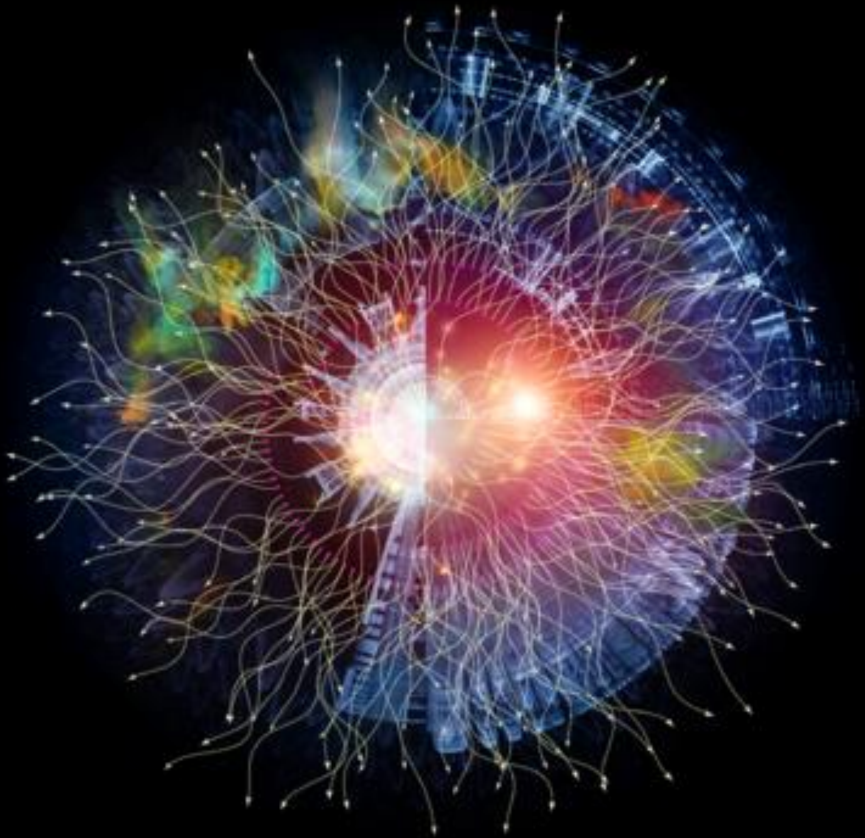

Workshop - Transfer Pricing and Customs

Munich International Tax Forum 2024

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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

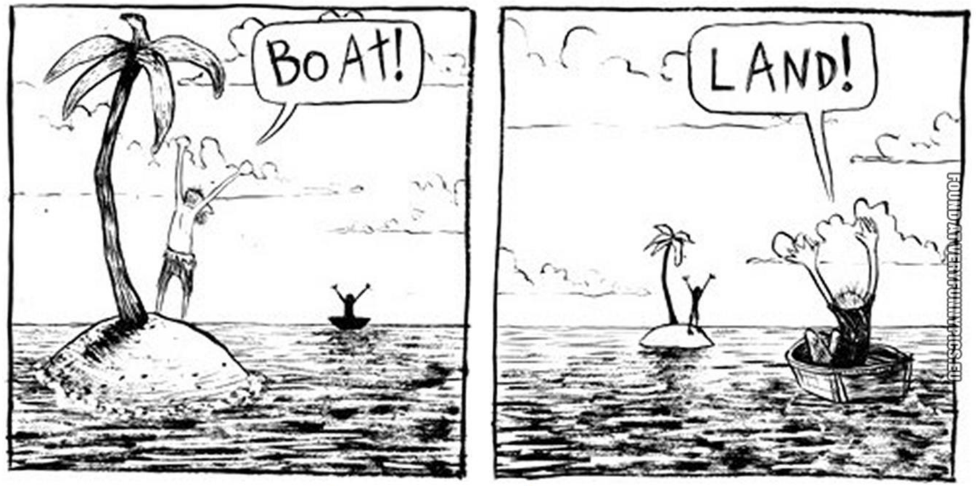
Key differences

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

Transfer Pricing vs. Customs



Perspective…

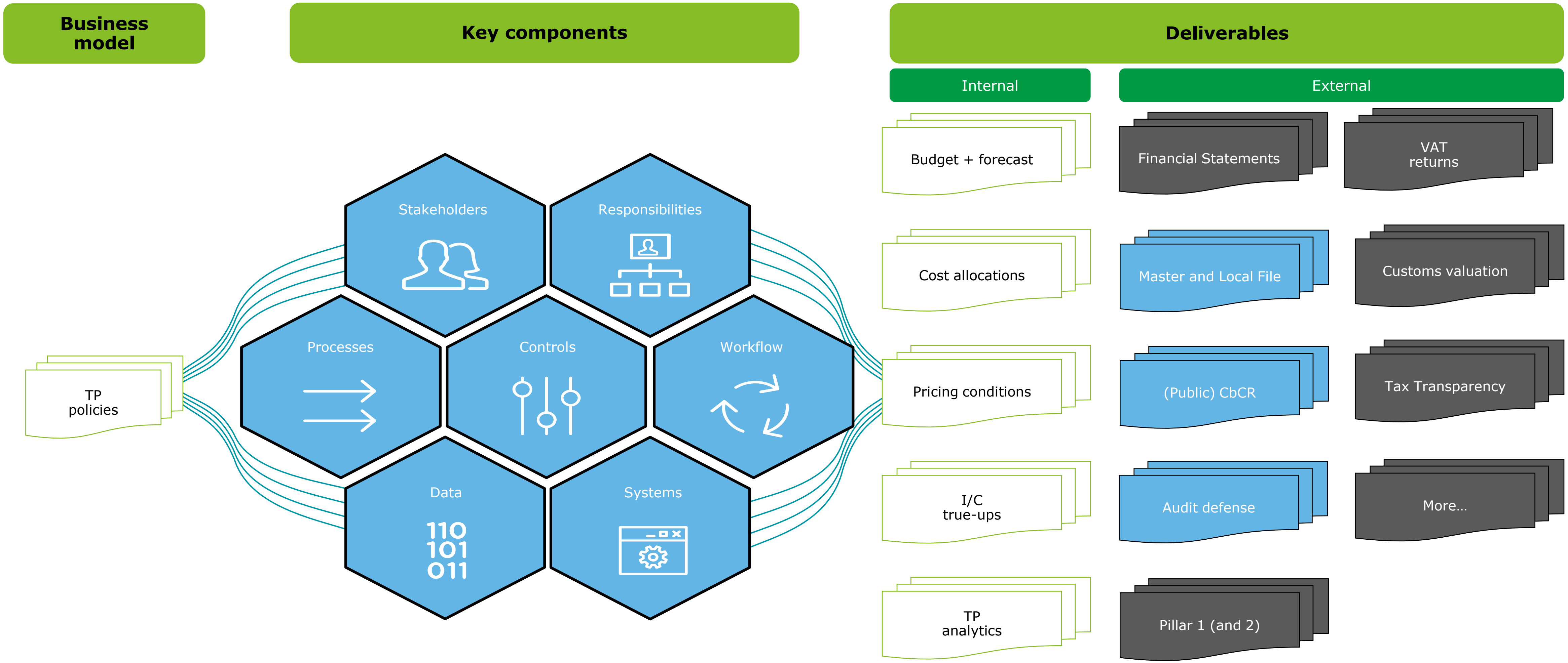
Taxable basis
Transaction value of a well determined product VS Net profit

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

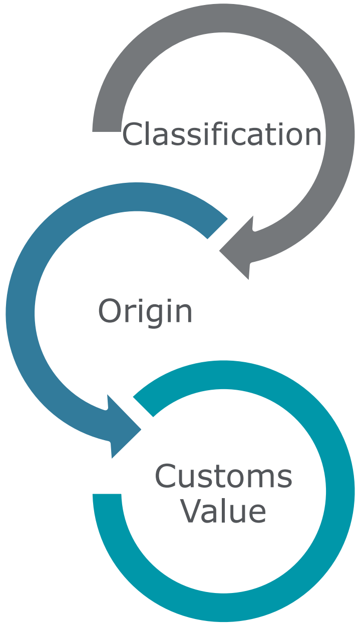
Introduction

Transfer Pricing in practice…



Introduction

Import and customs valuation



Customs Value:

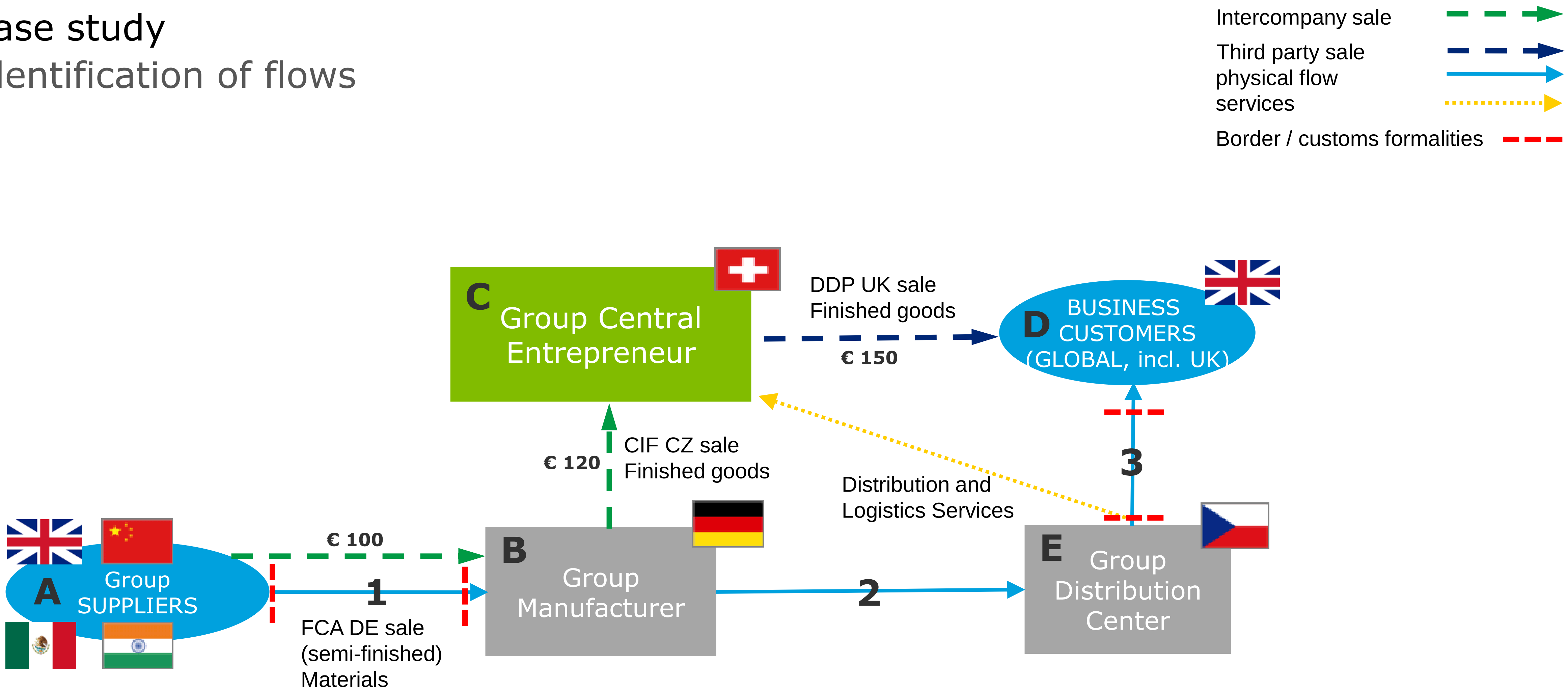
The customs value is the basis for calculating import duties and taxes upon importation.

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

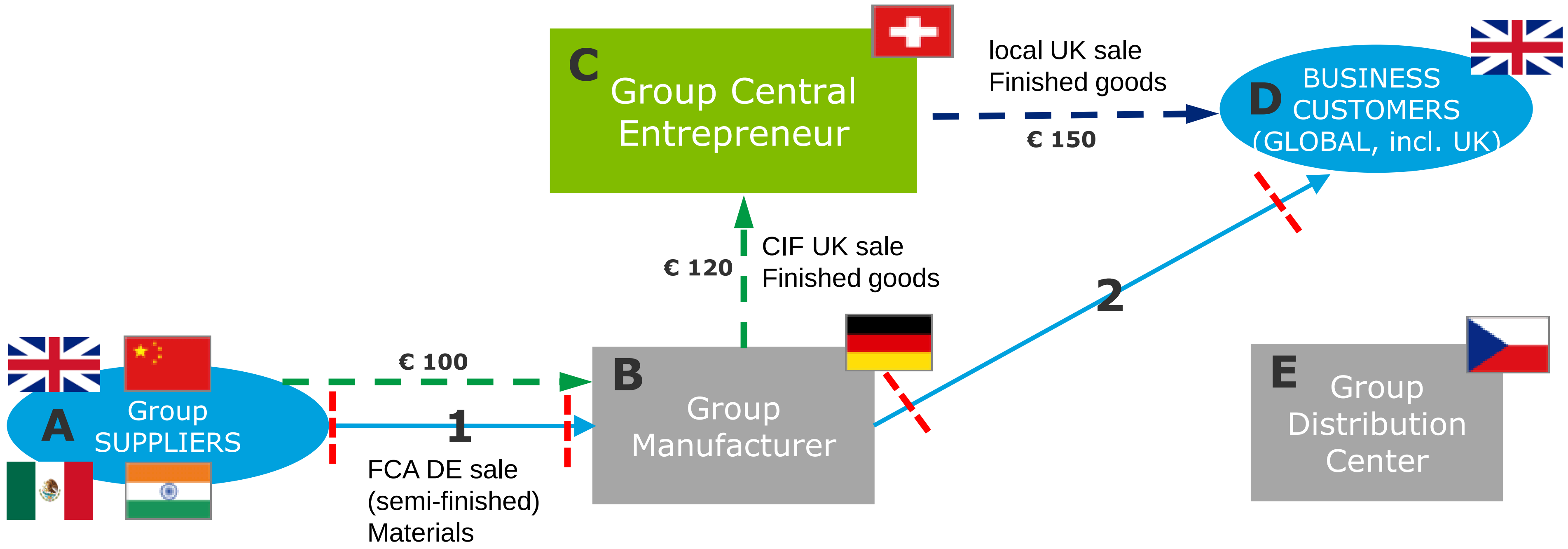
The customs value should reflect the real intrinsic economic value of the product when presented at the border for importation (incl. production costs, transport, royalties, etc.)

Customs valuation methods **Hierarchical order**	**Transfer Pricing Methods** **No fixed order**
1. Transaction value (TV)	1. Arm's length price
Related parties: not influencing the price Circumstances of sale test & test values	Related parties
2. Transaction value of identical goods	2.Comparable Uncontrolled Price
3. Transaction value of similar goods	
4. Deductive Value Method	3. Resale Price Method
5. Computed Value Method	**4.Cost Plus Method**
6. Fall back method	5.Profit Split Method **6.Transactional Net Margin Method** 7. Comparable Profit Method

Case study
Identification of flows



Case study
Identification of flows



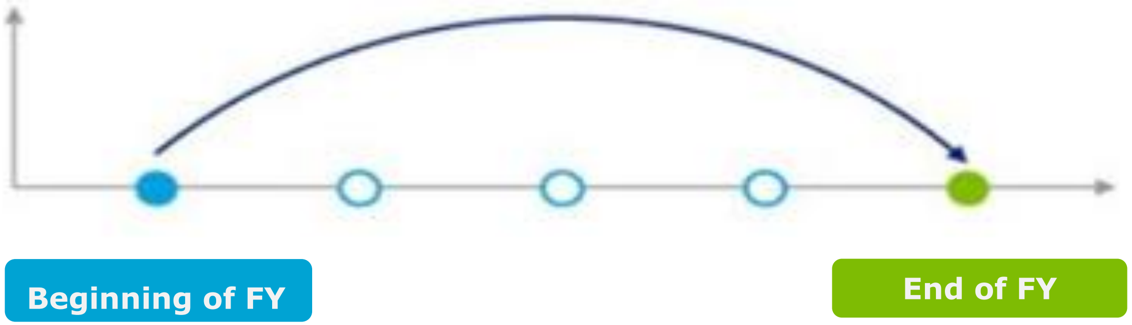
Setting IC Price Lists & Price Adjustments

(prospective and restrospective)

Setting IC Price Lists

Price setting at beginning of year / budgeting phase

1 **Transfer prices are determined once a year to reach the target margin at the end of the FY**



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

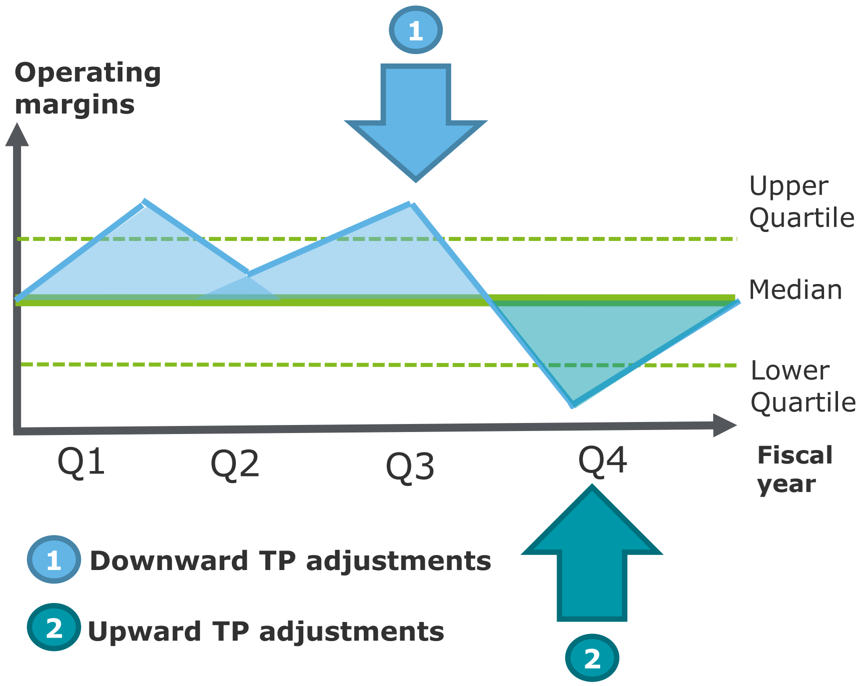
Data requirement

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 …

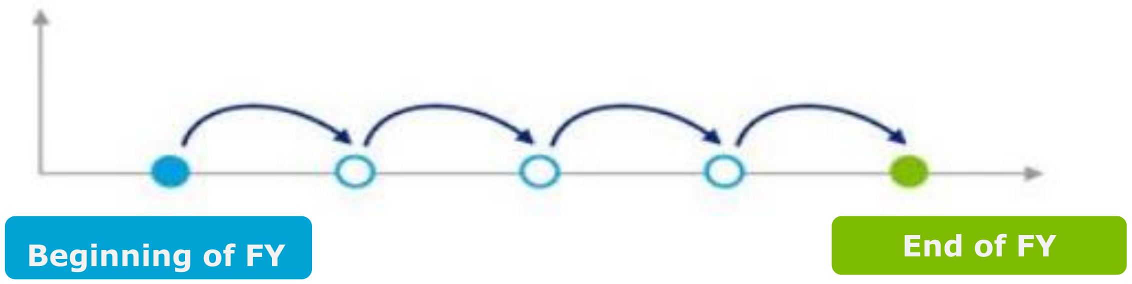
What is an TP adjustment by taxpayer?

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

2 **Transfer prices are determined once a year to reach the target margin at the end of the FY**



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 <u>prospective</u> 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)

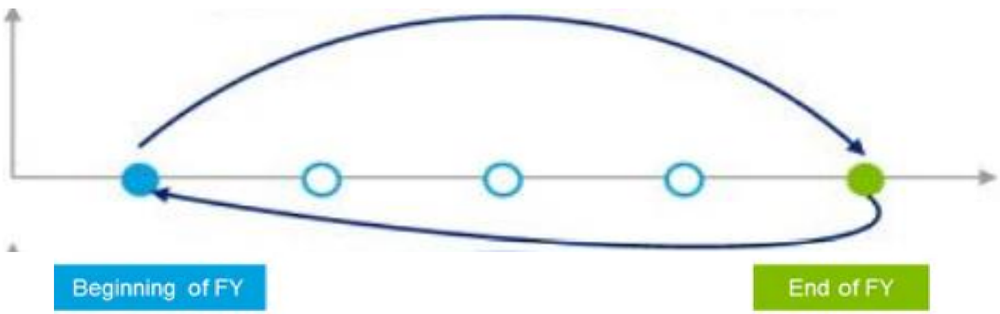
Customs perspective

- 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.

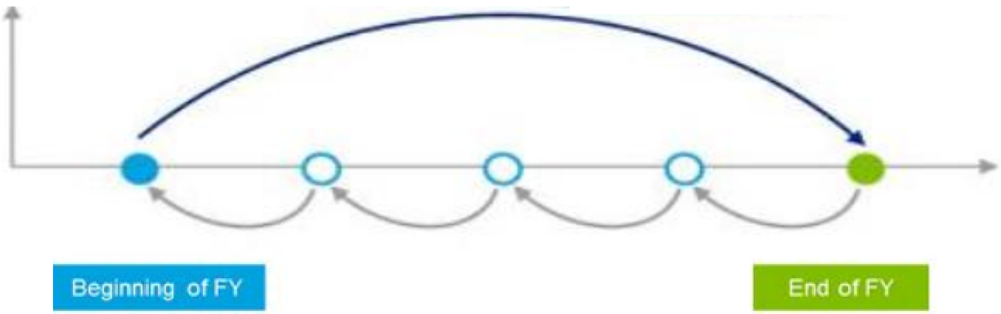
Retrospective TP adjustments

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

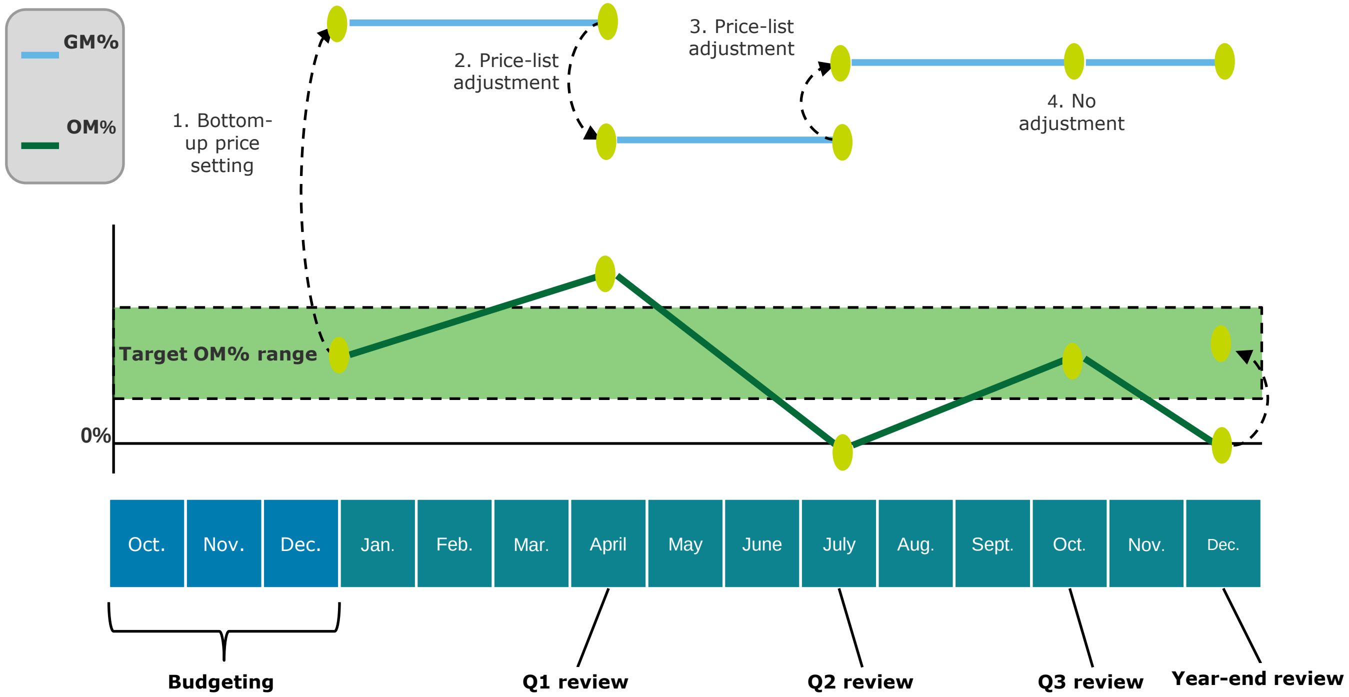
Customs perspective

- **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

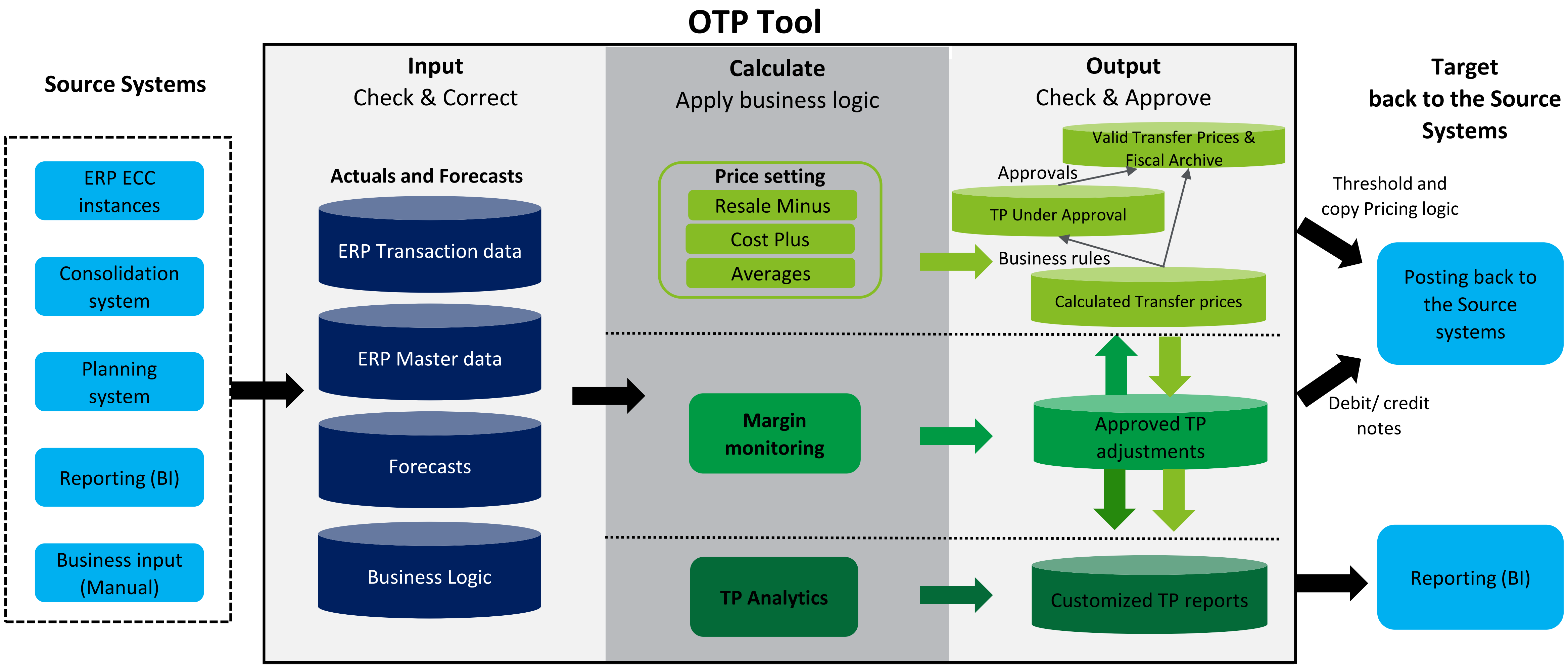
- Regulating **price setting and factors** (cost components) i.e. root cause analysis
- **Specific circumstances** on when price adjustments can take place and how these should be calculated
- Having an agreement with **tax and customs authorities** on the price/ value to be used

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)

ERP Vendors

- SAP
- SAP PaPM
- ORACLE
- IBM COGNOS

Finance Software

- Anaplan
- BLACKLINE
- APPTIO
- CCH Tagetik

OTP Software

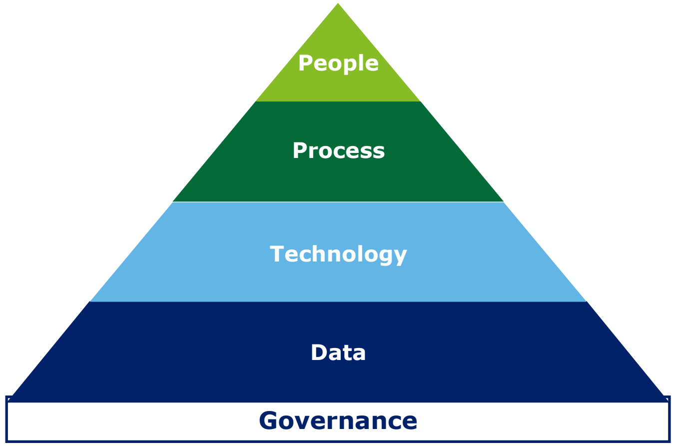
- THOMSON REUTERS ONESOURCE
- Virtual Trader
- TPH
- LONGVIEW
- VERTEX
- exa AG

Custom BI / ETL

- alteryx
- Qlik
- tableau
- Power BI
- Excel
- PowerPivot
- SQL

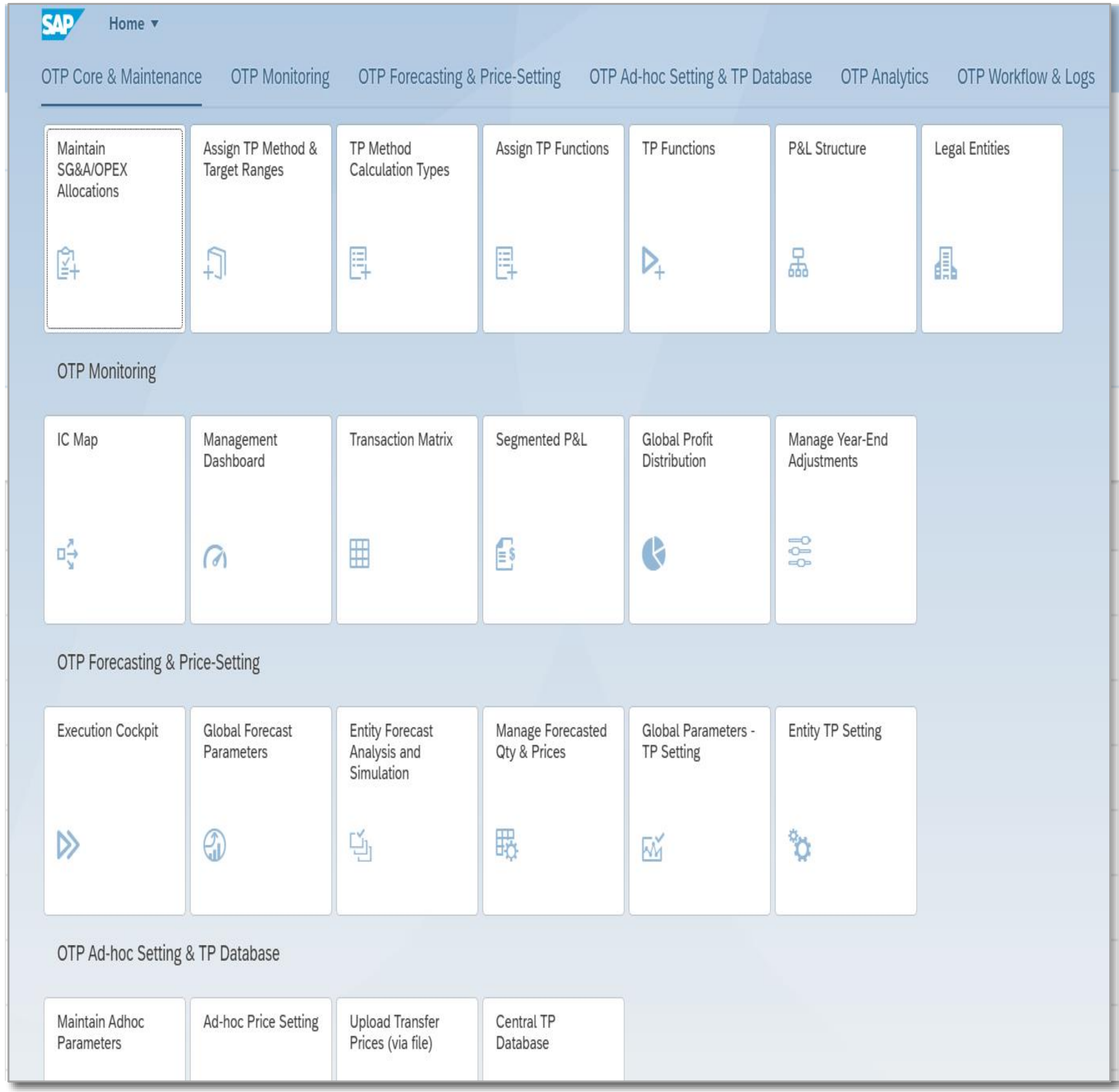
Typical key criteria for solution selection:

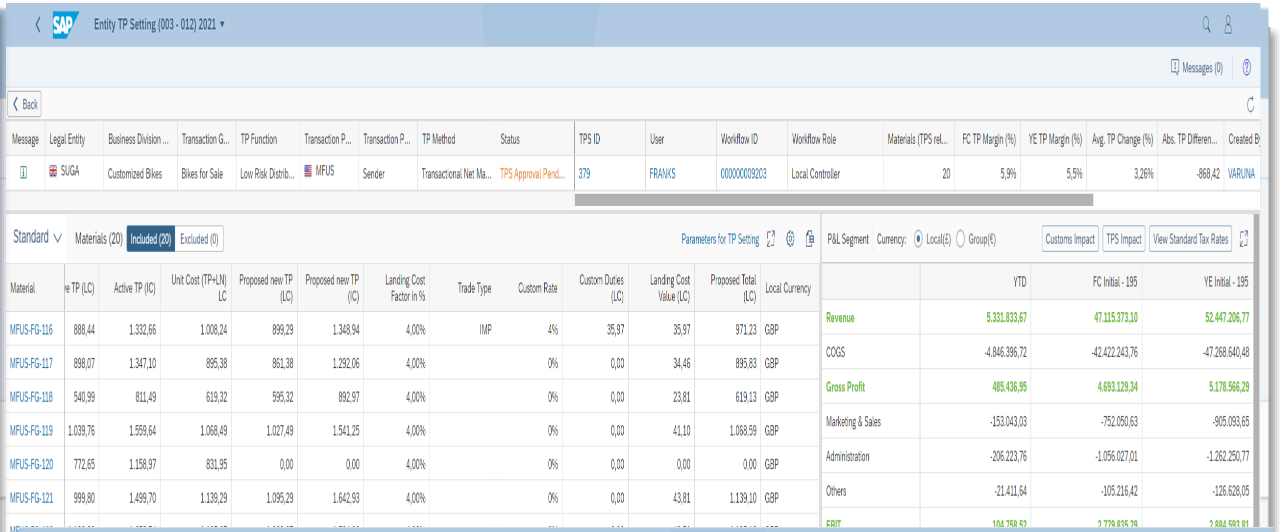
- Fit in the IT landscape;
- Full scope and scalability;
- Flexibility;
- High performance and user-friendly;
- Ability to handle complex calculations and rules;
- Total cost of ownership, etc.

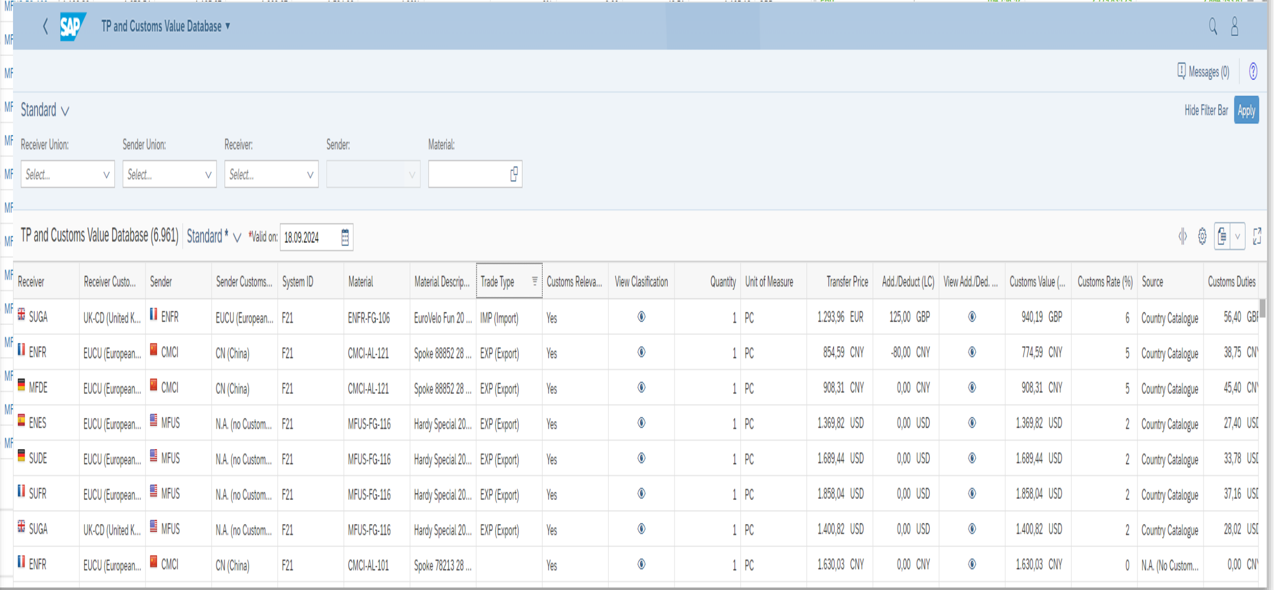


Solutions: Best practices on People, Process, Data and Technology

Screenshots EXA OTP – TP & Customs interconnection







Q&A