ICAEW
REPRESENTATION 1/24

PROVISION ON ACTIVITIES IN CONNECTION WITH THE EXPLORATION AND EXPLOITATION OF EXTRACTIBLE NATURAL RESOURCES

Issued 4 January 2024

ICAEW welcomes the opportunity to comment on the public consultation document published by the OECD on 16 November entitled "Provision on Activities in Connection with the Exploration and Exploitation of Extractible Natural Resources", a copy of which is available from this link.

For questions on this response please contact ICAEW's Tax Faculty at taxfac@icaew.com quoting REP 1/24.

This response of 4 January 2024 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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GENERAL COMMENTS

TAXATION OF THE ENTERPRISE

1. We question both the need and policy behind the proposals.
2. First, the proposals are unnecessary in giving resource-rich or resource-dependent states the right to tax the extraction of natural resources. The existing rules reflect the policy stated in paragraph 178 of the consultation. The extractive activity, whether in the nature of mining or oil and gas production is, of necessity, longer term and inevitably gives rise to a fixed place of business within Article 5(1), apart from rights granted under article 6. This is explicitly recognised by Article 5(2)(f) which illustrates such fixed places of business. The proposals add nothing to that right. It may be observed that the same will apply to alternative energy sources such as wind and solar as such facilities are similarly longer term in nature.
3. Second, the anti-fragmentation rules in Article 5(4.1) introduced in 2017 as a result of BEPS Action 7 will prevent MNEs from dividing activities among connected entities to avoid the existence of a permanent establishment in the source state.
4. Third, the effect of the proposals will be to alter allocation of taxing rights of, usually smaller, providers of services to the extractive industry in a way that is arbitrary and discriminatory. A provider of the same service to a non-extractive industry will be subject to a higher threshold for source state taxation than the supplier of that service to an extractive industry. For example, a self-employed chef working at a catering facility for film production will have a different treatment from the same chef working at an extractive site for the same time period. The distinction between onshore and offshore services in this respect is similarly unjustified.
5. This is apparent from the absence of any explanation in the proposed article of “relevant activity” in the offshore only provision and the reference to undefined “specialised services” only in the extension to land based activity. The word “includes” places no limit on the kind of services. Using the commentary (Consultation paragraph 183) to relieve excessively broad language in the article is also unsatisfactory and demonstrates the failings of the proposed article.
6. The same can also be seen in relation to building sites and installation activities that currently fall within Article 5(3) which have a 12-month threshold. If a contractor installs a water pipe in a city, the 12-month threshold will apply. If the pipe is in connection with extractive activity, the threshold is proposed to be 30 days. Both are objectively in the same position but suffer different tax treatment.
7. The same unequal treatment will likewise apply to the provision of services in those treaties that have a services PE provision based on Article 5(3)(b) of the UN Model (or the OECD variation in paragraph 144 of the Commentary to Article 5, on that). Again, two service providers in the same position objectively, will suffer different tax treatment.
8. We are also concerned that the proposed provisions represent a fundamental departure from long-standing principles regarding the attribution of taxing rights in relation to permanent establishments. If these changes were to be extended to a wider range of activities, those principles could be upended, having a significant impact on the compliance and administration costs of businesses operating cross-border.

EMPLOYMENT INCOME

9. Lowering the PE threshold to 30 days for extractive related activities will have a knock-on effect on the taxation of non-resident employees of companies providing services in that area under article 15(2)(c). Again, employees in objectively the same position will be subject to different treatment depending on who their employer's customer is. Furthermore, there is no policy reason for treating a mining engineer differently from, say a civil or software engineer.
10. If the provision is introduced a minimum period for actual performance employment in relation to the relevant activities (days worked) should be added to the requirements in article 15(2) rather than a separate modification of the article for affected employees.

ANSWERS TO SPECIFIC QUESTIONS

Question 1

The proposed alternative provision covers only activities connected with extractible natural resources (oil, gas and minerals), as explained at paragraph 187. Is there a case for extending the provision to cover the harnessing of renewable resources such as hydroelectric, wind, wave, tidal or solar power?

11. We understand that one of the key drivers for the proposed wording is to assist source states with abundant extractible natural resources to secure for themselves an adequate share of the value that is bound up in those finite resources. Ensuring that the state can tax profits from extracting those resources is one such way. The policy considerations for renewable resources are different because such resources do not deplete the wealth of a state.
12. This change may arguably deter some service providers from providing their services to extractive industries (especially if the tax rate is higher in the source state than in its state of residence).
13. The proposal does nothing to actively promote the creation of renewable energy resources.
14. For these reasons, we believe that the provisions should not be extended to include renewables. Excluding renewable energy resources would also ensure that additional taxing rights and the associated administration would not be created by, for example, the provision of short term emergency solar power as part of disaster relief.

Question 2

Are there particular challenges of profit attribution to the short-duration permanent establishments that this provision would create? What are they and how should they be addressed?

15. Calculating the profits of a short-term establishment and setting up the compliance administration for reporting it will require just as much resource as for one that lasts for a much longer period. Attribution of profit under the Authorised OECD Approach is complex and prone to disputes. Compliance cost may be disproportionate for both taxpayers and tax authorities, particularly in relation to smaller contractors, including increased MAP requests.
16. Having said that, it seems reasonable that a very large MNE, which can invest in complex technological infrastructure and extraction of resource, via short term complex projects, can put in place in place accounting processes adequately to capture data, but this may not be the case for smaller service businesses.
17. Given the increased amount of reporting required under the Global Anti-Base Erosion (GloBE) rules, many very large MNEs are already implementing improved data capturing processes for their PEs and subsidiaries. The requirements of environmental, social and governance (ESG) reporting are also helping to ensure that data is collected by MNEs

operating in extractive industries. However, those businesses that fall below the size threshold for having to deal with these reporting regimes will experience a disproportionately-sized additional compliance burden.

Question 3

The paragraph on capital gains in the new provision (paragraph 4) largely replicates the rules in Article 13 of the OECD Model. But subparagraph c) allows the aggregation of movable and immovable property for the purposes of triggering a rule modelled on Article 13(4). Are there particular challenges in doing that?

18. If the property within scope is restricted to that directly used for properly defined specialised activities (whether onshore or offshore) that are used for the purpose of the permanent establishment as proposed, it should not prove unduly onerous to identify those assets when aggregating immovable and moveable property for the purposes of applying the 50% value test in proposed paragraph 4(c). However, such an exclusion would be a significant departure from a long-established principle. As moveable property tends to be held by affected businesses for a shorter period than immoveable property, its inclusion may not provide a reliable measure of the value of the business concerned. We therefore express caution in including it within the 50% test.

Question 4

The provision contains an exclusion for the operation of ships or aircraft designed or modified, and used, for the primary purpose of (i) transporting supplies or personnel, or (ii) towing or anchor handling. Is the "designed or modified" a useful extra condition, and would there be any practical difficulties in applying it?

19. There is an inappropriate distinction drawn between ships and aircraft in the one hand and functionally similar land-based vehicles. In both cases the inclusion of ships, aircraft and vehicles should be confined to those "designed or modified" to undertake properly defined specialised activities.

Question 5

Are the vessels mentioned as examples at paragraph 184 as within and outside the provision the right ones?

20. We believe that only ships, aircraft and vehicles carrying out core extraction activities should be included. See response to Question 4. .

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).

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