Customs Valuation Challenges in Multinational Enterprises’ Controlled Transactions: An African Perspective

*Marina Bornman*, University of Johannesburg, South Africa

*Simba Chirevo*, University of Johannesburg, South Africa

*Corresponding author’s email: mbornman@uj.ac.za

<table>
<thead>
<tr>
<th>ARTICLE DÉTAILS</th>
<th>ABSTRACT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>History</strong></td>
<td><strong>Purpose</strong>: The paper aims, from an African perspective, to investigate the practice of inconsistent custom duty valuations experienced by related MNEs and to explore the impact this may have on MNEs.</td>
</tr>
<tr>
<td>Revised format: Nov 2022</td>
<td><strong>Design/Methodology/Approach</strong>: Perceptions from industry experts from various African countries were sought by means of a questionnaire and supplemental literature was reviewed with a view to address the stated objectives.</td>
</tr>
<tr>
<td>Available Online: Dec 2022</td>
<td><strong>Findings</strong>: The main findings point to custom officials’ lack of knowledge of transfer pricing principles, possible corruption by custom officials and custom authorities keeping reference prices. The impact on MNEs appear to mainly relate to additional costs in the form of storage, consignment seizure, and lengthy court battles.</td>
</tr>
<tr>
<td><strong>Keywords</strong></td>
<td><strong>Implications/Originality/Value</strong>: Strategies to address challenges arising in custom valuations suggest training of customs officials, coordination and exchange of information between relevant departments within the revenue authority and making use of advanced pricing agreements.</td>
</tr>
<tr>
<td>Customs valuation, GATT, Transfer Pricing, MNE, Controlled transactions, Global trade.</td>
<td>© 2022, The authors, under a Creative Commons Attribution-NonCommercial 4.0</td>
</tr>
</tbody>
</table>

**JEL Classification**

F20, F23


**Introduction**

Developing countries are becoming more and more important in the global economy, not only because of their large numbers, but also because trading across borders is becoming a vital tool for these countries to grow and develop their economies (World Trade Organisation (WTO), 2023). When goods move through country borders, customs duty becomes payable in the importing country, which serves as a revenue stream for government (Cooper, Fox, Loeprick & Mohindra, 2016). The role of customs in Africa is critical to revenue collection as trade taxes account for, on average, 30% to 50% of total state revenue in African countries (Cantens & Raballand, 2017).

Multinational enterprises (MNEs) establishing new operations in foreign markets, cause an increase of goods flowing across borders between companies of the same group. By 2015, it was reported that 60%
of global trade value were between related companies (The International Chamber of Commerce (ICC), 2015). However, global trade between related MNEs has been shown to contribute to the erosion of the tax base through the use of transfer pricing methods which consequently results in the diversion of profits, especially in developing countries (Organisation for Economic Co-operation and Development (OECD), 2016).

According to OECD (2017, p. 612), the OECD transfer pricing guidelines provide guidelines for the application of the Arm’s Length Principal “ALP”, which is the international consensus on transfer pricing, i.e., on the valuation for tax purposes of cross-border transactions between associated enterprises.

These transfer prices are then naturally considered in valuation of transactions for custom duty purposes as agreed on in the General Agreement on Tariffs and Trade 1994 (hereafter referred to as the GATT 1994) (GATT, 1994). Pike and Schuette (2020) remark that the relationship between transfer pricing and custom valuation becomes more complex and evolves every day and may significantly impact companies who are importing tangible goods from related parties.

A recent study by Wier (2020) provides evidence of miscalculated transfer prices in South Africa, a developing country. In his study, Wier (2020, p. 14) used transaction-level customs data, testing for deviations between transfer prices and arm’s-length prices and concludes that there is proof of “tax-motivated transfer mispricing of goods”. His study, however, focused on the transfer mispricing conducted by multinational firms, while the present paper investigates customs duty valuation practices of tax authorities in some African countries. Gedge (2021) notes that tax authorities and customs authorities in the country of import may simultaneously seek to challenge the prices of imported goods and suspicion on prices being too high (thereby decreasing taxable profit) or too low (thereby decreasing the customs duties to be paid in the importing country). Atki (2020) similarly investigates the reconciliation of the overlap between customs valuation and transfer pricing by considering the interests of the different stakeholders, while Chitimira and Maselwa (2021) examines retrospective transfer pricing adjustments and the associated customs valuation procedures with a view to unpack the regulatory challenges in these procedures. Chitimira and Maselwa discussed these challenges and custom valuation processes from a South African perspective, however, their study did not include empirical research, which thus leaves a gap that the present study fills. In the Deloitte 2018 Country Guide, “The Link Between Transfer Pricing and Customs Valuation” results from a survey among 58 countries indicates, inter alia, that 36 of the countries surveyed note customs valuation of related party transactions as an increasingly high-focus enforcement area. A large number of the countries also expect increased scrutiny by customs officials (Deloitte, 2018). The present study addresses a gap in the literature by approaching this customs valuation challenge from the perspective of the taxpayer and aims to empirically investigate the reasons behind customs mispricing in controlled transactions as well as the impact this may have on MNEs.

The ICC (2015) states that it appears that customs officials distrust custom values (transfer prices) declared by MNEs that sell goods between their related entities and that they may suspect that such values were set as a result of the connection between the MNEs. Further, the ICC (2015) acknowledges that divergent customs and tax regulations lead to MNEs facing difficulties in determining the value of goods in cross-border trade. Customs authorities aims to establish “whether or not a price has been ‘influenced’ by the relationship between the parties” while tax authorities aims “to seek an ‘arm’s length price’. Each is ensuring that the price is set as if the parties were not related and had been negotiated under normal business conditions” (WCO, 2018: p. 57).

In comparison to OECD countries, African countries traditionally have high customs duty to total tax revenue ratios, indicative of their dependence on custom duties as a large percentage of the total tax base (Chalendard, Duhaut, Fernandes, Mattoo, Raballand & Rijkers, 2020; De Wulf, 1980; The World Bank (WB), 2020). Developing countries, including most African countries, feel increased pressure on their
fisci as a result of weaker global economic growth. Aggressive customs duty collection practices focusing on related MNES with Africa bound goods could arguably be a result of this pressure on tax authorities to maximise revenue collection. For the purposes of this paper, “aggressive customs duty collection practices” are viewed as the use of higher values than the invoice value for goods when calculating customs duty (Chirevo, 2021, p. 3). The tax uncertainty resulting from such aggressive customs duty practices in Africa targeting related MNES, and the impact this may have on these MNES, are the focus areas of the present paper.

“For Customs valuation purposes, import transactions between two distinct and legally separate entities of the same MNE group are treated as ‘related party transactions’” (World Customs Organisation (WCO), 2018, p. 4). When goods are sold between related MNES, the custom values are driven by transfer prices. It is important to any business to have certainty on the valuation of imported goods and the resulting taxes. The ICC (2015) and UN (2017) have reported on the hesitancy by customs officials to accept declared values for customs purposes in the case of goods sold across borders between MNES in the same group. However, no study has explored this phenomenon empirically from an African perspective. The present paper therefore aims to investigate the challenges related MNES face because of unpredictable customs duty valuation processes which appears to target especially their shipments bound for the African continent. In addition, this paper aims to identify, from the perspective of industry specialists, the adverse impact these customs valuation challenges of controlled transactions may have on MNES.

Research Methodology
Primary data was collected by means of a questionnaire and comprised of perceptions and experiences of customs and transfer pricing experts. Using purposive sampling, tax professionals specialising transfer pricing and/or customs in Africa in four of the top audit firms, as well as customs specialists within various MNES were selected for inclusion in the sample. The final respondents who agreed to participate in the study included:

- Five specialists from the four biggest audit firms based in South Africa, Nigeria, Ghana, Kenya and Morocco;
- Five specialists from various MNES operating in South Africa, Nigeria, Ghana and Morocco.

The reasons for selecting participants from these countries are twofold: Firstly, these five countries are all on the list of the top ten largest economies in Africa. Nigeria is the largest economy in terms of its GDP, followed by South Africa (IMF, 2021). Secondly, the geographic spread of the countries means that Northern, Eastern, Western and Southern Africa are represented with the sample. All participants provided their consent for the use of their responses for the purpose of this research. Confidentiality was ensured as all responses were anonymised in reporting the findings of this study.

It is acknowledged that obtaining the views from custom officials too, would have resulted in a more balanced interpretation of results. This is a limitation of the present research but also provides an opportunity for further research to expand or challenge findings presented in this study.

Secondary data were used to support and supplement this study’s findings and included reports and other publications from global bodies like ICC, WTO, WCO, the OECD and the World Bank. Reputable academic databases were searched using combinations of keywords including, but not limited to, “transfer pricing and customs” and “custom valuation practices” to find relevant publications.

A thematic analysis was performed on the responses received to the open-ended questions while data obtained from close-ended questions were reported on by quantifying the results.

To ensure validity when performing research of a qualitative nature, it is important to use appropriate tools and processes for collecting data and to obtaining data appropriate to the research problem (Leung, 2015). In the present study, the researchers ensured validity by collecting data from credible sources which
includes sampling respondents who are knowledgeable about the research problem and using secondary data from credible global bodies and academic sources.

**Understanding the Link between Customs Valuation Process and Transfer Pricing**

This section presents a brief synopsis of how transfer pricing drives customs value determination of goods imported in controlled transactions. The WTO prescribes a customs valuation system based on the transactional value of the imported goods, but when related MNEs sell goods between themselves, their transfer pricing policy determines this value.

An internationally accepted and mandatory system of customs valuation for all WTO members (WTO, 2017), is contained in Article VII of GATT 1994. According to the WTO (2017), “customs valuation shall be based on the actual price of goods to be valued as shown on the invoice (transactional value method) except in exceptional stated circumstances.” Therefore, the strict application of the GATT 1994 regulations means that the price as it appears on the invoice plus elements contained in Article 8 of Article VII of GATT 1994, if any, will equal the transaction value. For the customs value to be declared as the transaction value, the following conditions need to be met: 1) there must be proof that a sale took place to an importing country; 2) the goods may not be subject to any constraint on their use or disposal; and 3) the goods may not be subject to any supplementary conditions. Paragraph 1 of Article 1 of the Agreement on implementation of Article VII of the GATT 1994 provides that:

The customs value of imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of Article 8.

Certain provisions to Article 1 then follow and Article 2 through to 7 of the Agreement on implementation of Article VII of the GATT 1994 provides for more methods to establish value, such as the transaction value of identical goods sold (Article 2), or similar goods sold (Article 3). Also see Article 5, 6 and 7 for more methods, for example, computed value and deductive value.

Transaction value may be impacted by the relationship between the two transacting parties. Market forces normally determines the conditions and price of a sale of goods between a buyer and seller that have no relation or connection between them (also referred to as uncontrolled transactions) (OECD, 2017). However, when the buyer and seller are entities within same MNE group, it is possible to negotiate a price for a transaction taking place between them that is not influenced by market forces (referred to as controlled transactions). Such pricing may be set to achieve group strategic objectives and may be regarded as “abusive transfer pricing” (Cooper *et al.*, 2016). Treidler (2019) states that it is no surprise that tax authorities would check closely if conditions applied to controlled transactions would have been obtained in comparable uncontrolled transactions too.

The ALP is regarded an internationally accepted standard for the determination, for income tax purposes, of the prices of goods and services exchanged between related entities (OECD, 2017). The OECD Model Tax Convention (OECD MTC), in Article 9, describes “the taxation of the profits of associated enterprises and the application of the arms’ length principle” (OECD, 2017, p. 13). This standard has been adopted by many countries since the original version of the OECD Transfer Pricing Guidelines were first approved by the OECD Council in 1995. The African countries represented in the present study, of which none is a member of the OECD, have all adopted the ALP as prescribed by the OECD, in dealing with transfer pricing matters. As at December 2020, 140 countries, of which 25 is African countries, are included in the OECD’s Inclusive Framework on Base Erosion and Profit Shifting (BEPS) (OECD, 2021; African Union, 2020).

Treidler (2019) argues that when an MNE can provide evidence to the fact that its transactions with a related entity are priced at a value as if imported by independent enterprises, it can be assumed that ALP has been applied and that no artificial shifting of profit occurred. Thus, for a transaction where goods...
have been imported from a related entity where the ALP was applied, “the importing country customs authorities should accept the transaction value used for customs valuation as comparable to a value declared by an importer in an uncontrolled relationship” (Chirevo, 2021, p. 39).

It is known fact that the ALP and transfer pricing “is not an exact science” (OECD, 2017, p. 38). Customs authorities should accept that finding an exact independent comparable might be an impossible task. Many reasons exist for the difficulty of finding a comparable. Firstly, a significant amount of data may be needed; secondly, accessible data may be incomplete or difficult to interpret or difficult to obtain; thirdly, confidentiality concerns may hinder accessibility of data; and fourthly, it is possible that appropriate may simply not exist (OECD, 2022). It is acknowledged that transfer pricing requires the exercise of judgement from both tax authority and taxpayer and when “customs authorities challenge customs values declared by MNEs based on arbitrary values sourced from internet sources” (Chirevo, 2021, p.39) it is regarded as a practice against the spirit of the ALP.

The above paragraphs demonstrated that a clear link exists between transfer pricing, the ALP and the practice and processes of customs valuation. It is submitted that if the ALP is applied correctly, then the customs declaration based on the transfer price should be accepted for customs valuation purposes.

**Results and Discussion**

The first objective of this paper was to identify the reasons, as perceived by the participants to the study, for the challenges experienced in customs valuation practices driven by MNEs’ transfer pricing policies. Secondly, the aim was to identify what impact these customs valuation challenges of controlled transactions may have on MNE operations in Africa.

To address these objectives, the results obtained from the questionnaire administered to ten industry specialists from across Africa are presented in this section.

**Confirmation of Participants’ Experience of Transfer Pricing and Customs Valuation**

Eight of the ten participants had five or more years’ experience in the domain of transfer pricing. When asking participants whether they agreed to a claim that customs duty valuation challenges generally target Africa-bound imports in controlled MNE transactions more than in uncontrolled transactions, five participants agreed to the claim. Two more participants were undecided about the claim, however, they declared that they either dealt with or witnessed such challenge. Only two participants disagreed with the claim and stated that they are not aware of a case where a customs authority challenged a custom value declaration in a controlled transaction.

**Identifying the Perceived Rules Applied when Imported Goods’ Customs Valuation are Challenged**

Participants were asked to comment on their perception of what rules customs officials are applying when challenging the value of goods in a controlled transaction. The common theme arising from the analysis pertains to “use of arbitrary values. Responses highlighted that it appears that customs officials do not adhere to specific rules but are simply using arbitrary values derived from prices of goods deemed comparable. Although only five participants responded to this question, three of the responses related to this theme.

**Identifying Reasons for the Customs Valuation Challenges**

Participants were specifically asked their opinion on why customs valuation challenges occur. A number of options were provided in the survey and participants could select any number of options and also expand on the reason for their choice. There was also the option to formulate any other reasons not provided for in the questionnaire.

Seven of the participants selected the option: “Pressure to meet targets by Customs Officials”. However, no participant provided a reason for selecting this option, nor provided further details. Although the
statement may hold truth, it is accepted that this is only an opinion held by the participants.

Some participants selected the option “Lack of Transfer Pricing knowledge by custom officials”. This was further investigated with a follow-up question in which participants were asked to rate customs officials’ awareness and understanding of the association between transfer pricing guidelines and regulations on customs duty valuation. All the participants responded to this question irrespective of their selection of “lack of knowledge” in the previous question. The majority of the participants selected the option “limited knowledge” from the three options given (the options were: high; intermediate; and limited).

Another option provided in the close-ended section on participants’ opinions on the reasons why customs valuation challenges occur was: “Suspicious over transfer pricing used for customs value declaration”. This option did not get much support, with only one participant selecting this option and not providing any further detail.

Additional comments provided by participants on reasons for customs valuation challenges were analysed and two themes emerged: 1) reference prices; and 2) corruption.

Reference Prices
According to five of the participants, “reference prices deemed to be market values” are kept by customs authorities. The five participants described situations where customs values declared in a controlled transaction were reported to be at values lower than prices kept by customs authorities as reference prices. This declaration was then challenged by customs authorities by questioning the determination of the transfer prices which were used as the bases for the declared the customs values. According to four participants, a resulting upliftment of the customs value occurred despite arguments submitted to prove that the ALP was met.

Corruption
Three participants mentioned “Corruption” as another reason for experiencing customs valuation challenges. Some respondents added that corruption occurs because of a lack of transparency by authorities. However, no detailed descriptions of situations involving corruption were provided by any participant.

Impacts of Challenges Experienced in Custom Duty Valuations on d MNEs
Participants were asked if they are aware of adverse impacts that the described custom valuation challenge may have on MNEs. Five participants, referred to as A, B, etc. below, shared their perceptions as follows:

- A: “detentions and additional costs for storage and loss of revenue”
- B: “consignment seizure by customs officials”
- C: “costly controversy processes, local country profitability impacted resulting in income tax challenges”
- D: “lengthy and costly legal court battles, consignment seizure by customs officials”
- E: “…as customs had their own pre-set prices (reference prices) for goods, they were not objective leading to taxpayer finding alternative ways which were not necessarily in line with their transfer pricing policy”

The main theme inferred from the responses shown above was that of “increased cost”. The perceptions by respondents point to additional costs being incurred due to consignment seizures and storage as well as costs incurred because of tax disputes with the customs authorities. It was also mentioned by a respondent that the dispute process was a lengthy process which involved the submission of numerous documentations.
Suggested Solutions Identified by Participants

Participants were asked to suggest measures that would assist in addressing the identified challenges. Table 1 below provides a summary of the suggestions put forward:

<table>
<thead>
<tr>
<th>Suggested measure</th>
<th>Frequency of suggestion</th>
<th>Participants’ description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementing GATT 1994</td>
<td>1</td>
<td>Custom officials should place more reliance on, and apply, the GATT 1994.</td>
</tr>
<tr>
<td>Advanced Pricing Agreements (APA)</td>
<td>1</td>
<td>Multinationals must be encouraged to explain their transfer pricing model. This may result in their purchase prices being accepted. However, this should be kept confidential by the Customs office.</td>
</tr>
<tr>
<td>Training</td>
<td>2</td>
<td>• Training of Custom officials to understand and apply the TPG.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Training to be provided to African jurisdictions, for example by the OECD or WTO.</td>
</tr>
<tr>
<td>Coordination between customs and transfer pricing</td>
<td>2</td>
<td>• Tax authorities create a single authority for tax and customs and not operate it as separate authorities.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Rotation of staff in customs offices and transfer pricing sections are proposed.</td>
</tr>
</tbody>
</table>

Source: Authors’ compilation

One of the main themes evident from the responses in Table 1 is “training”. It appears that participants believe that custom officials may not be sufficiently competent in understanding the rules of transfer pricing and its link with customs valuation. They also suggest that global bodies who draft guidelines on transfer pricing and customs valuation, such as the OECD and WTO, could play a role in training of custom officials in developing countries. Even the suggestions on consistent application of GATT and the rotation of officials between customs and transfer pricing sections point to an element of a need for training.

Another important finding from the responses points to better coordination or merging of customs and transfer pricing departments. This may aid in eliminating conflicting targets between the two departments.

Other Findings from a Review of the Literature

Secondary data were further scrutinised in finding explanations for the perceived challenges experienced by MNEs’ based in developing countries when they applied transfer pricing policies in determining customs values. According to the ICC (2015) and WCO (2018), some of the reasons for this customs valuation challenge that MNEs face are as follows:

- Methodologies by Customs authorities and direct tax authorities for determining transaction value are “often different and incompatible due to different motivations, theoretical frameworks, documentation requirements and other factors” (WCO, 2018, p. 57);
- Many developing countries are still experiencing “practical challenges in conducting comparability analysis”, especially because of limited availability of information (WCO, 2018, p. 25).

Some developing countries struggle with administrative and technical capacity in transfer pricing and customs departments.

Recommendations from the Literature

A review of appropriate literature was performed in search for strategies to address custom valuation challenges as experienced by importer MNEs in Africa. The WCO provides guidance on the use of transfer pricing documentation in the customs valuation process (ICC, 2015). A number of recommendations gained from the Technical Committee on Customs Valuation of the WCO (Commentary 23.1) are
provided below:

- Custom officials to be better trained in transfer pricing guidelines.
- Customs processes could be automated. This could also include a better coordination between customs and transfer pricing departments and improved accessibility of data between these departments.
- MNEs and revenue authorities to agree on customs values in advance using advance pricing agreements.

**Conclusion**

African countries need MNEs’ presence within their borders for economic growth. However, for MNEs who conduct trade between related companies, operational and legal certainty in tax and customs processes are vital. This paper confirmed that the certainty that MNEs require in respect of customs valuations is being hampered by the fact that African inbound imports in controlled transactions are experiencing challenges in terms of the valuation of goods when transfer pricing practices were applied.

The findings from the present study highlights that the reasons for customs valuations difficulties in controlled transactions, as perceived by industry experts and as gained from the literature, are:

1) A lack of knowledge of transfer pricing principles by custom officials, including lack of capacity to deal with controlled transactions in these departments;
2) Claims that customs authorities keep “reference prices” in their risk systems as opposed to finding value of comparable items. Therefore, there appears to be inconsistent application of and reliance on GATT 1994 by customs officials.
3) Possible corruption by custom officials.

It was further evidenced by the participants that the main impact on MNEs emanating from these custom valuation challenges are the additional costs it may bring. These costs can relate to additional storage costs, consignment seizure and resulting revenue loss, and costs incurred due to lengthy court battles.

Recommendations to assist in addressing the challenges in customs valuations in controlled transactions as gained from suggestions from the participants in the study as well as the literature can be grouped into three main themes as follows:

1) Training (specifically of customs officials in transfer pricing guidelines and the GATT);
2) Harmonisation of departments specialising in transfer pricing and customs departments within the revenue authority (with a view to facilitate exchange of information);
3) Advanced pricing agreements (between MNEs and local customs offices).

It is suggested that further research may focus on more extensive and conclusive solutions to assist in eradicating inconsistent valuation of goods for custom duties purposes as experienced by MNEs in Africa. A further suggestion is for empirical research to be conducted from the perspective of custom duty officials so as to provide a more balanced view on the challenges of custom valuations in controlled transactions.

**References**


