

U.S. Customs and Border Protection: Perspectives on Transfer Pricing

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Plan

- > What does the U.S. government expect
 - > Internal Revenue
 - > Customs and Border Protection
- > What's the problem?
- > What has changed?
- > What should an importer do?

Basic Law

- > What does the U.S. Internal Revenue Expect?
 - > Tax code § 482
 - > Tax code § 1059A
 - > Arms' Length
- > What does U.S. Customs and Border Protection Expect?
 - > Transaction value
 - > Related parties (19 U.S.C. § 1401a(b)(2)(B))
 - > Circumstances of sale: relationship did not impact
 - > Test values: similar or identical merchandise, computed or deductive value

IRS 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.

IRS Section 482

- > 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

IRS Section 482

- > Purpose is achieve a fair result for all countries involved
- > Consistent with OECD rules

IRS Section 1059A

- > Attempt to address clash between IRS and CBP
- > Limits inventory basis declared on corporate income tax to value declared to customs
- > Four adjustments are allowed:
 - > Freight charges
 - > Insurance charges
 - > Construction, erection, assembly in the U.S.
 - > Others that are properly included in costs basis or inventory cost but not in customs value

Exceptions

- > U.S. Goods Returned
- > No-duty goods (value for statistics only)
- > Zero duty rate goods
- > Items subject only to MPF, HMT, or both

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
 - > Unilateral
 - > Bilateral

Comparable Price Method (CPM/TNMM)

- > Most common methodology
- > Compares profitability of controlled transaction with similar uncontrolled transaction
- > Used with manufacturers and distributors
- > Look for similar resources, risks, functions
(Note: not necessarily similar products)

Comparable Uncontrolled Price (CUP)

- > Compare controlled price to CUP
- > Most direct and reliable comparison
- > Look for similar products, economic conditions
- > Adjust for quality, date, geography, etc.

Cost Plus Method (CPM)

- > Compare gross profit markup in controlled to uncontrolled
- > Used in manufacturing, assembly, etc.
- > Look for similar functions, risk, products
- > CBP has used in “special circumstances” HRL 546979
 - > Approved by the IRS in an APA
 - > Customs participated in the APA-prefile conference
 - > CBP had access to APA documentation

Resale Price Method (RPM)

- > Subtract gross profit from resale price in controlled transaction
- > Used for resales without value added by seller
- > Look for similar functions, risk, and products

Customs Valuation

- > Most imports appraised on “transaction value”
- > The price actually paid or payable for the merchandise when sold for exportation to the United States
- > Plus CRAPP (not relevant here)

Related Party Issues § 1401a(b)(2)(B)

The transaction value between a related buyer and seller is acceptable for the purposes of this subsection if an examination of the circumstances of the sale of the imported merchandise indicates that the relationship between such buyer and seller did not influence the price actually paid or payable; or if the transaction value of the imported merchandise closely approximates—

- (i) the transaction value of identical merchandise, or of similar merchandise, in sales to unrelated buyers in the United States; or
- (ii) the deductive value or computed value for identical merchandise or similar merchandise;

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 United States at or about the same time as the imported merchandise.

Circumstances of Sale Considerations

- > How 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)

Advance Pricing Agreements

- > Prior review by IRS is “significant” to CBP
- > CBP may be invited to conference with IRS
- > Importer may give CBP access to IRS materials via a waiver
- > Comparable companies should produce goods of the same class or kind (“important consideration”)
- > Normal analysis is of seller’s profit
- > Profit should fall within arm’s length benchmarks
- > Evidence of negotiation between the parties
- > Buyer’s overall profit may be relevant for comparison
- > Compensating adjustments must be reported to CBP

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

Transfer Pricing Studies

- > 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

Alternative: 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
- > The test values are for comparison, not for value

Test Value

- > Adjustments may be made for
 - > Commercial levels
 - > Quantity
 - > Permitted additional to the price paid or payable (e.g., assists, commissions)
 - > Costs that are saved as a result of the relationship
- > Test transactions must be actual imports to the United States at or about the time of the imports in question

What's New?

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

The Set Up

- > HQ 547654 (Nov. 9, 2001)
- > Value of imported bulk chemicals
- > Used formula based on subtracting expenses from predicted resale price in U.S.
- > Certain deductions were not known until after entry and resale
- > CBP held there was no transaction value because the price was not fixed and determinable at entry

Transfer Pricing

- > 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
- > Via Reconciliation, the importer could report final and true value

CBP Response -1-

- > Transaction value may be based on an objective formula if:
 - > A written transfer price policy
 - > Covers the transactions
 - > Is in place prior to importation
 - > Prepared for compliance with IRS code 482

CBP Response -2-

- > The importer is the U.S. taxpayer
 - > The policy for income tax purposes
 - > Resulting adjustments are reported for income tax purposes as well

CBP Response -3-

- > The policy specifies how the price and the adjustments are determined

CBP Response -4-

- > The company maintains and provides accounting details to support claimed adjustments

CBP Response -5-

- > No other conditions exist that may affect the acceptance of transfer price

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 & Thanks

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