



## Application of customs between related entities in international business

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### Abstract

*In modern business conditions, conditions of globalization, there are more and more transnational companies that transfer their operations outside their home country and thus achieve a competitive advantage. A large part of the total foreign trade commodity exchange takes place between mutually related persons (e.g., between a foreign company and its daughter company, general representative, dealer, etc.), which more and more often leads to contracting prices that are the result of conditioning or restrictions. Transfer prices that cannot be realized in a business relationship of unrelated persons under free market conditions are also agreed upon. In cases where the customs authority suspects that the existence of any of the aforementioned relationships has influenced the agreed price, it will, respecting the customs regulations, proceed to determine the real value of the goods in order to apply the customs rate stipulated in the Customs Tariff, calculate the tax and apply other foreign trade restrictions. Otherwise, certain business entities will be in a position to place goods on the domestic market under more favorable conditions, achieve a dominant position and disrupt the market balance. In the paper, the authors deal with the problem of determining the actual customs value and the application of customs regulations in view of the growing trade between related parties. This issue is economically and legally delicate because the correct determination of the customs value protects the economic space of a country and vice versa the interests of importers.*

**Key words:** customs, transfer pricing, related parties, international economy


## 1. Introduction

Transfer pricing is a critical aspect of international business operations, playing a pivotal role in determining the allocation of profits and costs among related entities within a multinational corporation. This academic response delves into the complexities of transfer pricing, highlighting its significance, challenges, and potential solutions. Transfer pricing enables multinational corporations to establish internal pricing mechanisms for transactions between their subsidiaries or affiliated companies, situated in different jurisdictions. This practice is crucial as it directly impacts the tax liabilities of individual entities and, consequently, the overall tax burden of the multinational enterprise. Moreover, transfer pricing influences various financial and managerial decisions, such as performance evaluation, resource allocation, and strategic planning, making it a crucial driver of global business performance.

One of the fundamental principles guiding transfer pricing is the arm's length principle, which requires transactions between related parties to be conducted as if they were independent entities dealing at market-based prices. However, determining such market-based prices can be challenging, especially in cases where comparable transactions are scarce or where intangible assets play a significant role. Different countries have varying transfer pricing regulations, documentation requirements, and methodologies for assessing the arm's length nature of transactions. Navigating this intricate landscape poses compliance challenges for multinational enterprises, potentially leading to disputes with tax authorities. Transfer pricing inconsistencies across jurisdictions may result in double taxation, where income is taxed in multiple countries, or double non-taxation, where income escapes taxation altogether. Such scenarios can create tension between countries and affect business certainty and international trade.

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Potential Solutions and Recommendations for transfer pricing are: Advance Pricing Agreements (APAs): Encouraging the use of APAs (EU Commission 2022) provides businesses with certainty and predictability in transfer pricing arrangements. These agreements, negotiated with tax authorities beforehand, offer protection against potential disputes and penalties. Enhanced Documentation and Transparency: Robust documentation is critical to substantiate transfer pricing methodologies and demonstrate compliance with the arm's length principle. Encouraging businesses to maintain detailed records of their transfer pricing decisions enhances transparency and facilitates tax authority reviews. Multilateral Cooperation and Alignment: Encouraging countries to work together in harmonizing transfer pricing rules and adopting common methodologies can minimize discrepancies and reduce the risk of double taxation or double non-taxation. Use of Multiple Methods: Employing multiple transfer pricing methods, where applicable, can provide a more comprehensive picture of the arm's length nature of transactions. Combining various methods, such as comparable uncontrolled price (CUP), resale price method (RPM), cost-plus method (CPM), and profit split, can mitigate the reliance on a single approach and ensure more accurate pricing (Hendriksen, 2020).

## 2. Transfer pricing and customs valuation in EU

The application of customs between related entities in international business is a significant aspect of transfer pricing, international trade, and customs regulations. When related entities, such as subsidiaries or affiliates of the same multinational corporation, engage in cross-border transactions, customs authorities closely scrutinize these transactions to ensure compliance with applicable customs regulations and to prevent potential abuses or manipulation that could impact customs duties, taxes, and trade flows (Korin, 2021). Transfer pricing refers to the setting of prices for goods, services, or intangible assets exchanged between related entities within a multinational corporation (Kononov, I. 2022). Customs valuation, on the other hand, involves determining the customs value of imported goods to assess customs duties and taxes. The two are closely linked because customs authorities often require that the value declared for customs purposes align with the arm's length principle used in transfer pricing. Transfer pricing and customs valuation are two distinct but related concepts that impact international trade and taxation. Let's explore each of them in the context of the European Union (EU).

Transfer pricing refers to the pricing of goods, services, or intangible assets transferred between entities within the same multinational enterprise (MNE) group (Parra, E.2018). This helps prevent MNEs from artificially shifting profits to low-tax jurisdictions to minimize their overall tax burden. The EU member states generally adhere to the OECD Transfer Pricing Guidelines when assessing transfer pricing practices. These guidelines provide a framework for determining arm's length prices and ensuring that profits are appropriately allocated among the entities involved (OECD 2023).

The EU has also introduced measures to combat transfer pricing abuse and tax avoidance, such as the Anti-Tax Avoidance Directive (ATAD). ATAD aims to combat harmful tax practices and ensure fair taxation within the EU. Additionally, the EU has been working towards implementing the recommendations of the Base Erosion and Profit Shifting (BEPS) project, an initiative by the OECD to address corporate tax avoidance strategies. Customs valuation refers to the process of determining the customs value of imported goods. The customs value is used to assess the amount of import duties and taxes that should be levied on the imported goods. In the EU, customs valuation is governed by the EU Customs Code (Regulation (EU) No 952/2013) and its implementing provisions. The primary method for customs valuation in the EU is the transaction value method, which is based on the actual price paid or payable for the imported goods when sold for export to the EU.

However, if the customs authorities doubt the accuracy or truthfulness of the declared transaction value, they can use alternative valuation methods outlined in the WTO's Agreement on Customs Valuation (ACV) or the EU Customs Code. It's important for businesses engaged in cross-border transactions within the EU to ensure compliance with both transfer pricing rules and customs valuation regulations to avoid potential penalties, disputes, and delays in customs clearance. Professional advice from tax and customs experts is often sought to navigate the complexities and ensure compliance with relevant regulations (Taxation and Custom Union 2002).

Customs authorities may conduct audits to verify that the declared values for imported goods align with the arm's length principle. As a result, businesses engaged in international trade with related parties must maintain comprehensive and accurate transfer pricing documentation to demonstrate the legitimacy of their declared customs values. Failure to provide adequate documentation can lead to delays in customs clearance, penalties, and potential legal disputes (KPMG,2020). While multinational corporations have the flexibility to optimize their supply chain and global operations, they must do so in a manner that remains compliant with customs regulations. The use of transfer pricing strategies to shift profits to low-duty jurisdictions or to manipulate customs values can attract regulatory scrutiny and penalties. Businesses must carefully balance their transfer pricing policies with customs compliance to minimize the risk of disputes and regulatory action (Bakker & Obuoforibo, 2009).

Customs authorities use various methods to determine the customs value of imported goods, such as transaction value, transaction value of identical goods, transaction value of similar goods, deductive value, computed value, and residual

value. The appropriate method is chosen based on the availability of data and the principles outlined in the World Trade Organization's Agreement on Customs Valuation.

To provide certainty and reduce the risk of disputes, multinational corporations can seek Advance Pricing Agreements (APAs) with customs authorities. These agreements establish a predetermined transfer pricing methodology and customs valuation approach for future transactions, subject to certain conditions. APAs help avoid potential conflicts and provide a clear framework for customs compliance.

### 3. Custom control between related parties in Serbia

Customs in Serbia controls trade between related parties. When importing goods, in addition to other documentation, the freight forwarder submits the DCV form - Declaration on the customs value of the goods to the Customs Administration. When filling out the Form, it is necessary to check the box whether it is about the import of goods from a related party. It often happens that this important information is filled in without first checking the accuracy of the information. The DCV form in the first part contains sections related to the name and address of the seller, information about the buyer (importer), but also an important note that the declarant - importer is responsible for the accuracy of the data, even if he does not fill out the mentioned form.

Buyer and seller are considered to be related parties if:

- one of them is a manager or director of a company owned by the other;
- are legally related business partners;
- are in the relationship of employer and employee;
- is one of them the direct or indirect owner, controls or owns 5% or more of the voting shares or shares in each company;
- one directly or indirectly controls the other;
- are directly or indirectly under the control of a third party or
- are members of the same family.

Field 7 of the DCV form is very important, like all fields. But this is where a mistake is made very often. There is also question (b): Does connectivity affect the price of imported goods?

And optional answer under (c) Does the transaction value of the imported goods approach the transaction value of the same or similar goods imported at or around the same time? The text part is on the left side of the form, while on the right side there are boxes with the option to check the answers with YES or NO. Not knowing the specific relationship between the seller and the importer, freight forwarders usually check all fields with NO, which can later cause serious consequences for the importer.

Declaration for customs value is a prescribed official form on which data on the value of imported goods for one shipment is entered for the purpose of collecting customs duties and value added tax. Declaration forms can be supplemented with additional BIS pages that form an integral part of the declaration.

DCV is attached to each import customs declaration for goods subject to ad valorem customs duty except when:

- the total customs value of the shipment, the equivalent in dinars of €3,000 or less, i.e., the equivalent amount in another convertible currency;
- for goods without payment of equivalent value, whose customs value of the shipment is the equivalent value in dinars of €1,000 or less, i.e., the equivalent amount in another convertible currency;
- and in other prescribed cases.

### 4. Conclusion

Transfer pricing is a multifaceted and crucial aspect of international business, with far-reaching implications on taxation, financial reporting, and operational decision-making. As the global business landscape evolves, addressing the challenges surrounding transfer pricing calls for collaboration between governments, businesses, and international organizations to foster fairness, transparency, and predictability in the realm of intercompany transactions.

In conclusion, the application of customs between related entities in international business is a critical area where transfer pricing, customs valuation, and compliance intersect. Businesses engaged in cross-border transactions with related parties must ensure transparency, accurate documentation, and adherence to customs regulations to avoid disputes and penalties while maintaining a healthy global supply. The customs authorities in the EU have a right to challenge the declared value and request additional information or documentation from importers to determine the appropriate customs value. Customs authorities rely on the document DCV document when determining related parties.

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