



# **Conflict (and interaction) between Transfer Pricing and Customs Valuation**

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# Ties between Customs Valuation and Transfer Pricing: The US Case

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In the United States, there is a direct tie between a declared customs value in a related party transaction and transfer pricing of imported products for income tax purposes.

## 1. IRS Perspective

**Section 1059A** of the Internal Revenue Code establishes the declared customs value as the ceiling for the “tax basis” or carrying cost of imported goods in inventory.

*“If any property is imported into the United States in a transaction (directly or indirectly) between related persons (within the meaning of section 482), the amount of any costs—*

*(1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and*

*(2) which are also taken into account in computing the customs value of such property, shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.”*

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Questions of adjustments to the “customs value” arise in the context of poorly drafted and out of date tax regulations.

Note: US importer/taxpayers which are more than 25% owned by a foreign party are required to file form 5472, which certifies that the importer is in compliance with Section 1059A (is the “basis or inventory cost of the goods valued at greater than the customs value of the imported goods?”).

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## 2. CBP Position

CBP issued an Informed Compliance Publication on **Determining the Acceptability of Transaction Value for Related Party Transactions** in April, 2007.

This sets forth the official position on the “convergence” of the two disciplines. This ICP did not establish a new position but confirmed existing US practice.

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In the context of an Advance Pricing Agreement (APA) or transfer pricing study, CBP has adopted a middle ground position, neither accepting as determinative nor dismissing out of hand an APA or a TP study.

Instead, as the ICP recites, CBP has ruled that the fact that the importer's transfer pricing methodology satisfies one of the IRS methods is not determinative of whether it is an acceptable transaction value for customs purposes.

Rather, a related party transaction value will be considered acceptable only if it satisfies either the circumstances of sale test or closely approximates one of the test values as provided in customs value law.

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In the context of an APA, CBP will ask whether

1. The TP methodology has been approved by the IRS in the APA
2. CBP participated in the APA prefiling conference between the importer and the IRS
3. The importer provided a waiver to the IRS to enable CBP access to APA documents
4. All of the importer's products were covered by the APA
5. The APA was bilateral, in which case the foreign income tax authorities can have been expected to take the same position as CBP would have (i.e., a higher customs value).

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One Typical US Import Business Model presenting TP issues:

Factory  
(China, Vietnam,  
etc)

Related Foreign  
Sourcing Company  
(HK)

US Importer / Buyer



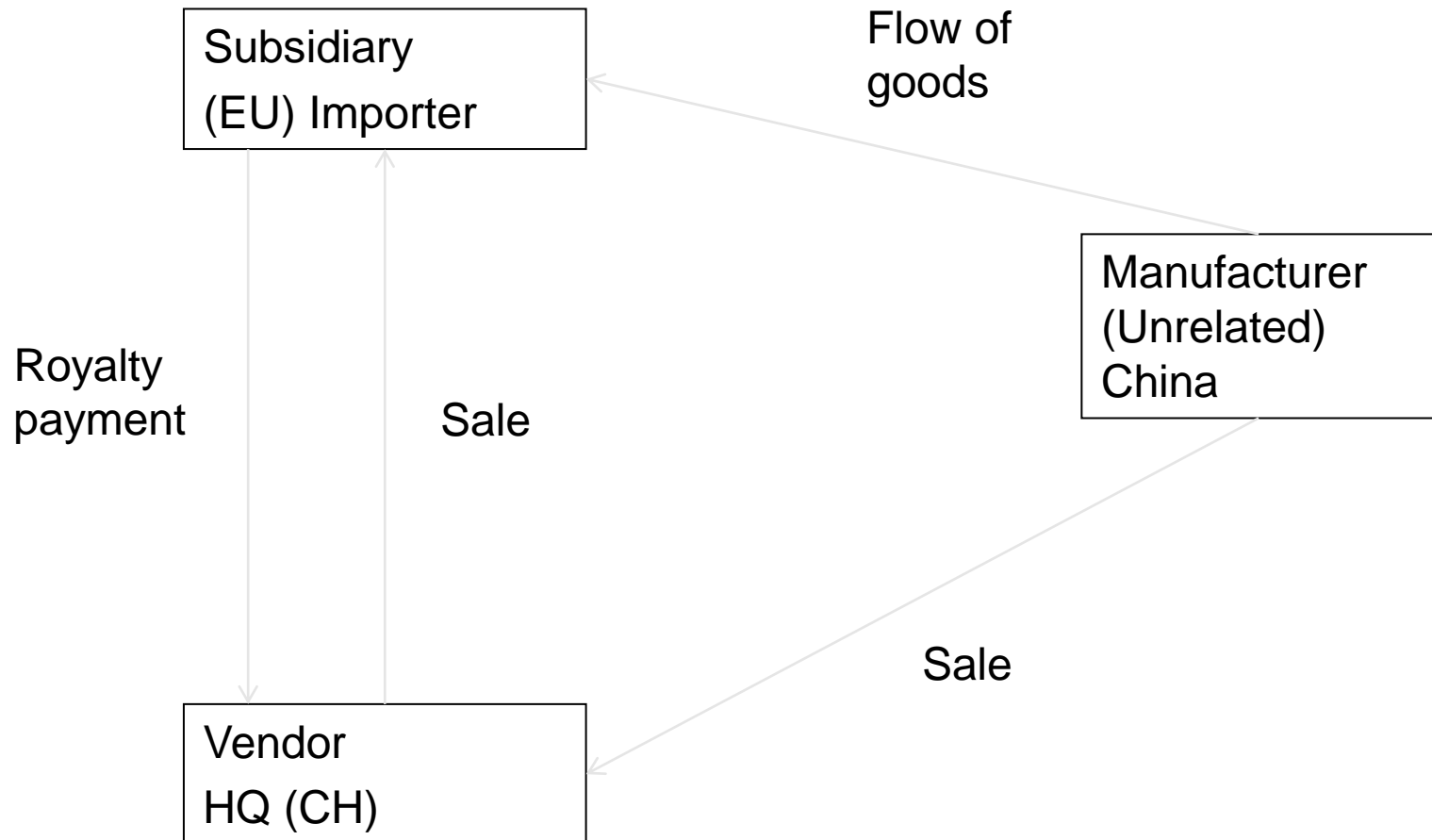
**John Pitt**

# The European perspective

# The European position

- There are no formal direct links between TP and customs valuation
- TP and Customs audits in the EU are generally completed by different government officials at different times, even when the responsibilities sit within one Government Department (e.g. UK and NL)
- Reviewing TP arrangements are now a standard part of most EU customs audits
- Generally companies will be asked to present any relevant TP studies as part of any customs audits
- There is particular focus on APAs but any customs value based on an inter-company pricing is likely to be subjected to review

# Example EU model



# Considerations

What is the value for customs purposes – invoice from V or M?

If M, what has to be added to the customs value?

If V, how do we convince Customs that the price is arm's length?

What is the relevance of the royalty payment? Is it part of the Customs value?

# EU Commentary 11 (aligned with WCO commentary 25.1)

The following elements should be analysed to determine if there is control:

- The Licensor selects the manufacturer and specifies it to the buyer;
- There is a direct contract of manufacturer between the seller and the buyer;
- The Licensor exercises actual control either directly or indirectly over the manufacture
- The Licensor nominates / restricts who the producer can sell their goods to;
- The Licensor sets conditions on sales prices for either the manufacturer or the importer
- The Licensor has the right to review the accounts records of the manufacturer or buyer
- The Licensor designates the methods of production / provides designs
- The Licensor designates / restricts the sourcing of materials / components
- The Licensor does not allow the manufacturer to buy directly from the manufacturer (instead insisting on sales via related party buying agent)
- The manufacturer is not allowed to produce competitive products without permission from the Licensor
- The goods produced are specific to the Licensor
- The characteristics of the goods produced are laid down by the manufacturer