Instituto Superior de Economia e Gestão

UNIVERSIDADE TÉCNICA DE LISBOA

MESTRADO EM CONTABILIDADE, FISCALIDADE E FINANÇAS EMPRESARIAIS

The tension between Transfer Pricing and Customs Valuation

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Setembro de 2012

Abbreviations

APA	Advanced Pricing Arrangement
CBP	United States of America Customs and Border Protection
CUP	Comparable Uncontrolled Price Method
EU	European Union
GAAT	General Agreement on Tariffs and Trade
MNE	Multinational enterprise
OECD	Organization for Economic Cooperation and Development
OECD Guidelines	Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
TCCV	WCO Technical Committee on Customs Valuation
US	United States of America
WCO	World Customs Organization
WTO	World Trade Organization
WTO Agreement	Agreement on implementation of Article VII of the General Agreement on Tariffs and Trade

Abstract

This master thesis intends to examine the tension between transfer pricing and customs valuation, showing how transfer pricing, in the context of corporate income taxation, and customs valuation, in the context of tariffs, are two realities that share a common starting point– the pursuant towards the achievement and corroboration of the arm's length principle – but incorporate critical differences and inconsistencies. After summarily describing the theoretical highlights behind the structure of each discipline, we perform an in-depth comparative analysis on the interactions between transfer pricing and customs valuation, exploiting the issues that arise from the lack of convergence between these two systems, which might act as a burden for the taxpayer / importer and be a source of situations of double taxation. The work developed led us to the conclusion that convergence and harmonization is a desirable and necessary step. While concluding that a full convergence would be difficult to implement mainly due to structural focus and timing differences, an acceptable degree of convergence would be reached based on three main foundations: the harmonization of the mechanism of choice of method, the mitigation of timing and focus differences and the clarification of the process of reflecting post importation transfer pricing adjustment at the customs level.

Key Words: transfer pricing, customs, valuation, arm's length, convergence, harmonization.

Resumo

O trabalho realizado pretende analisar a tensão existente entre preços de transferência e a valorização alfandegária, demonstrando que os preços de transferência, no contexto da tributação do rendimento das empresas, e a valorização alfandegária, no contexto da tributação aduaneira, são duas realidades que derivam de um ponto de partida comum – ambas as disciplinas procuram validar o princípio de plena concorrência nas operações vinculadas –, mas incorporam diferenças e inconsistências que se revelam críticas no resultado final obtido. Após descrição sumária dos princípios teóricos subjacentes, realizámos uma análise comparativa detalhada às interacções entre preços de transferência e a valorização alfandegária, com foco nas questões que estão na base da falta de convergência entre as duas disciplinas e que se revelam penalizadoras para o contribuinte / importador, podendo estar na origem de situações de dupla tributação. Concluímos que a convergência e harmonização destas realidades constituem passos necessários e desejáveis, embora atentas as diferenças identificadas, consideremos que a convergência total será de implementação difícil na medida que diferenças de natureza estrutural ao nível do foco e implementação temporal subsistirão. Um nível aceitável de convergência entre as duas realidades deverá basear-se na harmonização do procedimento de escolha do método; na mitigação de diferenças de foco e implementação temporal e na clarificação do procedimento de reflexo do ajustamento correlativo ao nível aduaneiro.

Palavras-chave: preços de transferência, valorização alfandegária, métodos de valorização, princípio de plena concorrência, convergência, harmonização.

Acknowledgements

First and foremost, I would like to thank my thesis supervisor, Master Graduated Joaquim Miranda Sarmento, for his assistance, ideas and guidance.

I would also like to thank my great friends and transfer pricing practitioners Marcelino Cardoso and Diogo Marques for their ideas, support and assertive discussions, from which great inputs emerged.

Lastly, I would like to thank my family, girlfriend and friends for their support and comprehension over this project.

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1. Introduction

The role of multinational companies[1] ("MNEs") on worldwide trade has been suffering massive development over the last 50 years mainly due to technological and communications development, which led to a major boost in commercial integration. A large part of global transactions occurs between subsidiaries and units of the same companies (Trent and Roberts, 2009), called for these effects related parties[2]. For reference, latest data available[3]refers that related party trade in the United States of America ("US"), one of the biggest players in globalized trading scene, accounted for 40,8% ($1.295 billion) of total goods trade ($3.176 billion). In 2010, US related party trade increased by 23,6% ($247 billion) while total trade increased by 21,9% ($570 billion) when compared to 2009.As a result taxation gains relevance as an important factor to consider both at a corporate income level and at customs level.

Globalization is a reality for business. That, by itself, constitutes a relevant motivation for the focus of tax and customs administrations, taxpayers and importers, on transnational tax considerations. As a consequence, on one side, following the development and increasing awareness of national tax authorities on transfer pricing issues and the consciousness that it mainly is in cross-border transactions that tax adjustments may result in relevant financial gains, the valuation of these transactions rises in importance. On the other side, as transactions are not confined within regional economic spaces characterized by an absence of internal borders and internal free movement of goods (e.g. EU[4]), customs duties on imports and exports play a relevant role on the decision process carried out by economic agents. The way these two issues align and potentially conflict is within the scope of this work.

[1] According to OECD Guidelines for Multinational Enterprises, "*these usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, state or mixed*".

[2] Both customs valuation rules and the income tax share a similar definition of related parties (Marsilla, 2011). For income tax purposes, an associated enterprise as defined in Article 9 of the OECD Model Tax Convention is (i) an enterprise that participates directly or indirectly in the management, control or capital of an enterprise or (ii) a set of two companies directly or indirectly controlled by a third entity. For customs purposes, related persons are defined in article 15.4 of the WTO Agreement in a similar way. In fact, most country specific variations are related to the adherence or not of "economic dependency" or "economic control" to these concepts.

[3] Related Party Trade Report, 2010, United States Census Bureau News.

[4] European Union ("EU").

In fact, there can be identified an inherent tension between these two disciplines. On the tax administrations' perspective the goal is to minimize the cost of goods sold for imported goods and thus the import prices, resulting in higher taxable profits, as direct tax income is directly related to taxable basis, which is naturally influenced by costs incurred with imported goods. Consequently, tax official's natural inclination would be to verify whether the value declared by a resident should be decreased in order to limit the tax deductible amount. For customs purposes, the transfer price has a direct impact on the determination of the customs value of the imported goods, which constitute the base on which duties are charged. A lower transaction value means lower revenue collections. Therefore, a customs officer natural inclination would be to verify whether the value declared by an importer should be increased in order to collect more duties.

Nevertheless, transfer pricing and customs duties share a common founding principle: the price established for goods traded between related parties must be consistent with the verified price if the parties were unrelated and the transaction occurred under the same circumstances, i.e., both disciplines strive to validate that the relationship did not influenced the price. That is called the arm's length principle.

While this subject is been discussed on the scope of supranational instances (OECD[5] and WCO[6]), this work aims to contribute to the global discussion, considering the following research questions: Is it possible that two different authorities accept two different answers to the same question i.e. what is the arm's length price? Considering a common departure point – the arm's length principle - what makes these two disciplines different? How deep are the existing differences? How can these two disciplines align in order to find a common way of interpreting the arm's length principle? Is the process of post importation adjustments to customs value in the event of a transfer pricing adjustment a source of tax inefficiency and double taxation for the importers?

It is important to refer that, for the purpose of this thesis, it is presumed that imports and exports imply that physical goods are liable to customs duties and are subject to the valuation principles of both transfer pricing as customs frameworks. Furthermore, an in

[5] Organization for Economic Cooperation and Development ("OECD").
[6] World Customs Organization ("WCO").

depth analysis on the methodology subjacent to each discipline is beyond the scope of this thesis as it would disperse the attention on the main questions on study.

As to answer the questions raised herein, we first focus our attention on the arm's length principle, on Chapter 3. As the application of the arm's length principle is transversal to both transfer pricing and customs valuation, we intended to give an insight on the way each discipline interprets that standard, bringing to light preliminary evidences on the foundations that originate the further identified differences and inconsistencies.

Chapter 4 exploits the identified differences, enumerating the flaws, the underlying issues and the complexity of these two systems which make the interaction between them not as subtle as the above referred common founding base would assume.

The types of transfer pricing adjustments are explained on Chapter 5, while the following chapter illustrates the available ways to reflect post importation transfer pricing adjustments on the customs value – i.e., the existence of an objective price review clause – detailing the issues and limitations that arise from existing mechanisms and form the base for their inefficiency.

At last, Chapter 7 incorporates the conclusions and the author's perspective on the current "state of art" regarding the identified issues, as well as recommendations on future steps towards the desirable harmonization of customs and transfer pricing.

From this work we concluded that several issues arise from the way transfer pricing and customs valuation interpret the arm's length principle and may result in situations of double taxation. Main conflicting issues identified are related to the existence of differences between each conceptual structure - namely related to priority setting of methods, different comparability requirements and approaches to similar realities -, as well as inconsistencies in methodology, different documentation requirements and differences in focus. The inadequate process for reflecting post importation transfer pricing adjustments on previously declared customs value is also an issue.

Considering that some differences would be hard to overcome as structural differences regarding focus and timing would most likely subsist, our work led us to conclude that structural differences should be prioritized in order to achieve an acceptable degree of

consistency, namely the convergence in priority setting of methods, under which customs should soften their strict method choice process; the mitigation of timing and focus differences at the back of an increase in pro-activity and coordination between authorities and importers /taxpayers, encouraging joint APA[7] setting, the establishment of price review clauses and adequate contractual support to entail the possibility of future adjustments on the customs side; as well as clarifying the post importation corresponding adjustment process to the customs value, enabling importers to obtain refunds of the excess of duties paid in case of a downward adjustment.

[7] Advanced Pricing Arrangement ("APA").OECD defines an APA as "*an administrative approach that attempts to prevent transfer pricing disputes from arising by determining criteria for applying the arm's length principle to transactions in advance of those transactions taking place*".

2. Literature Review

In this chapter we carry out a brief literature review on the interaction between customs valuation and transfer pricing, with focus on the identified differences and similarities between the two disciplines and perspectives related to the possible harmonization process and solutions.

At the premise that taxes and tariffs determine the magnitude and direction of incentives for transfer pricing manipulation while transfer price penalties and costs attenuate the actual degree of tax-induced transfer pricing manipulation, Swenson (2000) created a model of transfer pricing incentives[8]. As a result of his research, the author concluded that tariff variations create incentives for underpricing or overpricing related firm transactions that may either complement or detract from general tax-induced income shifted motives. The author added that, despite reported prices rise when the combined effect of taxes and tariffs provides an incentive for firms to increase their prices, evidence suggests that the manipulation of product transfer prices is not generally responsible for large movements in reported income. Grubbert and Mutty (1991) suggested that taxes and tariffs have a strong impact on MNEs operations.

Regarding the interaction between customs and transfer pricing, Malm (2009) concludes on the advantage of harmonizing both disciplines under the umbrella of supra-national institutions like OECD and WTO[9]; on the need of cooperation and information exchange between institutions at national level, exemplifying with joint customs and transfer pricing audits and joint APA negotiation; on the advantage of establishing common documentation requirements to mitigate the burden of setting up expensive documentation reports and on the importance of submitting price review clauses as a way to for companies to be prepared for possible post importation adjustments. Marsilla (2011) enforces that importers should prepare contracts and commercial documentation to thoroughly contemplate the circumstances that can originate post importation adjustments, while underlining the relevance of APAs as a convergence tool.

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[8] According to the model, transfer prices are a function of the comparable arm's length price, the costs of avoidance, and a tax factor that combines corporate tax rates, applicable tariffs and the features of the home country tax system.

[9] World Trade Organization ("WTO").

Jovanovich (2000) concludes on the advantage of harmonization based on two premises: the idea of consistency, stating that common principles should lead to similar results, and the idea of reasonability, stating that transfer pricing and customs valuation analysis are often complex, expensive and time consuming.

Herksen (2009) identifies several differences and similarities between the two disciplines. Main differences identified are related with the existence of different sets of rules, valuation regimes and mechanisms of collection of the tax. The author states that while valuation methods seem initially similar, they operate differently because the valuation for customs purposes is on a transaction-by-transaction basis, while transfer pricing usually operate over aggregation of transactions. As for similarities, the author identified that both disciplines set ground on the arm's length principle and require evidence that the price was not affected by the relationship between the parties. Additionally, it is referred that making errors in either discipline is likely to be tremendously costly (in terms of penalties, interest, adjustments) and labor intensive.

Masui (1996) identifies arguments in favor and against the establishment of uniform valuation in these two disciplines. To defend uniform valuation, he points that the arm's length principle should be an objective single value, stating that inconsistent standards create perception issues for tax payers. He also claims that current differences in valuation concepts may bring to scene perverse motivations for both governments and taxpayers, as they have opposite objectives regarding tax and customs expenditure[10]. On the opposing side, the author identifies a set of arguments against uniform valuation. He states that different standards for valuation are appropriate because each purpose of ascertaining the arm's length price is different and that non-uniform standards of valuation do not harm the taxpayers. Also refers that different branches of governmental body may pursue their own objectives and that the alleged "whipsaw problem" may be refuted by saying that the two taxes are completely independent and that there is nothing wrong with taking the most beneficial position for each tax.

[10] The author refers to this question as a "whipsaw problem" for both governments and taxpayers.

3. The arm’s length principle

This chapter aims to demonstrate the way each discipline approaches the arm’s length principle – i.e., how they validate that the price established for goods traded between related parties is consistent with the price that would have been realized if the parties were unrelated and the transaction occurred under the same circumstances, assuring that the relationship did not influenced the price – focusing on both conceptual structures and frameworks which will permit the identification of the issues that make them incoherent and inconsistent.

3.1. The transfer pricing’s approach to the arm’s length principle

The OECD issued in 1995 the first original version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [11] (“OECD Guidelines”) providing guidance on the application of the arm's length principle for tax purposes on transactions between associated enterprises. The aim was to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein, while limiting the risks of economic double taxation that may result from a dispute between two countries on the determination of the arm’s length remuneration for their cross-border transactions with associated enterprises.

The OECD Guidelines indicate that when independent enterprises deal with each other, the conditions of their commercial and financial relations (e.g. the price of goods transferred or services provided and the conditions of the transfer or provision) ordinarily are determined by market forces [12]. When controlled transactions do not reflect this premise, the arm’s length principle is at stake and tax liabilities may arise. The authoritative statement of the arm’s length principle is found in paragraph 1 of

[11] OECD Guidelines have been updated since then (2008; 2010), despite keeping the core principles present on their original release.

[12] OECD Guidelines – paragraph 1.2.

article 9 of the OECD Model Tax Convention[13], which provides that *"[When] conditions are made or imposed between … two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued for one of the enterprises, but, for some reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxes accordingly*"[14].

The definition of a framework for evaluating the controlled transactions has both tax purposes - because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, avoiding the creation of tax advantages/disadvantages that would otherwise distort the relative competitive positions for either type of entity[15] – and economic purposes – considering that the above mentioned parity promotes international trade and investment.

Accordingly, one of the main goals in a transfer pricing analysis is to seek for comparability, which is deeply related to the concept of arm's length principle, generally based on the comparison of the conditions in a controlled transaction and conditions in transactions between independent enterprises. Furthermore, according to the OECD Guidelines, to be comparable means that none of the differences (if any) between situations being compared could affect the condition being examined in the methodology (e.g., price or margin), or if it can, adjustments can be made to eliminate those differences.

In what concerns to the methodology itself, the OECD Guidelines aggregate transfer pricing traditional transaction methods (including comparable uncontrolled price method , resale price method and the cost plus method) and transaction profit methods (including profit split method and transactional net margin method)[16]. Following the 2010 revision of the OECD Guidelines, in principle, there is no priority set among the

[13]The OECD Model Tax Convention forms the basis of bilateral tax treaties, providing guidelines to settle on a uniform basis the most common problems that arise in the field of international juridical double taxation.

[14] OECD Guidelines - paragraph 1.6.

[15] OECD Guidelines - paragraph 1.1.

[16] For a summary on the methodology used for transfer pricing purposes, see Annex – Table 2: Valuation methods as prescribed in the OECD Guidelines.

different traditional transaction methods, although the CUP method is considered the most direct and reliable way to apply the arm's length principle due to comparability factors when methods can be applied in an equally reliable way. The same principle applies to the traditional methods and transaction methods, the first being preferable over the latest, when equal conditions of comparability and reliability are met[17].

3.2. The customs' approach to the arm's length principle

Customs valuation is governed by domestic laws of each country or in case of customs union, by a common customs code[18]. General Agreement on Tariffs and Trade ("GAAT"), as an umbrella treaty used by WTO in trade of goods, provides the basis for customs framework containing the provisions on valuation for customs purposes. In compliance with the Agreement on the Implementation of Article VII of the GATT ("WTO Agreement"), established on 1994, the basic principle to determine the value of imported goods is the transactional value, i.e., the price paid or payable for the goods when sold for export to the country of importation, on which duty is assessed. The price paid or payable adjusted to the additions and deductions[19] constitutes the tax base of customs duties (Jovanovich, 2000).

Nevertheless, the acceptance of transactional value on transactions between related parties is subject to certain conditions. The WTO Agreement establishes that "*the fact that buyer and seller are related shall not itself be grounds for regarding the transaction value as unacceptable*"[20]. To dismiss the possibility that the relationship between the buyer and the seller influenced the prices paid or payable, customs administrations examine the circumstances surrounding the sale. In practical terms, under the circumstances of the sales test, customs administration might examine whether the sales prices of the transactions were settled in a similar manner to the way the seller settled prices with unrelated parties or with the normal pricing practices of the

[17] OECD Guidelines, Paragraphs 2.5 and 2.7.
[18] Commission Regulation n.º 2454/93 of 2 July 1993, established the provisions for the implementation of Council regulation n.º 2913/92 i.e., the Community Customs Code.
[19] For a description of mandatory additions and deductions to the price paid or payable, see Annex - Table 3: Mandatory additions and deductions to the price paid or payable according to the WTO Agreement.
[20]Article 1.2 a) of the WTO Agreement.

industry, whether the sales prices were adequate to ensure the recovery of all costs plus a profit equivalent to the company's overall profit realized over a representative period of time and whether there were any other factors that indicated that the relationship between the buyer and the seller did not influence the price (Pike, 2010). Alternatively, the WTO Agreement establishes that the transaction value shall be accepted and open market conditions validated if the importer demonstrates that it closely approximates to one of the test values[21].

Where the customs value cannot be determined as the transactional method fails to succeed (i.e., after examining the circumstances surrounding the sale and failing to prove that the relationship did not influence the price throughout comparison with test values, customs administration does not possess enough information to disregard the possibility that the relationship did influence the price paid or payable[22]), the establishment of a substitute value for the transaction is required. As to this purpose, the WTO Agreement establishes a sequence of methods (as we show in Annex – Table 4: Valuation methods as prescribed in the WTO Agreement), to be applied in a prescribed hierarchy. The importer must choose among the valuation methods by selecting the first listed which is available[23].

[21] Article 1.2.b) of the WTO Agreement establishes that n a sale between related persons, the transaction value shall be accepted 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 or; (ii) the customs value of identical or similar goods.

[22] Article 1.2. a) of the WTO Agreement.

[23] For example, an importer begins with the transaction value of identical goods and, if available, chooses that method, but if unavailable, determines whether the next method in descending order, the transaction value of similar goods, is available, and so on.

4. Main differences between transfer pricing and customs valuation

"As things stand now, tax and customs authorities are not obliged to accept a value that is calculated in accordance with each other's legislative requirements" (Ping and Silberztein, 2007). Nevertheless, as both systems adopt common base principles – starting with the adoption of the arm's length principle as a standard - it would be expectable that the results would be to the extent possible, consistent (Jovanovich, 2000). Considering the reasons bellow, that does not always happens as differences in valuation may arise. In the present chapter main differences between direct tax and customs rules on the valuation of related party transactions are identified and their impacts studied.

4.1. Differences in conceptual structure as a source of inconsistency

For transfer pricing purposes, the choice of the method depends on the circumstances surrounding the situation. In accordance, despite stating the "*preference for higher degrees of comparability and closer relation to the transaction*"[24] which culminates with the preponderance of traditional methods over transactional profit methods, transfer pricing's framework does not prohibit hybrid approaches or analysis to the arm's length principle based on other methods. In fact, paragraph 1.68 of the OECD Guidelines state that "*MNEs retain freedom to apply methods not described in this report* (the OECD Guidelines) *provided those prices satisfy the arm's length principle in accordance with these Guidelines*" while paragraph 1.69 reinforces that a "*flexible approach would allow the evidence of various methods used in conjunction*".

On the opposing side, in valuing a related party transaction, customs privileges the use of the transaction value. In case it is considered that the transaction value of the imported goods is not at arm's length as it neither passed through the circumstances of the sales test, nor through the test values test, a substitute customs value is determined by applying, in a hierarchical order, one of the methods available.

[24] See paragraph 1.70 of the OECD Guidelines.

The identified differences have direct impact on the linkage and consistency between transfer pricing and customs valuation. Exemplifying, if during the examination of the circumstances surrounding the sale the tax and customs authorities based their analysis on the cost-plus method or on the computed value method[25], respectively, and such methods demonstrated that the price had been influenced by the relationship between parties, then the tax administration (on the basis of the OECD Guidelines) could substitute the cost-plus method price for any transactional method, while customs administration (based on the WTO Agreement) would be obliged to go sequentially through the methods available.

Additionally, in some aspects the comparability requirements are lower under customs framework when compared to comparability standards present in OECD Guidelines. Thus, customs administrations may find transactions at the same commercial level to use as comparables for a given importation, but intervenient companies allocate totally divergent functions, assets and risks into the operation. Those comparables would not be considered valid under the OECD Guidelines. On the other side, transaction value admits a narrower set of comparables when compared to the analogue transfer pricing method, the CUP, as it requires the prices to be adjusted for quantities, establishes location restrictions for the potential comparable operations and states the preference for internal comparables (Jovanovich, 2000).

Treatment of royalty fees also brings to the spotlight the differences between both disciplines. As mentioned before, under current customs rules certain license fees must be included in the customs value of the relevant goods and thus subject to customs duty, namely if (i) the royalty is related to the goods and (ii) the royalty is a condition of the sale. On the opposite side, tax authorities might consider the same royalty as a separate reality and subject the cash-flow to withholding tax on the country of export. As such, the same license fee could be separately taxed by the tax authorities, being considered as transference of *know-how* unrelated to the goods, and by customs authorities, being considered as a part of the transaction value of goods.

[25] The nature of these methods is similar.

4.2. Method comparison

Obtaining distinct valuations for the same product can also derive from differences in methods. In fact, while it is possible to establish parallelism between transfer pricing and customs valuation methods, some critical differences arise[26]. Most derive from the fact that for customs purposes the focus relies on the product being object of transaction, while transfer pricing methods focus on functions and risks allocation. Idsinga (2005) and Marsilla (2011) suggest that certain adjustments can be made on each area in order to enhance comparability and mitigate those differences to acceptable standards. In this context, limitations regarding the possession of sufficiently desegregated information arise, both in the context of adjustments to enable the comparison between prices that derive from both valuations or in a context of the need to adjust comparables. Marsilla (2011) also considers that differences between customs valuation and transfer pricing rules can be huge and the reconciliation of both values could prove to be impossible.

4.3. Documentation requirements

Whilst stating that collection and treatment of information shall not be a burden for the taxpayer, the OECD Guidelines reinforce the utility of information relating to each related enterprise in a controlled transaction[27], namely business related information, group related information and information regarding transactions and controlled operations. Functions, assets and risk allocation are relevant for transfer pricing purposes, as they are the base of the choice of the method that provides the most reliable measure of the arm's length principle (Amerkhail, 2006).

For customs purposes, documentation for valuation purposes still lacks harmonization among various jurisdictions, due to the lack of a defined framework, although the importer shall be able to demonstrate that the relationship did not affect the price paid or payable, in case customs authorities require.

[26]Annex: Table 5 – Transfer pricing and customs valuation: highlights on method comparison, illustrates the most important differences identified when comparing seemingly similar methods of transfer pricing and customs valuation.
[27] See paragraph 5.18 and following of OECD Guidelines.

There is lack of synchrony between these two disciplines regarding documentation requirements. There is also no clear defined framework as to the utilization of transfer pricing documentation for customs purposes which constitutes a clear burden for the taxpayers/importers, as might obligate the constitution of parallel documentation. Nevertheless, first steps have been undertaken. The WCO Technical Committee on Customs Valuation ("TCCV") approved, in October 2010,commentary 23.1 to the WTO Agreement, providing guidance on the use of a transfer pricing study prepared in accordance with the OECD Guidelines, on the examination of the "circumstances surrounding the sale" on a customs assessment of the arm's length principle[28].

4.4. Analytical focus

There can also be identified inconsistencies related to the analytical focus on both disciplines. Transfer pricing analytical focus is often directed to the aggregate results on the scope of the tested party, which may include a large number of transactions and other related operations (intangibles and other services related to the transactions) and often consubstantiates on year end reasonability tests to gross or net margin[29].In fact, while stating that ideally the arm's length principle should be applied on a transaction-by-transaction basis – i.e., similarly to what occurs for customs purposes under the WTO Agreement – the OECD Guidelines refer that "*where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate*

[28]Although it is a generic guideline (it does not give information as to how the two disciplines interact), it constitutes a relevant step. The conclusion of Commentary 23.1 states that: "*Accordingly, 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. As a conclusion, any relevant information and documents provided by an importer may be utilized for examining the circumstances of the sale. A transfer pricing study could be one source of such information*".

[29]The gross margin represents the percent of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold by a company. Net margins also reflect the impact of some "below the line" expenses (e.g., service charges, royalty fees). Where enough information is available, gross margins produce more accurate and reliable results than that of net margins, as "bellow the line" expenses may bias the result on a net margin method application.

basis[30]". Reasonability reasons may also contribute to the proliferation of aggregate analysis[31].

On the opposing side, the nature of customs valuation framework makes almost inevitable the analysis of a given transaction on a case-by-case basis, as the import values are relevant at each customs entry. As for audit procedures, customs audits occur in real-time and with a transactional basis, as customs officials will investigate the valuation of goods at the moment of importation. This makes it difficult for authorities to take any holistic view on the business model or any strategic reasons behind low import values, whilst this can be better communicated to tax authorities, who review the overall tax return and have access to transfer pricing documentation on an annual integrated basis.

As a result, customs authorities tend to focus on price comparisons while tax authorities often turn to margin comparisons. Also, customs authorities generally focus on goods only, while tax authorities can look at tangibles, intangibles and services associated with the transaction of goods[32].As a consequence, different outcomes might arise for the same transaction, i.e., totally different valuation values might derive from the analysis carried out under each discipline's scope and a transaction (or aggregation of transactions) might be at arms' length for transfer pricing purposes, but not for customs purposes.

[30]Paragraph 1.42 of the OECD Guidelines.

[31] Paragraphs 3.80, 3.83, 5.6, 5.7 and 5.28 of the OECD Guidelines, repeatedly emphasize that documentation requirements should be reasonable and should not impose on taxpayers' costs and burdens disproportionate to the circumstances.

[32]As referred on this chapter, some payments of intangibles may give rise to customs duties as well and constitute a source of double taxation (e.g., royalties).

5. The transfer pricing adjustment process

There are several types of transfer pricing adjustments, with underlying impacts either at a national or multinational level. The main goal is to reflect the arm's length standard in controlled transactions, in accordance to article 9 of OECD Model Tax Convention. The aim of this chapter is to approach the existing types of transfer pricing adjustments, highlighting the realities that should be considered on a hypothetical post importation corresponding adjustment to the customs value, to be subject to analysis on the following chapter.

The first and most common adjustment is called primary adjustment[33]. As defined on the glossary of OECD Guidelines, these adjustments represent changes to taxable profit that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction.

When a subsequent adjustment / recharacterization is made after a primary adjustment in order to establish the situation as it would have been if transactions had been at arm's length, by treating the excess profits resulting from a primary adjustment as having been transferred in some form and taxed accordingly, it is called secondary adjustment. It is an adjustment that arises from imposing tax on a secondary transaction (a constructive transaction) in order to make the actual allocation of profits consistent with the primary adjustment[34]. Joint transfer pricing forum[35]stated that "*it implies the assertion of a constructive transaction (the secondary transaction) that attempts to explain why the cash is sitting differently to what would have been should the arm's length principle had been applied by the related parties from the outset*", exemplifying with situations of constructive dividends, constructive loans and constructive equity contributions.

[33] See commentary on article 25 of OECD Model Tax Convention.

[34]According to Mas (IBDF, 2009), secondary adjustments can also serve to prevent tax avoidance, as subsidiaries (or low tiers companies in a multinational group) might tend to make overpayments to the parent, instead of dividend distribution, to avoid withholding taxes.

[35]Joint Transfer Pricing Forum, 2010, "*Secondary Adjustments: A risk of double taxation within the EU*".

In addition to secondary adjustments, primary adjustments might also trigger corresponding adjustments[36]. A corresponding adjustment[37], which is reached under a mutual agreement[38], can mitigate or eliminate double taxation in cases where one tax administration increases a company's taxable profits (i.e. makes a primary adjustment) as a result of the application of the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction. In such case, the corresponding adjustment is a downward adjustment to the tax liability of that associated enterprise, made by the tax administration of the second jurisdiction, so that the allocation of profits between the two jurisdictions is consistent with the primary adjustment and no double taxation occurs.

At last, despite not being recognized by the majority OECD member countries on the grounds that the tax return should reflect the actual transactions, it is important to mention the existence of compensating adjustments[39]. In practical terms, it is a procedure that would be made before the tax return is filed and reduces the need for primary adjustments by allowing the taxpayer to report 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 related enterprises.

[36]Mas, Mayra O. Lucas (IBDF), 2009, edited by Bakker, Anuschka, Obuoforibo, Belema, "Transfer pricing and customs valuation: Two worlds to tax as one".

[37]Paragraphs 4.32 to 4.37 of the OECD the Guidelines.

[38] Paragraph 2 of Article 9 specifically recommends that the competent authorities consult each other to determine corresponding adjustments. Under paragraph 2 of Article 9, a corresponding adjustment may be made by a contracting state either by recalculating the profits subject to tax for the associated enterprise in that country using the relevant revised price or by letting the calculation stand and giving the associated enterprise relief against its own tax paid in that State for the additional tax charged to the associated enterprise by the adjusting State as a consequence of the revised transfer price.

[39]Paragraphs 4.38 and 4.39 of the OECD Guidelines.

6. The impact of transfer pricing adjustments on customs valuation: price review clauses as an incomplete solution to the problem

There is inherent tension and conflict between the objectives of customs and transfer pricing authorities, as customs would like to see inbound prices maximized to increase dutiable base, whereas tax authorities in the importing countries would look for low inbound prices which maximize taxable profits. Transfer pricing regulations may lead to greater voluntary (compensating) or imposed (primary, secondary or corresponding) adjustments to taxable profits on an ex-post basis and these adjustments would typically lead to challenges on the customs side, which justifies the need for a working regime that clarifies the linkage between these taxation realities.

As described before, both customs and tax authorities use diverse methodology and procedures to evaluate the price declared by the importer or the transfer price. In this process, adjustments to the pricing of goods may occur and the lack of synchrony between these areas may lead to situations of double taxation. This chapter focuses on the analysis of the impact that transfer pricing adjustments have on customs valuation, being the adjustments either caused by imposition of national tax authorities in case of a subsequent transfer pricing adjustment or by the posterior impact of unknown costs at the time of the entry, based on the possibility of setting an undetermined pricing formula at the time of the import – i.e., a price review clause. Price review clauses are to be set by the importer relating to components of the pricing that are identifiable at the time of entry, but not quantifiable at that time, as they require the use of data that is not available at the time of the import[40]. We will further exploit the variations intrinsic to this possibility.

Several authors (Marsilla, 2008 and 2011; Mas, Hersken et al., 2009; Jovanovich, 2000;Malm, 2009) suggest that the introduction of price review clauses at the time of the import might be enough for customs authorities to accept the delay on the final determination of the customs value claiming that customs framework entails the

[40]Consequently, the importer will only be able to declare an arm's length price when such data becomes available and will not be able to demonstrate that the relationship did not influence the price if the customs administration does not delay final determination of customs value until such data becomes available (Jovanovich, 2000).

possibility that the price paid or payable can be changed in the future[41] if, at the time of entry, it was not in any way provisional, giving the importer the possibility to review or adjust the price of the goods in the light of future events[42]. Mas (2009)adds that "*if the buyer and the seller introduce a price review clause in the sale and such clause is based on the results of a transfer pricing study prepared on the basis of the methodologies of the OECD Guidelines, the customs authorities should be able to delay the final determination of customs value*". Table 1 bellow summarizes the identified alternatives and impacts:

Table 1: Impact of post importation transfer pricing adjustments on customs previously declared value[43]

Hypothesis 1: The contractual price setting process (i) does not establish price review clauses and (ii) the price is declared to customs in a definite manner	If the modification of the price is agreed after importation due to a transfer pricing retroactive adjustment, the originally declared transactional value could be regarded as being influenced by the relationship and not compliant with the arm's length standard, being rejected on the basis of article 1 of the WTO Agreement. **Consequences:** In case of an upward adjustment, additional duty shall be paid by the importer. In case of a downward adjustment, duty refund would not occur. The importer may incur in relevant penalties and interest compensation for delaying the payment on the base of a incorrect valuation.
Hypothesis 2: The contractual price setting process (i) establishes a pricing formula and (ii) a price review clause is in effect at the time of the importation	The price actually payable for the imported goods cannot be established on the basis of the data specified on the contract (e.g. cost plus method where not all costs are available at the time of importation). In these cases, the transaction value of the imported goods must be based on the final price paid or payable, as final price determination should be delayed. **Consequences**: The acceptability of the corresponding impact of a post importation transfer pricing adjustment, while not guaranteed as further explained, in more probable.

[41]Price review clauses and formula pricing might be used to allow goods to be valued under provisions of articles 1 and 13, and commentary 4.1. of the WTO Agreement (we underline that none of these guidelines specifically refers to transfer pricing post importation adjustments).

[42] Process commonly called of "reconciliation". Reconciliation is the process by which an importer notifies customs authorities of undeterminable information for post-entry adjustment, and by which the outstanding information is provided at a later date. Under reconciliation, the importer is not disclosing a violation, but rather identifying information that is undeterminable and will be provided at a later date.

[43]Based on Jovanovich (2000) and Malm (2009), adapted by the author.

It is clear that the existence of detailed price review clauses is crucial for the possibility of setting a provisional and adjustable price under the umbrella of articles 1 and 13 of the WTO Agreement. Nevertheless, it might not be sufficient. In effect, even if a price review clause is implemented, the acceptability by customs authorities of the impact of a post importation transfer pricing adjustment is not guaranteed as, even on the optimal circumstances for the importer, several limitations arise. Firstly, legal support is unclear, as neither article 13 nor the commentary 4.1. of the WTO Agreement directly refer to transfer pricing adjustments, which originates inconsistent application on adhering countries.

Additionally, on general terms, it has already been stated that post importation adjustments to customs provisional price can only occur at the back of a price specific formula, which makes it almost impossible to cover all situations[44]. Conversely, price review clauses could be used to reflect transfer pricing post importation adjustments on customs value, provided adjustments can be made at a cost basis[45]. Even if that could be done (i.e., if a formula could be set in such a detailed way that is able to incorporate the transfer pricing adjustment), further limitations arise. Transfer pricing often aims at establishing aggregate arm's length profit margin analysis while customs valuation is transactional. Accordingly, a transfer pricing adjustment may lead to the need to unbundling of the costs elements included in the transfer price, which may reveal to be difficult due to limitation on data available.

Time restrictions to go into reconciliation in case of a post importation transfer pricing adjustment are also an issue. If an adjustment is made to income tax, the corresponding review of customs valuation is most likely impossible because of the time limit for an

[44]In the context of a Korean dispute in the case of a post importation adjustment dispute in the import of motorcycles and automobile parts by a foreign parent of a local company, a claim for retroactive post-importation adjustment caused by currency fluctuations was rejected. Korean tribunal stated that the clause that allows the price adjustment must have a detailed method to calculate the variation in price, i.e., the imported goods must contain price adjustment terms, and these must be of such specificity, including such sufficient data and formulas, that the actual price payable can be determined accordingly.

[45]On the context of an aggregate analysis, tax authorities may find the need to adjust the margin considering that it was not established at arm's length. There is no current mechanism to reflect that adjustment on customs previously declared values.

assessment probably has expired[46]. In the EU, this time limit is only three years starting after the submission and acceptance on a customs declaration (Malm, 2009). Nevertheless, even if the importer manages to make a review in a timely manner, the authorities could argue that such review has no merit, based on the structural differences between valuation methods, as we explained in chapter 4.2.

Considering the identified limitations, in the event of an upward transfer pricing adjustment, customs authorities would likely require additional duty, taxes and interest. However, if a downward transfer pricing adjustment occurs, the importer most likely will not be able to obtain a refund of duty, concerning the above referred limitations. Denying the duty refund means the importer is being subject to double taxation, as two conditions verify: (i) increased income tax due to increased taxable profits caused by the lowered transfer price, and (ii) duties accessed on a higher transfer price of goods imported. Herksen (2009) states that "*whereas in the field of direct taxation there exists an international mechanism to avoid double taxation, such mechanism does not exist for customs. No such mechanism exists to provide relief for the burden resulting from increased customs duties or the unavailability of any scope to get a refund for customs duties paid due to a transfer pricing adjustment*".

[46] It is frequent that tax authorities act 2 or 3 years behind present tax year, which itself represents a relevant time restriction for importers to enter in reconciliation programs to adjust import values. Additionally, in case of an unfavorable decision to the tax payer, further defense mechanisms may be triggered, which can invalidate the chances of recovering excessive customs paid.

7. Conclusions, recommendations and future work

Transfer pricing and customs valuation are disciplines that share common foundation. This is almost unanimous in all the literature we have consulted (e.g., Marsilla, 2008 and 2011; Mas, Hersken et al., 2009; Jovanovich, 2000; Malm, 2009). Both disciplines are based on the arm's length principle, i.e., seek to validate that the relationship between parties did not influence the terms and conditions verified in the transactions and, on direct taxation perspective, to grant that the correct allocation of profits and taxable income between companies and jurisdictions occurs.

Nevertheless, the way they interpret the arm's length principle often leads to problems for the entities in cross-border transactions, as different valuations may arise, culminating in situations of double taxation. Main conflicting issues identified are related to the existence of a different conceptual structure - namely related to priority setting of methods, different comparability requirements, and different approaches to similar realities –, relevant differences in methodology, inconsistency in documentation requirements and differences in timing and focus, as customs valuation act on a transaction basis while transfer pricing often uses aggregated data. The inadequate process for reflecting post importation transfer pricing adjustments on previously declared customs value also constitutes a relevant issue.

We found out with this work that total convergence might not be feasible and neither should supranational institutions and governments impose one system into the other. These disciplines have different focus and timing actuation which would be the biggest obstacles to overcome. That being said, we concluded that an acceptable degree of harmonization would be reached by focusing on three aspects: convergence on the process of selection of method, clarification of customs rules regarding the corresponding adjustment process in the event of a transfer pricing adjustment and mitigation to the extent possible of focus and timing differences.

As referred, the procedures regarding the choice of method shall be harmonized in order to avoid different valuations. We consider that customs valuation method choice system is excessively strict and lacks capacity of adaptability to particular circumstances of transactions. The change to a system based on the best method choice would be a

decisive contribute to convergence. This situation is critical and more important than uniformizing the methods itself. In fact, although it would be important to pursue convergence between each discipline's methodology, our work led us to the conclusions that those differences can already be identified under current frameworks and if necessary, adjustable to acceptable standards, if sufficient detailed data is available.

Focus and timing differences between both disciplines would be hard to overcome. Considering the circumstances, it would be utopian to assume that tax authorities could shorten their time gap on the actuation with taxpayers and that transfer pricing analysis would start being held at each transaction. On the other side, it is difficult to conceive customs valuation not having a transaction based focus and customs authorities not acting at the time of the import. As a result, part of the solution resides in acting proactively rather than focusing on the posterior validation/auditing of the procedures and pricing policies. This requires efforts on coordination and the establishment of a cooperative posture between customs, tax authorities and the taxpayer / importer. In this context, bilateral APA rulings should be considered as a potential solution[47]. As a downside, although APAs can resolve tax valuation concerns to a certain extent, they are often very rigid, time and cost consuming, and not appropriate for businesses in continuous evolution. Also, APAs are not deemed as a viable option for small and medium sized enterprises or for transactions that are not material in size.

Additionally, the definition of adequate price review clauses at the customs level – not avoiding the transaction value method – with an adequate contractual setting of terms and conditions regarding the circumstances that may lead to a post importation adjustment (Marsilla, 2008 and Malm, 2009), may contribute to the avoidance of conflicting valuations. We found that reflecting the impact of post importation transfer pricing adjustments in customs previously declared value is far from being a simple task even in the context of a price review clause and specifically in the event of a downward adjustment, in which a duty refund is unlikely to happen. Clarifying and standardizing this process, enabling importers to obtain refunds of the excess of duties paid on the

[47] As referred in ruling HH029658 issued by CBP (December, 2009), under the circumstances of the sale test and in the context of a bilateral APA – APA ratified by two jurisdictions – CBP considered that the fact that two jurisdictions ratified profit levels and allocation was an important sign that the relationship between parties did not influenced the price. This shows the role that can be attributed to APA's as a convergence mechanism.

event of a downward adjustment is critical as a measure to prevent double taxation.CBP recently took a major step regarding the referred concerns, issuing a ruling to permit post-entry adjustments to transaction value in related party transactions where the transfer price had been "*fixed or determinable under an objective formula"* prior to importation[48] as qualified by five specific criteria[49].

Considering the efforts towards convergence, WCO and OECD held two joint conferences, in 2006 and 2007, to understand the issues and discuss them amongst customs and tax authorities, as well as the business community. The main themes that emerged from the conferences included the analysis of the pros and cons on converging the two sets of rules, exploring avenues to provide greater certainty for business through APA, joint rulings, dispute resolution, increased information sharing between tax and customs authorities, and exploring the potential for joint audits and compliance. Subsequent to the conferences, a cooperative focus group was set up. More visible results on these efforts are yet to be revealed.

[48]Previously, in accordance with ruling 547654, the transaction value could not be applicable once the price at issue could not be fixed or determinable pursuant to an objective formula prior to importation.

[49]The list of factors provided by CBP as guidance for determining whether an objective formula was in place prior to importation for purposes of determining the transaction value include the following:

- A written Transfer Pricing Policy is in place between the parties prior to importation;
- The US 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 US; and
- No other conditions exist that may affect the acceptance of the transfer price by CBP.

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9. Annexes

Table 2: Transfer pricing methods as prescribed in the OECD Guidelines[50]

Traditional transaction methods	Comparable uncontrolled price method[51]	Compares the price charged for propriety of services transferred in a controlled transaction with the price charged for property or services transferred in a uncontrolled transaction in comparable circumstances. If any differences between the two prices are identified, there is a strong possibility that the conditions of the commercial and financial relations between parties are not arm's length, i.e., the pricing was affected by the relationship between intervening companies.
	Cost-plus method[52]	The OECD Guidelines provide that the cost plus method begins with the costs incurred by the supplier of property transferred or services provided to a related purchaser. An appropriate cost plus markup is then added to this cost is then added to this cost, to make and appropriate light of the functions performed and market conditions. What is arrived at after adding the cost plus mark up and the above costs may be regarded as an arm's length price of the original controlled transaction.
	Resale price method[53]	The OECD Guidelines provide that "the resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The price (the resale price) is then reduced by an appropriate gross margin (the resale price margin) representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between associated enterprises.". Conversely, in a group manufacturer/group distributor/final customer chain, if to the end selling price (i.e., price paid by independent final customer) is deducted a reasonable mark-up, the result is an arm's length price to the original transfer of property between the first two entities. Resale price is easier to determine where the reseller does not add substantially to the value of the product.

[50] Source: author.
[51] Paragraphs 2.6 and following of the OECD Guidelines.
[52] Paragraphs 2.32 and following of the OECD Guidelines.
[53] Paragraphs 2.14 and following of the OECD Guidelines.

Transactional profit methods	Profit split method[54]	Where transactions are very interrelated it might be that they cannot be evaluated in a separate basis. Under similar circumstances, independent enterprises might decide to set up a form of partnership and agree to a form of profit split. Profit split method aims to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions. The profit split made upon economically valid basis according to functions, risks and assets of each associate enterprise that participates in the transaction or transactions.
	Transactional net margin method[55]	The transactional net margin method examines the net profit margin relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realizes from a controlled transaction. This means in particular that the net margin of a taxpayer from the controlled transaction should ideally be established by reference to the net margin that the same taxpayer earns in uncontrolled comparable transactions or, if the previous is not possible, using comparable independent enterprise's net margin as a benchmark.

[54]Paragraphs 3.5 and following of the OECD Guidelines.
[55]Paragraphs 3.26 and following of the OECD Guidelines.

Table 3: Mandatory additions and deductions to the price paid or payable according to the WTO Agreement[56]

Mandatory additions to price paid or payable	According to WTO Agreement, when not reflected in the price paid or payable and if sufficient quantitative data exists, the following items should be considered and adjusted by the importer[57]: • commissions and brokerage, except fees paid or payable by the purchaser to his agent for the service of representing the purchaser abroad in respect of the sale buying commissions; • the cost of containers which are treated as being one for customs purposes with the goods in question; • the cost of packing whether for labor or materials; • the value, apportioned as appropriate, of the goods (e.g., construct materials incorporated in the imported goods) and services (e.g., engineering and development services undertaken elsewhere than in the country of importation and necessary for the production of the imported goods), where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable: • royalties and license fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable; and, • the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.
Mandatory deductions to price paid or payable	The transaction value shall exclude the following categories of costs: • costs incurred in the country of importation related to after importation transport, • charges with construction and after importation maintenance and • duty and taxes of the country of importation.

[56]Source: author.
[57]Article 8 of the WTO Agreement.

Table 4: Valuation methods as prescribed in the WTO Agreement[58]

Designation of the test	Nature of the test
Transaction value of identical goods[59]	The transaction value of identical goods[60] sold for export to the same country of importation and exported at or about the same time as the goods being valued. The value of identical goods must be a previously accepted customs value, and the transaction must include identical goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued. The transaction of goods at different commercial level and /or the quantities leads to the need of adjustments to mitigate the effect in value of goods attributable to these factors (in practical terms, this means that unitary value is always required).
Value of similar goods[61]	The same as previous test, except that the goods need not to be identical to those being valued, although they need to be capable of performing the same functions and commercially interchangeable[62].
Deductive value[63]	A notional import value deduced from the price at which the goods are resold after importation to an unrelated buyer in the "condition as imported". In arriving at the deductive value, the importer may deduct some specific costs: • either the commissions usually paid or agreed to be paid or the additions usually • made for profit and general expenses in connection with sales in such country of imported goods of the same class or kind; • the usual costs of transport and insurance and associated costs incurred within the country of importation; • where appropriate, the costs and charges associated with importation (transport, handling costs and insurance) • the customs duties and other national taxes payable in the country of importation
Computed value[64]	A notional import value computed by adding to the total cost of producing the imported goods, the profit and general expenses usually added by manufacturers in the same country of goods of the same class or kind, which are: • the cost or value of materials and fabrication or other processing employed in producing the imported goods; • an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the country of importation;

[58]Source: author.
[59]Article 2 of the WTO Agreement.
[60] "identical goods" means goods which are the same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance would not preclude goods otherwise conforming to the definition from being regarded as identical.
[61]Article 3 of the WTO Agreement.
[62] "Similar goods" means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. The quality of the goods, their reputation and the existence of a trademark are among the factors to be considered in /determining whether goods are similar.
[63]Article 5 of the WTO Agreement.
[64]Article 6 of the WTO Agreement.

Designation of the test	Nature of the test
	• the cost or value of all other expenses necessary to reflect the valuation option as to the costs and charges associated with importation (transport, handling costs and insurance) chosen by the Member. Note that, as an exception to the hierarquical rule and at the option of the importer, the computed valuation method can be used in preference of the deductive valuation method.
Fall-back method[65]	In case any of the above mentioned tests cannot be used in order to determine an acceptable value for custom purposes, a diverse method can be used as long as (i) it respects general provisions of the WTO Agreement and (ii) it is based on data available in the country of importation. In fact, customs value cannot be based on: • the selling price of goods in the country of importation (i.e. the sale price of goods manufactured in the importing country); • a system which provides for the acceptance for customs purposes of the higher of two alternative values (the lowest should be used); • the price of goods on the domestic market of the country of exportation (valuation on this basis would go against the principle in the Preamble that "valuation procedures should not be used to combat dumping"); • the cost of production other than computed values which have been determined for identical or similar goods (valuation must be arrived at on the basis of data available in the country of importation); • the price of goods for export to a third country (two export markets are always to be treated as separate and the price to one should not control the customs value in the other); • minimum customs value (unless a developing country has taken the exception which allows for use of minimum values); • arbitrary or fictitious values (these prohibitions are aimed at systems which do not base their values on what happens in fact in the marketplace, as reflected in actual prices, in actual sales, and in actual costs, reason of the importation or sale of the goods are also to be deducted;

Table 5: Transfer pricing and customs valuation: highlights on method comparison[66]

Method correspondence	Main differences identified
CUP vs Transactional value of identical goods / Transactional value of similar goods	Under customs methods, if more than one comparable transaction is identified, the lowest value shall be used to determine the transaction value[67].On the opposite, transfer pricing uses statistical methods (e.g., inter-quartile, average) to establish comparable prices. The precluded adjustments under referred customs methods – adjustments to quantities, commercial level and transport costs – can also be used under

[65]Article 7 of the WTO Agreement.
[66]Source: author.
[67]Article 2.3 of the WTO Agreement.

Method correspondence	Main differences identified
	CUP although not being obligatory, which may lead to different analysis outputs. Also, if it increases comparability, under CUP additional adjustments can be implemented (e.g., foreign currency risks, level of market). According to the WTO Agreement, comparable goods must be produced in the same country as the goods being valued. No such limitation exists for transfer pricing purposes, although it might be implicit – not obligatory – to increase comparability.
Resale price method vs. Deductive value	Resale price has higher requirements of comparability regarding functions and risks assumed, while deductive value emphasizes the comparability of products (Ainsworth, 2009). Deductive value method stipulates categories of costs to deduce to the price that resale price method omits. It also establishes a time restriction of 90 days (before or after importation) for the acceptability of the sale prices. Under resale price method, gross margins (excluding accessory expenses related to the sale) are subject to comparison. Deductive value incorporates operating expenditure related with the sale of goods of the same class or kind. Marsilla (2011) refers to a statistical issue regarding in case several sales occur. Under deductive value method, target price is the price at which a greater amount of the goods has been sold (i.e., the most repeated value), while resale price method states preference for the statistical relevance of the average.
Cost plus method vs Computed value	Cost plus method operates at a gross level, i.e., the margin is obtained on direct and indirect costs (excluding accessory expenses related to the sale). Under computed value, customs margin calculation also operates over these expenses (general expenses usually added by manufacturers in the same country of goods of the same class or kind). Marsilla (2011) disregards this difference as he considers that the focus on the importer makes the disaggregation made in the transfer pricing method irrelevant in the importing country.