Our Agenda

01. Transfer Pricing in a nutshell
02. Issues with Transfer Pricing
03. Fostering Cooperation between Customs and Tax Authorities
04. Increasing Effectiveness of PCA Through Customs and Tax Cooperation
Transfer Pricing in a Nutshell

NEUTRAL DEFINITION

• “the amount charged for internal sales of goods and services between the divisions of a business enterprise” (Rugman, Alan M. and Eden, Lorraine., 1985)

PEJORATIVE DEFINITION

• “a systematic manipulation of prices in order to reduce profits artificially, cause losses, and avoid taxes or duties in a specific country” (Plasschaert, Sylvain R. F., 1979)

HOW TO VIEW IT THEN?

• “Transfer pricing is not, in itself, illegal or abusive. What is illegal or abusive is … transfer pricing manipulation or abusive transfer pricing.” (Tax Justice Network).
Issues with Transfer Pricing

If you change the way you look at things, the things you look at change.
(Wayne Dyer)
Issues with Transfer Pricing

Transfer pricing can deprive governments of their fair share of taxes from global corporations and expose multinationals to possible double taxation. No country - poor, emerging or wealthy - wants its tax base to suffer because of transfer pricing.

Once you take on board the fact that more than 60% of world trade takes place within multinational enterprises, the importance of transfer pricing becomes clear.

It is the fact that the various parts of the organisation are under some form of common control that is important for the tax authority as this may mean that transfers are not subject to the full play of market forces.

Issues with Transfer Pricing

Relationship between parties
.... as this may mean that transfers [price] are not subject to the full play of market forces

- they are officers or directors of one another's businesses;
- they are legally recognized partners in business;
- they are employer and employee;
- any person directly or indirectly owns, controls or holds 5 per cent or more of the outstanding voting stock or shares of both of them;
- one of them directly or indirectly controls the other;
- both of them are directly or indirectly controlled by a third person;
- together they directly or indirectly control a third person; or
- they are members of the same family.

Does it influence the price??

Is it the arm’s length price??

- an enterprise.... participates directly or indirectly in the management, control or capital of an[other] enterprise
- The same persons participates directly or indirectly in the management, control or capital of an enterprise and ... an[other] enterprise

*These criteria may differ according to respective domestic laws*
Issues with Transfer Pricing

Manufacturer (parent)  
Country A

COGS = 75  
OPEX=25  
Total Cost: 100

Distributor (subsidiary)  
Country B

Transfer Price?

Profit A  | Transfer Price | GrossProfit B | Total Profit
----------|---------------|--------------|-------------
-50       | 50?           | 250          | 200         
0         | 100?          | 200          | 200         
50        | 150?          | 150          | 200         
100       | 200?          | 100          | 200         
150       | 250?          | 50           | 200         
200       | 300?          | 0            | 200         
250       | 350?          | -50          | 200         

Selling Price to customers (3rd party) = 300

Is influenced? Is it arm’s length?
Issues with Transfer Pricing

Relationship between parties
... as this may mean that transfers [price] are not subject to the full play of market forces.

<table>
<thead>
<tr>
<th>Does it influence the price??</th>
<th>Is it the arm’s length price??</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction value method</td>
<td>Comparable uncontrolled price</td>
</tr>
<tr>
<td>Identical goods method</td>
<td>Resale price method</td>
</tr>
<tr>
<td>Similar goods method</td>
<td>Cost Plus method</td>
</tr>
<tr>
<td>Deductive value method</td>
<td>Profit split method</td>
</tr>
<tr>
<td>Computed value method</td>
<td>Transactional net margin method</td>
</tr>
<tr>
<td>Fall-back option</td>
<td>Other method</td>
</tr>
</tbody>
</table>

These criteria may differ according to respective domestic laws.
...it can be seen that the aim of both Customs valuation and transfer pricing methodologies is very similar: whereas Customs are establishing whether or not a price has been ‘influenced’ by the relationship between the parties, the tax objective is to seek an ‘arm’s length price”. Each is ensuring that the price is set as if the parties were not related and had been negotiated under normal business conditions. (WCO Guide to Customs Valuation and Transfer Pricing, 2018)
Increasing Effectiveness of PCA Through Cooperation

Coming together is a beginning.
Keeping together is progress.
Working together is success.
(Henry Ford)
Increasing Effectiveness of PCA Through Cooperation

“A structured examination of a business’ relevant commercial systems, sales contracts, financial and non-financial records, physical stock and other assets as a means to measure and improve compliance.”

(WCO PCA Guidelines Vol.1)

The **Customs value** of imported goods is primarily used as the basis for determining Customs duty liability for imported goods where ad valorem duty applies. Tariff **classification** and preferential **origin** are the other key elements necessary for establishing duty liability.

(WCO Guide to Customs Valuation & Transfer Pricing)

**Abuse:**
- Manipulation of value
- Manipulation of classification
- Manipulation of origin

For related party transaction: Tax authorities have information and direct knowledge that may be useful to counter these problems.
Transaction 2015

Country B

Flow of Goods

X. Ltd

Invoice Rp. 50M

Country A

PT. A
(Manufactur)

PT. A's Profit Profile
Sales 50M
COGS 28M
G/P 22M
Opex 10 M
NOP 12M
Tax 25% 3M

Is there a TP/CV problem in this particular case?
Increasing Effectiveness of PCA Through Cooperation

Transaction 2016

Is there a TP/CV problem in this particular case?
Increasing Effectiveness of PCA Through Cooperation

Transaction 2017

Other Countries

X. Ltd
Country B

A. Ltd
Country C

Invoice Rp. 50M

A. Ltd’s Profit Profile
- Sales: 50M
- Man Inc: 4M
- COGS: 40M
- G/P: 14M
- Opex: 2M
- NOP: 12M
- Tax 5%: 0.6M

PT. A’s Profit Profile
- Sales: 40M
- COGS: 28M
- G/P: 12M
- Opex: 9M
- Mgmt. Fee: 4M
- NOP: 12M
- Tax 25%: 0

Is there a TP/CV problem in this particular case?
Transaction 2018

Is there a TP/CV problem in this particular case?

*Now the invoice is made for two separate transactions:
  - Trademark/intangible (10M)
  - Stripped product (30M)
Increasing Effectiveness of PCA Through Cooperation

In relation with transfer pricing, tax authorities have:

- **Master File**: Overview of MNE group business
- **Local File**: More detailed information on intercompany transactions affecting local jurisdiction
- **CbCR**: Aggregate tax jurisdiction wide information for MNE groups Turnover > Euro 750 M

An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.

It is acknowledged that information contained in a transfer pricing study [and APA's] may be useful to Customs… in examining related party transactions

Customs officials require a sufficient level of knowledge to interpret transfer pricing documentation [and APA's] and derive relevant information. This is most effectively done via a post-clearance audit and in cooperation with the business concerned.
The Whole is Greater than the Sum of its Parts.
(Aristotle)
Fostering Cooperation between Customs and Tax Authorities

Why?

Potential risk of customs offences, tax evasion, and tax avoidance

Complexities of economic value chains

limited
government
resources

Our opinion

Concerted effort between customs and tax authorities is imperative to mitigate such potential risk. Emphasis on shared goals and objectives and tackling common challenges
Fostering Cooperation between Customs and Tax Authorities

Huge Benefit of cooperation
ELEPHANT

Ear !!
Ivory !!
Stomach!!
Trunk !!
Foot !!
Tail !!
Fostering Cooperation between Customs and Tax Authorities

How to get the ELEPHANT

Comprehensive and harmonise approach
- Exchange of Information
- Joint activities
- Interact & interlock
Key Takeaways

- There is a heightened Potential risk of customs offences, tax evasion, and tax avoidance

- Relationship between parties may affect the transaction between them (Is the transfer price influenced? Is it arm’s length?)

- Despite competing tensions, custom and tax authorities are actually faced with similar problem.

- Concerted effort between customs and tax authorities is imperative to mitigate such potential risk.
  - Exchange of Information
  - Joint activities
  - Interact & interlock
THANK YOU

DIRECTORATE GENERAL OF TAX
Directorate of International Taxation
Sub-Directorate of International Tax Dispute Prevention and Settlement