CUSTOMS VALUATION: ARE YOU INADVERTENTLY UNDERVALUING IMPORTED MERCHANDISE?

U.S. Customs and Border Protection (CBP or Customs) valuation laws and regulations cover a wide range of transactions that may occur when importing into the United States. One area often over-looked is the transactions and payments that may occur outside of the invoice for the merchandise, commonly referred to by CBP as "statutory additions" to the price actually paid or payable. This area is often overlooked and misunderstood because company accountants and tax lawyers may not be familiar with CBP valuation laws.

Some examples of these required additions include assists, royalty payments, and selling commissions. Each type of statutory addition can be complex and involve documentation not part of the CBP Entry Package or documents provided to a Customs broker. Review of the Financial Statements, Working Trial Balance, and the Chart of Accounts/General Ledger (collectively referred to as "financial data") may not always come first to mind when considering these areas. CBP requires importers to exercise reasonable care during all parts of the import process. This includes relevant transactions that may occur before or after the shipment of the merchandise.

In this guide, we highlight the role that the financial data may have on Customs valuation. The valuation and statutory additions are comprehensive and covered by U.S. laws, CBP regulations, CBP Informed Compliance publications, and CBP Rulings.

A fully integrated valuation program must cover the price actually paid or payable, basis of appraisement, related party transactions, and statutory additions. Reviewing your company's financial data is one key area to identify the statutory additions. Like other trade areas in a Customs compliance program, risk assessment and monitoring are a balance of the appropriate internal resources and external expertise.

Laws, Regulations, and Rulings for Documentation

CBP regulations at 19 C.F.R. Part 163 describe the general records to be maintained, what entities are responsible for recordkeeping, retention periods, and a recordkeeping compliance program. The Appendix to Part 163 is a list of documentation, commonly referred to as the "(a)(1)(A) List."

Additionally, CBP regulations at 19 C.F.R. § 152.103 stipulate that to determine the transaction value for imported products, the following must be added to the price paid or payable: 1) Packing costs; 2) Selling Commissions; 3) Assists; 4) Royalty or License fees; and 5) Proceeds of any subsequent resale, disposal, or use that accrue directly or indirectly to the seller. In other words, the importer is required to increase the price paid or payable based on sufficient information. Without including these costs, a company would be inadvertently undervaluing merchandise imported into the United States.

The list of additions can cover a wide range of agreements, circumstances, and payments between parties, unrelated or related. The range of documentation CBP can request is often not considered at the time of import since the Customs regulations on additions do not provide any further explanation. The scope of the required documentation is covered in more detail at 19 U.S.C. § 1509 (Examination of Books and

Witnesses). Section 1509 gives CBP the authority to examine any record, which may be relevant to an investigation or inquiry. This includes, but is not limited to, statements, declarations, documents, or electronically generated or machine-readable data.

Further, CBP can require a wide of range of documents as part of a Ruling request to provide CBP sufficient information to reach a conclusion. All-together, this allows CBP to review Financial Statements, General Ledger transactions, and a variety of accounting reports, Working Trial Balances, and Chart of Accounts when relevant to support the declared value. Financial Statements may include Consolidated Statements of a parent entity and Segmented Statements of entities under the parent corporate structure. At times restrictions imposed by a parent entity limit the amount of information that can be shared between related entities creating challenges to accurately support additions.

Financial Records and Documentation Trail for the Price Paid or Payable

The Financial Statements and Chart of Accounts/General Ledger provide an overview of how an entity has organized their accounting transactions. Areas of interest for Chart of Accounts/General Ledger could include various types of accounts, such as assets, revenue, expenses, adjustments, and less identifying account names that include “other,” “miscellaneous,” or “inter-company.”

The Working Trial Balance is relevant to show not just the end of month, quarter, or year balances, but to identify any activity that flowed through an account during the fiscal year. This is important in evaluating the risk of potential additions. An account used to net or enter adjustments may be zero at the end of a period, but the transactions may still be of interest for identifying additions.

Transactions to record payments or internal accounting entries for statutory additions, often occur outside the cycle of purchase order, invoice, and final payment. The risk assessment, identification, and review of these types of transactions requires a different approach by CBP beyond the normal entry documents. The financial data will give a high-level overview for CBP to inquire and identify any potential transactions impacting the price paid or payable. Every entity will have its own organization structure for the accounting system and how transactions will flow into the General Ledger and ultimately the Financial Statements.

Risk Based Methodology for Review

CBP will ask questions to identify transaction flow and how this may be unique for each entity. The process is a top to bottom level risk approach. CBP takes a risk-based approach to make most efficient use of its resources. An importer’s trade data, industry, and type of product will be available to CBP for review. That information will drive the questions for how the importer operates with agents, suppliers, and any middle parties.

The responses will determine what General Ledger accounts are of interest to help identify any potential additions that may have occurred. CBP may review and ask questions on certain accounts without requiring further detailed documentation. Additionally, CBP may inquire further and select transactions from multiple accounts for further supporting documentation. The documentation will either need to support that an item is not an addition or have a documentation trail to show it was included in the price paid or payable.

Integration of Audit and Customs Experience into Compliance Program

For companies, the important part is to be proactive and aware of the complete flow of how import transactions impact and are recorded in the accounting system. At a minimum, regular communication is required between multiple departments as applicable for reviewing and identifying internal potential additions. These departments include research and development, purchasing, logistics, accounting, tax, finance, sales, and Customs. Depending on the importer's circumstances, it can be straight forward or very complex.

It is important for Companies to be knowledgeable not only of Customs criteria, but also accounting requirements and systems, Generally Accepted Accounting Principles (GAAP), and international accounting standards. As many global entities currently present Financial Statements and data in various formats to meet U.S. and International Financial Reporting Standards (IFRS).

The number of CBP inquiries and the extent of questions has increased with the newer section tariffs and industry changes occurring due to COVID-19. We have seen importers believe to their best knowledge they had no additions, but a review of the company's financial data identified accounts, unbeknownst to the importer, impacting the price paid or payable. At a minimum, most CBP inquiries or audits will result in providing responses and documentation to CBP, even if there are no additions.

A detailed listing of all the factors related to evaluating risk and compliance is beyond the extent of any one article or guidance. There is no one size fits all approach and method. If your company has not recently completed a review of the company's financial data, a more thorough approach and review is warranted. When identified, the risk of additions is low, and a stop-and go approach can be taken with fewer transactions reviewed.

Summary of Financial Data Review

Resources and time are harder to manage every day. Supply chains, mergers and acquisitions, material requirements, and consumer product requirements are constantly changing and impacting foreign supplier purchases and the possibility of additions. The monitoring process is a continual effort that can be challenging based on available resources. The COVID-19 pandemic has every importer reviewing its supply chains to consider diversification in the future. Increasing the number of countries and suppliers to import from also increases the risks and resources to monitor.

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We recommend companies review their financial data minimally on an annual basis. For some importers, an end of year review might be the most appropriate depending on the industry cycles. A comprehensive Customs compliance program is an integrated balance of internal and external resources. A new or periodic review conducted by external resources with the combined perspective of Customs, CBP criteria and Rulings, supply chain, accounting, and auditing can identify any potential concerns first, before a CBP inquiry or audit.

If you have not recently completed a review of your company's financial data, or need assistance with Customs audits or evaluating internal controls, please feel free to contact Torres Law attorneys and trade advisors to assist. Our network of trade advisors includes prior CBP Assistant Field Directors and Senior Auditors.

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