

## TRANSFER PRICING ROUSING CUSTOMS AUTHORITIES TO ACTION

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### Asia International Trade Alert

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As the world slowly emerges from the COVID-19 pandemic, companies are busy grappling with the huge disruption to global manufacturing and supply chains, the permanent closure of some businesses, the downsizing, consolidation or divestment of other operations, and the retrenchments or displacement of workers. While most focus on measures governments are taking to support businesses and workers, very little attention is paid to how governments will be paying for such financial assistance programs.

In this alert, we focus on several countries' customs authority, specifically considering concerns in regard to transfer pricing and related party transactions, and the actions businesses can take to mitigate exposures.

The primary revenue source for governments are through direct (individual income tax and corporate tax) and indirect taxes (import/export duties, VAT/GST/sales tax, and excise duties) which are collected by the customs authority (indirect taxes) and the tax authority (direct tax). In the current economic environment, even though there is a drastic drop in revenue collection due to the huge disruption to trade and business activities, these two revenue authorities would still need to meet their annual revenue collection targets. In other words, the authorities would need to ensure that the revenue collected is correct and where possible, seek to collect additional revenue through other means provided under the law, such as fines and penalties for offences. We note that penalties can be as high as 10 times the revenue short-paid, and managers responsible for the customs compliance function or their managers may face jail time.

Given the revenue shortfalls, it is no surprise that these two revenue authorities are increasing their post-import audits, investigations, and requests for more documentation. These audits and investigations are normal "tools" the customs and tax authorities use to verify the accuracy, completeness and authenticity of revenue declarations made to them by businesses. These actions are usually taken post-clearance (in the case of customs) or post-reporting/filing (in the case of tax). In Asia, the customs authorities in China, Korea, Thailand, and India are most active in conducting audits and investigations into cross-border trade in goods. Korea has been conducting free trade agreement country of origin verifications, while China is focusing on customs valuation and transfer pricing, particularly in relation to royalties and management fees.

During a customs audit or investigation, the customs authority will likely speak directly with a company's finance/accounting personnel, particularly in regard to transfer pricing. Based on past customs audit/investigation experience, we found that most finance/accounting personnel usually understand transfer pricing from a direct tax perspective but do not appreciate its relevance from a customs valuation perspective. In other words, most companies' transfer pricing policies do not take customs valuation rules into account. In case of customs audit or investigation, the company's customs and supply chain personnel will be placed in a vulnerable position as they would not be able to explain the company's transfer pricing policy to the customs authority; the finance/accounting

personnel will also not be able to respond satisfactorily to Customs. This is a situation in which the company may not have any choice as it will be customs who are the primary drivers, and they will expect that the accounting and finance personnel will not have a great deal of knowledge on customs valuation. Thus, we recommend that key transfer pricing personnel should ensure that they understand customs valuation rules, or better yet, the transfer pricing team should involve customs and supply chain personnel at the time of setting transfer prices and adjusting those prices.

## **ACCOUNTING FOR RELATED-PARTY TRANSACTIONS**

The following are some examples of how some countries in Asia have amended their operations, laws, and processes to ensure that the revenue being collected is in fact accurate and complete.

### **Thailand**

A key area of focus for the Royal Thai Customs Department when carrying out post-clearance audits has been related party transactions.

In November 2019, the Revenue Department of Thailand released the Notification of the Director General of the Revenue Department on the Official Transfer Pricing Form (Disclosure Form). Companies trading with related parties must complete and submit the form. The Disclosure Form applies to taxpayers who have related party transactions, with total annual operating revenues of THB 200 million or higher, and have an accounting period starting from January 1, 2019 onwards.

The disclosure to the Revenue Department of Thailand of intra-company payments such as royalties, license fees, technical service fees, commissions, and management fees will be made available to the Royal Thai Customs Department. The Customs Department can then use information provided in the disclosure to determine whether such inter-company payments meet the conditions prescribed under the customs regulation for inclusion into the customs value of imports.

Besides the information obtained from the new Disclosure Form, the Customs Department also receives from the Revenue Department, the withholding tax returns (Form P.N.D. 54) and the self-assessment VAT returns (Form P.P.36). This information, when combined with the information already provided to customs by importers and their third-parties, provides substantive insight into a company's operations.

We note that the Thai Customs Act rewards customs officers for uncovering certain offences. Currently, the total award is 40 percent of duty shortfall plus fines (comprising 20 percent incentive payment and 20 percent reward). The reward and incentive payments are separately capped at THB 5 million (approximately US\$158,000). Thus, Thai customs officers have a huge incentive to audit or investigate companies for customs offences. Based on our successful work assisting clients in dealing with Thai Customs' audits/investigations, we fully appreciate Thai customs' capacity and tenacity in this regard. We suggest that importers in Thailand conduct regular due diligence on their import activities and bonded operations. Otherwise, a duty evasion offence under Section 243 of the Customs Act B.E. 2560 (2017) would attract a maximum imprisonment not exceeding 10 years and/or a penalty ranging between 50 to 400 percent of customs duty shortfall.

### **Taiwan**

In November 2019, Taiwan introduced new rules on the management of Transfer Pricing Adjustments (Tax Ruling No. 10804629000). The new rules apply to the handling of retroactive one-time transfer pricing adjustments.

Coinciding with the new Tax Ruling, the Taiwan Customs Administration released “Guidelines on assessing one-time transfer pricing adjustment to determine the dutiable value” (“Guidelines”). The Guidelines are designed to assist companies which have imported or are importing goods from related parties and would like to adopt the Tax Ruling.

According to the Guidelines, at the time of goods importation, the importer should declare a provisional customs value using a pro-forma invoice, provide a customs value declaration form, and apply for release of their goods upon the payment of a deposit. On the import declaration form, the importer must indicate Code 136 (special relationship field) and Code 65 (payment method as duty estimate); in the “Other declared items” field, indicate that the declared item(s) is/are subject to a one-time transfer pricing adjustment in the fiscal year.

Within one month after the end of the fiscal year, the importer must apply to the Customs Department for a final customs value assessment for all goods imported under provisional values.

## Information Sharing

With the implementation of many of the action items recommended in the Organisation for Economic Co-operation and Development (OECD) report on Base Erosion and Profit Shifting (BEPS), the Tax authorities can now access a substantially increased amount of information which companies operating in jurisdictions that have agreed to comply with OECD BEPS standards must provide. This includes information on a company's supply and value chains which may be detailed in country-by-country (CbC) reports. Although such information is specifically required by the Tax authority, it may be shared with its sister agency (customs) through a collaborative arrangement. Furthermore, there are increasing efforts by revenue authorities to cooperate on a cross-border basis. Jealously guarding information appears to be a thing of the past; now, the holistic or “single-window” approach has permeated revenue collection and enforcement efforts as well. With access to such detailed information, the customs authorities can more accurately profile companies for audit or investigation.

An example of this is the March 4, 2020 announcement by the Inland Revenue Department of Hong Kong that China and Hong Kong have entered into an arrangement for the automatic exchange of CbC reports. This exchange would be applied retrospectively to accounting periods beginning on or after January 1, 2018. While the sharing of CbC reports will benefit companies in regard to tax filings, it also means that such information will also be available to the tax authorities in China and Hong Kong. For many companies using Hong Kong as a transit, transshipment and/or re-invoicing hub for goods exported from China or destined for China, this would mean greater exposure to customs review, audit and/or investigation, including transfer pricing and customs valuation audits and investigations. This could be undertaken by either Hong Kong or China Customs or a combined audit/investigation. This trend can also be seen in other Asian jurisdictions, including India, Thailand, and Korea.

## ADDITIONAL CONSIDERATIONS

Although we are highlighting customs valuation and transfer pricing concerns in this alert, businesses should also be aware of other changes that have already occurred or are being proposed by countries in Asia. These include new classifications of products, increases in import duty rates, drops in the value threshold for import duty exemption for goods imported via courier, closer monitoring, and possible nonacceptance of self-certified preferential origin claims.

Businesses need to examine their operations, agreements, arrangements, etc., especially intra-company transactions, to ensure that all their activities are fully compliant with the relevant laws and regulations. In

particular, businesses need to ensure that the information provided to the revenue authorities is accurate, complete, and consistent, especially in respect to transfer pricing reports.

## HOW WE CAN HELP

K&L Gates' customs and international trade team provides advice and assistance to companies in reviewing their current and past operations for customs and trade compliance. During this restricted travel phase, our team can remotely review all contracts, agreements, and arrangements, as well as conduct video interviews with key personnel.

Should you wish to discuss this further, we welcome your enquiry. Please contact the author or our team members listed below.

## KEY CONTACTS



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