Transfer Pricing – Impact on other taxes

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It is common for multinationals to license intangible assets to their related company entities, particularly if there are dedicated manufacturing arms of the business. Intangible assets that may be granted include trademarks, trade names, software, technology, and patents.

Royalty agreements just like the prices for goods between related entities need to meet the arms - length principle found in Transfer Pricing rules. Royalty and TP agreements are been challenged more and more by Customs authorities who are seeking to raise the duty revenue collected on imported goods. It is important for multinationals to understand how Customs impacts their TP and Royalty making decisions in these challenging times.

In most cases Customs first inclination is to say that a royalty is dutiable, if the royalty payment is not related to imported goods it is then for the importer to rebut Customs position.

Types of Royalty

Transfer Pricing	Customs
• Cinematograph films • Patent/Trademark • Design/Model • Secret formula or process • Information concerning industrial, commercial or scientific experience	• Patent or know-how • Trademark/Copyrights • Distribution rights

Value

Transfer Pricing	Customs
The value is determined by the arm's length prices using comparable uncontrolled pricing methods or other valuation techniques, taking into account the contributions to the anticipated intangible value of functions performed, assets used, and risks assumed.	The value [if] to be added to the imported goods is determined by the fee charged in the royalty agreement.

Royalty

Tax

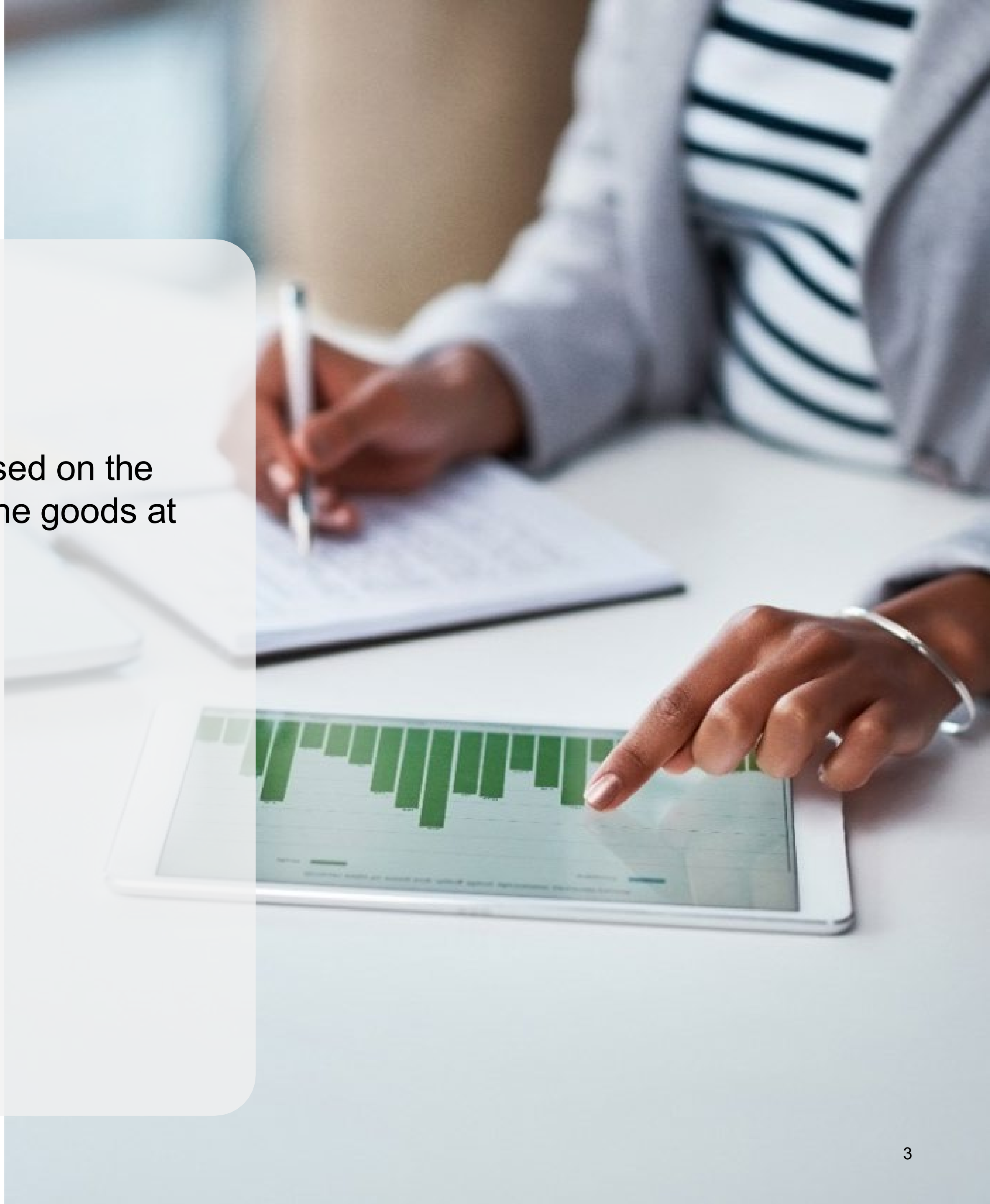
Transfer Pricing

- For outbound payment of royalties, for example, China withholding income tax (WHT) may apply before remittance, and it may be credited by the overseas entity.
- The outbound payment of royalties shall also be subject to China value-added tax (VAT) of 6%, which shall be withheld.
- In addition to the above, local surtaxes will also be levied on VAT payable, ranging from 5% to 12% (which are different among locations).

Duty

Customs

- Duty is charged based on the tariff (HS) code of the goods at time of import.



Royalty

Licensing agreements

Transfer Pricing

- Intangible ownership and contractual terms relating to intangibles as a starting point
- Functions performed, assets used, and risks assumed in connection with the development, enhancement, maintenance, protection, exploitation (and promotion) of intangibles. Economic ownership is essential from a transfer pricing perspective.
- Remuneration (identifying the arm's length prices)

Conditions

Customs

- Royalties and license fees **related to the goods** being valued that the buyer must pay, either directly or indirectly, except in either of the following cases:
  i) Royalties and license fees that are **not related** to the imported goods being valued; and
  ii) Royalties and license fees that are not paid as a **condition for the sale** of goods in question to the customs territory of the PRC.

Pricing

Difference in assessment

Under Customs rules the invoice price can normally be accepted, provided the buyer and seller are not related, and where they are related that the relationship did not influence the invoice price. In practice many multinationals tend to refer to their TP agreement as proof that the relationship did not impact the price. The submission of such documents without properly understanding the differences between TP and customs valuation methods brings with it its own risks.

Transfer Pricing	Indirect Tax
OECD	WTO/GATT
Annual net taxable income	Individual import transaction values
Prices high > income low > tax low	Prices low – values low . Duty low

Methods

Transfer pricing methodologies endorsed by China's transfer pricing rules of STA Public Notice [2017] No. include comparable uncontrolled price ("CUP") method, resale price method, cost plus method, TNMM, profit split method, and other methods consistent with the arm's length principle. China's transfer pricing rules do not, however, place any emphasis on the sequential order in which taxpayers and/or tax authorities should select the transfer pricing method to be used to analyse the arm's length nature of related party transactions.

The current descriptions in the table are consistent with the OECD Guidelines, which are not exactly the same as what are stated in Chinese transfer pricing regulations.

Transfer Pricing	Indirect Tax
1. Traditional ➢ CUP ➢ Resale minus ➢ Cost Plus 2. Profits based ➢ CPM/TNMM ➢ Profit split	1. Transactional value 2. Identical goods 3. Similar goods 4. Deductive 5. Computed 6. "Fall back"

Pricing

Differences

Factor	CUP	Customs value
Comparability of goods	Similar goods	Identical goods [M2] Similar goods [M3]
Functional analysis	relevant	In principle not relevant; the marketing expenses incurred by the buyer are irrelevant and do not impact price determination.
Range of arm's length prices	permitted	Lowest price governs
Mandatory additions to the arm's length price	No	Yes
Mandatory exclusions to the arm's length price	No	Yes
Set-off	relevant	Partly relevant
Priority of external or internal comparison	no	Yes
Exchange rate	Date of delivery	Date of importation
Time of comparable transaction	Time of purchase	Time of importation [at or about the same time]

Pricing

Differences

Factor	Resale	Customs Deductive value
Comparability of goods	Similar goods	Specific rules are to be applied to identify goods as been a) identical and b) similar
Similarity of deductions	In general the deductive method is similar to the resale method.	
Time of comparable transaction	Time goods are resold to independent third parties	Time when importation takes place
Factor	**Cost-plus**	**Customs Computed value**
Similarities	In general the computed method is similar to the cost-plus method.	
Profit & general expenses	Treated and analyzed separately	Taken as a whole
Profit & general expenses	The manufacturer resides in the country of the assessing tax authorities	The manufacturer is based in a foreign country
Factor	**Other methods**	**Residual/Fall Back**
Comparable	No – TP looks primarily at allocating the profits.	Determining “fair” price for the goods.

Royalties/Pricing

The dutiability of royalties or a Customs review of your import prices from related parties can be complex and any incorrect submissions can be costly, we at PwC are here to help you through this journey please reach out to us.

Contact us

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Thank you

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