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The notion of economic value in taxation - A comparison of valuation methods

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Summary

The concept of economic value is not well explored nor consistently applied in the field of taxation. Different systems of taxation assess value from their own perspectives and with their own interests in mind resulting in situations where different values for taxation are determined for the same transaction. Efforts have been made to harmonise valuations between customs and transfer pricing. This has however met resistance by the Court of Justice of the European Union through their judgment in the recent Hamamatsu case.

Using a functional comparative method this thesis examines the valuation methodologies of customs, transfer pricing and value added tax. Focus is on the degree and method of harmonisation within the systems and how their underlying principles of value guide valuations of cross-border transactions between related parties. The Hamamatsu judgment serves as a basis for discussion on the practical implications of their divergent purposes and methodology.

Notable differences exist in the level of harmonisation between the areas. While customs matters are extensively harmonised, direct taxation is almost exclusively governed by the Member States. As for value added tax the principle of neutrality necessitates harmonisation of the taxable amount although this is subject to derogations for the purpose of combatting tax evasion.

Where customs and value added tax to a large extent rely on the positive value as decided by the parties, the object of transfer pricing is establishing conformance to a notional value. Differences exist also as regards from which perspective value is determined as customs focus on the value of a good on the Union market while transfer pricing seeks to establish appropriate divison of the use value of the good. Division is apparent also from a temporal perspective. Where customs valuation is determined at the time of importation, transfer pricing valuations may be retroactively adjusted based on subsequent profit margins. The effect on value added tax in this regard is uncertain and has been subject to debate.

The opportunities for legislative harmonisation of valuation methods appear slim though increased cooperation in data collection does seem feasible. Improved horisontal harmonisation of customs and value added tax valuations would also bring benefits to international traders.

Sammanfattning

Konceptet ekonomiskt värde är vare sig väl utforskat eller konsekvent tillämpat inom det skatterättsliga området. Olika skattesystem bedömer värde utifrån sina egna perspektiv och intressen vilket skapar situationer där olika skattemässiga värden bestäms för samma transaktion. Ansträngningar har gjorts för att harmonisera värderingar mellan tull och internprissättning. Dessa har dock stött på motstånd genom domen från Europeiska unionens domstol i det nyligen avgjorda Hamamatsu-målet.

Utifrån en funktionell komparativ metod utforskar denna uppsats värderingsmetodologin inom tull, internprissättning och moms. Uppsatsen fokuserar på nivån av och metoderna för harmonisering inom systemen samt hur deras bakomliggande principer kring värde styr deras värderingar av gränsöverskridande transaktioner mellan parter i intressegemenskap. Hamamatsu-målet används som utgångspunkt för diskussion kring de praktiska implikationerna av deras skiftande syften och metoder.

Det finns noterbara skillnader vad gäller nivån av harmonisering inom respektive område. Emedan tullärenden är föremål för långtgående harmonisering står direkt beskattning närmast uteslutande under medlemsstaternas kontroll. Vad gäller moms fordrar neutralitetsprincipen harmonisering av beskattningsunderlaget. Undantag ges dock utifrån syftet att motverka undandragande från skatt.

Inom tull och moms förlitas i stor utsträckning på det positiva värdet såsom bestämt mellan parterna medan syftet med internprissättning är att finna överensstämmelse med ett teoretisk belopp. Skillnader finns också ifråga om ur vilket perspektiv värdet bestäms där tullvärdering fokus på en varas värde på unionsmarknaden medan internprissättning eftersträvar en lämplig fördelning utifrån varans bruksvärde. Skillnader finns också från ett temporalt perspektiv. Tullvärdet bestäms vid tiden för import medan värderingar relaterade till internprissättning kan justeras i efterhand baserat på resulterande vinstmarginaler. Vilken effekt detta får i momshänseende är osäkert och har varit föremål för diskussion.

Möjligheterna att åstadkommande harmoniserade regelverk vad gäller värderingsmetoder tycks starkt begränsade. Utökat samarbete vad gäller insamling av data tycks dock uppnåeligt. En utökad horisontell harmonisering av värderingar gällande tull och moms hade också varit till nytta för den internationella handeln.

Abbreviations

ACV: Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade

ALP: Arm's Length Principle

APA: Advance Pricing Agreement

BEPS: Base Erosion and Profit Shifting

BDV: Brussels Definition of Value

CCC: Community Customs Code

CCP: Common Commercial Policy

CUP: Comparable Uncontrolled Price

CJEU: Court of Justice of the European Union

CN: Combined Nomenclature

DA: Delegated Act

EU: European Union

GATT: General Agreement on Tariffs and Trade

ICC: International Chamber of Commerce

IA: Implementing Act

MNE: Multinational Entity

OECD: Organisation for Economic Co-operation and Development

OEEC: Organisation for European Economic Cooperation

OMV: Open Market Value

TEU: Treaty on European Union

TFEU: Treaty on the Functioning of the European Union

TP: Transfer Pricing

VAT: Value Added Tax

WCO: World Customs Organisation

WTO: World Trade Organisation

1 Introduction

The notion of economic value lies at the heart of both economics and taxation. The ability to generate and capture value determines the success or failure of a business and valid methods of assessing value are central to the fair application of taxes. Yet in the fields of both business and taxation opinions differ on what constitutes the true nature of economic value and how it should be properly measured.

The notion of ”value” was remarked upon already by the ”Father of history”, Herodotus, to the effect of meaning ”price” or ”equivalence” in reference to the exchange of goods for gold.[1] The Greek philopsopher Aristotle remarked on the importance of fairness in exchange and the utility of money in this regard.[2] The extensive debate on what should be considered the proper nature and measurement of value continues to this day. Rather than reaching consensus new definitions and dimensions have been suggested seemingly with every generation of philosophers in the area, to the point of prompting calls for the abandonment of the concept of value altogether within the field of economics.

Situated somewhat in the intersection of law and economics the area of taxation relies heavily on assessing the value of goods and services. Yet it has been remarked that the concept is largely unexplored within the legal sciences.[3] Whatever the reasons for this it must be regarded as unfortunate given its paramount influence on fiscal matters. If you cannot validly and reliably determine the value, how can you have a fair system of taxation? For that matter, if things were to have no value, what would there be to tax?

This thesis will examine and compare three areas of taxation; customs, transfer pricing (TP) and value added tax (VAT) from the perspective of the manner in which the value of goods is ascertained within their respective domain, particularly with regards to transactions between related parties. While all three differ in terms of

[1] Commonly recognised as the first historian and the origin of the term ”history”, Herodotus related the custom of Carthaganian traders when trading their wares for gold aready in 500 B.C. in his work ”Histories”, book IV, chapter 196.

[2] Aristotle, part IX.

[3] See Vieira who also argues for a more holistic approach to value in taxation.

origin, purpose and underlying principles their interaction, due to the increasing globalisation of trade and the establishment of multinational entities (MNE), has become increasingly relevant and problematic.

In the last decades voices have been raised by various stakeholders and expert groups to harmonise their valuation methods for the benefit of international traders. It was therefore met with great consternation and debate when the recent ruling by the Court of Justice of the European Union (CJEU) in the Hamamatsu case[4] seemed to reinforce the divide between customs and direct taxation. To provide a better understanding of the problem it would be helpful to examine the legal framework and hierarchies of these areas and the principles upon which they are constructed as regards determining the economic value of goods.

1.1 Purpose

Modern trade has evolved globally with the advent of MNEs creating an environment where international trade, in some respects, may be more appropriately divided by corporate value chains rather than national lines. It has been estimated that 80% of transactions take place in value chains involving related entities.[5] The issue of international fiscal cooperation and establishing conformity of transactions to the arm´s length principle (ALP) has thus become increasingly relevant. Also, goods crossing the border into the European Union (EU) are subject to customs duties most often based on the value of the transacted goods. This importation and subsequent transactions are also liable to incur VAT based on the taxable amount. Value chains involving importation of goods into the EU transactions are thus subject to scrutiny by three different forms of taxation.

It has been suggested that harmonising these different forms of taxation would improve the current situation of international trade increasingly involving MNEs. Accordingly, the purposes of this thesis are twofold. The first purpose is to compare the level and method of harmonisation within and between the aforementioned

[4] C-529/16 Hamamatsu.
[5] UNCTAD 2013, p. 135. As noted by Cadestin et al. (p. 24) however, this number varies considerably between countries and is based on limited research.

systems of taxation. The second purpose is to examine the systems with a view to discerning the principles and perspectives of economic value to which account is taken when determining value of goods especially in the case of transactions between related parties.

1.2 Research questions

1. What methods are used for valuation of goods within the systems of customs, TP and VAT especially where the parties are related?
2. How and to what degree are the respective legal systems harmonised within the EU and on the international level?
3. What aspects of economic value are taken into account by the respective forms of taxation and do they differ between the systems?
4. What opportunities and obstacles exist for harmonisation between the systems?

1.3 Method

Establishing prices within organisations and for the purpose of direct taxation is commonly referred to as transfer pricing, or TP, which will be the term used from here on in reference to this form of taxation. To answer the questions posed in this thesis requires investigation of multiple systems of law from the perspective of a shared ambition which is the determination of value for the purpose of taxation. For proper understanding of the function of the different systems, it is necessary to consider issues such as the hierarchical order of laws as well as the historical context and purpose of the respective system. Some methodological considerations in this regard are accounted for in the following.

1.3.1 A comparative functional approach

A comparative approach will be taken in this thesis utilising a functional method. While by some regarded as the premiere method for comparative studies of law the functional method has also been subject to heavy criticism as to its underlying

assumptions and indeed its very existence as a discrete method.[6] While often applied eclectically, as stated by Michaels there is however consensus on some crucial elements utilised in the method.[7] These are the focus on the effects of rules on real life situations where the comparison is made concerning the response by the respective system to similar situations. The objects are thus investigated from the perspective of their functional relationship with society and the common denominator, or *tertia comparationis*, is the function itself. Included may also be an evaluative aspect which seeks to determine the ”best approach” among those investigated, this will however not be incorporated in this thesis. This is because, unlike comparisons between different jurisdictions where the same function may be evaluated from the perspective of a common purpose, it is in this case recognised from the outset that the judicial systems covered do not necessarily share the same purpose and thus do not aspire to reach the same conclusion. In that regard, while the comparative approach usually rests on the presumtion of similarity, in this instance the comparison is based on the recognition of the differences inherent to each system.[8]

Consequently there may be no ”best” approach as their functional goals differ. While all three systems share a common denominator, that is the determination of economic value, the focus for comparison lies rather in the underlying perspectives taken and how these generate varying consequences in practice. The comparison thus lies not in the handling of similar events by different jurisdictions but rather how the very same event may be handled by different legal systems within the same jurisdiction. The evaluative aspect lies instead in whether these systems may be harmonised for practical purposes.

1.3.2 Concepts of economic value

The subject of economic value has been debated seemingly since the conception of the term with each new generation of thinkers adding to the definition and basis for

[6] For a review of several points of criticism see De Coninck.
[7] Michaels, p. 342.
[8] Both views have been put forth as the correct starting point for comparison as related by Samuel, pp. 105 – 106.

assessing value. Accordingly, the notion of economic value is multidimensional and not easily defined. Without delving too far into its theoretical underpinnings a brief look will be provided in the next chapter at some common distinctions regarding the concept of value to serve as basis for the purposes of the thesis.

1.3.3 The legal order of the European Union

This thesis takes its starting point and main focus in fiscal legislation at the EU level which merits certain considerations as to the legal methodology applied. The Union system of law is partially harmonised and of a hierarchical order where primary legislation in the form of treaties takes precedence over secondary law consisting of regulations and directives. The formal role of the CJEU has been described as comprising the competence to determine the *validity* of Union legislative measures, to *interpret* Union law and to rule on matters of *compliance* with Union law by Member states.[9] As argued by Horsley the CJEU has, through its case law, played a critical role in the development of the internal Union market by extensive exercise of its vested competence to interpret Community legislation.[10] The case law of the CJEU therefore becomes a vital part in assessing EU legislation, although it must be noted that for this thesis the crucial role of ”following through” with their judgments by Member States in adjusting the letter and application of national law fall outside the scope of examination.[11]

Through the principle of pacta sunt servanda international conventions and agreements take precedence over secondary legislation while their status relative primary law may be considered somewhat more uncertain, as is their binding nature upon the jurisprudence of the CJEU. In order to properly understand and put EU legislation into its right context it is thus necessary to some extent to explore legislative and political aspects both at the level of international conventions and guidelines as well as national application. It is not the intent however to analyse in detail the interplay between these levels of legislation.

[9] Horsley, p. 405.
[10] Horsley, p. 402.
[11] Which is not a given, see in this regard Alter, p. 507f.

1.3.4 Material

Both customs administration and VAT are extensively regulated within Union legislation. The primary sources of law in these areas are, for customs matters, the Union Customs Code (UCC)[12] with the adjoining Delegated Act (DA)[13] and Implementing Act (IA)[14] and for VAT the VAT Directive.[15] Both areas have also been developed through considerable CJEU case law which is given due deference in light of the prominent function of the CJEU in interpreting EU law. Preparatory works of EU legislation are referenced though only as to elucidate underlying intents and considerations in legislation. As customs valuations are governed also by international agreements through the World Trade Organisation (WTO) these are consulted where appropriate. Although TP is subject to national legislation the OECD Guidelines[16] have been approved by all Member States and they will serve as source of the underlying principles of valuation methods in this regard.

An interdisciplinary approach is used as the multidimensional concept of value has been developed within the philosophy of economics. To establish a basis for reference recourse is therefore taken to classic and contemporary works treating different perspectives on economic principles as well as their practical application within modern business and MNEs. Principles of economic value as applied in the area of taxation have been addressed by Vieira. Taking a *de lege feranda* viewpoint he has argued for a holistic approach where consideration is given both to the nature of the goods and the circumstances of the transaction as well as to the situation of the person subject to taxation.

As noted by Vieira there is a paucity of research regarding economic value in the area of taxation and indeed within the area of law. Ample commentary has been made

[12] Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code.
[13] 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.
[14] 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.
[15] Council Directive 2006/112/EC on the common system of value added tax.
[16] OECD TP Guidelines 2017. OECD: Organisation for Economic Co-operation and Development.

though on practical consequences for international trade of the interplay between the different systems of taxation as well as on the subject of harmonisation in valuation methods. That commentary is addressed within this context. As for the conceptual view of economic value taken within the respective system this seems however rarely discussed which is a reason for this thesis.

1.4 Delimitations

This thesis will examine the underlying principles of harmonisation and economic value that govern the methodology in determining value of goods on the level of EU law. This will be done from the perspective of international trade and business to business transactions of goods. The subject of trade in services will not be addressed. Customs, TP and VAT are all complex areas of law with different degrees of harmonisation between states and hierarchical structures. Their application on a national level falls outside the scope of this thesis as do questions of procedural nature, such as allocation and extent of the burden of proof and application processes. In this regard only the issue of retroactive amendments, as this is currently a much debated topic, will be addressed in so far as it relates to the main subject of this thesis, that is the manner in which each form of taxation is shaped by its underlying purpose and history.

1.5 Outline

This first chapter is followed by chapter 2 in which an overview is given of certain economic and legal concepts, to serve as reference points for comparison and discussion in the following chapters. In chapter 3 the different legal systems of taxation will be examined as to their methodology of valuation as well as their apparent purposes and historical contexts. In chapter 4 the Hamamatsu case will serve as basis for discussion on the interrelationship of the systems and also some general concepts will be touched upon. Concluding remarks will be provided in chapter 5.

2 Theoretical concepts

In this chapter a brief overview will be provided of theoretical concepts that will be subject to discussion further on in this thesis. The aim of this chapter is to, for the sake of clarity, establish a frame of reference as there is a lack of uniformity within taxation and law as regards several legal and economic terms and concepts.

2.1 Legal harmonisation

The concept of harmonisation lacks uniform definition and such ambitions have been advised against altogether.[17] Legal harmonisation has been described by Andenas et al as *"the basic notion of the bringing together of legal ideas to allow a functioning in unison."*[18] The same authors also note the lack of uniform definition and that legal harmonisation may take many forms and apply to different degrees. This thesis will consider both what Andenas et al. refer to as *consequential harmonisation*, that is to what extent substantive legal phenomenon are harmonised as well as *procedural harmonisation*, that is the techniques used for adoption of harmonised law.[19] This will be examined from the view of *horisontal* harmonisation, the degree of resulting harmonisation between jurisdictions as regards a specific area of law, and *vertical* harmonisation, referring to the degree of harmonisation within a single jurisdiction between different areas of law.[20]

2.2 The arm´s length principle

Historically, the term "arm´s length" has been used both in reference to relationships involving dealings only between two persons as well as to describe the circumstances of collusion where related parties work towards a common interest at the expense of a third party. For example, on the purchasing by a trustee of the propery of which he is entrusted, it was remarked in the Handy-book of Lord St.Leonards that *"Unless there is perfect fair-dealing, and the dealing is, as it is*

[17] Windholz, p. 326.
[18] Andenas, p. 576.
[19] Andenas p. 579 and p. 583 respectively.
[20] Thompson Ainsworth, p. 8.

termed, at arm´s length, it would not be allowed to stand."[21] In this regard it relates to the term "undue influence" as exampled in a relationship between a mortgagor and mortgagee where the former is not of full faculty and consequently *"the onus of justifying the transaction, and shewing that it was a right and fair transaction, is thrown upon the mortgagee."*[22]

Today the more common and established use refers to the relationship between taxpayers involved in mutual transactions and their respective fiscal authorities, which is also the context in which the principle will be discussed in this thesis. All three systems of taxation employ a notion of arm´s length relationships either explicitly or by analogy though their definitions are subject to variations. While, as related by Newman,[23] deviation from "real" market value may be practised also between non-related entities the concept as utilised in all three systems presumes a certain connection between the parties.

2.3 The notion of value

The concept of value has been treated indiscriminately in taxation with several meanings attached to one term and different tems applied to the same phenomenon.[24] Some basic notions on economic value will therefore be explained as to their intended interpretation in the context of this thesis.

As a sidenote it should be kept in mind that while the valuation of goods and consequently the subject of this thesis limits itself to the economic and legal aspects of value the field of taxation does not.[25] Although account for non-economic value is not taken in establishing the value of goods as such the different systems of taxation do differentiate in their own manner according to the social, moral and other forms of value perceived in goods or services.

[21] Sugden, p. 35.
[22] Prees v Cook, p. 649.
[23] Newman, p. 147.
[24] For examples of this, see Vieira.
[25] For the argument that not even economics itself is strictly "economic" see Kirk, who postulates that there is indeed an inescapable etymological and principled interconnectedness between the fields of economics, politics and morals.

For customs matters the use of classification systems such as the combined nomenclature[26] enables states to make use of differentiated tariffs and consequently different rates of taxation based on the nature and perceived value of the goods in question.

In the field of VAT the possibility of applying exemptions, differential rates or indeed zero rating goods and services from the application of VAT provides lawmakers the option to afford special treatment to goods perceived as beneficial to society.

For its part direct taxation provides the ability to deduct or apply differential rates of taxation on costs or profits derived from certain activities allows for the encouragement of socially responsible activities by corporations as well as individuals.

2.3.1 Utility and exchange value

The dual use of things was acknowledged by Aristotle who classified them as the ”proper” use and the ”improper” or ”secondary” use. The proper use was the use for which the thing was made, such as shoes being made to wear, while recognising that shoes may also be used in exchange, a use it shares with all things.[27]

Today these concepts are referred to as *use,* or *utility,* value and the *exchange* value, respectively. The utility value refers to the perceived use of a good for the recipient. It may be aimed towards the final consumer, where it has been described simply as the satisfaction gained with ownership of the good in question, as well as for business purposes where it refers to the use to which a business owner may put property such as for example factories or machinery or indeed services rendered for the purpose of furthering one’s business endeavours. For a business, the utility value of a good may also be expressed as its ability to generate profit.[28]

[26] The combined nomenclature (CN) is a hierarcichally numbered system used by EU customs to classify goods into categories depending on their intended use or other characteristics. It is regularly updated to follow the WTO mandated ”Harmonised system” although some additional categories are utilised in the CN.
[27] Aristotle, Part IX.
[28] Bowman and Ambrosini. P. 2 -3.

Bilgram sees exchange value simply as determining *”that which can be obtained in exchange for”*[29] denoting it in this sense as a quantitative expression of the purchasing power which is a quality of a good. As shall be seen below this is connected to the notion of price and can be specified in terms of market value or the like.

2.3.2 Subjective or objective value

The notion of subjective and objective valuations may be approached from the context of *the nature of value*, or of methods of *assigning value.* The question of whether things have a subjective, or *extrinsic*, value dependent on the perception of the individual or if value is objective, *intrinsic,* that is inherent to an object ,relates to the nature of value. Proponents for the former view include Menger[30] who emphasised that persons will assign differing values according to supply and individual needs. Kagan has suggested that intrinsic value may comprise two concepts. Either as that of the value of a good *in itself* regardless of external influence (a value which would remain even if it was the only object in existence), or as a value *to an end* but owing to its inherent properties (for exemple the value of a car owing to its *ability* to go fast regardless of whether it is ever driven fast) which may include an *instrumental* property, that is a measure of usefulness of the object.[31]

The terms subjective and objective value are used also in the context of *assigning* value. In this regard the subjective, or *positive,* value has been used in reference to the price or amount actually agreed upon, regardless of whether this has been decided utilising objectively measurable criteria.[32]

The use of an objective, or *notional*, measure of value for customs matters was prevalent in the middle of the 20th century in the form of the Brussels Definition of

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[29] Bilgram, p. 195.
[30] See Menger, p. 145f.
[31] See Kagan, pp. 283 -284.
[32] Reference to the subjective value was made by the CJEU in the *Argos* case (C-288/94) while the distinction between a *positive* and *notional* approach with regards to value for customs purposes has been discussed by, among others, van Raan.

Value (BDV).[33] By this convention customs value was defined by its ”normal price”, or open market value (OMV). While the price actually paid was in general accepted for customs purposes[34] countries would apply minimum values for products, deviation from which was allowed only by a certain percentage.[35] The system also made it possible to attribute activities undertaken by the buyer to the customs value, giving rise to arbitrary decisions undermining the purpose of ensuring legal certainty of the duty to be paid.[36]

While the amount the buyer is willing to pay for a good and the amount for which the seller is willing to part with the same good is thus determined by subjective valuations the combination of the two result in an *objective* market price, that is the rate for which (usually) money is exchanged for a good.[37] Market value is thus an objective measure, or expression, of the subjective valuations on which is based. Market value has been defined as:

> *”…the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.”*[38]

2.3.3 To create and capture value

Within the Resource Based Theory of firms the notion of creating and capturing value has been conceptualised by Bowman and Androsini. Their view, in brief, is that the latent use value of resources is ”activated” and new use values *created* through labour within the organisation. The resultant use value for the organisation is then realised in the form of exchange value when purchased by the customer, this

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[33] As defined by article 1 – 3 in Annex I to The Convention on the Valution of Goods for Customs Purposes.
[34] Van Raan, p. 127.
[35] Keen, p. 92.
[36] Van Raan, p. 128.
[37] This is explained by Murphy. The same notion is expressed by Bilgram (p. 198) who also makes the division between the preceding, subjective, utility valuation and the exchange value, which is determined through the making of the exchange. The values are thus dependent on each other but distinctly separate.
[38] IVSC, p. 8ff. This provides the connection to price in that the amount to which is referred shall represent the best price obtainable for the both the seller and the buyer. One may note also the close, though not identical, definitions of ”fair value”, ”fair market value” and ”equitable value”, the application of which adds to the confusion of value determinants in taxation and law.

being a function of, *inter alia*, the use value as perceived by the customer. In their view though the creation of *new* or *different* use value does not necessarily translate to greater *exchange* value of goods. Value creation thus does not by definition mean added value in terms of profit, which is determined by the exchange value captured from which is subtracted the costs incurred in the process of generating and capturing these values.[39]

The notion of *value creation* has seen a resurgence in recent years. This is primarily in association with intangible assets and the digital economy though it is employed on a general basis with regards to the function of MNEs and TP assessments. Its basic tenets have been traced back to the 1920´s and the work of the ”Four Economists” which is considered the roots of modern international taxation.[40] However, while frequently referred to as a fundamental principle of taxation its validity has been questioned and the term remarked upon to lack precedence or established definition both in taxation and law.[41] Among others, Christians has remarked upon the impossiblities of deconstructing the value creation process with an MNE and has suggested the influence of political interests of wealthier countries to ensure distribution of the taxation rights upon their own tax authorities.

The suggested role of the consumer in balancing markets and co-creating value has served as a basis for criticism of recent developments in TP policy which is accused of neglecting this aspect of value creation.[42] Becker and Englisch for their part suggest that value creation may be seen simply as a restatement of the ALP in the assumption that market forces will ”naturally” guide businesses to deals aligning with their respective contributions to the creation of value. They also contend that user contributions, though they may in some regard add use value, in general do not add value to businesses in such a manner as should be acknowledged for tax purposes.[43]

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[39] Bowman and Ambrosini. P. 5.
[40] The four economists were an expert group tasked by the League of Nations in 1921 with examining the problem of double taxation which resulted in a study on the issue published in 1923. See Langbein et al.
[41] See Devereux to this effect.
[42] Trinh, p. 10 – 11 and Das p. 4 – 6.
[43] Becker and Englisch.

2.3.4 Value or price

While classical economists such as Ricardo[44] and Marx[45] held labour and the cost of production as the primary source of value, Jevons argued that value ultimately depends on the *final degree of utility* in a good.[46] Later philosophers have discussed value more from the perspective of that as a function of supply and demand.[47]

The start of the 20th century saw the usefulness of the concept of value itself brought into question. Looked upon merely as a rate of exchange between goods mediated by currency the notion of value, it was suggested, could be replaced by that of *price* with no loss suffered to the discussion. The position of the value concept has thus been somewhat weakened with authors highlighting a lack of clarity and requesting a more uniform approach to the question of how value is created and measured.[48]

The issue of pricing in business transactions is subject to significant variation, not the least of course within MNEs. One may broadly identify three different principles; *Cost-based*, that is through determining production costs and applying a profit margin; *Competition-based*, setting prices based on competing traders or *Value-based*, that is pricing according to the assessed value of the good for the purchaser.[49] Although among theorists value-based pricing is generally considered superior in terms of potential profit generation,[50] research suggests cost-based pricing is favoured in practice much due to it being simpler to calculate with reliability.[51] A variable within the structure of an MNE is also the extent to which prices are set in order to minimise tax liability or to ensure compliance with tax regulations.[52]

[44] King, Pp. 72 – 74.
[45] Marx, Chapter 1.
[46] See Wicksteed.
[47] See in that regard for example Marshall.
[48] Bochenek, p. 324 – 325.
[49] Guerreiro and Amaral, p. 391.
[50] Hinterhuber, p. 74 – 75.
[51] Geurreiro and Amaral, p. 390.
[52] See Klassen et al.

3 Establishing value in the legal systems

In this chapter an outline will be given of the legal framework regarding the determination of value within customs, TP and VAT. A brief historical context will be provided as well as an outlook on the horisontal harmonisation of the respective system. Following this the applicable provisions and relevant case law will be presented with regards to the specific conditions for each area of taxation.

3.1 Customs

The concept of levying customs duties is not new but rather has been an integral part of trade since the very beginning of civilisation. Its practice has been traced back at least as far as the 6th century BC and in a wide range of societies over the globe. The purpose of collecting customs duties has also varied throughout history. While it would be presumed to have served primarily as a source of revenue it has also been described as a service fee for the use of infrastructure by traders as well as for regulating trade flows.[53] The rise of colonialism and mercantilist ideas promoted the protectionist aspect of customs duties.[54] By subjecting imports to customs measures and encouraging exports states sought to protect their local markets and industries and achieve positive trade balances. With the advent of more liberalist views on economics the mercantilist attitude appears to have lost traction and the protectionist role of customs has decreased. Customs duties however still retain their use for states, especially those who are poorer and less developed, as a measure to protect their respective markets and as a source of revenue.[55] Also, the recent trade conflicts such as between the US and China as well as between the US and the EU could indicate a continuing trend towards an increasingly protectionist global trade climate.[56]

[53] Kafeero pp. 18, 20.
[54] Ibid.
[55] Keen p. 5, though its utility for this purpose has been questioned by, among others, Dornbusch.
[56] See in this regard Armella and Conti who also relate some macroeconomic aspects of customs duties.

Customs unions have a longstanding history and are widely used, though subject to individual variations, across the globe.[57] The EU originated primarily as a customs union which is still reflected as a primary base of legislation.[58] Realisation of the internal market necessitated the implementation of a uniform customs legislation in the form of the Community Customs Code (CCC).[59] In the initial proposal by the Commission guidance was provided as regards the perspective on value to be taken in account when levying customs duties:

> *Whereas the application of customs legislation is economic in character; whereas certain provisions of current customs legislation must be adopted to take account of this aspect in order to ensure the requisite degree of consistency; whereas the charging of import duties must consequently be linked, in general, to the integration of imported goods into the Community economy; whereas such integration takes place at the time when use may freely be made of such goods; whereas, however, any value added within the customs territory of the Community must not be taxed;*[60]

Perhaps telling, this statement highlighting the impact of foreign goods entering the Union market and the aspect of when value is to be determined was not included in the adopted regulation. The stated mission of customs measures and duties are today more focused on matters such as security, immigration control and as regards international trade protection from unsafe merchandise as well as anti-dumping measures. As stated in article 3 of the UCC its purposes are, *inter alia,* to supervise international trade thereby contributing to fair and open trade as well as the implementation of the Common Commercial Policy (CCP), the internal market and other Union trade policies. Specific aims include protection of the financial interests of the Union and its Member States and the balancing of customs controls with the facilitation of legitimate trade. An important source of income, in 2018 customs

[57] Lyons, pp. 3 – 6, see also Ovadek and Willemyns as to the variety among customs unions.
[58] See article 3 of the Consolidated version of the Treaty on European Union (TEU) and article 28 of the Treaty on the Functioning of the European Union (TFEU).
[59] Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code.
[60] Proposal for a Council Regulation (EEC) No of establishing a Community customs code COM(90) 71 final.

duties provided about 13% of the total annual revenue for the EU.[61] From a political perspective it may also be argued, not the least as regards the EU, that customs duties or rather their selective abolision such as within a free trade agreement is a potent tool to incentivise political and legislative change in third countries.[62] This increased tendency may well gain political and economic significance in the future.

3.1.1 International harmonisation of customs regulations

To achieve uniform standards and facilitate international trade the General Agreement on Tariffs and Trade (GATT) was established in 1947 and succeeded by the forming of the (WTO) in 1995. Harmonised rules have been established among its 164 Member states regarding virtually all aspects of international trade and treatment of foreign products. Of fundamental importance are the Most Favoured Nation principle[63] and the principle of National Treatment.[64] The former principle dictates that members must afford any preferential treatment provided to any contracting party or product immediately and unconditionally to all other members while the latter prohibits the domestic protection through additional internal charges or regulations placed upon foreign products compared to domestic products. The valuation of goods for customs purposes is regulated by the WTO in two documents; through article VII of the GATT and the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (ACV). Especially the latter of the two is in large parts transposed more or less verbatim into EU legislation and thereby forms part also of secondary Union law.

The fundamental notion of value for customs purposes as stated in the GATT is that of a value based on *"the actual value of the imported merchandise… or of like merchandise"* not to be based on *"merchandise of national origin or on arbitrary or fictitious values."*[65] The actual value is *"the price at which… such or like merchandise is sold or offered for sale in the ordinary course of trade under fully competitive*

[61] https://ec.europa.eu/taxation_customs/facts-figures/customs-duties-mean-revenue_en (Accessed 2020-05-25)
[62] Commonly known as the "Brussels effect".
[63] Expressed in article 1 of the GATT.
[64] Article 3 of the GATT.
[65] See article 7(2)(a).

conditions." As specified in the notes to article VII(2)(1) of Annex I to the GATT it may be presumed that the basis for actual value is the invoice price. Article 1 of the ACV describes the customs value in terms of a transaction value defined as *"the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance…".*

Per article X(3) of the GATT the EU is obligated to administer customs valuations in a *"uniform, impartial and reasonable manner"* and provide procedures for *"prompt review and correction of administrative action relating to customs matters."* Uniformity is thus mandated, as stated by the WTO Appellate Body in *European Union: Selected Customs Matters*, both in the regulations themselves and the manner in which they are administered.[66] In the same Appellate Body decision it was however held that judicial procedures do not necessarily have to bind all agencies throughout the territory of (as in this case) the EU.[67]

Article 216(2) of the Treaty on the Functioning of the European Union (TFEU) states that agreements concluded by the union such as the GATT and the ACV are binding upon the EU institutions as well as the Member States. Union provisions are to be interpreted in conformity to provisions of international agreements and the general viewpoint as per CJEU case law is that they supercede secondary legislation although not primary EU law.

In terms of EU jurisprudence the CJEU has however repeatedly ruled that no WTO legal acts have direct effect unless EU legislation has been implemented clearly with the intent to fulfill a WTO obligation or refers expressly to a WTO provision.[68] By its case law the CJEU thus has developed an autonomous legal position with respect to the valuation for customs purposes within the EU.

[66] European Communities – Selected Customs Matters p. 49 – 52.

[67] P. 119. Concluding that the provisions refers to courts of first instance, the Appellate Body effectively approved of national courts adjudging customs matters, although their judgments are only nationally binding.

[68] The notion of direct effect of WTO obligations is debated. The WTO itself has neither demanded nor excluded the possibility of direct effect. The EU position is shared by all major trading countries, see Ruiz Fabri, which was an express reason for the position held by the CJEU in C-377/02 Van Parys vs BIRB para. 53. See also C-307/99 OGT Fruchthandelsgesellschaft, para. 22 – 31.

3.1.1.1 World Customs Organisation

The World Customs Organisation (WCO), formerly the Customs Co-operation Council, comprises customs authorities around the world including all EU Member States as well as the EU as an international person among its 183 members.[69]

The WCO has official standing through provisions of the ACV and acts, *inter alia*, through its Technical Committee on Customs Valuation whose responsibilities include issuing advisory opinions, commentaries and explanatory notes on the issue of customs valuations.[70] As recognised by the CJEU they are however considered of a consultative nature and thus do not bind the CJEU in their jurisprudence.[71]

3.1.2 Harmonisation on the Union level

External economic relations of the EU, such as trade in goods and matters concerning the WTO, is part of the CCP of the Union. Through article 3(1) of the TFEU exclusive competence in this area has been conferred upon the Union as well as for matters regarding the customs union.[72]

As consistently stated in CJEU case law, mirroring the intention expressed in the preamble of the ACV, the objective of Union legislation is to introduce a *fair, uniform* and *neutral* system and to exclude the use of arbitrary or fictitious values for customs purposes.[73] To ensure EU-wide uniformity in national interpretation of the UCC, as with all community law, its application is subject to the scrutiny of the CJEU. Legislation is laid down in the form of regulations thereby prohibiting national legislation except for limited additional national provisions for the purposes of practical application of the regulations.

The main legal document regulating customs matters in the EU is the UCC which came into force May 1 2016 replacing the CCC, itself implemented with the birth of the internal market of the EU and replacing national legislation on the matter. The

[69] http://www.wcoomd.org/en/about-us/wco-members/membership.aspx (accessed at 2020-04-15)
[70] As per Annex II article 2(d) of the ACV.
[71] As stated in Repenning C-183/85 para. 13.
[72] Article 3 TFEU.
[73] As stated in for example C-11/89 Unifert, para. 35 and Mitsui C-256/07 para. 20.

principles and provisions of the GATT and the ACV are transposed within the UCC along with the adjoining DA and IA.

Through their website the European Commission also issues explanatory guidance documents on the application of, *inter alia*, customs valuations.[74] These are however not legally binding.[75]

3.1.3 The notion of related parties for customs purposes

Article 127 of the IA specifies the conditions under which parties are considered to be related with respect to the valuation for customs purposes. This is a reflection of article 15 of the ACV in which an exhaustive list is provided of what may be considered related persons including where:

- They are officers or directors of one another's businesses
- They are legally recognised partners in business
- They are employer and employee
- Any person owns, controls or holds, directly or indirectly, a minimum of 5 percent of outstanding voting stock or shares of both of them
- Either person directly or indirectly controls the other
- A third person controls both parties, directly or indirectly
- A third person is controlled directly or indirectly by both persons together
- Persons are members of the same family-
- One of the parties is the sole agent, distributor or concessionaire of the other provided they fall within any of the criteria above.

As clarified by the explanatory note to article 15 in annex I of the ACV, the term person may refer to a legal person and *"…one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter.."*[76]

[74] https://ec.europa.eu/taxation_customs/business/union-customs-code/ucc-guidance-documents_en
[75] See to that effect p.2 of the Guidance document issued by the European Commission, as noted by the CJEU in case 661/15 X BV para. 39.
[76] Implemented in Union legislation by article 127(3) IA.

3.1.4 Determining the customs value in Union legislation

To establish an *ad valorem* duty, the value for customs purposes of the good is multiplied by the corresponding tariff rate determined by its origin and classification.

As consistently held in CJEU case law the valuation for customs purposes must include all elements of economic value of the good in order to reflect its *real* economic value.[77] Six methods for determining the value of a good for customs purposes are prescribed as also outlined in the GATT and the ACV. These methods are:

1. The transaction value
2. The value of identical goods
3. The value of similar goods
4. The deductive value
5. The computed value
6. The fall-back method

As per article 70 UCC the primary method is the transaction value while article 74 UCC denotes the secondary methods of valuation. As stated in article 74(1) UCC with the exception of the deductive and computed value methods, which may be interchanged upon request of the importer, these methods are to be applied sequentially. Each subsequent method is actualised only in the event that the previous method fails to produce an acceptable value.[78]

3.1.4.1 Primary method of valuation - The transaction Value

The transaction value is defined as *"the price actually paid or payable for the goods when sold for export to the customs territory of the Union, adjusted, where necessary."*[79] It shall be determined *at the time of acceptance* of the customs

[77] See, *inter alia*, C-256/07 Mitsui, para. 20..
[78] Adherence to this sequential nature has been repeatedly emphasised in case law both by the WTO (see Panel Report in Colombia – Ports of Entry pp. 107ff.) and the CJEU, as for example in C-46/16 Valsts (para. 49 – 52) and C-116/12 Christodoulou (para. 41).
[79] Article 70(1) UCC.

declaration and shall be based on the sale that occurs immediately before the goods were brought into the customs territory.[80] Should the goods be sold after they have been brought into the Union but placed in temporary storage or under special procedure then that sale shall be the basis for the transaction value. Consequently, for the transaction value to be applicable the goods must first and foremost be the object of a *sale*, intended *for export* to *Union territory*.

A ”sale” has been regarded an autonomous concept of Union law requiring a broad interpretation in order to afford the widest possible use of the transaction method for valuation. Other types of transactions, such as a working or processing contract may therefore still be regarded as a sale for customs purposes.[81] The transaction must involve two separate legal entities and cannot consist of a transfer between branches of a single company or shipments into consignment. This means that use of the transaction value is not possible where the goods have been transferred into Union territory prior to a sale within the Union. As long as the sale occurs while the goods are situated outside Union territory both buyer and seller may however be domestic to the Union.[82] The sale must also be effected with the intention for release in Union territory. In the event that goods are sold intended for release on a third country market but subsequently released within the Union the transaction value may not be used with respect for the geographical sensitivity of the market value.[83]

The transaction value is applicable on the conditions that disposal of the goods is not subject to restrictions unless by law or authority, pertaining to the geographic areas where they may be resold or to conditions that do not substantially affect their customs value. There may also be no condition attached with an indeterminable value or proceeds accruing back to the seller unless this may be

[80] Art. 128 IA. This last sale requirement meant a change from the previous customs code which included the option for the importer to choose, where goods were subject to several sales, a previous sale as long as the intention was for export to the union. This enabled assignment of a lower customs value.
[81] C-116/12 Christodoulou, pp. 8f.
[82] See C-11/89 Unifert. While commission guidelines have indicated that the buyer and seller both being domestic to the EU would preclude the instance of a sale, this has later been removed.
[83] C-46/16 Valsts.

adjusted for. Finally, the transaction value may be used only when buyer and seller are not related or the relationship did not influence the price.[84] In broad terms, the transaction value is made up by three main components: the *price paid*, *incidental costs* and *contractual conditions*.

The price paid or payable

The price of a sales transaction shall consist of the total actual payment made or to be made by the buyer. For customs purposes this includes all payments that are a condition of the sale if made by the buyer to either the seller or to a third party.[85]

Discounts on the price shall be accounted for insofar as the amount and application is provided by the sales contract and, regarding discounts for early payment, the price has not yet actually been paid as the customs declaration is accepted. No account may be taken to amendments to contracts providing for discounts that are made after the customs declaration has been accepted.[86]

In the event that goods are defective, account may be taken to an adjustment of the price by the seller, to the benefit of the buyer. This applies so long as the adjustment is made within 1 year after the acceptance of the customs declaration, the defect was present in the goods at the time of acceptance of the customs declaration and the adjustment is in fulfilment either of a contractual obligation established prior to the acceptance of the customs declaration or to fulfil a statutory obligation applicable to the goods.[87]

The term ”defective” is not defined in customs legislation but is interpreted through its use in everyday language with respect to the context in which it occurs and the purposes of the rules of which it forms part, with its everyday use suggested as *”goods which do not possess the qualities which may legitimately be expected*

[84] Art. 70 UCC.

[85] As held by the CJEU in C-15/99 Sommer this includes supplementary costs charged to the buyer by the seller to satisfy obligations within the Union (in that case testing for insurance that imported honey was of sufficient standard). The court held that as a resulting certificate would increase the value of the honey that cost must be part of the price paid and be included in the transaction value.

[86] Art 130 IA.

[87] Art. 132 IA.

having regard to their nature and all the relevant circumstances."[88] In its case law the CJEU has established that in order to reflect the real economic value and avoid arbitrary or fictitious customs values it is necessary to allow adjustments where the commercial value of the goods is diminished due to unforeseen circumstances. This may include where a portion of imported goods become unusable[89] or the goods have safety issues that require servicing.[90] In the event that the proposed defect has been taken into account and included in the price by the parties no further adjustment shall be allowed.[91]

By article 140 of the IA custom authorities are, upon reasonable doubts, authorised to ask of the declarant additional information regarding whether the declared transaction value represents the total amount paid or payable. Should these doubts not be alleviated the customs authorities may declare the transaction value method inapplicable for determining the customs value. This may be the case also where the veracity of the invoice and bank statements regarding payments is not in question but the price differs significantly from that of similar transactions effected by other parties on comparable markets.[92]

Incidental costs

The buyer may have additional costs in relation to the purchase beyond those accounted for in the sales contract. The transaction value is therefore to include costs incurred by the buyer in relation to the production and transport of the goods as regulated in the legislation. The UCC provides an exhaustive list of cost factors to be included solely on the basis of objective and quantifiable data.[93]

As regards the production of the goods, any goods and services provided by the buyer shall be added with either their purchase price or production cost or, should these not be ascertainable, on the basis of objective and quantifiable data, adjusted

[88] C-661/15 X BV para. 27-28.
[89] See 183/85 Repenning where a pro rata deduction of the customs value was allowed when a portion of imported frozen beef thawed and became unusable during transport after the sale, although the contract did not obligate a price deduction by the seller.
[90] As was the case in C-256/07 Mitsui and C-661/15 X BV.
[91] C-11/89 Unifert, article 118 IA.
[92] C-291/15 Euro 2004.
[93] Art 71(2) UCC.

for value depreciation in the event of prior use.[94] The list of products and services includes materials, components, tools, moulds, engineering and design work.[95] Also unsuccesful development costs incurred through orders or projects related to the goods shall be included but not research and preliminary design sketches.[96] Additional elements included are commissions and brokerage excluding buying commissions, the cost of containers as well as packing costs both for labour and materials.[97] The cost of transport, insurance and loading and handling are to be included up to the point where the goods are brought into Union customs territory.[98] The CJEU has held that the concept of ”cost of transport” is to be interpreted broadly and to include for example the profit margin of a transport agent[99] and demurrage costs.[100]

Contractual costs

Additional fees that are a condition of sale[101] but are not included in the price actually paid or payable may consist of royalties or license fees[102] or of proceeds from resale, disposal or use that are the gain either directly or indirectly of the seller.[103] If calculation of the amount is derived from the price of the goods it is presumed to be related to the goods, however the method of calculation is not decisive in determining whether the fees are related to the goods.[104] The exact amount of royalties payable need not be determined at the time of acceptance of the customs declaration.

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[94] Art. 135 IA.
[95] Art 71(1)(b) UCC. As in C-306/04 Compaq this may also include intangibles such as computer software that is supplied by the buyer to the seller in order for purchased computers to be imported with that software pre-installed.
[96] Art. 135 IA.
[97] Art 71(1)(a) UCC.
[98] Art. 71(1)(e) UCC. Costs within the Union are not to be included, see C-290/84 Mainfrucht.
[99] C-59/16 Shirtmakers, para. 25
[100] C-11/89 Unifert.
[101] Payments not considered a ”condition for sale” shall not be included in the customs value per art. 72(g) UCC. In C-173/15 GE Healthcare the CJEU held that the criteria ”condition of sale” is a question of whether *”..without such payment, the seller would not have concluded the sales contract…”* para. 60.
[102] Art. 71(1)(c) UCC.
[103] Art. 71(d) UCC, see also art. 70(3) UCC.
[104] Art. 136 IA.

Elements not forming part of the customs value

By article 72 of the UCC certain items are excluded from the customs value. These are:

- Cost of transport after entry into Union customs territory
- Charges related to work on industrial plants, machinery or equipment undertaken after entry into Union territory
- Interest charges for the buyer related to the imported goods due to a written financing arrangement where the goods are sold at the declared price and the claimed rate of interest is not higher than normal for the time and country where it was provided
- Charges for the right to reproduce the goods in the Union
- Buying commissions[105]
- Import duties or other charges due to import into the Union

Simplified measures

The price paid or payable and the elements referred to in articles 71 and 72 may not always be possible to quantify on the date of acceptance of the customs declaration. Pursuant to article 166 UCC a simplified declaration may be allowed where some elements of value and/or supporting documents are not provided. As stated in article 146 DA a supplementary declaration must then be submitted within 10 days from the release of the goods.[106]

If a procedure under article 166 UCC would result in disproportionate administrative costs these values may, by article 73 UCC, in these instances, subject to the conditions in article 71 DA, instead be calculated upon specific criteria.[107] This is provided that the value does not differ significantly from what would have been determined otherwise, that the importer has an accounting system and

[105] "A fee paid by an importer to an agent for representing him or her in the purchase of goods being valued" as per art. 5(41) UCC.
[106] As held by the CJEU in C-173/15 GE Healthcare this may apply in situations where it is not known whether royalties will be due as a condition of sale. Note though the restrictive time limits for supplementing the customs declaration.
[107] Where such specific criteria are absent upon which to determine elements of the customs value the transaction value method may not be applied and secondary methods must be applied.

administrative resources to detect illegal or irregular transactions and that accounts are kept to facilitate audit customs controls.

3.1.4.2 Determining the customs value when parties are related

As stated in article 70(3)(d) the transaction value shall apply provided that the buyer and seller are not related or the relationship did not influence the price. Reflecting the principles laid forth in the GATT the circumstance of a relationship does not in itself mean the inapplicability of the transaction value. While the sale may be examined more closely the declarant shall have the opportunity to supply details as to the circumstances where necessary.[108] The declarant may also perform a so called ”transaction test” demonstrating a close approximation either to the transaction values between unrelated parties that are effectuated closely related in time and involve identical or similar goods, or according to the deductive or computed method of determining value.[109] Should either of the above criteria be fulfilled the declared transaction value shall be used for determining the customs value.[110] Otherwise secondary methods of valuation must be used to determine the customs value.

3.1.4.3 Secondary methods of valuation

Pursuant to article 140 IA the customs authorities may decide that the primary method in article 70(1) UCC may not be applied. In this case a secondary method must be used.

Identical or similar Goods

As specified in article 141 of the IA, by the second and third methods of establishing the customs value the goods are compared to the transaction value of identical or, failing that, similar goods sold for export to the Union. Ideally they shall be traded in substantially the same quantities and at the same commercial level, at or around the same time as the transaction in question. If necessary, adjustments may be

[108] Art. 134(1) IA.
[109] Art. 134(2) IA.
[110] Art. 134(4) IA.

made as to allow comparison with different quantities or commercial levels. Differences as regards the mode of transport and the distance shall be adjusted for and where more than one transaction value is found the lowest value shall be chosen.

Deductive method

The deductive method as outlined in article 142 IA involves establishing a unit price consisting of the price at which either the same, identical or similar goods as those imported are sold in the same condition and at the same commercial level as the first sale efter importation, at or about the time of importation. It may not include sales to related persons or to persons supplying goods or services denoted in article 71(b) at reduced or no charge. From the unit price is deducted margins for profit and expenses as are usual for sales of goods within the same industrial sector, transport and insurance costs incurred within the Union as well as customs duties and other related taxes. Special regulations apply to perishable goods.

Computed method

Determining the customs value by use of the computed method is outlined in article 74(2)(d) UCC and further specified in article 143 IA. It involves the summation of: the cost or value of materials and fabrication or processing involved in the production of the goods; usual profits and expenses associated with sales of similar goods made for export by producers in the country of export; and costs of transport, insurance, loading and handling up to where the goods are brought into Union customs territory.

Fall-back method

Where valuation is not possible in adherence to the abovementioned methods a fall-back method is provided by article 74(3) UCC as specified in article 144 of the IA. This method calls for the application of data available within Union customs territory and using ”reasonable means” while still in compliance with the principles of the ACV, the GATT and the UCC. In application first and foremost ”reasonable flexibility” is allowed in the use of all previously mentioned methods while striving

to base the value on previously determined customs values. Failing this ”other appropriate methods” may be applied, excluding the following: The union selling price of domestically produced union goods, a system using the higher of two values for valuation, domestic market prices in the country of exportation, the cost of production unless according to article 74(2)(d) UCC, export prices to a third country, minimum customs values or arbitrary or fictitious values.

3.1.4.4 Retroactive adjustments of the customs value

Adjustments of the customs value after goods are released for circulation are afforded for in certain circumstances. An application for repayment of customs duties levied may be made to the customs authorities pursuant to article 121 of the UCC. In accordance with article 116 there are four grounds upon which repayment or remittance[111] shall be granted which are in the case of overcharged amounts, defective goods, errors by the authorities or for equity.

Although neither the previous CCC or the current UCC contain any express provision on the matter of TP adjustments many EU Member States have nevertheless, subject to various conditions, in practice allowed for retroactive repayments of duties levied where, due to a subsequent TP adjustment, the transactional customs value of goods has been reappraised accordingly.[112]

3.2 Transfer Pricing

The globalisation of trade with its emergence of MNEs and subsequent increase of cross-border dealings between related parties has brought TP to the increased attention of tax authorities. Originally applied mainly in domestic situations its relevance for taxation today stems from the retained sovereignty and resulting differences in, *inter alia,* taxation rates between states. It has now for some time been on the agenda of international organisations such as the OECD who launched

[111] That is, dependent on whether the customs duty has been paid by the importer, customs authorities will either return the payment or refrain from levying the overcharged duty.

[112] For a comprehensive global review, see Deloitte. It is however uncertain to which extent practice has changed with respect to the CJEU judgment in C-529/16 Hamamatsu. This will be adressed further in the Discussion chapter.

the Base Erosion and Profit Shifting (BEPS) project in order to combat undue tax evasion by reallocation of profits.[113]

Transfer pricing refers to *"the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises"*[114] and thus does not restrict itself to fiscal matters but forms an integral component of the business strategy of an MNE. In the realm of economics and business organisation, TP refers to the issue of appropriate pricing between divisions on the internal supply of goods and services in order to achieve optimal allocation of resources and accurate guidance for strategical and business related decisions at various organisational levels. It entails complex assessments of the structure and functioning of the organisation to be weighed against potential tax liabilities and risks of tax disputes.[115] Thus TP has an *ex ante* perspective in the actual price setting practice of the MNE and an *ex post* perspective in a subsequent audit by tax authorities.

3.2.1 International harmonisation of Transfer Pricing

The OECD comprises 36 member countries and represents some 80% of world trade and investment. Founded in 1948 as the Organisation for European Economic Cooperation (OEEC) its origins, much like the EU and European VAT system, may be traced back to the end of the second World War and was established for the reconstruction of the European continent through the Marshall Plan. The inclusion of Canada and the US saw it expanding its membership outside the continent and by the Convention on the Organisation for Economic Co-operation and Development the OECD was founded on 30 September 1961.[116] As per article 5 of the Convention the OECD may issue decisions that are binding on its members as well as make recommendations to members or enter into agreements with members as well as with non-members and international organisations.[117]

[113] OECD BEPS Action Plan 2013.
[114] OECD Guidelines, p. 20.
[115] Klassen, p. 457. An overview of factors may be found by Cecchini et al. who has characterised these assessment from a combined Transaction Cost Economic (TCE) and Resource-Based View (RBV).
[116] http://www.oecd.org/about/history/#d.en.194377f
[117] http://www.oecd.org/general/conventionontheorganisationforeconomicco-operationanddevelopment.htm

The OECD has long concerned itself with the issue of avoiding double and non-taxation of MNEs while retaining sovereignty of each state to tax income and capital. Since its first recommendation on double taxation in 1955 the OECD has regularly published updated recommendations and the Model Tax Convention on Income and on Capital had its latest iteration in 2017. While in the strict sense not legally binding upon its members the recommendations of the OECD are formulated subsequent to open discussions and with agreement among all its members and are followed closely, though subject to certain derogations, when tax treaties are formulated. Since 1995 the OECD has also published guidelines on the subject of TP, outlining a comprehensive approach to assessment as well as six different methods to compare the conditions of transactions with that of an independent party.[118]

In 2013 the OECD formulated its ”Action Plan on Base Erosion and Profit Shifting” to prevent practices of tax evasion and profit shifting among MNEs and avoid its harmful consequences for governments, taxpayers and business.[119] In so doing the concept of ”value creation” came to the forefront.

3.2.2 Harmonisation on the Union level

The competence of the EU is governed by the principle of conferral as outlined in articles 4(1) and 5(1-2) of the TEU. It is a strong fundamental principle that the right to legislate in the area of direct taxation shall be within the sovereignty of national states. Accordingly, competence in this area has not been conferred upon the Union and all competences therefore remain with the Member States. As per the case law of the CJEU however this competence must be exercised in conformance with the fundamental principles of EU law.[120] The principle of sincere cooperation expressed in article 4(3-5) of the TEU calls for mutual assistance between the institutions of the Union and the Member States in fulfilling the tasks and objectives of the Union and the Treaties.

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[118] OECD TP Guidelines 2017.
[119] OECD 2013, p. 7 - 8.
[120] T-755/15 and T-759/15 Luxembourg and Fiat v Commission, para 104. For a more comprehensive review of the complex legislative relationship regarding taxation between the Union and its member states see Wattel.

Consequently, national law in the area of direct taxation must follow general principles of EU law such as freedom of establishment and freedom of movement. In the context of MNEs and TP this may apply as regards the circumstance both of over and under-taxation of business. Tax authorities may be inclined to question the validity of TP arrangements and documentation making upwards adjustments of taxable profits. Conversely there is also a ”race to the bottom” in terms of attracting business through beneficial tax arrangements. The subsequent differences in classifications and rates of taxation provide ample opportunities for MNEs to shift their profits to jurisdictions where the tax burden is lighter or non-existent. Consequently these arrangements have prompted challenges by the Commission on the grounds of constituting state aid pursuant to article 107 of the TFEU. These situations, predicated on Advance Pricing Agreements (APA), are evaluated by the CJEU on the basis, *inter alia*, not primarily in terms of correct application of the ALP or of TP methods but rather on whether a preferential treatment is conferred to the taxpayer compared to other businesses.[121]

While TP concerns are not harmonised within the EU a directive on the cooperation and exchange of information is in effect to enable coordination regarding cross-border audits by the Member States with regards to taxes. This does not however incorporate the subjects of customs duties, VAT or excise duties.[122] As reported by the EU Joint Transfer Pricing Forum the directive has not been implemented uniformly among the Member States and has been put to limited use.[123]

[121] See in this regard for example T-755/15 and T-759/15 Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission

[122] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC. See articles 1 and 2 for subject matter and scope.

[123] See JTPF 2018 p. 6 and the adjoining Annex I as to the degree of implementation among the Member states.

3.2.3 Arm´s length in direct taxation

In article 9 of the OECD Model Tax Convention on Income and on Capital the ALP is defined as:

Where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State and

In either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[124]

As explained in the Guidelines on TP the ALP is objective in the sense that the conditions of the relevant transaction is evaluated on the basis of a comparable uncontrolled transaction, that is one made between independent entities. Although related business entities often engage in transactions that would not occur between independent parties and TP may be influenced by economically relevant motivations it is the distortion per se that is to be adjusted for regardless of intent or motivation. This for the purpose of *"establishing the conditions of the commercial and financial relations that they would expect to find between independent enterprises in comparable transactions under comparable circumstances."*[125] It should be kept in mind, though, that a fiscal adjustment does not itself alter the contractual relationship between the parties but is confined to the purposes of taxation. To adjust for such a fiscal adjustment requires compensating adjustments.[126]

[124] Article 9(1) Model Tax Convention on Income and on Capital.
[125] OECD TP Guidelines para 1.3
[126] These are described by van Brekel et al, pp. 183 – 184.

3.2.4 Determining value according to the OECD Guidelines

The OECD TP guidelines outline the methodology for assessing the adherence of a transaction to the ALP. This methodology is guided by the presumption that an independent entity would enter into a transaction only if it provides a clear advantage, as regards either the price or other condition, over any other option. It entails a multistep process which involves identifying and evaluating all relevant conditions and circumstances of a transaction to establish whether an independent entity would agree to those same conditions in a comparable situation. The ALP either has been adopted or is adhered to by all EU Member States.[127]

3.2.4.1 Understanding the dynamics of the MNE in its market context

The first step of the assessment concerns understanding the industrial sector in which the MNE operates to ascertain what factors influence the performance of businesses within that sector. How these factors are managed by the MNE is then evaluated. This may *inter alia* pertain to the business strategy chosen relative to the market, what products are offered and how supply chains are set up, management of assets and risks as well as how different functions are assigned within the MNE. The above factors form the basis when evaluating the role of the individual entity with regard for what particular function it assumes, for example if it is a sales department or production facility.[128]

Assessing the transaction within its proper context

Understanding the role of the individual party within the context of the MNE and the relevant industrial sector then allows for an accurate assessment regarding the nature of the transaction so that a proper evaluation may be performed of its relevant conditions and circumstances.[129] This would pertain to the terms of the contract but include also factors previously identified such as the business strategies of the parties, risks assumed and assets utilised, services rendered and

[127] https://ec.europa.eu/taxation_customs/business/company-tax/transfer-pricing-eu-context/joint-transfer-pricing-forum_en#heading_1
[128] See para. 1.34 of the OECD TP Guidelines.
[129] See, *inter alia,* para. 1.35 – 1.37 of the OECD TP guidelines.

functions performed within the MNE subject to the specific conditions of the sector in which it operates. A functional analysis is performed where the actual individual contribution of the MNE to the value creation[130], or its economic significance, is assessed based on the above cited performance factors. The transaction is thereby delineated in the context of the relevant market, the organisation of the MNE as well as the assumed roles of the specific parties to that MNE. This data may then be used to determine appropriate pricing by comparison to that which would be agreed to by an independent entity.

Comparing the transaction to that of an independent entity

In this comparison the main question is as to whether the conditions of the transaction evaluated would be acceptable to an independent entity making a comparable transaction in comparable circumstances.[131]

When making this assessment the TP guidelines present five different methods divided into two categories; “traditional transaction methods” and “transactional profit methods” respectively. These methods are to be applied based on which is more suitable to the type and context of the transaction or transactions to be assessed. There is, strictly speaking, no hierarchy however where equal reliability may be achieved the traditional transaction methods are to be prioritised and particularly the Comparable Uncontrolled Price (CUP) method. There is no obligation and in most cases no need to apply more than one valuation method but they may be used in conjunction should it be necessary.[132] Certain flexibility may also be applied as to whether to determine each transaction on its own or by combining transactions. Ideally performed on the basis of single transactions it is recognised that transactions may be linked in such a way as to prohibit separate evaluation, such as with long-term contracts, pricing product lines or rights to use of intangible property.[133]

[130] A term seemingly used interchangeably with the term value generation (see para. 1.51 of the OECD TP guidelines.)
[131] OECD TP Guidelines para. 1.33.
[132] OECD TP Guidelines para. 2.12.
[133] OECD TP Guidelines para 3.9.

3.2.4.2 Traditional transaction methods

Traditional Transaction methods include the *Comparable Uncontrolled Price (CUP)* method, the *resale price* method and the *cost plus* method. Where applicable these are the preferrable methods of assessment as the differences in price can generally be attributed directly to the commercial relations between the parties. Where a discrepancy is identified substituting the price in the controlled transaction with that in the comparable uncontrolled transaction will result in an arm's length condition.

Comparable Uncontrolled Price method

Relatively straightforward, the CUP method entails comparing the sale between related parties to that of a comparable transfer between unrelated parties.[134] Application of the method is subject to the condition that either there are no differences between the transactions capable of materially altering the price in an open market or that such differences may be adjusted for with reasonable accuracy. Regarded as the most reliable and direct, where applicable this is to be the preferred method of comparison.

The resale price method

Using the resale price method the starting point would be the subsequent sale when the product that was bought from a related party is in turn sold to an independent enterprise.[135] A "resale price margin" is then subtracted to allow for recovery of costs and an appropriate profit depending on which functions and liabilities are assumed by the reseller. Similar to the CUP method its application relies on there being no differences materially altering the resale price margin or that these differences may be adjusted for with reasonable accuracy. This method allows for comparisons of a wider range of products with less adjustments necessary as it relies on the profit margin rather than the price as the value of comparison. Also in the case of substantial differences in price between specific products, the respective profit margin may often be assumed to be similar within a

[134] OECD TP Guidelines, para. 2.14ff.
[135] OECD TP Guidelines, para. 2.27ff.

product category. This method is recommended preferrably where the reseller does not add substantially to the value of the good, such as by additional processing or adding trademarks.[136]

The cost plus method

Using the cost plus method an arm's length price is arrived at by accounting for the transactional costs incurred by the seller and adding the costs and profit mark-up for the buyer with due regard to the market conditions and the functions performed by the buyer.[137] This method is considered applicable primarily in the sale of semi-finished goods, in joint-facility agreements or where the parties have long-term agreements of purchases and sales.

3.2.4.3 Transactional profit methods

In some circumstances it may be more appropriate to focus on the profit generated rather than the price of the transaction in which case two methods are recommended by the OECD: The *transactional profit split* method and the *transactional net margin* method.

Transactional net margin method

Similar to the cost plus and the resale price methods outlined above this method examines the net profit accrued from a controlled transaction, ideally in relation to similar uncontrolled transactions by the same enterprise (so called internal comparables).[138] If such comparison is not possible external comparables, such as commercial databases, may be used.

Transactional profit split method

A transactional profit split method is to be used primarily where valuable contributions are made by both parties to the transaction where it would be appropriate to share profits proportionally to their respective contributions.[139] The

[136] OECD TP Guidelines, 2.35.
[137] OECD TP Guidelines, para. 2.45ff.
[138] OECD TP Guidelines, para. 2.62ff.
[139] OECD TP Guidelines, para. 2.114ff.

process entails identifying profits and losses from the transactions and then splitting those profits based on how they would be divided in an agreement between unrelated parties. It is thus possible to apply with great flexibility and according to the unique circumstances of the relationship, but less appropriate when either party performs only limited functions such as contract manufacturing.

3.2.4.4 Use of customs valuations

According to the TP guidelines the valuation methods use for customs purposes are not valid for use when determining arm's length adherence in TP. Cooperation between customs and tax authorities is encouraged however, particularly as customs authorities may have access to more detail regarding the transaction as such while tax authorities may have more documentation regarding the circumstances of the transaction. While it is recognised that motivations differ regarding valuation for TP and customs purposes (a lower price would result in a lower customs duty but presumably lead to higher profits subject to tax) greater cooperation is still seen as a way to closer align and establish singular values that are considered in line with the ALP according to both tax and customs authorities.[140]

3.2.4.5 Advance pricing agreements

To avoid continuous discussions and uncertainty on pricing arrangements it is possible to conclude an agreement as to what constitutes acceptable transactions within MNEs, based on predetermined criteria for TP over a set period ot time. Advantages to such arrangements are increased legal certainty and predictability as well as, ideally, avoiding the risk of double (or non) taxation.[141]

An APA may be a uni, bi or multi-lateral agreement. A unilateral agreements is binding only between the taxpayer and one tax authority. The OECD recommends that bi or multi-lateral APAs be concluded rather than unilateral which, while they

[140] OECD TP Guidelines, para. 1.137f.
[141] See JTPF (2007) para. 13 – 15.

may be appropriate in some situations, are generally not recommended and are not employed by all national authorities. This is as they provide less protection from the risk of double taxation as the tax authorities of the corresponding party to the transaction may yet determine that tax evasion has occurred and levy additional taxes as well as penalties on this party.[142] Bi and multi-lateral agreements have also not been subject to dispute in the context of state aid, which has been the issue with unilateral APAs.[143]

3.3 Value added tax

While the collection of turnover tax has been reported going as far back as the ancient Rome[144] the characteristics of the current VAT system originate from the 20th century. Credit for its invention has been afforded several sources but two people regularly cited as originators are Carl Friedrich von Siemens and Maurice Lauré. Though von Siemens is considered the first to discuss the concept of a VAT Lauré was responsible for the French VAT system from which the Union VAT system was developed.[145] The French system was adopted in 1954 as a solution to an economic crisis where VAT was seen as a means to raise revenue without hindering economic growth.[146]

As laid down in article 1 of the VAT Directive the principle of VAT is that of *"...a general tax on consumption exactly proportional to the price of the goods and services..."*[147] charged as calculated on the price of the goods or services after the VAT directly borne by costs is deducted. Described as a general indirect tax on consumption VAT is accumulated on a multi-level basis through the production and distribution chain while collected and reimbursed on each level.[148] As compared to a sales tax, which taxes only the last sale to the consumer, charging and subsequently refunding all actors in the value chain helps mitigate erosion of the

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[142] OECD TP Guidelines para. 4.141.
[143] Markham (p. 4) who also notes an increased tendency towards bi and especially multi-lateral agreements in recent years (p. 13).
[144] Terra, section 7.1.
[145] Charlet and Owens, p. 943.
[146] Lindholm, pp. 13 – 14.
[147] Article 1(2).
[148] For an explanatory summary of this multi-stage system see Cnossen.

tax base due to fraud and tax evasion. Thus it is essential that VAT and the method for calculating the taxable amount is applicable through all stages of the value chain. However, as a tax on consumption it is still ultimately targeted to the final consumer. The definition of “taxable amount” in VAT was therefore designed mainly with the end-stage transaction in mind.[149]

The principle of neutrality is a prominent guideline in the field of VAT. One aim of this principle is to ensure that the taxable persons, that is producers and retailers who in practice serve as collectors of the tax, are not themselves economically burdened by the tax. To that end, along with the obligation to pay to the tax authorities the outgoing VAT on supplies, taxable persons have the corresponding right to deduct and be reimbursed for the incoming VAT assigned to their costs. In this way VAT remains neutral as it does not affect either the profit for the taxable person or the real price of transaction until the final stage where the non-taxable person consumes the good paying the added VAT without possibility of reimbursement.[150]

Crucial factors for the success of VAT is the inclusion of a broad tax base, that is that all goods are subject to VAT with minimum exemptions, and the related principle of neutrality in the sense that business is fully relieved from the tax. Consequently it is held to be an integral part of the system of VAT that taxable persons have the right to deduct all VAT related to activities that are, in principle, subject to VAT regardless of their purposes or results.[151]

The importance of ascertaining a correct taxable amount thus lies in ensuring that the amount of VAT collected correlates to the amount of VAT reimbursed so that neutrality is conserved and an appropriate amount of tax is collected from the final consumer. Consequently, as long as there is a full right to deduct, whether the taxable amount accurately reflects the economic value of the goods is not relevant

[149] See Common system of value added tax: uniform basis of assessment. Proposal for a sixth Council Directive on the harmonization of Member States concerning turnover taxes, pp. 13 – 14.
[150] A point of considerable grievance and debate is the inclusion of several exemptions to the application of VAT which in many cases leave taxable persons without the right to fully refund their VAT payments. This of course hampers business and raises costs for the consumer.
[151] See C-424/12 SC Fatorie, para. 30 – 35.

as it does not affect either the price of final consumption or the revenue retained by tax authorities.

3.3.1 International harmonisation of value added tax

Turnover tax in the form of VAT or General Sales Taxes have been, or are being, implemented in the majority of states across the globe. While guidelines have been published by the OECD these focus mainly on the allocation of taxes so as to avoid double and non-taxation. They do not have binding effect and respect for the sovereignty of each state to implement and apply its own VAT regime is explicitly expressed.[152] This means that, with respect to the method for determining the taxable amount for VAT purposes, the EU is the primary source of legislation.

3.3.2 Harmonisation on the Union level

To eliminate distortion of competition and ensure free movement of goods and services on the common market, in 1967 the EU began implementing VAT directives to harmonise turnover taxation. Implementation proceeded in stages in order to give Member States the opportunity to adapt to the changes brought on by the new system of taxation. This has resulted in a succession of VAT directives.[153]

Member States have had opportunities to make certain exceptions and derogations in implementing the VAT system. Some provisions remain optional for Member States who also, in a number of instances, are free to enact further legislation and deviate in application for the purpose of correct collection of VAT. As a result, owing both to lagging implementation and individual choices, national application and practice diverges within the Union. This has an impact on the interaction between areas of taxation which will be touched upon further in the discussion.

[152] OECD VAT/GST Guidelines 2017.

[153] As stated in the preamble to the First Council Directive of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.s

3.3.3 Arm's length according to the VAT Directive

The relationship between VAT and the ALP is one of some uncertainty. Until 15 years ago the Directive bore no mention of this principle and the CJEU in the case of FCE Bank declared the entirety of the OECD convention ”irrelevant” as it concerns direct taxation.[154] Since then, however, the term “arm's length” has been employed in article 72 of the VAT Directive when defining the concept of OMV while in article 80 guidance is afforded as to the application of the OMV for VAT purposes.[155]

According to article 80, implementation of which is optional,[156] Member States may, in the case the supply involves related parties, take measures to prevent the evasion or avoidance of tax by applying the OMV as the taxable amount. As a guideline the following types of relationships are listed in this regard: Family or other close personal ties, management, ownership, membership, financial or legal ties (which may include that between an employer and an employee as well as the latter's family or closely connected person).

This provision may apply insofar as either; the recipient does not have full right of deduction and the consideration is lower than OMV or; the supplier does not have full right of deduction, the consideration is lower than OMV and the supply is exempt or; the supplier does not have full right of deduction and the consideration is higher than OMV. As confirmed by the CJEU these criteria are exhaustive and no other circumstances may invoke the use of the OMV under article 80.[157]

This article has been implemented by the majority of EU Member States though to varying degrees and subject to differing criteria. It has been criticised also for lacking guidance as to the practical application both in terms of when it is to be applied and how to calculate the OMV.[158]

[154] C-210/04 FCE Bank para. 39.
[155] Council Directive 2006/69/EC of 24 July 2006,
[156] Most Member States utilise open market valuation in this situations though to somewhat varying extent. See in this regard Annacondia, ch. 5.1.
[157] C-621/10 Balkan and Sea Properties, para 51.
[158] Matesanz, p. 7.

3.3.4 Determining the taxable amount according to the VAT Directive

The main rule for determining the taxable amount for a supply of goods as established in article 73 of the VAT Directive entails *"everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply."*

This includes, as specified in articles 78 and 79, taxes, duties, levies and charges except the VAT itself as well as incidental expenses exemplified as commission, packing, transport and insurance costs that are charged to the customer by the supplier. In order for a subjective value to be determined the consideration must be capable of being expressed in a monetary value. Failing this there is no consideration and consequently no VAT may be levied.[159] This does not mean, however, that consideration must be *in the form of* money. The exchange of goods or services as mutual payment has been held to be economically and financially identical to consideration in the form of money.[160] Where a good is offered at a reduced rate in exchange for a service the consideration makes up the subjective value placed on the service as expressed either by the reduction relative to the ordinary price for the good or its cost value.[161] While the CJEU has not ruled in the circumstance of a strict exchange of goods it has been argued to the effect that the consideration would be the cost price for the supplier of the respective good.[162]

Direct Link

The criteria for what constitutes consideration is the existence of a direct link between the payment and the supply of either goods or services. This direct link may be specified as a contractual obligation of reciprocical performance, that is the exchange of a supply for remuneration.[163]

[159] C-154/80 Staatssecretaris van Financiën v Coöperatieve Aardappelenbewararplaats GA, para 10 – 14.
[160] C-330/95 Goldsmith, para 23.
[161] C-230/87 Naturally Yours, para 18 and C-33/93 Empire Stores, para 19.
[162] Terra, section 13.2.1.
[163] See C-16/93 Tolsma para. 14, a case that laid the foundation for subsequently developed case law on the subject.

Where a direct link to a deductible transaction cannot be established a *pro rata* deduction is possible as a function of the general costs of business for the taxable person. The taxable person may then deduct a sum corresponding to the proportion of total turnover that is attributable to deductible transactions.[164]

Discounts

According to article 79 the taxable amount shall be reduced accordingly due to price discounts and rebates granted the customer and which are obtained by him at the time of the supply, amounts received by a taxable person from the customer that serve as repayment of expenses that have been incurred in the name and on behalf of the customer and has been entered in a suspense account by the taxable person. Also, price reductions due to discounts for early payment shall lower the taxable amount.

This underlying principle of the taxable amount was confirmed by the CJEU in the Argos case.[165] A company sold multi-purpose vouchers for subsequent distribution where, if purchased in certain quantities, the purchase price for the voucher was less than its face value. The question arose as to whether, when the vouchers were claimed by the consumer, the consideration should be determined by the discounted purchase price or by the higher face value of the voucher. The CJEU held in its judgment that the consideration received as regards the taxable amount is a subjective value consisting of the value actually received, not to be estimated according to objective criteria.

In instances where, in a transaction separated from the taxable person, a discount is provided the final consumer which reduces the consideration retained by that taxable person that discount must also be accounted for. The taxable amount is reduced accordingly as the consideration received is effectively reduced.[166]

[164] See articles 173 – 175 of the VAT Directive.
[165] C-288/94 Argos. This has since been codified in art. 73a of the VAT Directive.
[166] See 317/94 Elida Gibbs and C-462/16 Boehringer.

Incidental costs

Article 78 states that the taxable amount includes taxes, duties, levies and charges as well as incidental expenses such as commission, packing and transports costs. Incidental expenses, however, form part of the taxable amount only if charged the customer by the supplier. No account is taken to the effect for instance of lowering the taxable amounts where the supplier pays a third person to handle payment transactions, the costs of which are collected by that third person before reaching the taxable person.[167]

3.3.4.1 Retroactive adjustments

As VAT is a tax on consumption the burden of which, subject to the principle of VAT neutrality, is not to fall on taxable persons there is a strong propensity to allow retroactive adjustments so that taxable persons can fully enjoy their right to deduct and remain free of the burden of VAT.[168] This issue however becomes pressing only in the event that the taxable person is unable to make a full deduction. Adjustments are accounted for in articles 90, 184 and 185 of the VAT Directive and in a substantially more generous wording relative the customs code.

The issue of establishing a direct link may become problematic however in the event of subsequent TP adjustments made on an aggregate basis as a prerequisite for the deduction of VAT is the presentation of a specified invoice. In the case of extensive trade between companies the administrative burden of such a practice may be substantial and it is to some extent left to the discretion of the Member States to navigate these situations.

3.3.4.2 The taxable amount of imported goods

For goods imported from a third country article 85 of the directive states that the value for customs purposes shall also constitute the taxable amount with regards to VAT. Account is taken of additional, incidental, expenses as well as taxes and charges (including the customs duties) incurred outside the Member State (article

[167] As was the case in C-18/92 Ballys.
[168] See to that effect C-81/17 Zabrus.

86). Price reductions and discounts lower the taxable amount (article 87) and, by article 88, transactions for the purpose of repairs and other processing shall be treated, for the purposes of VAT, as if conducted within the territory of the Member State.

3.3.4.3 Open market value

Open market value is defined for VAT purposes in article 72 as *"the full amount that, in order to obtain the goods or services in question at that time, a customer at the same marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm's length within the territory of the Member State in which the supply is subject to tax."*

Where no market value can be established the taxable amount for a supply of goods is the purchase price either of the actual or similar goods or, failing that, the cost price at the time of supply. Similarly, as stated in articles 74 – 77, where a taxable person applies or disposes of goods that are part of his business assets or when taxable economic activity ceases and goods are retained by a taxable person or his successors, the taxable amount is defined as the purchase price of the goods or similar goods.[169] Should there be no purchase price the cost price at the relevant time shall be applied. The same method applies where a transfer is made of goods to another Member State, a so-called intra-community transfer.[170]

Member States have the opportunity subject to articles 273 and 395 of the VAT Directive to implement legislation in order to prevent tax evasion, including the use of objective measures of valuation. They are still to conform to the principles of neutrality and proportionality and as stated in article 273 may not impose obstacles for trade between the Member States. Assessments derogating from the subjective value should strive for determining a taxable amount as closely as possible to the consideration actually received on the basis of factual information and may be extrapolated for example from studies of the relevant sector.[171]

[169] VAT Directive, article 74.
[170] VAT Directive, article 76.
[171] See judgments in C-57/15 Maya Marinova and C-648/16 Fontana.

4 Discussion

In this chapter the CJEU judgment in the Hamamatsu case will serve as a basis for discussion on two principal questions that have been proven problematic as regards the relationship between customs and TP. These will be discussed from the viewpoint of the concepts of economic value accounted for in chapter 2. These questions are the connection between the ALP and the notion of the relationship *"not influencing the price"* and the impact of a subsequent TP adjustment on the established value for customs purposes. An analogous situation as regards TP and VAT interactions will also form basis for discussion. The chapter will conclude with some remarks of a more general nature on the nature of assessments within the respective systems.

4.1 Customs value and transfer pricing adjustments

The parallel administration of different systems of taxation is associated with significant administrative costs and legal uncertainty for MNEs.[172] This has been acknowledged by interest organisations and government authorities alike who have collaborated to find ways for increased uniformity in valuation methods between the systems. While recognising that WTO law is not expected to change anytime soon the WCO and the OECD have made joint efforts to increase cooperation and flexibility between TP and customs valuations.[173] For their part the International Chamber of Commerce (ICC) has advocated for official recognition by customs authorities of the presumption that TP documentation is sufficient proof of a valid transaction value. They also propose that retroactive adjustments are approved both for specific transactions and for weighted averages of multiple transactions over a fiscal year.[174] Landwehr has made suggestion to the effect of equating the ALP with the criteria of the relationship not influencing the price. By virtue of being the more developed principle, he argues that the ALP can be used to substantiate the corresponding principle within customs valuation. He finds support for this in the principle of systematic interpretation and the interpretative methods outlined

[172] Salva, pp. 347 – 348.
[173] WCO, pp. 59 – 60.
[174] See to that effect the policy statement of the ICC and also the ambitions expressed by Ping and Silberztein, representing the ICC and the OECD respectively.

in the Vienna Convention on the Law of Treaties. Where the countries involved have an agreement such as a tax treaty prescribing a method like that recommended by the OECD this method would then effectively be used also to guide the valuation for customs purposes.[175] It has been the practice, to varying degrees, throughout the EU to acknowledge TP documentation as validation of the declared transactional value of imported goods. It has also been accepted as grounds for a subsequent adjustment of the customs value in the case of a TP adjustment, issuing refunds or additional duties as appropriate.[176] With this seemingly uniform outlook on the relationship between TP assessments and customs valuations it was met with great surprise and consternation when a roadblock appeared in the form of the CJEU verdict in the Hamamatsu case.

4.1.1 The Hamamatsu case

As a part of a global MNE the German company Hamamatsu imported and sold optoelectronic devices, purchasing from their parent company Hamamatsu Photonic established in Japan. An APA was in place between the companies and the German tax authorities based on the Profit split-method.[177] An acceptable profit margin was determined for Hamamatsu Germany within which it was agreed that the ALP was satisfied. Upon importation, comprising thousands of consignments over the year, the selling price was checked regularly to ascertain that the transaction price was appropriate to achieve this profit margin. The agreed upon price was also used as a basis for declaring the customs value of the purchased goods according to the primary valuation method, that is the transaction value.[178]

When Hamamatsu Germany failed to reach the agreed-upon profit margin a year-end adjustment was made with the Japanese parent issuing a credit of EUR 4 million in order to comply with the APA. Following this adjustment Hamamatsu applied for a corresponding summary downward adjustment and repayment of customs duties for the goods in question in total of EUR 42 thousand which was rejected by the

[175] See Landwehr.
[176] Deloitte.
[177] See section 3.2.4.3 above.
[178] See section 3.1.4.1 above.

customs office. The question was eventually referred to the CJEU whether the customs code permits

> *"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?"*[179]

In its judgment the court briefly asserted through reference to its previous case law that the customs value "must reflect the real economic value of imported goods and take into account all the elements of those goods that have economic value"[180] and that retroactive adjustments may be necessary in order to avoid arbitrary or fictitious values. Such adjustments have however been held to be limited to "specific situations relating, *inter alia*, to quality defects or faulty workmanship in the goods discovered after their release for free circulation".[181] The court remarked that the CCC, which was the legislation in force, did not oblige either the importer to report an upward adjustment or allow the customs authorities to ascertain that adjustments are not made only downard. It was subsequently ruled that a pricing arrangement such as that in question was not permitted by the customs legislation in force.

Response to the judgment has been mixed. Rovetta et al. have argued that the court´s decision is simply reaffirming the obvious divide between customs and TP and that MNEs should make separate assessments to validate the transaction value declared. Others have questioned the apparent divergence from the harmonising ambitions expressed by organisations and expert groups alike.[182] Questions have been raised as to the interpretation and impact of the judgment and the relationship between customs and TP is very much uncertain. Certain loopholes have been suggested to continue accounting for TP adjustments, associated with

[179] Para. 22(1) of the judgment.
[180] Para. 28 of the judgment.
[181] Para. 30 of the judgment.
[182] See to that effect Friedhoff and Schipper, EY and PWC.

the simplified measures available in customs administration[183] which have been reported as being considered for extension.[184]

An extended time frame would presumably allow for adjustments of the customs value stemming from year-end assessments *ex post*. It is however questionable whether this would be in line with the purpose and principles of customs valuations as will be discussed in the following.

4.1.2 The relevance of the arm´s length principle for customs purposes

The CJEU remained silent on the issue of whether TP considerations to attain an ALP conformant price constitutes proof that the relationship between the parties did not influence the price.[185] This even though note was taken of the referring courts position that the initial value was a provisional and fictitious value and consequently should be disregarded. An e contrario reading of the verdict would thus indicate that a transaction value based on TP considerations is permitted as such by the CJEU. On a conceptual basis there are reservations to be had about this notion.

In EU legislation and communications the protectionist aspect of customs seems to have been downplayed in favour of its role in Union security, safety and in facilitating trade.[186] There is however no denying that customs duties have a protective function as regards the domestic market. This distinction was expressed by the CJEU in Chatain,[187] as well as in the initial proposal for the CCC by the European Commission.[188] It follows that the vested interest in customs administration, as protected by Union legislation, is the common market rather

[183] See PWC. These measures are described on p. 29 of this thesis.
[184] Friedhoff and Schipper
[185] A position taken by all major interest and expert organisations.
[186] Such as in article 206 of the TFEU referring to the CCP mandating the contribution of the Union in abolishing restrictions on international trade and to lowering customs as well as other barriers. Also preamble 15 of the UCC calling for ”simple, rapid and standard” procedures to facilitate legitimate trade, sentiments echoed also by article 3(b) and (d) calling for support of legitimate trade and for balancing protective and supportive functions. See also the description on the official website https://europa.eu/european-union/topics/customs_en (Accessed on 2020-05-16)
[187] C-65/79 Chatain, where the CJEU determined that the protective interest of customs legislation is to prevent under but not over-valuation and that the interests of the member states as regards direct taxation are not to be protected by Union legislation.
[188] By reference to customs duties as economical in nature, clarifying the relationship between the good and the common market and by specifying the relevant date to that of the introduction of the good to the common market.

than the country of importation.[189] Accordingly, the relevant relationship is that between the imported good and the common market. This is in contrast to TP where the price shall represent a fair apportionment of taxable profit between the respective countries of the buyer and the seller.

While to a certain extent the notion of value creation plays a role in determining the customs value,[190] for the purposes of TP this principle is given substantially more respect and a wider base of factors are taken into account to determine proper adherence.[191] It may be argued that the customs value as expressed in the original GATT is defined with the ideal in mind of a sale between two fully independent parties where the only interest is the exchange of full ownership, with no further commitments, for nothing but monetary compensation. Additional elements are accomodated for to compensate the deviation from this ideal in order to more accurately approximate the market exchange value inherent to the good. Interpreted in this context demonstrating that a relationship has not influenced the price would, strictly speaking, mean showing that such a price is actually found on the relevant market.

As an MNE often functions fundamentally differently from mutually independent business interactions, with for example pricing subject to strategies that differ between MNEs,[192] in absolute terms the price would in these cases assuredly differ between the two organisational constructs. As customs duties are levied directly based on the value of the transaction and not the resultant profit margin the ALP cannot, although it may result in an adequate distribution of profits, compensate for the inevitable distortion of the price stemming from the nature of the relationship itself. On principle therefore, adherence to the ALP can only in rare

[189] To this effect attention may be drawn also to ”Regulation (EU) 2015/478 on common rules for imports” regarding safeguards for serious injury. In article 4(3) of this regulation it is specified that the protected interest as regards, *inter alia*, the price of imports (art. 9(1)) is that of Union producers of like or competing products as those imported.
[190] As expressed in art. 71 and 72 of the UCC.
[191] Such as the assumption of risk and also for example the issue of intangible assets such as trademarks and royalties. While these are considered in a functional TP analysis they are part of the customs value only when connected to the imported goods.
[192] See Klassen and Cecchini referenced earlier. See also Cobham who remarks (p. 2) that the use of arm´s length pricing of intra-company transactions defeats the very purpose of organising business within an MNE.

cases be said to be equivalent to the criteria that the price is not influenced by the relationship between the parties.

Such a principled approach, however, denies the commercial reality of todays international trade and would likely be unworkable in practice. In addition to operating under conditions not found between independent parties, global value chains today involve trade in goods in all stages of production frequently making it impossible to actually establish a corresponding non-related party value.[193] It would also likely not result in less arbitrary or fictitious customs values, or for that matter greater uniformity, to forego the transaction value method due to the ALP not equating the corresponding customs requirement. With identical or similar goods often not to be found or their value unable to be determined recourse would need to be had to the deductive and computed methods of valuation. This would undoubtedly entail similar issues with obtaining information and finding reference values.[194]

In this regard it is also stated in the interpretative notes to the ACV that the existence of a relationship between the parties warrants a further inquiry only upon *reasonable doubts* as to the declared transaction value. Customs authorities may also use previous establishment of valid pricing arrangements as an indication of valid subsequent customs declarations. With this in mind it would appear that, despite their differences in methodology and purpose, there are economic incentives, political will and legal room to support the notion that TP information may well be used when determining customs values. Substantial convergences exist and though not explicitly stated in legislative documentation it is generally recognised that the price upon which the transaction value is based for customs purposes must adhere to the ALP.[195]

[193] WCO, pp. 48 – 50. Lack of data for reference concerning the CUP method of TP has been noted also by Peeters et al. (p. 31).
[194] WCO, p. 59.
[195] See Ping and Silberztein (p. 2), Salva (p. 348) and Landwehr to that effect. Note though that the CJEU has been dismissive of mixing direct and indirect concepts of taxation (as stated in FC Bank referenced earlier).

The ACV was signed in recognition of the primacy of the transaction value[196] and of the notion that customs valuation should be consistent with commercial practice, of which the ALP must be considered an integral part.[197] It should also be noted that while article 134(2) of the IA provides for the use of secondary valuation measures to support the declared value the formulation of article 134(1) leaves ample room for the importer to demonstrate how the circumstances of the sale justifiy the value declared. This has also been the practice for customs authorities throughout the EU.[198]

Accordingly, the use of TP documentation in proving adherence to the ALP should generally be sufficient for the importer to be able to demonstrate that the price was not unduly influenced by the relationship between the parties. In considering whether the final price may be made subject to a subsequent price adjustment due to an APA or other measure related to the ALP, however, the CJEU took a different stand.

4.1.3 Does a transfer pricing adjustment retroactively alter the customs value?

The second question thus remains, one that is debated also in the context of VAT and direct taxation. That is whether an adjustment for the purposes of direct taxation should result in a corresponding change in the customs value. The apparent consensus among experts and interest groups, including that of the WCO, has been that the affordance of a retroactive adjustment may be necessary in order to conform to the ALP and in extension constitute a valid price also for customs purposes. This was expressed in the published WCO case study 14.2[199] which described a situation, similar to that of Hamamatsu, where an importer of luxury

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[196] Which has been consistently reaffirmed by the CJEU, see para. 26 of the Hamamatsu judgment and the case law cited.
[197] Although the principle has certainly been questioned, not the least in light of the ever more pertinent issue of intangible assets and digital trade where the distinction between goods and services becomes less defined. See in that regard Cobham.
[198] Though this author has found no formal investigation as to the practice of customs since the Hamamatsu judgment, it has been reported anecdotally that the impact is mixed among the Member States, see PWC and Friedhoff in that regard.
[199] These case studies serve to guide customs valuation decisions but, as previously stated, are not legally binding. They may be found at http://www.wcoomd.org/en/topics/valuation/instruments-and-tools/recent-instruments/cases-studies.aspx (Accessed at 2020-05-18)

bags generated a higher than projected profit margin because "*more bags were sold at full price, and fewer at a discounted price, than anticipated*."[200] The case study concluded that since no compensating adjustment was made this transaction did not conform to the ALP and subsequently could not form the basis for customs value under the transaction value method.[201] Opinions to this effect have been expressed also by the ICC who has advocated the allowance both of a customs value declared on the basis of a TP valuation and that of a summarised retroactive adjustments of concluded importations over a fiscal year. These issues were also reflected by the questions submitted by the referring court.[202]

The CJEU stated that this is not permissible with the current legislation.[203] In fact, neither the customs authorities nor the importer may retroactively adjust the customs value either up or down due to the value being re-determined by a TP adjustment.[204] The CJEU reiterated the notion, which has been consistently repeated in its case law, that adjustment of the declared price is permitted only due to changes in the quality of the goods.[205]

In this reasoning the CJEU appears to express the notion that the economic value of a good as such must be affected. Their view would seem to align in this regard to that of value as an inherent or objective quality of the good, at least in so far as that in order to be accounted for a change in economic value must be present regardless of market context. There is also a temporal aspect distinguishing customs value from TP value. This is as where the basis for customs value is the *price,* the ALP governing TP valuations concerns *profits.*

As previously stated the price of a good may be viewed as determined by the subjective value assigned to it by the buyer and seller but also represents the objective exchange value of the good expressed as a monetary amount.[206] The

[200] Para. 6 of the case study.
[201] Para. 17 – 18.
[202] Note the questions referred in C-529/16 Hamamatsu para. 22, as compared to proposals 2 – 4 in the ICC policy statement, pp. 6 – 7.
[203] While the Hamamatsu case concerned the CCC no changes have been made to to warrant the conclusion that the situation should be handled differently under the UCC.
[204] Hamamatsu, para. 33.
[205] Hamamatsu, para. 29 – 32.
[206] Chapter 2.3.2.

transaction value thus consists of the exchange value made up of the *price* and further elements related to bringing the *goods* into the *Union market.* This is determined upon acceptance of the customs declaration where it is evaluated also as to its conformance with reference to a notional concept of value.[207] At this point, save for instances where information is omitted or falsely provided or the quality of the goods differ from that agreed upon between the parties, this determined value will be considered final.[208] Consequently, the subjective value, or *use value* it represents for the importer[209] is no longer relevant beyond this point as this has been replaced by the *objective exchange value* inherent to *the good* visavi the *Union market.* This latter value is determined *ex ante* and agreed upon between the parties and the customs authorities who, to the best of their knowledge at the time, declare and approve the customs value at the time of importation.[210] The CJEU thus would seem to hold a different view in that regard than what may be inferred from the WCO in their case study 14.2.

In contrast, while the TP strategy and actual price is also formulated *ex ante,* a tax audit evaluating conformance to the ALP (in the case of Hamamatsu through an APA) is made *ex post.* As this audit is done to ensure a proper allocation of taxable *profits* it is done from the perspective of the MNE as an organisation rather than that between the good and the Union market. Consequently the transaction is evaluated as to whether the realised *use value* validates the earlier *exchange value.* Should this not be the case an adjustment will be made. There are of course a number of factors that could influence this relationship of which purchase costs of

[207] The positive value is thus a presumtion but, as in Euro 2004, may be questioned if it deviates from established ranges of prices.
[208] While, pursuant to articles 46 and 48 UCC, customs authorities have mandate to perform customs controls as deemed necessary, by this logic and as expressed by the CJEU, this does not extend beyond the accuracy of the documents provided into comparing the realised use value with the established exchange value per se.
[209] Including its use for generating profit through its future exchange value.
[210] As expressed in the interpretative notes to article 1 of the ACV, the price shall be shown adequate to recover all costs and provide a representative profit. This is similar to the computed customs value method which mandates an amount covering expenses and profits representative to those ”usually reflected” in sales by producers in the country of export. Note that what is to be demonstrated is the *potential* of profit and the general references to the respective market.

goods are but one. This evaluation will therefore be of far greater complexity in practice.[211]

The ambition of EU customs legislation to determine the ”real economic value” of a good must evidently be balanced against the express mission of customs authorities to facilitate international trade. This mission includes minimising the burden of administration, part of which must be considered the finality in determinating the customs value. It would be in conformance with this interest and the original principles of the GATT to presume that the positive expression of the transaction value represents the customs value although this must not deviate too far from a notional concept such as ”normal” price levels of similar goods.[212] This balance is maintained also by holding that the customs value is determined at the time of importation and is not affected by subsequent developments between the buyer and seller or of the commercial success of the importer. This is reflected also in the rather formulaic secondary methods of valuation that seek to establish the customs value on a notional basis regardless of the specific business and pricing strategy of the importer, which are examples of factors that may be taken into account in a TP evaluation.

From a practical standpoint this view would relieve the issue of retroactive adjustments that places an administrative burden on customs authorities and MNEs alike. Avoided to a large extent is also the prospect of customs valuations being dependent on disputes between businesses and tax authorities that may drag on for several years.[213] As will be discussed further, separating customs valuations from TP in this manner also enables the CJEU to retain its authority over Union legislation without transgressing the bounds of its competence.

On the other hand such an arrangement of course puts additional pressure on the national customs authorities as well as MNEs to make sure their declared customs values are acceptable to all parties regardless of subsequent developments. It has

[211] Although the OECD guidelines caution against the use of hindsight (see, *inter alia,* para. 3.73) it is a complex issue evaluating what was known or foreseeable at the time of transaction and who bore what risks.
[212] As in Euro 2004.
[213] As by the EU Joint Transfer Pricing forum *”transfer pricing is potentially more subjective than other areas of direct and indirect taxation and, for this reason, sensitive to disputes.”* (p. 3).

been suggested that the practice of making the contracted price dependent on subsequent adjustments will no longer be viable due to the present verdict.[214] This is not necessarily true however and would probably be subject to a case by case evaluation. Upholding the distinction between direct taxation and customs means that the price of the good as initially agreed may well represent its value upon importation although developments after importation would call for an adjusted price for direct taxation purposes.

4.1.4 Some notes on harmonisation

As a supranational organisation with legal personality the EU has taken a unique position in terms of judicial authority. By conferring upon itself exclusive competence over a common, internal, market and customs matters it has assumed responsibility for the uniform administration of its customs regulations as obligated by the WTO. It is thus responsible for the horisontally uniform determination of value of goods for customs purposes. At the same time, the corresponding competence over direct taxation lies almost exclusively with the respective Member State the sovereignty of which is to be respected by the Union. In between these systems lies the partially harmonised area of VAT which as a general rule is harmonised as regards determining the taxable amount though derogation is allowed for the purpose of combatting fraud and tax evasion.

Bearing this in mind, the case of Hamamatsu can be seen as having faced the CJEU with a dilemma. The approval of TP valuations forming the basis of the transaction value, retroactively adjusted depending on end-of-year profits, would in effect mean that customs values were extensively decided by the German tax authorities and thus subject to national fiscal legislation, thereby effectively circumventing Union customs legislation.

This would have compromised the position of the CJEU as its competence lies in interpreting Union legislation, not national legislation. A subsequent referral for a preliminary ruling in a similar situation would put the CJEU in the position where it

[214] See the report by PWC.

would either have to refrain from judgment so as not to encroach on national legislation or to issue a judgment on the matter. The former would render the court essentially handcuffed and incapable of ensuring uniform administration on customs matters. Choosing the latter would risk overstepping the limits of its competence as it would essentially be ruling on matters of direct taxation. Neither is of course a preferrable scenario and keeping the two forms of taxation separate was likely the only way for the court to retain its authority in matters of the customs union. The Hamamatsu judgment may thus be interpreted as an example of differing principles on horisontal harmonisation precluding the opportunity for vertical harmonisation within the Union.

4.2 Transfer pricing and value added tax

The issue of retroactive adjustments is relevant also as regards VAT and TP adjustments. Had the Hamamatsu group been established solely within the Union a similar TP adjustment would raise the question of whether a subsequent TP adjustment could precipitate a corresponding change of the taxable amount for VAT purposes. Or, for that matter, if an adjustment for VAT purposes necessitates an adjustment as regards direct taxation. In a parallel intra-Community Hamamatsu scenario where an APA mandates the seller issuing the buyer a credit in order to restore an ALP adherent profit margin, would then the taxable amount for VAT also be lowered?

Three scenarios may be envisioned in this case:

1. An adjustment is made by tax authorities but the contractual obligations remain unchanged.
2. An adjustment is made by tax authorities and a compensating adjustment of the price of supply is made between the parties.
3. The parties make a preemptive voluntary adjustment of the price in order to conform with the ALP.

The VAT Directive, being reliant upon transposition into the legislation of the respective Member States and providing more options for individualised application, is less uniformly applied within the Union compared to the UCC. It may

be noted that, like the UCC, the VAT Directive does not regulate the issue of TP adjustments related to the supply of goods and neither has the issue been addressed by the CJEU. Although the subject matter has been discussed in doctrine actual practice is liable to vary significantly among the Member States.

The view has been put forth that where both parties have full right of deduction all TP motivated adjustments, voluntary or otherwise, should be considered ”out of scope” of VAT.[215] The distinction is noted between TP and VAT, where for VAT purposes taxable persons function as collectors of tax and should suffer no negative consequences related to adjustments linked to direct tax considerations. From the underlying purpose and function of the two systems of taxation there is indeed an obvious difference as to the significance in practice. Whereas a price set differently to market value will affect the profits subject to direct taxation and thereby fiscal revenue, VAT neutrality will not be affected as the difference in VAT paid by the seller is offset by the corresponding difference in deductible expenses for the buyer. Establishing and conforming to an OMV is therefore inconsequential for VAT purposes and poses an unnecessary administrative burden for the taxable persons involved.

It has however also been suggested that, although an adjustment mandated by authorities not stemming from an agreement between the parties should not lead to an adjusted taxable amount, this should be possible by a voluntary agreement.[216] This would presuppose that a specific transaction may be identified so that remuneration for each individual supply may be adjusted.

It is doubtful that the principle of neutrality would mandate such a right given that the net result for VAT purposes would not be affected. Due to the lack of harmonisation in this regard this is a situation likely to be handled quite differently throughout the Union. This is unfortunate as where full right to deduction exists lack of harmonisation and legal certainty is likely a bigger concern than either option being mandated throughout the Union.

[215] VAT Expert Group, pp. 8 – 9.
[216] Matesanz, p. 9.

4.2.1 The case of related parties with limited rights of deduction

Where either party does not have full right of deduction article 80 of the VAT Directive allows Member States to require the OMV be used for supplies between related parties.[217] The motivation for establishing a market value in this case is of course the incentive for taxable persons to manipulate the consideration in order to unfairly minimise their tax liability. Where the business of a taxable person includes both exempt transactions and transactions subject to VAT, by altering the price (higher for deductible and lower for exempt transactions) a higher proportion of turnover will be made deductible for that person.[218]

It has been suggested that the use of the OMV to combat tax evasion was a sign that VAT is moving closer to objective valuation methods and aligning with OECD TP methodology.[219] In these scenarios there is for tax authorities a common interest in applying the OMV as it would maximise revenue of both direct tax and VAT, the full collection of which is also an obligation of the Member States.[220]

The principle of neutrality and proportionality would dictate that only where the actual intent of the taxable person is to evade tax liability is the application of article 80 motivated.[221] This is also stated in the original proposal by the commission and the proposed wording of article 80 qualified it as to apply only to ”significantly” higher or lower consideration.[222] This word was omitted in the final version. It would follow that it is to a large extent subject to the discretion of Member States in transposing it into national legislation as well as how it is applied. As noted by Rouberol in Denmark for instance implementation was motivated by domestic situations but there is nothing in their national law to preclude its use in

[217] Interestingly, and unfortunately, the VAT Directive employs the term ”fair competition” in article 72 to speficy the OMV. This term is not defined for VAT purposes and would not seem to be widely used in either system of tax legislation. It is therefore unclear what, if anything, it adds to the definition at hand.
[218] Compare the pro rata calculation in section 3.3.4 under ”Direct link”.
[219] See Idsinga et al., p. 202.
[220] See for example C-576/15 Maya Marinova para. 40 – 41 as well as C-42/17 MAS para. 30 – 33. See to this effect also preamble 26 of the VAT Directive.
[221] Matesanz, p. 10.
[222] Proposal for a COUNCIL DIRECTIVE amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion and avoidance, and repealing certain Decisions granting derogations, pp. 5 - 6.

cross-border transactions.[223] In practice there is thus nothing stopping a Member State from fully aligning VAT with direct taxation assessments in these scenarios nor is there any obligation to allow for the reassessment of the taxable amount at all. Consequently this article has been implemented to varying degrees as regards the type of goods and circumstances around the supply.[224]

4.3 Legal harmonisation

There are notable differences between the systems both in the degree of horisontal harmonisation and in the measures by which that harmonisation is achieved. In customs matters the EU is obligated by the WTO to uphold uniform customs administration subject to adjudication by the WTO Dispute Panel and has subsequently imposed exclusive legislation on its Member States supervised by the CJEU. In contrast, its competences within direct taxation is in general restricted to matters concerning fundamental EU principles. Similarly the OECD guidelines that dictate the methods for TP valuations are not legally binding and are not enforced upon the concerned states. There is thus no central or international legal forum for disputes in most matters of TP concerns. As for the VAT system the EU is the prime legislator and the CJEU the competent authority for its correct and uniform application. Despite the ambition for EU wide harmonisation as regards determining the taxable amount Member States have been provided opportunies for derogations and further national legislation to combat fraud and tax evasion. This has made for divergent practice among the Member States with concepts such as the ALP and OMV left without harmonised definition in the field of VAT.

4.4 The basis for taxation

The taxable base of customs and VAT are both made up of transactions in the form of an importation and a supply respectively. Notable in this regard is the reverse perspective in that customs is levied on the importer and based on everything paid or payable while VAT is levied on the supplier based on everything received in

[223] Rouberol, p. 318.
[224] See Annacondia, section 5.1, for an overview by country.

consideration. In contrast TP valuations are based from the perspective of profits. Although traditional transactional valuation methods are made based on transactions, ultimately it is the resultant profits that are subject to taxation and thus more account is taken of the use value of the good for the buyer.

For all three systems it is thus the exchange value of a good that is to be determined. Their methodologies vary and incorporate both market assessments as well as determining production costs or calculating standardised profit margins. The principle of value creation guiding TP assessments is not well defined making the assessment more prone to individual bias and variation across the Union.

4.5 Positive or notional value

A common feature of both customs and VAT is their reliance on the positively expressed exchange value, that is the invoiced price, as the primary basis for determining the value of a good. Regarding customs the CJEU held in the Euro 2004 case that an ”exceptionally low” (less than 50 %) amount paid relative to the statistical mean value of the good may precipitate the use of other methods than the transaction value if sufficient motivation is not provided by the importer.

By this judgment the CJEU would appear to prioritise the concept of ”real economic value” over the principle of transaction value as the primary method for determining customs value. Although the legal basis used for rejecting the transaction value (current article 140 of the IA) refers to doubts of the ”total amount paid or payable” the CJEU apparently approves of rejecting the declared transaction value as such, even though the authenticity of the price or payment was not brought into question. It would thus appear that although current agreements and legislation mandates the use of positive values, the CJEU has not fully abandoned the notional concept of value as a reference even between unrelated parties.

In VAT the use of notional methods, primarily in the form of OMV, is permitted only exceptionally, to combat fraud and tax evasion. To ensure neutrality for the taxable person Member States are subject to principles of, *inter alia*, proportionality and right to defence. The facultative nature and absence of clear guidance to

accompany this opportunity to alter the perspective on economic value indicate a pragmatic approach rather than one firmly rooted in principles. The lack of harmonisation when allowing for such a dramatic change in perspective of valuation may however prove detrimental to intra-community trade and the functioning of the internal market. This due to the uncertainty and increased administrative costs for traders in addition to the opportunity for Member States to apply these methods beyond their intended use.

For their part TP valuations may be performed either by MNEs when establishing prices or by authorities in auditing to assess the conformity of pricing to the ALP. Both instances take a distinctly reverse perspective to that of VAT and customs in the intent of establishing a notional exchange value by reference to which the positive value is decided or measured.

4.6 The scope of the assessment

The aim of customs valuations is to determine a transaction value which may be expressed as the price + additional costs in bringing the goods into free circulation within the Union. Accordingly, the reference values used for secondary valuation methods are domestic to the Union rather than the Member State of the importer. To achieve uniformity a more formulaic approach is taken with pre-established factors such as standardised ”usual” commissions, transport and other connected costs and profits,[225] used to increase or decrease the customs value accordingly.

For TP purposes a proper distribution is sought and assessment may be performed from a more narrow perspective on the market. A significantly more extensive and individually adapted assessment may be performed, to a larger extent taking into consideration contextual aspects such as intangible assets, the financial structure of the MNE and pricing strategies.

[225] See article 142 IA in reference to the deductive method.

5 Conclusion

The historical context and underlying purposes for these different forms of taxation have shaped their legislation and principles by which value is determined. While ultimately all three systems of taxation are based mainly on the exchange value of goods this is determined from different perspectives and on the basis of different notions of value such as the production and use value. The potential for vertical harmonisation thus seems rather limited other than in the form of using data from the respective field as a basis for information.

Compounding this dilemma is the differences in degree and manner of horisontal harmonisation and the unique function of the EU as a legislator and arbiter of law in a partly harmonised collective of sovereign nations. Managing the interactions of systems with different degrees of harmonisation and subject to varying forms of international governance means effectively walking a legal tightrope. Increasing the horisontal uniformity in valuation for customs and VAT purposes must however be seen as within the competence of the EU and would serve to ensure legal certainty for international traders.

The Hamamatsu verdict could be a step in the direction of improved horisontal harmony and also of clarity. At the present day however it would seem to have caused even more uncertainty and it is unclear as to what extent it has affected the practice of Union customs authorities. It would be unfortunate if the verdict inspired more legal circumvention and local makeshift practices rather than uniform measures. Further clarification either by case law or legislation would be welcome. Although being held accountable by three distinct systems of taxation is an administrative burden, this need not be compounded by the legal uncertainty inherent to conformance also to their differing application within 27 Member States.

It would seem that uniform measures of value cannot be accomplished between the systems while remaining true to their stated and implicit principles. It remains to be seen who will hold on to their principles and who will realise that they do, in fact, have others to offer.

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