

AN ALERT FROM THE BDO TRANSFER PRICING PRACTICE

# BDO KNOWS:

## TRANSFER PRICING



### SUBJECT

## WORLD CUSTOMS ORGANIZATION GUIDE TO CUSTOMS VALUATION AND TRANSFER PRICING

### SUMMARY

On June 24, 2015, the World Customs Organization (“WCO”) published its Guide to Customs Valuation and Transfer Pricing. The guide attempts to bridge gaps between customs valuation and transfer pricing for customs officials conducting audit and control on multi-national enterprises (“MNEs”), private sector participants and tax administrators. In its guide, the WCO discusses the challenges preventing synergy between transfer pricing compliance efforts and customs valuation, and sets forth best practices to achieve desirable and efficient outcomes in both customs valuation and transfer pricing. Through the issuance of this guide, the WCO intends to further the discussion on developing a consistent approach for customs valuation and transfer pricing, as well as reduce the burdens on private sector business to facilitate international trade.

### DETAILS

The WCO was established in 1952 as the Customs Co-operation Council (“CCC”). It currently represents 180 customs authorities, which account for approximately 98 percent of world trade. The WCO recognizes that while the outcomes from customs valuations and transfer pricing analyses appear similar, they often differ and produce regulatory issues for both customs and tax administrations. The WCO’s guide is comprised of five main elements: (i) Customs Valuation and Related Party Transactions; (ii) An Introduction to Transfer Pricing; (iii) Linkages Between Transfer Pricing and Customs Valuation; (iv) Using Transfer Pricing Information to Examine Related Party Transactions; and (v) Raising Awareness and Closer Working.

### CONTACT:

#### INTERNATIONAL TAX

ROBERT PEDERSEN  
Practice Lead and Partner  
(212) 885-8398 / rpedersen@bdo.com

WILLIAM F. ROTH III  
Partner  
(616) 776-3761 / wfroth@bdo.com

#### TRANSFER PRICING

VEENA PARRIKAR  
Principal  
(408) 352-3534 / vparrikar@bdo.com

MICHIKO HAMADA  
Senior Director  
(212) 885-8577 / mhamada@bdo.com

KIRK HESSER  
Senior Director  
(312) 233-1802 / khesser@bdo.com

The guide begins with an overview of customs valuation that describes the methodology set out in the World Trade Organization (“WTO”) Valuation Agreement. The Agreement lists a hierarchy of customs valuation methods, of which the transaction value method is primary. Customs valuation methods assess duties on individual transactions at the time the goods are imported into the country. When determining customs valuations for transactions between related parties, the MNE must be able to demonstrate that the price determined in the transaction was not influenced by the relationship between the related parties. To determine whether the price was influenced by the relationship, customs officials should consider the following circumstances: (i) whether the price was settled in a manner consistent with the normal pricing practices of the industry; (ii) whether the price was settled in a manner consistent with the way the seller settles prices for sales to unrelated buyers; and (iii) whether the price is adequate to ensure recovery of all costs plus a profit representative of the firm’s overall profit realized over a representative period of time in sales of goods of the same class or kind.

The WCO provides an introduction to transfer pricing that focuses on the transfer pricing regulations set out in the Organization for Economic Co-operation and Development (“OECD”) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“OECD Guidelines”). The OECD Guidelines use the arm’s-length principle to determine whether the conditions (prices, profit margins, etc.) surrounding transactions between related parties are the same as those that would have prevailed between two independent parties in a similar transaction under similar conditions. The OECD Guidelines set forth a hierarchy of methods for determining if intercompany transactions are consistent with the arm’s-length principle. Due to the difficulties in obtaining transactional level data and comparable information, many transfer pricing analyses are conducted using profit-based methods. Profit-based methods often look at aggregated transactions or the overall profitability of an entity to determine if the prices charged in its intercompany transactions are arm’s-length. When aggregated transaction data is examined, it often includes transactions involving various products. It is also common for MNEs to make year-end adjustments to their transfer pricing to ensure that an arm’s-length level of profitability is earned by each entity.

Although customs valuations and transfer pricing methodologies both seek to ensure that the price is set as if the parties were not related and had been negotiated under normal business conditions, the objectives of parties involved in customs valuations and transfer pricing differ. Customs authorities seek to ensure that all appropriate elements are included in the customs value and that the price is not understated, while the tax authority in the importing country seeks to ensure the transfer price does not include inappropriate elements and that it is not overstated. Similarly, for MNEs, lower custom values lead to reduced duty liability, while a higher transfer price leads to a reduced taxable profit in the importing country. Since there are conflicting objectives between customs valuation and transfer pricing methodologies, the WCO, United Nations (“UN”), OECD, Technical Committee on Customs Valuation (“TCCV”), World Bank Group (“WBG”), and the private sector are discussing ways to bridge gaps and streamline the customs and transfer pricing processes. One proposal is to utilize transfer pricing documentation, and the information presented therein, for customs valuation purposes. This suggestion is supported by the private sector but is only supported on a case by case basis by the TCCV.

Use of transfer pricing information to examine related party transactions is encouraged in the WCO guidelines. While using transfer pricing documentation for customs purposes would reduce the compliance burden for MNEs, this practice gives rise to a number of practical issues. Transfer pricing analyses often look at aggregated transaction data that span a range of products, while customs valuations examine single product transactions. In this case, transfer pricing documentation must give additional assurance to customs authorities that the products sold are of the same class or kind, and can therefore be considered as a group. It is also important that the dates of transfer pricing documentation and customs valuations align to ensure that all information presented in the transfer pricing documentation is relevant to the customs valuation. Furthermore, many MNEs make transfer pricing adjustments to ensure that each entity earns an arm’s-length level of profitability. One method of adjustment is to adjust the actual price of the goods sold between related parties. This type of adjustment presents an issue for customs valuation, for which duty is assessed at the time of import. MNEs also conduct transfer pricing adjustments that affect only the tax liability (i.e., no actual change to the amount paid for the goods). For adjustments of this type, customs authorities must consider whether the change in tax liability indicates that the original price was not arm’s-length.

The guide closes with suggested best practices for customs valuation policy managers, MNEs, and tax administrations. The WCO suggests that customs valuation policy managers assess the extent to which MNEs are importing from related parties,

ensure that employees have proper training, leverage information represented in transfer pricing documentation when sufficient, participate in industry discussions, and strengthen relationships with tax administrations. MNEs should ensure that customs and tax advisors communicate, be mindful of customs valuation when preparing transfer pricing documentation, and give advance notice to customs authorities when an adjustment is expected. Finally, tax administrators should strengthen their relationships with customs authorities and take into account how a customs valuation was determined when assessing transfer pricing.

## BDO INSIGHTS

- ▶ The WCO's guide provides a comprehensive summary of customs valuation and transfer pricing issues, making it worthwhile reading for parties interested in both issues. It is important for firms to employ complementary transfer pricing and customs policies to reduce compliance burdens, but differences between customs valuation and transfer pricing practices pose significant barriers to accomplishing this goal. This guide should serve as a platform to stimulate discussion between interested parties about ways to standardize customs valuations and transfer pricing policies.
- ▶ BDO supports its clients in all aspects of transfer pricing and customs valuations. The agility of BDO as a firm ensures that maximum communication occurs between the transfer pricing and customs valuations teams. This synergy between the transfer pricing and customs valuation teams allows BDO to prepare transfer pricing documentation that considers customs valuation issues and ultimately saves money and time for clients.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,328 offices in 152 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit [www.bdo.com](http://www.bdo.com).

*Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.*