Publish What You Pay
NORWAY

BRIEFING

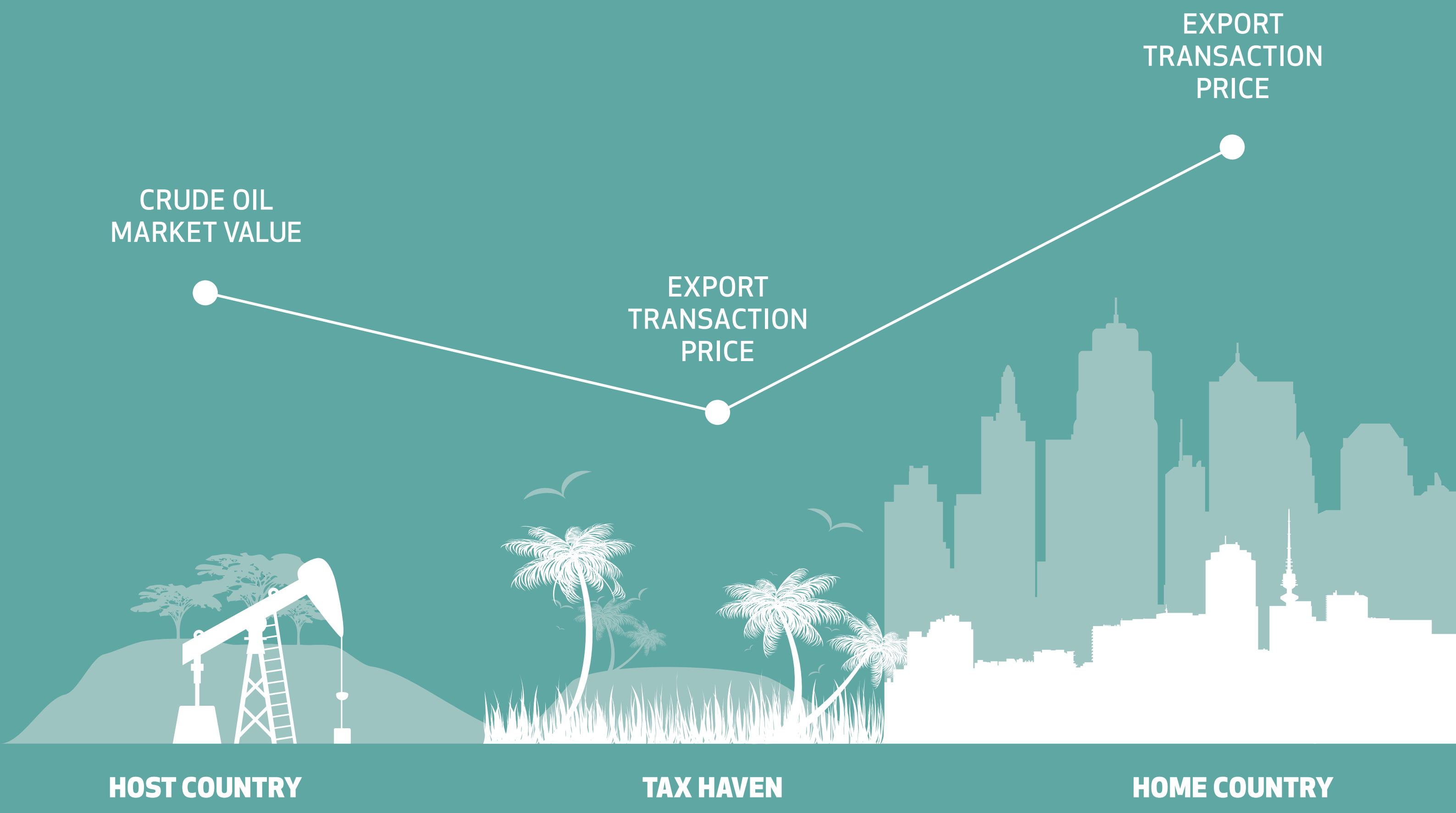
- Over 110 billion US dollars "disappeared" through potential mispricing of crude oil in the US and the EU between 2000 and 2010.

- Mispricing effectively moves profits from the host and home countries to the extractive companies themselves in tax havens.

- Today's guiding principle for transfer pricing is not sufficient to avoid mispricing. A policy proposal on extended country-by-country reporting is a necessary next step.

Lost billions.

Transfer pricing in the extractive industries



In the report "Lost Billions. Transfer pricing in the extractive industries", **Publish What You Pay Norway** investigates the potential trade mispricing in imports of crude oil in the European Union (EU) and the United States (US) between 2000 and 2010.

THE PROBLEM

The report finds that at least 110 billion US dollars have "disappeared" during import of crude oil to the EU and the US during 2000-2010. To understand how and why, we need to look closer at "transfer pricing" – which happens when two related companies trade with each other and set a price for this transaction. This is not in itself abusive or illegal. But it becomes so when the price is deliberately set too high or low in order to escape tax or to shifts profits across borders, so-called transfer mispricing. Today, over 60% of world trade is taking place within multinational companies. Transfer mispricing is one of the most used techniques for extractive companies to transfer profits from host and home country to the company itself.

THE CONSEQUENCES

Transfer mispricing minimizes the overall tax bill for the company, and helps the company move much of its profits to tax havens with low or zero taxes. As a result, tax dollars that should accrue to tax authorities in the home and host countries, are converted into higher profits for the multinational company. It is nearly impossible for national tax authorities to determine whether they are collecting their fair share of taxes. Developing countries in particular often lack access to the necessary information, as well as the capacity to verify the prices set by companies and their related entities outside their own jurisdictions. This is even more difficult, if not impossible, when entities are located in secrecy jurisdictions or tax havens, where company accounts are not required or available.

Q&A

How does transfer mispricing work?

Take for example a company that extracts gold in Tanzania and then processes it and sells it in the United States. The company does this through three subsidiaries: one in Tanzania (host country), one in a tax haven (with zero taxes) and one in the United States (home country). The subsidiary in Tanzania sells the produce to the subsidiary in the tax haven at an artificially low price, creating artificially high profits for the latter. The subsidiary in the tax haven then sells the produce to the subsidiary in the US for a very high price, creating artificially low profits in the US and consequently a lower tax bill. Notice that the intermediary subsidiary has bought at a low price and sold at a high price, and thus created artificially high profits – without any costs. As it is located in a tax haven, it pays no or little taxes on this profit. In this example, the profits are effectively moved to the company itself, while the cost is picked up in Tanzania and the US.

A SOLUTION

To avoid abusive transfer mispricing, the OECD suggests the use of the principles of "arm's length prices". This implies that companies should set prices as if they traded with a company outside the company structure. However, there is no mechanism in place today to ensure that companies really do this. PWYP Norway has proposed one very simple and effective reporting mechanism called "An extended country by country reporting standard for the extractive industries". It will not directly target transfer pricing, but it is a significant step in the right direction of getting necessary information about key accounting figures and the distribution of these between operating countries, tax havens and home-bases. It will allow investors to follow their money and governments to access valuable and standardized information across all jurisdictions where the companies operate. Only through such reporting can governments be certain that they are collecting their fair share of revenues and taxes.

What is extended country-by-country reporting?

Extended country-by-country reporting is a reporting standard proposed by PWYP Norway for multinational companies in the extractive industries. It will require the companies to publish data on their full revenues, costs, profits, tax, resources extracted and remaining reserves for any given year in every country it operates. Such reporting will give investors, governments and citizens the instrument to follow their money, and can prevent tax evasion and capital flight by ensuring transparency. You can read more about the policy proposal in PWYP Norway's report "An Extended Country by Country Reporting", free for download at **www.pwyp.no**.

Why should I read the report "Lost Billions"?

In our report "Piping Profits", we show that ten of the world's most powerful extractive companies operate with at least 6038 subsidiaries, where more than 1/3 are located in secrecy jurisdictions. Consequently, a lot of their trade is within their own corporate structure and the potential for transfer mispricing is great. This report, "Lost Billions", will give you insight into a tax abusive practice that concerns citizens in poor and rich nations alike.

Download the full report for free at **www.pwyp.no**

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Do you want to see financial transparency and accountability in the extractive industries?

...

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...

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Publish What You Pay NORWAY

PWYP Norway is the Norwegian chapter of a global network of more than 750 organizations from over 70 resource rich countries. We work to establish financial transparency and accountability in the extractive sector, so that countries can mobilise their own capital to promote a sustainable future, democracy, and human rights

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