Customs Valuation
&
Transfer Pricing

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Member of THE CUSTOMS ADVISORS *The Logical Alternative*

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Purpose of Customs Valuation

- **Customs Value Important because:**

Customs Value x **Duty Rate*=** **Duty Payable**

- **So, deduction of Customs Value = Import Duty Reduction**

** Duty rates can be influenced by the origin, the use, the destination and also the classification of the product in the customs nomenclature and may be subject to planning*

Purpose of Transfer Pricing

Charging an ‘arm’s length’ price for inter-company transactions, such as:

• Tangibles - e.g. flow of goods

• Intangibles - use of patented know how, brands, trade marks, trade names, etc. But also for example source codes

• Services - i.e. any headquarters or operational service that provides a benefit for the recipient. Also financial services, including guarantee fees.

Customs Valuation Methods

1. Transaction Value
2. Value Identical Goods
3. Value Similar Goods
4. Deductive Value
5. Computed Value
6. Flexible Application 1-5

Transfer Pricing Methods

- **Traditional transaction methods; e.g. Comparable Uncontrolled Price, Resale Price Method, Cost Plus Method**

- **Transactional profit methods; i.e. Profit Split and Transactional Net Margin Method**

A non-arm's length approach: Global Formulary Apportionment

Definition Transaction Value

- **Price Actually Paid or Payable**
  - for the goods
  - when sold for export to customs jurisdiction of importation
- **If Buyer and Seller Related: Price should not have been influenced by relationship**

Customs Value Price Not Influenced

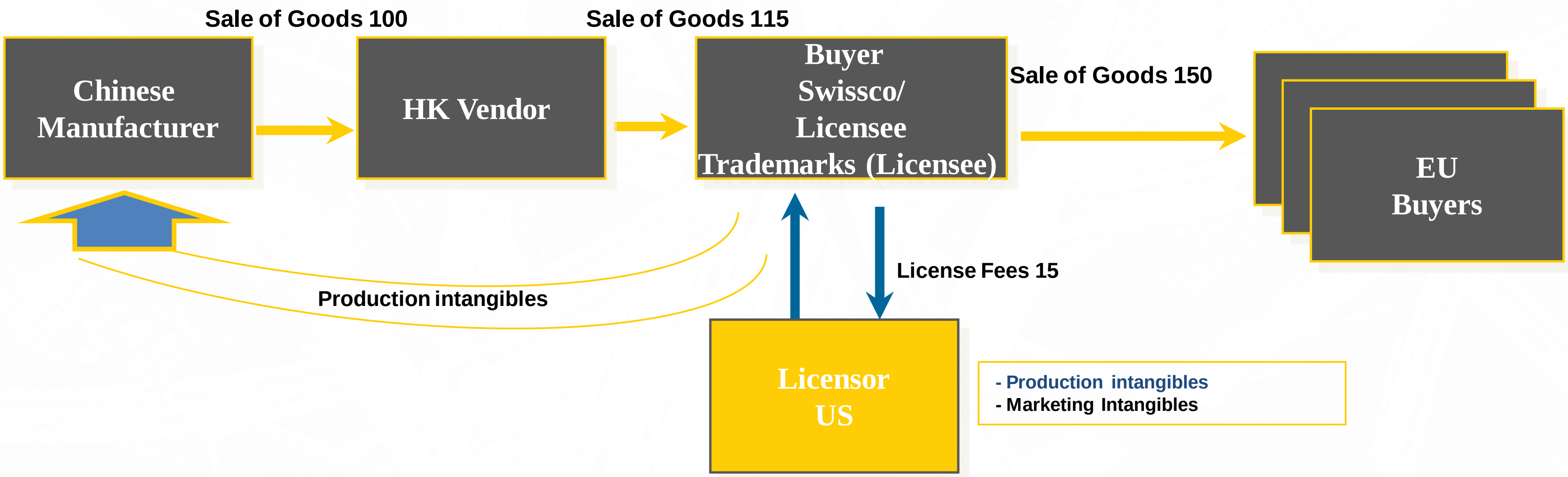
- **Price Settled Manner Consistent Industry**
- **Price Settled Similar to Way Sold to Unrelated Buyers; or**
- **Price Adequate Ensure Recovery Costs Plus Profit**

  Representative to Seller's Overall Profit Realized over Representative Period for Goods Same Class or Kind

TP & Customs Value Global Issues

- Sales to Branches, Commissionaires and LRDs
- Use of Series of Sales concept ("First sale")
- **Royalties (trademark and/or technology related)**
- **R&D Costs (distinction of type of costs and allocation)**
- Buying Agent Fee
- Interest and Financing Agreements
- Transfer Pricing and Origin Requirements
- **Retroactive Price Adjustments**

Royalty Payments (1)



- Swissco (licensee) pays royalties to related US licensor who is not related to the Chinese Mfg (seller)
- The products are sold by Swissco under the trademark in Europe
- The royalty contract does contain restrictions regarding manufacturing

Royalty Payments (2)
Trademark Royalties

Trademark royalties paid to licensor unrelated to seller of the goods:

- Dutiable only if the seller or a person related to the seller requires the royalty to be paid
- Key consideration is the nature of any relationship or agreement between licensor and seller
- Non-dutiable royalty may be wholly or partly dutiable as an assist (e.g., if also tangibles or intangibles covered by the license are directly or indirectly supplied to the seller)

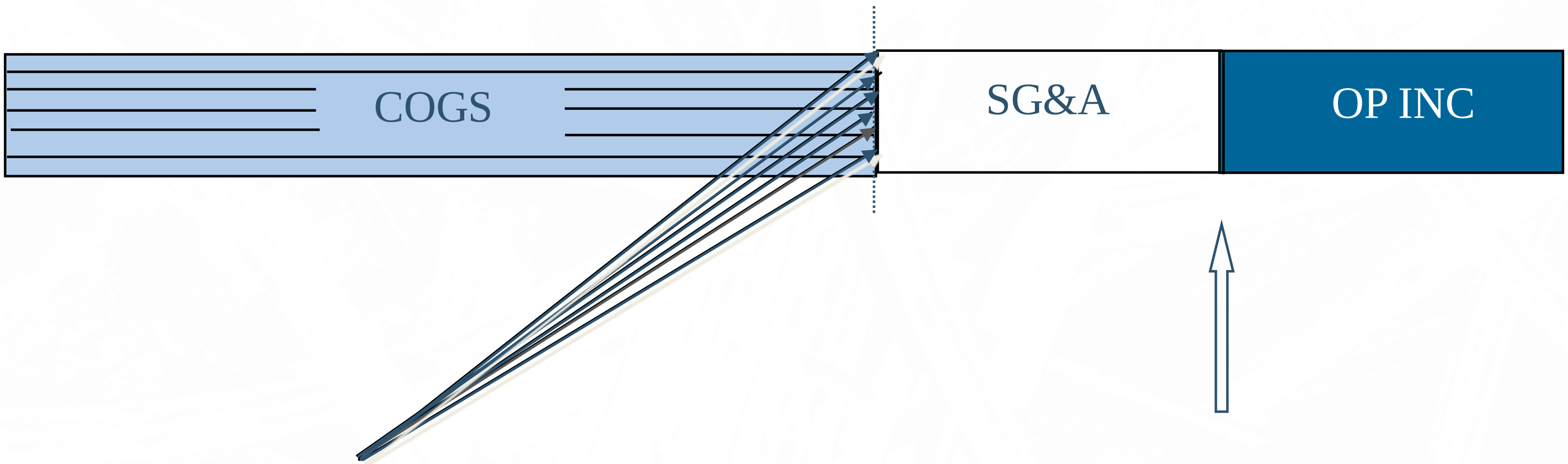
Trademark royalties dutiable only if:

- They relate to imported goods resold in same state or after minor processing; *and*
- Goods are marketed under the trade mark affixed before or after importation; *and*
- The buyer is not free to obtain *such* goods from suppliers unrelated to the seller

Royalties Dutiable: Wholly/Partly??

EU Customs currently considers to tax all trademark royalties (change legislation)

Different Objectives
Customs Valuation and TP



Customs Objective:

Each import **transaction** is not influenced by the relationship

Transfer Pricing Objective:

Same prices as with uncontrolled taxpayers in the same situation – often “results” oriented

Transfer pricing Adjustments

Income > Target: ⇧ Prices

Income < Target: ⇩ Prices

There are many reasons for transfer pricing adjustments, e.g.

- Not meeting target income
- Change in business structure / functions / risk
- Fluctuating costs of raw materials prices
- New TP method /updated TP policy
- Enforced by tax authorities

Transfer pricing Adjustments

If transfer pricing adjustment relates to imported goods, customs valuation adjustments may be necessary

- **Customs Authorities may require to make adjustments to the originally declared customs values**

Making an Adjustment

Retroactive adjustment

- Corrects historic position
- Single invoice or journal entry is used to correct the differential

Prospective adjustment

- Prices are changed going forward
- Generally used to manage ongoing position
- May be used to gradually reverse out historic position

TP-Customs: Differences in Assessment

	Transfer Pricing	Customs
What is taxed?	Annual net taxable income	Individual import transaction values
How do they do that?	Entity level annual tax filing	Declaration required on a product basis at import
What are the implications for transfer pricing?	Arm's length for the year ⇒ net off 'profits and losses"	Each declaration must have cost + representative profit ⇒ no netting
How do they test that?	Entity comparables	"Test values" product by product
What are their concerns?	Prices high ⇒ income low ⇒ Tax low	Prices low ⇒ values low ⇒ Duty low

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Adjustments & Options

Upfront valuation rulings from Customs:

- Not all Authorities provide these type of rulings
- Agree the methodology in principle
- Formalize process to discuss and report periods of adjustments

Joint Tax / Customs APA:

- May want to enter into an APA for a number of reasons (e.g. business tax)
- Consider inviting a Customs representative to join the APA discussions
- Some successful cases in the US
- Could be long process
- Complicated if many products in many different tax and customs jurisdictions

Managing Retroactive Adjustments

Need to make a retroactive adjustment

Inform Customs before making the adjustment

No surprises

Reduces risk of penalties

Opportunity to present preferred calculation method

Improve relationship with customs

Pay duty if price increases but hard to get a refund if price decreases

Still may have other tax issues (e.g. business tax)

Customs issues too great, so don't adjust

Tax risk remain

Customs may still challenge on
audit that relationship influences the price

Make the adjustment, don't tell Customs

Customs increasingly aware that there are tax documents

Risk resulting in additional duties and penalties if identified on audit - *reduced risk if price decreases*

May result in forced calculation method

Harm Customs relationship

Other tax issues

INCREASING CUSTOMS RISK

Bringing it Together

TP documentation either mandatory or necessary to manage penalty

Tax and customs authorities trying to deal with the same issue in different ways for different reasons

Most countries do not require state-of-the-art documentation

- Demonstrating ‘reasonable care’ may limit penalties

Nonetheless, TP and Customs should be addressed together

- Determine an overall strategy from both RISK and COST perspectives
- Consider synergies and economies of scale