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Commentary: Customs' New Clarity in Transfer Pricing

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On May 30, U.S. Customs and Border Protection published new guidelines concerning the treatment of post-entry valuation adjustments to related-party import transactions. The new guidelines should interest any importer engaged in multinational related-party transactions and be of particular interest to those who routinely make post-entry adjustments to their transfer prices.

There has always been an inherent tension between the prisms through which the Internal Revenue Service and Customs view related-party transfer prices. Simply put, the IRS traditionally has been concerned with transfer prices that are artificially high so as to "unfairly" reduce the U.S. company's profits. Customs traditionally has been concerned with transfer prices that are set artificially low to "unfairly" reduce the dutiable value of goods on entry.

The result has been something of a "Goldilocks paradox" for financial consultants who handle transfer pricing issues for multinational corporations: How do you establish a viable methodology that isn't too high for one and too low for the other? In practice, however, given the overwhelming attention paid to corporate tax issues, customs valuation is often treated as a neglected stepchild, to the extent it's considered at all.

The regulatory goal of many multinational transfer-pricing methodologies is to derive an acceptable arm's-length price for related-party transactions that approximates the fair market price for that product in non-related transactions. Typically, pricing methodologies acceptable to the IRS would be acceptable to Customs as a viable "transaction value" when there are no post-entry adjustments to the sales price. Many multinational companies, however, routinely provide for post-import adjustments to the transfer price based on changed market conditions (such as changes in the spot market or currency exchange) for the product at the time of ultimate sale.

Although this doesn't pose any particular problems for tax filing purposes, it can be a headache for Customs. Importers in most circumstances are required to report and declare post-entry changes to sales prices that may be attributable to goods entered into the United States.

Customs specifically provides for post-importation amendments to entries and has taken steps via its reconciliation program to allow for convenient mass filing of changes such as this. Over the past decade, however, importers have had increased difficulty in justifying their post-entry changes to valuation under the Customs' fixed-price rule.

The fixed-price rule provides that in order to be acceptable to Customs, the final sales price must be determined (fixed) prior to importation on the basis of some wholly objective events or occurrences over which neither the buyer nor the seller has any control.

Until this ruling, Customs has taken such a broad view of what constitutes a subjective event under the control of the buyer and seller that post-importation adjustments became an overly complex and burdensome process.

The new formula for determining whether an objective transfer pricing policy is in place prior to entry is based on the following guidelines:

-- There must be a written "Intercompany Transfer Pricing Determination Policy" in place prior to importation, and that policy must be prepared taking Section 482 of the IRS Code into account.

-- The U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return.

-- The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted.

-- The company maintains and provides accounting details from its books or financial statements to support the claimed adjustments in the U.S.

-- No other conditions exist that may affect the acceptance of your transfer pricing methodology by Customs.

If these conditions are met, an importer can rely upon those values in making its post-entry adjustments. Although importers don't need to participate in Customs' reconciliation program, the rule-making took pains to suggest that using the reconciliation is highly recommended.

Importers who meet the above criteria now should be able to make post-entry adjustments, particularly downward adjustments, with some confidence that those adjustments will stand up to Customs scrutiny. Importers must keep in mind that their valuation decisions, like their classification and country-of-origin decisions, still will be subject to Customs scrutiny.

Companies should be prepared to support Customs-related decisions with documentation and other evidence. A well-maintained and -regulated compliance program should provide steps needed to support an importer's decision-making policies regarding valuation and other Customs-related issues.

The guidelines represent a refreshing effort on the part of Customs to provide the trade community with workable guidelines that facilitate transfer-pricing policies that comport with IRS and Customs rules.

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