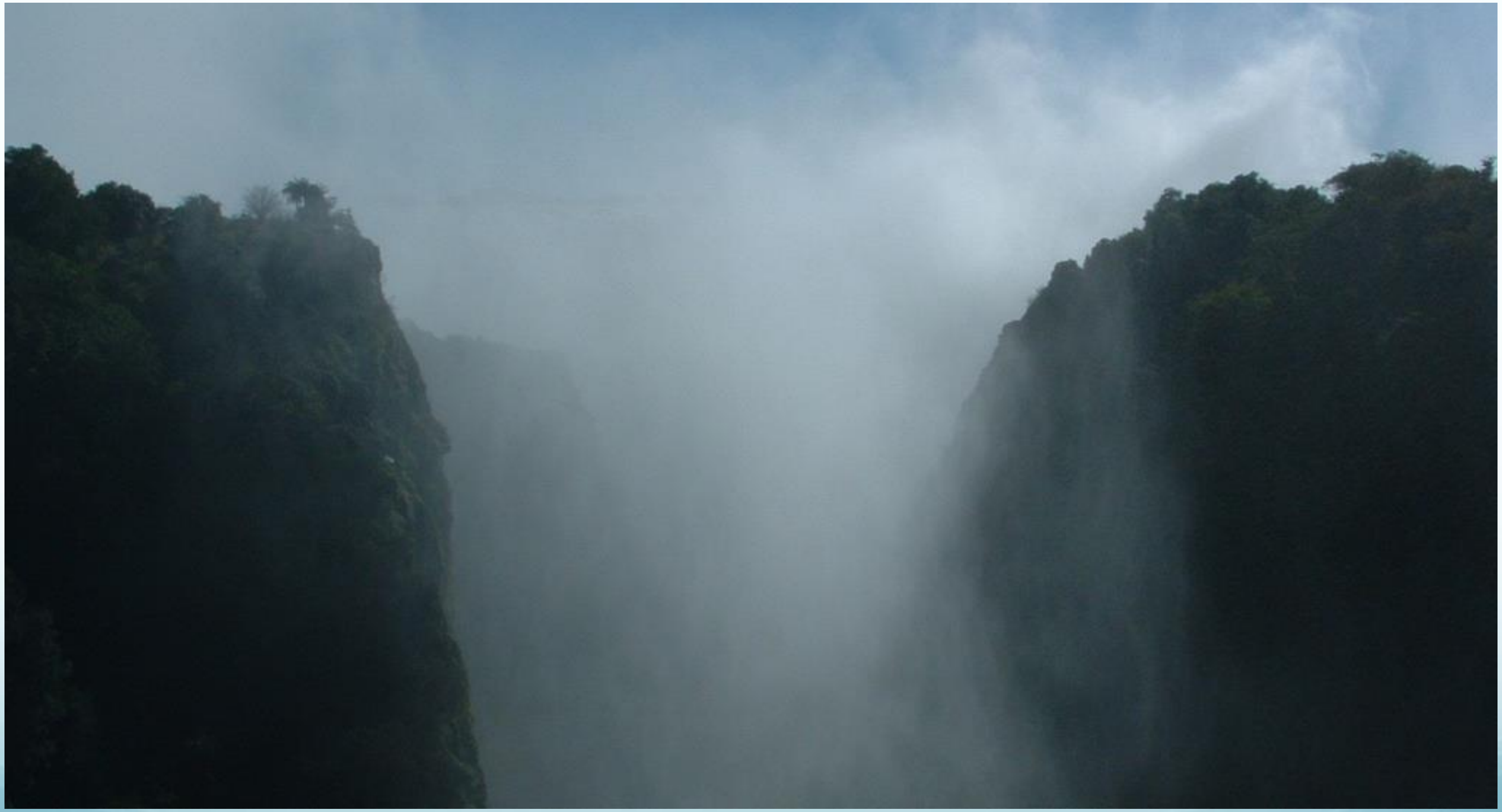
Transfer Pricing and Customs Valuation

Background and current developments

WORLD CUSTOMS ORGANIZATION
ORGANISATION MONDIALE DES DOUANES

Transfer Pricing & Customs Valuation - Bridging the gap



What is Transfer Pricing?

- A price established for property, goods & services transferred between companies of a multi-national enterprise (“MNE”) that control each other or that are controlled by a common entity.
- Sales within MNEs account for a large proportion of global international trade
- Transfer pricing can be used to shift profit to low tax jurisdictions

Transfer Pricing – how governments protect their tax bases

Objective of transfer pricing rules:

- Ensuring prices (and thus taxable profits) are what they would have been had the parties been independent of each other

Countries introduce tax rules that:

- Require multinational enterprises to use ***arm's length pricing*** for their internal transactions
- .. and require them to demonstrate this by documenting their transfer pricing policies
- Give tax administrations the authority to increase the tax measure of profit where multinational enterprises use non-arm's length prices

Transfer Pricing - foundations

- Ideally, involves testing the price against the price achieved in comparable, independent transactions (“CUP”)
- But, in practice, such data is often not available
  - 4 other OECD transfer pricing methods
  - Used to deduce the arm’s length price from available, sufficiently comparable, independent transactions
  - Ensuring profit aligned with value creation

Transfer Pricing - Adjustments

- Transfer pricing methods used to *test* transfer prices
  - Ideally applied transactionally
  - But in practice transactions often need to be aggregated → greater reliability given available, sufficiently comparable, independent data
- Periodic adjustments may be required
  - May be actual adjustments to price paid/payable
  - In some countries notional (i.e. for tax only) adjustments may be permitted

Transfer pricing adjustments

Type	Who makes?	What?	Why?	Voluntary?	Effect on…
Compensating or..'Year-end' or.. 'True -up'	Taxpayer – before tax return	Actual pricing	Compliance	Yes	Actual prices Taxable profit
Primary or .. 'Audit'	Tax Administration- after tax return	Notional pricing	Enforcement	No	Taxable profit and (possible) penalties
Compliance	Taxpayer – in tax return	Notional pricing	Compliance	Yes	Taxable profit
Secondary	Taxpayer or tax admin – after a compliance or secondary adj.	Actual pricing or loan accounts or dividends	Take notional adjustment towards actual adjustments	Yes or no	Actual prices (possibly)
Corresponding	Tax administration	Taxable profit	Avoid double taxation	Yes- taxpayer requests, but not automatic	Taxable profit Notional prices

OECD Transfer Pricing Guidelines

- Guidelines provide an international standard for direct taxation authorities. (not restricted to OECD Members)
- Guidelines require that determination of a corporate tax liability in each tax jurisdiction is based on the “arm’s length principle” incurred.
- Issued in 1979
- Substantially revised in 1995 and 2009

OECD Transfer Pricing Guidelines

Comparison with WTO Valuation Agreement

- Comparable Uncontrolled Price (CUP)

  ≈ identical value method & similar value method (Article 2 & 3)

- Resale Price Method ≈ Deductive value method (Article 5)

- Cost-plus Method ≈ Computed value method (Article 6)

- Profit Methods:
  - Transactional Net Margin Method
  - Profit Split Method

  ≈ Fallback value method (Article 7)

Key Differences

Customs Valuation

- Goods only
- Transaction based
- Confirmed at point of customs clearance

Transfer Pricing

- Goods, services & property
- Based on aggregates/annual
- Confirmed retrospectively (some years after event)

Competing tensions

Customs administration objective

Ensuring all appropriate elements are included in the customs value

Direct Tax authority objective

Ensuring the transfer price does not include inappropriate elements

Pull in opposite directions

Trade objective

To minimise Customs value

Trade objective

To maximise transfer price (incl. cost of imported goods) to reduce taxable profit

What is the issue?

- Customs aim to verify whether a price has been influenced in a related-party transaction
- Multi-nationals offer a transfer pricing study as ‘proof’ that the transactions are ‘arm’s length’
  - Is this helpful to Customs?
- What are implications for Customs of TP adjustments?

Activities to date

- Two joint WCO/OECD conferences (2006, 2007)
- Focus Group 2007 – identified key issues
- On agenda of TCCV
- Commentary 23.1

Commentary 23.1

Examination of the expression "circumstances surrounding the sale" under Article 1.2 (a) in relation to the use of transfer pricing studies

- First text of the TCCV to refer to transfer pricing
- Key questions:
  - *Has price been settled in a manner consistent with the normal pricing practices of the industry?*
  - *Is price adequate to ensure recovery of all costs plus a profit representative of the firm's (seller's) overall profit realized over a ..period of time?*
  - Acknowledgement that a TP study may be of use in examining a related parties transaction

Use of information from a TP study