

A satellite-style view of the Earth from space, showing the continents of Asia, Australia, and parts of Europe and Africa. A network of white lines and glowing nodes is overlaid on the map, representing global connectivity or a network.

Increasing Effectiveness of PCA Through Customs and Tax Cooperation –Transfer Pricing

Directorate of International Taxation
Sub-Directorate of International Tax Dispute Prevention and Settlement

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Increasing Effectiveness of PCA Through Customs and Tax Cooperation

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).

Transfer Pricing in a Nutshell

Country A

Sales of goods



ABC Co



Country B

100%



PT ABC

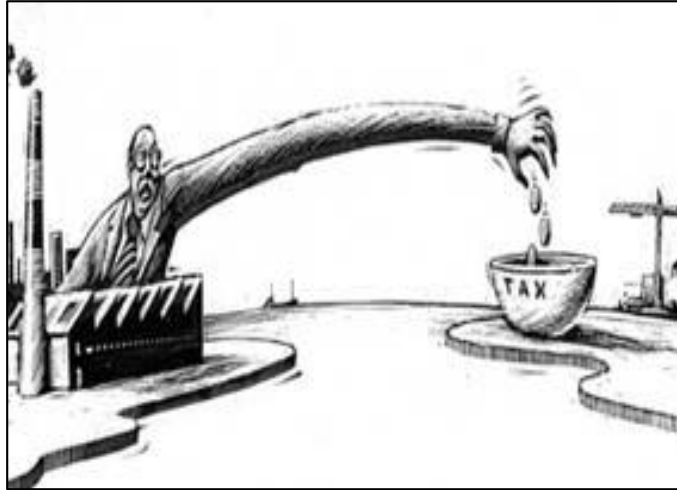


Rp?



Issues with Transfer Pricing

**If you change the way you look at things, the things you look at change.
(Wayne Dyer)**



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.

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??

- 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

Is it the arm's length price??

Issues with Transfer Pricing



Manufacturer (parent)
Country A

COGS = 75
OPEX=25
Total Cost: 100

Distributor (subsidiary)
Country B

**Selling Price to
customers (3rd party)**
= 300

<u>Profit A</u>	<u>Transfer Price</u>	<u>GrossProfit B</u>	<u>Total Profit</u>
-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

Is influenced? Is it arm's length?

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

Does it influence the price??

Transaction value method

Identical goods method

Similar goods method

Deductive value method

Computed value method

Fall-back option

Is it the arm's length price??

Comparable uncontrolled price

Resale price method

Cost Plus method

Profit split method

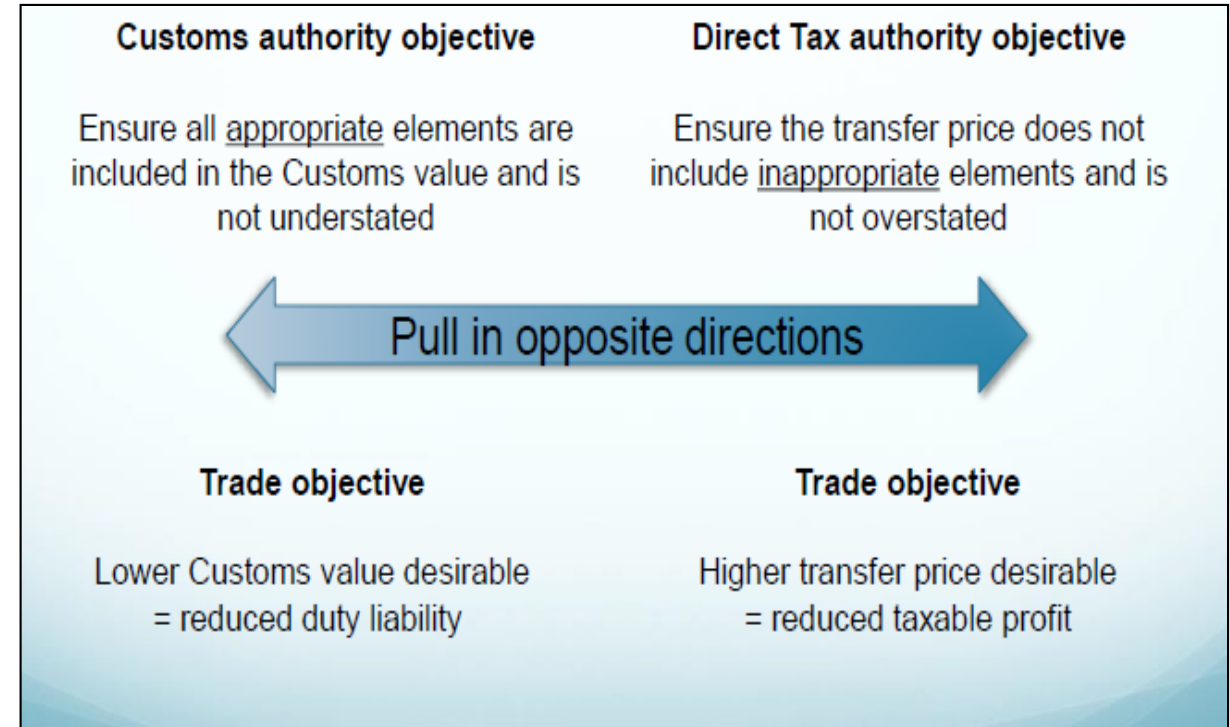
Transactional net margin method

Other method

Relationship between Transfer Pricing & Customs Valuation

...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)

Similarities



Dilemma



Increasing Effectiveness of PCA Through Cooperation

**Coming together is a beginning.
Keeping together is progress.
Working together is success.
(Henry Ford)**

“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)

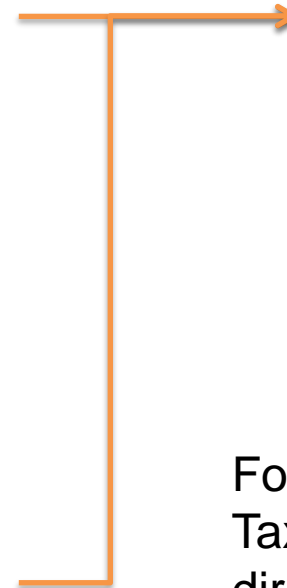
The Customs value of imported goods is primarily used as the basis for determining Customs duty liability for imported goods where ad valorem duty applies. Tariff classification and preferential origin are the other key elements necessary for establishing duty liability.
(WCO Guide to Customs Valuation & Transfer Pricing)

Abuse:

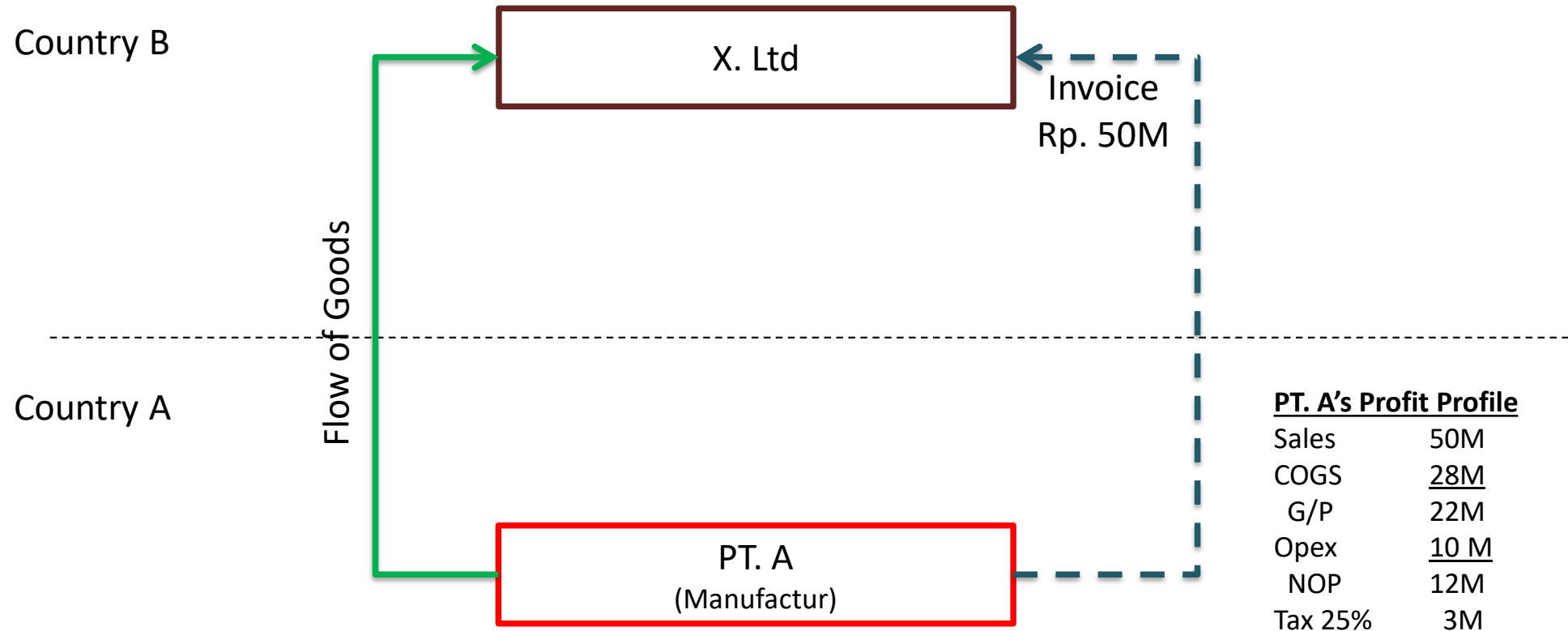
Manipulation of value
Manipulation of classification
Manipulation of origin



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



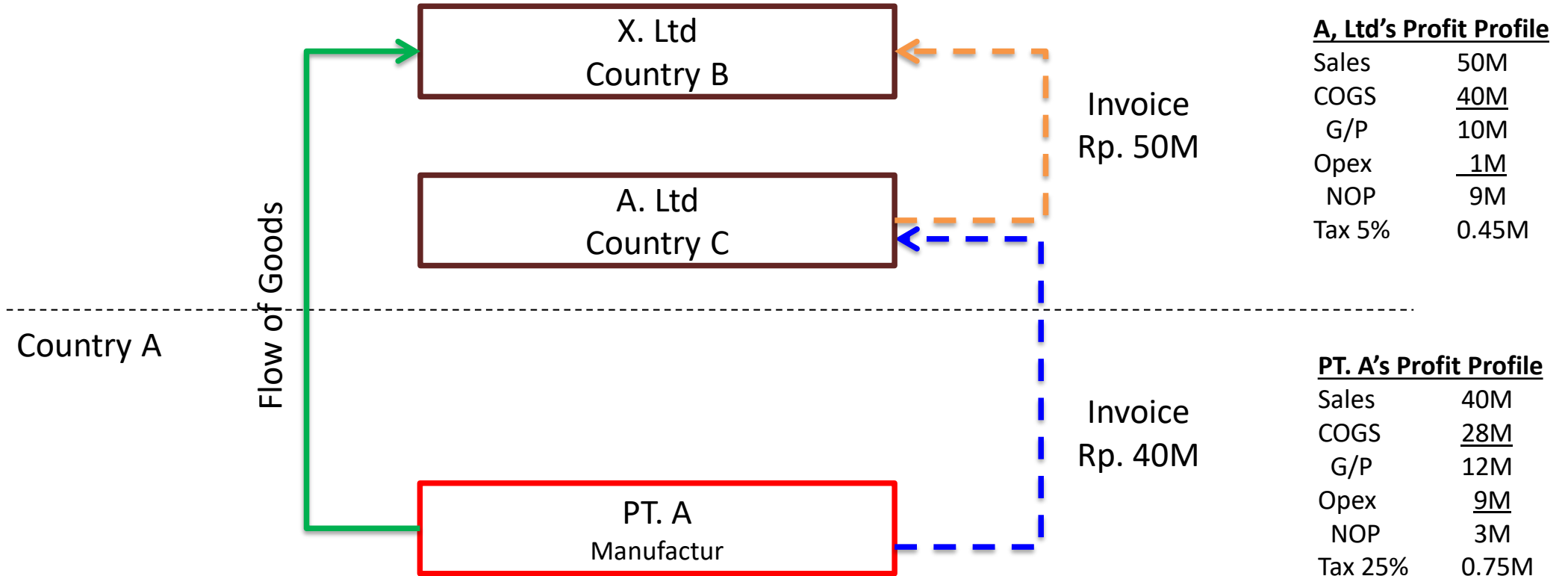
Transaction 2015



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

Transaction 2016

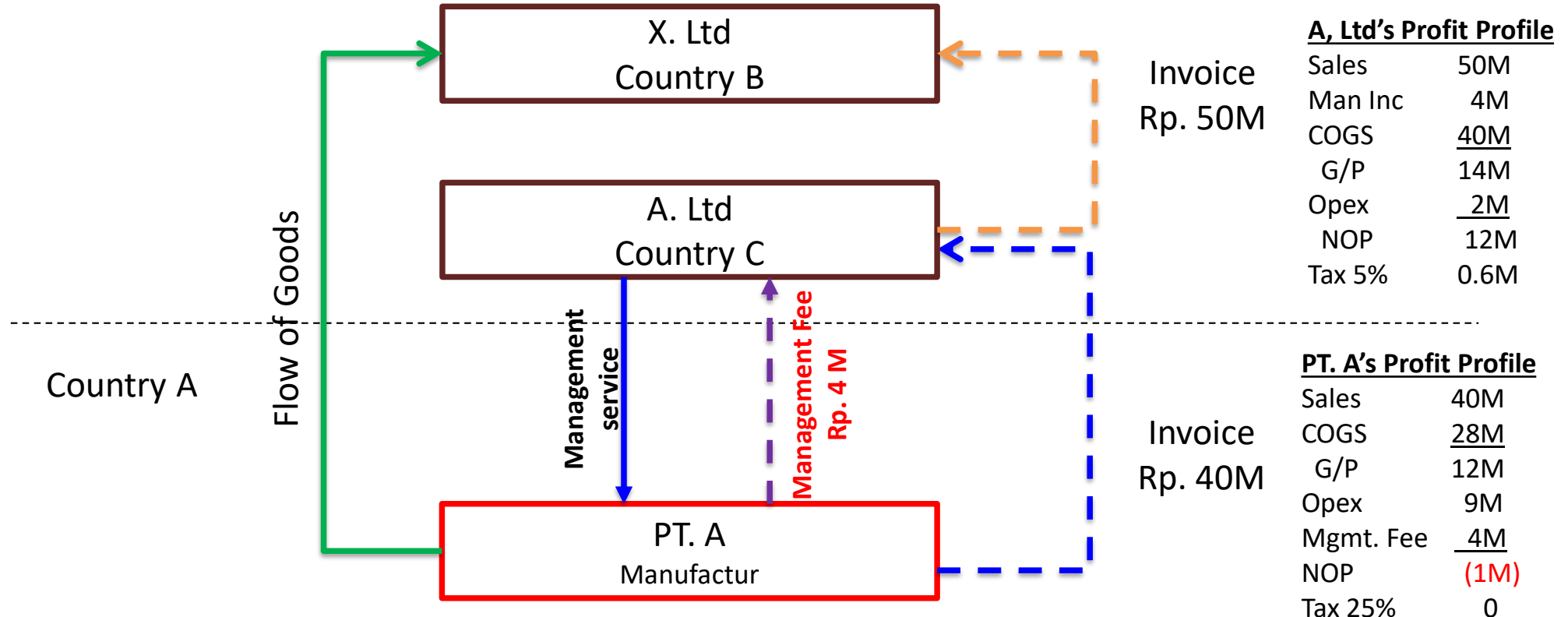
Other Countries



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

Transaction 2017

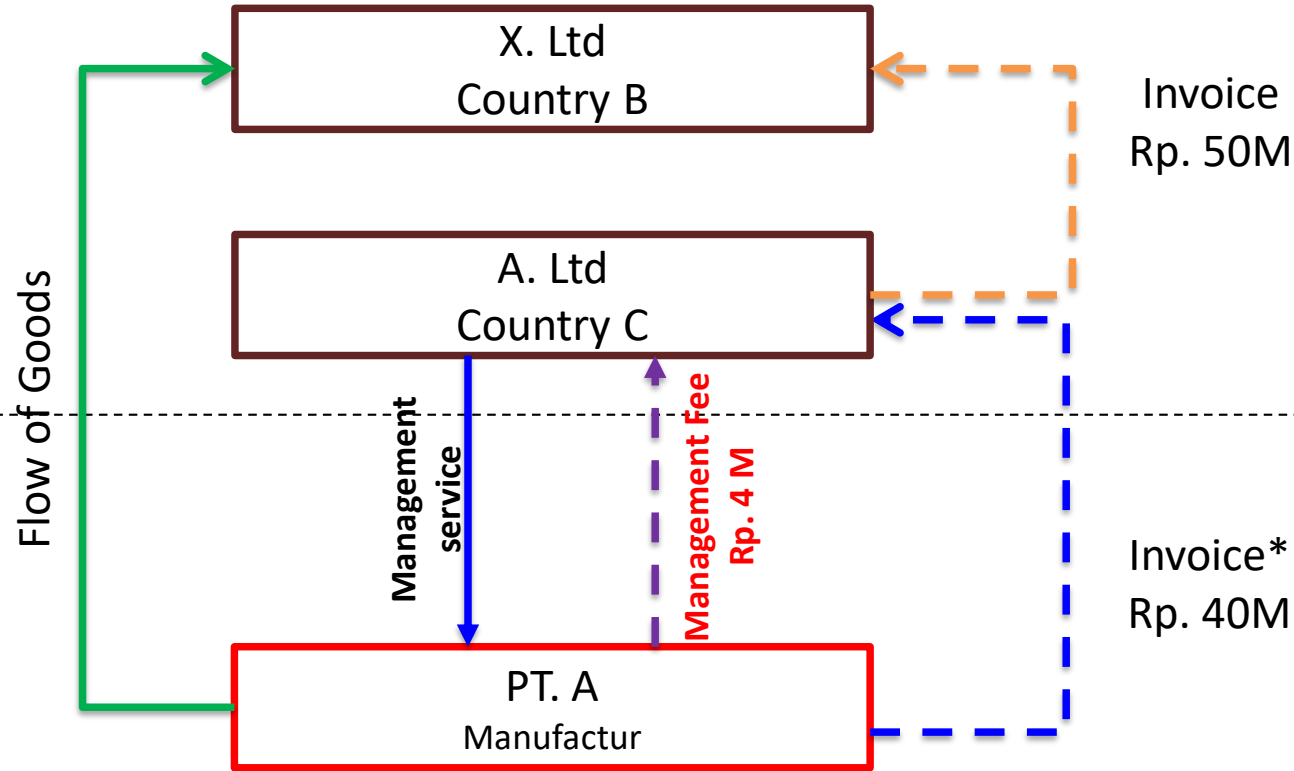
Other Countries



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

Transaction 2018

Other Countries



A, Ltd's Profit Profile

Sales	50M
Man Inc	4M
COGS	<u>40M</u>
G/P	14M
Opex	<u>2M</u>
NOP	12M
Tax 5%	0.6M

PT. A's Profit Profile

Sales	40M
COGS	<u>28M</u>
G/P	12M
Opex	9M
Mgmt. Fee	<u>4M</u>
NOP	(1M)
Tax 25%	0

*Now the invoice is made for two separate transactions:

- Trademark/intangible (10M)
- Stripped product (30M)

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

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



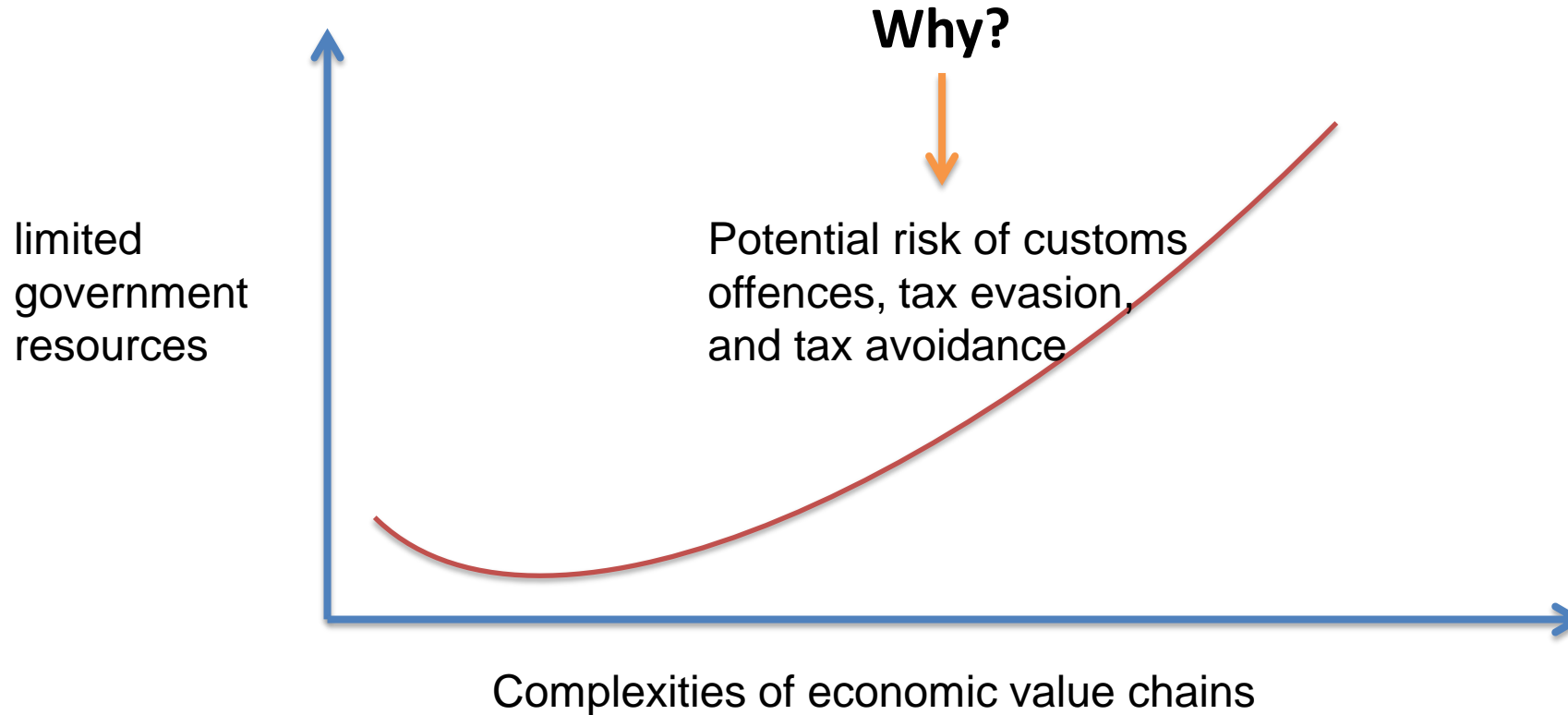
Customs officials require a sufficient level of knowledge to interpret transfer pricing documentation [and APA's] and derive relevant information. This is most effectively done via a post-clearance audit and in cooperation with the business concerned..





Fostering Cooperation between Customs and Tax Authorities

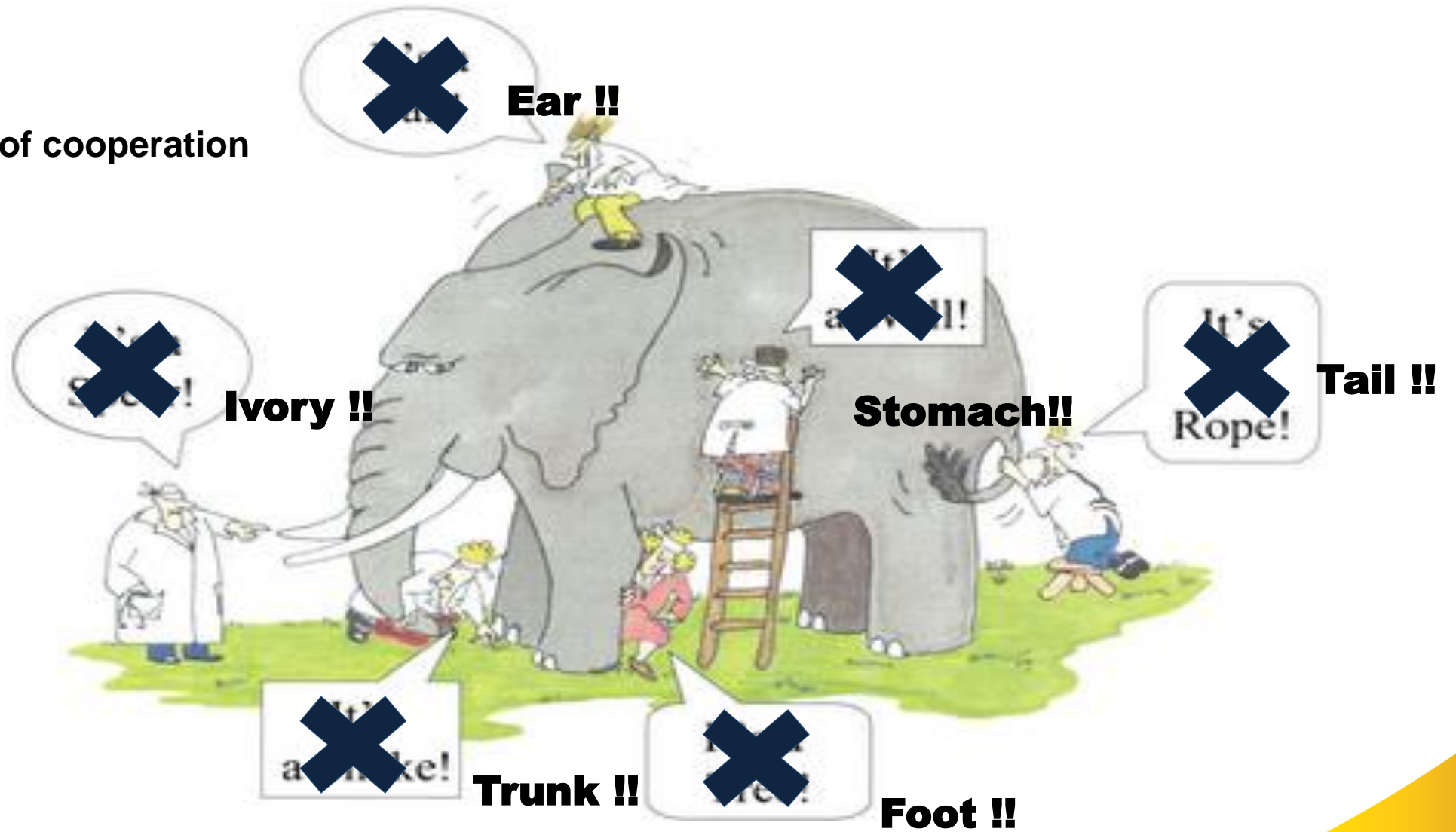
**The Whole is Greater than the Sum of its Parts.
(Aristotle)**



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

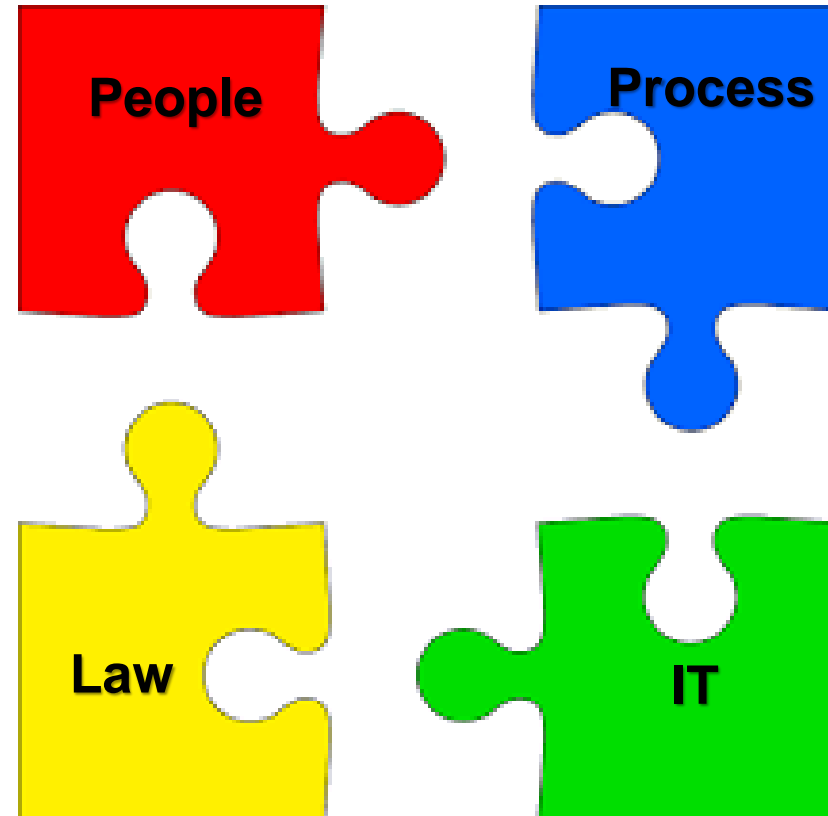
Huge Benefit of cooperation
ELEPHANT



How to get the ELEPHANT

Comprehensive and harmonise approach

- Exchange of Information
- Joint activities
- Interact & interlock



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
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