

Transfer Pricing in the Extractive Sector in Sierra Leone

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EXECUTIVE SUMMARY

Sierra Leone is rich in mineral resources, including diamonds, bauxite, iron ore, and rutile. Despite this vast mineral wealth, Sierra Leone remains one of the poorest countries in the world, ranked 158th of 169 on the Human Development Index. The contribution of the mining sector to the domestic tax base has been limited so far, accounting for 60 percent of exports in 2010, but only eight percent of government revenue. The common explanation for this variation is the generous tax incentives afforded to mining companies, often reinforced by political corruption. However it is likely that tax avoidance is also a major factor. The Open Society Initiative for West Africa (OSIWA) estimates that illicit financial flows (IFFs) have grown at an annual rate of 23 percent within the Economic Community of West African States (ECOWAS), rising from less than US \$3 billion in 2002 to more than US \$18 billion in 2011.¹ Despite concerns about tax revenue leakage in the mining sector the government of Sierra Leone is yet to take action to safeguard its tax base. Comprehensive legal and administrative reform is urgently required if Sierra Leone is to combat tax avoidance and secure its fair share of resource rents.

Transfer pricing is the mechanism by which prices are chosen to value transactions between related legal entities within the same multinational enterprises (MNE). These are referred to as “controlled transactions” and may include the purchase and sale of goods or intangible assets, the provision of services, the provision of financing, cost allocation, and cost sharing agreements. As long as the price that is set matches the “arm’s length” price at which a transaction would have taken place between unrelated parties, this is not problematic. However, transfer pricing may become abusive or illegal when related parties seek to distort the price as a means of reducing their overall tax bill. In these instances the practice may be referred to as “transfer mis-pricing.”

This case study investigates the barriers to implementation of transfer pricing rules in the extractive sector in Sierra Leone. It forms part of a series of five country case studies also including Ghana, Guinea, Tanzania, and Zambia. The result of this study is a number of recommendations that aim to provide guidance on practical steps to improve transfer pricing enforcement in the extractive sector. The focus is primarily on mining given that the petroleum sector is still under development. The recommendations can be broadly grouped into four categories: transfer pricing legal framework, administrative arrangements, knowledge and skills, and information.

¹ Open Society Initiative West Africa (OSIWA) and Dalberg. *Domestic Resource Mobilization in West Africa: Missed Opportunities* (OSIWA, 2015), 1.

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Overview of recommendations

		Recommendation	Responsibility
Legal framework	1	Introduce transfer pricing regulations to operationalize Section 95 of the Income Tax Act. The regulations should include strong documentation rules.	Ministry of Finance (MoFED)
	2	Use the development of the new Core Minerals Policy as an opportunity to expressly limit deductible expenditure according to the arm's length principle, and provide for advance pricing agreements. These provisions were included in the draft Extractive Industry Revenue Bill.	Ministry of Mines (MMMR)
	3	Ensure that Mining Lease Agreements reflect the relevant transfer pricing provisions in the Income Tax Act. This will strengthen the transfer pricing legal framework as it applies to the mining sector.	MMMR
Administrative arrangements	4	Identify a small number of transfer pricing focal persons within the Domestic Tax Department, including the Extractive Industry Revenue Unit (EIRU). These focal persons should be the primary recipients of transfer pricing training, ensuring continuous development of expertise.	National Revenue Authority (NRA)
	5	Afford the EIRU, as well as the Extractive Industry Revenue Taskforce (EIRT) the necessary political, financial, and technical support required to succeed in monitoring extractive industry taxpayers, and improve inter-agency coordination. The latter is essential for the exchange of information and expertise needed to identify and evaluate transfer pricing risks in the extractive sector. This should be supported by an automatic information-sharing platform.	NRA and MoFED
Information	6	Improve access to transfer pricing information by: <ul style="list-style-type: none"> a. Introducing a transfer pricing return form that taxpayers are required to submit with their annual tax return. This information enables more accurate selection of cases for audit, and improves information gathering. b. Subscribing to the Bauxite Price Index to improve monitoring of bauxite sales. c. Securing a subscription to a transfer pricing comparables database, for example Orbis, by Bureau van Dijk. 	NRA
	7	Advocate for UK financial disclosure requirements to be extended to companies registered on the Alternative Investment Market (AIM). This will enable the NRA to obtain a fuller picture of the tax activities of medium-sized mining companies operating in Sierra Leone.	International partners
	8	Improve audit reporting so as to enable more effective oversight of NRA activities, and to provide a basis for follow-up of audit outcomes.	NRA
	9	Build the NMA's capacity to verify production volume and grade of mineral exports.	Government of Sierra Leone (GoSL)
Knowledge and skills	10	Officials from the NRA, MoFED, MMMR, NMA and Petroleum Directorate must receive training on the basic principles of transfer pricing, as well as how transfer pricing relates to the extractive sector specifically. While transfer pricing capacity is being built, the government may wish to contract an international tax audit firm to conduct preliminary transfer pricing audits of all mining companies.	GoSL and international partners
	11	Develop a transfer pricing risk assessment tool to guide selection of cases for audit. This basic risk tool should then be adapted to include specific benchmarks for the extractive sector to guide tax officials in differentiating between abusive versus standard industry practice.	NRA
	12	Train civil society organizations as well as parliament on the basics of transfer pricing and how it relates to the extractive sector specifically. This training is necessary for civil society, the media and parliament, to function as an effective check on the government regarding implementation of transfer pricing rules in the extractive sector.	International partners

TRANSFER PRICING LEGAL FRAMEWORK

Status of transfer pricing rules

Since the Income Tax Act (ITA) of 2000, the commissioner general of the National Revenue Authority (NRA) has had the power to re-characterize transactions between associated persons deemed not at arm's length. This provision was strengthened in 2013 when the Finance Act repealed and replaced Section 95 of the ITA with more comprehensive rules; in particular, confirming that the onus is on the taxpayer to calculate their chargeable income as per the arm's length standard. According to the definition of "associate," Section 95 can be interpreted as covering transactions between directly related parties, as well as other types of controlled relationships between a taxpayer and their customers, suppliers, shareholders and so on. Section 95(5) specifies that the provision should cover transactions between companies permanently established in Sierra Leone and their non-resident owners, however it does not preclude two associated companies both resident in Sierra Leone from being subject to this provision.

There is currently no transfer pricing regulation in Sierra Leone. However, the Revenue Tax Policy Department (RTPD) at the Ministry of Finance is planning to develop transfer pricing regulations, and included such provisions in the ministry's performance management plan for 2015. Despite this, international advisors to the NRA are of the view that, due to capacity constraints, the Ministry of Finance should include transfer pricing provisions in the proposed Income Tax Regulations to be developed in 2016. Regardless of which approach is adopted, a regulatory framework to support implementation of Section 95 of the ITA is urgently required, particularly in relation to transfer pricing documentation. According to one mining company interviewed for this study, the company do not keep transfer pricing documentation and are unclear on existing transfer pricing provisions in the ITA, specifically, whether the provisions are operational. The government must prioritize the development of transfer pricing regulations to clarify how Section 95 is to be applied; specifically, which transfer pricing methods taxpayers are to use to apply the arm's length principle, and what documentation must be kept to justify related party transactions.

The Mines and Minerals Act (MMA) of 2009 reinforces the transfer pricing provision in the ITA. Section 154 stipulates that where mineral rights holders sell mineral products to affiliates, this must be done according to the arm's length price. This requirement only applies to holders of large-scale mining licenses having a capital expenditure of no less than US \$5 million. The MMA does not define "affiliate," however presumably the ITA's definition is deemed to apply.

Mining lease agreements (MLAs) vary as to whether, and to what extent, the arm's length principle must determine related party transactions, as the table on the next page shows.

Transfer pricing regulations are urgently required in Sierra Leone. Regulations must clarify which transfer pricing methods taxpayers are required to use to apply the arm's length principle, and what documentation must be kept to justify related party transactions.

Mining lease agreement	Reference to "arm's length" price	Interpretation of "arm's length"
African Minerals MLA 2010	YES	Article 19(b) Royalties must be calculated according to the 'market value' as defined by Section.148(3) of the MMA.
London Mining MLA 2012	YES	Article 5.2 Royalties must be calculated according to the 'market value' which is defined as the "sale value receivable by LMC in an arm's length transaction", free on board (FOB).
Koidu Holdings S.A/ Octea MLA 2010	YES	Article 15.12 Any transactions with affiliates must be conducted at arm's length; and supporting documentation must be kept.
Sierra Minerals Holdings MLA 2012	YES	Section 6(b) "Related Party Transactions" – the terms of sales, leases, licenses, other transfer of goods and services shall be determined pursuant to arm's length transactions in accordance with OECD principles. Section 6(f)(1) Royalties to be calculated based on the "Next Bauxite Sales Price" determined in an arm's length transaction.
Sierra Rutile MLA 2004	NO	Section 6(b)(i) Royalties to be calculated based on gross sales price FOB.

Interpretations of "arm's length" in mining lease agreements

Relevant anti-tax avoidance rules

Thin capitalization

Prior to the 2013 Finance Act, which repealed the Sixth Schedule of the ITA, interest deductions made by mining and petroleum companies were prohibited when total debt exceeded three times the total equity, and where interest payments exceeded 50 percent of income before capital allowances. Any amount disallowed on this basis would be treated as a dividend under Section 85. Capping interest deductibility is a less common approach to preventing thin capitalization, referred to as the "earnings-stripping rule." This is where the cost of debt is limited, not just the debt stock itself, which is useful given the challenges of monitoring interest rates on related party loans. Many other countries that opted for a debt-to-equity ratio as the primary means of preventing thin capitalization, have had subsequent challenges ensuring that interest payments are at arm's length.

The Sixth Schedule was repealed in anticipation of the introduction of the Extractive Industries Revenue Bill (EIRB), however given that the Bill is unlikely to be passed into law, the NRA put the Sixth Schedule back in the Income Tax Act in 2016. In reinstating the Sixth Schedule, it is useful to review concerns raised by the IMF in 2011 with respect to inconsistencies between thin capitalization provisions in the ITA, and the mining lease agreements. According to the IMF, the African Minerals MLA (now the property of Shandong Iron and Steel), references Section 35 of the ITA, the general thin capitalization provision, rather than the Sixth Schedule. The Koidu Holdings Agreement takes a different approach, setting a maximum debt-to-equity ratio for the license holder. According to interviews conducted by the IMF at the time of the review, neither Section 35 nor the Sixth Schedule were having much impact on company financing.²

Unlike most African countries, Sierra Leone limits interest deductibility. By controlling the cost of debt, as well as total debt stock, the risk of thin capitalization is significantly reduced.

² Philip Daniel, Peter Harris, Oana Luca, and Carole Nakhle. *Fiscal Regimes for Extractive Industries – A Preliminary Review* (IMF, 2011), 16-17.

Advance pricing agreements

The ITA, EIRB, and at least two MLAs, provide for advance pricing agreements (APAs) to be signed between taxpayers and the NRA.³ Despite this, APAs are yet to be used in the extractive sector. Section 168 of the ITA provides for private rulings relating to income tax as well as any other type of tax or revenue collected by the NRA. Section 6 of the EIRB specifically applies to determining market value of minerals supplied under contract. The MLAs with both London Mining and Sierra Minerals allow for the government and the company to agree on a “mutually satisfactory methodology” to determine the sale price of a mineral product. This affords the government the opportunity to have a say in setting a fair sale price. Not only has the government never signed an APA with an extractive company, it is only recently that the NMA has gained access to off-take agreements, despite the requirement for companies to submit all financial agreements in excess of US \$50,000 as per Section 153 of the MMA.

Government has made little use of its right to review the sale price of mineral exports. With the National Minerals Agency in place there is now an opportunity to ensure that sales are arm’s length.

Box 1. Limited use of the “right to review” sale prices

There is currently only one bauxite company operating in Sierra Leone. It has a 20 year agreement to sell 90 percent of its bauxite to its owner. According to the mining lease agreement, the government has the opportunity to establish an APA with the company, as well as review the off-take agreement between the local company and its parent company every year.

However, staff at the local company could only recall this happening on one occasion in 2011/12, despite the fact they re-negotiate the sale price with their parent company annually. In 2011/12 the government asked the local company to review its sale price on the grounds that it was below market value. The company subsequently agreed to revise the sale price up from US\$28 to US\$36 per ton. When a senior official at the NMA was informed of this change they remarked “obviously they were under-invoicing if they could afford to increase the sale price by US\$8, the question that must be asked is how far back does this go?” This remains the only time that the company’s sale price has been reviewed.

While APAs are taxpayer led, there is no reason why the government should not encourage the use of APAs or at least exercise its right to review pricing agreements between mining companies and their customers. With the NMA in place this may start to change; official correspondence has been sent to all mining companies explaining what information is to be provided for the purpose of computing royalties, and that any previous under-invoicing will be incorporated into future royalty payments.. However, interviews with various government officials still indicated a lack of understanding and awareness of APAs, as well as general disorganization regarding management of offtake agreements. This supports the view that the NMA still needs to spend more time monitoring company pricing formulas to make sure that royalty assessments are accurate.

3 Section 6(f)(5) of the MLA with Sierra Minerals Holding requires that any sales agreement with an affiliate must be determined through a pricing formula entered into by the company and GoSL, and that the pricing formula must be in accordance with Section 6(f)(6) which requires that royalties and income tax attributable to the sale should be no less than they would have been in an arm’s-length transaction. Section 5.2(c) of the MLA with London Mining required that prior to any disposal of minerals to affiliated parties the company and GoSL enter into an APA.

TRANSFER PRICING ADMINISTRATIVE ARRANGEMENTS

The NRA is in charge of collecting all tax and non-tax revenue, including additional tax recovered via transfer pricing adjustments. There is no specific transfer pricing unit or designated transfer pricing specialists; any transfer pricing issues are dealt with during the course of general audits conducted by the Audit Team within the Domestic Tax Department. The Design and Monitoring Unit is responsible for case selection and audit design, the Audit Team then conducts both desk based and field audits, and the Compliance Team is responsible for making tax adjustments. Over the long-term the Audit Team manager intends to appoint auditors to particular sectors including extractive industries, however currently there is very limited specialization, including on international taxation.

Internal coordination

The Extractive Industries Revenue Unit (EIRU) is the first sector specific audit unit at the NRA, established in 2014. While there is no intention for the EIRU to focus exclusively on transfer pricing, its mandate to monitor mining taxpayers will inevitably involve some transfer pricing oversight. Currently, the EIRU reports directly to the commissioner general of the NRA, which ensures high-level support during the setup of the unit. However, in the long-term the EIRU will report directly to the head of the Domestic Tax Department. It is envisaged that the EIRU will enable the NRA to develop extractive industry expertise, as well as improve coordination between the NRA and the NMA, particularly in terms of information sharing. However, there is still some concern about internal coordination challenges between the EIRU and the Audit Team in the Domestic Tax Department, the team traditionally responsible for overseeing mining taxpayers. There is a risk that the EIRU becomes a “toothless tiger” by virtue of not receiving the support it requires in terms of access to information to monitor extractive industry taxpayers. Recently, the domestic tax team were caught trying to select extractive companies for audit, however this was corrected. The sooner the EIRU reports directly to the head of Domestic Tax, the more likely there will be effective collaboration between the two teams. Moreover, the commissioner general must formally clarify the responsibility split between the EIRU and the Audit Team so as to avoid any confusion or misunderstanding, as well as encourage linkages so that the EIRU does not work in isolation.

Inter-agency coordination

Mining

The NRA has the power to collect non-tax revenue, including royalties, but it is the Minister of Mines who has the responsibility to assess the sale price of minerals, and in doing so determine royalties payable. This responsibility split was intended to be complementary with the Ministry of Mines and Mineral Resources (MMMR), now via the NMA, assuming a technical role in valuing mineral products. However, to avoid any potential conflict or politicization of the process, it may be advisable to clearly state that the minister of mines is to advise the NRA on the re-characterization of royalty payments rather than make the adjustment internally.

This slight overlap of responsibilities is made more problematic by the general power struggle between the MMMR and MoFED, and the NRA. It is not unusual for a country’s ministry of mines to have a privileged relationship with mining companies; they may be required to represent company interests where conflicts

with other arms of government arise. However, critics suggest that the MMR is reluctant to coordinate with MoFED and the NRA, and even challenge their authority when the RTPD engage with mining companies on issues within their own remit.

The NMA however appears to be more collaborative, and is already working closely with the EIRU, for example, initiating a joint visit to Sierra Minerals Holdings following a request for concessions. An MoU between the NMA and the EIRU was drafted in 2015, clarifying the responsibilities of both agencies, as well as areas of potential collaboration, including joint assessment of royalty payments. The MoU is yet to be signed. Close coordination with the NMA is particularly useful given that the EIRU is only just beginning to develop extractive sector expertise. By working with the NMA, the EIRU will begin to understand the mining value chain, as well as have access to relevant production and cost information from companies. Previously, the NRA was blocked from liaising with the NMA. The commissioner general did not understand the mandate of the NMA and so instead of collaborating became competitive. Similarly, the NMA had thought it was their role to audit company's books. Tensions were exacerbated due to the NMA wanting to retain revenues collected, rather than submitting them to the Consolidated Revenue Fund (CRF). However, the establishment of the EIRU, a specific interface for mining, as well as the MoU should resolve many of these challenges. A series of joint visits to mining companies looks extremely promising for a good working relationship moving forward.

The Extractive Industries Revenue Taskforce (EIRT) has significantly improved inter-agency coordination regarding implementation of the mining fiscal regime. The EIRT was formed in 2013, initially as an informal mechanism to troubleshoot various issues in relation to the Extractive Industries Transparency Initiative (EITI). The taskforce is hosted by the NMA, chaired by the director (or designated officer) of the RTPD Policy Division, and brings together the NRA, the NMA, the Petroleum Directorate, SLEITI, the Forestry Division, and key development partners. The taskforce has now been formalized following the development of a ToR, which needs to be signed by senior management of the EIRT stakeholders. Regardless, the taskforce has greatly improved coordination at the technical level with respect to revenue collection and is a valuable byproduct of the EITI.

Petroleum

Established in 2011, the Petroleum Directorate (PD) is the regulatory authority for the petroleum sector, and is tasked with monitoring, regulating and facilitating oil and gas investments. The PD reports directly to the president, working closely with the Strategy and Policy Unit at State House. The strong link to the executive is a major concern given the potential for politicization of the award and management of concessions. The close relationship with State House also reduces the PD's incentive, as well as willingness, to cooperate with other government agencies. This is evidenced by the PD retaining all surface rent payments and signature bonus payments in 2012 and 2013, and creating an account parallel to the CRF despite this being in contradiction with the law. However, rather than correcting the situation, MoFED requested a loan from the PD after a delay in expected budget support in 2013. Coordination between the PD, MoFED and the NRA is extremely minimal, in part, this is due to the petroleum sector still being under exploration, however political interference also plays a key role.

The Extractive Industries Revenue Taskforce has greatly improved inter-agency coordination in the implementation of the mining fiscal regime, such that joint audits are now being planned between the National Minerals Agency and the Extractive Industry Revenue Unit.

The Audit Service Sierra Leone (ASSL) has recently begun cost audits of petroleum companies. While it is part of their mandate to audit public institutions, the NRA and MoFED were unaware that such audits had begun, further emphasizing the lack of coordination in the sector. The fact that the request for the ASSL to undertake cost audits came directly from the PD, without the NRA's knowledge, indicates how much more needs to be done to improve relationships as well as coordination.

TRANSFER PRICING ACCOUNTABILITY MECHANISMS

Civil society

In general, civil society and the media are increasingly knowledgeable about the extractive sector. However, this knowledge is limited to discrete components such as local content and community development agreements, rather than an integrated understanding of the sector as a whole. There are a small number of civil society groups working on issues of extractive sector management, these include: the Network Movement on Justice and Development (NMJD), the National Coalition on Extractives (NACE), the Budget Advocacy Network (BAN), and the recently formed Natural Resource Governance and Economic Justice Network (NaRGE). Despite serious resource constraints, civil society groups continue to demonstrate an understanding of the sector through the production of reports such as "Not Sharing the Loot," "Sierra Leone at the Crossroads," and "Losing Out," as well as pushing for reforms. In addition, NACE has worked closely with Parliament to transfer knowledge and produced a parliamentary guide in 2011. Finally, the representation of civil society groups (NACE and NMJD) on the Sierra Leone Extractive Industries Transparency Initiatives (SLEITI) multi-stakeholder group (MSG) and the Natural Resource Charter benchmarking expert panel is indicative of their knowledge and understanding of the sector.

However, there is a significant gap in the understanding of fiscal issues, including tax avoidance, as well as the business operating environment. In terms of revenue collection, civil society has largely been concerned with assessing the impact of tax exemptions in the mining sector, but they are yet to go beyond this to look at issues of tax avoidance or evasion. This is partly because the problem of exemptions and political discretion are still so great in Sierra Leone. But for civil society and the media to function as an effective check on the government with respect to implementation of tax avoidance rules in the extractive sector, significant capacity building is required.

Civil society organisations are powerful advocates for improved fiscal transparency in the extractive sector. But significant capacity building is required if they are to be an effective check on government and companies in the implementation of transfer pricing rules.

Extractive Industries Transparency Initiative (EITI)

Since Sierra Leone joined the EITI in 2006, and became a candidate in 2008, the extent to which this initiative has been able to advance the fiscal transparency agenda has been varied. There is significant political support for the initiative, as demonstrated by the fact that President Koroma's chief of staff is the EITI champion as well as chair of the EITI multi-stakeholder group. Annual reconciliation reports have enabled greater scrutiny of the financial exchange between companies and the government. For example, the 2008-10 reconciliation report revealed that some companies had reported higher payments to the government than those received; the NRA and other stakeholders were able to resolve these discrepancies. However, there is a concern that while the reconciliation process may highlight discrepancies, citizens are not equipped to ask the right questions and follow-up can be limited. Despite this, SLEITI has been effective in consolidating other fiscal transparency

developments in the extractive sector. The Mining Cadastre System (MCAS) which was set up in 2009 as a solution for improved license management, has not only been a huge asset to the SLEITI process, but the financial information available from companies as a result of SLEITI has made the MCAS more comprehensive. Similarly, the EIRT has become a more relevant and effective coordination mechanism due to the improved information transfer from mining companies to government.

However, there are concerns regarding SLEITI's effectiveness in progressing the transparency agenda. This was most evident when Sierra Leone was suspended from the EITI in April 2013 as a result of having failed four of the EITI requirements during the 2012 validation. The reasons for Sierra Leone's suspension have since been addressed, and EITI compliance was attained in April 2014, yet the problems exposed by the reconciliation process revealed wider challenges regarding fiscal administration in the extractive sector, particularly coordination of tax and non-tax revenue. This has led to concerns about whether Sierra Leone will meet the new EITI standards as the government are required to provide detailed information regarding how extractive revenues are spent. There is also a need for Sierra Leone to get up to date on the production of reconciliation reports: the most recent published report was for 2011. Timely information is critical if oversight actors are to use SLEITI for meaningful accountability purposes.

Despite some shortcomings, SLEITI has provided an important opportunity to open up management of the extractive sector to a wide range of stakeholders including companies and civil society, all of which are represented on the MSG. SLEITI has also been a catalyst for the recent online publication of all re-negotiated contracts,⁴ as well as a vehicle for improving disclosure of beneficial ownership, which is critical to transfer pricing as it has the potential to reveal related parties. Following discussions with the Revenue Development Foundation there are now plans to connect the MCAS to a database called Open Corporate, which will help to reveal ownership connections at the international level.

Parliament

All MLAs, petroleum agreements, and extractive sector legislation, must be ratified by parliament. However, in practice, there is limited opportunity for debate in parliament on extractive sector management, including when MLAs and petroleum agreements are tabled for approval. MPs contend that the lack of parliamentary oversight of relevant extractive sector legislation, mining and petroleum agreements in particular, is due to the Executive not involving them in the negotiations. Instead, documents are brought to MPs at the last minute for approval. For example, in April 2012, the second amendment to the Sierra Rutile Agreement Act of 2002 was fast tracked through parliament under emergency procedures, allowing limited time for discussion. The amendment liquidated the government's equity, a decision widely criticized in hindsight given the current value of rutile. At the time, local media speculated that this rushed move was to finance the ruling All People's Congress (APC) party's 2012 re-election bid. More recently, the National Carrier Act of 2013, which requires companies to ship 40 percent of all cargo imported into and exported out of Sierra Leone via the Sierra Leone National Shipping Company (SLNSC), was rushed through at the end of a parliamentary session. The outcome may not have been different if parliament had been given more time,

Parliamentarians argue that their limited oversight of mining and petroleum agreements is a function of the Executive rushing these documents through parliament, often under emergency procedures, stifling opportunity for debate.

⁴ Publication of mining contracts was also the result of a budget support requirement developed by the African Development Bank.

yet the significance of this legislation to existing mining operations, as evidenced by the subsequent uproar from companies, indicates that further consideration was clearly warranted.

Further reasons for limited parliamentary oversight include insufficient expertise and understanding of the extractive sector, as well as lack of political interest. First, many MPs lack detailed knowledge of the extractive sector. For example, no MPs have a tertiary qualification in mining or geology, nor any relevant practical experience. While this is not essential to effective parliamentary accountability, it is significant given that large-scale mining is still relatively new to Sierra Leone. Secondly, and perhaps of greater concern, is the impact that party politics has on parliamentary engagement in extractive sector management. Interviews with the parliamentary committee revealed limited knowledge and interest in the recent developments with AML and Timis Corp. Arguably, this general lack of interest is due to parliament's close ties to the executive: MPs understand that they can't win much by getting into trouble with the executive and/or companies, so they avoid raising concerns and instead focus on channelling benefits to their constituency. According to civil society, MPs only become concerned with the fiscal terms of MLAs and PSAs when they themselves have failed to benefit. The boycotting of a pre-legislative session on the EIRB, despite parliament having requested it, is indicative of the overriding nature of political interests in Sierra Leone.

TRANSFER PRICING ADMINISTRATIVE CAPACITY

Transfer pricing expertise

A lack of transfer pricing expertise has been cited as the major obstacle to effective implementation of the transfer pricing provisions in the ITA. According to a UK Department of International Development (DFID) funded consultant to the NRA, "transfer pricing legislation is appropriate, the issue is capacity, the NRA needs to know what to look for and what to do about it." It is only in the last few months that the head of the EIRU, the head of the LTO, and an officer from the RTPD of MoFED were invited to attend a two-day training on transfer pricing in Zambia facilitated by the African Tax Administration Forum (ATAF) and the United Nations Development Program (UNDP). This is the extent of transfer pricing training for the entire NRA and MoFED. None of the 17 members of the audit team have received training on transfer pricing. Most NRA auditors were trained as accountants, however they admit a lack of knowledge on international tax law, trade, and mining, and have limited opportunities to top-up their training. DFID previously contracted Crown Agents to provide specialized mining audit training to the NRA, however the audit team regard this as brief and superficial. The audit manager of the NRA is currently planning to develop comprehensive training for all staff in the Domestic Tax Department, in addition to the short orientation, which they receive when recruited.

The National Revenue Authority urgently requires capacity building on transfer pricing. Only a handful of auditors have received training on transfer pricing, and this has been limited to a two day event in 2015.

Understanding the mining value chain

NRA officials openly admit that mining and petroleum audits are not happening. Before London Mining and African Minerals stopped mining in Sierra Leone, the NRA had not received annual financial statements from either company since 2012, making it difficult to audit them even if there had been a desire to do so. There was an attempt to audit AML in 2014, requested by the NMA, however it was stopped early due to the iron ore price slump. Previously the NRA audited a gold mining

company in Kono regarding PAYE and withholding tax, however the company was already in financial distress and by the time the audit was complete the company had closed down.

There are a number of inferences that can be drawn from the fact that the NRA has not yet completed an audit of an extractive company. A key reason is lack of technical expertise and understanding of the extractive sector. Crown Agents previously selected a handful of audit staff to receive a short training on mining audits, this included site visits to Koidu Holdings and Cluff Gold. These visits were intended to be on the job audit training but as the mentors were not grounded in mining the training was fairly general, ignoring the technical aspects of the sector. The audit manager admitted the lack of knowledge of the extractive sector, hence the establishment of the EIRU.

The EIRU has four staff, including two economists and two accountants. None of the staff have been trained in specialized audits, nor do they have prior experience in the sector. Following a visit to Sierra Minerals Holding earlier in 2015, the Head of the EIRU organized a subsequent orientation tour visiting the five mining companies. While the EIRU will undoubtedly begin to receive training on taxation of extractive industries, strong coordination with the NMA is required to enable the transfer of technical expertise, industry experience, as well as information.

TRANSFER PRICING INFORMATION

Risk assessment and selection of transfer pricing cases

There is currently no specific transfer pricing risk assessment framework by which taxpayers are selected for audit. However, there is a general risk matrix against which tax returns are analyzed. This includes indicators such as past tax compliance, profitability compared with other taxpayers in the sector, and whether they are new or old taxpayers. The head of the EIRU has developed a draft audit manual for the extractive sector which includes a risk assessment framework covering profits, operating costs, and the results of previous audits. This initiative would benefit from technical support.

The NRA has a target of auditing one-third of large taxpayers each year. Large taxpayers are defined as taxpayers with US \$1 million annual turnover. Every six months the Design and Monitoring Team submit a list of approximately 40 companies to the audit team, with the expectation that they will audit the majority. Audit findings and subsequent adjustments are the responsibility of the Compliance Team. The Risk Intelligence Unit intends to monitor internal and external fraud and recommend companies for audit to the Design and Monitoring Team. There is speculation that this team is deliberately ineffective so as to avoid causing problems for the government.

Notwithstanding the fact that mining and petroleum audits are yet to commence, reporting on audit results is generally poor. There is very little data on the number of audits completed, additional tax assessed, disputes, and final results. This is indicative of the government's disproportionate focus on revenue collection versus actual tax compliance. It has been suggested some of these additional metrics should be included in the NRA's performance contract with the president.

While the Extractive Industries Revenue Unit is finally receiving specialized audit training, it must continue to work closely with the National Minerals Agency to benefit from its industry experience and knowledge.

Access to appropriate transfer pricing comparables

The NMA has a subscription to Energy and Metals price forecasts, and receives Platts index information from a third party. These are useful sources insofar as determining the market value of mineral products, and to compare operational costs such as freight and insurance. The NRA however, does not have access to any form of international transfer pricing comparables, for the extractive industry or otherwise.

Beyond these basic mineral product pricing benchmarks the NRA and NMA rely on being able to compare industry trends, or similar domestic transactions. This is challenging given the small number of mining companies in Sierra Leone, as well as the limited industry experience among government officials. For example, Koidu Holdings a diamond mine in the East of Sierra Leone, has exhausted its existing resources and is having to go underground, creating a huge expense for which they require further concessions. The NMA should be in a position to verify the costs forecasted by Koidu Holdings, but nobody has experience in underground diamond mining in Sierra Leone. The expert panel from the Sierra Leone extractive sector benchmarking project have suggested that in such instances short-term consultants with relevant experience must be contracted to review the company's expansion plans, as well as forecasted expenditure.

Bauxite sale prices have been particularly challenging as there is only one company engaged in bauxite production, making it impossible to establish domestic comparisons.

Verifying the sale price of bauxite has been particularly difficult. To limit the risk of undervaluation government should subscribe to the bauxite price index, which gives a monthly spot price that can be used to evaluate related party sales.

Box 2. No domestic comparison for bauxite mine

There is currently only one bauxite producer operating in Sierra Leone. The local company was established in 2005 when operations began, and the asset was acquired by the current parent company, along with two other subsidiaries, in 2008. The mine has a resource base of approximately 31 million tons of bauxite and currently produces approximately 1 million tons annually for export.

The parent company is an integrated aluminium group registered in Romania and China. The bauxite is purchased by a subsidiary company registered in the British Virgin Islands, and used to cover the demand of its owner's refinery. This creates a clear risk of under-invoicing. Despite this risk, the government has only once exercised its right to review the purchase annual agreement. This is due to the NMA feeling ill-equipped to evaluate the sale price.

The integrated nature of the aforementioned value chain is not unique. It is commonplace in the bauxite industry for the purchasing company to be closely related to the extraction company. This feature of the industry is primarily due to bauxite having few alternative uses other than in the production of aluminium, and, after numerous buyouts only a handful of large companies remain in business. While the bauxite industry presents specific transfer pricing challenges, the sector is changing and the government has the opportunity to strengthen its capacity to evaluate the sale price between related parties. For example, there is now a bauxite price index that the government can subscribe to which gives the monthly spot price. Despite spot prices being more volatile and higher than long-term contractual prices, this index offers the government an objective reference point when evaluating sale prices. According to the bauxite mine in Sierra Leone, their sale price is no secret. They send lab results along with their royalty calculations, so the NMA can examine the quality and cost of production, and then verify the sale price against the bauxite price index. However, the absence of a laboratory in Sierra Leone to test mineral quality makes independent verification difficult.

The NMA was established in 2012, and the EIRU in 2014, so it is only recently that government has had the appropriate institutions, as well as expertise, to begin to properly evaluate deductible expenditure. This is despite longstanding concerns that generous carry forward provisions, as well as withholding tax exemptions, mean that deductible expenditure represents a particular transfer pricing risk in Sierra Leone. For example, in the case of Koidu Holdings and Sierra Rutile there is no limit to the duration that losses can be carried forward; Sierra Rutile has a further advantage in that it is exempt from all forms of withholding tax.

Excessive management fees are not a new problem for Sierra Leone. As far back as the early 1990s, a major mining company included in their accounts a three percent management fee. With annual turnover at approximately US \$76 million at the time, the company was transferring a little under US \$4.5 million annually to its parent company. Nothing was done about this then, however with the arrival of the NMA, invoices to support management fees are now being requested from this company, as well as other companies generally. Accessing invoices for intra-company services is an important first step, yet the NMA currently has no way of verifying these fees. This is where access to a transfer pricing comparables database such as Orbis, which would provide benchmarks for generic costs such as management fees and interest rates, would be useful. However, training on transfer pricing is required first to ensure that officials are able to use a database correctly.

Access to information

The NMA receives production and cost information on a monthly, and quarterly basis, respectively. Annual tax return and financial statements are submitted to the NRA, however as mentioned previously, prior to AML and LMC ceasing operations in 2014, the last returns received from these companies had been from 2012. At the time of interview the NRA had updated financial statements for Sierra Minerals Holdings, Sierra Rutile, and Ocea. The NRA does not automatically share these financial reports with the NMA; according to the NMA, the NRA receives the reports and files them away. MoFED requests companies to provide quarterly project economics through the NMA, for use in the country's macroeconomic forecasting model, however companies do not always provide the relevant information. According to international development partners, mining companies provide data to the IMF which is not necessarily provided to the government.

To date, coordination of information collected from mining companies has been poor, in part due to overlapping responsibilities between various agencies. According to several companies, the Environmental Protection Agency (EPA) will make a number of requests for information and the NMA will follow with the same requests. Consequently, companies wonder who is responsible for what. To clarify responsibilities for information gathering, and to improve information sharing, the NMA and MoFED, via the EIRT, are compiling a consolidated list of information requirements. This template will then be shared among members of the EIRT on a regular basis.

Mining companies may not always be forthcoming, yet the main reason for the current lack of information is poor enforcement of reporting obligations. The government has failed to press companies to comply. According to some officials, the NRA did not receive financial statements from companies because they didn't ask for them, and they didn't enforce penalties. This was largely due to the political clout of some mining companies, making officials reluctant to hold them accountable. One official said: "There is no incentive for companies to provide information because

Poor enforcement of reporting obligations is largely to blame for incomplete information from companies. According to some officials, the NRA did not receive financial statements from companies because they didn't ask for them, and they didn't enforce penalties.

the political class have given them a blank check.” Despite the legal basis for the NRA to request from mining companies financial agreements in excess of US \$50,000, they have failed to do so, notwithstanding concerns about transfer pricing.

Box 3. Excessive price discounts to related parties

Since the company made its first iron ore shipment from Sierra Leone in 2011 there was significant variation between the international sale price and the company sale price. The company FOB sale price dropped from 58 percent of the CFR price in 2013 to 42 percent in 2014, an average deduction of US \$62.4 p/ton. The main reasons for the lower price were deductions for freight costs, quality adjustments, and customer discounts. The latter accounted for 18 percent of the price difference. While it is not unusual for such deductions to be made under off-take agreements, there was concern that the discounts were unnecessarily high for two of the four customers, both of which were affiliates. At the end of April 2014, it was estimated that US \$5.9mn may have been foregone in royalties (about 14 percent less than what was due) as a result of customer discounts. This is despite Section 148(3) of the Mines and Minerals Act of 2009 explicitly excluding discounts, commissions or deductions, in the calculation of mineral royalties.

The recent experiences of the NMA and the RTPD indicate that it is possible to get the information that the government is legally entitled to, all that is required is proper enforcement. In the case of AML, MoFED used their duty waiver as leverage for documentation, and in the end they received the relevant information. It seems that simply requesting the information, and enforcing compliance is what has been missing. In addition, poor information management and record keeping on the part of the government has further exacerbated problems of access to information. This has improved with the creation of the MCAS and the online repository, however challenges remain.

Given the problem of transfer mispricing with respect to related party sales, it would be reasonable to expect the NMA to have requested and received all offtake agreements. However, when trying to confirm whether the NMA had Sierra Minerals Holding’s offtake agreement it took the director general of the NMA to personally call the CFO of the company to confirm whether it was in their possession. Information management at the NRA also requires significant improvement, particularly in the area of reporting on audits, consequently there is limited available information on how many audits have been completed, the additional tax assessed, the extent to which there are disputes with taxpayers, and what the outcomes are. A key priority for DFID, the World Bank and the African Development Bank (AfDB), is to support the NRA with the introduction of an Integrated tax administration system to improve record keeping.

Strengthening enforcement of reporting requirements is critical, however without independent information to verify company reports, it may be difficult to identify and evaluate potential transfer mispricing. The NMA had requested government support to setup a pre-shipment inspection facility to verify the grades and tonnages of bulk commodities. However, instead of capacitating the NMA to do the pre-shipment inspection, the government contracted the services of a private company. The agreement signed between the government and this company stipulates that a fee of one percent of the value of the export is to be paid by companies for the service. This is a huge burden for companies, plus there will be no transfer of skills to local people.

Information from other tax jurisdictions

There are currently no partnerships or points of cooperation between the NRA and other international tax authorities. Consequently, the NRA and MOFED have virtually no knowledge of tax issues pertaining to members of multinational companies registered in other jurisdictions. Despite recent improvements in international financial disclosure requirements, the vast majority of extractive companies operating in Sierra Leone are not covered by these initiatives due to where they are registered, and their size. The majority of the companies operating in Sierra Leone are listed on the Alternative Investment Market (AIM), a sub-market of the London Stock Exchange that allows smaller companies to float shares with a more flexible regulatory system. This means that companies such as Sierra Rutile, Amara Mining, and Nimini Mining, which are all listed on AIM, are not covered. Similarly, Koidu Holdings, a subsidiary of Beny Steinmetz Group Resources, which is registered in Guernsey, is not subject to UK company law.

The majority of mining companies in Sierra Leone are exempt from recent international financial disclosure requirements, either because of where they are registered, and/or their size. This reduces the possibility of building a complete picture of companies' global activities.

Box 4. Suspicious cancellation payments to related subcontractors

In 2012 AML paid Global Iron Ore Cyprus US \$50 million to break their contract in order to create room to give Shandong Iron and Steel a 25 percent ownership stakes and rights to the ore produced. GIO had been arranging supply deals with Chinese consumers, as well as providing logistics support and managing construction of a desalination plant. These contracts were cancelled in return for US \$50 million.

Two years prior, concerns surfaced that a non-executive member of AML's board, who later resigned, had a financial interest in a company related to GIO. Following this there was speculation that Frank Timis owned a quarter of GIO. An internal investigation of GIO revealed that the allegations were "neither proved or disproved." It was later found that most of the money had been paid to an entity in the the British Virgin Islands called Marston Enquiries. According to a joint venture arrangement Marston was entitled to "70 percent of any and all revenue, profits, income or fees generated by GIO," however all contracts were to be entered into solely in the name of GIO. Ownership records and the identity of directors of the company in the British Virgin Islands are not public.⁵

⁵ Bloomberg Business. *Africa Minerals Probed Chairman Over \$50 Million Payment* (2014), accessed at May 18 2016, <http://www.bloomberg.com/news/articles/2014-08-06/african-minerals-probed-chairman-over-50-million-payment>

TRANSFER PRICING DOCUMENTATION REQUIREMENTS

There are no specific transfer pricing documentation requirements in Sierra Leone. However, Section 134 and 135 of the ITA authorizes the NRA to request information or evidence from taxpayers. There are also relevant documentation provisions in the MMA of 2009. Specifically, Section 153 requires large-scale mining licence holders to provide the NRA with copies of all sales, management, commercial and other financial agreements in excess of US \$50,000 concluded with any other person, including affiliates. Furthermore, Section 158 provides a catchall information provision, giving the Minister of Mines the power to request any relevant information. The Petroleum Act of 2011 does not require disclosure of financial agreements with related parties, however Section 122 and 123 outline company obligations in so far as maintaining information, data, reports, accounts and so on. Penalties for failure to disclose are very limited: US \$200 and US \$500 in the ITA and MMA respectively.

Interestingly, despite the absence of transfer pricing documentation requirements in the ITA, there are some MLAs that specifically reference this obligation. For example, the MLA with Koidu Holdings requires affiliate transactions to be accompanied by contemporaneous documentation, giving the government the right to review all transactions. Similarly, the MLA with Sierra Minerals Holdings requires the company to provide documentation pertaining to related party transactions.

Transfer pricing documentation requirements are urgently needed. Without documentation it is virtually impossible for the National Revenue Authority to prove that transfer mispricing has taken place, and make the corresponding tax adjustment.

TRANSFER PRICING DISPUTE RESOLUTION MECHANISMS

There are no specific dispute resolution mechanisms for transfer pricing in Sierra Leone. According to Section 151 of the ITA, the penalty for underestimation of tax payable is applicable to first and second installments less than 60 percent of actual chargeable income, and then less than 90 percent for the third and fourth instalments. The taxpayer is then liable to a penalty of three percent above the “specified rate of interest” on the difference between the instalment and tax payable. Such breaches by mining and petroleum companies may also provide grounds for license cancellation.

Taxpayer disputes can go to court in Sierra Leone: a disagreement between the NRA and a company over goods and services tax went to court last year, however they are since pursuing an out of court settlement. Just recently, parliament approved the establishment of the Board of Appellate Commissioners, a court specifically for taxpayers which was provided for in the ITA. Assuming that the board is equipped to handle tax avoidance cases in relation to the extractive industry, it should provide an adequate forum in which to resolve transfer pricing disputes if they arise in the future. With respect to mining specifically, disputes tend to get resolved at the level of the Strategy and Policy Unit at State House. According to the MMR: “We do not have capacity to get involved with legal issues. Companies have the best lawyers, as a ministry we don’t have the best lawyers. We need to have bright minds that can take quick decisions.” Sierra Leone does however have access to the African Legal Support Facility funded by AfDB, which is currently assisting in the negotiation of two industrial gold concessions, the first of their kind in Sierra Leone.

TRANSFER PRICING TECHNICAL ASSISTANCE

Sierra Leone has received virtually no international technical assistance on transfer pricing thus far. The only training that Sierra Leone has participated in is an introductory workshop on the general principles of transfer pricing delivered by the UNDP to the head of the EIRU, assistant commissioner of DTD of NRA, and an officer of MoFED. There are plans for follow-up trainings to be facilitated by ATAF. The moment is ripe for technical assistance on transfer pricing due to high-level interest, as well as political commitment, particularly from MoFED. The head of the RTPD included the development of transfer pricing regulations in his performance plan. Having uncovered potential transfer mispricing issues in relation to the sale of mineral products, MoFED is particularly aware of the risk that transfer mispricing poses to the mining sector.

Some observers suggest that transfer pricing reform, and indeed capacity building in this area, should not be a major priority for the government at this stage. Advisers to the NRA are of the view that given capacity constraints the NRA would be better off bringing in international experts to take care of transfer pricing issues for now. Instead, the more urgent training needed for NRA and MoFED officials relates to mineral economics, so that they know what to look for and what to do about it, whereas transfer pricing experts can be brought in to investigate the issue. Basic tax administration strengthening is needed in order to provide a solid foundation on which to pursue international tax issues. Some of these areas include revising the ITA, development of supporting regulations, promulgation of the 2010 GST regulations, as well as customs regulations. There is also a need to update these laws on the NRA website and develop taxpayer guides.

There is an argument to be made for sequencing tax reforms, and yet there is clear political momentum regarding the issue of transfer pricing in Sierra Leone. Consequently, it would seem sensible to capitalize on this momentum to tackle tax avoidance, and for international partners to help guide the government in developing appropriate transfer pricing regulations, as well as provide targeted capacity building opportunities. Given that the government has highlighted the problem of transfer pricing in relation to mining, and the EIRU is now in place, it would be advisable to focus capacity building efforts specifically on this sector. Training on the basic principles of transfer pricing is required for the NRA, however given capacity constraints it may be appropriate to focus further training on the most strategic sectors. There is no doubt that the NRA will require significant support to implement transfer pricing regulations once they are in place, and access to the OECD Tax Inspectors Without Borders would be particularly useful. The AfDB is reportedly planning something similar for the EIRU.

There is clear political momentum to tackle transfer pricing in Sierra Leone. International partners should seize this opportunity to support the development of appropriate regulations, and provide relevant training.

GOVERNMENT LEADERSHIP

The extractive sector in Sierra Leone is deeply political. This may explain, at least in part, weak enforcement of company compliance with the fiscal regime, specifically, the absence of tax audits for mining companies. It is widely known that at least a couple of major mining companies have significant influence over the government. According to tax officials, these companies are “untouchable.” While it is unclear whether the NRA has ever been disallowed from conducting an audit of a mining company, it is evident that officials are wary of putting too much pressure on companies in the event that they receive a “tap on the shoulder” from someone higher up. There are some officials that are prepared to be more resolute with companies, and have demanded and received information.. This suggests that the problem is lax law enforcement, although companies could also be more forthcoming rather than the government having to run after them. It is important to note that not all companies have a cosy relationship with the government, for example Koidu Holdings was forced to shut down for one year following a riot in 2007, however the government only tends to intervene when there is a community problem.

Poor enforcement of company compliance is not solely due to personal relationships, but ad hoc decision-making, which enables corruption and mismanagement. The case-by-case approach to developing MLAs makes enforcement of the fiscal regime unnecessarily complicated. The government has been widely criticized for departing from the legislation in these agreements and granting generous tax concessions. Regardless of whether these concessions were necessary to attract investment, the fact that MLAs have been negotiated on a case-by-case basis means that each one is adding a layer of complexity to the governance of the sector, which in turn makes it complicated for government officials to enforce compliance. The Mining Negotiations Team is regularly circumvented depending on the particular company and its relationship with government. According to a member of the team, “We started reviewing the Sierra Rutile agreement which had been breached with impunity in the past, then Rutile stopped coming to the table and government did nothing.” Similarly, the team tried to get involved in negotiations regarding the transfer of rights from AML to Shandong, but the Cabinet, the MMMR, and MoFED handled this. Finally, it was only last year that the Ministry of Finance stopped calling up companies and requesting royalty payments without consulting the NMA. While this was due to MoFED wanting to pay salaries, the lack of process, as well as the attitude of “we’ll sort it out later,” sent a signal to companies and officials that anything goes.

The lack of appropriate institutions and limited technical expertise, has also been a factor in the poor enforcement of company compliance. Prior to the establishment of the NMA in 2012, there was no appropriate institution to monitor company compliance; the MMMR was focused on signing MLAs, limiting their ability to be an effective watchdog. According to an industry expert, “The only people who can do justice to monitoring companies are senior officials at the NMA. Checking on operational costs is complex, requiring industry experience.” Even the NMA is not sufficiently equipped to fulfil this function; it is in need of a mineral economics unit, as well as additional mining engineers. It was only in 2014 that the EIRU was setup to build the specific capabilities to monitor extractive industry taxpayers. So while audits have been limited to date, Sierra Leone may now have the appropriate institutions and be building the necessary expertise to improve enforcement of the extractive industry fiscal regime.

It is unclear whether the National Revenue Authority has ever been stopped from auditing a mining company. Regardless, officials are wary of pressuring companies for fear that they will receive a “tap on the shoulder” from higher up.

CONCLUSION

The government of Sierra Leone is poorly prepared to protect the extractive industry tax base against potential transfer mispricing. There is growing awareness among government officials of the problem of transfer pricing, yet this has not transformed into action: the transfer pricing legal framework is inadequate and lacks appropriate regulations and documentation rules; too few tax officials have been trained in transfer pricing; there are major gaps in the information required from both local companies as well as other tax jurisdictions; and political interference remains a particular obstacle. It is unknown the extent to which these various shortfalls have already undermined the extractive industry tax base, however it is clear that vital revenues have been lost. The alleged under-invoicing of the sale of iron ore to related parties in Box 3 is a case in point, with approximately US \$5.9 million in royalties lost due to transfer mispricing not to mention the impact on chargeable income. This is despite the fact that the law prohibits mining companies from including discounts, deductions, and commissions in the computation of royalty payments.

Notwithstanding Sierra Leone's general lack of preparedness to tackle transfer pricing in the extractive sector, there are some features of the natural resource governance framework that promise to be a strong foundation for transfer pricing reform. The EIRT has been extremely successful in improving inter-agency coordination in extractive industry revenue collection at the technical level. In particular, the collaboration that has emerged between the NMA and the NRA, especially the EIRU, bodes well for the sharing of information and expertise, a necessary condition for implementing transfer pricing rules in the extractive sector. Already the NMA and EIRU have conducted joint site visits and agreed to collectively assess royalty payments. Unlike the other countries included in this study that have focused almost exclusively on related party sales, Sierra Leone has also sought to limit deductible expenditure according to the arm's length principle. This requirement is included in the EIRB, and while this is unlikely to be introduced into law, key elements will be reintegrated into the Income Tax Act and the new Core Minerals Policy.

Building on these foundations, the government, with support from international partners, must set a clear path for transfer pricing reform. A broader package of tax administration improvements are required to enable effective implementation of transfer pricing rules, yet this should not be an impediment to moving forward on this particular issue, especially if there is political momentum. Transfer pricing reforms should be simple and strategic, focusing on the most economically significant sectors, companies, and even transaction types. There are only a small number of large-scale mining companies operating in Sierra Leone. Consequently, the EIRU, in collaboration with the NMA, must identify the transfer pricing risks in relation to each company, the information required to monitor and evaluate these risks, and gradually begin to undertake transfer pricing enquiries. This approach may not be as comprehensive or accurate as is ultimately required, however it will enable the government to begin to protect the extractive industry tax base, and in doing so ensure that Sierra Leone secures its fair share of resource rents.

RECOMMENDATIONS

Transfer pricing legal framework:

- 1 The Ministry of Finance should introduce transfer pricing regulations to operationalize Section 95 of the ITA. The ITA may provide an adequate legal basis from which to pursue transfer pricing cases, however regulations will enable increased awareness of transfer pricing among government officials and taxpayers; a focus for capacity building as well as structural change; a consistent and coordinated approach to interpreting and applying transfer pricing provisions in the primary legislation; and increased confidence amongst auditors to pursue transfer pricing cases. The regulations should include strong transfer pricing documentation rules so as to avoid delays when requesting information.⁶
- 2 The MMMR should amend the MMA of 2009 to (a) limit deduction of expenditure according to the arm's length principle, and (b) provide for APAs. At present, Section 154 of the MMA applies the arm's length rule to the sale of mineral products, but not to deductible expenditure. Section 33(3) of the EIRB sought to rectify this issue, however given that the EIRB is unlikely to be passed into law, the MMA must adopt this provision. With regard to the second issue, while the ITA provides for private rulings, including the option for APAs empowers the government to set parameters for a range of intra-company fees, as well as other types of deductible expenditure. Many developing countries are not using APAs due to concerns about negotiation capacity and information asymmetry. However, it is possible to overcome these challenges with technical support from international partners.
- 3 The MMMR should ensure that MLAs reflect the relevant transfer pricing provisions in the ITA, as well as the MMA. All of the MLAs currently require royalties to be calculated based on the market value or the arm's length price, however some MLAs go beyond this to specify how the transfer price should be calculated, and what type of documentation taxpayers are required to keep. This should be standardized across all MLAs, so as to avoid conflicting regimes.

Transfer pricing administrative arrangements:

- 4 The NRA should identify a small number of transfer pricing focal persons within the Domestic Tax Department, including the EIRU. These focal persons should be the primary recipients of transfer pricing training, ensuring continuous development of expertise. Specialists should remain embedded within the Domestic Tax Department, primarily the Audit Team, enabling them to identify potential transfer pricing issues during general audits. Once transfer pricing specialists are sufficiently experienced, the NRA may wish to consider setting up a separate transfer pricing unit, however this depends on whether the number of multinational companies warrants a stand-alone unit.
- 5 The NRA and the Ministry of Finance should give the EIRU as well as the EIRT the necessary political, financial, and technical support required to succeed in monitoring extractive industry taxpayers, and improving inter-agency coordination. The EIRU and the EIRT must be supported by an information-sharing platform to improve exchange of information. This platform should

⁶ See Chapter 7 of the UN transfer pricing Manual (2013) for detailed guidance on transfer pricing documentation rules. Ghana and Tanzania have both used the UN Manual as the basis for their transfer pricing documentation rules.

consolidate all production and financial data from mining companies. Access to the platform should be strictly controlled, and systems put in place to ensure confidentiality of information.

Transfer pricing information:

- 6 To improve access to information, the NRA should undertake the following:
 - Introduce an annual transfer pricing return form that taxpayers are required to submit with their annual tax return. The transfer pricing return form would require taxpayers to specify all related party transactions for that tax year, as well as detail the taxpayer's structure in relation to other related parties within the multinational group. This information enables more accurate selection of cases for audit, and improves information gathering.⁷
 - Subscribe to the Bauxite Index⁸ to improve monitoring of the sale of bauxite. The Bauxite Index provides the CFR reference price, as well as the CBIX calculator, a simple tool that gives an indicative price for any bauxite, based on the specific alumina, silicon, and water content. The EIRU and the NMA should use these benchmarks as a basis to review the realized sale price, as well as pricing formulas.
 - Secure a subscription to a transfer pricing comparables database, for example Orbis, by Bureau van Dijk. While these benchmarks may not always reflect the local context, they at least provide a guide that can be adapted as the NRA builds up its own log of transfer pricing information.
- 7 International partners should advocate for financial disclosure requirements to be extended to companies registered on the Alternative Investment Market (AIM). Despite recent improvements in international corporate regulation, the vast majority of extractive companies operating in Sierra Leone are not covered by these disclosure initiatives due to where they are registered, and their financial turnover. The new UK standards must be extended to apply to companies listed on AIM.
- 8 The NRA should improve audit reporting so as to enable more effective oversight of NRA activities, and to provide a basis for follow-up of audit outcomes. Reporting of audits is currently very poor, partly because the NRA relies on a manual reporting system, but also because their performance indicators focus primarily on revenue collection rather than other metrics. To ensure that the NRA is fulfilling its responsibilities, particularly with respect to oversight of extractive industry taxpayers, it is critical that performance indicators be made more comprehensive, and audit reporting improved. Budget Support partners could consider designing a condition around completion of tax audits for large scale mining companies; this would also incentivize them to build capacity in the area of specialized audits.
- 9 With support from international partners, the government should build the NMA's capacity to verify the grades and tonnages of bulk commodities. Recently, these responsibilities have been outsourced to a private firm that charges a commission. While the private sector may provide an appropriate interim solution to the lack of pre-shipment inspection facilities, the government must be

⁷ Ghana and Tanzania's annual transfer pricing return forms can be found on their tax administration websites.

⁸ <https://thebauxiteindex.com/>

mindful of not letting the cost exceed the potential impact on revenue collection, as well as the need to transfer skills to government officials.

Transfer pricing knowledge and skills:

- 10 With support from international partners, officials from the NRA, MoFED, MMMR, NMA and Petroleum Directorate must access further transfer pricing training. So far, only two officials at the NRA have received training on transfer pricing. Further training must be fast tracked, with priority given to transfer pricing risks in the mining sector. It is critical that the industry regulators are included in the training so that they can apply their technical expertise and industry knowledge to monitor potential transfer pricing risk areas, particularly regarding the deductible expenditure.⁹ As transfer pricing capacity is being built, the government may wish to contract an international tax audit firm to conduct preliminary audits of all mining companies. Although this approach is not financially sustainable over the longer term, it may be a useful interim measure to limit revenue leakage whilst also enabling skills transfer to the EIRU.
- 11 The NRA, specifically the EIRU, should develop a transfer pricing risk matrix specific to the extractive sector to guide selection of cases for audit. To adapt the transfer pricing matrix to the extractive sector, the NRA, in collaboration with the NMA and Petroleum Directorate, must map the extractive industry value chain in Sierra Leone, identifying potential transfer pricing risks. This should include initial analysis of the cost structures of major multinational extractive companies operating in Sierra Leone. Using this information, generic transfer pricing indicators can be adapted to the extractive industry, even to specific companies, enabling more informed risk profiling and analysis.
- 12 With support from international partners, civil society, the media and parliament, should obtain training on the basic principles of transfer pricing, as well as how it relates to the extractive sector specifically. This training is necessary for civil society, the media and parliament, to function as an effective check on the government regarding implementation of transfer pricing rules in the extractive sector. This training should improve basic knowledge and form the basis for the development of performance monitoring tools to keep government accountable, and the citizenry informed.

Research for this case study took place in August 2015.

⁹ The AfDB Sierra Leone office has expressed some interest in providing training on transfer pricing and the extractive industries to member countries.

APPENDIX 1: INTERVIEW PARTICIPANTS

Country director, International Growth Centre: Herbert Mcloed

Mission economist, IMF: Matthew Sandy

Deputy director, National Minerals Agency: Peter Bangura

Director general, National Minerals Agency: Sahr Wonday

ODI Fellow, Revenue Tax Policy Unit, Ministry of Finance: Thomas Scurfield

Revenue and Tax Policy Economist, Ministry of Finance: Mohamed Salisu

Deputy Minister, Ministry of Mines: Hon. Abdul Agnosi Koroma

Deputy Commission General Domestic Tax Department, NRA: Alfred Akibo-Betts

Audit manager, NRA: George Smith

Director of monitoring, research and planning, NRA: Philip Kargbo

Head of the Extractive Industries Revenue Unit, NRA: Abu Tarawallie

Technical advisor, Adam Smith International: Graham Burnett

Executive director, CEMAT: Andrew Keilli

Chief financial officer, Sierra Minerals Holding: Abu Bangura

Director of Revenue Tax Policy Unit, Ministry of Finance: Idrissa Kanu

Senior macro-economist, African Development Bank: Ibrahim Ansu Bangura

APPENDIX 2: ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AIM	Alternative Investment Market
AML	African Minerals Limited
APA	advance pricing agreement
ASSL	Audit Service Sierra Leone
ATAF	African Tax Administration Forum
BAN	Budget Advocacy Network
CRF	Consolidated Revenue Fund
DTD	Domestic Tax Department
ECOWAS	Economic Community of West African States
EIRT	Extractive Industries Revenue Taskforce
EITI	Extractive Industries Transparency Initiative
EIRU	Extractive Industries Revenue Unit
EIRB	Extractive Industries Revenue Bill
EPA	Environmental Protection Agency
IFF	illicit financial flows
ITA	Income Tax Act 2000
LMC	London Mining Company
MCAS	Mining Cadastre System
MLA	mining lease agreement
MMA	Mines and Minerals Act 2009
MMMR	Ministry of Mines and Mineral Resources
MoFED	Ministry of Finance and Economic Development
MoU	memorandum of understanding
NACE	National Coalition on Extractives
NaRGE	Natural Resource Governance and Economic Justice Network
NMA	National Minerals Agency
NMJD	Network Movement on Justice and Development
NRA	National Revenue Authority
OSIWA	Open Society Initiative for West Africa
PD	Petroleum Directorate
PSA	production sharing agreement
RTPD	Revenue Tax Policy Department
SLEITI	Sierra Leone Extractive Industry Transparency Initiative
UNDP	United Nations Development Programme