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Year-End Tariff Mitigation and Customs Valuation Compliance Strategies

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Higher tariffs have increased costs for many businesses, with the auto, manufacturing, agricultural, technology, solar, and retail industries bearing the brunt of the upsurge. Year-end planning considerations for importers should include lessening tariff-related costs through potential duty mitigation strategies.

FY 20 year-end planning for many importers is expected to focus on strategies that lower their customs duty spend, increase available cash flow and enhance compliance with trade laws to avoid undue enforcement attention. This is particularly important in the current international trade environment characterized by high U.S. tariffs and retaliatory tariffs from U.S. trading partners, economic disruption from the COVID 19 pandemic, and heightened compliance scrutiny by U.S. Customs and Border Protection ("CBP").

The United States has imposed Section 301 tariffs (on imported goods of Chinese origin) and Section 232 tariffs (on global imports of steel and aluminum), ranging from 7.5 percent to 25 percent, on many imported goods in addition to normal duties. This has significantly affected U.S. importers by raising the costs of both imported finished goods and raw materials. In particular, the auto, manufacturing, agricultural, technology, solar, and retail industries are among the hardest hit by the tariffs.

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Thus, year-end planning discussions should include consideration of how to blunt the impact of Section 301 and Section 232 tariffs through potential duty mitigation strategies, including how to compliantly report, and potentially reduce, the customs value (or tariff basis) of imported goods.

Customs Valuation

Most customs duties, including Section 301 and 232 tariffs, are assessed on an *ad valorem* basis. Thus, determining the customs value of imported goods plays a significant role in determining an importer's duty spend. A few related issues discussed below should be considered.

Arm's Length Price

In transactions between unrelated parties, the customs value of imported goods is presumed to be undertaken at arm's length. However, between related parties, the seller's price must generally meet the "circumstances of sales" test or "test values" to be considered arm's length.

Under the *circumstances of sale* test, the transaction value between a related buyer and seller is acceptable if an examination of the circumstances surrounding the sale of the imported merchandise indicates that the relationship did not influence the "price actually paid or payable" for the imported goods. In this context, information provided to CBP in a tax transfer pricing ("TP") study (pursuant to IRC section 482) may be relevant in examining the circumstances of the sale, however, it is generally insufficient to satisfy customs arm's length requirements. This is because the customs legal requirements and methods to establish that import *transactions* are conducted at an arm's length are different from those found in IRC section 482.

Given the complexities involved with accurately declaring an acceptable customs value in related-party transactions, it is recommended that importers document the appropriateness of their customs valuation method in a customs "reasonable care" study. This study can assist the U.S. importer to ward off potential penalties and help to simplify responses in case of a CBP inquiry or audit.

Year-End Transfer Price Adjustments (Potential Duty Refunds)

Year-end compensating TP adjustments may trigger the obligation on importers to retrospectively report adjustments to the previously declared customs value of imported goods. Depending on the nature of the TP adjustment (upward or downward) and the impact on the "price actually paid or payable" by the importer for imported goods, the importer must either tender additional duties and related fees owed, or may be eligible for a refund for any overpayment of duties.

For instance, in situations in which an upward TP adjustment is made resulting in an additional payment by the importer to the related foreign seller, increasing the customs value, the importer generally must report the additional payment and allocate the payment on a pro rata basis over affected customs entries. The importer must also pay any additional duties owed on the increased value.

Similarly, with regards to downward TP adjustments, effectively resulting in a reduction in price or a rebate from the foreign seller to the related importer, the importer may be eligible for a refund of duties paid on the decreased value but only if the TP adjustment satisfies CBP's five-factor "formulaic pricing" test. Thus, companies should proactively ensure that they have the necessary facts and documentation to be eligible for a duty refund.

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When it is anticipated that companies will be making TP adjustments, importers should consider enrolling in CBP's *Reconciliation Program* to manage and facilitate the reporting of adjustments to CBP on an on-going basis. This may also enhance cashflow by expediting the refund of duties on eligible import transactions.

Shortfall/Maintenance Payments

Importers should also consider whether additional "shortfall" or "maintenance" payments made to manufacturers (related or unrelated) may be excluded from customs value. In related-party situations with a significant shortfall between anticipated production or ordered quantities and actual production (e.g., for the importer's failure to purchase the contracted number of products due to economic COVID-19 disruptions), it is possible that the underlying supply-side losses or operating "shortfalls" can be more aptly addressed through an additional payment unrelated to the imported goods rather than through a dutiable adjustment to the transfer price of imported goods.

Generally, the "shortfall" payments made by the importer/buyer to the manufacturer/seller would allow the manufacturer to recover certain fixed costs related to production underutilization, while potentially being treated as non-dutiable if certain conditions are met.

In addition, various other payments to the seller/manufacturer for goods not purchased are also not dutiable. Examples of potentially excludable payments include:

- Compensation for out-of-pocket expenses incurred due to the foreign seller's excess capacity, caused by a reduction in customer purchases
- Compensation for maintenance costs incurred by the seller for reserved but underutilized production capacity
- Payments for termination of supply contracts or cancellation of future purchase orders

Importers should thus evaluate whether their existing arrangements (i.e., written agreements, accounting records and the actions of the parties), currently support the exclusion of these payments from the customs value of imported goods, or whether additional action should be undertaken to support the exclusion on a go-forward basis.

Statutory Additions and Deductions

Year-end is also a good time to review all off-invoice payments and costs that may be related to imported goods but are not already included in the "price actually paid or payable." This is because there are potential additions or deductions to customs value that must be considered to comply with the customs valuation rules. Examples of these additions under the transaction value method include:

- Royalties or license fees related to imported goods that the buyer is required to pay, directly or indirectly, as a condition of the sale of the imported goods for exportation to the United States
- "Assists" supplied directly or indirectly, and free of charge or at a reduced cost, by the buyer of the imported merchandise for use in connection with the production or the sale for export to the United

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States of goods (e.g., materials, components, tools, molds, production consumables, engineering, development, design, etc.)

— Proceeds of any subsequent resale, disposal, or use of the imported goods that accrue, directly or indirectly, to the seller

— Selling commissions incurred by the buyer with respect to imported goods

— Packing costs incurred by the buyer with respect to imported goods

It can often be difficult for a company's customs compliance team to identify these costs unless there is intracompany coordination and communication with other functions or departments (i.e., procurement, legal, accounting, tax, etc.). For example, a product design "assist" supplied free of charge by the importer to the foreign seller/manufacturer would not generally be itemized on the seller's commercial invoice for imported goods and may require coordination with the R&D group. Similarly, a license royalty for IP that the importer pays to the foreign seller on an annual basis may appear on its general ledger of accounts but likely is not separately invoiced with the imported goods. In both these cases, it is important that the importer identify the potential addition to customs value, evaluate whether additional duties are owed thereon, and report the additional value to CBP in order to avoid potential customs penalties and fines.

The customs rules also provide that certain charges or costs—such as maintenance or technical assistance provided with respect to imported goods after importation, international freight or insurance, and customs duties and other federal taxes (including excise taxes) payable on the imported merchandise for reason of its importation—are excludable from customs value. Thus, importers should understand how product prices are determined and which of these costs, if any, may already be "baked" into the product price. It may be possible to back-out such costs and reduce the cost basis of the product on which the *ad valorem* duties are assessed.

Other Duty Mitigation Strategies

Given the potentially significant impact of the high tariffs in the current international trade environment, it is also important to understand what other duty mitigation opportunities are available to importers. Among the most significant opportunities are Section 301 exclusions, duty drawback, and use of the *de minimis* value exception.

Section 301 Exclusion

In imposing the Section 301 tariffs, the United States Trade Representative created a process by which importers could petition for the exclusion of their specific products from those duties. While the time period to file an exclusion request expired, importers may still take advantage of an exclusion that has been granted on a similar product to another importer. Thus, companies should review what exclusions have been granted for similar products that they import.

Duty Drawback

The customs drawback rules permit the recovery, or refund, of 99 percent of the duties, including Section 301 tariffs, originally paid on imported merchandise when subsequently exported from the

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United States. These rules apply to imported goods that are either incorporated into products manufactured in the United States subsequently exported (i.e., manufacturing drawback), or that are exported in the same condition as originally imported (i.e., unused merchandise or same condition drawback). The lengthy time period during which to file a drawback claim (i.e., five years from the import date) and recently simplified drawback process allowing for more generous application of the drawback rules may present new or broader duty refund opportunities than before.

De Minimis Value

Customs rules also provide for a duty and import tax exemption for any shipment of goods imported by one person on one day having a fair retail value of $800 or less. Coupled with the fact that more consumers are shopping on-line from home due to COVID-19, use of this exemption has increased direct business-to-consumer e-commerce import transactions given that importing and holding inventory in the United States has become more costly from a customs tariff perspective. Thus, the use of the *de minimis* exception for direct retail shipments to U.S. consumer from abroad should be kept top of mind when planning e-commerce and inventory strategies in order to reduce duty costs.

Conclusion

It is important for each importer to consider these compliance and cost-savings opportunities as part of their FY 20 year-end discussions and in their FY 21 planning. When multinational corporations are contemplating TP adjustments, modifications to or termination of existing supply or e-commerce arrangements, or reviewing the accuracy of their import values, there may be opportunities to obtain duty refunds or put in place a customs valuation strategy to mitigate import costs and enhance cash flow. The potential benefit can be significant, particularly for importers operating in industries hardest hit by the current high tariff levels.

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