Bridging transfer pricing and customs

Alan Bennett and Nico Ooyevaar, of McMan & Co, argue for a model for customs transfer pricing

The link between transfer pricing and customs valuation is the new hot issue in the world of tax. International conferences have recently been conducted on this topic in Europe and Asia. Customs services around the world including the US, Canada, Australia and some Asian countries have changed their administration of what is now being called customs transfer pricing.

This change should be of particular interest to those organisations buying from or selling to related parties. It will be an additional cost burden for those organisations that have already developed costly transfer pricing strategies to comply with the requirements of their revenue authorities.

So what is this all about? The finance directors of most related party importers/exporters would be shocked if they were advised that the bargained price in the contract of sale was *prima facie* not able to form the basis of the customs valuation in the country of importation because the parties were related. Nevertheless, this is the essence of the new customs administration change. More specifically, many customs administrations throughout the world are now reviewing all related-party contractual prices to determine whether those prices have been affected by the relationship.

In 1979 the old Gatt valuation rules were replaced by a completely new system, ending years of dispute between the US and Europe on how to value imported goods. Most countries now apply this newer methodology of customs valuation which is almost universally referred to as the transaction value of goods (that is the price actually paid or payable between the buyer and the seller in the relevant contract of sale, subject to certain adjustments).

It is the related-party transaction provisions of the current customs valuation system which have attracted renewed attention of the customs and revenue authorities. For some time now revenue authorities in the OECD and customs authorities in the WCO (World Customs Organisation) have been discussing how the methodologies of transfer pricing and customs valuation can perhaps converge given the fact that transfer pricing and customs valuation seem to use similar methodologies in establishing an arm's length dealing.

This convergence seems unlikely for a number of reasons including: transfer pricing is focussed on profit allocation; while, customs valuation deals with transactions. Nevertheless it is now recognised that there is much in common between the two systems. In particular, customs administrations have recognised the energy which revenue authorities direct at transfer pricing between related parties. After a review of the relevant customs international agreement and their domestic laws many customs administrations now recognise that more resources should be directed at reviewing related-party contracts for the sale of goods from a customs perspective.

Most customs authorities have up until now considered related party prices for the export/importation of goods as being acceptable without much enquiry at all. In general, the customs approach has been along the lines of: "We will allow it unless we have reason to believe that the price has been unduly influenced." In fact, not much effort was made by customs administrations to check the bona fides of related party contractual prices.

Customs administrations are now looking much closer at these contractual arrangements. It is estimated that the majority of global cross-border movement in goods is transacted between related parties.

Careful reading of the rules shows that where the buyer and seller are related the transaction value is simply *prima facie* not acceptable. The rules for all contracting parties to the WTO require customs to investigate the circumstances of the sale before the contracted price between related parties is acceptable for customs valuation purposes. To the extent that customs administrations adopt this principle- which they are compelled to do according to the international agreement- importers will be obliged to request a customs valuation ruling (that will require as a matter of prudence a pricing analysis to be conducted in advance).

In determining "the circumstances of sale test" an importer/exporter may be at liberty (subject to the facts) to use for customs valuation purposes a pricing analysis which has been prepared for revenue purposes.

Importers/exporters therefore now have an additional administrative burden to comply with this new customs administrative direction.

Step 1 is to enquire whether the customs administration in the importing country has implemented the WTO international agreement obligations into its domestic law (it would be rare indeed if a WTO member has not done this).

Step 2 is to enquire further whether the customs service within the importing country administers its law in accordance with its international agreement obligations.

If the answer in Step 2 is positive, then Step 3 is that a pricing analysis should be performed (or a pricing analysis already completed for revenue law purposes should be reviewed for customs purposes).
Step 4 is to lodge an application for a customs valuation ruling specifying that customs is satisfied that the price has not been affected by the relationship between the parties (and enclosing the pricing analysis as evidence).

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