Transfer Mis-Pricing

A review of challenges and opportunities for the Mining Industry

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Content

Background..

Tanzania anti-corruption body charges Acacia subsidiaries with tax evasion, money laundering

Cecilia Jamasmie | Oct. 17, 2018, 10:05 AM |

"We couldn't wait to pass the laws because of the large scale theft taking place in the mining sector," President John Magufuli said.
Telegraph, UK.

Business

Out of Africa: How London's mining giants are battling the rise of 'resource nationalism'

MARK SHAPLAND | Monday 6 August 2018 10:23 | 0 comments

Right now Africa is going through a wave of so-called "resource nationalism" — protectionism by another name — as leaders demand more tax, bigger ownership stakes and royalties from multinational miners operating in their countries.

CEO, major gold company, IGF Annual Meeting dinner, 2014:
"Keep your hands off our profits"

Developing country participant:
"Keep your hands off our minerals, we'll keep our hands off your profits"

Calle wants mining companies to pay more taxes

05 April 2019 Author NYASHA FRANCIS NYAUNGWA

"We are a mineral resource based economy, but if you look at the taxes that we receive from the sector they are actually very low," Schlettwein said.
Observer Newspaper.

DRC miners form new body to fight mining code

Cecilia Jamasmie | Aug. 23, 2018, 3:50 AM |

The increase in the royalties and taxes is among the principal innovations of the new mining code.
DLA Piper, Law Firm.

Background

Top 10 risks

2017-2018	
01	Digital effectiveness
02	Competitive shareholder returns
03	Cyber
04	New world commodities
05	Regulatory risk
06	Cash optimization
07	Social license to operate
08	Resource replacement
09	Access to and optimization of energy
10	Managing joint ventures

- **A change in the regulatory framework e.g increasing tax rates can cause significant uncertainty to companies and possibly impact foreign investment.**

- **It is therefore critical to keep abreast of proposed regulatory changes.**

Abusive practices are said to contribute to tax base erosion and profit shifting.

Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions.

Transfer Pricing

- Transfer pricing is a **''legitimate''** business practice that involves the purchase of a goods or services between two related parties at Arm's Length (AML). (i.e., part of the same corporate group).

- Arm's Length Price is determined according to fair market value.

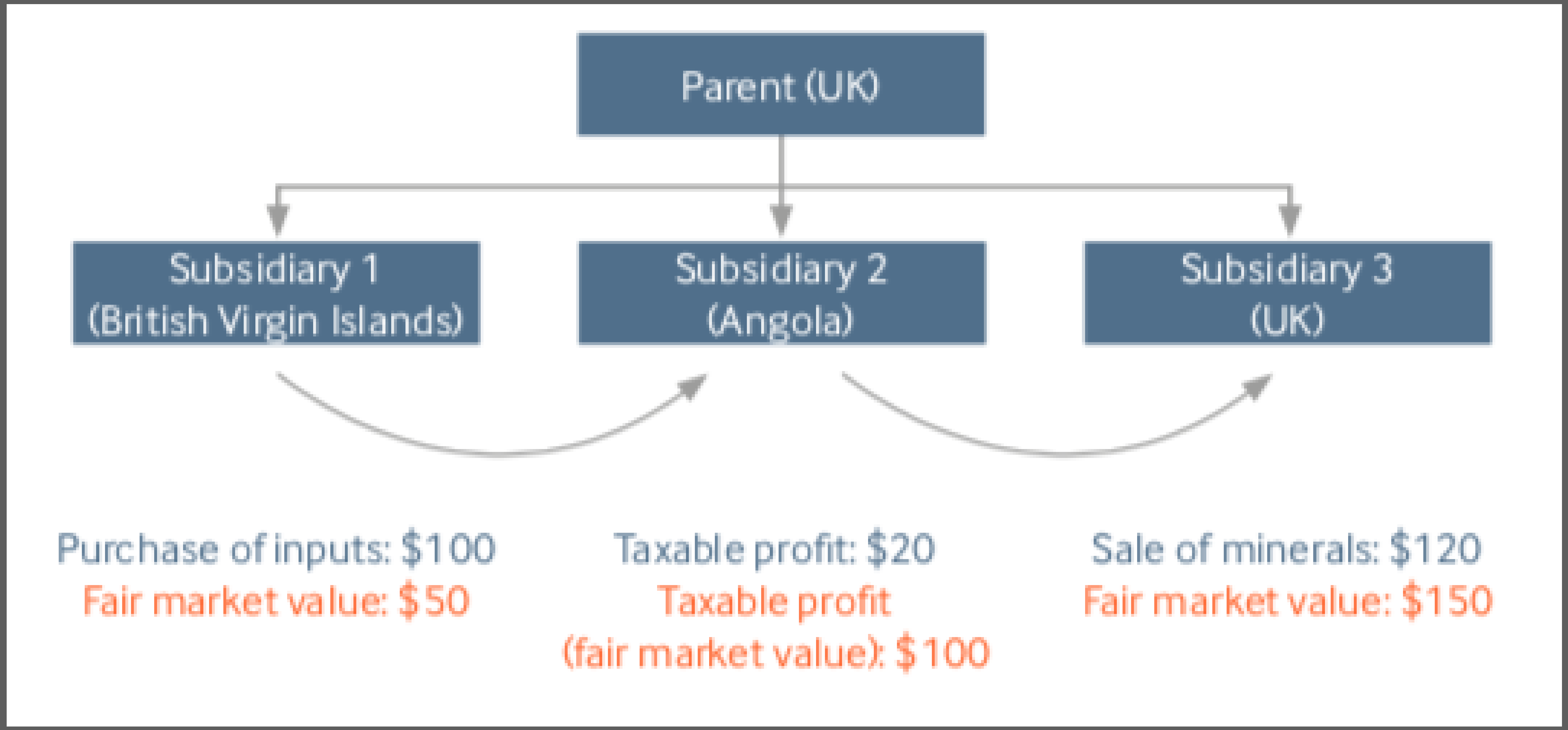
- These transactions can be abusively used to shift profits away from the mining country when the related parties charge the price of a transaction in a manner "inconsistent" with what unrelated ("arm's length") parties would have done.

- One tax system vs Cross border transactions

Transfer Pricing — **Normal business practice**

Vs

Transfer Mis-Pricing — **Tax Avoidance**, **Tax Evasion**



Legitimacy?

- AML is the internationally agreed standard for transfer pricing.
- *Article 9*, OECD Model Tax Convention

Arm's length principle

- Comparable uncontrolled transaction (used for traded commodities Cu, Zn, Au, Iron Ore)
- Resale Method - apply price margins
- Transactional Net Margin Method

NB! Governments and civil society should not automatically assume that companies seek to manipulate their profits.

There may be a genuine difficulty in determining market price e.g contracted prices not quoted on market stocks.

Transfer Pricing challenges

- Determining the sales price: Easy for minerals with reference price, i.e. LME, TSE prices but challenging for commodities without internationally set price
- Service (management) fees are charged by holdings companies but there is no standard unit of measuring such fees. Hence they will vary from holding company to another.
- Absence of adequate legislation to govern and monitor abusive practices
- Regulator for transfer pricing not yet in place to allay concerns of price mis-pricing

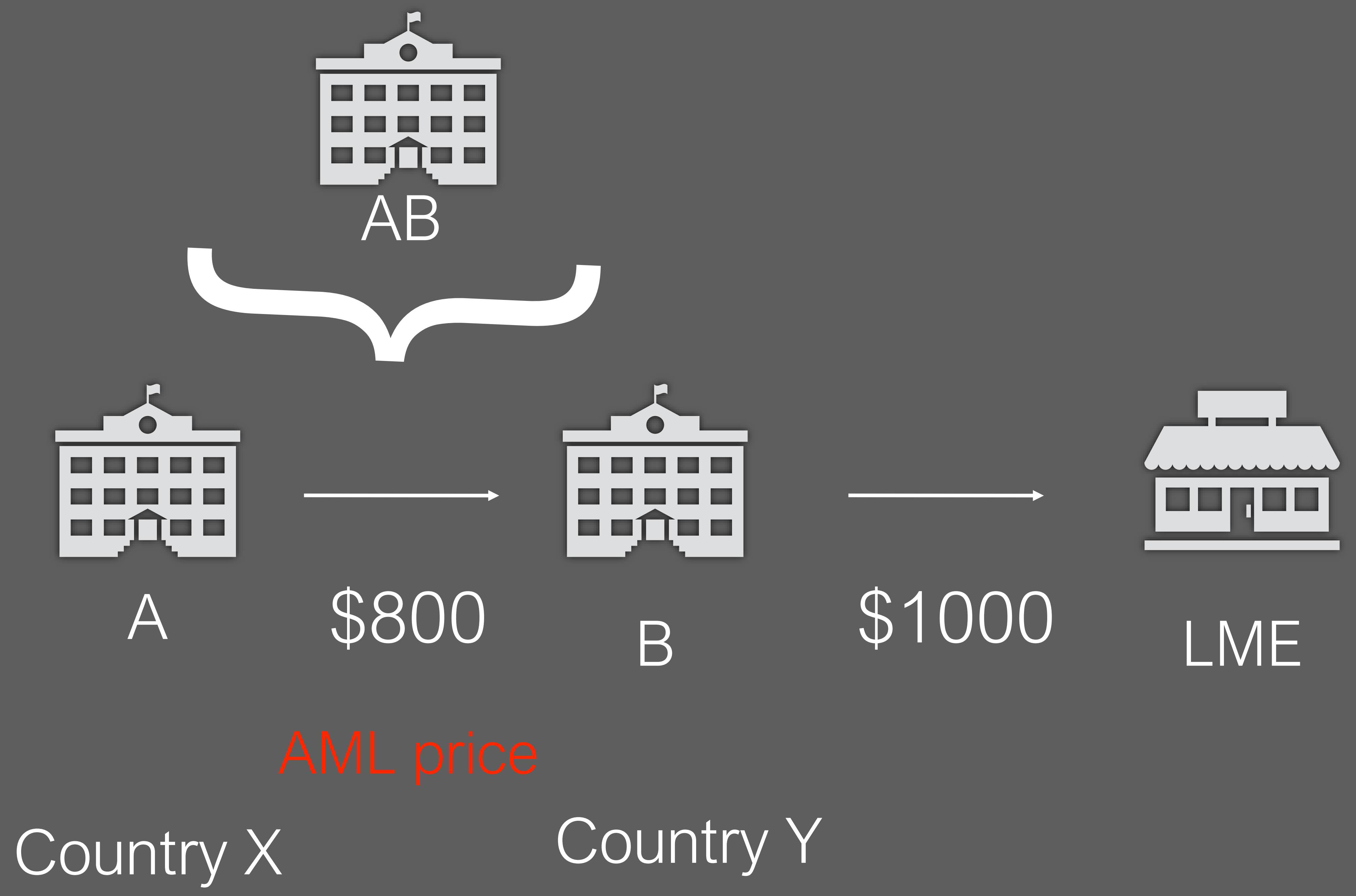
Transfer Mis-Pricing: The Problem

- When transfer mispricing is practiced, profits are shifted from a tax jurisdictions where the effective tax rates are higher to a tax jurisdiction where the effective tax rates are lower (Holzmann, 2016; Nielsen, et al. 2014).
- Tax havens - zero or negligible CIT

Exploiting loopholes to engage in abusive practices by:
- Excessive tax base erosion and profit shifting (BEPS)
- Manipulating transfer price i.e contract prices
- Misleading reports on profits
- Under-invoicing mineral exports

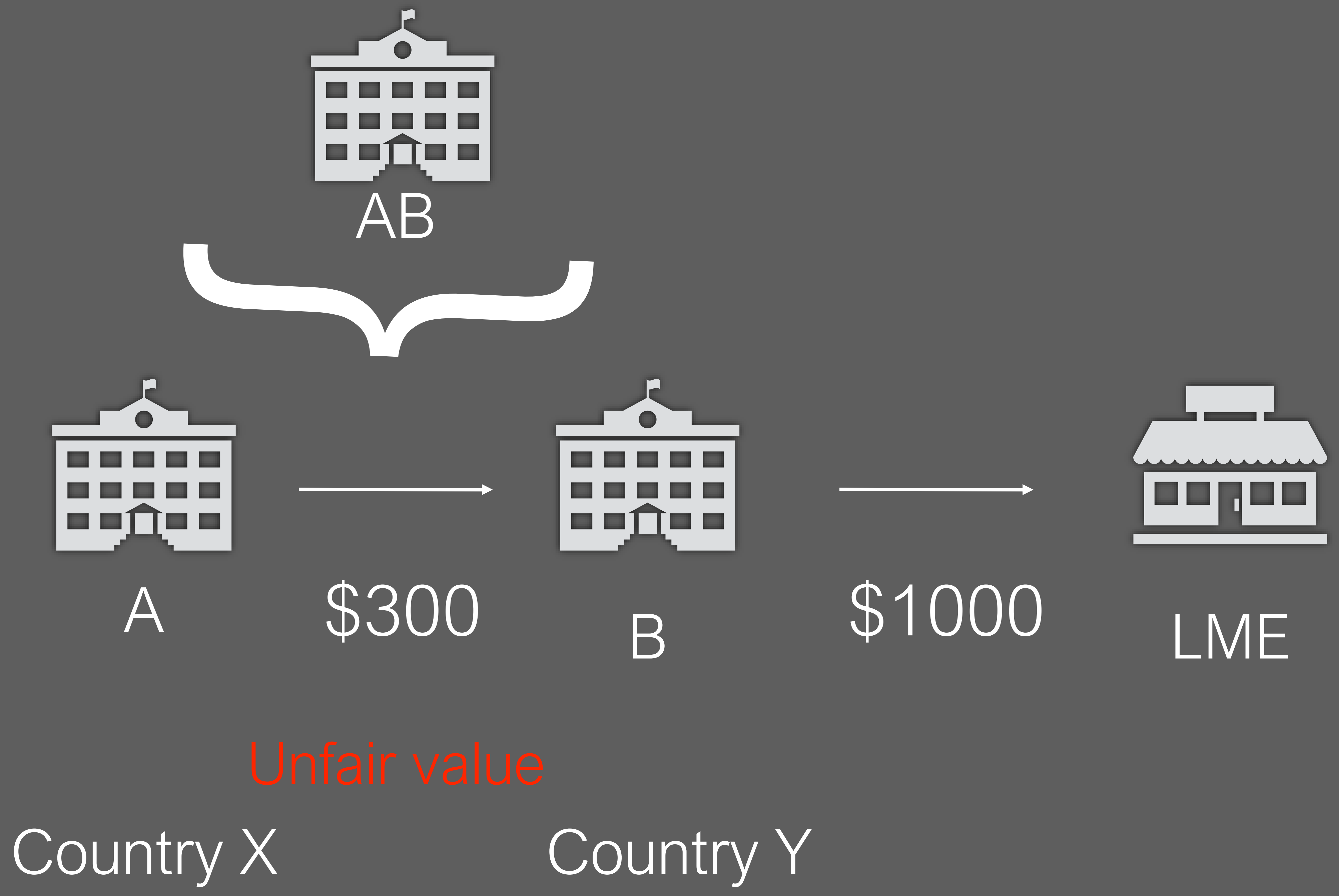
Illustration..

Transfer Pricing



	Company A	Company B
Tax Rate	30%	5%
Tax Base (Profit)	$400	$500
Tax paid	$120	$25
Total Taxes	$145	

Transfer Mis-Pricing



	Company A	Company B
Tax Rate	30%	5%
Tax Base (Profit)	$150	$600
Tax paid	$45	$30
Total Taxes	$75	

- $75 forgone in taxes for country A by transfer mis-pricing

Why transfer mis-pricing?

1. To minimize the tax base
2. Unethical behaviour to maximise profit

How do governments react?

1. Imposing higher taxes
2. Expropriating mineral assets
3. Export bans

Why is this not good?

1. Evading taxes undermines government's ability to promote development
2. Imposing higher taxes kills the economy
3. The outcome may result in unfair disparities amongst mining taxpayers
4. The whole scenario brings the mining industry into disrepute
5. Lengthy and costly dispute resolution processes - Arbitration

Recommendations

1. Governments should have adequate legislation for transfer pricing, to ensure that abusive prictices do not take place.

In Namibia: Income Tax Act Section 95A and Exchange Control Regulations (Bank of Namibia).

- GRN should expedite establishment of Namibia Revenue Authority (NAMRA) on the same lines as SARS.
- NAMRA should have a strong Transfer Pricing Unit to ensure that abusive practices do not occur.

2. Regulatory authority should elaborate transfer pricing rules to create a climate of ‘’certainty’’ and; monitor company compliance through tax audits.

3. Mining companies should adhere to international best practice - AML principle, and domestic laws.

4. Transparency and business integrity

5. Capacity of tax administration and political will

6. Overarching mining policy framework between Mines Ministry and Finance Ministry

Conclusions..

- Resource nationalism takes different forms including higher tax charges
- Has been documented as a potential threat to industry
- Threat for increased tax charges emanate from perceived transfer mis-pricing, amongst others
- Companies should operate with high business integrity and transparency, adhere to AML principle
- Capacity development of tax administration and political will to enforce
- For an industry to thrive, all stakeholders (government & private sector) are integral
- Cooperation, cooperation, cooperation!

''Coming together is a beginning, staying together is a progress, working together is a success!'' - Hon. Tom Alweendo


The End :)