

Section 1059A: An Obstacle to Achieving Consistent Legislation?

This article provides an overview of the origin and main features of Section 1059A. It also discusses the role of this provision for customs and tax purposes from a transfer pricing perspective. In addition, alternatives will be considered for improving and easing the harmonization of tax and customs transfer pricing rules, specifically, the importance of the customs reconciliation process and advanced pricing agreements.

1. Introduction

Sec. 1059A of the Internal Revenue Code (the Code)¹ is thought to be the core piece that provides consistency between customs and tax rules regarding transfer pricing. Nevertheless, an in-depth analysis of the statute and underlying regulations reveals that the inclusion of Sec. 1059A, far from providing consistency, has given rise to situations of inconsistent treatment, as the statute and regulations have not been modified in order to form a homogeneous and unified set of rules.

This article will discuss various features of Sec. 1059A, as well as the differences between the customs and tax regimes regarding transfer pricing. Much has been written regarding the methods of valuation for customs and transfer pricing, such that a lengthy analysis of that issue is beyond the scope of this article. Rather, the goal of this article is to study the interaction of Sec. 1059A with other provisions and regulations in the Code and the Customs Value Code, and analyse the inconsistencies resulting from such interplay. Finally, this article will consider possible alternatives for improving and easing the harmonization process for tax and customs transfer pricing regimes, specifically, the importance of the customs reconciliation process and advanced pricing agreements (APAs).

2. Transfer Pricing: Tax versus Customs

Although the Customs Service and the Internal Revenue Service (IRS) are sister agencies within the Treasury Department, significant tensions exist between them. In particular, problems arise with regard to inbound transfers of tangible goods between related parties. This is because both the IRS and the Customs Service have a different set of rules for determining the price of imported property, as well as different objectives and principles. In this regard, the main features and differences of both regimes will be considered briefly.

Sec. 482 deals with the transfer pricing for tax purposes. Although Sec. 482 applies to both domestic and international transactions, customs issues arise in the context of economic dealings between related US and foreign companies. The express objective of Sec. 482 is to ensure the proper allocation of income between related parties that clearly reflects income attributable to controlled transactions and thus prevents the avoidance of taxes with regard to such transactions. Therefore, controlled taxpayers are placed on an equal footing with uncontrolled taxpayers in a similar situation.² This goal is articulated in the legislative history of Sec. 482, which states that by enacting such provision, "Congress pretended to ensure that the division of income between related parties reasonably reflects the economic activities that each undertakes".³

The Customs Service, on the other hand, has a different aim. It seeks to attach the correct value to specific imported goods in order to calculate customs duties, which in the vast majority of cases are determined on an ad valorem basis. Therefore, valuation of the goods is of capital importance.

Thus, while customs duties are determined by applying the appropriate duty rate⁴ (which depends on the imported item) to the value of the imported tangible goods, taxable income is determined by calculating gross income and making the proper deductions. Consequently, the natural motivations of the IRS and the Customs Service result in divergent interests. The direction of the adjustment that would increase customs revenue is opposite to the direction of the adjustment that would increase tax revenue. An increase from the transaction price would increase customs revenue and decrease tax revenue. A decrease in the transaction price would increase tax revenue and decrease customs revenue. Thus, when the circumstances are such that one agency concludes that it is justified in making an adjust-

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1. Unless indicated otherwise, all statutory references are to the Internal Revenue Code, 26 USC, and the regulations thereunder.

2. Jerrold E. Anderson, "Related Party Transactions: A Primer on Internal Revenue Code Sections 482 and 1059A for Customs Attorneys," 28 *International Lawyer* (1994), at 113.

3. H.R. Rep. No. 841, 99th Cong., 2nd Sess. Pt. 2, at II-637 (1986).

4. The Harmonized Tariff System (HTS) provides duty rates in force for virtually every item that exists. For more information, see the official website at <http://www.cbp.gov>.

ment, the other agency is unlikely to make consistent adjustments in the absence of special circumstances.⁵

Another aspect in which both regimes differ concerns the time for valuation of the imported goods. The relevant moment for determination of the transfer price for customs purposes is the date of entry of the item into the United States. The importer must provide the agency with the value of the tangible property imported, as well as with the necessary documentation that supports the importer's classification of the items according to the US Harmonized Tariff Schedule (HST). The Customs Service will liquidate the customs duty, and may either accept the entry as entered or modify it by issuing a refund or an additional duty bill.⁶ After liquidations, the importer has 90 days to file a protest with the port director. For judicial review, and after administrative remedies have been exhausted, the importer may turn to the US Court of International Trade.

On the other hand, under tax law, the date on which the tax return is filed is the only important moment for determining the correctness of the transfer price of the goods. Thus, the price will be set once the year in which the transaction took place has passed, and sometimes it takes even longer. One should bear in mind that the taxpayer, under the Sec. 482 regulations and in order to reflect an arm's length result, may report a transfer price for its controlled transactions based on prices different to those actually charged.⁷ This possibility is not available under customs law.

Finally, and regarding the principles and methodologies applied under the tax customs regimes, there are some points which should be highlighted.

The arm's length principle is the foundation of customs and tax provisions applicable to cross-border transactions between related parties. However, it is not the statute, but the Treas. Reg. Sec. 1.482-1 that clearly establishes that the arm's length principle is the crux of transfer pricing, which seeks to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer.⁸ Moreover, Treas. Reg. Sec. 1.482-1(b) states that:

In determining the true taxable income of a controlled taxpayer, *the standard to be applied* in every case is that of a taxpayer dealing at *arm's length with an uncontrolled taxpayer*. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances. (emphasis added)

In a very similar sense, Sec. 1401a(b)(2)(B) of the Customs Duties (19 USC) provides as follows when introducing the essential role played by the arm's length principle in determining the transfer value for customs purposes:

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*. (emphasis added)

Therefore, even though it is not expressly recognized, the applicability of the arm's length principle can be clearly derived from the tone of this provision.

Nevertheless, each field has developed its own set of methods in order to arrive at the arm's length transfer price. The following methods have been developed for customs purposes:

- *transaction value*: the price is that actually paid or payable for the merchandise when sold for export to the United States, subject to certain adjustments;⁹
- *transaction value of identical merchandise, or of similar merchandise*:¹⁰ imported goods are subject to appraisal based on (1) the value of identical merchandise or (2) the value of similar merchandise;¹¹
- *deductive value*: the price is determined by reference to the post-import resale price of the merchandise, as reduced by certain amounts;¹²
- *computed value*: the price is derived from the cost of producing the imported goods, and is the result of adding up the elements established in Sec. 1401a(e);¹³ and
- *other value*: the price is derived from application of any of the methods set forth, being reasonably adjusted to the extent necessary to arrive at a value.¹⁴

As to transfer pricing valuation from a tax perspective, the following methods have been developed:

- *comparable uncontrolled price (CUP) method*: evaluates whether the amount charged in a controlled transaction is arm's length by reference to the amount charged in a comparable uncontrolled transaction;¹⁵
- *resale price method*: evaluates whether the amount charged in a controlled transaction is arm's length by reference to the gross profit margin realized in comparable uncontrolled transactions. This method measures the value of functions performed, and is ordinarily used in cases involving the purchase and resale of tangible property in which the reseller has not added substantial value to the tangible goods by physically altering the goods before resale;¹⁶

5. Robert T. Cole and Ralph H. Sheppard, "Customs Issues Arising Out of Transfer Pricing Compliance", *Practical Guide to US Transfer Pricing* (1999), at 25-4.

6. *Id.*, at 25-7.

7. Treas. Reg. Sec. 1.482-1(a)(3).

8. Treas. Reg. Sec. 1.482-1(a)(1).

9. 19 USC, Sec. 1401a(b)(1)

10. According to Sheppard and Cole, this method is analogous to the comparable uncontrolled price (CUP) method. See note 5, at 25-13.

11. 19 USC, Sec. 1401a(c).

12. 19 USC, Sec. 1401a(d).

13. According to Sheppard and Cole, this method is the customs equivalent to tax cost-plus method. See note 5, at 25-14.

14. 19 USC, Sec. 1401a(f).

15. Treas. Reg., Sec. 1.482-3(b).

16. Treas. Reg. Sec. 1.482-3(c).

- *cost-plus method*: evaluates whether the amount charged in a controlled transaction is arm's length by reference to the gross profit markup realized in comparable uncontrolled transactions. The cost-plus method is ordinarily used in cases involving the manufacture, assembly or other production of goods that are sold to related parties;¹⁷
- *comparable profit method*: evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances;¹⁸
- *profit split method*: evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss;¹⁹ and
- *unspecified methods*: any other method not specified may be used to evaluate whether the amount charged in a controlled transaction is arm's length, but must always be applied in accordance with the provisions of Sec. 1.482-1.²⁰

As stated above, a further examination of the various customs and tax methods is beyond the scope of this article. What is relevant for purposes of this article is to determine which method is applicable. In this regard, Treas. Reg. Sec. 1.482-1 provides for the well-known "best method rule", under which "the arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result". This provision goes on to expressly mention that "there is no strict priority of methods, and no method will invariably be considered to be more reliable than others". Therefore, "an arm's length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm's length result, such other method must be used".²¹

A completely different, and perhaps even contrary, approach is followed under the US customs valuation system, which has adopted a hierarchical approach with the transaction value as its linchpin. Only when one of the methods fails to properly achieve a transfer price for customs purposes, may the importer use the next method in the hierarchical sequence.

With regard to the valuation of transactions among related parties, Sec. 1401a(b)(2)(B) of 19 USC, specifies certain conditions that must be met in order to use the transaction value, as it will be acceptable only if an examination of the circumstances of the sale of the imported merchandise indicates that

- the relationship between the buyer and seller did not influence the price actually paid or payable; or,
- the transaction value of the imported merchandise closely approximates (1) the transaction value of

identical merchandise, or of similar merchandise, in sales to unrelated buyers in the United States or (2) the deductive value or computed value of identical merchandise or similar merchandise, but only if each value referred to in (1) or (2) 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.²²

Thus, this scenario may force an importer/taxpayer to apply two different methods and determine two different values: one for tax purposes, and another for determining customs duties. This is clearly burdensome, time consuming and expensive for the controlled parties affected, and may lead to differing values for the same imported tangible goods, which in turn may cause the importer to incur higher customs duties and tax liability.

*Ross Glove Co. v. Commissioner*²³ and *Brittingham v. Commissioner*²⁴ are the two most notable cases regarding this issue. In *Ross Glove*, the IRS took the position that customs valuations were not reliable and did not provide an arm's length price for tax purposes. The Tax Court rejected this argument, holding that because the methods adopted by the Customs Service and the IRS were quite similar, the markups used by the Customs Service to compute the value of gloves purchased from a related party were deemed to be adequate for determining the arm's length price for Sec. 482 purposes. The Court found that the customs valuation was the "best evidence available as to amounts that a seller would receive to cover overhead and profit in an arm's length sale".²⁵

In *Brittingham v. Commissioner*, the IRS subsequently sought to base the transfer price on the customs valuation. This resulted in a lower cost of the relevant imported items, greater profit margins and higher tax liability. However, the Tax Court held that the valuation by the Customs Service was not indicative of an arm's length price. The Tax Court upheld the taxpayer's argument that it had paid a higher price for the goods (tiles) than the value reported to the Customs Service (as the Customs Service had applied valuation information regarding a lower quality tile). Thus, the Tax Court stated that the customs valuation was based on an erroneous assumption that a competitor's product was similar.

3. The "Whipsaw Effect" and the Enactment of Sec. 1059A

The decisions in *Ross Glove Co. v. Commissioner* and *Brittingham v. Commissioner*, that examined the overlap

17. Treas. Reg. Sec. 1.482-3(d).

18. Treas. Reg. Sec. 1.482-5.

19. Treas. Reg. Sec. 1.482-6.

20. Treas. Reg. Sec. 1.482-3(e).

21. Treas. Reg. Sec. 1.482-1(c).

22. 19 USC, Sec. 1401a(b)(2)(B).

23. 60 T.C. 569 (1973).

24. 66 T.C. 373 (1976).

25. 60 T.C. 569 (1973).

between tax and customs issues, opened the door for taxpayers to declare different values for customs and tax purposes – a practice that is known as “whipsawing”. This term refers to the process by which a taxpayer uses different valuations for customs and tax purposes in an attempt to minimize the overall amount owed to the government.²⁶ Indeed, the Senate Finance Committee expressed its concerns regarding this issue:

The committee understands that some importers may claim a transfer price for income tax purposes that is too high to be consistent with the transfer price claimed for customs purposes.

[...]

The committee is particularly concerned that such practices between commonly controlled entities may improperly avoid US tax.²⁷

As a result, as part of the Tax Reform Act adopted in 1986, Congress enacted Sec. 1059A,²⁸ which provides as follows:

If any property is imported into the United States in a transaction (directly or indirectly) between related persons (within the meaning of section 482), the amount of any costs:

- (1) which are taken into account in computing the basis or inventory cost of such property by the purchaser; and
- (2) which are also taken into account in computing the customs value of such property,

shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.²⁹

According to the Joint Committee on Taxation, by enacting Sec. 1059A:

Congress was concerned only with establishing a limit on the price an importer could claim for income tax purposes. (...) Customs value (as appropriately adjusted) provides a ceiling on transfer price valuation for income tax purposes, it does not provide a floor on that valuation.³⁰

Thus, in the case where a US importer purchases goods from a foreign affiliate, Sec. 1059A merely prevents the US importer from claiming a transfer price for US income tax purposes that is higher than would be consistent with the value claimed for customs purposes. It has been pointed out that Sec. 1059A has erroneously been interpreted by many importers to require the tax basis and customs value to be equal.³¹ This, undoubtedly, was not the approach taken by Congress, which acknowledged the existing differences between the tax and customs valuation regimes.

In order to understand how Sec. 1059A is applied, it is important to bear in mind that this provision has a rather narrow focus, namely to prevent the government from being whipsawed by an importer on property acquired from a related party, by claiming a low valuation for customs purposes and a higher valuation for tax purposes.³² Therefore, this provision has no application to:

- property not imported from a related party;
- property not subject to customs duty;
- property not subject to an ad valorem customs duty;
- the portion of an item that is a US good returned and not subject to duty;³³
- property subject to a zero rate of duty;³⁴ and

- property subject only to the user fee³⁵ or the harbour maintenance tax.³⁶

Treas. Reg. Sec. 1.1059A-1(c)(2) specifies the adjustments to be performed to the customs value in order to determine the limitation on a claimed basis or inventory cost of property for tax purposes. The taxpayer may increase the customs value by the costs it has incurred for freight charges; insurance charges; the constructions, erection, assembly or technical assistance provided with regard to the property after its importation into the United States; and any amounts which are not taken into account in determining the customs value, which are not properly includible in customs value and which are appropriately included in the cost basis or inventory for income tax purposes.³⁷ Although this provision is straightforward, there are certain aspects, such as the notion of assistance, that have been quite controversial.

4. Problems Arising from Application of Customs Rules and Sec. 1059A

Under Treas. Reg. Sec. 1.1059A-1, when there is an inbound transfer of tangible property between related parties, the taxpayer is bound by the ultimately determined customs value and by any final determination made by the Customs Service.³⁸

The customs value is deemed to be final when the liquidation of the entry of the imported good is final, which will take place 90 days after notice of liquidation is issued if the importer does not file a protest. If the importer does file a protest, the customs value will be deemed to be final when a decision by the Customs Service on the protest is not contested after expiration of the period allowed for doing so, or when judgment of the Court of International Trade becomes final. In either case, it seems at first glance that the customs value sets an upper limit on the basis or inventory cost of the imported items. Nevertheless, the statute and underlying regulations do not envisage every fact pattern, giving rise to a gap in the legislation, which has caused great uncertainty for taxpayers. Consequently, the experience gained with the application of the rules has led to the issuance of administrative documents and notices by the

26. Suzanne I. Offerman, “The Effect of Customs Reconciliation on Taxable Income”, 25 *Brooklyn Journal of International Law* 693 (1999), at note 170.

27. S. Rep. No. 313, 99th Cong. 2nd Sess., at 418-419 (1986).

28. The Treasury Department further developed Sec. 1059A in 1989 by issuing a set of regulations, Treas. Reg. Sec. 1.1059A.

29. Sec. 1059A(a).

30. Staff of Joint Committee On Taxation, 99th Cong. 2d Sess., “General Explanation of the Tax Reform Act of 1986”, at 1062 (1987).

31. See note 2, at 129.

32. IRS National Office Technical Advice Memorandum, published as Private Ruling 9301002 (10 July 1992). Available at www.unclefed.com/GAOReports/ggd94-61.pdf.

33. 19 USC, Sec. 1202.

34. Id.

35. 19 USC, Sec. 58(c).

36. 19 USC, Sec. 4461.

37. Treas. Reg. Sec. 1.1059A-1(c)(2)(iv) refers to Sec. 263A and Treas. Reg. Sec. 1.471-11, which contain the absorption rules for inventory.

38. Treas. Reg. Sec. 1.1059A-1(d).

IRS, the Customs Service and other administrative bodies in order to provide guidance and answer the needs of taxpayers. In some cases, the position adopted has favoured the government, while in others the taxpayer that has taken a bigger piece of the pie.

The analysis below will focus on some of the problems that arise from implementation of customs provisions, which, as noted above, will determine the transfer price for customs purposes, upon which the limitation under Sec. 1059A will be computed. Close scrutiny will be given to the loss of tax revenue generated by direct payments. The treatment of royalties and fees for customs and tax purposes will also be considered. Finally, the effect that Sec. 1059A has on the self-help rule contained in Treas. Reg. Sec. 1.482-1(a)(3) will be discussed.

4.1. Direct payments

On 10 July 1992, the IRS issued Technical Advice Memorandum 93-01-002 regarding the application of Sec. 1059A.³⁹ In this document, the IRS National Office analysed the tax treatment for Sec. 1059A purposes of certain expenses paid by the taxpayer on behalf of a foreign manufacturer (the taxpayer’s subsidiaries in Mexico, also known as *maquiladoras* or *maquilas*) and which were not taken into account in the books and records of the foreign manufacturer. The expenses for which the taxpayer pretended to take deductions (which were not reflected in the books of the *maquiladoras*, but should have been included in the cost basis of the products) included accounting and legal expenses, automobile expenses, telephone expenses, depreciation, dues and subscriptions expenses, employee benefits expenses, equipment rental expenses, freight expenses, general insurance expenses, office supply expenses, outside service expenses, rent expenses, supplies and tools expenses, repairs and maintenance expenses, taxes and licence expenses, advertising expenses and entertainment and travel expenses. In addition, these were not included in the dutiable value for customs purposes. The totality of these circumstances, considered in light of Sec. 1059A, caused the IRS to disallow the deductions under Sec. 162 and reallocate them to the *maquiladoras* under Sec. 482.

The products manufactured by the *maquiladoras* and imported into the United States were appraised under the computed value method. The National Office evaluated the nature of the expenses incurred by the taxpayer in order to determine if they could be considered “assists”, (which is one of the factors taken into account under the computed value method in order to obtain a value for customs purposes) under Sec. 1401a(e)(1). The National Office requested advice from the Customs Service, which responded that “general, administrative and overhead expenses are not assists”.⁴⁰ In its conclusions, the IRS explained that:

since the expenses when paid by the importer do not appear on the books of the maquilas, Customs has little authority to increase dutiable value by the amount of the expenses. This is true even though the US importer is paying on the foreign manufacturer’s behalf what are normally considered general, admin-

istrative, and overhead expenses, includible in a manufacturer’s cost basis.”⁴¹

In summary, the expenses at issue did not constitute assists.

The National Office argued that the Sec. 1059A ceiling could be increased by the expenses, which were not required to be included in the customs valuation, and which are properly included in the cost or inventory basis for federal tax purposes.⁴² Thus, the Technical Advice Memorandum clarifies that Sec. 1059A cannot prevent US taxpayers from taking into account certain expenses in the taxpayer’s cost or inventory basis for tax purposes.

The position adopted by the IRS seems sound and logical, since Sec. 1059A cannot constitute a tool to discourage direct payments by US taxpayers to foreign companies. However, there is an adverse consequence to this interpretation, which consists in the loss of tax revenue to the detriment of the government, which is analysed in the Report issued in 1994 by the US General Accounting Office (GAO)⁴³ regarding the enforcement of Sec. 1059A by the IRS.

By providing a fact pattern and analysis involving a *maquiladora*, the GAO demonstrates how the payment of part of the expenses of a foreign related party (the *maquiladora*) by the US company (the US parent) results in a decrease of the customs duties collected. Although the entire example will not be reproduced here, the key conclusions will be indicated. Basically, through the transactions described below, in the aggregate the US parent obtains customs and tax advantages that would not arise if the foreign subsidiaries paid their own expenses.

Briefly, the facts described in the *maquiladora* example are as follows:

- the US parent has a Mexican *maquiladora* under a cost-plus contract that pays 5% of total costs;
- the total expenses of the *maquiladora* amount to USD 20 million (USD 10 million of which are dutiable expenses incurred in Mexico);
- the US parent is able to pay half of the amount of dutiable expenses (i.e. USD 5 million) on behalf of the *maquiladora* and deduct the same amount for US tax purposes;
- the *maquiladora* does not declare dividends;
- the Mexican corporate income tax rate is 35%, while the maximum US income tax rate is 34%; and
- the customs duty rate on the imports of the *maquiladora* is 4%.⁴⁴

.....
 39. See note 32.
 40. Id., at section 3 of the Discussion.
 41. Id.
 42. See note 32, at section 1 of the Discussion.
 43. US General Accounting Office, “International Taxation: IRS’ Administration of Tax-Customs Valuation Rules in Tax Code Section 1059A” (4 February 1994).
 44. Id., at 45.

The GAO report sets forth two scenarios. Under the first, the foreign company (the *maquiladora*) pays its expenses, while under the second, the US parent incurs USD 5 million for the expenses of the foreign company.⁴⁵ The GAO report also presents data in table form to facilitate a comparison of the results of both scenarios:

	<i>maquila</i> pays its own expenses (USD)	US parent pays USD 5 million of <i>maquila</i> expenses	variance (USD)
US government			
duties	440,000	230,000	-210,000
US tax	2,570,400	2,726,800	156,400
total US revenues	3,010,400	2,956,800	-53,600
foreign government			
foreign tax	350,000	262,500	-87,500
net income of the two related parties			
US parent	4,989,600	5,293,200	303,600
<i>maquiladora</i>	650,000	487,500	-162,500
combined net income	5,639,600	5,780,700	141,100

The results of the *maquiladora* example in the GAO report are as follows:

- the US government decreases its customs duties revenue by 47%, as the USD 5 million expenses incurred by the US parent no longer are part of the import value;
- the US government increases its tax revenues by 6%, but the overall payment is lower because the additional US tax was less than the loss derived from customs duties;
- as for the Mexican government, its tax revenue is also reduced by 25%, as the price paid by the US parent for the products is lower. In addition to this tax benefit in this case, the company as a whole might be obtaining additional benefits from assembling the products in Mexico (e.g. lower wages and non-existent or poorly enforced environmental regulations); and
- the company increases its net profit by 2.5%.

An overall advantage would still be achieved if there were no customs duties imposed on the imported merchandise.⁴⁶

As can be seen in the following table, and assuming the same facts as in the baseline example except for the removal of customs duties for the goods imported from Mexico, the payment of part of the expenses by the US parent on behalf of the *maquiladora* would still lead to an overall increase in net income, although in this case the US government would not be directly jeopardized.

	<i>maquila</i> pays its own expenses (USD)	US parent pays USD 5 million of <i>maquila</i> expenses	variance (USD)
US government			
duties	0	0	0
US tax	2,720,000	2,805,000	85,000
total US revenues	2,720,000	2,805,000	85,000
foreign government			
foreign tax	350,000	262,500	-87,500
net income of the two related parties			
US parent	5,280,000	5,445,000	165,000
<i>maquiladora</i>	650,000	487,500	-162,500
combined net income	5,930,000	5,932,500	2,500

This table indicates that the payment of USD 5 million by the US parent on behalf of the *maquiladora* reduces by 25% the amount of taxes paid to the Mexican government, as the income paid for the manufactured goods is also decreased. Although the revenue received by the US government is not affected, the truth is that in the aggregate, the company as a whole obtains better results, as it increases its combined net income.

The US imports goods from several countries, not only Mexico or Canada, which means that customs duties are an important consideration. These are simplified examples which are aimed at showing how direct payments by a US company to its foreign related parties can effectively alter the results obtained, not only for customs and tax purposes, but also for the company's own purposes. Although in some circumstances only the foreign government might be adversely affected in terms of lost revenue, the foreign tax authorities might adopt certain legal measures which could eventually impact the competitiveness of US companies in an international commercial context.

Finally, many other factors and data should be taken into account when analysing the reasons for and impact of direct payments by a US company to a foreign related company. The tax aspects to be considered include the disallowance of certain expense deductions in the foreign country, which would be taken by the US parent as a result of the direct payment; or the application of a lower tax rate. Moreover, as mentioned above, there are non-tax issues that might create an overall benefit for the company, such as reduced labour costs, less strict environmental regulations or more flexible labour conditions (which might imply the adoption of reduced security measures or the extension of working hours).

45. *Id.*, at Appendix I.

46. Under Annex 302.2(1) of the Agreement Establishing the North America Free Trade Area (NAFTA), tariffs on goods originating from Mexico were supposed to be eliminated immediately or over a five-, ten-, or fifteen-year period. It is thus still possible until 2009 to find goods from Mexico that have been subject to customs duties.

4.2. Royalties and fees

Another controversial issue involves royalties and fees, particularly with regard to the approach taken by the IRS in Field Service Advice (FSA) 200036015, which has had a significant impact for purposes of Sec. 1059A. In the case at hand, Corporation A and Corporation C are two sister companies, whose parent is Corporation B. Corporation C manufactured Product X and sold it to Corporation A for importation, resale, installation, repair, maintenance and upgrading. Corporation A paid the customs duties based on the amounts invoiced, which did not include the royalties and licence fees. These were separately paid to Corporation B by Corporation A under the terms of a separate agreement.

For the purposes of this article, there were mainly two issues raised. With regard to the first one, namely the treatment under customs provisions of the royalties and fees, the IRS stated that “the royalties or license fees should have been taken into account in the price actually paid or payable pursuant to Secs. 1401a(b)(1) and (b)(4)(A) 19 USC “. The IRS noted that the fact that the payments were made to a party related to the seller, instead of to the seller itself, was “immaterial” under Secs. 1401a(b)(1); 1401a(b)(1)(E) and 1401a(b)(4)(A) of 19 USC. Therefore, the customs value reported at the time of entry, which formed the basis for liquidation, was erroneous.⁴⁷

In this sense, it should be considered that Sec. 1401a(b)(1)(D) of 19 USC provides that the transaction value of imported merchandise, which is the “price actually paid or payable”, includes “any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly, as a condition of the sale of the imported merchandise for exportation to the United States”.⁴⁸ Therefore, if all conditions are met (i.e. the buyer is required to pay the royalties and fees as a condition of the sale of imported merchandise for export to the United States), royalties and fees are dutiable and, therefore, taken into account in order to calculate the Sec. 1059A limitation. Thus, the FSA concluded that the taxpayer had incorrectly failed to compute the royalties and fees in the dutiable amount. This had an impact on the Sec. 1059A limitation, as well as taxable income, as deductions could not be claimed for the royalties and fees paid.⁴⁹

The second and core issue here is whether a voluntary tender by the taxpayer would increase the dutiable value of the imported goods for purposes of the Sec. 1059A limitation. The taxpayer had made a voluntary tender, supposing that this would remedy the loss of duties that resulted from its original, erroneous reporting, thereby eliminating the existing abuse. The IRS broadly considered when an import entry becomes final for the Customs Service, as well as those circumstances which might lead to an adjustment of the customs value.

As the significance of the term “liquidation” has already been made clear, one must bear in mind those events that might create a change in the value for customs pur-

pose. The FSA cites Treas. Reg. Sec. 1.1059A-1(d), which specifies three post-liquidation circumstances that may give rise to an change in the liquidated value for customs purposes:

- a decision issued by the Court of International Trade;⁵⁰
- a voluntary reliquidation by the Customs Service within 90 days of the original liquidation to correct errors in valuation, classification or any element related to a liquidation or reliquidation;⁵¹ and
- reliquidation⁵² in order to correct a clerical error, mistake of fact or other inadvertence within one year of a liquidation or reliquidation.

The IRS concluded that the taxpayer’s position regarding the effects that the voluntary tender should imply, had “no support in the statutory provisions governing liquidation or voluntary tenders, or in the language of Treas. Reg. Sec. 1059A-1”.⁵³ Thus, in this regard, the IRS concluded that “the importer’s post-liquidations did not increase the dutiable value from that determined upon liquidation”,⁵⁴ and would not be taken into account for computing the Sec. 1059A limitation.

The FSA caused great dismay among practitioners, who made clear the need to update tax and customs provisions regarding transfer pricing values of tangible goods. Hence, a simplified example of the situation that could arise would be as follows. The importer/taxpayer declares a value of USD 50 for customs purposes. After liquidation of the import entry, it is ascertained that the correct price should have been USD 60. The importer/taxpayer pays customs duties for the USD 10 of understated value. Nevertheless, the importer/taxpayer will not obtain an adjustment for purposes of the Sec. 1059A limitation. Therefore, the voluntary payment of additional customs duties has a relevant effect only of reducing the potential customs penalties that might have arisen due to the calculation error made by the importer/taxpayer.⁵⁵ This is a clear instance in which the position of the taxpayer is significantly disadvantaged from both a tax and customs perspective. In addition, it is also an example of a fact pattern in which the use of a determined customs valuation method would have avoided the described result.

In the author’s opinion, under these circumstances, the use of the computed value method, instead of the transaction value, would have prevented this problem from arising. As explained in a letter dated 27 July 1993 from the Commissioner of Customs to the GAO,⁵⁶ to deter-

47. FSA, at 10.

48. 19 USC, Sec. 1401a(b)(1).

49. FSA, at 17.

50. 19 USC, Sec. 1503.

51. 19 USC, Sec. 1501.

52. 19 USC, Sec. 1520(c)(1).

53. FSA, at 14.

54. FSA, at 3.

55. 19 USC Sec. 1592.

56. This letter is included as Appendix XI in the US GAO report. See note 43.

mine the price under the transaction value approach, the Customs Service does not use the books and records of either party to appraise the merchandise, whereas in the case of the computed value methodology, the Customs Service must use the data as stated on the manufacturer's books. Amounts paid as royalties and fees would undoubtedly be reflected on the books of both parties, and it is more likely than not that they would have been taken into account in the price of the imported goods.

4.3. Is the taxpayer-initiated transfer pricing adjustment rule in Treas. Reg. Sec. 1.482-1(a)(3) deficient?

It is expressly stated in Treas. Reg. Sec. 1.1059A-1(c)(7) that neither Sec. 1059A nor its regulations "limits in any way the authority of the Commissioner to increase or decrease the claimed basis or inventory cost under section 482 or any other appropriate provisions of law". In addition, with the 1994 regulations, Congress introduced a provision known as the "self-help" rule, contained in Treas. Reg. Sec. 1.482-1(a)(3) and which allows taxpayers to initiate an adjustment under Sec. 482. Under Treas. Reg. Sec. 1.482-1(a)(3):

If necessary to reflect an arm's length result, a controlled taxpayer may report on a timely filed US income tax return (including extensions) the results of its controlled transactions based upon prices different from those actually charged. Except as provided in this paragraph, section 482 grants no other right to a controlled taxpayer to apply the provisions of section 482 at will or to compel the district director to apply such provisions. Therefore, no untimely or amended returns will be permitted to decrease taxable income based on allocations or other adjustments with respect to controlled transactions.

Thus, under the regulations, a subsequent transfer pricing adjustment for tax purposes will not trigger the limitation in Sec. 1059A if such an adjustment has been made under the authority of the IRS. Moreover, if all conditions are met, the taxpayer may also report less income than it actually earned if it is justified in order to comply with the tax provisions regarding transfer pricing. However, what happens if the taxpayer applies Sec. 482 and reports less income for merchandise imported and purchased from a foreign related party? Does the limitation set forth in Sec. 1059A apply?

One should bear in mind that the provision allowing taxpayer-initiated adjustments ('self-help rule') was adopted together with the 1994 regulations. This might be the reason why neither Sec. 1059A nor its underlying regulations provide for the possibility that adjustments may be made at the initiation of the taxpayer. Aware of the possible inconsistencies, the IRS declared that Sec. 1059A would be amended in order to harmonize the content of the existing provisions. Nevertheless, and to date, no action has been taken to reconcile Treas. Reg. Sec. 1.482-1(a)(3) with Sec. 1059A. Faced with this situation, one must enquire whether, in the case of inbound transfers of tangible goods between related parties, in the case where Treas. Reg. Sec. 1.482-1(a)(3) cannot be invoked, certain taxpayers would be deprived of this right.

As a basic premise, when a related-party transaction involves importation into the United States of items or tangible goods subject to duty, the taxpayer must take into account the customs conformity limitation under Sec. 1059A. There are two ways in which the taxpayer may apply Sec. 482:

- invocation of Sec. 482 to adjust downwards the transfer price for tax purposes. This will automatically increase the taxpayer's taxable income. Sec. 1059A would not be triggered in this case, as it sets an upper limit, not a lower limit, on the basis or inventory cost for the imported merchandise. Therefore, no Sec. 1059A limitation conflict will arise when the taxpayer applies Treas. Reg. Sec. 1.482-1(a)(3) to reduce the price and comply with Sec. 482 (unless the results initially obtained by the taxpayer were already within the arm's length range). Nonetheless, neither the statute or the regulations, nor case law or tax literature⁵⁷ have clearly resolved whether under these circumstances, the Customs Service should redetermine the customs duties for the imported goods and refund the overpayment. From the examination of the customs provisions, it is unlikely that the Customs Service would adopt such a position. As explained above, there are only three post-liquidation events that may imply a change in the liquidated value: (1) a final decision of the Court of International Trade overturning the denial by the Custom Service of a customs protest with regard to valuation, (2) voluntary reliquidation within 90 days of the liquidation in order to correct errors in the liquidation and (3) reliquidation within one year of liquidation to correct an error, mistake of fact or other inadvertence.⁵⁸ The self-compliance adjustment by the taxpayer under Treas. Reg. Sec. 1.482-1(a)(3) does not fall under any of these three exceptions. Therefore, there is no statutory or regulatory authority to decrease the price for customs purposes and grant a refund of excess duties paid, once the liquidation is final; or
- invocation of Sec. 482 to adjust upwards the transfer price for tax purposes. In this scenario, Sec. 1059A might be triggered. This adjustment would result in a higher basis or inventory cost than that declared to the Customs Service. In this case, Sec. 1059A will prevent a reduction of taxable income.⁵⁹

For this reason, it can be firmly stated that, as Sec. 1059A and its regulations are currently written, certain taxpayers are left with virtually no right to apply the self-help rule contained in Treas. Reg. Sec. 1.482-1(a)(3). Taxpayers engaged in inbound transfers of merchandise with

57. See note 5, at 25-31.

58. See FSA.

59. IRS Rev. Proc. 99-32, (on the adjustment of a taxpayer's accounts to reflect Sec. 482 allocations) states that "if the adjustment results in a decrease in the taxable income (after appropriate accounting for Sec. 1059A of the Code), the arm's length result may be reported on a timely filed return (including extensions)" (emphasis added). This supports the thesis that the Sec. 1059A limitation does not apply when the change resulted in an increase of the transfer price. Available at www.irs.gov.

related parties subject to customs duty would be restricted from claiming an adjustment that increases the transfer price for tax purposes over the computed Sec. 1059A limitation.

5. Alternatives to Unify Tax and Customs Regimes

5.1. Generally

Many efforts have been made to reconcile the existing divergences between tax and customs provisions, especially with regard to Sec. 1059A. Some of the more notable efforts have been the Mutual Assistance Agreement established in 1992, which is designed to facilitate communication and cooperation between agencies; and the exchange of information between the IRS and the Customs Service; as well as the customs reconciliation programme; and the APA programme involving the IRS and Customs Service. The feasibility of amending the tax and customs statutes will also be considered below.

As for the increasing practice of the IRS and the Customs Service regarding the exchange of information, it can go in either direction. However, the IRS is subject to certain restrictions when releasing information to the Customs Service.⁶⁰ On the other hand, there are no limitations on the information that the Customs Service may share with its sister agency, which it is provided through the Customs' Outlier Analysis Targeting System. As asserted by the IRS,⁶¹ the use of customs data is becoming a more general resource in the transfer pricing compliance efforts of the IRS. This close cooperation between the IRS and the Customs Service facilitates compliance with Sec. 1059A, as well as a more consistent application of the customs and tax provisions.

5.2. Customs Reconciliation Programme

The reality of modern international trade is that many components of a transaction may be undeterminable at the time the merchandise enters the United States.⁶² Aware of this, the Customs Service and the Border Protection Service announced in 1995 that they would bring into operation a customs reconciliation programme. This project was based on the Mexican experience with this issue. In 1998, this reconciliation programme was implemented as the Automated Commercial System Reconciliation Prototype (ACS Reconciliation) and was scheduled to apply for two years. However, in September 2000, ACS Reconciliation was extended indefinitely.

Reconciliation allows an importer to revise certain elements of a summary entry that were indeterminable at the time the merchandise entered the United States.⁶³ Therefore, in the case of related-party importers, this programme would allow for an upward adjustment to the price of the merchandise in cases where, at the time of entry into the United States, the importer would not have all the requisite information needed to establish the correct price of the goods. The adjustments would be limited to elements such as value (e.g. assists, royalties,

computed value, or indirect payments), the HTS of the US Heading 9802, classification and eligibility under the NAFTA.

Schematically, the ACS Reconciliation has two parts. The first step involves flagging the entry summaries, whether on an entry-by-entry basis or using the blanket application. This takes place where, at the time the importer files the entry summary, important factors are undetermined or unknown. When the entry summary is flagged, the Customs Service receives a notice of intent to file reconciliation. Nevertheless, at the time of entry, the importer must use the "reasonable care" standard and estimate the declared value of the merchandise, as "reconciliation cannot be used to defer compliance obligations".⁶⁴ The second step is to file reconciliation when the relevant and correct information required is finally available. This must be done within 15 months of the earliest entry summary date.⁶⁵ Afterwards, the reconciliation will be liquidated and payment of duties, taxes and interest will be due, or the taxpayer may request a refund, as the case may be.

The ACS Reconciliation is thought to be one of the main tools that can be used to ameliorate harsh effects of the current system, as it allows the taxpayer to declare "unknown cost at a later date for Customs purposes and reflect that increased cost for tax purposes without risk of noncompliance",⁶⁶ nor risk of triggering Sec. 1059A.

As already discussed, under Sec. 1059A the taxpayer is bound by the declared customs value as finally determined, i.e. when the liquidation of the entry becomes final. Unless a protest is filed, this usually happens 90 days after the Customs Service has issued the notice of liquidation.⁶⁷ The ACS Reconciliation defers liquidation of the customs value to a later time (a minimum of 15 months of the earliest entry summary date), which provides the importer with additional time and means to establish an accurate and correct transfer price for tax purposes, and reconcile it with the price to report to the Customs Service. The taxpayer will not be subject to the limitation of Sec. 1059A, as the value for customs purposes would not yet be final as a consequence of having filed reconciliation. Moreover, the taxpayer would not bear the risk of penalties for non-compliance or violation of tax or customs provisions.

Obviously, the ACS Reconciliation does not cover every fact pattern, and therefore might not provide the expected relief and advantages to every taxpayer. It is

60. 19 USC, Sec. 6103(1)(14) and regulations thereunder.

61. US Department of the Treasury, IRS, "Report on application and administration of section 482" (1999), at 2. Available at www.irs.gov.

62. For further information, see www.cpb.gov.

63. US Customs Service, Office of Field Operations Trade Programs Reconciliation Team, *ACS Reconciliation Prototype: A Guide to Compliance* (2002), at 7.

64. Donald Fischer, "Reconciling Data for US Customs", *Journal of Commerce* (28 July 1999), at 12.

65. The reconciliation is due within 12 months of the earliest entry import date in the case of NAFTA Reconciliation.

66. See note 26, at 728.

67. Robert Feinschreiber, *Transfer Pricing Handbook* (2001), at 83-11.

possible that the IRS, under Sec. 482, will carry out adjustments to the transfer price reported by the importer for tax purposes once the customs value has become final, after filing reconciliation. If such a change implies a downward adjustment to the transfer price, there is uncertainty as to whether the Customs Service would grant the importer a refund for the overpayment of customs duties.

5.3. Advance pricing agreements

The establishment of a system where both the IRS and the Customs Service participate in the negotiation of APAs would definitely constitute a step forward in achieving a more cohesive and consistent regime for all transfer pricing purposes. Moreover, and from the perspective of the importer/taxpayer, it would provide greater certainty with regard to their inbound transactions with related parties.

The first move towards this goal was a ruling issued by the Customs Service on 30 August 2000.⁶⁸ The importer requested a ruling regarding the acceptability of the transfer prices paid by the importer for merchandise imported from related party suppliers. In this case, the importer had simultaneously applied to the IRS and the Customs Service in order to negotiate an APA. The importer also requested the participation of a member of the Customs Service during the APA pre-filing conference, which provided the Customs Service with access to information regarding the selection of the tested party, how the comparable companies were selected, the determination of financial results related to the controlled transactions, the selection of the years for comparison, what accounting adjustments were made to the financial statements of the comparable companies and the tested party, the selection of the most reliable profit level indicator, the capital adjustments and the use of interquartile range.

Customs issued a ruling favourable to the taxpayer and stated that the taxpayer could declare values for the imported goods (from related-party transactions) based on prices established in the bilateral APA. Furthermore, if any additional compensating adjustments had to be performed, the Customs Service would have to be immediately informed and the corresponding duties satisfied.

Thus, under these circumstances, the Customs Service concluded that it would not be necessary to provide further information because the importer would operate according to the APA negotiated with the tax authorities (not only in the United States, but also with the Japanese tax authorities). Moreover, the Customs Service concluded that:

Our review of the information, including attending the APA pre-filing conference and review of information submitted to the IRS pursuant to the waiver referenced previously, allows us to conclude that we have examined the relevant aspects of the transaction, including the way in which the Importer and its related suppliers organize their commercial relations, as well as the way in which the price in question was arrived at between the parties. Based on this review we hold that the Importer has

demonstrated that the price has not been influenced by the relationship for purposes of the circumstances of the sale test. Thus, transaction value is the proper basis of appraisal for the related party transactions.⁶⁹

This was a pioneering case in which the Customs Service granted certainty to the importer/taxpayer with regard to both the transfer price and customs valuation, thereby allowing the taxpayer to avoid further customs examinations and corresponding adjustments, as well as penalties.⁷⁰

This project obviously demands a great level of cooperation between the two main agencies, as well as taxpayer. Nevertheless, for many practitioners, this APA process, which serves as a forum for tax and customs purposes, constitutes a workable answer to the current complications arising in cross-border transactions with related parties.

However, there are some concerns regarding this approach. First, doubts have widely been cast on whether the Customs Service has the required authority or the appropriate resources to enter into APAs with taxpayers. In this regard, in July 2004 the Customs Service issued a ruling that might imply a step forward in its receptiveness to accept the applicability of transfer pricing rules when certain requirements are met.⁷¹

Also, the fact that not all importers have access to an APA programme or have the necessary resources to enter into one must be considered. It is widely known that, despite the advantages that the programme offers, it is expensive and requires a great amount of time. Participation in APA negotiations by the Customs Service would definitely be positive, but would also slow the process of trying to reach a consensus among the different parties.

More controversial are the fears shared by taxpayers. According to these, when pursuing a joint IRS-Customs APA, a great amount of information must be provided to the Customs Service which would not be protected under Sec. 6103 of 19 USC, and therefore, might be disclosed to third parties by the Customs Service.⁷² This uneasiness has also been expressed by the IRS.⁷³

68. US Customs Service Ruling HQ 546979 (30 August 2000). Available at www.cbp.gov.

69. Id., at the section 'Law and analysis'.

70. Some practitioners believe that the additional advantages achieved by a joint IRS-Customs APA would imply very little additional costs. See Steven C. Wrappe, Damon Pike and Kerwin Chung, "Joint APA Efforts Signals New Levels of IRS-Customs Coordination", 15 *Tax Management Transfer Pricing Report Analysis* 9 (29 November 2000), at 549.

71. For further information, see Damon V. Pike, "Customs Ruling Setback for Efforts to Further Harmonize Customs Valuation, Transfer Pricing Rules", 13 *Tax Management Transfer Pricing Report Perspective* 19 (16 February 2005), at 1013.

72. Dennis I. Meyer and William D. Outman, "US Tax and Customs consequences of dealing with a related foreign supplier", 13 *Journal of International Taxation* 1 (2002), at 16.

73. See Molly Moses, "Fairness, Faster Execution Urged in Second APA Program Hearing", 13 *Tax Management Transfer Pricing Report* 20, at 1023.

6. Customs or Tax Law Reform?

As a corollary, some documents referred to in the GAO Report⁷⁴ are worth noting. Particularly, the comments issued by the IRS and Customs Service regarding the possibility of amending either the tax or customs provisions affecting transfer pricing, are indeed worth discussing.⁷⁵ These documents arose from the case analysed in the GAO Report regarding the enforcement of Sec. 1059A with regard to direct payments by a US related party (discussed above). Such direct payments would create serious financial damages and would lead to undesired results due to the differences in application of the pricing and valuation methodologies. The GAO Report specifically analysed the fact pattern characteristic of Mexican *maquiladoras*.

The GAO Report suggested two alternatives for solving the existing inconsistencies regarding the issue examined, namely “a multilateral negotiation of the Customs Valuation Code of GATT, or the unilateral amendment of either Sec. 1059A of the [Code] or Sec. 1401a of the Customs legislation.”⁷⁶ It is worthwhile to briefly discuss the concerns expressed by both agencies regarding these alternatives, as adopting one or the other could indeed bring both regimes closer for transfer pricing valuation purposes. The IRS asserted that, under the facts stated, the problem addressed by the IRS Technical Advice Memorandum⁷⁷ was not the consequence of applying the tax provision, but was due to a “loophole in customs law.”⁷⁸ Therefore, it was a responsibility of the Customs Service to amend the customs law in order to modify the content of certain terms. In-depth analysis of the Customs Service is not warranted here because there are major obstacles to undertaking an amendment of the customs provisions.

Sec. 1401 implemented the Customs Valuation Code⁷⁹ adopted in the Tokyo Round, and which had as its precedent Art. VII of the General Agreement on Tariffs and Trade (GATT). The Customs Valuation Code later became the Agreement on Customs Valuation, which is a multilateral agreement on Trade in Goods adopted during the Uruguay Round and included in Annex 1A of the Agreement establishing the World Trade Organization (WTO). Given its multilateral character, taxpayers must abide by its decisions regarding customs valuations and it may only be amended through consensus of all the contracting parties. Besides, infringement of its rules may give rise to disputes before the Dispute Settlement bodies of the WTO and eventually to suspension of concessions (i.e. retaliation) to US exports.

Undertaking an amendment of the customs law could place US valuation legislation in conflict with the Customs Valuation Code,⁸⁰ with all the consequences that would bring with it. Therefore, this would not be a feasible alternative. Nor would be the renegotiation of the Customs Valuation Code, which is not on the table of the WTO Doha Round and which would require approval of all the contracting parties in the WTO.

It is clear from this discussion that there are significant reservations on the part of the agencies and major obstacles to addressing any reform that improves the valuation system and brings the tax and customs regimes closer together. However, it is certainly true that undertaking a reform of the customs legislation would necessarily have a broad international scope, as it would involve different countries and supranational institutions, such as the WTO, the European Union and the World Customs Organization.

7. Conclusion

There is a growing concern in the international arena, in both the public and private sector, regarding the burden that arises in a transfer pricing context from having to deal with two different sets of rules issued by two different administrative agencies, namely the IRS and the Customs Service. A significant example of the increasing importance of harmonization of the tax and customs regimes is the joint conference held by the World Customs Organization and the OECD on 3 and 4 May 2007 in Belgium. At that time, representatives from both fields addressed the feasibility of achieving a greater level of convergence of transfer pricing and customs valuation rules.

This article has explored the main features of both systems in the United States, including the complications that arise when they interact due to the disconnect between transfer pricing and customs valuation. The effect of Sec. 1059A has been analysed, which, far from being a bridge between the different tax and customs provisions, in some circumstances has created more financial damages and has cast doubts on its application. Also, it has been revealing that while Sec. 1059A prevents the taxpayer from benefiting from reporting inconsistent values for tax and customs purposes, it does not impose any restrictions on the government.

To date, none of the efforts undertaken by the IRS or the Customs Service in order to overcome these inconsistencies have been completely satisfactory. This is not unusual if one considers the reality underlying all these proposals, namely the existence of a dual system that governs inbound transaction between related parties – two regimes with different scopes, goals, principles and methodologies.

74. See note 43.

75. Id., at Appendix VIII and IX.

76. Id., at 10.

77. See note 32.

78. Note 43, at 12.

79. The Customs Valuation Code was implemented through the Trade Agreements Act of 1979.

80. Note 43, at 56.

Harmonization of the tax and customs systems is a must. This harmonization process should not pretend to make both legal regimes identical or minimize the differences between them, as to do so would impair the main functioning of the laws. The aim of this harmonization process would rest in changing certain provisions and governmental regulations and practices in order to make both systems compatible and consistent among them. While the ACS Reconciliation programme or the creation of a joint IRS-Customs programme might constitute viable alternatives to unite the interests of taxpayers as well as those of the IRS and the Customs Service, none of these will really constitute an effective device for either the government or the taxpayer unless some legislative reforms are undertaken. To date, and for several years, all actions

taken have not worked properly due to the fact that they have been adopted outside the normative reality and isolated from the rest of the tax and customs provisions.

It is obvious that this is a difficult challenge. There are certain obstacles that might hinder achievement of the ultimate goal; many economic and political agents must take part in the process; and numerous political and economic considerations, from both a domestic and international perspective, must be carefully considered. Nevertheless, as Michel Danet, the WCO General Secretary, has said, the achievement “will impact favourably on national economic development and lead to prosperity and growth across the globe”.⁸¹

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81. OECD-WCO, Press Statement “International Conference on Transfer Pricing and Customs Valuation. Brussels, 22-23 May 2007”, 21 May 2007. Available at www.oecd.org.