BEPS and transfer pricing but what about VAT and Customs?

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Forum

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1 INTRODUCTION

‘BEPS and Transfer Pricing, but what about VAT and Customs?’ was the subject of the seminar organized by the Foundation for European Fiscal Studies to mark the end of this year’s Post-Masters in Indirect Taxes and EU Customs Law.

This subject is at the intersection of transfer pricing, VAT and customs, with the common denominator being developments in the BEPS project of the Organisation for Economic Co-operation and Development (OECD). This is a very topical issue, given the recently published final reports of the BEPS project,2 the WCO Guide to Customs Valuation and Transfer Pricing published by the World Customs Organization (WCO)3 and the forthcoming introduction of the Union Customs Code (UCC)4 on 1 May 2016.

The well-attended seminar, chaired by René van der Paardt5 was held in a conference hall at the Erasmus University Rotterdam.6

2 UPDATE ON THE TRANSFER PRICING-RELATED ELEMENTS OF THE OECD’S BEPS PROJECT

Ronald van den Brekel7 engaged the audience in his clear explanation of the background, aims, approach, implementation and contents of the BEPS project, while also discussing the European Commission’s proposed package of measures to combat tax fraud and evasion. These discussions formed a prelude to the presentations examining the impact of BEPS on the link between transfer pricing and VAT on the one hand and transfer pricing and customs (specifically customs valuations) on the other.

2.1 Background, Objective and Approach of the BEPS Project

The BEPS project is an OECD study to establish whether and, if so, why current legislation allows taxable profits to be allocated to states other than those where the related business activities are performed. The reasons prompting the project included the digitalization of economies and the decline in tax revenues seen as a result of the economic crisis. The main aim of the BEPS project is to ensure that company profits are taxed in the country where value is created. In this way, the project is seeking to realign taxation with the country where activities are performed. Van den Brekel acknowledged that this place is not the same as the place of supply for VAT purposes, which is determined on a more legalistic basis. The BEPS project has been approached differently from previous OECD projects in that, as well as OECD members, those participating in this project also include G-20 countries. This was because the OECD wanted to create broad-ranging support for the project.

2.2 Implementing the BEPS Project

The OECD published its final BEPS reports on 5 October 2015, which can be divided into three

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1 This contribution is an adaptation of an report previously published in Dutch.


3 The WCO Guide to Customs Valuation and Transfer Pricing is available on http://www.wcoomd.org/en/topics/key-issues/revenue-package/-/media/SDE1A94DC54B47109514FFCD0AAE0BA.adpx.


5 René van der Paardt is a board member and programme director of EFS’ Post-Master in Indirect Taxes, Professor of Economics of Taxation at the Erasmus School of Economics and also counsel at Loyens & Loeff N.V.

6 The seminar sheets are available on http://www.europesefiscalestudies.nl/?page_id=1019.

7 Ronald van den Brekel is a lecturer of EFS’ Post-Master in International and European Tax as well as being partner at EY, where he leads the transfer pricing practices in Belgium and the Netherlands.
categories. The first of these, ‘Minimum Standards’, comprises Actions that all participating countries must at least implement in their treaties or national legislation. The second category, ‘Reinforced Standards’, consists of Actions designed to tighten the standards applying in the OECD’s existing Transfer Guidelines and Model Tax Convention and may have retroactive effect.\(^9\)\(^\text{10}\) While the third category comprises ‘Common Approaches and Best Practices’. These Actions can be seen as building blocks that countries participating in the BEPS project can implement as they see fit, while the optional nature of these blocks means they will be significant only insofar as the taxable entity carries out activities in the country in which the blocks have been put in place. Taxable entities will have to determine this on a country-by-country basis.

2.3 Contents of the BEPS Project

Van den Brekel went on to focus on Actions 7, 8-10 and 13 as he sees these as having an impact on VAT and customs.\(^11\)

2.3.1 Action 7: Preventing the Artificial Avoidance of PE Status

Action 7 gives a more economic approach to the concept of the permanent establishment, with a lowering of the threshold for qualifying as such an establishment, since:

- Action 7 creates the opportunity for tax authorities to classify warehousing facilities as a permanent establishment, providing they are not merely for support and preparation purposes;
- The factual analysis does not cover the economic activities of just one enterprise, but also takes account of the activities of other members of the group;
- Companies that contractually split their activities in a temporal sense solely in order to avoid classification as a permanent establishment will therefore be affected, given that the factual analysis will examine such activities in their totality.

\(^8\) These are Action 5 ‘Harmful tax practices’, Action 6 ‘Treaty abuse’, Action 13 ‘Country-by-country reporting’ and Action 14 ‘Dispute resolution’ (or parts of these Actions). The OECD has consequently devised a multilateral instrument in the form of Action 15 that allows Actions that have to be incorporated into treaties to come into effect as early as 2017.

\(^9\) In the case of the OECD Transfer Pricing Guidelines, these are Actions 8-10 ‘Transfer pricing’ and Action 13 ‘Transfer pricing documentation’. In the case of the OECD Model Tax Convention, these are Action 2 ‘Hybrid mismatch arrangements’, Action 6 ‘Treaty abuse’, Action 7 ‘Permanent establishment status’ and Action 14 ‘Dispute resolution’.

\(^10\) The Dutch tax authorities, for example, would seem to share this view, given the State Secretary for Finance’s answers on 2 Feb. 2016 to questions and comments raised by the House of Representatives following the government’s response to the European Commission’s decision on Starbucks, Parliamentary Papers II 2015/2016, 29 058, No. 113.

\(^11\) Action 1 was also mentioned by Van den Brekel, but it is left out because it is discussed in more detail by Van Kesteren.

Speaker was surprised that the OECD had not chosen first to consider the question of how much profit should be allocated to specific economic activities (in the event of a permanent establishment). After all, if no profits are allocated to economic activities, this simply creates unnecessary extra administration for such enterprises. Moreover, since certain tax authorities are inclined to regard economic activities as constituting a fixed establishment if the existence of a permanent establishment is recognized.

2.3.2 Action 8-10: Transfer Pricing

Van den Brekel moved on to the question of risk allocation, where signs of a shift from a legal to an economic approach are evident. The focus now is on who actually exercises control of the risk (‘control’) and is able to bear the risks (‘financial capacity’). The OECD has devised a six-step framework for this purpose, with a functional analysis being used to establish where the risks for transfer pricing purposes lie. A similar framework has also been created for intangibles. Van den Brekel noted that here, too, the analysis is of a functional nature, primarily focusing on economic aspects. The key issue now is who exercises control over and performs what are referred to as ‘DEMPE’ functions.\(^12\)

2.3.3 Action 13: Guidance on Transfer Pricing

Documentation and Country-by-Country Reporting

The current documentary requirements for enterprises vary from country to country and create a substantial administrative burden. This is why Action 13 introduces the concept of the ‘Master File’, which provides tax authorities with information on where an enterprise is active, details of the enterprise’s royalties and licensing rights around the world, how an enterprise structures its value chain, where the entities contributing to this chain are located and so on.

Another innovation that has attracted considerable public attention is country-by-country reporting. This requires an enterprise to inform the tax authorities in the country in which the group’s ultimate parent is resident of where in the world the group performs economic activities, how much profit these activities generate and how much tax the group pays on these profits. This report will then be shared with other tax authorities.

2.4 EU Anti-abuse Directive

In recent years, ahead of the BEPS final reports, the EU has amended various directives in order to implement various recommendations comparable to those in the...
BEPS project, while the European Commission has also launched an inquiry into rulings practices applied in various EU Member States. Aiming at the uniform implementation of the final BEPS reports, the European Commission issued a proposal on 28 January 2016 for a package of measures to combat tax avoidance practices. In this way, the EU, in contrast to the OECD, has set the stage for binding rules.

3 BEPS: IMPACT ON TRANSFER PRICING AND VAT

Herman van Kesteren focused first on the differences and similarities between direct and indirect taxes and then commented on the impact that BEPS will have on the link between VAT and transfer pricing.

3.1 Direct and Indirect Taxes: A Comparison

Direct taxes are slow in terms of their impact, whereas indirect taxes have fast effect. Van Kesteren is referring to the fact that the VAT treatment has to be determined at the time of supply. This contrasts with corporate taxes, which are assessed annually. This makes it immediately evident that a price adjustment could create problems in case it influences the VAT tax base, as a result of the ‘timing difference’ referred to above.

Tax avoidance in the field of direct taxes can often involve profit-shifting. Although profits cannot be shifted in indirect taxes, it is possible to shift consumption. In this respect, Van Kesteren mentions the shift between the (customer) recipient of a supply and when consumption occurs. Whatever the case, parallels with tax avoidance in direct taxes can certainly be drawn.

3.2 Influence of BEPS on Link between Transfer Pricing and VAT

3.2.1 Action 1: Addressing the Tax Challenges of the Digital Economy

Action 1 is the only Action explicitly referring to indirect taxes. The OECD’s idea is for electronic services to be taxed in the country in which the consumer is resident or in which consumption takes place. This is not a new idea within the EU. Van Kesteren referred in this respect to the fact that the place of supply in the case of a B2C service supplied by an entrepreneur resident outside the EU is the place where the consumer of that service is registered or resident or normally lives. The Mini-One-Stop-Shop (MOSS) has been introduced to avoid the need for an entrepreneur not resident in the EU to VAT register in each EU Member State in which a customer is based. Since 1 January 2015, telecommunication, broadcasting and electronic B2C services have also aligned in this respect with the country in which the consumer is resident. Here, too, the MOSS solution can be applied, under certain conditions, to avoid additional administration.

3.2.2 Action 7: Preventing the Artificial Avoidance of PE Status

Under Action 7, subsidiaries acting as commissionaires can be classified more rapidly as a permanent establishment. Van Kesteren noted that such subsidiaries are in principle regarded as separately liable for VAT. This situation can change, however, if a subsidiary is resident outside the EU and performance of the commissioner activities results in the subsidiary being regarded in that country as both a permanent establishment and a fixed establishment. In such cases, the EU will continue to consider there to be a supply for VAT purposes. Services, however, will be ‘out of scope’ as far as VAT is concerned, given that the headquarters and the fixed establishment are regarded as comprising part of a single taxable entity.

Van Kesteren referred to the varying definitions of the fixed establishment, including the ‘sales fixed establishment’, the ‘purchase fixed establishment’ and the fixed establishment concepts used in the VAT...
Refund Directives.25 It should be noted that these definitions does not cover all situations, and that it is therefore conceivable that recourse will sometimes have to be sought to the definition applied by the Court of Justice.26

Van Kesteren referred in this context to the recent European Court of Justice (ECJ) judgment in Welmory,27 in which it was ruled that if a parent company uses technical and human resources belonging to the subsidiary, the economic activities of the parent can be regarded as constituting a purchase fixed establishment. This means that if a subsidiary in an EU Member State is classified as a commissionaire and, owing to BEPS, as a permanent establishment, this subsidiary could be categorized as independently liable for VAT while, in the same country, a fixed establishment of the parent company will be recognized. This is despite the fact that a subsidiary operating as a commissionaire in a non-EU country will be classified as both a fixed establishment and a permanent establishment. Van Kesteren consequently does not exclude the possibility that companies playing a commissionaire role will in future also be regarded as a fixed establishment in the EU.

3.2.3 Actions 8-10 and 13: Intangibles; Country-by-Country Reporting

Van Kesteren continued by discussing the extent to which price adjustments will affect the base for charging VAT. The first question is whether any adjustment actually has to be made and, if so, whether it is the taxable amount of the supply that needs to be adjusted, or whether a separate taxable supply is deemed to be made. According to Van Kesteren, the first question has to be answered in the affirmative if the price adjustment can actually be linked to the original supply and it has been contractually agreed that the transaction value can be amended in certain circumstances. Amendment will not be possible, however, in the absence of such a link. It can also be assumed, he explained, that because the BEPS final report will produce greater insight into the various transactions, it will be easier in future to establish a link between price adjustments and VAT transactions.

Van Kesteren answered the second question by giving three examples. In the first example, two Member States differed in their opinions on whether an adjustment should be made. The risk then is that the first Member State will take the view that the original transaction needs to be revised, with the result inter alia that VAT and Intrastat returns will have to be amended, while the second Member State will recognize a ‘new’ transaction, which will then result in additional administrative obligations. In the second example, a parent company issues an additional invoice for imported goods to an affiliated Limited Risk Distributor (LRD) in a non-EU Member State. The customs authorities could see this additionally invoiced amount as a late payment and decide to impose a fine. Depending on the type of goods imported by the parent company, this could result in additional customs duties becoming dueable. In the third example, in which the facts are the same as in the second example, a discount is granted after the goods have been imported. According to Van Kesteren, there are cases where the non-EU country has regarded this discount as a marketing service provided by the LRD to the parent, with the place of supply being in the non-EU country. In that situation, the parent will not be entitled to a VAT refund, while fines and interest can also be imposed on the LRD for late payment.

4 BEPS: Impact on Transfer Pricing and Customs

Walter de Wit28 focused on the impact that BEPS will have on the link between transfer pricing and customs. After first outlining this link, he discussed the implications of BEPS and then considered the various changes likely to be seen in customs after the introduction of the UCC. His main focus in this latter respect was on changes made ‘in the spirit’ of BEPS.

4.1 General Aspects of the Link between Transfer Pricing and Customs

The customs value is determined, in principle, on the basis of the transaction value. However, if the buyer and seller are related parties, the importer has to demonstrate that the price has not been influenced by this relationship; is set at arm’s length.29 The principle of arm’s length makes the link between the customs value and transfer pricing immediately visible. The link in the case of royalties and licence fees, however, is different.


Royalties and licence fees play an important role in determining the customs value as, under certain conditions, they can be included in this value. At the same time, they are also important for transfer pricing because they can affect the prices set. The wide-ranging definition of intangibles and the new allocation provisions from the BEPS project are consequently significant in this respect.

The usual practice in the EU is that transfer pricing reports are used to show that the transaction value has not been influenced by a relationship with a related party and can therefore be used as the value for customs purposes. De Wit referred in this respect to the WCO Guide on Transfer Pricing and Customs, which encourages tax authorities affiliated to the WCO to accept transfer pricing documentation for determining customs valuations. This guide also contains a list of ‘good practices’ for international enterprises on the most effective way of structuring the convergence between transfer pricing and customs values for their businesses, as well as how businesses and tax and customs authorities can best coordinate their activities in this respect. Although the report is not binding on WCO members, De Wit sees it as a significant step forwards, given that this is the first time that such guidelines have been published.

Still unresolved is the issue of whether a price adjustment should automatically result in adjustment of the customs value, particularly if this will result in a request for a refund, on the grounds that the price adjustment has reduced the value for customs purposes. Views on this vary within the EU and, despite legal action in some countries, the issue has not yet been brought before the ECJ. In addition, the UCC makes no mention of the link between transfer pricing and customs valuations, and price adjustments in particular.

4.2 Impact of BEPS on the Link between Transfer Pricing and Customs

Actions 8-10 and 13 are especially important with regard to customs values. Regardless of any contractual provisions, Actions 8-10 shift the risk to the party with the financial capacity to bear it. De Wit concluded that this means a shift from the legal to the economic reality, commenting that this ‘trend’ is also significant and perceivable with regard to the imposition of customs duties.

De Wit referred to the fact that BEPS addresses the valuation of intangibles, while the use of transfer pricing reports for determining customs values means that BEPS will also indirectly impact on customs valuations. He also noted that Action 13 creates certain opportunities by requiring businesses to separate their royalties from their licence fees. The insight this change provides will enable business to determine which amounts are currently incorrectly being included in the customs value and can be excluded as not all royalties and licence fees necessarily have to be included in the value for customs purposes.

4.3 Introduction of the Union Customs Code

De Wit then questioned whether there are also any customs measures that have been introduced in the spirit of BEPS. The obvious answer is to look at the UCC and the new provisions relating to customs valuations, where the focus now seems to have shifted more towards the economic than the legal reality.

4.3.1. Introduction of ‘Last-Sale’ and Abolition of ‘First-Sale-for-Export’ Rule

Under the Community Customs Code (CCC) – the EU Regulation covering community customs law until 1 May 2016 – the value for customs purposes is based upon the transaction value. This is the price paid or payable for goods when sold for export to the customs territory of the EU. Under the CCC, any sale destined for export to the EU can be used to determine the transaction value for customs purposes. This rule, commonly referred to as the ‘First-Sale-For-Export’ rule, will end upon introduction of the UCC as the UCC Implementing Regulation states that the transaction value and, therefore, the customs value, has to be determined on the basis of the sale occurring immediately before the goods were brought into the customs territory (i.e., the ‘Last-Sale’). De Wit commented that the main reason for abolishing the ‘First-Sale-For-Export’ rule would seem to be the excessive extent to which this rule has been applied.

The consequences of abolishing the ‘First-Sale-For-Export’ rule can be mitigated, according to De Wit, by having the goods imported by a party positioned earlier in the value chain. Admittedly, this will require that party to be registered for VAT in an EU Member State and so submit local and intra-community VAT returns, as well as Intrastat returns.

The next question raised by De Wit concerned the transaction to be used for determining the customs value if goods are sold for export into the customs territory of the EU, but, before physically arriving in this territory, are sold between two EU established parties. Here, too, the second transaction would seem to have to be used to determine the value for customs purposes.

The final question in this respect was what is actually meant by the term ‘sale’. Should a purchase order, for example, be seen as a sale? There is no need for any transfer of risk at the time of a purchase order, given that legal ownership has not yet been transferred. There would not seem, therefore, to be any question of a sale.
in such circumstances. De Wit pointed out that this is
the view adopted in the United States. VAT also seems to
require more conditions to be met before a supply
(which is obviously different from the term ‘sale’ as used
in customs legislation) can be said to take place.
However, despite both US and EU customs law being
based on WTO law and the strong link between the
moments at which customs duties and VAT are imposed,
the term ‘sale’ seems to be assigned a wider-ranging
interpretation in the EU. De Wit referred in this respect
to the ECJ judgment in Christodoulou,31 from which it
can be concluded that as the primary way for
determining the customs value is on the basis of the
transaction value, the fact that the underlying sales
contract is essentially a contract for processing or
working materials is irrelevant. In other words, speaker
claimed, this could constitute an argument for regarding
even a purchase order as a sale for export to the customs
territory of the EU. Whether the actual transfer of the
risk relating to the goods ultimately plays a role has still,
however, to be seen. If that is the case, a purchase order
will never be able to constitute a sale destined for
export.

4.3.2. Royalties and Licence Fees

Under the CCC, royalties and licence fees are not always
included in the customs value, while certain royalties
and licence fees, such as trademarks, are excluded from
this value. The BEPS project is aiming, however, to
subject royalties and licence fees more quickly to tax.
This is also the case under the UCC, according to De
Wit, and it is being done by imposing stricter conditions
for the inclusion of royalties and licence fees in the
customs value. Under the UCC, royalties and licence
fees have to be included in the customs value if the
seller or person related to the seller requires the buyer to
make this payment and the payment by the buyer is
made to satisfy an obligation of the seller, in accordance
with contractual obligations. The goods cannot then be
sold – and this is a new element – or purchased by the
buyer without payment of the royalties or licence fees to
a licensor. As De Wit emphasized, it consequently also
makes no difference in this respect if the licensor is an
unrelated person. Under the UCC, the exception
previously applying to trademarks has also been
withdrawn.

31 ECJ EU 12 Dec. 2013, C-116/12, ECLI:EU:C:2013:825, paras
44–45.
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Verschenen in:
EC Tax Review 2016 nr. 3
juni 2016. - p. 174-179,
een uitgave van
Kluwer Law International te Den Haag