

Valuation: Latest Shared Perspectives on New Importers Obligations and International Trends

Ted Murphy

Partner

Baker McKenzie LLP
(Washington, DC)

Yuliya Gulis

Attorney-Advisor,

Office of International Trade Regulations and Rulings,
Valuation and Special Programs Branch

US Customs & Border Protection (Washington, DC)

Tweeting about this conference?

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Intercompany Customs Valuation

- The challenges of using an intercompany transfer price for customs purposes
 - How best to address from an internal compliance perspective
- The impact of the OECD's Base Erosion and Profit Shifting (BEPS) initiative on customs valuation
- Enforcement issues

Intercompany Customs Valuation

- Utilizing intercompany transfer prices for customs purposes present **two challenges** for multinationals:
 - 1) Demonstrating during customs audits that the transfer prices are acceptable under the customs valuation methodologies (not just for tax purposes)
 - 2) Dealing with retroactive transfer pricing adjustments and other adjustments to declared customs values
- A global issue

Transfer Prices as Customs Values

- Similarities/differences between customs and tax
- Main similarity – goal of arm’s length values
- Differences in methodologies
 - Different methods of calculation
 - Different “tested” parties
 - Different priorities

Transfer Prices as Customs Values

- Preferred method of customs valuation is “transaction value”
 - Defined as the price actually paid or payable for the merchandise when sold for exportation, plus amounts for certain statutory additions
- Related-party transaction values (e.g., intercompany transfer prices) are acceptable if:
 - “**Circumstances surrounding the sale**” indicate that the relationship between the buyer and seller did not influence the price paid or payable; or
 - Transaction value closely approximates certain “**test values**”

Transfer Prices as Customs Values

- If ICTP is used for customs purposes, then need to document its acceptability under customs law
 - APA or transfer pricing study can provide foundation
 - Take the analysis to the next level (i.e., from entity to product/product family level) to try to show customs test is satisfied
 - Need to be aware of limitations of circumstances of sale/test values

Transfer Prices as Customs Values

- US Customs' position on the use of ICTPs for customs purposes:
 - “[A]n APA or transfer pricing study by itself is not sufficient to show that a related party transaction value is an acceptable transaction value.”
 - “The importer must provide information and evidence regarding the circumstances of sale and/or test values.”
 - “An importer that relies solely on an APA or transfer pricing study to conclude that transaction value is acceptable would not be exercising reasonable care.”

Determining the Acceptability of Transaction Value for Related Party Transactions, US Customs and Border Protection Informed Compliance Publication (April 2007) (pp. 14, 16 and 17)

CBP and IRS Advance Pricing & Mutual Agreement (APMA)

- Decide to apply (renew) for the APA
 - Consider both tax and customs issues (for APAs as well as for transfer pricing studies and documentation prepared for tax purposes)
- CBP involvement: execute IRS Form 8821 (authorizing CBP to participate in the APA process)
- CBP's participation in the APA process: pre-filing or opening conference
- Provide CBP with all documents submitted to the IRS
- Confidentiality issues: CBP obtaining information directly from the taxpayer (the company)

CBP and IRS Advance Pricing & Mutual Agreement (APMA)

- Challenges:
 - Lack of familiarity with both customs and tax issues
 - Confidentiality: ability for CBP to obtain information
 - Timing: APAs (especially bilateral APAs) may take a long time to negotiate
 - CBP would generally not issue a ruling until APA process is completed
- Additional submission to CBP: still need to file a request with CBP and explain why the prices between related parties are not influenced

CBP's Perspective

- What to look for (circumstances of sale):
 - Internal v. external comparables (TP policy based on direct competitors v. functionally comparable companies; sales to the unrelated distributors around the world; importer purchasing from unrelated manufacturers)
 - Functional v. product comparability analysis – look for product comparability (functional analysis is important, but TP study based on CPM is more persuasive if products of comparable companies are of the same class or kind as the imported products)
 - Transactional v. profit-based methodology (CUP is more relevant for customs than CPM – consider customs valuation when applying for APA or preparing TP studies)

CBP's Perspective

- What to look for (circumstances of sale):
 - Look at the totality of the circumstances/information (**H029658**: evidence of a bilateral APA is highly persuasive and so is the detailed account of price negotiations as well as the independent study of the industry; **H219515**, **H176775**, **H228298** (description of how prices are set, supported by the independent study of the industry and transfer pricing documentation; separate comparability of profits of the importer to the profits of direct competitors)
 - **Importer v. seller as a tested party under TP analysis** (importer as a tested party is acceptable under certain circumstances (must have product comparability if relying strictly on transfer pricing studies)
 - Consider the transfer pricing documentation as supporting documentation (importer must have either the totality of the circumstances or meet one out of 3 illustrative examples under COS)

Transfer Prices as Customs Values

- US Customs notice (May 30, 2012)
 - Transaction value method allowed where related party price is subject to post-importation adjustments provided certain conditions are met
 - Transaction value method was historically precluded because related party price was not fixed or determinable pursuant to “objective formula” in place prior to importation
 - Strongly encourages importers to use ACS Reconciliation Program to report RPAs (both upward and downward)
 - Downward adjustments and resulting refunds were historically disregarded for customs valuation purposes

Transfer Prices as Customs Values

- US Customs Headquarters Ruling #H219515 (Oct. 11, 2012)
 - Allows use of transaction value method based on transfer pricing study and other information demonstrating transfer prices were acceptable customs values (e.g., comparison of gross profits earned by direct competitors)

Transfer Prices as Customs Values

- US Customs Penalty Case
 - Importer used transfer prices as customs values and declared RPAs through Reconciliation Program
 - Upon audit, CBP Regulatory Audit did not accept the customs values as being arm's length
 - Alleged declaring downward RPA was a grossly negligent violation (penalty = 4 x lost duties, taxes and fees)
 - Appealed and US Customs Headquarters determined no violation occurred because importer relied on customs valuation studies which predated reconciliation entries

Retroactive Transfer Price Adjustments

- Generally relevant for customs purposes
 - Can affect the “price actually paid or payable” and, therefore, the customs value
 - Adjustments can have significant duty impact (lesser VAT impact generally)
 - Have an obligation to report adjustments to the declared value – regardless of revenue impact
 - Failure to do so, can lead to customs issues as well as to US tax issues under 26 U.S.C. §1059A
 - Internal communication issue

Retroactive Transfer Price Adjustments

- No consistency among countries in accepting RPAs
 - Some allow upward post-importation adjustments only
 - Some allow no post-importation adjustments (e.g., most of Latin America)
 - Some allow both upward and downward adjustments as long as certain criteria are met (e.g., US, Canada, Australia)

Retroactive Transfer Price Adjustments

- Relevant around the world because of WTO Customs Valuation Agreement
 - \$320 million assessment against subsidiary of US multinational by the Indian Directorate of Revenue Intelligence
 - \$152.5 million assessment against subsidiary of UK multinational by the Korean Customs Service
- Mechanisms to report adjustments
 - Some countries have formal programs (US, EU, Australia, Korea); others working on formal programs; and others have informal procedures (Canada, Japan)

CBP's Perspective

- What to consider (post-importation adjustments):
 - Factor #1: if the policy is not prepared in accordance with IRS rules – not a formula (control issue)
 - Factor #2: link the adjustments reported to the IRS with the adjustments reported to CBP (waiver)
 - Factors #3 and 4: specify and document how the adjustments are determined, allocated, and maintain accounting details from its books and/or financial statements to support the claimed adjustments.

CBP's Perspective

- What to consider (post-importation adjustments):
 - Paper trail example:
 - Provide documents showing the allocation; COGS calculation used to reach the necessary profit margin; financial statements supporting calculations and reflecting the amounts on the debit notes to the seller; statement of earnings; corresponding debit notes to the seller showing the amount of adjustments
 - Must document all aspects of intercompany pricing

Impact of BEPS

- BEPS is an international effort to combat tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax
 - Increased transparency of value chain – unbundled prices, intangibles, etc.
 - Actions 8-10 – ensure that transfer pricing outcomes are in line with value creation (e.g., intangibles, risk allocation, etc.)
 - Action 13 – revised transfer pricing documentation/country-by-country reporting to increase transparency

Impact of BEPS

- BEPS will have meaningful customs implications
 - It will affect the normal “cost-unbundling” exercises employed by multinationals to legally reduce the customs value of tangible goods
 - It may result in an increased use of the Profit Split Method for transfer pricing purposes, which will make retroactive transfer price adjustments more likely – which raises customs challenges
 - Increased transparency of value chain – unbundled prices, intangibles, etc.

Impact of BEPS

- BEPS also provides a meaningful opportunity
 - Intersection between transfer pricing and customs valuation on most governments' radar screens now
 - Include customs valuation considerations when addressing BEPS issues (e.g., documentation, restructuring, etc.)
 - Customs Administrations will likely start asking for this documentation – be prepared!

World Customs Organization/Technical Committee on Customs Valuation

- The WCO is an independent intergovernmental body whose mission is to enhance the effectiveness and efficiency of Customs administrations
- Technical Committee on Customs Valuation (TCCV)
 - Examines specific problems arising in day-to-day administration of the value agreement and give advisory opinions on appropriate solutions
 - Studies and prepares reports of the valuation laws, procedures and practices
 - Prepares and circulates annual reports on the technical aspects of the operation and status of the Agreement
 - Furnishes information and advice, in the form of advisory opinions, commentaries or explanatory notes, on valuation of imported goods as requested by a Member
 - Facilitates technical assistance to Members to further the international acceptance of the Agreement

International Resources and Guidance

- WTO Customs Valuation Agreement
 - WCO Guide to Customs Valuation and Transfer Pricing (June 2015) (available at <http://www.wcoomd.org>)
 - Technical Committee on Customs Valuation Instruments:
 - Commentary 23.1 (Examination of the expression “circumstances surrounding the sale” under Article 1.2(a) in relation to the use of transfer pricing studies)
 - Case Study 14.1 (Use of transfer pricing documentation when examining related party transactions under Article 1.2(a) of the Agreement)
- OECD Transfer Pricing Guidelines
- Guidelines for Strengthening Cooperation and the Exchange of Information between Customs and Tax Authorities at the National Level (draft)

Case Study 14.1

- Products: electrical relays
- Method used: TNMM
- Tested party: importer (routine distributor);
PLI – operating profit
- Documentation: transfer pricing study (used as basis for
bilateral APA)
- Analysis: link transfer pricing study and prices as settled in the
normal pricing practices of the industry
 - Focus on: comparable companies benchmarked in the transfer
pricing study, which were distributors of electrical apparatus and
electronic parts
 - Key: product comparability

Take-Away's

- Take your tax colleagues to lunch
 - Ask about the company's tax strategy, establish lines of communication, BEPS documentation, etc.
 - Piggyback off of tax's contemporaneous documentation
 - Show the transfer prices are also acceptable customs values
 - Reconciliation of RPA's and other interco adjustments
 - Intercompany communication issue
 - Work the communication into both the tax and customs policies, procedures, work instructions