

Key Developments in Customs Valuation

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Overview

- Introduction
- **Transfer Pricing and Related Party Transactions**
- Treatment Relating to the Applicability of Transaction Value and Post-Importation Adjustments



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Transfer Pricing and Related Party Transactions

- Relevance of APA's and TP Studies Pertaining to Section 482 of U.S. Tax Code to Customs Valuation:
 - APA or Transfer Pricing Study *by itself* is not sufficient to show that a related party transaction value is acceptable for Customs purposes
 - The underlying facts and conclusions of an APA or transfer pricing study may contain relevant information but the burden of identifying this information is on the importer



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Common Transfer Pricing/Customs Pitfalls

- Transfer pricing study “tested party” may not necessarily be the right party for customs valuation purposes

Customs is concerned with the transaction causing the importation (typically manufacturer or seller) whereas the TP tested party could be the distributor in the country of importation

- Comparables for transfer pricing and customs may not be consistent

Customs comparables are much narrower than TP

- Customs and Tax rules have different objectives:

Tax objective – allocate income to reflect overall taxable income over a period of time vs.

Indirect Tax objective – define value of a specific imported item at transaction level



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Transfer Pricing – Other Issues

- Generally, customs duties are imposed as the goods are imported into a country. However, without proper planning, certain other payments may also be subject to customs duties and VAT.
 - Royalty payments – may be subject to customs duties & VAT
 - Cost Sharing Agreements/Management Fees/“Indirect Payments” to the Seller – payments may be treated as subject to customs duty & VAT
 - Management Fees – Typically not subject to customs duties but could be subject to VAT



Importer's Obligations Regarding the Declaration of Value in Related Party Transactions

- The importer must use reasonable care in declaring the value of imported goods.
- Questions to consider before declaring the value based on transaction value:
 - Is related party transaction value acceptable based on either circumstances of sale test or test values?
 - Do I have sufficient information and documentation to demonstrate how the test is met?



Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H037375, dated December 11, 2009
- This ruling involved a variety of imported healthcare products entered under transaction value .
- A transfer pricing study had been conducted using the resale profit method, comparing the profits of the importer to other similarly situated companies. No APA was in place.



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- In examining the circumstances of sale, CBP considered the following factors:
- The transfer pricing study included companies in the same industry as the importer, including some competitors. Consistency of the gross margins on resale of imported products among these companies allowed CBP to conclude that the importer's pricing was consistent with the market as a whole and in accordance with normal industry practice.
- The importer also provided internal comparables, gross margins earned on products manufactured by unrelated parties. Although the margins were not consistent, the importer was able to provide an explanation of the extra marketing and distribution costs undertaken with regard to products produced by related parties, allowing CBP to reach the conclusion that the margins as adjusted were comparable.



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- HRL H029658, dated December 8, 2009
 - Company at issue was a U.S. exclusive distributor of motor vehicles, parts, accessories, and service tools for its foreign-owned parent company.
 - Company provided a detailed description of its sales process.
 - The U.S. Buyer/Importer had a bilateral APA with the IRS that covered all of its imported items (vehicles and parts).
 - The tested party was the U.S. Buyer/Importer. The term of the importer's APA was for five tax years.
 - The comparable profits method ("CPM") was identified as the best method to use.
 - The arm's length price range of operating profits was selected by comparing the profitability of the tested party (US Buyer/Importer) to that of unrelated companies.
 - None of the comparable companies selected for the analysis were automobile distributors
 - Compensating adjustments were not at issue (company's profits always fall within the interquartile range) for the period at issue.



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- HRL H029658, dated December 8, 2009
- Issue: whether the price paid between the related seller/manufacturer and the buyer/importer, established pursuant to the approved bilateral APA, was an acceptable transaction value?
- The decision noted that the regulatory examples are just that, examples. Other factors may be relevant to show that the related-party relationship did not influence the price.
- Although the company in this case did not definitively satisfy the test under any one of the relevant examples in 19 CFR Part 152, CBP was persuaded by “the totality of the evidence.”



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065015, dated April 14, 2011
- This decision involved a company that submitted multiple transfer pricing studies covering the manufacturing activities of its affiliates in Singapore and the United Kingdom and distribution activities of the US Importer.
- There was no APA; all transfer pricing studies utilized CPM.
- All of the transfer pricing studies focused on functional comparability of the companies (the transfer pricing studies fell short of achieving product comparability for customs purposes).



Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065015, dated April 14, 2011
- Sales commissions were referenced in the Distribution Agreements and royalty payments were applicable to the affiliate in the United Kingdom.
- Due to the lack of information concerning these payments, CBP was unable to determine what effect, if any, these payments had on the price paid by the importer to its affiliates.



Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065015, dated April 14, 2011
- Company submitted 2 tables, which summarized the total profits earned by the company's related suppliers and calculated the manufacturers' profitability on the products exported to the United States.
- Company asserted that the manufacturers'/sellers' profitability on the product-line level should be compared to the manufacturer's total profit in the sale of the merchandise of the same class or kind into the United States.
- CBP found that this type of comparison of the total profit of the seller in sales of the merchandise to the United States to the product line profit of the seller in the sales of the same merchandise to the same country, does not shed any light on whether the sale is at arm's length.



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065024 dated July 28, 2011.
- Company purchased and imported the following products from its subsidiary: chemistry products, data products, and mass spectrometry instruments.
- 2 transfer pricing studies were submitted: for the IRS and Customs purposes; no APA; CPM was utilized with Gross Margin as PLI; products sold by comparable companies used for the analysis were not of the same class or kind as the imported merchandise.
- Company tried to meet the circumstances of the sale test based on the all costs plus a profit test and provided CBP with the profits of the parent company and its subsidiaries. Only the prices for mass spectrometry instruments were found to be at arm's length.
- Only gross profit margins were submitted – not having an operating profit complicated CBP's assessment of the case.



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Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065024 dated July 28, 2011.
- There was no evidence presented to show that the price was consistent with industry standards (unlike H037375 and H029658).
- The parent company did not present evidence of a bilateral pricing agreement, as the importer did in HQ H029658.
- The parent company showed profits that were quite different from its competitors, and they were quite different between the subsidiary and the parent company.



Current Decisions – Applicability of Tax Guidelines in Customs Valuation

- H065024 dated July 28, 2011.
- The transfer pricing study prepared exclusively for CBP did not include companies that import and distribute products of the same class or kind as the imported merchandise (the direct competitors were not appropriate to review as benchmarks for the profit of the importer).



Effect of Post-Importation Adjustments Made Pursuant to Transfer Pricing Policies on the Application of Transaction Value

- Can transaction value be applied?
- If so, how should these adjustments be taken into account?
- Are increases and decreases treated differently?



Post-Importation Adjustments to Transfer Price

- What effect do they have on the application of transaction value?
- Fixed price or objective formula requirement



Fixed Price or Objective Formula Requirement

- If the price is not fixed at the time of importation, transaction value is not applicable
- The fixed price rule is satisfied when the price is determinable by an objective formula agreed upon prior to the importation
- Under CBP's current policies as reflected in rulings, a firm price need not to be known or ascertainable at the time of importation, but it is necessary for the formula to be fixed so that the final sales price can be determined at a later time *on the basis of some event or occurrence over which neither the seller nor the buyer has any control*
- Most transfer pricing policies do not satisfy this requirement



Current Policy with Respect to Post-Importation Adjustments

- Inconsistent application:
- In certain instances CBP has allowed the adjustments, but not under transaction value.
 - Use of the “fallback” method because the price was not determined via an objective formula.
- In other instances, CBP has disallowed the adjustments because CBP considered a decrease in the transfer price to be a post-importation rebate or decrease under 19 U.S.C. 1401a(b)(4)(B).



CBP Proposal and Request for Advance Public Comments Regarding HRL 547654 and Treatment Relating to the Applicability of Transaction Value and Post-Importation Adjustments

- HRL 547654, dated November 9, 2001.
- In HRL 547654, the price for the goods was arrived at pursuant to a methodology that included an initial sum subject to adjustments.
- CBP determined that transaction value did not apply because the price was not considered to be fixed or determinable pursuant to an objective formula prior to importation because at least one of the elements for determining the price was within the control of the buyer and/or the seller.
- Nonetheless, following the hierarchy of the valuation statute, CBP found that the goods could be appraised using the “fallback” method of valuation based on the related party price and that the adjustments could be reported (and claimed) to CBP through reconciliation.



CBP Proposal and Request for Advance Public Comments Regarding HRL 547654 and Treatment Relating to the Applicability of Transaction Value and Post-Importation Adjustments

- CBP is proposing that even though the parties are related and certain costs may be within the control of the parties, if the transfer pricing policy is set before importation and is used by the parties, it may be considered an objective formula, allowing the use of transaction value, provided that certain criteria are met.



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CBP Proposal and Request for Advance Public Comments Regarding HRL 547654 and Treatment Relating to the Applicability of Transaction Value and Post-Importation Adjustments

- Some criteria CBP may consider:
 - a written “Intercompany Transfer Pricing Determination Policy” exists which sets out how the transfer price is to be determined prior to the importation;
 - the importer/buyer is the U.S. taxpayer, and it uses its transfer pricing methodology in filing its corporate income tax returns;
 - the company’s transfer pricing policy specifically covers the products for which the value is to be adjusted;
 - the policy specifies what adjustments must be made to the transfer price, and the company provides detailed explanations and calculations of the adjustments incurred and claimed in the U.S.;
 - there is an absence of other conditions which may indicate that the compensating adjustments do not result in an arm’s length price between the parties.



CBP's Application of Post-Importation Rebate Provision

- “Any rebate of, or other decrease in, the price actually paid or payable that is made or otherwise effected between the buyer and seller after the date of importation of the merchandise into the United States *shall be disregarded in determining transaction value.*” 19 U.S.C. §1401(a)(b)(4)(B).
- CBP has ruled that this provision does not apply when the rebate or decrease is made pursuant to an objective formula in place prior to importation. However, under current policies, many transfer pricing formulas would not qualify as objective formulas.
- Therefore, many post-importation rebates or decreases to the transfer price cannot be taken into account.



CBP's Proposal Re: Post-Importation Rebate Provision

- CBP is considering that downward adjustments in the transfer price made pursuant to the transfer pricing study are not rebates of, or other decreases in, the price actually paid or payable (19 U.S.C. §1401a(b)(4)(B)).
- The post-importation adjustments represent an element of the determination of the price actually paid or payable in accordance with 19 CFR §152.103(a)(1).
- Thus, the post-importation adjustments made pursuant to the transfer pricing policy in the proposed revocation simply reflect what should have been reported as the invoice price upon entry, had the exact price information of the imported merchandise been available at the time.



Reconciliation

- Importers must use the reconciliation program to properly apply transaction value and account for the total “price paid or payable for” imported merchandise where a formal transfer pricing study or policy, or an APA, provides for upward or downward post-importation adjustments that directly (or indirectly) relate to the value of the merchandise.



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