INTERPLAY BETWEEN CUSTOMS VALUATION AND TRANSFER PRICING FOR RELATED PARTIES

RUSSELL WILKINSON
National Lead Partner- Customs & International Trade

20 February 2013
“A significant and ever increasing percentage of international trade of goods is being conducted by multinational enterprises”

- Customs and the ATO share a common objective, that the profit derived from, and the price of imported goods, are market driven rather than relationship driven i.e. in accordance with the respective “arm’s length” principles
- Comparisons need to be made of the respective methodologies for Transfer Pricing (OECD) and Customs (*Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994)
- Two central questions need to be considered for Customs Valuation purposes (Part VIII; Division 2 of the Customs Act 1901 refers):
  - Are the parties related in terms of the Customs Act 1901?
  - Has that relationship impacted the price paid for the goods imported?
- Dealing with Transfer Pricing adjustments and ensuring compliance
- Recent developments
  *The WTO Committee on Customs Valuation of the Council for Trade in Goods (CTG) carries out work in the WTO on customs valuation.
International Perspective

- OECD Methodologies
  - Transaction Based Methods
  - Profit Based Methods

- WTO Valuation Agreement
  - Adjustments to Price Paid or Payable
  - Price Reduction after Importation

Optimal solution for Transfer Pricing and Customs
- Transaction Value Versus Comparable Uncontrolled Price
- Price Paid or Payable Versus Comparable Price
- Transaction Value of Identical or Similar goods Versus Comparable Uncontrolled Price
- Deductive Value Versus Resale Price
- Computed Value Versus Cost Plus
- Other Methods
The arm’s length principle is elaborated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“the OECD Transfer Pricing Guidelines”)

Alignment of domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Transfer Pricing Guidelines can:

- Provide countries with the tools they need to fight artificial shifting of profits out of their jurisdiction by multinational enterprises (“MNEs”);
- Provide MNEs with some certainty of treatment in the country concerned;
- Reduce the risk of economic double taxation;
- Provide a level playing field between countries, which is less likely to distort the pattern of international trade and investment; and
- Provide a level playing field between MNEs and independent enterprises doing business within a country.

Domestic courts may fall back on internationally accepted principles to interpret domestic legislation, especially where countries do not provide detailed guidance on the application and interpretation of their domestic legislation. It is therefore desirable to avoid any significant discrepancy between domestic transfer pricing legislation and internationally agreed principles.
Why are we concerned with cross border “related parties”? 

**Customs and Border Protection (CBP) & the Australian Taxation Office (ATO):**

- The key concern is that the “price” [s154(1)] of goods imported into Australia may not reflect the true value of parties acting independently of one another that would reasonably be expected to have been paid in the same situation i.e. the price is not at “arm’s length”.

**Implications of not pricing at “arm’s length”:**

- The method in which imported goods are valued is important from a CBP and ATO perspective.
- Transfer Pricing adjustments to the price of imported goods will have Customs Duty and GST implications.
### Definition of ‘related parties’ and implications for CBP

<table>
<thead>
<tr>
<th>CUSTOMS</th>
<th>TRANSFER PRICING</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition of “related parties” under the Customs Act 1901</strong></td>
<td><strong>Definition of “related parties” for Australia’s Transfer Pricing rules</strong></td>
</tr>
<tr>
<td>Entities will be deemed related where they control or are controlled by a third party</td>
<td>The relation is not dependent upon the existence of “control” or “share ownership”.</td>
</tr>
<tr>
<td>One of the entities is in a position to control the casting of at least 5% of the maximum number of votes that might be cast at a general meeting of each of them</td>
<td>Entities will be deemed related where “any connection” exists i.e., broader definition.</td>
</tr>
</tbody>
</table>

### Implication for related Multinationals involved in the cross border trade of goods:

- Disclosure on the “Full Import Declaration” that goods being imported are between “related parties” as per the definition under the Customs Act 1901
- Failure to correctly disclose “related transactions” may result in penalty units for each incorrect disclosure and sanctions (current penalty unit value is $170/unit under the Crimes Act 1914 - Sect 4AA)
Comparison: Valuation methods for Customs & Transfer Pricing

**Customs:**

Sequence of valuation methods:

1. Transaction Value Method
2. Identical Goods Value Method
3. Similar Goods Value Method
4. Deductive Value Method
5. Computed Value Method
6. Fall Back Value Method

**Transfer Pricing:**

Transaction Based Methods:
- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method

Profit Based Methods:
- Profit Split
- Transactional Net Margin Method

s161C - s161F Customs Act 1901
➢ The primary basis for customs value under the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (GATT) is "transaction value" as defined in Article 1.

➢ Article 1 is to be read together with Article 8 which provides, *inter alia*, for adjustments to the price actually paid or payable in cases where certain specific elements which are considered to form a part of the value for customs purposes are incurred by the buyer but are not included in the price actually paid or payable for the imported goods.

➢ Article 8 also provides for the inclusion in the transaction value of certain considerations which may pass from the buyer to the seller in the form of specified goods or services rather than in the form of money.

➢ Articles 2 to 7, inclusive, provide methods of determining the custom value whenever it cannot be determined under the provisions of Article 1.

➢ The transaction value method requires the transaction be at arm’s length, that is the transaction is market driven rather than relationship driven.
Circumstances surrounding the sale

To satisfy Customs and Border Protection that the relationship between the related parties has not influenced the price of the goods based on the circumstances surrounding the sale, the importer may present information to show that:

- the price of the goods had been settled in a manner consistent with the normal pricing practices of the industry in question or with the way the seller normally settles prices for sales to buyers who are not related to the seller;

- the price is adequate to ensure recovery of all costs plus a profit which is representative of the firm’s overall profit realised over a representative period of time (e.g. on an annual basis) in sales of goods of the same class or kind;

- any other information to show that the price reflects the market price of the imported goods between unrelated parties subject to the same conditions of sales, e.g. quantity, level of sales, times of sales.
Modernisation of transfer pricing rules

On 22 November 2011 the Hon David Bradbury MP released an exposure draft of the proposed amendments to reform Australia's transfer pricing rules.

The proposed amendments are designed to modernise Australia's transfer pricing regime, aligning the domestic law with international best practice and improving the integrity and efficiency of the tax system. The reforms will ensure that Australia's domestic laws are applied in a manner that is consistent with international best practice as set out by the Organisation for Economic Co-operation and Development. (OECD) guidelines

Australia's current rules have broad coverage and this will be maintained. Direct access to the OECD guidelines will now be available in all cases to help interpret transfer pricing issues, which is particularly important for complex arrangements to assist Australia protect its tax base-Submissions closed 20 December 2012

The proposed amendments are designed to ensure that the transfer pricing articles contained in Australia's tax treaties are able to be applied and operate independently of Australia's unilateral transfer pricing rules in relation to treaty cases through explicit incorporation into the *Income Tax Assessment Act 1997*. 
Transfer pricing reforms bill introduced in Parliament – 14 February 2013

The Government has introduced the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 – containing the proposed reforms and changes to transfer pricing rules.

In relation to transfer pricing, the Bill proposes to implement an approach more consistent with the OECD’s preferred approach, applying the arm’s length principle to profit allocation in dealings between both associated and non-associated entities.

Proposed Legislation will introduce new Subdivisions 815-B, 815-C and 815-D, expressly allowing the use of the reconstructive provisions to the OECD guidelines in identifying the arm’s length conditions.
Interplay between Customs and Transfer Pricing

Transfer Pricing adjustments:
- To ensure that they fall within the “arm’s length” range.
- To meet the conditions of an Advanced Pricing Agreement.
- As a result of an ATO transfer pricing audit.

Dealing with a Transfer Pricing adjustment:
- Transfer pricing adjustment may result in adjustments to the originally declared customs value.
- Lodge an application in accordance with PS 2009/21 “Applying for a Valuation Advice relating to Transfer Pricing” with CBP.
- Where the adjustment is an:
  - Increase in value of goods – payment of additional duty owed against the imported goods on the appropriate import declaration.
  - Decrease in value of goods – a refund application must be lodged by amending the original import declaration or completing a signed refund application form.
- Completing the above steps ensures that the client has complied with its Customs obligations.
Recent Developments

Transfer Pricing:

- Case Law:
  - *Roche Products Pty Ltd v Commissioner of Taxation* [2008] AATA 639.
  - *SNF (Australia) Pty Ltd v Commissioner of Taxation* [2010] FCA 635.

- Proposed revisions of the Transfer Pricing legislation:
  - Judicial findings in the SNF Australia Case.
  - The revisions to the OECD Guidelines in 2010.
  - Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012 (Royal Assent on 8 September 2012)

Customs:

- Clients should consider a joint approach to manage their Customs and Transfer Pricing obligations.
- Current review of Transfer Pricing connect with CBP Valuation currently being undertaken, announcement expected shortly.
- CBP to announce the outcome of their review shortly, currently with the CBP Executive
Summary

Companies should ensure that accurate disclosures are being made to CBP for importation of goods between related companies (inbound and outbound).

Failure to accurately disclose this information may result in fines and penalties.

Subsequent Transfer Pricing adjustments may impact the customs value and duty payable.

Customs and the ATO are considering a joint approach to manage Customs and Transfer Pricing.

Increases in the number of Transfer Pricing year end adjustments occurring.
Thank you

Russell Wilkinson
Principal, Customs and International Trade
Tel +61 2 9619 1930
Mobile 0428 115 153
russell.wilkinson@crowehorwath.com.au

Megan White
Manager, Customs and International Trade
Tel +61 2 9619 1705
Mobile 0405 139 358
megan.white@crowehorwath.com.au

Richard Nutt
Supervisor, Customs and International Trade
Tel +61 2 9619 1607
Mobile 0409 906 302
richard.nutt@crowehorwath.com.au