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Asia-Pacific: Interplay between transfer pricing and customs valuation

The interaction between transfer pricing and customs valuation can be challenging anywhere in the world but especially in the Asia-Pacific (APAC) region. Unlike in the EU, the implementation of the World Trade Organization (WTO) customs valuation rules is not harmonized across the various countries in the APAC region because they are independent customs jurisdictions. In addition, due to the generally high duty rates in the region, the financial impact of customs-valuation-related matters can be significant for businesses and customs authorities alike. This makes reviewing intercompany transactions and transfer pricing adjustments a key priority for customs authorities across the APAC region. This article aims to provide insights on the interplay between transfer pricing and customs valuation in the region. It also suggests strategies to mitigate disagreements with customs authorities, including illustrations for select jurisdictions.

Both transfer pricing and customs valuation prescribe rules regarding the acceptability of intercompany prices. The aim is to ensure related parties interact with each other as if they are not related and, therefore, comply with the arm's-length principle. However, certain differences exist between these sets of rules, specifically in how they are implemented. Transfer pricing generally focuses on the profitability of a legal entity, while customs valuation focuses on an acceptable price for each individual product and import transaction. The World Customs Organization (WCO) has said, despite these differences, transfer pricing documentation can be a valuable source of information for customs valuation purposes.[1] While several customs authorities agree on some degree of usefulness of transfer pricing documentation, the practical implementation across the APAC region can vary significantly. In addition, multinational enterprises (MNEs) should recognize that transfer pricing documentation is seldom drafted with customs valuation in mind. This, in a best case, may not be very useful for defending a customs valuation challenge; in a worst case, this could lead to unintended consequences, such as having to provide additional elements to customs authorities to challenge customs values.

Acceptability of intercompany transaction prices

From a customs perspective, parties should demonstrate that their relationship has not influenced the price in a transaction. Most MNEs argue that this requirement is met if the importer earns a remuneration in line with a transfer pricing benchmark validated by an independent service provider. As customs authorities often point out in such a situation, simply providing transfer pricing documentation will not be sufficient. In practice, it is up to the importer to demonstrate that the intercompany prices are acceptable from a specific customs valuation perspective.

1 For an example, see WCO Technical Committee on Customs Valuation (TCCV) Commentary 23.1, TCCV Case Studies 14.1 and 14.2, or the WCO Guide to Customs Valuation and Transfer Pricing (June 2015, updated in 2018)

Customs authorities across the APAC region regularly use import price databases to challenge the import prices as being too low. Complying with requests of customs authorities (i.e., higher import prices) may in turn result in scrutiny from tax authorities (i.e., higher import price results in a lower corporate income tax base in the importing market). According to the WCO, customs authorities may not use customs valuation databases to determine the customs value of imported goods as a substitute value for imported goods or as a mechanism to establish minimum values.[2] Nevertheless, it is likely that this will not be a successful argument. A first step in such cases is to determine whether the import prices in the database relate to products that are identical or sufficiently similar. This includes not just the product itself but also the other details of the sale (e.g., commercial level, quantities, timing). Alternatively, the importer will have to demonstrate that the intercompany prices, while potentially being lower than prices from an import price database, should still be acceptable from a customs valuation perspective. See the section "Customs valuation defense file" below for suggestions as to how to address this.

Retrospective transfer pricing adjustments

In all APAC jurisdictions, certain actions are required for retrospective transfer pricing adjustments. Failure to report transfer pricing adjustments may lead to additional duties and other import taxes, significant fines, and interest, once discovered by the customs authorities in an audit. As a starting point, the customs value becomes final once the import declaration is accepted by customs authorities, barring certain exceptions. As retrospective transfer pricing adjustments, per their definition, occur after the time of import, they create challenges from a customs valuation perspective. Some APAC jurisdictions have well-defined procedures, and some even have guidance available. However, for most jurisdictions, the treatment of retrospective transfer pricing adjustments is a gray area and requires case-by-case analysis.

2 'Guidelines on the development and use of a national database as a risk assessment tool', *World Customs Organization website*. Find it here.

One thing that customs authorities across the APAC region generally agree on is that if a transfer pricing adjustment results in an increase in the price of imported goods, then additional duties and other import taxes (if applicable) must be paid. However, in many jurisdictions, obtaining a refund in the case of a reduction in prices due to a transfer pricing adjustment is, in practice, not possible. Nevertheless, there are some APAC jurisdictions (e.g., Australia, Japan, New Zealand, Singapore, South Korea) where refunds can be obtained if certain procedures are followed. Often, proactive alignment with the customs authorities is required to qualify for refunds.

In certain jurisdictions, businesses can apply for rulings to get clarification on how to treat retrospective transfer pricing adjustments or other customs-valuation-related matters. This usually involves explaining the underlying transfer pricing model and providing legal agreements and other relevant documents. The ruling effectively is an agreement between parties on how potential transfer pricing adjustments should be treated for customs valuation purposes. This provides certainty for the importing business and helps to avoid audits and fines.

Australia illustration

Retrospective transfer pricing adjustments should be proactively reported to Australia Customs. If price changes are not notified, Australia Customs may impose penalties for a false and misleading statement, regardless of whether any duty is payable in connection with the imported goods. A voluntary disclosure can be submitted to obtain penalty protection. In addition, in the case of transfer pricing adjustments that increase the value of imported goods, the importer may be permitted to make a single additional payment for additional duties and import taxes based on a bulk amendment. However, to obtain a refund, all the relevant import entries will need to be amended. To avoid an uncertain outcome in the case of a voluntary disclosure and for ease of administrative formalities, importers can apply for a "Valuation Advice." This is a private and binding agreement with Australia Customs regarding customs valuation matters, including, but not limited to, retrospective transfer pricing adjustment. This enhances certainty and predictability for Australian importers on customs valuations matters.

China Mainland illustration

In recent years, managing retrospective transfer pricing adjustments has been getting increasingly difficult in the mainland China tax jurisdiction from a customs perspective. This includes reaching an agreement with China Customs to facilitate foreign exchange payments related to transfer pricing adjustments that increase the value of imported goods.

In May 2022, the first pilot scheme in Shenzhen, China, was introduced seeking alignment between Shenzhen customs and tax administrations on prices for related-party imports. The aim is to reduce potential scrutiny from a tax transfer pricing perspective and customs perspective as both administrations are proactively involved. Once both administrations reach an agreement, a memorandum (i.e., a Memorandum of Collaborative Management of Transfer Pricing of Related Party Imported Goods) will be signed. This pilot is currently in its early stage, and there is still uncertainty regarding certain aspects. For example, it is currently unclear whether foreign exchange payments arising out of transfer pricing adjustments would be facilitated by the memorandum. Also, there is no indication whether the pilot will be extended to other parts of China. While MNEs are interested in the program, they are hesitant to enrol in the pilot until additional details have been finalized. For the time being, businesses should consider retrospective transfer pricing adjustments in China on a case-by-case basis.

Japan illustration

Japan Customs is increasingly aware of the relevance of retrospective transfer pricing adjustments for customs valuation purposes. The agency is actively looking into this matter and asking targeted questions to importers. Retrospective transfer pricing adjustments should be proactively reported to Japan Customs to avoid penalties. The standard approach in these cases is to amend each impacted import declaration individually. However, it may be possible to negotiate a simplified method for declarations that share the same conditions (e.g., place of import, duty rates, customs year) to be combined into a single amended declaration. It may be possible to obtain a refund, subject to having robust documentation and/or having a prior agreement with Japan Customs.

Korea illustration

Businesses importing into Korea can submit a voluntary disclosure informing Korea Customs of retrospective transfer pricing adjustments. However, customs authorities have the discretion to not accept such disclosures. This may not immediately result in an audit, but there is a high likelihood that the customs authorities will investigate this further.

As part of the audit, Korea Customs tends to strictly examine transfer pricing adjustments. In addition to payment of additional duties, import taxes and penalties, the importer may lose the right to deduct import value-added tax (VAT) for any additional VAT assessed in the audit, resulting in an additional cost. The standard VAT rate is 10%.

The restrictions on the recoverability of the VAT assessed in customs audits appear to have been eased under revised VAT legislation in 2023. However, the authorities are still strictly applying the regulation in determining when import VAT on transfer pricing adjustments can be treated as deductible. To manage this risk, importers can apply for an Advance Customs Valuation Arrangement (ACVA). This provides protection against audits and penalties and facilitates the deductibility of import VAT.

New Zealand illustration

Importers in New Zealand are able to use the provisional value scheme (PVS) to manage retrospective transfer pricing adjustments. Under the PVS, importers can declare a provisional value for goods, then declare a final value later. This eliminates exposure to any penalties or other charges (assuming adherence to the respective compliance obligations). Post-importation adjustment disclosures are made by way of a reconciliation letter submitted within 12 months of the financial year-end to New Zealand Customs. To apply for PVS, importers will need to provide transfer pricing documentation and other relevant information to New Zealand Customs.

Thailand illustration

In some jurisdictions, obtaining a customs valuation ruling may not be the answer. For example, in Thailand, while there is an administrative process to obtain legally binding customs valuation rulings, this often does not provide a workable solution. Thai Customs is generally more inclined to consider and issue a nonbinding "consultation letter." In practice, this can usually be relied upon to support taxpayers' valuation position and assist with challenges at the port level or during customs audits.

In the case of retrospective transfer pricing adjustments, a voluntary disclosure is possible if the adjustment leads to a duty shortage. A voluntary disclosure helps reassure Thai Customs that there is no duty-evasion intent in relation to the price adjustment, for the case to be settled without penalties. Nevertheless, interest surcharges will still apply.

Taiwan illustration

Taiwan has a so-called one-time transfer pricing adjustment mechanism to facilitate one retrospective transfer pricing adjustment per financial year. At the time of the import, certain elements should be included in the import declaration. This includes, for example, information indicating that the customs value may be subject to retrospective transfer pricing adjustments. Customs duties, excises and other import taxes are then paid based on the initial customs value. Within one month following the end of the year, a package should be submitted to Taiwan Customs containing details of the transfer pricing adjustment. In case the importer cannot provide the necessary information within the one-month period, they should proactively reach out to Taiwan Customs to discuss how to proceed. Depending on the type of transfer pricing adjustment, either an additional payment will have to be made or a refund can potentially be requested, subject to meeting the relevant criteria.

Customs valuation defense file

Given the challenges surrounding intercompany prices and retrospective transfer pricing adjustments in the APAC region, several MNEs have instituted "customs valuation defense files." In the case of an audit, it is often difficult to swiftly provide a high-quality and consistent response taking into account all relevant considerations and data sources. As previously mentioned, simply handing over transfer pricing documentation is usually not sufficient as this does not specifically address the acceptability of import prices from a customs valuation perspective. A customs valuation defense file can explain the customs valuation logic regarding various matters, such as intercompany pricing, transfer pricing adjustments, royalties and value-added services fees. This allows the importer to provide a timely, consistent and high-quality response to customs authorities. It also allows creating and maintaining contemporaneous documentation (e.g., customs-specific benchmarks), which often may not be possible to do after the fact, especially when disputes arise in post-clearance audits years after the relevant import transactions. This may help to manage disagreements with customs authorities, avoid unnecessary additional duty payments and fines, and limit delays at the port. In addition, by carefully reviewing the customs valuation position, a business may identify potential risks or business opportunities.

Prospective transfer pricing adjustments

MNEs are increasingly looking into prospective transfer pricing adjustments to avoid various customs valuation challenges on account of retrospective transfer pricing adjustments. If an MNE uses prospective transfer pricing adjustments, it needs to actively monitor the profitability of the importing entity. In case profitability is not in line with the benchmark, it will adjust the price of the imported goods going forward.

The aim is to avoid retrospective transfer pricing adjustments at the end of the year or at least to reduce the amount of the adjustment. At first glance, this seems like a good solution from both a transfer pricing and a customs valuation perspective. However, prospective transfer pricing adjustments do not come without their (customs) challenges.

Customs authorities in the APAC region actively compare the prices of imported goods both to the prices of other importers and the historical prices of the importer itself. Significant price fluctuations, either upward or downward, can raise a red flag. What is considered significant will differ per jurisdiction and is usually not public knowledge.

For a reduction of the price of the imported goods, customs authorities can simply continue to determine the customs value based on the previous (higher) price, thereby preventing any reduction in customs duties payable. However, for a significant increase in price of the imported goods, the customs authorities may take the position that the customs value of the previous imports was too low. This could result in retroactively increasing the price of the previously imported products (sometimes covering the imports of multiple years), resulting in additional customs duties. In addition, they may claim that the previous import declarations were incorrect, potentially resulting in additional fines and interest. Therefore, a careful implementation of prospective transfer pricing adjustments is key in the APAC region.

Action for businesses

The interplay between transfer pricing and customs valuation is a dilemma for most MNEs importing goods in the APAC region. Due to its inherent complexity, combined with varied practices in the different jurisdictions, it needs to be navigated carefully. A solution that works in one country may not work in another. Engage in proactive customs planning to avoid noncompliance and incurring additional duties and other import taxes, fines, interest, etc. Potential solutions to consider include rulings, voluntary disclosures, a customs valuation defense file and implementing prospective transfer pricing adjustments. ■

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Japan: New definition of Importer of Record

On 30 June 2023, Japan Customs released a revised Basic Circular to the Customs Law[1] relating to who can act as an Importer of Record (IoR) in Japan. The changes that came into effect from 1 October 2023 provide clarity on who may be the IoR for goods imported into Japan not pursuant to an import transaction or a buy/sell transaction (e.g., when a company moves its own inventory into Japan).

Due to the rapid increase in imports of goods conducted by e-commerce traders, Japan Customs has found widespread underpayments of import taxes on such imports and has faced difficulty in collecting additional duties and import consumption tax on these imports.[2] The Council on Customs, Tariff, Foreign Exchange and Other Transactions (Customs Committee), which is a consultative body within the Ministry of Finance, was tasked in June 2022 with discussing how to treat import declarations by e-commerce traders.[3] As a result, the Basic Circular was amended.

Who can act as the IoR in Japan?

Before the revision, Basic Circular 6-1 to the Customs Law stipulated that the IoR should be the person who intends to import the goods, which, in principle, should be the person who appears on any invoices or bills of lading as the consignee. This implied that the IoR could be anyone who acts as the consignee for the shipment even when such person did not have an adequate understanding of the goods being imported. The Customs Committee highlighted many examples of such cases in which the IoR did not have full understanding of the imported goods,[4] which ultimately led to incorrect or fraudulent declarations. It used these examples as reasons for why the Basic Circular needed to be amended to provide more clarify on the definition of IoR.

1 Basic Circular 6-1 to Customs Law and Basic Circular 67-3-3-2 to Customs Law.

2 This is mentioned in the final report issued by the Customs Committee: "Regarding the cargo handled by Fulfillment Service provider, there have been cases of non-residents using the names of domestic residents without their consent, a practice commonly known as impersonation, to import goods. Furthermore, instances have arisen where imports are declared at unfairly low prices, even though no actual transaction has occurred at the time of import, leading to the evasion of customs duties and other taxes." Find it here.

3 Further background information is provided in our article "Japan: 2023 tax reform changes to the customs law,' *TradeWatch* Issue 1 2023, page 24. Find it here.

4 This is mentioned in the discussion paper of the 31 October 2022 Customs Committee meeting, pages 18 to 22. Find it here.

As a result, the new definition of "a person who intends to import the goods" has been clarified in the revised Basic Circular under Article 67-3-3-2 as follows:

- Where goods are imported pursuant to an import transaction under the Customs Tariff Law, the importer shall be the consignee stated on the commercial invoice.
- Where goods are not imported pursuant to an import transaction, the importer shall be either:
  - The person who has the authority at the time of importation to dispose of the imported goods after the goods are released for free circulation in Japan or
  - Any other persons who perform the act which constitutes the purpose of importation. Examples of the act which constitutes the purpose of importation are:
    - Importing goods that are leased goods
    - Importing goods to conduct toll manufacturing services
    - Importing goods to provide sales agent or commissionaire services
    - Importing goods to conduct repair services of damaged goods
    - Importing goods to conduct disposal services of goods as waste

Impact of this revised Basic Circular

While the reason for this revision in the definition of IoR was the increase in imports by e-commerce traders, the way the Basic Circular was amended does not limit its application to e-commerce traders alone. As a result, the revised circular could have a much broader application for other importers as well.

Specifically, if an importer is not purchasing or does not own the imported goods at the time of importation, and it is not providing certain services related to the imported goods that constitute having a purpose to import the goods, the importer may no longer qualify as an IoR for customs purposes.

Japan Customs may still allow companies to act as IoRs, provided they have a legitimate reason for why they need to import goods into Japan. However, given that the revised Circular is so new and lacking in past precedents, it would be advisable for companies to carefully review their IoR position if they do not fit the definition provided in the revised Circular and, where necessary, seek clarification from Japan Customs as to their position. ■

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Vietnam: Draft proposal to abolish some on-the-spot export-import transactions

As of 29 May 2023, new laws apply to on-the-spot (OTS) export-import transactions. The changes arise from an Official Letter 2587/TCHQ-GSQL issued by the Vietnam General Department of Customs (the GDC) to Vietnam Ministry of Finance (the MoF).[1] Based on its internal review of relevant laws and regulations, the GDC provided feedback on and proposed some regulatory amendments to the execution of OTS transactions in Vietnam.

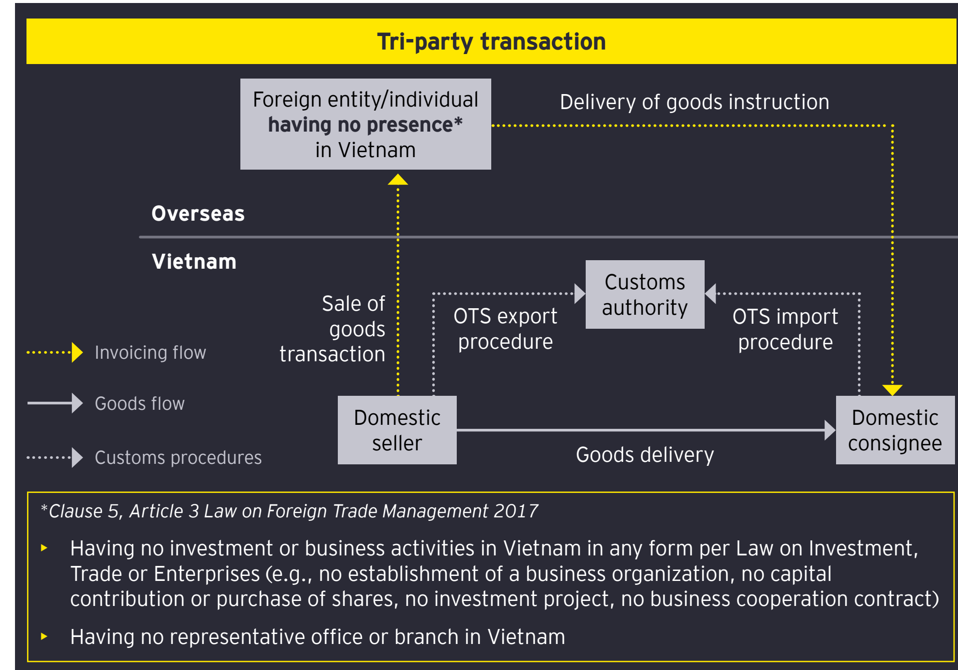
OTS transactions

OTS transactions are sales of goods from sellers in Vietnam to overseas buyers, but the goods do not physically leave the country and are delivered to another party in Vietnam, who purchase them from the overseas buyers. The goods are treated as exports by the sellers in Vietnam, which are subject to 0% export duty (except for natural resources) and 0% value-added tax (VAT). They are then re-imported by the other party in Vietnam. The importation is subject to import duty, special consumption tax (if any) and import VAT, which is calculated on an ad valorem basis.

The proposal

The GDC has submitted a proposal to the MoF and other competent authorities to abolish tri-party transactions (point c, clause 1, Article 35 of Decree No. 08/2015/ND-CP), which provides guidance on the implementation of the Customs Law related to these transactions.

For example, under the proposal, the below OTS tri-party transaction would be abolished.



1 Official Letter 2587/TCHQ-GSQL 2023 commenting on amendments and supplements to Article 35 of Decree 08/2015/ND-CP. Find it here.

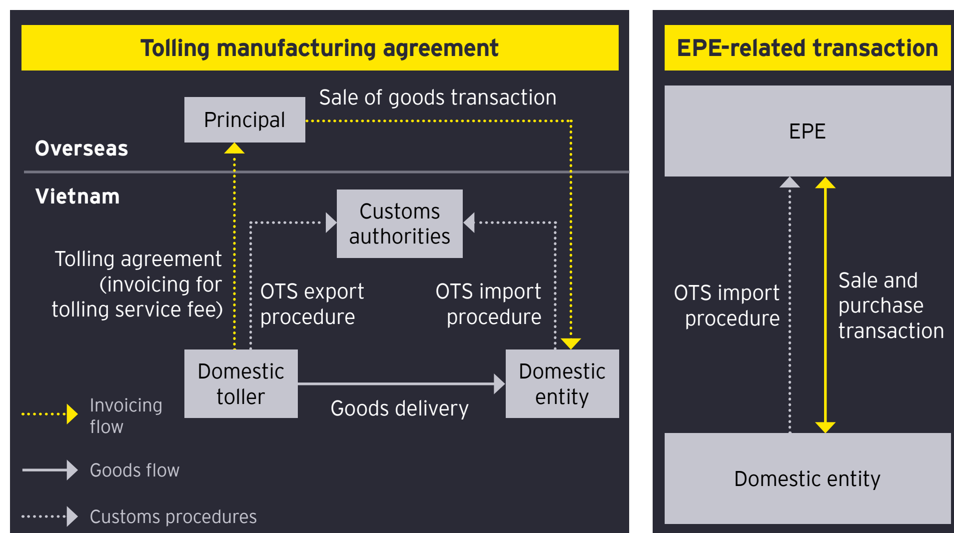
The MoF has reviewed the GDC's proposal and seems agreeable to the suggested abolition. In its recent Official Letter No. 9133/BTC-TCHQ dated 25 August 2023[2] to the Vietnam Government Office, the MoF provided its assessment on the matter, including potential impacts on business and tax budget collection, as well as setting out some recommended alternative transaction structures for businesses to consider adopting as a replacement for their current OTS transactions after the abolition is approved.

To support businesses and to avoid sudden supply chain disruption, the MoF has proposed a transition period of one year before the abolition becomes permanent, provided that the foreign entity can strictly satisfy the condition of having "no presence in Vietnam."

Remaining OTS transactions unaffected by the change

The two remaining OTS transactions – toll manufacturing agreements and export processing enterprise (EPE)-related transactions – are not set to be abolished.

An EPE is a company set up and located in Vietnam, but its main business activity is to manufacture for export, and so it is treated as being in a non-tariff zone, therefore, it is exempted from almost all customs duties and VAT.



Alternative options

As mentioned, the MoF suggested some alternative options for businesses operating in Vietnam to consider if the proposed abolition is approved. Those alternatives include:

- Treating the sale or purchase transaction in the same way as a transaction between domestic entities
- Using a bonded warehouse
- Converting domestic entities into EPEs
- Notwithstanding these suggestions, the MoF has not yet issued any concrete guidance on these alternatives, which may create some confusion for businesses.

Common trends and practices

- Businesses should review the MoF's proposed abolition and suggested alternative arrangements to explore their possible options for business continuity and to avoid supply chain disruption.
- In considering any new arrangements, in addition to the supply chain feasibility, businesses should also assess the potential new tax, customs duty and customs procedure implications, in particular:
  - If a "bonded warehouse" is used, would new or additional customs procedures apply for the first domestic seller? Who would bear the cost of such warehousing? How long can goods be stored in such a warehouse?
  - If the sale between the foreign entity and the domestic buyer or consignee is treated as a domestic sale, is there an obligation for the foreign entity to register for VAT and pay VAT in Vietnam?
  - Given that the cost structure of the transaction may change, there is a potential need to revisit transfer pricing for the transactions to ensure they are at arm's length and comply with transfer pricing regulations if the transactions involve related parties.

2 Official Letter 9133/BTC-TCHQ 2023 draft Decree amending Decree 08/2015/ND-CP. Find it here.

   - To convert a domestic entity into to an EPE, there are likely to be many administrative procedures, potential consequences and possible risks that should be analyzed, such as the possibility for VAT refund of existing VAT credits and the possibility of using subcontractors for the business in the future.
   - There may be some other nontax considerations to assess, such as the possibility of collecting foreign currencies by the first domestic seller under any alternative options.
- In addition, for previous periods, businesses should do an internal review of their qualification for OTS tri-party transaction status. In particular, it is crucial to supply evidence to the authorities that the foreign entity has "no presence in Vietnam" upon audit or request.
- Businesses should continuously monitor the progress of this policy change to be able to respond with appropriate actions and decisions.

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Vietnam: Trends in customs valuation for imported goods

Vietnam generally follows the World Trade Organization (WTO) Valuation Agreement[1] framework. As in that framework, Vietnam's domestic regulations provide the following six methods for customs valuation:

- Transaction value
- Transaction value of imported identical goods
- Transaction value of imported similar goods
- Deductive value
- Computed value
- Fallback method

In this article, we do not present the details and rules for each of these methods. Rather, we will review the latest practices and customs valuation trends as applied by Vietnam's customs authorities, who may interpret and implement certain aspects of the valuation rules differently from the WTO agreement. Customs inquiries about valuation may happen at any the stage of an importation, including in the process of a customs valuation consultation, through questioning by the customs authority, or in the course of a regular or special customs audit.

1 "Trade Guide: WTO Customs Valuation Agreement," *International Trade Administration website*, accessed 4 October 2023. Find it here.

Trend 1: Using the export price with other countries or the domestic selling price in export countries

The Vietnamese regulations prohibit the customs authorities from using these prices for the purposes of imposing a customs value on imported goods. However, these prices may be used (especially if used by the importer) by way of comparison to see whether these prices are approximately the same as the importer's import price that is being questioned by the customs authorities.

This comparison is especially helpful if the importer does not have any other documents or justification for its import price, such as when the importer and the foreign exporter or seller have a special relationship and the importer has no way to justify that this special relationship has not influenced the transaction price.

For the comparison to be accepted, the importer would need to convince the customs authorities why this is an effective method to follow. This would also depend on the specific situation of each company (e.g., whether it is difficult to find identical or similar goods on the market, whether the exporter or seller is willing to disclose such information).

It is also important to stress that this comparison is a way to help an importer to justify its transaction price; it cannot be used to impose a customs value. If this comparison is not accepted, the customs authorities will still follow the six valuation methods (listed above) to impose a customs value for duty collection purposes.

Trend 2: Detailed review and assessment of ordering processes and sales contracts to determine whether a special relationship has influenced the transaction value

The customs authorities verifying whether the relationship between parties has affected the transaction is not a new topic. The WTO rule stipulates that if a transaction is conducted between unrelated parties, then the customs authorities may accept the transaction value. That said, there is no detailed guideline in the Vietnamese regulations as to how or what documents the customs authorities will look at to determine this (other than the use of value of identical or similar goods, or the use of the deductive value).

In practice, we have seen the tax authorities tend to focus on the ordering process of the importer and the importer's compliance with what has been agreed in its contract with the seller. For example, if the order is automatically made through an internal system (which is very common for related parties within the same multinational group) without any back-and-forth negotiation, the customs authorities may question the relationship. In this case they could deem the transaction not equivalent to a sale between unrelated parties. Therefore, for the importer to prove that the transaction value has not been influenced, it may need to improve the ordering process or document it better, depending on each individual case.

Another criterion for examination may be whether the importer and seller comply with what they have committed to in their sales contract. For example, if the importer promises to make a payment by a deadline but fails to do it without any consequences or penalty, the customs authorities may deem the contract just a formality with no substance, such that the special relationship between two parties has influenced the transaction price.

Trend 3: Reviewing intercompany service agreements

The customs authorities may now request to review relevant intercompany service agreements (other than goods sales contracts) between the importer and the foreign seller, or between related parties in the same group, to identify whether there may be "additions" to the customs value, if they are directly related to the imported goods.

For importers, this trend implies the need for strong collaboration between global and local customs and tax functions within the group to review intercompany agreements together to ensure consistency.

Royalty payments are an area where attention is needed. It is well known that such payments are usually subject to withholding tax. However, not all companies are aware that such payments should be added to the customs value and are thus subject to customs duty as well, if they are directly related to imported goods and subject to certain conditions as prescribed by law. The situation may be exacerbated if such royalties are provided for under a service agreement and the agreement only provides for a lump-sum fee rather than separating out the payments for royalties and services respectively. In this case, the risk is that the customs authorities may require that the entire lump-sum amount be added to the customs value for the purposes of duty calculation.

Trend 4: Detailed review of insurance fees and international freight

The customs authorities may compare the insurance fee or international freight charge for a particular import shipment with similar import shipments — maybe in the same industry or maybe in different industries — to identify anomalies.

For example, if customs finds that the insurance fee for a luxury goods shipment is much lower than that for a normal goods shipment, they may ask questions and even send a verification request to the insurance company. The same may happen for international freight charges.

It is crucial that the importer ensures the accuracy of its declarations and is able to provide strong commercial justification for the values declared. There have been cases in which, upon verification by the customs authorities, it has been found that payments for insurance and international freight were paid overseas and re-charged to the local importer through intercompany service agreements, but the local importer was not fully aware of this

fact. As a result, it failed to declare these dutiable amounts for customs purposes. This type of omission is a serious violation of the customs regulations and may result in disqualification for the use of the transaction value method by the importer.

Trend 5: Transfer pricing adjustments (i.e., the Vietnam importer makes additional payments for imported goods)

There has been little regulatory progress on the matter of how to treat transfer pricing adjustments for customs valuation purposes involving an increase in the price. The matter has been unofficially discussed between companies and the customs authorities, but no formal guidance has been issued so far. In practice, a few companies have declared and paid customs duties on such price adjustments although the process is not straightforward.

Notwithstanding the lack of guidance, Vietnam importers should voluntarily disclose any relevant pricing adjustments to the local customs authorities and document any such disclosure, as doing so could be a mitigating factor for the waiver of any penalties for underpayments that may be imposed at a later date.

Businesses operating in Vietnam should monitor the progress of this hot topic.

Trend 6: The use of the deductive value (deduction method)

The deduction method of customs valuation is applied more commonly now than in the past, both to test whether a transaction value is acceptable where there is a special relationship between the parties and to impose a customs value on imported goods.

Although there is guidance under the Vietnamese regulations on the use of this method, issues remain with its application in practice:

- What profit ratio may be deducted? The answer to this question may depend on each customs audit team. Some teams may simply agree to the ratio mentioned in the importer's transfer pricing documentation, but some may challenge that amount and may apply a different ratio (e.g., the auditors may refer to a profit ratio as announced in annual statistics).
- What expenses may be deducted? There are also some uncertainties on this issue. Some authorities may agree to deduct all expenses, but some may not agree to deduct any expenses that the importer treats as nondeductible for corporate income tax purposes, while others may not agree to deduct indirect expenses (e.g., general expenses that cannot be directly linked to the goods, financial expenses, ad hoc bonuses to distributors). This type of question often requires detailed discussion and consultation with the customs authorities on a case-by-case basis to find a resolution.
- What local selling price should be used? The local selling price may be the price used for the largest volume of goods sold, but it may also be the price of each item of goods sold. In addition, if a price is discounted, the customs authorities may also consider the legal validity of that price (i.e., whether the importer has complied with other legal procedures to sell the goods at that lower price). If it has not, the authorities may use a standard or normal price before making any deduction.

The process of using this deduction method is typically time-consuming and requires a great deal of consultation with the customs authorities. Importers involved in such a process need to be patient and do their best to present the necessary evidence to support their position. ■

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- EY Global Tax Controversy Flash Newsletter (Issue 63) – Free trade agreements provide opportunities for global businesses – but may increase controversy risk
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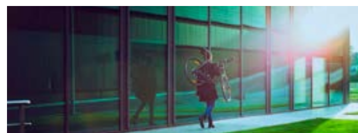

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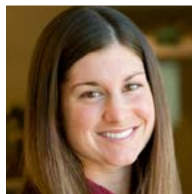

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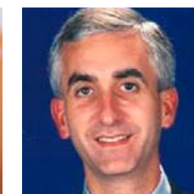

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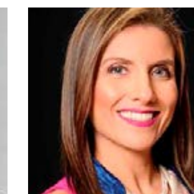

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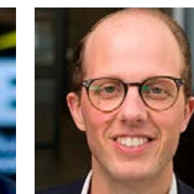

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