draft Case study based on Resale Price Method

Facts of transaction I

- XCO of country X sells luxury bags to ICO, a distributor of country I
- Both XCO and ICO are wholly-owned subsidiaries of ACO, the headquarters of a multinational enterprise and the brand-owner of the luxury bags
- Neither XCO nor other companies related to ACO sell the identical or similar luxury bags to unrelated buyers in country I
- ICO is the only importer of the luxury bags in country I

… thus all luxury bags imported into country I are purchased by ICO from XCO

Facts of transaction II

- In 2012, ICO declared the price of imported luxury bags based on the value on the invoice issued by XCO
- Commercial documents submitted to Customs of country I indicated that there was no special arrangement or additional payments (such as restrictions as to the disposition or use of the goods or a trademark fee, etc.) which would prevent the use of the transaction value or require an additional adjustment to the import price.

Background

- In 2013, Customs in country I conducted a Post-Clearance Audit to verify ICO's declared import price
- ICO's transfer pricing policy showed that the import price of all luxury bags was determined using the Resale Price Method (in accordance with OECD Guidelines)
- At the end of each year, ICO estimated its sales income and corresponding selling general and administrative expenses("SG&A") for the next year in order to calculate the targeted gross margin
- The targeted gross margin equals *Estimated SG&A / Sales Income* + *Net Margin*
- The targeted gross margin for 2012 was estimated at 40%.

Background

- After the targeted gross margin was determined, ICO then calculated the import price of luxury bags to be imported in 2012 by using the Resale Price Method according to the formula: *Import Price=Estimated Sale Price x(1 – Targeted Gross Margin)*

Background

- In 2012, due to the popularity of the luxury bags, the actual sales income far exceeded the estimated income. However, the SG&A was only slightly more than originally estimated
- Therefore, ICO's gross margin in 2012 was 64% which was higher than the estimated gross margin stated in ICO's transfer pricing policy. Therefore Customs asked ICO to provide further information in order to review the acceptability of its declared import price.
- ICO submitted its transfer pricing report, which used the Resale Price Method that compared ICO's gross margin with the gross margins earned by comparable companies in their transactions with unrelated parties (i.e. comparable uncontrolled transactions)
- The transfer pricing report was prepared in accordance with the OECD Guidelines.

Background

- According to T.P. report, ICO was a simple distributor that performs distribution functions and does not employ any valuable, unique intangible assets or assumes any significant risk. The transfer pricing report submitted by ICO selected 8 comparable companies located in country I. The functional analysis indicated that the 8 selected comparable companies imported similar goods from country X, performed similar functions and assume similar risks as ICO.
- The transfer pricing report indicated that the arm's length inter-quartile range of gross margins earned by the selected comparable companies was between 35%-46%, with a median of 43%. The 64% gross margin earned by ICO did not fall within the arm's length inter-quartile range as per the report.

Issue for determination

- Can Customs of country I reject ICO's import price based on the transfer pricing report submitted by ICO and re-evaluate the imported goods by using the Resale Price Method and the gross margins of the 8 comparable companies ?