ADDRESSING INFORMATION GAPS ON PRICES OF MINERAL PRODUCTS

METHODOLOGY FOR IMPROVING KNOWLEDGE OF MINING INDUSTRY TRANSFORMATION CHAINS AND IDENTIFYING MINERAL PRODUCTS

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Please note: This document is a draft for consultation. It does not reflect the views of the OECD or its member states, and is not for reference.

Feedback and comments on the draft can be sent to dan.devlin@oecd.org, by 18 December 2015.

Background to the Issue

The production and sale of commodities drive the economies of many developing countries, contributing to income growth, foreign exchange earnings and employment. Commodities also generate government revenue, which can in turn be used to boost living standards.

In the mining sector, corporate income taxes and royalties frequently use mineral product sales as a key component of the tax base, but like other sectors, there are base erosion and profit shifting (BEPS) risks that may reduce the revenue available to developing countries. One key BEPS risk is profit shifting via the pricing of mineral products in transactions between related parties. This issue is of significant concern to many including mineral exporting countries, the G20 and civil society. For developing countries, these risks are elevated particularly where revenue authorities are still building their sector-specific expertise and ability to detect and mitigate transfer pricing. A key issue is ensuring these authorities have the information they need to review transaction terms, coupled with the capability to apply that information effectively.

The objective of this work is to improve the industry knowledge and understanding of revenue authorities, whilst noting the diversity of mineral products, their markets and uses means the specific facts and circumstances of each transaction limit the scope for approaches that can be applied to all mineral products.

A Systematic Process to Assist Developing Countries Address Information Gaps for Mineral Product Prices

The OECD has developed a systematic process to assist revenue authorities to build their understanding of mining products and pricing practices.

The process has 6 steps, beginning with understanding the profile and structure of the domestic mining industry, the mines in operation and what they are producing. Once the mining sector has been mapped, this allows administrators to identify key mineral products which can then be examined. Naturally, different revenue authorities are at different stages of expertise with mining practices and mineral product markets, which will affect the amount of time needed for each step. Revenue authorities can then use this information to inform their transfer pricing analysis.

As mineral product knowledge becomes increasing sophisticated, information asymmetries should narrow and revenue authorities should be able to use market pricing information more effectively. In addition, it should help to narrow areas of dispute with taxpayers based on misunderstandings of common industry practices.

Box 1: A Process for Understanding a Mineral Product Transaction

Understanding a Mineral Product Transaction

Review how minerals are transformed from ore to traded products.

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Identify points on the transformation chain where products are produced and traded.

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Understand how those products are priced and the key factors affecting prices.

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Identify available data that could be used to review the transaction, and identify where there are information gaps.

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Devise approaches or methodologies to address those information gaps.

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Apply the information to the particular transaction.

Step 1: Example Guidance Questions

Review how minerals are transformed from ore to traded products

- ❑ What kind of mine is it?
- ❑ What type of ore is the mine extracting?
- ❑ What products can be created from the mine?
- ❑ Who verifies the products produced?
  (for example, is testing/assay reliable?)
- ❑ What method of transformation and beneficiation is used to produce those products?
- ❑ Where does this take place?
- ❑ Does this mine have similarities with other mines domestically?
  (These similarities might be in, for example, inputs used; products produced; transportation methods employed; and/or customers.)
- ❑ What entities are involved in the transformation and what are their key functions?

Step 2: Example Guidance Questions

Identify points on the transformation chain where products are produced and traded.

- ❑ What product quantities are being produced per month/year?
- ❑ Who is checking this production and is the check reliable?
- ❑ How will those products be transported when they are sold?
- ❑ How will they be exported?
- ❑ Who will the mining company sell the product to?
  - ❑ In particular, are they a related party?
  - ❑ If so, where are they located?
- ❑ Is this product routinely sold to independent parties (i.e., at arm's length?)

Step 3: Example Guidance Questions

Understand how those products are priced and the key factors affecting prices

- ❑ What are the key features of the product market?
- ❑ For example, is it a global market, or regional?
- ❑ What are the market conditions and concentration of buyers and sellers? Are they changing?
- ❑ What adjustments are made to account for physical attributes, and which have the largest potential impact on price?
- ❑ Is the product traded on an open exchange?
  for example, the London Metal Exchange?
  - ❑ If so, on what terms?
- ❑ Are there other physical features that can affect price, such as the size of the ore pieces?
- ❑ Does the location of the product or delivery date materially affect the price?
- ❑ Is the transaction a one-off or part of a longer-term agreement between the parties?

Step 4: Example Guidance Questions

Identify available data that could be used to review the transaction, and identify where there are information gaps

- ❑ Is there publicly available data that could be used to compare the transaction?
- ❑ How reliable is that information?
  (for example, would it be accepted as evidence in a dispute in a court?)
- ❑ Would the information need to be adjusted to ensure it is comparable with the transaction under review?
  (for example, to adjust for geographical or quality differences)?
- ❑ Can this be done reliably?
- ❑ How much does it cost to purchase the information?
- ❑ Is the information easy to use?
  - ❑ If not, is support provided to use the data?
- ❑ What revenue is at risk?
  - ❑ How does this compare to other revenue risks?

Step 5: Example Guidance Questions

Devise approaches or methodologies to address those information gaps

- ❑ Are there alternate sources of information?
  (for example, could information on smelting or refining costs be obtained from elsewhere?)
- ❑ Are there commonly used methodologies to derive a price from another product?
- ❑ Would these withstand dispute resolution processes?
- ❑ Is it worth investing in additional data or consultancy expertise?
  - ❑ If so, how much will this cost?
- ❑ How long will it take to receive the information?
- ❑ What legal powers are available if the taxpayer refuses to provide information?
- ❑ Which other countries might be able to assist?
- ❑ Can informal country networks help reinforce understanding of key pricing practices for that product?
- ❑ Can information be obtained through formal information exchange mechanisms?

Step 6: Example Guidance Questions

Apply the information to the transaction

- ❑ Has the taxpayer entered into a controlled transaction at this point in the process?
  - ❑ If so, obtain details of:
    - ❑ who sold to
    - ❑ where they are tax resident
    - ❑ documentation of the transactions including composition of the traded product, transportation details, payment details etc
- ❑ Has some of the product been sold to a third party? If so obtain details of:
  - ❑ who sold to
  - ❑ documentation of the transactions including composition of the traded product, transportation details, payment details etc. to see if this may provide a comparable uncontrolled transaction
- ❑ Does the taxpayer have a unique production process or are all the processes the same? Are they publicly known?
- ❑ Have assets (related to the production process), and mainly, valuable unique assets been purchased by the taxpayer from a related party?