Managing Year-End Transfer Pricing Adjustments from a Customs Perspective

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In brief

Year-end transfer pricing adjustments are generally intended to achieve a specific arm's length profit to demonstrate pricing compliance from an income tax perspective. However, what many businesses are not aware of is the unintended impact it can have on customs compliance. Managing year-end transfer pricing adjustments from a customs perspective can be vital to ensure on-going compliance with Customs Laws, mitigate the risk of being assessed with penalties for noncompliance when undergoing a customs audit, and maintaining good rapport with customs authorities. The purpose of this newsletter is to highlight the customs risk that may arise from a year-end transfer pricing adjustment and address how businesses in Japan can best manage and mitigate such risk.

This newsletter has been prepared by PricewaterhouseCoopers Worldtrade Management Service (WMS) Pte. Ltd. WMS is the global customs and international trade consulting practice of PwC which consists of a specialized team of trade and customs professionals who have proven experience in helping companies throughout the region to manage customs and trade compliance.

In detail

1. *Year-end transfer pricing adjustments from a customs perspective*

Many companies that deploy a transfer pricing policy of targeting a specific arm's length profit margin often find it necessary to make transfer pricing ("TP") adjustments when actual financial results differ from projected results. Although TP adjustments generally are intended to demonstrate pricing compliance and mitigate risk from an income tax perspective, they can have the unintended effect of creating risk from a customs perspective.

Initiating a retrospective TP adjustment that can be tied to the price paid for imported products suggests the originally declared values at time of importation may not have been correct and therefore needs to be amended, possibly resulting in additional customs duties, import consumption tax, penalties and interest charges.

If a retrospective TP adjustment results in an upward adjustment (in other words, if an importer is in a payable position), Japan Customs expects the importer to file an amended declaration and pay the additional customs duty and import consumption tax. Filing an amended declaration is expected even if the products imported are duty free in order to accurately account for the shortfall in import consumption tax.

In situations where companies make a downward TP adjustment (in other words, if an importer is in a receivable position), in theory a refund request should be accepted and overpaid duty and import consumption tax should be refunded. In practice, however, we are not aware of such a precedent where an importer has been able to get a refund as a result of a downward TP adjustment.

It is also worthwhile to note that frequent and significant transfer pricing adjustments may suggest to Japan Customs that the original invoice price upon importation is unreliable, and therefore may deny the use of this original price as the basis for the duty value. In such a case, Japan Customs could apply, in principal, a more complicated valuation method, which may result in an unfavourable outcome to a company.

2. *Being Compliant: Voluntary Disclosure*

Voluntary disclosure with Japan Customs to report an upward TP adjustment and file amended declarations can help to mitigate the risk of a penalty assessment.

Filing amended declarations due to TP adjustments tend to be smoothly accepted by Japan Customs, provided appropriate supporting documents as well as tables for calculating the additional customs duty (if any) and import consumption tax payable are in place. In this respect, the time and effort required to prepare the right documentation to meet Japan Customs expectations can often be a challenge to importers and generally require the following steps to be undertaken:

- Analyse the nature of the TP adjustment and determine an appropriate method for filing amended declarations
- Gather relevant import data on an entry-by-entry basis
- Quantify the additional import duty and import consumption tax payable
- Disclosing and explaining the facts and circumstances surrounding the TP adjustment, along with the calculation of duties and taxes owed, to Japan Customs, to agree on the amount and administrative procedure
- Officially file the amendment and pay the additional duty (if any) and import consumption tax payable.

In addition to ensuring compliance and mitigating the risk of a penalty assessment, proactively reaching out to Japan Customs also demonstrates alignment and transparency with Customs Valuation Laws and Regulations that can help to build good rapport with Japan Customs. In fact, Japan Customs is more likely to take a reactive role and listen to the importer during a voluntary disclosure compared to if the TP adjustment is uncovered during a Customs audit.

3. *Penalty Assessment and Interest Charges*

In the event an undisclosed upward TP adjustment is uncovered during a Customs audit, the importer will be required to pay the unpaid customs duty and import consumption tax owed, **plus** a penalty along with interest charges.

The penalty is collected at a rate of up to 10% of the short-fall in customs duty and import consumption tax owed.
An additional 5% may apply if the shortfall exceeds the customs duty and import consumption tax paid in the initial declaration or the amount of JPY 500,000 whichever is lower.

Interest charges will apply for up to 1 year on a daily basis from the date of receiving an import permission even to importers that file voluntary disclosure; however, early filing of amendments can result in a reduction of the total amount. The interest rate is currently 2.9% per annum for days on and after January 1st 2014 and 4.3% for days before January 1st 2014.

Although the financial impact arising from the additional payment of import consumption tax can be offset by the local consumption tax charged to customers when selling imported products in Japan, the additional duty, penalty assessment and the interest charges represent additional costs that are borne by the importer. Reducing this potentially sizeable amount can only be achieved if the importer takes a proactive approach and voluntarily declare the TP adjustment to Japan Customs.

How we can help

PricewaterhouseCoopers Worldtrade Management Service (WMS) Pte. Ltd. is a service line specializing in customs duties, the taxation of international trade transactions, and trade compliance issues. The WMS team consists of professionals from a variety of backgrounds including former customs and trade officials from authorities across the Asia Pacific region, Europe and North America, as well as seasoned trade attorneys, accountants and systems specialists.

With our extensive experience in supporting many of our clients with filing amended declarations and proactively managing customs valuation issues arising from retrospective TP adjustments we offer the best solution to companies that wish to ensure compliance while managing costs effectively. Our assistance may range from providing general ad-hoc advice, to supporting companies' internal resources throughout the amendment process, including the data collection, reconciliation, discussion/presentation to Customs authorities, etc., all of which can be tailored to match the needs of each client.

Contact Details

For a deeper discussion on how this issue might affect your business, please contact:

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