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

Transfer Pricing Issues in Extractive Industry
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Comments received from Susana Bokopo, Alvaro De Juan (Repsol) and Jolanda Schenk (Shell)
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

- Contract Negotiation
- Exploration Activities & Evaluation
- Abandonment and Decommissioning
- Extraction, Production, Export
- Development of the Infrastructure
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
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

Off-shore Company (Principal)

Company in DTT Country (Agent)

Natural Resource Company (S)

Can be owned by foundation, not to appear related party

Payment

Profit Margin

Sale’s purchase agreement (manipulated price)

Sale’s purchase agreement (market price)

Payment

Independent Customer
Solutions?

- Developing countries develop their specific approaches to deal with these challenges
  - Ring-fencing
  - Use of quoted prices (6\textsuperscript{th} method)
  - Application of TP rules to all
    - Both related and unrelated parties
6th Method

• Developing Countries
  – Latin America (Argentina, Peru, Brazil, Equator,...)
  – Asia & Africa follow (KZ, South Africa, India)

• Debate
  – Is it a 6th 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...

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