Transfer Pricing and Customs Valuation

Background and current developments

WORLD CUSTOMS ORGANIZATION
ORGANISATION MONDIALE DES DOUANES

Importance of transfer pricing

- Transfer pricing affects the amount of revenue and profit recognised in members of multinational groups
- MNEs may use their transfer pricing for tax planning – recognising taxable profit in low tax (or tax sheltered) jurisdictions
- Other motives than tax planning: customs duties, price and exchange controls and dividend policy
- Transfer pricing is seen as one of the most important issues facing MNEs

Impact of transfer pricing rules

Transfer pricing rules generally:

- Require taxpayers to calculate their taxable profit in accordance with the arm's length principle
- Give powers to the tax authority to adjust the calculation of taxable profit where arm's length pricing has not been used

Transfer pricing methods

- The OECD Guidelines specify five methods,
  - With the <u>most appropriate method</u> to be applied
- Each method compares the relevant <u>condition(s)</u> in controlled transaction(s) with condition(s) in comparable uncontrolled transaction(s)
- No one method is suitable in all situations
- Other methods may be applied where they are the 'most appropriate' and provided the results produced satisfy the arm's length principle

Transfer pricing methods

- Comparable Uncontrolled Price (CUP) method
- Resale price method
- Cost plus method
- Transactional net margin method (TNMM)
- Transactional profit split method

Arm's length range

- Application of the arm's length principle may produce
  - a single figure (price / margin),
  - but in many cases, an arm's length range may result, i.e. a range of figures all of which are **relatively equally reliable**
- No adjustment where the financial indicator of the controlled transaction falls within the range
- If it falls outside the range, the tax administration may adjust to within the range – to a point that best reflects the circumstances of the case

Adjustments

Taxpayers are encouraged to use arm's length pricing in their actual transactions.

Where they do not:

- Taxpayer may make an adjustment in their accounts, or
- Taxpayer may make adjustment in computation of taxable profit
- Tax authority may make adjustment in computation of taxable profit

OECD Transfer Pricing Guidelines – Comparison with WTO Valuation methodology

OECD methodology	WTO Valuation methodology
Traditional transaction Methods :	
Comparable Uncontrolled Price (CUP)	Identical and similar goods method (Article 2 & 3)
Resale Price Method	Deductive value method (Article 5)
Cost-plus Method	Computed value method (Article 6)

Competing tensions

Customs authority objective

Ensure all appropriate elements are included in the customs value

Direct Tax authority objective

Ensure the transfer price does not include inappropriate elements

Pull in opposite directions

Trade objective

To minimise Customs value
= reduced duty liability

Trade objective

To maximise transfer price
= reduced taxable profit

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)

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?*
- The use of a transfer pricing study as a possible basis for examining the circumstances of the sale should be considered on a case by case basis
- Any relevant information and documents provided may be utilized for examining the circumstances of the sale
- A transfer pricing study could be one source of such information.

Questions?