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Treatment of Royalties and Transfer Price Adjustments in the U.S. and the EU

Who can learn from who – and how?

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Preface

September 2017 marked the beginning of a three-year journey to study Customs and Supply Chain Compliance topics. After completing ten modules related to IT, supply chain, logistics and customs I embarked on the detailed study related to aspects of customs valuation. Specifically, for my thesis, I have chosen to research the treatment and comparison of certain customs valuation elements in the United States and the European Union.

I would like to thank prof. mr. dr. de Wit and mr. drs. Zwitser for their supervision. I would also like to thank Erik Zietse and prof. dr. Robert Risse for their support during my studies and encouragement over the past three years.

I hope you enjoy reading my thesis.

Kathryn Bussey

September 10, 2020

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1.0 List of Abbreviations

WTO	World Trade Organization
ACV	Agreement on Customs Valuation
U.S.	United States
EU	European Union
C.F.R.	United States Code of Federal Regulations
UCC	Union Customs Code; European Parliament and Council Regulation (EU) 952/2013 of 9 October 2013 laying down the Union Customs Code [2013] OJ L269/1
UCC IA	Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code [2015] OJ L343/558
UCC DA	Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code [2015] OJ L343/1.
CCC	Community Customs Code
GATT	General Agreement on Tariffs and Trade
WCO	World Customs Organization
OECD	Organization for Economic Co-operation and Development
TPG	Transfer Pricing Guidelines
ECJ	European Court of Justice
APA	Advance Pricing Agreement
CBP	Customs and Broder Protection
CROSS	Customs Ruling Online Search System
ACE	Automated Customs Environment
ACS	Automated Commercial System
TCCV	Technical Committee on Customs Valuation
AES	Automated Export System
ICC	International Chamber of Commerce

2.0 Executive Summary

Multinationals conducting import activities must adhere to the applicable Customs Legislation in the country of import. When goods are imported into a customs territory, they are subject to specific formalities set forth by the respective importing customs territory. One of the particular requirements upon importation of goods, is the proper appraisement for customs valuation purposes conforming to the presiding customs legislation.

In accordance with the World Trade Organization (WTO) Agreement on Customs Valuation (ACV), all imported merchandise is subject to appraisement. The ACV sets forth the rules for appraisement of imported merchandise of which WTO member states must implement into their national customs legislation. Furthermore, the ACV requires that importers use reasonable care in their valuation of imported goods and provide additional information as necessary to enable customs to correctly calculate duties, collect accurate statistics, and determine whether any other applicable legal requirements are applicable.[1]

In an effort to provide guidance to WTO member states, the ACV puts forth (6) different methods of appraisement for customs purposes and their order of preference. The preferred method is the transaction value. The transaction value is defined as the price actually paid or payable for the goods when sold for export to the country of importation with certain adjustments (upward and/or downward). However, according to the ACV, if the imported merchandise cannot be appraised on the basis of the transaction value, secondary bases of appraisement must be utilized in the following order:

(ii) Transaction Value of Identical Merchandise

(iii) Transaction Value of Similar Merchandise

(iv) Deductive Value

(v) Computed Value

(vi) Values if Other Values Cannot be Determined.

The ACV defines there are certain additions to be added to the customs value if not already included. Additions to the price actually paid or payable when sold for export to the country of importation, includes among others, royalties, and licensing fees insofar they are not already included in the price. Specifically,

[1] WTO Agreement on Customs Valuation

per Article 8 of the ACV, the following elements must be added to the price actually paid or payable if not already included in the price:

> "Royalties and license fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable."[2]

These amounts are added only to the in case they have not been already included in the price and are based on information accurately justifying the amount.

The United States of America (U.S.) and the European Union (EU), as members of the WTO, are obliged to implement the WTO Agreement on Customs Valuation into their customs legislation. As a result, the US and the EU put forth applicable legislation with respect to customs valuation and specifically, the treatment of royalties and licensing fees in 19 Code of Federal Regulations (CFR), United State Trade Agreements Act of 1979 and the Union Customs Code (UCC) respectively.

As a result of the legislation on customs valuation, multinationals conducting imports in the U.S. and the EU face practical challenges when dealing with reporting royalties and licensing fees as a part of the customs value to relevant customs authorities.

The questions posed and addressed in this thesis include: "How do the United States and the European Union treat royalties and transfer pricing adjustments from both a legal and practical perspective in light of WTO rules? What are the differences between both legislations, what can be learned from such differences, and ultimately what changes should be made as a result?

This thesis will address which parts of legislation require clarification and/or potential revisions in EU customs legislation to minimize challenges multinationals face when dealing with royalties, license fees and transfer pricing adjustments as part of the customs value. The research on this topic will show the practical challenges that multinationals face when adhering to EU customs legislation and the UCC. The

[2] Article 8 of the WTO Agreement on Customs Valuation

outcome of this research may demonstrate how one or both jurisdictions may need to clarify or even revise the way customs valuation legislation is written with respect to the central topic.

Prior coming to proposing a recommended solution in section 7, I will outline the customs valuation rules stemming from the (GATT) and WTO in section 3, EU and U.S. customs valuation requirements in sections (4) and (5) respectively, address the challenges faced by multinationals in section (7), and finally provide recommendations to legislators in section (7).

3.0 Customs Valuation

The customs valuation process is vital for customs agencies to properly allocate the duties owed upon import. Customs duties are typically levied based on one of two methods. The first is on the basis of a specific quantity (e.g., weight or unit) and the second is on the basis of the value of goods, also referred to as the *ad valorem* customs duty. Customs valuation requirements are applicable for the *ad valorem* customs duty.[3] The WTO ACV sets forth the international legal basis for customs valuation.[4]

3.1 General Agreement on Tariffs and Trade / World Trade Organization (WTO) Background

Since 1947, the General Agreement on Tariffs and Trade (GATT) has provided the rules for much of world trade. The aim of the GATT was to create a separate organization to preside over international trade topics.[5] From 1973 to 1979, the Tokyo Round Negotiations minimized customs valuation divergences that were borne by some member states. The Uruguay Round Negotiations, from 1986 to 1994, established the WTO ACV. Article VII of the GATT, 'Valuation for Customs Purposes', outlines the principles for customs valuation which are applicable for all member states of the World Trade Organization (WTO) and the ACV illustrates the methods of customs valuation.[6]

The ACV requires that importers use reasonable care in their valuation of imported goods and furnish any additional information where relevant to facilitate customs to properly assess duties, collect accurate

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[3] Tim Hesselink, 'EU Customs Valuation: Wake-Up Call for MNE' (2012) *Global Trade and Customs Journal,* Vol 7, issue 3, p 80

[4] The Agreement on Implementation of Art. VII of the General Agreement on Tariffs and Trade 1994, also referred to as the WTO Valuation Agreement (officially GATT 1994)

[5] See background explanation from WTO, <https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm>

[6] Satapathy, C., Implementation of WTO Agreement on Customs Valuation, Economic and Political Weekly, Vol. 35, No. 25, 2000, p. 2101, <http://www.jstor.org/stable/4409407> accessed 11 November 2019

statistics, and determine whether all other applicable legal requirements are met.[7] The ACV aims to provide a single system that is fair, uniform and neutral for the valuation of imported goods for customs purposes, conforming to commercial realities and outlining the use of arbitrary or fictitious customs values.[8]

The ACV recognizes (6) different methods of appraisement, and their order of use. The preferred method of appraisement is transaction value, which is the price actually paid or payable for the goods when sold for export to the country of importation with certain adjustments. However, in the event that the specific article cannot be assessed on the basis of transaction value, alternative basis of appraisements are available in the following order:

(ii) Transaction Value of Identical Merchandise

(iii) Transaction Value of Similar Merchandise

(iv) Deductive Value

(v) Computed Value

(vi) Values if Other Values Cannot be Determined[9]

3.1.1 Additions to the price actually paid or payable

Per Article 8(a) of the ACV, the following elements must be added to the price actually paid or payable if not already included in the price:

(i) Commissions and brokerage, excluding buying commissions;

(ii) The cost of containers which are treated as being one for customs purposes with the imported goods;

(iii) Cost of packing whether for labor or materials.

Per Article 8(b) of the ACV, the value of the following goods and services where supplied directly or indirectly by the buyer either for free or at reduced price for use in related to the production and sale for export of the imported goods, if not included in the price already:

(i) Materials, components, parts and similar items incorporated in the imported goods;

[7] See WTO, Short Historical Overview, < https://www.wto.org/english/tratop_E/cusval_e/cusval_info_e.htm>
[8] Article VII of the GATT, *Valuation for Customs Purposes*, para 2(a)
[9] Article 1.2 of the WTO Agreement on Customs Valuation

(ii) Tools, dies, molds and similar items used in the production of the imported goods;

(iii) Materials consumed in the production of the imported goods; and

(iv) Engineering, development, artwork, design work, plans and sketches, undertaken elsewhere than in the country of importation and necessary for the production of the imported goods.[10]

Royalties and license fees are outlined in ACV Article 8.1(c) and must be added to the price actually paid or payable if the following criteria is met:

- The royalties and listening fees are related to the goods;
- The royalties and licensing fees are paid directly or indirectly by the buyer;
- The royalties and licensing fees are paid as a condition of sale;
- The royalties and licensing fees are not included in the price paid or payable;
- The adjustment should be performed on the basis of objective and quantifiable data.[11]

While the aforementioned elements, must be included in the price paid or payable, the way in which Customs Authorities for individual WTO member states treat said additions may differ under certain facts and circumstances which lead to divergences globally.

3.1.2 Intersection with transfer pricing and treatment of retroactive adjustments

Transfer pricing is a pricing method, used by related companies to manipulate prices at either a high or low level to generate a specific income payment or capital transfer between related companies.[12] Transfer pricing is used by multinationals to set prices for both physical products and intangibles. The Organization for Economic Co-operation and Development (OECD) set forth the international standard for transfer pricing through the Model Tax Convention and the Transfer Pricing Guidelines (TPG).[13] As laid down in the TPG, "Preface", paragraph 16, OECD member states are recommended to follow the TPG in their national transfer pricing guidelines and taxpayers are encouraged to follow the TPG in evaluating (for tax purposes) if the transfer pricing adheres to the 'arm's-length principle'.

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[10] Article 8.1(b) of the WTO Agreement on Customs Valuation
[11] Article 8.3 of the WTO Agreement on Customs Valuation
[12] OECD 'Glossary of Statistical Terms', <https://stats.oecd.org/glossary/detail.asp?ID=2757> accessed on 3 December 2019
[13] OECD Model Tax convention and the Transfer Pricing Guidelines (TPG) <https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page12>, accessed 4 December 2019

The 'arm's-length principle' within the transfer pricing context, refers to the notion that the price charged for a product by a multinational to a related party, must be the same price charged by said multinational to a non-related party.[14] The Customs Authorities' objective in obtaining the correct customs valuation for related party transactions is to establish that the price of the goods has not been 'influenced' by the relationship of the enterprises. The objective of the Direct Tax Authorities' aims to obtain a price as if the associated enterprises were not related and the price was negotiated under normal business circumstances.[15]

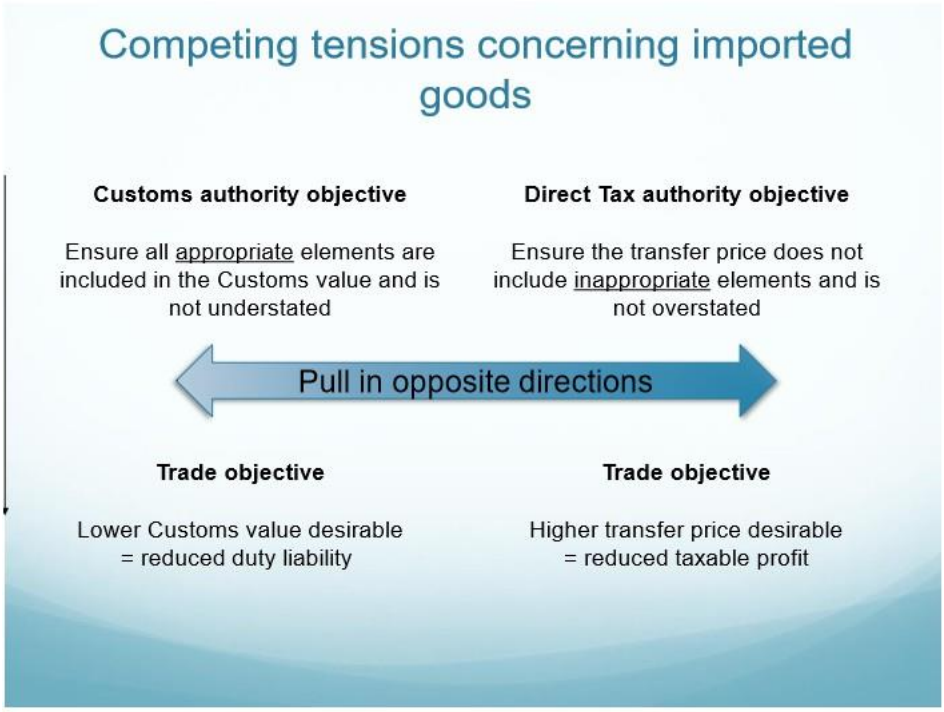

Figure 2: Objective Comparison: Customs versus Direct Tax Authorities[16]

3.1.3 Supplementary Guidance for treatment of royalties

Annex II of the ACV provides notes as supplementary guidance to the articles. Article 18 of the ACV establishes a Technical Committee on Customs Valuation ("the Committee") for the WCO. The Committee has published Advisory Opinions and Commentary specific to treatment of royalties and licensing fees.[17]

[14] Paragraph 6 Article 9 of the OECD Model Tax convention and the Transfer Pricing Guidelines (TPG)
[15] WCO, 'Guide to Customs Valuation and Transfer Pricing 2018', Chapter 4: Linkages Between Transfer Pricing and Customs Valuation, Page 57
[16] *Ibid 15*
[17] Article 18 of the WTO Agreement on Customs Valuation

Advisory Opinions related to the treatment of royalties and licensing fees may be found in 4.1 – 4.17 (Advisory Opinions) and the Commentaries 19.1 and 25.1.[18] As mentioned in Article 14 of the WTO Agreement of Implementation of Article VII of the GATT, the Interpretive notes are to be applied in combination their respective article.[19]

3.1.4 Technical Committee on Customs Valuation: Advisory Opinions

The Technical Committee on Customs Valuation (TCCV) Advisory Opinion 4.3 addresses a royalty connected to a patent for a manufacturing process paid by the buyer for rights to produce in the country of import subsequent to the importation process. The importer was required to pay the patent holder, a third party, only under a separate contract. While the imported machine incorporates the manufacturing process, the TCCV did not find the royalty dutiable as the payment was not considered a condition from the buyer to the seller.[20]

TCCV Advisory Opinion 4.6 addresses a scenario where a royalty is owed by an importer to the seller and trademark holder, as a condition of sale, when the importer resells the imported merchandise with the trademark.[21] An importer conducts two purchases for concentrate from a foreign manufacturer who owns the trademark, the trademark may or may not be applied when the goods are sold depending on the dilution of the concentrate within the agreement of the sale. Here the concentrate is diluted with water and packaged for sale. The trademark fee is paid on a per unit basis. With respect to the first purchase, the concentrate is diluted, and further sold without a trademark (no trademark fee is due). With respect to the second purchase, the concentrate is diluted and resold with the trademark as a condition of sale. The trademark fee is required. The TCCV advised with respect to sale one, the fee is not dutiable as the goods are resold without the trademark. With respect to the sale two, the importer must add the trademark fee as it a condition of sale.[22]

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[18] *Ibid 1*

[19] Article 14 of the WTO Agreement on implementation of Article VII of the General Agreement on Tariffs and Trade (GATT) 1994 (ACV) and WTO, State Trading Enterprises: Technical Information, "The rules," https://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm accessed 1 November 2019

[20] Advisory Opinion 4.3, WTO Technical Committee on Customs Valuation, 2 October 1981

[21] Customs Valuation Compendium, accessed on 7 April 2020 https://ec.europa.eu/taxation_customs/sites/taxation/files/customs_valuation_compendium_2018_en.pdf

[22] Advisory Opinion 4.6, WTO Technical Committee on Customs Valuation, 11 March 1983

TCCV Advisory Opinion 4.8 addresses a scenario where a royalty payment paid for rights to use a trademark made by a buyer to a third-party licensor for placement of certain designs to be used on shoes. The royalty on the trademark was calculated based on the amount of shoes sold at a fixed cost per pair of shoes. In this example, the seller provided the designs as an assist to the buyer located in the country of import. All parties involved, the buyer, seller and licensor are not related. The TCCV found that since the payment was not required as a condition of sale by the seller towards the buyer (but rather based on an agreement made with the licensor), the royalty was not dutiable.[23]

TCCV Valuation Advisory Opinion 4.17 addresses royalties and license fees under Article 8.1 (c) of the ACV. Here there is a scenario where a franchisee, buyer and importer (Company A) located in country I enters into a franchise agreement with a franchisor (Company B), located in country E. The agreement is for the operation of stores under the brands of Company B. Under the agreement, Company A may only procure inputs used in the manufacturing process either directly from Company B or from suppliers which are authorized by Company B. Furthermore, Company A may source from a third-party supplier where the price is lower upon quality approval by Company B. The inputs are not covered by a patent, nor are they protected by intellectual property rights. Under the agreement, Company A must pay Company B royalties for the use of brands and system. The royalties are determine based on a percentage of Company A's gross sales on the manufacture of final products from the inputs it has used.

In this scenario the TCCV assessed that in this scenario, the payment of royalties was not related to the imported products but rather the use of brands and system of the franchisor in the production and sale of the goods for use of the brand. Additionally, the imported goods / inputs may be purchased from both the franchisor or authorized outside suppliers, neither branded nor patented and additionally not manufactured under a patented process related to the royalty payment. Thus, the royalties were not to be added to the price actually paid or payable under Article 8.1(c). Here the TCCV attempts to provide clarity regarding franchise fees and the inclusion into the customs value insomuch as they are related to the imported merchandise.[24]

3.1.5 Technical Committee on Customs Valuation: Commentary

[23] Advisory Opinion 4.8, WTO Technical Committee on Customs Valuation, 8 October 1993
[24] Advisory Opinion 4.17, WTO Technical Committee on Customs Valuation, 12 May 2017

Commentary 19.1 addresses the expression of 'right to reproduce imported goods' both physical reproduction and right to reproduce an idea or concept integrated into imported products. The Commentary also states that acquiring products covered by a right itself does not equate to the right to reproduce.[25]

Commentary 25.1 addresses payments of royalties and licensing fees to a third-party licensor not related to the seller. An analysis must be performed in each case to assess the facts and circumstances around the royalty agreement and related documentation. In particular, one must assess how the payment is related to the imported products and if the payment is a condition of sale. Essentially, what is tested here is twofold: 1) if the buyer is if the importer goods incorporate intellectual property covered by the royalty or license agreement (e.g., trademark) and 2) if the buyer unable to buy the imported products without paying the royalty or license fee as a condition of sale. For this there are five indicators the TCCV put forward to assess if a payment of the royalty and license fee is considered a condition of sale:

1) There is a reference to the royalty or license fee in the sales agreement or other documentation;
2) There is a reference to the sale of goods in the royalty or license agreement;
3) The sale can be terminated per the royalty or license agreement if the buyer does not pay the fee (this would provide a link between the royalty or license fee and the sale of goods being valued);
4) The royalty or license agreement forbids the manufacturer to produce or sell the goods incorporating the licensor's intellectual property if the fee is not paid;
5) The royalty or license agreement indicates the licensor is allowed to manage the production or sale between the manufacturer and importer beyond quality control.[26]

3.1.6 Supplementary Guidance for treatment of price adjustments

In 2018, the WCO published an updated version of the *WCO Guide to Customs Valuation and Transfer Pricing.* The aim of the guide is to assist officers within the Customs Agencies around the globe who are responsible for conducting audits and controls on multinationals. As stated in Chapter 1, the WCO recommends that industry professionals and tax administrations to review the guide.[27] The WCO does not aim to give a solution in dealing with the intersection of customs valuation and transfer pricing but strives

[25] Michael Lux, Dan Cannistra & Miguel A. Rodriguez Cuadros, 'Customs Treatment of Royalties and License Fees with Regard to Imported Goods' (2012) *Global trade and Customs Journal,* Vol 7, Issue 4, p 122
[26] *Ibid 25*
[27] WCO, 'Guide to Customs Valuation and Transfer Pricing 2018', Chapter 4: Linkages Between Transfer Pricing and Customs Valuation, Chapter 1: Introduction, Page 4

to provide technical background and a platform for possible treatment and solutions by respective WCO members. As such, there are practical problems that arise and will be addressed in this thesis.

Furthermore, section 5.3 of the WCO Guide addresses the treatment of customs valuation that will be updated at a later date as a result of transfer pricing. Section 5.3.1 addresses the non-uniform treatment of how Customs Authorities around the globe treat upward and downward transfer pricing adjustments, essentially confirming there is not a globally agreed approach for pricing adjustments. Annex I of the WCO Guide provides for practical examples of how Australia, Canada, Korea, the United Kingdom, and the United States address the topic from a national perspective.

4.0 EU Customs Valuation Rules

All goods imported into the EU is subject to appraisement. Upon importation into the EU, goods must be 'declared' to the applicable Customs Authorities. Upon import, the customs duty, VAT, and other relevant taxes are due. One of the requirements on the import declaration is to declare the 'customs value' of which the ad valorem customs duty is due.[28] While the all information on the import declaration should be provided for at the time of import, the UCC provides space to submit an incomplete import declaration and resubmit a complete import declaration, in principle, within 10 days after the customs declaration was lodged.[29].This is also valid when declaring the customs value. However, this must be agreed with the national member state Customs Authority presiding over the imports as Article 146 (4) states that until AES and the National Import System referred to in the Annex of Implementing Decision 2014.255/EU is running, Customs Authorities may permit other deadlines than those indicated in paragraphs 1 and 3 of the article. From a practical perspective, this places a burden on the importers. Firstly importers have to align with each member state Customs Authority in the country of import, and secondly the allotted time limit within Article 146 (1) does not provide for either a feasible or realistic timeframe for importers to amend the customs value particularly with respect to transfer pricing adjustments as these adjustments may be performed in monthly, quarterly or yearly intervals.

The International Chamber of Commerce (ICC) acknowledges the high burden placed on importers with respect to having 'open' customs declarations. This is noted in the WCO Guide to Customs Valuation and Transfer Pricing, where the ICC recommends that the obligation for importers to submit an amended

[28] Duty rate may not apply if Free Trade Agreement is utilized
[29] Article 146 of the UCC DA

customs declaration for post-transaction transfer pricing adjustments (either upward or downward) should be waived. The ICC goes so far to also state that the payment of penalties as variations of transfer prices should also be waived.[30]

The UCC sets forth rules for appraisement of imported merchandise. EU customs regulations require that importers use reasonable care to value imported goods and provide additional information, as necessary. Having a commonly agreed and accurate measuring standard ensures:

- Economic and commercial policy analysis;
- Application of commercial policy measures;
- Proper collection of import duties and taxes; and
- Import and export statistics.[31]

4.1 Implementation of ACV in the EU

All members of the WTO must implement the customs methodology into their national legislation. Even various countries that are not participating in the WTO also choose to adopt it; as such the concept is applicable for the majority of all global trade.[32] The EU thus applies the internationally accepted 'customs value' methodology established by the WTO Customs Valuation Agreement.[33] Specifically, Articles (1) through (8) of the ACV were implemented in the EU's customs legislation in 1992.[34] Customs value as defined by the UCC Delegating Act, "means the value as determined in accordance with the 1994 Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (WTO Agreement on Customs Valuation)."[35] Articles 69 through 76 of the UCC and Articles 127 through 146 of the UCC Implementing Acts outline the legislation for customs valuation.

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[30] WCO Guide to Customs Valuation and Transfer Pricing (June 2015, updated 2018), page 98
[31] See text of European Commission, < https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/what-is-customs-valuation_en> accessed 3 January 2020
[32] Article 37(12) of the UCC Delegating Acts (DA), <https://ec.europa.eu/taxation_customs/sites/taxation/files/06_taxud_ucc_customs_valuation_quick_info_en.pdf > accessed 2 November 2019
[33] UCC Customs Valuation Quick Info from TAXUD, <https://ec.europa.eu/taxation_customs/sites/taxation/files/06_taxud_ucc_customs_valuation_quick_info_en.pdf > accessed 2 November 2019
[34] Regulation (EEC) No. 2913/92, OJ 1992 No. L302, 1.
[35] Article 37(12) of the UCC DA

4.2 EU Customs Valuation Methods

When determining the customs value, the methods must be applied in the prescribed order as illustrated below.

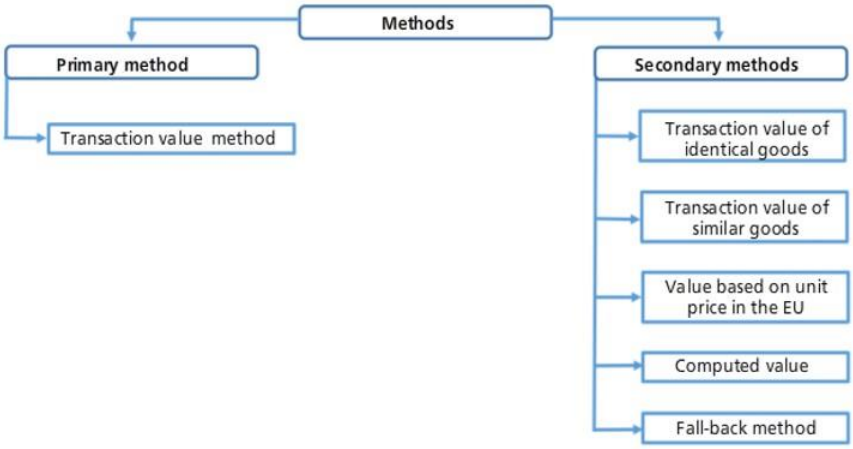

Figure 1: Illustration to determine customs valuation method[36]

In accordance with the WTO ACV, the UCC outlines (6) methods to determining the customs value. Per the UCC, the primary customs valuation method is transaction value, which is defined as the "price actually paid or payable for the goods when sold for export to the customs territory of the Union, adjusted, where necessary."[37] The price actually paid or payable is to be the complete payment made or to be made by the buyer to the seller or third party, in benefit of the seller, for the imported goods and include all payments made or to be made as a condition of sale of the imported goods.[38]

The transaction value must be applied if the below conditions are met:

(a) there are no restrictions as to the disposal or use of the goods by the buyer, other than any of the following:

(i) restrictions imposed or required by a law or by the public authorities in the Union;

(ii) limitations of the geographical area in which the goods may be resold;

[36] UCC Customs Valuation Quick Info from TAXUD, https://ec.europa.eu/taxation_customs/sites/taxation/files/06_taxud_ucc_customs_valuation_quick_info_en.pdf, accessed 2 November 2019

[37] Article 70(1) of the UCC

[38] Article 70(2) of the UCC

(iii) restrictions which do not substantially affect the customs value of the goods;

(b) the sale or price is not subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued;

(c) no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the seller, unless an appropriate adjustment can be made;

(d) the buyer and seller are not related, or the relationship did not influence the price.[39]

Article 74 of the UCC touches on the secondary methods of customs valuation. For the purpose of this thesis, the focus will remain solely on the transaction value and certain statutory additions to the price actually paid of payable when sold for export.

Article 71 of the UCC outlines which elements must be ascertained as part of the transaction value. In particular, the following elements need to be included in the transaction value if not already done so:

(b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:

(i) materials, components, parts and similar items incorporated into the imported goods;

(ii) tools, dies, moulds and similar items used in the production of the imported goods;

(iii) materials consumed in the production of the imported goods; and

(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the Union and necessary for the production of the imported goods;[40]

(c) **royalties and license fees** related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable;[41]

(d) the value of any part of the **proceeds of any subsequent resale**, disposal or use of the imported goods that accrues directly or indirectly to the seller.[42]

[39] Article 70(3) of the UCC
[40] Article 71(1)(b) of the UCC
[41] Article 71(1)(c) of the UCC
[42] Article 71(d) of the UCC

Additions to the price actually paid or payable shall be made only on the basis of objective and quantifiable data.[43]

4.3 Treatment of royalties & licensing fees in the UCC

The royalty and licensing fee provisions of the UCC are laid out in Article 71(1)(c), Article 71(2) and Article 72(d) and (g) of the UCC; and Article 136 of the UCC IA. In that respect the following considerations are of importance when assessing the dutiability of royalties and licensing fees:

> 1. *Royalties and license fees are related to the imported goods where in particular, the rights transferred under the license or royalties agreement are embodied in the goods. The method of calculation of the amount of the royalty or license fee is not the decisive factor.*
> *2. Where the method of calculation of the amount of royalties or license fees derives from the price of the imported goods, it shall in the absence of evidence to the contrary be assumed that the payment of those royalties or license fees is related to the goods to be valued.*
> *3. If royalties or license fees relate partly to the goods being valued and partly to other ingredients or component parts added to the goods after their importation, or to post-importation activities or services, an appropriate adjustment shall be made.*[44]

The EU treatment of royalties and licensing fees is more explicit than those of the ACV. Pursuant to Article 129 of the UCC Implementing Acts (IA), the price actually paid or payable shall include all payments made or to be made as a condition of sale of the imported goods by the buyer to the following parties:

(a) the seller;

(b) a third party for the benefit of the seller;

(c) a third party related to the seller;

(d) a third party where the payment to that party is made in order to satisfy an obligation of the seller.[45]

From a practical perspective, royalty or license fee payments are typically in the form of continuous instalments (e.g. monthly, bi-monthly, quarterly, annually). The payment could be made in a single

[43] Article 71(2) of the UCC
[44] Article 136(1) through (3)
[45] Article 129(1) of the UCC IA

occurrence or an up-front lump sum, known as a 'fee for disclosure" with subsequent payments thereafter. The instalments are usually based on a percent of the proceeds of sale of the licensed goods.[46]

According to the Guidance on Customs Valuation Implementing Acts, the EU Commission states, "*there is an implicit recognition that the commercial practices, and the related legal framework related to intellectual property rights, relating to royalties and license payments, are relevant and applicable. However, EU customs legislation will not provide a definition of royalties and license fees."* [47]

While the EU customs legislation does not rightfully define royalties or licensing fees, the OECD does. Said definition may be found below:

"payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial, or scientific experience (commonly referred to as "know-how")." [48]

The OECD definition claims royalties and license fees are essentially payments made for use of certain rights. EU customs legislation does not differentiate between said rights. This provides for a situation where royalties and licensing fees for the right to use a trade mark would not be subject to specific provisions but would fall under the scope of Article 71 UCC and Article 136 UCC.[49] Furthermore, while licensing agreements are also not addressed in valuation rules, as outlined by the EU Commission Guidance on Customs Valuation Implementing Act, some examples would cover, *"the manufacture and/or sale for export of imported goods (incorporating, e.g., patents, designs, models and manufacturing know-how, trademarks), the use or resale of imported goods (in particular, copyright, manufacturing processes inseparably embodied in the imported goods)."* [50]

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[46] Compendium of Customs Valuation Texts of the EU Commission 2018, https://ec.europa.eu/taxation_customs/sites/taxation/files/customs_valuation_compendium_2018_en.pdf, accessed 2 November 2019

[47] EU Commission Guidance: Customs Valuation Implementing Act, https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_code/guidance_valuation_en.pdf, accessed 4 November 2019

[48] Article 12(2) of the OECD Model Tax Convention on Income and on Capital (2014)

[49] *Ibid 47*

[50] *Ibid 47*

4.3.1 License Agreements

Royalties and licensing fees are typically setup as a written 'licensing agreement' which outlines the license specifics, including the product(s) applicable, the rights / know-how, responsibilities of the licensee and licensor, and payment method and penalties as a result of non-compliance. In order to determine whether or not the license agreement is relevant for customs valuation, one must review the terms of the contract. The review must cover the terms of the sale contract and any link it may have to the license agreement to assess the *condition of sale* concept per Article 136 of the UCC IA.[51]

4.3.2 Condition of Sale

Article 136(4) UCC IA defines the requirements for when royalties and license fees are a *condition of sale* for the imported products. The three criteria are:

a) the seller or a person related to the seller requires the buyer to make this payment;
b) the payment by the buyer is made to satisfy an obligation of the seller, in accordance with contractual obligations; and
c) the goods cannot be sold to, or purchased by, the buyer without payment of the royalties or license fees to a licensor.[52]

Here we note that to determine the *condition of sale* concept is applicable, one must review the license agreement to assess if the goods may be purchased without the royalty or licensing fee payment. As such, this concept is important to assess the dutiability of royalties and licensing fees in the EU as supported by Article 71(1) (c) of the UCC.

4.4 Change in perspective CCC to UCC

Prior to May 1, 2016 EU customs legislation was governed by the Community Customs Code (CCC).[53] As of May 1, 2016 the UCC took effect.[54] Under the CCC when determining the customs value, the value of goods

[51] *Ibid 47*
[52] Article 136(4) of the UCC IA
[53] Regulation (EC) No 450/2008 of the European Parliament and of the Council of 23 April 2008 laying down the Community Customs Code
[54] Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code

and services whether provided directly or indirectly by the buyer for free or at a reduced price for use in related to the imported products, must have included the following elements (if not already included):

(i) materials, components, parts, and similar items incorporated in the imported goods,

(ii) tools, dies, moulds and similar items used in the production of the imported goods,

(iii) materials consumed in the production of the imported goods,

(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the Community and necessary for the production of the imported goods;[55]

Also, under the CCC, royalties and licensing fees meant specific to payments for the use of rights relating:

- to the manufacture of imported goods (in particular, patents, designs, models, and manufacturing know-how), or
- to the sale for exportation of imported goods (in particular, trademarks, registered designs), or
- to the use or resale of imported goods (in particular, copyright, manufacturing processes inseparably embodied in the imported goods).[56]

Under the new customs legislation, the UCC IA includes language which discussed the royalties and licensing fees related to the goods being valued and the condition of sale concept. Section 3.3.2 defines the *conditions of sale* under the UCC. 136(4)(c) UCC IA. This point leaves way for interpretation. This point addresses the obligations of the buyer over the obligations of the seller. For example, a licensor may not be able to forbid a non-related seller from selling the goods to a buyer, but it could forbid the purchase of the goods if the royalty payment is not made by the buyer.[57]

In sum, the main differences with respect to royalties under the new legislation are twofold. The first being the free sourcing exemption under Community Customs Code will no longer be applicable. The second, 'de facto' all royalties become dutiable as license agreements tend to require a licensee to pay a royalty in relation to the purchased merchandise (whether or not calculated over their resale revenue).

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[55] Article 32(1)(b) of the CCC

[56] Article 157(1) of the CCIP

[57] EY, "Union Customs Code becomes fully applicable as of 1 May 2016" (2016) *Trade Watch,* Vol 15, issue 1, pp 2-4, <https://www.ey.com/Publication/vwLUAssets/ey-tradewatch-march-2016/$FILE/ey-tradewatch-march-2016.pdf>, accessed 3 January 2020

4.5 Intersection with transfer pricing and treatment of retroactive adjustments

As mentioned in section 3.1.2 of this paper, transfer pricing is a pricing method, used by related companies to manipulate prices at either a high or low level to generate a specific income payment or capital transfer between related companies.[58]

4.5.1 Transfer Pricing Challenges

The treatment of transfer pricing across the EU is executed on a national level. While transfer pricing guidelines in each EU member state may stem from OECD transfer pricing guidelines, there are divergences across the EU. As a result, the treatment of transfer pricing topics could differ from one member states. This is supported by Figure 3: Information noticed in particular reports OECD, guidelines of Ministry of Finance and relevant legislation of EU Member States. These divergences add to the complexity for importers dealing with transfer pricing elements across the EU in addition to meeting the requirements of both Direct Tax Authorities and Customs Authorities.

[58] *Ibid* 12

Member States	Arm's length principle	Reference to the OECD Guidelines	Statement of related parties	TP methods	TP Documentation	Specific TP audit procedures / penalties	APAs
Austria	yes	yes	reference art. 9 OECD Model Treaty	reference to the OECD Guidelines	yes	no	yes, bilateral
Belgium	yes	yes	yes	reference to the OECD Guidelines	yes	yes / no	yes
Bulgaria	yes	yes	yes	yes	yes	no / yes	yes
Czech Republic	yes	yes	yes	yes, reference to the OECD Guidelines	yes	no / yes	yes
Denmark	yes	yes	yes	reference to the OECD Guidelines	yes	no / yes	no
Estonia	yes	yes	yes	yes	yes	no	no
Finland	yes	yes	yes	reference to the OECD Guidelines	yes	no / yes	yes
France	yes	yes	yes	reference to the OECD Guidelines	yes	no / yes	yes
Germany	yes	yes	yes	yes, reference to the OECD Guidelines	yes	no / yes	yes, bilateral
Greece	yes	no	yes	yes	yes	no / yes	no
Hungary	yes	yes	yes	yes	yes	no / yes	no
Italy	yes	yes	yes	reference to the OECD Guidelines	yes	no	yes
Ireland	yes	no	yes	yes	no	no	no
Latvia	yes	no	yes	yes	in process	no	in process
Lithuania	yes	yes	yes	yes	yes	no / yes	in process
Luxembourg	yes	no	yes	yes	yes	no	yes, unilateral
The Netherlands	yes	yes	yes	yes, reference to the OECD Guidelines	yes	no / yes	yes
Poland	yes	no	yes	yes	yes	no / yes	yes
Portugal	yes	yes	yes	yes	yes	no	yes
Romania	yes	yes	yes	yes	yes	no / yes	yes
Slovak Republic	yes	yes	yes	yes	yes	yes / no	yes, unilateral
Slovenia	yes	no	yes	yes	yes	no / yes	no
Spain	yes	yes	yes	yes	yes	yes / no	no
Sweden	yes	yes	yes	reference to the OECD Guidelines	res	no	no
U.K.	yes	yes	yes	reference to the OECD Guidelines	no	no	yes

Figure 3: Information noticed in particular reports OECD, guidelines of Ministry of Finance and relevant legislation of EU Member States[59]

[59] Solilova, Veronika. (2010). Transfer pricing rules in EU member states. Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis

4.5.2 Transfer Pricing Adjustments

Periodic transfer pricing adjustments is a common practice exercised by multinationals in an effort to target a specific transfer pricing margin or profit allocation in a taxable jurisdiction. From a Customs perspective, transfer pricing adjustments indicate an incorrect declaration of the customs value at the time the import declaration was filed. Additionally, the customs value is determined on a transactional basis while transfer pricing rules effect a group of transactions. In a recent court case, the ECJ ruled that economic operators would not be permitted to use the transaction value for customs valuation purposes if the transfer price had both an amount initially invoice and declared, and a flat-rate adjustment conducted post the accounting period.[60]

The UCC does not provide any provisions on how to deal with amendments to the transaction value. This, however, does not indicate that the adjustments could not affect the customs value of the imported products.[61]

4.5.3 Upward & Downward Pricing Adjustments

In many cases, multinationals assess the transfer price allocation on a periodic basis (e.g., monthly, bi-monthly, quarterly, or annually). When a transfer price is adjusted and increased, an upward price adjustment is made. This 'true-up' made retroactively to the imported goods may impact the customs value of the imported goods. When a transfer price is adjusted and decreased, this may be referred to as a downward price adjustment. While there is no formal customs provision laid down in the UCC for pricing adjustments, certain countries Customs Authorities permit an adjustment for incomplete customs declarations as a result of an upward adjustment and an additional assessment may occur. With respect to a downward adjustment, one could interpret Article 116 of the UCC to mean a refund could be granted, if there is a transfer pricing policy in place.

The treatment of pricing adjustments with respect to customs valuation differs within the EU member states. This is problematic as each EU member states adheres to the same customs legislation. Furthermore, this poses an additional burden for multinationals importing into different EU member

[60] Judgment of 20 December 2017, Hamamatsu Photonics Deutschland GmbH, C-529/16, EU:C:2017:984
[61] Idsinga, Folkert, Bart-Jan Kalshoven and Monique van Herksen, *Let's Tango! The Dance between VAT, Customs and Transfer Pricing,* p. 208

states, as the treatment of transfer pricing adjustments may differ by EU member state, creating non-uniform requirements and reporting obligations for the importer.

4.5.4 ECJ Judgment in Hamamatsu Photonics Deutschland, Case C-529/16

Until the decision by European Court of Justice (ECJ) on the Hamamatsu Photonics Deutschland GmbH (Hamamatsu) case, there was no published guidance in this domain by either the European Legislator or the ECJ.[62] On December 20, 2017 the European Court of Justice (ECJ), published a binding decision where it ruled on the use of transfer prices, subject to retroactive pricing adjustments, to value imported goods into the EU in related-party transactions. It appears the judgment has created more confusion than clarity for importers and national Customs Authorities alike.

4.5.4.1 Facts and Circumstances of the Case

Hamamatsu, a Japanese parent company with a German establishment, provides high level solutions for photometry systems, light sources, cameras. The Hamamatsu group of companies had an Advance Pricing Agreement (APA) in place with the German Tax Authorities where an operating margin range was established. In the application of the APA, the operating margin of Hamamatsu was lower than required, which led to a price reduction to comply with the targeted profit range and meet the OECD Guidelines for the arm's-length principle. Thus, the intercompany transfer prices between the Japanese parent and the German daughter, were adjusted downward and a credit note was issued. Subsequent to the price reduction, Hamamatsu requested a refund to the German Customs Authorities for the overpayment of customs duties. Hamamatsu did not allocate the adjustment across the individual imported goods, which had duty rates varying between 1.4% -6.7%. The refund was requested against a 'flat rate' lower than range of customs duty which its products are subject to.[63]

The German Customs Authorities did not grant the request stating that the transaction value could only be determined for individual products and not 'mixed consignments'. In order to assess if Hamamatsu would be eligible for a partial refund, the Finanzgericht München refer to the EUCJ on two questions. The first, if a customs value based on an initial transfer price is later subject to an adjustment using an

[62] Michiel Friedhoff, 'The Treatment of Transfer Pricing Adjustments for the Purpose of Customs Valuation' (European Fiscal Studies Thesis, Erasmus University 2017)
[63] Mark K. Neville, Jr., "ECJ: Transfer Pricing Adjustments Derail Transaction Value" (March 2018), Journal of International Taxation, p 25

apportionment mechanism regardless of upward or downward adjustment may lead to either a refund or additional payment of customs duties. The second question posed, if the EUCJ responds affirmatively to the first question, could the customs valuation be reviewed or determined using a simplified method?[64]

4.5.4.2 EUCJ Ruling

The EUCJ addresses the first question by commenting on the objectives of the customs valuation system of which the customs value must reflect the actual economic value of the goods at the time of import.[65] For use of the transaction value or the price actually paid or payable, the customs valuation system of the UCC allows for the amendment of the value in an effort to avoid fictitious values and follow the WCO ACV. The EUCJ further states the Customs Authorities and declarants are permitted to amend the customs declaration in case of adjustments to the transaction value under the CCC under certain situations where the goods were defective. Additionally, the EUCJ states the CCC did not mandate importers to correct the transaction value which would be subsequently either upwardly or downwardly adjusted. Nor did the CCC contain any article or provision which would prohibit companies applying only downward adjustments. The EUCJ goes on to reject the use of the transaction value as the appropriate customs valuation method as it was an amount that was initially invoiced, where a flat-rate adjustment was made post the accounting period, without having knowledge if the adjustment would be upward or downward.[66] Specifically, in paragraph 35 of the Hamamatsu case, the EUCJ ruled that Articles 28 to 31 "must be interpreted as meaning that they do not permit an agreed transaction value, composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the customs value, without it being possible to know at the end of the accounting period whether that adjustment would be made up or down". This conclusion requires another method of customs valuation in this case. Given the outcome of the first question, the second question posed by the Finanzgericht München need not be answered.

4.5.4.3 EUCJ Ruling Analysis on use of Transaction Value

Given the conclusion of the EUCJ, there can be various interpretations. In particularly, the judgement may have set a precedent that the transaction value method may not be permitted for use as a customs

[64] Michiel Friedhoff, Martijn Schippers, 'ECJ Judgment in Hamamatsu Case: An Abrupt End to Interaction Between Transfer Pricing and Customs Valuation?' (2019) 28 EC Tax Review, Issue 1, pp. 32–42
[65] *Ibid 64*
[66] *Ibid 64*

valuation method if the price originally invoiced is rejected by the importer due to a post-importation retroactive adjustment of intercompany transfer prices and a secondary method of customs valuation would need to applied.

This point is interesting considering that one of the requirements to use the transaction value method is that the relationship between the buyer and seller cannot influence the price. In order to demonstrate this, a 'circumstances of sale' test is conducted. However, guidance or provisions on how to conduct the 'circumstances of sale' test are not provided for in the UCC.[67] Article 134 (2) of the UCC IA, deems the relationship not to have influenced the price if one of the following test values are met:

(a) the transaction value in sales, between unrelated buyers and sellers, of identical or similar merchandise for export to the to the EU;

(b) the customs value of identical or similar merchandise, established in accordance with Article 74(2)(c) of the UCC;

(c) the customs value of identical or similar merchandise, established in accordance with Article 74(2)(d) of the UCC.

Practically speaking, the abovementioned test values are frequently unavailable. Consequently, this leaves importers to rely transfer pricing documentation to prove the relationship has not influenced the price.[68] Furthermore, the WCO guidance further states that transfer pricing documentation can give relevant information for the 'circumstances of sale' test related to 1) commercial transaction between the buyer and seller and 2) how the price was derived.[69]

This ruling has quite an impact from a practical perspective if the transaction value is to be reject in circumstances where there is a retro-active transfer pricing adjustment. If this interpretation deems true, and a secondary valuation method.

In sum, importers into the EU that use transfer prices subject to retroactive pricing adjustments, as the foundation for transaction value, need to diligently assess the customs implications of this ruling and how

[67] *Ibid 64*
[68] WCO Guide to Customs Valuation and Transfer Pricing (June 2015, updated 2018), page 9
[69] WCO Guide to Customs Valuation and Transfer Pricing (June 2015, updated 2018), page 63

is may affect the customs value on a country by country basis. This can result in a costly, timely and non-uniform approach towards reporting the customs value across multiple countries subject to the same customs legislation. As per Article 73 of the UCC, there are certain possibilities to submit a pre-defined customs value with the relevant Customs Authorities via the use of an authorized simplification based on specific criteria. Furthermore, Article 71 of the UCC DA outlines the criteria in which the authorization under Article 73 may be granted. These criteria are twofold: the first is that the application of the procedure referred to in Article 166 of the UCC would, pose excessive administrative costs; the second being that the customs value would not significantly differ from the customs value in the case there was no authorization in place. If the aforementioned UCC Articles were amended to reflect authorizing a fixed customs value at the time of import, it would remove the requirement for importers to have to amend individual transactions as a result of adjustments made after the import has occurred. Given the current timing and the fact that adjustments need to be allocated to individual transactions is an extensive procedure.

4.6 Rulings

While the EU operates as a single customs territory, there is not a central Customs Authority which presides over the customs territory. Customs responsibilities for import and export governance for the EU are executed at the member state level. The EU allows for economic operators to submit questions for clarification as a ruling on the interpretation of certain customs legislation. Article 14 of the UCC states, "customs authorities shall maintain a regular dialogue with economic operators and other authorities involved in international trade in goods. They shall promote transparency by making the customs legislation, general administrative rulings and application forms freely available, wherever practical without charge, and through the Internet."[70]

Advanced rulings, commonly referred to as Binding Information in the EU, are currently available for customs classification and origin of goods. At the present moment, the EU does not maintain a platform for Binding Information ruling in the area of customs valuation. The EU Commission has recognized the potential value-add for economic operators to put forth a Binding Information platform for customs valuation. This is demonstrated by the *Exploratory Public Consultation on the establishment in the EU of Decisions relating to binding information in the field of customs valuation*, which aims to assess, "the level

[70] Article 14 of the UCC

of interest in, and the need for, a possible initiative by the Commission, on the basis of the Union Customs Code, to establish a legal basis for decisions on Binding Value Information.[71]" The lack of publish customs valuation rulings, limits both importers and National Customs Authorities to understand the reasoning and opinion that would address specific valuation topics, including but not limited to additions to the price paid or payable.

4.7 IT infrastructure in accordance with Customs legislation

Delegated Regulation (EU) 2016/341, sets forth certain 'transitional rules' for provisions to the UCC which outlines important electronic systems are not yet operational.[72] Article 166 of the UCC outlines that importers may utilize in specific cases a 'Simplified declaration'. The UCC TDA further outlines the conditions for authorization to submit a simplified customs declaration. A simplified declaration allows importers to omit certain elements addressed in Article 162 of the UCC or supporting documents outlines in Article 163 of the UCC. An example may be if an importer does not have the correct customs value at the time of import, a simplified declaration may made with the request to subsequently submit additional information or documentation by way of a supplementary declaration.

The current possibilities within the UCC that consider transfer pricing elements in the customs value are accounted for in Article 73 of the UCC. This article permits an importer to seek authorization from Customs Authorities to agree on a defined amount if there are elements of the valuation that are unknown or not quantifiable, such as transfer pricing adjustments, at the time of import and would therefore affect customs valuation determination at the time of importation. As a result, the importer would be permitted to reconcile the transactions based on transfer price adjustments made. The conditions for the granting of the simplification possibility of Article 73 of the UCC DA are further outlined in the first paragraph of Article 71. Specifically paragraph one of Article 71 puts forth that the Simplification of Article 73 UCC may be granted if the application for a Simplified Declaration, outlined in Article 166 UCC, would represent excessive administrative expenses and the customs value under the Simplification will not substantially diverge from that when no Simplification exists.

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[71] EU Commission Consultations, <https://ec.europa.eu/info/consultations/exploratory-public-consultation-establishment-eu-decisions-relating-binding-information-field-customs-valuation_en> accessed 5 December 2019

[72] Commission Delegated Regulation (EU) 2016/341 of 17 December 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards transitional rules for certain provisions of the Union Customs Code where the relevant electronic systems are not yet operational and amending Delegated Regulation (EU) 2015/2446 (OJ L 69, 15.3.2016, p. 1).

Article 146 of the UCC DA and Article 105 of the UCC outlines the timing which must be adhered to when lodging a supplemental declaration. Single supplemental declarations are covered under Article 105 of the UCC and should be lodged within ten days of the release of the goods. Periodic supplemental declarations also outlined in Article 105 of the UCC should be launched with ten days following the end of the period they cover. The aforementioned timeframe is not sufficient for companies to gather supplemental documentation, apportion any transfer price adjustments to individual transactions and subsequently lodge the supplemental declaration. The time limits related to customs value supplementary declarations, set forth in Articles 146 and 147 the UCC DA should be increased to be more in line with the reconciliation and liquidation possibilities of the U.S., further described in section 5.

Article 179 of the UCC, Article 149 DA and Articles 229-232 IA outlines that importers may utilize a 'centralized clearance' mechanism in which a customs declaration may be lodged in a customs office in the country of establishment for imported goods taking place in another EU member state.

Centralized clearance would be a good option for centralized instructions and treatment by one Customs Authority in the EU for handling customs valuation topics. However, this simplification is not yet available and likely delayed until 2026.[73] As a result, importers must align with the respective member state Customs Authorities for use of simplified procedures in accordance with national IT capabilities as each member state has its own declaration system creating differences in the processing of simplified and supplementary declarations. Importers must also deal with a time limit placed for lodging a supplemental declaration.

5.0 U.S. Customs Valuation Rules

As of December 1993, Title VI of the North American Free Trade Agreement Implementation Act (Pub. L. 103-182, 107 Stat. 2057), commonly referred to as the Customs Modernization or "Mod" Act, entered into force in the United States. These updates in legislation amended many sections of the Tariff Act of 1930 and associated laws. The objective of the Mod Act was to increase voluntary compliance by importers and enhance customs enforcement. Imported goods into the Customs Territory of the United States are also subject to certain customs formalities by the U.S. Customs and Border Protection (CBP). In

[73] European Court of Auditors, A series of delays in Customs IT systems: what went wrong?, https://op.europa.eu/webpub/eca/special-reports/custom-it-systems-26-2018/en>, accessed 11 November 2019

accordance with the Mod Act, the importer is must use 'reasonable care' when importing goods and declaring the customs value and customs classification. 19 U.S. Code § 1500(a) authorizes the Customs Authorities as the responsible agency to assess the final valuation of the merchandise in accordance with 19 U.S. Code § 1401a. While all information on the import declaration should be submitted to Customs at the time of import, the U.S. Customs Legislation provides space to submit an incomplete import declaration and resubmit a complete import declaration within 314 from the day of importation. This is also valid when declaring the customs value.

5.1 Implementation of ACV in the U.S.

As in the EU, all goods imported into the U.S. are subject to appraisement. The Trade Agreements Act of 1979, codified in U.S.C. 1401a, provides for the customs valuation rules for imported goods, as adopted into domestic law by the ACV. Title 19 of the U.S. Code of Federal Regulations (CFR) 'Customs Duties', is one of fifty titles which comprises the U.S. Code of Federal Regulations.

5.2 U.S. Customs Valuation Methods

In accordance with the WTO ACV, the U.S. Customs Legislation outlines (6) methods to determining the customs value which are to be considered in the following order:

(i) Transaction Value
(ii) Transaction Value of Identical Merchandise
(iii) Transaction Value of Similar Merchandise
(iv) Deductive Value
(v) Computed Value
(vi) Values if Other Values Cannot be Determined[74]

The most common method for appraisement of merchandise in the U.S. is the transaction value.[75] The transaction value is the "Price actually paid or payable" for the merchandise when sold to the U.S. including the following additions:

a) Packing costs incurred by the buyer;
b) Selling commission incurred by the buyer;

[74] 19 CFR §152.101, Basis of Appraisement
[75] CBP Informed Compliance Publication (2006), 'What Every Member of the trade Community Should Know About: Customs Value,' <https://www.cbp.gov/sites/default/files/assets/documents/2016-Apr/icp001r2_3.pdf>, accessed 3 January 2020

c) The value, appropriately apportioned of any assist;
d) Any royalty or license fee that the buyer is required to pay, directly or indirectly as a condition of sale; and
e) Proceeds of any subsequent resale, of the imported merchandise that accrue, directly or indirectly to the seller.[76]

19 CFR §152.103 through 153.107 touches on the secondary methods of customs valuation. 19 CFR §152.103(c) declares that the price actually paid or payable may be used if there is enough information to determine the accuracy of the additions insofar, they are not included in the price. 19 CFR §152.103 further discusses the additions and the deductions to the price actually paid or payable of the merchandise.

In the U.S. assists are defined as:

(i) Materials, components, parts, and similar items incorporated in the imported merchandise.
(ii) Tools, dies, molds, and similar items used in the production of the imported merchandise.
(iii) Merchandise consumed in the production of the imported merchandise.
(iv) Engineering, development, artwork, design work, plans and sketches that are undertaken elsewhere than in the United States and are necessary for the production of the imported merchandise.[77]

To be rendered an assist, the merchandise must be 1) supplied either directly or indirectly by the buyer 2) provided either for free or at a reduced price 3) used in connection with the manufacture or sale for export to the U.S.

5.3 License Agreements

Royalties and licensing fees may be setup as a written 'licensing agreement' which outline the license specifics, including the product(s) applicable, the rights / know-how, responsibilities of the licensee and licensor, and payment method and any penalties assessed as a result of non-compliance. In the U.S., royalties, or licensing fees, paid by the buyer to the seller, directly or indirectly, as a condition of sale of the imported goods for import into the U.S. are to be comprised of in the transaction value. In order to

[76] 19 CFR § 152.103, Transaction Value
[77] 19 U.S.C. 1401a(h)

determine whether or not the royalty or licensing fee is dutiable, one must review the facts and circumstances. Dutiability will ultimately depend on 1) if they are a condition of sale and 2) to which party and under what conditions they were paid.[78]

5.4 Treatment of royalties & licensing fees & condition of sale determination

Royalties and license fees are not precisely defined within the U.S. statute or regulations. As mentioned in Section 3, the ACV notes that royalties and license fees are to be included in the customs value if not already, as an addition to the price paid or payable. Furthermore, in the Interpretive Notes of the ACV, royalties and license fees may include, but not be limited to, payments for patents, trademarks and copyrights.[79] Hence, it is typically recognized that royalties and license fees refer to intellectual property and could potentially refer to patents or trademarks.[80]

As previously outlined, there are certain statutory payments or additions to the transaction value which are typically always dutiable. However, royalties and license fees are only dutiable under certain circumstances. The statute provides that a royalty or license fee may be added to the value of the imported goods when "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."[81] In other words, the royalty or license payment may not be considered dutiable unless the products cannot be imported without paying said fee. While the law may seem straight forward, practically speaking it is in many cases difficult to determine if the royalty or license fee payment is a condition of sale.

5.4.1 The Generra Presumption

In order to assess what fees are included in the declared value, a presumption is made in which all payments made by a buyer to a seller are part of the price actually paid or payable for the imported merchandise.[82] This is referred to as the Generra Presumption and was established by the U.S. Court of Appeals for the Federal Circuit.

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[78] *Ibid* 76
[79] The Customs Valuation Agreement, at Interpretative Note to Art. 8.1 (c), para. 1.
[80] ITC Trade Law, A Quick Look at Patent Royalties, <http://www.itctradelaw.com/articles/patent-royalties.html>, accessed 29 August 2020
[81] 19 U.S.C. § 1401a(b)(1)(D)
[82] *Generra Sportswear Co. v. United States*, 8 CAFC 132, 905 F.2d 377 (1990).

Nonetheless, an if an importer is able to establish that a royalty or license payment is not related to the imported merchandise, the payment may not be considered dutiable. In order to establish this, the buyer must prove that even if the payment was made directly or indirectly to the seller it was not related to the imported goods. This could mean a payment may not be dutiable if it is made regardless if the importation takes place. Thus, is it key to decipher what types of payments are made and whether there is a relationship with the imported goods.

5.4.1.1 U.S. Federal Circuit reverses U.S. Court of International Trade

The case, *Generra Sportswear Co. v. United States*[83], assesses whether or not certain payments for import quota are dutiable. In this particular case, Generra Sportswear, a U.S. importer, negotiated a fixed price for a quota with a manufacturer in Hong Kong. This manufacturer purchased the quota from a third party and paid a higher price for the quota to the third party than the price originally negotiated by Generra Sportswear. Generra Sportswear paid only the price negotiated with the manufacturer in Hong Kong. As a result, the U.S. Court of International Trade (CIT) assessed the foreign manufacturer could not have benefited as they incurred a loss in purchasing the quota. Furthermore, the CIT noted the manufacturer did not purchase specifically for 'imported merchandise' but instead for the 'quota.'[84]

The Court of Appeals for the Federal Circuit reversed the CIT decision, holding that the quota payments were made to the seller by the buyer for benefit of the seller. As such, part of the total payment in accordance with 19 U.S.C. 1401a(b)(4)(A). The Federal Circuit further states that quota charges are also not excluded under 19 U.S.C. 1401a(b)(3), which states:

> "*the transaction value of imported merchandise does not include any of the following, if identified separately from the price actually paid or payable and from any cost or other item referred to in paragraph (1):*
> *(A) Any reasonable cost or charge that is incurred for— (i) the construction, erection, assembly, or maintenance of, or the technical assistance provided with respect to, the merchandise after its importation into the United States; or (ii) the transportation of the merchandise after such importation.*

[83] *Ibid* 82

[84] Robert J. Ward Jr., 'Preserving the Nondutiable Character of Overseas Buying Agent Commissions for United States Importations' (Winter 1990) The International Lawyer, pp. 1119-1129

(B) The customs duties and other Federal taxes currently payable on the imported merchandise by reason of its importation, and any Federal excise tax on, or measured by the value of, such merchandise for which vendors in the United States are ordinarily liable."

5.4.2 HASBRO II Test

Further to the initial Generra Presumption, there is a specific test for assessing the dutiability of royalties and license fees. Not all royalty or license payments are made from the buyer to the seller. This can lead to difficulty in determining the dutiability of the payment. CBP may consider certain payments to be dutiable even if the Generra Presumption is met. CBP ascertains that the payment may still be a condition of sale and added as an addition to the transaction value even if the payment is not made directly or indirectly to the seller of the imported goods.

To determine if royalties and license fees are dutiable, one must assess, on a case-by-case basis, if 1) if the payment is connected to the U.S. import transaction and 2) to whom and under which circumstances they were paid, meaning whether or not the payment was a *condition of sale.*

In an effort to aid importers in determining the dutiability of royalties and license fees, CBP established a three-part test in assessing if the payment meets the WTO standard:

1. Was the imported merchandise manufactured under a patent?
2. Was the royalty involved in the production or sale of the imported merchandise?
3. Could the importer purchase the merchandise without paying the fee? [85]

In practice this is often referred to as the Hasbro II test. Answering no to the first two questions and yes to the third question would result in a non-dutiable royalty. In response to question two, typically the licensing agreement between the buyer and seller would need to be reviewed. The third question essentially strives to determine if the payment is made as a condition of sale.

The Hasbro II test arose when an importer, Hasbro, had an agreement with the seller to pay both 1) 7% of the resale invoice price of the imported goods and 2) and additional 7% of the price sold in the U.S.

[85] CBP General Notice titled as Dutiability of Royalty Payments, vol. 27, No. 6 Cust. B. & Dec., 1 (10 Feb. 1993)

Here the question arises as to whether or not the additional 7% of the price sold in the U.S. (which Hasbro must pay to the seller) is in fact dutiable.

Under U.S. law, if the payment is not for the goods when sold for export to the U.S. then the payment would only be dutiable if the statute particularly calls for it. For example, related to the first payment of 7%, 19 U.S.C. 1401a(b)(1)(E) states that "proceeds of any subsequent resale… that accrue, directly or indirectly, to the seller" would be a dutiable addition. We can consider the second 7% payment may fall under a dutiable royalty or license fee related to the imported merchandise which the buyer must pay as a 'condition of sale.'[86] However, CBP was uncertain regarding the dutiability and looked to a Statement of Administrative Action, which aims to explain a trade bill to Congress.[87] The Statement indicates that proceeds of subsequent resale must be related directly to the imported merchandise to be considered dutiable and the CBP should assess each situation on a case-by-case scenario. With respect to royalties, the Statement indicates that royalties related to patents for manufacturing activities related to the imported merchandise will typically be considered dutiable. With respect to royalties payments made to third parties and not the seller, for use of copyrights and trademarks in the U.S. which are tied to the imported goods will typically be seen as a buyer's selling expense and not considered dutiable.

As a result, CBP must analyze the facts and circumstances on an individual case basis as the use of product name or logo may add value for branding but may not reflect the inherent value of the goods sold by the seller. Furthermore, if the payment by the buyer to the seller is a condition of sale for export to the U.S., then the payment is related to the physical goods and may be considered dutiable.

In the Hasbro ruling, CBP considers the following questions to aid in the determination of a dutiable royalty:

1. Were the imported goods produced under a patent?
2. Was the royalty specific to the manufacture or sale of the imported goods?
3. Would the importer be able to purchase the merchandise without this payment?

Regarding question 1, if the response is affirmative, the payment is related to the manufacture of merchandise is therefore likely dutiable. Regarding question 2, if the importer can demonstrate the

[86] 19 U.S.C. 1401a(b)(1)(D)
[87] Customs Law, 'Ruling of the Week 2015.29: Hasbro II, Royalties and Proceeds', <https://customslaw.blogspot.com/2015/10/ruling-of-week-201529-hasbro-ii.html> accessed 29 August 2020

payment is not related to the manufacture or production process or can buy the imported merchandise then the payment may not be considered dutiable. Question 3 assesses whether or not the payment is a condition of sale. Thus, if the importer cannot import the merchandise without paying the fee it is likely dutiable.

The facts as to whether the product was manufactured under a patent were unclear in this case. However, the buyer did have the right to manufacture it and thus the response to the first question is likely a 'yes'. Thus, CBP held the royalty to be dutiable as the payment obligation accrued once the product was sold not when Hasbro collected the sale price from their customer.[88]

5.4.2.1 CBP's Totality of Circumstances Test

When CBP analyzes the facts and circumstances in each determination, they use additional considerations that were published in a 1981 Statement of Administrative Action.[89] These are as follows:

(i) the type of intellectual property rights at hand (e.g., patents covering processes to manufacture the imported merchandise generally will be dutiable);

(ii) who the royalty was paid to (e.g., payments to the seller or a related party are more inclined to be dutiable as opposed to payments to an unrelated third party);

(iii) if the purchase of the imported goods and the payment of the royalties are intricately linked (e.g., provisions in the same agreement for the purchase of the imported merchandise and the payment of the royalties; license agreements that refer to the sale of the imported merchandise; termination of one agreement upon termination of the other, or termination of the purchase agreement due to the failure to pay the royalties); and

(iv) payment of the royalties on every single importation.[90]

[88] *Ibid* 87

[89] Statement of Administrative Action, H.R. Doc. No. 153, 96 Cong., 1st Sess., pt 2, reprinted in, Department of the Treasury, Customs Valuation under the Trade Agreements Act of 1979 (October 1981), at 48-49

[90] CBP Ruling no. 548552 (August 19, 2004)

The royalty payment is likely non-dutiable if paid to a non-related, third-party and the license agreement does not disallow the importer to purchase from another supplier / factory as it would not be considered involved in the production or sale of the imported goods.[91]

5.4.3 Treatment of Patents and Trademarks

CBP makes a distinction between patents and trademarks with respect to their dutiable status. Most patent royalties could be considered dutiable, particularly if the payment represents the right to manufacture imported merchandise. CBP clearly opined this in the Hasbro II ruling where a three-question test is set forth in determining the dutiability of royalties. The 1979 customs valuation statute puts forth that royalties and license fees for patents covering manufacturing activities of imported goods is typically dutiable.[92] As such, it is noted that patent royalties are likely dutiable and it is up to the importer to establish that said royalties are not.[93] Importers would thus need to prove the imported merchandise is not related a patent or royalty in order to fall outside of the dutiability scope.

5.4.4 Third Party Licensors

While U.S. customs legislation touches on the dutiable status of royalties to be paid as a condition of sale, the law does not strictly define if the buyer and seller must be related to meet the condition of sale requirement. Even though a reference to the seller is part of the 'price actually paid or payable' definition, the statute does not preclude royalties paid to unrelated third parties as non-dutiable. As such, even in the scenario where royalties were paid for a patent of manufacturing activities, one must assess if the royalty is related to the production or sale of the imported goods, not whether or not the buyer and seller are related.[94]

5.4.5 Condition of Sale

Concerning the third question of the Hasbro II test, which addresses if the importer could purchase the merchandise without paying the fee, the importer must assess here the 'condition of sale' requirements. Unlike the EU, "CBP does not automatically assume that all payments related to the goods are being paid as a condition of the sale."[95] From a business perspective, failure to pay a royalty or license fee could be

[91] CBP Ruling no. 563382 (May 25, 2006)
[92] CBP Ruling no. W548692 (March 2, 2007)
[93] *Ibid* 83
[94] CBP Ruling no. H024980 (July 22, 2008)
[95] Mark K. Neville, Jr. 'The ABCs of Dutiable Royalties' (April 2014), Journal of International Taxation, p 35

considered a breach of the agreement, it would also force the seller to provide the sale for export. From a legal perspective, the 'condition of sale' requirement is reviewed on the basis of its payment is binding as a result of the sales transaction. As mentioned above, if the royalty or license fee is intricately linked to the imported goods, then it would be considered a 'condition of sale'.[96] Thus, CBP will consider the contractual obligations of the manufacturing activities of the imported good and the license agreement of said goods between the buyer and the seller to determine if there is a nexus between them.[97] Furthermore, in a 2003 CBP valuation ruling, CBP deemed that royalties paid on goods that were both imported as well as made domestically, even though related to the imported goods, were not considered a condition of sale.[98]

5.5 Intersection with transfer pricing and treatment of retroactive adjustments

Transfer pricing is a pricing method, used by related companies to manipulate prices at either a high or low level to generate a specific income payment or capital transfer between related companies.[99] The U.S. legislation relevant for transfer pricing is upheld by the U.S. Treasury Department and overseen by the Internal Revenue Service (IRS). The objective for U.S. transfer pricing legislation is to prevent related parties from shifting income through inappropriate pricing mechanisms.[100] The U.S. the arm's length principle also requires related party transfers to be based on market conditions and reflect the applicable tax jurisdiction.

5.5.1 Transfer Pricing Challenges

The acceptability of transfer pricing agreements used for customs valuation purposes is demonstrated in a CBP headquarter ruling. Here CBP writes that while both U.S. customs law and transfer pricing legislation aim to make certain the related party transactions are executed at arm's length, the methodologies for determining is different under each set of regulations. The ruling goes on to state that the Customs approach analyzes related party transactions at the detailed product level, while the IRS methods review related party pricing profitability on an aggregate level.[101]

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[96] *Ibid 25*
[97] *Ibid* 83
[98] CBP Ruling no. 548368 (December 24, 2003)
[99] *Ibid* 12
[100] Section 482 of the Internal Revenue Code (IRC)
[101] CBP HQ Ruling no. 546979 (August 30, 2000)

In 2007, CBP published an Informed Compliance Guide on 'Transaction Value for Related Party Transactions'. The publication states that, "the mere fact that an importer provides CBP with an APA or transfer pricing study is not sufficient to establish that a related party transaction value is acceptable.[102] The importer must furnish proof regarding the circumstances of sale and/or test values and cannot rely only on a transfer price study or APA for use of transaction value.

5.5.2 Transfer Pricing Adjustments

Under specific facts and circumstances, CBP has permitted the use of transfer pricing policy for use of transaction value. CBP HQ Ruling W548314, states that, "factors used to determine whether an objective formula is in place prior to importation for purposes of determining the price within the meaning of 19 CFR §152.103(a)(1) as follows:

(1) A written "Intercompany Transfer Pricing Determination Policy" is in place prior to importation and the policy is prepared taking IRS code section 482 into account;
(2) The U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
(3) The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted;
(4) The company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the United States; and,
(5) No other conditions exist that may affect the acceptance of the transfer price by CBP."[103]

This ruling published by CBP provides a set of clear guidelines to aid importers in assessing if their transfer pricing policy may be used in establishing the transaction value.

5.5.3 Upward & Downward Pricing Adjustments

[102] CBP Informed Compliance Publication (2007), 'What Every Member of the trade Community Should Know About: Determining the Acceptability of Transaction Value for Related Party Transactions,' <https://www.cbp.gov/sites/default/files/documents/icp089_3.pdf>, accessed 3 January 2020
[103] CBP HQ Ruling no. W548314 (May 16, 2012)

Related party transactions using transfer prices may be subject to certain adjustments post-importation. Commonly, the transfer price is based on a company's set policy for a transfer pricing formula. This formula, in accordance with the policy and national tax regulations may need to be adjusted either upwards or downwards on a periodic basis to bring companies within the profit range established and for the transfer price to be considered at arm's length for tax purposes.[104]

The importer in HQ Ruling W548314, seeks further clarification from CBP by asking if the formula at the time of importation were found to be acceptable in determining the transaction value, is it then permitted to make upward and downward post-importation price adjustments.[105] CBP states that if all five factors in Section 5.5.2 of this paper are met, than in importer may file post-importation adjustments.

5.6 Rulings

One of the mechanisms importers my utilize for reference purposes is the CBP Customs Ruling Online Search System (CROSS). CROSS is a searchable database of thousands of CBP rulings related to classification, valuation, origin, and other customs relevant topics from 1989 until present. The rulings can be searched by key words, company names (although some rulings are redacted for confidentiality purposes) or ruling numbers. This database provides regularly published rulings and is available to the public free of charge. The published CBP rulings related to customs valuation, provides an additional level of understanding as to the interpretation of the customs valuation legislation by CBP and may provide a preliminary guidance on certain customs valuation topics, provided there are similar facts and circumstances, without an importer having to reach out to CBP or an external advisor.

5.7 Customs & Border Protection's Reconciliation Program

In the 1990's, the Mod Act, entered into force, which provided a legal basis for customs reconciliation. Specifically, the Mod Act enhanced the customs declaration process by permitting certain data elements to be identified and reported to CBP at some point in the future. This reconciliation process is commonly referred to as the ACE Reconciliation Prototype.

Title VI of the North American Free Trade Agreement (NAFTA) Implementation Act, contains specifications in relation to CBP modernization. Subtitle B of Title VI establishes the CBP Automation Program (NCAP).

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[104] WCO Guide to Customs Valuation and Transfer Pricing (June 2015, updated 2018), page 17
[105] *Ibid* 103

NCAP is an electronic system for processing commercial importations.[106] The CBP reconciliation program provides a platform in which importers can file their entries using currently available data (e.g., customs value, classification and origin) and electronically 'flag' the entry which would need to be updated and re-filed to CBP at a later submission date with the corrected data elements..[107]

For U.S. importers, whose related party imports, are subject to the criteria for use of transaction value and could require a post-importation customs valuation adjustment, the Reconciliation Program is a simplified and automated tool for communicating changes to CBP. The adjustments may result in either an overpayment of customs duties (downward adjustment) or an overpayment of duties (upward adjustment). Through use of the CBP Reconciliation program, importers can request refunds from CBP for the overpayment and/or pay the additional duties owed.[108]

5.8 IT infrastructure in accordance with Customs legislation

CBP's Automated Customs Environment (ACE) is a nationwide system in which the trade community can report imports and exports which are reviewed and assess by the government.[109] The objective of the portal is to provide relevant trade information to allow the trade community to access data via a web-based automated environment and secure data portal. As outlined directly on the ACE Portal website, "the ACE Portal helps improve compliance with trade laws by enabling account holders to identify and evaluate compliance issues, monitor daily operations, set up payment options, review filings, access a reports tool, compile data, perform national trend analysis, and be provided with insight into entries under review by CBP.[110]" The ACE Portal enables relevant importers to electronically file Reconciliation entries via one IT platform across the U.S.

5.9 Liquidation

Upon entry of the goods into the United States, the goods must be "entered" or declared to the Customs. At the time of import, an importer is required to pay the estimated duties and file the entry summary

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[106] See Background Information on the CBP Reconciliation Program < https://www.cbp.gov/trade/programs-administration/entry-summary/reconciliation> accessed on 5 December 2019

[107] *Ibid 82*

[108] Lexology, EU Court of Justice Significantly Limits Use of Related Party Transfer Prices for Customs Value, <https://www.lexology.com/library/detail.aspx?g=da85c14b-5a81-4e1e-aafe-977016660444>, accessed 29 August 2020

[109] CBP Ace & Automated Systems https://www.cbp.gov/trade/automated first accessed on 6 December 2019

[110] Ace Secure Data Portal < https://ace.cbp.dhs.gov/> first accessed on 6 December 2019

within a maximum of 15 calendar days of the release of the goods.[111] Different from the EU, the U.S. permits an estimated customs value and provides 314 days from the day of importation for an importer to declare, if different, the final customs value[112]. The 314-day period is known as a liquidation period. As defined in 19 CFR§ 150.0, liquidation is the final assessment of duties on entries for consumption or drawback entries types into the United States by the Customs Authorities. If the entry was filed via the Automated Broker Interface (ABI) by a customs broker, they will receive an electronic liquidation notice. If the entry was filed via the CBP's Automated Commercial Environment (ACE), importers can review the liquidation dates within ACE.

6.0 Challenges coming from the difference in Customs Legislation

6.1 Treatment of royalties & licensing fees & condition of sale determination

In both the EU and the U.S. importers must assess the following four considerations to determine the dutiability of royalties or licensing fees:

Why the royalties or licensing fees were paid;

If the fees were related to the imported merchandise;

By which party and to which party the fees were paid;

Terms surrounding the fees and where the activity associated with the fees occurs.[113]

In the EU, the implementation of the UCC changed the treatment of royalties and licensing fees. By adding a new condition to the *condition of sale* requirement which deems the fees to be dutiable if the merchandise cannot be sold or purchased by the buyer short of paying the royalties or licensing fees to the licensor. Thus, in the EU, royalties and license fees that are paid by a buyer to a third party are more likely to be dutiable under the *condition of sale* requirement, as the buyer and seller are not required to be related.

As opposed to the EU, the U.S. specifically defines the condition of sale requirement and royalty and license fees payments essentially are treated as a *condition of sale* when they are paid on every import

[111] 19 CFR §142.2, Time for filing entry
[112] 19 CFR §141.103, Amount to be deposited
[113] *Ibid 25*, p126

transaction and 'inextricably intertwined' with the imported goods. As outlined, the U.S. created a test to aid importers in determining the dutiable status of royalty payments.[114]

Thus, the U.S. puts forth clear guidance for importers in this respect in the Hasbro II test. The U.S. also provides access to public valuation rulings specific to royalty treatment in the customs value and has one national approach as opposed to the EU where the Customs Authorities in the respective member state of import location is formally required to assess this treatment. Given the potential of different interpretations across each EU member states of the UCC, it is possible that conflicting guidance could be given to importers on the treatment of royalties creating inconsistent treatment and lack of uniform approach across the EU.

6.2 Intersection with transfer pricing and treatment of retroactive adjustments

The WCO Guidance for Customs Valuation and Transfer Pricing explains there is not a generally accepted rule on how to deal with pricing adjustments. As such the global treatment is not uniform and leaves the treatment up to the national Customs Authorities. This provides uncertainty for relevant importers and unequal treatment of pricing adjustments globally.[115] In the EU and the U.S., the way Customs Authorities handle upward, and downward price adjustments is different. This treatment alone is a challenge for economic operators when having to comply with both sets of requirements.

6.3 Valuation Rulings

The lack of Binding Information in the area of customs valuation limits importers in understand the general interpretation of Customs Authorities across the EU with respect to the treatment of transaction value for related party transactions, treatment of royalty additions, etc. This obligates importers to seek rulings at the National Customs level in each country of importation. The lack of uniformity lends way to different application of customs valuation treatment across different member states and a lack of uniformity for importers declaring customs value processes in different EU

[114] *Ibid 25*, p124
[115] *Ibid 27*

countries. The EU Commission attempts to address this concern by assessing the need for Binding Valuation Rulings in 2018.

As referred to in section 5.6, the U.S.'s CROSS database publishes valuation rulings for importers to use as a guide. This database includes, among various other customs valuation topics, rulings on treatment and handling of royalties, proceeds of subsequent resale, condition of sale determinations, use of transaction value for related party transactions subject to pricing adjustments and treatment of pricing adjustments. The database is another means for relevant importers to understand the approach and opinion of CBP on the treatment of the abovementioned topics.

Through the use of published rulings, importers can infer the opinion of CBP on certain customs related topics. This is apparent through the treatment of royalties in Generra Sportswear Co. v. United States, 905 F.2d 377 (Fed. Cir. 1990) where CBP is entitled to presume all payments made from the buyer to the seller or a related party of the seller must be included in the price actually paid or payable for the imported goods *unless* the importer can prove the payments are unrelated to the importer merchandise. A subsequent CBP ruling provides criteria beyond the Generra Sportwear case to test if royalties and license fees are dutiable under the "Hasbro II." [116]

6.4 IT infrastructure in accordance with Customs legislation

The UCC supports the electronic submission of customs declarations. The EU Commission specifies the common domain of responsibility for member states to adhere to when setting up their respective IT administrations. However, the national domain remains at the responsibility of the member state. This leaves space for different setups, divergences in national budgets to support IT infrastructure and levels of sophistication across the customs IT platforms in the EU.[117] Thus, the EU's setup with respect to Customs IT systems is disjointed and provides importers with 28 different IT domains they must adhere to (or select a customs broker which has the capability) when submitting a customs declaration or supplemental declaration.

While the UCC supports simplified declarations and supplemental declarations for use in the area of incomplete or unknown customs valuation in accordance with Article 166-167of the UCC, the possibility

[116] CBP General Notice titled as Dutiability of Royalty Payments, vol. 27, No. 6 Cust. B. & Dec., 1 (10 Feb. 1993)
[117] Interview with Vivien Monti, CEO, Vivansa, (Amsterdam, Netherlands, 4 December 2019)

to submit an EU-wide simplified declaration is not yet possible in accordance with Article 179 of the UCC, concerning Centralized Clearance, and Article 20 Delegated Regulation (EU) 2016/341. This is not possible as the prerequisite for this is the use of a European-wide system for data-exchange, currently not available until 2022 at the earliest.[118] As a result, the importer is obliged to obtain an agreement with each member state how and by which method the customs value should be reported. For example, in the Netherlands, the simplifications of Articles 166 and 167 of the UCC apply. Use of simplifications for customs valuation purposes must be addressed with the Dutch National Valuation Team. The additional declaration must be submitted within 120 days. It is technically impossible in the declaration system (AGS) to hold the declaration for longer than 120 days.[119] For an importer conducting imports across the EU, the task of agreeing with each respective member state on the treatment of customs valuation topics (e.g., treatment of royalties or pricing adjustments) is timing consuming, burdensome and resource-exhaustive.

The fact that the U.S. is one country with one IT infrastructure removes the disjointedness for importers with the need to file post-summary corrections. CBP uses an 'Automated Commercial System' (ACS) to process imports into the U.S. in connection with the 'Automated Broker Interface' (ABI), the interface in which permitted parties (e.g., customs brokers, importers, carriers, port authorities, etc.) in the trade domain to electronically file import relevant data to CBP.[120] The 'Automated Commercial Environment' (ACE), is a portal that enables relevant trade parties to access customs specific data.[121] ACE is also a platform that may be used to submit supplemental information including post-summary corrections to the customs value. [122] CBP's use of ACS, ABI and ACE, in connection with the U.S. Reconciliation program, provides an electronic solution for relevant importers to upload data required for post-summary corrections for customs valuation adjustments (e.g., upward or downward transfer pricing adjustments) within 300 days from the date of entry and up to 15 days of the scheduled liquidation

[118] Irish Tax and Customs, Centralised Clearance (SASP), <https://www.revenue.ie/en/customs-traders-and-agents/simplified-customs-procedures/centralised-clearance-sasp.aspx> accessed 24/12/2019

[119] Interview with Bas de Kok and Pim Mutsaers, Customs Officers, Dutch Customs (Breda, Netherlands, 12 December 2019)

[120] U.S. Customs and Border Protection, Automated Commercial System, <https://www.cbp.gov/trade/acs> accessed 24 December 2019

[121] U.S. Customs and Border Protection, Ace Secure Data Portal, <https://ace.cbp.dhs.gov/> accessed 24 December 2019

[122] Post-Summary Corrections operates under the 19 CFR 101.9(b), ACE prototypes

date, whichever date is earlier, through one IT portal governed and maintained by one customs authority for the entire import jurisdiction.[123]

7.0 Recommendations to EU Legislators for a streamlined implementation of UCC Customs Value

7.1 Use Binding Valuation Rulings & Make them Publicly

In the EU, importers may apply for binding rulings related to tariff information or origin information.[124] Article 35 of the UCC allows for, in certain instances, the Customs Authorities to make decisions for binding information with respect to factors mentioned in Title II. While it could be interpreted that binding valuation rulings fall within the scope of Title II, binding valuation rulings are not specifically mentioned in the UCC as origin and tariff. This is further supported by the 2018 inquiry to the trade community by inquiring about the need for binding valuation rulings in the EU. It would be reasonable for legislators to amend the UCC to allow for the trade community to apply for binding valuation rulings. Furthermore, making the valuation rulings publicly available, as in the U.S. CROSS database, would provide the trade community with insight into the treatment of various customs valuation treatments, the levels of interpretation of the Customs Authorities and overall guidance to practical cases which does not currently exist in the EU.

7.2 Define criteria in the EU so importers can understand royalties are applicable (Hasbro II)

The EU may consider publishing the criteria it deems relevant to determine the dutiability of royalties. The EU could adopt a similar test as CBP uses with the Hasbro II test. By making this available to the trade community, importers would have a better understanding of how the Customs Authority's interpret the UCC with respect to the dutiability of royalties and what preliminary questions importers may ask themselves given their setup. Specifically, UCC Legislators could indicate that royalties and license fees are dutiable when connected to the EU import transaction(s) and if the payment was a condition of sale. To determine this, the EU should publish guiding questions that assist both importers and Customs Officers in assessing the dutiability:

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[123] U.S. Customs and Border Protection, Post Summary Corrections, <https://www.cbp.gov/trade/programs-administration/entry-summary/post-summary-correction> accessed 24 December 2019

[124] Article 33 of the UCC

1. Was the imported merchandise manufactured under a patent?
2. Was the royalty involved in the production or sale of the imported merchandise?
3. Could the importer purchase the merchandise without paying the fee? [125]

As in the U.S. scenario, if the response is negative to the first two questions and an affirmative to the third question then importers would already have a likely indication the royalty would not be dutiable. Additionally, further guidance with respect to question two should discuss what elements in the license agreement between the buyer and seller should be reviewed and are required for further determination of a dutiable royalty. If the license agreement does not cover a royalty related to the production or sale of imported products this would be an additional element for a non-dutiable royalty.

With respect to the third question, if an importer may import the products without paying the fee, the EU Legislators should consider putting forth guidance as to what is considered a 'condition of sale' like the TCCV did in several of the Advisory Opinions issued.

Furthermore, by providing this criteria, Customs Authorities throughout the EU would have to follow the guidance. This streamlined approach could provide consistency that the treatment of royalties with respect to the customs value are treated equally among the member states. The EU may also consider publishing considerations regarding what is considered to be a 'condition of sale.' In the U.S., CBP analyzes four criteria to assess the 'condition of sale' determination. Again, having this available to the trade community would allow importers to understand the EU interpretation and potentially streamline the approach in this determination across EU member states ultimately limiting the non-uniform treatment of royalties.

7.3 Define criteria in the EU so importers can understand when APA is used / TP & retro price adjustments

As a result of the *Hamamatsu Court Case*, there remains a confusion in the EU as to the treatment of retroactive transfer pricing adjustments and the effect on the declared customs value. A potential solution could be to define the criteria for use of transfer prices as the transaction value. The EU could adopt a similar approach as the U.S. CBP where they apply a "5-factor test" to determine if a company's transfer pricing policy is also acceptable as the basis for the transaction value.[126] If all five factors are

[125] CBP General Notice titled as Dutiability of Royalty Payments, vol. 27, No. 6 Cust. B. & Dec., 1 (10 Feb. 1993)
[126] *Ibid* 62

met not only can the transfer price serve as the basis for the transaction value, but the importer can file a post-entry adjustment to the customs value and pay CBP the additional duties owed or request a refund for overpayment. This would provide more transparent guidance to the treatment of customs valuation for related party transactions in the EU and decrease the various interpretations on this topic across EU member states.

7.4 Amend UCC to include Liquidation and Reconciliation

One of the problems that importers face when dealing with post-entry adjustments to the customs value is issue of timing. At the present moment, the UCC requires the import declaration to be complete upon entry unless the declaration is a simplified one and there will be a supplemental declaration filed with the remaining information.

With respect to royalty calculations and transfer pricing adjustments this calculation is could be executed on a yearly basis. With royalties calculated based on historical figures from the previous calendar year and transfer pricing adjustments made at the end of the year. Article 146 and 147 of the UCC DA, provides a timeframe in which a company must furnish the supporting documentation relevant for a supplemental declaration. Article 146 of the UCC DA, sets a ten day limit in which a supplemental declaration must be lodged and not to exceed thirty days in the instance where supplemental declaration is general or periodic, the time covered by the supplemental declaration may not surpass a calendar month. As specifically outlined in section 4.7, there is not a feasible solution for transfer pricing adjustments given the administrative burden.

One way the UCC could deal with this is to introduce a similar mechanism as the CBP Reconciliation Program. Specifically, UCC legislators could extend Article 146(1) of the UCC DA to include the bold text:

> "Where the customs authorities are to enter the amount of import or export duty payable in the accounts in accordance with the first subparagraph of Article 105(1) of the Code, the supplementary declaration referred to in the first subparagraph of Article 167(1) of the Code shall be lodged **within 21 months of the release of the goods if the importer is approved for the Reconciliation Program.**"

UCC legislators would also have to incorporate the Reconciliation Program into the UCC. This Reconciliation Program would allow for importers to submit a customs import declaration with the information best known at that time for various data elements required at the time of import, valuation purposes included. The importer would flag the declaration as incomplete, which informs Customs upon import that the declaration is not fully complete and will be updated within the allotted timeframe. The importer would then have 21 months from the time the first import declaration was filed to submit the final import declaration reconciled with the accurate customs value. The 21 months would provide a window for importers to recalculate the correct customs value for example royalty additions based on real time data as opposed to historical data and to apply the transfer price adjustment across the weighted value of the imports.

In order for this proposed solution to bring fruitful results, there would need to be an EU-wide IT infrastructure that would capture the electronic submission of every 'incomplete' import declaration filed from the Customs side and made available to the trading community. Ideally, the Customs IT platform from every member state would feed a portal with all electronic versions of 'incomplete' declarations made available in a downloadable format including for example, Excel. This would provide importers with a platform to extrapolate the values to be adjusted against all of the open declarations. Once the values for each HS Code and their associated entries would be updated by the trader, they would upload the file and any supporting information. This file would provide line item details at the HS Code level, declaration level and total level. Thus, Customs would be able to tell at first instance how the customs value was affected and if additional duties would be owed or a refund request would be submitted. The importer would then subsequently pay any additional duties or request a refund for overpayment. Furthermore, the burden to correct every single import declaration in accordance with each member state's timeframe and IT capability would become obsolete.

Similar to AEO, Traders that would take advantage of the Reconciliation Program could be vetted and require an approval from their Customs Authorities in the member state of incorporation. During this process, Customs would understand what purposes the Trade would use the portal for and any concerns about the internal controls and procedures used by the importer. From a customs valuation perspective, Customs and the Trade would ideally discuss the royalty process, transfer pricing process and timing with the Trader. The internal activities and methods around these two processes would be understood and approved by Customs before the Trader could use the Reconciliation Program. Thus,

the Reconciliation Program would provide a practical, digital and uniform solution for both Traders and Customs.

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