

Related Party Transactions

Taxation administrations internationally focus on "transfer pricing" to address the perceived risk to the revenue of taxpayer non-compliance with the arms length principle. Those administrations have become very sophisticated in formulating relevant methodologies and principles ((based on international agreements) so that a taxpayer can better determine an arms length outcome. In particular, the OECD methodologies of establishing an arms length price play an important role in most countries administration of transfer pricing.

The term "transfer pricing" has now developed a secondary meaning. That is, most customs administrations have now commenced to examine more carefully the contractual prices for imported goods between related parties. These related party contractual prices are increasingly being referred to as " customs transfer pricing".

The international agreements on which customs valuation law is based provide that prima facie, the contractual price for the sale of goods between related parties cannot be used for customs valuation purposes. However, where customs is satisfied that the contractual price has not been affected by the relationship between the parties then the negotiated contractual price may be able to be used for customs valuation purposes.

In other words, where customs has not satisfied itself concerning a related party's contractual prices for imported goods, then prima facie that importing organisation has a problem because the agreed contractual price cannot be used as the customs value of. More specifically, retrospective customs duty, VAT and/or penalties could apply.

It seems logical for all related party importers to obtain from the customs administration a written ruling confirming that the organisation's contractual prices for imported goods are acceptable for customs purposes. However, before importers apply for such a ruling they are advised to familiarise themselves with what obligations are imposed by law and international agreements on customs in reviewing such pricing.

Customs must rely on either one of 2 general tests in satisfying itself that related party contractual prices have not been affected by the relationship between the buyer and the seller of imported goods.

The first of these two tests which customs must consider is called internationally the "circumstances of sale" test. The alternative test is called the "test values" test.

The "circumstances of sale" test envisages the importer supplying detailed information as may be necessary to enable customs to examine the circumstances surrounding the sale. That is the customs administration should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and seller organise 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 demonstrated to customs that the related buyer and seller buy from and sell to one another as if they were not related then this would demonstrate that the price had not been influenced by the relationship. The international agreement illustrates for example that customs should be satisfied that the price had not been affected where an importer can demonstrate that the price had been settled in a manner consistent with the normal pricing practices of the industry in question or alternatively with the way the seller settles prices for sales to buyers who are not related to the seller. A further example of where customs should be satisfied is where the importer can demonstrate that the purchase price is adequate to ensure recovery of all costs plus a profit which is representative of the selling organisation's overall profit realised over a representative period of time (e.g. on some agreed periodical basis) in sales of goods of the same class or kind.

The alternative methodology which should be used by customs administrations to determine whether a contractual price paid between related parties for imported goods has been affected by the relationship is the "test values" test. This test provides the importer with an opportunity to demonstrate to customs that the contractual price for imported goods closely approximates some "test" value previously accepted by the customs administration. These test values generally relate to previously accepted customs values between unrelated parties or of specified identical/similar goods.

Customs administrations internationally (including the US, Canada, Australia and an increasing number of Asian countries) are rearranging their limited resources to prioritise this customs transfer pricing issue. Related party importers are encouraged to conduct a customs pricing analysis prior to making any representation to the customs administration.

An intercompany transfer pricing report may contain an abundance of information for the customs administration. They have recognized the energy which revenue authorities focus at transfer pricing between related parties and realize that more resources should be directed at reviewing related party contracts for the sale of goods from a customs perspective.

Related party exporters should be aware of this new development which may involve a disclosure of their transfer pricing policy to foreign customs administrations. These policies are often not compiled with customs valuation rules in mind and may therefore contain information which may not be acceptable for customs transfer pricing purposes.

Any company exporting or importing to or from related parties in other countries is advised to make sure that the pricing of the goods in the importing county meet the customs related party standards of that country. The risk of leaving this up to the importer may be very high and this can also have adverse effects on the exporter's transfer pricing policy.