



TECHNICAL COMMITTEE
ON CUSTOMS VALUATION

-
43rd Session
-

VT1068E1a
(+ Annexes)

O. Eng.

Brussels, 20 September 2016.

SPECIFIC TECHNICAL QUESTIONS

RELATED PARTY TRANSACTIONS UNDER THE AGREEMENT

AND TRANSFER PRICING –

DRAFT CASE STUDY BASED ON RESALE PRICE METHOD

(Item V (a) on the Agenda)

Reference documents :

VT0935E1b (TCCV/38)
VT0941E1b (TCCV/38 – Report)
VT0949E1a (TCCV/39)
VT0961E1a (TCCV/39)
VT0967E1a TCCV/39 – Report)

VT0975E1a (TCCV/40)
VT0985E1a (TCCV/40)
VT0994E1a (TCCV/40 – Report)
VT1002E1a (TCCV/41)
VT1013E1a (TCCV/41)
VT1028E1a(TCCV 42)
VT1041E1a(TCCV/42)
VT1051E1b(TCCV/42 – draft Report)

I. MEMBERS' COMMENTS

1. Following the 42nd Session, China provided an updated version of the draft case study designed to provide guidance to Members in a situation where transfer pricing information based on the resale price method may be useful to Customs when examining a related party transaction. The revised text was made available in the Annex to Doc. VT1058E1a and Members were invited to provide written comments.
2. In response, written comments were received from China and Uruguay. These comments are reproduced in Annexes I and II of this document. In its comments, China have provided clarification regarding the updated draft text. Uruguay indicates support for the draft text and encourages Members to work towards finalizing a new instrument. Additionally, Canada provided some linguistic comments on the French text of the case study which will be taken into account when the document is next updated.

II. SECRETARIAT COMMENTS

3. During the intersession, the OECD provided the following example which gives a helpful illustration relevant to this case, as follows :

For reasons of economy, documents are printed in limited number. Delegates are kindly asked to bring their copies to meetings and not to request additional copies.

- The importer is a simple distributor of clothing (with no retail functions). The related party exporter (or another related party) sets the marketing strategy to be undertaken by the importer, including advising the importer on the levels of inventory it should maintain and establishing the recommended sales price of the products which are seasonal in nature.
 - The importer buys a single shipment of clothing at the start of a season from the exporter. (A selling season typically lasts 6 months.) The exporter advises / instructs the importer to resell the products (to retail outlets) at :
 - 100 % of the 'full' recommended sales price in the first and second months of sales,
 - 80 % of this price in the third and fourth months, and
 - 60 % in the fifth and sixth months of sales.
 - Based on the marketing strategy established by the exporter, the pricing of the shipment of clothing to the importer at the start of the season was calculated to provide the importer with a 45 % gross margin based on expected sales. (This 45 % was established from margins of comparable simple distributors in the same market as the importer.) However, almost the entire stock of the season's clothing was sold in the first two months of the season.
4. The Technical Committee is reminded that it was agreed that the first step would be to deliberate on the question of price influence in this case, (covered in paragraphs 1 to 17 of the draft text). Once this point is concluded (and assuming the conclusion was that the price had been influenced by the relationship), the Technical Committee would then decide whether or not it wished to discuss application of the alternative methods of valuation (draft text in square brackets, paragraphs 18 to 20).
5. Delegates are invited to study the recent written comments and latest version of the draft text and be prepared to discuss at the next Session, with a view to finalization of this document.

* * *

COMMENTS BY CHINA

1. China Customs would like to thank the Secretariat for its help in preparing the new version of our draft case study and we also wish to express our appreciation to the delegates who gave their valuable contributions.
2. We have made some changes in the new draft version (Annex to Doc.VT1058E1a) of the case study based on the comments/suggestions made at 42nd Session and during the inter-session. The changes are as follows :
3. Considering suggestions from Korea, several sentences were added to further elaborate the facts. "The luxury bag market of country I where the imported goods were resold has been very competitive." was inserted in Paragraphs 5 and 15 to indicate that high gross margin did not result from other factors such as unexpected domestic market circumstance. "And these comparables had been deemed suitable for Customs valuation comparison purposes as well." was added in Paragraph 14 to support the comparability of the eight comparable companies. Besides, "Article 5 is not applicable because the necessary information for the deduction based on reliable source was not available from ICO and the public sector." was added in Paragraph 18.
4. United States has proposed to delete Paragraphs 18, 19 and 20. Since it was agreed at the 42nd Session that this question would be discussed at a later stage, those paragraphs were maintained in this version.
5. The second proposal made by the US is to add the sentence : "Thus, by virtue of ICO earning a higher margin, XCO sold the merchandise at a lower price, which in turn indicated that ICO's prices were not settled in a manner consistent with the normal pricing practices of the industry." in Paragraph 5. We considered it to be an analysis rather than a fact. Thus, this sentence was added in Paragraph 15. We suggested deleting the same sentence in Paragraph 5.
6. Other proposals made by the US concerning certain grammar and phrase expressions were amended accordingly.
7. Based on the four hypotheses given by the observer from the OECD (paragraph 81 of the draft Report VT1051E1a), amendments were made aiming to give assumptions to the facts of the case in order to narrow down the possibilities behind the higher resale price. "ICO just followed the routine distribution work and did not undertake any more marketing activities in that year" was added in Paragraphs 5 and 15. "There was no evidence showing it had performed its activities more successfully than the competitors, therefore there was no evidence of ICO giving added value to the transaction" was added in Paragraph 15. "The eight selected comparable companies do not employ any valuable intangible assets" was added in Paragraphs 7 and 14.
8. Concerning the proposal on deletion of "the popularity of the bags", we have explained at the 42nd Session that this expression had been added to the original version of the case study in order to help the delegates understand the situation where the actual sales income far exceeded the estimated income as indicated in this case, and we agreed that this expression could be deleted if it had been understood by the Committee. However, when redrafting the new version, taking into account the comments made by the OECD expert, we noticed that it would be better to keep this expression - "the popularity of the bags", since it is consistent with other facts of the case which in total support a finding that the higher margin

was due to the reputation of international brand and ICO made no contribution to the added value. Therefore, this expression remained in the new version.

9. The concern of transfer pricing adjustment was repeatedly expressed at previous sessions. We would like to reiterate that the facts were based on a real case, and this situation was not uncommon in China's practice that companies under similar circumstances did not perform transfer pricing adjustment afterwards. Footnote 2 was added to further explain the situation, and demonstrated that Customs has the right to re-determine the Customs value of imported goods when no adjustment was made.
10. China Customs would like to make additional explanation and comments on this case at the forthcoming session, and work towards a better version with the help of the Secretariat and the delegates.

* * *

COMMENTS BY URUGUAY

1. Uruguay would like to thank China, the United States and the Secretariat for the work undertaken on document VT1058E1a, "Related party transactions under the Agreement and Transfer Pricing - case based on resale price method".
2. In line with the principles of the Agreement and the Interpretative Note to Article 1.2, and taking into consideration Commentary 23.1 and the recent Case Study 14.1 issued by the Technical Committee, our delegation feels that it would be very useful for Customs officials and the private sector in general to have a Technical Committee instrument which would provide for the possibility of using information contained within a transfer pricing study based on the resale price method, and which would conclude that the relationship had influenced the price actually paid or payable.
3. We would therefore like to encourage Members to make every effort to finalize and approve such a document during the next Session.
4. Uruguay would like to point out that it may make further comments during the next session, with a view to obtaining a new Technical Committee instrument.

* * *