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Toolkit for Transfer Pricing Risk Assessment in the African Mining Industry

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About this toolkit

The African Tax Administration Forum (ATAF) and the German Federal Ministry for Economic Cooperation and Development (through the Gesellschaft für Internationale Zusammenarbeit), have developed this toolkit for African tax authorities seeking to assess transfer pricing risk in the mining industry. The purpose is to strengthen authorities' capacity to determine whether they should audit particular high-risk "related party transactions."

The toolkit employs a specific risk review approach, which focuses on particular transfer pricing issues that present a high risk to revenue (as distinct from a comprehensive risk review, which tax authorities use when they cannot detect where transfer pricing issues are likely to arise). A loss of even 1 percent of the value of these transactions is likely to be significant for developing country revenues. These issues are also very prevalent: many African tax authorities report corporate services, including procurement and management, as common causes of tax loss.

The four issues of focus are:

1. **Marketing arrangements.** A related company, for example a marketing hub, buys mineral products from the mine. The key issue is whether the mineral products are transferred to a fully fledged related party marketer that takes ownership of the product, performs value-adding functions and assumes entrepreneurial risk, or, more commonly, a hub that merely provides a support function.
2. **Intercompany debt.** A subsidiary receives debt from a parent or an affiliate company, often a corporate treasury located in a low-tax jurisdiction, to finance geological exploration or mine development. Debt generates interest payments, which are tax deductible. Most African countries currently limit the maximum amount of debt on which deductible interest payments are available, by way of a debt-to-equity ratio. However, the cost of related party debt (i.e., the interest rate) is difficult for tax authorities to price, leaving the tax base vulnerable to excessive interest deductions.
3. **Procurement services.** A company purchases mining goods and services on behalf of its subsidiary; the price charged to the subsidiary will include the direct cost, plus a "mark-up." Usually in such cases the cost base should be the cost of providing the service, not the value of the goods.
4. **Management services.** The subsidiary pays a fee to a related party in return for a range of administrative, technical and advisory services.

There are four phases in the transfer pricing compliance process: (1) case selection, (2) risk assessment, (3) audit and (4) dispute resolution. The toolkit focuses on stage 2, risk assessment. It assumes the tax authority has already selected cases and compiled a list of mining companies for risk assessment. Case selection is not yet a critical concern for tax authorities in African countries that host a small number of mining multinational enterprises (MNEs) that contribute most of government's revenue. However, case selection will grow in importance as the number of tax paying companies increases.

STRUCTURE OF THE TOOLKIT

The toolkit is divided into four sections, mirroring the issues outlined above: marketing arrangements, intercompany debt, procurement services and management services.

Each section begins with an **information checklist** that details all the information a tax authority is likely to require to assess the risk of transfer mispricing in relation to a particular transaction. This includes information from the mining subsidiary, the foreign related party or parties, as well as relevant databases and publications (free and subscription based).

The information checklist is followed by a **step-by-step guide** to risk assessment which comprises a list of questions that tax authorities should consider when reviewing the transfer price for that transaction.

The guide is followed by a more **detailed explanation** of the related party transaction, including:

- An explanation of the transaction and the appropriate transfer pricing method(s)
- A detailed discussion of key factors likely to determine the transfer price
- Financial data gathered from uncontrolled and controlled transactions in the mining sector

Note: The financial data included in this toolkit DO NOT constitute "comparable data." Do not use it as basis for transfer pricing adjustments. The data is merely intended as an indication of industry practice; there may be additional divergences across the industry due to a range of factors including, but not limited to, country context, commodity type and business size. Tax authorities should subscribe to commercial searchable electronic databases to extract comparable data, which can be adjusted for country context.

HOW TO USE THIS TOOLKIT

The toolkit is designed to be applied in the context of national tax legislation, with reference to other authoritative documents such as the World Bank sourcebook *Transfer Pricing in Mining with a Focus on Africa: A Reference Guide for Practitioners* (below referred to as the "World Bank sourcebook"), the OECD's Transfer Pricing Guidelines for Multinational Enterprises, the OECD base erosion and profit shifting (BEPS) reports, and the United Nations' Practical Manual on Transfer Pricing for Developing Countries. Specific references to these documents are highlighted throughout the toolkit and users are encouraged to familiarize themselves with the World Bank, OECD and U.N. guidance.

There may be significant variation in tax legislation, as well as economic and political differences, across jurisdictions. The toolkit cannot account for all the country-by-country differences that may affect transfer pricing risk assessment and outcomes. Consequently, tax authorities should use the toolkit as a guide and adjust for country difference where necessary.