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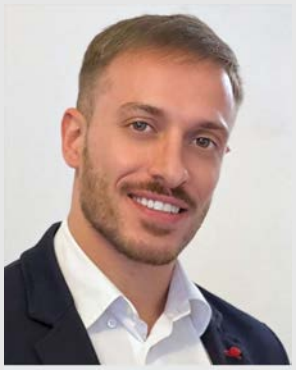

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In this article, D'Andrea and Jelfs explain how the EU BEFIT proposal could bring needed uniformity to transfer pricing and customs valuation rules across the EU and beyond, particularly taking into account the stance of the United Kingdom post-Brexit.

Introduction

In today's interconnected business world, the relationship between customs and transfer pricing authorities has become a focal point of potential conflict. The situation calls for a robust and efficient regulatory framework that fosters a transparent and harmonious connection between these two domains.[1]

It is claimed that there is an inherent tension surrounding the widely accepted arm's-length principle.[2] The tension stems from national tax authorities primarily directing their attention toward transfer pricing cases involving high prices to minimize inbound prices and maximize taxable profits. On the other hand, EU customs authorities prioritize cases in which inbound prices are too low, to ensure a larger base subject to duties.[3]

There are therefore potential customs valuation repercussions from transfer pricing adjustments made to prevent base erosion and profit shifting and ensure that intercompany transactions are conducted at arm's length. An example is the *Hamamatsu*[4] case, in which national tax authorities made transfer pricing adjustments because of either a transfer pricing adjustment itself or unforeseen costs during the import process.[5] Discrepancies between transfer pricing and customs valuation rules gave rise to a variety of issues.[6]

Transfer Pricing vs. Customs Valuation

When examining transfer pricing and customs valuation, it is apparent that besides discrepancies there are broader considerations that need to be considered. These form the basis of a

[1]World Customs Organization, "Guide to Customs Valuation and Transfer Pricing," at 58 (2018).

[2]Michael Landwehr, "New Findings on the Benefit of Transfer Pricing Rules for Customs Valuation Purposes," 13(1) *World Customs Journal* 141 (2018). World Customs Organization, "Guide to Customs Valuation and Transfer Pricing," at 5 (2018).

[3]Duarte Nuno Tenreiro Freitas dos Reis, "The Tension Between Transfer Pricing and Customs Valuation," *Maestrado em Contabilidade, Fiscalidade e finanças* 8-9 (2012). Giangiacomo D'Angelo et al., "Customs Valuation Adjustment in Recent CJEU Case Law," *Aspects of Customs Controls in Selected EU Member States* 178 (2023).

[4]*Hamamatsu Photonics Deutschland GmbH v. Hauptzollamt München*, C-529/16 (2017).

[5]Michiel Friedhoff and Martijn Schippers, "ECJ Judgment in Hamamatsu Case: An Abrupt End to Interaction Between Transfer Pricing and Customs Valuation?" at 9 (2019). S. Claeys, "The Convergence Between Customs, VAT, and Transfer Pricing in a Global Supply Chain," at 22 (2018).

[6]D'Angelo, *supra* note 3, at 178.

comprehensive evaluation of transfer pricing and customs valuation and what each means for tax outcomes[7]:

- There are differences in responsibilities and jurisdictions between transfer pricing and corporate taxation authorities that can result in double taxation.[8]
- The OECD guidelines provide recommendations and guidance on transfer pricing practices, but they are not legally binding.[9] Also, the guidelines grant the taxpayer the freedom to select the most appropriate criterion on a case-by-case basis, without limitations. Each country can adopt the guidelines in its own way, leading to the potential for different transfer pricing rules across Europe. On the other hand, the Union Customs Code is a hard-law instrument that contains legally binding provisions. It ensures that rules implemented by member states are in line with the EU's uniform framework for customs procedures.[10]
- EU customs rules seek to ensure that price paid and actual value closely align, which makes customs authorities more vigilant when the price is unusually low. In contrast, transfer pricing regulations seek to curb the shifting of profits from high- to low-tax countries. Consequently, transfer pricing authorities focus on cases in which prices are unusually high.[11]
- Determination of the customs value coincides with the transaction itself. This means that during the importation of goods, the customs value is determined when the goods are presented to customs for release into free circulation. On the other hand, transfer pricing considers aggregated values over a specific period, typically a financial year.[12]
- There are distinct approaches when it comes to determining the value of transactions for customs valuation and transfer pricing purposes. Customs valuation involves assessing each transaction separately, while transfer pricing calculations are often based on the company's overall profitability.[13] Also, relying on aggregated data in transfer pricing makes it challenging to pinpoint the precise value of individual transactions, which hinders its integration into the customs framework.

The evident absence of efficient collaboration between the two governing bodies presents a significant barrier in closing the divide between the domains. As a result, multinational enterprises find themselves susceptible to government manipulation and face the potential hazards of being subjected to double taxation.

Council Directive on BEFIT

Overview

A change in international taxation could be ignited by establishing a dynamic alliance between transfer pricing and customs valuation. An initial undertaking could be creating binding, enforceable transfer pricing regulations. A new set of binding rules, universally applicable to all member states, would enable meaningful comparison between the rule manuals of transfer pricing and customs valuation, the latter covered by the EU Customs Code.

On September 12, 2023, the European Commission proposed the Council Directive on Business in Europe: Framework for Income Taxation (BEFIT). It establishes a common corporate tax framework to support the internal market and contains European transfer pricing rules.[14]

Under articles 2 and 5 of the proposal, regulations are obligatory for companies operating within the EU that have annual combined revenue of at least €750 million.[15] Also,

[7] *Id.*

[8] *Id.*

[9] Claeys, *supra* note 5, at 19.

[10] D'Angelo, *supra* note 3, at 178.

[11] *Id.*

[12] Claeys, *supra* note 5, at 21.

[13] D'Angelo, *supra* note 3, at 178.

[14] European Commission, "Council Directive on Business in Europe: Framework for Income Taxation (BEFIT)," at 7 (Sept. 2023).

[15] *Id.*

the ultimate parent entity must hold at least 75 percent of the ownership rights or rights granting entitlement to profit, either directly or indirectly.

Further, for groups headquartered in non-EU countries, their EU subsidiaries must generate at least €50 million in annual combined revenues in two out of the last four fiscal years, or at least 5 percent of the group's total revenues.[16]

Transfer Pricing and European Harmonization

The commission's proposal would unify transfer pricing regulations across the EU and establish a consistent approach to transfer pricing issues. It incorporates the arm's-length principle and essential transfer pricing rules into EU law. Also, it provides clarity on the role and status of the OECD guidelines and introduces the potential for establishing unified, harmonized, and binding rules on the specific aspects of the regulations.

Implementation of these measures, which member states are to complete by January 1, 2026, will increase tax certainty, mitigate the risk of litigation and double taxation, and reduce opportunities for companies to exploit transfer pricing for aggressive tax planning purposes.[17]

It is worth noting that the council directive on BEFIT complements pillars 1 and 2 by providing additional guidelines for promoting fairness and transparency in tax systems. Together, they form a cohesive strategy for strengthening fiscal governance and ensuring a level playing field for business across the EU and beyond.[18]

Mitigating Brexit

It is claimed that the post-Brexit era has brought significant changes in the EU-U.K. relationship. With EU directives no longer applicable to U.K. companies,[19] tax-related regulations have undergone a transformation. Therefore, the United Kingdom may become less attractive as a holding and financing company jurisdiction. Moreover, the shift not only alters the United Kingdom's appeal to businesses, it also raises concerns for U.K. companies that previously relied on EU directives.

The introduction of BEFIT could reduce Brexit's ripple effects on the EU-U.K. relationship. Under BEFIT, groups headquartered in non-EU countries that have EU subsidiaries that meet certain thresholds may now fall under the legislative scope of the council directive. This means that U.K. groups with an EU presence could again be subject to a council directive, even post-Brexit.

By indirectly including U.K. groups in the directive's scope, BEFIT extends the reach of EU binding law to the United Kingdom. It suggests that the United Kingdom may subtly become part of the EU's binding body of law in this field. This could lead to coordination of rules at the EU level, in spite of Brexit.

Conclusion

There are still doubts about how the United Kingdom perceives and embraces change, despite the significance of European harmonization and the potential achievements that can be realized through BEFIT. The EU-U.K. relationship will continue to develop, especially with the imminent U.K. general election and possible change in government. For whatever government comes to power, coordinating EU binding laws more effectively could produce revolutionary change for the international tax system.

As further evidence, there is a legal precedent that states:

> The objective of the EU legislation on customs valuation is to introduce a fair, uniform and neutral system[20] excluding the use of arbitrary or fictitious customs values.[21]

This article reinforces the idea that the implementation of a binding EU transfer pricing law through BEFIT will enable the establishment of a fair, uniform, and neutral system. This would

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[16] *Id.*

[17] European Commission, "Questions and Answers on BEFIT and Transfer Pricing" (Sept. 12, 2023).

[18] Nadya Britton, "Understanding BEFIT vs. Pillar 2: What Corporate Tax Teams Need to Know," Thomson Reuters, Mar. 14, 2024.

[19] EY, "Tax Implications of Brexit, Minds Made for Shaping Financial Services," at 1 (Apr. 2019).

[20] General Agreement on Tariffs and Trade, "Agreement on the Implementation of Article VII," para. 4.

[21] *See Gaston Schul BV v. Staatssecretaris van Financiën*, C-354/09 (CJEU 2010); *Mitsui & Co. Deutschland GmbH v. Hauptzollamt Düsseldorf*, C-256/07 (CJEU 2009). *See also* D'Angelo, *supra* note 3, at 154.

become a foundation for initiating and fostering coordination among member states and the United Kingdom and building a bridge between transfer pricing and customs valuation. ■