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**The link between transfer pricing and the EU
customs valuation law:**

Is there any and how could it be strengthened?

by

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Summary

Transfer pricing and EU customs law are regulated by two separate sets of rules. Ultimately, the objective of transfer pricing, as a *tax* measure, is to ensure that the transactions between associated enterprises are conducted in accordance with the same terms as between independent enterprises. The objective of EU customs law is, however, to ensure that the single market of the EU functions properly and that the playing field for the European *trade* is even. The current differences in the scopes and objectives of the two different sets of rules cause inevitable clashes between the two sets of rules. As a consequence, the taxpayer is forced to make a decision to be in compliance, either, with the best practice of transfer pricing, or, with the strict interpretation of the applicable EU customs law.

The primary purpose of the thesis is to investigate the link between transfer pricing rules and EU customs valuation rules under the currently applicable EU customs law. Moreover, the purpose is to present different potential solutions which could be considered in order to solidify the link between the two different topics.

In terms of practice, transfer pricing and EU customs law follow each other. As a consequence of the lack of the common legal basis between these two topics, an everyday issue rises for the multinational enterprises that engage in business in the EU. Consequently, a pragmatic solution is highly needed.

Preface

First, I would like to express my gratitude to Winni Nielsen and Martijn Schippers for the discussions we had about the general connection points between customs law and transfer pricing.

I would also like to thank EY Sweden for being flexible and giving me the freedom to work on my thesis. Now it is time to put the ‘pedal to the metal’.

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Abbreviation list

Abbreviation text	Abbreviation
Advance pricing agreement	APA
Arm's length principle	ALP
Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code [2015] OJ L343/1.	UCC DA
Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code [2015] OJ L343/558.	UCC IA
Comparable uncontrolled price method	CUP method
Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47.	TFEU
Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code [1992] OJ L302/1. Amended with Regulation (EC) No 82/97 of the European Parliament and of the Council of 19 December 1996 amending Regulation (EEC) No 2913/92 establishing a Community Customs Code [1997] OJ L 17/1.	CCC
Court of Justice of the European Union	CJEU
European Parliament and Council Regulation (EU) 952/2013 of 9 October 2013 laying down the Union Customs Code [2013] OJ L269/1.	UCC
European Union	EU
<i>Exempli gratia</i> , for example	E.g.
General Agreement on Tariffs and Trade concluded by the members of the World Trade Organization	WTO agreement

Hamamatsu Group	The Group
Hamamatsu Photonics	Hamamatsu Japan
Hamamatsu Photonics Deutschland GmbH	Hamamatsu Germany
Helsinki Administrative Court	HAC
<i>Id est</i> , that is, in other words	I.e.
Judgment of 20 December 2017, Hamamatsu Photonics Deutschland GmbH, C-529/16, EU:C:2017:984.	Hamamatsu case
Multinational enterprise	MNE
OECD Model Tax Convention on Income and on Capital, published 18 December 2017	OECD Model
OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published 10 July 2017	OECD Guidelines
Paragraph	Para
Paragraphs	Paras.
Resale price method	RPM method
The Organisation for Economic Co-operation and Development	OECD
Transactional net margin method	TNMM method
Transactional profit split method	PSM method
U.S.	The United States of America

1. Introduction

1.1 Background

During the recent years, the tax authorities around the world have increased their focus on cross-border related issues, and especially transfer pricing. Multinational enterprises (“MNEs”) have also identified that indirect taxes, including customs duties, cause them increased tax related risks.¹ In 2013, the Organisation for Economic Co-operation and Development (“OECD”) estimated that up to 60 percent of the global trade takes place between associated enterprises, i.e. up to 60 percent of the global trade is related to transfer pricing.² When put together, transfer pricing and customs law have historically created a ‘grey zone’ under which MNEs have had to operate without knowing exactly how to be in compliance with both sets of rules at the same time.

The definition for ‘associated enterprises’ is laid down in the OECD Model Tax Convention on Income and on Capital (“*OECD Model*”).³ Associated enterprises is a term often connected to direct taxation and it is generally understood as ‘parent and subsidiary companies’ and ‘companies under common control’.⁴ Furthermore, the term relates closely to the arm’s length principle (“*ALP*”), which is the cornerstone of transfer pricing.

In theory, the ALP is based on the market forces, i.e. the supply and demand. The rationale is that when the transfer price is determined by the same factors that determine the price between independent enterprises, the price agreed between associated enterprises should be acceptable to every party affected by the transaction.⁵ From a fiscal perspective, the purpose of the transfer pricing rules and the ALP is to ensure that the taxable profits and, consequently, the tax revenues are not shifted from high tax jurisdictions to low tax jurisdictions.⁶ The ALP, thus, requires that associated enterprises charge the same price when engaging in

¹ EY, ‘Global Transfer Pricing Survey 2016’ <[www.ey.com/Publication/vwLUAssets/ey-tax-steps-into-the-light/\\$FILE/ey-tax-steps-into-the-light.pdf](http://www.ey.com/Publication/vwLUAssets/ey-tax-steps-into-the-light/$FILE/ey-tax-steps-into-the-light.pdf)> accessed 14 April 2018, 3 & 6.

² OECD, ‘Implications of Global Value Chains for Trade, Investment, Development and Jobs 2013’ <www.oecd.org/trade/G20-Global-Value-Chains-2013.pdf> accessed 2 April 2018, 8.

³ OECD, ‘Model Tax Convention on Income and on Capital: Condensed Version 2017’, <www.dx.doi.org/10.1787/mtc_cond-2017-en> accessed 4 March 2018, article 9.

⁴ OECD (n3) commentary on article 9(1).

⁵ Jérôme Monsenego, *Introduction to Transfer Pricing* (2015, Wolters Kluwer Law & Business) 16-17.

⁶ Monsenego (n5) 3-4.

intercompany transactions as what would have been charged between independent parties in comparable circumstances.⁷

The EU customs law in general, however, is based on the objective of ensuring that the single market of the EU functions properly and that the playing field for the European trade is even.⁸ In terms of customs valuation in the EU context, it has been stated by the Court of Justice of the European Union (“CJEU”) that “*the objective [...] is to introduce a fair, uniform and neutral system excluding the use of arbitrary or fictitious customs values*”.⁹ It is important to notice that the customs valuation rules of the EU have been incorporated directly from the General Agreement on Tariffs and Trade concluded by the members of the World Trade Organization (“WTO agreement”) which the EU is obliged to follow. Although the purpose of the EU customs valuation rules might, to some extent, sound similar to the purpose of the ALP, the way the two different sets of rules are applied in order to accomplish their goals is different.

Transfer pricing is mainly based on the OECD Model, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“*OECD Guidelines*”)¹⁰ and the domestic laws. The EU customs law is based on the Union Customs Code (“*UCC*”)¹¹, its Delegated Act (“*UCC DA*”)¹² and Implementing Act (“*UCC IA*”)¹³. In addition, the CJEU is of great importance with cases, where it has provided its interpretation. This is because, first, the CJEU is the ‘ultimate’ institution which provides interpretation of the EU law, but, most of all, because the CJEU must comply with the global Customs Valuation Code of the WTO agreement and related commitments to adopt the World Trade Organization’s and World Customs Organization’s rulings and decisions to the European context.

⁷ OECD, ‘Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017’ <www.dxi.doi.org/10.1787/tpg-2017-en> first accessed 4 March 2018, para 1.35.

⁸ See, e.g. European Commission, ‘Implementing Decision of 17.2.2017 concerning the adoption of annual work programmes for 2017 for the Customs 2020 and Fiscalis 2020 programmes and on the financing of the programmes for expenditure to be committed by DG Taxud from the 2017 budget lines 140201 and 140301’ COM (2017) 826 final, 2.

⁹ See, e.g. judgment of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, para 36.

¹⁰ OECD (n7).

¹¹ European Parliament and Council Regulation (EU) 952/2013 of 9 October 2013 laying down the Union Customs Code [2013] OJ L269/1.

¹² Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code [2015] OJ L343/1.

¹³ Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code [2015] OJ L343/558.

In other words, although the purpose of finding the right value for each individual transaction might seem to be similar, transfer pricing and the EU customs law are in lack of common legal basis. When in practice one follows the other, i.e., first there has to be a cross-border (intercompany) transaction before there is a need for a customs valuation, the two topics are seen as completely separate topics from a theoretical perspective. Consequently, the fundamental differences between the two sets of rules cause inevitable clashes, and, as a consequence, MNEs which are interested in doing business in the EU face complicated issues and the ultimate objective, i.e., the even playing field for the European trade, is at risk.

1.2 Aim

The purpose of the thesis is to investigate the link between transfer pricing rules and the EU customs valuation rules under the currently applicable EU customs law. This is done by investigating connecting factors and differences through a comparison between the two topics. The purpose is also to analyse the recent case law of the CJEU and to identify, first of all, the consequences of the recent case law, and second, compare the CJEU case law with the case law of different national courts in order to identify whether the CJEU is more willing than the national courts to strengthen the link between the two separate sets of rules.

Furthermore, the aim is to find potential solutions in order to solidify the link between transfer pricing and the EU customs law.

Thus, the research question is: *The link between transfer pricing and the EU customs valuation law: is there any and how could it be strengthened?*

1.3 Method and material

As the legal question relates to the law as it stands, based on the current sources of law, and especially the recent case law, the methodology chosen is the legal-dogmatic research method.¹⁴ More precisely, the focus will be on *de lege lata*¹⁵ and *de lege ferenda*¹⁶.

The central point of the analysis will be on the applicable parts of the OECD Guidelines and the EU customs law. Moreover, a major part of the thesis and important aspects of the argumentation are derived from a recent decision of the CJEU, namely, *Hamamatsu Photonics Deutschland GmbH* (“*Hamamatsu case*”)¹⁷. Other material, such as the OECD Model and

¹⁴ Jan Vranken, ‘Exciting Times for Legal Scholarship’, [2012] 2(2) *Recht en Methode* in onderzoek en onderwijs 42, 43.

¹⁵ How the law is now.

¹⁶ How the law should be.

¹⁷ Judgment of 20 December 2017, *Hamamatsu Photonics Deutschland GmbH*, C-529/16, EU:C:2017:984.

suggestions from different international organisations will be used where relevant.

Furthermore, available case law from national courts of the different Member States concerning the link between transfer pricing and the EU customs law will be introduced. In order to find practical solutions, a brief look into case law and guidelines provided by the customs authorities from the U.S. and Canada will be taken.

It is also purposeful to use articles and academic texts as a source to be able to present a more comprehensive view of the main aspects of the topic of the thesis. Articles and academic texts are also of great help when building the theoretical background for the topic.

1.4 Delimitation

The scope of the thesis is limited to identifying the differences and similarities in transfer pricing and the *EU* customs law. Although the main purpose of the thesis is to analyse and compare the valuation aspects of the two topics in relation to international trade of goods, selected topics of general nature from transfer pricing and EU customs law are necessary to be introduced in order to present a more comprehensive picture of the current situation and the problem surrounding the topic of the thesis.

Although the scope of the thesis is limited to the current situation in the EU, some examples are drawn from the U.S. and Canada, as described above. For future research purposes, it would be interesting to expand the scope and to perform a comparative analysis of the current situation of the approaches chosen by the EU and other jurisdictions outside of the EU.

The amount of case law from the CJEU in connection to customs valuation is very limited. Case law which concerns the link between transfer pricing and customs valuation comprises of one case, the *Hamamatsu case*. Other customs law related case law from the CJEU than the *Hamamatsu case* and the case law cited in the *Hamamatsu case* is not considered to be important for the purposes of the thesis.

Furthermore, notable is that the number of analytical articles and academic texts on this specific topic is very limited.

The author is aware of one more national court's case where the link between transfer pricing and the EU customs law is questioned.¹⁸ However, due to the author's limited knowledge in the Italian language and in the absence of an English translation, this case has not been included in the thesis.

¹⁸ La Corte Suprema Di Cassazione Sezione Tributaria Civile, case Chevrolet Italia S.p.A. (case number: 07715-13), dated 12 February 2013.

1.5 Outline

After the introduction, transfer pricing in general as well as the different transfer pricing methods will be introduced briefly. The chapter two then continues with an introduction to the general aspects of the EU customs law along with a brief description of the different EU customs law valuation methods. The chapter two is finished with a comparison between the general aspects of transfer pricing and EU customs law.

Chapter three is dedicated to analysing the *Hamamatsu case*. Chapter three begins with a summary of the *Hamamatsu case* and continues with an analysis of the different aspects that arise from the case. Chapter three ends with a brief overlook of the Finanzgericht München's (Germany), the Helsinki Administrative Court's (Finland) and the Tribunal Supreme's (Spain) (potential) judgments on domestic cases where the link between transfer pricing and customs law has been questioned.

Chapter four presents various different options which could be considered in order to strengthen the link between transfer pricing and the EU customs law. In the fourth chapter, examples from the U.S. and Canada are drawn to support the potential changes that could be considered as a reference point for the link between transfer pricing and EU customs law to be strengthened.

As the last chapter of the thesis, chapter five concludes with the findings of the previous chapters.

2. Transfer pricing and the EU customs law

2.1 Introduction to transfer pricing

A significant amount of the world trade takes place between entities of the same group of companies, which are located in different countries.¹⁹ These transactions, whether they comprise of transfer of goods, provision of services, provision of financing, licensing of intangibles, or something else, are commonly referred to as ‘intercompany transactions’. When associated enterprises are engaged in business activities, market forces do not necessarily apply in the same way as they apply between independent enterprises. As a consequence, the price agreed between associated enterprises, i.e. the ‘transfer price’, might deviate from what would have been paid between independent enterprises.²⁰

As described in the introduction, the ALP, as laid down by the OECD Model, is the cornerstone of transfer pricing, which requires that the transfer prices set between the associated enterprises have to be the same as what independent enterprises would have agreed upon in comparable circumstances.²¹ The ALP is followed globally by most of the tax administrations.²² In practice, this is ensured, by granting the tax authorities the right to adjust the profits of the enterprise located within their jurisdiction in case their transfer prices and profits of a MNE are not at arm’s length.²³ Notable is that the OECD Model forbids the tax authorities to use valuation standards in relation to their profit adjustments that cause the tax burden of the taxpayer to go further than what the ALP requires.²⁴ In practice the ALP is a highly subjective valuation standard, and generally, it is impossible to find one specific value that is at arm’s length.²⁵

In order to ensure that the fundamental principles of international taxation endorsed by the OECD member states^{26;27;28} are followed in the cross-border

¹⁹ OECD (n2) 8.

²⁰ Monsenego (n5) 3-4.

²¹ OECD (n7) para 1.35.

²² OECD, ‘Dealing Effectively with the Challenges of Transfer Pricing’ <www.dx.doi.org/10.1787/9789264169463-en> accessed 14 May 2018, 14.

²³ OECD (n3) article 9(1-2).

²⁴ Jens Wittendorff, *Transfer Pricing and the Arm’s Length Principle in International Tax Law (Series on International Taxation 35)* (2010, Wolters Kluwer Law & Business) 193.

²⁵ OECD (n7) para 3.55.

²⁶ The residence state principle: “Principle according to which residents of a country are subject to tax on their worldwide income and non-residents are only subject to tax on domestic-source income.” IBFD, ‘Glossary’ (IBFD Tax Research Platform, 2018), <www.online.ibfd.org/kbase/> accessed 6 March 2018, ‘Source principle of taxation’^[1]^[2]^[SEP]

²⁷ The source state principle: “A principle for allocating taxing jurisdiction over income according to which a country may tax income having its source in that country, regardless of the residence of the taxpayer.” IBFD (n26) ‘Residence principle of taxation’^[1]^[2]^[SEP]

trade between associated enterprises, the OECD has published the OECD Guidelines.²⁹ Although the OECD Guidelines lack binding legal value and they are seen as an ‘international standard’ by the OECD member states and some of the non-member states, they are often used as an interpretative aid by the national courts of different countries worldwide.³⁰

The OECD Guidelines lay down a guidance on how to apply the ALP in practice when a MNE engages in cross-border intercompany trade. According to the OECD Guidelines, the ALP requires that the conditions of the intercompany transaction are compared with those that would have been agreed upon with independent third parties when engaging in a comparable transaction under comparable circumstances.³¹ In order to illustrate that the intercompany transactions have been conducted as if they had taken place between independent enterprises, and that the circumstances surrounding the transaction did not affect the pricing, the taxpayer has multiple transfer pricing methods available for illustrating that its transfer prices and, consequently, taxable profits are at ‘arm’s length’.

2.1.1 Transfer pricing methods under the OECD Guidelines

The selection of the most appropriate transfer pricing method is based on a case-by-case assessment. None of the transfer pricing methods are suitable for every situation. The OECD Guidelines introduce five different methods that the taxpayer can use to assess whether the commercial and financial relations between the taxpayer and the counterparty of the transaction follow the ALP. These methods can be divided into ‘traditional transaction methods’ and ‘transactional profit methods’.³²

The traditional transaction methods are the comparable uncontrolled price method (“*CUP method*”), the resale price method (“*RPM method*”), and the cost plus method. Transactional profit methods are the transactional net margin method (“*TNMM method*”) and the transactional profit split method (“*PSM method*”). Additionally, in case none of the methods recognised by the OECD seem appropriate to use in the particular case, the taxpayer has the freedom to apply other methods as long as they are in compliance with the ALP.³³

²⁸ The separate entity approach: “The amount of profits that may be taxed in the source state is generally restricted in tax treaties to the amount that would be expected if the permanent establishment were a distinct and separate enterprise in the same circumstances dealing independently, i.e. at arm’s length, with the company of which it is a permanent establishment.” IBFD (n26) ‘Allocation (of business profits)’.

²⁹ OECD (n7) 15-17.

³⁰ Jose Calderón, ‘The OECD Transfer Pricing Guidelines as a Source of Tax Law: Is Globalization Reaching the Tax Law?’, [2007] 35(1) Intertax 4, 4 & 26.

³¹ OECD (n7) paras. 1.33-1.36.

³² OECD (n7) paras. 2.1-2.2.

³³ OECD (n7) paras. 2.1 & 2.9.

The traditional transaction methods analyse, more or less directly, the price of the transaction. When using the CUP method, the element under comparison is the actual price of the transaction. Therefore, a difference in the two prices indicate that the commercial and financial relations of the associated enterprises are not at arm's length.³⁴

The functioning of the RPM method is based on discounts which are given to associated enterprise based on the market price and targeted gross margin (or resale price margin) of a specific product or a service.³⁵ The comparable element with the RPM method is, thus, the gross margin. The cost plus method, on the other hand, analyses the mark-up that is added on top of the incurred direct costs in relation to, e.g., manufacturing activities.³⁶ It could be concluded that the operating principle of the RPM method and cost plus method is somewhat the opposite from each other, although both of the methods analyse the price of the transaction indirectly.

Because there is either a direct or an indirect link with the price of the transaction when using the traditional transaction methods, they are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length. Where possible, the taxpayer should prefer to use the traditional methods.³⁷

The transactional profit methods can be considered as more indirect methods when compared with the traditional transaction methods, as they analyse the profit level earned by the party/parties of the transaction rather than the actual transfer price of a single transaction. This is why the transactional profit methods can be applied in situations where there is no comparable price directly available.³⁸

The different methods endorsed by the OECD Guidelines can also be divided into two categories based on how they analyse the transaction from the supply and demand perspective. The RPM method, the cost plus method and the TNMM method analyse only one side of the transaction, while the CUP method and the PSM method take into account both, the supply and the demand side of the transaction.³⁹

³⁴ OECD (n7) para 2.14.

³⁵ Alessio Rombolotti & Pietro Schipani, 'Resale Price and Cost-Plus Methods: The Expected Arm's Length Space of Coefficients' [2012] 19(3) International Transfer Pricing Journal 186, 186.

³⁶ OECD (n7) para 2.45.

³⁷ OECD (n7) para 2.3.

³⁸ OECD (n7) paras. 2.3 & 2.6.

³⁹ OECD (n7) paras. 2.4, 2.65 & 2.119.

As a conclusion, the OECD Guidelines do not set objective requirements on, on the one hand, what should be included, and, on the other hand, what should not be included in the transfer price between the associated enterprises. As a consequence, the ALP is considered as a highly subjective valuation standard; the transfer price is in compliance with the ALP when the taxpayer can illustrate that the transfer price charged between associated enterprises is the same price that independent parties would have agreed to charge in comparable circumstances.

2.2 Introduction to the EU customs law

One of the ultimate objectives, based on which the EU has been built, is the idea of the EU comprising of an internal market.⁴⁰ In order to ensure that the business within the internal market operates efficiently, the businesses have, among other freedoms, the freedom to move their goods within the EU as they wish.⁴¹ This is made possible by removing all customs requirements when goods are crossing borders between two Member States of the EU. In addition, it is necessary to impose a common customs tariff to the trade taking place between a Member State and third countries. A geographic territory without customs duties for the internal trade but a common tariff for external trade is also referred to as a customs union.⁴² As described in the introduction, the general rules and procedures to be applied on the customs union level are at present to be found in the UCC and its UCC DA and UCC IA, which have been applicable since 1 May 2016. The legal basis for the UCC is found in the Treaty on the Functioning of the European Union ("*TFEU*").⁴³

The UCC is not entirely an independent document of the EU. For example, the customs valuation articles are incorporated directly from the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade⁴⁴ which is a part of the General Agreement on Tariffs and Trade ("*WTO agreement*")⁴⁵. The WTO agreement is a multilateral agreement concluded between countries⁴⁶ of the World Trade Organisation, as well as

⁴⁰ Consolidated version of the Treaty of the European Union [2012] OJ C326/13, article 3(3).

⁴¹ Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326/47, article 26(2).

⁴² TFEU (n41) article 28(1).

⁴³ TFEU (n41) articles 33, 114 & 207.

⁴⁴ World Trade Organization, 'Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade' <www.wto.org/english/docs_e/legal_e/20-val.pdf> accessed 1 May 2018.

⁴⁵ World Trade Organization, 'General Agreement on Tariffs and Trade', <www.wto.org/english/docs_e/legal_e/gatt47.pdf> accessed 1 May 2018.

⁴⁶ 164 members since 29 July 2016. Source: <www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm> accessed 23 April 2018.

some non-member countries and territories.⁴⁷ In other words, and as described⁴⁸, the valuation methods introduced in the EU through the UCC are generally the same as the methods, which the other member countries of the WTO agreement are obliged to apply. Thus, a comparison of the customs treatment in the EU and in the other states, where the WTO agreement is applied, is possible to a high extent.

2.2.1 Valuation methods under the WTO agreement and the UCC

Customs duties can be either specific, *ad valorem*, or a mix of these two. When the customs duty is based on a specific duty, e.g., EUR 5 per kilogram, there is no need for the rules in relation to customs valuation. When the customs duty is based on an *ad valorem* rate of duty, e.g., 5 percent of the total value of the imported goods, the customs valuation rules become applicable.⁴⁹

The WTO agreement and thus, the UCC, lays down a strict hierarchy which must be followed when valuing goods for customs purposes. The transaction value must always be used as the primary method for customs valuation purposes.⁵⁰ In case the criteria laid down in the UCC are not fulfilled, the valuation must be based on the five secondary methods.⁵¹

2.2.1.1 The primary valuation method

The primary basis for customs valuation is the transaction value, which is the price actually paid or payable for the goods when they are sold for export to the customs territory of the Union. The price actually paid or payable shall include all payments made or to be made, also where the payments are to be made as a condition of the sale of the imported goods. The price paid or payable must to be adjusted, when necessary.⁵²

There are several conditions for when the transaction value is applicable as the primary mean of valuation. In connection to transfer pricing, it must be mentioned that the UCC allows the related parties to use the transaction value as the valuation method for customs purposes, as long as the price is not influenced by the relationship of the parties of the transaction.⁵³ The declarant has the burden of proof to demonstrate that the transaction value used between related parties approximates to a value that has been used between unrelated parties or to a value that has been determined by the secondary valuation methods of the UCC.⁵⁴ Thus, the requirement is similar

⁴⁷ UCC DA (n12) article 37(12).

⁴⁸ See chapter 1.1 of the thesis.

⁴⁹ World Trade Organization, 'Technical Information on Customs Valuation', <www.wto.org/english/tratop_e/cusval_e/cusval_info_e.htm> accessed 19 May 2018.

⁵⁰ UCC (n11) article 70(1).

⁵¹ UCC (n11) article 74.

⁵² UCC (n11) article 70(1-2).

⁵³ UCC (n11) article 70(3)(d).

⁵⁴ UCC IA (n13) article 134.

to what is required under the ALP. However, it should be mentioned that although the documentation prepared for transfer pricing purposes aims at illustrating that the trade between associated enterprises has not been affected by the relationship, the different customs authorities within the customs territory of the Union are not required by the UCC to accept the transfer pricing documentation as sufficient evidence for analysing the related party status for customs purposes. The same also applies the other way around.

After it has been determined that the transaction value method can be used as a valuation method for customs purposes, the actual transaction value, i.e., the basis for the customs duty, is built on two building blocks. Firstly, all payments made or to be made, also as a condition of the sale, must be included in the value for customs purposes.⁵⁵ These payments can be verified based on a commercial invoice, contract or another similar document concluded between the parties of the transaction.⁵⁶ Then, several different price elements, which are separately listed in the UCC, shall be included or excluded from the transaction value. The list of the different price elements is to be interpreted strictly, meaning that any other items, other than the ones listed, shall not be included or excluded from the transaction value.⁵⁷ The declared value for customs purposes may be adjusted retroactively only in specific circumstances.⁵⁸ When the ALP is characterised as a highly subjective valuation standard, *Lasiński-Sulecki* notes that the transaction value method for customs valuation purposes can be characterised as a method that is based on the importer's subjective price, i.e., the price based on the commercial documents, which is adjusted by objective price elements in accordance with the UCC.⁵⁹

The transaction value is used as the primary method for customs valuation purposes. It is not public information how often the different customs valuation methods are applied.⁶⁰ Nevertheless, it seems reasonable to conclude that, first, because of the strict hierarchy of the different customs valuation methods, second, the fact that transactions generally have values under civil law, and, third, the *de facto* possibility for adjusting payments based on specific price elements after the importation of the goods, the transaction value method is used in the vast majority of the customs valuation cases.

⁵⁵ UCC IA (n13) article 129(1).

⁵⁶ World Trade Organization (n49).

⁵⁷ UCC (n11) articles 71-72.

⁵⁸ UCC (n11) article 116.

⁵⁹ Krzysztof Lasiński-Sulecki, 'Impact of Transfer Pricing Adjustments for VAT and Customs Law Purposes' [2013] 20(3) *International Transfer Pricing Journal* 173, 177.

⁶⁰ This assumption is made based on the fact that the Finnish customs authorities do not publish this data.

2.2.1.2 The secondary valuation methods

As secondary means of valuation, the UCC lists five different methods which are to be applied in the order they are listed. These methods must be used only in cases where the transaction value cannot be used as a valuation method.⁶¹

The first and second method are based on the *transaction value of identical or similar goods*, which are exported at or about the same time to the customs territory of the Union as the goods, which are being valued.⁶² This implies that the importer must be able to document and demonstrate that a transaction value in another import situation of identical or similar goods is comparable with the present importation. The comparison must be performed, when possible, at the same commercial level and in the same quantities as the goods which are being valued. The deviation from the commercial level or the quantity is permitted, however, adjustments that take into account these differences should be performed.⁶³

The third and fourth method, which can also, as an exemption to the strict hierarchy, be used in a reversed order if requested by the importer, are the unit price method and the computed value method. When using the unit price method, the importation value shall be the same as the unit price of imported goods, identical goods or similar goods which are sold to *non-related parties* within the customs territory of the Union. The computed value method is a pure mathematical method, based on which the importation value is the sum of production related costs, the common profit and general expense made by producers in the country of export and cost or value of the same items as what would be included as an element of the transaction value under the primary valuation method for customs purposes.⁶⁴

In a situation where the customs value cannot be determined in accordance with any of the methods described above, a fall-back method can be used as a final mean of valuation. Based on this method, the value shall be determined on the basis of the information available in the customs union, which is interpreted in accordance with the WTO agreement, the Agreement on Implementation of Article VII of the WTO agreement and the chapter of the UCC which relates to customs valuation.⁶⁵ Thus, the fall-back method ‘closes the circle’ and takes the customs valuation back to square one, i.e. to apply the methods in a more flexible manner and in accordance with the same hierarchy.

⁶¹ UCC (n11) article 74(1).

⁶² UCC (n11) article 74(2)(a-b).

⁶³ UCC IA (n13) article 141.

⁶⁴ UCC (n11) article 74(2)(c-d).

⁶⁵ UCC (n11) article 74(3).

2.3 Comparison between transfer pricing and the EU customs law

2.3.1 Comparison of the general aspects of transfer pricing and the EU customs law

Legally, transfer pricing and the EU customs law are not related to each other. Transfer pricing is based on the OECD Model and the OECD Guidelines, which are globally accepted ‘soft’ sources of law and often used as an interpretative aid by national courts.⁶⁶ In addition to the primary OECD sources, countries may have transfer pricing related clauses in their domestic laws. The ALP can be found, e.g., in the Finnish domestic law, among other transfer pricing related clauses.⁶⁷ In many cases, however, the OECD Model is used as the basis for concluding tax treaties between states. In these situations, the interpretation of the OECD Model generally has legal value.⁶⁸

The customs law, on the other hand, is not a tax but a trade policy measure. It is based on EU level regulations and, in some cases, on the interpretation given by the CJEU. The legal basis for the UCC derives from the TFEU.⁶⁹ Member States of the EU have an obligation to follow the regulations, since they are directly applicable and binding in their entirety.⁷⁰ Therefore, whereas transfer pricing rules may vary between different countries, the customs legislation is the same throughout the EU.

The objective of transfer pricing from a fiscal perspective, is to share the profits and losses of a MNE between states in a way they would have been shared if the associated enterprises had been engaged in business activities as independent enterprises. Consequently, the tax revenues are ‘divided’ as if the associated enterprises were engaged in business as independent enterprises.⁷¹ Moreover, the transfer pricing rules prevent the tax base from eroding and profits being taxed twice.⁷²

The objective of the EU customs law is to ensure that the single market functions properly and that the European trade within the different Member States is treated equally. At the same time the international trade commitments must be complied with. This can only be achieved when the same rules are followed by every customs authority of the Union. The

⁶⁶ Calderón (n30) 26-27.

⁶⁷ Finnish Act on Assessment Procedure, 18.12.1995/1558, article 31.

⁶⁸ Klaus Vogel & Alexander Rust, *Klaus Vogel on Double Taxation Conventions* (4th edn, 2015, Wolters Kluwer Law & Business) 3.

⁶⁹ TFEU (n41) articles 33, 114 & 207.

⁷⁰ Paul Craig & Gráinne de Búrca, *EU Law – Text, Cases and Materials* (6th edn, 2015, Oxford University Press) 107.

⁷¹ Monsenego (n5) 7.

⁷² Jens Wittendorff, ‘The Arm’s-Length Principle and Fair Value: Identical Twins or Just Close Relatives?’ [2011] April 18 Tax Notes International 223, 227.

ultimate goal for the EU customs law is to harmonise the customs rules throughout the customs territory of the Union and to ensure a level playing field for the European trade.⁷³

However, it could be argued that the purpose of transfer pricing and the customs valuation rules is, to some extent, similar: to ensure that the pricing of the cross-border (intercompany) transactions is based on objective international principles, including that prices have not been affected by the relationship of the two parties, i.e. that no artificial or arbitrary pricing or values have been used.⁷⁴

Furthermore, by following *Maisto*, and by taking the argumentation to an extreme level, it can be said that the ultimate motivation of tax authorities and customs authorities is the opposite of each other. The customs authorities' motivation is to collect as much customs duties as possible. This is possible when the value of the imported goods is high.⁷⁵ The tax authorities want to collect as much tax revenues as possible. This is possible when the value of the imported goods is low; the less the taxpayer pays for the (imported) products, the more profits he/she will record in the books, and consequently, the more taxes will be paid.⁷⁶

In this connection it should be mentioned that one significant difference between the two sets of rules arises from the fact that in direct taxation, the tax authorities are ultimately interested in the taxable profits and not in the value of a single product.⁷⁷ The customs authorities, however, have the ultimate goal of determining the value of a single imported product in order to impose the right amount of customs duties, as the customs duties are based on the value, classification and origin of the imported products.⁷⁸ Thus, it could be said that as long as the profits are in line with the ALP, the tax authorities have a limited interest in what is the value of single products. Furthermore, for direct taxation purposes, the taxable event is often triggered with the change of ownership.⁷⁹ In contrast to this, in customs law, it is the moment of physical importation and the time of the release of the

⁷³ See, e.g. European Commission (n8) 2.

⁷⁴ Sunny Kishore Bilaney, 'Suggested Approaches to Harmonization of Transfer Pricing and Customs Rules' [2017] 24(4) *International Transfer Pricing Journal* 268, 268.

⁷⁵ Assuming that there is a customs duty to be levied when importing the product in question.

⁷⁶ Guglielmo Maisto, 'Cross-Border Valuation for Income Tax, Customs Duties and VAT' [2001] 55(3) *Bulletin for International Taxation* 107, 108.

⁷⁷ Hence, the OECD Model article 9 gives the tax authorities the right to adjust the *profits* and not the price of the transactions.

⁷⁸ UCC Title II "Factors on the basis of which import and export duty and other measures in respect of trade in goods are applied".

⁷⁹ Lee Burns & Richard Grever, *Tax Law Design and Drafting – Chapter 16: Taxation of Income from Business and Investment*, (2nd volume, Victor Thuronyi ed., 1998, International Monetary Fund) 48-49.

goods for free circulation when the value of the imported goods has to be determined.⁸⁰

Furthermore, transfer pricing and the ALP applies to all types of transactions taking place between associated enterprises which are located in different jurisdictions. The UCC generally applies only to the international trade of *goods*.⁸¹ Some services⁸² are ‘caught’ by the UCC in relation to determining the price paid or payable for customs valuation purposes.⁸³ The CJEU has interpreted the term ‘goods’ as being “*products which can be valued in money and which are capable, as such, of forming the subject of commercial transactions*”.⁸⁴ Thus, the scope of application of the UCC in relation to the tax object has been legally defined to be very narrow.

Lastly, it must be remembered that in order for the transfer pricing rules to apply, the entities engaging in the transaction must be associated enterprises.⁸⁵ In EU customs law, there is no similar requirement and the scope of application from a tax subject perspective is very wide. In case the parties of a transaction are considered to be related to each other, they must be able to prove that this relationship did not affect the transaction value for customs purposes.⁸⁶ Where the interpretation of the term *associated enterprises* is based on domestic laws due to the lack of a definition in the OECD Model⁸⁷, two parties are deemed related for customs purposes on a very broad and clearly defined basis.⁸⁸ Troublesome is that the requirements between transfer pricing and the EU customs law differ from each other. The evidence illustrating that the relationship did not affect the pricing in EU customs law is most likely not sufficient for transfer pricing purposes. This is because of the fact that the documentation required for transfer pricing purposes, in many countries worldwide, comprises of the comprehensive three-tiered transfer pricing documentation.⁸⁹ Similarly, the customs authorities do not have any obligation to follow the transfer pricing documentation, and in a worst case scenario, the taxpayer has to prepare two

⁸⁰ UCC (n11) article 77.

⁸¹ UCC (n11) article 1(1).

⁸² See, e.g. UCC (n11) article 71(1)(b)(iv): “Engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the Union and necessary for the production of the imported goods”.

⁸³ UCC (n11) articles 71-72.

⁸⁴ Judgment of 10 December 1968, *Commission v Italy*, Case 7/68, EU:C:1968:51, 428.

⁸⁵ OECD (n3) article 9.

⁸⁶ UCC (n11) article 70(3)(d).

⁸⁷ Other than the brief description in the commentary of article 9(1) of the OECD Model, as described in chapter 1.1.

⁸⁸ UCC IA (n13) article 127.

⁸⁹ OECD, ‘BEPS Action 13: Transfer Pricing Documentation and Country-by-Country Reporting, Final Report 2015’, <www.dx.doi.org/10.1787/9789264241480-en> accessed 29 April 2018, 9.

different sets of documentation illustrating that the price or value of the transaction is not arbitrary or fictitious.

Table 1: Summary of the comparison of different general aspects of transfer pricing and the EU customs law.

	Transfer pricing	EU customs law
Legal basis	OECD Model, OECD Guidelines and domestic laws.	EU level regulations, mainly the UCC, as interpreted by the CJEU. Valuation rules of the UCC are based on the WTO agreement.
Purpose	To allocate profits within a MNE the same way as they would be allocated between independent enterprises.	To harmonise the customs rules throughout the customs territory of the Union and to ensure a level playing field for the European trade.
Authorities' motivation	Decrease the value of the goods.	Increase the value of the goods.
Tax/customs duty object	Wide, i.e. the profits of the taxpayer.	Narrow, i.e. the value of the imported goods.
Scope	All cross-border intercompany trade. Includes goods, services, intangibles, and financing.	International trade of goods.
Taxable event	Generally, change of ownership.	Generally, release for free circulation, i.e., importation.
Tax/customs duty subject	Narrow, i.e. only associated enterprises.	Wide, i.e. generally everyone who imports goods from outside of the customs territory of the Union.

2.3.2 Comparison of the general aspects of the transfer pricing methods and the EU customs valuation methods

Prima facie, it seems that there are a lot of similarities between certain transfer pricing methods and the customs valuation methods. However, when looking at the functioning of the different methods, it turns out that the differences outnumber the similarities. Since, e.g. *Maisto* has published a comparative analysis on the similarities and the differences between the specific transfer pricing methods and the customs valuation methods and, since it is not the main purpose of the thesis, only the general level of the similarities and differences of the transfer pricing methods and customs valuation methods will be discussed below.⁹⁰

⁹⁰ See, e.g. *Maisto* (n76) 107.

To start the comparison, the choice of the right customs valuation methods is relatively easy. The UCC clearly states that the transaction value method should always be primarily used for customs valuation purposes.⁹¹ It is only in situations where the transaction value is not applicable according to the criteria set by the UCC, when the secondary methods for illustrating the value for the importation should be considered.⁹² Furthermore, although the basis for determining the transaction value is the price paid or payable in accordance with, e.g., a commercial invoice or contract⁹³, it is clearly stated which price elements need to be included and which should not be included in the customs value.⁹⁴ Once the customs declaration has been filed with the customs authorities, the customs value can be adjusted retroactively only in very limited number cases.⁹⁵

In transfer pricing, the selection of the most appropriate method is based on different factors, most of all, on the functional analysis and the availability of reliable information.⁹⁶ Although the OECD recommends that, when possible, a taxpayer should use the traditional transaction methods over the transactional profit methods and the CUP method over the other traditional transaction methods, there is no strict hierarchy between the different transfer pricing methods.⁹⁷ Also, the transfer price is highly dependent on the comparability analysis performed by the associated enterprises. As an example, if the comparability analysis shows that transportation costs are often borne by the independent manufacturer, then also the associated manufacturer has to bear these costs in accordance with the ALP.

Ultimately, the transfer price is based on a contract between the parties and not on the OECD Guidelines or any other list of includable and excludable items. Furthermore, the operating principle of some methods, especially the transactional profit methods, is based on two stages where the initially invoiced transfer price is often subject to retroactive transfer pricing adjustments, which are performed by the taxpayer voluntarily.⁹⁸ As long as these retroactive price adjustments are performed in accordance with the ALP, there are generally no limitations to them under the OECD Guidelines.

The UCC does not make any distinction between different parts of the customs territory of the Union and thus it considers the customs territory of the Union to be one and the same market area.⁹⁹ For transfer pricing purposes, however, it is required to perform a market analysis when

⁹¹ UCC (n11) article 70(1).

⁹² UCC (n11) article 74.

⁹³ World Trade Organization (n49).

⁹⁴ See, e.g. for transaction value method, UCC (n11) articles 71-72.

⁹⁵ UCC (n11) article 116.

⁹⁶ OECD (n7) para 2.2.

⁹⁷ OECD (n7) paras. 2.3 & 2.8.

⁹⁸ Bilaney (n74) 269.

⁹⁹ See, e.g. UCC (n11) article 74(2).

comparing two transactions with each other. If the market analysis shows that two Member States of the EU are not comparable to each other in terms of their markets, the otherwise comparable uncontrolled transactions may not be used as comparables for transfer pricing valuation purposes.¹⁰⁰

Table 2: Summary of the comparison of different general aspects of the transfer pricing methods and the EU customs valuation methods.

	Transfer pricing	EU customs law
Strict hierarchy of methods?	No.	Yes.
Value has to be determined based on:	Contract between associated enterprises.	The UCC and commercial documents relating to the imported goods.
Retroactive price adjustments permitted?	Generally, yes.	Generally, no.
Geographical requirements for application?	Yes, i.e., the EU is not considered to be one tax territory.	No, i.e., the EU is considered to be one customs territory.

2.3.3 Conclusion based on the comparison

Based on the brief comparison above, it can be concluded that there are some similarities between the different aspects of transfer pricing and the EU customs law. However, it is clear that the amount of differences is far greater than the amount of similarities. The main reason for the differences derives from the fact that the purpose and scope of transfer pricing and the EU customs law are different. Although in terms of transfer pricing and customs valuation the purpose seems to be similar, using the saying ‘comparing apples and oranges’, seems reasonable in this context.

There is, however, one similarity that can be considered significant enough to link these topics together when interpreting the two sets of rules. This is the fact that the transaction value must be used as the primary method when performing valuation for customs purposes and there will always be a value for the transactions between associated enterprises due to the ALP.

Transfer pricing is often based on budgets and forecasts which are prepared at the beginning of the year. However, the actual activities may differ from what was planned, which often gives rise to a retroactive transfer price adjustment performed voluntarily by the taxpayer. If the cross-border

¹⁰⁰ OECD (n7) paras. 1.110-1.113.

intercompany transactions took place between an EU resident company and a non-EU resident company of the same MNE, and, the transaction value was used for customs valuation purposes, also the customs declaration should be amended to match the customs value with the transfer pricing value. The problem is that the UCC does not automatically allow an adjustment to be performed to the customs value based on an adjustment made to the transfer price. As a consequence, the final, i.e. the adjusted, transfer price paid and the transaction value, which was declared to the customs authorities for customs valuation purposes, differ from each other. This was the core issue in the *Hamamatsu case*, which will be analysed in the next chapter.

As a preliminary note, it must be mentioned that the *Hamamatsu case* concerns the previous version of the applicable EU customs law, namely the CCC. However, as the valuation rules have, for the significant parts regarding the legal problem of the *Hamamatsu case*, remained the same after the introduction of the UCC, references to the UCC are also made. The reason for the customs valuation rules to remain the same is that they are derived directly from the Agreement on Implementation of Article VII the WTO agreement, which has been in force since 1 January 1995.

3. C-529/16 Hamamatsu Photonics Deutschland GmbH

3.1 Summary of the Hamamatsu case

3.1.1 Facts and background

Hamamatsu Photonics Deutschland GmbH (*“Hamamatsu Germany”*) is a German company which belongs to the global Hamamatsu Group (*“the Group”*). Hamamatsu Germany’s parent company, Hamamatsu Photonics, (*“Hamamatsu Japan”*) is established in Japan. Hamamatsu Germany is a distributor of optoelectronic devices, systems, and accessories, which it purchases from Hamamatsu Japan. The intercompany charges for those goods were in accordance with an advance pricing agreement (*“APA”*)¹⁰¹, which the Group had concluded with the German tax authorities. In the case at hand, the PSM method with a residual analysis approach was chosen as the most appropriate transfer pricing method. The first stage of using the residual profit split method was that Hamamatsu Germany was ensured to earn a minimum rate of return for its distribution activities. If Hamamatsu Germany did not earn an operating margin that was in compliance with the arm’s length operating margin range agreed upon in the APA, Hamamatsu Germany’s profits were retroactively adjusted upwards or downwards by a voluntary lump-sum transfer pricing adjustment so that the operating margin was within the arm’s length range.¹⁰²

Between 7 October 2009 and 30 September 2010, Hamamatsu Germany imported consignments from Hamamatsu Japan for distribution purposes. The operating margin of Hamamatsu Germany from distributing those goods fell below the arm’s length operating margin range and Hamamatsu Japan agreed to adjust the profits, i.e. lower the price of the products, in accordance with the concluded APA. Consequently, Hamamatsu Germany applied for a repayment of the customs duties, since the transaction value, i.e. the price Hamamatsu Germany had paid for the imported products, had decreased retroactively as a result of the voluntary transfer pricing adjustment. The Principal Customs Office rejected Hamamatsu Germany’s

¹⁰¹ Zahra Mulachella, ‘Improving the Effectiveness of the International Advance Pricing Agreement Process’ [2018] 25(2) International Transfer Pricing Journal 68, 69: APA is a contract between the tax authority and the taxpayer in which the parties agree before the cross-border intercompany transactions take place how the profits arising from these transactions will be taxed. APAs, which can be unilateral, bilateral or multilateral, usually define, e.g. the transfer pricing method to be used and the pricing of the transactions so that the counterparties have legal certainty on what will be the tax consequence of the transactions in question. In other words, the goal of APA is to minimise the need for lengthy transfer pricing disputes.

¹⁰² *Hamamatsu case* (n17) paras. 13-15.

application on the ground that the applicable EU customs law (“CCC”)¹⁰³ refers to the transaction value of individual goods and not of mixed consignments. However, the referring court considered that the final transfer price, i.e. the adjusted transfer price, established in accordance with the ALP, reflects the economic value of the imported goods and should be declared as the price payable for the imported goods in question. Consequently, the initially declared value should be considered as constituting a fictitious value of the imported goods. In addition, there is no need to consider the provisional pricing under the APA since the final transfer price is directly available.¹⁰⁴

Based on this background, two questions were referred to the CJEU for a preliminary ruling by the Finanzgericht München:

- *“Do the provisions of Article 28 et seq. of [the Customs Code] (author: Articles 28 et seq. means Articles 28-31 of the CCC, which are the same as Articles 70-74 of the UCC) permit an agreed transfer price, which is 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, using an allocation key, regardless of whether a subsequent debit charge or credit is made to the declarant at the end of the accounting period?”*
- *If so: may the customs value be reviewed and/or determined using simplified approaches where the effects of subsequent transfer pricing adjustments (both upward and downward) can be recognised?”*¹⁰⁵

3.1.2 CJEU’s decision

The CJEU began its decision by pointing that the objective of the EU customs valuation law is to introduce “*a fair, uniform and neutral system excluding the use of arbitrary or fictitious customs values*”. By referring to various cases¹⁰⁶ and in accordance with the WTO agreement, the CJEU reminded that it is the real economic value of an imported good against which the customs value must be reflected. Additionally, all elements which can be considered to have economic value should be taken into account. By

¹⁰³ Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code [1992] OJ L302/1. Amended with Regulation (EC) No 82/97 of the European Parliament and of the Council of 19 December 1996 amending Regulation (EEC) No 2913/92 establishing a Community Customs Code [1997] OJ L 17/1.

¹⁰⁴ *Hamamatsu case* (n17) paras. 16-19 & 21.

¹⁰⁵ *Hamamatsu case* (n17) para 22.

¹⁰⁶ Judgments of 16 November 2006, *Compaq Computer International Corporation*, C-306/04, EU:C:2006:716, para 30; of 16 June 2016, *EURO 2004. Hungary*, C-291/15, EU:C:2016:455, paras. 23 & 26; and of 9 March 2017, *GE Healthcare*, C-173/15, EU:C:2017:195, para 30.

referring to numerous cases¹⁰⁷, the CJEU reminded that the main valuation method for customs purposes is the transaction value method. When valuing the goods for customs purposes, the transaction value is to be adjusted only with the items that are listed in the CCC. The secondary methods can be used only if it is not possible to determine the price paid or payable for the goods which have been sold for export^{108, 109}.

The CJEU also held, by referring to its previous case law¹¹⁰, that if the customs value turns out to be arbitrary or fictitious when it is based on the price paid or payable for the goods, i.e., the transaction value method, then the price must be adjusted, i.e., the secondary valuation methods should be used, in order to avoid arriving at an outcome that goes against the objective of the EU customs valuation law. The transaction value must always reflect the real economic value of the imported goods. All factors that have economic value are to be included in the transaction value^{111, 112}.

The Court acknowledged that it is possible, under the applicable EU customs law, to amend the customs declaration, either unilaterally by the customs authorities or on request by the declarant. However, this has been allowed only in very specific situations, e.g., where the quality of the products released for free circulation have been found defective. As an example, in *Mitsui & Co. Deutschland*¹¹³, a transaction value adjustment could take place since the goods were damaged after they were bought but before they were released for free circulation. This was due to the fact that the commercial value of the goods was unforeseeably reduced due to the suffered damages. Lastly, the Court noted that, under the applicable EU customs law, importers are not legally obliged to apply for increases in their customs value if the transaction value is retroactively adjusted upwards, and on the other hand, the customs authorities do not have any safeguard against

¹⁰⁷ Judgments of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, para 38, and of 16 June 2016, *EURO 2004. Hungary*, C-291/15, EU:C:2016:455, para 24.

¹⁰⁸ Judgments of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, paras. 38, 41-42 & 44, and of 16 June 2016, *EURO 2004. Hungary*, C-291/15, EU:C:2016:455, paras. 24 & 27-30.

¹⁰⁹ *Hamamatsu case* (n17) paras. 24-26.

¹¹⁰ Judgments of 12 June 1986, *Repenning*, 183/85, EU:C:1986:247, para 16; of 19 March 2009, *Mitsui & Co. Deutschland*, C-256/07, EU:C:2009:167, para 24; of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, para 39; and of 16 June 2016, *EURO 2004. Hungary*, C-291/15, EU:C:2016:455, para 25.

¹¹¹ Judgments of 12 December 2013, *Christodoulou and Others*, C-116/12, EU:C:2013:825, para 40, and of 16 June 2016, *EURO 2004. Hungary*, C-291/15, EU:C:2016:455, para 26.

¹¹² *Hamamatsu case* (n17) paras. 27-28.

¹¹³ Judgment of 19 March 2009, *Mitsui & Co. Deutschland*, C-256/07, EU:C:2009:167, paras. 25-26 & the case-law cited.

the risk that importers will only apply for decreases in the customs value reported in the customs declaration.¹¹⁴

Based on these arguments, the Court held that once the initially invoiced transaction value has been declared to the customs authorities, it cannot be adjusted in case a retroactive flat-rate adjustment for transfer pricing purposes takes place when it is not possible to know at the time of the importation whether the adjustment is made upwards or downwards. In other words, such an adjustment relates to other price elements or payments than those mentioned in the WTO agreement and the EU customs law. As the answer to the first question was in the negative, there was no need to answer to the second question.¹¹⁵

3.2 Analysis of the Hamamatsu case

3.2.1 The price actually paid or payable shall include all payments made or to be made as a condition of sale of the imported goods

*“The price actually paid or payable shall be the total payment made or to be made [...] and includes all payments made or to be made as a condition of sale of the imported goods”.*¹¹⁶

The price paid or payable shall include all payments made or to be made as *a condition of sale* for export of the imported goods. The Hamamatsu Group had concluded an APA with the German tax authorities (supposedly) before Hamamatsu Germany imported the goods in 2009 and 2010.¹¹⁷ In this APA, Hamamatsu Germany had agreed on which transfer pricing method it will use. As a consequence of using the residual profit split method, when acting as a distributor in Germany, there was a possibility that the purchase prices are subject to retroactive price adjustments depending on Hamamatsu Germany’s operating margin level at the end of the fiscal year and after receiving the minimum rate of return after the first step of the method. Thus, *prima facie*, and by arguing that there is a condition of sale for export to the customs territory of the Union because of the APA, the retroactive price adjustment should be taken into consideration, when following the exact wording of the abovementioned article.

However, the question presented to the CJEU states that *“an agreed transfer price [...] is composed of an amount initially invoiced and **declared** and a flat-rate adjustment made after the end of the accounting period”*.¹¹⁸

In other words, Hamamatsu Germany had used a standard customs declaration where it had stated that the initially invoiced amount is the

¹¹⁴ *Hamamatsu case* (n17) paras. 30-33.

¹¹⁵ *Hamamatsu case* (n17) paras. 34-36.

¹¹⁶ CCC (n103) article 29(3)(a) / UCC (n11) article 70(2).

¹¹⁷ *Hamamatsu case* (n17) para 14.

¹¹⁸ *Hamamatsu case* (n17) para 22.

transaction value for customs purposes and consequently declared it as the price actually paid for the imported goods in connection to its importation.¹¹⁹ Consequently, the CJEU held that it is possible that the finished declaration can be amended. However, this has been allowed in very limited cases, such as, in relation to quality defects.¹²⁰

Therefore, it can be said that the CJEU decided the case exactly in line with its previous case law by strictly interpreting the applicable EU customs law. The application to adjust retroactively the already declared customs value of imported goods did not relate to, first, *a condition of sale* for the export to the customs territory of the Union¹²¹, second, the different *price elements* of the transaction value method¹²² or, third, the *condition of the goods* at the time of importation¹²³. The application to adjust the already declared customs value related merely to *after import circumstances* which were not in line with the UCC, but only with the ALP.

3.2.2 The PSM method's compatibility with the transaction value method for customs purposes

As described above, strictly from the EU customs law perspective, the Court's decision in the *Hamamatsu case* is clear. The applicable EU customs law does not allow customs value adjustments to be made to the declared customs value as a consequence of a retroactive transfer pricing adjustment, when it is unknown at the time of the importation whether such adjustments are made upwards or downwards.

However, to put the problem of the *Hamamatsu case* into the transfer pricing world, the facts of the case ultimately forced the Finanzgericht München to ask whether the applicable EU customs law permits the use of transaction value as a customs valuation method where the transaction value is based on the PSM method for transfer pricing purposes. First, it is important to understand how the method applied in the *Hamamatsu case*, i.e. the residual PSM method, works.

As described earlier¹²⁴, the PSM method is a two-sided transfer pricing method, as it analyses the profit level earned by both parties of the transaction.¹²⁵ The Hamamatsu Group had chosen the residual analysis as their approach when using the PSM method.¹²⁶ The way the residual analysis approach works is that in the first stage, the participants¹²⁷ received

¹¹⁹ CCC (n103) article 62 / UCC (n11) article 162.

¹²⁰ *Hamamatsu case* (n17) paras. 29-30.

¹²¹ UCC (n11) article 70(1-2).

¹²² UCC (n11) articles 71-72.

¹²³ UCC (n11) article 116.

¹²⁴ See chapter 2.1.1 of the thesis.

¹²⁵ OECD (n7) para 2.4.

¹²⁶ *Hamamatsu case* (n17) para 15.

¹²⁷ Both Hamamatsu Germany and Hamamatsu Japan.

a minimum rate of return. If the minimum rate of return was not enough to result in the targeted operating margin,¹²⁸ a lump-sum adjustment was performed retroactively. This is also how the OECD recommends the residual PSM method to be used.¹²⁹

There is one significant problem with the residual PSM method from the customs valuation perspective. For customs valuation purposes, it is required that the value of a *single imported product* is known.¹³⁰ For direct taxation and transfer pricing purposes, the taxpayer has to illustrate that the *profit of the fiscal year*, and not the price of a single product, is at arm's length.¹³¹ When a taxpayer performs a retroactive *lump-sum* price adjustment for transfer pricing purposes, the value of a single product becomes unknown. Although the lump-sum adjustment is in compliance with the ALP, it is not in compliance with the transaction value method for customs purposes. The initially invoiced and declared amount for customs purposes cannot generally be adjusted retroactively after a lump-sum transfer pricing adjustment, amount of which is unknown at the time of importation, because the EU customs law does not permit it.¹³²

Based on the Court's judgment, it can be concluded that since the retroactive transfer price adjustments are a 'standard practice' when using the PSM method, the PSM method is not compatible with the transaction value method for customs valuation purposes.

3.2.3 Which set of rules comes first?

Since the PSM method is not compatible with the transaction value method for customs valuation purposes, a question whether the EU customs law should be followed over the transfer pricing rules rises. In other words, should the strict hierarchy of different customs valuation methods be followed over the most appropriate method principle as laid down in the OECD Guidelines? After all, the OECD Guidelines are considered to set out important international standards, which, although they lack binding legal value, are still often referred to by the domestic courts.¹³³ Then again, the UCC is an EU level regulation, which has to be strictly followed by the Member States.¹³⁴ Ultimately the two sets of rules concern two different fields of law and hardly seem to have a link between each other.¹³⁵

¹²⁸ This time the 'least complex party' is the Hamamatsu Germany, just as if the TNMM method was used.

¹²⁹ OECD (n7) para 2.127.

¹³⁰ UCC (n11) Article 70.

¹³¹ Monsenego (n5) 7.

¹³² *Hamamatsu case* (n17) para 30. The 'defective goods' argument used by the Court has legal basis in article 238 of the CCC/article 116 of the UCC.

¹³³ Calderón (n30) 26-27.

¹³⁴ Craig & de Búrca (n70) 107.

¹³⁵ See chapter 2.3.6 of the thesis.

In the *Hamamatsu case*, it is stated that Hamamatsu Germany was engaged in business in accordance with the ALP and that the chosen method was in line with the OECD Guidelines.¹³⁶ According to the Court's strict interpretation of the applicable EU customs law, although Hamamatsu Germany was in compliance with the transfer pricing rules and standards, it was not enough to permit an adjustment to be performed to the initially declared transaction value for customs purposes due to the fact that the amount of retroactive adjustment was not known at the time of the importation, and a certain value had already been declared to the customs authorities.¹³⁷ Therefore, the Court gives precedence to the EU customs law valuation rules over the ALP. This argument is also supported by the fact that the CJEU has never referred to the OECD Guidelines as a source of law due to its lack of legal value.¹³⁸

3.2.4 How about the other transfer pricing methods?

Although the Court's judgment is not primarily about transfer pricing methods, it is possible that the CJEU would have chosen a different approach for its judgment if a traditional transaction method had been used. This is because the fundamental idea behind these methods is different than with the profit-based methods.

All of the traditional transaction methods are, more or less directly, connected to the price of single products, whereas under the PSM and the TNMM methods, the targeted element is the profit level of the entity. Consequently, since the operating principle¹³⁹ of the TNMM method is generally the same as with the PSM method, it can be concluded that also the TNMM method is non-compatible with the transaction value method for customs valuation purposes.

However, the criteria of knowing the price paid or to be paid in relation to the transaction value should generally be fulfilled when using the traditional transaction methods. For example, in relation to the CUP method, there is, in some cases, an option to use prices which are derived directly from global and public databases, in real time, and thus no retroactive transfer pricing adjustments should be needed. This is the case for, e.g., commodities.¹⁴⁰ Therefore, the transfer price is always automatically the final price. Consequently, it should generally be accepted by the customs authorities,

¹³⁶ *Hamamatsu case* (n17) paras. 14-15, 21.

¹³⁷ *Hamamatsu case* (n17) para 35.

¹³⁸ For the case law of the CJEU regarding the arm's length principle, see, e.g. judgments of 13 March 2008, *Test Claimants in the Thin Cap Group Litigation*, C-524/04, EU:C:2007:161; and of 21 January 2010, *Société de Gestion Industrielle (SGI)*, C-311/08, EU:C:2010:26.

¹³⁹ I.e. first the products are sold with a certain price which is often subject to retroactive transfer pricing adjustment.

¹⁴⁰ OECD (n7) para 2.18.

without adjustments, as the price paid for the traded goods when sold for export to the customs territory of the Union.

Moreover, also with the other traditional transaction methods, Hamamatsu Germany would, potentially¹⁴¹, have been able to present an allocation of the retroactive adjustment amount on an individual imported goods level.¹⁴² A consequence of allocating the retroactive adjustment on the imported goods level would be that the transaction value, also after the transfer pricing adjustment takes place, reflects the real economic value of the imported goods, as it has been required by the Court in many cases.¹⁴³ If these requirements would have been filled, the *Hamamatsu case* would have been more complicated to decide and required a deeper analysis of the facts. It is possible that ultimately the question would have come down to weighing whether:

- The retroactive adjustment to the already declared customs value should be denied, because it has not been allowed by the Court in other cases except for the ones listed in the applicable EU customs law and the case law of the CJEU; or
- The retroactive adjustment to the customs value should be allowed, because of a fundamental criterion, i.e., the price actually paid or payable for imported goods, is generally known.

In other words, the question would have come down to choosing between a strict literal interpretation (as in the *Hamamatsu case*) and a purposive interpretation.

In case a more direct transfer pricing method, i.e., a method that is more compliant from the EU customs law perspective, would have been used, the purposive interpretation could have been supported by two arguments. First, when not allowing the retroactive transfer price adjustments to be taken into consideration for customs valuation purposes, the current state of the customs valuation rules jeopardises the level playing field of the European trade for entities engaged in business as associated enterprises. This is further validated by the fact that most of the world trade, and, as a consequence, a large proportion of the trade conducted between EU resident companies and non-EU resident companies takes place within the same MNE. Consequently, this large proportion is also affected by the current state of the customs valuation rules. Secondly, one could argue that it is unlikely that the purpose of the customs valuation rules of the WTO agreement, and, thus, the UCC, is to require the MNE importers, on the one

¹⁴¹ Potentially, because 'tracing' the retroactive price adjustment to a single product level would have required that Hamamatsu Germany had an advanced financial reporting system implemented.

¹⁴² *Hamamatsu case* (n17) para 18.

¹⁴³ *Hamamatsu case* (n17) para 28.

hand, to perform valuations for the same goods multiple times, and, on the other hand, to demonstrate for the different authorities that the price of the same imported products is in compliance with the respective requirements.

Based on the *Hamamatsu case*, the judgment would be the former option. However, the transfer pricing method chosen by Hamamatsu Germany is so fundamentally flawed from an EU customs law perspective that it is impossible to say, based on the current judgment, what the Court's decision would be if, e.g., the CUP method had been used and the price, for some reason, would have been subject to a retroactive price adjustment on a single product level.

3.3 Some EU Member States' national courts' solution to the problem

The *Hamamatsu case* was not the first time the link between transfer pricing and customs valuation has been questioned in national courts of different EU Member States. It was, however, the first time the question ended up in the CJEU.

First, the referring court in the *Hamamatsu case*, the German Finanzgericht München (Finance Court Munich), was of the opinion that it is the final transfer price, i.e. the adjusted transfer price, that should be accepted as the basis for the customs valuation and the price declared at the moment of importation should be deemed to be fictitious and not reflect the real economic value of the imported goods.¹⁴⁴ The Finanzgericht München's interpretation of the applicable EU customs law would, thus, have been the opposite from what the CJEU decided. Based on the Finanzgericht München's interpretation, a link between transfer pricing and EU customs law would have been established.

Next, a case in which the link between transfer pricing and customs valuation is questioned has been decided in Finland¹⁴⁵ by the Helsinki Administrative Court ("*HAC*") in 2007. In the Finnish case, A (former B Oy) purchased cars from its parent company C for resale purposes to third party distributors in Finland. The transfer pricing of the cars has been agreed upon in a transfer price agreement which has been valid since 1 January 2004. However, B Oy had not notified the customs authorities about the fact that the declared value might be subject to retroactive price adjustments in the future. When the retroactive transfer pricing adjustments were carried out downwards in accordance with the transfer price agreement, B Oy applied for a repayment of import duties. Consequently, the customs

¹⁴⁴ *Hamamatsu case* (n17) para 21.

¹⁴⁵ Finland is a member of the WTO agreement. See World Trade Organization, 'Finland and the WTO', <www.wto.org/english/thewto_e/countries_e/finland_e.htm> accessed 20 April 2018.

authorities rejected B Oy's application for the repayment of the customs duties, because, according to the information provided by B Oy, the initially declared transfer price was to be considered as the price actually paid for the cars. However, the HAC was of the opposite opinion. According to the HAC, when the importation took place, the final transfer price was unknown despite of the fact that the customs authorities thought that the initially declared transfer price was the final price. Consequently, the initially declared value was not the true economic value of the imported cars. When determining the customs value, the HAC considered that it is important to apply the applicable EU customs law articles based on the price actually paid for the imported goods instead of focusing on the price that was paid at the moment of importation. Therefore, the Helsinki Administrative Court decided that the retroactive downward transfer pricing adjustment must be taken into consideration when determining the customs value and the B Oy's repayment application should have been accepted, or, alternatively, the customs value should have been adjusted by the customs authorities.¹⁴⁶ What is notable is that the HAC decided the case by referring to the same article as the one that the CJEU acknowledged, but rejected as a legal ground for an adjustment in the *Hamamatsu case*.¹⁴⁷ Consequently, the decision by the HAC is the opposite to what the CJEU decided in the *Hamamatsu case*, where a link between transfer pricing and the EU customs law was established.

Although the legal bases and objectives of the two sets of rules do not coincide when interpreted independently, the Spanish¹⁴⁸ Tribunal Supremo (Supreme Court) has taken a pragmatic approach when interpreting the two sets of rules in relation to the same goods under valuation by the two different authorities. This case was about a situation where the customs authorities had initially, during importation, determined the value of certain goods according to the information provided by the importer. Later on, the direct tax auditors performed their own valuation for the same goods and determined that the value should be more than what the customs authorities had determined. The Tribunal Supremo decided that having two different values for the same goods is not possible since both, the direct tax rules and the customs valuation rules are based on the same principle, namely, the ALP. Therefore, both authorities should use the same valuation parameters and end up with the same value.¹⁴⁹ Consequently, the profit adjustment performed by the direct tax auditors was in breach of the constitutional

¹⁴⁶ Helsinki Administrative Court (Helsingin hallinto-oikeus) case 07/0285/1, dated 15 March 2007.

¹⁴⁷ *Hamamatsu case* (n17) para 29.

¹⁴⁸ Spain is a member of the WTO agreement. See World Trade Organization, 'Spain and the WTO', <www.wto.org/english/thewto_e/countries_e/spain_e.htm> accessed 20 April 2018.

¹⁴⁹ However, this approach is not in accordance with the WTO agreement and the EU customs law.

principle of legal certainty and the direct tax auditors had no other choice than to follow the values set by the customs authorities. Thus, as a consequence of the case, a direct link between transfer pricing value and customs value was established in Spain.¹⁵⁰ Also the Tribunal Supremo's decision is contrary to the decision of the CJEU in the *Hamamatsu case*.

Based on the above cases, it is clear that national courts have been willing to establish a link between transfer pricing and customs valuation.

3.4 Conclusion on the Hamamatsu case

The *Hamamatsu case* has been decided precisely the way it should be decided based on the applicable EU customs law. As it stands, there is no possibility to adjust the already declared transaction value, if this adjustment does not relate to a condition of sale for the export to the customs territory of the Union, the different price elements of the transaction value method, or, the condition of the goods at the time of importation.

Moreover, and as *Robetta, Beretta, and Smiatacz* submit, the decision and the current interpretation of the applicable EU customs law is balanced since, although not giving the importer the right to adjust the customs value retroactively, neither does it grant the customs authorities the right to require that the customs value should be adjusted upwards in cases where the price paid or payable is retroactively adjusted upwards.¹⁵¹

As it is clear, despite of the fact that Hamamatsu Germany's activities are in accordance with the ALP, the CJEU does not consider this fact and gives precedence to the wording of the EU customs law. However, the taxpayers seldomly make decisions solely based on a single CJEU case, especially when using the not-most appropriate transfer pricing method might give rise to scrutiny by the tax authorities. Moreover, the consequences of transfer pricing adjustment performed by tax authorities based on the OECD Model, might be more severe than not being able to have the customs duties repaid. What should also be remembered is that in order to apply the EU customs valuation rules, a cross-border (intercompany) transaction has to occur in the first place. Thus, from the taxpayer perspective, it could be said that there is a natural tendency and a higher interest to apply the transfer pricing rules over the EU customs law.

¹⁵⁰ Tribunal Supremo (the Spanish Supreme Court) case 3582/2003, dated 30 November 2009. English summary available at: <www.online.ibfd.org/kbase/#topic=doc&url=/collections/ttcls/html/cl_es_2009-11-30_1-summary.html&q=%22%203582/2003%22&WT.z_nav=outline&hash=cl_es_2009_11_30_1_ttcls> accessed 28 April 2018.

¹⁵¹ David Rovetta, Laura Carola Beretta & Agnieszka Smiatacz, 'The Court of Justice of the European Union Judgment in the Hamamatsu Case: Defending EU Customs Valuation Law from the 'Transfer Pricing Folly' in Customs Matters' [2018] 13(5) Global Trade and Customs Journal 187, 190.

Moreover, since the same customs valuation rules have been applicable since 1 January 1995, one could even argue that the customs valuation rules could use an update, at least from the transfer pricing perspective. This is due to the generally known fact that transfer pricing has taken a huge leap forward since 1995 and the practices used in transfer pricing have changed during the last 20 years.

In relation to the ‘usefulness’ of the *Hamamatsu case* for the taxpayers and importers, it has to be said that the *Hamamatsu case* did not give a solution to the described problem; it merely confirmed that the current link between transfer pricing and EU customs law is very thin, at least in terms of the profit-based transfer pricing methods. A key issue rises with the fact that a major part of the world trade takes place between associated enterprises¹⁵² and that the TNMM method and, thus, retroactive transfer pricing adjustments are currently the best practice¹⁵³. Consequently, the current wording of the customs valuation rules in relation to retroactive transfer pricing adjustments clearly causes increased risks for the taxpayers and importers, either from transfer pricing or the EU customs law perspective, depending on which set of rules the taxpayer decides to follow primarily.

In order to tackle the current problem with the mismatch of the best practice and strict theory, the next chapter introduces several possible solutions which could be considered in order to establish a solid link between transfer pricing and EU customs law and to mitigate the risks arising from the differences between the two different sets of rules.

¹⁵² OECD (n2) 8.

¹⁵³ Joel Cooper & Rachit Agarwal, ‘The Transactional Profit Methods in Practice: A Survey of APA Reports’ [2011] 18(1) *International Transfer Pricing Journal* 8, 13.

4. Potential solutions for strengthening the link between transfer pricing and EU customs valuation

4.1 Amending the UCC so that the adjusted transfer price is the real economic value of the imported goods

The first, and very obvious, potential solution would be to amend the UCC so that the final transfer price, i.e. the adjusted transfer price, would be considered to be the real economic value of the imported goods. This amendment could be done to, e.g., article 116, which currently includes the legal basis for the ‘defect goods’ argument used by the CJEU. This solution is also supported by the judgments given by the Finanzgericht München in the *Hamamatsu case* as well as by the HAC in Finland.¹⁵⁴ However, due to the nature of customs valuation, i.e., the requirement that the value of a single product must be known for customs valuation purposes, ultimately this option goes against the other provisions of the UCC and, more importantly, the WTO agreement. Consequently, it is not the most feasible option.

4.2 Introducing an EU level guidance

In the *Hamamatsu case*, the Hamamatsu Group had entered into an APA with the German Tax Authorities.¹⁵⁵ The CJEU did not consider this fact in any way in its judgment and the reason is obvious; generally, and supposedly also in the *Hamamatsu case*¹⁵⁶, the APA only includes the taxpayer and the tax authorities, but not the customs authorities of the applicable country.¹⁵⁷ This, of course, does not mean that the APA could not include a description of the facts and circumstances which can be used in relation to customs matters; it just is not automatically accepted by the customs authorities.

Therefore, a practical solution to establish a link between transfer pricing and the EU customs law would be that, e.g., the European Commission would present an EU level guidance for the customs authorities in relation to whether or not the customs authorities may accept transfer pricing related documents, such as, APAs or transfer pricing documentations, as the basis for determining the transaction value. There has been some discussion on

¹⁵⁴ See chapter 3.3 of the thesis.

¹⁵⁵ *Hamamatsu case* (n17) para 14.

¹⁵⁶ The German customs authorities are not bound by an APA. See Deloitte, ‘The Link Between Transfer Pricing and Customs Valuation – 2018 Country Guide’ <www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-the-link-between-transfer-pricing-customs-valuation-country-guide.pdf> accessed 20 April 2018, 22.

¹⁵⁷ Mulachella (n101) 69.

the European Commission level, however, nothing has been decided in this relation yet.¹⁵⁸ Involving customs authorities more to the transfer pricing related documents has also been suggested by different international organisations.¹⁵⁹ However, the problem is that these suggestions from international organisations completely lack legal value and it is up to the domestic authorities to adopt and follow the suggestions. Therefore, this material could be used only as a basis for determining the link between the two sets of rules on a European level.

Some customs authorities have published guidelines in relation to transfer pricing from a customs valuation perspective. For example, the Canada¹⁶⁰ Border Services Agency has published a public memorandum in which it confirms that in order for the transfer price to remain uninfluenced by the relationship between the parties of the transaction from the customs authorities' perspective, a correction to the declared value must be submitted, despite of whether the retroactive adjustment is made upwards or downwards. In other words, in the case that a retroactive transfer pricing adjustment is performed and this adjustment has not been declared to the customs authorities, the customs authorities will consider that the relationship has affected the transaction value and consequently, will not accept it as the basis for a customs valuation. However, in Canada, a decrease in the declared transaction value is precluded under the domestic law when a price reduction takes place after importation, unless there has been a written agreement in place between the parties of the transaction before the transaction took place.¹⁶¹

Although the memorandums published in Canada are not law, they provide certainty for the customs authorities as well as the importer on how the customs authorities will treat certain issues, such as the one presented above, under the applicable law.

¹⁵⁸ European Commission, 'Implementing Decision concerning the adoption of annual work programmes 2016 for the Customs 2020 and Fiscalis 2020 programmes and a financing decision for expenditure to be committed by DG Taxud from the 2016 budget lines 140201 and 140301 – Annex 1' COM (2016) 815 final, 34-35.

¹⁵⁹ See, e.g. World Customs Organization, 'WCO Guide to Customs Valuation and Transfer Pricing', <www.wcoomd.org/~media/wco/public/global/pdf/topics/key-issues/revenue-package/15_-_wco-guide-to-customs-valuation-and-transfer-pricing_-_final_en.pdf?db=web> accessed 20 April 2018, 54; and International Chamber of Commerce, 'Transfer Pricing and Customs Valuation 2015 – Policy Statement' <www.icc.nl/docman-standpunten/docman-commissies/docman-commissies-douanezaken/67-icc-transfer-pricing-and-customs-valuation/file> accessed 20 April 2018, 6.

¹⁶⁰ Canada is a member of the WTO agreement. See World Trade Organization, 'Canada and the WTO', <www.wto.org/english/thewto_e/countries_e/canada_e.htm> accessed 20 April 2018.

¹⁶¹ Canada Border Services Agency, 'Memorandum D13-4-5 – Transaction Value Method for Related Persons' <www.cbsa-asfc.gc.ca/publications/dm-md/d13/d13-4-5-eng.html> accessed 20 April 2018, paras. 20-22, 24-25 & 27.

4.3 Extending the deadline to provide a supplementary declaration

Currently, the UCC allows the importer to place the goods under a customs procedure under a simplified customs declaration in which certain items of the standard customs declaration can be omitted.¹⁶² In other words, this means that, if the customs authorities allow it, goods could be brought to the customs territory of the Union without knowing their final value. However, after the goods have been released into free circulation, the importer has ten days¹⁶³ to supplement the simplified customs declaration and to present the customs authorities with the value of the imported goods.¹⁶⁴

As it reads now, the simplified customs declaration is clearly of no use in order to establish a link between transfer pricing and the EU customs law. This is due to the fact that the transfer price adjustments generally take place at the end of the fiscal year and not within ten days from releasing the goods for free circulation. This problem could be solved by adopting a similar legislation as is in place in the U.S.¹⁶⁵ The U.S. has adopted a so-called ‘Reconciliation System’ under which it is possible for the importer to import the goods and file an entry summary, i.e. a customs declaration, based on the best available information. Thus, it is not required under this system for the importer to know, e.g., what the final price of the goods is. Later, after the final price of the goods is known, the importer must file a ‘reconciliation entry’ in which the final price of the goods is declared. The ‘reconciliation entry’ has to be filed within 21 months from the date of the first entry summary.¹⁶⁶

Furthermore, the U.S. Customs and Border Protection applies a ‘five factors test’ to determine whether retroactive transfer pricing adjustments can be taken into consideration when calculating the final customs value under transaction value method.¹⁶⁷ The factors applied by the U.S. Customs and Border Protection are:

- Before the importation takes place, the taxpayer has prepared a written intercompany transfer pricing policy, such as, an APA;

¹⁶² UCC (n11) article 166.

¹⁶³ 30 days under the CCC, see Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Regulation No 2913/92 [1993] OJ L253/1. Amended with Commission Regulation (EC) No 881/2003 of 21 May 2003 [2003] OJ L134/1, article 256.

¹⁶⁴ UCC DA (n12) article 146.

¹⁶⁵ United States of America is a member of the WTO agreement. See World Trade Organization, ‘United States of America and the WTO’, <www.wto.org/english/thewto_e/countries_e/usa_e.htm> accessed 20 April 2018.

¹⁶⁶ U.S. Customs and Border Protection ruling HQ W548314, dated 16 May 2012. Available at: <www.rulings.cbp.gov/ruling/W548314> accessed on 20 April 2018, 13.

¹⁶⁷ In the U.S., the transaction value method is laid down under Code of Federal Regulations (19 CFR 152.103).

- The taxpayer follows its transfer pricing policy and the transfer pricing methodology when filing its corporate income tax return. Furthermore, any adjustments must be reported in the corporate income tax return;
- The goods which customs value is being adjusted must be covered by the transfer pricing policy;
- The taxpayer is able to support its claimed adjustments by way of its accounting details, e.g., from its books and/or financial statements; and
- There are no other conditions on why the U.S. Customs and Border Protection could not accept the adjusted transfer price as the customs value^{168, 169}.

A system similar to the ‘five factors test’ as applied by the U.S. Customs and Border Protection would ensure that the retroactive transfer pricing adjustments, whether upwards or downwards, would be taken into consideration only in relation to the importers which can illustrate that their transactions have been in compliance with the applicable transfer pricing rules. Consequently, a direct link between transfer pricing and the EU customs law would be established.

A third solution would therefore be, first, to amend the deadline of supplementing the simplified customs declaration under the UCC from ten days to at least 12 months, and preferably more. Second, in addition to the amended deadline, further criteria, such as the ‘five factors test’, could be included in the provisions of the UCC when associated enterprises apply for the simplified customs declaration procedure in order to ensure that the simplified customs declaration is not abused. This change in the UCC would most likely have the least consequences to other provisions of the EU customs law, and thus would be the most feasible solution to generate a solid link between transfer pricing and EU customs law.

4.4 Potential solution by applying for binding decision in relation to ‘other factors’

The customs authorities may, upon application, take binding decisions on binding tariff information and binding origin information.¹⁷⁰ In addition to this and in specific cases, the customs authorities may, upon application, take decisions in relation to other factors referred to in the Title II of the

¹⁶⁸ One of these ‘other conditions’ could be, e.g., the fact that the WTO agreement does not permit adjustments made on already declared customs value solely based on a retroactive transfer pricing adjustment.

¹⁶⁹ U.S. Customs and Border Protection (n166) 7 & 11.

¹⁷⁰ UCC (n11) article 33.

UCC¹⁷¹. Based on these decisions, import and export duties, as well as other measures in relation to trade of goods are applied.¹⁷² The rules for customs valuation are located under the Title II of the UCC.¹⁷³

It is reasonable to argue that since there is a legal basis to apply for binding information in relation to ‘other factors’, but, in lack of further description in the UCC or in the case law on what is meant by ‘other factors’, the importer could potentially refer to this article of the UCC and request for a binding decision in relation for the customs authorities to determine the customs value by also taking into account the possible retroactive transfer pricing adjustments.

4.5 Potential solution under the simplification rule

The second question in the *Hamamatsu case*, which the Court did not answer, related to the possibility to use the simplified approach when determining the customs value in situations where the value has been affected by a retroactive transfer pricing adjustment.¹⁷⁴ The current simplification rule under the UCC allows the customs authorities to authorise, if requested by the importer, for the “*amounts [to] be determined on the basis of specific criteria, where they are not quantifiable on the date on which the customs declaration is accepted*”.¹⁷⁵ However, the simplification rule may be applied only when a simplified customs declaration¹⁷⁶ would result in high administrative costs and when the customs value determined under the simplification rule would not differ significantly from what the customs value would be under the normal customs valuation procedure.¹⁷⁷

This does not seem to be a feasible option. This is mainly because “*amounts to be determined on the basis of specific criteria*” is not clearly defined and it seems to refer to a formula or other criteria based on which the value of the goods would be determined. Furthermore, since the amount of the retroactive transfer pricing adjustments is often unknown when the transaction takes place, it would not seem possible to base the determination of the final customs value on the basis of specific criteria.

4.6 Using alternative transfer pricing methods

The abovementioned potential solutions have been connected to the customs side of the problem of the lacking link between the two sets of rules. From a

¹⁷¹ “Title II: Factors on the basis of which import or export duty and other measures in respect of trade in goods are applied”.

¹⁷² UCC (n11) article 35.

¹⁷³ See “Title II, Chapter 3 – Value of goods for customs purposes” of the UCC (n11).

¹⁷⁴ *Hamamatsu case* (n17) para 22.

¹⁷⁵ UCC (n11) article 73.

¹⁷⁶ UCC (n11) article 166, also discussed above.

¹⁷⁷ UCC DA (n12) article 71(1).

purely transfer pricing perspective, and as already discussed¹⁷⁸, the use of the traditional transaction methods is unclear from the perspective of the *Hamamatsu case*. However, it seems reasonable to conclude that at least with the application of the CUP method, it seems possible that the transaction value could still be used as the customs valuation method in trade between associated enterprises. Furthermore, in case the taxpayer has an advanced intercompany financial reporting system in place, which often is the case for MNEs, it would be possible to allocate the retroactive transfer pricing adjustments on a single product level. Consequently, it is possible that the RPM method and the cost plus method would be in compliance with the requirement of knowing the value of a single product.

As an example, in the U.S. the use of the RPM method as the basis for transaction value for customs purposes has been accepted in cases where the comparable companies distribute similar products. In the case at hand, a domestic importer, who was engaged in a medical product business, brought goods to the U.S., which its foreign related manufacturer had manufactured. The transfer price was determined with the RPM method by using internal and external comparables for determining the arm's length gross margin level that was deducted from the importer's price in order to arrive at the arm's length price for transfer pricing purposes. Furthermore, no APAs were in place. The U.S. Customs and Border Protection allowed the use of the transaction value as the customs valuation method by stating that "*since all comparable companies sell merchandise of the same class or kind, the transfer pricing study supports a finding that the importer's price was settled in a manner that was consistent with the normal pricing practices of the industry*".¹⁷⁹ In relation to this ruling, it is important to emphasise that the aim for customs valuation is to find the correct customs value. Thus, in the ruling it was deemed that the approach chosen for transfer pricing purposes will also result in correct customs valuation, and a link, for situations having these specific facts and circumstances, was established.

Although the consequences from a customs perspective may or may not¹⁸⁰ be more favourable in relation to the traditional transaction methods, the taxpayers who can use the traditional transaction methods in connection to their cross-border intercompany transactions will already benefit from this solution due to the 'most appropriate method principle', and, consequently, as long as the taxpayers comply with the OECD Guidelines, this solution is already used in its 'maximum capacity'.¹⁸¹

¹⁷⁸ See chapter 3.2.4 of the thesis.

¹⁷⁹ U.S. Customs and Border Protection ruling H037375, dated 11 December 2009. Available at: <www.rulings.cbp.gov/ruling/H037375> accessed on 28 April 2018, 1, 3 & 6.

¹⁸⁰ The author is in the favor of the former.

¹⁸¹ OECD (n7) para 2.2.

5. Concluding remarks

The scopes of application and the objectives of transfer pricing and the EU customs law are very different, and in some cases, the opposite. As a consequence, the link between these two topics is almost non-existent. After the CJEU gave its decision in the *Hamamatsu case*, the ‘thinness’ of the link was merely confirmed, not changed. However, there are still uncertainties which need to be solved before deeming that the link is completely lost. This timeframe could be used to introduce a solution that will establish a more solid link between the two topics.

Based on the *Hamamatsu case* and the applicable EU customs law, once the value of the imported goods to the customs authorities is declared, there is no possibility to adjust the value retroactively, except in certain and very specific situations. In contrast to this, in transfer pricing, when the most flexible, and therefore, also the most used transfer pricing method, namely, the TNMM method is used, the opposite approach is applied; it does not matter what the price of the products was in the first place¹⁸², the price can generally be adjusted retroactively.

Therefore, the theory and practice of the EU customs law and transfer pricing clash. This is because, when looking at voluntary retroactive transfer pricing adjustments from EU customs law perspective, they do not relate to a condition of sale for the export to the customs territory of the Union or the different ‘price elements’ of the transaction value method. Neither do they relate to the condition of the goods at the time of importation. This clash and its consequences become of more importance under the consideration that most of the world trade, and, consequently, the European trade, is affected by this mismatch of the two different sets of rules. One could even say that the objective of the EU customs law of ensuring a level playing field for the European trade, is endangered.

Transfer pricing and customs valuation are like cats and mice; they follow each other. In order for the performance of a valuation for customs purposes to take place, international trade between companies is needed. Since the lack of the link between transfer pricing and EU customs law is an everyday issue for the MNEs, the solution introduced at a European level should be highly pragmatic.

Increasing the current deadline of ten days to provide a supplementary customs declaration in connection with the use of a simplified customs declaration seems to be the most practical option. The system applied in the U.S., where the deadline to provide supplementary information is 21 months, could be used as a reference point. Then, the taxpayers could keep on applying the most appropriate transfer pricing method and still be able to

¹⁸² At least in theory.

follow the strict hierarchy of different customs valuation methods without any major issues. In case of an apprehension of a system abuse, a ‘five factor test’, similar to the one which is used in the U.S., could be included in the law as a condition for associated enterprises to be able to use the simplified customs declaration.¹⁸³ As a consequence, the currently thin link between transfer pricing and EU customs law would be solidified and the taxpayers would have legal certainty on this matter.

¹⁸³ See chapter 4.3 of the thesis.

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