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Customs Valuation and Transfer Pricing

Reconciling the Conflicting Customs Valuation Requirements in Related-Party Transactions

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Thursday, January 7, 2010

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Customs Valuation and Transfer Pricing:

Reconciling the Conflicting Customs and Tax Valuation Requirements and Related Party Risks

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Agenda

- Valuing Imported Merchandise for Customs Purposes
 - ◆ General Valuation Methods
 - ◆ Related Party Requirements
- Conflict between Customs Valuation of Related Party Transactions and Transfer Pricing for Tax Purposes
- Importer's Reasonable Care Obligation: The role of APAs and Transfer Pricing Studies in Customs Valuation
- IRC Section 1059A Considerations
- WCO/OECD Efforts Toward Converging Customs Valuation and Transfer Pricing Rules



Customs Valuation – General Requirements and Methodology

- U.S. customs valuation system – based on the Agreement to Implement Article VII of the General Agreement on Tariffs and Trade (the “GATT Valuation Agreement”)
- The provisions of the GATT Valuation Agreement were incorporated into U.S. law through the Trade Agreements Act of 1979-codified at 19 U.S.C. § 1401a
- Under 19 U.S.C. § 1500(a), CBP has authority to fix the final appraisement of merchandise in accordance with 19 U.S.C. § 1401a



Customs Valuation – General Requirements and Methodology

- The Customs Valuation Statute - 19 U.S.C. § 1401a
 - ◆ Six methods of appraisement for imported merchandise in hierarchical order
 - ◆ Transaction Value: The preferred method of appraisement
 - ◆ Use other methods only if transaction value cannot be used
 - ◆ Special rules for “related party” transactions



Customs Valuation – General Requirements and Methodology

■ Transaction Value

- ◆ The price paid or payable by the buyer to the seller for the merchandise when sold for exportation to the United States, plus certain statutory additions:
 - Packing costs
 - Selling commissions
 - Assists
 - Royalty or license fees
 - The proceeds of any subsequent resale, disposal or use
- ◆ In short, the total payment for the merchandise, including direct or indirect payments and excluding certain amounts, e.g., international freight and insurance
- ◆ Generally, transaction value is the invoice price, i.e., the unit price times quantity



Customs Valuation – Related Party Requirements

- Is Transaction Value Acceptable for Related Party Transactions?
 - ◆ Transaction value may be used where the buyer and seller are “related” only if the importation meets one of two tests
 - Circumstances of Sale Test or Test Values
 - In either event, the transaction must be shown to be at arm’s length
 - ◆ Must declare related party status on entry documentation; closely scrutinized by CBP
 - ◆ Multinational Enterprises (MNEs) often have related party valuation considerations due to transactions between trans-border affiliates



Conflict Between Customs Valuation and Transfer Pricing

- U.S. tax law also requires satisfaction of arm's length principle for related party transactions
- Transfer Pricing: 26 U.S.C. § 482 (Internal Revenue Code)
 - ◆ How MNEs determine prices for the transfer of goods/services between their related entities
 - ◆ Transfer pricing determines amount of income that related parties earn and the amount of taxes
 - ◆ Purpose of IRC § 482 is to ensure proper reporting of income associated with related party transactions and to prevent avoidance of taxes
- Intersection with Customs law: transfer pricing policies determine price between related parties as reflected on invoice; invoice price is used to value imported merchandise for customs purposes



Conflict Between Customs Valuation and Transfer Pricing

- So what is the conflict between Customs Valuation and Transfer Pricing?
 - ◆ General common purpose: arm's length principle for related party transactions
 - ◆ Different rules/methodologies
 - ◆ Different and conflicting effects/goals
 - ◆ Different enforcement agencies
 - ◆ How to reconcile these inherent conflicts in light of MNE goal to reduce both taxes and customs duties?



Conflict Between Customs Valuation and Transfer Pricing

■ Different Rules/Methodologies

- ◆ IRC § 482 and regulations provide transfer pricing methods for determining whether related party transactions meet the arm's length principle
 - Transaction- and profit-based methods
 - “Best method” must be applied (no hierarchy)
- ◆ Key differences from customs valuation:
 - Customs: value determined for every imported article; entry-by-entry, product-by-product
 - Transfer Pricing: transactions may be aggregated and offsetting may be allowed
 - Customs: circumstances of sale test and test values for determining acceptability of related party transaction value
 - Transfer Pricing: transaction-based methods are similar but not same



Conflict Between Customs Valuation and Transfer Pricing

- **Key Differences continued:**
 - ◆ Customs: value determined as of date of importation
 - ◆ Transfer Pricing: tax return due date is relevant date
 - ◆ Customs: no specific documentary requirements to establish acceptability of related party pricing; burden is on importer
 - ◆ Transfer Pricing: APAs and Transfer Pricing Studies



Conflict Between Customs Valuation and Transfer Pricing

- Different and conflicting goals/effects in country of importation:
 - ◆ Lower customs value (price) reduces customs duties
 - ◆ Higher customs value increases customs duties
 - ◆ Lower transfer price increases taxable income
 - ◆ Higher transfer price reduces taxable income
 - ◆ MNEs seek to minimize customs duties and reduce taxable income



Conflict Between Customs Valuation and Transfer Pricing

■ Different Enforcement Agencies:

- ◆ CBP vs. IRS: different enforcement priorities
- ◆ GATT Valuation Agreement vs. OECD Transfer Pricing Guidelines
- ◆ MNEs must comply with the requirements of both authorities, which can produce different results
 - Often customs and tax compliance are function of different groups/offices within a corporate entity
- ◆ CBP position: the fact that an importer's transfer pricing methodology satisfies IRS requirements is not determinative of whether it is an acceptable transaction value for customs purposes; must satisfy circumstances of sale test or test values



Customs Reasonable Care Requirement

- Importer has obligation to use reasonable care in making entry
 - ◆ Includes obligation to correctly value imported merchandise; whether related party transaction value is acceptable based on one of two tests
 - ◆ Allows proper assessment of duties, fees and taxes
 - ◆ 19 U.S.C. § 1484
- Penalties for failure to exercise reasonable care:
 - ◆ Depend on level of culpability: negligence, gross negligence, fraud
 - ◆ 19 U.S.C. § 1592



Customs Reasonable Care Requirement

- Importer may claim that related party transaction value is acceptable for customs valuation purposes because it meets IRC § 482 requirements
- Importer submits APA or Transfer Pricing Study (TPS) to CBP as evidence of acceptability
- CBP Position: APA or TPS alone is NOT sufficient to establish acceptability of related party transaction value
- Position is based on differing goals and methods underlying customs valuation and transfer pricing



Customs Reasonable Care Requirement

- CBP recognizes: APA or TPS may contain relevant information about circumstances of sale and may be considered in applying test
- CBP position: APA or TPS generally does not establish normal pricing practices of industry for purposes of determining whether price was settled in manner consistent with normal pricing practices of the industry under circumstances of sale test (See HRL 547672 discussed infra)
- Other CBP considerations:
 - ◆ Which IRS methodology APA is based on (CBP view that Comparable Uncontrolled Price Method has most customs relevance; given more weight than profit-based methods)
 - ◆ Is APA bilateral or unilateral
 - ◆ Has TPS been considered by IRS
 - ◆ Are products covered by TPS comparable to imported products



Customs Reasonable Care Requirement

- HRL 546979 (2000)
 - ◆ Whether APA was sufficient for Customs to determine that transaction value between related parties was acceptable
 - ◆ No, while goal of 19 U.S.C § 1401a and IRC § 482 is to ensure that transactions between related parties are at arm's length, the method of making that determination is different
 - ◆ But Customs found that the information submitted to IRS and fact that APA was bilateral were valuable in applying circumstances of sale test
 - ◆ Customs participated in APA conferences with IRS
 - ◆ APA covered all Importer's products
 - ◆ Holding: Circumstances of sale test met; no further information necessary (note special circumstances present in this case)



Customs Reasonable Care Requirement

- HRL 547672 (2002)
 - ◆ Whether Transfer Pricing Study was sufficient for Customs to determine that transaction value was acceptable
 - ◆ No, TPS does not establish that prices were set in manner consistent with normal pricing practices of industry or ensured recovery of costs plus profit
 - ◆ TPS does not provide objective evidence of how transfer prices are set and normal pricing practices of industry
 - ◆ TPS is not specific to industry in question
 - ◆ No indication that parties actually used methods discussed in TPS
 - ◆ TPS covers 1996-1998; would not have relevance to importations outside that time period; not contemporaneous
 - ◆ TPS focus on function and risk, rather than product sold
 - ◆ TPS uses aggregate methodologies, rather than product-by-product



Customs Reasonable Care Requirement

- **Bottom Line: Importer's Burden to Establish Acceptability of Transaction Value**
 - ◆ Do not rely on APA or Transfer Pricing Study alone
 - ◆ Support with documentation and explanation as to why relevant to circumstances of sale claim
 - ◆ Make transfer pricing data useable to CBP
 - ◆ One of customs related party tests must be satisfied to establish acceptability of transaction value
 - ◆ Failure to support circumstances of sale test with additional information may be failure to exercise reasonable care that subjects importer to penalties
 - ◆ Be cognizant of CBP concern regarding undervaluation
 - ◆ Ensure compliance *before* importation



IRC Section 1059A Considerations

- Issues to Consider:
 - ◆ Impact of Reconciliation
 - ◆ Impact of Post-Entry Amendments
 - ◆ Impact of Post-Liquidation Protests
 - ◆ Impact of Re-Liquidation
 - ◆ CBP Authority to Share Import Data with the IRS



Practical Impact of Conflicting Value Systems

- Greater compliance costs for MNEs
 - ◆ Compliance with two legal regimes that can produce different outcomes on the answer to the same question—what is an arm's length price?
 - ◆ Synthesis of tax/accounting and customs compliance departments to ensure compliance and reconcile conflicting valuation issues
 - ◆ Potential for audit/investigation from two regulatory bodies
- Greater potential for penalties/enforcement issues under both legal regimes



WCO/OECD Efforts Toward Convergence

- Joint Conferences on Transfer Pricing and Customs Valuation of Related Party Transactions - 2006 and 2007
 - ◆ Focus: explore possibility of converging values for transfer pricing and customs valuation systems
 - ◆ Work toward reconciliation of OECD Transfer Pricing Guidelines and GATT Valuation Agreement
 - ◆ Concerns expressed that convergence may be more difficult and costly due to different theoretical principles that underlie the two legal regimes



WCO/OECD Efforts Toward Convergence

- 2007 Conference Discussion Points:
 - ◆ Increased use of APAs as means of convergence
 - ◆ Increased information sharing between revenue and customs authorities
 - ◆ Potential for joint approach to audit, compliance and APAs
 - ◆ Creation of focus group of customs and tax experts – Focus Group on Transfer Pricing
 - ◆ 4 Focus Areas Emerged:
 - Interaction between valuation methods used by customs and revenue authorities
 - Greater certainty for businesses: joint rulings, APAs, dispute resolution
 - Improving compliance and information flow
 - Improving the administrative capacity of tax and customs departments



WCO/OECD Efforts Toward Convergence

- Efforts of WCO Technical Committee on Customs Valuation (TCCV)
 - ◆ Meetings have addressed “Related Party Transactions Under the Agreement and Transfer Pricing” in recent years
 - ◆ Consideration of issues such as:
 - feasibility of applying OECD Transfer Pricing Guidelines methods for examining circumstances of sale and establishing test values under the Agreement
 - Possibility of utilizing APAs for examining circumstances of sale and establishing test values
 - Treatment of price adjustments after importation



WCO/OECD Efforts Toward Convergence

- ◆ U.S. Drafted Case Study under Consideration
 - Aims to address various issues that can arise due to differences between two valuation systems
 - Facilitates member discussion on convergence and development of a common platform for the language of the OECD Transfer Pricing Guidelines and GATT Valuation Agreement
 - Hypothetical focuses on relevance of Transactional Net Margin Method (TNMM) and transfer pricing studies for customs valuation purposes, namely the circumstances of sale test
 - Case study has been revised and subject to comment by various TCCV members
- ◆ Next meeting Spring 2010
- ◆ Stay up-to-date on TCCV efforts toward convergence!



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Customs Valuation and Transfer Pricing

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January 7, 2010

A blue-tinted map of East Asia, showing the Korean Peninsula, Japan, and parts of China. The map is overlaid with the text 'Customs Related Party Rules' in a white, italicized serif font. The map shows major cities like Seoul, Pyongyang, Tokyo, Osaka, and Kyoto, and labels for regions like Honshu, Shikoku, and Kyushu. The text is centered over the Japanese archipelago.

Customs Related Party Rules

Notice

- ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY KPMG TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.
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- The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Customs Related Party Parties (19 USC 1401a(g))

- Generally “related parties” for customs purposes include:
 - A. Members of the same family
 - B. Any officer or director of an organization and such organization
 - C. Officers or directors of common organizations
 - D. Partners
 - E. Employer and employee
 - F. Persons directly or indirectly owning, controlling, or holding with power to vote, 5% or more of outstanding voting stock or shares
 - G. Two or more persons directly or indirectly controlling, controlled by, or under common control with, any person.
- Contrast with OECD Model (Article 9):
 - Control is defined as a “direct or indirect participation in the management, control or capital of an enterprise.”
 - No percentage of ownership specified (varies by country e..g., as low as 10%, but often 50%). See also U.S. Treas. Reg. 1.482-1(i)(5).

Does Transaction Value Apply?

19 U.S.C. 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 the transaction value of the merchandise closely approximates certain [test values].
 - Test Values
 - The value closely approximates certain test values pertaining to identical or similar goods exported at or about the same time as the imported merchandise under review.

Customs Related Parties Criteria (19 CFR 152.103(1)(1))

Circumstance of Sales Test -

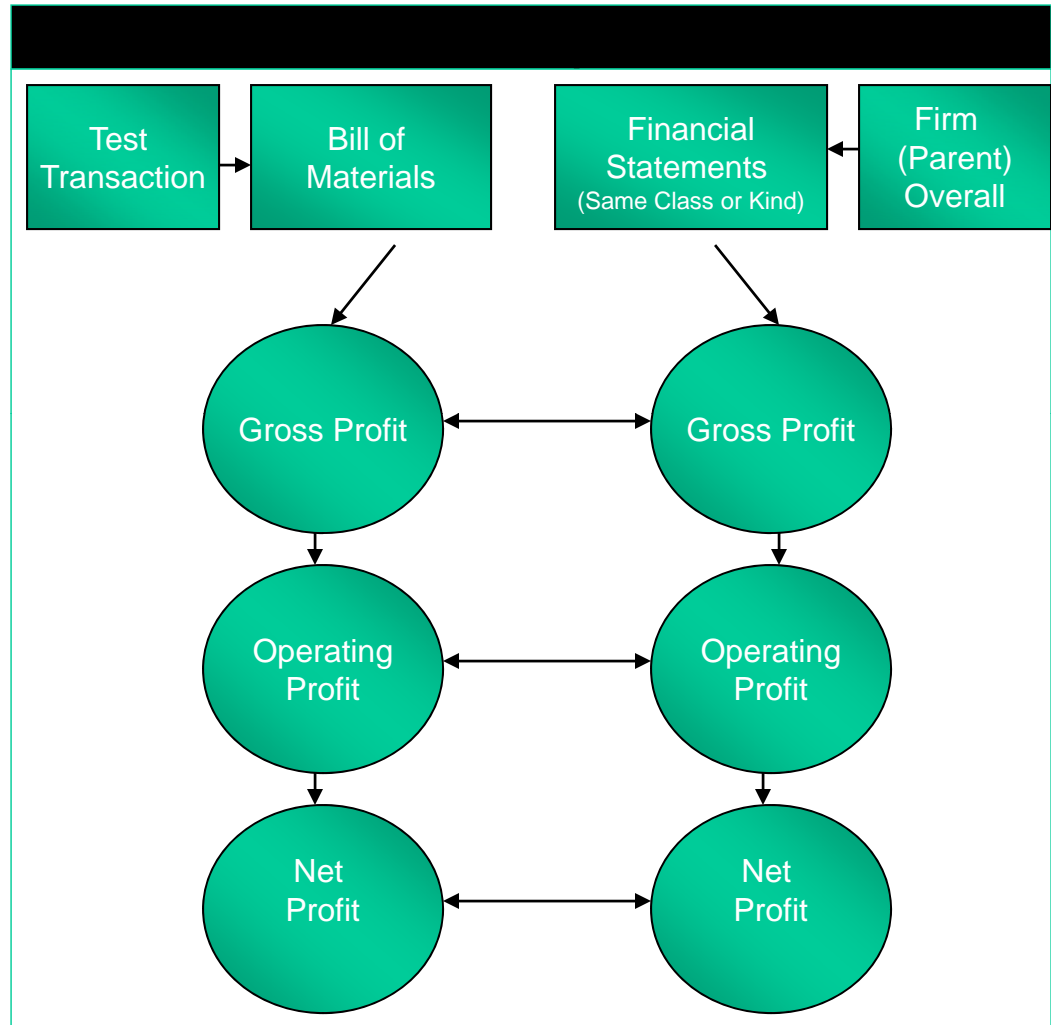
Interpretative Notes – Consider:

1. The manner in which buyer and seller organize their commercial relations and how prices are arrived at;
2. Whether price is settled consistent with the normal pricing practices of the industry in question;
3. Whether price is consistent with sales to unrelated buyers;
4. Whether the price is adequate to ensure recovery of all costs plus a profit equivalent to the firm's overall profit realized over a representative period of time in sales of goods of the same class or kind

Circumstances of Sale Test – Cost Plus a Profit

- The price is 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

- Compile evidence of product related costs incurred by the seller and compare those costs to the firm's overall profit (financial statements, bills of materials, general and administrative expense records, etc.) for similar goods
- "Firm" generally means the parent company (i.e., parent's sales)



Circumstances of Sale Test Cost Plus a Profit Example

Unit Manufacturing Costs Shelving Unit	
Components	\$US/Unit
Wood	\$ 0.29
Screws	\$ 0.05
Brackets	\$ 0.12
Casters	\$ 0.31
Paint	\$ 0.55
Packaging	\$ 0.09
Other	\$ -
PARTS SUBTOTAL	\$ 1.41
Direct Labor	\$ 0.02
Indirect Labor	\$ -
Maint Labor	\$ -
Overtime	\$ 0.02
LABOR SUBTOTAL	\$ 0.04
Hourly Benefits	\$ -
Salaries	\$ 0.09
Salary Benefits	\$ 0.05
BENEFITS SUBTOTAL	\$ 0.14
Maint Mats	\$ 0.18
Other Supplies	\$ 0.02
SUPPLIES SUBTOTAL	\$ 0.20
Electricity	\$ 0.18
Natural Gas	\$ -
Wood Fuel	\$ -
ENERGY SUBTOTAL	\$ 0.18
General Expenses	\$ 0.03
Operating Leases	\$ -
Environmental Exp	\$ -
Taxes	\$ 0.01
Government Subsidy	\$ -
Insurance	\$ 0.02
Depreciation	\$ 0.42
SERVICES SUBTOTAL	\$ 0.48
2006 MFG. COSTS	\$ 2.45

Shelving Company Overall	
Net Sales	\$ 295,000,000
Cost of Goods Sold	\$ 196,000,000
Gross Profit	\$ 99,000,000
<i>Gross Profit Margin</i>	33.56%
Total Operating Expenses	\$ 215,000,000
Operating Profit	\$ 80,000,000
<i>Operating Profit Margin</i>	27.12%

Tested Transaction	
Price per Unit	\$ 3.50
Manufacturing Price per Unit	\$ 2.45
Gross Profit	\$ 1.05
<i>Gross Profit Margin</i>	30.00%
Operating Costs per Unit	
Administration Cost	\$ 0.05
Distribution Cost	\$ 0.07
Selling Cost	\$ 0.01
Total Operating Costs per Unit	\$ 0.13
Operating Profit	\$ 0.92
<i>Operating Profit Margin</i>	26.29%

Consequences

- Potential consequences of invalid or unacceptable transfer prices:
 - Customs fines and penalties
 - Rejection of invoice transfer price for customs purpose
 - Alternative customs valuation method
 - Operational and administrative inefficiencies
 - Additional financial costs
 - Closer scrutiny by CBP

Customs Enforcement Environment

- CBP is increasing its scrutiny of related party pricing :
 - Focused Assessments or Quick Response Audits (QRAs)
 - Issuance of Customs Form 28 – requests for information.

- Importers are frequently asked to provide:
 - Contemporaneous information used to support the specific method used and determine the acceptability of the value.

- Excerpt of an actual CBP request :
 - “After we had a chance to review some of the information provided by you, we still need further information regarding transaction value. We need documentation to support that the value between related parties is at arm’s length. Please explain how the Company ensures this and provide support for what method is used.”



*Compensating Transfer Pricing
Adjustments*

Why Post-Year-End Transfer Pricing Adjustments?

- Actual financial results can differ from those expected from a given transfer pricing methodology for a number of reasons. Examples include:
 - Economic downturn may reduce demand for a manufacturer's product, resulting in lower sales and lower profit margins.
 - Significant increase in sales without a significant increase in operating expenses, increasing the distributor's operating margin.
- Post-year-end financial adjustments are often used in situations in which a taxpayer finds itself outside the arm's-length range for tax purposes. Often, the adjustment is a lump-sum adjustment to sales or cost of goods sold, for in-bound transactions.
- COGS is the key link between TP adjustments and customs value

Customs' Treatment of Post-Import TP Adjustments

Current Customs Policy

- In order for transaction value to be acceptable where the exact price is not known when sold for export to the U.S., a “fixed and determinable” pricing formula or methodology must be in effect on the date of export:
 - “... if the price paid or payable is determined pursuant to a formula, a firm price need not be known or ascertainable at the time of importation, although it is necessary for the formula to be fixed at that time so that a final sales price can be determined at a later time on the basis of some future event or occurrence over which neither the seller nor the buyer have any control.”
- Under current Customs policies, many transfer pricing formulas would not generally qualify as a “fixed” formula.
- Nonetheless, upward transfer price adjustments and downward transfer price adjustments are often treated by Customs differently.

Customs' Treatment of Post-Import TP Adjustments

Current Customs Policy (continued)

- Customs employs a similar “fixed formula” logic in determining whether a post-importation price decrease should result in a decrease in transaction value and a refund of corresponding customs duties:

“Any rebate of, or other decrease in, the price actually paid or payable that is made or otherwise effected between the buyer and seller after the date of importation of the merchandise into the United States shall be disregarded in determining transaction value.” 19 U.S.C.

1401(a)(b)(4)(B)

- Nonetheless, downward TP adjustments may impact transaction value although disregarded as a “rebate” without recovery of duties – consider arm’s length nature of original value.
- Customs generally requires upward TP adjustments to be reported and require payment of additional duties.

Important Considerations

- U.S. Customs Reconciliation Program does not change customs value law.
 - Is provisional pricing helpful with respect to downward adjustments?
- Importers seeking to coordinate their tax and customs' transfer pricing may be well advised to establish policies that incorporate:
 - i. A fixed pricing formula that is in effect prior to the sale for export
 - ii. Price is contingent on a future event or condition over which neither the buyer or seller possess any control.
- Considering recent rulings, is Customs policy changing?

A blue-tinted map of East Asia, showing the Korean Peninsula, Japan, and parts of China. The map is overlaid with the title "Managing Related Party Risks" in a white, cursive font. The map shows major cities like Seoul, Pyongyang, Tokyo, Osaka, and Kyoto, and labels for regions like Honshu, Shikoku, and Kyushu. The text is centered over the Japanese archipelago.

Managing Related Party Risks

Key Related Party Factors to Consider

- In-house import/export functions are not generally within the same department as the tax functions, and may not communicate well internally
- Global operations (different obligations and requirements per country)
- Shift from “Informed Compliance” to “Enforced Compliance”

Managing Risks

- Develop internal controls between customs and tax function
- Be proactive. Informed Compliance Publication (ICP) excerpts:
 - “The importer must have sufficient information available to demonstrate how it meets the particular test upon which it is relying before a declaration is made based on a related party transaction value”
 - “The exercise of reasonable care includes an analysis of whether there is sufficient information and documentation to establish that the related party transaction value satisfies the circumstances of sale or test value method...”
- Conduct and document “customs” related party pricing analysis in conjunction with transfer pricing tax studies and documentation
- Enroll into U.S. Customs “Reconciliation” Program
 - Allows entry of provisional value with 21 months to true-up value

Managing Risks (continued)

- Meet prospectively with Customs
 - Discuss methodology
 - Discuss timing of true-up
 - Address concerns and seek agreement
- Voluntary Disclosures
 - Covers prior five (5) years (statute of limitation)
 - Mitigates fines and penalties
 - Maintains good standing with Customs
- Seek binding ruling
 - Reduce uncertainty



*Potential Intersection for Customs and
Tax*

What is IRC Section 1059A?

Background

- When a taxpayer imports property from related person and declares a lower value for customs duty than for income tax basis, Section 1059A generally allows IRS to reduce income tax value to the customs value (specified differences are permitted).
 - Separate from Section 482 authority to adjust transfer price.
 - Not limited to foreign–owned taxpayers
- Section 1059A was enacted in 1986 after the decision in Brittingham v Commissioner., 66 T.C. 373 (1976), aff'd, 598 F.2d 1375 (5th Cir. 1979).
 - Taxpayer permitted to use differences between the customs and tax law to declare an income tax value that was significantly higher than the declared customs value, thereby minimizing its customs duty basis and minimizing taxable income.
 - Section 1059A was enacted to prevent this whipsaw by the taxpayer. Additional guidance is contained in Treas. Reg. sec. 1.1059A-1.

Limitation on Taxpayer's Basis in Property Imported from *Related Parties*

- IRC section 1059A generally applies to goods that are:
 1. Imported from related persons; and
 2. Are subject to *ad valorem* customs duties.

- Costs that are taken into account in computing the basis or inventory cost (COGS) of imported merchandise for tax purposes shall not be greater than the amount of such costs taken into account in computing the customs value for duties.

- A taxpayer is bound by the finally-determined customs value and therefore generally only can deduct the final “liquidated value” of imported goods for tax purposes.

IRC Section 1059A Financial Illustration

Must Report To
CBP: (examples)

- Certain royalties,
- TP Adjustments,
- Selling commissions
- Others...

Invoice Price / Liquidated Value	\$100M
Undeclared Customs Value	<u>\$ 20M</u>
True Inventory Cost Basis / COGS	\$120M

Tax Rate	35%
Tax Liability of Undeclared Custom Value:	\$7M

- The importer cannot take a full deduction for its COGS (\$120M)
- The importer can only deduct the \$100M liquidated value
- This results in an additional tax liability to the importer of \$7M, or potential exposure if the full COGS (\$120M) is taken

IRS Form 5472

- IRC Sections 6038A and 6038C require an annual information return for:
 - 25 percent foreign-owned U.S. corporations; and foreign corporations engaged in a U.S. trade or business.
 - Form 5472

- Part VI of Form 5472 requires:
 - The reporting corporation to identify whether that corporation imports goods from a related party;
 - If yes, to indicate whether the basis or inventory cost of imported goods is valued at greater than the **customs value**; and
 - If the basis or inventory cost (with permissible adjustments) is greater, then the reporting corporation must attach a statement to Form 5472 explaining the reasons for the difference and indicate supporting documents are available

Reporting value under Section 1059A

IRS Form 5472

Form 5472 (Rev. 12-2007) Page **2**

Part VI **Additional Information**
All reporting corporations must complete Part VI.

1 Does the reporting corporation import goods from a foreign related party? Yes No

2a If "Yes," is the basis or inventory cost of the goods valued at greater than the customs value of the imported goods? Yes No
If "No," do not complete b and c below.

b If "Yes," attach a statement explaining the reason or reasons for such difference.

c If the answers to questions 1 and 2a are "Yes," were the documents used to support this treatment of the imported goods in existence and available in the United States at the time of filing Form 5472? Yes No

Treas. Reg. sec. 1.6038A-2(b)(5) authorizes Form 5472 to request information related to Section 1059A.

- Report if company **imports** from a related party
- Determine - if the basis or inventory cost of goods is valued greater than the customs value
- Prepare a statement explaining the **difference** in the values
- Confirm the existence and availability of supporting **documentation**

Identifying Differences (COGS v. CV)

Example

	Source	Amount (\$)
<u>Step 1 - Identify Differences</u>		
•Inventory Costs (related)	Trial balance or financials	1,000
•Declared Customs Value	ITRAC or Import Records	<u>750</u>
Difference (if any)		250
<u>Step 2 – Analyze Differences</u>		
<u>(p = permissible) vs. (np = not permissible)</u>		
•International Freight (p)	GL account # _____	10
•Buying Commissions (p)	GL account # _____	10
•TP Adjustment (np)	GL / Adjusting Journal Entry	<u>200</u>
•Manufacturing Royalty (np)	GL / Adjusting Journal Entry	<u>30</u>
Total Differences		250
<u>Step 3 – Recommend Corrective Action</u>		
Ex. File PEA with CBP; tax provision, etc		

Correcting Customs Value

- Treas. Reg. sec. 1.1059A-1(d) binds the taxpayer to the “finally-determined customs value” *under the customs laws*.
- *Liquidation* generally occurs 314 days post-entry.
- However, post-entry adjustments (PEAs) must be filed 20 days *prior to liquidation* (*i.e.*, effectively reducing the adjustment period to 294 days post-entry).
- Customs Reconciliation Program allows the importer to make adjustments up to 21 months post-entry.