

New findings on the benefit of transfer pricing rules for customs valuation purposes

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Abstract

This article summarises new findings on the benefit of transfer pricing rules for customs valuation purposes. It is an extract of the author's doctoral thesis on the subject '*Customs value methods to prove that the price agreed between related parties has not been influenced by their relationship*' (in German: *Zollwertrechtliche Methoden zum Nachweis der Unbeeinflusstheit von Preisvereinbarungen zwischen verbundenen Kaufvertragsparteien*).¹

1. Arm's length standard in the GATT Customs Valuation Code (GCVC)

As an international standard laid down in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG), price agreements between related parties shall comply with the arm's length principle (OECD 2017, Chapter I). The arm's length principle also has to be followed in establishing the customs value of goods. It is stated in Art. 1 para. 2 lit. a) sentence 2 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (also known as GATT Customs Valuation Code or GCVC) in conjunction with the explanatory note, No. 3 sentence 3 to Art. 1 para. 2 GCVC. The aforementioned explanatory note is worded as follows:

Where it can be shown that the buyer and seller, although related under the provisions of Article 15 [GCVC], buy from and sell to each other as if they were not related, this would demonstrate that the price had not been influenced by the relationship.

The GCVC lacks a coherent methodology concerning the pass or fail of the arm's length test. However, such a methodology or review procedure is necessary for the uniform and transparent application of law for transactions between associated enterprises.

The uncertainty of the arm's length standard in the GCVC thus requires interpretation.

2. Interpretation of the arm's length standard in GCVC using the principle of systematic integration

In order to avoid 'fragmentation' and a 'drifting apart' of the various international legal instruments, Art. 31 para. 3 lit. c) of the Vienna Convention on the Law of Treaties (VCLT) embodies an interpretation method which aims at 'their consistent linkage in the sense of the unity of international law as a coherent and contradiction-free legal order' (Herdegen, 2016, § 5 margin number 21).

According to Art. 31 para. 3 lit. c) VCLT, any relevant rules of international law applicable in the relations between the parties shall be taken into account when interpreting a treaty.

This method of interpretation follows the principle of ‘systematic integration’ (McLachlan, 2005). It is a more general principle of interpretation (also called ‘General key’ or ‘Master key’, see: UN, 2006; McLachlan, 2005), based on the nature of international agreements which, as a part of international legal norms, may claim only a scope limited by other international law norms. An interpretation by reference to this principle applies to all questions that arise in the application of the international treaty concerned, but which cannot be resolved by the treaty itself on the basis of its express wording or otherwise (McLachlan, 2005, p. 311).

According to the principle of systematic integration, a reference to the legal environment of an international obligation and its objective is sought in the event of overlapping, conflicting or inconsistent regulations (UN, 2006, No. 420, 423). If such a reference can be established, the regulatory contribution of the international legal environment to this joint objective is extracted (UN, 2006, No. 412 et seq.) and the agreement in question is interpreted considering the regulatory contribution from other sources of international law (McLachlan, 2005).

However, this method of interpretation will be questioned critically, if its use would displace the provisions of the law applicable (cf. Higgins, 2003, p. 238 et. seq., no. 48 et seq.).

The interpretation method of Art. 31 para. 3 lit. c) VCLT could be used as the means of ascertaining the arm’s length principle’s legal purpose in Art. 1 para. 2 lit. a) sentence 2 GCVC in conjunction with the explanatory note, No. 3 sentence 3 to Art. 1 para. 2 GCVC.

3. General review procedure

The arm’s length principle under customs valuation law needs to be specified if the respective customs legislation of a state or customs territory concerned does not explicitly regulate how an arm’s length test must be executed.

In the absence of such explicit regulations (e.g. customs law of the European Union), the *ratio legis* of the GCVC can be specified according to the principle of systematic integration under certain conditions in the light of the otherwise existing multilateral or bilateral obligations at the level of international law.

The following generally valid review procedure for the specification of the arm’s length standard under customs valuation law according to the interpretation principle of systematic integration is applicable to the vast majority of states that are World Trade Organization (WTO) members and whose customs valuation law is based on the GCVC’s rules of international law (Landwehr, 2018).

Under international law, any of the following conditions have to be met to allow the application of an existing arm’s length arrangement (including its implementing provisions) for customs valuation law between the contracting states involved in the exchange of goods:

- a. There are no detailed provisions on the implementation of the arm’s length principle in the applicable customs law of a state obliged to carry out customs valuations.
- b. There is an international agreement (e.g. a bilateral double tax treaty) between the contracting states involved in the business transaction under consideration (e.g. import of goods according to a sales contract) and this agreement contains rules on the specification of the arm’s length principle or forms the basis for rules on the specification of the arm’s length principle, which have been implemented in national legislation or administrative practice.
- c. Application of these rules has the intended effect. It neither replaces a provision of the applicable customs law nor contradicts the wording and the meaning of the applicable customs law.

Since treaty law does not constitute mandatory international law, there is no obligation for a state to conclude treaties (e.g. double-taxation treaties). In the absence of an agreement containing legally

binding arm's length rules, there is no room for the method of interpretation pursuant to the principle of systematic integration under customs valuation law.

The intended effect (*effet utile*) of the application of this review procedure lies in the specification of the arm's length principle in customs valuation law (for more details on the origin of the *effet utile* under interpretation law see Landwehr 2018, p. 148 et seqq. with further references). Point c) above is to be seen against the background that Art. 31 para. 3 lit. c) VCLT may only be applied if the rules for carrying out transactions at arm's length conditions under another international agreement do not conflict with the source of law to be interpreted (here: GCVC). The other international agreement shall not be applicable instead of the source of law to be interpreted and it must not restrict the applicability of the source of law to be interpreted. The other international agreement has solely the hermeneutic function to shed light on the issue of how the arm's length principle in the GCVC can be executed with legal certainty (McGrady, 2008, p. 607).

4. Conclusions

In order to ensure a uniform and legally watertight implementation of Art. VII GATT, the arm's length principle in the GCVC has to be substantiated. Basically, the interpretation according to Art. 31 para. 3 lit. c) VCLT is suitable to achieve that purpose. The ambiguity as to how the arm's length comparison should be carried out under customs valuation law can be eliminated by means of a corresponding contribution to the regulation in other international agreements or in the national transfer pricing laws enacted on the basis of an international agreement. Such a contribution could be made by the OECD TPG or other international transfer pricing rules anchored in national law.

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Notes

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