

Standards in Tax and Customs Valuation & Documentation

**ICC Seminar on Transfer Pricing &
Customs Valuation**

Montreal, Canada – October 25, 2012



Agenda

- Purpose of documentation
- Common pitfalls
- Sources
- Standards and best practices

Purpose of transfer pricing documentation

Tax – Transfer pricing

- Tax audits
- The prevention of dispute and Alternative Dispute Resolution
- Formal Disputes – Tax litigation

Customs – Valuation

- Audits
- Demonstration/Legitimacy

Purpose of customs valuation documentation

- Many Customs authorities have determined that a transfer pricing study and/or an APA by itself **is not** sufficient to show that a related party transfer price is acceptable as Transaction Value for customs purposes.
- Rather, a transfer price can only be used as Transaction Value **as long as** the importer can show that the relationship did not affect the price under one of two Customs value tests:
 - Test Values
 - Circumstances of Sale
 - Cost plus a profit;
 - Treated each other as if unrelated;
 - Set price according to industry standards

Customs “Add-on” to transfer pricing

- The Customs “Add-On” analysis uses information generated by a transfer pricing study to support import values declared to the **Canada Border Services Agency** (“CBSA”)
- The analysis should set forth the required Customs information in a summary report geared towards an audience of Customs auditors
- Companies will have a tool to respond to valuation inquiries in such a way that Customs auditors will be unlikely to delve beyond the analysis provided
- The “Add-On” analysis scrutinizes the transfer pricing information and transactional data to determine its compliance with Customs valuation requirements between related parties
- In essence, translate a transfer pricing analysis into a Customs analysis

Sources for customs documentation

- WCO Commentary 23.1 (Nov. 2010) represents a step towards greater harmonization of transfer pricing and customs valuation
 - Seeks to provide guidance on the use of a transfer pricing study, prepared in accordance with the OECD Transfer Pricing Guidelines, and provided by importers as a basis for examining “the circumstances surrounding the sale”
 - States that a transfer pricing study:
 - May be a good source of information if it contains relevant information about the circumstances surrounding the sale
 - May not be relevant or adequate in examining the circumstances surrounding the sale due to significant differences in determining import value under customs methods and transfer prices under methods described in the OECD Transfer Pricing Guidelines
 - Concludes that a transfer pricing study is one source of information for examining the circumstances of sale and that the use of such a study should be considered on a case-by-case basis

Most common pitfall for taxpayers/importers

- **Assuming** that a transfer price is de facto acceptable as “transaction value” for Customs purposes
- In many cases, it may be acceptable
 - The value for transfer pricing purposes may often serve as an acceptable **starting point** for determining the import value, but is not the end point
- However, must analyze the TP against Customs rules to confirm acceptability
 - Requires a case-by-case, country-by-country analysis
 - Some TP methods provide greater support for use of the transfer price as transaction value, while others methods are more difficult to support

Canadian TP documentation standards

Must be Contemporaneous:

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graph TD; A[Must be Contemporaneous:] --> B[This documentation must be prepared or obtained on or before the taxpayer's documentation-due date for the taxation year or fiscal period in which a transaction was entered into.]; B --> C[Taxpayers must provide these records or documents within three months of the receipt of a written request to do so.]; C --> D[If not deemed not to have made reasonable efforts to determine and use arm's length transfer prices or allocations for the purposes of the penalty in subsection 247(3)  
Completeness  
Reasonableness];
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Completeness
Reasonableness

Canadian TP documentation standards (Cont'd)

(i) the property or services to which the transaction relates;

(ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction;

(iii) the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into;

(iv) the functions performed, the property used or contributed, and the risks assumed for the transaction by the participants in the transaction;

(v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, for the transaction; and

(vi) the assumptions, strategies, and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contribution to costs, as the case may be, for the transaction.

Effective practices

- **Establish Clear Communication and Collaboration Between Your Tax and Customs Functions**
 - If your Customs function and Tax function are not within the same department, establish the dotted line
 - Plan together for retroactive and prospective transfer pricing adjustments
- **Coordinate Tax and Customs Documentation and Reporting**
 - Conduct contemporaneous TP studies and customs valuation assessments
 - Document the acceptability of a transfer price as transaction value under the customs tests
 - Determine whether retroactive transfer pricing adjustments require reporting of adjusted customs values to the Customs authorities
 - Draft your TP studies, policies, APAs, etc., to make sure they support customs requirements

Effective practices (Cont'd)

- **Implement Coordinated and Robust Processes and Controls**
 - Include requirements in customs and transfer pricing policies and procedures
 - Implement training for key tax and customs personnel
 - Execute periodic reviews to confirm that the intercompany price still satisfies Customs requirements
 - Develop global processes with local procedures to match local country requirements
 - Revisit customs valuation requirements when changes transfer pricing policies, systems, etc., occur
- **Participate in Programs that Facilitate Customs Value Adjustments due to Retroactive Transfer Price Adjustments**
 - Frequent adjustments may warrant participation in Customs programs to facilitate repeated post-transaction adjustments (e.g. U.S., Australia, Japan)
- **Pursue Joint APAs and Customs Value Rulings**
 - Some countries require advance customs value rulings

Joint transfer pricing/customs valuation approach

Pre-project planning	Functional & risk analysis	Transfer pricing analysis	Customs valuation analysis	Comparable Data (Transfer Pricing)	Comparable data (Customs)	Documentation	Future process
Prepare in detail for Stage 1 and agree with Company a project plan which fits in with Company's commitments and timetable for implementation	STAGE 1 <ul style="list-style-type: none"> Issue request's Interview key personnel in each business segment Review agreements, financial information and customs-related information Agree functional analysis and possible implications on customs valuation 	STAGE 2 <ul style="list-style-type: none"> Agree appropriate pricing methodology Determine search strategy for comparable data 	STAGE 3 Review pricing methodology from customs valuation perspective	STAGE 4 <ul style="list-style-type: none"> Identify comparable data Determine arm's length range 	STAGE 5 Identify comparable benchmark and data that may be used by Customs Authorities	STAGE 6 <ul style="list-style-type: none"> Prepare transfer pricing documentation to comply with transfer pricing legislation documentation requirements Prepare customs valuation document to illustrate customs valuation methodology adopted 	STAGE 7 Put in place a plan and procedures for regular updating by Company of its transfer pricing policy/ customs valuation methodology

The bottom line

- A TP policy and how it's implemented affects customs values, as well as duties and VAT owed
- Related party Customs value and transfer pricing are one of the main targets by authorities for audits
- An importer cannot assume a TP is an acceptable basis for Customs value
- The key to minimizing the risk of reassessment and penalties is an integrated approach:
 - Meeting local requirements on both sides
 - Consistent global transfer pricing and customs valuation documentation
 - Take advantage of special programs, as available

Deloitte.