

Commodity Transactions: selected practical issues

The case under analysis:
the commercialization of soybeans

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The commercialization of soybeans

Some practical issues to be discussed in this workshop

- The aim of this case is to discuss some challenging transfer pricing issues that are usually present when auditing a commodity transaction under the Uruguayan transfer pricing regulations.
- The main issues to be analyzed in this workshop are:
 - Some particular characteristics of this sector
 - How the prices are defined: analysis from a global perspective
 - Accumulative or segregated transactions?
 - The transparent market to be selected as reference
 - How the freight cost adjustment should be done?

The domestic rules under analysis

Import and export of commodities (Article 42, Title 4 of the 1996 TO):

For imports and exports of goods where a public international price quoted in transparent markets, product exchange markets and similar can be determined, such prices should be used, unless it is proven that another price is more appropriate.

Under the method established by article 42:

- in the case of import transactions, the price used is the higher price quoted on a transparent market of recognized international standing, if the price agreed with the related party is higher; and
- in the case of export transactions, the lower quoted price is applied, if the price agreed with the related party is lower.

If the **contract is not registered**, the quoted price as referred to above is applied as of the date of the corresponding bill of lading or equivalent document issued.

The quoted price referred to in this method may be reasonably **adjusted** to the value of the merchandise at the local market, in respect of the **insurance and freight costs** involved.

The domestic rules under analysis

Imports and exports of commodities through a foreign intermediary other than the final recipient of the goods (Article 43, Title 4 of the 1996 TO)

Without prejudice of the above-mentioned rule, in transactions between related parties involving primary farming products, and, in general, goods known to be quoted in transparent markets, with the participation of a foreign intermediary other than the final recipient of the goods, **the CUP method must be applied**. In this case the price applied **must be the value quoted** in such market at the **date the goods are loaded**, regardless of the transportation means and the price agreed with the intermediary.

According to the law, this method is not enforced when the taxpayer can provide reliable evidence that the intermediary fully complies with certain requisites.

The price applied for importations is the highest price quoted for the goods in a transparent market of recognized international standing prevailing at the date of the bill of lading or equivalent document, if the price agreed with the related party is higher. In the case of export transactions, the lower quoted price is applied if the price agreed with the related party is lower.

The quoted price referred to in article 43 may be reasonably **adjusted** to the value of the merchandise at the local market in respect of the **insurance and freight costs** involved.

If the contract has been registered as required by Decree 392/2009, the comparable uncontrolled price applied should be the quoted price prevailing as of **the date of the contract**.

The domestic rules under analysis

Some other rules:

- The Tax Administration has provided a list of transparent markets to be considered for this TP analysis, apart from other markets that may receive international recognition. **For soybean: Chicago Commodity Exchange;** f.o.b. market in the Gulf of Mexico; C&F markets in the port of Rotterdam; f.o.b. markets in Brazilian ports.
- A simplification measure has been introduced in order to recognize the business day of the transaction: if contracts for purchases or sales of this type of goods have been registered in the “Registry of Contracts” (created by Uruguay with this purpose), the price applied should be the quoted price **at the date of the contract.**

Some issues to be considered

- When auditing the export and commercialization of soybeans from a transfer pricing point of view, some practical issues arise when applying the domestic rules. Some of them will be discussed in this workshop, namely:
 - Determine the real moment in which the transaction was performed.
 - Select the public international price quoted in a transparent markets.
 - Make the freight costs adjustment as a comparability adjustment.
- In order to face these issues, it is important to understand how this business works and how these products are traded internationally, understanding the economic context in which this transactions are undertaken.

Export markets

Below are the 15 countries that exported the highest dollar value worth of soya beans during 2018.

- Brazil: US\$33.2 billion (56% of exported soya beans)
- United States: \$17.2 billion (29%)
- Canada: \$2.2 billion (3.7%)
- Paraguay: \$2.2 billion (3.7%)
- Argentina: \$1.4 billion (2.3%)
- Ukraine: \$831.5 million (1.4%)
- **Uruguay: \$534.7 million (0.9%)**
- Netherlands: \$426.3 million (0.7%)
- Russia: \$292.7 million (0.5%)
- Belgium: \$126.6 million (0.2%)
- India: \$122 million (0.2%)
- China: \$100 million (0.2%)
- France: \$75.9 million (0.1%)
- Germany: \$69 million (0.1%)
- Romania: \$60.2 million (0.1%)

The listed 15 countries shipped 99.2% of global soya beans exports in 2018 by value.

Source: <http://www.worldstopexports.com/soya-beans-exports-country/>

Production by country

Rank Country

Soybean production (tonnes)

1	United States	117,208,380
2	Brazil	96,296,714
3	Argentina	58,799,258
4	India	14,008,000
5	China	11,963,244
6	Paraguay	9,163,030
7	Canada	5,827,100
8	Ukraine	4,276,990
9	Bolivia	3,204,639
10	Russia	3,135,177
11	Uruguay	2,208,000
12	Italy	1,081,340

In the 2018/2019 period, over **150** million metric tons of soybeans were imported globally. **China** was by far the leading importer of soybeans, with an annual import volume of **88 million** metric tons in that year.

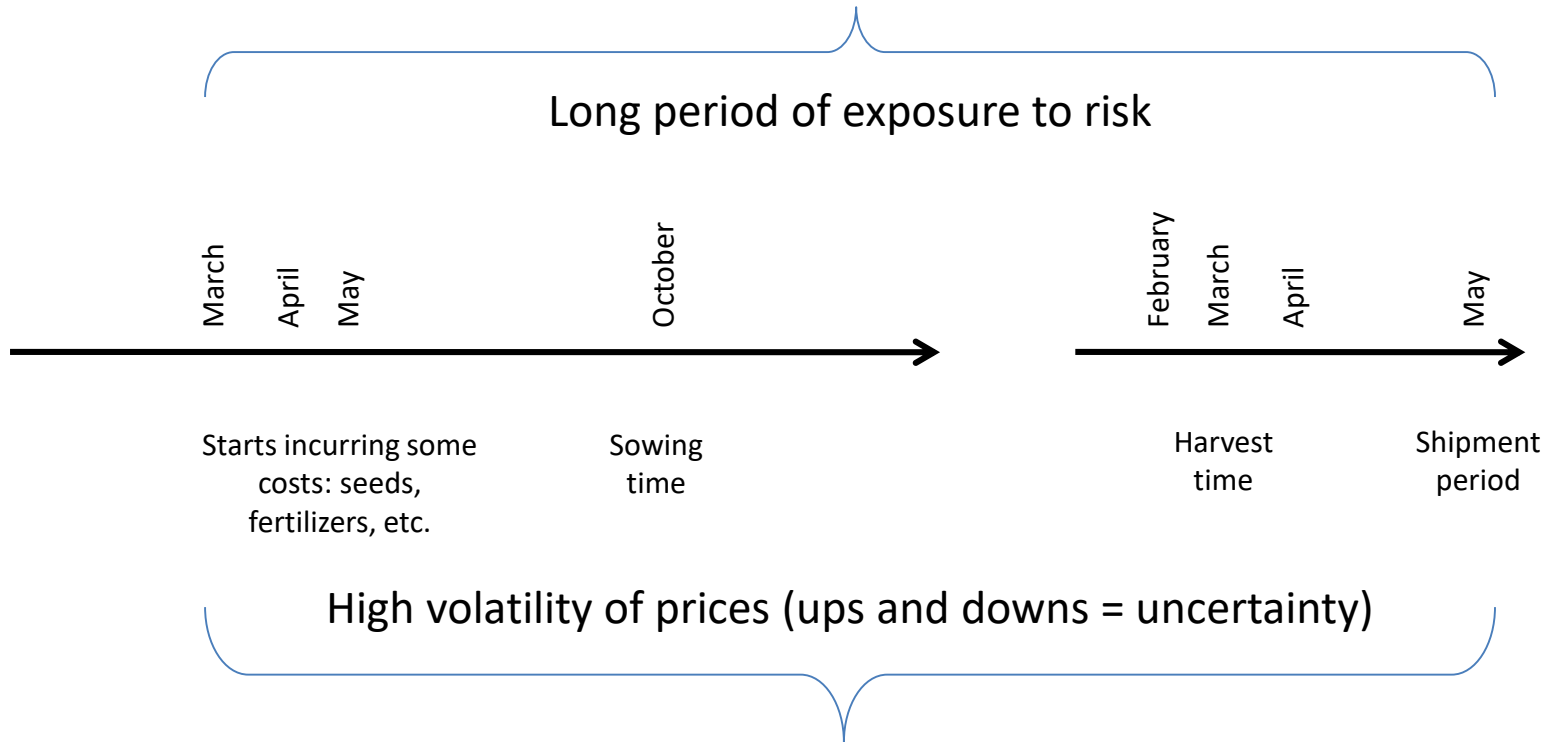
<https://www.statista.com/statistics/612422/soybeans-import-volume-worldwide-by-country/>

Source: https://en.wikipedia.org/wiki/List_of_countries_by_soybean_production

Some characteristics of this sector

Year 1

Year 2



Analysis from a global perspective

Key dates	Independent Producer (offer)	The Multinational Enterprise: A Group Co.				Independent Client (demand)
		Buyer A1 Co.	Hedge A2 Co.	Trade A3 Co.	Seller A4 Co.	
Agreement date (or business date) (M1)	Producer sells part of its expected production in advance in order to cover the cost and expenses incurred. He agrees to deliver the soybeans once harvested (in a future time).	<p>The MNE Group obtains trading volume.</p> <p>The MNE Group try to get a profit (as a difference between the sale price and the purchase price).</p>				Client buys in advance, trying to ensure the volume of product needed for its business.
Pricing date & Hedge instruments (M2)	When the price is determined by reference to the market (e.g. quoted price of Chicago), one party has the right to choose the point in time at which such quoted price will be taken as reference (to value the transaction agreed in M1). Usually, the producer is who has this option.	<p>When the moment in which producers and clients defines its prices, the MNE Group assumes the fluctuation price risk.</p> <p>Given that the quoted price taken as reference is a significant share of the price, with high fluctuations, the risk exposure is significant.</p> <p>As a consequence, the back to back operations (natural hedges or financial hedges) is needed. Some sophisticated financial instruments can be used. → FUTURE MARKET</p>				Idem Producer In some particular markets, the client has the right to choose the moment in which he will fix the price.
Delivery and shipment period.	Deliver product and collect the price	PHISICAL MARKET				Receive and pay

Hedge

PHYSICAL MARKET	FUTURE MARKET
January: <u>Target</u> : Insure a sale price (selling the soybean in advance and deliver it once harvested)	January : Sells future contracts, position July Quoted price: \$ 350
April: Sells soybean (physical export) Quoted price: \$ 380	April: Purchase future contracts, position July, Quoted price: \$ 380

CONSOLIDATED ACCAUNTS:

Accrued income, per metric tons:

Gross income in the physical market (export price):.....

~~\$ 380~~

Net income in the future market:.....

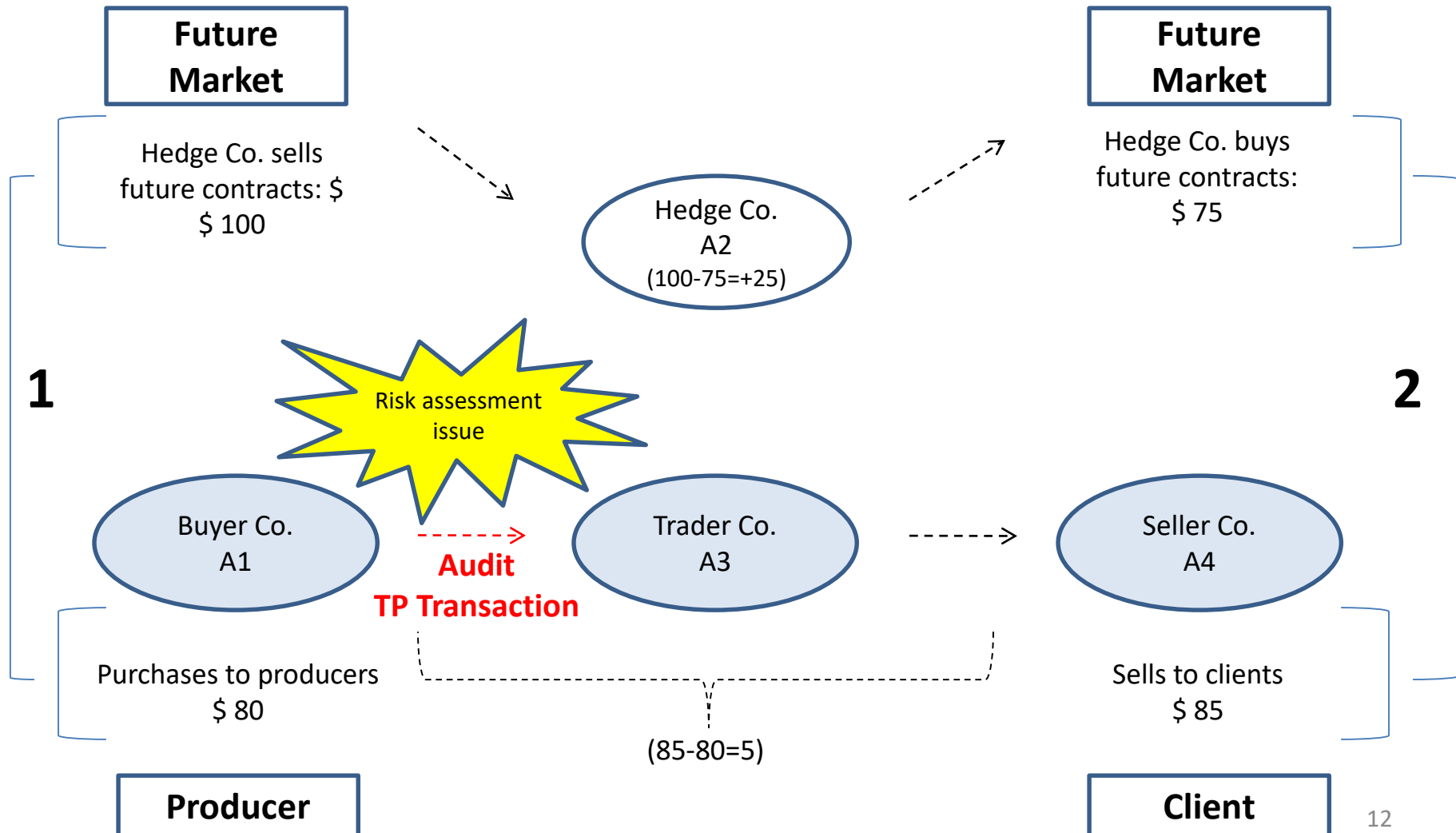
\$ (30) = (350 - 380)

Accrued income in both markets, from a global perspective.....

\$ 350 = equivalent to the first sale (in the future market)

Analysis from a global perspective

Accumulative or segregated transactions?



The transparent market

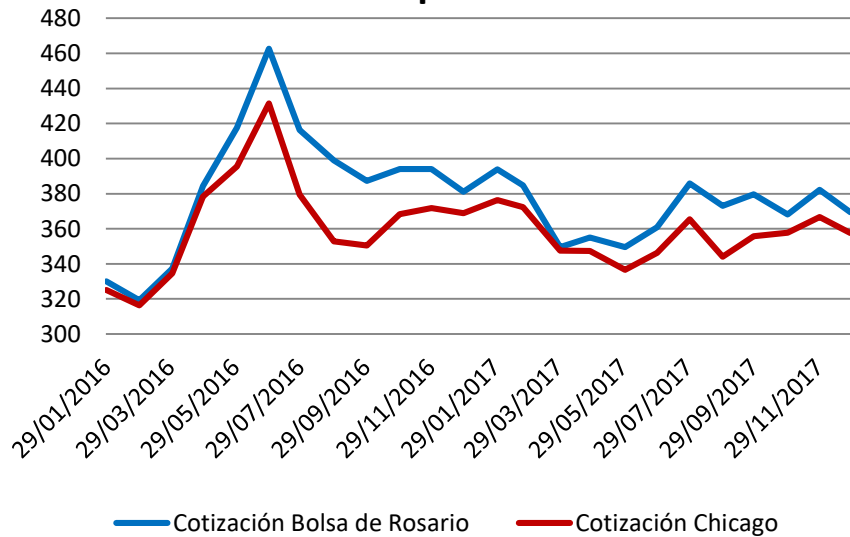
When comparing the quoted price in the **Chicago Board of Trade (CBT)** with other quoted prices available in the LATAM region, it was observed that the price selected as comparable by the Tax Administration resolution was below the regional quotation value obtained from the **Rosario Stock Exchange, Argentina** (for the same quotation date with the same future delivery date, in the same period). And, if the taxpayer makes the freight and insurance adjustment, the observed GAP increases.

In the investigation carried on this regard, it was compared the evolution of the price of soybeans in the Chicago market (USA) and in the regional market (Bolsa de Rosario, Argentina).

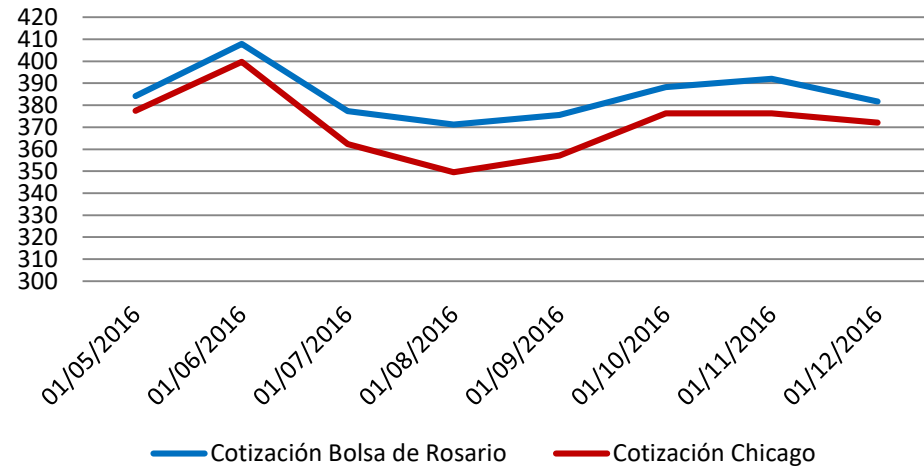
Evolution of prices

Is the CBOT the most appropriate market to be considered in order to price the exports of soybean from Uruguay, then?

**Soybean 2016-2017:
First future price available**



**Comparison considering the
future price in May-17**



Freight costs

- The domestic rule provides: *“The quoted price referred to in this method may be reasonably **adjusted to the value of the merchandise at the local market**, in respect of the insurance and **freight costs** involved”.*
- Considering this rule, the technical challenge is how to determine the local export price of soybean (FOB Uruguay), starting from the quoted price selected as comparable (CBOT, USA), without considering any other comparability adjustments other than insurance and freight cost.
- In order to do so, it must be taken into consideration that the main destination of the soybean harvest is the export, so the local prices take as reference the market of the main producer worldwide, the United States. In the United States, prices are formed in the "Chicago Board of Trade" (CBOT).
- Forming the FOB Price from the price of CBOT implies adding to the price of CBOT a **“premium” (positive or negative)** that includes differences in **freight, quality and availability of products** between the US and Uruguay. These premiums are negotiated day by day by the exporters and their counterparts.

Freight costs

- Define a relatively easy formula to calculate this adjustment in a fair and accurate manner is desirable.
- Some particular issues to be considered in this calculation are:
 - Define the quoted price to be considered as a starting point (example: CBOT, USA).
 - Sourcing of price information regarding maritime freight cost.
 - Adoption of many assumptions, some of them very subjective (type of vessel, routes, capacity, etc.).
 - Consider the available options to the buyer.
 - Consider the available options to the seller.
 - Consider this adjustment as a “comparability” ones.
- Up to now, there have not been a clear consensus on how to calculate this TP adjustment. It would be advisable to define this in the short term.

**MUCHAS GRACIAS
THANK YOU VERY MUCH**