MINERAL PRODUCT PRICING RISKS AND WAY FORWARD

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BETTER POLICIES FOR BETTER LIVES

Outline

- What is the base erosion risk?
  – What's wrong?
  – What have we seen?
- How can we address?
  – Build industry knowledge
  – Harness expertise

What's wrong?

- Concern that mineral product producing countries not receiving an appropriate return.
  - Under-price mine products in related party transactions
  - (or over-charge for related functions)
- This is a subset of all the many and varied TP issues that might arise.

An example

Copper Concentrate Shipment	Arm's Length Price $m	10% Under-priced Copper $m	Copper under-priced, no gold declared $m
Gross Value of Cargo FOB [A]	39.5	35.1	32.7
Production Costs [B]	22.5	22.5	22.5
Royalty [C]	1.7	1.5	1.4
CIT Base [A-B-C]		11.1	8.8
Company Tax Payable [D]		3.3	2.6
Total Revenue per shipment [C		4.8	4.0
Potential Revenue Loss Per Ship		**-1.4**	**-2.2**
Potential Annual Revenue Loss		**-71.4**	**-112.3**

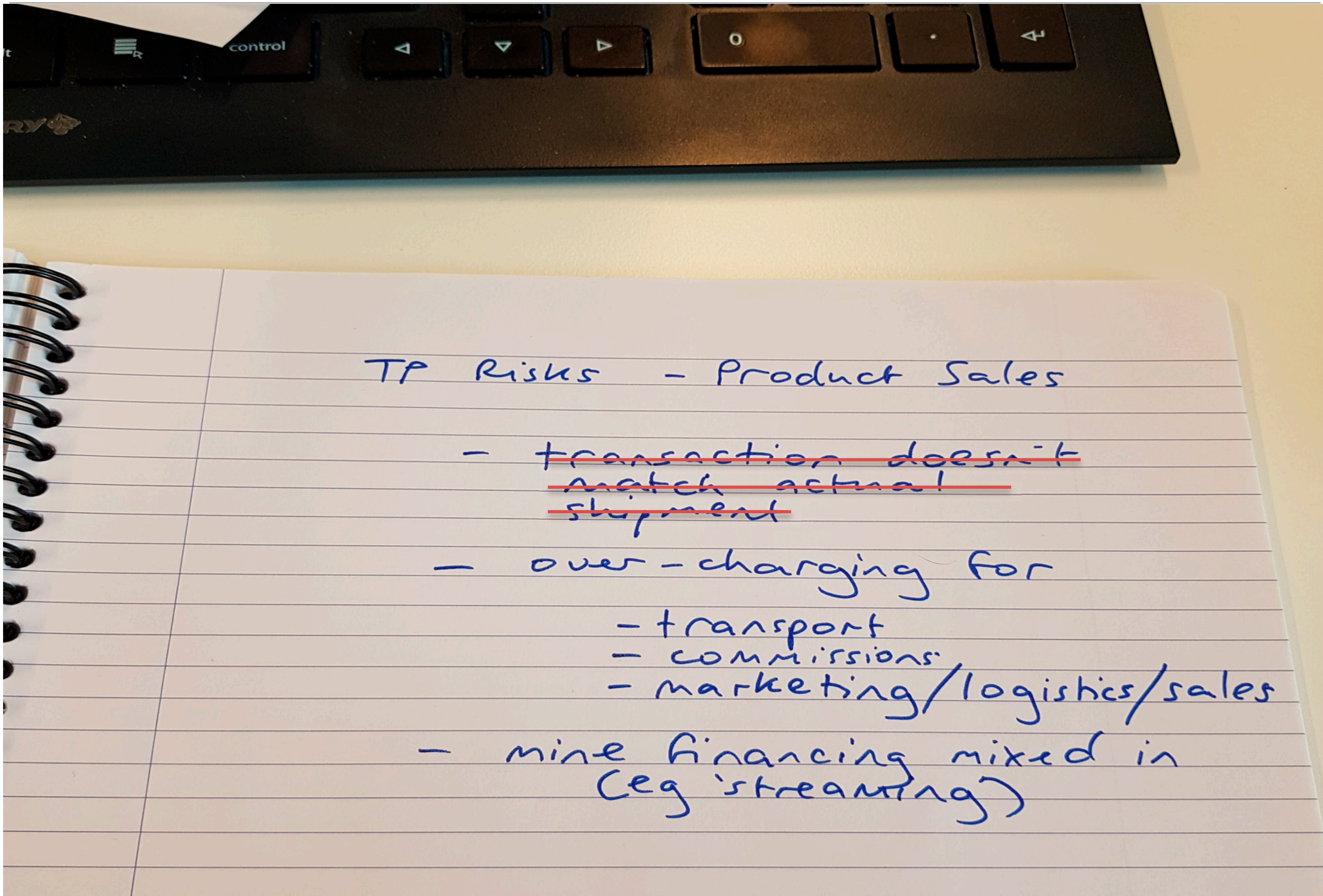
What have we seen?

- Reference prices don't match the product
  - Or keep changing without good reason
- Price is for a particular date
  - can allow MNEs to choose lowest price in the month
- Adjustments for physical characteristics (e.g. price penalties) are excessive/don't match industry practices
- Unnecessary handling fees/trial discounts/good customer discounts embedded in contracts
  - E.g. charging a marketing fee even when product never sold on (used in MNE's production processes)

CONTRATOS ENERO - AGOSTO

	Enero	USD	Febrero	USD	Marzo	USD	Abril	USD	Mayo	USD	Julio	USD	Agosto	USD
	04/01/2011	1,389	01/02/2011	1,332	01/03/2011	1,421	**01/04/2011**	**1,418**	03/05/2011	1,540	**01/07/2011**	**1,483**	**01/08/2011**	**1,623**
	05/01/2011	1,368	02/02/2011	1,337	02/03/2011	1,436	04/04/2011	1,436	04/05/2011	1,541	04/07/2011	1,495	02/08/2011	1,638
	06/01/2011	1,369	**03/02/2011**	**1,328**	03/03/2011	1,422	05/04/2011	1,434	05/05/2011	1,511	05/07/2011	1,510	03/08/2011	1,669
	07/01/2011	1,367	04/02/2011	1,355	04/03/2011	1,427	06/04/2011	1,462	06/05/2011	1,487	06/07/2011	1,527	04/08/2011	1,680
	10/01/2011	1,368	07/02/2011	1,348	07/03/2011	1,438	07/04/2011	1,460	09/05/2011	1,502	07/07/2011	1,528	05/08/2011	1,659
	11/01/2011	1,374	08/02/2011	1,364	08/03/2011	1,426	08/04/2011	1,470	10/05/2011	1,514	08/07/2011	1,542	08/08/2011	1,693
	12/01/2011	1,379	09/02/2011	1,365	09/03/2011	1,431	11/04/2011	1,468	11/05/2011	1,508	11/07/2011	1,556	09/08/2011	1,736
	13/01/2011	1,382	10/02/2011	1,353	10/03/2011	1,413	12/04/2011	1,451	12/05/2011	1,490	12/07/2011	1,551	10/08/2011	1,772
	14/01/2011	1,367	11/02/2011	1,364	11/03/2011	1,412	13/04/2011	1,458	13/05/2011	1,506	13/07/2011	1,579	11/08/2011	1,760
	17/01/2011	1,361	14/02/2011	1,365	14/03/2011	1,422	14/04/2011	1,466	16/05/2011	1,501	14/07/2011	1,591	12/08/2011	1,736
	18/01/2011	1,370	15/02/2011	1,373	**15/03/2011**	**1,401**	15/04/2011	1,477	**17/05/2011**	**1,479**	15/07/2011	1,587	15/08/2011	1,739
	19/01/2011	1,372	16/02/2011	1,371	16/03/2011	1,402	18/04/2011	1,493	18/05/2011	1,497	18/07/2011	1,599	16/08/2011	1,783
	20/01/2011	1,346	17/02/2011	1,379	17/03/2011	1,404	19/04/2011	1,491	19/05/2011	1,493	19/07/2011	1,601	17/08/2011	1,790
	21/01/2011	1,344	18/02/2011	1,384	18/03/2011	1,420	20/04/2011	1,501	20/05/2011	1,491	20/07/2011	1,586	18/08/2011	1,824
	24/01/2011	1,343	21/02/2011	1,403	21/03/2011	1,432	21/04/2011	1,504	23/05/2011	1,511	21/07/2011	1,601	19/08/2011	1,848
	25/01/2011	1,324	22/02/2011	1,401	22/03/2011	1,426	26/04/2011	1,498	24/05/2011	1,527	22/07/2011	1,602	22/08/2011	1,878
	26/01/2011	1,328	23/02/2011	1,409	23/03/2011	1,440	27/04/2011	1,511	25/05/2011	1,526	25/07/2011	1,614	23/08/2011	1,876
	27/01/2011	1,335	24/02/2011	1,412	24/03/2011	1,447	28/04/2011	1,536	26/05/2011	1,519	26/07/2011	1,613	24/08/2011	1,770
	28/01/2011	**1,319**	25/02/2011	1,403	25/03/2011	1,436			27/05/2011	1,533	27/07/2011	1,625	25/08/2011	1,729
	31/01/2011	1,327	28/02/2011	1,411	28/03/2011	1,417			31/05/2011	1,537	28/07/2011	1,614	26/08/2011	1,788
					29/03/2011	1,418					29/07/2011	1,629	30/08/2011	1,825
					30/03/2011	1,426							31/08/2011	1,814
					31/03/2011	1,439								
Mínimo	**28/01/2011**	**1,319**	**03/02/2011**	**1,328**	**15/03/2011**	**1,401**	**01/04/2011**	**1,418**	**17/05/2011**	**1,479**	**01/07/2011**	**1,483**	**01/08/2011**	**1,623**
Cuartil inferior		1,341		1,355		1,417		1,458		1,496		1,542		1,702
Mediana		1,367		1,368		1,426		1,469		1,509		1,587		1,765
Cuartil superior		1,370		1,401		1,434		1,496		1,526		1,602		1,808
Máximo		1,389		1,412		1,447		1,536		1,541		1,629		1,878
Precio Pactado	**28/01/2011**	**1,319**	**03/02/2011**	**1,328**	**15/03/2011**	**1,401**	**01/04/2011**	**1,418**	**17/05/2011**	**1,479**	**01/07/2011**	**1,483**	**01/08/2011**	**1,623**

So how do we proceed?



Pricing work – build a foundation first

6 steps.

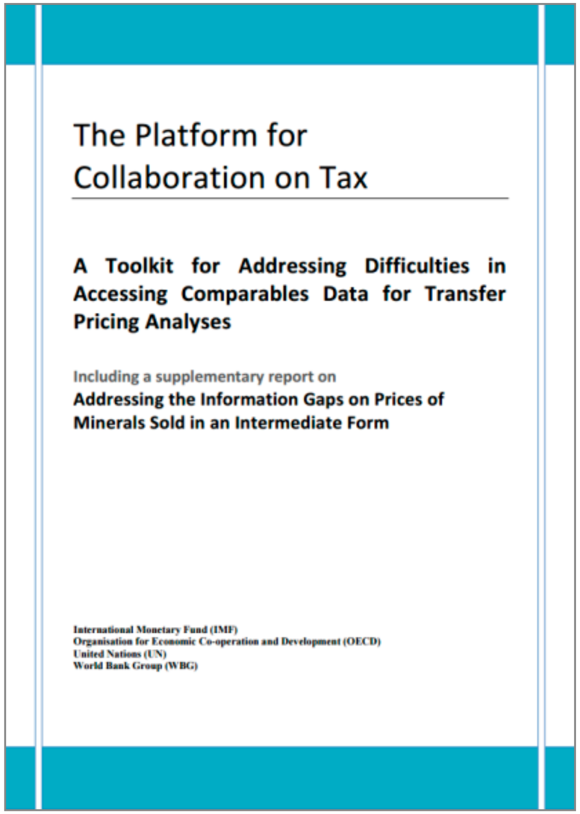
1. review each mine for how minerals are extracted and transformed to saleable products
2. identify actual products each mine produces and sells, and whether the processing facilities are also used by third parties (tolling)
3. understand what those products are used for, what drives their prices and how they're traded

The process continued

4. identify related party sales and their economic context (including the functions, assets and risks of the related parties)
5. identify available information, analysis and data to review product sales transactions between related parties
6. devise approaches or methodologies that can address as many of those information gaps as possible

Toolkit on Mineral Product Pricing

Toolkit has been delivered under the Platform for Collaboration on Tax (available in EN, FR, ES)



The Platform for Collaboration on Tax

A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Including a supplementary report on

Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form

International Monetary Fund (IMF)
Organisation for Economic Co-operation and Development (OECD)
United Nations (UN)
World Bank Group (WBG)

http://www.oecd.org/tax/toolkit-on-comparability-and-mineral-pricing.pdf

How to proceed?

- Once you understand the products and their markets, its harder to be misled and it reduces time auditors have to spend on this issue (still lots of others).
- Then:
  - Capture that knowledge (e.g. procedures/manuals).
  - Proactively work with companies to settle pricing approach for each product (e.g. interpretive guidance/MOU with company).
- For those minerals without transparent markets: consider more prescriptive approaches (e.g. price formula, APAs).
- Getting detailed industry expertise essential.
  - Can be costly if it's wrong!

Where do you get the expertise?

- Other entities of government.
- External data providers.
- International/Regional organisations.
- Industry Bodies.
- Companies themselves!
- Others in the supply chain with no connection to your companies (e.g. refineries, smelters).
- Informal tax networks (e.g. these kinds of regional meetings with other countries).
  - grab those business cards.
- Formal tax networks/information exchange.

Further work underway in related areas

Toolkit has been delivered under the Platform for Collaboration on Tax (available in EN, FR, ES)

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Planned extensions:

Led by:

- Pricing challenges in opaque reference markets (bauxite case) — OECD; Centre for EXPLORATION TARGETING
- Examining metals streaming — OECD
- Strengthening Oversight of Mineral Testing — IGF

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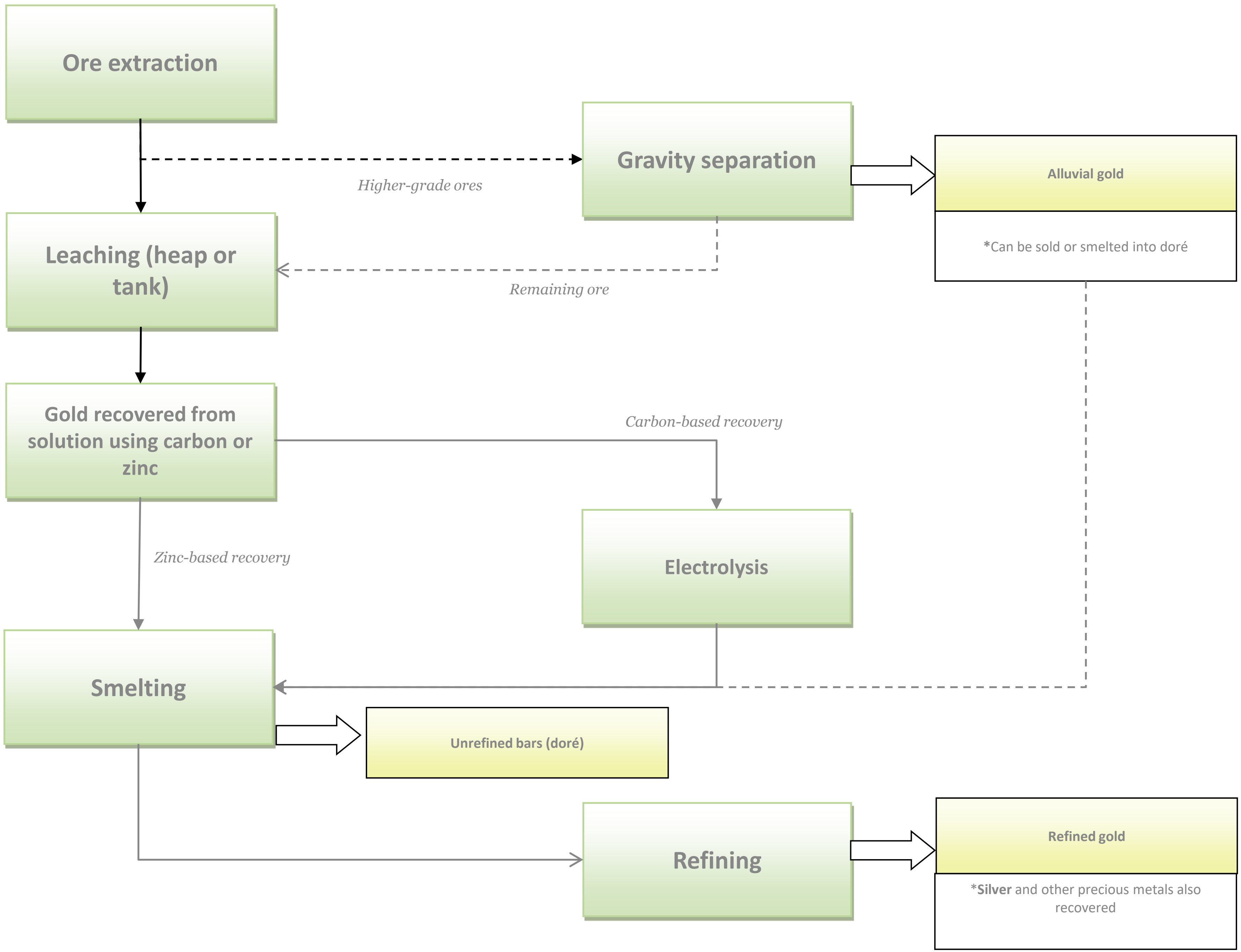
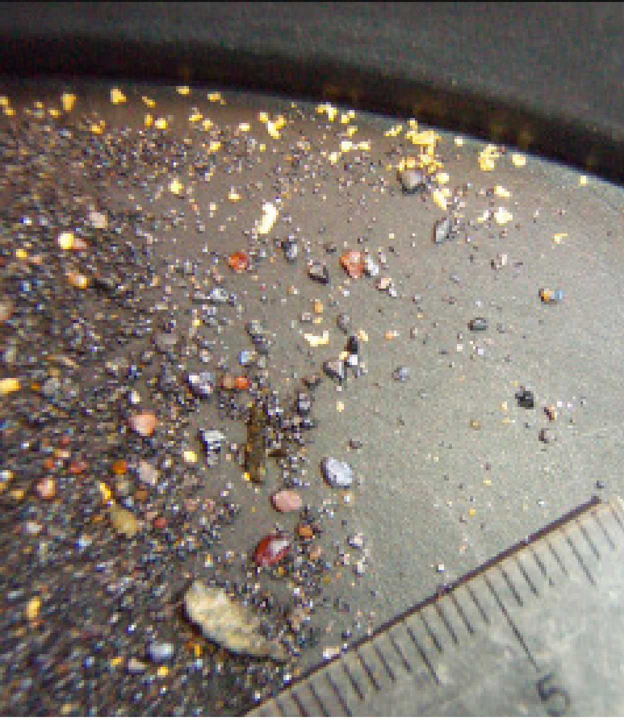
ADDITIONAL SLIDES - EXAMPLE CASE STUDY GOLD DORÉ


Ore extraction
Higher-grade ores
Gravity separation
Alluvial gold
*Can be sold or smelted into doré
Leaching (heap or tank)
Remaining ore
Gold recovered from solution using carbon or zinc
Carbon-based recovery
Electrolysis
Zinc-based recovery
Smelting
Unrefined bars (doré)
Refining
Refined gold
*Silver and other precious metals also recovered



Source: Australian Mining Monthly

Alluvial gold

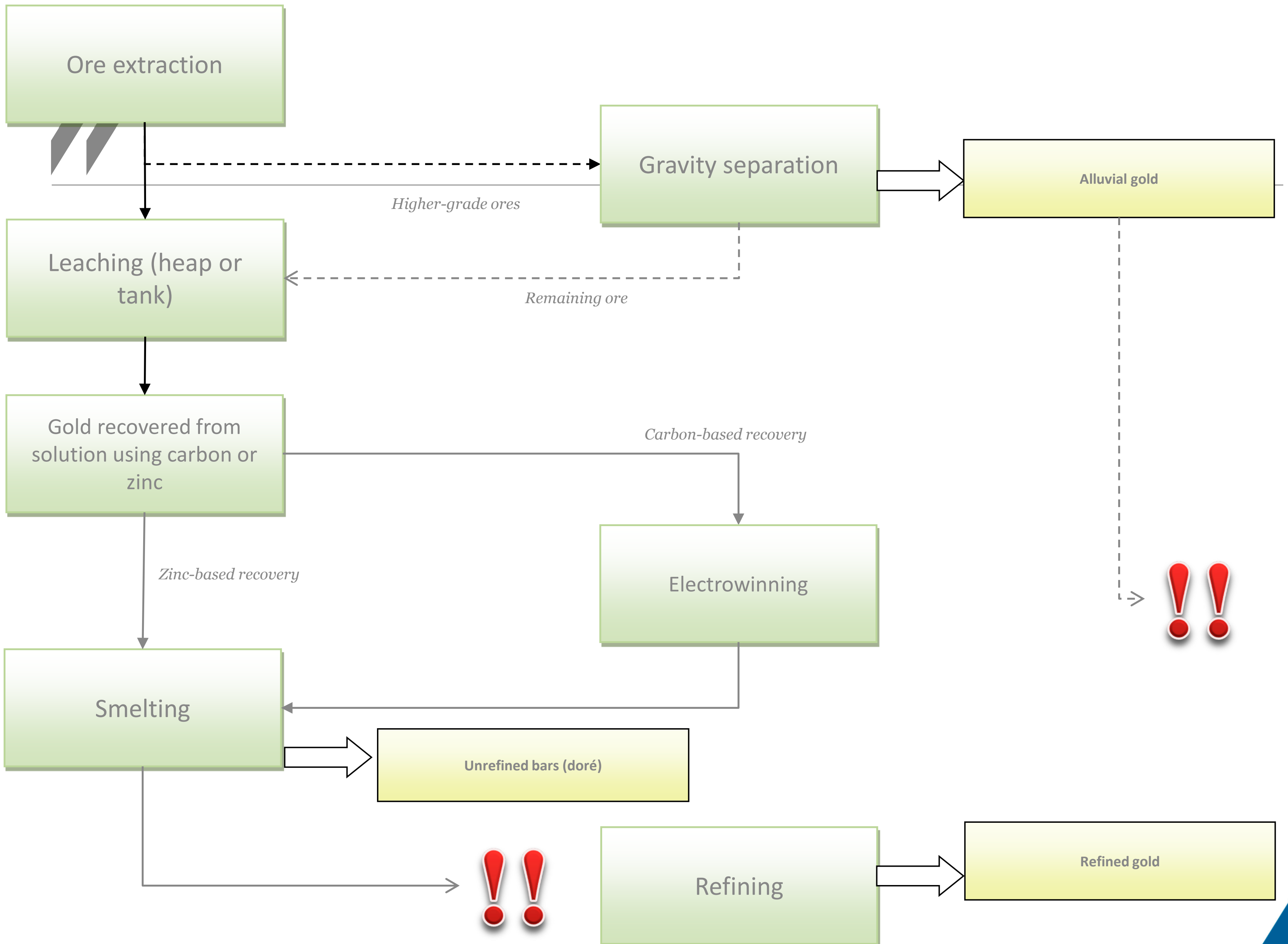
Doré – eg 85% gold, 10% silver, impurities

Source: bay area business centre

Refined gold

Risks

- High value metal..
- Gold can go missing during recovery processes
  - Early on: Gravity separated gold fragments
  - Later: Controls on doré bars – discrepancies between mine weight and refined weight
- Doré is mis-priced (sold cheaply to related entity abroad) or there are "handling/marketing fees"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Unrefined bars (doré)
Refining
Refined gold

Gold Pricing

- Doré an important export for many
  - requires refining to transform to pure gold, separate precious metals
- refinery will process the doré and sell the refined gold into global bullion markets
  - Might return to customer (eg breaking down a large gold bar)

Gold Refining

- An important third party against price manipulation. Most miners don’t have their own refinery.
- Why? It’s a competitive, low margin business.
  - Over-capacity globally
  - Quick turnaround to minimise price risks
  - Means they are <u>very</u> careful with weights/measurement
- Earnings are from:
  - Refining fee
  - Margin on price (paid to doré seller vs LBMA)
  - Bonus metals (grams not paid to doré seller)
    - Can be recovered at specialised facilities (especially Japan)
  - Special products e.g. retail coins
  - They will usually fully hedge price risks

MEMORANDUM OF OUTTURN

Our Ref:
Date of Lodgement: /11/2011
Date of Outturn: /11/2011 10:32
Gold Price: $ 0.00
Silver Price: $ 0.00
Shipment No.:

Deposit Number	Receipt Wt (oz)	Official Weight	Assay Report Gold (%)	Assay Report Silver (%)	Fine Gold Allowed (oz)	Fine Silver Allowed (oz)
	Description: SR 4393-					
25790	624.85	620.20	77.150	20.490	478.006	125.808
	Description: SR 4395-					
25791	968.77	963.99	87.020	10.870	838.025	103.738
	Description: SR 4397-					
25792	906.04	902.94	83.200	14.870	750.495	132.924
	Total Fine Allowed				2066.526	362.470
To Metals Account:					2066.526	362.470

Buyer:

L/No:

Less Charges:	Refining	1,499.79	
	Assay	265.50	
	Environmental	81.91	
	Freight Dep No:25792	2,299.69	
	GST	0.00	-4,146.89

Amount Due To Refinery
USD 4,146.89

Brief comment on gold markets

- Not a formal currency, but almost
- There's a global reference price
  - London Bullion Market Association (LBMA)
- But not all doré sellers get exactly the same price (commissions, fees etc)
- Implications:
  - Small regional differences may arise, but quickly eroded by arbitrage
  - pricing should not deviate far from LBMA
  - No need for marketing