

Ensuring equitable
mineral tax
revenues is a critical
step toward better
development
outcomes

Potential is high...
so are citizens'
expectations,
leading to
pressure and
instability

The big picture of mineral tax administration

- Nearly 50 countries are estimated to derive 20-50% percent of revenues from minerals
- 81 resource driven countries hosting about 69% of extremely poor; 65% are low income, with over 20% fragile
- 80% of undiscovered oil and gas and 64% of solid minerals non-OECD
- 64% of the world's mining undiscovered resources in non-OECD



Growing mineral economies don't meet their potential due to lack of sufficient sector control capacities

Problem - Arbitrary changes to mineral laws, and resulting disputes and instability

- Unclear policies and regulations for mineral taxation
- Tax systems not in place to address oil, gas & mining
- Poor cooperation between finance and mining ministries.
- Insufficient mineral tax collection capacity.
- Negative public perception on equity of benefits



A mineral fiscal regime is only as effective as the combined administrative capacity of government institutions charged with enforcement.

Problem – Countries lose to corporate structure and tax avoidance practices

- Collecting mineral revenues is challenging
- Corporate functions, assets and risks spread across multiple related entities located in different jurisdictions
- Value-adding activities moving away from developing countries hosting projects
- Lack of adequate physical and financial controls lead to significant losses

Examples of LOSS:

Nigeria :\$10.9 bn in oil theft between 2009-2011. (EITI)

Africa: \$70bn on oil and \$50bn on mining between 2000-2009 on mispricing only. Mbeki IFF Report

Examples of GAINS:

Gains of technical assistance with tax components

PNG: \$2m recovered \$30m in an audit.

South Sudan: \$500k recovered \$15m in an assessment



Many countries mostly collect what companies are willing to pay, losing significant domestic revenues.

WBG response: Mineral revenue work 2010-2017

- A series of research in collaboration with IMF, AUSAID, GIZ, SARS, etc
- Six regional workshops in Africa and Latin America exposed some 300 representatives of ministries of finances, mines, oil and gas, private sector and CSO from some 40 countries.
- Publications
 - How to Improve Mining Tax Administration and Collection Frameworks (2013)
 - Administering Fiscal Regimes for Extractive Industries (with the IMF in 2014.)
 - A briefing note to the G20 - Transfer pricing in mining: an African perspective (2014)
 - [Transfer pricing in mining with a focus on Africa](#) (2017)



WBG has the tools but we need to enhance capacity to support clients.

Key Drivers of Compliant Mining Tax Collection

- Policies : Administration must be built on strong policy and legislation that are well thought, defined, flexible, and largely aligned with existing skills
 - Policies and objectives understood by all relevant agencies and industry
 - Legislation consistent with current government policy objectives
 - Unambiguous powers to tax, establish regulations and collect information
 - Clear definitions and procedures in regulations (subsidiary legislation)
 - Clear rules and definitions for each of the payment types. Valuation basis, deductibles, etc.
 - Supporting documentation to be kept or supplied by taxpayers and to whom
 - How information is used for identifying and ranking risks and reconciling returns
 - Minimal need for ministerial or agency discretionary decisions
 - Equitable dispute resolution processes

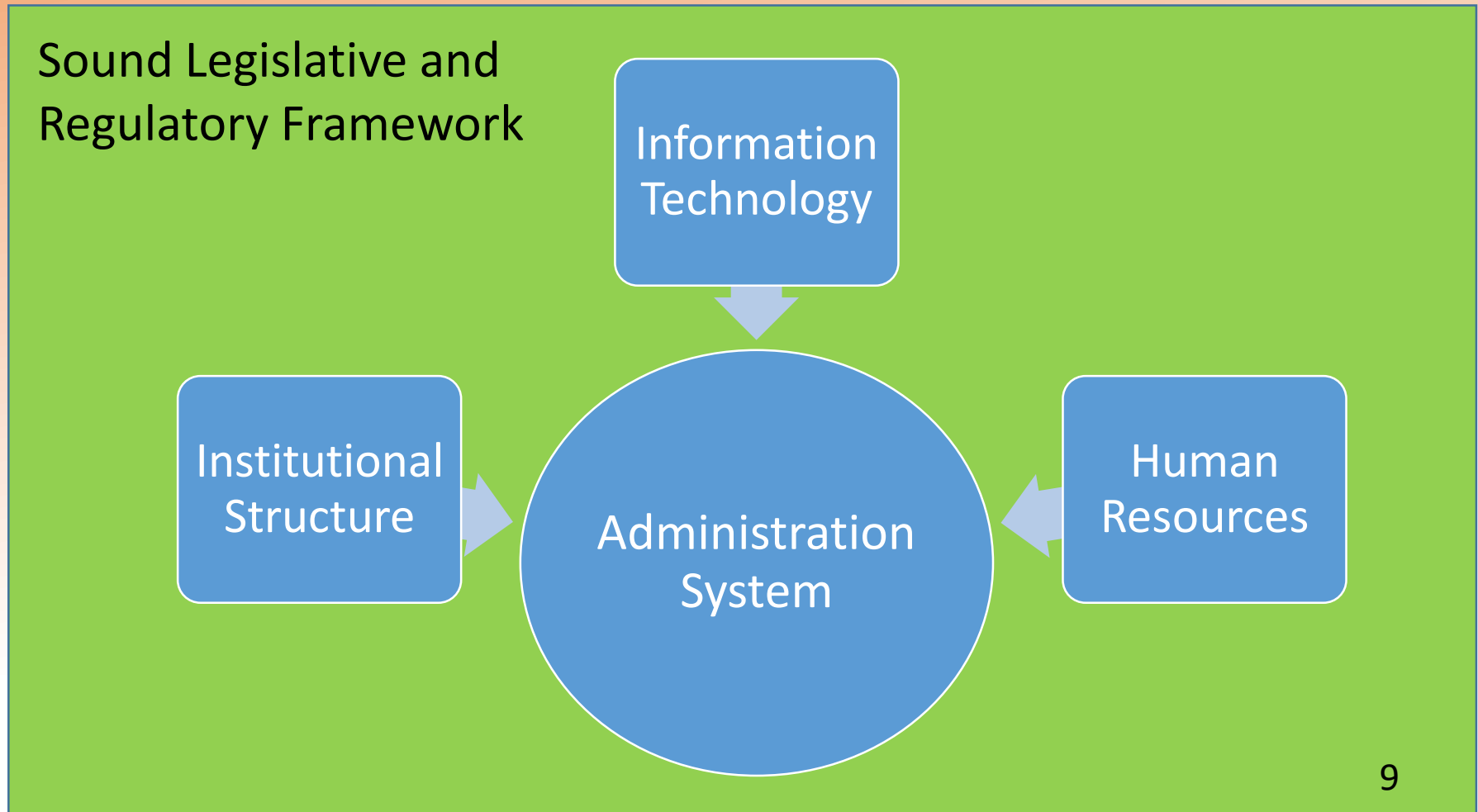
Key Drivers of Compliant Mining Tax Collection

- Systems and processes that cater to the specifics of mining, oil and gas.
 - Industry and companies risks profiling
 - Size and type: Big, small, listed, non listed; local international
 - Type of commodities: Bauxite or gold; iron ore or coal; gas or oil
 - Physicals controls. Who measures? What transport mechanisms are in place
 - Financials controls.
 - Audit: frequency and target based on risks and potential value of
 - Risks of related party transactions. Specific rules and systems in place for monitoring
 - Information systems and reporting
 - Integrated Tax Administration System (ITAS)
 - Embedded risks evaluation parameters?
 - E-budget/EITI
 - Compliance and penalties (if/as required)
 - Revenue forecasting

Key Drivers of Compliant Mining Tax Collection

- It is important for governments to promote further institutional cooperation and coordination between the ministries of finance and mining.
 - There is a need for more information sharing to improve the tax collection administration.
 - A range of institutional arrangements may be suitable for that: from intelligence units, to task forces, or the establishment of cultures of periodical multidepartment meetings including together with private companies to discuss and agree on tax administration related issues.
- It is also important to build technical capacity in extractive industries financing and accounting so that people working in these areas can better understand the information, forecast budgets, and assess whether the policies are delivering on the goals set.
 - It is important when necessary and as capacities are strengthening to look for external capabilities when required.

Three components to an effective administration system



International tax planning is a multi-faceted problem

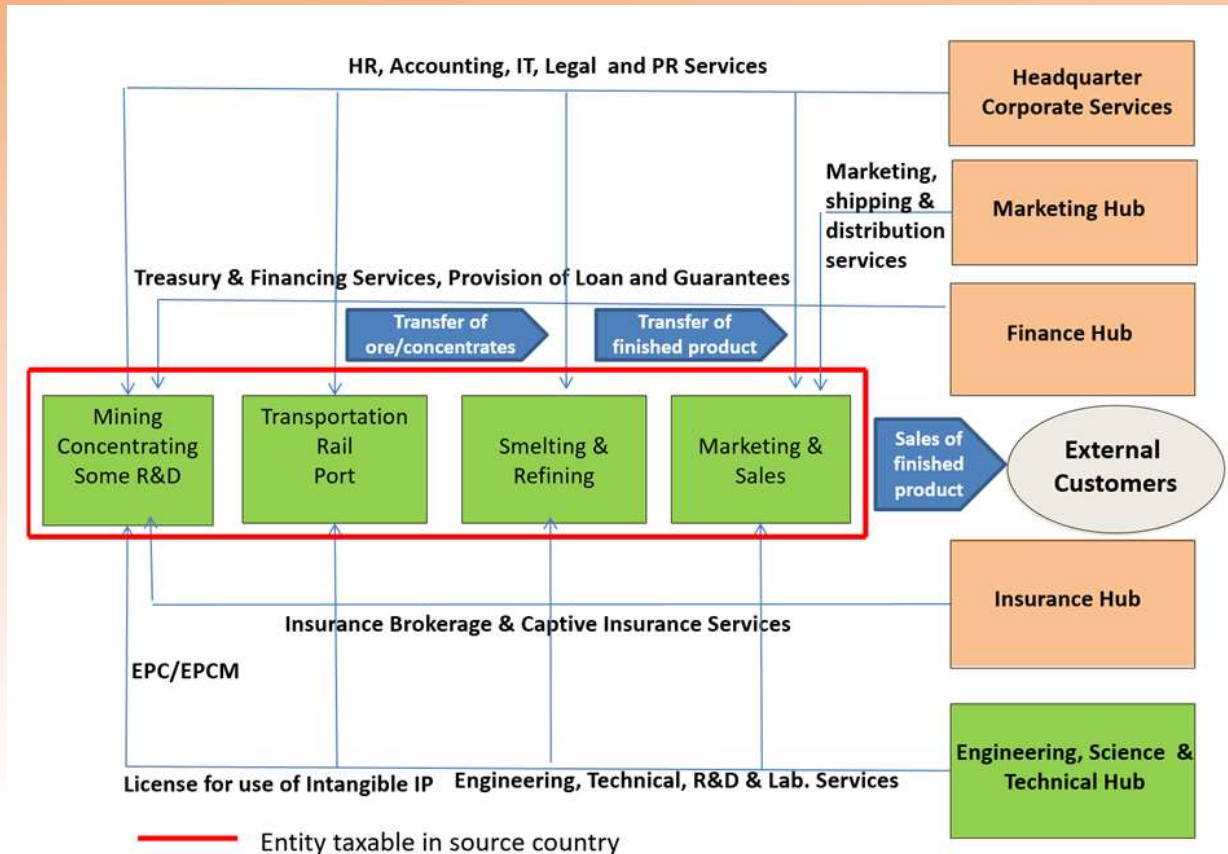
Transfer pricing is just one aspect of international tax planning arrangements that can include using particular country mismatches:

- Thin capitalization (Debt shifting)
- Withholding taxes for dividends, interest and royalties paid to non-residents
- Controlled foreign corporations (CFC) rules
- Double tax agreements (DTAs)
- MNE restructuring

What is a transfer price?

- The price paid for the transfer of goods or services between related parties
 - When done right it does not necessarily have tax consequences
- Misuse of transfer prices can result in profits being shifted from one related entity to another having tax consequences
 - If not correctly set transfer pricing may also be called transfer 'mispricing'.
- The internationally accepted benchmark for transfer prices is the **'arm's length principle' (ALP)**.
 - ALP refers to transactions in which the buyers and sellers of a product act independently and have no relationship to each other.

Fully Vertically Integrated Mining Operation and Potential Relationships with Related Service Providers



Simplified financials for a fully vertically integrated zinc miner

CASE 1 - FULLY VERTICALLY INTEGRATED MINING/SMELTING/REFINING COMPANY	Mining/smelter/refining and Marketing Co. High-tax (35%) jurisdiction			Consolidated Tax Effect
Market Sale of Refined Zinc	1295			
Mining and Concentration Cost	302			
Smelting and Refining Cost	188			
Marketing Cost	43			
Profit before Tax	763			763
Tax	267			267
After-tax Profit	496			496

Effects of restructuring and fragmentation of the value adding chain

CASE 2 - GEOGRAPHICALLY DIVERSIFIED	Mining/concentrating Subsidiary High-tax (35%) jurisdiction	Smelting/refining Subsidiary Low-tax (5%) jurisdiction	Marketing Subsidiary Low-tax (5%) jurisdiction	Consolidated Tax Effect
ARM'S LENGTH TRANSACTIONS				
Market Sale of Refined Zinc		1295		
Arm's Length Transfer of Zn Concentrate	755	755		
Marketing transfer pricing revenue			72	
Mining and Concentration Cost	302			
Smelting and Refining Cost		188		
Marketing Cost	26	45	43	
Profit before Tax	428	306	29	763
Tax	150	15	1	166
After-tax Profit	278	291	27	596
PROFIT SHIFTED FROM SOURCE COUNTRY THROUGH RE-STRUCTURING				335
TAX REDUCTION DUE TO SOURCE COUNTRY THROUGH RE-STRUCTURING				117

Effects of mispricing on a fragmented entity

CASE 3 - GEOGRAPHICALLY DIVERSIFIED	Mining/concentrating Subsidiary High-tax (35%) jurisdiction	Smelting/refining Subsidiary Low-tax (5%) jurisdiction	Marketing Subsidiary Low-tax (5%) jurisdiction	Consolidated Tax Effect
10% MISPRICED TRANSACTIONS				
Market Sale of Refined Zinc		1295		
Mispriced (-10%) Transfer of Zn Concentrate	680	680		
Marketing transfer pricing revenue			76.0	
Mining and Concentration Cost	302			
Smelting and Refining Cost		188		
Mispriced (+10%) Marketing Cost	26.2	50	43	
Profit before Tax	352	377	33.0	763
Tax	123	19	1.7	144
After-tax Profit	229	358	31	619
TAX AVOIDED THROUGH MISPRICING				22.6

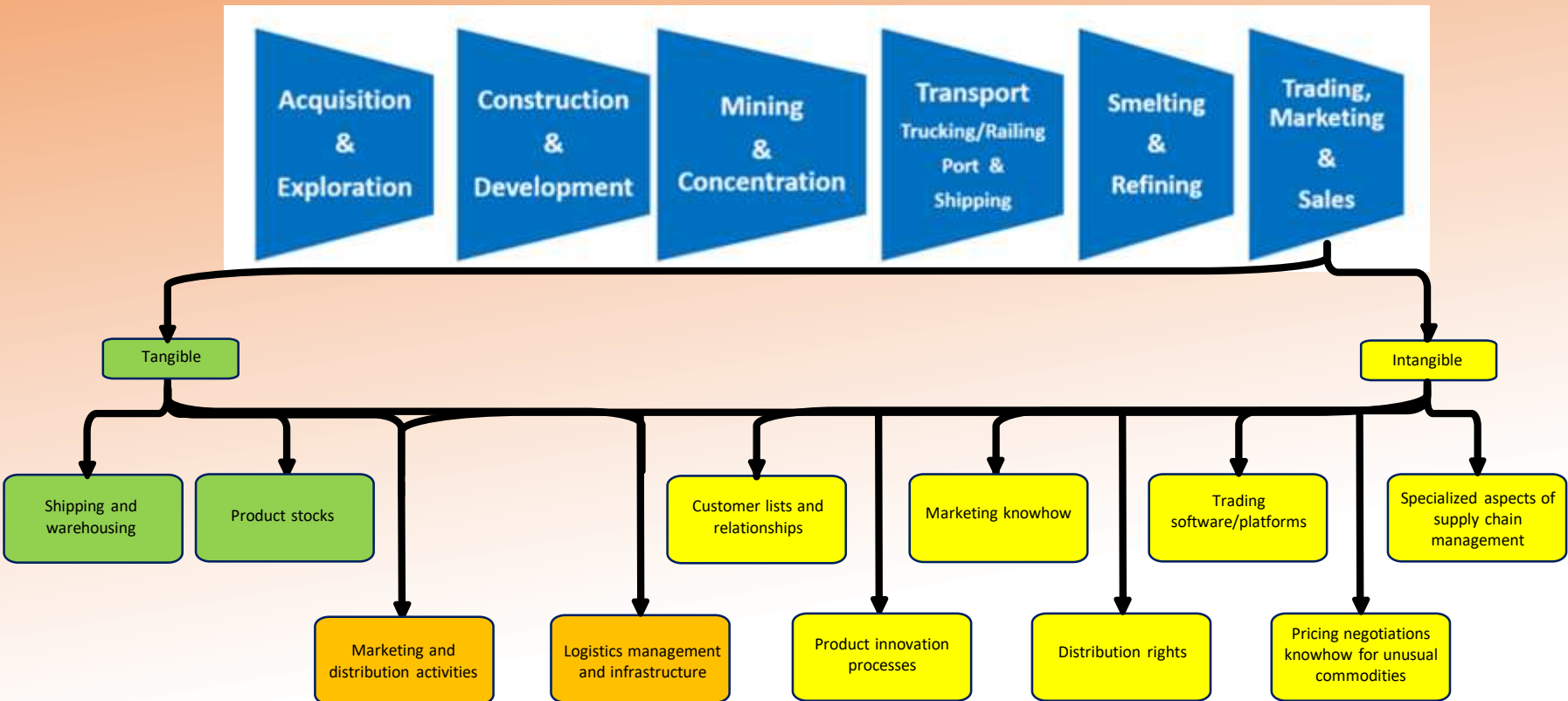
Understanding MNE's drive to optimize their effective tax rates

- Effective tax rates (ETR) are a measure of the level of taxes paid by global groups with respect to their income earned:

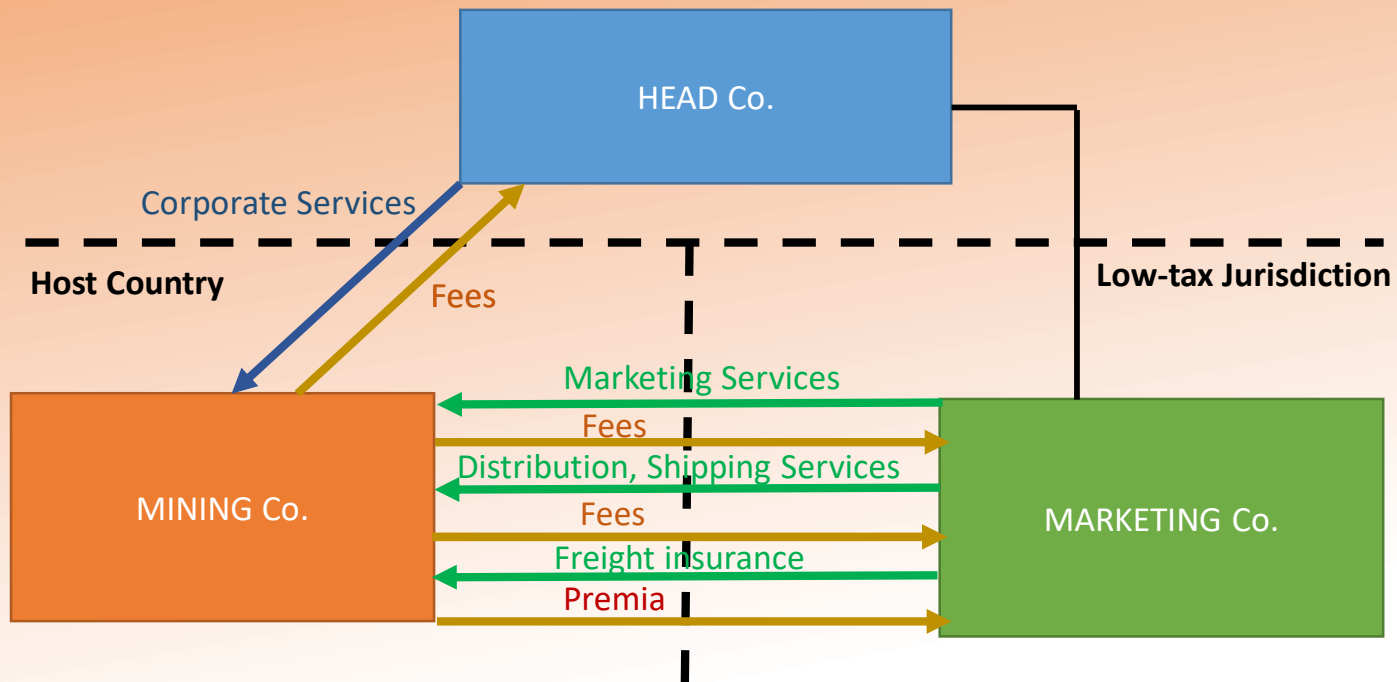
$$ETR = \frac{\textit{Global tax burden}}{\textit{Global profits}}$$

- MNEs attempt to minimize their ETR through tax planning

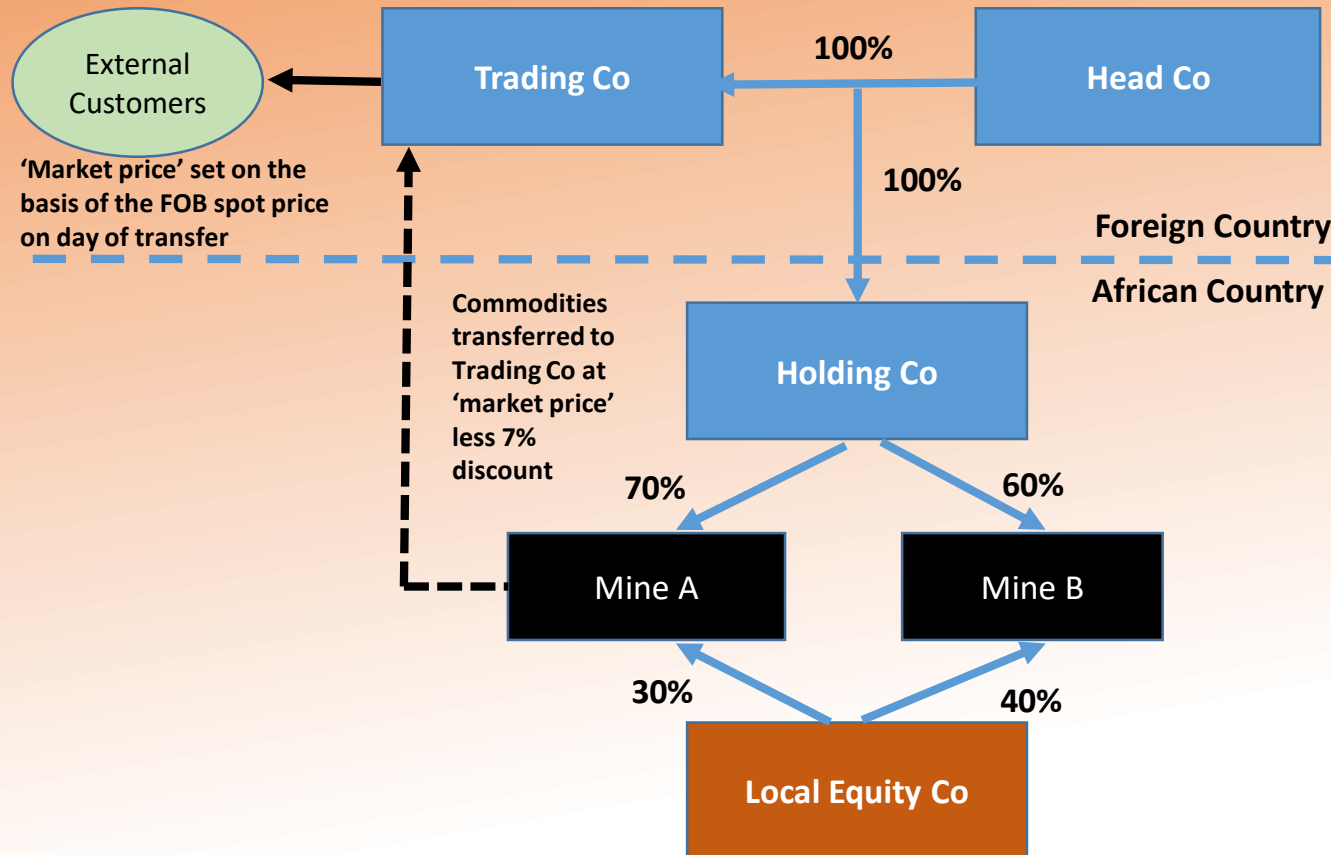
Assets Utilized – Trading, Marketing and Sales



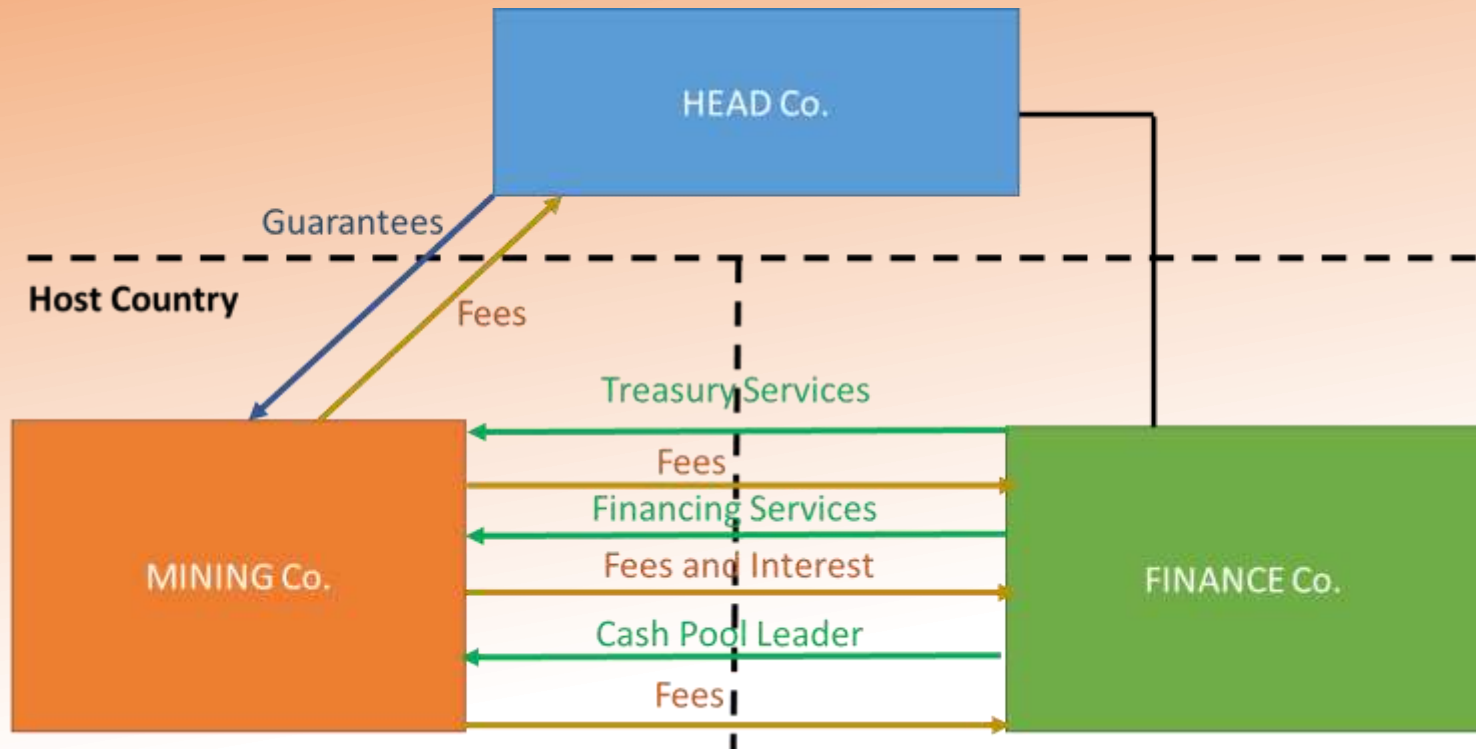
Illustrative Marketing Hub Structure

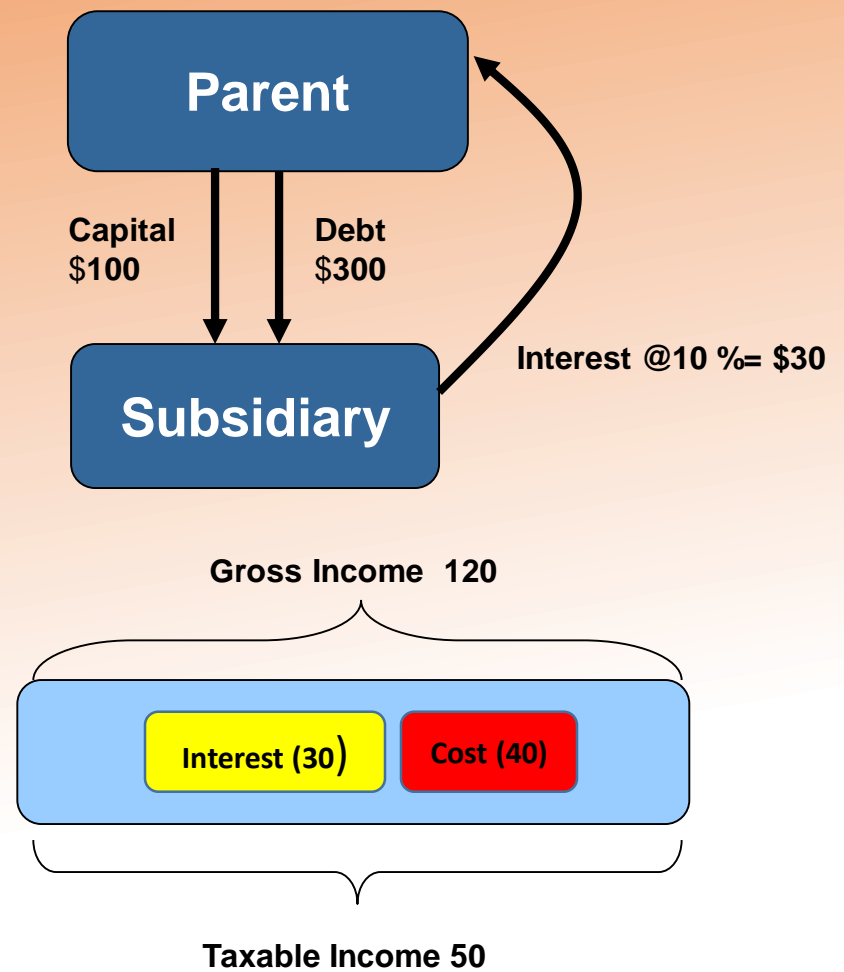
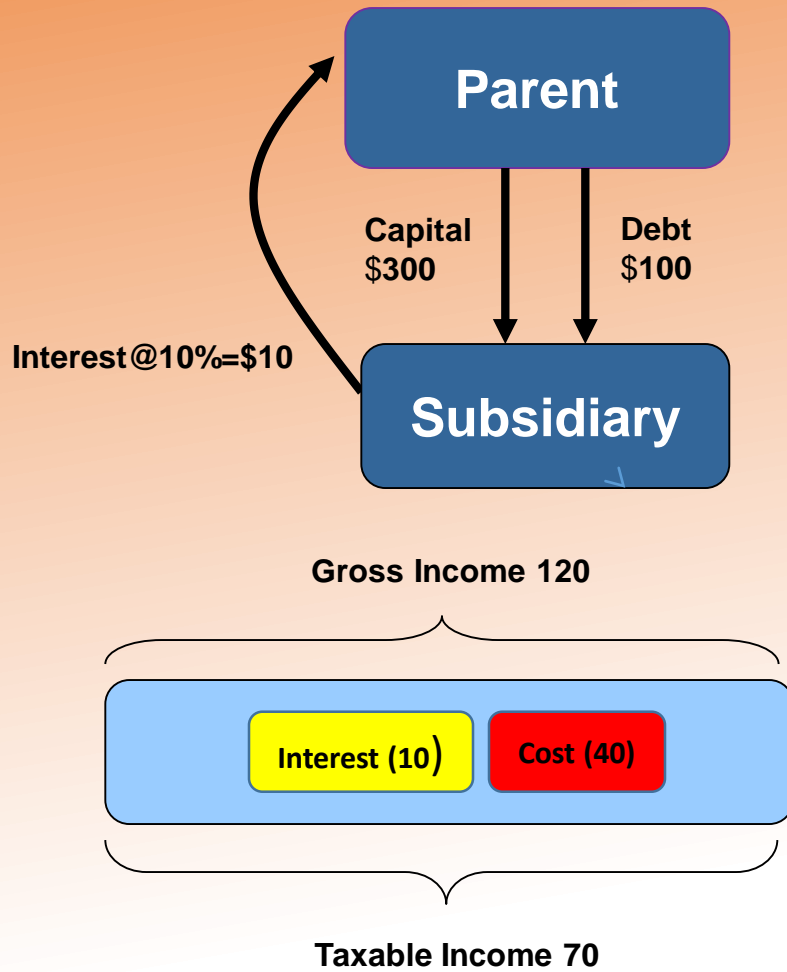


PGM Example



Illustrative Finance Hub Structure





Potential Sources of Information

Local Mining Taxpayer

Filed with the Tax Authority:

- Copy of Transfer Pricing Policy;
- Annual tax return and financial statement;
- Local employee;

Filed with Ministry/ Dept. of Mines and other govt. agencies:

- Agreements with related parties (e.g. financing, shipping);
- Quarterly production reports;
- Royalty returns;
- Industry analysis;
- Mining tenements;
- Customs documentation.

Publically Available Information

- MNE's annual reports;
- Wall Street Journal (Publishes daily spot price for gold based on PM London fix);
- World Bank "Pink Sheets" (monthly average gold prices);
- London Metals Exchange (spot prices).

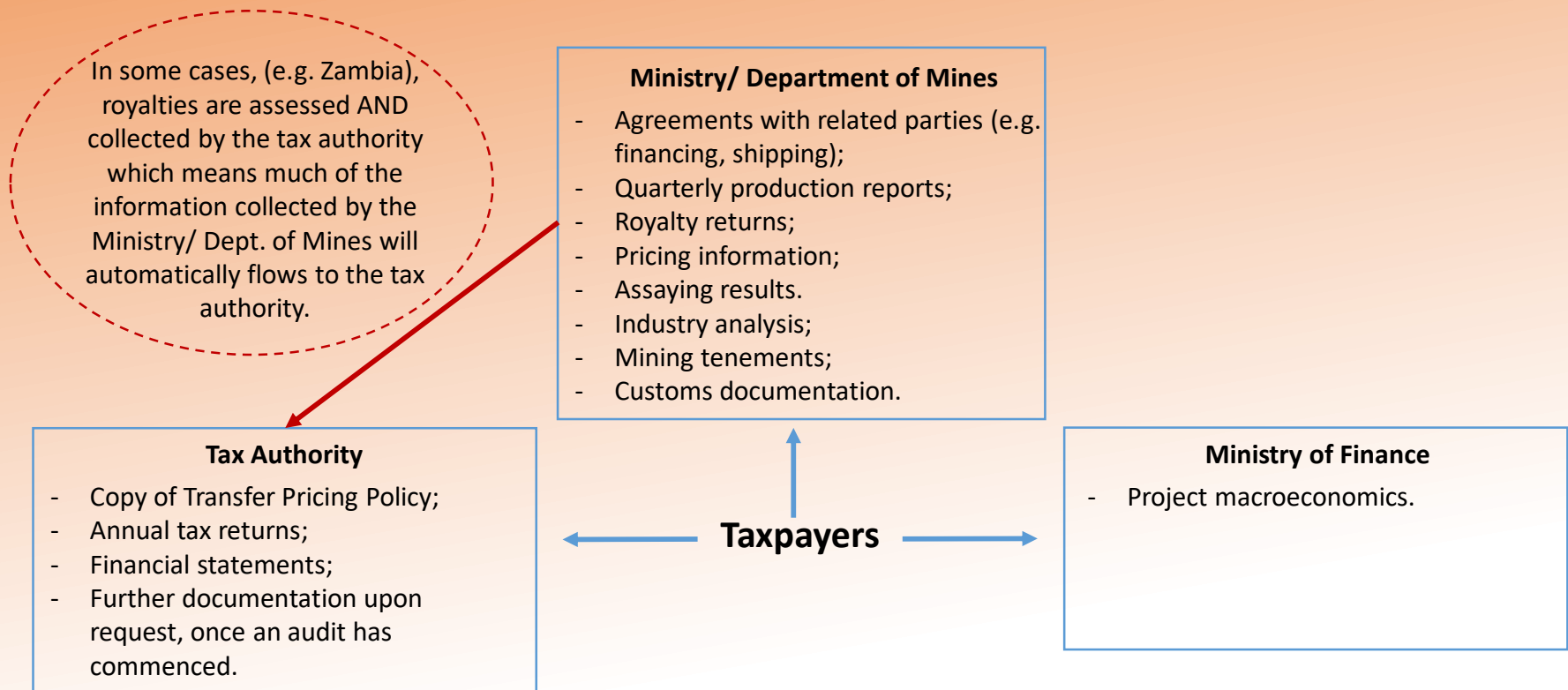
Foreign Related Parties

- Statutory Annual Financial Statements;
- Tax returns;
- Annual reports;
- Company registration documents;
- Board minutes (most likely the parent company);
- Employee + travel information;
- Details of business re-structurings;
- Agreements with end customers (e.g. sale agreements)
- Benchmarking studies.

Commercial Databases (usually subscription based)

- Transfer pricing data (e.g. Bureau Van Dijk, Thomson Reuters, RoyaltyStat LLC);
- Mineral product pricing information (e.g. Platts, London Metals Exchange, Kitco);
- Mine cost information (e.g. Infomine, World Mine Cost Data Exchange).

1. Which Government Agencies Collect What Information from Local Mining Taxpayers



List of Information Required for Transfer Pricing Risk Audit Within the Mining Sector

- Copy of the formal Transfer Pricing Policy Document setting out all related-company transactions;
- Details of any business restructurings;
- Tax Returns of both local and international related parties;
- Statutory Annual Financial Statements of the foreign related parties to the inter-company transactions;
- MNE's Annual Report and of individual related parties dealing with the mining subsidiary;
- Segmented financial information where the related party is involved in distributing various' suppliers' products;
- Company Registration Documents for each of the related parties;

See Appendix C.5 –Transfer Pricing in Mining With a Focus on Africa: A Reference Guide for Practitioners

List of Information Required for Transfer Pricing Risk Audit Within the Mining Sector

- Agreements between the related parties in the supply chain as well as between related parties and end customers (e.g. Sale and Purchase Agreement);
- Payments (E.g. Letters of Credit);
- Industry Analysis (e.g. use of mineral);
- Board minutes regarding related party dealings;
- Employee Information pertaining to each related party within the supply chain (e.g. number of employees);
- Travel Information pertaining to each related party within the supply chain (e.g. travel schedules);

See Appendix C.5 –Transfer Pricing in Mining With a Focus on Africa: A Reference Guide for Practitioners

List of Information Required for Transfer Pricing Risk Audit Within the Mining Sector

- Pricing Information;
- Insurance Agreements;
- Shipping/ Transport Agreements (e.g. shipping service agreement);
- Customs Documentation (e.g. Bill of Lading);
- Financing information (e.g. Loan agreements);
- Benchmarking Studies performed by taxpayer;
- Perform own benchmarking study.

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2. International Mechanisms to Collect Information on Related Parties, from the Relevant Foreign Tax Authorities

Accessing information directly from foreign related parties is difficult. However, it may be possible to access some information from the foreign tax jurisdictions where related parties are registered through a number of mechanisms:

1. Double Taxation Agreements (DTAs)
2. Tax Information Exchange Agreements (TIEA)
3. OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters
4. Engaging a law or accounting firm in the relevant foreign tax jurisdiction to search and/or obtain information available.

Sources of Information Specific to Mining Costs

Sources of cost information in order of least reliable to most reliable



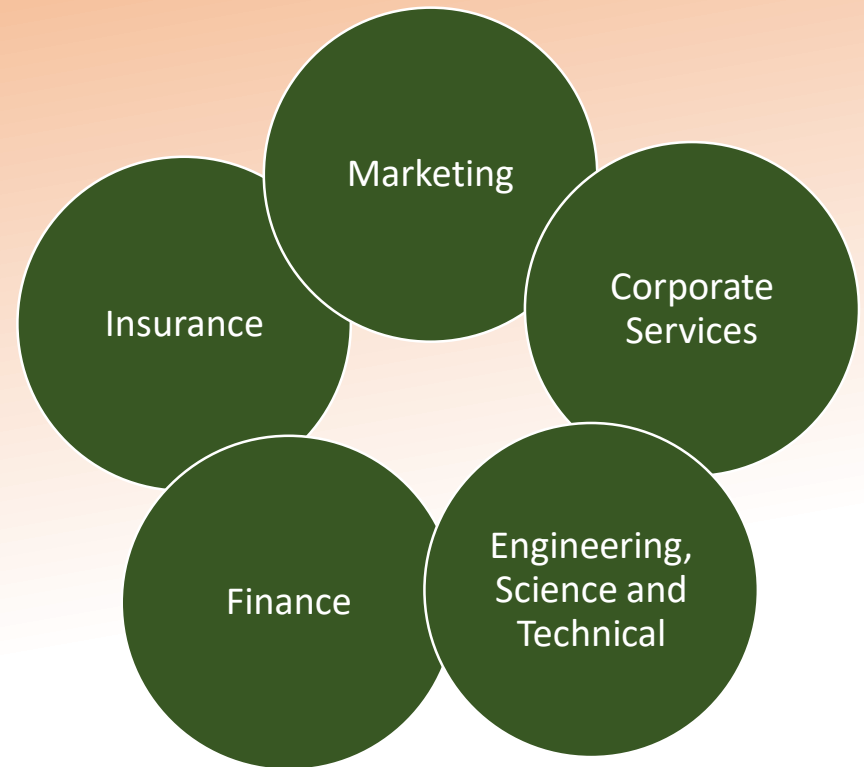
Sources of Information Specific to Mining Costs

Industry reports

- Brook-Hunt Associates: <http://www.brookhunt.com/>
- CRU International: <http://crugroup.com>
- Shipping:
 - Tex Report (iron ore shipping information)
 - Platts Coal Trader International (bulk freight rates)
 - Baltic Exchange (bulk freight rates)

Skills required to address transfer pricing depend on relevant hubs

- Due to scarce resources, tax administrations in Africa may wish to focus on the skills associated with the Hub which they are dealing with



Development/training of personnel

- In general training needs to provide a thorough grounding in
 - Resource industry operations and accounting
 - National resource tax legislation and the issues it presents
 - Audit powers and techniques
 - Use of available IT
- Officers also need to understand the drivers of value in the mining industry so as to match company expertise, which requires knowledge of
 - Mining, finance and the relevant mining tax legislation
- A well-structured training program will establish a culture of excellence, and place senior officers in a position where they can offer guidance to less experienced colleagues

Thank you