GHEITI EXTRACTIVE SECTOR TRANSFER PRICING WORKSHOP

22 Oct. 2015

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ENSURING TRANSPARENCY IN THE EXTRACTIVE INDUSTRIES TAXATION IN GHANA

THE

EXTRACTIVE COMPANIES’ PERSPECTIVE

GHANA CHAMBER OF MINES

Introduction

- In line with the practice of most trading nations with extensive outward and inward investment flows and transactions between associated persons within jurisdictions, The Minister of Finance and Economic Planning ("MOFEP") in exercise of the powers conferred on him in terms of Section 114 of the Internal Revenue Act, 2000 ("Act 592"), as amended, introduced the Transfer Pricing Regulations, 2012 by way of Legislative Instrument 2188 ("L.I. 2188").

Introduction -*ctnd*

- The Regulations seeks to tax profits which may not have been accounted for by a taxpayer because the transaction(s) may have been concluded on non-arm's length basis.
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- The Regulation specifically focuses attention on transactions between associated persons who may be in a controlled relationship and is applicable to the following:
- Commercial transactions between persons who are in a controlled relationship;
- dealings between a permanent establishment ("PE") and its head office;
- dealings between a PE and other related branches of that PE;

Introduction -*ctnd*

A controlled relationship is defined in the Regulations as follows:

"controlled relationship means a relationship between one person and another person by the terms of which, the relationship is able to influence the transfer price set in a transaction, and in which that other person is

- *An associate of the first person*
- *A person in a trust relationship with that first person;*
- *A person who is in a partnership relationship with that first person;*
- *A holding company, a subsidiary or a subsidiary of a holding company to which that first person is a subsidiary;*
- *A member of a closed corporation together with that first person; and*
- *A relative of a person who is a member of a closed corporation together with that first person;"*
- *A relative of the first person;*

COVERAGE

- **Transactions Covered**
  - The following transactions are covered by this Transfer Pricing Regulations:
  - The purchase and sale of goods
  - The purchase, sale, lease or use of tangible assets;
  - The purchase, sale, lease or use of intangible assets;
  - The provision of management services, technical services and other intra group services;
  - The provision of finance and other financial arrangements;
  - Rent and hire charges; and
  - Any other transaction that may affect the profit or loss of the entity.

TRANSFER PRICING METHODS

TP Methods

- **Pricing Methods**
- The Regulations recognises five main pricing methods as follows:
    - Comparable uncontrolled price method;
    - Resale price method;
    - Cost-plus method;
    - Transactional profit split method;
    - Transaction net margin method.
- Where good cause is shown and the unsuitability of any of the above, a taxpayer may be permitted to apply a different pricing method for transactions with associated persons.
- These are methods to **test** if the pricing between parties is at arm's length.

TP Methods

We note that the OECD has also made provision for the same methods and actually provides a great deal of guidance in that regard

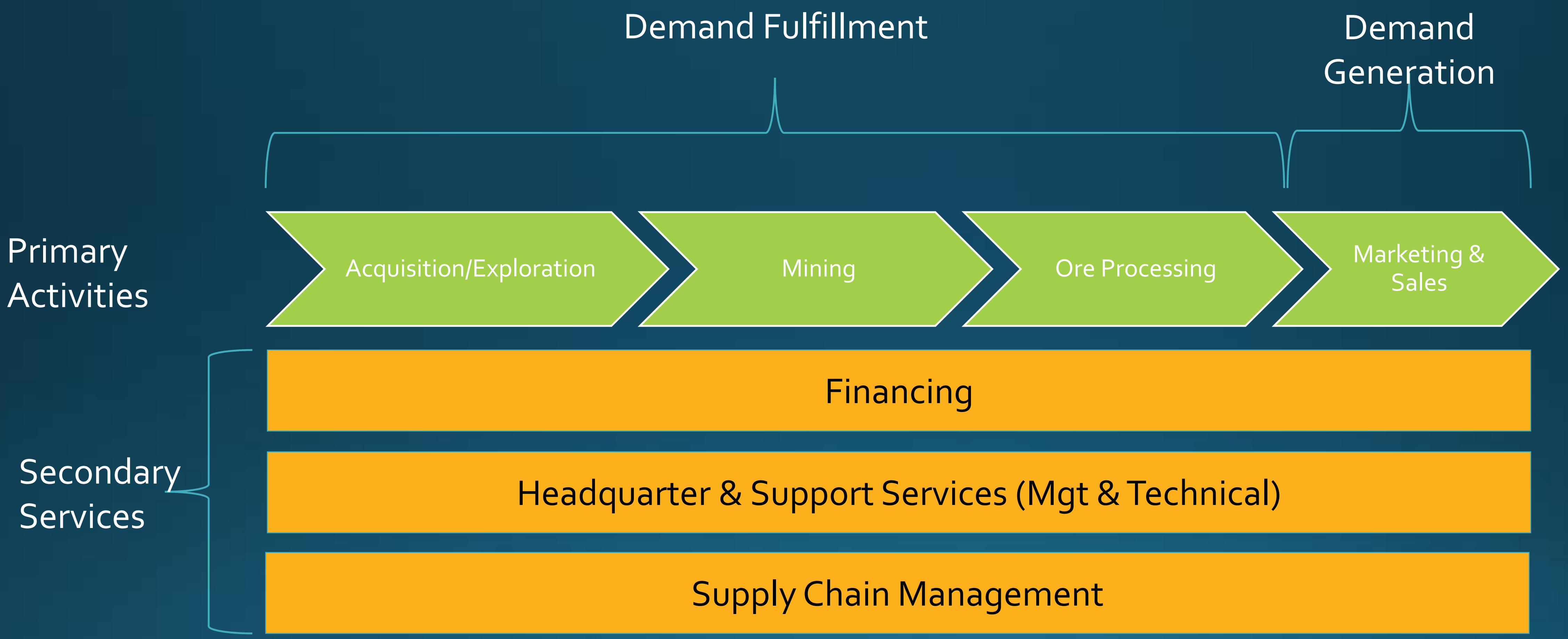
Comparable Uncontrolled Price Cost Plus Resale Price	Traditional transaction methods
Transactional Net Margin Method Profit Split	Transactional profit method

Where a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method. Moreover, where the comparable uncontrolled price method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred.

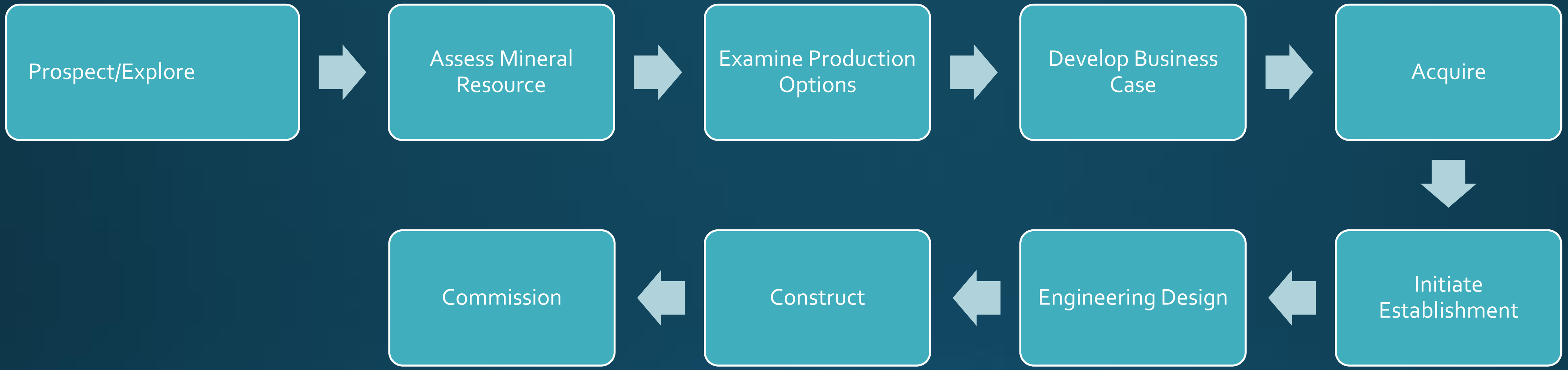
Source: OECD Transfer Pricing Guidelines 2010

Mining Industry Value Chain

Business Model



Acquisition/Exploration

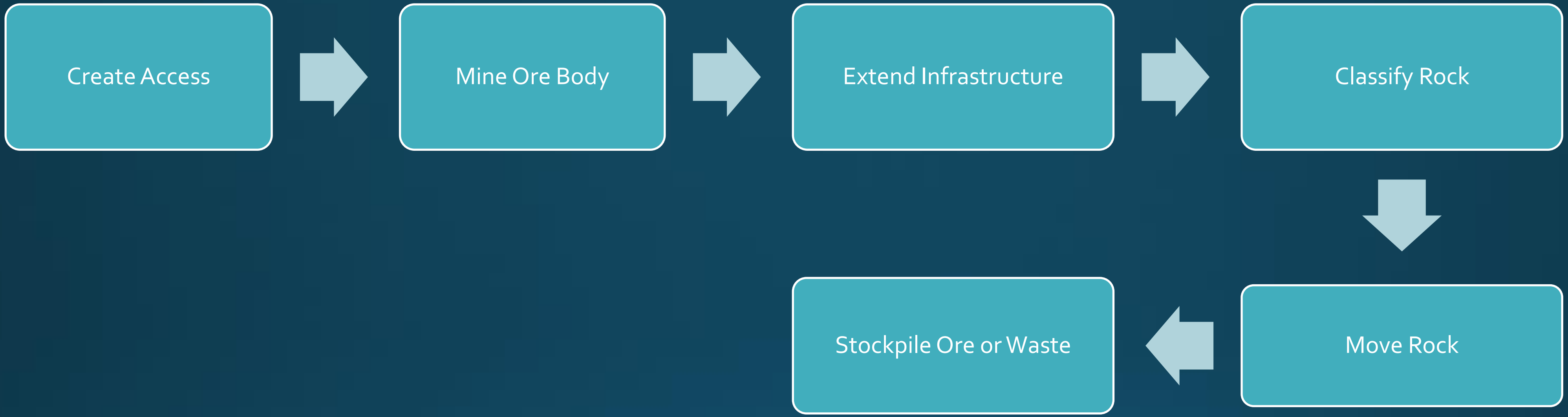


- This stage involves the exploration strategy and associated activities to find new or unknown mineral deposits.

- The process focuses on all the activities needed to access the ore body with the associated supporting engineering infrastructure.

Source: *Information retrieved from the August 2010 "Exploration and Mining Business Reference Model" created by the Exploration, Mining, Metals, and Mineral Vertical Group and modified to fit the purposes of this presentation.*

Mining

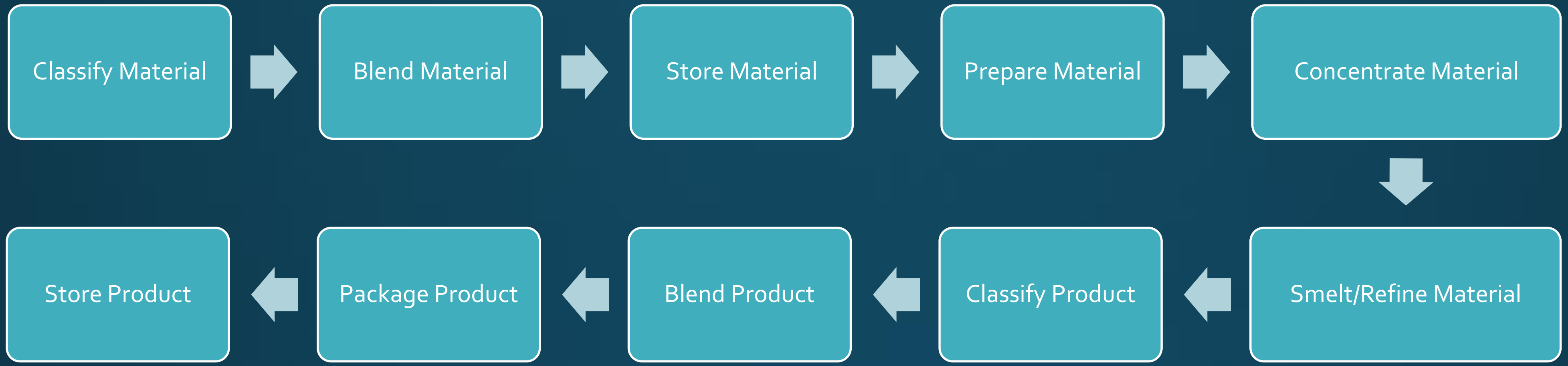


- For a given mine type, rock type, and mining type this process includes the breaking and removal of "rock". Rock is a generic term used to describe all types of mineral resources (e.g. coal, metal ores, limestone)

- The process also includes the transport of the broken rock and waste material from the working place to the plant and/or stockpile.

Source: *Information retrieved from the August 2010 "Exploration and Mining Business Reference Model" created by the Exploration, Mining, Metals, and Mineral Vertical Group and modified to fit the purposes of this presentation.*

Ore Processing



Ore Processing focuses on the following procedures:

- Regulating the physical properties of the desired product (e.g. size),
- Removing unwanted constituents, and
- Improving the quality, purity, or grade of the desired product

Source: *Information retrieved from the August 2010 "Exploration and Mining Business Reference Model" created by the Exploration, Mining, Metals, and Mineral Vertical Group and modified to fit the purposes of this presentation.*

Marketing & Sales

Engage Customer → Handle Order → Ship and Distribute → Process Financial Transaction → Support Product Marketing

- This stage focuses on dealing with customers in order to sell the product and attain revenue.
- The process also includes product marketing.

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Main Transfer Pricing Aspects

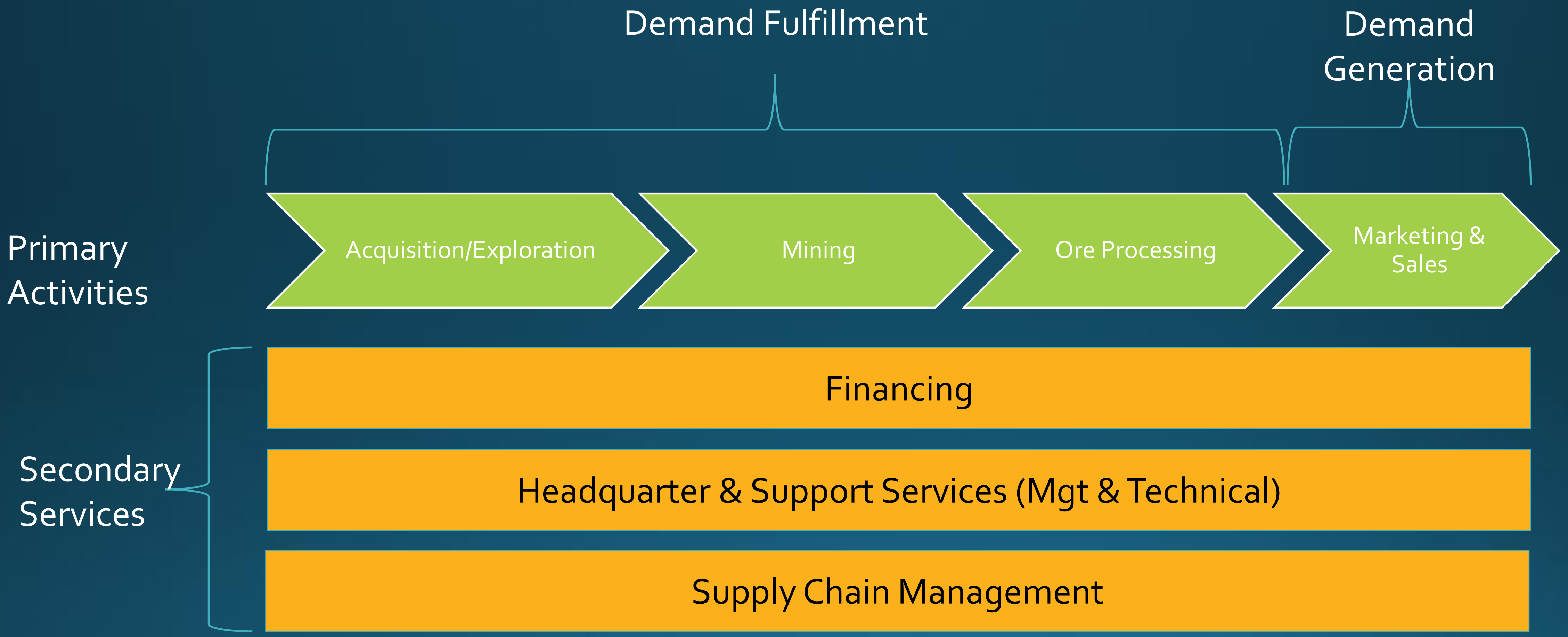
- **Exploration**
  - Funding the investment (and associated risk) and the rights to access any losses
  - Ownership and entitlement of profits from mining rights / licenses
  - Remuneration for use of centralized services, engineering expertise, people, and technology Examples include arm's length compensation of geological exploration studies, management services dealing with the feasibility of the project, R&D services, etc.
  - Ownership of exploration equipment and proper compensation for rental or leased equipment
  - Responsibility of insurance and associated liability risks – compensation and deduction of payments
- **Mining**
  - Financing and related arm's length payment of costs
  - Relationship with ore processing companies
  - Management and design of production infrastructure
  - Ownership of mining equipment and proper compensation for rental or leased equipment
  - Reward structure for design and manufacture of equipment, if any
  - Payment of royalties / leasing / service fees (people, technology, equipment)
  - Remuneration of support services
  - Attribution of liabilities, regulatory and environmental risks, insurances, and indemnities
  - Design and ownership of facilities and infrastructure
  - Investment in relation to the mine

Main Transfer Pricing Aspects

- **Ore Processing**
  - R&D and IP ownership in relation to smelting/refining processes and protocols etc.
  - Plant property and equipment – design, investment / funding, ownership, characterization, location
  - Characterization of processing activities (low-risk contract processor/smelter, fully fledged risk-bearing processor/smelter)
  - Remuneration of support services
  - Reward structure for supply chain management and logistics
  - Arm’s length compensation to bearer of environmental, regulatory, and insurance risks

- **Marketing & Sales**
  - **Characterization – fully fledged marketer, limited risk sales functions, commission agent**
  - **Margin on sale of final products**
  - **Remuneration of support services**
  - **Ownership of transportation assets and right to remuneration**
  - **Ownership of marketing intangibles**
  - **Allocation of profits from sale of final product**
  - **Arm’s length compensation for product liability risks, warranties, and associated risks**
  - **Reward structure for supply-demand management performed by Trade House**

Business Model



Inter Company Transactions | Marketing

- Minerals are publically traded commodities
  - London Metal Exchange
  - London Fix

- Government institutions have visibility of processes
  - Pouring & measuring of bullion
  - Shipping process
  - Repatriation of funds
  - Periodic reports to Government institutions
- Gold bars are uniquely numbered & in sequential order

Inter Company Transactions | Marketing

- There is however an exception when it comes to bulk minerals
  - Thy have unique and complex peculiar circumstances
    - No market price available at different stages (i.e. from mine mouth to final market price)

- In the case of aluminum, the major cost sensitivity is electrical power rather than bauxite costs and as can be seen from the table below, although fairly old, the mining and processing to being shippable is only 0.55% of the total cost of the finished product: 99.45% lies with the processes beyond the mine gate).

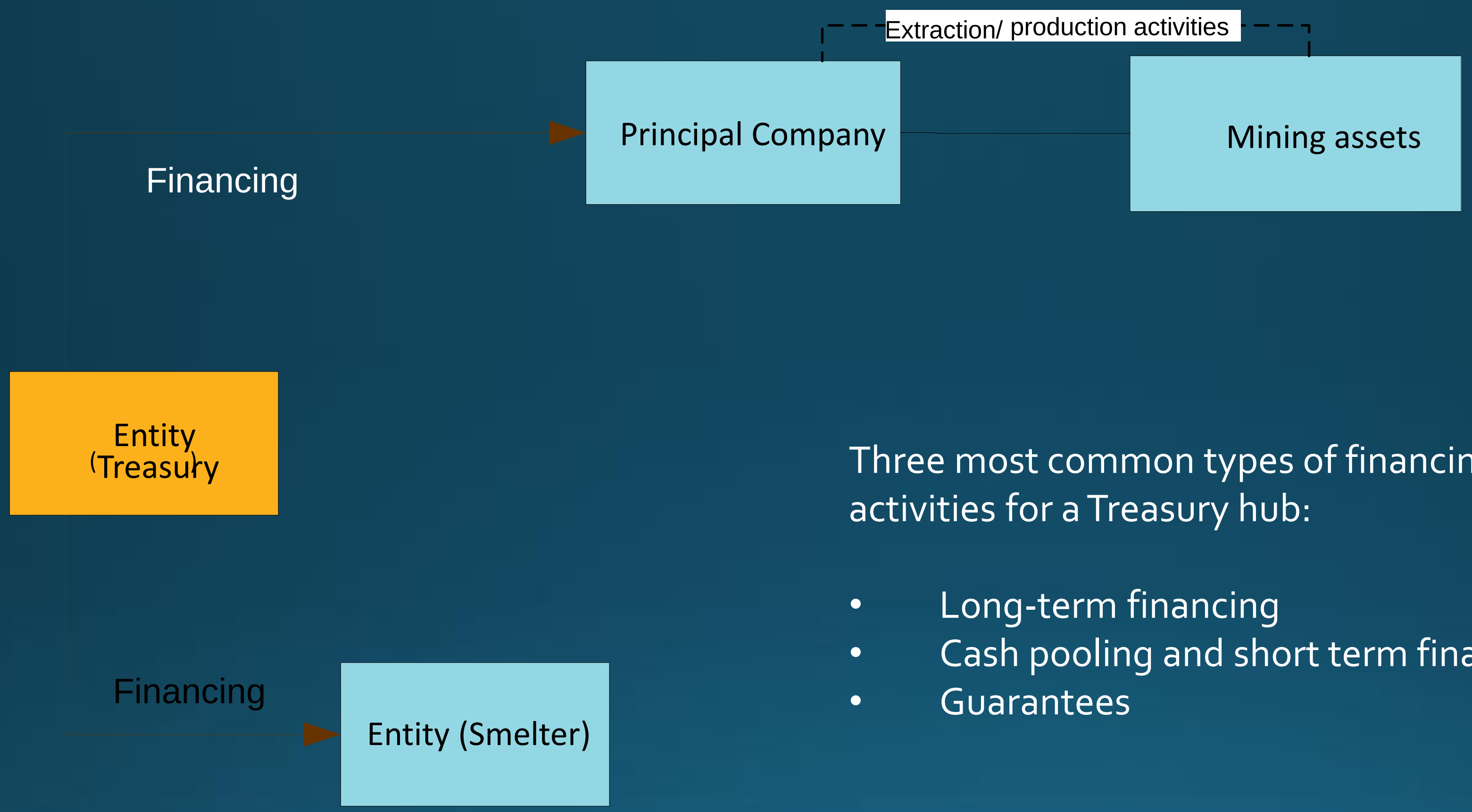
Michael Seager: How should the prices of bulk minerals be set for royalty purposes? An experiment with Bauxite

Inter Company Transactions | Marketing

	Process	Cost	Relative Cost
1	Mining & Drying of Bauxite	£1.93	0.55%
2	Benefaction of Bauxite to Alumina	£15.54	4.41%
3	Smelting	£99.05	28.13%
4	Semi fabrication	£235.60	66.91%

Source: Graham, R., The Aluminum Industry and the Third World – Multinational Corporations and Underdevelopment, P.79 (United Kingdom, London: Zed Press, 1982).

Inter Company Transactions | Financing (Treasury)

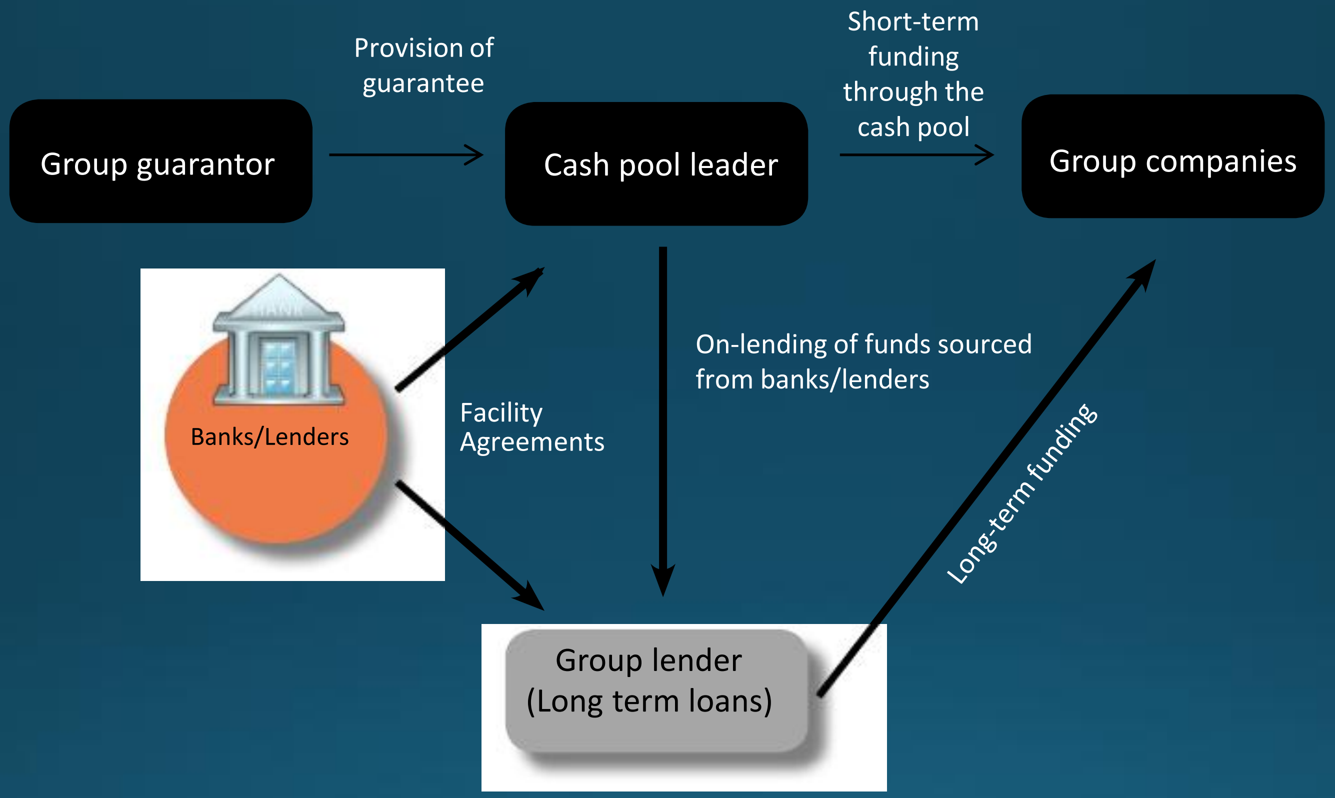


Three most common types of financing activities for a Treasury hub:

- Long-term financing
- Cash pooling and short term financing
- Guarantees

Inter Company Transactions | Financing (Treasury)

Through proper pricing of the following intercompany financial transactions



Shared Headquarter & Support Services (Mgt & Technical)

Sharedservicecentre

Shared service centre services:

- General management
- IT
- HR
- Legal
- Commercial Services
- Marketing
  Accounting & financial administration
- Treasury
- Technical

CHARGEABLE vs NON CHARGEABLE SERVICES

CHARGEABLE vs NON CHARGEABLE SERVICES

Service Rendered

Economic or commercial value

Benefit Test

OECD Guidance

Paragraph 18 of Practice Note 7 states as follows:

"Chapter VII of the OECD Guidelines deals specifically with intra-group services. The Commissioner considers the guidance provided in that chapter relevant and recommends that taxpayers follow the guidance in establishing arm's length conditions in international agreements with connected persons involving intra-group services

OECD GUIDANCE

The OECD Guidelines state that the first question in relation to intra-group services is whether intra-group services have in fact been provided. This is stated at paragraph 7.6 of the guidelines as follows:

- *"Determining whether intra-group services have been rendered under the arm's length principle, the question whether an intra-group service has been rendered when an activity is performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance its commercial position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service under the arm's length principle."*

- The OECD Guidelines refer to those activities as "shareholder activities". Paragraph 7.10 states that:

  "The following examples (which were described in the 1984 Report) will constitute shareholder activities, under the standard set forth in paragraph 7.6:
  b) Costs relating to reporting requirements of the parent company, including the consolidation of reports;"

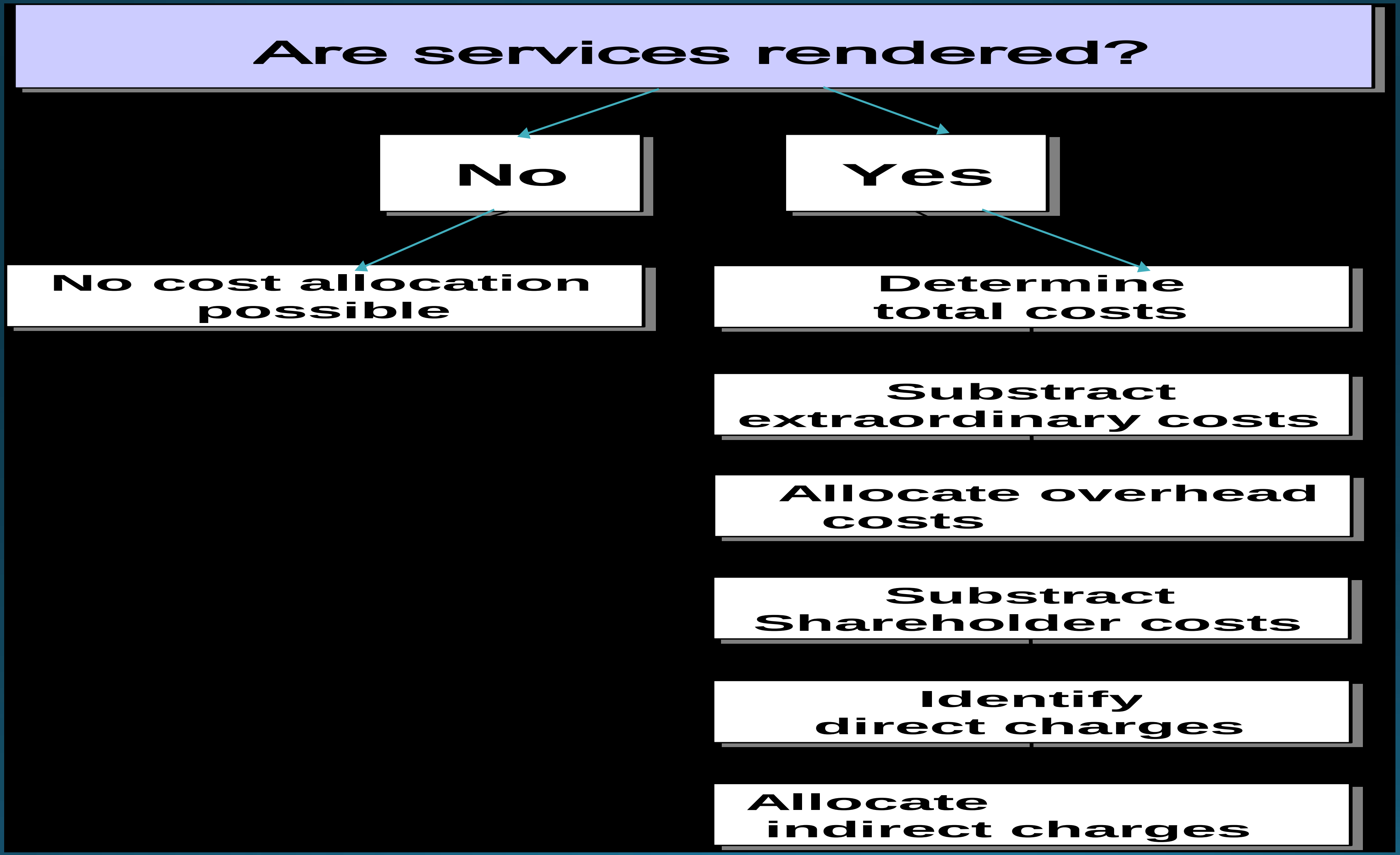
What is the most appropriate basis for allocating or charging out costs?

Shared Headquarter & Support Services (Mgt & Technical) – Cost Base Charges

- **Allocation criteria**:
  - Number of employees(FTEs)
  - Timesheets
  - Number of computers
  - Turnover
  - Invested funds
  - Cost allocation and charging budgeted versus actual costs
  - Etc.

What is the most appropriate allocation key?

Cost Allocation Process - Cost Base Charges



Challenges

- *Lack of data for comparable analysis*
- *How to select comparables*
- *The burden of keeping contemporaneous documents*
- *Determining the most appropriate range or mark up acceptable to all stakeholders*
- *Implementation of new Transfer pricing policies is becoming increasingly complex and resource-intensive*
- *Lack of harmonisation of international taxation and domestic tax laws could result in double taxation*
- *Lack of harmonisation of the TP legislation with existing special tax regimes, development agreements and tax incentives in developing nations*

Thank You

GHANA CHAMBER OF MINES