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# GLOBAL DIGITAL TAX REFORMS AND MINING: THE ISSUE OF TIMING DIFFERENCES



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Global Digital Tax Reforms and Mining: The issue of timing differences

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## EXECUTIVE SUMMARY

In March 2021, the IGF issued a [briefing note](#) on the implications for the mining sector of the latest blueprints on global digital tax reforms published by the Organisation for Economic Co-operation and Development (OECD). The OECD released the blueprints on behalf of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS),<sup>1</sup> a group of over 130 nations negotiating new international tax rules to reduce tax avoidance by multinational companies. The IGF briefing raised some concerns regarding aspects of the blueprint of the second pillar of the reform proposal (Pillar Two) that may prove problematic for resource-rich countries. This briefing note digs deeper into the important issue of timing differences arising under Pillar Two and the impact it may have on investment in the mining sector—particularly in resource-rich developing countries—and identifies possible policy solutions.

Overall, Pillar Two's Global Anti-Base Erosion (GloBE) proposal supports more effective mining taxation in resource-rich developing countries by creating a minimum tax rate. The minimum tax rate is assessed against the Effective Tax Rate (ETR) of multinational companies in every country where they operate. It should therefore disincentivize harmful tax competition and costly tax incentives such as income tax holidays. However, it does not adequately address timing, or temporary, differences in the calculation of the ETR. These differences arise from the discrepancies between the accounting profits used to assess the GloBE ETR and taxable profits, which follow domestic tax rules. They are particularly important in the mining sector, where large capital expenditures are generally depreciated faster under local tax rules than under accounting norms.

Unresolved timing differences could lead to lost investment and revenue from the mining sector in resource-rich countries, especially in the developing world. Under the GloBE proposal, any corporate income taxed below the minimum rate in a jurisdiction would be subject to a top-up tax in the country of the parent company. Therefore, tax incentives such as accelerated depreciation, designed to attract investment, would lose their effectiveness and could result in the transfer of billions of tax dollars from developing to developed countries.

There are three proposals to resolve timing differences arising from the GloBE proposal. The first one consists of a combination of loss carryforwards and tax credits to compensate for any temporary differences over time. This would not work well for the mining sector, where tax losses are concentrated in the early stage of project development. The second is deferred-tax accounting, already used by corporations to resolve timing differences between tax accounting and tax payments. It would create lower compliance costs but require rules to exclude uncertain tax positions and to guard against abuse of the system by companies or governments. The third one would use local tax rules to compute the GloBE ETR. It could solve timing differences in a way that involves less judgment or estimation by industry

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<sup>1</sup> For more information on the Inclusive Framework on BEPS, see <https://www.oecd.org/tax/beps/beps-about.htm/>



than deferred-tax accounting but with more complexity and a higher compliance burden.

While this note is focused on temporary differences, it is important to state that many resource-rich developing countries have offered various tax incentives that may give rise to permanent differences under the GloBE rules. Tax holidays are the clearest example and precisely the type of incentive that Pillar Two is intended to target. However, it will take a long time for developing countries to fulfill the purpose of GloBE and adapt their legal framework and potentially review investment agreements to remove tax holidays and other incentives, giving rise to permanent differences—especially in the mining sector, where stabilization clauses in laws and contracts are prevalent. Developing countries will need the full support of the international community to adapt their legal frameworks in order to comply.

This note is structured as follows. Part 1 provides a brief refresher of Pillar Two—the OECD–G20 Inclusive Framework proposal for a global minimum ETR. Part 2 explains what timing differences are. Part 3 explains why timing differences matter for the mining sector and what impact they might have on resource-rich countries if left unresolved under Pillar Two. Part 4 describes some of the policy options being considered to address the concerns arising from timing differences. Part 5 briefly explores the issues arising from permanent differences, which will be elaborated on in a forthcoming dedicated briefing note. Part 6 concludes.



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# 1. PILLAR TWO: A GLOBAL MINIMUM EFFECTIVE TAX RATE

In October 2020, the OECD released the blueprints of the global digital tax reforms on behalf of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS). In March 2021, the IGF issued a [briefing note](#) on the implications for the mining sector of the two pillars of the proposal. This briefing note digs deeper into the important issue of timing differences arising under Pillar Two.

Pillar Two, also referred to as the Global Anti-Base Erosion (GloBE) proposal, tries to reduce tax competition and profit shifting in all economic sectors, including mining. It does this through rules that, if adopted, would ensure all global profits of multinational enterprises are taxed at least at a minimum Effective Tax Rate (ETR). Depending on the actual rules and the minimum global tax rates, this could serve to reduce the number of cases where mining companies shift profits through structures such as offshore marketing hubs or by routing their intercompany loans through shell companies in low-tax jurisdictions. It may also provide protection against the pressure felt by many governments to offer tax breaks and incentives to investors, also known as the “race to the bottom,” which can deprive governments of much-needed fiscal revenue.

Despite the potential benefits of Pillar Two, some aspects of the reform proposal could impact resource-rich developing countries negatively if left unresolved. The concern is that Pillar Two, as presently designed, compares actual taxes paid to “accounting profit” to determine the ETR. The problem is that companies do not pay taxes on accounting profits—they pay taxes on taxable income, subject to local tax rules, which often allow faster depreciation of exploration and development expenses, which are significant in the mining sector. Most mining projects in cost-recovery periods therefore declare accounting profits on their financial statements but no taxable profit, a situation that reverses over time after tax depreciations expire. During the cost-recovery period, it may look as if the mine’s ETR is under the minimum rate, triggering a top-up tax to be paid under the GloBE proposal, most likely in the country of the mine’s parent company—and specifically not in the country where the mine is located. In addition, many mining projects benefit from tax incentives during the early years of production, again reducing taxes paid. These factors could result in the transfer of billions of dollars of taxes from developing to developed countries.



## 2. WHAT ARE “TIMING DIFFERENCES” AND WHY DO THEY OCCUR IN MINING?

The Pillar Two blueprint proposes that the Global Anti-Base Erosion (GloBE) Effective Tax Rate (ETR) is calculated annually at the jurisdictional level, that is to say, on a country-by-country basis. The ETR would be the total (covered) taxes paid to government authorities, or “cash tax” (the numerator), as a proportion of the GloBE tax base, which is based on accounting profits (the denominator) expressed as a fraction (see the equation below). In each income year, if a subsidiary’s ETR is below the minimum globally agreed rate, it must pay a top-up tax to the country where its parent company is located. Many members of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) propose that the minimum global rate should be around 12.5%, although the African Union has called for a rate of at least 20%. In its earlier [briefing note](#), the IGF flagged that even 20% is likely to be low for mining.

$$\text{GloBE ETR} = \frac{\text{Covered Taxes (current year cash tax paid)}}{\text{GloBE Tax Base}}$$

Key terms:

- **Covered taxes** are based on cash tax paid on taxable profits in accordance with each country’s local tax rules in the relevant year. They include all taxes on profits, whether or not they are labelled as corporate income taxes (e.g., tax on dividends or profit-based royalties).
- **GloBE Tax Base** is the profit (or loss) before income tax as determined using the relevant financial accounting standard, which may include items previously included in other comprehensive income. Certain items of income are removed from and certain items of expense are added back to the profit (or loss) before income tax to arrive at the GloBE tax base. See Table 1 for an example.
- **Taxable profit** is the portion of a company’s income that is subject to income taxes in accordance with the tax laws of the jurisdiction.
- **Timing differences** are the differences between when an item flows through the calculation of taxable profits as compared to when it flows through the calculation of accounting profits used in the GloBE tax base.



## BOX 1. ACCELERATED DEPRECIATION: AN EXAMPLE OF TIMING DIFFERENCES IN THE MINING SECTOR

According to the global accounting norms International Financial Reporting Standard (IFRS) and International Accounting Standard (IAS) 16, “depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.”<sup>2,3</sup> So, in the simplified example below, a processing plant costing \$50 million for a 15-year mining operation would be depreciated for accounting purposes proportionally to the mineral output.

In local tax rules, however, the company might be allowed to depreciate its investment over a 5-year period using a straight-line depreciation rule.

The difference would be an accounting profit declared from the first year of production, but a tax profit declared much later, in year 5—even later if early tax losses can be carried forward. The project would therefore have an ETR of 0% for the first 5 years because of timing differences created by accelerated depreciation.

Over time, those timing differences reverse such that the GloBE ETR should equal and eventually surpass the local statutory rate, notwithstanding BEPS risks and collection challenges. In our example, assuming a 25% nominal tax rate, the ETR would be close to 40% at the end of the 5-year depreciation period, disregarding any carryforward of earlier losses.

**Table 1. Accelerated depreciation example, million dollars (assuming no loss carryforward)**

Year	0	1	2	3	4	5	6-15	Total
Investment	50							<b>50</b>
Production value	0	2	4	8	10	10	10	<b>134</b>
Accounting depreciation	-	0.75	1.49	2.99	3.73	3.73	3.73	<b>50</b>
Tax depreciation	10	10	10	10	10	0	0	<b>50</b>
Accounting profit	-	1.25	2.51	5.01	6.27	6.27	6.27	<b>84</b>
Taxable profit	-10	-8	-6	-2	0	10	10	<b>84</b>
CIT rate	25%	25%	25%	25%	25%	25%	25%	
CIT paid	0	0	0	0	0	2.5	2.5	<b>27.5</b>
GloBE ETR	NA	0.0%	0.0%	0.0%	0.0%	39.9%	39.9%	<b>32.7%</b>
Minimum ETR	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	
Top-up tax due	No	0.16	0.31	0.63	0.78	No	No	<b>1.88</b>

<sup>2</sup> IFRS. (n.d.). *IAS 16 Property, Plant and Equipment*. <https://www.ifrs.org/issued-standards/list-of-standards/ias-16-property-plant-and-equipment/> (see footnote 5 for IFRS copyright and disclaimer information).

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There are two forms of differences between accounting profits and taxable income: temporary and permanent. This paper is largely concerned with temporary (timing) differences; however, permanent differences are equally important for resource-rich developing countries. Aside from the definition below, permanent differences are discussed briefly in Section 5, as well as in a forthcoming note dedicated to this specific aspect of the reforms.

## 2.1 TEMPORARY DIFFERENCES

Temporary differences reverse over time. They must be excluded from the ETR; otherwise, it will appear that there is under-taxation when that is not the case. This would be contrary to a core principle of the OECD's BEPS Actions: to ensure that taxes are paid where the value is created. It would shift taxing rights out of the resource-hosting country to where the parent company is domiciled.

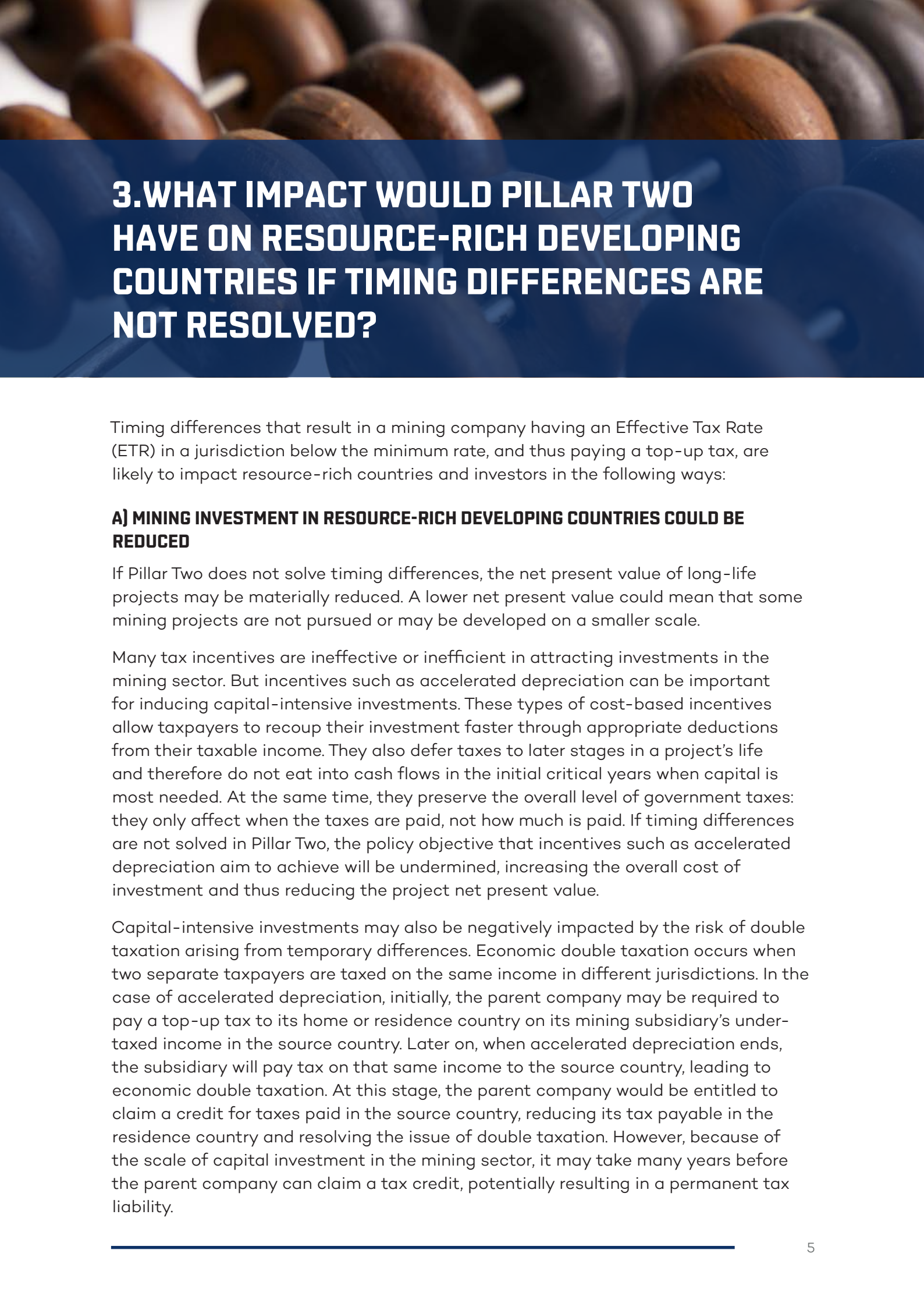
The most material timing, or temporary, differences for the mining sector relate to capital expenditures on building the mine, the plant and equipment, and all the way through to rehabilitation. Unrealized foreign exchange losses are another temporary timing difference, as local tax rules may only allow companies to claim a deduction when they realize the loss. The example in Box 1 shows how the different depreciation rules on capital expenditure between accounting rules and domestic tax rules create a temporary timing difference.

Mining is not the only industry where there may be significant temporary differences. All capital-intensive sectors would be affected, especially if they operate under a long cost-recovery business model. The insurance industry is another. The scale of capital investment in the mining sector means that the size of timing differences is very significant, and the period over which they reverse is extensive.

 Accelerated depreciation can be important for inducing capital-intensive mining investments.

## 2.2 PERMANENT DIFFERENCES

A permanent difference does not reverse: there is a permanent difference between the tax expense and tax payable caused by an item that does not reverse over time. For example, a 5-year tax holiday on corporate income would permanently reduce the total amount of tax paid by a mining project, but it would not affect the ETR measured as accounting profits multiplied by the statutory rate. This would result in a permanent difference, leading to under-taxation compared to the minimum rate under the proposed GloBE rules and the payment of a top-up tax, often to the parent company's jurisdiction. This issue is elaborated in Section 5 of the note.



## 3. WHAT IMPACT WOULD PILLAR TWO HAVE ON RESOURCE-RICH DEVELOPING COUNTRIES IF TIMING DIFFERENCES ARE NOT RESOLVED?

Timing differences that result in a mining company having an Effective Tax Rate (ETR) in a jurisdiction below the minimum rate, and thus paying a top-up tax, are likely to impact resource-rich countries and investors in the following ways:

### **A) MINING INVESTMENT IN RESOURCE-RICH DEVELOPING COUNTRIES COULD BE REDUCED**

If Pillar Two does not solve timing differences, the net present value of long-life projects may be materially reduced. A lower net present value could mean that some mining projects are not pursued or may be developed on a smaller scale.

Many tax incentives are ineffective or inefficient in attracting investments in the mining sector. But incentives such as accelerated depreciation can be important for inducing capital-intensive investments. These types of cost-based incentives allow taxpayers to recoup their investment faster through appropriate deductions from their taxable income. They also defer taxes to later stages in a project's life and therefore do not eat into cash flows in the initial critical years when capital is most needed. At the same time, they preserve the overall level of government taxes: they only affect when the taxes are paid, not how much is paid. If timing differences are not solved in Pillar Two, the policy objective that incentives such as accelerated depreciation aim to achieve will be undermined, increasing the overall cost of investment and thus reducing the project net present value.

Capital-intensive investments may also be negatively impacted by the risk of double taxation arising from temporary differences. Economic double taxation occurs when two separate taxpayers are taxed on the same income in different jurisdictions. In the case of accelerated depreciation, initially, the parent company may be required to pay a top-up tax to its home or residence country on its mining subsidiary's under-taxed income in the source country. Later on, when accelerated depreciation ends, the subsidiary will pay tax on that same income to the source country, leading to economic double taxation. At this stage, the parent company would be entitled to claim a credit for taxes paid in the source country, reducing its tax payable in the residence country and resolving the issue of double taxation. However, because of the scale of capital investment in the mining sector, it may take many years before the parent company can claim a tax credit, potentially resulting in a permanent tax liability.



Reducing mining investment in developing countries would impact not only tax revenues but also employment and the economy more generally at a time when countries are trying to recover from the decimation of their economies and health sectors due to the COVID-19 pandemic.

**B) DUE TO THE TIMING DIFFERENCE, TAXES WILL BE PAID IN THE HEADQUARTER COUNTRY FIRST, BEFORE THE HOST COUNTRY.**

If a mining company's ETR is lower than the minimum rate, this will trigger a top-up tax paid to the country where the mining company is headquartered before taxes are paid to the source country. This is because of the primacy of the "Income Inclusion Rule" (IIR) in the Global Anti-Base Erosion (GloBE) proposal. This rule would apply in countries where parent companies of multinational groups are located and allow the tax administration to collect a top-up tax on any foreign income taxed under the minimum global rate. This is contrary to the principle of taxing income where value is created, which in the mining sector is where the publicly owned resource is located. Taxes paid in the home or residence countries at the expense of the resource-hosting country would be politically indefensible and could give rise to global tensions between developed and developing countries.

**C) THE IMPACT OF THE TIMING DIFFERENCE IS LIKELY TO BE FELT DISPROPORTIONATELY BY DEVELOPING COUNTRIES.**

In many developing countries, the mining sector has not reached a mature phase, with most multinational companies owning only one or a few mines, often in their early stages of development or operation. Mines in these early stages are most likely to be harmed by the timing differences described above.

By contrast, richer countries tend to have diversified mining sectors with many home-based mining companies, where most foreign mining companies own several assets at various stages of their life cycles—some paying little tax, others paying significant amounts. These companies are less likely to be subject to the GloBE IIR. Their taxes will be "blended," or combined, at the jurisdictional level, so low or nil tax payments on new projects will be added to high tax payments from mature mines. As a result, the companies' ETRs should be above the minimum global rate in any given year.

Developing countries can least afford to forego mining investments and revenues—but they would be the ones negatively impacted by GloBE if the timing issue is not adequately resolved.



## 4. WHAT CAN RESOURCE-RICH DEVELOPING COUNTRIES DO TO AVOID BEING NEGATIVELY IMPACTED BY TIMING DIFFERENCES UNDER PILLAR TWO?

The latest Pillar Two blueprint clearly states that it “should not impose tax where the low Effective Tax Rate (ETR) is simply a result of timing differences in the recognition of income or the imposition of taxes.”<sup>4</sup> Specifically, it recognizes timing issues arising through immediate expensing and accelerated depreciation of assets for local tax law purposes. The OECD Secretariat has made three proposals to solve this problem. All three are discussed below.

### 4.1 LOSS CARRYFORWARDS AND INCOME INCLUSION CREDITS

The OECD’s proposed mechanism to reconcile timing differences is a combination of local tax carryforwards and IIR tax credits. Taxes paid in excess of the minimum rate may give rise to an IIR tax credit or a local tax carryforward. If a multinational company has paid a top-up tax in previous years on income in a jurisdiction, excess tax paid in that jurisdiction creates an IIR tax credit limited to IIR tax paid within an agreed period. This amount can be used to reduce the parent company’s IIR tax liability with respect to any jurisdiction arising in the year the IIR tax credit was created or any subsequent year. The period for using the IIR tax credit is unlimited. Excess taxes in a jurisdiction that do not create an IIR tax credit create a local tax carryforward that may be carried forward an agreed number of years and used to increase the ETR (and reduce the top-up tax) in a subsequent low-tax period. Local carryforwards can only be used to increase the ETR in the jurisdiction in which they arise.

📌 Using deferred-tax accounting could be a simple way to resolve potential timing differences as long as there are rules to exclude uncertain tax positions and protect against abuse.

<sup>4</sup> OECD. (2020). *Tax challenges arising from digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*. OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. <https://doi.org/10.1787/abb4c3d1-en>



While this proposal may adequately resolve timing differences in most sectors, for capital-intensive industries such as mining, it falls short. The Pillar Two blueprint acknowledges that timing differences related to depreciation require additional measures and that the IIR tax credit is not adequate for capital-intensive businesses, leading to excessive taxation (Paragraph 220). Consequently, alternative proposals are required specifically for mining and other long-life, capital-intensive industries.

## 4.2 DEFERRED-TAX ACCOUNTING

Deferred-tax accounting is used by the mining subsidiary with respect to depreciable property that is eligible for immediate expensing or accelerated depreciation for tax purposes. A deferred-tax liability is a tax that is assessed for accounting purposes or is due for the current period but has not yet been paid. The deferral comes from the difference in timing between when the tax is accrued and when the tax is paid.

Deferred-tax accounting follows international accounting standards. According to IFRS:

IAS 12 requires an entity to recognise a deferred-tax liability or (subject to specified conditions) a deferred-tax asset for all temporary differences, with some exceptions. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.<sup>5</sup>

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<sup>5</sup> IFRS. (n.d.). *IAS 12 Income Taxes*. <https://www.ifrs.org/issued-standards/list-of-standards/ias-12-income-taxes/#>. See footnote 3.



## BOX 2. EXAMPLE OF DEFERRED-TAX ACCOUNTING

Consider the previous example in Box 1, where a mine buys a mining processing plant for \$50 million to be used over a 15-year mining operation.

The plant is depreciated over the useful life of the mine for accounting purposes and over 5 years for tax purposes. The outcome is a temporary difference between accounting profits and taxable profits, first positive, then negative, at the end of the tax depreciation period. It also gives rise to a difference in the taxes calculated on profits. Such a difference is recorded in financial statements as deferred taxes.

In the example below, described in more detail in the appendix, assuming a corporate income tax rate of 25%, the deferred-tax liability would amount to \$1.25 million in year 3. Deferred-tax accounting would add the deferred-tax liability \$1.25 million to the numerator of the ETR fraction (i.e., taxes paid), so the ETR would be equal to the statutory rate, 25%. This would neutralize the effect of tax depreciation on the ETR.

**Table 2. Accelerated depreciation example, with deferred-tax accounting, million dollars [assuming no loss carryforward]**

Year	0	1	2	3	4	5	6-15	Total
Investment	50							<b>50</b>
Production value	0	2	4	8	10	10	10	<b>134</b>
Accounting depreciation	-	0.75	1.49	2.99	3.73	3.73	3.73	<b>50</b>
Tax depreciation	10	10	10	10	10	0	0	<b>50</b>
Accounting profit	-	1.25	2.51	5.01	6.27	6.27	6.27	<b>84</b>
Taxable profit	-10	-8	-6	-2	0	10	10	<b>84</b>
CIT rate	25%	25%	25%	25%	25%	25%	25%	
CIT paid	0	0	0	0	0	2.5	2.5	<b>27.5</b>
Deferred-tax accounting	-	0.31	0.63	1.25	1.57	(0.93)	(0.93)	<b>-6.5</b>
Minimum ETR	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	
<b>No resolution to timing differences arising under Pillar Two</b>								
GloBE ETR	NA	0.0%	0.0%	0.0%	0.0%	39.9%	39.9%	<b>32.7%</b>
Top-up tax due	No	0.16	0.31	0.63	0.78	No	No	<b>1.88</b>
<b>Deferred-tax accounting</b>								
GloBE ETR	NA	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	<b>25.0%</b>
Top-up tax due	No	No	No	No	No	No	No	



The benefits of using deferred-tax accounting to solve timing differences include:

- It is governed by the same international accounting standards that are relied on for the determination of accounting profit (the denominator of the ETR), making it easier for businesses and governments to comply.
- It is well understood, is standard practice for industry, forms part of existing compliance processes, is independently audited by accounting firms, is reflected in the statutory financial accounts reported to local tax authorities and stock exchanges, and is therefore transparent.
- It may be less burdensome from a compliance and administration perspective than having to oversee a proliferation of IIR tax credits to compensate companies for excess tax paid on account of the reversal of timing differences.
- It would prevent double taxation as a result of the Global Anti-Base Erosion (GloBE) reform. If tax laws allow a company to postpone paying taxes on income recorded in the current period's income statement, the company must report a deferred-tax liability to reflect the fact that this income (while recognized in the current period) is taxable in a future year.
- It would also prevent under-taxed profits as a result of GloBE. If tax laws require the company to pay tax on a greater amount of income than is indicated by the income and expenses reported in the current period, the company reports a deferred-tax asset reflecting the fact that (from an accounting perspective) this tax has been pre-paid with respect to a future income item.

The risks or limitations of using deferred-tax accounting to solve timing differences include:

- There are differences between the policies of the GloBE rules and financial reporting that will likely mean that modifications would need to be made to certain deferred-tax accounting outcomes in order to adapt deferred-tax accounting to the GloBE rules. These modifications would need to be kept to a minimum to avoid adding a significant amount of additional complexity.
- In certain circumstances, deferred-tax accounting allows the tax expense used in the numerator of the ETR to be determined based on estimates of taxes to be paid in the future. There is a risk: an inaccurate estimate of how much future tax will be paid could lead to an incorrect ETR. For example, the tax might never be paid, or it may be substantially lower than the estimate.
- The above point reflects the degree of judgment involved in the application of deferred-tax accounting. Mining industry tax representatives argue that the use of judgment in deferred-tax accounting can be isolated to a few very specific areas and that this is more limited than in the case of determining accounting profit (the denominator of the ETR), which also requires a degree of estimation.<sup>6</sup> The specific areas are listed below.

<sup>6</sup> International Council on Mining and Metals (ICMM). (2020). *Submission to the OECD/G20 Inclusive Framework on BEPS on the Pillar One and Pillar Two blueprints*. <http://www.oecd.org/tax/beps/public-comments-received-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm>



- **Uncertain tax positions** – When companies are in a dispute with a tax authority, they will make an estimate of what they expect the ultimate tax liability to be. This is purely an estimate. To address policy concerns about the risk of manipulation, companies could be required to exclude uncertain tax positions from tax expense for the purposes of calculating the ETR (consistent with the approach currently applied for country-by-country reporting purposes). Every company should be able to make this adjustment to their accounts.
- **Deferred-Tax Asset** – A company makes a “tax loss” when the total deductions it claims for an income year exceeds its total assessable income. For capital-intensive projects, tax losses may be large and run for many years. In preparing their financial accounts, companies will need to assess whether they will be able to recover their tax losses in the future. This estimate is based on expected future income, as well as the timing of income.
- **Deferred-Tax Liabilities** – If tax laws allow a company to postpone paying taxes on income recorded in the current period’s income statement, the company must report a deferred-tax liability to reflect the fact that this income (while recognized in the current period) is taxable in a future period. Similar to deferred-tax assets, some estimation is required. However, in many cases, this will be a mechanical process based on applying the local tax law. Accrued withholding tax on interest revenue is a common example. A company that provides a loan to its subsidiary will accrue interest revenue in its accounts. This is income the company expects to receive in the future. In addition, the company will estimate how much tax they expect to be withheld on the interest income. There is no more estimation involved in determining the interest income accrued than the withholding tax accrued. Once the company determines the interest income, the withholding tax is purely a mechanical calculation based on the local tax rules. The only reason that the estimation of future withholding tax liabilities would be inaccurate is if the country changed its tax rules before the tax was paid. This type of timing difference requires little judgment, in which case it could be included in the deferred-tax accounting to be included in the ETR calculation.

In summary, using deferred-tax accounting could be a simple way to resolve timing differences in GloBE, as long as there are rules to exclude uncertain tax positions and to protect against abuse of the system by companies or governments.





### 4.3 LOCAL TAX RULES

The third proposal is to use local tax rules on depreciation and cost-recovery allowances to determine the denominator, rather than the rules used for financial accounting purposes. The OECD has said that the relevant tax depreciation rules could include depreciation rates (the percentage) and depreciation periods (the number of years), and be placed in service conventions (the first and last years' amount of depreciation to be included). It would not, however, permit deductions in excess of the actual cost of the asset.

Using the previous example, in Table 3, under this approach, local tax depreciation rules would be used in place of accounting depreciation rules to determine the cost of the equipment for the purpose of calculating the ETR. Therefore, there would be no profit reported under GloBE until year 5, just as there is no profit reported according to local tax rules.

**Table 3. Accelerated depreciation example, with local tax rules, million dollars (assuming no loss carryforward)**

Year	0	1	2	3	4	5	6-15	Total
Investment	50							<b>50</b>
Production value	0	2	4	8	10	10	10	<b>134</b>
Accounting depreciation	-	0.75	1.49	2.99	3.73	3.73	3.73	<b>50</b>
Tax depreciation	10	10	10	10	10	0	0	<b>50</b>
Accounting profit	-	1.25	2.51	5.01	6.27	6.27	6.27	<b>84</b>
Taxable profit	-10	-8	-6	-2	0	10	10	<b>84</b>
CIT rate	25%	25%	25%	25%	25%	25%	25%	
CIT paid	0	0	0	0	0	2.5	2.5	<b>27.5</b>
Deferred-tax accounting	-	0.31	0.63	1.25	1.57	(0.93)	(0.93)	<b>-6.5</b>
Minimum ETR	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	
<b>No resolution of timing differences arising under Pillar Two</b>								
GloBE ETR	0.0%	0.0%	0.0%	0.0%	0.0%	39.9%	39.9%	<b>32.7%</b>
Top-up tax due	No	0.16	0.31	0.63	0.78	No	No	<b>1.88</b>
<b>Local tax rules</b>								
GloBE ETR	NA	NA	NA	NA	NA	25.0%	25.0%	<b>32.7%</b>
Top-up tax due	No	No	No	No	No	No	No	



The benefits of using local tax rules to solve timing differences include:

- Compared to the first proposal, using local tax rules may be less burdensome from a compliance and administration perspective than having to oversee a proliferation of IIR tax credits to compensate companies for excess tax paid on account of the reversal of timing differences.
- Using local tax rules is generally considered to be less vulnerable to manipulation than deferred-tax accounting. Local tax rules are transparent and easily verifiable—it is simply a case of applying the law.

The risks or limitations of using local tax rules to resolve timing differences include:

- Using local tax rules introduces additional complexity into the computation of the GloBE tax base. It would be necessary to identify the specific capital expenditures to which local tax rules should be applied for the purpose of calculating the ETR. It would also require verification of local tax rules to ensure that countries are conforming to Pillar Two. Without proper oversight, there is a risk that governments could use this exception to pursue tax competition by making the applicable local tax rules as favourable as possible to companies, going against the objective of GloBE.
- It also represents a departure from the proposed approach of determining the GloBE tax base (accounting profits) using financial accounts. This would mean using a mix of financial accounts and tax accounts to determine the denominator, thus increasing the compliance and administration burden.
- Accurately applying local tax rules to the accounting base would increase the compliance burden because companies would have to maintain parallel accounting and tax registers for fixed assets.

For this approach to comprehensively solve timing differences, it would need to apply to the full suite of capital expenditure, not just fixed assets. It would need to capture money invested in drilling, removing the overburden (waste material that lies above the mineral deposit), constructing the mine, costs associated with dismantling, and rehabilitation.

In summary, using local tax rules could resolve timing differences in GloBE in a way that involves less judgment or estimation by industry than deferred-tax accounting but with more complexity and a higher compliance burden.



## 5. THE IMPACT OF PERMANENT DIFFERENCES

Many resource-rich developing countries have, in the past, offered various forms of tax incentives that may give rise to permanent differences under the Global Anti-Base Erosion (GloBE) rules. Tax holidays are the clearest example and precisely the type of incentive that Pillar Two is intended to target. However, it will take a long time for developing countries to fulfill the purpose of GloBE, adapt their legal framework, and potentially review investment agreements to remove tax holidays and other incentives giving rise to permanent differences. Unless developing countries are given time to transition, they will be affected twice: first, by forgoing taxes from the incentive, and second, by losing tax to developed countries under the IIR, undermining their investment propositions. This is a critical issue for all developing countries dependent on foreign direct investment.

For most other sectors, investment incentives are contained in investment and tax laws and can be unwound unilaterally by governments. However, in the mining sector, many countries have valid contracts with mining investors containing onerous fiscal stabilization clauses that prevent them from changing the fiscal terms applicable to the investment. Some of these contracts are decades old and contain overly generous fiscal incentives. In many cases, they have already foregone large tax revenues as a result, partly leading to the growing perception that mining has failed to deliver for host countries from a revenue perspective. While companies under such regimes are not paying taxes in the host state or only in a limited way, GloBE may require these companies to pay taxes in another country. This outcome would not seem sensible.

One option would be to grant countries an exception from Pillar Two in cases where they are contractually or otherwise bound to maintain certain fiscal incentives vis-à-vis certain investors. This would create a carve-out for countries that are bound by very strict resource contracts' stabilization provisions but would delay the impact of GloBE and could open a loophole to avoid its implementation in future resource contracts.

A better option both for resource-rich countries and to fully achieve the objectives of GloBE might be to exceptionally allow countries to modify their resource contracts to adjust to the impact of GloBE, regardless of stabilization provisions, so that they



do not have unintended under-taxed mining income. This position would be a natural extension of the OECD's guiding principles for durable extractive contracts. Principle VIII specifies that:

the adoption of bona fide anti-avoidance measures or the interpretation of existing laws by host governments to protect the revenue base against tax base erosion and profit-shifting (e.g., on interest deduction limitations and transfer pricing) and consistent with internationally recognised tax practices should not be considered a change in law constrained by stabilisation clauses.<sup>7</sup>

GloBE, once approved, will be an internationally recognized tax practice to protect the revenue base against tax BEPS. However, developing countries may be reluctant, and in some cases legally unable, to amend resource contracts that contain tax incentives that create permanent differences. The Inclusive Framework on BEPS should therefore make this allowance explicit, such that countries can reasonably amend the fiscal terms of existing resource contracts to conform with the new GloBE rules. The problems with permanent differences, and the options to solve them, will be fully developed in a dedicated briefing note.

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<sup>7</sup> OECD. (2021). *Guiding principles for durable extractive contracts*. [https://www.oecd-ilibrary.org/development/guiding-principles-for-durable-extractive-contracts\\_55c19888-en](https://www.oecd-ilibrary.org/development/guiding-principles-for-durable-extractive-contracts_55c19888-en)



## 6. CONCLUSION

The current Global Anti-Base Erosion (GloBE) proposal of international tax reforms has the potential to support more effective mining taxation in resource-rich developing countries. Critically, it will likely disincentivize harmful tax competition and costly tax incentives, such as income tax holidays. However, it does not adequately resolve timing differences in the calculation of the Effective Tax Rate (ETR) and may lead to lost investment and revenue from the mining sector in resource-rich countries, especially in the developing world. It is vital that the Inclusive Framework on BEPS responds to this issue before finalizing and adopting Pillar Two of the global digital tax reforms.











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