

TRANSFER PRICING AND CUSTOMS VALUATION – 2015

POLICY STATEMENT

Prepared by the ICC Commission on Taxation and the
ICC Commission on Customs and Trade Facilitation

Summary

International businesses face difficulties regarding the valuation of goods due to diverging customs and tax rules regulating transactions between related parties. ICC calls for more alignment and puts forward concrete proposals to secure harmonized tax and customs valuation of transactions between related parties in an international context.

Highlights

- Recognition by the customs administration that businesses which establish prices between related parties in accordance with the arm's length principle (as per Article 9 OECD Model Tax Convention) have generally demonstrated that the relationship of the parties has not influenced the price paid or payable under the transaction value basis of appraisal and consequently that the prices establish the basis for customs value.
- Recognition by the customs administration of post-transaction transfer pricing adjustments (upward or downward). This recognition should be applicable for adjustments made either as a result of a voluntary compensating adjustment – as agreed upon by the two related parties – or as a result of a tax audit
- It is recommended that in the event of post transaction transfer pricing adjustments (upward or downward), customs administrations accede to review the customs value according to either of the following methods as selected by the importer: application of a weighted average duty rate, or an allocation according to specific codes of the customs tariff nomenclature.
- It is recommended that in the case of post-transaction transfer pricing adjustments (upward or downward), companies be relieved from:
 - a) The obligation to submit an amended declaration for each initial customs declaration
 - b) The payment of penalties, as variations of the transfer price
- It is recommended that customs administrations recognize that the functions and risks undertaken by the parties as documented in a transfer pricing study following an OECD transfer pricing methodology are crucial to the economic assessment of the circumstances of the sale.
- Recognition of the acceptability of relevant transfer pricing documentation by the customs administration as evidence that the price paid for imported goods was not influenced by the relationship of the parties.

Introduction

As the world business organization, the International Chamber of Commerce (ICC) confirms that multinational companies, from all sectors and in every part of the world, face difficulties with respect to the valuation of goods. These difficulties arise because transactions between related parties are subject to both customs and fiscal examinations and are thereby bound by differing rules and contradictory interests. ICC believes these examinations should yield the same value and that a resolution to the problem is in the interests of all concerned.

There are two reasons for this problem:

1. Tax and customs administrations, even within one country and sometimes within the same government department, have different approaches: tax administration focuses on intra-group sales' prices that may be perceived as higher than they should be; whereas customs authorities control imported goods for which prices may be perceived as lower than the market price. While both administrations seek to achieve the same goal, which is arm's length pricing, revenue interests in the transaction still remain at odds with each other.
2. Tax and customs administrations often set rules independently for the same transaction/good. Tax authorities seek conformity with the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines which have been largely codified in many countries. This set of rules provides guidance on the application of the arm's length principle for the valuation of cross-border transactions between associated enterprises, whereas customs authorities conform to Article VII of the General Agreement on Tariffs and Trade (GATT) Valuation Code.

This dichotomy, present in both developed and developing countries, creates a climate of uncertainty and complexity compounded by economic globalization. It also leads to increases in implementation and compliance costs, absence of flexibility in the conduct of business operations, and furthermore creates a significant risk of penalties. Indeed, even when a company complies with both the OECD guidelines/principles and the World Trade Organization (WTO) Valuation Agreement, there is no guarantee that there will not be a dispute between two countries or two administrations in the same country on the determination of the arm's length price. This means that valuation conflicts can arise not only prior to but also after an audit.

Given that intercompany transactions account for more than 60% of global trade in terms of value, the divergence of customs and transfer pricing valuation presents an obstacle to the liberalization of trade and inhibits international development for companies of all sizes.

Key features

Although numerous points of divergence can be listed between customs and tax approaches, it is important to stress that points of convergence also exist. Therefore, while it may not be necessary to change WTO rules or the OECD guidelines we believe that the two can and should be aligned by finding a common way of interpreting the arm's length principle. As a basic principle, we recommend that tax administrations assess and appreciate how the enterprise has arrived at the declared customs value (and vice versa – as the case may be - the customs administration assess and appreciate how the enterprise has arrived at the transfer price) prior to issuing a formal tax or duty assessment. If the conflict between the enterprise and the relevant fiscal administration cannot be resolved, then the tax administration and the customs administration of the respective country should work in concert and attempt to harmonize valuation determinations.

A recommended method to accomplish harmonization of customs and income tax requirements is

for customs administrations to use information contained in transfer pricing studies. It will help determine whether the price between related parties is acceptable for customs valuation. Indeed, ICC notes that the World Customs Organization (WCO) has already considered the appropriateness of transfer pricing documentation in Commentary 23.1 of the Technical Committee on Customs Valuation (TCCV). To the extent a customs administration believes it needs additional data that is readily available in the normal course of business to supplement standard transfer pricing study data sets, those data elements should be clearly defined and published (see Proposal 6).

This approach considers that it is not currently conceivable to try to find solutions outside existing and well-recognized principles, nor is it realistic to seek a total harmonization of customs and tax rules or even to impose one's view onto another. Furthermore, the business community believes that creating yet another set of rules will not solve these problems. ICC therefore recommends a focus on how these principles can be more closely aligned and made acceptable to both governmental authorities and the private sector. This document is offered as an input from the business sector to international organizations working on these issues.

The goals of the proposals that follow are to:

- Secure harmonized tax and customs valuation of transactions between related parties in an international context
- Clarify rules for both companies and administrations
- Suppress or at least reduce financial impact linked to divergent valuation
- Simplify regulations

And thereby:

- Reduce compliance costs to companies
- Eliminate the risk of penalties resulting from disputes arising from divergent views taken by customs and tax authorities
- Streamline intercompany operations and facilitate international business

Proposals

Although Advance Pricing Agreements (APAs) can resolve tax valuation concerns, APAs are often very rigid, time- and cost-consuming, and not appropriate for businesses that continually evolve. Often, APAs are also not a viable option for small and medium sized enterprises or for transactions that are not material in size.

Accordingly, in order to enable more documentation supportive of valuation validation, ICC proposes the following additional options to derive customs value:

Proposal 1

Recognition by the customs administration that businesses which establish prices between related parties in accordance with the arm's length principle (as per Article 9 OECD Model Tax Convention) have generally demonstrated that the relationship of the parties has not influenced the price paid or payable under the transaction value basis of appraisal, and consequently that the prices establish the basis for customs value.

The customs value is normally based on Article VII of the GATT agreement 1994 which states that, in article I, Rules on Customs Valuation:

1. The customs value of imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of Article 8 (...)

Thus, customs authorities prefer to determine customs duties on the sales price of imported goods, which is deemed to represent an arm's length value. When the seller and the buyer are related, and arm's length pricing comes into question, transaction value can still be used for customs valuation purposes if the importer can demonstrate that the declared transaction value: 1) meets the circumstances of sale test or 2) by comparison with test values.

As explained below in article I, Rules on Customs Valuation of GATT Article VII:

1. The customs value of imported goods shall be the transaction value (...) provided (...) 3 (d) that the buyer and seller are not related, or where the buyer and seller are related, that the transaction value is acceptable for customs purposes under the provisions of paragraph 2.

*2. (a) In determining whether the transaction value is acceptable for the purposes of paragraph 1, the fact that the buyer and the seller are related within the meaning of Article 15 shall not in itself be grounds for regarding the transaction value as unacceptable. In such a case the circumstances surrounding the sale shall be examined and the transaction value shall be accepted provided **that the relationship did not influence the price**. If, in the light of information provided by the importer or otherwise, the customs administration has grounds for considering that the relationship influenced the price, it shall communicate its grounds to the importer and the importer shall be given a reasonable opportunity to respond. If the importer so requests, the communication of the grounds shall be in writing.*

(b) In a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of paragraph 1 whenever the importer demonstrates that such value closely approximates to one of the following occurring at or about the same time:

(i) the transaction value in sales to unrelated buyers of identical or similar goods for export to the same country of importation; (ii) the customs value of identical or similar goods as determined under the provisions of Article 5;

(iii) the customs value of identical or similar goods as determined under the provisions of Article 6;

With regard to 2(b), the Agreement at 2(c) requires that an inquiry under 2(b) must be undertaken only at the request of the importer and that the tests are only for comparison purposes. The Interpretative Notes to 2(b) require that the test values must be previously determined, pursuant to an actual appraisal of imported merchandise. If there are no previous importations of identical or similar merchandise that were appraised by customs authorities under the transaction, deductive or computed value methods, there may not exist any test values that will be accepted by the customs administration. Therefore, it is common practice to evaluate the circumstances surrounding the sale in relation to the above 2(a).

The Interpretative Notes to 2(a) provide examples of how to evaluate the circumstances of sales in order to satisfy the customs administrations that the relationship of the parties did not influence the transaction value. The Interpretive Note to Article 1, 2(a) of GATT Article VII reads as follows:

2. *Paragraph 2(a) provides that where the buyer and the seller are related, the circumstances surrounding the sale shall be examined and the transaction value shall be accepted as the customs value provided that the relationship did not influence the price. It is not intended that there should be an examination of the circumstances in all cases where the buyer and the seller are related.*

Such examination will only be required where there are doubts about the acceptability of the price. Where the customs administration has no doubts about the acceptability of the price, it should be accepted without requesting further information from the importer. For example, the customs administration may have previously examined the relationship, or it may already have detailed information concerning the buyer and the seller, and may already be satisfied from such examination or information that the relationship did not influence the price.

3. *Where the customs administration is unable to accept the transaction value without further inquiry, it should give the importer an opportunity to supply such further detailed information as may be necessary to enable it to examine the circumstances surrounding the sale. In this context, the customs administration should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and seller organize their commercial relations and the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price. Where it can be shown that the buyer and seller, although related under the provisions of Article 15, buy from and sell to each other as if they were not related, this would demonstrate that the price had not been influenced by the relationship. As an example of this, if the price had been settled in a manner consistent with the normal pricing practices of the industry in question or with the way the seller settles prices for sales to buyers who are not related to the seller, this would demonstrate that the price had not been influenced by the relationship. As a further example, where it is shown that the price is adequate to ensure recovery of all costs plus a profit which is representative of the firm's overall profit realized over a representative period of time (e.g. on an annual basis) in sales of goods of the same class or kind, this would demonstrate that the price had not been influenced.*

Consistent with Commentary 23.1 of the WCO Technical Committee on Customs Valuation (TCCV), for importers that establish related party pricing policies in accordance with the OECD Transfer Pricing Guidelines and provide the necessary transfer price documentation, such documentation should be considered a solid basis on which customs administrations can evaluate the circumstances surrounding the sale. The OECD Guidelines are based on sound underlying economic principles designed to result in arm's length prices being charged the same result sought by customs administrations when determining that prices have not been influenced by the relationship.

Consequently, consistent with Commentary 23.1, in certain instances ICC recommends that importers who set prices in accordance with the OECD Transfer Pricing Guidelines have demonstrated that the relationship between the buyer and the seller did not influence the price.

Accordingly, the arm's length principle (Article 9 OECD Model Tax Convention) may be directly aligned with the rules for determining the acceptability of transaction value under the circumstances of sale test. This alignment should be recognized by customs administrations and doing so will set up a convergence between the OECD and WTO rules with regard to the value of transactions between related parties.

Moreover, there are many situations where voluntary or a fortiori imposed adjustments were not foreseeable at the time the import declaration had been made. The propositions 2 and 3 concern cases where the customs implications of any such transfer pricing adjustment need to be duly dealt with.

Proposal 2

Recognition by the customs administration of post-transaction transfer pricing adjustments (upward or downward). This recognition should be applicable for adjustments made either as a result of a voluntary compensating adjustment – as agreed upon by the two related parties – or as a result of a tax audit.

Post-transactions adjustments that affect product price are permitted by both the OECD guidelines and WTO customs valuation rules. These post-transaction adjustments can be done for a variety of reasons, including voluntary adjustments, but also for year-end adjustments when trying to achieve a pre-agreed profit range at the end of a year or period. However, the procedures to report such adjustments to customs administrations are determined by local rules, and adjustments are often disregarded by customs when the importer adjusts the purchase price downwards.

When such post-transaction adjustments that affect price – i.e. compensating adjustments – are made pursuant to an OECD transfer pricing methodology, these adjustments should be recognized by customs administrations as part of the price paid for the goods, and consequently as an element of the transaction value of the goods.

Companies should be permitted to perform customs value adjustments without being required to set up a provisional valuation procedure or being subject to penalties due to valuation adjustments.

Proposal 3

It is recommended that in the event of post-transaction transfer pricing adjustments (upward or downward), customs administrations accede to review the customs value according to one of the following methods as selected by the importer. These methods being applicable to the value of the goods impacted by the adjustment:

- ✓ **Application of the weighted average customs duty rate:** the weighted average customs duty rate is calculated by dividing the customs duties' total amount for the year by the respective customs value total amount for the same year. This may include the possibility of a lump-sum adjustment at the end of the year. For example, if at the end of the year, the transfer price adjustments result in an additional payment to the seller, then we recommend that the importer be able to report this lump-sum amount. That way customs will be able to allocate this to all entries declared within the year and the duty adjustment will be the weighted average duty rate.
- ✓ **Allocation of the transfer pricing adjustment, according to the nomenclature code, and to information provided by the importer or customs authorities disclosing all commodity codes and all relevant import data available in their national statistics.**

Proposal 4

It is recommended that in the case of post-transaction transfer pricing adjustments (upward or downward), companies be relieved from:

- ✓ **The obligation to submit an amended declaration for each initial customs declaration.** Instead, a single recapitulative return referring to all the initial customs declarations would be lodged.
- ✓ **The payment of penalties, provided the amended declaration is voluntarily timely filed with customs.** In fact, these variations depend on various factors which have absolutely nothing to do with an intention to evade customs duties.

Proposal 5

It is recommended that OECD transfer pricing methods are recognised as an acceptable framework for evaluation of the circumstances of sale by customs administrations with an acknowledgement of the following elements:

- ✓ **Identical or similar goods:** Many transfer pricing studies apply comparable pricing methods. In most cases such methods rely on the similarity of the functions performed, assets used, and risks assumed as well as similarities between the imported goods. Transfer Pricing studies also require geographic and temporal comparability, although it may be necessary to use regional and multi-year comparables if more precise comparables are unavailable. Customs administrations should recognize the use of comparable profits methods and regional and multi-year comparables where appropriate.
- ✓ **Corporate legal entities (performing specific functions and adding value within a group):** Transfer pricing studies evaluate the functions of each company in the related party group, and the risks undertaken by each party to make an economic assessment of arm's length prices between related parties. Customs administrations should similarly recognize that understanding the functions and risks undertaken by each entity provides valuable information for evaluation of the circumstances of the sale following sound underlying economic principles.

Proposal 6

Recognition of the acceptability of transfer pricing documentation by the customs administration as evidence that the price paid for imported goods was not influenced by the relationship of the parties.

Tax transfer pricing documentation is a tax legal requirement almost all over the world. Its content is largely aligned across the countries and can hence be considered fairly standard. It normally includes all of the information required to analyze the circumstances of sale, the parties involved, the added value, and the functions performed by each party. Should a customs administration believe that additional data – readily available in the normal course of business – beyond that commonly found in transfer pricing documentation is necessary to assess whether or not the prices are influenced by the relationship of the parties, ICC recommends that the additional customs data requirements be clearly defined and published in advance by the customs administration to enable incorporation of those requirements into transfer pricing documentation to serve both purposes.

Conclusion

This policy statement is an update of the 2012 ICC Policy Statement on Transfer Pricing and Customs Value, prepared by the ICC Commission on Taxation and the ICC Committee on Customs and Trade Regulations. A comprehensive approach on the nexus between transfer pricing and customs value is becoming of increasing importance for cross-border trade. It is to be expected that many around the world will contribute to this topic in the foreseeable future and ICC is ready to work with intergovernmental organizations such as the Organisation of Economic Co-operation and Development (OECD) and the World Customs Organization (WCO) on this highly complex and contentious area within the global tax and customs world.

ICC will continue to monitor developments in this important area and will issue an update of this policy statement if needed.

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With interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

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