Transfer Pricing Methodology for Refractory Gold Concentrates

In March 2022, to bring clarity to the tax valuation of transactions with gold concentrates, Kazakhstan’s government enacted a new transfer pricing methodology. The methodology applies to export sales transactions with concentrates with defined physical properties and contents of deleterious elements, such as arsenic, sulphur, and carbon. This article examines the new rules to clarify their scope and application.

1. The Regulatory and Tax Regime

1.1. Export and title transfer restrictions

Because of their value, uses and significance for Kazakhstan’s economy, exporting ores and concentrates containing precious metals, such as gold, for processing to overseas smelters, plants and refineries is restricted. The law “On Precious Metals and Precious Stones” also limits the transfer of title to gold when gold-bearing products are refined outside Kazakhstan. Such restrictions relate, inter alia, to Kazakhstan’s Central Bank’s preemptive right to purchase refined gold that originates from auriferous fields located in Kazakhstan.

Gold concentrates must be processed and refined in Kazakhstan, unless a subsoil user can prove that their domestic treatment is infeasible. For example, if ore is refractory or contains high levels of arsenic or other deleterious elements, a subsoil user or third-party plant can find it difficult to absorb related capital and operating expenditures.

A miner willing to export or process its production outside Kazakhstan must demonstrate that the government-approved domestic plants have refused processing the concentrates for economic or technological reasons, such as capacity constraints, the presence or high concentrations of impurities that exceed statutory thresholds and so on. In such limited cases, subject to licensing, sampling and other controls, the government can permit the miner to export concentrates outside Kazakhstan. The precious metals law and enabling regulations therefore differentiate between permanent and temporary mineral exports.

1.2. Transfer pricing controls

1.2.1. Legislative exceptions

Kazakhstan’s transfer pricing law respects the arm’s length principle, but can apply to cross-border and certain domestic transactions between unrelated parties. Transactions concluded under production sharing agreements that contain market pricing provisions are excluded from the law’s scope, provided they were approved before 30 June 2012. While such agreements are prevalent in Kazakhstan’s oil patch, in the mineral sector, the government’s take is limited by subsoil users’ special taxes, i.e., it is not based on a host country-contractor production sharing mechanism.

The legislative exception does not apply to in-scope gold mining contracts. The methodology, which implies that concentrates are not exchange-traded, can thus override tax regime stability and other exceptional clauses when they are envisaged by a subsoil use contract. In-scope subsoil use taxes should exclude one-time payments, such as signature and discovery bonuses, the volume-based mining bonus, or an investor’s compensation for the state’s historical costs.

Uncertainties as regards the rules’ scope can arise from the transfer pricing law’s interpretation. In contrast to the previous law that provided that the corporate income tax, royalties, value-added tax, excise and customs duties, and excess profits tax (EPT) are adjustable, the current statute is less specific as to taxes and dues the tax authorities may adjust for transfer pricing purposes.

1.2.2. In-scope subsoil use taxes

Under time-stabilized contracts, the EPT, a resource rent tax, can be due at a rate of 0%-30% on a subsoil user’s net

3. See KZ: "Rules on Importing Precious Metals and Mineral Commodities Containing Such Metals to Kazakhstan from Countries that are Not Members of the Eurasian Economic Union and Exporting Such Metals and Commodities from Those Countries", approved by Government Resolution No. 422 (22 July 2016) [Правила ввоза на территорию Республики Казахстан из стран, не входящих в Евразийский экономический союз, и вывоза с территории Республики Казахстан в эти страны драгоценных металлов и сырьевых товаров, содержащих драгоценные металлы. Утверждены постановлением Правительства Республики Казахстан от 22 июля 2016 года № 422].


---

* Sholpan Issakova is IBFD Correspondent based in Almaty, Kazakhstan. The author can be contacted at in-tax@mail.ru.


income for tax periods, in which its internal rate of return has exceeded 20%. That is provided that no renegotiation has occurred subsequent to the contract’s entry into force.

Adjustable taxes can include mineral royalties; their rates for precious metals, such as gold, can vary depending on mine geoeconomics.\(^5\) Royalties are paid on the market value of extracted ore based on the metal’s price on a designated international metals exchange. As the applicable norms might imply a disposal, rather than output, value, the tax base can be computed with reference to a subsoil user’s revenue rather than imputed based on observable quotes. That is, the royalty tax can fall within the transfer pricing law’s scope, as, for example, established under the preceding law, i.e., the assessable value must be proven to be arm’s-length.

The more recent mineral extraction tax (MET)\(^6\) that has displaced the royalty regime for later-in-time contracts arguably provides for more certainty as regards the extension of transfer pricing norms to operations that occur prior to the shipment of a mine’s production. The MET, the rate of which for gold is fixed at 5%, is paid on the value of extracted minerals and products like concentrates. That value now relies on London Bullion Market Association’s (LBMA) price quotes.

The explicit relationship between LBMA-quoted prices and the tax base might have eliminated the uncertainty as to the extent of allowed transfer pricing adjustments. That norm pricing approach is consistent with the requirement that LBMA quotations be applied for pricing supplies of gold concentrates with high levels of deleterious elements under the new transfer pricing methodology.

Yet no conceptual change should have occurred in a mine’s production valuation method following the introduction of the MET and reversal of the EPT model. In both cases, minerals’ value must be calculated at the mine’s gate based on observable market quotes, while adjustments remain grounded in the tax authorities’ power to assess a commodity’s price or value in potentially abusive situations and cases lacking transparency by applying a presumptive method.

### 2. Special Transfer Pricing Regulations

The transfer pricing law contains carveouts as regards the tax authorities’ right to adjust the value of a controlled transaction, provided a taxpayer complies with an alternative rule or procedure. For example, a price-setting mechanism might be subject to overriding treaty provisions or established in an intergovernmental agreement. Restrictions also apply to Central Bank’s acquisitions of refined gold, as well as when the price must be determined accord-


ging to a government resolution or government-approved pricing methodology.

Such standalone resolutions and methodologies can be issued by Kazakhstan’s government upon a taxpayer’s request. That is on condition that an authorized government agency has confirmed to the government the socioeconomic expediency of enacting such a resolution or methodology. The request must be supported by appropriate, likely industry-specific, documents and computations.

Although methodologies can focus on a particular operation or development, they must be distinguished from advance pricing agreements (APAs). Analyses, calculations, and so on must demonstrate that the absence of such a special transfer pricing regulation can have adverse socioeconomic consequences, i.e. social and economic ramifications that can impede or imperil Kazakhstan’s national interests or the sustainable development of its national economy.

As noted, transfer pricing controls can apply to transactions between unrelated parties, subject to overriding treaty provisions. However, the legislature establishes distinct reasons for departure from the transfer pricing law’s provisions. Therefore, at least as a matter of Kazakhstan’s tax administration policy, the methodology appears not to be restricted by an applicable treaty. Depending on a related acquirer’s tax residence and applicable foreign regulations, it is uncertain whether such prescriptive unilateral rules would not lead to economic double taxation.

### 3. The Concentrate Pricing Methodology

#### 3.1. The objective scope

Consistent with the transfer pricing law, the new rules do not require that a counterparty be a related enterprise. Customers can include roasters and pyrometallurgical plants, but the bulk of gold concentrates is known to be purchased by copper smelters.\(^7\) Smelters can acquire concentrates from a mine or traders, who can expedite sales and have blending facilities.\(^8\)

The methodology applies provided a miner fulfills the following conditions. First, a taxpayer must prove that high-carbon concentrates (HCC) and low-carbon concentrates (LCC) cannot be processed domestically to reach a 90% or higher recovery rate. To comply with that condition, the miner must obtain written rejections from the approved domestic processing facilities. Second, at least 90% of the doré produced from LCCs must be refined in Kazakhstan.

Methods other than the comparable uncontrolled price method, when applied to price mid-stream commodity transactions, might not reflect their true value.\(^9\) The conditions can be viewed as a substitute for the analysis

7. De Sousa, supra n. 2.

8. Id.

required for identifying realistically available economic options\(^{10}\) that could impact the price.

The methodology does not seem to restrict the tradable volume of HCCs, but might be limiting LCC sales. That is because the second condition mandates that the bulk of the metal contained in the processed LCCs be reimported to Kazakhstan. The rules do not otherwise differentiate between sales made to off-takers or through corporate marketing hubs and transactions in ultimate markets.

### 3.2. The pricing formula

#### 3.2.1. LBMA quotation-based price

For pricing concentrate sales, the government relies on LBMA quotations, i.e., spot prices for unallocated gold delivered in London. Such quotations are "widely and routinely" used as pricing benchmarks by unrelated parties.\(^{11}\) Therefore, LBMA-quoted gold prices can represent prices in comparable uncontrolled transactions or arrangements.

The deemed market price is calculated as follows.

\[
\text{Price} = \left( \frac{C}{31,1034768} \right) \times P \times K - TC
\]

Where:
- \(C\) = the final content of gold stated in grams per dry metric tonne (DMT) of concentrate.
- \(31,1034768\) = the conversion coefficient.
- \(P\) = the average of USD quotes per troy ounce of gold published during a quotation period on the LBMA’s website, taking into account LBMA morning and afternoon benchmarks (i.e., LBMA Gold Price AM and LBMA Gold Price PM).
- \(K\) = the recovery rate that is expressed as a percentage of payable gold in concentrate.
- \(TC\) = treatment charges expressed in USD per DMT of concentrate.

The methodology rules out the use of other prices published in the Metal Bulletin, a data source recognized by Kazakhstan’s transfer pricing legislation. The regulation states that LBMA quotations can be accessed through the LBMA website or the Metal Bulletin. COMEX or other gold quotes may not therefore be used as price benchmarks.

The computed price, i.e., revenue reduced by TC, can be regarded as a value returned to a miner.\(^{12}\) Assuming that the subsoil user produces only eligible concentrates, its return would thus depend on the mine’s output, concentrate grades, recovery rates, treatment costs, as well as prices prevailing during a quotation period, including those for creditable metals other than gold.

The computed price does not require a market access and other premiums related to location-specific advantages or adjustments related to potential dissavings.\(^{13}\) It is unclear whether the tax authorities can rely on the primary legislation that mandates economic analysis to make such adjustments in the future or the new regulation altogether rules out that eventuality because the requisite market qualities or risks are positively lacking.

#### 3.2.2. Payable metals

In the formula above, \(K\) is defined as the recovery rate that is expressed as a percentage of payable gold. That means that no fee etc. is retained by a smelter, i.e. there is no related profit or cost element a party earns or incurs. That is, however, improbable if economic actors are assumed to act in their own self-interest. Therefore, the intention might have been to refer to payable gold expressed as a percentage of the appraised recovery rate, which would have left a margin percentage for a smelter. The parties may agree on terms that diverge from those prevailing in the market, but that latter definition would have been more consistent with industry practice.\(^{14}\)

The methodology permits, subject to a statutory approval, to adjust the recovery rate if the content of gold in concentrate is less than the one stated in a contract. That should reduce payments for gold, but not impact those for other payable metals, the value of which must be factored in the price of concentrate, according to the methodology.

Such metal credits must be computed following an established industry practice, provided the latter conforms to the transfer pricing law. Absent a definition, “other metals” should include all or some precious metals other than gold and exclude, for example, rare earth elements. Yet that might require clarification, as the condition can be subject to the tax authorities’ interpretation.

#### 3.2.3. Comparability adjustments

Under the transfer pricing law, the arm’s length principle commands adjusting a benchmark price for a differential, i.e. a sum of economically reasoned comparability adjustments. Such factor-based adjustments are non-exhaustively defined in the law. The new methodology does not comprehensively address comparability factors either. It explicitly mentions only two factors that must be taken into account in computing the differential to ascertain concentrates’ market price. Such factors include the officially approved recovery rate and treatment charges.

TC must be supported by CRU International Limited’s industry research. It is not entirely clear what that research implies in the rules’ context. For example, it is unclear whether the regulation commands a CRU-certified total or cash cost analysis, cost component validation by reference to a CRU-developed database or utility, or establishing the acceptability of contractually agreed TC in light...
of forecast market conditions for such services, as distinct from the actually incurred costs.\textsuperscript{15}

That question is also because the LBMA standard for gold is tied to fine troy ounces, i.e. signifies a minimum of 995 purity.\textsuperscript{16} Clearly, 99.5\% gold bars, lower purity doré, and early in value-chain concentrates are different commodities. A miner’s revenue less (minus) TC can imply the doré price, unless TC are meant to also include refining, or parting, costs (RC). But that is doubtful, as RC are computed per gross ounce of payable metal, whereas TC are established per DMT of concentrate.

Treatment-related costs, especially those of capital nature, can be significant if concentrates are not free-milling and contain high levels of arsenic, sulphur, and carbon, while weights of individual operating cost items, such as sampling or assaying expenses, can be small.\textsuperscript{17} The new rules\textsuperscript{18} do not identify specific cost components or broad factors that can impact processing costs, such as, for example, concentrates’ supply relative to smelters’ furnace capacity.\textsuperscript{19}

In contrast to the transfer pricing law, the methodology does not differentiate between long-term arrangements, in which price can depend on parties’ bargaining power or expertise, and single-lot-or-load spot contracts.\textsuperscript{20} It is also unclear whether price participation covenants, i.e. escalation or de-escalation of charges depending on prevailing market prices,\textsuperscript{21} would be recognized for concentrate pricing purposes as, for example, industry practice. It is uncertain whether a mine’s receipts, which, according to the formula, depend on the concentrate’s dry weight, should account for concentrate losses during transportation. That uncertainty is because of a potentially restrictive scope of adjustments for variances other than those related to concentrates’ quality specifications.

The rules do not mention price penalties for deleterious elements, such as, for example, arsenic, that can affect payment terms.\textsuperscript{22} It is therefore unclear whether such penalties are included in TC, factored in the pricing model through the recovery rate or warrant a separate forfeit or cost surcharge.

The computed return does not explicitly account for off- mine costs, such as those incurred for storage, packaging, freight, insurance or marketing.\textsuperscript{23} As the LBMA standard relates to unallocated London gold, the rules that aim to approximate the concentrate’s sales price to the price that could have been agreed between independent parties in comparable economic circumstances should arguably permit accounting for at least some of such expenditures, depending on supply terms.

3.3. Mineral sales and toll processing

Outbound mineral sales, as well as related transactions, including services, can be susceptible to price manipulations. As such, they are subject to transfer pricing scrutiny, except when refined gold is sold to Kazakhstan’s Central Bank. The application of transfer pricing regulations to services can be unclear: The legislature recognizes the arm’s length principle, but does not relate economic rewards to risks, assets, or people, except for the profit split method. That deficiency can be explained by the predominance of natural-resource commodities in Kazakhstan’s exports and the resultant legislature’s greater reliance on the comparable uncontrolled price or other transfer pricing methods.

The pricing formula assigns a value to payments made between concentrate buyers and the seller, i.e. it does not apply to either doré sales or processing services. At the same time, the methodology implies that the intermediate product derived from LCCs is reimported for refining. The rules do not explicitly exclude the outward processing route for HCCs either. But the methodology’s objective scope and the difficulty of treating HCCs suggest that HCCs are probably disposed of without being further processed. Absent conditions, it is also uncertain whether such sales are not made to a related marketing company.

Domestic services can be viewed as being connected to controlled sales and are not therefore excepted from the transfer pricing law’s scope. In light of the approved list of refineries, in-scope domestic refining services that are likely to be provided by an unrelated enterprise might be low-risk. That is in contrast to outward processing services that can be provided by a vertically integrated enterprise. However, the legislature has left it for a miner to figure out an arm’s length value for related processing fees. The non-specific transfer pricing law does not order a risk allocation or assumption analysis and is silent on the treatment of toll manufacturing contracts.

4. Conclusion

In Kazakhstan, the mineral sector is an important source of revenue to fund new growth areas, socioeconomic programs and community projects. Clear pricing principles and concepts that are supported by industry-relevant detailed regulations are therefore crucial for creating


\textsuperscript{18} KZ: Resolution of Kazakhstan’s Government No. 152, “On the Approval of the Pricing Rules (Methodology) for Double Refractory Gold–Sulphide Concentrate[s] Containing High Levels of Arsenic” (24 Mar. 2022) [Постановление Правительства Республики Казахстан от 24 марта 2022 года № 152 “Об утверждении Правил (методики) ценообразования на золотосульфидный концентрат двойной упористости с повышенным содержанием мышьяка”].


\textsuperscript{20} Id.

\textsuperscript{21} Id.

\textsuperscript{22} See for example, De Sousa, supra n. 2.

\textsuperscript{23} See for example, Goldie & Tredger, supra n. 12, at pp. 159, 160.
an unambiguous tax environment in mining and other extractive industries.

The methodology applies to the sales of the defined kinds of concentrates originating from a specific field and replicates a limited scope APA. The price depends on a multi-factor estimate and might require interpretation, as payable taxes can be assessed by reference to public quotes, contractually defined revenue or earnings. Yet the operation’s scale, asset type, and constraints seem to justify the government’s recourse to a special pricing instruction. The confirmed acceptability of industry conventions, such as the use of LBMA quotations, metal credits, and recovery-related adjustments, for transfer pricing purposes enhance certainty for gold miners and possibly other operators.

Transfer pricing rules can apply to transactions at all stages in the gold value chain, but development, production, processing and marketing phases are known as demanding special attention.24 Aligning the creation of value with transfer pricing outcomes requires of the tax administration and taxpayers a structured analysis of operations from upstream exploration to downstream product marketing during a mine’s entire life-cycle. That calls for a regulatory transition to a value-based approach in pricing Kazakhstan-sourced natural-resource commodities like gold and other precious metals.

24. See for example, Stephanie et al., supra n. 13, at p. 112.