

**COOPERATION BETWEEN  
CUSTOMS AND INCOME TAX  
FOR BETTER TAX  
ADMINISTRATION :  
AREAS, CHALLENGES AND  
SOLUTIONS**

## **Project Group 4, MCTP Group 2,Phase 3**

### **Mentor:**

- Sh M Satish Kumar Reddy, Regional Cooperation Specialist,ADB

### **Members of the group:**

- Deepshikha Arora, Deputy Director  
(Group Leader)
  - V V Pandit, Joint Commissioner  
(Deputy Group Leader)
    - Honhar Singh Meena, Joint Commissioner
    - Sunil Kumar Singh, Joint Commissioner
    - PM Rao, Additional Commissioner
    - S K Narayana Reddy, Joint Commissioner

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## Cooperation between Customs and Income Tax

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## Introduction

Customs and Income Tax, the two major sources of Tax revenue in India are administered by two different boards: the CBEC (Central Board of Excise and Customs) and the CBDT (Central Board of Direct Taxes), under a common Department of Revenue in the Ministry of Finance, Government of India. Historically these two taxes were administered by a common Central Board of Revenue up until 1<sup>st</sup> January 1964 when it was split into two by the Central Boards of Revenue Act, 1963 owing to the unwieldiness of the growing tax administration.

The two boards continue to function in two separate silos regulating an overlapping tax base (Importers and Exporters are Income Tax assesseees as well). However, cooperation between the two departments is now an area of concern and study, with rapidly growing trade and commerce having implications on both direct and indirect tax liabilities. It is accepted that both departments already have their respective pool of data and information which will also aid the other in its functioning especially investigation. Cooperation also addresses the goal of “Minimum government; Maximum governance” ,the mantra of most democratic nations aiming to facilitate its taxpayers in expanding their economic activity and ensuring voluntary compliance.

In this backdrop this group has chosen to study the existing levels of cooperation between Customs and Income Tax in our country as well as some international practices. We have tried to examine the need for enhancing such cooperation, the areas in which it will be helpful and the challenges in achieving the same.

The following are the goals of the project:

- To understand whether there is a need for establishing or enhancing information exchange between Customs and Income Tax authorities at national level.

- To study cooperation mechanisms that currently exist between the two authorities nationally and internationally.
- To make recommendations regarding institutionalizing information exchange between Customs and Income Tax authorities.

The methodology adopted was study of material available through internet viz. WCO & OECD research papers, CBEC circulars, TARC report, discussions with senior colleagues, COIN officers and with officers of Singapore and Korean Customs during the overseas learning component of Mid-Career Training Programme, Phase 3. A Questionnaire based survey was also designed by the group and circulated to foreign customs administrations through NACEN.

## **Chapter 2**

### **The need to strengthen the engagement between Customs and Income Tax**

Customs and Income Tax departments have similar tasks in ensuring tax compliance and enforcement. Though both the departments have a wealth of information about the taxpayers, there is no institutionalized mechanism for exchange of information for compliance monitoring and facilitation.

Revenue generated by customs administrations accounts for a considerable share of government tax revenue in India.(30% of Indirect taxes)Cross-border trade is as susceptible to tax evasion as other cross-border economic activities like investment and saving.

A key objective of any tax administration is to identify data sources, collect data and make meaningful use of it for increasing revenue collection, optimizing operational capability, managing new risks and enforcing compliance. Both the Customs and Income Tax departments have huge amount of data and information. However, they are disjointed and disconnected and working in silos. The CBEC and CBDT collect or create lot of information, but without coherent framework. This approach needs to be tweaked to meet emerging realities, characterized by complex and voluminous transaction and interconnectedness of data and information across many tax jurisdictions, which often leads tax base erosion and tax evasion. Information exchange helps locate and levy taxes on hidden tax bases/hidden values. Tax base of both the departments is overlapping (Importers/Exporters are IT assesseees also). It is also a known fact that non compliers in one area tend to be the defaulters in the other also.

Many compliance tools of Customs such as “On Site Post Clearance Audit” (OSPCA), Authorized Economic Operator Programmes and valuation controls can be operated/ implemented more effectively if there is co-operation between the two departments. Such an approach also helps in improving the ease of doing business which is the need of the hour. There a need to strengthen the engagement between the two departments in the areas of overlap such as

Valuation and Transfer pricing, data exchange, trade facilitation and sharing of third party information which is possible only with the creation of robust mechanism for exchange between these two departments.

Globalization and liberalization of economic activity has converted the private sector into a world without borders, Customs and IT authorities continue to be constrained by national/jurisdictional borders, necessitating enhanced inter-agency cooperation. OECD has said that more than 60% of world trade takes place between Multi National Enterprises. Complex nature of transactions and changing global trade dynamics have impacted customs valuation tremendously. Digital economy is expanding day by day and e-commerce is the new buzzword. However, each authority already has a vast information pool with them.

Customs administrations can benefit from detailed transactional information from Income Tax authorities, especially with respect to taxing transfer pricing. Customs administrations and Income Tax authorities address the same tax bases (transfer prices of MNCs), and have the same goal (the collection of more tax) but each approaches the issue from a different perspective. Customs administrations concentrate on importers' undervaluation whereas Income Tax authorities zero in on MNCs' overvaluation. Indirect taxes (for example, customs duties and VAT) are imposed on the values of the goods whereas corporate income tax is levied on net profit – the difference between sales and purchases – and the more purchases, the less tax payment. Some MNCs report two different transfer prices to customs administrations and tax authorities to minimise their tax payment. A comparison of MNCs' import and purchase data for a particular commodity helps customs administrations and income tax authorities to identify decoupled transfer prices. The decoupled transfer prices are likely to result in the detection of either customs duty evasion or corporate income tax evasion, although customs administrations and tax authorities need to coordinate their respective audits. The WCO and the OECD have engaged in a cooperative endeavour to harmonise customs valuation and taxation on transfer pricing.

In addition to sharing ordinary trade data, customs administrations can help income tax authorities to detect cross-border tax evasion by sharing export and import declarations pertaining to the means of payment (for example, cash). Some residents may declare their exports of cash to Customs when leaving for other countries and purchase immobile assets overseas with the exported cash without reporting these assets to tax authorities of residence countries; some residents may declare their imports of cash earned overseas to Customs, not

reporting the income to tax authorities. Thus, if customs administrations share export or import declarations of monetary instruments with income tax authorities, they can detect unreported cash-based incomes and assets. In this way information exchange can curb Trade Based Money Laundering (TBML) also and have significant impact on terrorism funding.

Customs administrations can benefit from income tax information not only in the detection of illicit trade but also in the collection of unpaid trade taxes. Customs administrations have difficulties in dealing with traders' default on customs duty payment because many administrations do not have the requisite information on traders' incomes and assets which could enable them to collect the tax due. As customs administrations do not have the requisite information to enforce payment of customs duty, traders can continue with their domestic businesses even if they default. Information exchange could prove beneficial for customs administrations in these instances and help to ensure the recovery of unpaid duties from traders, leveraging tax information including traders' incomes, assets, and domestic business transactions. There is also an invisible impact of information exchange between the two authorities. It improves the preventive role by implanting the perception amongst citizens, potential evaders more so, that the Tax Man knows it all. It therefore pushes the fence sitters towards voluntary compliance.

Exchange of information between customs administrations and income tax authorities covers not only tax bases, such as trade transactions, purchases, sales, incomes, and assets, but also investigative cases. Customs administrations and income tax authorities can encounter the other party's enforcement targets, while examining or investigating their own enforcement targets. Most customs administrations and income tax authorities hesitate to share with each other their findings under the pretext of protection of the privacy of traders or taxpayers and of respect for the other party's turf. However, information on investigative cases is more useful and efficient than that on tax bases in the detection of their enforcement targets.

In the above circumstances it is essential that the two departments understand the value and benefits of information exchange and overall cooperation. Needless

to say, that the need for such a cooperation cannot be more than it is at present. Further, in subsequent chapters we will see how it is even a global norm and not very difficult to achieve.

## CHAPTER 3

### **Areas in which information exchange is beneficial to Customs and Income Tax**

The adoption of information and communication technology (ICT) by tax administrations has helped in the collection, collation and management of large volumes of data and information, providing a big opportunity for the tax administrations to improve tax compliance and ensure better enforcement. The Income Tax Department uses several ways and means to collect and collate data from different domestic and international sources. Various depositors are obliged under Section 285 BA of the Income Tax Act, 1961 to furnish Annual Information Return (AIR) to the Income Tax department. The Central Information Branch (CIB) collects the information from foreign jurisdictions. The CIB collects information from 40 internal and external source codes. The information is on financial transactions, payment of taxes etc. Information is also collected under special and pilot projects by the Directorate of Intelligence and criminal Investigation (DI&CI), Suspicious Transaction Reports (STRs) are received from Financial Intelligence Unit (FIU) and Tax Evasion Petitions (TEP) from individual agencies. The CIBDT is reportedly the largest recipient of STRs. The data mining tool of the Income Tax department namely Integrated Taxpayer Data management System (ITD-MS) can generate 360 degree profile of an entity by compiling information on a dynamic basis. It is stated policy of the Government to share information between the Tax Departments. In view of above, there is enormous scope for exchange of information with the Income Tax Department.

The ultimate goal of tax information exchange is to locate and levy taxes on hidden tax bases. The information collected by Income Tax is also useful for Customs in identifying the cases of tax evasion. The exchange of information in the following areas would benefit Customs.

**1. Transfer pricing and Customs Valuation in case of Related party transactions:** Transfer pricing is the term used in the Income Tax parlance, is a mechanism adopted by Multinational Enterprises (MNEs) for valuing the goods and services

traded with their subsidiaries or Associated companies situated in different tax jurisdictions, so as to lower their tax liabilities and maximize profit. Transfer pricing law has been enacted for Income Tax purposes in 2001 by amending the Income Tax Act, supplemented by Transfer pricing Rules which are broadly based on Organization of Economic Cooperation and Development (OECD) guidelines and model tax convention. The Transfer price has implication for Customs valuation in the case of related party transactions.

Customs addresses the Transfer Pricing through provisions on Related Party Transactions, as mandated by the World Trade Organization (WTO) Agreement on Customs Valuation. The Customs valuation treatment of Related Party Transactions has been dealt with elaborately in Articles 1.1 (d) , 1.2 (a) & (b) and 15 of the WTO Valuation Code. While Article VII of the GATT and the WTO Agreement on Customs Valuation do not refer explicitly to Transfer pricing, in the case related party transactions the Agreement indirectly accepts the ' arm's length principle'.

It is estimated that related party transactions account for almost 60% of the international trade. Hence, Transfer pricing is an important issue for both Customs and Income Tax authorities. Revenue Administrations are naturally concerned about Transfer pricing as it influences both direct and indirect taxes. Price of goods in a cross border transaction is the starting point for assessing customs duties and for determining profits that arise to each party for computing Income Tax. Transactions between related parties or Associate Enterprises are not always subject to the same market forces as transaction between independent parties. As a result there is potential for under or over pricing of the goods and services, thus influencing the determination of Customs duty and Income Tax.

### **1.1 Key similarities between Transfer Price and Customs Value:**

In order to seek convergence there is merit in looking at areas where Transfer pricing and Customs operate similarly. Both use market value as the starting point as the price for which related party transaction ought to be conducted. For Customs this results from the Agreement on implementation of Article VII of General Agreement on Tariff and Trade (GATT). For Transfer pricing, the arm's

length value results from the application of Art. 9 of OECD Model. Essentially fair market value and arm's length price means the same, pricing that is not influenced by the relationship between parties. The definition of related parties match the definition of associated enterprises that applies for Transfer pricing. In both the cases there is need to evidence that the price is not affected by the relationship between the parties. The method by which arm's length value in case of Transfer price and fair value in case of Customs, being calculated is almost similar. In both the cases there are five methods with overlap in the principles adopted. Common meeting grounds can be found in the OECD Arm's length methods of Comparable Uncontrolled Price (CUP) Method, Resale Price Method, Cost Plus Method and the methods laid down in the Articles 2,3,5, and 6 of the WTO Valuation Code.

## **1.2 Global Practices**

Transfer pricing is no longer an issue for developed countries only. It is becoming important for the developing and emerging economies as well to manage transfer pricing so that Revenue Administrations may protect their tax base effectively, while at the same time avoiding double taxes. While both Customs Valuation and Transfer pricing rules set standards for determining "arm's length" or "fair" value of these transactions, the international rules and guidelines are different in the Customs and Tax ( Income Tax) domains.

Many countries like USA, UK, Germany, Australia, Canada and France have already laid down specific provisions in National laws and Administrative procedures to regulate Transfer pricing practices. These are measures mainly based on the OECD guidelines to check the pricing pattern in international transactions between related parties for ensuring adherence to arm's length price principle. In 2000 the US Customs Service has held that a bilateral Advance Pricing Agreement (APA) setting forth a method of establishing transfer prices between a taxpayer importer and related parties may be used as a factor to determine that the transfer prices constitute Transaction value for purpose of appraising related party transactions under US Customs Law.

In USA, Section 1059 A has been introduced to prevent a US importer from jeopardizing the Government revenue by valuing merchandise inconsistently for Customs and Income Tax purposes. Under Section 1059A, importers are barred from declaring a transfer price that exceeds the value declared for Customs valuation purposes. The IRS and Customs have executed a document entitled "Working Arrangement for Mutual Assistance and Exchange of Information Between the U.S. Department of Treasury U.S. Customs Service and Internal Revenue Service regarding Compliance and importation issues" ( the Mutual Assistance Agreement) that is designed to facilitate communication and cooperation between the agencies.

There are challenging questions on the issue of Transfer Pricing for both the Tax and Customs Authorities as well as the Trading communities all over the world.

In response to these challenging questions, the World Customs Organization (WCO) and the OECD jointly hosted two international conferences on Transfer Pricing and Customs Valuation, at the WCO headquarters in Brussels in 2006, and 2007. Both the conferences were represented by Customs as well as Income Tax Authorities, consultant firms, large MNEs, and even academicians. In the first joint conference, the differences and similarities between two sets of rules applied by the two Departments were demonstrated on the basis of comparison between how Income Tax and Customs authorities treat Transfer Pricing in accordance with their specific international standards. The conference also discussed pros and cons of the desirability and feasibility of having converging standards for the two systems. On the question of coordinated administrative approaches, the consequences of a transfer pricing adjustment on the previously accepted Customs value and vice-versa, and the scope for joint Customs and Transfer Pricing audits were discussed. Further, the exchange of information and cooperation between Customs and Income Tax authority at both domestic and international level were also explored.

Two schools of thought emerged. Those who were in favour of convergence pointed out that a credibility question did arise if two sets of rules on value determination led to different answers to virtually the same question - what is the

'arm's length'/'fair' value for a transaction. They further argued that this situation would result in greater compliance cost for the Trade, and greater enforcement costs for the Administrations who must develop and maintain two types of expertise. As an illustration, they cited the situation of the Customs specialist and the Transfer Pricing expert examining and auditing the same transaction of an MNE. The proponents therefore suggested harmonisation of the law and procedure relating to Transfer Pricing and Customs Valuation. Those from the other school of thought called for caution against convergence. They pointed out that the two systems are based on different principles while viewing the valuation of imported goods. The Customs generally determines the value of the goods at the time of importation with respect to individual transactions based on information available at that time. The Income Tax authority often determines value of the goods based on aggregate transactions, where appropriate, and quite often use the information available at the end of the year. Therefore, their advice was to focus more on dispute resolution mechanisms to solve the questions that might arise from the divergence in the two systems. As a possible way forward, the first joint conference recommended that the Customs and Income Tax administrations, through WCO and OECD, should create an appropriate joint forum for dialogue, study and possible liaison, with invitation to the WTO, the Trade and the academics.

In the second joint conference held in May, 2007 the recommendations from the first conference were carried forward, and the Conference went more into the nitty-gritty of exploring possible convergence of Transfer Pricing, Customs Valuation and VAT. The Conference recommended, inter alia, for setting up of a Focus Group to suggest solutions for harmonization of the two streams of valuation. At the conclusion of the conference, one found the message to be loud and clear - convergence is definitely desirable, and ways and means would have to be found to reach that goal.

As a follow-up to the second joint conference of May 2007, the first meeting of the Joint WCO-OECD Focus Group on Transfer Pricing was held in October 2007 which was attended by representatives of the WCO, OECD, WTO, Customs administrations, Tax administrations and the Private sector. Mr. Kunio Mikuriya

the then -Deputy Secretary General, WCO in his opening remarks stated that the Focus Group was set up to have a meaningful discussion on the way forward on Customs Valuation and Transfer Pricing so as to identify problems and suggest possible solutions. The Focus Group recommended, inter alia, that the Technical Committee on Customs Valuation (TCCV) at the WCO may examine the phrase 'circumstances of sale' in Article 1.2 (a) of the WTO Valuation Agreement in respect of its application to Transfer Pricing situation. The TCCV at the WCO examined the issue and came out with a WCO instrument Commentary 23.1 titled " Examination of the expression ' circumstances surrounding the sale' under Article 1.2 (a) in relation to the use of Transfer Pricing Studies" . The said commentary sought to provide guidance on the use of a Transfer Pricing Study, prepared in accordance with the OECD Transfer Pricing Guidelines, and provided by importers as a basis for examining the circumstances surrounding the sale under Article 1.2 (a) of the Agreement . The Commentary observed that the question that arose was whether a Transfer Pricing Study prepared for tax purpose, and provided by the importer , could be utilized by the Customs administration as a basis for examining the circumstances surrounding the sale. The commentary further observed that on one hand, a Transfer Pricing Study submitted by an importer may be a good source of information, if it contains relevant information about the circumstances surrounding the sale. On the other hand, Transfer Pricing Study might not be relevant or adequate in examining the circumstances surrounding the sale because of the substantial and significant differences which existed between the methods in the Agreement to determine the value of the imported goods and those of the OECD Transfer Pricing Guidelines. The Commentary finally concluded that the use of a Transfer Pricing Study as a possible basis for examining the circumstances of the sale should be considered on a case by case basis, and that any relevant information and documents provided by an importer may be utilized for examining the circumstances of the sale. A Transfer Pricing Study could be one source of such information.

### **1.3 Indian Scenario: Harmonization of Regulatory Controls in India under the Customs and Income Tax Laws.**

The Customs and Income Tax authorities are driven by diametrically opposite approaches to valuation in view of the conflicting interests involved for measuring the tax incidence. A Transfer price reduces the Income Tax liability, while low transfer price lowers the Customs duty. Thus there lies an inherent conflict of interest between Customs and Income Tax. While the Income Tax authority may seek to stop diversion of profits to the exporting country by assessing lower transfer price on imports, the Custom authority may prefer to determine a higher transfer price on the same imports so as to enhance Customs duty. In order to circumvent transfer pricing provisions, certain taxpayers structure international transactions between group companies by involving a third party. In order to plug this loophole Section 92B(2) in the Income Tax Act was introduced. Section 92 of the Income Tax Act states that “ Any income arising from an international transaction shall be computed having regard to arm’s length price”. Arm’s length price is defined as a price which is applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

Transfer pricing under the Income Tax is administered by the Directorate General of Transfer Pricing and in Customs the Special Valuation Branch (SVB) under the Directorate General of Valuation examine the relationship based imports. The Income Tax Act provides for the application of the most appropriate method of Transfer pricing, whereas under the Customs Valuation Rules, after the rejection of the declared value, the hierarchy of the Valuation method must be followed strictly to re-determine the value. There are several common areas in both systems and efforts should be made at national level to coordinate the approaches. The first three methods of the Income Tax Act, namely (a) Comparable Uncontrolled Price method (b) resale price method (c) cost plus method are very similar to the identical/similar goods method, deductive value method and computed value method under the Customs Valuation Rules.

Transfer price data is a valuable source for re-determination of value in case of related party transactions. Various judicial pronouncements have upheld the enhancement in value on the basis of Transfer prices. Hon’ble Supreme court in

the case of Commissioner of Customs vs Ferodo India Pvt Ltd [ 2008(224) ELT. 23(SC)] while examining the issue of inclusion of Technical know-how cost and payment of royalty in the price of imported goods has observed that the deductive and computed value methods under the Customs Valuation ( Determination of Price of Imported Goods) Rules 1988, are akin to resale price method and cost plus method under the Transfer pricing in the Income Tax Act, 1961. In the case of Skoda Auto India Pvt Ltd vs Union of India [2011(268)ELT.37 (Bom)] Hon'ble High Court of Bombay has upheld the enhancement of value based on Transfer price.

**1.4 Conclusion:** For effective administration of valuation of related party transactions and transfer pricing policies, there is a need for comprehensive Database from Customs and Income Tax. The documentation requirements under Income Tax Transfer Pricing Rule 10D are quite exhaustive. The documentation requirements under Customs law are however not specific. Transfer pricing documents including Cost Accountants Certificate submitted to Income Tax Authorities are very useful for Customs valuation. In case of any adjustment of import value/ transfer price value there should be mechanism for automatic exchange of information. The information in respect of royalty payments, general margin of profits, the cost of technical know-how available with Income Tax authorities will help Customs to make appropriate additions under Rule 10(1) (b) &(c) of the Customs Valuation (Determination of Price of Imported Goods) Rules , 2007. There should be mechanism for automatic exchange of information regarding adjustments/revision made during assessments for uniformity in approach.

**1.5 Challenges:** (a) Harmonization of definition of related parties under Customs valuation Rules and Associated enterprises in Transfer Pricing rules. (b) In case of Customs the valuation is largely based on transactions whereas the Income Tax department collects the transfer price details on yearly basis. There is huge time gap in data availability.

## **2. Data warehouse and Business Intelligence**

The CBEC has not been procuring data from any outside agency, unlike the CBDT which has been procuring data under AIR and CIBon a regular basis. The CBEC has implemented Enterprise Data Warehouse (EDW) for data warehousing and the CBDT is in the process of setting up its Data warehouse and Business Intelligence (DW&BI) . The project aims to integrate enterprise data warehouse, data mining, web mining, predictive modeling, master data management, compliance risk management and case analysis capabilities. At present there are number of disjointed and disconnected data warehouses in CBEC and CBDT. Most advanced tax administrations recognize data and information as valuable assets. Keeping this in focus, they are moving towards a centralized governance framework for data and information collection. The Tax Administrative Reform Commission (TERC) has pointed in its first report that *“ICT enablement by both departments is completely isolated from each other with very limited application of technology for an integrated risk model or even seamless sharing of data. Both departments hold huge amounts of data in their systems which can be put together using the PAN to create a comprehensive profile of the taxpayer. There is huge potential to plug revenue leakage by doing so. However, one can well imagine the gains to the two administrations if , instead of having two separate silos, a single data warehouse covering both direct and indirect taxes had been set up in a collaborative manner, the availability of comprehensive cross tax data would have added significant muscle to their enforcement efforts”*.

**2.1 Conclusion:** At present the two Boards are maintaining data only for their own use. Each of these database provide information in a niche area. Such silo working tends to develop patchy data that lack integration. There is a need for coherent framework to meet emerging realities characterized by complex and voluminous transactions and inter-connectedness of data and information between CBEC and CBDT. There is a need for integration of data warehouses CBEC and CBDT so that all partner agencies are able to access and use data and information on a “create once,use many times” basis.

**2.2 Challenges** :(a) Promotion of a culture of mutual trust, openness and willingness to share between CBDT and CBEC. (b) Common framework for data integration.

### **3. Joint Audit of Related party Transactions**

In the case of related party transactions, both Customs and Income tax share the common tax base. The Customs department has notified the Onsite Post Clearance Audit at the premises of Importers and Exporters Regulations, 2011 vide Notification No 72/2011-Cus (NT) dated 04.10.2011. At present the Onsite PCA is restricted to Accredited Clients (ACP). The CBEC plans to roll out Onsite PCA in related party cases in the near future. Multinational companies are exposed to risks and potential adjustments and penalties resulting from independent audits of transfer prices and customs value by Income Tax and Customs authorities. Such independent will take up significantly large resources.

The Trade and Industry have voiced their concern about the difficulty they face in satisfying the different regulatory requirements of both Income Tax and Customs. Their basic concern is that different rules and standards, applied by the two departments, and the absence of coordinated efforts could also lead to double taxation that might create barriers to trade and investment. The trading community has been raising certain critical questions, some of which are as follows: To what extent is it acceptable to have different rules, merely because the policy objectives of Customs and Income Tax Departments are different? How can one accept different answers from two different authorities to the same question i.e. what is the 'arm's length' price? Should both sets of rules converge? And to what extent should they converge, and towards what standard?

In order to address above concerns, there is a need to implement joint audit of related party transactions by Customs and Income Tax authorities.

### **4. Profile building of Importers/Taxpayers**

The Customs department has implemented the Risk Management System (RMS) to balance the needs of facilitation and enforcement in the Customs clearance. The cornerstone of robust Risk Management System is the profile building of risk factors and analysis of patterns. Profile building leads to targeting the risky transactions for effective Customs control.

In U.K the HMRC collects data on its taxpayers through tax returns and from third party information and brings together data from different sources and cross-matches them to uncover hidden relationship in the transactions. The Connect System , one of its analytical tools helps it to do so. With this information the HMRC is able to produce target profiles and models to risk assess transactions.

Importers leave trails not only during Customs clearance but also whilst filing Income Tax returns. The money laundering data available with Income tax will be useful information for identifying pattern of behavior of importers/exporters. As the Income Tax maintains data on the basis of PAN, these information can be shared on the basis of IECs of Importers/Exporters.

## **5. Recovery of Arrears of Revenue**

The Section 142 of the Customs Act, 1962 provides for attachment and sale of properties of defaulters to recover the arrears of revenue. The identification of financial and other assets of the defaulters is critical in the area of recovery of arrears. The ITD-MS of the Income Tax department can generate 360 degree profile of the defaulters on the basis of PAN. This information is very vital for identification of assets of the defaulters and recovery of arrears.

## **6. Trade Facilitation**

As a Trade facilitation measure, the CBEC has implemented Authorized Economic Operator (AEO) Programme vide Circular no 37/2011-Cus dated 23.08.2011. Under the programme, a business authorized by the Customs as an AEO can enjoy benefits flowing from being a more compliant and secure company. Para 10.1 of the circular has stipulated procedure for compliance verification. Major violations in respect of any other fiscal law such as relating to Income/Corporate Tax will also be taken into account to confirm the compliance level of the applicant. Sharing of offence data by the Income Tax will facilitate compliance verification for granting AEO status to business.

## **7. Combat Trade Based Money Laundering (TBML)**

Trade Based Money Laundering (TBML) is the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origin. TBML has been recognized by the Financial Action Task Force ( FATF) as one of the main methods by which criminals move money for the purpose of disguising its origins and integrating back into the formal economy. Apart from the revenue, the money laundering affects national security. Illegal activities such as terrorist financing are also covered under TBML. Money laundering typically occurs in three stages namely, (a) placement stage (b) Layering stage (c) Integration stage.

#### Techniques of TBML

1. Over invoicing
2. Under invoicing
3. Multiple invoicing
4. Over/under shipments or no shipment
5. Manipulation of description of goods

#### Impact of Trade price manipulation –Exports

Over invoiced exports: Conversion of unaccounted money into white money. Income tax avoidance.

Under invoiced exports: Capital flight.

#### Impact of Trade price manipulation – Imports

Over invoiced imports: Income tax evasion. Capital flight

Under invoiced imports: Evasion of Customs duty.

The FATE, an inter-governmental body which sets standards and promotes policies to combat money laundering, has recommended that the Tax authorities at operational level should have effective mechanisms for sharing of information. The OECD in its report on Effective Inter Agency Co-operation in fighting Tax crimes and other Financial Crimes has recommended effective co-operation amongst tax authorities to combat money laundering.

The STRs and accompanying documents provide insights into behavior of the taxpayers which are critical in “Red flagging” potential money launderers.

Red Flag indicators:

1. Inward remittances in multiple accounts and payments made from multiple accounts
2. The transactions involving repeatedly amended LC
3. Transactions involving the use of front or shell companies.
4. Circuitous route of financial transactions.

Automated exchange of information between Customs and Income Tax and FIU will help identifying the potential money laundering transaction at placement/layering stage.

### **8. Types of information exchange:**

There are three main types of tax information sharing: on request, automatic, and spontaneous. Information exchange on request involves transmitting tax information in response to a specific request from the residence country. An automatic exchange of information enables tax authorities of the source country to pass all tax-relevant information, periodically, to the residence country with whom they have agreed to exchange information. In the latter concept, spontaneous information exchange, the authorities of one country, on their own initiative, send information which may be acquired in the course of an audit to the tax authorities of another country, believing that it would be of interest to them

The following categories of information can be shared between Customs and Income Tax departments.

1. Import/Export Data
2. Purchase/Sale Data
3. Export Incentives
4. Refund Data

5. SVB Orders

6. Defaulters

## Chapter 4

### Linkage and implication of the work done on Tax Fraud and Evasion under G20 and OECD fora

The G20 after the global financial crisis of 2007-08 and subsequent global tax scandals involving tax havens has shown a renewed concern to tackle cross-border tax evasion and avoidance. During the G-20 summit in St Petersburg in June 2013, world leaders agreed to adopt multilateral automatic tax information exchange as a global standard in the fight against cross-border tax fraud and evasion. The Organization for Economic Cooperation and Development (OECD) has also since the late 1980s, promoted tax information exchange between tax authorities to help its member states identify residents' incomes and assets contained in tax havens.

**The OECD's tax information exchange initiative however does not include information concerning customs duties.** Furthermore, the G20's renewed focus on cross-border tax evasion and avoidance does not take into account the global customs community's concerns and activities, in spite of the fact that cross-border trade on which customs administrations impose levies is as susceptible to tax evasion as other cross-border economic activities. This despite the fact that revenue accrued by customs administrations accounts for a considerable share (in some cases up to 30%) of government tax revenue.

In fulfilling one of their primary roles, levying taxes on cross-border trade and chasing illicit trade transactions, most strong customs administrations worldwide have come to realise that information exchange with other domestic relevant authorities (as also with foreign customs administrations and ) is absolutely necessary. The global customs community has explored ways to exchange trade data for over a decade. In this respect, the OECD's tax information exchange initiative with support from the G20 has led to a renewed impetus amongst the global customs community. Recent initiatives by the G20 Leaders and the OECD has significant implications for Customs administrations, though they do not directly take into account the global Customs community's concerns and

activities. In order to fully leverage the heightened global focus on fiscal transparency, Customs should engage tax authorities for mutual support.

The OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters contains a provision for the automatic exchange of information on a broad array of taxes covering direct taxes and virtually every form of indirect taxes (it however excludes customs duties) levied at both national and local levels.

### **OECD Standard for Automatic Exchange of Financial Account Information**

On 14 February 2014, the OECD released a Single Global Standard on Automatic Exchange of Financial Account Information (covering bank accounts and other financial assets held offshore) on an annual basis, after obtaining such information from their financial institutions. This was formally endorsed by the G20 Finance Ministers at their meeting on 22 and 23 February 2014 in Sydney. It is expected that the Global Standard will help tax authorities in identifying residents' income and assets which have escaped tax.

The Standard sets out the financial account information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by the financial institutions, incorporating Model Competent Authority Agreement (CAA) and Common Reporting and Due Diligence Standards (CRS).

Financial information to be reported with respect to reportable accounts includes all types of investment income (including interest, dividends, income from certain insurance contracts and other similar types of income), as well as account balances and sales proceeds from financial assets. Reportable accounts include accounts held by individuals and entities (which includes trusts and foundations). Financial institutions that are required to report under the CRS include not only banks and custodians, but also other financial institutions such as brokers, certain collective investment vehicles and certain insurance companies. The CRS includes the requirement to look through passive entities to report on the individuals that ultimately control these entities. The Standard underlines that it is intended to be a minimum standard and countries can ask for more information.

More than 40 countries have committed to an early adoption of the Standard. The Global Forum on Transparency and Exchange of Information for Tax Purposes

(a body of 121 jurisdictions), hosted by OECD, has been mandated by the G20 to monitor and review implementation of the standards.

## **Chapter 5**

### **Existing mechanism for information exchange in India**

Structured and effective coordination between Income tax and Customs for better tax administration is almost non-existent.

Discussions with most officers however conclude that strengthening of engagement between the two tax administrations is a must. This was also emphasised by the Tax administration reform commission (TARC) headed by Dr Parthasarathi Shome. In its first report submitted on 30<sup>th</sup> may 2014, TARC observed that there is artificial separation between Direct and Indirect taxation and lack of cooperation between these two. TARC further went on to recommend that CBEC and CBDT should be fully integrated in next 10 years and within next 5 years they should move to unified management structure under the Central board of direct and indirect tax.

Further TARC in its second report submitted on 26<sup>th</sup> September 2014 strongly emphasised on information exchange between these two. TARC pointed out that so far CBDT and CBEC as well as the other revenue agencies have been generating and collecting information separately for their own purpose. No substantial efforts have been made to integrate such information, whereas in most advance administration across the world, a collaborative and collective mechanism is prevailing for exchange of information for compliance and enforcement.

#### **Existing framework for collaboration:**

Some fora have been created by central government for better coordination amongst different revenue agencies including Customs and Income tax:- Economic Intelligence Council(EIC),Regional Economic Intelligence Committee (REIC) and Multi Agency Centre (MAC) at central level and Subsidiary Multi agency Centre (SMAC),its counterpart at state level. These agencies provide a platform for regular interchange of relevant information between Customs and Income tax along with multiple other agencies.

## **Economic Intelligence Council and Regional Economic Intelligence Committees**

In order to facilitate coordination amongst the Enforcement Agencies dealing with economic offences and to ensure operational coordination amongst them, a two-tier system has been established by the Government of India with an Economic Intelligence Council at the Centre under the Chairmanship of Union Minister Finance, and 18 Regional Economic Intelligence Committees at different places in India.

The Economic Intelligence Council is an apex forum for coordination, exchange of information and evolving common strategies to combat economic offences. It has the following broad objectives:

- (a) Discuss measures to combat economic offences and formulate a coordinated strategy for action by various Enforcement Agencies.
- (b) Discuss important cases involving inter-agency coordination.
- (c) Discuss measures to strengthen the working of various Enforcement Agencies under the Ministry of Finance.
- (d) Examine the changing dynamics of economic crimes, including new modus operandi being evolved and suggest measures for dealing with these crimes more effectively.
- (e) Advise on amendment of laws and procedures for plugging loopholes and taking action against economic offenders.
- (f) Act as a forum for exchange of intelligence on important economic offences.
- (g) Discuss measures to combat the generation and laundering of black money and formulating a strategy against black money operators and tax evaders.

The Composition of the Economic Intelligence Council at the Centre

Finance Minister	Chairman
Governor, Reserve Bank of India	Member
Secretary (Finance)	Member

Secretary(Revenue)	Member
Secretary, Company Affairs	Member
Chairman, Securities and Exchange Board of India	Member
Special Secretary cum Director General(Central Economic Intelligence Bureau)	Member
Chairman, Central Board of Excise & Customs	Member
Chairman, Central Board of Direct Taxes	Member
Addl. Secretary(Banking)	Member
Member(Anti-smuggling), Central Board of Excise & Customs	Member
Member(Excise), Central Board of Excise & Customs	Member
Member(Customs), Central Board of Excise & Customs	Member
Member(Investigation), Central Board of Direct Taxes	Member
Director General, Narcotics Control Bureau	Member
Director General, Directorate General of Revenue Intelligence	Member
Director General, Directorate General of Central Excise Intelligence	Member
Director, Directorate of Enforcement	Member
Director, Central Bureau of Investigation	Special Invitee
Director, Intelligence Bureau	Special Invitee
Director General, Foreign Trade	Special Invitee
Deputy Director General, CEIB	Member Secretary

#### The Composition of the 18 Regional Economic Intelligence Committees

Place & Convenor of Committee	Jurisdiction
Director General of Income-Tax(Investigation), Ahmedabad	Ahmedabad
Director General of Income Tax(Investigation), Bangalore	Bangalore
Chief Commissioner of Customs & Central Excise, Baroda	Baroda, Surat, Rajkot

Chief Commissioner of Income Tax, Bhopal	Bhopal, Indore, Raipur, Jabalpur.
Commissioner of Customs & Central Excise, Bhubaneswar	Bhubaneswar
Director General of Income Tax, Mumbai.	Mumbai, Goa.
Director General of Income Tax (Investigation), Calcutta.	Calcutta
Chief Commissioner of Income Tax (Investigation), Chandigarh.	Chandigarh, Rohtak, Amritsar, Jalandhar, Patiala.
Chief Commissioner of Income Tax, Cochin.	Cochin, Trivandrum, Calicut.
Director General of Income Tax (Investigation), Delhi	Delhi
Chief Commissioner of Income Tax, Hyderabad	Hyderabad, Visakhapatnam, Guntur.
Chief commissioner of Income Tax, Jaipur	Jaipur
Chief Commissioner of Income Tax, Kanpur.	Kanpur, Allahabad, Lucknow, Agra, Meerut
Director General of Income Tax (Investigation), Chennai	Chennai
Commissioner of Customs, Madurai	Madurai, Trichi, Coimbatore.
Chief Commissioner of Income Tax, Patna.	Patna, Ranchi
Chief Commissioner of Income Tax, Pune	Pune, Aurangabad, Belgaum, Kolhapur, Nasik, Nagpur.
Commissioner of Customs (Preventive), Shillong	Shillong

In order to make the Regional Economic Intelligence Committees broad based, besides Members from the Enforcement Agencies of the Department of Revenue posted at the station, Senior Officers of Income Tax, Customs and Central Excise, Heads of the Reserve Bank of India, State Bank of India, Registrar of the Companies, Head of the State Sales Tax Department, Head of the office of Directorate General of Foreign Trade, wherever posted in the State, have also been included as Members.

MAC and SMAC –

In 2002, for streamlining of intelligence efforts aimed at countering terrorism, a central Multi Agency Centre (MAC) was created at Delhi with Subsidiary Multi Agency Centres (SMACs) in various states comprising of representatives from various security agencies. They were strengthened in 2009 vide Multi Agency Centre (functions, powers and duties) order, 2008 and 24x7 Control Rooms were set up at MAC, New Delhi and at various SMACs at State Level and also at Headquarters of Intelligence Wings of other agencies to ensure timely sharing of information and better co-ordination between intelligence agencies. Nodal Officers of 25 member agencies meet on every working day. Presently, the MAC-SMAC network has 416 nodes spread across the country which are connected to MAC HQ at New Delhi.

Intelligence agencies of both Customs and Income tax are members of MAC-SMAC and are mandated to share information which can be useful to the other department. However, in spite of regular meetings there is a marked inhibition in disclosing any data and no valuable inputs are shared between both the tax wings.

**CBEC issued Circular No- 20/2007 dated 08.05.2007 for cooperation between two department on transfer pricing based on the recommendation of joint working group co-chaired by Member (IT), CBDT and Member (Customs), CBEAC and comprising senior officers from Income tax and Customs . It remains the only substantive instrument for coordination between Income tax and Customs department.**

The substantive recommendations of the Joint Working Group as mentioned in said circular as follows:

(a) Co-operation and coordination between the two Departments on Transfer Pricing issue is absolutely essential. The coordination should be at two tiers. In the first tier, there could be bi-monthly meetings at the regional level at each of the 4 metros, where Custom Houses with Special Valuation Branch (SVB) are located. These are Delhi, Mumbai, Chennai and Kolkata. From Customs side, the Regional office of the DGOV and from the Income Tax side the Regional Office of the Directorate of Transfer Pricing (DTP) may jointly coordinate such meetings. Since the SVBs are under the control of the respective Custom Houses, such meetings should be attended by Additional/Joint Commissioner in charge of SVB. The

Director (Transfer Pricing) and Commissioner (Valuation) will co-chair such meetings. In the second tier, there could be six-monthly meetings at the level of Director General Transfer Pricing, Director General of Valuation and the Chief Commissioners of Customs, in whose jurisdiction the SVBs are located. One such meeting in a year should be co-chaired by Member (IT) and Member (Customs).

(b) On exchange of information, it has been recommended that the information can be exchanged on specific cases. For this purpose, an officer from DGOV and an officer from DTP may be designated as the Nodal officers from the two departments at each of the four metro cities viz. Delhi, Mumbai, Chennai and Kolkata. The field officers from the two Departments will make available the respective data-base relating to Related Party/Associated Enterprises to each other on need to know basis.

(c) There is a need to have training programmes for the officers handling transfer pricing matters in Income Tax as well as Customs Department. In the first tier, the Custom Officers could be given two days training on Transfer Pricing matters in the Regional Training Institute of the Income Tax Department. Similarly, two days training programme can be drawn for the Transfer Pricing Officers (TPOs) on Customs Valuation treatment of Related Party Transaction at the regional unit of NACEN. This is necessary for familiarization about treatment of Transfer Pricing in the other Department. In the second tier, Seminar cum Workshop can be organized jointly for both Customs and Income Tax officers.

2. It has been decided to implement the forgoing recommendations made by the Joint Working Group. Accordingly, the following steps will have to be taken by the concerned officers with immediate effect:

(i) Bi-monthly meetings at the regional level at Delhi, Mumbai, Chennai and Kolkata should be held, as recommended in foregoing para 1(a). Minutes of the bi-monthly meetings shall be forwarded to the Director General (International Taxation) and the Director General (Valuation). The two Directors Generals will ensure that the meetings are conducted as per the recommendations of the Joint Working Group and the minutes reflect the constructive contents of ideas/views of both the departments.

(ii) Similarly, the six monthly meetings shall be held at the level of Director

General (International Taxation), Director General (Valuation) and Chief Commissioners of Customs and minutes to be forwarded to the two concerned Members of CBEC and CBDT. While doing so, any issue that require immediate attention of the two Boards may be highlighted and, if so required, meetings at the Boards level shall be held to consider and resolve such issues.

(iii) National Academy of Direct Taxes (NADT) and National Academy of Customs, Excise & Narcotics (NACEN) shall develop and organize training programmes to train officers of the two Departments on Transfer Pricing as recommended in foregoing para (c).

(iv) Exchange of information in specific cases should be done and Nodal officers from the two departments be nominated as recommended in foregoing para 1(b).

However the said circular was having proper mechanism for coordination but it could not be implemented in the way and sprit it was issued.

### **Suggestions-**

As far as the reasons behind non-sharing of information as well as lack of coordination ,it appears there is lack of mutual trust , and willingness to share the data between both the departments which may be primary cause responsible for that.

For better coordination in the interest of Nation there should be –Regular meeting to build up mutual trust.

-Mutual data transfer between both the departments from a common data network.

- Combined Training of officers from both the department on issues of common interest which will not only be beneficial in data sharing but also build up trust through better understanding.

TARC has also in its second report emphasised and recommended for information exchange as –

-To institutionalise a robust common framework for data and information.

-To create mutual trust, openness and willingness to share amongst participatory agencies.

-common standards and taxonomy for data exchange.

-the seamless flow of information across the agencies which has become the norms in most advanced tax administration remains uncharted in India. Like other nations it can be in the forms of partnership agreement, MOUs, statement of practices, standard protocol and others backed by the law. There are certain data/information which are needed by both the tax administration and the same is being collected by both the authorities separately such as on related party transaction similar data would be useful for customs for Valuation purpose and for Income tax for detecting transfer pricing. If a tax payer is importing goods he would be interested in setting up low price for the transaction so that the Customs duty imposed would be on lower side whereas the same taxpayer generally report a higher price paid for those goods in order to increase deductible cost so that he could show reduced profit and less taxable income.in this respects the taxpayer would seems to have conflicting price interests. It is only possible because it is assumed that both the tax authorities are not sharing the data base of each other and he get benefit out of it and government exchequer suffers.

Both the tax authorities maintain these type of data separately that result in duplicating efforts of collecting and processing the information. There are some examples where the information collected by both the authority may be useful to each other-

-Transfer price document including cost account certificate submitted to income tax authorities could also be submitted to Customs Special valuation branch (SVB) handling related party transaction.

- Similarly Customs valuation data maintained under NIDB and ECDB would be useful for Income tax authorities to determine proper transfer price in related party transactions.

For minimizing the efforts and cost the sharing of data would be very useful. That sharing between both the authorities including intelligence should be in a mechanical manner as there should be a Data network that provide access to both the authorities

## Chapter 6

### International Practices

#### 1. Global Practices in the area of Transfer Pricing

Transfer pricing is no longer an issue for developed countries only. It is becoming important for the developing and emerging economies as well to manage transfer pricing so that Revenue Administrations may protect their tax base effectively, while at the same time avoiding double taxes. While both Customs Valuation and Transfer pricing rules set standards for determining “arm’s length” or “fair” value of these transactions, the international rules and guidelines are different in the Customs and Tax ( Income Tax) domains.

Many countries like USA,UK, Germany, Australia, Canada and France have already laid down specific provisions in National laws and Administrative procedures to regulate Transfer pricing practices. These are measures mainly based on the OECD guidelines to check the pricing pattern in international transactions between related parties for ensuring adherence to arm’s length price principle. In 2000 the US Customs Service has held that a bilateral Advance Pricing Agreement (APA) setting forth a method of establishing transfer prices between a taxpayer importer and related parties may be used as a factor to determine that the transfer prices constitute Transaction value for purpose of appraising related party transactions under US Customs Law.

In USA, Section 1059 A has been introduced to prevent a US importer from jeopardizing the Government revenue by valuing merchandise inconsistently for Customs and Income Tax purposes. Under Section 1059A, importers are barred from declaring a transfer price that exceeds the value declared for Customs valuation purposes. The IRS and Customs have executed a document entitled “Working Arrangement for Mutual Assistance and Exchange of Information Between the U.S. Department of Treasury U.S. Customs Service and Internal Revenue Service regarding Compliance and importation issues” (the Mutual Assistance Agreement) that is designed to facilitate communication and cooperation between the agencies.

There are challenging questions on the issue of Transfer Pricing for both the Tax and Customs Authorities as well as the Trading communities all over the world.

In response to these challenging questions, the World Customs Organization (WCO) and the OECD jointly hosted two international conferences on Transfer Pricing and Customs Valuation, at the WCO headquarters in Brussels in 2006, and 2007. Both the conferences were represented by Customs as well as Income Tax Authorities, consultant firms, large MNEs, and even academicians. In the first joint conference, the differences and similarities between two sets of rules applied by the two Departments were demonstrated on the basis of comparison between how Income Tax and Customs authorities treat Transfer Pricing in accordance with their specific international standards. The conference also discussed pros and cons of the desirability and feasibility of having converging standards for the two systems. On the question of coordinated administrative approaches, the consequences of a transfer pricing adjustment on the previously accepted Customs value and vice-versa, and the scope for joint Customs and Transfer Pricing audits were discussed. Further, the exchange of information and cooperation between Customs and Income Tax authority at both domestic and international level were also explored.

Two schools of thought emerged. Those who were in favour of convergence pointed out that a credibility question did arise if two sets of rules on value determination led to different answers to virtually the same question - what is the 'arm's length'/'fair' value for a transaction. They further argued that this situation would result in greater compliance cost for the Trade, and greater enforcement costs for the Administrations who must develop and maintain two types of expertise. As an illustration, they cited the situation of the Customs specialist and the Transfer Pricing expert examining and auditing the same transaction of an MNE. The proponents therefore suggested harmonisation of the law and procedure relating to Transfer Pricing and Customs Valuation. Those from the other school of thought called for caution against convergence. They pointed out that the two systems are based on different principles while viewing the valuation of imported goods. The Customs generally determines the value of the goods at the time of importation with respect to individual transactions based on

information available at that time. The Income Tax authority often determines value of the goods based on aggregate transactions, where appropriate, and quite often use the information available at the end of the year. Therefore, their advice was to focus more on dispute resolution mechanisms to solve the questions that might arise from the divergence in the two systems. As a possible way forward, the first joint conference recommended that the Customs and Income Tax administrations, through WCO and OECD, should create an appropriate joint forum for dialogue, study and possible liaison, with invitation to the WTO, the Trade and the academics.

In the second joint conference held in May, 2007 the recommendations from the first conference were carried forward, and the Conference went more into the nitty-gritty of exploring possible convergence of Transfer Pricing, Customs Valuation and VAT. The Conference recommended, inter alia, for setting up of a Focus Group to suggest solutions for harmonization of the two streams of valuation. At the conclusion of the conference, one found the message to be loud and clear - convergence is definitely desirable, and ways and means would have to be found to reach that goal.

As a follow-up to the second joint conference of May 2007, the first meeting of the Joint WCO-OECD Focus Group on Transfer Pricing was held in October 2007 which was attended by representatives of the WCO, OECD, WTO, Customs administrations, Tax administrations and the Private sector. Mr. Kunio Mikuriya the then -Deputy Secretary General, WCO in his opening remarks stated that the Focus Group was set up to have a meaningful discussion on the way forward on Customs Valuation and Transfer Pricing so as to identify problems and suggest possible solutions. The Focus Group recommended, inter alia, that the Technical Committee on Customs Valuation (TCCV) at the WCO may examine the phrase 'circumstances of sale' in Article 1.2 (a) of the WTO Valuation Agreement in respect of its application to Transfer Pricing situation. The TCCV at the WCO examined the issue and came out with a WCO instrument Commentary 23.1 titled " Examination of the expression ' circumstances surrounding the sale' under Article 1.2 (a) in relation to the use of Transfer Pricing Studies" . The said commentary sought to provide guidance on the use of a Transfer Pricing Study, prepared in accordance with the OECD Transfer Pricing Guidelines, and provided by importers as a basis for examining the circumstances surrounding the sale

under Article 1.2 (a) of the Agreement . The Commentary observed that the question that arose was whether a Transfer Pricing Study prepared for tax purpose, and provided by the importer , could be utilized by the Customs administration as a basis for examining the circumstances surrounding the sale. The commentary further observed that on one hand, a Transfer Pricing Study submitted by an importer may be a good source of information, if it contains relevant information about the circumstances surrounding the sale. On the other hand, Transfer Pricing Study might not be relevant or adequate in examining the circumstances surrounding the sale because of the substantial and significant differences which existed between the methods in the Agreement to determine the value of the imported goods and those of the OECD Transfer Pricing Guidelines. The Commentary finally concluded that the use of a Transfer Pricing Study as a possible basis for examining the circumstances of the sale should be considered on a case by case basis, and that any relevant information and documents provided by an importer may be utilized for examining the circumstances of the sale. A Transfer Pricing Study could be one source of such information.

## **2. Global practices in Information exchange**

### **UK**

In U.K the HMRC collects data on its taxpayers through tax returns and from third party information and brings together data from different sources and cross-matches them to uncover hidden relationship in the transactions. The **Connect System** , one of its analytical tools helps it to do so. With this information the HMRC is able to produce target profiles and models to risk assess transactions.

### **USA**

### **France**

French Customs and tax authorities have an obligation to inform the other party of any suspicious cases that they encounter while conducting examinations/investigations for their own purposes.

### **Finland**

Finnish Customs and the Finnish tax authority exchange information from import/export declarations and VAT recapitulative statements. Unlike import/export declarations which are maintained on a transactional basis, VAT recapitulative statements include information on the total supplies to other taxpayers on a quarterly basis. Analysing each declaration using VAT recapitulative statements does not automatically lead to the detection of VAT fraud cases but is useful in identifying abnormal transactions.

In Finland, prior to exchanging information on investigative cases between customs administrations and tax authorities, assessment on illegal and informal economies is made by Gray Economy Information Unit of the Finnish tax authority in consultation with Finnish Customs in order to better aim to enforcement targets. In the course of conducting surveys on the gray economy and developing compliance reports of suspicious taxpayers, the unit collects information about suspicious individuals from the tax authority, Customs, and the pension service. Customs administration's criminal investigation unit and tax administration's VAT Anti Fraud Unit regularly exchange intelligence and early warnings on VAT returns and conduct joint operations to tackle missing trader inter-community (MTIC) fraud cases.

## **Korea**

The Korea Customs Service (KCS) also regularly exchanges information on tax bases such as trade transactions, quarterly purchases and sales of traders with tax authorities. The Korean example demonstrates that the introduction of automated systems to customs and tax authorities is important in exchanging information on tax bases because the electronic recording of traders' trade activities and systematic management of them are essential in identifying relevant data and collecting such data from the other party. The experience of the KCS suggests that the exchange of information on tax bases serves as a reference point to narrow down investigative targets rather than a guarantee of the detection of evasion of customs duties and taxes. In Korea, investigative information exchange between the customs administration and tax authority is concentrated on cross-border tax evasion. Whereas the customs administration informs the tax authority of cases where evasion of corporate income tax is

suspected, while investigating the flight of capital overseas and money laundering, the tax authority hands over the cases that are related to money laundering and capital flight uncovered during the investigation of cross-border tax evasion to the customs administration.

**Table: Legal and Administrative framework in some countries for information exchange**

Sr No	Country	Legal Framework	Administrative Procedure	Level of Exchange
1.	USA	Section 1059A: TP =CV	Mutual Assistance Agreement	Complete - Automatic
2.	France	Legal obligation (suspicious data)	-	Case by case
3.	UK	-	Connect System	Automatic
4.	Korea	LCITA	AM Process, MoU	Case by case
5.	Finland		Data Exchange	
6.	Netherlands	Common Deptt	Close cooperation(TP)	NA
7.	Singapore	None	None	None
8.	Australia	DMA,1990	MoU	MoU based

## Chapter 7

### Take Aways from Singapore and Korea

#### KOREA

Korean Customs Service (KCS) and National Tax Service (NTS) are under the administrative control of Ministry of Strategy and Finance (MOSF). NTS administers all central taxes, both direct and indirect.

There have been efforts to enhance the co-ordination between Customs and NTS in case of related party transactions. The Korean Transfer Pricing regime is in line with the OECD guidelines. The NTS regularly shares the Transfer Pricing documents with the Customs for Audit purpose. (Assessment is generally known as audit.) During the audit, Customs can call for any documents relating to Transfer Pricing available with NTS.

**Amendment to Korean Customs Act and Transfer Pricing Regulation-** With effect from July 1, 2012, the Korean TP regulation and Korean Customs Act have been amended so that taxpayer can formally file a request to resolve the double taxation issues from the Income Tax and Customs perspective.

If taxpayer is penalised with additional duties from the KCS, then he request the NTS for amendment to past IT returns and receive tax refund resulting from the income adjustments corresponding to the Customs adjustments made in Customs audit. If the claim of the taxpayer is not accepted, he can file appeal with the MOSF. The MOSF will set up review committee for advice.

**Advance Mediation process between the Customs value and Transfer Price-** This is newly proposed in Law for the Coordination of International Tax Affairs (LCITA) and Customs Act. The Taxpayer who applies for Unilateral Advance Pricing Agreement can also apply for Advance Customs Valuation Arrangement (ACVA) to the NTS. The Commissioner of NTS will discuss with Commissioner of the Korean Customs Service on the calculation method for Transfer Pricing and Customs value so that results from Transfer Pricing can align with Customs value.

This is applicable only if the Transfer Pricing method declared is Comparable Uncontrolled Price Method or Resale Price Method or Cost Plus Method and the Customs Valuation method is Transaction Value of Identical goods or Similar goods or Deductive Method.

**SINGAPORE**

Customs barely contributes to revenue of Singapore (roughly 5% of tax revenue). Therefore, Customs-Income Tax cooperation is not very high on the agenda of Singapore Government. Customs is a separate department with no enforcement powers, which have been taken away by the ICA.

However there is overall high level of cooperation between all government agencies with a national spirit. Absence of holding on to territories is conspicuous.

## Chapter 8

### Tax Payer Facilitation-Benefits of Customs-Income Tax engagement to the Taxpayers

**Ease of doing Business:** The Ministry of Finance had constituted a joint working group, comprising officers from Customs and Income Tax, to suggest measures of cooperation between Customs and Income Tax departments. Based on the recommendations of the working group, it has been laid out that periodic meetings should be held between Income Tax and Customs to discuss joint issues requiring attention. Going forward, institutionalization of mechanisms for exchange of information with one another on transfer pricing matters, joint audit of related party transactions will help the companies operating in India to plan and document their transfer prices comprehensively based on valuation principles contained in Customs as well as Income Tax laws and also to deal with both the authorities in a harmonious and seamless manner. This will help the Taxpayers to reduce the compliance cost. The Income Tax department has introduced the Advance pricing agreements (APAs) with effect from 01.07.2012. Exchange of information between Customs and Income Tax will help the Income Tax authorities to conduct the inquiries in effective manner which will expedite the finalization of APAs. Increase in liaison between the two departments will enable the Customs to implement its trade facilitation programmes like AEO programme without burdening the Taxpayers. This will help the taxpayers to reduce the transaction cost.

**Avoidance of double Tax :**At present the Income Tax authorities are conducting audit of transfer prices and Customs department proposes to conduct OSPCA of related party transactions. One of the main consequences of unilaterally made adjustments to transfer prices by Customs and Income Tax would be double taxation. Convergence of both sets of rules and joint audit will help to avoid double taxes.



## Chapter 9

### Recommendations

Chairman CBEC, Sh Najib Shah at the ASEM conference held at Goa very aptly stated that-

“Customs administrations should have a clear vision and a strategy for a new paradigm of working. (We have to formulate a vision for...) the critical role we can play in cross border controls, the fillip we can provide to trade facilitation, the change we can bring by imbibing advances in ICT, the alacrity with which we need to adapt ourselves to stay in tune with the dynamics of a changing world order, the performance metrics we need to put in place for measuring actual progress.”

After studying the global scenario, the current Indian scenario and analyzing the need for cooperation between Customs and Income Tax in our country, this project group, group 4 of MCTP, Group 2, Phase III, 2015 recommends the following:

- i. Data exchange is a must. It should be automatic and ICT driven. The cooperation mechanism between the two departments needs to be immediately institutionalized.
- ii. MoU delineating the protocol for information sharing should be signed between CBEC and CBDT. Data can be categorized into sensitive and non-sensitive, the former being sharable only with pre-defined approvals and under a protocol while the latter can be freely exchanged.
- iii. Common Business Identification Number (CBIN), which could be PAN based and common framework for data.
- iv. Customs consultation in Advance Pricing Agreements
- v. Using existing LTU framework as an immediate step for cooperation in any particular area.
- vi. Implementation of Circular No 20/2007 in full spirit.

- vii. Building of mutual trust through meetings and interactions.
- viii. Capacity building including training in both academies and visits to offices under both authorities.
- ix. Cooperative Audits.
- x. Regular Monitoring of all the above at CBEC and CBDT level.