

## Workshop - Transfer Pricing and Customs

Munich International Tax Forum 2024

# Speakers (Day1)



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# Speakers (Day2)



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## Agenda

- 1 Introduction
- 2 Theory: Setting IC Price Lists & Price Adjustments (pro- and retrospective)
- 3 Solutions: Best practices on People, Process, Data and Technology
- 4 Q&A

# Introduction

# Introduction

## Transfer Pricing and Customs: Pull and Push effect

### Interpretation of the concept of 'related party'

More factual interpretation (ownership) VS more circumstantial interpretation (control)

### Timing of value/price determination

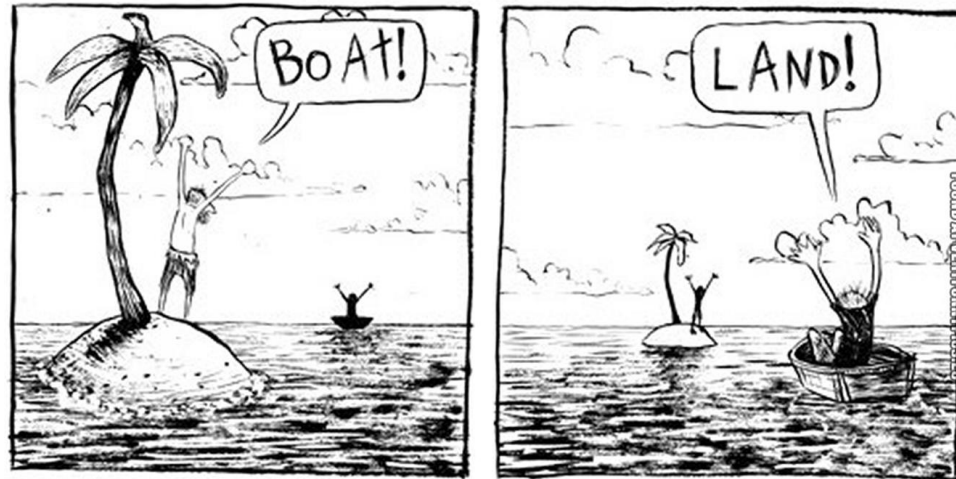
Date of physical entry of the goods into the customs territory VS Periodical and aggregate view

### Methodologies

Determined sequential methodology VS methodology chosen based on data availability

### Key differences

## Transfer Pricing vs. Customs



Perspective...

### Taxable basis

Transaction value of a well determined product VS Net profit

### Elements constituting the value/price

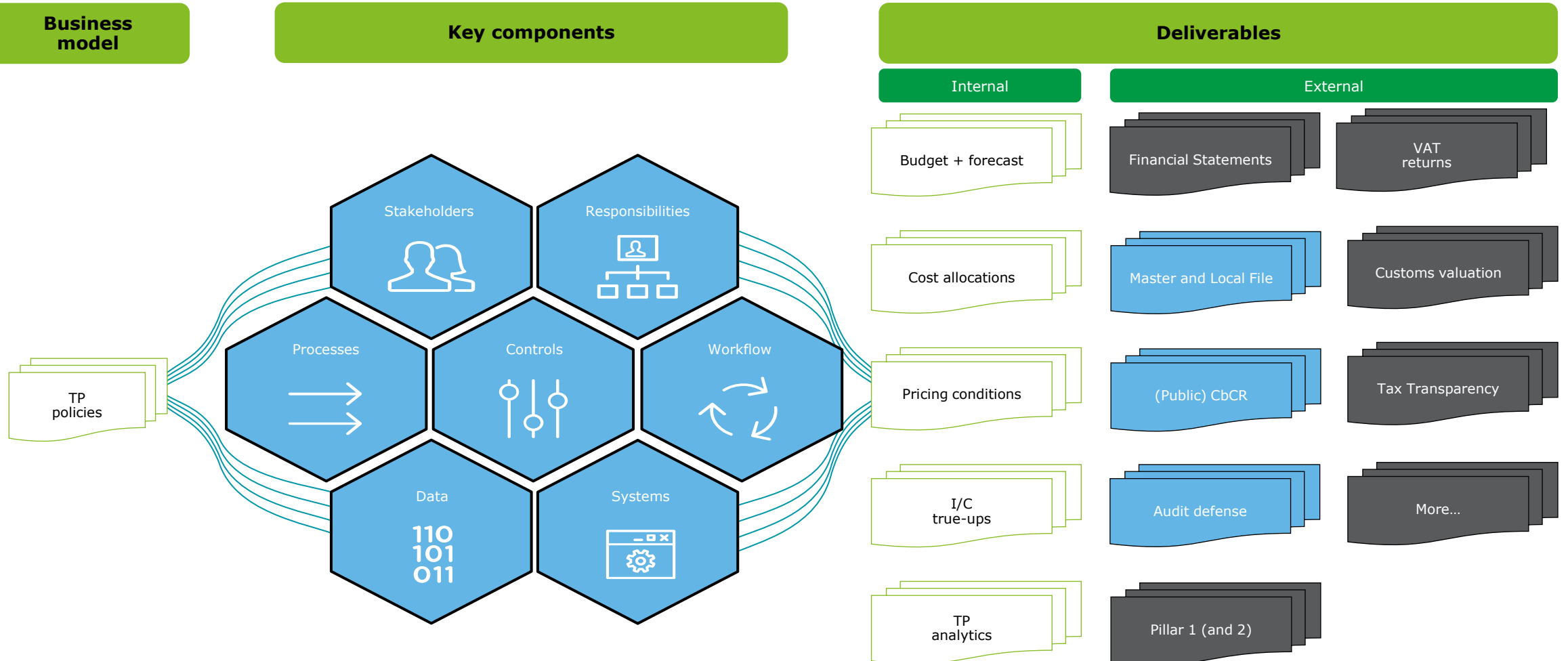
Intrinsic value of the product (i.a. incl. transport costs) VS arm's length price under OECD methods

### Origin of the rules and regulations

WTO Valuation Code (GATT) VS OECD guidelines

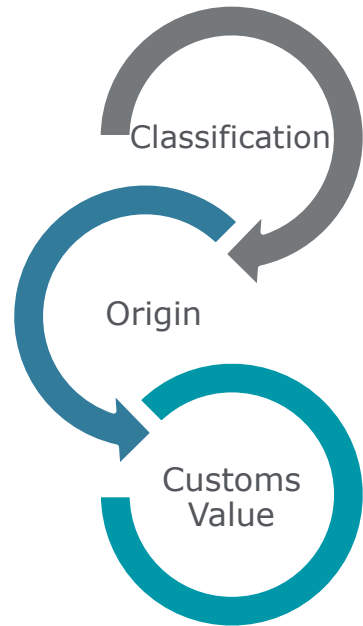
# Introduction

## Transfer Pricing in practice...



# Introduction

## Import and customs valuation



### Customs Value:

The customs value is the basis for calculating import duties and taxes upon importation.

→ *Import Duty Rate x Customs Value = Import Duties*

**The customs value should reflect the real intrinsic economic value of the product when presented at the border for importation (incl. production costs, transport, royalties, etc.)**

### Customs valuation methods Hierarchical order

1. Transaction value (TV)

Related parties: not influencing the price  
Circumstances of sale test & test values

2. Transaction value of identical goods

3. Transaction value of similar goods

4. Deductive Value Method

5. Computed Value Method

6. Fall back method

### Transfer Pricing Methods No fixed order

1. Arm's length price

Related parties

2. Comparable Uncontrolled Price

3. Resale Price Method

4. Cost Plus Method

5. Profit Split Method

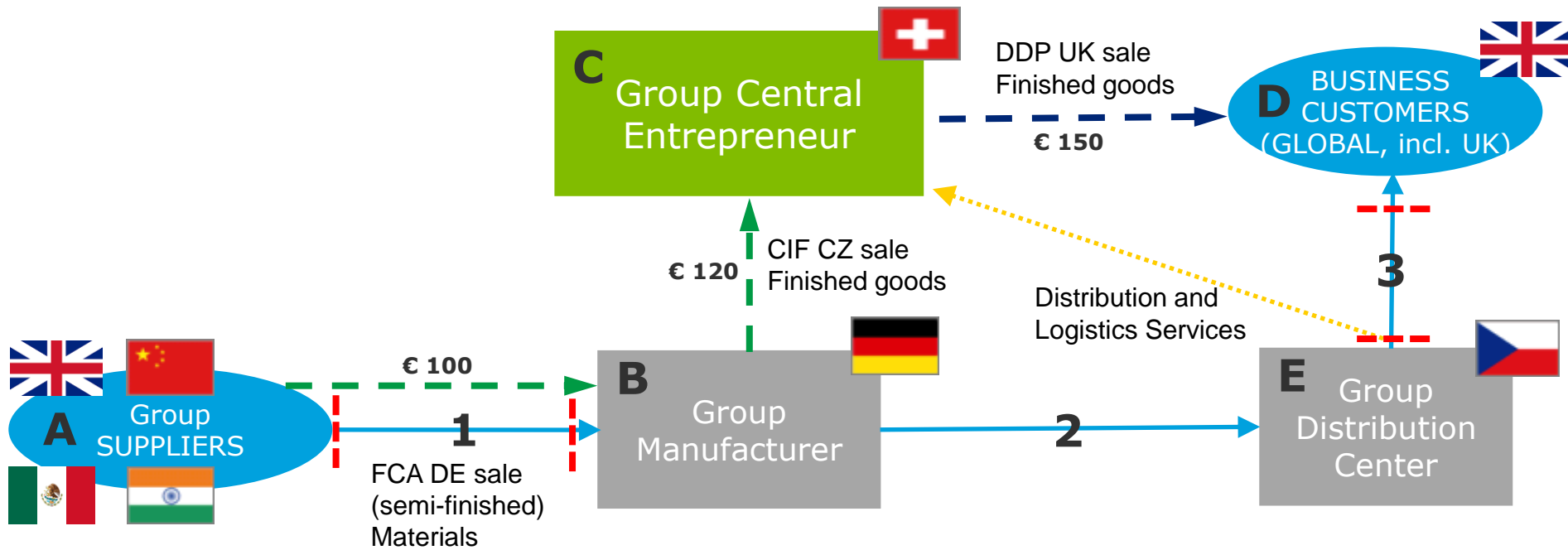
6. Transactional Net Margin Method

7. Comparable Profit Method



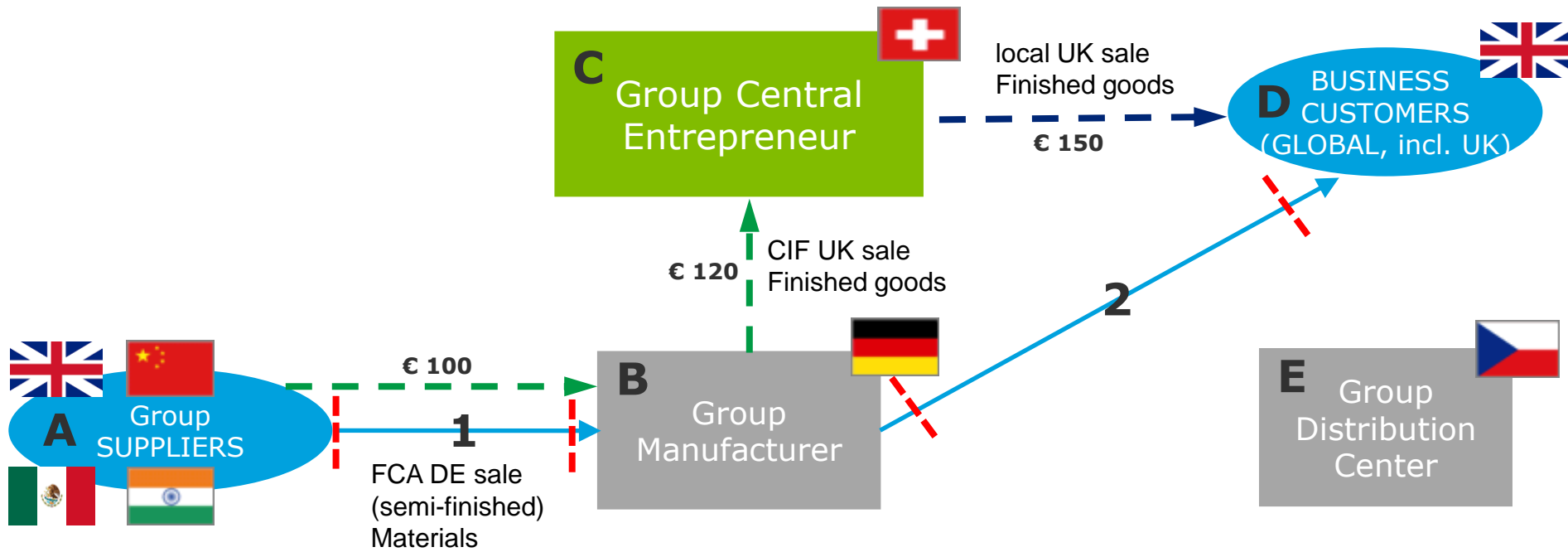
# Case study

## Identification of flows



# Case study

## Identification of flows



# Setting IC Price Lists & Price Adjustments

(prospective and retrospective)

# Setting IC Price Lists

Price setting at beginning of year / budgeting phase



## TP Perspective

- Determining transfer prices for intercompany supplies
- Clear process is needed for setting, agreeing and regularly reviewing IC price lists
- Ultimately relevant TP method is often TNMM, i.e. IC prices should be set such that desired EBIT-margins are obtained
- When targeting EBIT-margins, legal entity P&Ls incl. forecasts are required
- Setting margins only once at beginning of the year leads to high risk of being outside of EBIT ranges
- Adjusting price lists frequently leads to appropriate EBIT margins with higher likelihood, but is data-intensive and time-consuming

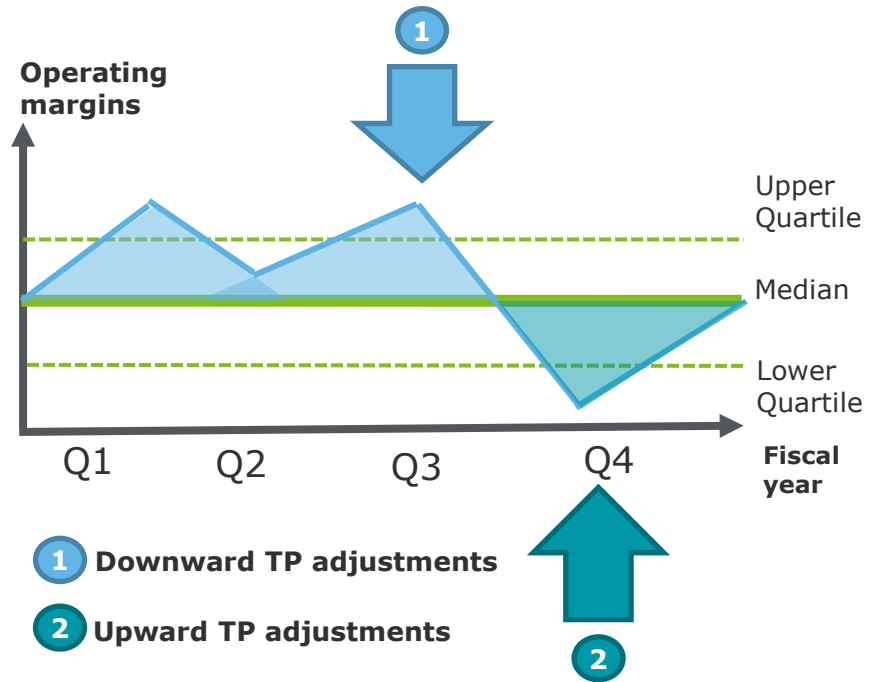
**Data  
requirement**

## Customs perspective

- Transaction value is known upon importation
- Customs authorities will assess whether the price is affected by relatedness, by analysing the circumstances surrounding the sale

# Variances require readjustments of transfer prices

## Results will fluctuate in practice



### TP Perspective

**Variances:** Unexpected circumstances that impact the actual operating margin realized:

- Exceptional deals with large client pushing for a minimum margin;
- Higher/lower volumes (or better/worse product mixes) compared to the budget;
- Receivable write-offs; Inventory write-offs;
- Unexpected effects from stock-based compensation
- Etc ...

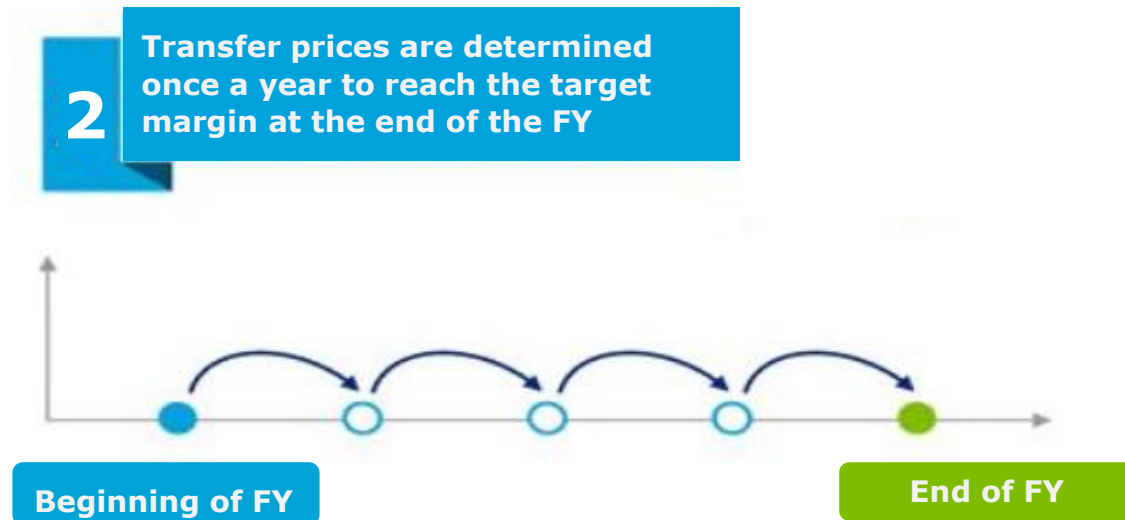


### What is an TP adjustment by taxpayer?

An adjustment to the transfer price, made by the taxpayer during the year, as a response to changes in the market situation to align the transfer pricing results with the arm's length principle. Adjustments can be **prospectively** (adjustment of transfer prices) or **retrospectively** (credit/debit note).

# Prospective TP adjustments

## Price adjustment



If the Net Cost Plus Margin (often for manufacturers) or Operating Margin (often for distributors) of the first period falls below the arm's length range, adjust the transfer pricing for the second period so that it makes up for the difference that occurred in the first period and also considers forecast for rest of FY.

### TP Perspective

#### What?

- A **prospective adjustment to the transfer price**, made by the taxpayer during a fiscal year, as a response to changes in the market situation or YTD P&L developments to align the transfer pricing results with the arm's length principle
- Does not result in the issuance of additional invoices or credit notes

#### How does it work?

- Made by taxpayer
- Align budget P&L with arm's length principle again after changes in the market/P&L situation have occurred
- Usually decided upon quarterly or mid-year review of budget
- Amendment calculated based on updated forecasts and targets

#### When?

- Optimal adjustment frequency depends on
  - industry and company
  - expected variance based on historical performance
  - degree of deviation tolerance (e.g. acceptable deviations)

### Customs perspective

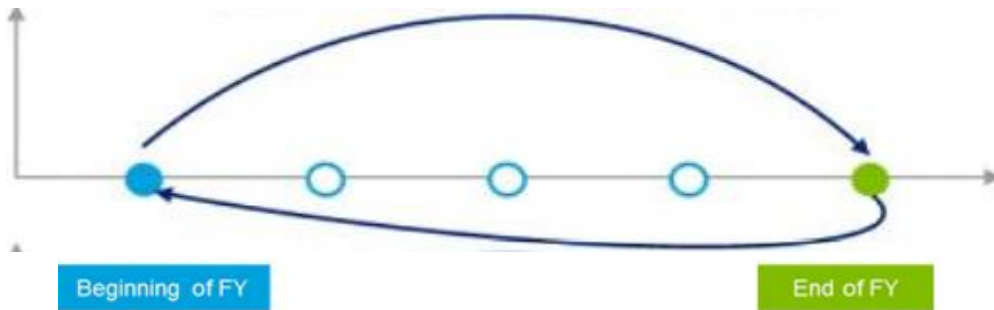
- Generally acceptable if prices are clearly defined in advance in agreements and price lists
- Large fluctuations can increase risk of customs inquiries
- the customs authorities might consider sales price as 'not sufficiently stable', and therefore, reject the TPs concerned as being the final transaction value.

# Retrospective TP adjustments

## Credit / debit note

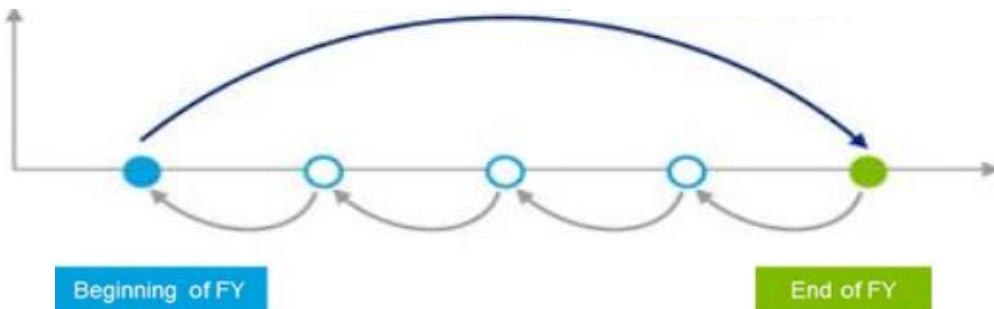
### 3

#### Year-end adjustments



### 4

#### Adjustments during the year (e.g. quarterly)



#### TP Perspective

##### What?

- Taxpayer corrects prices of prior periods via an additional invoice (if price was too low) or additional credit note (if price was too high).

##### How does it work?

- Typically adjust to median or nearer quartile in arm's length range
- Adjustment is recorded in the accounts of both companies
- Adjustment can either be a separate transaction or be linked to another transaction whereby the original price of that other transaction is adjusted (VAT implications!)

##### Main considerations

- No global acceptance (e.g. China, India): Double taxation issues
- Timing of corrections and understanding accounting treatment is key: Book-to-tax differences and unintended accounting effects (e.g. inventory re-valuation) may arise
- Need for clear intercompany agreements with adjustment clause

#### Customs perspective

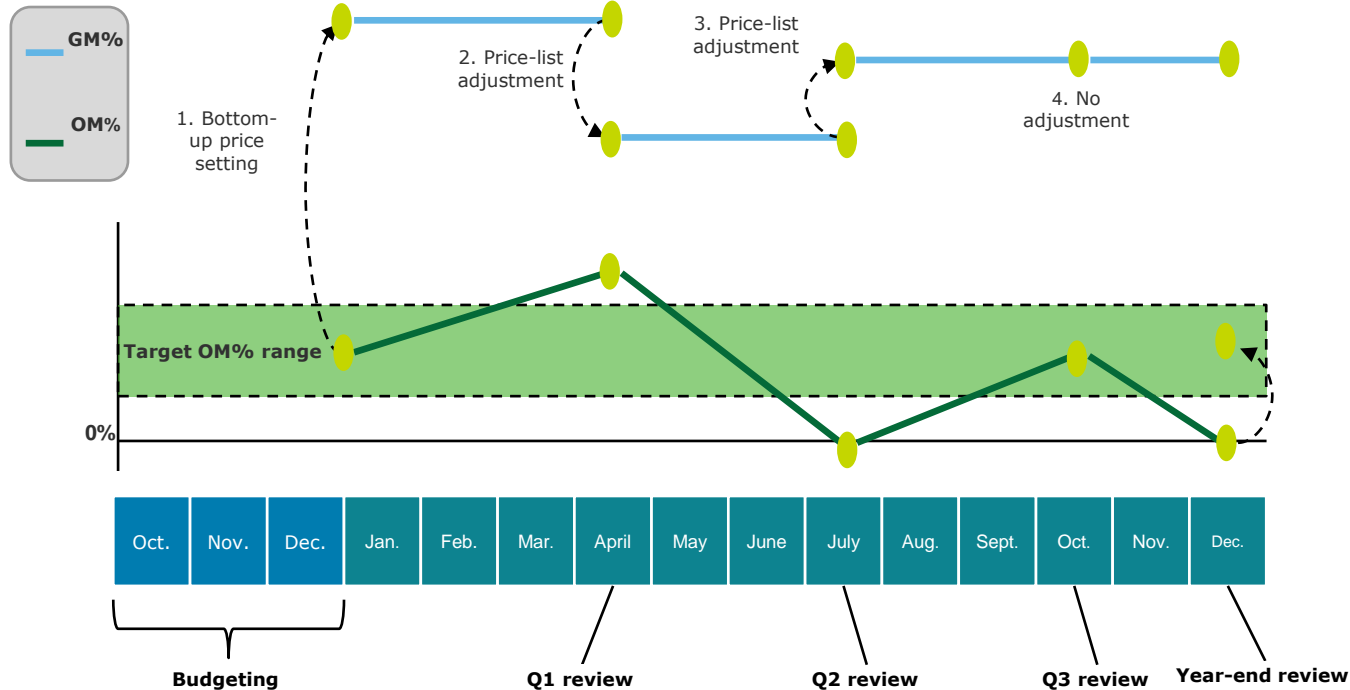
- **Retroactive** adjustments of imported goods prices can trigger customs issues.
- Increase in transfer prices can mean additional customs duties, whereas decreases can mean overpayment of duties.
- Possibility/obligation to modify customs value and get a refund or pay additional duties?
- Arm's length principle to be respected
- Recent ECJ Case Law ('Hamamatsu') might have an impact as well on the aforementioned and should in any case be considered.

# **Solutions: Best practices on People, Process, Data and Technology**



# Solutions: Best practices on People, Process, Data and Technology

## How to deal with variances and TP corrections?



### Risk mitigation

Multiple smaller adjustments during the year based on upfront agreements limits the risk of corporate income tax and customs exposure.

### Solutions: Best practices

#### 1. Implement price checking mechanism

- Increase frequency of **transfer pricing calculations**
- Optimal adjustment period depends on **industry and company**: stable & mature versus volatile
- Mitigate size of **expected deviations**, also based on historical performances and use of forecasts

#### 2. Build in flexibility

- **Degree of tolerance** if deviations are not too extreme and not systematic
- Tolerate results that fall outside median, but that are still within the **benchmarked range** (between Upper Quartile and Lower Quartile)

#### 3. Set-up upfront agreement

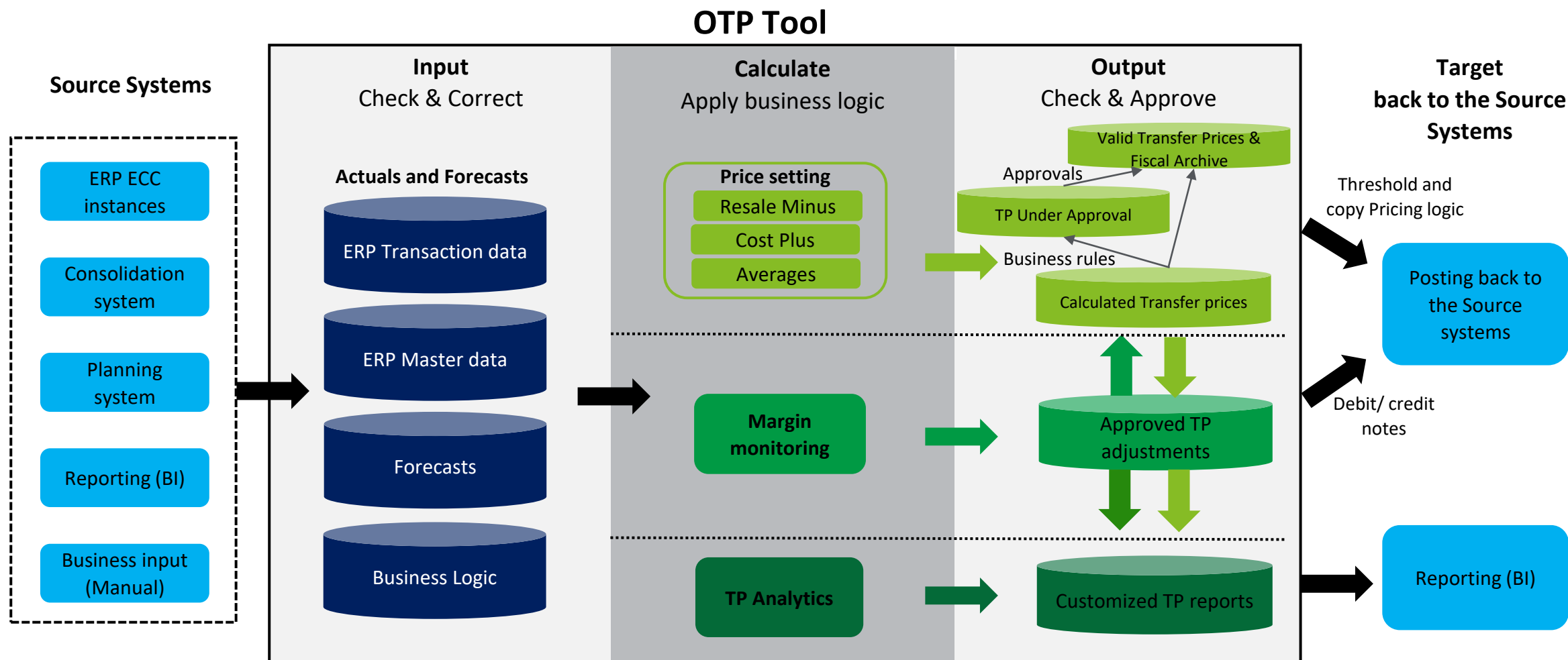
- Regulating **price setting and factors** (cost components) i.e. root cause analysis
- **Specific circumstances** on when price adjustments can take place and how these should be calculated
- Having an agreement with **tax and customs authorities** on the price/ value to be used

#### 4. Process automation

- **Process standardization** and automation go hand-in-hand
- Capabilities of the people revisited and **trend towards centralization** once automated
- **Use technology**. Pick the right technology in line with the company's IT landscape (current and future)

# Solutions: Best practices on People, Process, Data and Technology

## The Ins and Outs of a robust OTP Tool



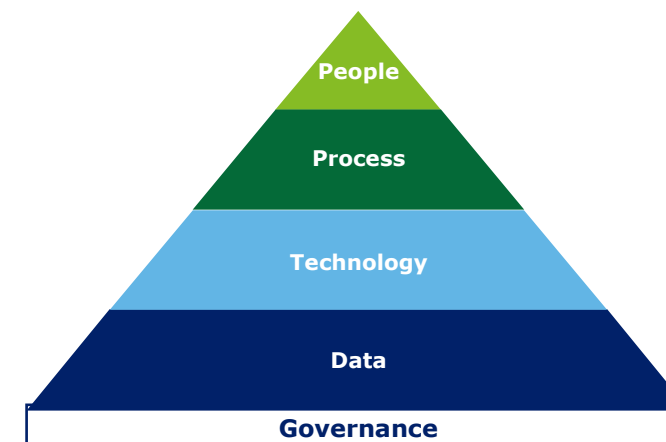
# Solutions: Best practices on People, Process, Data and Technology

## IT solutions available (Non-exhaustive list)



### Typical key criteria for solution selection:

- Fit in the IT landscape;
- Full scope and scalability;
- Flexibility;
- High performance and user-friendly;
- Ability to handle complex calculations and rules;
- Total cost of ownership, etc.



# Solutions: Best practices On People, Process, Data and Technology

## Screenshots EXA OTP – TP & Customs interconnection

Home

OTP Core & MaintenanceOTP MonitoringOTP Forecasting & Price-SettingOTP Ad-hoc Setting & TP DatabaseOTP AnalyticsOTP Workflow & Logs

Maintain SG&A/OPEX Allocations

Assign TP Method & Target Ranges

TP Method Calculation Types

Assign TP Functions

TP Functions

P&L Structure

Legal Entities

OTP Monitoring

IC Map

Management Dashboard

Transaction Matrix

Segmented P&L

Global Profit Distribution

Manage Year-End Adjustments

OTP Forecasting & Price-Setting

Execution Cockpit

Global Forecast Parameters

Entity Forecast Analysis and Simulation

Manage Forecasted Qty & Prices

Global Parameters - TP Setting

Entity TP Setting

OTP Ad-hoc Setting & TP Database

Maintain Adhoc Parameters

Ad-hoc Price Setting

Upload Transfer Prices (via file)

Central TP Database

Entity TP Setting (003 - 012) 2021

Back

Message	Legal Entity	Business Division	Transaction G...	TP Function	Transaction P...	Transaction P...	TP Method	Status	TPS ID	User	Workflow ID	Workflow Role	Materials (TPS rel...	FC TP Margin (%)	YE TP Margin (%)	Avg. TP Change (%)	Abs. TP Differen...	Created B...
	SUGA	Customized Bikes	Bikes for Sale	Low Risk Distrib...	MFUS	Sender	Transactional Net Ma...	TPS Approval Pend...	379	FRANKS	00000008203	Local Controller	20	5.9%	5.5%	3.26%	-868.42	VAPUNA

StandardMaterials (20)Included (20)Excluded (0)Parameters for TP SettingP&L SegmentCurrency: Local(E)Group(Y)Customs ImpactTPS ImpactView Standard Tax Rates

Material	TP (LC)	Active TP (IC)	Unit Cost (TP+LM) LC	Proposed new TP (LC)	Proposed new TP (IC)	Landing Cost Factor in %	Trade Type	Custom Rate	Custom Duties (LC)	Landing Cost Value (LC)	Proposed Total (LC)	Local Currency	YTD	FC Initial - 195	YE Initial - 195	
MFUS-FG-116	888,44	1.332,66	1.008,24	899,29	1.348,94	4,00%	IMP	4%	35,97	35,97	971,23	GBP	Revenue	5.331.833,67	47.115.373,10	52.447.206,77
MFUS-FG-117	898,07	1.347,10	895,38	861,38	1.292,06	4,00%		0%	0,00	34,46	895,83	GBP	COGS	-4.846.396,72	-42.422.243,76	-47.268.640,48
MFUS-FG-118	540,99	811,49	619,32	595,32	892,97	4,00%		0%	0,00	23,81	619,13	GBP	Gross Profit	485.436,95	4.689.128,34	5.178.566,29
MFUS-FG-119	1.039,76	1.599,64	1.068,49	1.027,49	1.541,25	4,00%		0%	0,00	41,10	1.068,59	GBP	Marketing & Sales	-153.043,03	-752.050,63	-905.093,65
MFUS-FG-120	772,65	1.198,97	831,95	0,00	0,00	4,00%		0%	0,00	0,00	0,00	GBP	Administration	-206.223,76	-1.056.027,01	-1.262.250,77
MFUS-FG-121	999,80	1.499,70	1.139,29	1.095,29	1.642,93	4,00%		0%	0,00	43,81	1.139,10	GBP	Others	-21.411,64	-105.216,42	-126.628,05
MFUS-FG-122													EBIT	104.769,43	3.776.926,78	3.881.696,21

TP and Customs Value Database

StandardReceiver Union:Sender Union:Receiver:Sender:Material:Select...Select...Select...Select...Select...

TP and Customs Value Database (6.961)Standard\*Valid on: 18.09.2024

Receiver	Receiver Customs...	Sender	Sender Customs...	System ID	Material	Material Descrip...	Trade Type	Customs Releva...	View Classification	Quantity	Unit of Measure	Transfer Price	Add./Deduct (LC)	View Add./Ded. ...	Customs Value (...)	Customs Rate (%)	Source	Customs Duties
SUGA	UK-CD (United K...	ENFR	EUCU (European...	F21	ENFR-FG-106	EuroVelo Fun 20 ...	IMP (Import)	Yes		1	PC	1.293,96 EUR	125,00 GBP		940,19 GBP	6	Country Catalogue	56,40 GBP
ENFR	EUCU (European...	CMCI	CN (China)	F21	CMCI-AL-121	Spoke 88852 28 ...	EXP (Export)	Yes		1	PC	854,59 CNY	-80,00 CNY		774,59 CNY	5	Country Catalogue	38,75 CNY
MFDE	EUCU (European...	CMCI	CN (China)	F21	CMCI-AL-121	Spoke 88852 28 ...	EXP (Export)	Yes		1	PC	908,31 CNY	0,00 CNY		908,31 CNY	5	Country Catalogue	45,40 CNY
ENES	EUCU (European...	MFUS	N.A. (no Custom...	F21	MFUS-FG-116	Hardy Special 20...	EXP (Export)	Yes		1	PC	1.369,82 USD	0,00 USD		1.369,82 USD	2	Country Catalogue	27,40 USD
SUDE	EUCU (European...	MFUS	N.A. (no Custom...	F21	MFUS-FG-116	Hardy Special 20...	EXP (Export)	Yes		1	PC	1.689,44 USD	0,00 USD		1.689,44 USD	2	Country Catalogue	33,78 USD
SUFR	EUCU (European...	MFUS	N.A. (no Custom...	F21	MFUS-FG-116	Hardy Special 20...	EXP (Export)	Yes		1	PC	1.858,04 USD	0,00 USD		1.858,04 USD	2	Country Catalogue	37,16 USD
SUGA	UK-CD (United K...	MFUS	N.A. (no Custom...	F21	MFUS-FG-116	Hardy Special 20...	EXP (Export)	Yes		1	PC	1.400,82 USD	0,00 USD		1.400,82 USD	2	Country Catalogue	28,02 USD
ENFR	EUCU (European...	CMCI	CN (China)	F21	CMCI-AL-101	Spoke 78213 28 ...		Yes		1	PC	1.630,03 CNY	0,00 CNY		1.630,03 CNY	0	N.A. (No Custom...	0,00 CNY

# Q&A



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