When Mongolia cancelled a tax treaty with the Netherlands, it was a small move that highlighted a $10 trillion contradiction.

The Mongolian mouse that roared

BY ANTHONY DEUTSCH AND TERRENCE EDWARDS
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Turquoise Hill Netherlands is a little-known Amsterdam-based company with three employees, no office, and not even its own mailbox. To the government of Mongolia, though, the company represents billions in taxes that it will never see.

Turquoise Hill was created in 2009, five years after Mongolia and the Netherlands signed a tax treaty to avoid double taxation and boost investment in Mongolia. But in 2011, Mongolia decided to cancel the pact, arguing that it would cost the country income from one of the most lucrative gold and copper mines in the world.

The move was rare – tax experts say only a handful of such deals between countries have ever been cancelled – and it highlights a big contradiction.

The Netherlands, which has more than 90 such treaties globally, spent roughly 13 million euros ($17 million) on three aid programmes to Mongolia in 2009 and 2010. Globally its aid budget is about $5.5 billion – the fifth most-generous rate among rich nations at 0.71 percent of Gross National Income, according to the OECD. At the same time, Europe’s fifth largest economy hosts some 12,000 companies like Turquoise Hill through which multinationals channel about $10 trillion both in and out of the country largely to avoid taxes, according to a June report by Amsterdam University.

The Netherlands may help countries like Mongolia with aid, but it also undermines development in poor countries by making it easier for companies to cut taxes.

In the Mongolia case, a big beneficiary was Anglo-Australian mining giant Rio Tinto. Toronto-listed Turquoise Hill Resources, named after the giant Oyu Tolgoi open pit mine in the Gobi Desert, is 51 percent owned by Rio Tinto. Oyu Tolgoi means turquoise hill, and the Toronto company in turn owns 66 percent of the project, with the government holding the rest.

The mining unit has so far spent $6.49 billion on the mine, which Rio Tinto believes will become the third largest for copper in the world. That investment amounts to more than half the size of Mongolia’s $10 billion a year economy.

Mongolia’s decision to unilaterally end its tax deal with the Netherlands – it also broke off similar deals with Luxembourg, Kuwait and the United Arab Emirates at the same time – was based on a reassessment of the fairness of the agreements. “We started to question why these countries would have greater advantages in Mongolia than us,” said Vice Finance Minister Surenjav Purev.

Under normal circumstances, Mongolia would levy a 20 percent withholding tax on dividends paid by mine companies. But the dual taxation agreement allowed Dutch-registered firms to channel income from dividends, royalties and interest earned in Mongolia through their Dutch company, so pay no withholding tax. Other Dutch treaties with states that charge little or no tax, such as Bermuda, let companies move that money on from the Netherlands to tax havens.

Terminating the treaty means firms that use countries like the Netherlands to channel tax-free earnings from Mongolia could lose the tax benefits, or be forced to seek a different low-tax route.

However, a Rio Tinto spokesman told Reuters in an email that the cancellation of the Dutch treaty will not affect Oyu Tolgoi’s use of its Dutch holding company, because the firm has a separate investment agreement with Mongolia which “stabilizes” treaties that were in force in 2009. Rio
Tinto said it has and will continue to pay all taxes due under Mongolian law.

Mongolia’s termination was noticed in tax circles at the time but not more widely, and comes as developing nations are increasingly concerned about the help that rich countries give big firms to avoid taxes. Last year, Argentina terminated treaties with Switzerland, Spain and Chile. Zambia’s new government is also reviewing bilateral treaties.

The Dutch say they strive to be fair on tax. Their latest tax policy, outlined in 2011, calls for “a fair fiscal system” in developing countries. “Good taxation plays an important role in strengthening the legitimacy of the recipient government,” it said. The Dutch Ministry for Foreign Development says its tax treaties help developing countries attract investment and “can lead to significant economic effects.”

But for people like Dendevsambuu Onchinsuren, Country Managing Partner at accountants Deloitte-Onch LLC in Mongolia’s capital Ulan Bator, the Dutch are part of the problem. “In general, if there are more companies working in Mongolia through the Netherlands, there is the risk of losing tax revenue,” she told Reuters in the sail-shaped Blue Sky Tower in the city’s financial district. “In terms of the amount of investment, it’s significant to our economy.”

As international pressure mounts for countries to stem tax avoidance, the Dutch are now considering whether their treaties do more harm than good. Dutch State Secretary of Finance Frans Weekers said he was already reviewing tax treaties with five developing countries to determine if they may be unfair, and will re-negotiate if they are. So far he is not looking at the Mongolia case, but Finance Ministry spokesman Remco Dolstra said that Weekers plans to visit soon and will discuss the matter.

Tax evasion was never the aim of the tax treaties, Dolstra said. “It was meant to bolster trade ties.”

“The use of a Netherlands-based investor (Turquoise Hill) was entirely transparent at the time,” Rio Tinto said in a statement. “It was done with full knowledge of the government of Mongolia.”

SPECIAL FINANCIAL INSTITUTIONS
The Netherlands started cutting treaties on tax in the 1950s. The country which four centuries ago produced one of the first multinationals, the Dutch East India Company, would often include tax breaks that were attractive to international firms.

Dutch corporate income tax, at 25 percent, is relatively high. But exemptions and bilateral deals reduce it sharply. Today the Netherlands is a centre for “treaty shopping” – where multinationals pick and choose locations depending on the tax benefits, which can often reduce effective tax rates to below 10 percent.

Those deals have attracted thousands of firms, including 80 of the world’s largest, to set up brass-plaque companies in the Netherlands, according to the report by Amsterdam University’s Centre for Economic Research (SEO), which was commissioned by the business community to measure the sector.

Most have no material presence, factories, advisers, or employees. Some, such as Turquoise Hill Netherlands, don’t even have their own brass plaque. Officially known as Special Financial Institutions (SFIs), they perform financial roles like holding assets for multinationals, channeling funds into foreign investments, or shifting profits to tax havens.

Rio Tinto has used the Dutch shell structure to channel investments into Mongolia: Turquoise Hill and a subsidiary, Oyu Tolgoi Netherlands B.V., are among financial holding companies it has used. Regulatory filings show that Oyu Tolgoi Netherlands has built up nearly $1.5 billion in financial assets since 2009, even though the first trucks laden with copper concentrate only left the mine earlier this month. Oyu Tolgoi has not been operating long enough to generate profit, so no dividends have been paid out yet on which it could save tax.

The use of the tax treaty with the Netherlands does not affect the taxes that Oyu Tolgoi pays to the Mongolian Government, a spokesperson for Turquoise Hill said. By the end of June 2013, Oyu Tolgoi had paid over US$1.1 billion in taxes, fees and other payments. “It created more jobs than any other company in Mongolia, and was the second highest-taxpayer in the country in 2012,” Rio Tinto says on its website. “The benefits for Mongolia will be even greater now that shipments have commenced as royalty payments and increased income from taxation flow to the government.”

That said, “the cancellation by Mongolia of its tax treaty with the Netherlands will have no impact on any dividends paid by Oyu Tolgoi in the future,” Rio Tinto said. The Mongolian government agreed with...
Taxing Mongolia’s mines

Mongolia cancelled a tax treaty with the Netherlands because it feared it would lose tax revenue from mines like Oyu Tolgoi. But a major beneficiary of the treaty, Rio Tinto, says other agreements preserve its right to send dividends tax-free to the Netherlands.

MINERAL EXPORTS BY TYPE
Percent

- Coal 46.5%
- Copper 20.0%
- Iron ore 9.1%
- Others 24.4%

MINING TAX REVENUES
Trillions of Mongolian tughriks

2010 – 2011

MINING TAX REVENUES
As a percent of total state budget

Note: $1 = 1,417 Mongolian tughriks.
Sources: Mongolia Ministry of Mining; Mineral Resources Authority of Mongolia.
Rio Tinto in 2009 to “tax stabilisation measures that included the stabilisation of tax treaties then in force.”

A handful of other Dutch-registered holding firms also hold hundreds of millions of dollars in assets associated with Mongolia.

**$1 BILLION A YEAR**

The registered address of Turquoise Hill Netherlands Cooperatief U.A. is in a concrete and glass-fronted tower on a busy traffic junction between a suburban rail station and a motorway entrance in Amsterdam. The building is also the official address for companies with names such as CM Balkans, CMI Africa Holdings and Tiger Global PIP Holding.

Like 75 percent of Dutch SFIs, Turquoise Hill’s affairs are looked after by a trust company, Intertrust Group, which declined comment. Rio Tinto said Intertrust provides three contracted employees dedicated to Turquoise Hill, but when Reuters visited, Intertrust’s receptionist knew nothing about them. No employees for the other companies could be located for comment.

The Centre for Research on Multinational Corporations (SOMO), an Amsterdam-based group that campaigns against tax avoidance, found in another recent study that multinational corporations in 28 developing countries, from Brazil to Kazakhstan, used the Dutch tax system to save $1 billion a year on dividends and interest payments alone. That is money that would otherwise be paid to those countries in withholding tax, and is equivalent to around one-fifth of the Netherlands $5.5 billion budget for development aid this year.

“We provide aid to developing countries, but at the same time we make it impossible for them to generate their own income,” says Jesse Klaver, a member of parliament for the Green Left party. “It’s harmful and unacceptable for us to help multinationals make profits at the expense of developing countries.”

For the Dutch, too, the benefits are ambiguous. The sums involved in its network of brass-plaque companies may sound enormous – money flows are more than 10 times annual Dutch GDP – but the country is little more than a means of transit for most of that. The 12,000 Special Financial Institutions contributed 3.4 billion euros to the Dutch economy, the SEO report said – that amounts to less than half a percent of Dutch GDP. They account for 13,000 full-time employees.

With the benefits flowing to just a select few, the sector is raising questions at home. “In the Netherlands, ordinary citizens pay an average of 39 percent in taxes,” said MP Klaver. “It’s a hard sell, during a time of belt tightening, to have workers or greengrocers pay such high taxes when a large corporation pays almost nothing.”

**BOLD GESTURE**

The stakes are even bigger for impoverished Mongolia, a former Soviet state of 2.8 million people, 30 percent of whom lived below the poverty line in 2011, according to the Asian Development Bank.

Mongolia, whose tax revenues rose
TAX IN TAX TREATY CASE, A MONGOLIAN MOUSE ROARS

... sharply between 2009 and 2011, has had little experience of corporate taxation since it opened up to the outside world in 1991. Its Vice Finance Minister Purev said that as much as 10 billion euros were invested in Mongolia from the Netherlands in 2010, which at the time was already equal to more than twice the country’s GDP and an increase from 4 billion euros in 2004. That wasn’t because the Dutch specialise in mining, Purev notes.

“We do understand that it is vital to have double tax treaties,” he told Reuters through an interpreter in his spacious office overlooking Ulan Bator’s government buildings. “We need ... double tax treaties that are for Mongolia.”

The Mongolian finance ministry said it was impossible to say how much tax revenue it stood to lose because of the Dutch agreement. If Oyu Tolgoi had not used Netherlands as its tax base, it could have used another centre, and taxes vary.

Mongolia first contacted the Netherlands in March 2011 to request changes to the tax agreement. Three months later, it received a reply, said Purev: No.

Mongolia then sent five different proposals to amend the treaty. In December 2011, the Netherlands agreed on one change: to allow Mongolia to tax dividends at 5 percent. Mongolia said that was too little, too late. “It was at that point that we decided to cancel,” said Purev. Parliament passed the legislation needed in September 2012 and it takes effect in January 2014.

Dolstra, the Dutch finance ministry spokesman, said the Netherlands would have preferred to amend the treaty and “regretted the decision.”

In 2012, the International Monetary Fund said Mongolian should consider “selectively re-negotiating” more than 30 tax treaties which are potentially harmful to tax revenue. Terminating should be an ultimate remedy to force negotiations if agreements are potentially harmful, it said. It declined to say if the treaty with the Netherlands is unfair to Mongolia, but the OECD has in the past said the Dutch treaties with poor countries may deny them important tax revenue.

“The Dutch government’s claim that treaties are beneficial for developing countries is simply not true,” said researcher Katrin McGauran at the Centre for Research on Multinational Corporations.

“Dutch tax treaties have a seriously negative impact on poor countries’ revenue and there is no evidence that these tax losses are compensated with an increase in investment as a result of having DTAs,” or double tax agreements.

Roel van der Meij, a spokesman for the Dutch finance ministry, said the treaties improve developing countries’ finances by reducing the risk the same income will be taxed twice, as well as boosting cooperation and legal certainty for investors.

“Developing countries regularly request tax treaties,” he said.

Mongolia is not so sure. It is also revisiting its arrangements with other countries.

“We will be implementing for Mongolia a standard tax treaty form,” said Purev. “We are issuing a new investment law for foreign investors for the coming period.”

Once that is in place, tax treaties may follow if “we can come to an agreement to abolish any disadvantages.”

Mongolia's massive mine will reach full production by 2021. To prepare for that, it wants to seal deals on tax which do not, in the words of opposition presidential candidate Natsag Udval, make its people “weak, pessimistic, not confident or self-reliant.”

Edited by Sara Ledwith and Simon Robinson

FOR MORE INFORMATION
Anthony Deutsch, Specialist Correspondent
anthony.deutsch@thomsonreuters.com

Sara Ledwith, Assistant Enterprise Editor
sara.ledwith@thomsonreuters.com

Michael Williams, Global Enterprise Editor
michael.j.williams@thomsonreuters.com

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CLEAR SIGNAL: Road signs waiting to be placed in 2007. The IMF suggested Mongolia renegotiate tax treaties that may be harmful, but Mongolia opted to terminate the deal instead. REUTERS/TOM MILES