

Recent Customs Transfer Pricing Developments in the U.S., and Global Repercussions

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Introduction

- > Why I'm here
- > A review of what you've heard
- > A preview of what you'll hear
- > Some observations

Transfer Pricing in Related Party Sales

- > US rules – 19 USC 1402a and 19 CFR part 152
- > Circumstances of Sale Test – Relationship between the buyer and seller did not influence the price actually paid or payable
- > Test Values -- Related party prices are acceptable if they “closely approximate:
 - > Transaction value of identical or similar merchandise to unrelated buyers in the United States
 - > Deductive or computed value for identical or similar merchandise

IRS Tax considerations – Section 482

- > In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Applicability of IRS rules to Customs Value

- > APAs and Transfer Price studies: How do they relate to the COS provision of customs law?
- > CBP position: APAs and TP studies are not sufficient alone. Burden is on the importer

IRS Section 482 Considerations

- > Income must be fairly apportioned between taxing jurisdictions
- > Recognizes that companies may structure intercompany transactions to move profits to low-tax jurisdictions
- > Companies may want less profit in high-tax jurisdictions

Two Approaches for IRS

- > Transfer Pricing Studies/Policies
- > Establish that sales are “arms’ length”
 - > Consider risk, investment, other factors
 - > Compare profitability to comparable companies
- > Advance Pricing Agreements

Circumstances of Sale Considerations

- > How do the buyer and seller “organize their commercial relations?”
- > How was the price in question determined?
- > Do buyer and seller act as if they are not related?

Circumstances of Sale Tests

- > Is the price determined in a manner that is consistent with normal industry pricing practices?
- > Is the price determined in the same way in which the seller deals with unrelated buyers?
- > Is the price 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?

Issue: Do Advance Pricing Agreements Show “Circumstances of Sale?”

- > IRS methodology is in the aggregate
- > CBP looks at products (by class or kind)
- > APA may contain relevant and valuable information for CBP review
- > Beneficial if all related party transactions are covered (avoids need to review individual product lines)

Transfer Pricing Studies

- > Much of the same analysis applies
- > Question is whether related buyer compensates seller for all of its costs of production plus a profit
- > Focus on sales of goods of the same class or kind
- > TPS does not substitute for CBP circumstance of sale analysis – it is a part of that analysis

Transfer Pricing Studies

- > Recent CBP Rulings
- > Information contained in TPS may be relevant
- > Weight to be given study will vary with
 - > Level of detail
 - > Whether study covers the imported goods
 - > Whether comparable companies produce the same products

TP Study Comparison Methodologies

- > Compare controlled price to Comparable Uncontrolled Price (CUP) -- Most direct
- > Cost Plus Method - Compare gross profit markup in controlled to uncontrolled
- > Resale Price Method
- > Comparable Price Method

Recent Rulings on TP

- > Ruling H065024 (7/28/11)
- > Requester submitted two transfer pricing studies utilizing CPM. Products were sold by comparable companies, 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 one class of merchandise 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”.

H065024 (cont.)

- > There was no evidence presented to show that the price was consistent with industry standards.
- > The parent company showed profits that were quite different from its competitors, and they were quite different between the subsidiary and the parent company.

H065024 (concluded)

- > The transfer pricing study 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 as benchmarks for the importer profit).
- > *Follow-up ruling October 2012*

H037375 (12/11/09)

- > Healthcare products.
- > A transfer pricing study, with companies in same industry, had been conducted using RPM, comparing the profits of the importer to other similarly situated companies.
- > CBP found gross margins on import resale were consistent with the market and normal industry practice. Transfer price was acceptable

H029658 (12/8/09)

- > U.S. exclusive distributor of motor vehicles, parts, accessories, and service tools for its foreign-owned parent company.
- > The U.S. Buyer/Importer had a bilateral APA with the IRS that covered all of its imported items (vehicles and parts).

H029658 (cont.)

- > CPM used for COS test.
- > The arm's length price range of operating profits was selected by comparing the profitability of US importer to that of unrelated non-auto companies.
- > Compensating adjustments were not at issue (company's profits always fall within the interquartile range) for the period at issue.

H029658 (concluded)

- > 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.”

Post Importation Adjustments and Transfer Pricing

- > Previously, Customs rejected transaction value where policy permitted year end adjustments
- > CBP: That price was not fixed at the time of importation
- > Also, post entry adjustments might permit subjective manipulation of pricing (showing influence of relationship)

New CBP Policy – May 2012

- > “CBP Revocation of HRL 547654 and Treatment Relating to the Applicability of Transaction Value and Post-Importation Adjustments”

The Background

- > HQ 547654 (11/9/01)
- > Bulk chemicals -- importer used formula based on subtracting expenses from predicted resale price in U.S.
- > Certain deductions were not known until after entry and resale
- > CBP: there was no transaction value because the price was not fixed and determinable at entry

Background (cont.)

- > Importer went back to CBP with a transfer pricing policy designed for tax purposes
- > Importer showed that adjustments to be made after importation and resale were fixed in an objective formula
- > CBP: Using fallback method, via Reconciliation, the importer could report final and true value

Elements of the New policy: CBP may consider:

- > 1. Whether a written “Intercompany Transfer Pricing Determination Policy” is in place prior to the importation and the policy is prepared in compliance with IRS code section 482;

CBP may consider:

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- > 2. Whether the U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any resulting adjustments are reported or used its income tax return;
 - > 3. Whether the company's transfer pricing policy specifies how the transfer price and any adjustments are determined for all products covered by the policy.

CBP may consider:

- > 4. Whether the company maintains and provides accounting details to support the claimed US adjustments, and,
- > 5. No other conditions exist that may affect the applicability of the transfer price

H219515 (10/11/12)

- > Follow-up to H065042
- > Illustration of CBP's May 2012 approach
- > Importer submitted TP study using Comparable Profits Method.
- > Gross margin was used as profit level indicator between tested company and comparable companies.

H219515 (cont.)

- > CBP first found a bona fide sale took place – risk of loss, title, consideration
- > COS analysis found some elements lacking but the price was not influenced based on totality of facts, including organization of suppliers in the industry and the way the price was arrived at.

H219515 (cont.)

- > Post importation adjustments
 - > Up and down adjustments required
 - > CBP found the 5 elements of new policy met:
 - > Written TP policy in place
 - > Written TP policy will be used in taxes/adjustments
 - > TP study covers all goods and specifies adjust.
 - > Importer maintains the details
 - > No other conditions affect acceptance

Planning

- > APA or Transfer Pricing Policy should address customs valuation
- > Cover all goods imported from related parties
- > Reference profit levels intended to cover costs and provide a profit
- > CBP will measure seller's profits against "the firm's" profits (usually look to highest level parent company)

Planning

- > Focus on goods of the same class or kind
- > Look to study to provide evidence of normal price setting methodology in the industry
- > Consider test values if there are sales to third parties

Questions

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