Analysis

Hamamatsu: when transfer pricing and customs valuation converge

Speed read

Transfer pricing and customs valuations have long co-existed, sometimes uneasily, as issues to be addressed on the cross-border transactions of goods between connected parties. The recent CJEU decision on *Hamamatsu* has put the relationship between the two under the spotlight, with uncertain consequences for taxpayers.

Paul Daly
BDO
Paul Daly is a tax partner at BDO LLP. He specialises in transfer pricing and value chain tax, and works with clients across a range of sectors on planning and implementing effective transfer pricing policies. Email: paul.daly@bdo.co.uk; tel: 0118 925 8512.

The recently published CJEU case *Hamamatsu v Hauptzollamt München* (Case C-529/16) is particularly relevant from a customs and transfer pricing point of view, as Hamamatsu's situation is a common one in today's global economy. The case concerns overlap between retrospective transfer pricing adjustments and the customs valuation of imported goods.

The objective of customs valuation as laid down by the WTO is to ensure a fair, uniform and neutral system excluding the use of arbitrary or fictitious customs values. On this basis, the general principle is that the customs value must reflect the real economic value of an imported good and take into account all of the elements of that good that have economic value. In the majority of cases, the customs value must equal the transaction value; i.e. the price actually paid or payable for the goods when they are sold for export to the customs territory, adjusted, where necessary, in accordance with prevailing customs law. This principle applies in equal measure to cross-border transactions between unrelated parties and related group companies.

Transfer pricing, on the other hand, typically seeks to apply the 'arm's length principle' to transactions between entities under common control, with the intention of enabling an alignment of the taxation of profit with economic value creation. A number of defined, OECD endorsed methods exist, including profit measures, such as the transactional net margin method, which looks to support arrangements by reference to the margin being made by the parties to the transaction, with adjustments made to the transaction as necessary to result in the appropriate net margin for that party.

Against that backdrop, the CJEU case of *Hamamatsu* was issued on 20 December 2017 and concerned the interpretation of articles 28 to 31 of the Community Customs Code (CCC). The case was referred to the CJEU by the Munich Finance Court, following the refusal of Hauptzollamt München to partially refund customs duties declared and paid by Hamamatsu, after transfer pricing adjustments had been made post importation. Whilst the CCC is no longer in force, it is anticipated to have bearing on the interpretation of the Union Customs Code (UCC), which came into force on 1 May 2016.

The case concerned intra-group arrangements for Hamamatsu, a global trading group. Hamamatsu Germany purchased imported goods from its Japanese parent company using intra-group prices, in accordance with the advance pricing agreement (APA) on transfer pricing concluded with the German tax authorities. The amounts charged by the parent company were adjusted retrospectively; i.e. effectively reducing the value of the goods post importation into the EU customs territory, in order to result in the targeted net margin as agreed under the APA.

A single credit was issued by the Japanese parent company covering all consignments between 7 October 2009 and 30 September 2010. Hamamatsu Germany then applied to Hauptzollamt München for repayment of customs duties proportional to the received credit. There was no allocation of the adjustment amount to the individual imported goods spread over more than 1,000 consignments over the 12 month period.

The CCC allows for post-importation customs value adjustments to be made but only under certain conditions. In *Hamamatsu*, the CJEU ruled that articles 28 to 31 must be interpreted as meaning that they do *not* permit an agreed transaction value, composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the customs value, *unless* it is possible to know at the end of the accounting period whether that adjustment would be made up or down.

The consequences of this decision will remain to be seen. It is yet unclear as to whether this decision will be interpreted as precedent that an initial amount cannot be relied on as the customs transaction value where a subsequent transfer pricing adjustment will be made but is unknown, and therefore another customs valuation method must be found. Alternatively, the main precedent effect may be cited as a reason why a customs refund will not be permitted where a transfer pricing true-up adjustment has the effect of reducing the value of goods post importation.

Regardless of the specific interpretation, the case does raise the profile of the interesting tension with transfer pricing arrangements, where true-up adjustments to the prices of goods, services or fees for accessing intangible property are common in arriving at a margin result.

In light of this, many groups may need to consider the basis on which product price is established (on which a customs transaction value is based) and the accuracy of their forecasting of the resulting gross and operating margins, to minimise the potential magnitude of true-up adjustments if these are required for their transfer pricing.

Additionally, it may give groups further impetus to understand the interaction of potentially interrelated arrangements between the connected parties that relate to the purchase of the product. For example, in some cases a true-up may be more appropriately characterised as an additional charge for services provided by a distributor to a company acting as principal, or vice versa.

This is particularly topical for the UK and its trading with EU members. Customs will be high on the agenda with the exit from the EU looming. For many transactions with established transfer pricing, the question of customs valuation may arise, and further scrutiny of the interactions can be expected. ■

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- Transfer pricing and customs values (Håkan Henningsson, 7.7.16)