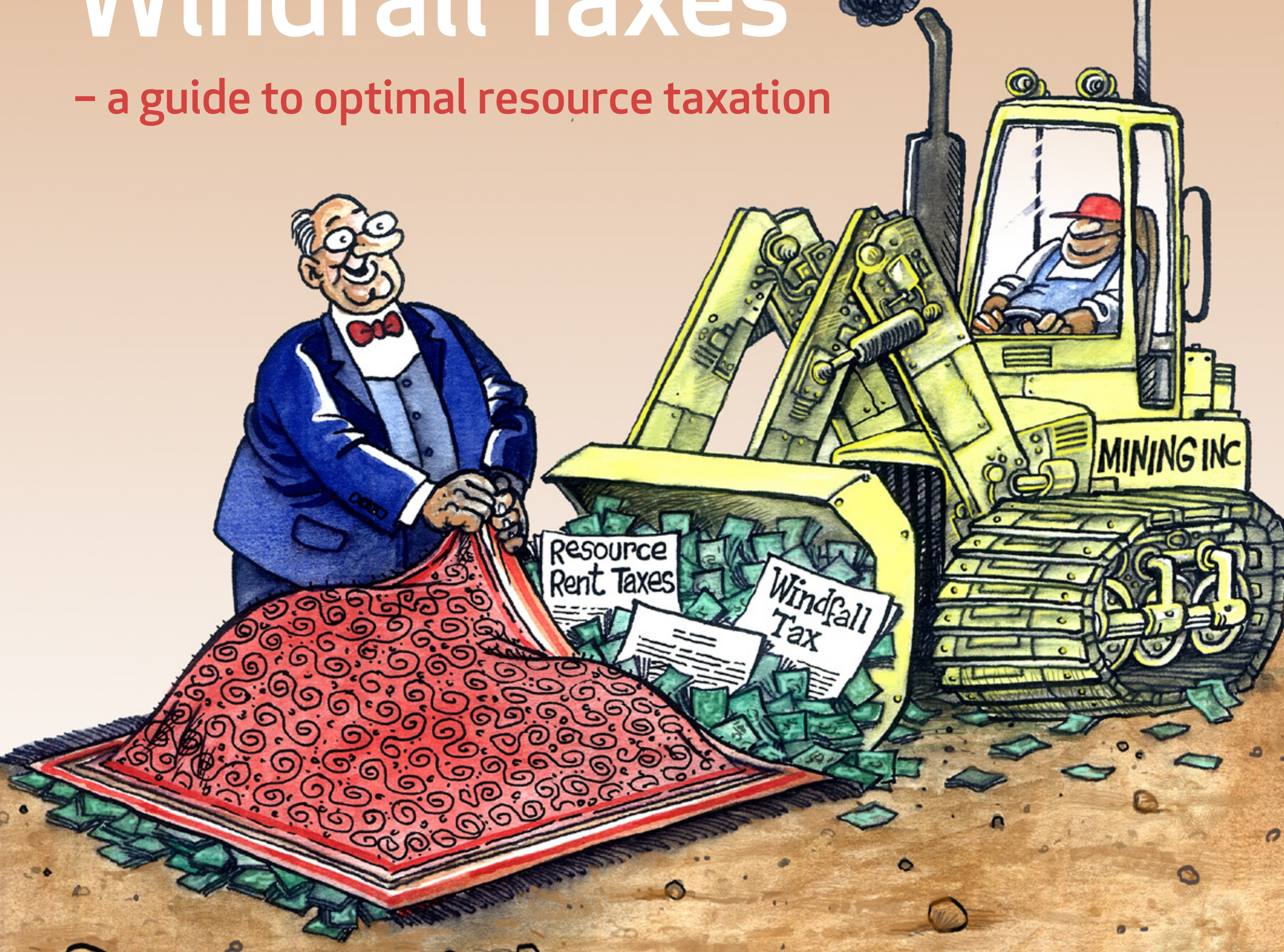
Publish What You Pay
NORWAY

BRIEFING

- The tax burden worldwide only covers 2/3 of global government expenditure.
- This huge discrepancy is unsustainable, and forces governments to increase their foreign debts.
- What is needed, is to close the loopholes in the tax systems for the extractive sector. Windfall taxes can also ensure the survival of the "fittest" extraction companies.

The Case for Windfall Taxes

– a guide to optimal resource taxation



When the prices of the minerals extracted rise, most places it is the international company operating the mine that gets the whole profit. The country where the mine is located gets little in the form of increased taxes. If the prices fall however, both are suffering the loss.

In the report "The Case for Windfall Taxes", **Publish What You Pay Norway** provides a framework for analyzing and fixing loopholes in the tax systems, in order to increasecost-efficiency and ensure fairer competition in the extractive industry.

THE PROBLEM

There is a growing understanding in the world today that the tax systems are not sustainable. In 2012, government expenditure worldwide amounted to 28,7 trillion dollars. The same year, total tax burden was only 18,8 trillion - a huge discrepancy. Governments cannot spend more than they earn, unless they borrow money. The problem of borrowing is that the interest paid on the loan will start to limit the economic freedom of the country, and thus its citizens. This is a problem uniting investors, governments and citizens. One of the reasons for the discrepancy between the states' income and costs is tax evasion and tax avoidance by large multi-national companies, including extractive companies, which to a great extent are the multinationals present in developing countries. Tax evasion and tax avoidance essentially destroys the "outsourcing contract" between the private and the public sector, by removing un-taxed revenues from the countries that provide the resources and the free markets, and placing these revenues in tax havens – only benefitting the companies themselves.

THE CONSEQUENCES

Tax evasion and tax avoidance by extractive companies is a problem both for poor and rich countries. For resource-rich, poor countries the natural resources offer their largest financial base to combat poverty and build sustainable societies - but not if the revenues are taken out of the country before they are taxed. As poverty has global consequences this is also a problem for rich countries. In addition, rich countries are tapped of legitimate tax revenues in their role as home country of most of the extractive companies. The revenues end up with the companies themselves, in tax havens. Tax evasion and avoidance effectively creates a large number of free riders: multinational companies who seek profits from resources and free markets, but are unwilling to pay their share.

Q&A

What are windfall taxes?

"Windfall taxes" are taxes on revenues from unusual large upswings in commodity prices; put simply, it's taxing these sudden windfalls. Natural resources are characterized by large fluctuations in price over short time. It is therefore important for tax authorities to have in place an effective taxation of these. In this context, windfall taxes are beneficial tools, if they are put into force at the moment the commodity price exceeds a certain level. The tax burden needs not be higher nominally, but it should be smarter, so that it captures tax from many more extraction companies which pay little or no tax today or which postpone the tax payments indefinitely.

How do windfall taxes work?

Windfall taxes reward the companies that operate in the most cost efficient manner, and encourage companies with high costs to reduce costs. As windfall taxes are taxes decided by the price of the commodity, and not by the profit, all companies will have to pay the same share in taxes. Companies with the lowest costs will then be left with more. This is "survival of the fittest". In today's world we have "survival of the most crocked", i.e. those willing to increase their cost or reduce their revenues in order to dodge taxes. Multinational companies that have earned big money on moving costs to subsidiaries in countries with high taxes, and income to countries where taxes are low, cannot use this strategy for revenues taxed by windfall taxes. Lastly, windfall taxes can provide a more equitable distribution of revenues from a country's natural resources. Today, companies can take most of the profits during periods of unusual high commodity prices. Governments worldwide can use windfall taxes to ensure that a fair share of the profits in good times benefits the government and citizens.

Why should I read this report?

There is a win-win-win situation in establishing windfall taxes as part of an extractive industry tax system. With windfall taxes, there are stronger incentives for the company to reduce costs or slow down cost increases. This protects investor opportunities, company profits and country revenues. This report will give you insight into how these taxes can be used to create optimal taxation of a country's natural resources. In addition, the report puts these taxes into an entire framework for analyzing extractive industry tax systems, and the reader can benefit substantially from the report even though windfall taxes are not being planned.

A SOLUTION

This report provides for the first time a complete framework for evaluating the tax systems used to tax multinational extractive companies. The framework makes it possible to evaluate the efficiency, or inefficiency, of the tax system in a country or in a sector. Governments can use the framework to check and fix industry regulation for industries where tax evasion and tax avoidance is widespread. In order to create prosperous societies with the lowest costs -economically, environmentally and socially - optimum resource taxation must be put in place. This means creating tax systems that protects the private sector against high taxation when revenues and profits are small, but at the same time protects the funding of the public sector when profits are higher. In reality, this involves a group of taxes, but the name "windfall tax" conveys very well the meaning of these taxes: taxing the sudden windfalls in a world with volatile prices, while protecting companies when profits are lower.

Download the full report for free at **www.pwyp.no**

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PWYP Norway is the Norwegian chapter of a global network of more than 750 organizations from over 70 resource rich countries. We work to establish financial transparency and accountability in the extractive sector, so that countries can mobilise their own capital to promote a sustainable future, democracy, and human rights

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