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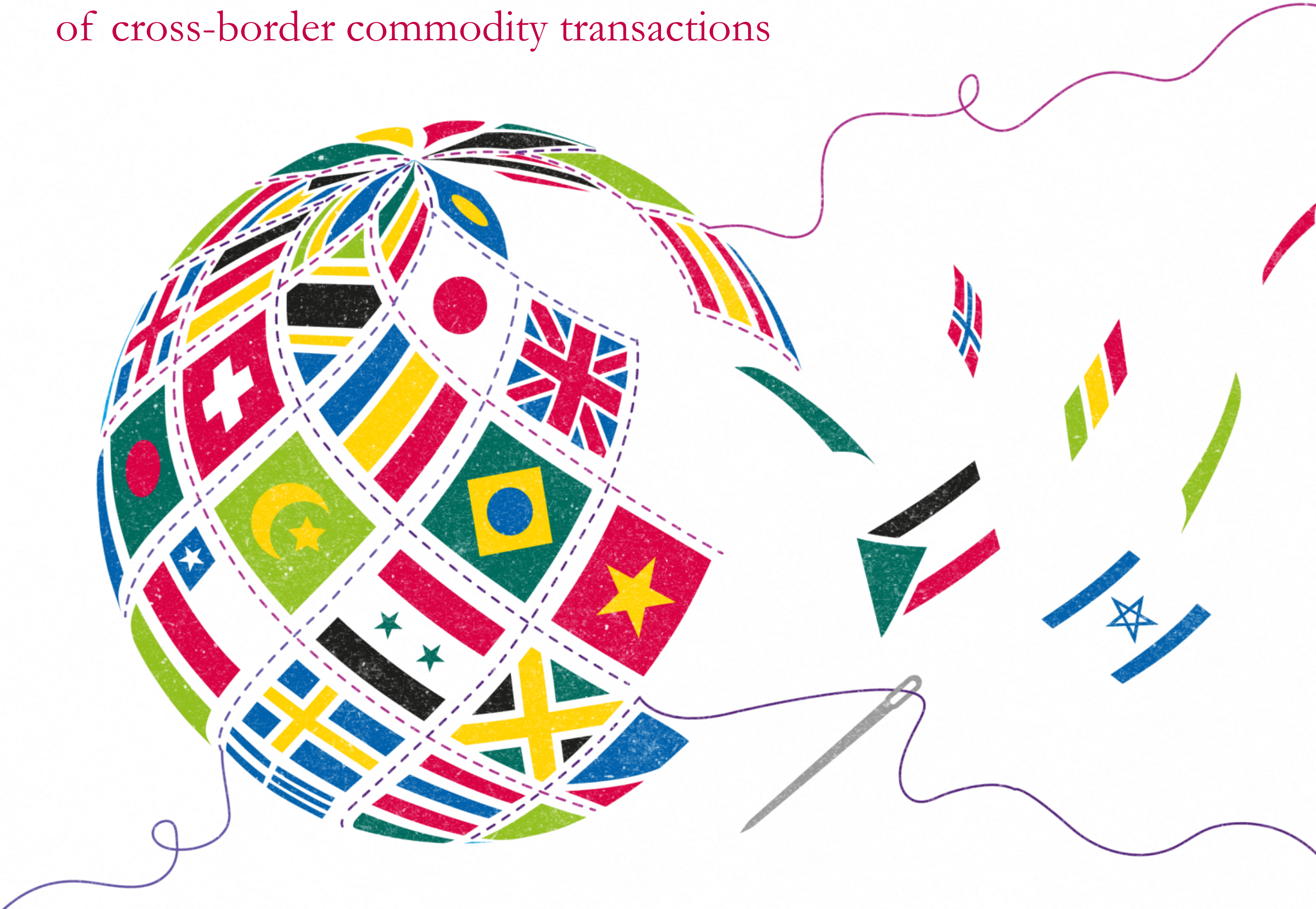
# Grant Thornton discussion draft response

## BEPS Action 10: Discussion draft on the transfer pricing aspects of cross-border commodity transactions



Grant Thornton International Ltd, with input from certain of its member firms, welcomes the opportunity to comment on the Organisation for Economic Co-operation and Development (OECD) discussion draft issued on 16 December 2014. We appreciate the work that the OECD has undertaken on the wider Base Erosion and Profit Shifting (BEPS) project and would like to make the following comments on the draft discussion points and proposals.

# Introduction

- The comments below do not relate to any specific paragraph of the discussion draft, but rather provide some additional context which should be considered in this process.

- Participants in the commodity sector are varied – in the case of the resources sector, these vary from mineral rights owners, large multinational mining houses, processors and beneficiators, logistics operations and commodity traders to governments. As much as the sector can be highly regulated and capital intensive. It is also very entrepreneurial and all parties should be remunerated for their risks taken, intellectual capital provided and funding injected on an appropriate basis. In dealing with commodity prices, it is therefore critical that the wider BEPS project gives specific consideration to the wider commercial and tax environment that makes up the developing country landscape.

- Developing economies should not be able to 'have their cake and eat it'. If the position is that commodities must be remunerated at a market price, then full market terms should conversely apply to everything – interest payable, technical fees, administrative and management fees, royalties, etc. There should also be free remittance of funds and withholding taxes should be appropriate. A realistic scenario is a taxpayer in a developing economy that pays corporate tax on its profits, has its tax deductions relating to related party charges limited, pays some type of mining royalty tax on its production or sales. Whenever this taxpayer wishes to remit funds to its non-resident related party, withholding taxes are applied and there are sometimes restrictions on the remittance of funds, whether they are for expenses that are being paid or capital that should be returned (loans or share capital). These developing economy 'fiscal challenges', along with other political, labour and economic interventions, discourages investment and will harbour informal and illegal trade. This does not just apply to the mining sector.

- Withholding taxes are particularly problematic in African countries, especially when domestic legislation is being used to override treaty relief.

# Proposed additions to 'Chapter II' of the transfer pricing guidelines

### The use of the comparable uncontrolled price (CUP) method for pricing commodity transactions and the use of quoted prices in applying the CUP method

In paragraph 8, it is stated that the CUP method using a quoted price would 'generally' be the most appropriate transfer pricing method for commodity transactions. Many industry participants may welcome the certainty that proposed recommendations could provide. We are encouraged by the use of the word 'generally', as there will still be circumstances where the CUP method will not apply and alternative methods would be better suited.

**Recommendation –** Importantly, the concept of a contract miner or processor/beneficiator should not be ignored. As much as we are supportive of proposals to ensure that pricing reflects value creation, thereby protecting the tax base of commodity dependent countries, the sound principles of risk and reward should be kept in mind. Therefore, there should still be room to use other transfer pricing methods to remunerate on an arm's length basis if they are more appropriate in the circumstances. The proposals should therefore make this very clear, as we would be concerned that certain jurisdictions may adopt a 'CUP only' approach.

In paragraph 9, the 'Draft' correctly points out that quoted prices are not set by a single individual or entity (except in the case of governmental price control), as they are the result of the interaction of supply and demand in the market for a certain quantity of a type of product at a specific point in time. It should however be considered that the quoted reference price is not always a pure market price. In a true arm's length environment, traders will trade above or below that price. The trade will then in turn impact on or determine the subsequent price level. Certain events that take place during any given day could have a significant impact on the reference price at any point during that day.

**Recommendation –** We would propose that a price range for the day in question be established and published. The range would be between the lowest and the highest price traded for the day. It could be considered to develop and interquartile range, but this may become administratively burdensome for all parties concerned. An alternative could be the average trading price for the day, which in our opinion, would be far more reflective than using a closing price on a particular day.

## Deemed pricing date for commodity transactions

Paragraph 15 proposes the insertion of a paragraph 5 into Chapter II of the transfer pricing guidelines. The essence of the proposal is that in the absence of reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction, tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. Using the shipment date may artificially either work for or against the taxpayer (and conversely, for or against the revenue authority). As a result, this approach may incentivise inappropriate behaviour from either the taxpayer or the revenue authority. As an example, if using the shipment date will result in the taxpayer achieving a lower taxable profit, it may purposely ignore the factual evidence and even destroy it. Similarly, if the shipment date will result in an increased tax burden for the taxpayer, a revenue authority may unduly focus on that date and dismiss factual evidence to the contrary.

**Recommendation –** It may be worthwhile to explore some type of averaging mechanism which will discourage such behaviour.

## Potential additional guidance on comparability adjustments to the quoted price

No specific comment or recommendation.

## Conclusion

Critical to the effectiveness of the proposals will be the ability to adequately deal with the many different adjustments that could be made to the quoted price of the commodity in attempting to attain a comparable position. Clear guidance will be an imperative to its adoption.

We would be pleased to expand on any of the points raised here. Please contact AJ Jansen van Nieuwenhuizen, partner for Grant Thornton South Africa at aj@za.gt.com for any further details.

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