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VAT IMPLICATIONS OF TRANSFER PRICING IN SERBIA – JOINING THE INCOMPATIBLE

Adjustments to transfer pricing (TP) have been a subject of intense scrutiny within international taxation and customs procedures. This paper provides a comprehensive survey of global practices and regulatory frameworks, focusing on Serbia's legal approach influenced by OECD standards and EU regulations. It examines the alignment of related party transactions with the arm's length principle, the impact of TP adjustments on corporate income tax (CIT), value-added tax (VAT), and customs valuation, and the challenges faced by multinational enterprises (MNEs). The study argues that TP adjustments should be considered outside the scope of indirect taxation due to their intrinsic characteristics. Through a comparative analysis of practices in the USA, Canada, and various EU member states, the paper highlights the need for clear guidance from Serbian authorities to ensure legal and fiscal consistency. The findings suggest adopting a U.S.-like five-factor test for TP adjustments concerning customs valuations to provide a clearer compliance route. The paper concludes with recommendations for synchronizing VAT and customs legislation with international standards to enhance compliance and reduce tax evasion risks.

Key words: *Transfer pricing. – TP adjustment. – Customs value. – VAT base. – Open market value.*

1. INTRODUCTORY REMARKS

The term “multinational entities” or “multinational corporations” (hereinafter: MNEs) refers to organizations operating in multiple countries,¹ with over 60% of global trade occurring between

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1 Eurostat, “Glossary: Multinational enterprise (MNE)”, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Multinational_enterprise_

The significance of TP adjustments extends beyond their impact on corporate income tax. It is equally important to determine how such adjustments affect the VAT and customs treatment of relevant transactions, which shall be the primary focus of this article. Namely, customs perspective aims to tax imports on objective price within parties involved, while VAT perspective offers only certain limitations to the matter which shall be discussed later on. When put together, TP and indirect taxation have historically created a “grey zone” under which MNEs have had to operate without knowing exactly how to be in compliance with both sets of rules – i.e. transfer pricing rules and EU customs valuation law and VAT – at the same time.⁵

The analysis, conducted under Serbian law, primarily examines EU VAT regulations as Serbia aims to align its VAT legislation with the EU. The author employs a comparative approach to analyse the legislation and practices of both EU and non-EU countries, aiming to derive valuable insights and potential solutions that could be beneficial for addressing similar issues in Serbia. This method allows for a broader understanding of how different jurisdictions handle TP adjustments and their implications for VAT and customs, thereby providing a more comprehensive perspective on possible strategies and best practices that could be adopted. It should be noted that there is limited literature available on this topic, so the deductive method is mainly employed to interpret the provisions of the law, with reference to significant views found in the literature. The article will outline TP principles, define key VAT terms, examine TP adjustments’ effects on VAT and customs, explore the relationship between direct and indirect taxes, and conclude with insights on future trends in this field.

2. INCOME TAX PERSPECTIVE

2.1. Arm’s length principle and income tax

The arm’s length principle is a cornerstone in the realm of international taxation, particularly concerning transfer pricing. Globally recognized and embedded in guidelines issued by Organisation for Economic Co-operation and Development (hereinafter: OECD) it is adopted by many countries to ensure equitable taxation and appropriate

5 Juha Tuominen, “European Union – The Link between Transfer Pricing and EU Customs Valuation Law: Is There Any and How Could It Be Strengthened?”, *International Transfer Pricing Journal* 6/2018, 436.

taxation of related parties based on their economic activities. The arm's length principle serves to prevent the manipulation of transfer pricing and the shifting of profits across jurisdictions to evade taxation. Compliance is monitored through audits, where tax authorities may adjust prices to market rates and impose penalties for non-compliance.

2.2. TP adjustments

As previously stated, TP adjustments in corporate income tax correct intra-group transaction prices to comply with the arm's length principle, ensuring related entities transact as if they were independent parties.

In Serbia, the regulation of TP adjustments is governed by the Corporate Income Tax Law (CIT Law) ⁶ and the Transfer Pricing Rulebook⁷ which align with international standards and OECD guidelines. Taxpayers must document transfer prices in accordance with the arm's length principle, reflecting necessary adjustments in their CIT return and tax assessment form. Compliance is enforced by tax authorities through audits, which may mandate TP adjustments as required.

The impact of TP adjustments on CIT can be twofold:

1. Income Adjustment: TP adjustments can raise or lower the taxable income of related entities, depending on whether the initial pricing was below or above the arm's length standard.
2. Other tax Implications: TP adjustments can have direct tax implications, including potential changes in tax liabilities, tax credits, or deductions. The adjusted income resulting from TP adjustments will be subject to the applicable CIT rate, potentially affecting the overall tax liability of the related entities involved.
3. VAT

6 Corporate Income Tax Law – CIT Law, *Official Gazette RS* No. 25/2001, 80/2002, 80/2002 – other law, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014 – other law, 142/2014, 91/2015 – auth. Interpretation, 112/2015, 113/2017, 95/2018, 86/2019, 153/2020 and 118/2021 – Serbian CIT Law.

7 Rulebook on transfer pricing and methods applied on the principle of arm's length in determining the price of transactions between related entities, *Official Gazette RS* No. 61/2013, 8/2014, 94/2019 and 95/2021.

3.1. General remarks

When discussing TP adjustments from a VAT perspective, it is essential to comprehensively examine the terms “taxable amount for VAT purposes” and “open market value”, particularly in relation to the widely used term “fair market value” in corporate taxation. Theoretically, the VAT system is inherently resistant to tax avoidance related to transaction pricing, as the VAT due from one taxable person constitutes another taxpayer’s input VAT. Consequently, transactions where the full deduction right can be exercised should not impact the budgetary income (tax revenue) from VAT in any manner.⁸

It should be noted that Serbia introduced VAT into its tax system in 2005, thereby replacing the sales tax.⁹ The VAT legislation in Serbia aims to harmonize with the EU’s VAT regulations, primarily with the VAT Directive¹⁰, to the extent appropriate given that Serbia is still a non-EU member state.

3.2. Taxable amount

Under Serbia’s VAT Law, the taxable amount is the total payment, either monetary or in-kind, that a supplier is entitled to for goods or services provided, excluding VAT but including import duties and additional costs. If compensation is in-kind, the market price at the supply date serves as the tax base. When no comparable price is available, the tax base should be no less than the purchase cost or expenses incurred to acquire the goods or services.¹¹

Thus, the taxable amount for VAT is based on a subjective valuation agreed upon by the parties to the taxable transactions, in line with the principles stated in the VAT Directive.¹² This approach is sup-

8 Krzysztof Lasiński-Suleck, “Impact of Transfer Pricing Adjustments for VAT and Customs Law Purpose”, *International Transfer Pricing Journal* 3/2013, 176.

9 Value Added Tax Law – VAT Law, *Official Gazette RS*, No. 84/2004, [...]72/2019, 8/2020, 153/2020 and 138/2022.

10 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax – VAT Directive, *Official Journal*, L 347 11.12.2006, p. 1 (VAT Directive).

11 VAT Law, Art. 17b.

12 VAT Directive, Arts. 72, 76, 78.

ported by various European Court of Justice cases¹³ and affirmed by a Serbian Ministry of Finance ruling¹⁴ which states that VAT laws do not provide alternative methods for determining taxable amounts when the remuneration received is lower than the purchase value of the goods.

3.3. Open market value

The subjective taxation principle may be vulnerable to tax evasion in transactions among related entities, such as setting lower prices or presenting falsely lower invoice amounts. Consequently, VAT legislation in both Serbia and the EU includes safety measures for transactions between related parties, such as open market value as an anti-abuse measure. However, open market value as anti-abuse measure differs from the goal intended to be achieved by prescribing transfer pricing rules introduced by direct taxes, which concern the correct allocation of the corporate income tax base for multinational enterprises among different tax jurisdictions.¹⁵

The VAT Directive stipulates that for supplies involving family or other close personal ties, management, ownership, membership, financial, or legal ties as defined by the Member State, the taxable amount is to be the *open market value* if the recipient is not entitled to deduct input VAT.¹⁶ The open market value represents the amount payable for the same supplies (goods/services) by a customer under conditions of fair competition at arm's length within the territory of the Member State. If no comparable supply can be determined, the open market value will mean: (a) the purchase price for the same or similar goods, or the cost price in the absence of a purchase price, and

13 Judgment of the Court (First Chamber) of 20 January 2005, Case C-412/03, *Hotel Scandic Gåsabäck*, ECLI:EU:C:2005:47, para. 21; Judgment of the Court (Eighth Chamber) of 9 June 2011, Case C-285/10, *Campsa Estaciones de Servicio*, ECLI:EU:C:2011:381, para. 28.

14 Law on tax procedure and tax administration – LATA, *Official Gazette RS* No. 80/2002 [...] 138/2022 envisages that all guidelines, rulings, and explanations issued by Ministry of finance are binding for actions of the Tax Authority for the purpose of uniform applicability of tax regulations.

15 Jelena Ž. Kostić, Miloš R. Vasović, “Pravilo o transfernim cenama kao anti-abuzivna mera u zakonodavstvu EU i praksi Suda pravde EU”, *Strani pravni život* 3/2024, 387–401.

16 VAT Directive, Art. 80.

(b) an amount that is not less than the full cost to the taxable person of providing the service for services.¹⁷ The open market value regime is allowed under the VAT Directive but must be implemented individually by each Member State¹⁸, where certain deviations and specifics are permitted.¹⁹ At the beginning of 2023, the same provision was introduced in Serbian VAT legislation²⁰, aiming to significantly align with the VAT Directive and was represented as one of the key implementation areas.²¹

Unlike income taxation, where the arm's length principle aims to reduce the probability of economic double taxation, the open market value is clearly a special anti-avoidance measure and constitutes a legal fiction applied for VAT purposes.²²

3.4. Adjustment of price

VAT legislation stipulates that price corrections may occur for various reasons, including the calculation of auxiliary costs or discounts, the return of goods, and the subsequent fulfilment of conditions for tax exemption, but is in essence based on subjective principle as VAT affect expenses related to consumption.²³ When a price correction occurs, an appropriate document (credit or debit note) must be issued, containing the elements prescribed by the Rulebook on VAT. It should be noted that this list is not exhaustive but is provided as illustrative examples.

17 VAT Directive, Art. 72.

18 This option has been introduced in its entirety in Austria, Bulgaria, the Czech Republic, Denmark, Estonia, Croatia, Hungary, Ireland, Italy, Lithuania, Poland, Portugal, Romania, Slovenia, Spain, and Sweden (ed. F. Annacondia), *EU VAT Compass 2017/2018*, IBFD, Netherlands 2018, 654–655.

19 For example, the France uses open market value solely when it comes to immovable properties and Hungary envisages that no open market value is applicable if consideration is determined by the law. *Ibid.*, 653.

20 Law on amendments of the VAT Law, *Official Gazette RS*, No 138/2022.

21 The most significant solutions proposed in order to further harmonize with EU regulations refer to prescribing a special tax base for supplies performed between related parties (where the acquirer does not have the right to deduct input VAT, The proposal on the VAT Law amendment, page 5 at the following link [2511–22.pdf \(parlament.gov.rs\)](#). 25.4.2024.

22 K. Lasiński-Suleck, *op. cit.*, 177

23 J. Kostić, M. Vasović, *op. cit.*, 391.

4. CUSTOMS VALUE

4.1. General remarks

The principles of customs valuation are established in the World Trade Organization's Customs Valuation Agreement²⁴ and these rules have been transposed into EU customs legislation²⁵ and, as previously mentioned, Serbian (customs) legislation has been extensively harmonized with EU customs legislation.

4.2. Transactional value

The Customs Act specifies that the primary method for assessing the customs value of goods is the transaction value, which is the actual or due price when goods are sold for export to Serbia.²⁶ This encompasses all payments made by the buyer to the seller or to a third party for the benefit of the seller. If the transaction value is not applicable, the Customs Act prescribes alternative methods for valuing imported goods. The transactional price method is used when the seller and buyer are not related. If they are related, it can still be used if their relationship hasn't influenced the price.²⁷ Otherwise, secondary methods are applied. This principle of using the transaction value is upheld in both international and EU law, with deviations only in specific cases outlined by law.²⁸

Customs transfer pricing rules are designed to prevent the underpayment of duties in related-party transactions by ensuring the

24 Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994.

25 The EU customs legislation comprises of the Union Custom Code, Commission Implementing Regulation (EU) 2015/2447, Commission Delegated Regulation (EU) 2015/2446, Commission Delegated Regulation (EU) 2016/341 as well as of Guidance on customs valuation as set out in the EC Customs Valuation Compendium. *2022 EU Valuation Compendium EN.pdf* (europa.eu), 10.11.2024.

26 Serbian Customs Act, *Official Gazette* No. 5/2018, 91/2019 – other law, 144/2020, 118/2021 and 138/2022) – Serbian Customs Act, Arts. 52 and 53; Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code – UCC, Art. 70.

27 Serbian Customs, Arts. 52 and 53; UCC, Art. 71.

28 Saul L. Sherman, Hinrich Glashoff, Bernard M. Field, *Customs Valuation: Commentary on the GATT Customs Valuation Code*, Kluwer Law, Deventer 1988, 105.

correct transactional value and duties, rather than implementing OECD Model Convention Article 9. Adjustments for customs purposes do not alter contracts and are considered a legal fiction for valuation. TP adjustments must be directly related to the goods and quantifiable i.e. adjustments unrelated to the goods, such as market contributions, do not affect the customs value. It is important to emphasize that any subsequent price alteration can only be made if the adjustment is related to the goods and is measurable. Therefore, adjustments like market contributions or any unrelated factors cannot be considered in determining the customs value.

In addition, it should be noted that a simplified (so-called incomplete) customs declaration may be utilized only in specific cases, such as when not all data required for determining the customs value are known at the time of import, and if such a procedure is approved by the customs authority.²⁹ For the applicability of a simplified customs declaration, it is crucial that the unknown data can be specifically measured and identified which is not always relatable when discussing TP adjustments. Given the complexities of TP adjustments, it could be argued whether this type of declaration would be permissible if there is no possibility to determine the value for each imported good or individual declaration.³⁰

4.3. *Integrated Perspectives on TP, Customs and VAT*

It can be argued that the purpose of transfer pricing and customs valuation rules is somewhat similar: both aim to ensure that the pricing of cross-border intercompany transactions is based on objective international principles, ensuring that prices are not influenced by the relationship between the parties and that no artificial or arbitrary values are used.³¹ However, the ultimate motivations of tax authorities, customs authorities, and VAT authorities differ. Customs authorities aim to maximize customs duties, which is achieved when the value of

29 Union Customs Code, Art 166 and Serbian Customs Law, Art. 145 which further elaborate on conditions for applicability of simplified customs declaration.

30 This could be the case when transactional net margin method is applied as refers to profit split and difficulties may exist related to the fact on how to identify each of the items imported and their price amendments.

31 J. Tuominen, *op. cit.*, 446.

imported goods is high.³² Tax authorities seek to maximize tax revenues, which is facilitated when the value of imported goods is low, as this results in higher recorded profits and, consequently, higher taxes.³³ From a VAT perspective, the focus is on ensuring that the taxable amount for VAT purposes accurately reflects the market value of the goods or services, preventing tax evasion and ensuring fair competition. Thus, VAT authorities are concerned with the correct valuation to ensure proper VAT collection and compliance.

In conclusion, while the objectives of TP, customs valuation, and VAT rules may align in their pursuit of fair and objective pricing, the differing motivations of the respective authorities create a complex landscape for MNEs. Understanding these nuances is crucial for ensuring compliance and optimizing tax and duty outcomes in cross-border transactions.

5. THE EU APPROACH

Article 72 of the VAT Directive defines “open market value” as the amount that would be paid between independent parties, incorporating the arm’s length principle from OECD guidelines. This highlights the link between transfer pricing and VAT. Article 80 lists situations where the taxable amount for transactions between related parties should be the open market value to prevent tax evasion. Although optional for Member States, many have adopted this provision to ensure accurate tax collection and fair competition.

Given the complexities and lack of provisions on the matter, the VAT Expert Group (VEG) issued an Expert Opinion in 2018 (VEG Report).³⁴ The VEG Report serves as a guideline for the VAT treatment of TP adjustments, stating that TP adjustments should be outside the scope of VAT when both parties have full VAT recovery rights. However, if one party does not have full recovery rights, a VAT

32 Customs authorities do perform customs calculation per item classified in appropriate customs nomenclature.

33 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, OECD Publishing, Paris 2022.

34 Paper on topic for discussion Possible VAT implication of Transfer Pricing (VEG Report), VAT Expert Group, *EU Commission*, No 71, 1(2018)2326098 – EN, April 2018.

adjustment may be required if there is a direct link between the adjustment payments and specific supplies.³⁵ The VEG Report suggests that a TP adjustment could be an adjustment of a previous taxable supply, additional consideration for the same supply, or even outside the scope of VAT.³⁶

In the absence of explicit rules, each case must be individually assessed to determine the correct VAT and customs treatment, based on whether there is a direct connection to the original transaction. If a TP adjustment is related to the initial supply, it implies that the prices of the original transactions have been altered, and the VAT treatment of the TP adjustment should align with that of the initial supply. Establishing a “link” requires that the TP adjustment be divisible, allowing a portion of the adjustment to be associated with each individual product sold or service rendered, ensuring that the payment corresponds to the actual value of the supply.³⁷

For customs purposes, similar principles apply as for VAT. The Customs Act mandates that the transaction value reflects the actual price paid or payable for the goods. Any price amendments must be linked to specific imports and the prices paid for each type of good. If there is no direct connection to the initial supply, the adjustment is presumed to achieve an agreed profit margin and is not considered a taxable transaction or consideration, thus falling outside the scope of VAT.

The tax implications of a TP adjustment depend on whether a direct link to the initial supply can be established. The contractual relationship between parties is also crucial in determining the tax nature of the TP adjustment. If the contract specifies how to handle TP

35 VEG Report, 2.

36 VEG Report, 3.

37 VEG Report, Direct and Indirect link with initial supply, 7. Furthermore, it is argued that TP adjustment as per its nature cannot form direct link. Such reasoning for direct link can be found in ECJ practice, see. Judgment of the Court (Eighth Chamber) of 2 June 2016, C-263/15, *Lajvér Meliorációs Nonprofit Kft., Lajvér Csapadékvízrendezési Nonprofit Kft. v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága*, ECLI:EU:C:2016:392 (NAV). Serbian VAT Law prescribes that the VAT base is a remuneration received for supplies and emphasizing the link between the remuneration and supplies i.e. the supplies must be specified. This is confirmed in the Rulings issued by Ministry of finance in Serbia. See Ruling No. 011-00-00928/2019-04 since 13.2.2020.

adjustments, that guidance should be followed. According to the VEG Report, if a contract characterizes a TP adjustment as a profit split or adjustment, it is considered an allocation of profit without a sufficient link to the supply, thus not subject to VAT or customs. Conversely, if the adjustment is linked to the supply, it is subject to taxation.

Even if there is no price correction, it is advisable to prepare documentation for corporate income tax and transaction records.³⁸ The document should be carefully prepared, as naming it an invoice may lead tax authorities to consider it proof of supplies and impose VAT.³⁹ The VEG suggests using a description like “Transfer Pricing Payment Request” for documents related to TP adjustments that are outside the scope of VAT.

The VEG paper explicitly stated that this discussion is for VAT purposes, although such correction may be of influence for customs purposes. Therefore, a significant part of the issue remains untacked or, at least, not sufficiently tackled. However, at the moment there are no ECJ cases available which specifically deal with the handling for VAT purposes of TP adjustments⁴⁰, but the significant ECJ case related to customs treatment of TP adjustment has been released in 2016 and its main effect will be elaborated in a more detail below since the related member state dealt with is issue in 2022 providing the most recent practice of EU Member states.

As mentioned earlier, the EU has not provided statutory guidance on using transfer pricing documentation for customs purposes. In contrast, the World Customs Organization has adopted instruments providing such guidance, which will also be mentioned in this article.⁴¹

38 Article 7a of the Serbian CIT Law stipulates that undocumented expenses will not be considered deductible for CIT purposes.

39 Art. 42 of the VAT Law imposes that the invoice should be issued for each of the supply of goods/services. If the document is named *invoice*, it could be argued that such document represents a proof of supply and consequently to treat such document as a proof of VAT-supply.

40 There are cases that address specific VAT issues and can be used to argue important points such as direct links and remuneration for transactions. However, there are no cases specifically related to TP adjustments from a VAT perspective.

41 Michiel Friedhoff, Martijn Schippers, “ECJ Judgment in Hamamatsu Case: An Abrupt End to Interaction Between Transfer Pricing and Customs Valuation?”, *EC Tax Review* 1/2019, 37.

5.1. Hamamatsu case⁴²

The Hamamatsu case is the one of the rare (if not the only one) example of EU authorities deciding on TP adjustment and starting to form much needed practice of the EU member states. Therefore, it is of utmost importance to give a short remark on main findings of the ECJ in respective case and further practice or related EU member state.

Hamamatsu GmbH is a German company, a part of group of companies whose parent company is established in Japan. Hamamatsu acts as distributor of optoelectronic devices, systems and accessories.⁴³ The respective goods are bought by parent company which charges the price determined in accordance with advanced price agreement (APA) concluded between that group of companies and the German tax authorities, which were checked on regular basis and, if necessary, adjusted to correspond to arm's length principle.⁴⁴

The APA provides that the consideration paid by Hamamatsu to purchase the goods sold allows Hamamatsu Photonics a target profit. However, Hamamatsu accounted for an operating margin below the threshold agreed upon in the APA and the parent company carried out a downward adjustment to allow the achievement of the target profitability. Hamamatsu filed a refund claim for the higher customs duties paid on the price that was declared to customs at the time of importation, but there was no allocation of the adjustment amount to the individual imported goods.⁴⁵ Customs, at that stage, did not seem to have challenged the carrying of adjustments but refused the refund claim, arguing that no allocation of the adjustment to the individual imported goods was made.⁴⁶

The decision of the ECJ remain rather vague stating that legislation in force does not allow for an agreed transaction value, composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the

42 Judgment of the Court (First Chamber) of 20 December 2017, Case C-529/16, *Hamamatsu Photonics Deutschland GmbH v Hauptzollamt München*, ECLI:EU:C:2017:984.

43 *Ibid.*, para 13.

44 *Ibid.*, para 14.

45 *Ibid.*, para 17 and 18.

46 *Ibid.*, para 19.

customs value, without it being possible to know at the end of the accounting period whether that adjustment would be made up or down.⁴⁷

In 2022 the German Federal Fiscal Court (or: *Bundesfinanzhof* “BFH”), the Highest court for tax related matters in Germany, gave its final judgement in the Hamamatsu case.⁴⁸ The BFH followed the ECJ’s decision and denied the refund claim based on downward adjustment stating that for both, upwards and downwards adjustments, it is unknown at the decisive moment of acceptance of the customs declaration whether the transfer price (which was declared as definitive) is to be adjusted at all and if, applicable whether the adjustment will be upwards or downwards.⁴⁹ BFH further states that the custom valuation methodology is transactional value or any alternative valuation methodology which in essence refers to price paid or to be paid by importer. As the initial price was considered as transaction value at the moment of import, any subsequent adjustment should be considered as irrelevant for customs purposes, as the customs value reflect the “real economic value” at the time of importation, so any amendment occurred afterwards should be irrelevant.

Although this judgement is applicable only in Germany, its reasoning is quite important as it will most definitely have a strong echo in the development of the EU practice regarding of TP adjustments from a customs valuation perspective. It remains to be seen how other EU customs authorities and the European Commission will respond to the BFH’s judgement.

5.1.1. Discussion on conclusions in Hamamatsu case

The Court’s decision in Hamamatsu is clear from an EU customs law perspective: retroactive TP adjustments cannot alter the declared customs value if such adjustments are unknown at the time of importation. The case raised the question of whether the transaction value method, based on the Profit Split Method (PSM) for transfer

47 *Ibid.*

48 Jaap Huegens Wajer, Nicole Looks, “Germany: The Hamamatsu TP/customs valuation case comes to a surprising conclusion”, [https://www.globalcomplianceupdate.com/2022-10-13-the-hamamatsu-tp-customs-valuation-case-comes-to-a-surprising-conclusion-_10132022/](https://www.globalcomplianceupdate.com/2022/11/06/https-www-internationaltradecomplianceupdate-com-2022-10-13-the-hamamatsu-tp-customs-valuation-case-comes-to-a-surprising-conclusion-_10132022/), 21.5.2024.

49 *Ibid.*

pricing, is permissible under EU customs law. The PSM involves retroactive lump-sum adjustments to ensure targeted operating margins⁵⁰, which complicates customs valuation as it requires the value of individual imported products to be known. Consequently, the PSM is generally incompatible with the transaction value method for customs purposes, as retroactive adjustments are not allowed under EU customs law.⁵¹

However, what could be argued whether the court decision would be different in case of traditional transaction methods, like the CUP method, directly connect to the price of individual products and often fulfil the criterion of knowing the price paid or payable, making them more compatible with customs valuation. If Hamamatsu had used a traditional method, the Court's decision might have required a deeper analysis, potentially allowing retroactive adjustments if they reflected the real economic value of the imported goods.⁵²

5.2. WCO Guidelines

The WCO's Technical Committee on Customs Valuation has issued several instruments outlining how to analyse the circumstances of a sale, with a particular emphasis on the use of TP studies. Several case studies which were in detail presented in Commentary⁵³ specifically address the use of TP documentation to determine whether the relationship between a buyer and seller has influenced the transaction price, highlighting that TP documents studies can be valuable for establishing the influence of relationships on transaction prices even when a profit-oriented method(s) is used.⁵⁴

50 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, *op. cit.*

51 J. Tuominen, *op. cit.*, 446.

52 This question can be further explored in terms of the supremacy of applicable rules, such as customs and TP regulations within the EU and ECJ decisions. However, while customs legislation is incorporated into the national laws of each member state, the OECD TP Guidelines are still regarded as soft law.

53 Commentary 23.1, Examination of the expression 'circumstances surrounding the sale' under Art. 1.2 (a) in relation to the use of transfer pricing studies (adopted, 31st Session, 29 Oct. 2010, VT0774E1c), <https://www.wcotradetools.org/index.php/en/valuation/tccv-texts>, 12.11.2024.

54 M. Friedhoff, M. Schippers, *op. cit.*, 7.

In one example⁵⁵ a TP study reviewed by tax authorities and supported by Advance Pricing Agreements (APAs) demonstrated that the relationship between the parties did not affect the customs value of the goods. The conclusion was that transfer prices were not influenced by the parties' relationship. However, it should be noted that no transfer pricing adjustments were made that year. In another case, the Resale Price Method (RPM) was used, and the comparability analysis revealed that the subsidiary's gross profit margin was significantly higher than the industry range, indicating that the transfer prices were influenced by the relationship.⁵⁶ The Technical Committee concluded that the transaction value should be redetermined using an alternative valuation method. Commentary 4.1 further supports that the transaction value method should not be rejected solely due to provisions in sales contracts that may affect prices later, as such provisions can also exist in contracts between unrelated parties.

6. COMPARATIVE ANALYSIS

After presenting the key provisions of the relevant regulations in Serbia and the EU, an overview of the approaches taken by the USA and Canada will be presented, given the lack of a clear stance on the matter in both the EU and Serbia. Additionally, as legislative framework of the EU is already presented, a national cases and/or legislation of specific EU member states will be presented for discussion purposes, to the extent available. Furthermore, the analysis will address rules that may create legal uncertainties for taxpayers, using illustrative examples to identify any potential legal loopholes in the upcoming chapter.

6.1. Canada and USA

Both Canada and the USA have provided guidance on the consideration of intercompany transfer prices and their retroactive adjust-

55 Case Study 14.1, Use of transfer pricing documentation when examining related party transactions under Art. 1.2 (a) of the Agreement (Adopted, 42nd Session, 22 Apr. 2016, VT0920E1c), <https://www.wcotradetools.org/index.php/en/valuation/tccv-texts>, 12.11.2024.

56 Case study 14.2, Use of transfer pricing documentation when examining related party transactions under Art. 1.2 (a) of the Agreement (Adopted, 45th Session, 23–25 Oct. 2017, VT1117E1c), <https://www.wcotradetools.org/index.php/en/valuation/tccv-texts>, 12.11.2024.

ments for customs valuation purposes, which also holds significance for VAT and sales tax positions. The Canada Customs Authority has issued a memorandum addressing customs valuation and transfer pricing relationships (Memo).⁵⁷

For customs purposes, the Memo stipulates that the prices paid or payable for imported goods should be derived from one of the transfer pricing methods specified by the OECD, unless more direct information pertaining to the specific imports is available. Essentially, taxpayers are permitted to use TP methods unless more precise information is accessible. The Memo provides a non-exhaustive list of methods to ascertain whether the price applied to imports between related parties has been influenced by their relationship.⁵⁸

The memorandum explicitly states that if a TP agreement is in effect between related parties at the time of import, the price is considered ‘uninfluenced.’ However, to maintain this status, any subsequent price adjustments, whether upwards or downwards, must be declared for customs valuation purposes, with duties adjusted accordingly.⁵⁹ The document also includes a chapter on test value, allowing customs authorities to verify the appropriateness of the applied value. The customs authority will assess whether the difference between the transaction value and the test value (of the same or similar goods imported within a relevant period) is commercially significant, considering market conditions and pricing practices. A minor difference may be acceptable if it is not commercially significant. If an importer demonstrates that the transaction value closely approximates a previously accepted test value, it is unnecessary to examine the circumstances surrounding the sale of the goods being imported.⁶⁰

In the United States (U.S.), where there is no federal consumption tax and individual states have discretion over sales/use tax policies, inter-company transactions raise issues regarding their sales/use tax consequences and their relationship with transfer pricing.⁶¹ In the

57 Memorandum on Transaction value for related persons, <https://www.cbsa-asfc.gc.ca/publications/dm-md/d13/d13-4-5-eng.html>, 11.11.2024.

58 Memorandum D13-4-5, Paras. 4, 5 and 6.

59 Memorandum D13-4-5, Paras. 19 and 20.

60 Memorandum D13-4-5, Paras. 13 and 14.

61 Henri Bitar, Amanda Z. Quenette, “European Union/United States – Indirect Tax Impacts of Transfer Pricing Adjustments: EU and US Approaches when the Price Evolves to Make It ‘Right’”, *International VAT Monitor* 4/2024.

U.S., as there is no concept of sales tax deduction rights, but similarly to Art. 80 of VAT Directive, section 482 of the Internal Revenue Code (IRC) permits the tax administration to adjust “gross income, deductions, credits, or allowances between or among” related entities if transactions are not made at arm’s length.⁶² Some authors argue that U.S. courts are more likely to establish a connection between customs and sales tax than the ECJ, potentially leading to different treatments of local sales and import or export transactions.⁶³

From a regulatory perspective, the U.S. adopts a similar approach to Canada, whereby a Ruling HQ W548314⁶⁴, which addresses this specific issue is published. This ruling establishes a five-factor test to determine whether retroactive adjustments of intercompany transfer prices should be included in the customs valuation of imported goods. Additionally, it introduces a reconciliation program that permits importers to report information that was unavailable at the time of importation at a later date.

The conditions of the test are: having a written ‘Intercompany Transfer Pricing Determination Policy’ in place before importation, using this policy when filing income tax returns and reporting any resulting adjustments, specifying how TP and adjustments are determined for all covered products, maintaining and providing accounting details to support the adjustments, and ensuring no other conditions affect the acceptance of the transfer price relevant authority.

The circumstances of the sale must be reviewed to determine if the initial intercompany transfer price was influenced by the buyer-seller relationship. The five-factor test permits the use of the transaction value method if the customs value is based on a retroactively adjusted intercompany transfer price. Depending on whether the adjustment is upwards or downwards, customs duties will be reassessed or refunded accordingly.⁶⁵ The reconciliation program allows importers to update their import declarations with missing information within twenty-one

62 *Ibid.*

63 *Ibid.*

64 US Customs and Border Protection, Notice of Revocation of a Ruling Letter HQ 547654 Relating to Post-Importation Adjustments; Transfer Pricing; Related Party Transactions; Reconciliation, Customs Bulletin and Decisions 23, 2012, https://www.cbp.gov/bulletins/Vol_46_No_23_Title.pdf, 11.11.2024.

65 M. Friedhoff, M. Schippers, *op. cit.*, 19.

months of importation.⁶⁶ The Ruling explicitly aims to provide practical guidance on incorporating transfer pricing adjustments into customs valuation. If the five conditions are met, retroactive adjustments of intercompany transfer prices will be considered for customs valuation purposes.

6.2. Member States' case studies

Although the Hamamatsu was certainly not the first, nor the last case dealing with issue at stake, it is one of the rare cases addressed to ECJ.⁶⁷ However, there are a certain number of cases known to the author that are referred to in particular national countries, which may be of significance for this topic and provide an in-depth understanding of the presented legislation. Additionally, some national relevant legislations that have specific documents on TP adjustment guidance for tax will be covered.⁶⁸

One of such cases was decided in Finland where the link between TP and customs valuation was analysed. A company located in Finland purchased cars from related entity, located outside of Finland, for further resale. The TP agreement was in force between the parties, but not represented to customs authorities. Based on TP agreement, the downward adjustment occurred resulting in request for repayment of import duties. This was rejected by customs authorities, stating that the price initially declared was final price actually paid for the cars (therefore similar as in Hamamatsu case years earlier). However, the

66 US Customs and Border Protection, *op. cit.*, 15.

67 A similar case is currently before the ECJ, case no. C-726/23, where the Bucharest Court of Appeals has asked whether the amounts included in yearly equalisation invoices, intended to ensure arm's length pricing within a group, constitute payment for VAT-relevant services. Additionally, if VAT is applicable, the court inquired whether tax authorities could require additional documentation for the deduction of such VAT.

68 In 2018, 13 out of 65 countries have had specific TP adjustment guidance document, while other member states applied general provisions from income, VAT and customs legislation. Therefore, author has chosen only examples where specific documents exists. To the best of the author's knowledge, no similar study has been conducted since 2018. Deloitte, "The Link Between Transfer Pricing and Customs Valuation: 2018 Country Guide", <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-the-link-between-transfer-pricing-customs-valuation-country-guide.pdf>, 11.11.2024.

relevant administrative court was of the opposite opinion by which the final transfer price was unknown despite of the fact that the customs authorities thought that the initially declared transfer price was the final price. Consequently, the initially declared value was not the true economic value of the imported cars repayment application should have been accepted, or alternatively, the customs value should have been adjusted by the customs authorities.⁶⁹

In the case of Spain, it is noteworthy that, even prior to the Hamamatsu ruling, the customs authority had recognized the issue at hand. To address this, the customs authorities issued a special resolution permitting declarants in related party transactions to utilize a simplified declaration and subsequently submit a supplementary declaration under exceptional circumstances related to the customs value.⁷⁰ In regard to relevant practice, a case was decided by Spanish Supreme Court which adopted a pragmatic approach when interpreting them in relation to the same goods under valuation by two different authorities. In this case⁷¹ the customs authorities initially determined the value of certain goods during importation based on the information provided by the importer. Later, direct tax auditors re-evaluated the same goods and concluded that their value should be higher than that determined by the customs authorities. The Supreme Court ruled that having two different values for the same goods is not permissible since both sets of rules—direct tax rules and customs valuation rules—are based on the same principle, the arm's length principle. Therefore, both authorities should have used the same valuation parameters and arrived at the same value. Consequently, the profit adjustment made by the direct tax auditors violated the constitutional principle of legal certainty, and they were required to follow the values set by the customs authorities.

Although the Hamamatsu Case is frequently referenced in resolutions by the Spanish authorities after its publishing, it has not

69 Helsingin hallinto-oikeus [Helsinki Administrative Court], 15 Mar. 2007, 07/0285/1, quoted in Tuominen, *op. cit.*

70 Resolución de 25 de agosto de 2017, del Departamento de Aduanas e Impuestos Especiales de la Agencia Estatal de Administración Tributaria, por la que se modifica la Resolución de 11 de julio de 2014, en la que se recogen las instrucciones para la formalización del documento único administrativo (DUA).

71 Tribunal Supremo (Supreme Court), case No. 3582/2003, since 30 November 2009, Refrescos y Envasados S.A. (the taxpayer), Administración General del Estado (the tax authorities), Tax Treaty Case Law IBFD.

influenced the *ratio decidendi* of the court reasoning. Notably, aside from updates to the prior cited instructions, the customs authority has not issued any explanatory notes on changes resulting from the Hamamatsu Case.⁷²

6.3. National legislation of some EU Member States

As already mentioned, not all member states have implemented specific document i.e. guidelines on TP adjustment treatment for customs and tax purposes, but specific legislative framework of some of them may be significant especially after Hamamatsu influence.

Belgian TP regulations include general provisions that require any advantages granted by a Belgian taxpayer to a non-Belgian entity to be included in the taxpayer's taxable basis when granted to a non-resident related enterprise. Anti-abuse rules disallow certain deductions arising from such advantages received by a Belgian taxpayer from a related enterprise.⁷³ On the other hand, Belgium does not require co-ordination between transfer pricing and customs valuation. Customs authorities may require APA, TP documentation and other proofs on price applied, but there is no mandatory rule that tax authority and customs authority need to align with price determined i.e. it is mostly dependable on their goodwill (opposite to Spanish practice stated above). The Belgian tax administration published the Circular Letter "Transfer Pricing" (Circular Letter 2020/C/35), but issue related to retroactive TP adjustment was not addressed and no referral to Hamamatsu case has been presented. Prior to Hamamatsu, in circular letter 2018/C/9 on customs valuation, customs authorities have set out their position regarding the acceptability of an intra-group price as customs value and amendments to the customs value based on a TP adjustment (downward or upward).⁷⁴

Further, France's tax and customs regulations do not specifically recognize an APA as sufficient on its own for indirect tax purposes, but

72 Giangiaco D'Angelo *et al.*, "Interplay between customs valuation and transfer pricing in the European Union: general observations and administrative practices in four countries after the Hamamatsu Case", *World Customs Journal* 1/2023, 16.

73 Belgian Income Tax Code 1992 (ITC), Arts. 26, 79, 185 and 206/3.

74 Chambers and Partners, "Transfer Pricing 2024: Belgium", <https://practice-guides.chambers.com/practice-guides/transfer-pricing-2024/belgium>, 11.11.2024.

it may contain important information for TP adjustments. The customs authority may require a cost analysis of the TP documentation. There is specifically published guidance on this topic, which was updated in 2017 following the implementation of the new Union Customs Code (UCC).⁷⁵ Prior to this amendment, it was difficult to approve retroactive adjustments, especially decreases, as no simplified customs declaration could be submitted and to correspond to TP adjustment purposes. However, the situation has changed, and now retroactive adjustments can be approved if there is an APA and a (prior) agreement with the customs authority. Therefore, the conclusion which can be drawn up from French experience is that TP methodology and APA may be used, but if the taxpayer is aware that the applied price is not the final one, it has to go step further and not submit final customs declaration but simplified one i.e. incomplete declaration.⁷⁶

In Italy, the judgment, the customs authority issued documents to align customs value with transfer pricing, proposing two solutions: the simplified declaration and the flat-rate adjustment, both which would have direct VAT effect on import VAT calculation. Despite the potential contradictions introduced by the Hamamatsu, no new statements or official documents addressing these changes in customs area, leaving the situation as it was.⁷⁷ However, the tax authority elucidated the VAT treatment of price adjustments contingent on the profits achieved by the involved parties.⁷⁸ The case concerned two companies, one acting as the supplier and the other as the marketer, who agreed on a provisional

75 Instruction du 14/01/2020, La valeur en douane des marchandises, <https://www.douane.gouv.fr/sites/default/files/uploads/files/DOSSIERS/VALEUR-EN-DOUANE/Instruction%202020%20-%20Valeur%20en%20douane.pdf>, 11.11.2024.

76 For definition, please refer to Art. 166 of UCC, Declarants are allowed to place goods under a customs procedure based on a simplified declaration where either some particulars or some documents are missing at the time of lodging the customs declaration. For the non-regular use of the simplified declaration, no authorisation is required. Specifically, the applicability of this type of declaration addresses two key issues: the awareness that the price is not final now of import (from a TP perspective) and the method for amending the declaration and the reasons for doing so after the import (from a customs perspective).

77 G. D'Angelo *et al.*, *op. cit.*, 15.

78 Ruling Answer No. 529/2021 in *Italian Trattamento fiscale applicabile agli aggiustamenti di prezzo sulla base imponibile – IVA – art. 13 e 26 del DPR n.*

price subject to subsequent adjustment based on profits, referred to as the “Profit True Up”. The companies sought confirmation that this adjustment was pertinent for VAT purposes and influenced the taxable base, and it was affirmed that the Profit True Up was directly linked to the original sale, thereby impacting the VAT taxable base and resulting in an increase or decrease in the original taxable base.

6.4. Exemplary case studies

To illustrate potential dilemmas, an example is provided from a Serbian perspective. This simplified example is rarely found in practice but offers clear insight into possible issues.

Company A, a multinational enterprise, operates in multiple countries with subsidiaries in country B (manufacturing) and country C (marketing and distribution). These subsidiaries engage in intercompany transactions, such as the sale of products from country A to country B at prices below arm’s length. Subsidiaries B and C, with limited functional profiles, recharge advertising and promotion costs exceeding a certain threshold to company A. At the start of each fiscal year, company A sets and approves the prices and budget for finished goods sold to subsidiaries B and C, which remain unchanged throughout the year. At year-end, the actual remuneration and profit are verified against the arm’s length price, and adjustments are made if necessary. Complications arise if company A’s policy allows compensating adjustments to subsidiaries if their profit is lower than expected. This scenario presents following dilemmas:

- How should the TP adjustment be treated – as a retroactive correction of price or transfer of profit i.e. profit adjustment,
- What is the tax treatment of compensating adjustment,
- What is the tax treatment of recharge of costs that surpass the agreed threshold.

Alternatively, the case could involve only the supply of products or services between two related entities, where a cost incorporated into the price changes, necessitating a yearly TP adjustment to account for this price correction.

633/72, <https://www.agenziaentrate.gov.it/portale/documents/20143/3744575/Risposta+529+del+2021.pdf/43e6524f-5d5b-b840-49c6-d7010a442518>, 11.11.2024.

A similar issue may arise in the opposite direction, i.e., during export. From a Serbian VAT perspective, such a transaction would not be affected as exports are VAT exempt with the right to deduct input VAT.⁷⁹ However, the issue becomes complex from a customs perspective, even without customs duties, as the value of goods can directly influence their preferential origin.⁸⁰

The open question is whether this constitutes a price change. If not, it would be treated as a simple profit adjustment with no VAT effect. However, if it is a price correction, the respective adjustment must be made for each imported good and the procedure itself has to be conducted by the customs authority. The key question is where such a difference can be determined.

7. CHALLENGES AND COMPLIANCE RELATED TO TP ADJUSTMENTS

7.1. Upward and Downward adjustment from VAT perspective

VAT is a general turnover tax levied on supplies of goods and services, as well as on the importation of goods.⁸¹ The transfer of money is significant for VAT purposes as it typically reflects the consideration for taxable activities, constituting the taxable amount. However, without the supply of goods or services, the mere transfer of money cannot be treated as a supply for VAT purposes.

If transfer pricing is adjusted to match actual cash flows, resulting in additional payments, this could increase the taxable value for VAT purposes. Although the VAT Directive does not explicitly address timing issues, considering payments received after the transaction can be problematic, as the taxable amount should be assessed at the time of the taxable event. Depending on the contract, such corrections may be seen as adjustments to the initial price. If prices are retroactively amended, the seller must provide exact price calculations for each item.

79 Serbian VAT legislation envisages that export is VAT exempt upon fulfilment of certain conditions imposed in VAT Rulebook (obtaining the certified export declaration).

80 The Central European Free Trade Agreement. PEM Convention, 2013.

81 Serbian VAT, Art. 3 and VAT Directive, Art. 2.

When it comes to subsequent correction of the price of imported or exported goods, the VAT treatment depends on the approach by customs authorities which is elaborated in more detail below.⁸² Cross-border service supply between related entities and its price correction is less problematic. In B2B transactions, where the place of supply is the recipient's location, the service supplier issues a corrective document, and the recipient adjusts the VAT base and calculation. For cross-border B2B transactions, only the recipient's country is concerned with amendments.

The primary issue is whether such TP adjustments constitute a price correction. In the absence of clear practice and approach, each case must be carefully reconsidered. Although the list of cases for VAT base amendments is not exhaustive⁸³, the most common instances involve discounts and the calculation of additional costs related to the price of goods or supplies, both of which can theoretically be considered related to TP adjustments. If applicable, this approach should be appropriately documented, specifying which costs are calculated and how (e.g., related to production or distribution costs) or detailing the type of discount applied and its calculation (e.g., logistic rebate).⁸⁴ In the case of rebates, there is ongoing debate in practice and legal theory about their permissibility in all cases and whether the VAT base can be subsequently amended.⁸⁵

However, in the author's opinion, it should be carefully assessed whether a TP adjustment can be considered a price reduction or discount, or if this reasoning merely frames an unregulated concept into a familiar one. While this approach may be somewhat sufficient for VAT purposes, its effects from a customs perspective remain uncertain. A

82 In Serbia import VAT base can be changed only by the decision of Customs Authority. See VAT Law, Art. 31a and VAT directive, Art. 85.

83 Serbian VAT Rulebook, Art. 55, Montenegrin VAT Rulebook, Art. 48.

84 See. Judgment of the Court (Sixth Chamber) of 24 October 1996, Case C-317/94, *Elida Gibbs Ltd. v Commissioners of Customs & Excise*, ECLI:EU:C:1996:400 or Judgment of the Court of 15 October 2002, Case C-427/98, *Banca Antoniana Popolare Veneta SpA v Ministero dell'Economia e delle Finanze*, ECLI:EU:C:2002:581.

85 Rulebook on VAT explicitly envisages that subsequent discounts are not new supply but change of VAT base. However, certain limitations to this conclusion may be drawn for natural rebate that is actually supply of goods without remunerations and, hence, subject to VAT as such.

TP adjustment, if viewed as a price reduction, should have a unified effect on a single transaction, such as the import or export of goods.

7.2. Adjustment from customs perspective

If a TP adjustment affects VAT and is treated as a price correction, it also impacts the customs valuation of the supply. A change in the price of imported goods would increase the customs duties base, which is determined by the actual price paid or payable. If this amount is fictional for income tax purposes, it should not influence the customs base. Contracts rarely state that post-sale payments to the seller are a sale condition, raising questions about whether year-end income tax adjustments should correct the reported customs value, and taxes paid. Downward price adjustments are particularly significant as they directly impact the budget and customs duties on imports, necessitating clear criteria for when such adjustments are allowed.

In comparative practice, some countries reject price reductions based on post-transactional discounts, deeming any subsequently determined discount unacceptable for customs purposes.⁸⁶ According to the Union Customs Code, import or export duties must be refunded if it is proven that the amount paid was not legally due or was accounted for in violation of customs declaration rules.⁸⁷ However, the term “not legally owed” is broadly interpreted in ECJ practice.⁸⁸

When related parties do not follow the arm’s length principle, tax authorities may adjust the taxable base during audits. Such adjustments do not represent transactions between parties (unless actual payments are made) nor do they constitute price corrections from an indirect tax perspective. These adjustments are beyond the scope of this article and are viewed as penalties or corrective measures for adjusting income or profit.

86 Canada Border Services Agency, Memorandum D13-4-10 Ottawa, February 6, 2018, ISSN 2369-2391. The similar may be found in Irish tax practice in Customs Manual on Valuation, December 2022, 13.

87 Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code Union Customs Code, Arts. 116 and 174.

88 Judgment of the Court (Third Chamber) of 5 October 2006, Case C-100/05, *ASM Lithography BV v Inspecteur van de Belastingdienst-Douane Zuid/kantoor Roermond*, ECLI:EU:C:2006:645.

TP adjustments for income tax purposes may prompt an inquiry into the pricing used for customs purposes, but this does not necessarily lead to adjustments for customs purposes. However, applicability of simplified customs declaration⁸⁹, as a type of declaration where not all data are known in the moment of import (irrespective of TP method applied) may be relevant. Taxpayers expecting any kind of adjustment may claim that the price payable at the moment of import is not final and that variable data, dependent on TP adjustment, if any, will be known later, which may include both upward and downward adjustments.

7.3. Serbian approach

While Serbia has introduced TP legislation that is loosely based on the OECD model, neither VAT nor customs legislation specifically addresses this issue. Therefore, it is necessary to refer to general legislation for interpretative purposes.

If it can be argued, based on the business model and intercompany agreement, that the TP adjustment constitutes a retroactive price correction, an appropriate document containing the elements required by the VAT Rulebook should be issued. Furthermore, the correction is performed in the current tax period, eliminating the need for amendments to previous VAT returns.

Similar to the VAT perspective, the Serbian Customs Authority lacks a clear approach regarding TP adjustments for customs purposes. They may either permit simplified declarations, contingent on the TP method and the ability to measure the variable part of the price at the time of import or prohibit any adjustments altogether. Although some official rulings have been issued by the Customs Authority, these are

89 Simplified customs declaration is envisaged in Art. 166 of UCC. In addition, Serbian Customs Law envisage also a specific simplification procedure in Article 55 which is a different solution in comparison to simplified declaration. Namely, this article envisage that the customs authority may, at the request of the interested party, approve that the amounts be determined based on specific criteria if they are not measurable on the day the declaration is accepted while for simplified declaration those data should be somehow measurable (from Serbian interpretation of the provision). However, to the best of our knowledge no practical applicability of this article is available in Serbia due to technical issues at Serbian customs, so this solution is not further investigated at this moment.

not publicly available and are provided only to the specific taxpayers who requested the information. The unofficial analysis of these rulings indicates that customs legislation does not offer a definitive approach, leaving it to the taxpayer to interpret the provisions of their agreement with related parties and how TP adjustments are defined therein. The primary consideration is whether there is a subsequent price change or a financial correction of the related party's position. In any case, any adjustment that may affect the transactional value should be reported to the Customs Authority.

No additional duties, including higher VAT, may be imposed without a decision from the Customs Authority. This also applies to the reduction of import duties and potential refunds. If a TP adjustment in a particular case could be treated as a price reduction, it could be argued that such a reduction, although based on TP adjustment, essentially represents a discount. Consequently, its influence on customs value should be considered. When determining the customs value of imported goods, agreed price reductions and customary cash discounts for similar goods are accepted. However, discounts resulting from contract changes after the acceptance of the declaration are not considered.⁹⁰

Conversely, in the case of exporting goods, amendments to the value of exported goods may directly affect their preferential origin. The preferential origin of products is determined based on a set of complex rules outlined in both local and international customs regulations. To ascertain the preferential origin, which allows for reduced or no customs duties, it is essential to identify the country of origin of the materials used in production and the destination country of the product. Additionally, it is necessary to determine whether these countries are signatories to relevant free trade agreements and international conventions, such as the PEM Convention or the Revised PEM Convention, to apply the appropriate rules of origin prescribed by these conventions.⁹¹

90 Regulation on customs procedure and customs formalities, *Official Gazette RS* No. 39/2019, 8/2020, 132/2021 and 144/2022, Art. 107.

91 Serbian origin rules are determined by PEM Convention Law on Ratification of the Pan-Euro-Mediterranean Regional Convention on preferential origin rules, *Official Gazette of the RS - International Agreements*, No. 7/2013) where applicable or by respective free trade agreement if one of the parties is not PEM signatory. The Pan-Euro-Mediterranean Regional Convention on

Although origin rules are not within the scope of this article, it is important to emphasize that a single amendment, such as a TP adjustment, can have various and multifaceted consequences on the business operations of related parties. A similar approach, treating TP adjustments as financial transactions and outside the broader tax scope, was taken by the latest opinion of the Ministry of Finance. This opinion states that TP adjustments (whether monthly or yearly) aimed at bringing the contractual manufacturer to a certain level do not affect the CIT position of the taxpayer.⁹²

As indicated above, each case is handled on a case-by-case basis, highlighting the need for more detailed guidance and structured frameworks similar to those in the U.S. and Canada.

Serbia could benefit from adopting a formalized test or criteria, similar to the U.S. five-factor test, to determine the acceptability of TP adjustments for customs valuation. This test could consider the TP method used and the adequacy of the prepared TP documentation, following the WCO approach. This would provide businesses with a clear process and reduce the risk of non-compliance including its clearer VAT position. Additionally, the Ministry of Finance should establish a clear stance on the matter, specifying which rules take precedence (TP or indirect tax) and to what extent one can override the other. Drawing from Spanish practice, this approach would ensure a comprehensive and practical regulatory framework.

preferential origin rules is a multilateral agreement that aims to establish a common rule of origin and cumulation among its contracting countries. It integrates a network of FTAs that having identical rules of origin, by replacing these rules (stated in Protocols/Annexes) by a reference to the PEM Convention rules. Contracting countries / Signatories of PEM Convention are as follows: EU member states, EFTA States (Iceland, Liechtenstein, Norway, Switzerland), countries that signed Barcelona Declaration (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestine*, Syria, Tunisia, Turkey), the Faroe Islands, the participants in the EU's Stabilization and Association Process (Albania, Bosnia and Herzegovina, the Republic of North Macedonia, Montenegro, Serbia, Kosovo*), the Republic of Moldova, Ukraine and Georgia. Most of the countries with which Serbia has FTAs are contracting countries of PEM (CEFTA, EFTA, EU/SAA, Turkey). UK is currently not signatory to PEM Convention.

92 Opinion of Ministry of Finance No. 011-00-188/2023-04 since 1.12.2023.

8. CONCLUSION

This topic remains complex and lacks a clear approach in both Serbian and EU legislation. The existing practice is vague and insufficient to establish a definitive practical approach. Forming a unified opinion is challenging because the position must be applicable from both VAT and customs perspectives. If a TP adjustment is treated as a price reduction, it should be processed through the appropriate customs procedures. If treated as a discount, it can be easily documented for VAT purposes. However, customs regulations for goods pose an obstacle, as discounts not agreed upon in advance are not considered. Taxpayers cannot always predict the direction of price corrections and stipulate them in agreements beforehand, suggesting that customs regulations effectively restrict the applicability of discounts from TP adjustments. The issue is less complex for the supply of services or domestic supply of goods between related parties, but it remains unresolved. From the perspective of taxpayers and legal certainty, it is unacceptable to have solutions that are not fully applicable due to the nature of cross-border goods transactions. A unique approach and specific provisions regulating TP adjustments are needed. The current practice, which allows for different interpretations, leads to taxpayer insecurity.

Comparative experiences from countries such as the United States and Canada demonstrate that issuing formal guidance documents is essential for ensuring tax certainty for taxpayers. Such guidance helps prevent multinational enterprises (MNEs) and other entities from operating in an uncertain regulatory environment. Clear and authoritative instructions from tax authorities are crucial for fostering compliance and reducing the risk of inadvertent non-compliance.

Considering the cited provisions and the EU approach, the author argues that TP adjustments should be treated as profit allocation and outside the scope of VAT. Since TP adjustments are determined in total amounts rather than per individual transaction, there is no direct link between the initial supply, remuneration, and the TP adjustment. Although this argument can be contested, from an income tax perspective, such adjustments relate more to the allocation of profit over a period (e.g., annually) rather than reflecting a particular transaction. This approach is supported by the fact that TP adjustments are subsequent to the initial supply, which was conducted under acceptable

conditions, and income tax conditions should not affect already completed transactions. Additionally, this approach aligns with the VEG Report, and it is crucial for Serbia to follow the EU approach available for this issue.

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POREZNE IMPLIKACIJE TRANSFERNIH CENA U SRBIJI – SPAJANJE NESPOJIVOG

Rezime

Prilagođavanja transfernih cena (TC) postala su predmet intenzivnog nadzora u oblasti međunarodnog oporezivanja i carinskih procedura. Ovaj rad pruža sveobuhvatan pregled globalnih praksi i regulatornih okvira, sa posebnim osvrtom na pravni pristup Srbije, koji je oblikovan standardima OEBS-a i regulativama Evropske unije. Analizirana je usklađenost transakcija povezanih lica sa principom „dužine ruke“ (eng. arm's length principle), kao i uticaj ovih prilagođavanja na porez na dobit pravnih lica (DPL), porez na dodatu vrednost (PDV) i vrednovanje za carinske svrhe. Uz to, rad se bavi izazovima sa kojima se suočavaju multinacionalne kompanije (MNK). Istraživanje ukazuje na to da bi prilagođavanja transfernih cena, zbog svojih suštinskih karakteristika, trebalo isključiti iz okvira indirektnog oporezivanja. Kroz komparativnu analizu praksi u SAD-u, Kanadi i državama članicama EU, istaknuta je potreba za jasnijim smernicama od strane srpskih vlasti kako bi se osigurala pravna i fiskalna konzistentnost. Rezultati sugerišu da je važno usvajanje američkog „testa pet faktora“ za prilagođavanja transfernih cena u vezi sa carinskim vrednovanjem, kako bi se obezbedio jasniji put za usklađenost. Zaključak rada sadrži preporuke za usklađivanje zakonodavstva o PDV-u i carinama sa međunarodnim standardima, sa ciljem unapređenja usklađenosti i smanjenja rizika od poreskih utaja.

Ključne reči: *Transferne cene. – Prilagođavanje transfernih cena. – Carinska vrednost. – Osnovica PDV-a. – Tržišna vrednost.*

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