Report on the proceedings of the Seminar G

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Seminar G: Transfer pricing and indirect taxation

The seminar dealt with the interaction between direct taxes (transfer pricing), VAT and customs.

The seminar was divided in four parts. The first issue addressed was the relevance of transfer pricing for indirect tax purposes. The second issue relates to the legal framework: what is the regulatory framework for indirect taxes and transfer pricing? Further, some case studies were discussed. Finally the panel addressed future developments in terms of convergence between transfer pricing and indirect taxation.

In relation to the first topic, it was discussed that indirect taxes are "destination-based", while direct taxes are "origin-based". Transfer prices determine allocation of corporate tax revenues among the various origin states. Under a destination-based tax, all the tax revenues are collected by one state: the state of final consumption or destination. As such, intermediate transactions do not matter. However, in practice transfer prices do matter mainly because of either imperfections in the design of the indirect tax system or because the taxes are not creditable. The best example of a non-creditable VAT is a customs tariff. This is a one-time tax that is paid on import of goods when they enter the country: this tax is usually non-refundable. In the case of VAT-type indirect taxes, transfer prices do matter if the tax that is collected by the supplier is not creditable or deductible in the hands of the buyer. In addition, in case of an exempt supply, import taxes in the hands of the buyer become final taxes. Transfer prices also matter when the supplies are being made to non-residents who are not taxpayers in their jurisdictions and they may not be allowed to claim a refund of the taxes paid. In case of a non-comprehensive VAT, e.g. a single-state sales tax like in the case of Brazil, then clearly transfer prices have a very substantial impact.

A panellist illustrated a case study whereby a bank wishes to purchase computers in a VAT friendly fashion. Banks do not normally have the right to recover VAT on purchases, as engaged in VAT-exempt activities. As a consequence the VAT that is charged on the price of the computers will be an additional cost to the bank. In the example, the retail price of the computer is US$ 1,000. The VAT rate is assumed to be 10%, which is a very low rate in the European Union considering that VAT rates range from 15% to 25%. The bank has two alternatives to choose from. The bank could purchase the computers directly from the supplier (A Co). If it does so, the bank pays $1,000 plus $ 100 VAT. Alternatively, the bank could consider establishing a special purpose vehicle (SPV Co.), which would purchase the computers and then lease them to the bank. Assuming that the lease is an activity subject to VAT, SPV Co will be able to recover the full VAT amount in connection with the purchase of the computers. Although SPV Co. will have to – at least initially – charge VAT to the bank on the lease instalments, such VAT burden can in practice be mitigated by either charging a very low lease instalment or by forming, shortly after the purchase, a VAT

group with the bank or even merge with the bank. One of the keys for success for this sort of planning structures is the fact that the amount subject to VAT is based on the consideration for the supply, i.e. the price agreed upon by the parties to the transactions. The fact that parties are related is generally considered to be irrelevant for VAT purposes. The European Commission implemented measures to combat the application of such schemes by introducing the concept of the "open market value" for VAT purposes. A few other examples of important developments that reflect the increasing importance of considering the interaction between transfer prices and indirect taxes are, for instance, the use of shared service centres and the outsourcing of business processes (BPO). The same for supply chain optimization structures such as commissionaire structures, contract manufacturing or Cost Sharing Arrangements (CSA's).

The Chair pointed out that the VAT legal framework applicable on transfer prices for the supply of goods implies that a tax is levied on the value of the goods as reported for customs purposes. In the case of related parties the value could be other than the transaction value, in fact. In the case of transactions other than the import of goods, valuation rules are required. In the case of import of services since these cannot be taxed at the point of importation (there is no visible "crossing point"), the "reverse-charge" mechanism applies, where the buyer is required to self assess the tax. The case studies discussed by the panel, the Chair explained, aim at describing the legal framework focusing on four main aspects: what are the relevant "valuation rules"? How does the reverse charge mechanism work? Do countries accept the concept of VAT-group? What are the compliance rules? From a direct tax perspective, on the other hand, currently taxpayers may face the following situations: there are jurisdictions with virtually no rules for transfer pricing; some countries have basic rules; and finally there are countries with very comprehensive sets of rules. This lack of uniformity on the direct tax side complicates the situation further, when looking at evaluating the level of interaction between direct and indirect taxation.

A panellist addressed the situation in the European Union. He clarified that the conceptual frameworks of VAT (and indirect taxes in general) on the one hand, and transfer pricing on the other hand, are quite different. This applies not only to the EU but also to other jurisdictions. This illustrates how simply adopting the more familiar concepts of corporate income tax transfer pricing also in the field of indirect taxes there is a material risk of potential frictions and non-compliance. In most member states there are transfer pricing rules in corporate taxation, which follow the OECD Guidelines. EU law (directives such as the "arbitration convention") and soft-law initiatives have created a slightly more predictable environment in the field of transfer pricing, but still differences may be large. On the other hand, in the field of VAT there is a relatively high degree or a substantial degree of harmonisation which is enshrined in a binding VAT directive. Further, while transfer pricing in corporate taxation is about allocating profits to the various parties to a transaction, in VAT profit is a meaningless measure. VAT in fact applies on the consideration for an exchange of goods or services. Even in circumstances where no money is paid, there is the requirement to determine a price for the supply, for instance by referring to an open market value. In addition, elaborated transfer pricing rules require documentation rules and several countries have implemented these. Incidentally, it is important to note that a review of transfer pricing documentation might in future also serve to identify VAT issues. There are no such documentation rules currently in the

VAT area. Conversely, detailed invoicing and compliance rules exist. Furthermore, in corporate tax transfer pricing it is not uncommon to aggregate transactions that are closely linked and occur on a continuous basis. Conversely, aggregating transactions is completely unknown in the field of VAT where the analysis has to be conducted on individual transactions, which cannot be off-set even if there is a full deduction of import tax. If services are bundled the approach to the analysis for VAT purposes would be to unbundle them to the extent possible. "Grouping" is important for direct taxation. Detailed rules exist in the corporate tax area. Some rules exist in the area of VAT within the EU but only as an option for Member States to apply them domestically: no cross-border grouping rules exist. In relation to the allocation of costs for the provision of services within a group of companies, the OECD provides detailed rules on Cost Contribution Agreements (CCA's). Very often in practice, CCA's will lead to the application of a mark-up on the charged-out costs. In VAT there is something broadly similar: cost-sharing, as it is called in the VAT directive, but it is currently available under a number of limited circumstances and only for exempt activities. And if there were a mark-up applied to the transactions within the cost-sharing group, the conditions would no longer be met. In relation to branches there are material overlaps between the concept of permanent establishment for direct tax purposes on the one hand and the concept of fixed establishment for VAT purposes. However, there are differences in practical terms at least in some EU Member States. Finally, and not at all to be neglected, the underlying objective of transfer pricing policies from a company perspective is often to lower the transfer price in order to lower the corporate tax liability. But in many instances, it will be just the opposite for VAT purposes, because a higher transfer price with a higher VAT charge as an input to a bank with a low or partly limited right of deduction would allow that bank to take advantage of a higher rate of recovery of import tax. This leads to a conflict of objectives between the direct and the indirect tax worlds. The brief overview of the regulatory framework shows that there are overlaps between transfer pricing and VAT but the fundamental differences in approaches also provide a risk of friction that should not be overlooked. There is little concrete legislation in the VAT directive which one could classify as transfer pricing rules and the VAT directive does address transfer pricing as such. Article 80 of the VAT Directive allows Member States, in order to prevent tax evasion and avoidance, to foresee that an open market value should be applied to supplies of goods or services where certain ties, family ties or other close personal ties, management, ownership, membership, financial, legal ties are involved. This begs the question of what the open market value for VAT purposes is. In the directive the language is the result of political compromise between 27 Member States, as such not particularly clear. The open market value is a comparable market price if such market price is available. If there is no such open market price, then it is the purchase price, the cost price or the full cost as available in the specific case. The purpose of using the open market value concept is to combat evasion and/or avoidance and therefore as a matter of policy should only be applied between related parties. One should also bear in mind that the European Court of Justice has already found that the concept of corporate tax transfer price is of no relevance for the open market value, the panellist said.

A panellist explained that Italy has not implemented the VAT Directive provisions on transfer pricing. As a consequence, the taxable amount relevant for VAT applicable to transactions between related parties is still determined having reference to the consideration agreed upon by the parties. The relationship between the parties is in

general irrelevant for the purposes of the determination of the VAT-taxable base. That notwithstanding, recently some anti-fraud provisions have been introduced, which set forth the application of the open-market value in relation to some restricted cases. The first case relates to the supply of certain goods listed by the law, but only in case the supplier omitted to pay the VAT charged to the purchaser. If the supplier did not pay VAT and if the open-market value was higher than the consideration agreed upon by the parties, there will be a joint liability of the purchaser of the goods with the seller of the goods. In this case the concept of open-market value is applied in order to ascertain whether a liability for the purchaser is present or not. A second, simpler case is in relation to immovable property. In this case, if the open-market value is higher than the consideration agreed upon by the parties, the open-market value shall be applied in order to determine the taxable base of the transaction and so VAT might be accounted for with reference to this higher amount. In all the above circumstances, the relationship between the parties (the seller and the purchaser) is irrelevant. Currently, the definition of the open-market value under the Italian legislation does not exactly reflect the contents of the VAT Directive, as already commented. No reference is made to the possibility to take into account the purchase price of the goods or the cost price of the goods or services from the purchaser. As to the VAT grouping, Italy does not have a concept of VAT group as a separate taxable person. Finally, VAT does not apply to relation to transactions between head office and its permanent establishments as also decided upon by the European Court of Justice (specifically referring to an Italian case).

A panellist, commenting on the VAT rules applied in the Netherlands, clarified that the EU Directive regarding the open-market value has not yet been implemented. Although there is draft legislation in place, the Dutch government believes that legislation is not the best way to attack the VAT-saving schemes. The diffused opinion is that it would be better to use the “abuse of law” concept. The abuse of law concept was introduced in the ECJ case Halifax at the beginning of 2006 and that was the reason for the Dutch government to suspend application of the open-market value concept. On the other hand, in the Netherlands the concept of VAT grouping applies. However, as in other countries where VAT grouping is applied it in principle only possible between two parties that are established in the Netherlands. There is one exception to this rule and that was also introduced in a very interesting court case before the Dutch Supreme Court. Domestic law also allows that PE’s of foreign head offices can be included in a VAT group. The Supreme Court ruled that the transactions between head office and fixed establishment are considered to be within one and the same legal entity so they are outside the scope of VAT.

Another panellist gave an overview of the indirect taxes in Brazil, where there are five indirect taxes: the federal VAT, named IPI; the state VAT named ICMS; the indirect tax on services or ISS; finally two value added-based social contributions apply. Four of them apply like the VAT, the only exception being the surtax on services. Exports are not taxed. Domestic supplies of goods are subject to the federal VAT and the state VAT. Supplies of services are subject to the municipal tax on services. In relation to the federal VAT, the taxable base is the supply of goods at the manufacturing level only. On imports, the consideration (price paid) for the supply is the taxable amount. For domestic transactions, different establishments of the same company are considered to be separate entities. The standard rate is 10%. Import credits are allowed. In relation to the state VAT, it is worthwhile noting that it is levied by all the

twenty seven Brazilian member states. As with IPI, different establishments belonging to the same company are considered to be separate entities, and supplies between them are subject to tax. The tax is applied on the supply of goods at the manufacturing level as well as at the commercialization level, as well as on imports. ICMS is also levied on two types of services: telecommunications and inter-state and inter-municipal transportation services. The standard interstate rate is on average 18% and this same rate applies to interstate sales in business-to-consumer transactions. Interstate business-to-business transactions are taxed at 7% or 12% depending on the state of destination. The municipal tax on services is levied by all the municipalities and on services listed in the federal law. The intra-transportation services are taxable under ISS. The standard rate is 5% and no import credits are allowed taking into account that the ISS is a non-value added tax. The taxable amount is the gross revenue of the company and the fact that triggers taxation is the monthly corporate invoicing. The standard tax rate is 9.25%. Import credits are allowed. In relation to possible interrelations between transfer pricing and indirect taxes, it is worthwhile noting that also in Brazil some taxpayers scheme to avoid taxation by interposing a related entity. In relation to the federal VAT, for example, taxpayers instead of selling goods directly to the end-consumer, sell at a lower value to a trading (exempt) company. The exempt company sells to the final consumer. In other circumstances, freight is invoiced separately also through a related party to lower the amount of tax by surreptitiously increasing the freight charge and reducing the consideration for the goods. The taxpayer supplies underpriced goods to the end-consumer and the related entity supplies an overpriced transportation service which is taxed at a lower rate (5%). In relation to the state VAT, valuation is very important. That is because in the state of destination the import credits will correspond to whatever is collected in the state of origin. Also in relation to state VAT there is the phenomenon of interposing related entities possibly located in exempt zones. Regarding the transfer pricing rules in Brazil, it is worth noting that the only formal rules are related only to direct taxes. On the other hand, there are some anti-abuse rules providing for a “minimal amount” of a consideration for a supply under VAT-like legislation. This minimal amount will correspond to the market value to be measured through the application of the comparable uncontrolled price method or by the cost-plus method. In relation to the freight issue, the exceeding amount may be considered taxable for VAT purposes, in a clear attempt at curbing the manipulation of prices.

The Chair illustrated how in fact Canada has perhaps the most elaborated system of applying taxes to transfer prices. The regime is virtually limited to the finance sector only, but that is the only sector which is taxable on its imports with very limited rights of import tax deduction. The tax (Gross Sales Tax or GST) applies to the transaction value as declared for customs purposes. In the case of exempt taxpayers who cannot claim full import tax credit, there is a rule that states that supplies to related parties will be valued at the arm’s length value or the fair market value. Furthermore, Canada has a very comprehensive reverse charge rule. Fixed establishments are regarded as separate legal entities, so any charges from head office to a foreign establishment or reverse are taxable transactions for GST purposes. Further, inter-branch cost allocations are deemed to be a consideration for a supply. There are very detailed rules for timing and valuation which are directly linked to income tax transfer pricing rules, including adjustments. Canada is probably the only country that has gone to such an extent in integrating its GST with income taxes. This is also true in general of

all the newer countries which have adopted a comprehensive VAT system such as Australia and New Zealand.

The Chair then introduced the second topic, which dealt with the application of the rules and characterization of transactions, including valuation issues. The first case study addressed the issues related to cost-allocation systems. Often three different types of arrangements may be found: cost allocation; master service agreement and shared services centres.

The first type is a mere a cost allocation system where the parent company is incurring certain costs for the benefit of a number of entities within the consolidated group. For these purposes entities could be subsidiaries in the country, outside the country, or they could be fixed establishments. All costs are usually initially incurred by the parent company and then allocated on the basis of the benefit derived by recipient. These types of structures may take the form of a Cost Contribution Arrangement.

In master service agreements, vice-versa, the parent company will enter into a master agreement with one or more suppliers: an example would be telecom services where the parent company has a supply agreement with one operator for providing global connectivity. Services would be rendered to individual entities directly as opposed to flowing to the head office. Invoicing, however, is performed through a single invoice to the parent company for the entire set of services provided under the master service agreement. That invoice can report, for instance, one single supply of telecom services or it could identify different components of that supply. The degree of segregation can vary. Alternatively, arrangements whereby the invoice can go individual entities are also possible.

Finally, the third type of arrangement is the shared services centre. Here the different entities within the group will designate an entity, will create a partnership or will create a service hub, which will then provide services to all individual entities, as and when needed (e.g. an accounting centre all the payable invoices go to). Like the master service agreement, the supplies could be collectively or individually invoiced. Despite the similarity or identity of purposes and the overall effects of these three types of arrangements, the VAT treatment can vary a lot.

A panellist explained that whenever there is an individual supply against consideration (which does not necessarily mean a movement of cash) the supply should be taxed. The very basic approach under VAT rules is one whereby in any of these arrangements, if a supply can be ascertained, it should be taxed individually. The only specific rule existing in the EU VAT Directive is a cost sharing rule in article 132, paragraph 1(f), which foresees that Member States *shall* exempt the supply of services of independent groups of persons where these carry out activities which are exempt from VAT (or outside the scope of VAT) but those services are directly necessary for exercising the exempt activity. The cost of the service is jointly shared and paid as an exact reimbursement. A practical example would be a group of banks, of smaller banks, because such structures are less attractive for larger banks, centralising the development of software and the expenses incurred are then jointly shared. This rule is unevenly applied by Member States, however. Further, the conditions for this cost sharing in the current wording of the Directive are relatively

strict: it is only applicable to exempt activities. Some Member States have a more generous approach to this, however. One can wonder whether the conditions are really necessary in the current form, because after all, when dealing with a group of companies with exempt or out of scope activities, an adjustment with one group member in one direction would automatically lead to an adjustment in the other direction with another group member so the overall result should not really harm tax administrations. And if a mark-up is applied, one might also wonder whether it is not preferable to apply VAT only on the mark-up element and not on the underlying transaction.

Another panellist commented that, in principle, these cost allocations have to be seen as compensations for services. Whether or not there is a mark-up imposed by the shared service centre does not matter for VAT. One remark that is worth making is that what can be often seen in practice is that taxpayers become very creative in trying to avoid the principle of preserving the nature of the supply. This is often carried out through "blending" different types of services. The question then is whether the blended service that is provided by the shared services centre should be subject to a different place-of-supply rule than the one that relate to each service component. Usually that is automatically the case and that can be very beneficial for taxpayers in cases where the local subsidiaries do not have the right to recover input tax. As a response, the tax authorities become very creative in re-defining the nature of the service. They also have been taking substance over form approaches, such as arguing that actually there is no supply from the shared services centre to the subsidiary but in fact there is a direct supply from the supplier to the local subsidiary, so VAT should be applicable following the characterization of the original transaction.

The Brazilian panellist illustrated how in fact the existence of a mark-up would not be important in Brazil. Whether a cost sharing is considered a supply of services is a controversial issue in Brazil. There are some rulings by the federal revenue providing that the cost sharing is a supply of services and as such taxable. On the other hand, there is a tax administrative precedent stating that cost sharing is not a supply as long as some requirements are met: the existence of a formal contract establishing all the rules for the cost sharing, the proof of the provision of services, the inherence of costs and a reasonable allocation mechanism.

The Chair then, in summarizing the discussion stated that under most countries' rules, any reimbursement to the parent for costs incurred in a cost sharing will be regarded as a supply that is potentially subject to VAT. The character of the supply will be the same as the input service purchased by the parent. For instance, if the parent is purchasing a telecom service, a reimbursement of that cost to the branch or the subsidiary will also be a payment for the telecom service. But in some cases the character can change because the parent is acquiring different services then bundled into a new service altogether. If the supplies are rendered to a fixed establishment, in many cases they will be ignored without requiring an explicit rule in the legislation. In Europe companies may have the benefit of the grouping rules. The presence of a mark-up or not does not have remarkable consequences in terms of identification of a supply. Finally, invoicing requirements are very complex and burdensome. For these purposes the definition of recipient is very critical. In Canada for instance, the recipient is defined as the entity which is legally liable to pay the consideration under the agreement.

A panellist clarified that in Europe, in addition to the concept of recipient, there is also the 'actual use and enjoyment' provision. Further, it was discussed how crucial the contractual arrangement of the cost sharing is, and especially from a civil law perspective when an entity acts as an "agent" in acquiring and providing services to affiliates.

A further case study was then discussed. In the example there is a parent company located in country A. It has a subsidiary in country B and it has a fixed establishment in country C which is included in the VAT group with one of the other subsidiaries also in country C. There is a service supplier that is located in B that supplies IT services to the parent company. The case study was then addressed by the panellists.

A similar case has essentially been the subject of an important court ruling by the European Court of Justice, one panellist mentioned. The Court, in that case, decided that a fixed establishment and its head office form one single entity and it follows from this that there can't be any supplies between the branch and its head office. And the mere fact that costs are imputed to a fixed establishment in another Member State does not make the fixed establishment a separate taxable person. The panellist argued that it might be possible that this case will trigger the EU to think also more thoroughly about the need to introduce more detailed transfer pricing rules.

In the case of Canada, a panellist illustrated, when the GST was introduced in 1991, permanent establishments abroad were deemed to be separate entities and any dealings or any charges flowing back and forth between the parent and the branch were deemed to be supplies and considerations for a supply, respectively. There was an important court case called State Farm Insurance where the parent was in the US and they were allocating management costs to the branch in Canada and it was questioned whether that was a consideration for a supply, hence subject to tax. The court agreed with the taxpayer: the largest component of the payment to the parent was salary costs incurred by the parent, and the employees being also employee of the permanent establishment the "reimbursement" could not be regarded as supplies for the purpose of GST. Supplies are provided only by an independent contractor: employees (and employee services) are not. Moreover, the court concluded that the parent was providing (on the whole) a financial service to be exempted from VAT even though the input elements to the supply were material assets (desks, chairs and computers), computer services and employee services. This is an example where the nature of supply changes, and the cost reimbursements acquire an independent character and that character was regarded to be such that the supply went exempt. As a consequence of this Court case, Canada brought out very detailed rules. Currently under the Canadian GST rules a reimbursement of any outlay or expense incurred is deemed to be supply and has a character of that outlay and expense. Further, supplies cannot be bundled to change the nature of the supply.

As to Brazil, a panellist reiterated that companies structure transactions through special purpose vehicles (SPVs) in tax exempt zones. By selling at a reduced price to the SPVs, which in turn on-sell to customers, companies substantially reduce the amount of VAT due. Brazilian legislation has specific provisions aimed at curbing these practices, and the legislation is in fact based on the concept of "arm's length" pricing.

The Chair introduced then the topic of adjustments and the consequent implications for VAT purposes.

A panellist argued that from a European perspective, there are no specific VAT guidelines on how to deal with transfer pricing adjustments, where by adjustments it has to be intended adjustments to voluntarily correct the profitability of a related party in order to comply with the arm's length principle. As a consequence, ordinary VAT rules have to be applied and interpreted. He further argued that the most important issue is to determine whether an adjustment needs to be seen as an additional consideration (or a discount) for the specific transaction that has already taken place. If that is the case (if in other words there is a relation between the adjustment and the transaction that has already taken place) the VAT reporting may or must be adjusted. If there is no specific relation with the transaction that already took place, then the question arises whether the transfer pricing adjustment constitutes a consideration for a service in itself. There are many views on this matter. In his opinion in situations whereby adjustments are made or enforced by the tax authorities, there is EC jurisprudence where some guidance is provided concluding that there is no need to adjust for indirect tax purposes the transactions that have already taken place. In addition, he said, one could question whether, when transfer pricing adjustments are made on the equity of two related entities, that triggers any VAT consequences. In his opinion there is sufficient guidance from the ECJ that when there is a dividend payment or when there is a capital contribution, that should not be regarded as a supply for VAT purposes and therefore, adjustments would not trigger any VAT. Finally there is the issue of balancing payments. The question is whether these payments are connected with the supplies that already took place. If there is a strong connection, VAT reporting should be adjusted, he opined. In practice this has proven to be very burdensome, because invoices may need to be adjusted (depending on the nature of the transactions), European sales listings must be adjusted, Intrastat returns must be adjusted and also VAT returns may need to be adjusted. Another panellist argued that penalties should not apply if documentation is timely edited.

The Chair then asked the panel to address any future policy developments that point towards a convergence between transfer pricing and indirect taxes.

A panellist explained that currently a number of developments which are not primarily directed at transfer pricing issues but which will have an impact on transfer pricing are under way. First and foremost the adoption by the EU of a so-called "VAT package". The package is composed of four elements: a set of directives to change the rules on the supply of services for business-to-business supplies. For these supplies the place of supply will be the place/country of consumption/utilization. This calls for the implementation of a reverse-charge rule In relation to business-to-consumer supplies, the place of supply will still be the country of the supplier but with a number of elaborated exceptions. This will lead to a situation where transfer pricing issues will occur more frequently in the area of VAT. Further, a simplification is foreseen for all sorts of telecommunication, broadcasting and other electronic services provided to final customers. This requires accompanying measures for the cooperation between Member States. The last element of the package is a revision of the 8th directive on the refund of VAT. A major proposal which is nearing adoption is one on the VAT treatment of financial services. Further, a complete overhaul of the

scope of the definition of exempt financial services in the VAT directive is under preparation. The Commission is also working on new cost-sharing rules with fewer and more relaxed conditions whereby the cost-sharing will also be applicable to non-exempt activities, and possibly cost-sharing agreements could be extended across the border. Rules on invoicing will be thoroughly reviewed in the course of 2008, and that might be an opportunity to work on a convergence between transfer pricing and VAT especially with reference to the area of adjustments and compliance related to adjustments.

The Chair finally addressed the issue of the interaction between transfer pricing and customs.

A panellist discussed how, for customs purposes, there can only be one value used to establish the tax levy, as opposed to ranges of values as for instance established through the application of the TNMM under the OECD Guidelines. There are no valuation rules under the WTO Agreement but the Community customs code provides detailed valuation rules. These must all lead to one single value, the so-called transaction value which is in principle the price actually paid or payable for the transaction (subject to some relatively minor adjustments on fees, commissions etc.) The Community customs code also provides for a range of different valuation methods which are prescribed in detail and which follow a hierarchy. A number of steps need to be carried out in order to come to the one single transaction value, however the basic approach is very much resembling what is done for transfer pricing purposes, giving preference to the CUP method. If no listed method is proven to be applicable, then the Customs code resorts to valuation based on reasonable means. On the other hand, despite the similarities, there is no general equivalence between transfer pricing rules and customs rules. Interestingly, in the EU and according to the Community customs code, transfer prices are acceptable as customs value but it is not necessarily the case the other way around. This gives rise to timing issues because in the course of normal events, the customs value is immediately ascertained and available, whereas the transfer price will be established only later in the process. Clearly, in relation to imports the direct tax authorities would normally seek a low transfer price, often contrary to what the company would wish to see applied, in order to increase the corporate tax take. That might be in practice a source of friction, considering that customs authorities tend to prefer a higher value at import. In the work carried out by the World Customs Organisation, the OECD and other organisations, two different schools of thought have recently emerged, one of which is taking a more cautious approach towards convergence, whereas the other is proactively advocating for an integrated approach.

The Chair observed that if VAT were to be a comprehensive tax with no exemptions (such as in the case of the financial services industry), no real transfer pricing issues would arise. The financial sector generates a very large number of cross border transactions, particularly in outsourcing their back office functions (BPO's, call centres, CSA etc.) and as a consequence also a considerable number of transfer pricing issues, which require synchronization of the workings of transfer pricing rules and VAT rules. On the other hand, VAT and customs are sufficiently aligned, because the value of a transaction for VAT purposes is always used for customs purposes as well. The question arises as to whether an adjustment on the price for customs purposes requires adjusting the value for VAT purposes or not. In the opinion of the

Chair this is a minor issue that can be addressed allowing for more flexibility. The Chair concluded that there is no conceptual reason why the values for customs purposes have to be different from the value used for direct tax purposes. The only issue is one of timing: the direct tax adjustments take place after the fact, while valuation for customs purposes has to be determined at the time of the importation of the goods. Finally, he argued, it is questionable whether the tax authorities can agree that any adjustment for direct taxes will lead automatically to customs adjustments.

In concluding, a panellist observed that the answer to that question would be probably negative. Since customs duties once levied are considered to be final, any further adjustment of on the transfer prices would, with some difficulty, be reflected in the customs value. In the opinion of another panellist, this answer is technically correct. However, often customs authorities, direct tax authorities and taxpayers agree upon practical solutions through informal agreements. In the case of Australia, for instance, customs authorities do refund customs duty where there is a downward adjustment for transfer pricing purposes.