

## Worksheet G

### IV. Taxation and other company payments

**Background:** Resource extraction can be a significant source of revenue for a country but the government must carefully consider how to maximize revenues without driving away credible companies. Finding this balance is tricky and requires that the government do the following:

1. Set fiscal terms that are neither too high nor too low and that provide a suitable share of both risk and return to the extraction operations.
2. Create a legal framework that provides sufficient assurances to investors, but is not so rigid that the assurances prevent the government from responding if economic circumstances change significantly.
3. Ensure that authorities collect the full amount of revenue set by the fiscal terms, which is sometimes improved by setting a fiscal framework that is simple to collect.
4. Ensure that government officials are held to account for all of the above.

Many political parties have been involved in setting the terms of fiscal frameworks and monitoring whether they are consistently applied. In South Africa, the relatively new Economic Freedom Fighters party was founded in part because of a debate within the ruling African National Congress over the extent to which government revenues from extraction should be prioritized over the type of company involved in extraction projects.<sup>154</sup> In Peru, questions about whether the terms of extraction were a good deal for the country became central to a national presidential campaign.<sup>155</sup>

Political party positions often arise because of particularly controversial deals, but can be crafted to inform a larger set of extraction projects. Questions related to the actual collection of the revenues, although sometimes overlooked, are invaluable to ensuring that the country fully realizes the potential benefits. This often requires involvement of oversight institutions, such as the supreme audit institution, the internal audit offices of the tax authority, taxpayer tribunals and parliament.

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<sup>154</sup> See the South Africa case study in Chapter 2.

<sup>155</sup> See the Peru case study in Chapter 2.

### Costs and trade-offs

When developing policy stances related to **the overall fiscal framework** it is particularly important to consider:

- The balance between attracting enough high-quality, competent investors and ensuring that the country gets the best deal for extraction over the lifecycle of projects
- The balance between securing revenues in the short term and spreading revenues more evenly over the lifecycle of projects
- The balance between receiving a bigger take when prices rise or having a more consistent take across price variations
- The benefits and costs of the state holding equity shares in resource companies; for example, equity allows the government to benefit whenever the company declares dividends and possibly to hold positions on the board, but dividends are typically paid later than profit tax payments (if at all) and equity may come with high financial costs
- In situations where the government is not attracting quality investors, what parts of the framework could be altered (e.g., royalty rates, cost limits, variable rate tax, corporate income tax and incentives) while still securing a reasonable return for the government

When developing policy stances related to **the legal framework for fiscal terms** it is particularly important to consider:

- If there is legitimate justification for including stabilization clauses in contracts to assuage investor concerns, or if there are better fiscal mechanisms for offering stability while allowing for any necessary adjustments (e.g., a progressive tax regime)
- The extent to which stabilization clauses in contracts could bind government action to address fluctuations in commodity prices and profitability, both in the number of terms and the length of time

When developing policy stances related to **the tax administration and oversight** it is particularly important to consider:

- The time and financial costs involved in strengthening the tax administration and other official oversight institutions (e.g., enabling them to adequately track all costs and payments of companies), weighed against the costs of tax evasion and avoidance, and corruption in the administration and collection of taxes

For more information on these policy issues, please refer to Precept 4 in the Benchmarking Framework and the NRG primers on fiscal regime design and transfer pricing.<sup>156</sup>

Guiding questions	Current orientation
<ul style="list-style-type: none"> <li>Does the party already have a stance (formal or informal, public or internal) on what the fiscal regime for the resource sector should be? If so, what is that stance?</li> </ul>	
<ul style="list-style-type: none"> <li>What do the party base and its core constituencies think about resource sector taxation and other company payments? What does the wider population think?</li> </ul>	
Guiding questions	Current framework
<ul style="list-style-type: none"> <li>What is the current fiscal regime for resource extraction? Is it adequately implemented?<sup>157</sup></li> </ul>	
<ul style="list-style-type: none"> <li>Do the current fiscal terms provide sufficient accountability to citizens, stability for investors and the flexibility to respond to changing circumstances?</li> </ul>	
<ul style="list-style-type: none"> <li>Are government authorities able to collect the full value of taxes and other payments owed to the state? Are they transparent and accountable in the way they set and collect company payments?<sup>158</sup></li> </ul>	
<ul style="list-style-type: none"> <li>How does the country perform on the 'Taxation' subcomponent of the Resource Governance Index? What underlying rules and practice indicators does the country perform poorly on and why?<sup>159</sup></li> </ul>	
<ul style="list-style-type: none"> <li>If the country is an EITI member, what were the findings and recommendations around the 'Legal Framework and Fiscal Regime' and 'Revenue Collection' requirements in the most recent EITI report?<sup>160</sup></li> </ul>	

<sup>156</sup>The Fiscal Regime Design primer is available at <<http://www.resourcegovernance.org/analysis-tools/publications/primer-fiscal-regime-design>> and the Transfer Pricing primer is available at <<https://resourcegovernance.org/analysis-tools/publications/primer-transfer-pricing-0>>.

<sup>157</sup>Information on the current framework may be available in the RGI data under questions 1.2a and 1.2.5f.

<sup>158</sup>Information on the current framework may be available in the RGI data under questions 1.2.5a-e.

<sup>159</sup>For detailed answers to these questions, refer to the downloadable RGI Data explorer available at <<http://www.resourcegovernanceindex.org/about/data-and-source-documents>> (subcomponent 1.2). But for a quick snapshot of the subcomponent and indicator scores, see the country profiles at <<http://www.resourcegovernanceindex.org/country-profiles>> (select your country, scroll down to the Full Scores section, and click + to expand the relevant scores).

<sup>160</sup>Find the most recent report and other information on country progress on the EITI website at <<https://eiti.org/countries>>.

Policy options	Stances
<p><b>What should the government do to ensure that the fiscal regime secures a reasonable return for the government while still attracting sufficient investment?</b></p> <ul style="list-style-type: none"> <li>• What should be done to ensure that government officials have the expertise and information to effectively evaluate and design fiscal regimes?</li> <li>• How should the government avoid the use of costly or non-essential investment incentives?</li> <li>• Should the fiscal regime include a tax on gross sales—a royalty or equivalent—to ensure that the state receives some payment despite changes to profitability?</li> <li>• Should the fiscal regime include a variable rate tax targeted explicitly at profits?</li> <li>• Should the fiscal regime for the extractive sectors include the country’s generally applicable corporate income tax?</li> <li>• Should the state hold equity shares in resource companies? If so, how should the government ensure that the expected fiscal and non-fiscal benefits of that equity are greater than the costs of acquiring it?</li> </ul>	<p><i>Example stance:</i> The party believes that the country must establish a fiscal regime that strikes the right balance between securing a reasonable return while still attracting good investors. We therefore commit to reviewing the current fiscal regime and considering the appropriateness of a variable rate tax on resource sector profits.</p>
<p><b>What should the government do to ensure that the legal framework on fiscal terms provides sufficient accountability to citizens, stability for investors and flexibility to respond to changing circumstances?</b></p> <ul style="list-style-type: none"> <li>• Should the government set all fiscal terms using legislation or model contracts, with a minimum number and defined scope for bidding or negotiation terms?</li> <li>• Should legal clauses that stabilize legal terms governing an extractive project be allowed? If so, what should be done to ensure that these clauses are limited to specific fiscal terms and that stabilization is limited in duration?</li> </ul>	<p><i>Example stance:</i> The party believes that the fiscal regime for the natural resource sector should be enshrined in law. We therefore commit to establishing as many fiscal terms as possible in legislation and that the legislation includes the guarantees necessary for public accountability.</p>
<p><b>What should the government do to ensure that government authorities collect the full value of taxes and other payments owed to the state?</b></p> <ul style="list-style-type: none"> <li>• What needs to be done to ensure that tax administrators are competent and well resourced?</li> <li>• What needs to be done to simplify and harmonize tax administration procedures?</li> <li>• Should there be fewer tax collecting organizations and better coordination between government agencies related to tax administration?</li> <li>• Should the government further simplify the tax regime (e.g., reduce the number of tax types)?</li> <li>• Should new provisions to limit avoidance practices be added to the fiscal regime?</li> </ul>	<p><i>Example stance:</i> The party believes that fighting tax evasion and avoidance in the natural resource sector should be a priority for the country. We therefore commit to simplifying the tax base and putting in place and enforcing strong anti-abuse legislation.</p>
<p><b>What should the government do to ensure that it is held to account for setting and collecting taxes and other company payments?</b></p> <ul style="list-style-type: none"> <li>• What should be done to ensure that official agencies perform strong oversight of the fiscal regime?</li> <li>• What fiscal terms and company data should the government disclose to inform oversight?</li> <li>• How should the government consult with businesses and civil society before reforming the fiscal regime?</li> </ul>	<p><i>Example stance:</i> The party believes that the government should be transparent and accountable in the fiscal governance of natural resources. We therefore commit to holding regular consultations with different stakeholders, including trade associations and civil society organizations, to ensure that we have a deeper pool of knowledge to inform tax policy.</p>