

# Inputs from UN Extractive Industry Taxation Subcommittee to the UN Transfer Pricing Subcommittee

Transfer Pricing Issues in Extractive Industry

JUDr. Tomas Balco, LL.M., FCCA

*Comments received from Susana Bokopo, Alvaro  
De Juan (Repsol) and Jolanda Schenk (Shell)*



MINISTRY OF FINANCE  
OF THE SLOVAK REPUBLIC

# Objective

- Reflection on the discussions from the Subcommittee on Taxation of Extractive Industry on transfer pricing issues in this sector
  - Specific issues
  - Specific concerns
  - Specific practices
    - Reasons of Existence of Subcommittee for Extractive Industry – Chaired by Eric Mensah
- Consider the next steps forward...

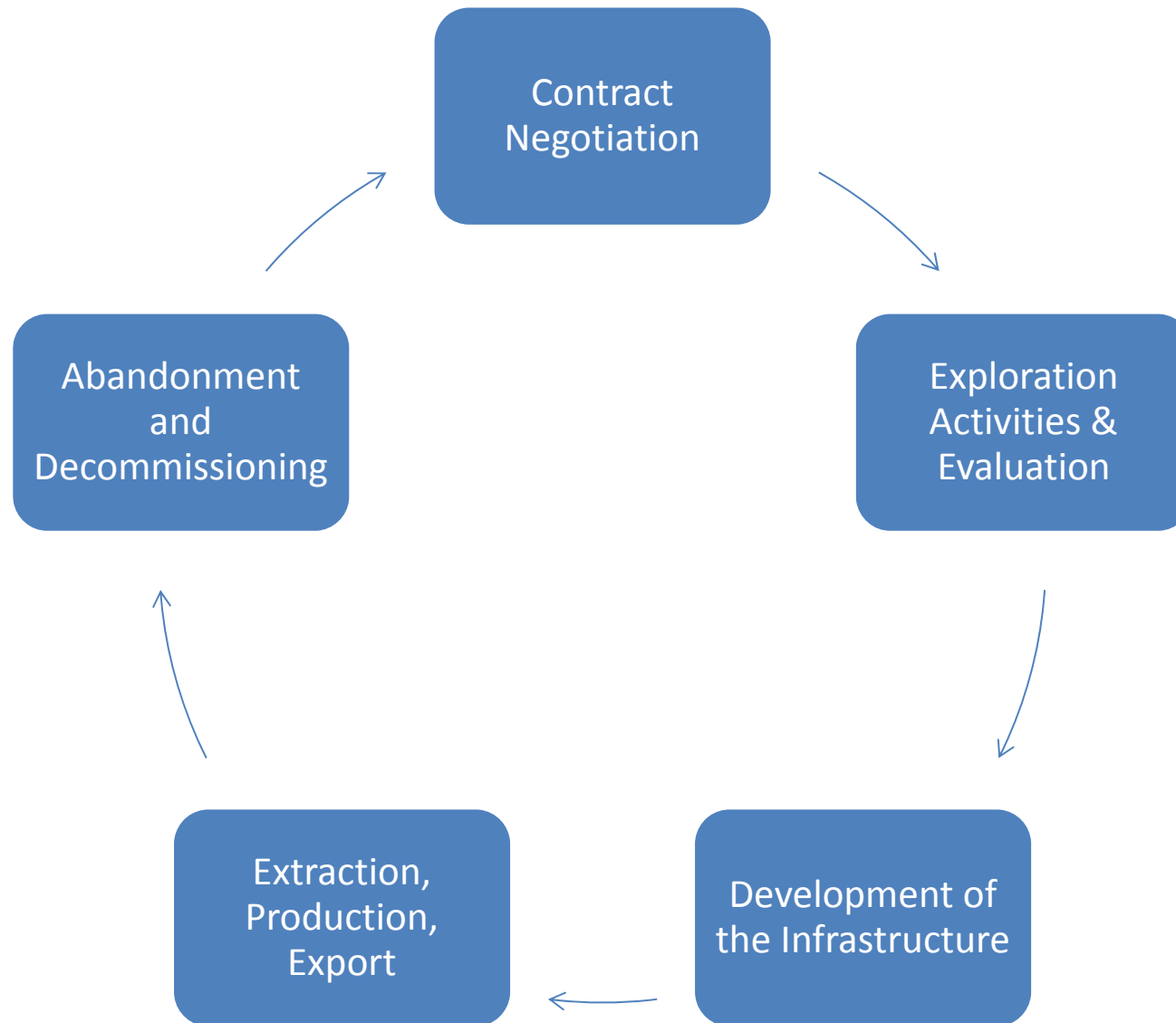
# Specifics of the Industry

- Critical to economies of many developing countries – Domestic Resource Mobilization
- Long project life – see next slide on life-cycle
- Different players and actors
  - Large MNE's – subject to scrutiny, disclosures and reporting – stock-exchange and other
  - Local and regional players – lack of regulatory oversight – aggressive tax planning, abuse
- JV investment arrangements – see next slide

# Specific JV issues

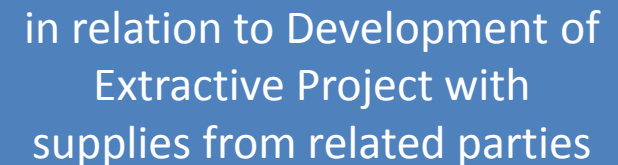
- Large projects – pooling assets and funding from independent players – consortia – element of internal checks and controls
  - Due to inherent conflict of interest – degree of arm’s length scrutiny
- Cash-calls – no profit / no loss principle – no mark up?
  - Why not mark-up?
    - Agreement among partners - standard in the industry
    - Issues? – some countries may not accept → double taxation
- Issues of cost allocations
  - timesheets
  - confidentiality (competitors concerns with sensitive data)
  - Specific allocation keys
    - Due to specifics of the industry – e.g.:
      - drilling rigs – number of days
      - Timesheets
      - Capital expenditure

# Lifecycle of Extractive Industry Project



# Issues Experienced

- Transfer Pricing Issues
  - Exploration stage
    - Purchase of services from related parties
    - Financing arrangements – is loan reasonable?
  - Development stage
    - Purchases of
      - Materials,
      - Equipment and
      - Technical and other Services
    - Financing Arrangements
      - Loans for development and construction



in relation to Development of  
Extractive Project with  
supplies from related parties

# Issues experienced - continued

- Transfer Pricing issues
  - Extraction Stage
    - Sales of natural resources during the extraction stage to related parties:
      - Domestically – processing – motivation – different tax regime or tax incentive – lower tax burden
      - Internationally – export – motivation – store, process and refine abroad – lower tax burden
    - Financial arrangements – Use of Derivative instruments
      - Forward contracts between related parties on purchase of the natural resource or using back to back arrangements via intermediary

# Sale of Shares

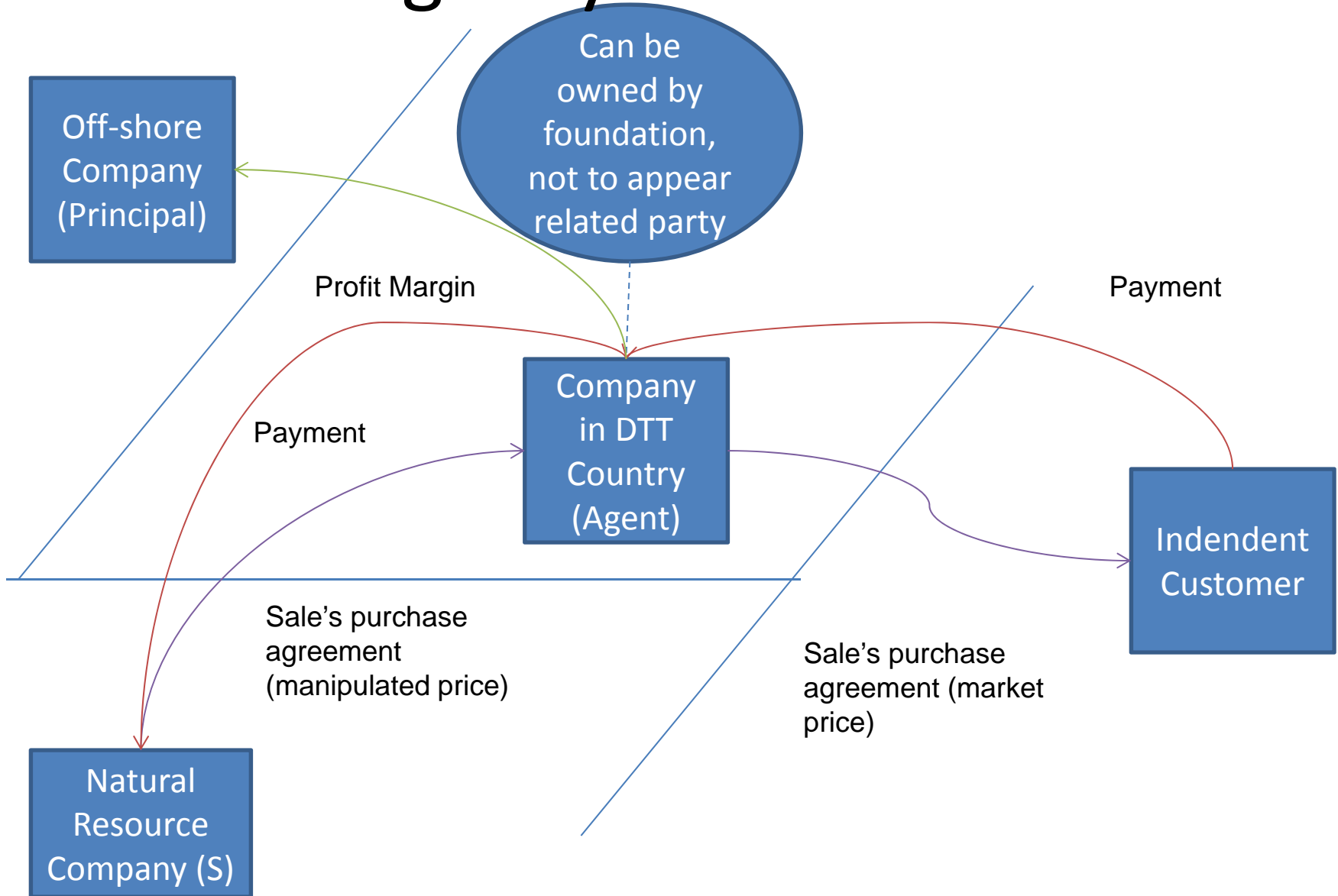
- Sale of Shares and Transfer Pricing?
  - Sometimes countries limit the scope of TP rules or administrative focus on the transactions with goods and services
- Sale of shares between related parties
  - Motivation?
    - Transfer the shareholding to a jurisdiction with “suitable” tax treaty that takes away taxing rights from country of source
      - Sale for market price from the “suitable jurisdiction”
    - Utilize accumulated losses of related party and realize capital gains in the hands of the related party



# Deactivation of Transfer Pricing Rules

- Using the Agency Structures
  - Using the Services of Independent intermediaries
  - Transactions primarily not between related parties
    - Deactivation of the TP rules

# Agency Structure



# Solutions?

- Developing countries develop their specific approaches to deal with these challenges
  - Ring-fencing
  - Use of quoted prices (6<sup>th</sup> method)
  - Application of TP rules to all
    - Both related and unrelated parties

# 6<sup>th</sup> Method

- Developing Countries
  - Latin America (Argentina, Peru, Brazil, Equator,...)
  - Asia & Africa follow (KZ, South Africa, India)
- Debate
  - Is it a 6<sup>th</sup> Method?
  - Is it a variation of CUP?
- What and how?
  - “Home grown” approach of Developing countries to deal with TP complexities and challenges?
  - Reference to quoted prices on the day of shipment
    - Adjustments or not?
      - Volume, quality, transportation costs, other factors?
  - Notable practice of Norway – Norm Price – Administratively set Arm’s length price to all transactions (related and unrelated)

# Documentation and Disclosures

- Special disclosure rules
  - Dodd-Frank Act – Project by project disclosures
  - Country by Country Reporting

# Next Steps

- What can be the response of UN Committee of Experts?
  - Important topic and deserves attention?
    - If yes...
  - Which Subcommittee to take further questions?
    - TP Subcommittee – perhaps include specific examples in relevant sections of the Manual, but not a Chapter
    - Extractive Industry Subcommittee – perhaps a dedicated note to the various issues of extractive industry with inputs from members of TP Subcommittee and joint approval of the note

Thank you...

Tomas.balco@mfsr.sk