



Many Ways to Lose a Billion: Protecting Government EI Revenues



RESOURCES for
DEVELOPMENT
CONSULTING

Don Hubert (PhD)

September 2017

Resources for Development Consulting

Assist *citizens* of resource rich developing countries to secure a *fair* share of government *revenue* from petroleum and mining projects.



RESOURCES for
DEVELOPMENT
CONSULTING

Host Country Benefits from EI

1. GDP Growth

2. Employment

3. Infrastructure

4. Corporate Social Investment

5. Taxes

When we look at the economic contribution that we make, we have a certain budget for corporate social responsibility and we create a certain number of jobs, and we clearly buy goods and services from local suppliers. **But the biggest single contribution by far that we make is the tax that we pay. Its just huge in comparison to the others.**

Simon Thompson
Chairman, Tullow Oil
2015

El Value Chain

“Revenue Generation”

- 1. Legal Framework**
2. Surveying and Data Management
3. Award of contracts and licenses
- 4. Monitoring of Operations**
- 5. Collection of Revenue**
6. Revenue Management and Allocation
7. Implementation of Sustainable Policies

Unrealized Revenue Expectations

- Promising forecasts; disappointing receipts
 1. Commodity price fluctuations
 2. Scale of capital investments
 - 3. Fiscal terms including the “fine print”**
 - 4. Company tax minimization strategies**

A Revenue Risk Assessment Methodology

- Many, but not unlimited, pathways to revenue loss
- Comprehensive framework to analyze risk
- At the project-level, individual revenues streams

Revenue Risks: Pathways to Revenue Loss

Tax Rate	Tax Breaks	Tax Incentives
		Tax Holidays
	Treaty Shopping	Withholding tax
		Capital Gains Tax
Tax Base	Under-Reported Project Revenues	Production volumes
		Sale price
	Over-Reported Project Costs	Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

MANY WAYS TO LOSE A BILLION

How Governments Fail
to Secure a Fair Share of
Natural Resource Wealth

Don Hubert, PhD

Real-World Examples Companies and Countries

- Companies protest tax avoidance allegations
- Concrete examples illustrate main pathways to revenue loss.
- Not limited to “rogue” companies or governments with weak capacity.

Revenue Risks: Pathways to Revenue Loss

Tax Rate	Tax Breaks	Tax Incentives
		Tax Holidays
	Treaty Shopping	Withholding tax
		Capital Gains Tax
Tax Base	Under-Reported Project Revenues	Production volumes
		Sale price
	Over-Reported Project Costs	Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

The Terms of the Deal

1. Select mix of fiscal instruments:
 - Trend towards profit based taxes
 - More efficient but vulnerable to avoidance
2. Tax rates and how they are calculated
 - Emphasis tends to be on the %
 - Need to know what those % will be applied to
3. High Level Recommendations
 - Investment and revenue generation
 - Avoid tax holidays
 - Watch the fine print – accounting procedures

Revenue Risks: Pathways to Revenue Loss

Tax Rate	Tax Breaks	Tax Incentives
		Tax Holidays
	Treaty Shopping	Withholding tax
		Capital Gains Tax
Tax Base	Under-Reported Project Revenues	Production volumes
		Sale price
	Over-Reported Project Costs	Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

Treaty Shopping: Companies “Sweetening” the Deal

- Subsidiaries created to secure treaty benefits
 - Exemptions in withholding and capital gains taxes
 - Reduces government revenues
 - Enables profit shifting (e.g. intra-firm debt)
- High Level Recommendations
 - Map subsidiaries to identify treaty shopping
 - Renegotiate Double Taxation Treaties

Assessing Fiscal Regimes

Good in Theory Weak in Practice?

- Fiscal regime modeling can show good results
- But actual receipts fall short of expectations
- Inclination is to change the fiscal terms
- Often the problem is the tax base

Revenue Risks: Pathways to Revenue Loss

Tax Rate	Tax Breaks	Tax Incentives
		Tax Holidays
	Treaty Shopping	Withholding tax
		Capital Gains Tax
Tax Base	Under-Reported Project Revenues	Production volumes
		Sale price
	Over-Reported Project Costs	Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

Risks from Hidden Income

1. Under-reporting quantity & quality of production
 2. Intra-firm sales at below market prices
- Cameco (Canadian uranium mining company)
1. Monitor volume and value of production
 2. Reference prices (international benchmarks)

Revenue Risks: Pathways to Revenue Loss

Tax Rate	Tax Breaks	Tax Incentives
		Tax Holidays
	Treaty Shopping	Withholding tax
		Capital Gains Tax
Tax Base	Under-Reported Project Revenues	Production volumes
		Sale price
	Over-Reported Project Costs	Ineligible costs/misallocated costs
		Inflated goods and Services
		Debt Financing

Risks from Over-Reported Costs

- Reduce profit-based taxes by overstating costs
- Ineligible and inflated costs
 - Capital purchases, transportation, management
 - Intra-firm financing
- Examples: Chile, Tanzania, India and Indonesia
- High Level Recommendations
 - Close loopholes in contracts / legislation
 - Risk based audits

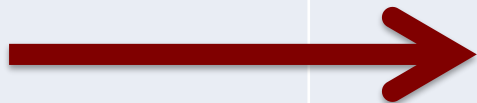
Home Jurisdiction
Tax Rate 30%

Developing Country
Tax Rate Mining 40-60%
Tax Rate Petroleum 65-85%

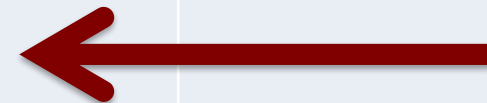
Offshore Tax Haven
Tax Rate 0%



**PROJECT
REVENUES**



**PROJECT
COSTS**



Gross Revenue (Production × Price)

\$100 Million

1

Project Costs

\$60 Million

Taxable Income

\$40 Million

2

Project Costs

\$60 Million

Inflated Costs

\$20 Million

Taxable Income

\$20 Million

3

Project Costs

\$60 Million

Taxable Income

\$20 Million

Hidden income

\$20 Million

4

Project Costs

\$60 Million

Inflated Costs

\$20 Million

Hidden income

\$20 Million

Conclusion 1: Monitoring and Auditing

- Joint ventures face same challenges
- Quantity and Quality of Production
- Capital and Operating Costs
- Attention to Accounting Procedures

Conclusion 2: Tax Administration Capacity

- Imbalance in expertise not easily overcome
- Developed countries often fail:
 - Alaska, Canada, Norway, Australia
- What are metrics for assessing results
- Technical support (insider expertise)

Conclusion 3:

Applying Revenue Risk Assessments

1. **Country:** common challenges but specifics depend on the country situation.
2. **Commodity:** resources are vulnerable to revenue loss in different ways.
3. **Company:** differing corporate structure including affiliated companies in tax havens.
4. **Contract:** loopholes often found in the “fine print”

Thank You.



RESOURCES for
DEVELOPMENT
CONSULTING

www.res4dev.com