ADDRESSING BASE EROSION AND PROFIT SHIFTING

Remarks to INTOSAI Working Group on Extractive Industries
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Focus of Presentation

Two main parts:
– international efforts to counter base erosion and profit shifting in the international tax system
– Current work on mineral product pricing
BASE EROSION AND PROFIT SHIFTING
Time of change in international taxation

• big push to rewrite international tax rules
  – in a very compressed time frame
• Driven by the G20 in partnership with OECD
• growing sense in many countries that the tax rules for multinationals hadn’t kept up with the realities of business
What is BEPS and why is it a problem?

- BEPS arises because under existing rules MNEs can artificially separate the allocation of their taxable profits from the jurisdictions in which they arise.

- Consequence is income untaxed anywhere or taxed at very low rates and significant reduction of the corporate tax revenue in the jurisdictions where MNEs operate.

- BEPS is due to the interaction of a number of rules (domestic laws, treaties, transfer pricing).

- BEPS distorts competition and investment decisions. In the current climate, it is an issue of fairness of the tax system.
What is BEPS and why is it a problem?

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- BEPS is due to the **interaction** of a number of rules (domestic laws, treaties, transfer pricing).

- BEPS distorts **competition** and **investment decisions**. In the current climate, it is an issue of **fairness** of the tax system.
Overview of the work so far

- **Feb 2013**
  - **Diagnosis**: “Addressing Base Erosion and Profit Shifting”

- **July 2013**
  - **15 Actions**: “Action Plan on Base Erosion and Profit Shifting”

- **Sep 2014**
  - **First Set of Deliverables**: 3 Reports (Digital Economy, Multilateral Instrument) and 4 Instruments (Hybrids, Treaty Abuse, TP Intangibles, TP Documentation and CBC Template)

- **Sep 2015**
  - **Second Set of Deliverables**: Action 3 (CFC rules), Action 4 (Interest), Action 5 (HTP), Action 7 (PE Avoidance), Action 8-10 (TP), Action 11 (Economic Analyses), Action 12 (MDR), Action 14 (MAP)

- **October 2015**
  - **Completion and Final Deliverables**: Completion of BEPS Project and delivery of all supplemental reports to the G20 Finance Ministers
So that means..

• This is a fast moving, global push to re-write many parts of the international tax framework
  – (but doesn’t end this year – implementation continues)

• Govts have taken on numerous complex, interconnected tax issues simultaneously (ambitious and/or courageous!)
And also means..

- sends a message to business that old ways of avoiding tax are on the way out
  - “buyer beware” if companies continue with old ways (can’t complain later)
- Unilateral approaches risk double taxation (why getting a consensus has been important)
VERIFYING PRICES USED FOR MINERAL PRODUCT TRANSACTIONS
Challenges in raising revenue from extractives are pressing, diverse, international

- Across spectrum of policy, law design, administration, corruption, capacity, accountabilities, resourcing (and so on)

Where to begin?

- Countries, the G8, and G20 told us to focus on significant asymmetries in information between companies, revenue authorities
Background

- Developing countries expressed concerns about the availability and quality of financial data on comparable transactions.
- Financial data about transactions between unrelated parties that are similar to the related party transactions (“comparable transactions”) vital to enforce TP rules:
  - (CIT and also royalties)
  - Mitigate against price manipulation (underpricing)
• **Aim**: provide information to help develop countries assess whether transactions within corporate groups are equivalent to arm’s length transactions.
  
  – Examine how mineral products are priced when they are sold at arm’s length
  
  – Build a stock of knowledge, but more importantly, a methodology others could apply
Review how minerals are transformed from ore to traded products.

Identify points on the transformation chain where products are produced and traded.

Understand how those products are priced and the key factors affecting prices.

Identify available data that could be used to review the transaction, and identify where there are information gaps.

Devise approaches or methodologies to address those information gaps.

Apply the information to the particular transaction.

FOCUS SO FAR

THEN: HOW TO APPLY THE FINDINGS?
• Initial undertaking: copper, iron ore, gold
  – Also thermal coal (underway)
• Your participation important:
  – As a potential customer of the work
  – As experts to improve the study
CASE STUDY – COPPER
• Oxide-based ores and sulphide-based ores.
  – Which do you have? Determines the products you’ll be pricing.
• Oxide-based: leaching, solvent extraction, electrowinning: cathodes
• Sulphide-based: concentration, smelting, refining: concentrates, matte, blister/anode, cathodes
COPPER ORES

To separate the copper ore from the surrounding rock, drilling and blasting processes are used. The broken ore is then conveyed to a stockpile for further processing. At this point, the copper content is typically 1-2 per cent by mass or less. Other valuable metals may also be present, such as gold, silver, nickel and cobalt – indeed many mines are considered as ‘multi-mineral’.

The ore may be of consistent grade or, if not, be separated by grade into different piles. It is then taken to be broken down into smaller pieces of roughly uniform size at a mill that is located at the mine site, or transported to an off-site mill by road or rail.

Crushing and screening are the first steps of transformation. For sulphide-based ores, the ore will be ground down further in preparation for concentration processes.

For oxide ores, the rocks will be heaped in preparation for leaching processes.
### SULPHIDE ORES

1. Sulphide-based ores are firstly ground to the consistency of sand, then mixed with water and chemicals to coat the copper sulphide particles, along with a frothing substance.

2. This slurry is moved to flotation tanks, where air is pumped through the mixture, forming bubbles which attract the chemically coated copper sulphide. The bubbles float to the surface and overflow or are skimmed off, filtered, and then dried to form a powder (copper concentrate). This process is usually able to recover 85 to 95 percent of the copper in the ore. The dried concentrate contains approximately 20-30 percent copper by mass, 30 percent iron, 30 percent sulphur, with the remainder including small amounts of gold, silver, and unwanted elements such as arsenic and mercury. Exported copper concentrates are transported by sea as a bulk commodity, either in drums or packages, or as loose powder.

3. Smelters are key purchasers of concentrate for physical delivery. Smelting removes most of the iron, sulphur and other unwanted materials from the concentrate. The concentrate may be initially roasted to remove sulphur and moisture. Concentrates are combined with silica sand and limestone and transferred to a furnace to melt them. Melting separates the materials with the heavier copper sinking to the bottom of the furnace, while the silica, which draws away impurities, floats and is poured off as slag.

Following this furnace process, the copper is in ‘matte’ stage with copper concentration between 50 and 70 percent. In most instances the matte is transferred directly as a molten liquid to a converter, but it may also be poured into ingots, cooled, and moved to a separate facility. In the converter, more silica is added to the matte and air is blown through the furnace to again melt the materials and separate the copper from another slag containing the iron. Following this process, the copper is known as “blister” copper, and is typically around 99 percent copper. Small impurities including oxygen, sulphur and iron are still present, requiring further treatment to remove. Depending again on the type of smelter, the blister copper may be cooled and shaped into ingots for transportation to another facility, or carried directly to an anode furnace for casting. During the casting process, natural gas is blown into the melt to burn off excess oxygen. At end of the process, molten copper of approximately 99.4 percent purity is poured into moulds and cooled to form ‘anodes’.

Refining is the final step. Anodes are placed in tanks with a sulphuric acid solution along with fine “starter” sheets of pure copper. An electrical current is applied to the solution causing the anodes to dissolve and copper to attach to the starter sheets, eventually forming 99.9 percent pure copper cathodes. Precious metals do not dissolve in the solution, instead dropping to the base of the refining cell and forming ‘anode slime’. This slime is collected and the precious metals recovered through a leaching process.
Cu (sulphide) – Early in Value Chain

Copper ore (1-2% copper)
Source: Sikal

Copper concentrate (20-30% copper, 30% iron, 30% sulphur, gold, silver, and unwanted elements eg arsenic, mercury)
Source: Freeport McMoran
Cu Concentrate Transferred to Smelters

• Concentrates widely traded, using reasonably standard trading terms:

• Payment to mine = (payable metals – TC – RC – penalties, +/- shipping/insurance)
Example: Copper Concentrate Reference Price

Price = (% copper * reference price) + (value of gold, silver) − (charges, penalties) +/- delivery terms
Copper – later in the chain

Blister – 99% copper
Source: Jiangxi XinJinye

Anode – 99.4% copper
Source: EPS McGill

Copper cathode – 99.9965% cu
Source: Boliden
Some Issues Raised

• Needless to say, understanding the mining industry is essential.
• Each mineral has unique characteristics and market structure.
• Pricing data is not available for every transaction, and some components of a price are more difficult to verify.
  – Eg products with opaque markets
• Other transactions may be embedded in prices (eg project financing, service fees), making TP analysis more difficult.
• This work has limits – elements of price that will be unique to the facts and circumstances of the transaction.
• Verifying prices best if timely.

Broader issues
• Product testing is fundamental
• Wider efforts to obtain information can greatly assist in revenue protection
• Broader revenue policies may be undermining goals
Toolkit on Comparability Data
What is being developed?

• Two part toolkit…
  – to assist developing countries address difficulties in accessing comparables data
  – presenting approaches to apply internationally accepted principles in the absence of comparables

• Supplementary Work on determining Appropriate Prices for Mineral Commodities
  – Helping to understand the value chain of three minerals
THANK YOU