Transfer Pricing in Mining in West Africa

Fiscal Management of Mining and Petroleum in West Africa

Accra Ghana
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Presented by Alexandra Readhead.
Technical Advisor, IGF
Agenda

- Brief description of transfer pricing

- An overview of transfer pricing risks in the mining sector

- A guide to transfer pricing risk assessment, using offshore marketing arrangements as a case study

- An overview of the toolkit

- Discussion
Transfer pricing

Manipulation of transfer prices is a tax avoidance strategy.

1. Purchase of drilling rig: $100 + Procurement mark-up: $20 + Arm’s length mark-up: $10
   - $10 to tax haven

2. Lease drilling rig: $30 (p/day) + Arm’s length fee: $50 (p/day)
   - Reduces taxable profit by $20p/day
Transfer pricing in mining

Figure 1. Mining value chain showing nature & timing of related party transactions:

- Transfer of mineral products and/or rights to related entities
- Provision of corporate and financial services and assets by related entities
- Financing
- Corporate and support services
- Tangible and intangible assets/ Research and development/ intellectual property

Source: Institute for Mining for Development, 2014
Transfer pricing risk assessment in mining

Table 1. Most common transfer pricing risks along the mining value chain

<table>
<thead>
<tr>
<th>Related party transaction</th>
<th>Acquisition &amp; exploration</th>
<th>Development construction</th>
<th>Mining</th>
<th>Transport</th>
<th>Smelting/refining</th>
<th>Marketing &amp; sales</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Marketing hub</strong></td>
<td></td>
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<tr>
<td>Marketing services</td>
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<td></td>
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<td></td>
<td></td>
<td>H</td>
</tr>
<tr>
<td>Shipping &amp; distribution services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>M-H</td>
</tr>
<tr>
<td>Cargo insurance services</td>
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<td>M</td>
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<tr>
<td><strong>Finance hub</strong></td>
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<tr>
<td>Treasury services</td>
<td>M</td>
<td>H</td>
<td>L-M</td>
<td>L-M</td>
<td></td>
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<tr>
<td>Financing services</td>
<td>L-M</td>
<td>H</td>
<td>L-M</td>
<td>L-M</td>
<td>L-M</td>
<td>H</td>
</tr>
<tr>
<td><strong>Insurance hub</strong></td>
<td></td>
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<tr>
<td>Insurance brokerage services</td>
<td>L</td>
<td>L-M</td>
<td>L-M</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Captive insurance services</td>
<td>M-H</td>
<td>H</td>
<td>H</td>
<td>H</td>
<td>H</td>
<td>H</td>
</tr>
<tr>
<td><strong>Engineering, science &amp; tech hub</strong></td>
<td></td>
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</tr>
<tr>
<td>EPC/EPCM contracts</td>
<td>H</td>
<td>L-M</td>
<td>M-L</td>
<td>L-M</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technical &amp; scientific services</td>
<td>H</td>
<td>M</td>
<td>M</td>
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<td></td>
<td>M</td>
</tr>
<tr>
<td>Patents and other IP</td>
<td>H</td>
<td>H</td>
<td>M-H</td>
<td>M-H</td>
<td>M</td>
<td>M</td>
</tr>
<tr>
<td><strong>Corporate services</strong></td>
<td></td>
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</tr>
<tr>
<td>HR, accounting, IT, legal, etc.</td>
<td>L-M</td>
<td>M-H</td>
<td>L-M</td>
<td>L-M</td>
<td>L-M</td>
<td>L-M</td>
</tr>
</tbody>
</table>

Risk is high (H), medium (M), low (L), or an intermediary likelihood (e.g., L-M). Boxes in red are high financial flows.
Evaluating transfer pricing risks

1. Request information
2. Test substance
3. Test risk
4. Verify method
Case Study: Marketing of Mineral Products

“Marketing”: negotiating, selling and delivering minerals.
Fully Fledged Marketing Offtaker?

Minning Co (source country) → Related Marketing Hub (low-tax country) → External Customer (Other jurisdiction)

Physical delivery of product (transfer of title) → Physical delivery of product

Services:
- Marketing & trading
- Shipping
- Warehousing & packaging
- Distribution
- Insurance
Or Trader?

- **Mining Co (source country)**
- **Related Marketing Hub (low-tax country)**
  - Marketing & trading
  - Shipping
  - Insurance
- **External Customer (Other jurisdiction)**
  - Physical delivery of product

- Controlled transaction
- Uncontrolled transaction
1. Request Information

**BEPS Action 13 - Three Tiers**

**Master File**
- to be provided by MNEs to tax administrations
- contains info about global business and TP policies

**Local File**
- identifies RP transactions and amounts involved
- analysis of TP determinations for those transactions

**Country-by-Country Reporting**
- to be provided annually to tax jurisdiction in country of residence of parent entity
- for each country revenue, profit before tax, taxes paid
Specify TP Documentation for Mining

• Agreements between the related parties in the supply chain as well as between related parties and end customers; these may include:
  • **Sale and purchase agreements**
  • Procurement agreements
  • Marketing agreements
  • Shipping agreements
  • Services agreements
  • **Loan agreements**
• Industry analysis (e.g. value in use of the mineral; pricing of the mineral and pricing; applicable commodity index, and movement on index)
• Employee information for the mine and each related party within the supply chain
• Travel information, same as above.
2. Test Substance

- What does the related party claim to do?
- How is it organised?
- How many employees does the related party have?
- Do they have relevant academic and professional qualifications?
- How does this compare with the employees at the local mine?
## Marketing:

### i) Is there scope to influence the sale price?

<table>
<thead>
<tr>
<th>Low</th>
<th>Medium</th>
<th>High</th>
</tr>
</thead>
</table>
| Refined base/precious metals  
Gold, copper, lead, zinc, nickel, cobalt, tin, aluminum, platinum and silver  
**Bulk commodities**  
Iron ore, coking and steam coal, manganese ore and phosphate rock  
**Metallurgical products and specialty metals**  
Alumina and doré | Physical concentrates  
Copper silver, zinc silver, lead silver, zinc lead, cobalt nickel  
**Metallurgical products and specialty metals**  
Blister copper, nickel matte, alumina, doré  
**Gemstones**  
Industrial diamonds | Non-metallic industrial minerals  
Barite, fluorite, graphite, industrial diamonds, beryl  
**Gemstones**  
Refined diamonds and other gems |

Source: Adapted from the World Bank Sourcebook, 37.
Marketing:

ii) What efforts are made to increase the price?

<table>
<thead>
<tr>
<th>Some of the activities of marketing hubs (ranking by officials from SARS)</th>
<th>Importance of activity to achieving the realized sale price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiating sales contracts and terms</td>
<td></td>
</tr>
<tr>
<td>Managing supply</td>
<td></td>
</tr>
<tr>
<td>Customer relationships</td>
<td></td>
</tr>
<tr>
<td>Managing contracts</td>
<td></td>
</tr>
<tr>
<td>Market development and relations</td>
<td></td>
</tr>
<tr>
<td>Market analysis</td>
<td></td>
</tr>
<tr>
<td>Sales and price forecasting</td>
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<tr>
<td>Invoicing</td>
<td></td>
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<tr>
<td>Logistics</td>
<td></td>
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<tr>
<td>Financing</td>
<td></td>
</tr>
</tbody>
</table>
3. Test Risk

- What type of risk?
- How is the risk created?
- Is the risk economically significant?
- Which entity bears the risk?
### Marketing:

### iii) Which type of risk?

Types of Risk Associated with Taking Legal Title of the Mineral Product

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>Product price falls.</td>
</tr>
<tr>
<td>Market</td>
<td>Demand for the product falls.</td>
</tr>
<tr>
<td>Supply</td>
<td>Mine is unable to produce the quantity that the marketer has already sold to customers.</td>
</tr>
<tr>
<td>Quality</td>
<td>Product does not comply with the terms of the offtake agreement.</td>
</tr>
<tr>
<td>Credit</td>
<td>Late or non-payment by customers.</td>
</tr>
</tbody>
</table>
**Marketing:**

iv) Is the risk real?

<table>
<thead>
<tr>
<th>Information</th>
<th>Questions to consider</th>
</tr>
</thead>
</table>
| **Offtake agreement & third-party agreements** | 1. Are third-party sales instantaneous?  
2. Do the terms of the offtake agreement and the third-party sales agreement vary (key terms: payment, price, quotation period, volume, quality, penalties)?  
3. What does the variation in terms reveal about risk? |
| **Financial statements from the hub**       | 4. Is the stock of goods included in the hub’s inventory?  
5. Does the hub have the financial capacity to bear the risks that it is purported to bear? |
| **Bill of Lading**                          | 6. Does the hub sell the product FOB or CIF?                                                                                                           |
4. Verify Method

OECD Transfer Pricing Methods

Traditional Transaction Methods (preferred methods)
- Comparable Uncontrolled
- Resale
- Cost-plus

Transactional Profit Methods (last resort methods)
- Transaction Net Margin
- Profit-split
a) Profits relative to the hub’s operating costs

Is the compensation received by the marketing hub proportional to its operating costs?

✔

b) Commission on sales

Is the remuneration the hub receives commensurate with commission rates observed in other similar associated entities, as well as in other similar independent entities?

Marketing:

v) Are the results realistic?
Marketing:

vi) Return on costs a more reliable indicator

Marketing fee of 3% of sales  $30bn in sales

Mining Co  Related Marketing Hub (OPEX: $150mn)  Customer

0.03*$30bn = $900mn-$150mn = 600% return on costs

Mining Co  Related Marketing Hub (OPEX: $300mn)  Customer

0.03*$30bn = $900mn-$300mn = 200% return on costs
How can the Toolkit help your tax authority?

- **Information**: Information checklist for each transaction, including useful publications.
- **Methodology**: A step-by-step guide to reviewing high-risk related party transactions in the mining sector.
- **Industry Insight**: Practical experiences from tax officials in mining countries, as well as industry experts.
- **Financial Data**: Limited data showcasing industry practices (NOT comparable data).
Thank You

Download the Toolkit here:
https://www.bmz.de/rue/includes/downloads/2017_GIZ_Transfer_Pricing_Risk_Tool_EN.pdf

Interested to receive training on the Toolkit?
Contact alexandra.readhead@iisd.org