

Administrative interplays between CV and TP

*Considerations about retroactive adjustments, advance rulings,
common documentation, special schemes*

Universitat de València, 26 November 2021

Prof. Walter de Wit / Dr. Martijn Schippers

Agenda

1. Common documentation
2. Transfer pricing adjustments
3. Advance rulings
4. Special schemes

1. Common documentation (1)

Concept	Circumstances of sale test ('COS')
Basis	<ul style="list-style-type: none">• WCO guide to tp/customs valuation (2018).• Chapter 5: Using TP information to examine related party• Commentary 23.1 / case study 14.1
Structure of COS	<ul style="list-style-type: none">• <u>WTO rule: The use of transaction value between related parties is acceptable only if either:</u><ol style="list-style-type: none">1. an examination of the circumstances of the sale of the imported merchandise indicates that the relationship between the parties did not influence the price actually paid or payable; or2. if the transaction value of the imported merchandise approximates certain test values price.• <u>WTO interpretive note: COS, in the form of questions such as:</u><ol style="list-style-type: none">1. Has the price been settled in a manner consistent with the normal pricing practices of the industry in question?2. Has the price been settled in a manner consistent with the way the seller settles prices for sales to buyers who are not related to the seller?3. Can it be demonstrated 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?

1. Common documentation (2)

Concept	Comparability study
Basis	<ul style="list-style-type: none">Paragraph 1.36 of the OECD Transfer Pricing Guidelines 2017
Structure of comparability study	<ul style="list-style-type: none"><u>Identify economy relevant characteristics or comparability factors in the commercial or financial relations between the associated enterprises:</u><ul style="list-style-type: none">The contractual terms of the transaction.The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices.The characteristics of property transferred or services provided.The economic circumstances of the parties and of the market in which the parties operate.The business strategies pursued by the parties

1. Common documentation (3)

Concept	Comparability study (Industry report)
Basis	<ul style="list-style-type: none">Chapter 1 (D.1.) of the OECD Transfer Pricing Guidelines 2017
Structure of comparability study	<ul style="list-style-type: none"><u>Industry report typically discusses economic circumstances like:</u><ul style="list-style-type: none">Geographic locationMarket sizeBarriers to entryLevel of the market (wholesale, retail etc.)CompetitionExistence and availability of substitute productsLocation specific costsGovernment regulationEconomic condition of the industryConsumer purchasing powerEconomic, business or product cycles

1. Common documentation (4)

- Three-tiered approach after BEPS for documenting intercompany transactions:

Master file

- Organizational structure
- Geographic locations of operations
- Main value/profit drivers
- Descriptions of business activities of business units (products and services)
- Intangible assets
- Intercompany financing
- Enterprise financials and tax positions

Local file

- Management structure of the local entity
- Intracompany transactions executed during the tax year
- Related intercompany agreements
- Transfer pricing methodology and application
- Local entity financials (including APA/rulings)

Country-by-country report

- Summarize the activities of all the enterprise's related entities doing business within the jurisdiction.

2. Transfer pricing adjustments (1)

When relevant for setting the final customs value?

- Impact on the price paid or payable (credit or debit invoice)
- Related to the imported goods
- Within the statute of limitation has not been expired
- Documentation available prior to import

2. Transfer pricing adjustments (2)

Price-setting approach vs. outcome approach

Five types of **retroactive** transfer pricing adjustments:

- i. Primary adjustment: initiated by the tax authorities after the CIT return has been submitted (ex post). It is a adjustment to the prices for CIT purposes, but does not necessarily lead to adjustments to the commercial price.
- ii. Corresponding adjustment: adjustments that follows on the primary adjustment by the related party in the other tax jurisdiction for consistency purposes of profit allocation.
- iii. Secondary adjustment: an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment.

2. Transfer pricing adjustments (3)

Five types of **retroactive** transfer pricing adjustments (cont'd):

- iv. Compensating adjustment: an adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises.
- v. Year-end adjustment: journal entries made to the accounts of a business prior to the preparation and distribution of the financial statements for a given accounting period. End-of-period adjustments ensure that these financial statements reflect the true financial position and performance of a business by allocating to the appropriate period the income earned and expenses incurred.

2. Transfer pricing adjustments (4)

Prospective transfer price adjustment:

- i. Rolling forward (example with transfer prices above arm's length range)

[illegible]

2. Transfer pricing adjustments (5)

Prospective transfer price adjustment:

- i. Rolling forward (example with transfer prices below arm's length range)

Target profit	Q1	Q2	Q3	Q4	Total year

3. Advance rulings (1)

Trade Facilitation Agreement (TFA) of the WTO

Article 3(9)(b)(i) - Advance rulings

(b) In addition to the advance rulings defined in subparagraph (a), Members are encouraged to provide advance rulings on:

(i) the appropriate method or criteria, and the application thereof, to be used for determining the customs value under a particular set of facts;

[...]

3. Advance rulings (2)

Few examples

Country	Aim/what is it?	Validity	Public?
	A valuation ruling provides legal certainty for determining the Customs value for your goods.	3 years	Yes, unless here are reasons to prevent publication such as information being commercially sensitive or private.
	Advance rulings are formal advices on how Customs and Border Protection will apply certain laws to goods for importation.	5 years	No
	Advance rulings provide the international trade community with a transparent and efficient means of understanding how CBP will treat a prospective import or carrier transaction.	N/A	Yes, Customs Bulletin and Decisions

3. Advance rulings (3)

South Korea

- Combined Advance Customs Valuation Arrangement (ACVA) and Advance Customs Agreement (APA)
- Introduced in 2015 for traditional TP methods, after 2018 also for other TP methods
- TP adjustments can be taken into account if:
 - Importer holds an ACVA/APA
 - Price adjustment follows from documentation drafted before the goods have been imported
 - Aim of the price adjustments is to ensure the arm's length nature and are made in accordance with S-K TP legislation
 - An additional payment or refund has taken place

3. Advance rulings (4)

Article 35 UCC

Decisions relating to binding information with regard to other factors

In specific cases, the customs authorities shall, upon application, take decisions relating to binding information with regard to other factors referred to in Title II, on the basis of which import or export duty and other measures in respect of trade in goods are applied.

Public Consultation on the establishment in the EU of Decisions relating to binding information in the field of customs valuation

- Of the responses published (200):
- 53% responded that transfer pricing is, inter alia, why the provisions on Transaction Value are more challenging in practice?
- 87% are interested in obtaining a customs valuation ruling
- 72% would apply to, inter alia, cover the impact of transfer pricing (adjustments)

4. Special schemes (1)

Commentary 4.1 – Price review clauses

WCO Guide on Customs Valuation and Transfer Pricing (page 69)

This instrument considers the Customs value implications of goods contracts which include a “price review clause”, whereby the price is only provisionally fixed at the time of importation; **“the final determination of the price payable being subject to certain factors which are set forth in the provisions of the contract itself”**. It concludes that such clauses: “should not, of themselves, preclude valuation under Article 1 of the Agreement”. **This scenario can be compared to situations where the price declared to Customs at importation is based on a transfer price which may be subject to subsequent adjustment** (for example to achieve a pre-determined profit margin). Hence, the possibility of a transfer pricing adjustment exists at the time of importation.

4. Special schemes (2)

Reconciliation programme US

- A written Transfer Pricing Policy is in place between the parties prior to importation and has been prepared taking IRS Code Section 482 into account;
- The U.S. taxpayer uses its transfer pricing policy when filing its income tax return, and reports any adjustments resulting from the policy when filing its return;
- The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the policy for which the value will be adjusted;
- The company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the U.S.; and
- No other conditions exist that may affect the acceptance of the transfer price by CBP.

4. Special schemes (3)

European Union

Minutes 4th meeting of the Customs Expert Group (Valuation section):

1. The first step to be made in ease of transaction between related parties is to ascertain whether the relationship influenced the price;
2. When it is declared (and accepted) that the relationship did not influence the price, if the operator lodges a normal ("definitive") declaration, no adjustments deriving from a transfer price arrangement will be possible;
3. If using the simplified declaration, then the said adjustments may be possible; subject to the test that the relationship has not influenced the resulting price (the "circumstances of sale" test).
4. In any case, flat-rate adjustments are not permitted.

4. Special schemes (4)

European Union

Depends on EU Member State. Broadly speaking there are four schemes applied in the EU/that can be considered:

1. Simplified declaration
2. Article 73 license
 - Article 73 UCC and Article 71 UCC DA
3. Amending customs declaration retro-actively;
4. Normal import declaration followed by annual reconciliation sheet.

4. Special schemes (5) – Simplified declaration

- Article 166 UCC
- Article 147, para 3, UCC DA: 120 days plus 2 years for customs value (to be supplemented)

Preferred solution of the EU Commission (for now)

4. Special schemes (6) – Customs valuation license

Article 73 UCC and Article 71 UCC DA

- Specifically for elements to be included or not to be included in the customs value on the basis of articles 71 and 72 UCC respectively (predominantly royalties, assists, R&D);
- Disproportionate administrative burden;
- No significant difference from the value determined in absence of license.

Suitable for transfer pricing?

Can differences appearing after reconciliation at year end be corrected (repayment or additional assessment), legislation is silent on this

4. Special schemes (7) – Amending customs declaration

- Article 173 UCC: request to amend import declaration for retrospective downward price adjustments (3 years timelimit) or to increase the customs value as a result of an upward price adjustment;
- But see article 173 (2) (c) UCC, no adjustment after release of the goods by the authorities (or is 173 (3) UCC a solution here?)
- Or in case of downward adjustment ask for refund based on Article 116 – 117 UCC?

4. Special schemes (8) – Normal import declaration followed by annual reconciliation sheet

- Results in the solution defended by Hamamatsu and in *that case* rejected by the CJEU;
- Nevertheless sometimes/regularly (?) applied by customs authorities;
- But current application not foreseen in legislation

Thank you for your attention!

Prof. dr. Walter de Wit
dewit@law.eur.nl

Dr. Martijn Schippers
schippers@law.eur.nl