

Transfer Pricing in Mining in West Africa

Fiscal Management of Mining and
Petroleum in West Africa

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IGF

**INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development**

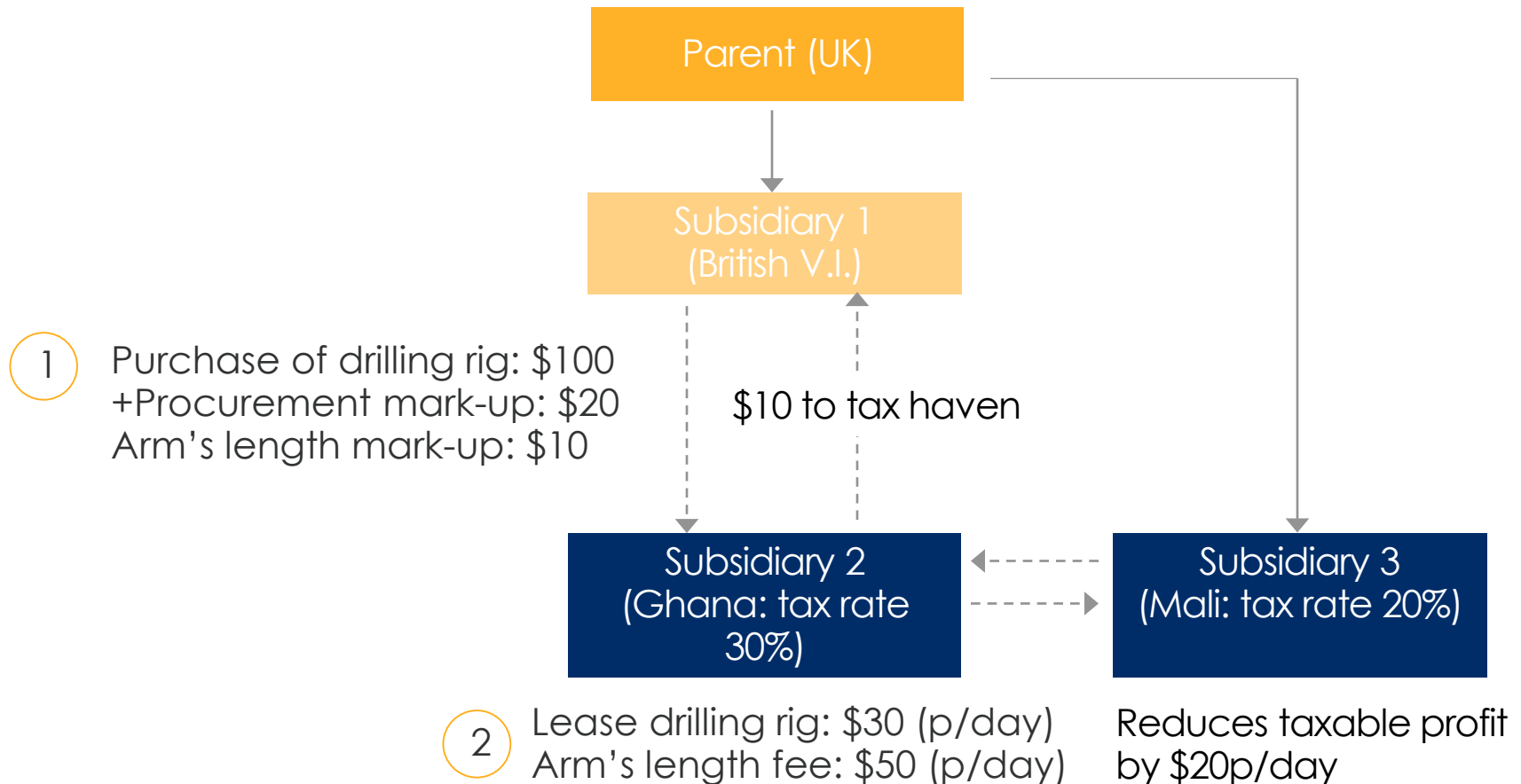


Agenda

- 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
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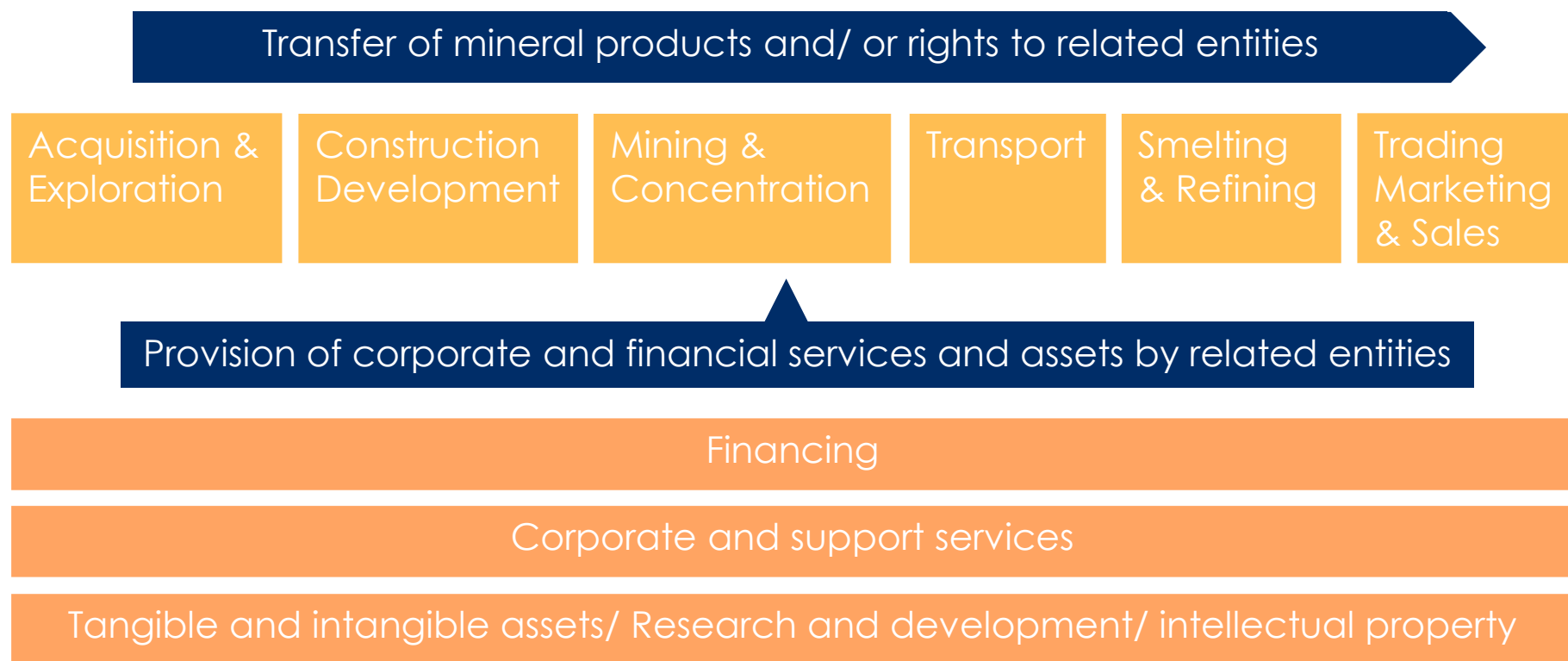
Transfer pricing

Manipulation of transfer prices is a tax avoidance strategy.



Transfer pricing in mining

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



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

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

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**

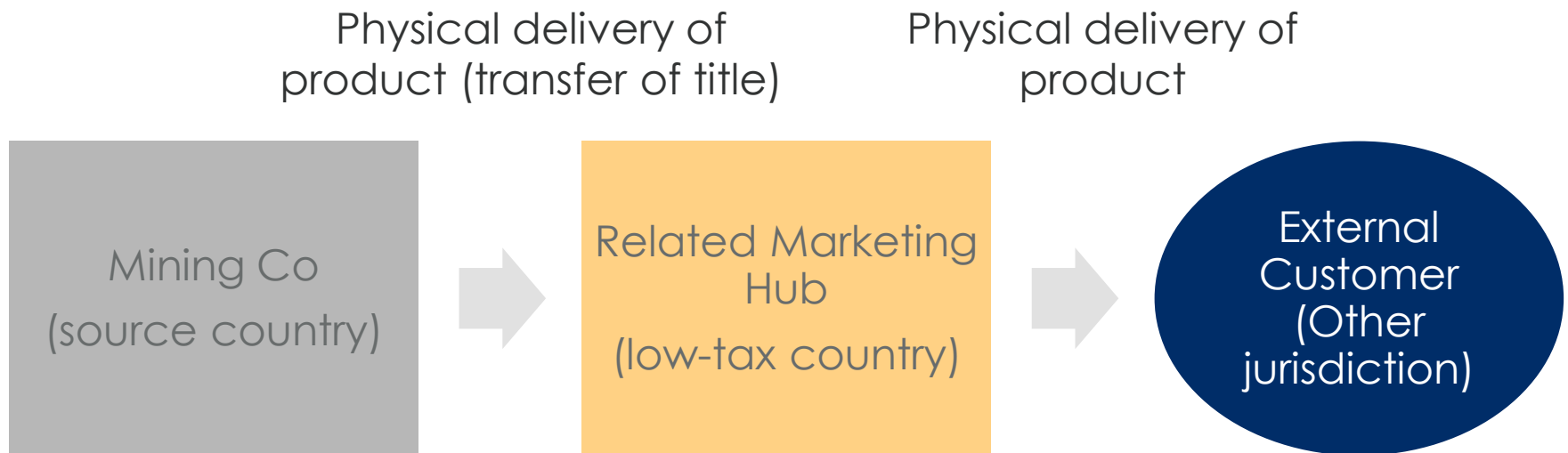


Case Study: Marketing of Mineral Products

“Marketing”: negotiating, selling and delivering minerals.



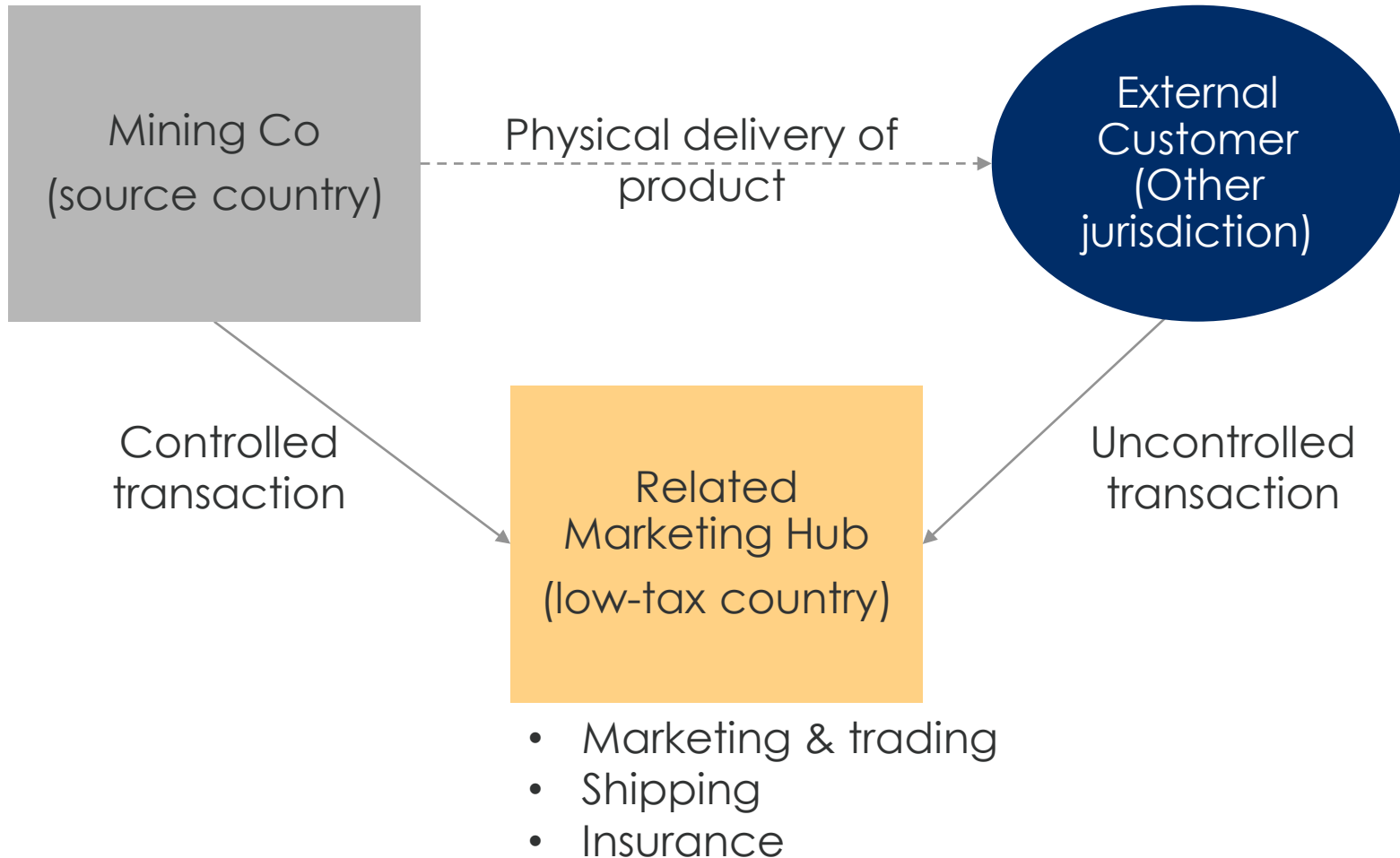
Fully Fledged Marketing Offtaker?



Services:

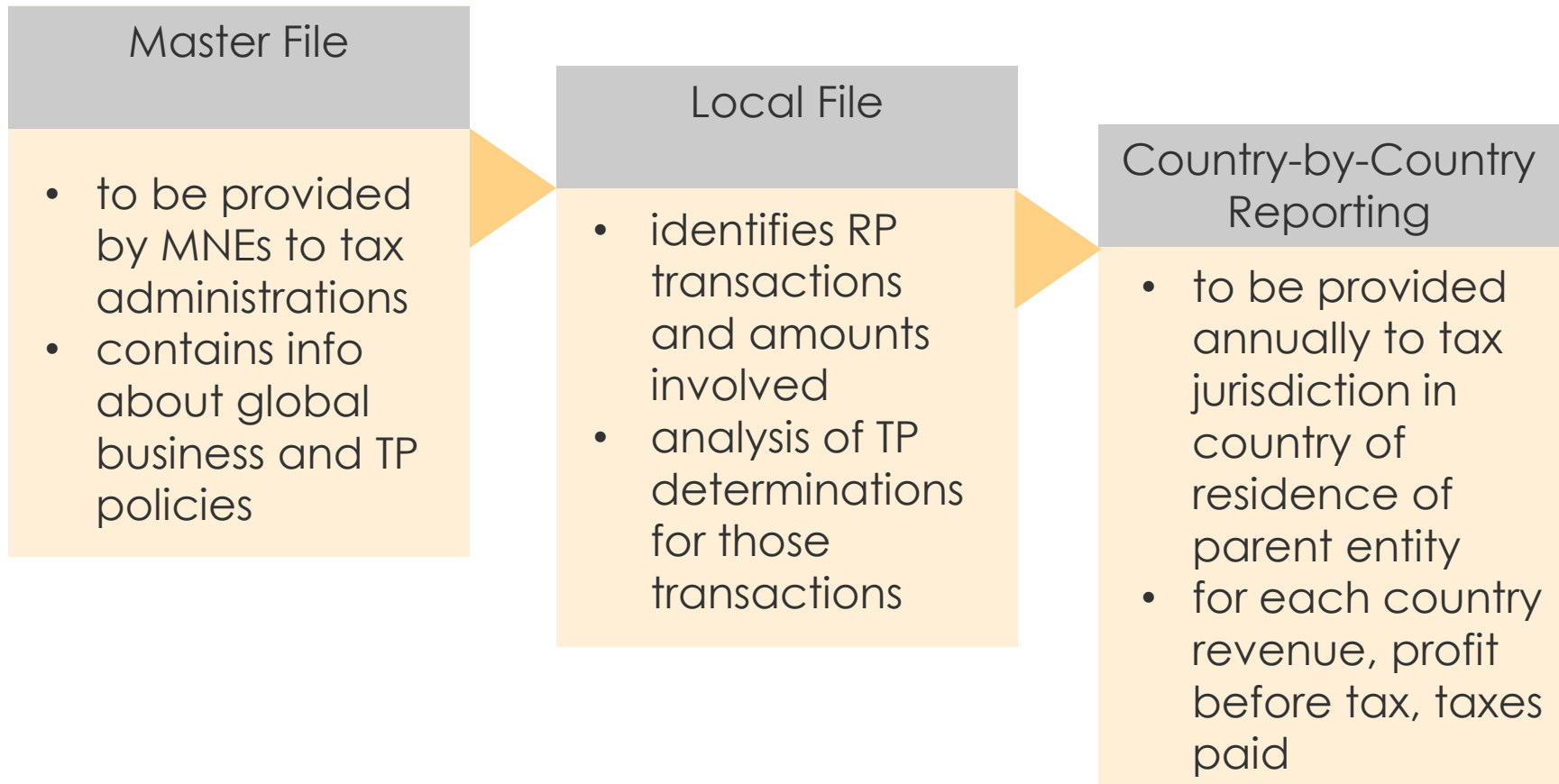
- Marketing & trading
- Shipping
- Warehousing & packaging
- Distribution
- Insurance

Or Trader?



1. Request Information

BEPS Action 13 - Three Tiers






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?

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


Source: Adapted from the World Bank Sourcebook, 37.



Marketing:


ii) What efforts are made to increase the price?

Some of the activities of marketing hubs (ranking by officials from SARS)	Importance of activity to achieving the realized sale price
Negotiating sales contracts and terms	Dark blue bar
Managing supply	Dark blue bar
Customer relationships	Dark blue bar
Managing contracts	Dark blue bar
Market development and relations	Medium-dark blue bar
Market analysis	Medium blue bar
Sales and price forecasting	Medium blue bar
Invoicing	Medium blue bar
Logistics	Light blue bar
Financing	Light blue bar





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

Price	Product price falls.
Market	Demand for the product falls.
Supply	Mine is unable to produce the quantity that the marketer has already sold to customers.
Quality	Product does not comply with the terms of the offtake agreement.
Credit	Late or non-payment by customers.

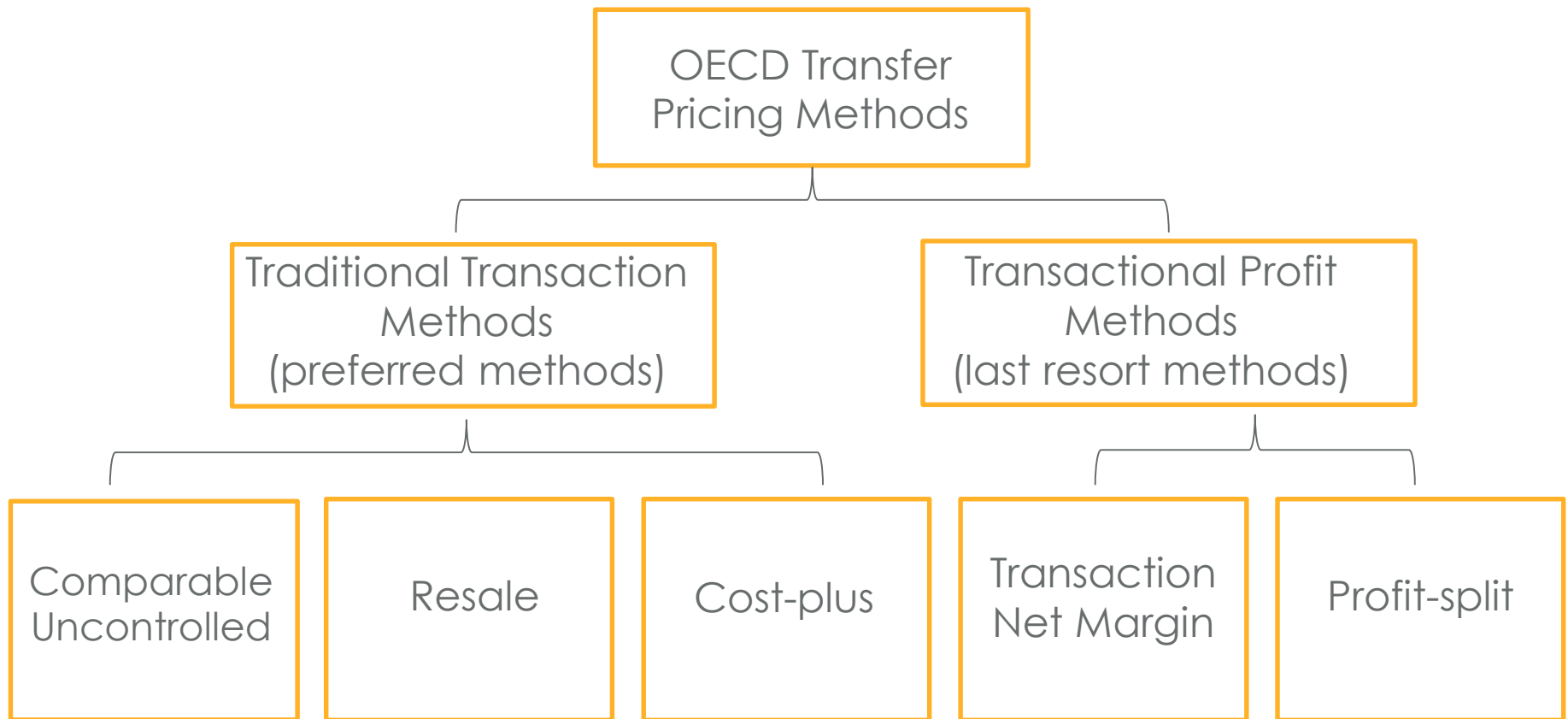


Marketing:

iv) Is the risk real?

Information	Questions to consider
Offtake agreement & third-party agreements	<ol style="list-style-type: none">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	<ol style="list-style-type: none">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	<ol style="list-style-type: none">6. Does the hub sell the product FOB or CIF?

4. Verify Method





Marketing:

v) Are the results realistic?

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

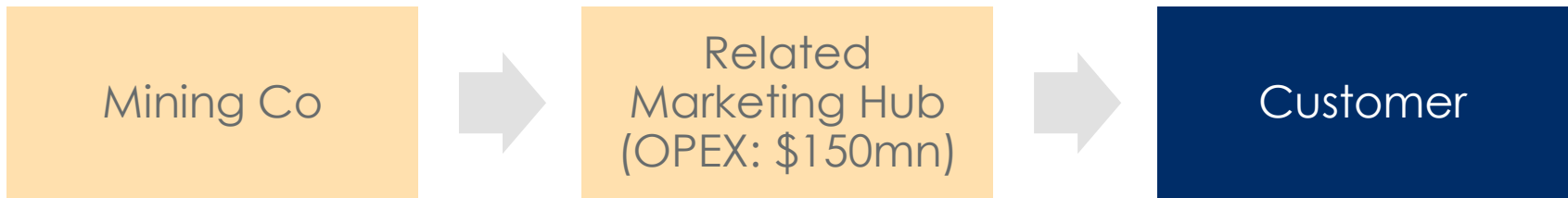
Is the remuneration the hub receives commensurate with commission rates observed in other similar associated entities, as well as in other similar independent entities?

Marketing:

vi) Return on costs a more reliable indicator

Marketing fee of 3% of sales

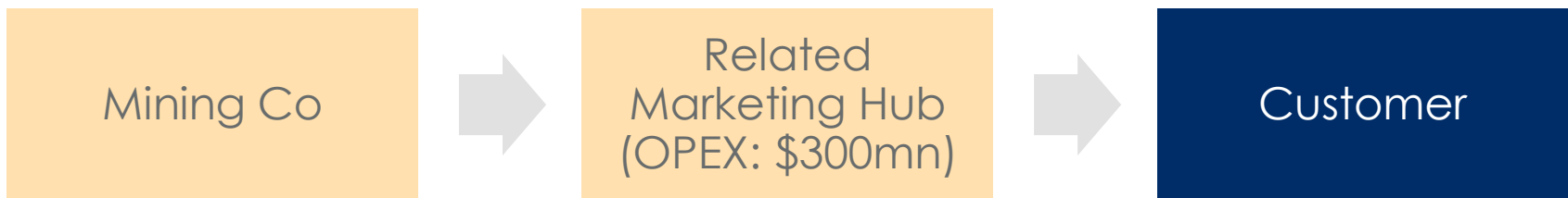
\$30bn in sales



$$0.03 * \$30\text{bn} = \$900\text{mn} - \$150\text{mn} = \mathbf{600\% \text{ return on costs}}$$

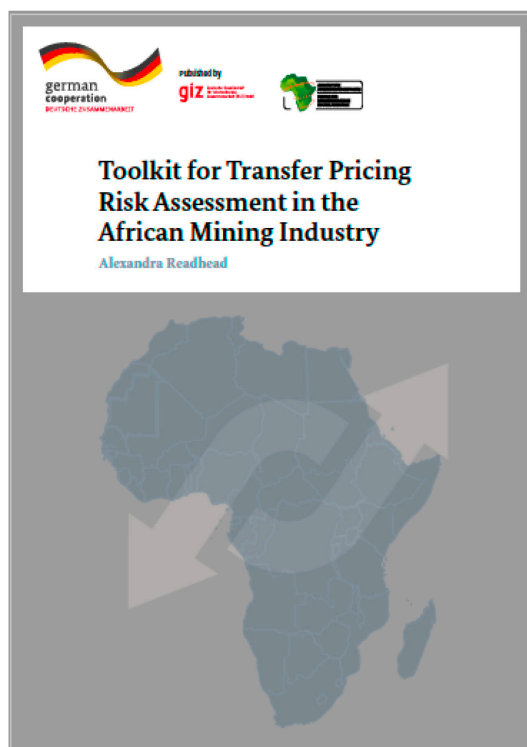
Marketing fee of 3% of sales

\$30bn in sales



$$0.03 * \$30\text{bn} = \$900\text{mn} - \$300\text{mn} = \mathbf{200\% \text{ return on costs}}$$

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 received training on the Toolkit?

Contact alexandra.readhead@iisd.org

