

Fiscal Affairs Department

# Revenue Administration for Extractive Industries Common Challenges



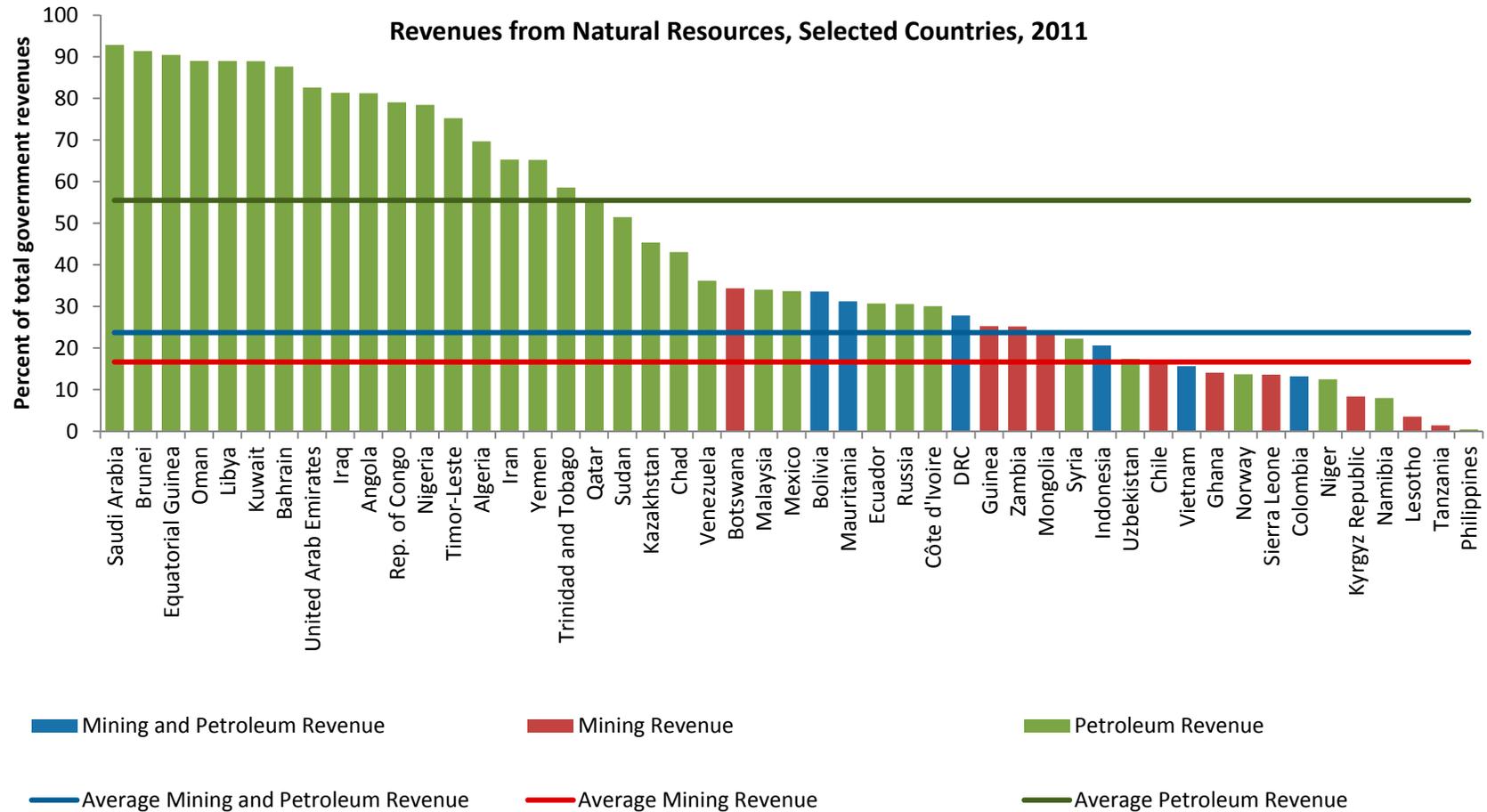
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Natural Resource Taxation in the Asia-Pacific Region

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# Significance



# Nature of the Industry

- Multinational in nature
- Capital Intensive and High Risk
- Price and Currency Volatility
- Non Renewability
- Long development and operating periods
- High levels of exports and imports
- Poor governance
- State control and ownership

# Nature of the Industry

- Artisanal Mining

Large artisanal mining sectors in some countries which consist of both licensed and unlicensed miners and generally operate outside of and have little understanding of the countries regulatory environment. This can be a significant portion of the economy that operates outside of the tax system.

# Risks Introduced by the Characteristics of the Industry

- International planning Techniques
  - Expense allocations
  - Know how and research and Development Costs
  - Hedging, financial instruments
  - Dispositions including indirect transfer of licenses
  - Allocation of Financing costs
- Pre-production costs
- Early Revenue realization
- Shadow Economy

# Nature of the Regulatory Regime

- Mixture of Concessionary and contractual
- CIT, VAT, Royalties (incentives, special rules)
- PSA's (Stabilization Clauses, Incentives, different rules)
- Additional profits tax
- Capital gains
- Withholding
- Equity Participation

# Nature of the Regulatory Regime

## Specialized Rules

- Reclamation Costs
- Infrastructure charges
- Skills Improvement
- Ring Fencing
- Farm-in/Farm-out
- Thin Capitalization
- Depreciation
- Stabilization clauses

# Challenges from Regulatory regime

- Valuation from Natural Resource sales
- Transfer Pricing
- Finance costs
- Hedging
- Ring Fencing
- Capital Expenditure Rules
- Social Infrastructure, training, reclamation Costs
- Transfers of Licence Interests

# Challenges from Regulatory regime

- With holding taxes and double taxation agreements
- Exemption of imports for NR operations from VAT and Customs duties
- Administering departures from standard legislation which requires specialization
  - Special taxes
  - Contract based regimes
  - NR related tax provisions
    - Bench-mark based pricing, ring fencing, cost recovery limits, deduction and abandonment reserves, investment incentives
- Stability clauses

# Regulatory Environment

## Institutional Issues

- *Revenue Authority*
- *Ministry of Mines and/or Petroleum*
- *National Oil Company*
- *Equity interest held by Ministry*
- *Other Regulatory Agencies*

# Challenges from Regulatory Environment

- Can lead to revenue administration fragmentation
  - Interagency cooperation and information exchange
- Conflict of Interest

# Risk Based Compliance Management Theory

- A primary goal of revenue administrations is to collect the taxes and duties payable in accordance with the applicable policies, laws, regulations and procedures through a facilitative compliance environment. This goal must be accomplished in a manner that will sustain confidence in the administration and the tax system as a whole.
- Revenue administrations have limited resources that are insufficient to address all risks and therefore need to develop targeted strategic and tactical responses in a manner which maximizes compliance from taxpayers

# Risk Based Compliance Management Theory

This is best achieved through:

- Taxpayer education and assistance
- Simple laws and procedures make it easier and less expensive for taxpayers to comply (taxpayers will not voluntarily comply if the tax system itself makes it difficult or too expensive); and
- Risk-based verification deters non-compliance (taxpayers are more likely to comply if they perceive a strong chance of detection and see blatant offenders penalized).

# Risk Based Compliance Management Strategy for Industry

- Specialization (transfer pricing, industry)
- Targeted Taxpayer service and Education
  - Key Client Manager
  - Industry forums
- Robust risk based audit
- Rulings, practice notes and tax alerts
- Robust Tax dispute processes

# Strategic and Capacity Challenges

Generally:

- risk assessment skills
- coordinated risk based compliance strategy
- audit capacity
- robust training programs
- Acquiring necessary information

# Strategic and Capacity Challenges

- Qualifications
- Training
  - NR Industry operations
  - NR Industry Accounting
  - NR tax Legislation
  - Bench mark pricing
  - NR Volume and Quality measurement
  - Multinational Tax planning Techniques

# Information Sources

- “Administering Fiscal Regimes for Extractive industries – A Handbook” , International Monetary Fund, Jack Calder
- “Revenue Administration: Administering Revenues from Natural Resources – A Short Primer”, International Monetary Fund, Andrea Lemgruber and Scott Shelton