Mining Vision
AMLA	African Mining Legislation Atlas
ATAF	African Tax Administration Forum
AU	African Union
BEPS	Base Erosion and Profit Shifting
BIT	Bilateral Investment Treaty
CCSI	Columbia Center for Sustainable Development
CIT	Corporate Income Tax
CSOs	Civil Society Organizations
DRC	Democratic Republic of the Congo
DTA	Double Tax Agreement
ECOWAS	Economic Community of West African States
EITI	Extractive Industries Transparency Initiative
ESG	Environmental, Social, and corporate Governance
ETR	Effective Tax Rate
GAAP	Generally Accepted Accounting Principles
GRI	Global Reporting Initiative
HLP on IFFs	High-Level Panel on Illicit Financial Flows from Africa
IBA	International Bar Association
ICTD	International Centre for Tax & Development
IF	Inclusive Framework of the BEPS Program
IFFs	Illicit Financial Flows
IFRS	International Financial Reporting Standards
IGF	Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development
ILP	International Lawyers Project
IMF	International Monetary Fund
ISLP	International Senior Lawyers Project
ISDS	Investor-State Dispute Settlement
MNE	Multinational Enterprise
NRGI	Natural Resource Governance Institute
QDMTT	Qualified Domestic Minimum Top-up Tax
OECD	Organization for Economic Cooperation and Development
OHADA	Organization for the Harmonization of Business Law in Africa

PSA	Product Sharing Agreements
QDMTT	Qualified Domestic Minimum Top-up Tax
SADC	Southern African Development Community
SARS	South African Revenue Service
SOEs	State Owned Enterprises
STTR	Subject to Tax Rule of the BEPS program
TJNA	Tax Justice Network Africa
UMK	United Manganese of Kalahari (PTY) Ltd.

Glossary

This Glossary introduces Parliamentarians and CSOs to a number of terms and organizations that some may not be familiar with. The terms and organizations are discussed in more detail in the text of the Toolkit.

AMGF African Mining Vision, African Minerals Governance Framework – The African Union (AU) created the AMGF in 2017 to deepen the commitment to implementing the Africa Mining Vision (AMV) by serving as a monitoring tool to help African countries determine their progress with regard to realizing the transformative ambitions of the Vision.

AMLA African Mining Legislation Atlas - The organization known as the African Mining Legislation Atlas created the AMLA Guiding Template as a mining law drafting and reference tool that guides the elements of a jurisdiction's mining law.

BEPS Base Erosion Profit Shifting – The OECD created the BEPS program to curb aggressive tax planning by Multinational Enterprises (MNEs). The program has several action items, the most important of which, for the purposes of this Toolkit, is Pillar 2, which seeks to establish a worldwide minimum tax of 15%.

BIT Bilateral Investment Treaty – BITs are entered into between two jurisdictions to protect investors from one jurisdiction making cross-border foreign direct investments in another jurisdiction.

DTA Double Tax Agreement – DTAs are entered into between two jurisdictions to provide rules for the taxation of an enterprise organized in one jurisdiction when doing business in another.

EITI Extractive Industries Transparency Initiative – The EITI is a CSO that promotes the open and accountable management of oil, gas and mineral resources. Over 50 countries have agreed to a common set of rules governing what should be disclosed and when – the EITI Standard. Many extractive industry companies are supporters of the EITI standards.

ESG Environmental, Social, and corporate Governance – ESG provides standards for companies to follow with respect to the three named terms. The standards are increasingly covered in public company reporting.

ETR Effective Tax Rate – The ETR of a business is the rate at which it pays taxes. It consists of both current taxes being paid and deferred taxes (taxes that will be paid or deducted) in the future. Companies typically report their ETR in their financial statements.

GAAP GAAP Generally Accepted Accounting Principles – GAAPs are the accounting standards used by U.S. companies in preparing their financial reports. The standards are set by the Financial Accounting Standards Board (FASB).

GRI	Global Reporting Initiative – The GRI is an international standard-setting organization that sets widely used sustainability reporting standards.
HLP on IFFS	HLP on IFFs High-Level Panel on Illicit Financial Flows from Africa – The Joint African Union Commission (AUC)/United Nations Economic Commission for Africa (UNECA) established a panel to deal with IFFs originating from Africa. The panel started its work in 2012 and issued a report on IFFs emanating from Africa thereafter.
IF	Inclusive Framework of the BEPS Program – The IF, which is a consortium of different countries, was organized by the OECD as part of its work on BEPS. It now has 140 countries as members, including about half of African countries.[1] Two African countries, Nigeria and Kenya, have not preliminarily agreed to the standards set by the IF in Pillars 1 and 2 but are now considering doing so.
IFFs	Illicit Financial Flows – IFFs consist of the movement of money across borders that is illegal in its source (e.g., corruption, smuggling), its transfer (e.g., tax evasion), or its use (e.g., terrorist financing).
IFRS	International Financial Reporting Standards – IFRS are the accounting standards used by most companies organized outside of the U.S. in preparing their financial reports. The standards are set by the IFRS Foundation.
ISDS	Investor-State Dispute Settlement – ISDS is a system through which countries can be sued by foreign investors for state actions affecting foreign direct investment. This system most often takes the form of arbitration between a foreign investor and the nation receiving the inbound foreign investment.
IMV	African Mining Vision – The AU created the AMV in 2009 to inspire African government to think about how to integrate mining much better into development policies at local, national and regional levels.
Pillars 1 & 2	The two Pillars are part of the BEPS project. Pillar 1 proposes a method for taxing the digital economy (Amount A) and, in addition, proposes a method for standardizing the taxation of marketing and distribution expenses (Amount B). Amount A only applies to MNEs with revenues in excess of 20 billion Euros and a pretax profit margin in excess of 10%; Amount B's precise scope is to be determined. Pillar 2 seeks to establish a global minimum tax of 15% and also contains the Subject to Tax Rules (STTR) as described below. Pillar 2 applies to MNEs with revenues of at least 750 million Euros.
PSA	Product Sharing Agreement – A PSA is an agreement between a government and an extractive industries company to share the output of an extractive industry project. PSAs are commonly used in oil and gas ventures.

1 The complete list of the countries in the IF can be found here: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

QDMIT	Qualified Domestic Top-up Tax – The QDMTT is a minimum tax of 15%, conforming with the prescription set out in Pillar 2. It is designed to ensure that the source country imposing the QDMTT will not have the income of local companies subject to an indirect minimum tax of 15% by another jurisdiction.
Residence Country	Residence country is the jurisdiction where an MNE is organized, typically a developed country or a low-tax jurisdiction.
Royalty - CIT	Royalty – CIT The term used for a combination of a royalty and a Corporate Income Tax (CIT) imposed in a mining regime project.
Source Country	Source country is the jurisdiction where an extractive industry project is being undertaken; typically for purposes of this Toolkit, a less developed country.
STTR	STTR Subject to Tax Rule of the BEPS program – The STTR is part of Pillar 2. It seeks to create a system to override Double Tax Agreement (DTA) provisions that reduce the rate of withholding taxes on cross-border payments made by MNEs that will suffer little or low taxation by the recipient jurisdiction.

Introduction

This Toolkit analyzes three fiscal issues – i) royalties as applied to the mining and oil and gas sectors of extractive industries, ii) PSAs as applied to the oil and gas sector and increasingly to the mining sector, and iii) the taxation of MNEs engaged in these industries. The concepts applicable to the oil and gas sector are increasingly being applied to the mining sector, and the reverse is true as well. This Toolkit also covers several issues closely related to the three fiscal issues. Case studies are included to illustrate the application of issues discussed in the context of real life. Appendix A contains oversight questions for each area discussed in the Toolkit that parliamentarians and CSOs may wish to consider when addressing extractive industry projects. Appendix B gives the major sources individuals may wish to access for additional information about a particular topic.

This Toolkit is divided into eight sections:

- **Section 1**: Sets out the underlying reasons for the Toolkit.
- **Section 2**: Identifies the players involved in the extractive industries and summarizes the different sources of revenue that are produced by it.
- **Section 3:** Discusses the relevant law used in extractive industry contracts.
- **Section 4:** Reviews the use of royalties and PSAs as a source of revenue from extractive industry projects.
- **Section 5:** Reviews the corporate taxation of extractive industry projects and the application of other forms of taxes to such projects.
- **Section 6:** Outlines the tools to make a financial analysis of an extractive industry project.
- **Section 7:** Discusses other important issues raised by projects, including transparency, the use of tax incentives, the application of investment contracts, Bilateral Investment Treaties (BITs), stabilization and arbitration clauses, monitoring of extractive industry projects once underway, and state equity participations.
- **Section 8:** Provides the Way Forward for persons interested in ensuring the benefits that extractive industries offer to Africa are realized.

1.0 Reasons for the Toolkit

1.1 Understanding of the Fiscal Issues of the Industry

Resource-rich countries in Africa and elsewhere enter into contracts to govern mining and oil and gas projects. The value of Africa's subsoil assets far exceeds the cost of the continent's robust development aspirations. Hence, it is critical that these resources provide the maximum possible benefit to assist in the realization of these development goals.

Despite the critical importance of extractive industries in Africa, many African parliamentarians face disadvantages in evaluating the merits of projects being negotiated. This can be because of asymmetric information or expertise, lack of preparedness, power imbalances, among other factors. Similarly, many African CSOs who are not working exclusively in the extractive industries field are keen to engage with governments and MNEs in assessing such contracts, but they, too, may need to develop additional skills to do so.[2] This Toolkit is designed to cure some of these disadvantages.

The laws pursuant to which extractive industry projects are undertaken are of critical importance in the governance of these projects. They should be enacted for the following purposes:

- To follow model provisions that should govern the contracts, licenses and associated agreements which are entered into for the projects.
- To set the procedures for monitoring the production under the ventures once they have begun.
- To contain rules that provide for the transparency of the negotiations being undertaken and the results of the venture once production has begun.
- To provide an opportunity for public input at appropriate times in the negotiation of agreements and in the monitoring of the results of any extractive industry operation.

The absence of an exacting set of laws controlling these matters can, at times, lead to governments abusing the processes for their self-enrichment. Because parliamentarians and CSOs often lack the technical expertise to get involved in the details of valuation issues, this Toolkit recommends utilizing experts in areas where parliamentarians and CSOs need assistance.

1.2 Challenges to Taxing the Extractives/Mining Sector

Of the fifty-four African countries, twenty are known to be rich in mineral resources. Indeed, African countries are the top producers or one of the top producers of at least eight important minerals. In 2017, 20% of total merchandise exports from Africa came from minerals. Africa also has five of the top 30 oil-producing countries in the world, and almost half of the African countries have natural gas reserves.[3] Mining, oil and gas extraction are thus key industries in many African states.

2 Some CSOs are devoted to working on issues related to natural resource extraction, such as the IGF, and have expertise in the industry. While it may be of relevance to these CSOs, this toolkit is not targeted at this audience.

3 AMV, Table 1; UNCTAD, State of Commodity Dependence (2019); W. Carpenter & T. Brock, The Main Oil Producing Countries in Africa, Investopeida (September 21, 2021), available at: https://www.investopedia.com/articles/investing/101515/biggest-oil-producers-africa.asp ; Y. Bouterige, C. de Quatrebarbes & B. Laporte, Mining Taxation in Africa: What Recent Evolution in 2018, ICTD Summary Brief (2018).

Given the importance of the extractive industries to Africa, it should provide an important source of revenue to nurture development plans across the continent. In some cases, this is indeed so. Unfortunately, this has not been true in many cases. The increase in government revenues reaped from the industry has not kept pace with the increase in corporate revenues and profits being realized from the expanding extractive industry activity across the continent. There are many reasons for this, some of which include:

- *Aggressive tax planning by MNEs* – Many MNEs engaged in extractive industries in Africa employ transfer pricing techniques and related party charges to reduce their taxable income far below what it should be.
- *Poor governance* – Many governments lack the resources and skills needed to engage in proper oversight of the industry. This results in actual tax collections that are much lower than would be indicated by the corporate tax rates formally in place in many jurisdictions. This is exacerbated in some instances by government indifference or outright corruption.
- *Unnecessary tax incentives* – Governments often grant unnecessary tax and other incentives to MNEs to engage in projects. These can take the form of tax holidays, tax-free zones and low tax rates. These benefits are often locked in place by stabilization clauses. There is scant evidence that these tax incentives induce greater investment than would otherwise take place. Moreover, they will be increasingly suspect as the effort to impose a global minimum tax begins to take effect.
- *Lack of government and CSO oversight* – The foregoing problems are aggravated by the absence of knowledgeable oversight by parliamentarians and involved CSOs. Often, this is simply because the parliamentarians and CSOs lack sufficient knowledge and resources to undertake this oversight. This Toolkit is designed to help cure this problem.
- *Lack of mineral beneficiation and manufacturing* – In many cases, minerals produced in Africa are simply exported in their rawest form. Since a substantial part of the profits for extractive industry companies comes from the refinement and related processing of minerals, this profit is foregone by the African countries that produce these same minerals.

Because of these factors, the International Monetary Fund (IMF) has calculated the tax revenue loss from mining alone in Sub-Saharan Africa to be between \$470 million and \$730 million per year.[4] More generally, Africa loses close to an estimated \$15 billion annually in corporate taxes due to these factors.[5] Indeed, the High-Level Panel (HLP) on IFFs states that Africa suffers a loss of at least \$50 billion annually from IFFs, a good portion of which can be attributed to aggressive tax planning by MNEs.[6] While the statistics can be criticized because so much activity takes place in Africa in the informal economy, the amount of revenue collected as a percentage of a country's gross revenue is, in many cases, remarkably low in Africa.[7] As one CSO has put it, Africa is only rising for the few.[8]

Given the forgoing facts, considerable work remains to bring the revenue collected from extractive industries in African countries more in line with the level of their activity there.

4 G Albertin, et al., Tax Avoidance in Sub-Saharan Africa's Mining Sector, IMF (2021).

5 TJN, State of Tax Justice, at p.36 (2021), available at: https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf.

6 HLP on IFFs at Chapter 2.2.

7 E. Asen, OECD Report: Tax Revenue in African Countries, Tax Foundation (May 28, 2020).

8 Oxfam, Africa: Rising for the few (June 2015), available at: https://policy-practice.oxfam.org/resources/africa-rising-for-the-few-556037/

2.0. Players and Sources of Revenue

2.1. Players in the Industry

Extractive industry projects often involve multiple persons playing different roles. The focus here is on MNEs, the key driver in most major projects from which revenue may be derived, as well as several other players.

MNEs – MNEs engaged in extractive industry projects are typically large corporations with operations in many different countries. They are mainly incorporated in developed countries, although in some cases, their headquarters may be located in tax havens. Most often, they will operate in any given jurisdiction through a local subsidiary. The subsidiary, in turn, is likely to have arrangements with commonly controlled entities that will provide financing for it and a variety of other forms of services, including technical and management services. The related parties providing the financing and technical services will charge fees for the assistance they provide, and these charges can be mispriced to lead to a revenue loss to the source country where the project is located. In addition to providing financing and services, a related company will often be used to market and sell the product of the extractive industry being produced locally. This will involve a sale of the product from the subsidiary producing it to the subsidiary marketing and selling it. This transaction can also result in mispricing, leading to further revenue loss for the source country.

Contractors – A number of contractors may be involved in the exploration and early development stages of a project. Contractors may also be retained for specified activities during the entire extractive process. The contractors may be independent companies retained by an MNE to undertake exploration and other activities, or they may be its subsidiaries. In many cases, they operate in a jurisdiction only for a relatively short period of time. If their operations are only there for less than six months, they typically will not be subject to tax in the jurisdiction.

State-Owned Enterprises (SOEs) – In addition to MNEs, SOEs are an important part of the local extractive industry in many countries. SOEs can have many sizes and scopes of activity. They are more frequently employed and of substantial size in the oil and gas industry than in the mining industry. At one end of the spectrum, they can be the sole operator of an extractive industry project. More frequently, SOEs are a minority partner in projects taking place in Africa.

State Equity Participation – Related to SOEs, the state, as part of the negotiation of a mining contract, may ask for a percentage ownership in the local operating subsidiary of the MNE. This interest can be paid for or obtained without cost. The amounts can vary and will depend on the nature of the interest involved. The interest may be owned by a SOE or directly by the government. This ownership interest will give rise to revenue taking the form of dividends or other types of shareholder payments. If the local subsidiary is sold, the SOE will also receive a share of the proceeds arising from the sale.

Artisanal Miners – In most countries with mineral resources, local people will engage in small-scale mining activities, the so-called artisanal mining. The mining tends to focus on gold, diamonds, tin, lithium and rare earth elements, but can also include other usable commodities. While any individual effort is typically quite small, yielding substantially less than $1 million per year, collectively, the figures can be quite large. For example, it is estimated that 20% to 25% of the annual production of gold and diamonds worldwide comes from artisanal miners.[9] In many cases, artisanal mining is done illegally and can be quite dangerous to the persons engaging in it.[10] Nonetheless, if properly supervised, it can be a vital force in bolstering local economies and enhancing the financial position of lower-income segments of a population.[11]

Government Departments and Agencies – A variety of government departments may be involved in negotiating contracts and regulating extractive industries. While the names will vary, most countries will have a Department of Mineral Resources that is directly concerned with extractive industry contracts and the monitoring of projects. A number of other agencies are also likely to be involved. These include:

- The Treasury Department and a subsidiary component of it.
- The Revenue Authority, will be involved in the taxation of the project.
- A Department of Health and Safety will regulate mining conditions.
- A Development or Trade Ministry may be involved in encouraging foreign direct investment.
- An agency under the Ministry of Environment or Natural Resources may look after the interests of indigenous people located where the project will take place.

Civil Society Organizations (CSOs) – CSOs can and often do play a vital role in tax matters in Africa. A number of them have tax expertise in domestic and international tax issues and expertise in matters more broadly affecting extractive industries, including extractive industry environmental issues. Given this expertise, they can help educate government officials on tax and related matters and assist with the capacity building of revenue agents. Many of them are adept at arguing for tax reform measures that benefit all segments of society. They can also intercede with international organizations such as the OECD and the UN on international tax matters and other issues impacting extractive industries that affect African countries and suggest ways to improve these measures. In addition to TJNA, a significant number of other CSOs are focused in part or entirely on African tax matters.[12]

2.2. Sources of Revenue

The various types of revenue that can be gained from the operation of extractive industries are summarized here.

Concession Regimes - Under these regimes, the operator takes ownership of the resources at the wellhead. The operator often pays Corporate Income Tax (CIT) under the general income tax code. They also compensate the government for the resources extracted through a royalty. These regimes are thus known as tax and royalty regimes.

9 See F. W. Schwartz & S. L. Thomas, A Review of the Scope of Artisanal Mining and Small-Scale Mining Worldwide, Poverty and the Associated Health Impacts, GeoHealth (January 15, 2021), available at: https://agupubs.onlinelibrary.wiley.com/doi/full/10.1029/2020GH000325.

10 See Delve, State of the Artisanal and Small-Scale Mining Sector, World Bank (2019), available at: https://delvedatabase.org/resources/state-of-the-artisanal-and-small-scale-mining-sector.

11 According to the Ghana Statistical Service, ASM gold production constituted 44.66% of Ghana's total gold production in 2020.

12 F. Mohiuddin and P. Renzio, Of citizens and taxes: A global scan of civil society work on taxation, International Budget Partnership (November 2020), available at: https://internationalbudget.org/publications/dataset-for-global-scan-of-civil-society-work-on-taxation/.

Royalties Royalty agreements are typically employed in mining and some oil and gas ventures in Africa. They should be considered in conjunction with the laws taxing mining operations. The critical issue on the revenue generated by a royalty is when and how it is to be calculated.

Corporate Income Tax (CITs) These are levied on both oil and gas and mining operations in Africa. Unlike royalties, which are an expense of the extractive industry operation and are not dependent on the degree of profitability of the operation, CITs are only levied on the profits of an operation. While in the early stages of a project, losses may be expected; the use of these losses to offset future profits will need to be monitored to ensure that the substantial profits, when realized, are subject to tax. Where profits are high, a windfall profits tax may be imposed on so-called "rents" on top of the regular corporate taxes.

The IMF has projected the revenues to be earned from a tax and royalty (concession regime) mining project on a theoretical basis. In the ideal case, the CIT is expected to yield about 50% of the government revenue, the royalty in the range of 20%, and withholding taxes, import duties and other revenue sources, making up the balance of the expected revenue. However, in practice, the CIT revenue is often materially reduced by government tax incentives and aggressive tax avoidance tactics.

Production Sharing Arrangements (PSAs) A PSA is a contract between an extractive industry company and the government in which rights to the exploration and extraction of a mineral over a period of time are determined. PSAs are the most common type of contractual arrangements for petroleum exploration. In PSAs, the government retains ownership of the mineral, and the company runs the business at its expense and risk but shares part of the production output with the government. Under these agreements, royalties may be collected on gross production. After that, the operator is allowed to recover a portion of its costs. This is known as cost oil. The remainder of the revenue is known as profit oil. This is split between the government and the operator. This profit oil may then be subject to income tax payable either by the operator or the government.

Returns from joint ventures and equity interests Many jurisdictions take some form of equity interest in an extractive industry project. This may take the form of a State-Owned Enterprise (SOE) operating the extractive industry project independently. However, in Africa, this typically will take the form of a minority interest in a corporation or a partnership interest in a joint venture. The equity type of return on these investments is another source of revenue, mostly through dividends.

Other taxes A variety of other taxes are important sources of revenue to many jurisdictions. These include the so-called indirect taxes, such as value-added tax (VAT), withholding taxes on payments outbound from a jurisdiction, import and export duties, and employee withholding taxes.

The remainder of this Toolkit focuses on royalties, PSAs, and CITs since they are the major sources of revenue for most extractive industry projects.

3.0 Relevant Laws

3.1. The Law

In almost all cases in Africa, the state has legal ownership of all minerals, gas and oil until removed from the ground. Therefore, the extraction of natural resource products involves a sale or other type of financial transfer from the state to the extractive company. The right of indigenous people to the free, prior and informed consent to an extractive industry concession must also be considered.[13]

The relevant law may be found in a jurisdiction's constitution, its legislation and regulations, and the extractive industry contracts it enters. In addition, the law contained in Bilateral Investment Treaties (BITs) and multilateral trade agreements must be considered.

- ***Concessionary vs. contractual systems*** – The relevant law can be used as the basis for either a "concessionary system" or a "contractual system" for the extraction of minerals or the production of oil and gas. A concessionary system grants the extractive industry company the right to tap into the local resource pursuant to pre-established terms. In a contractual system, the terms are agreed afresh for each venture. In many cases, the extractive industries contract will contain elements of both kinds of agreements, with some terms defined by legislation and regulations and incorporated by reference in the agreement and other terms defined exclusively in the agreement.

- ***Concessionary systems*** – As noted, under a concessionary system, contracts are based closely on the terms (including "model terms") that are set out in some detail in the jurisdiction's laws. The contract typically will refer back to the laws and regulations and incorporate their terms in the contract by reference. The government and the MNE must still agree on some of the financial terms of the agreement, but the basic principles have already been created in the legislation and regulations issued thereunder. The majority of African countries with extractive resources have enacted laws and regulations dealing with the industry, some with more detail than others. However, even in jurisdictions with pre-existing laws, they are not always followed in granting new rights to an MNE to mine or extract oil and gas.

- ***Contractual systems*** – In contractual schemes, the fundamental terms of the extractive agreement are drafted on a contract-by-contract basis. The agreement normally will fit within the parameters set by any legislation and/or regulations in effect, but the essential terms are in the contract.

- ***Preferred methodology*** – Most industry experts believe that the concessionary system is preferable to a contractual system, provided that the pertinent laws and regulations are enacted in a transparent fashion and follow model laws. A concessionary system, if followed, will avoid abuses of discretion by local authorities that sometimes happen with contractual systems. No system is perfect, and oversight by parliamentarians,

13 A. K. Barume, Land Rights of Indigenous Peoples in Africa, IWGIA Document 115 (2010), available at: https://www.iwgia.org/images/publications/0002_Land_Rights_of_Indigenous_Peoples_In_Africa.pdf. ; UNEP, South African indigenous community win environmental rights case over mining company (December 7, 2018).

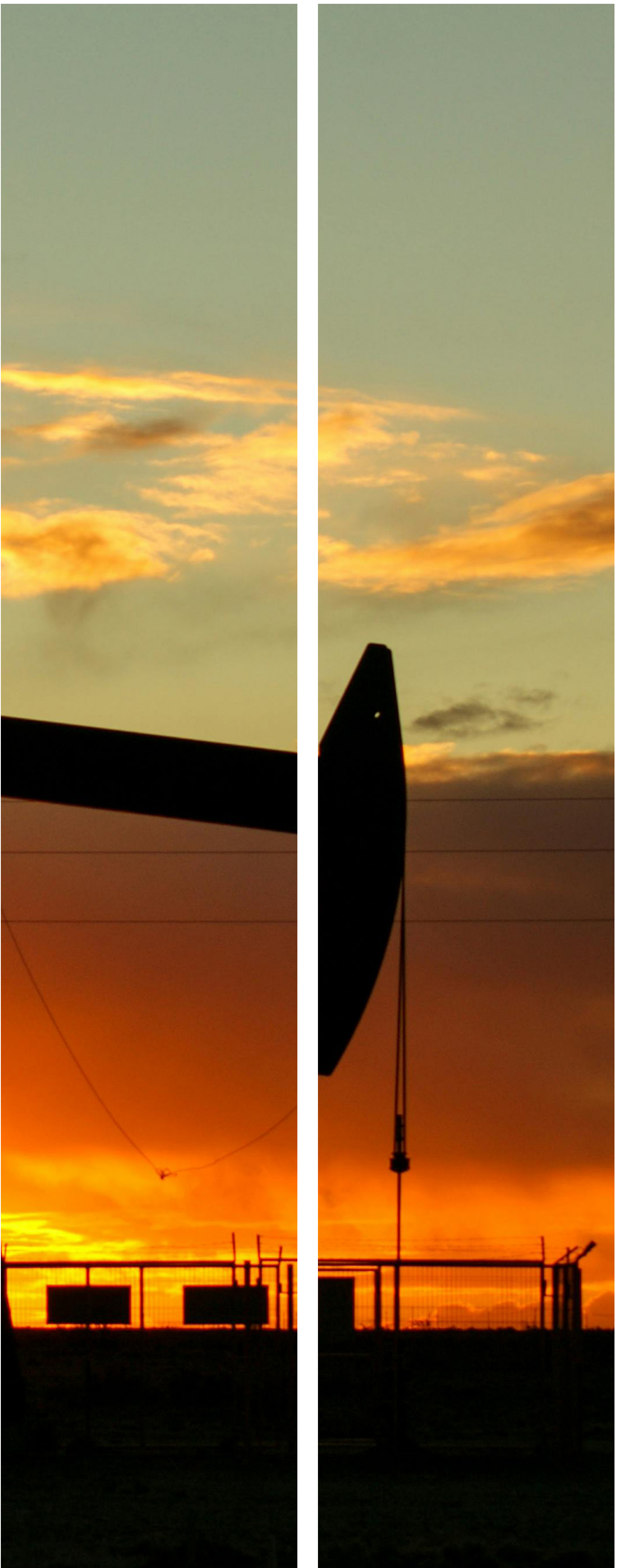
concerned CSOs and individual citizens can also assist in avoiding abuses.

- ***Model laws and contracts*** – A number of organizations have created model extractive industry agreements and model legislative provisions that can be used in negotiating a contract between a jurisdiction and an extractive industry MNE. The model agreement most frequently cited is one created by the International Bar Association (IBA.) The OECD and World Bank have also issued guidance on some of the matters that should be covered in extractive industry contracts. Several African organizations, most notably the African Minerals Development Center (AMDC), have drafted guides and model extractive industry laws as well. USAID has created a guide to crafting proper Product Sharing Agreements (PSAs). These are noted in the source's Appendix, but for ease of reference, the three of the most useful resources can be found here:

o IBA, Model Mine Development Agreement, https://www.mmdaproject.org.

o IISD, Model Mining Development Agreement, Transparency Template, https://www.iisd.org/system/files/publications/mmda_transparency_report.pdf.

o AMDC, et al., African Mining Vision: African Minerals Governance Framework (2018), available at: https://archive.uneca.org/sites/default/files/PublicationFiles/african_mining_vision_african_mineral_governance_framework.pdf.



4.0 Royalties

4.1 Types of Royalties

Various types of royalties are employed in extractive industry projects. They can be divided for purposes of analysis between royalties measured by product volume and royalties measured by product value. Most royalties fall in the latter category with various combinations of them being employed. Royalties are employed in both mining and oil and gas projects, but they predominate in the mining industry. The following are some examples of the different types of royalties:

- ***Product value-based royalties*** – This type of royalty is computed as a fixed percentage of the revenue derived from the sale of the product. Thus, if a mineral is sold for $1 million, a royalty of 6% would give rise to a royalty of $60,000. In some cases, these royalties are based on a sliding scale, with higher rates charged when the extractive industry product reaches a certain price, or the rates may be made higher for more valuable products. Sliding scale royalties are intended to combine some features of product value royalties with some features of a profit-based royalty. Royalties based solely on net profits earned from the product take this a step further. Here, the costs of production, as well as the value of the product extracted, must be considered. The determination of this type of royalty is similar to the calculations undertaken under a CIT. Overall, consideration should be given to making the royalty rate as progressive as possible while still preserving a reasonable return to the MNE engaged in a project. The following case will serve to illustrate some of the issues that can arise in measuring a value-based royalty.

South African Case Study
United Manganese of Kalahari

United Manganese Kalahari (UMK) took the South African Revenue Service (SARS) to court over how the value of gross revenue was to be determined when calculating the royalty. The point of contention was whether transport, insurance and handling costs could be subtracted from the price of the manganese ore sold at a South African port to a third party in determining the royalty. UMK argued that these costs should be deducted from the gross sales price to the third party because the relevant statute provided that the royalty price was to be determined "without regard to any expenditure incurred in respect of transport, insurance and handling of mineral …" (Quoted from Mineral and Petroleum Resources Act 28 of 2008 at Section 6(3)(b)).

SARS argued that transport, insurance and handling costs would only be deductible in calculating the gross sales on which royalties would be payable where the expenses had, in fact, been incorporated in the price of the manganese sold to the third party at the port where the mineral was being put on a ship for export. UMK disputed this contention and argued that whether those amounts had been specified was irrelevant when determining the price charged to customers. According to them, what mattered was whether they had incurred the cost. Ultimately, the Supreme Court of Appeal of South Africa sided with UMK and the value of royalties was determined by deducting transport, insurance and handling costs.[14] The lesson from the case is that many complicated issues can arise in even a seemingly simple royalty agreement. Accordingly, caution must be taken when drafting these agreements to avoid subsequent disputes regarding royalty determination.

14 C:SARS v United Manganese of Kalahari (Pty) Ltd, (264/2019 ZASCZ 16 (25 March 2020).

Product Volume-based royalties – This type of royalty is less common and is confined to low-value, high-volume types of minerals. Here, a company pays a fixed amount for each unit of production. For example, a royalty on gravel might be set at $5 per ton. The royalty would not depend on what the ton of gravel could be sold for in the market at a given time.

Beneficiation adjustments – After mining, the beneficiation stage involves activities that separate minerals from impurities or waste materials. This process is usually concluded at the mine, and its aim is to yield a product with a higher content of valued material. Some consideration may be given to reducing royalty rates when the product is processed to produce a higher-grade product in-country. A complete reduction in rates may be considered if the product is both processed and the finished product used in the country. The use of a beneficiation adjustment will depend on a cost-benefit analysis and whether a country has the conditions to make a value-added addition to the mineral production. Going forward, policymakers will be keen to implement these adjustments to encourage the value addition of minerals in-country.

4.2 Elements in the Creation of a Royalty Agreement

Background – Governments are, or at least should be, interested in maximizing their returns from a given project up to the point where the project is still financially viable. Royalties must be considered in the context of the entire mining or oil and gas venture. They are only one of a variety of measures that can benefit the source country. The additional measures include, among others, land rents, investments in infrastructure, and remediation costs. Royalties and corporate taxes often employ the same measures of income (viz, what is the correct transfer price for the sale of a mineral) and interrelate with each other in that the royalty payment typically will be an expense for income tax purposes. All of the terms affecting the economics of a project must be considered together.

Process of negotiating a contract – While not everyone who wishes to do so may be able to be in the room for a negotiation, the source country should acknowledge that negotiations of a transaction are underway and be prepared to solicit comments at appropriate times during the course of the negotiations. This will give parliamentarians and CSOs the right to ensure that a competitive process has been undertaken in soliciting bids for a project, that community groups will be consulted about the impact of the project on their land and livelihoods, and that the parties will have the right to have their own experts analyze the terms and conditions of any contract before it is concluded and agreed upon by parties.

Determination of costs and values – The method of valuing an extractive industry product, including the timing within the extraction and refinement process at which the valuation is to occur, is the most critical element in implementing a mining royalty contract. The calculations can be quite complicated. For example, what market reference posted price for a mineral, if any, will be used? The spot market posted prices for products that are openly traded will be more reliable indicators of value than products that are traded on closed markets, but in many cases, relevant posted prices may not exist. What adjustments to the posted prices should be made to reflect the quality of the product and where it is being produced?[15] Basic questions concern whether recognized industry standards are being followed, whether the provisions in model agreements are being used, and, if not, what the reasoning underlying the departure from the model provisions is. An important element of the determination of value may involve so-called transfer pricing. This concept is borrowed from the income tax law and is discussed further there.

Monitoring the result – While negotiation of any agreement is important, monitoring the results produced once the project is underway is also of great importance. This subject is discussed in some detail later in Section 7.2. The process by which the monitoring is done needs to be addressed in the agreement itself, and both the government and the MNE involved in the negotiation need to be open to having the process subject to outside review.

4.3 Critical Issues to Address in Royalties

While royalties can be profit-based or value-based, the focus here is on value-based royalties, the more common of the two. Many of the issues relating to profit-based royalties are covered in Section 6.0 on CITs. In evaluating a gross value-based royalty, parliamentarians and CSOs should focus on defining the base. Typically, the base will be the sale price of the mineral. However, where the sale is between the project company in the developing country and a related corporation that will export the mineral and sell it downstream, the selling price between the two related parties may not be a fair indication of value since it may be prone to manipulation by the mining MNE. Hence, further proof of the validity of the base can be attained through the following steps:

- ***Use an international reference price*** – Published international reference prices are available for many minerals and sources and grades of crude oil. These are a good indicator of their value, and a

15 The IBA model mining agreement has a number of alternative methods of calculating royalties. See Section 4 of the model mining agreement.

model law or contract should require their use when they are available. Adjustments to the publicly quoted price are likely to be necessary to reflect the quality of the product and the cost of getting it to market.

- ***Employ an arm's length price*** – Where an international reference price is unavailable, and the sale is between related parties, the prices should be set at the arm's length rate. This is the rate at which independent parties would sell the product. This measure is difficult because it is subject to transfer pricing manipulation.

- ***Agree on an independent arbitrator*** – The proposed law or contract may provide for the use of an independent arbitrator to set the price for a mineral where a related party sale is involved. This has the advantage of a price determination that is not affected by the vagaries of transfer pricing. However, normally, the law or contract will typically state that this can only be done when both parties to a contract agree upon the choice of the arbitrator.

- ***Decide on the point of valuation*** – The possible points of valuation of the mineral should be specified in the proposed law or contract. These may include the mouth of the mine, the point of sale or some intermediate point. Where it is a point distant from the mine, transportation and processing costs will need to be considered in determining the reference price on which the royalty is to be set.

- ***Review the range of royalty rates set in regulations*** – In appropriate cases, the proposed law may specify that a royalty rate or a range of royalty rates are to be published in regulations issued under it. When published, these rates should then be referenced in determining the royalty rate to be employed in a contract.

- ***Model the output and compare prices*** – A financial model of the expected royalty revenue and overall project revenue over the life of a project should be undertaken where the relevant information is available to do so . The model results should be compared to the actual results, and the differences explained.

- ***Seek competitive bidding*** – Where feasible, competitive bidding should be employed to engage an MNE in a project.

5.0 Product Sharing Agreements (PSAs)

A PSA is a complex instrument that sets out the rights and obligations of the government and an MNE to explore and develop an oil and gas or mining property in a jurisdiction. The government retains ownership of the oil and gas or mineral while the MNE shares in the revenues from its production. PSAs originated in the oil and gas industry in 1966 and gained popularity thereafter. In part, this is attributable to the prevalence of SOEs in the oil and gas industry as compared to the mining industry. In recent years, PSAs have also begun to be employed in the mining industry.

5.1 Elements in the Creation of a PSA

Background – PSAs are used in oil and gas ventures in jurisdictions with SOEs and where there are proven reserves, resulting in less uncertainty about the costs involved. PSAs can be pure in form, or they can be combined with elements of Royalty and CIT regimes. In a typical oil and gas PSA, the revenues are split into two pieces, the first piece covering the expenses of the company (so-called "cost oil") and the remaining piece being split between the government and the company (so-called "profit oil"). The determination of these two pieces will often involve complex accounting calculations.

Mechanics – The mechanics of a PSA are simple in concept but can involve somewhat complicated calculations in practice. The revenues from the production of the extractive industry project are split into cost oil and profit oil pieces. The government piece of profit oil may go to the government itself or a government-owned company. The calculation of the cost piece is of critical importance and can involve some complicated cost accounting elements. Both direct and indirect costs, including overhead charges and funding costs, go into this calculation. In most PSAs, the cost element will be subject to a cost recovery limit to ensure that a profit will be generated that can be split between the mining company and the government. For riskier ventures, the cost recovery limit will be greater. The split of the profit element can be done under various formulas, with the government's share typically falling somewhere between 40% and 60% of the profit.

5.2 Critical Issues to Address in PSAs

In evaluating a proposed PSA transaction, many of the same elements as those employed in reviewing a royalty are relevant. Some additional steps that should be considered are:

- ***Seek competitive bidding*** – Competitive bidding is more common where there are proven reserves of oil and gas or minerals. This tends more often to be the case in the oil and gas industry, and for this reason, competitive bidding is more common there. While exploration and development are still important steps in any project, parliamentarians and CSOs should see if consideration is being given to competitive bids in a project when there are proven reserves. Unfortunately, some evidence of rigged bidding between competitors exists; this needs to be guarded against.
- ***Examine cost oil calculations closely*** – The oil and gas producer is entitled under

the cost oil element of a PSA to recover its costs first when oil and gas production commences. The accounting for the cost element needs close review. Both direct and indirect costs are likely to enter into the calculation of the cost of oil.

- ***Ensure other fiscal measures are considered*** – While PSAs provide the source country with a split of the profits from a venture, many ventures also provide other sources of government revenue. For example, royalties may also be levied on the output, and income taxes imposed on the MNE’s share of the profit oil. The complete picture of revenue to be produced by a project needs to be considered when evaluating its worth.

5.3 Comparison of PSA and Royalty Regimes

While there are many common issues between the two regimes, there are some notable differences as well. To begin with, since they involve fewer calculations, PSAs are usually easier to monitor than the calculations underlying the determination of royalties and CITs. In PSAs, interest expense is typically not allowed as part of the cost recovery measure. In contrast, in the determination of CITs, it is allowed, although new legislation increasingly puts limits on it. Finally, using cost recovery limits in PSAs gives the government some share of a venture’s revenue almost yearly. In contrast, the tax taken from a venture can be sporadic, particularly in the early years.

6.0 Corporate Income Tax (CIT)

6.1 Basic Concepts

Extractive industry projects are invariably undertaken in some corporate form. In most cases, they are undertaken by a locally created corporation owned by a foreign parent. In some instances, they are undertaken by a local branch of a foreign corporation. In either case, the tax imposed on the operation will be a CIT. A discussion of basic income tax concepts follows.

Determination of income – Taxable income is derived from the financial statements of an MNE with changes required under the local jurisdiction's laws. Companies use financial statements prepared in accordance with accounting standards[16] to disclose their after-tax profitability to shareholders and creditors. In contrast, revenue authorities use the pretax income on the statements as the starting point in determining taxable income. Typically, a jurisdiction will have rules for some items of income and other expenses that change the timing when these items are considered for tax purposes. For example, a straight-line method of depreciation of mining equipment might be used in financial statements, whereas accelerated depreciation might be allowed for tax purposes. The changes in timing result in "deferred taxes", with "deferred tax liabilities" representing future taxes owed and "deferred tax assets" representing future tax deductions. In addition, tax incentives may permanently reduce the amount of tax payable, resulting in "permanent differences" from the tax that would otherwise be paid based on the amount of pretax income.

A useful starting point for tax authorities and outside observers in reviewing an MNE's tax liability in a source jurisdiction is to look at its ETR and current tax liability on its locally filed financial statements.[17] The ETR is the rate of tax expense after reflecting permanent differences. The cash tax expense is determined by additionally reflecting timing differences. For example, if a company earns $1,000 of pretax income and is in a jurisdiction with a 30% tax rate, its expected tax would be $300. If it has a tax credit of $50, its tax expense will be reduced to $250, and its ETR will be 25%. If it has a deferred tax liability of $50 resulting from accelerated depreciation allowed for tax purposes over the depreciation allowed under accounting standards, it will have a current tax payable (or cash tax due) of $200, a 20% cash tax rate. If the ETR and current tax payable are materially lower than the statutory tax rate, the MNE's accounts will be closely scrutinized.

Typically, financial income is determined separately for each jurisdiction and for each legal entity engaged in business in a jurisdiction, but in some cases, the income of related entities may be consolidated in a given jurisdiction. Also, some MNEs may operate in a jurisdiction in the form of a branch of a foreign-related corporation, creating what is known as a "permanent establishment" of the foreign corporation in the jurisdiction where

16 Except for U.S. based firms, the accounting standards in International Financial Reporting Standards (IFRS) are used by most companies to prepare their financial statements. For U.S. based firms, the accounting standards in Generally Accepted Accounting Principles (GAAP) are used.

17 A look at Effective Tax Rate (ETR) in the consolidated worldwide financial statement of a MNE also may be of interest. Under BEPS Article 13, members of the Inclusive Framework of the BEPS Program (IF) that have qualified to do so share country by country reports prepared by large MNEs that report the global allocation of income, profit, taxes paid and economic activity among the jurisdictions where they are engaged in business. This too is useful information for tax authorities to review.

the branch is located. For mining companies, some jurisdictions may "ring-fence" the determination of income so that income is determined separately for each mining operation of an MNE in the jurisdiction.

Transfer pricing – Transfer pricing is the practice by companies of pricing intercompany transactions, which are then reviewed by the government to detect and establish whether the prices paid for these transactions are fair (legal transfer pricing) or abusive. Transfer pricing often is a key element in determining the profitability of the source country entity. For example, in a mining operation, a source country entity undertaking mining may sell the minerals produced from the mine to a related corporation that transports the minerals and sells them to a buyer in a foreign jurisdiction. In cases where a publicly available reference price is not used, the price paid by the related marketing company to the mining company will determine the royalty due to the source jurisdiction and the taxable income on which the local corporate tax will be levied.

Current transfer pricing rules around the world are based on "arm's length pricing", which looks at the prices that would be charged by independent parties doing the same work. Two commonly used standards are the "comparable uncontrolled price" and the "transactional net margin" methods. As applied to extractive industries, the comparable uncontrolled price method applies to the mineral or oil and gas export price when sold from the producing subsidiary to a related marketing and distribution subsidiary outside of the source country. How does the related party price compare to the price charged between unrelated parties? The transactional net margin method is applicable when comparing the relative measure of profits earned on a base such as sales compared to the relative measure of profits earned elsewhere by related parties or unrelated parties engaged in the same extractive industry businesses. Unfortunately, the range of acceptable prices (referred to as the "interquartile range") that can be plausibly set under this standard are often quite broad and can lead to abuses in determining the correct amount of income.

In most cases, aggressive transfer pricing will have a greater impact on the determination of taxable income than on royalty calculation, as illustrated by the following example.

Transfer Pricing Example

Company A is headquartered in Country X. It has a marketing and sales subsidiary company; Company B, established in Country Y, is a tax haven and a mining subsidiary; Company C is operating an iron mine in Country Z.

Company B buys iron ore from Country C at $90 per metric ton, when the third-party rate should be $100 per metric ton. Company C has operating expenses of $80 per metric ton and reports income of $10 to Country Z, which has a tax rate of 30% and imposes a tax of $3 on the transaction. It also has a royalty rate of 7%, so it collects a royalty of (.07 x $90) of $6.3.

If Company C had paid the correct price to Company B of $100, its tax would have been $6, and its royalty would have been $7.[18] *The revenue loss from taxation is 50% ($3 compared to $6), whereas the revenue loss from the royalty is 14% (1/7).*

Given the importance of transfer pricing, tax authorities need to be able to conduct probing and persuasive transfer pricing audits under the arm's length standard to ensure that the proper income is reported to the government.

18 The impact of the increase in the royalty, in the calculation, of taxable income has been ignored in the example in the interest of simplicity.

This generally requires access to specialized expertise.[19]

Capital gains and indirect transfers of local entities - Capital gains are the gains derived from the sale of an asset. For extractive industries, this often will involve the sale of a part or the entirety of a shareholding interest in a mining or oil and gas project. This can take the form of a sale by the parent company of the stock of the source country subsidiary or, in some cases, the sale of an intermediate holding company owning the mining company that, in turn, is owned by the ultimate parent company. Conversely, the actual operating mine or oil and gas project could be sold. In addition, exploration companies and other early participants in extractive industries projects frequently would sell their minority shareholding interests in a project. The selling companies often realize substantial capital gains on these sales; these capital gains can be an important source of income to a source jurisdiction. Indeed, mine ownership can be transferred at times for hundreds of millions or even billions of dollars, leading to huge capital gains taxes.

If the sale in question takes place in the source country where the project is located, the gain on the sale will be subject to a local capital gains tax. However, in many cases, the sale of stock of the mining company, a foreign corporation owning the stock of the local company, or some other interests in an extractive industry operation will take place offshore. The offshore sale may take place because foreign capital markets offer a better price for extractive industry assets than is available in local markets. The offshore transfer of the property in question may also be designed to avoid capital gains tax or contractual obligations imposed by the source country. The offshore transactions have resulted in protracted litigation involving both court cases and arbitration. To ensure that the local jurisdiction is able to levy a capital gains tax on these sales and to monitor them, appropriate legislation may need to be enacted.

The Freeport-McMoRan case study shows how a significant transaction affecting a large slice of a developing country's economy can take place in secret. There is no reason for this to occur. In addition, the case shows the difficulty of tracking indirect transfers of stock of a local operating company and applying the law to them. Some countries have enacted laws to trace and tax such transactions, but implementing these laws can get complicated.[20]

Case Study

Freeport-McMoRan

In 2016, Freeport-McMoRan, a mining company, sold its controlling 56% stake in a copper mine in the Democratic Republic of Congo (DRC) to China Molybdenum for $2.65 billion. It did so by selling outside of the DRC its 70% interest in a Bermuda holding company that owned an 80% interest in the copper mine.[21] *The transaction was an "indirect" transfer of a controlling interest in the mine, and it took place without the knowledge of the DRC.*

Subsequent to a public announcement of the sale, Gecamines, a DRC state-owned entity that owned a 20% interest in the mine,

19 See for further guidance in this area, IGF – OECD, Public Consultation Document, Determining the Price of Minerals: A Transfer Pricing Framework (May 2023).

20 For a discussion of indirect transfer tax issues, see P. Toledano, J. Bush & J. Mandelbaum, Designing a Legal Regime to Capture Capital Gains Tax on Indirect Transfer of Mineral and Petroleum Rights, CCSI (October 2017), available at: https://scholarship.law.columbia.edu/sustainable_investment_staffpubs/13/.

21 A. J. Pinto & D. Thomas, Freeport to sell prized Tenke copper mine to China Moly for $2.65 billion, Reuters (May 9, 2016), available at: https://www.reuters.com/article/us-freeport-mcmoran-tenke-cmoc/freeport-to-sell-prized-tenke-copper-mine-to-china-moly-for-2-65-billion-idUSKCN0Y015U.

having found out about the sale, brought suit in an international court to block it, arguing that it violated its right of refusal to the transfer and its preemption rights in the sale of the mine. While shrouded in secrecy, the suit was apparently settled months later by a payment of $100 million by Freeport McMoRan to Cecamines.[22] As best can be determined, no tax was levied by the DRC on the sale since it took place outside of the DRC.

Double Taxation Agreements (DTAs) – DTAs are entered into by two jurisdictions and cover tax matters that may affect both jurisdictions. The underlying reason for a jurisdiction to agree to a DTA is to avoid double taxation. This might arise for an MNE if the two countries that are party to the treaty take different positions with respect to the MNE's transfer pricing. In addition to providing a means for the jurisdictions to resolve double tax issues, DTAs often reduce or eliminate the withholding taxes that a source jurisdiction can impose on outbound payments of royalties and similar items and interest. DTAs, therefore, can lead to the erosion of the tax base of a developing country. For this reason, developing countries should enter DTAs with caution.

Base Erosion and Profit Shifting (BEPS) – The OECD initiated the BEPS program[23] to curb aggressive tax planning schemes, especially those schemes directed at developing countries. Under the BEPS program, over 140 countries in the IF have agreed in principle to adopt the tax programs called Pillar 1 and Pillar 2. Pillar 1 addresses the taxation of the digital economy and has a program to standardize the amounts charged for distribution and marketing services by MNEs to a foreign jurisdiction. Extractive Industries are excluded from part of Pillar 1, which deals with the digital economy, but they could benefit from the provisions aimed at developing more uniform charges for distribution and marketing services. These provisions are still under development, and their adoption by countries around the world is still in question.

Pillar 2 seeks to impose a worldwide minimum corporate tax at a rate of 15%. Under Pillar 2, the parent company of an MNE is directed to impose a minimum tax on the operations of its subsidiaries in each jurisdiction in which they are engaged in business. This tax will be imposed unless the source jurisdiction imposes its own tax at a rate of 15%, even if the source jurisdiction is not part of the IF. The base of the tax is financial statement income with some relatively minor adjustments. Developing countries are then put in the position of ensuring that the extractive industry subsidiary operating there is taxed at least at the minimum rate or, if not, to have the resident jurisdiction or another related jurisdiction[24] impose a tax at the minimum rate on the income earned in the developing country. To enable developing countries to impose a conforming minimum tax, the IF developed the Qualified Domestic Minimum Top-up Tax (QDMTT). If adopted by a developing country, the country will tax the local operating company at the 15% rate and avoid having the resident jurisdiction tax

22 Bloomberg, Congo said to get $100 million to clear China Moly Purchase, available at: https://www.engineeringnews.co.za/print-version/congo-said-to-get-100-million-to-clear-china-moly-purchase-2017-02-22; see also, Carter Center Urges DRC, Freeport, and Lundin to Publish Revised TFM Contract and Disclose Payments to DRC State-owned Miner Gecamines (January 19, 2017), available at: https://www.cartercenter.org/news/pr/drc-011917.html.

23 The UN Committee of Experts on International Cooperation in Tax Matters also takes an active role in setting international tax standards. Articles 12A and 12B of the UN Model Tax Convention deal with taxing the digital economy, and the committee is considering proposals similar to those contained in Pillar 2. In November 2022, the UN General Assembly adopted a resolution that mandates the UN to set course for a global tax leadership role. A cite to the Committee's web page is provided in the source's Appendix.

24 A complicated provision known at the UTPR requires a subsidiary owned by an ultimate parent MNE that is resident in a jurisdiction not adopting Pillar 2 to apply the minimum tax if the subsidiary is resident in a jurisdiction adopting Pillar 2.

the local operating company's profits. The African Tax Administration Forum (ATAF) has promulgated a form of the QDMTT for use by African jurisdictions.[25]

Many African countries have adopted tax incentive provisions and rewarded MNEs with such incentives with the ostensible purpose of attracting extractive industry investments in their jurisdiction. Most of these tax incentives will be curtailed by Pillar 2 . To ensure that an agreement with beneficial tax incentives is not changed after it is entered into, MNEs often have sought to include a "stabilization clause" in an agreement, providing that its terms cannot be changed to the taxpayer's detriment for the period of the agreement. The conflict between the Pillar 2 minimum tax and tax incentives covered by stabilization clauses is an important issue to sort out and is discussed in Section 7.3. Pillar 2 also has a Subject to Tax Rule of the BEPS program (STTR) that allows source jurisdictions to impose withholding taxes on certain related party payments, such as marketing service payments, in a fashion that will override existing DTA limits. This rule, which will be of importance to African countries, applies when the rate of taxation by the recipient country of a payment, is less than 9%. It tops up the withholding tax to the 9% rate.

The minimum tax provisions appear likely to come into effect in 2024, and the STTR provisions sometime after that pursuant to some form of a multilateral tax treaty instrument.

25 ATAF, ATAF Suggested Approach to Drafting Domestic Minimum Top-Up Tax Legislation (2023), available as of 6-24-2023 at: https://orbitax.com/news/archive.php/ATAF-Releases-Suggested-Approa-51930.

6.2 Critical Issues to Address with Regard to Corporate Tax

In connection with tax matters, parliamentarians and CSOs should focus on the following items.

- ***Determination of income*** – A jurisdiction's tax authorities has the primary authority to determine an MNE's taxable income. Parliamentarians and CSOs should support the proper training of the tax authorities and actively encourage them to pursue audits of MNEs.
- ***Transfer pricing*** – Transfer pricing is critical in obtaining the right revenue from an extractive industry project. Parliamentarians and CSOs need to be aware of this, and where they have an opportunity to review the transfer pricing in a project, they should seek expert advice.
- ***Tax incentives*** – Developing countries often feel they need to offer tax incentives to attract MNEs to develop an extractive industry project. As is discussed in some detail in Section 6.2, tax incentives should be used with caution.
- ***Capital gains*** – Many extractive industry projects generate large capital gains for the corporations engaged in them when they decide to dispose of their interests. Parliamentarians and CSOs should ensure that the laws in their jurisdiction tax both locally incurred capital gains and offshore transfers of interests in local projects - so-called indirect transfers.
- ***Pillar 2*** – It will override local tax laws and impose a minimum tax of 15% on the operations of local extractive industry subsidiaries of MNEs. It will impact any tax incentives already given and will force

consideration of the form of future tax incentives. Countries need to review the existing tax incentives they have given and how they may be protected by stabilization clauses. Most importantly, they need to develop a strategy to deal with the complex interaction between the new global minimum tax and their current and anticipated future tax situation.

6.3 Other Taxes

CITs are not the only taxes that developing countries must consider. A brief description of a number of other taxes is below:

- ***Withholding taxes on outbound payments*** – Withholding taxes supplement the CIT in that they are often imposed as a substitute for the CIT on certain outbound payments. They cover payments of interest, royalties, certain types of service payments, and dividends and can be an important source of revenue for developing countries. They are often reduced or eliminated by investment agreements or DTAs. Employing its theoretical model of the breakdown of the sources of mining revenue, the IMF states that withholding taxes, particularly the withholding tax on dividends, should yield about 15% of total revenues derived from a mining project. Given the impact of DTAs, this figure is probably too high in Africa at present.
- ***Import and export duties*** – Customs duties are often imposed on the cost of goods used in mining and oil and gas projects. Export duties may be imposed on the product produced by an extractive industries project. These duties can be an important source of revenue to source countries, but they are often reduced or eliminated by legislation in the local jurisdiction (particularly with respect to export duties) or by investment contracts or trade agreements.
- ***VAT*** – This is a form of consumption tax that is imposed on the ultimate consumer of a good or service. It may be imposed on imports of goods employed in an extractive industries project, but it may be reduced or eliminated by VAT refunds on the export of the extractive industry product.
- ***Windfall profits tax*** – These taxes are intended to be imposed on profits in excess of the amount needed to give an investor a return on investment sufficient to justify the cost of capital involved in the investment. This theory has proved to be too difficult to apply in practice. Consequently, these taxes are typically imposed when the price level of an extractive industry product reaches a certain level.
- ***Employee withholding taxes*** – Employee withholding taxes are normally applied by withholding taxes from the compensation of the employee when the compensation is earned. Typically, the taxes support medical, retirement, and related benefits. They can be an important source of revenue for a state to cover these expenses.

6.4 Possible Alternatives / Enhancements to Traditional CITs

The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), in partnership with the ATAF, has published a paper on ten policy ideas to mobilize mining revenues. The paper is a useful resource not only for these ideas but also for the current status of revenue collection from the mining industry.[26] Three of the ideas that are examined are briefly reviewed here; the balance can be read about in the reference

26 A. Readhead, et al., The Future of Resource Taxation: 10 policy ideas to mobilize mining revenue (IGF & ATAF 2023).

paper cited in the footnote and in sources. For parliamentarians and CSOs, the important point to recognize is that these ideas exist, and some of them are ready to be incorporated into new extractive industry projects.

- ***Minimum profit share for the Government*** – A guaranteed profit share provision in an extractive industry contract will provide the government with a share, say 50%, for example, of the profits of an extractive industry project if the share that they would receive from the project, under the traditional royalty and income tax routes, fall below this level. To implement this idea, a jurisdiction will need to have confidence in its ability to measure the profits accurately from a project involved in the program.
- ***Development turnover tax*** – A development turnover tax will require the MNE in an extractive industry project to take a low flat rate of the gross revenue from the project and invest it in shared public infrastructure. This is intended to be on top of the traditional royalty and tax revenue being earned by the government.
- ***Sixth method for transfer pricing*** – The widely used transfer pricing manual of the OECD postulates five methods for transfer pricing, all of which rely on the arms' length principle. Some Latin American countries avoid transfer pricing issues by referring to published prices on a relevant exchange, such as the London Metals Exchange, with few or only minor adjustments to the quoted prices. African countries might consider this alternative as well.

7.0 Financial Modeling

Once the nature of a project has been established, and the terms of an extractive contract is in the process of negotiation, a financial analysis of the project should be undertaken, an outline of the analysis of which is provided here. This analysis is drawn largely from an IMF paper on the financial modelling of extractive industry projects.[27]

7.1 Key Concepts

Any financial model will involve certain key financial concepts that must be understood when dealing with the model. A summary of three of the most important ones is provided here:

- ***Discounted cash flow (DCF)*** – A discounted cash flow looks at the cash flows (such as revenues, operating expenses, royalties and taxes) generated by the project over its life and applies an interest rate to discount them to their present value. For example, a $100 payment estimated to be paid in five years would have a present value of roughly $62 if discounted at a rate of 10%. Put differently, a person would be satisfied to be paid $62 today or $100 in five years.
- ***Net present value (NPV)*** – The NPV takes all of the cash flows expected to be generated by a project, both revenues and expenses, nets them and discounts them back to their present value using the DCF method to do so. In a very simple example, say a project has an expected loss of -$50 in year one and expected profit of $100 in year two; its NPV using a 10% discount rate for the two years cash flows would be $32.6 ($100 discounted from year two at 10% equals $82.6 less $50).
- ***Internal rate of return (IRR)*** – The IRR is the rate determined by taking the net cash flows over the life of a project and calculating the discount rate needed to get them to equal the initial investment in a project. To return to the simple example used in the DCF case, an investment of $62 today that generated $100 in Year 5 would have an IRR of 10%. Investors will demand a certain IRR on a project in order to make an investment in it.

7.2 Modeling Calculations

Four Phases – The IMF divides financial modelling into four phases, namely: (i) exploration, (ii) development, (iii) production, and (iv) closure and decommissioning. In each phase, the project will have both positive and negative cash flows. These are to be projected and then reduced using DCFs to their NPV. Assuming some investment parameters have been set, the projected IRR on the project can then be calculated.

Evaluation

The first step in any evaluation is to determine the valuation metrics. In a Royalty–CIT type project, the project's metrics would include the net cash inflows each year over the life of the project before any payment to the government in the form of royalties and taxes. In a PSA project, the metric would be the parties' shares of revenue. These cash flows set the base on which the fiscal calculations will be based. Using the base, the government's take in the form of royalties and taxes or profit split can then be modelled. These can be adjusted to see their impact on the IRR and compared to the IRR reasonably expected by an investor. The government's take should also be spread

27 IMF, Fiscal Analysis of Resource Industries (the FARI framework for fiscal modeling).

over the life of the project so that its annual impact can be determined.

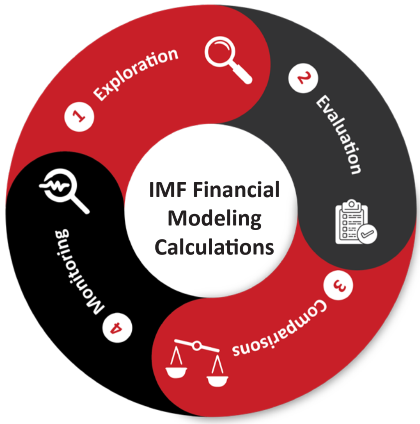
Comparisons

Once the evaluation figures have been produced, they can be compared to data from comparable projects in the same country and to data from comparable projects in other countries. What was a comparable price for the mineral? What was the royalty rate? Was a tax incentive given? What was the IRR earned by the investor? This data may be difficult to obtain since some of it will not be publicly available. However, if specific data on other similar projects is not available, a considerable amount of public data on the type of inputs being used in the financial model should be available. For example, comparisons should be made between the IRR expected from the proposed project and the IRR earned by the MNE and by competitors of the MNE in the same line of business. Further, what is the projected government revenue from the project compared to that earned on other projects and to that earned in other jurisdictions, not only in Africa but also elsewhere in the world?

M**onitoring**

Once a project is underway, the same set of calculations should be used to compare actual cash flows from the project. Was the modelling too optimistic, too pessimistic, or on point? If the modelling was materially off the mark, should adjustments be made, and if so, does the project contract permit or require that they be made?

When the occasion permits, parliamentarians and CSOs should be prepared to review the modelling undertaken by the government.



7.3 Critical Issues to Address with Regard to Financial Modeling

- ***Analysis requirement*** – Governments should undertake a complete financial analysis before agreeing to an extractive industry project, and the local law should require that this be done. This analysis should be mandated prior to a contract being executed.
- ***Nature of the analysis*** – The financial model should cover all aspects of the proposed project and should contain sufficient details that can be compared to other projects, as well as the underlying data that can be compared to publicly available data.
- ***Monitoring*** – Once a project is underway, the government should review the actual results against the financial model. The laws should permit adjustments to be made to a contract based on a model where the results differ materially from the projected results.
- ***Transparency*** – The jurisdiction's laws should require that the financial analysis undertaken by the government be made available for public inspection. It should also provide for reasonable comments to be made on the analysis.

8.0 Other Important Issues

A number of additional critical issues for parliamentarians and CSOs to consider are described below. Because the focus of this Toolkit is on fiscal issues, it does not cover all of the many social issues raised by extractive industry projects. We recognize this but are constrained in this Toolkit to maintain a principal focus on fiscal issues only.[28]

8.1 Transparency

Members of Parliament and CSOs will need government transparency at all stages of the extractive industry process in order to play a meaningful role. Where possible, parliamentarians should press to have committee hearings open to the public and seek to have the provisions of agreements being negotiated open for criticism and comment before being put in final agreed form. While this is a laudable goal, multiple parties cannot be simultaneously engaged in negotiating a contract with an MNE. Accordingly, a number of points in the negotiating process need to be identified where parliamentary oversight and public comment can be productively employed.

Parliamentarians and CSOs need also to play a significant role in monitoring the outcomes of an agreement after it has been implemented. Unfortunately, in many situations today, they do not have the opportunity to do so because of a lack of transparency.

The Extractive Industries Transparency Initiative (EITI) has created a transparency guide for extractive industry participants to follow. It consists of a number of requirements, such as creating the framework for multistakeholder oversight and requiring full disclosure of all pertinent laws and regulations that can affect extractive industry agreements. In addition to the EITI, the Global Reporting Initiative (GRI) has an exposure draft of Environmental, Social, and corporate Governance (ESG) disclosure standards for the mining industry, and the International Financial Reporting Standards (IFRS) has created an international sustainability standards board that is expected to issue guidance in this area as well.

A large number of African countries have adopted disclosure laws. Unfortunately, in many cases, these laws are disregarded in practice. The Sinosteel case study presents an instance where the lack of transparency caused local tensions.

Case study

The Sinosteel Cameroon Case

In 2022, Cameroon entered into a major iron ore extraction contract with Sinosteel, a Chinese company. The transaction was not publicly disclosed while being negotiated, and even later, when disclosed, many of the pertinent fiscal details in the contract were not published. Indeed, the contract provides that certain details of the agreement are confidential

28 See for example of social issues: ICMM, Mining Principles, available at: https://www.icmm.com/en-gb/our-principles; World Bank, Mining Community Development Agreements (2012); see on tax and the environment: World Bank, Global Tax Program, Environmental Tax, available at: https://www.worldbank.org/en/programs/the-global-tax-program/environmental-taxes.

and provide for negotiating "special agreements." The failure of disclosure took place despite the fact that Cameroon has a law requiring disclosure of these matters. The law provides: "Contracts between the administration and public or private companies, particularly companies exploiting natural resources and companies operating public service concessions, shall be clear and made public. These principles apply both to the procedure for awarding the contract and to its content" (Law No. 2018/n11, Article 6).

Not surprisingly, the disclosure of the contract after it was executed without any of its details created a public controversy, with many CSOs denouncing the contract. It also raised suspicions about the conduct of the government in the matter.

8.2 Tax Incentives, Investment Contracts and Bilateral Investment Treaties (BITs)

These three areas have independent importance but also relate to each other and, for this reason, are considered together.

Tax incentives – Many African countries have given MNEs tax incentives to open extractive industry engagements. A number of different incentives are offered, frequently including a 10-year tax holiday, followed by 15 years of a reduced tax rate. They can also take the form of tax credits and outright cash grants. Because of tax incentives, the ETR of many extractive industry projects is very low, depriving the affected jurisdiction of revenues needed for development.

Although many MNEs seek such incentives and argue that they need them in order to enter into an extractive industry contract, there is an open question of whether these incentives provide an overall benefit to the jurisdictions offering them. In hindsight, many experts reviewing the use of tax incentives have concluded that they were not needed to secure the engagement of the MNE and did little to benefit the developing country.

As discussed, Pillar 2 of the BEPS project is likely to have a material impact on tax incentives. That said, some tax incentives will still be acceptable under Pillar 2. The 15% rate can be reduced by incentives that satisfy a "substance-based carve-out" test, a test that permits a reduction in taxable income up to a fixed rate of return on activities in the source country. Refundable tax credits, credits that can be claimed irrespective of tax liability in a given period, are also acceptable. Pillar 2 appears set to come into effect in 2024, but its impact should be considered immediately.

Investment contracts and BITs – Investment contracts (also called "concession agreements") between a jurisdiction and an MNE are executed to set in legal form the terms of the agreement for an extractive industry project. As discussed above, they are created pursuant to the local law of the source country where the extractive industry project is to take place. Many jurisdictions have also entered into BITs with provisions that provide for "fair and equitable treatment" of MNEs and protect them against expropriation of their investments. These are often supported by arbitration clauses and can affect the treatment of extractive industry ventures.

Stabilization clauses may be employed to prohibit a developing country from modifying any tax incentive given to an MNE to the MNE's detriment. They are found in many extractive industry contracts. Stabilization clauses can take many forms, and they need to be read carefully to understand exactly what is covered and the degree of protection they provide. In general, they often state that a source country which granted the tax incentive cannot reduce or eliminate the tax benefit for a period of years, often the full duration of the benefit. In many cases, the stabilization clause is to be enforced by arbitration. Because they may limit the sovereign right to tax as a country sees fit, parliamentarians and CSOs should view stabilization clauses with scepticism, and they should be entered into only with great care.[29]

Arbitration clauses are provided as a means for dispute resolution. They may be required under BITs entered into by the source country. Many African countries have entered into such treaties with developed countries and sometimes with tax haven jurisdictions, such as Mauritius, that have established treaties with African countries. Hence, the parties to a particular mining contract may not have discretion over whether to enter into an arbitration proceeding.

Most often, the arbitration clauses call for arbitration under Investor-State Dispute Settlement (ISDS) procedures outside of the jurisdiction of the developing country where the extractive industry investment has been made. Historically, arbitration cases have often been won by the MNE bringing them. Arbitration decisions are frequently kept secret from all but the parties engaged in the proceedings. As with stabilization clauses, they should only be used with caution. If arbitration is to be employed, a focus on regional organizations, such as the East African Community, Economic Community of West African States (ECOWAS), Organization for the Harmonization of Business Law in Africa (OHADA) and Southern African Development Community (SADC) may be helpful. Care should also be taken to limit arbitrations if allowed, to only one such claim and not allow multiple claims under different instruments.

29 See a discussion on stabilization clauses, OECD, Guiding Principles for Durable Extractive Contracts (2020) at Guiding Principle VIII.

The Carin India case serves to illustrate the application of arbitration clauses and the complications of some indirect transfer capital gains cases. Most importantly, it illustrates the frustrations that can arise for a developing country when it gets involved in an international arbitration proceeding.

Case Study

The Carin India Case

In 2006, Carin, an energy company, restructured its operations in India so as to permit a public listing of the shares of its local subsidiary on the Indian stock exchange. Most of the $2 billion raised by the listing was then distributed by the Indian subsidiary up to the UK parent company as a dividend. Effectively, this complicated transaction resulted in Carin selling a good part of the stock of its Indian subsidiary. The law in India was unclear whether this form of sale was subject to Indian tax. Following the sale, the Indian government enacted legislation clarifying retroactively that the law did apply to the sale and levelled a $1 billion plus capital gains tax on Carin.

Carin then took the Indian government into international arbitration over the levelling of the tax. After a struggle in arbitration proceedings consuming several years, Carin was awarded an arbitral award of slightly over $1 billion that it moved to collect by initiating proceedings to seize overseas assets of the Indian government. The Indian government finally settled the case by paying Carin back the taxes that it had previously collected. Considering this case and another major indirect transfer case that the Indian government also lost, the Indian government moved to eliminate international arbitration clauses in its investment agreements.

In addition to investment contracts between an MNE and a jurisdiction and BITs, many jurisdictions have entered into multilateral trade agreements. Trade agreements contain a number of provisions, including, most importantly, the most favoured nation and national treatment articles, that, while not affecting CITs, can impose restrictions on the application of customs duties, tariffs, and other forms of indirect taxes. Essentially, they prohibit any different treatment in the imposition of these taxes between an MNE engaged in a project within a jurisdiction from that accorded to other MNEs or local companies similarly engaged.[30]

8.3 Monitoring

While the focus is often on the negotiation of extractive industry contracts, the monitoring of the fiscal results of operations under the contracts is equally important. Monitoring the fiscal output of an agreement can take many dimensions. See the discussion in Section 7.2 on monitoring financial modelling calculations.

The Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) provides an excellent guide to the monitoring process. The IGF posits that a number of logical steps are involved in the monitoring process. To start, what is the point of export valuation involved, and how is the product sampling to be done? Once the sample is taken, how is its valuation to be determined? Should the government rely on the internal valuation of the product by the producing company? Does it want to set up a laboratory of some sort to do it by itself, or does it want to hire an outside firm to undertake the valuation?

30 S. E. Rolland, The Impact of Trade and Investment Treaties on Fiscal Resources and Taxation in Developing Countries, Chicago Journal of International Law, Vol. 21: No.1, Article 3 (2020), available at: https://chicagounbound.uchicago.edu/cjil/vol21/iss1/3/.

The risk of undervaluation of any product is at its greatest when the product is sold at the point of departure from a developing country to a related-party marketing and distribution company. Here, the transfer pricing issues discussed previously come to the forefront.

8.4 Environment[31]

Before a mining or oil and gas venture begins, a review of the environmental impact of the proposed project must be undertaken. Extractive industry projects can be situated in a variety of different locations, some remote, some in wilderness areas, some heavily populated, and some having a multiple of important factors. In undertaking a project, the environment will be disturbed no matter where the project is to take place. No project should be undertaken before the government has concluded a thorough environmental review. Parliamentarians and CSOs need to keep in mind that the damage to the environment from some projects will be so extreme that the project should not be undertaken. For this reason, environmental laws and contracts with investors must clearly reserve the right of the government to stop a proposed project after the exploration phase and before exploitation permits are granted.

A key to managing the environmental impact of any project is having proper governance in place. This entails reviewing existing laws and regulations to ensure that they are adequate to protect the environment during the entire cycle of the project. If this is not the case, the laws and regulations need to be redrawn along suitable lines before the project begins. In addition, as the project proceeds, parliamentarians and CSOs working with the government should continually evaluate whether the laws and regulations

31 This section draws heavily on the material in the IGF report: IGF, Guidance for Governments: Environmental Management and Mining Governance (2021).

are appropriate for the tasks assigned to them and, if not, update them so that they are. However, once a project is underway, pertinent laws may not be updated unless the project agreement allows changes to laws relied upon by an investor. A violation of this principle may result in an adverse arbitration award.

The IGF breaks down mining environment concerns into four main areas:

- ***Water, air quality and soil management***: The goal here is to protect the quantity and quality of water for its use for the populations and ecosystems impacted by the project, as well as to prevent or mitigate significant air and soil pollution resulting from the project
- ***Biodiversity***: Here, the impact of a mining venture over its life cycle can have a direct and indirect on biodiversity. Thoughtful advance planning can mitigate this impact.
- ***Mine waste management***: Mine waste can take many forms, including waste rock, tailings, and precipitates from the mining processes. The goal here is to ensure the stability of all mine waste facilities and monitor them to ensure they are performing as required.
- ***Emergency preparedness and response procedures***: Mining almost always has unplanned instances of concern; the mining management team and the government need to be prepared to respond to them.

The key to successful management of the environment in oil and gas projects follows much of the guidance articulated above. Oil and gas exploration and drilling can disturb land and marine ecosystems. Seismic techniques used to explore oil and gas under the ocean floor may harm fish and aquatic animals. Oil spills may take place during the life of a project. In order to deal with these matters, the governance measures articulated for mining projects have equal application here.

Mining reclamation and restoring oil well sites are critical aspects of any extractive industry project. Mining reclamation should create useful landscapes and restore productive ecosystems. Oil and gas restoration requires that wells need to be properly plugged and the site be restored to its original condition.

A jurisdiction's laws and regulations need to include provisions requiring reclamation measures after any project runs its course. The obligations here may include the deposit of sufficient monetary proceeds during the life of a project to ensure that the proper reclamation steps are taken at the project's conclusion or, if available in a market, require the project operator to secure an environment performance surety bond that would fund restoration costs if the mine operator went into bankruptcy.

8.5 State Equity Participation

In Africa, states are increasingly taking equity interests in extractive industry projects. This is common in gas and oil projects and is becoming more common in mining projects. The interests can vary from a small equity ownership in the local subsidiary of the MNE undertaking a project to the case where a State-Owned Enterprise (SOE) has a controlling interest in a project. The World Bank has authored a detailed toolkit for equity participation in mining ventures, which is a valuable resource.[32] In evaluating equity participation, the following subjects need to be considered:

What is the size of the position that is being considered, and what form will it take?

32 World Bank, Toolkit for State Equity Participation in Mining Companies (2022).

In many instances, the position will be a 10 % to 20% shareholding in the local project corporation. However, positions can also take the form of a partnership interest or a controlling interest in a venture operated by an SOE.

How will the position be funded?

Three forms can be explored – a free interest, a carried interest, and a fully paid interest. The free interest is typically small and may be dictated by a local statute. A carried interest is one where another party to the venture absorbs the cost of the interest and is to be paid back over time for its investment. A fully paid interest is, as the term indicates, one that is paid for in full value by the government. The nature of the project and its economics will dictate the form of the investment.

What will be the economic impact of the investment?

The government should reap a benefit from its equity participation in a venture in addition to the revenue it may obtain from a Royalty-CIT program. In many cases, this will be true, but in some cases the equity stake may actually reduce what might be the return on a Royalty-CIT program since the investor may insist on an offset for the investment in a reduced royalty rate. This should be evaluated as part of the financial modeling of the project.

Who will own the investment?

The government may own the stake directly, or a SOE may own the interest. This will depend on whether the government has established a SOE that can manage such an investment

How will the investment be managed?

In many cases, the investment will entitle the government to sit on the local operating company's corporate board or otherwise participate in the management of the venture.

Can the government bring principles of good governance to this role?

This is an important consideration to consider before taking a state participation venture.

8.6 Critical Issues to Address with Regard to Other Important Issues

Transparency

In order for transparency to be meaningful, three critical elements need to be present:

- ***Local law*** – The local law must mandate that the government be required to make pertinent information on extractive industry projects available to the public. This should include the parties involved in a project, its expected outcomes both in terms of output and revenues associated with the output, the costs involved, the environmental impact of the project, and its impact on local communities.
- ***Timing*** – The timing of making information available is critical. If it is only available after the fact, it is limited in value.
- ***Right to comment*** – People should be given the right to comment at different stages of the project so as to have some impact on the government's actions.

Tax incentives, investment contracts, and BITs

These are three areas are related and considered together:

- ***Tax incentives*** - Too often, tax incentives are given to MNEs without proper examination to determine if they are really needed to attract an investment. Proposed tax incentives need to be critically reviewed and, if granted, limited in amount and duration. The impact of

Pillar 2 must also be considered.

- ***Investment contracts*** – Investment contracts should be issued wherever possible under a concessionary legal system where the critical elements of the contract are set forth in the jurisdiction's laws. The use of stabilization and arbitration clauses should be limited and structured so as not to cause future harm.
- ***Bilateral Investment Treaties (BITs)*** – Parliamentarians and CSOs need to be aware of the numerous BITs that have been executed. While they may not directly incorporate tax and other fiscal provisions, some of the provisions dealing with fair and equitable treatment of investors have been interpreted to apply to fiscal matters.

Monitoring

While early engagement by parliamentarians and CSOs in extractive industry projects is of great importance, monitoring the results is also important. The monitoring effort should focus on these questions:

- ***Review actual output*** – How does the output of the mine or oil and gas venture compare with the projections initially made for the project?
- ***Review revenue*** – How much revenue in the form of royalties or profit oil and taxes was generated under the project, and how does this compare with the projections initially made?
- ***Effective use of revenue*** – Is the government using the revenue generated from the project in a beneficial manner?
- ***Value of agreement*** – In comparison with other similar projects, was the agreement a good one?

Environment

Environment issues need proper attention in any project. They include:

- ***Early focus*** – Well before a project begins, the project's impact on the environment needs to be considered. In some cases, the impact may be so deleterious that the project should not be undertaken.
- ***Proper governance*** – The key to managing the environmental impact of any project is to ensure that the jurisdiction has enacted laws and regulations properly to manage extractive industry projects. These must include provisions to deal with unanticipated emergencies that will invariably occur.
- ***Reclamation*** – No project should be undertaken without a valid reclamation plan. The plan should include adequate sources of financing for the reclamation steps, including, where necessary, the deposit of funds to cover these steps once the venture is concluded.

State equity participation

The taking of equity participation in a project has an appeal to African governments and the local population. However, before taking a participating interest, the questions posed on good governance need to be considered.

9.0 Way Forward

No document such as this Toolkit can cover every issue that parliamentarians and CSOs may encounter in dealing with extractive industry projects. We believe that the Toolkit provides a starting point for an inquiry into the fiscal issues involved in the negotiation of an extractive industry contract and monitoring its execution thereafter. To summarize, in their extractive industries work, parliamentarians and CSOs should focus on these goals:

Building good governance – No extractive industry project will provide a fair share of resources to a source country absent a responsive and capable government, and parliamentarians and CSOs can play a key role in building good governance.

Creating proper legislation and contracting principles – Parliamentarians and CSOs can actively support the enactment of model extractive industry legislation and comprehensive transparency laws and work to ensure the use of model contracting principles.

Focusing on valuations – The most important issue affecting a source country's revenue from an extractive industries project is the determination of the pricing of the mining or oil and gas product being produced. For this reason, parliamentarians and CSOs should focus on this area and, where possible, bring in experts to assist them with examining the pricing.

Monitoring implementation – Parliamentarians and CSOs can also play a key role in ensuring that the negotiation of extractive industries contracts and the implementation of the resulting projects are consistent with applicable model rules.

Holding the government accountable – Finally, parliamentarians and CSOs should be among the principal parties holding their governments responsible for using the revenue gained from an extractive industry project to benefit the public.

We hope that the critical issues articulated throughout this Toolkit and the oversight questions in the Appendix to the Toolkit will assist parliamentarians and CSOs in working toward the successful implementation of the foregoing goals.

Appendixes

Appendix A: Oversight Questions

Relevant Law

Based on the discussion of relevant law, one or more of these oversight questions may be of relevance. A much more detailed set of questions pertaining to this subject can be found in the African Minerals Governance Framework (AMGF).

Oversight Questions	MP/CSO Response
Has the jurisdiction enacted laws based on a form of model extractive industries legislation?	
If not, what steps can be taken to see that such legislation is adopted?	
Has the jurisdiction adopted a model extractive industry contract based on pertinent laws to be used in negotiating contracts with MNEs?	
If the jurisdiction has, has it consistently employed the contract in its negotiations with MNEs? If not, what steps can be taken to ensure a model contract is adopted and used in practice?	

Royalties and PSAs

Based on the discussion of royalties and PSAs, one or more of these oversight questions may be of relevance.

Oversight Questions	MP/CSO Response
Has the jurisdiction adopted transparency legislation that opens contract negotiations for public comment and other forms of public participation, especially by directly affected communities at appropriate times?	
Do proposed extractive industry contracts in the jurisdiction meet the standards of model royalty contracts or PSAs?	
Has the relative administrative simplicity of a model gross value-based royalty been appropriately considered?	

Profit-based royalties involve many of the administrative challenges of a CIT. Are such royalties contemplated, and if so, is the cost of administering them being considered adequately?	
Do you have the necessary expertise to analyze the pricing in a royalty contract or PSA, and if not, can you acquire such expertise with the assistance of industry experts?	

CIT

Based on the discussion of corporate taxes, one or more of these oversight questions may be of relevance. Pertinent subjects to explore may also be found in the AMGF and Fair Tax Monitor, citations of which can be found in the sources section.

Oversight Questions	MP/CSO Response
What is the methodology for any transfer price assessment incorporated in an extractive industry contract, and how will the application of this methodology be audited?	
Do you have the necessary expertise to analyze transfer pricing issues, and if not, can you acquire such expertise with the help of industry experts?	
How will Pillar 2 apply to the jurisdiction's tax system, and how will any tax incentives associated with an existing extractive industry agreement be treated?	
Does the jurisdiction have both a CIT and a profit-based royalty? Will the two related systems clash or produce more revenue	
Is it worthwhile to explore the adoption of any of the alternatives/enhancements to the traditional corporate tax systems referred to in the IGF/ATAF paper or suggested from other sources?	

Financial Modeling

Based on the discussion of financial modelling, one or more of these oversight questions may be of relevance.

Oversight Questions	MP/CSO Response
Does the jurisdiction's laws require the government to make a financial analysis of each extractive industry project?	
Has the government undertaken a financial analysis of a projected project, and does it appear reasonable?	
Does the jurisdiction's laws require that the financial analysis undertaken by the government be made available for public inspection and comment?	
Do you have the capacity to review the financial model, and if not, can you obtain assistance to do so?	

Other Important Issues

Based on the discussion of other important issues, one or more of these oversight questions may be of relevance.

Oversight Questions	MP/CSO Response
What transparency laws have been adopted by a jurisdiction, and if none have been adopted, can appropriate legislation be enacted?	
Are tax incentives contemplated in the negotiation of an extractive industries contract? If so, do they need to secure the investment or take other beneficial measures?	
Has the impact of Pillar 2 on tax incentives been considered?	
Can the use of a stabilization clause be avoided in the event tax incentives are provided?	
Can tax disputes be resolved fairly using local or regional dispute resolution measures? To what degree do BITs constrain choices here?	
What monitoring processes have been put in place by the government, and can these standards be improved?	
What type of government oversight is possible with respect to the use of the proceeds from an extractive industry project?	

Has a careful consideration been made about taking a state participation in a proposed venture?	

Appendix B: Sources for Additional Information

3.0 Relevant Law

General references:

- AMGF, et al., African Mining Vision: African Minerals Governance Framework (2018), available at: https://archive.uneca.org/sites/default/files/PublicationFiles/african_mining_vision_african_mineral_governance_framework.pdf.
- AU, Africa Mining Vision, available as of 4-2-2023 at https://au.int/en/ti/amv/about.
- AU, Africa Mining Vision, African Minerals Governance Framework (2017), available as of 4-2-2023 at: https://repository.uneca.org/handle/10855/24172.
- ISLP, Open Oil, NRGI & CCSI, Mining Contracts: How to Read and Understand Them (2013), available as of 4-2-2023 at: https://scholarship.law.columbia.edu/sustainable_investment_books/7/.
- P. D. Cameron & M. C. Stanley, Oil, Gas, and Mining, A Sourcebook for Understanding the Extractive Industries (World Bank, 2017).
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- A. Aukati & V. Miroshnychenko, Product Sharing Agreements, What Constitutes a Good PSA? Should They Be Pursued? (USAID 2021).
- A. Readhead, Public consultation document, Determining the Price of Minerals: A Transfer Pricing Framework (OECD & IGF 2023), available as of 5-12- 2023 at: https://www.oecd.org/tax/tax-global/oecd-igf-public-consultation-document-determining-the-price-of-minerals-a-transfer-pricing-framework.pdf.

Model contracts:

- IBA, Model Mine Development Agreement, available as of 4-2-2023 at: https://www.mmdaproject.org.
- H. Mann, et al., Model Mining Development Agreement- Transparency Template (IISD 2012), available as of 4-2-2023 at: https://www.iisd.org/system/files/publications/mmda_transparency_report.pdf.
- OECD, Guiding Principles for Durable Extractive Contracts (2020).
- World Bank, Mining Community Development Agreements, Source Book (2012).

Model Legislation:

- AMLA, Guiding Template, available as of 4-2-2-23 at: https://a-mla.org/en/guidingtemplate.
- SADC, Protocol on Mining (1997), available as of 4-2-2-23 at: https://www.sadc.int/document/protocol-mining-1997.
- ATAF, ATAF Suggested Approach to Drafting Domestic Minimum Top-Up Tax Legislation (2023), available as of 4-2-2023 at: https://events.ataftax.org/index.php?page=documents&func=view&document_id=191.

4.0 Royalties – Same as in Relevant Law

5.0 PSAs – Same as in Relevant Law

6.0 CITs

- See supra The Taxation of Petroleum and Minerals, Principles, Problems and Practice.
- International Taxation and the Extractive Industries (P. Daniel et al. eds., Routledge 2017).
- See supra Mining Contracts: How to Read and Understand Them.
- UN, United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries (2018, revised edition pending).
- UN, Committee of Experts on International Cooperation in Tax Matters, web site at:https://www.un.org/development/desa/financing/what-we-do/ECOSOC/tax-committee/tax-committee-home.
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