January 26, 2012

U.S. Customs and Border Protection
Office of International Trade - Regulations and Rulings
Attention: Trade and Commercial Regulations Branch
799 9th Street, N.W., Fifth Floor
Washington, D.C. 20229–1177

Dear Commissioner Aguilar:

The American Bar Association (“ABA”) Section of International Law (“Section”) appreciates this opportunity to provide comments in response to “PROPOSED REVOCATION OF A RULING LETTER HQ 547654 RELATING TO POST-IMPORTATION ADJUSTMENTS; TRANSFER PRICING; RELATED PARTY TRANSACTIONS; RECONCILIATION; REQUEST FOR COMMENTS” published in the “Customs Bulletin” on December 28, 2012 (Vol. 46, No. 1) (the “Notice”) by U.S. Customs and Border Protection (“CBP”).

We present these views exclusively on behalf of the Section. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, accordingly, should not be construed as representing the policy of the ABA itself.

The ABA is the largest voluntary professional association in the world. Its many Sections, with over 20,000 members, are the ABA leaders in the development of policy in the international arena, the promotion of the rule of law, and the education of international law practitioners. Many of its members are experienced in the customs valuation and transfer pricing (“TP”) laws of the United States and other countries.

OVERVIEW

Since the first comprehensive set of TP regulations were issued by the Internal Revenue Service (“IRS”) in 1994, multinational companies have sought to develop global inter-company pricing policies and documented procedures which comply with these rules for the sale of tangible goods to related parties. In developing these policies and procedures over the years, companies became aware that the rules for customs valuation of these tangible goods (rules which pre-dated the IRS rules through enactment of the Trade Agreements Act of 1979) were implicated. However, given that two different statutes (26 U.S.C. § 482 and 19 U.S.C. § 1401a) and two different agencies were involved (IRS and CBP), blending the requirements of these two statutes and their respective implementing regulations into a comprehensive set of global inter-company policies and procedures proved challenging.

Further compounding this corporate compliance dilemma was an implicit recognition that, at the end of the day, declared customs values for merchandise imported into the United States (and
nations as well) were essentially driven by TP and the corresponding corporate policies and
procedures of each global entity. This reality can be well-understood given the levels of corporate
income tax rates (hovering near 40% in the U.S.) versus the level of average global duty rates (far less
than 40%). Nonetheless, in responding to past CBP port-level inquiries regarding the arm’s length
nature of related party pricing, importers attempted to support and justify their customs values with
TP documentation and explanations tied to the customs value statute and regulations. These kinds
of responses were frequently rejected by CBP.

To resolve the legal issues involved, importers increasingly applied for Internal Advice (“IA”)
requests and HQ rulings. The result, as acknowledged in the Notice, produced various outcomes;
some approved transfer prices as the basis of appraisement under the primary method of customs
valuation (“transaction value”), while others applied the “fall-back” method (the last alternative in
the hierarchy of available methodologies). The resulting variety of IA and HQ rulings based on
specific fact patterns left importers with a less-than ideal “roadmap” to follow in their efforts to
exercise “reasonable care” and achieve the required global corporate compliance.

However, with publication of the recent Notice, CBP has taken an important step in bringing much-
needed clarity to a vital issue which has a significant impact on the amount of revenue collected by
CBP every year. The Notice correctly acknowledges that related party trade (both imports and
exports) has increased significantly over the last few years, and accounts for 40.8% of all total trade
(exports and imports) in goods, according to the U.S. Commerce Department statistics. Given that
CBP’s definition of related party trade requires only 5% common ownership between the buyer and
seller, in reality, the percentage of imports from related sellers is likely much greater. In certain
industries, e.g., automotive, imports from related parties account for closer to 70% of all trade.

Thus, we applaud CBP for publishing the Notice and acknowledging the commercial reality that the
customs value for merchandise imported from related parties is primarily based on an objective
pricing “formula” which, at its core, seeks to ensure that both the seller and the buyer earn the
requisite level of profit needed to meet the TP rules of section 482 (in the U.S.) and the
corresponding foreign income tax law (based on the guidelines of the Organization for Economic
Cooperation and Development (“OECD”)) as well. In its well-reasoned overall approach to this
issue, CBP is correctly proposing that the usual adjustments (direct or indirect) to inter-company
pricing which periodically take place to facilitate the proper reporting of income on the taxpayer’s
annual income tax return can form part of the “transaction value” of imported merchandise – as
long as the “formula” is in place prior to the time of importation of the goods which may be subject
to post-importation pricing adjustments, and the formula is actually used by the parties.

Certain aspects of the proposed new ruling (and hence CBP’s new policy) deserve specific attention,
which are addressed in detail below.

**COMMENTS ON SPECIFIC SECTIONS**

**Reconciliation**
Importers in the United States are fortunate to have an administrative mechanism available to report
certain data elements of an import transaction which are not known at the time of entry until a later
date. The ACS Reconciliation Prototype (“Recon”) was launched in 1998 to facilitate the proper
and efficient reporting of, among other things, the valuation of imported goods. Recon allows
importers up to 21 months from the date of the first “flagged” entry to report the final value. For
related parties, Recon is an ideal mechanism to utilize in reporting post-importation adjustments so that accurate reporting of the final transfer price/transaction value can occur in an administratively efficient manner. Some importers, because of the cost involved in obtaining customs bond riders and other administrative costs, do not participate in Recon.

However, Recon is also not a statute, and is not legally required in order for an importer to use “transaction value” as the basis of appraisement. In the Notice at p. 32, CBP proposes that “the reconciliation program must be used to properly apply transaction value and account for the total value for the imported merchandise where a TP study, policy, or an APA allows for upward or downward post-importation adjustments that directly (or indirectly) relate to the value of the imported merchandise.” While we understand and support CBP’s goal of promoting the efficient administrative reporting of these adjustments, it does not appear that any legal basis exists for making participation in Recon mandatory in order to report such post-importation adjustments – and hence, making Recon a mandatory requirement for using transaction value in these circumstances. Instead, we suggest that CBP replace “must” with “should” in the above-cited sentence, and include any additional language needed that would strongly encourage importers to use Recon for reporting these kinds of adjustments. Other traditional administrative mechanisms (such as Protests), though, should remain available for importers that do not participate in Recon, but which seek to report downward adjustments to entry values based on post-importation pricing adjustments – and to obtain corresponding duty refunds.

The Five Factors
In the Notice at pp. 30-31, CBP proposes a new “roadmap” to be used when analyzing whether transaction value may be used in related party import scenarios: five factors that “should be examined to determine whether there is a fixed price, pursuant to a formula.” Before addressing these factors, we would encourage CBP to change the word “should” with “may” – especially given that, on p. 32, CBP proposes that “no single factor is determinative, and CBP’s findings with respect to whether an objective formula exists will be made on a case-by-case basis.” Changing this language as suggested will allow CBP the flexibility to consider additional factors as warranted by each specific import transaction’s fact pattern.

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1 We note that in certain TP scenarios, 21 months after the date of entry will not allow a final value to be determined. Although one-year extensions of Recon are possible (for up to two additional years, for a total of three years after 21 months from the date of the first flagged entry), even this additional amount of time may not allow a final value to be determined when the imports are subject to an Advance Pricing Agreement (“APA”). APA’s are legally binding contracts between the taxpayer/importer and the IRS – and one or more foreign income tax authorities, if the APA is bilateral or multilateral. Given their complex nature (and the fact that they appeal to the very largest taxpayers as alternative dispute resolution mechanisms), APA’s can take many years to negotiate and finalize. Thus, Recon may not be able to capture all of an importer’s adjusted values that are subject to an APA or other protracted TP audit/dispute.

2 Conversely, if duty payments result from upward adjustments, importers should be able to file simple “administrative letters” to the local port involved, explaining the adjustments with any supporting spreadsheets/documentation and tendering the duty owed. Because no violation is involved in this scenario, the Prior Disclosure procedure would not apply.

3 This analysis is in addition to the traditional “circumstances of sale” test that must also be applied, as discussed infra.
In examining the five suggested factors, we are aware that the local ports of entry will assume primary responsibility for determining whether an objective formula is present. Thus, guidelines such as those proposed can be helpful, and the ports should be encouraged to focus on the factors listed – but should not be limited by them. In addition, it may be helpful to revise the language of the factors as follows:

1. A written transfer pricing (“TP”) policy is in place prior to importation;

2. The TP policy is supported by one of the following specific documents: (a) a transfer pricing study prepared in accordance with IRS Code Section 482 or its foreign equivalent under the OECD guidelines; (b) an APA; or (c) an intercompany agreement or memorandum of understanding;

3. The documentation noted above specifies how the transfer price and any adjustments are determined with respect to all products covered by the TP policy;

4. The adjustments resulting from the TP policy are reported or used by the taxpayer in filing its income tax return; and

5. The importer maintains accounting details from its books and/or financial statements to support the claimed adjustments.

We believe that these refined guidelines will result in a “five-factor” test that comprehensively captures the legal requirements and supporting information needed by the ports in the vast majority of cases to determine whether an objective formula is present and whether transaction value thus applies. Importers which believe that other factors and documentation (such as internal controls and guidelines pertaining to transfer pricing methods and adjustment calculations) are warranted in other cases can also provide them under our proposed “permissive” nature of the factors above.

Circumstances of Sale Test

Our final comment centers on the nature of the “circumstances of sale” (“COS”) test addressed in the Notice. The illustrative examples of the COS test set forth in CBP’s regulations are as follows: “Customs will consider pertinent details of the transaction, e.g., the manner in which the parties organize their commercial relations and the methodologies utilized to derive the price in question, to determine whether the relationship influenced the price actually paid or payable. Interpretive Note 1 – 19 C.F.R. § 152.103(l)(1)(i). In making this determination, Customs will also seek evidence that the price has been settled in a manner consistent with the normal pricing practices of the industry in question, or with the manner in which the seller settles prices for sales to unrelated buyers. Interpretive Note 2 – 19 C.F.R. § 152.103(l)(1)(ii). Furthermore, if it is shown that the price is adequate

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4 In some cases, adjustments are made periodically throughout the fiscal year such that formal “compensating adjustments” need not be reported after the income tax return has been filed. The adjustments are thus used to report the correct amount of taxable income on the tax return, but are not formally reported; hence, our proposed use of the term “used or reported” in this factor.

5 We understand that application of this new standard will vary on a case-by-case basis. Thus, it would be helpful to the ports and to the trade if CBP could provide examples of hypothetical situations applying the “five-factor” test when it updates the April, 2007 Informed Compliance Publication entitled “Determining the Acceptability of Transaction Value for Related Party Transactions” which we understand is now underway.
to ensure recovery of all costs plus a profit that is equivalent to the seller’s total profit realized over a representative period of time, in sales of merchandise of the same class or kind, then Customs will accept that the relationship did not influence the price. Interpretive Note 3 – 19 C.F.R. § 152.103(l)(1)(iii).” The Notice at p. 34 prudently points out that “other factors” may be relevant as well.

The Notice then analyzes confidential sales data submitted by the importer concerning “the prices of merchandise sold to related and unrelated buyers around the world.” Id. These prices, according to the Notice, were set according to the company’s TP policy and supported by a TP study prepared by its outside accounting firm. Because the importer provided detailed sales data and charts (including volumes, values, and weighted average per unit sales prices), CBP found it unnecessary to examine the TP study that was prepared for income tax purposes. Id. The agency concluded that the related party prices were settled in a manner consistent with the way the seller settles prices in sales to unrelated buyers. Id.

Based on the facts of the proposed ruling in the Notice, this approach to the COS test may well have been warranted given the documentation, calculations, and explanations presented. However, as aptly stated, “. . . CBP generally requires that the comparison sales to unrelated buyers be sales to buyers in the U.S.” Id. There is good reason for this: most sales to markets outside the U.S. involve many different variables (including the cost of compliance with local, e.g., environmental, food, and safety regulations; the maturity of the market at issue; and the volume of goods sold). Thus, comparing prices of products sold to countries other than the U.S. may not be the most reliable benchmark for future guidance, even though such comparisons may validate the global nature of fluctuations in pricing that are present in cyclical industries.

Instead, we encourage CBP to adopt a new factor in applying the COS test: whenever the “objective formula” pricing requirement for transaction value is met, then -- by definition -- the COS test is met. All of the elements of the current illustrative COS tests in the regulations are addressed in one way or another by application of the “five-factor” test for formula pricing – which, under our proposed permissive standard, would also allow other factors to be examined where necessary to determine if an objective formula is present. Thus, the comprehensive nature of the “formula pricing” analysis captures all of the elements of the existing COS tests such that an examination of any single existing COS test is redundant. Application of this “formula pricing” factor alone should be used as a means to satisfy the COS regulations.

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In conclusion, we appreciate the opportunity to submit these comments in response to the Notice and commend CBP for its forward-thinking approach to this important issue.

Sincerely,

Michael E. Burke
Chair, Section of International Law