# Transfer Pricing in Mining in West Africa

Fiscal Management of Mining and Petroleum in West Africa

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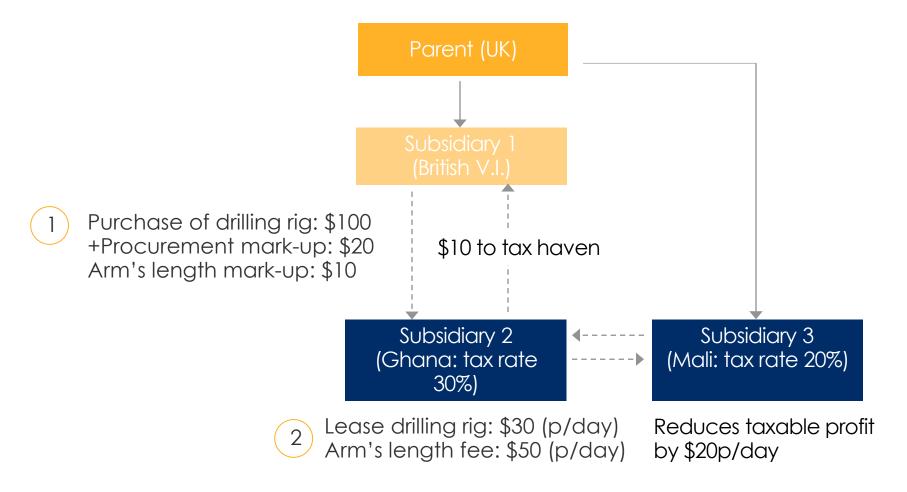


#### Agenda

- 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.



### 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

Acquisition & Exploration Construction Development

Mining & Concentration

Transpor<sup>-</sup>

Smelting & Refining Trading
Marketing
& Sales

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

Related party transaction	Acquisition & exploration	Development construction	Mining	Transport	Smelting/ refining	Marketing & sales
Marketing hub						
Marketing services						Н
Shipping & distribution services				Н		M-H
Cargo insurance services				М		М
Finance hub						
Treasury services	M	Н	L-M		L-M	
Financing services	L-M	Н	L-M	L-M	L-M	Н
Insurance hub						
Insurance brokerage services	L	L-M	L-M			
Captive insurance services	M-H	Н	Н	Н	Н	Н
Engineering, science & tech hul	<b>o</b>					
EPC/EPCM contracts		Н	L-M	M-L	L-M	
Technical & scientific services	Н	M	М		M	
Patents and other IP	Н	Н	M-H		M-H	М
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?

Physical delivery of product (transfer of title)

Physical delivery of product

Mining Co (source country)



Related Marketing
Hub

(low-tax country)



External
Customer
(Other
jurisdiction)

#### Services:

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

#### Or Trader?

Mining Co (source country)

Physical delivery of product

External
Customer
(Other
jurisdiction)

Controlled transaction

Related Marketing Hub (low-tax country) Uncontrolled transaction

- Marketing & trading
- Shipping
- Insurance

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

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 Importance of activity to achieving the realized (ranking by officials from SARS) sale price Negotiating sales contracts and terms Managing supply Customer relationships Managing contracts Market development and relations Market analysis Sales and price forecasting Invoicing Logistics Financing



#### 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?

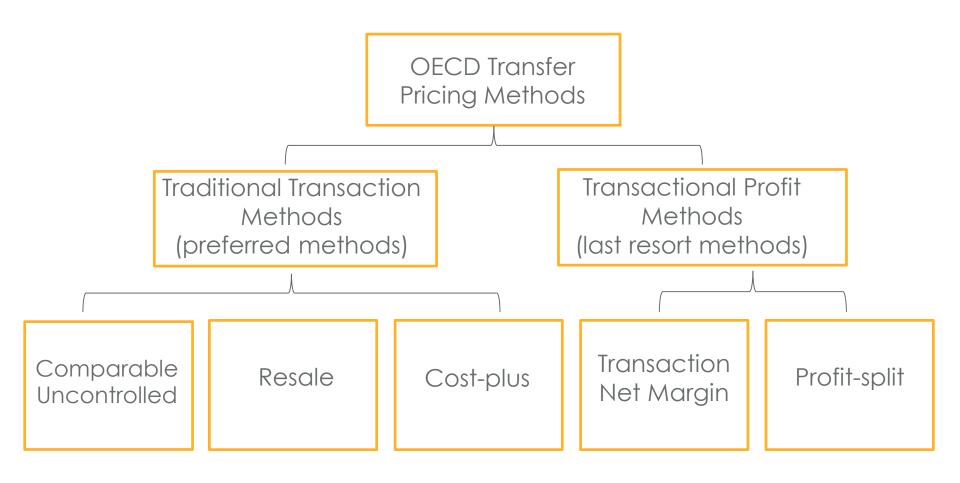
Types of Risk Associated with Taking Legal Title of the Mineral Product

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 &	1. Are third-party sales instantaneous?			
third-party agreements	2. Do the terms of the offtake agreement and the third- party sales agreement vary (key terms: payment, price, quotation period,12 volume, quality, penalties)?			
	3. What does the variation in terms reveal about risk?			
Financial statements from	4. Is the stock of goods included in the hub's inventory?			
the hub	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



# 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

Mining Co



Related Marketing Hub (OPEX: \$150mn)



Customer

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

Marketing fee of 3% of sales

\$30bn in sales

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).



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 <u>alexandra.readhead@iisd.org</u>