

United Kingdom

BEPS Action 10: Transfer pricing aspects of cross-border commodity transactions

On 16 December 2014, the OECD, as part of its work on the Action Plan to address Base Erosion and Profit Shifting ('BEPS'), released a Discussion Draft on Action 10 in relation to the transfer pricing aspects of cross-border commodity transactions. The short Discussion Draft considers additional guidance for determining the arm's length price for commodity transactions. This work has been driven by concerns, particularly in commodity-producing developing countries, that the tax base may be being eroded in relation to (i) the difference between the price charged and publicly quoted commodity prices, (ii) variable dates for pricing the commodity transaction prior to shipment; and (iii) adjustments made to publicly-quoted prices in relation to services performed by other group companies.

As with other Discussion Drafts on BEPS Actions, the proposals do not represent a consensus view from the G20/OECD governments involved but are designed to provide preliminary but substantive proposals for public analysis and comment.

Deloitte Comments and Business Next Steps

The Discussion Draft proposes the use of quoted commodity prices as a starting point for transfer pricing, where the quoted prices are used in commercial transactions between third parties. The difficulty will be in determining the (possibly many) circumstances when the quoted prices are not the same as the market price for the specific commodity in question at the location where title transfers from the extractive company. The prices reported may be based on a sample of trades conducted and based on notional weight, quality etc. and in particular, may not cover the market as a whole. Their reliability will depend on the facts and circumstances including, *inter alia*, the commodity in question, the size and liquidity of the quoted market, and the location and quality of the commodity being sold. It would help the OECD if businesses could provide as much information as possible as to the use of quoted commodity prices in transactions with third parties to help establish benchmarks for their use.

The Discussion Draft does not cover marketing activities in relation to commodities, currently a common area of dispute. The value of marketing activities will depend on facts and circumstances, but, for example, they may result in long term-contracts which allows a mine to produce to a set capacity for a number of years, in the knowledge that there are buyers for the commodity. In other cases, where there is a shortage of the commodity, the value of marketing activities in the supply chain may instead relate to the ability to achieve pricing premiums from customers. Greater clarity as to how to approach the arm's length pricing of marketing activities and long-term contracts, and the acknowledgement that these may, depending on the facts, be of considerable value, would be helpful.

The Discussion Draft notes that transfer pricing work being undertaken under BEPS Action 9 (on risk and capital), BEPS Action 10 (recharacterisation and low value-adding services) and BEPS Action 13 (transfer pricing documentation and country-by-country reporting) is also relevant to commodity transactions as part of the wider modernisation of the transfer pricing rules.

The Discussion Draft is a good starting point for considering some of the difficult areas in what is a very complex industry. Further transfer pricing guidance and examples would be welcomed, particularly given the importance of commodity production to developing countries and the desire of businesses to minimise double taxation and lengthy disputes.

Proposed additions to the OECD's Transfer Pricing Guidelines

The Discussion Draft proposes amendments to the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* in relation to the most appropriate transfer pricing method for intra-group commodity transactions.

Comparable uncontrolled price ('CUP') method for pricing commodity transactions: The Discussion Draft proposes that (i) the CUP method will generally be appropriate for commodity transactions; and, (ii) that quoted or publicly available prices ('quoted price') may be appropriate as a reference to determine the arm's length price under the CUP method, where the quoted price is routinely used in the ordinary course of commercial business.

Deemed pricing date for commodity transactions: The Discussion Draft recognises that contracts may provide for shipment at some point in the future, and commodity prices may fluctuate significantly in the intervening period. The proposal is that the actual pricing date agreed between the parties should be used where there is reliable evidence supporting it. If the evidence is not consistent with the agreed date, then tax authorities may assume a pricing date consistent with the facts. Where there are no facts indicating the pricing date, tax authorities should it to be the date of shipment (as evidenced by the bill of lading or similar).

Potential additional guidance on comparability adjustments to the quoted price: The OECD and the World Bank Group have been asked to support ongoing efforts to improve the availability of good quality transfer pricing comparability data for developing economies. As part of the Tax and Development Programme, research (initially focussing on mineral commodities when they are traded as ores or in intermediate forms including iron ore, copper and gold) will be undertaken to identify common comparability adjustments to quoted prices to account for physical and functional differences.

The Discussion Draft also specifically seeks input on the common adjustments applied in third party commercial transactions to the quoted price to take into account, for example, physical differences in the product, different specificities, freight, any further processing costs, and other features of the particular transaction) and also the sources of information used to determine such comparability adjustments.

Timetable

Comments are invited by 6 February 2015. A public consultation meeting will be held on the Discussion Draft at the OECD in Paris on 19-20 March 2015. Registration details will be published on the OECD website in due course.

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