



CBP's Heightened Focus on Revenue Collection: Use of Transaction Value

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"Revenue" is a CBP Priority Trade Issue ("PTI")

- ∅ CBP Trade Strategy for FY 2009-2013 encompasses the need to collect accurate revenue.
- ∅ How? Improved risk analysis and targeting through information sharing with the trade community.
- ∅ Employ trade expertise to verify compliance.

Focus on Revenue Collection and Use of Transaction Value

∅ CBP is increasingly questioning the trade community's use of "Transaction Value."

→ checkpoint in a Focused Assessment

→ subject of a Quick Response Audit

→ subject matter of a CBP Form 28/29

∅ CBP knows that use of transaction value by related parties is commonplace.

Focus on Revenue Collection and Use of Transaction Value (cont.)

- ∅ *As an important aside . . .*
- ∅ Senate Finance Committee recently declared that transfer pricing issues will be among the tax reform efforts planned for 2009.
- ∅ Widespread belief that U.S. multinationals are engaged in tax avoidance by moving income offshore.

When are parties “related” in CBP’s eyes?

Family / Work Relations

- ∅ Officers and directors of each other’s businesses.
- ∅ Partners of same business.
- ∅ Employer / Employee.
- ∅ Members of same family.

Control Relations

- ∅ One person owns 5% of voting stock of both parties.
- ∅ One party controls the other.
- ∅ Both parties under the common control of a third party.
- ∅ Both parties control a third party.

Sec. 402(g)(1), Tariff Act of 1930, as amended
(19 U.S.C. 1401a(g)(1)).

Transaction Value Defined

- ∅ Price actually paid or payable for the merchandise when sold for exportation to the United States, plus certain statutory additions to the price.
- ∅ "Price Actually Paid or Payable"
 - the total payment (whether direct or indirect) for the imported merchandise from the buyer to the seller.
 - often the invoice price, but certain upward and downward adjustments may be made.
- ∅ Must have sale (no consignment shipments).
- ∅ Related party sales must be at arm's length,
 - Customs reviews related party transaction to ensure an arm's length sale.
 - Related party sales may still be appraised using transaction value.
 - Agency may scrutinize sale to ensure relationship did not impact the price.

Transactions of Concern

Why is CBP concerned with related party transactions?



- ∅ "Transaction Value" relies on competing businesses to freely negotiate the fair market value of imported merchandise.
- ∅ CBP believes transactions between related parties are not subject to the same market forces as those between independent parties.

Transactions of Concern (cont.)

∅ There is an inherent conflict between the IRS rules and CBP rules on how imported goods from related parties should be valued.

→ IRS generally insists on a low transfer price to ensure greatest income in the U.S.

→ For CBP, the higher the dutiable value of imported goods, the greater the revenues for the agency.



Winds of Change

- ∅ CBP updated its Informed Compliance Publication entitled “Determining the Acceptability of Transaction Value for Related Party Transactions” in April, 2007.
- ∅ Highlights:
 - What is the proper weight to be given to information an importer prepares for tax purposes?
 - Application of the arm’s length principle for CBP purposes v. IRS purposes.
 - Relevance of Advanced Pricing Agreement (APA) and Transfer Pricing Study to Customs Valuation.

Good News, Bad News

- ∅ APA or similar pricing study by itself is not sufficient to show that a related party transaction is acceptable for customs purposes.
- ∅ Information in the APA or transfer pricing study may contain information relevant to determining the acceptability of the transfer prices for CBP, such as:
 - Pertinent information about the way the related parties transact business.
 - Information on sales of similar products to unrelated purchasers.
- ∅ If using APA or transfer pricing study to support circumstances of sale test, importer must identify the relevant information, explain its relevance, and submit supporting documentation to CBP.

What if Transaction Value Does Not Apply?

- ∅ Whenever transaction value cannot be applied, the other methods of valuation must be applied in sequence:
 - Transaction value of identical merchandise
 - Transaction value of similar merchandise
 - Deductive value
 - Computed value
 - Fallback

Questions...



Save them!



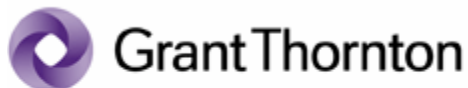
U.S. Transfer Pricing Rules

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U.S. Transfer Pricing Rules

- **The Arm's Length Standard – Treas. Regs §1.482-1(b)(1)**
 - A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).
- **“Control” Defined – Treas. Regs §1.482-1(i)(4)**
 - Controlled includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.



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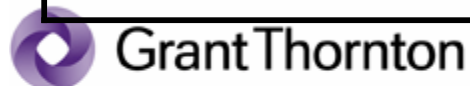


The Arm's Length Principle - Article 9 of the OECD Model Convention

“where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”

Transfer Pricing Rules – Specified Methods

Treas. Regs. §1.482	OECD Guidelines
Comparable Uncontrolled Price (CUP)	Comparable Uncontrolled Price (CUP)
Resale Minus (RP)	Resale Minus (RP)
Cost Plus (CP)	Cost Plus (CP)
Comparable Profits Method (CPM)	Transactional Net Margin Method (TNMM)
Profit Split Method (PSM)	Profit Split Method (PSM)



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U.S. Transfer Pricing Rules – Key Concepts

- **Best Method Rule**
 - The best method is the transfer pricing method that, under the facts and circumstances, provides “the most reliable measure” of an arm’s-length result.
- **Arm’s Length Range**
 - In some cases, application of a pricing method will produce a single result that is the most reliable measure of an arm’s length result. In other cases, application of a method may produce a number of results from which a range of reliable results may be derived. A taxpayer will not be subject to adjustment if its results fall within such range.

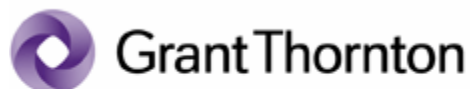
U.S. Transfer Pricing Rules – Key Concepts

- **Aggregation of Transactions**

- The combined effect of more than one transaction may be considered if these transactions as a whole are so interrelated that consideration of the multiple transactions as a whole, rather than in segmented parts, leads to the most reliable means of determining an arm's-length range.

- **Multiple Year Data**

- Data from multiple years may be relevant for purposes of certain enumerated provisions, including the analysis of risk, market share strategy, periodic adjustments, and CPM.



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Transfer Pricing Risk Management

- **Section 6662**
 - Requires taxpayers to create and maintain contemporaneous transfer pricing
 - Includes principal documents and background documents
- **Advance Pricing Agreement (APA)**
 - Is an alternative to contemporaneous documentation
 - Is a prospective agreement between the taxpayer and the IRS concerning the taxpayer's facts, the appropriate transfer pricing method, and an arm's-length range of results with regard to the covered intercompany transactions



How to Gain CBP's Approval of Your Related Party Transactions

Sherri L. New

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Transaction Value

For Customs purposes, there are special rules that apply when the buyer and seller are related parties as defined in 19 U.S.C. §1401a(g).

Transaction value between a related buyer and seller is acceptable if the importation meets either of two tests:

- Circumstances of sale,
- Test values

Circumstances of Sale Test

Under the U.S. customs value law, the following circumstances demonstrate that the relationship has not influenced the price:

- The price was settled in a manner consistent with the normal pricing practices of the industry in question;
- The price was settled in a manner consistent with the way the seller settles prices for sales to buyers who are not related to it; or
- The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind.

Test Values Test

Under the test value method the transaction value between related parties is acceptable if the value closely approximates one of the following “test values”:

- i. The transaction value of identical merchandise, or of similar merchandise, in sales to unrelated buyers in the U.S.; or
- ii. The deductive value or computed value of identical merchandise or similar merchandise from other import transactions.
- iii. But *only* if each value referred to in clause (i) or (ii) that is used for comparison relates to merchandise that was exported to the U.S. at or about the same time as the imported merchandise.

Transfer Pricing Methodologies

Section 482 of the Internal Revenue Code (IRC) lists 5 methods one of which must be employed as the “best method” to establish the arm’s length nature of related party transactions :

Product Similarity:

- Resale Price Method;
- Comparable Uncontrolled Price Method (CUP) or Comparable Uncontrolled Transaction Method (CUT);
- Profit Split Method;

Functional Similarity

- Cost Plus Method; or
- Comparable Uncontrolled Price Method (CPM) – most common method employed

Section 6662 mandates all related party transactions be compiled in a transfer pricing study

Valuation *versus* Transfer Price

§ The broad goal of both the Customs law and the IRC is to ensure that related party transactions are at arm's length, however there are substantial differences in the legal requirements.

- Section 482 allows for aggregation of transactions
- A customs value must be determined for every imported article

§ Although the CUP/CUT, Resale price Method and Profit Split methods employed by the IRC have similarities to the circumstances of sale method and test values method under Customs law since they all require product similarity, their application is not the same.

§ The CPM and Cost Plus methods have little similarity to the customs methods.

How to Obtain Approval by CBP

Companies should not merely present the CBP with its transfer pricing documentation or Advance Pricing Agreements

- Merely submitting your transfer pricing documentation as presented to the Internal Revenue Service will result in the CBP rejecting the circumstances of sale test.
- Transfer pricing documentation must be tailored to fit the customs test.

Knowledge of both customs law for related party transactions and transfer pricing law is needed

- CBP's questions are based upon knowledge of both transfer pricing and customs laws.
- Transfer pricing professionals must tailor their speech to be understood by CBP, not vice versa.

Questions and Answers

