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ARTICLES

The Reconciliation Programme as a Role Model to Resolve Complex Customs Valuation Cases?

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This paper introduces scenarios that are very common in commercial reality. It poses typical questions regarding when and how the customs value is determined, especially in situations where the importer cannot provide all the information concerning the customs value at the time of filing. The paper then looks at practical solutions in different customs legislations, notably in the European Union and the United States.

1. Introduction

Customs valuation is one of the most challenging areas of customs law. The rules of customs valuation date back to the World Trade Organization (WTO) Valuation Agreement, which was drafted more than 40 years ago (WTO, 1994). This Agreement consists of a mere 24 articles, which are further described and illustrated in Explanatory Notes, but the essence of the Agreement has been unchanged since it first came into force. According to Article 1 of the Agreement, the price actually paid or payable shall be the basis for customs valuation – but what if this price is not (yet) known at the time the customs declaration is to be submitted by the importer? According to Article 8 of the Agreement, certain costs incurred by the buyer (e.g. royalties and licence fees) are to be added to the price actually paid or payable when determining the customs value. But what if the (exact) amount to be added is not yet known when the customs declaration is filed? This paper first describes a couple of scenarios that are very common in commercial reality, and then looks at the options offered in European customs law. Later, the author looks at the reconciliation procedure practised in the USA from a European perspective.

Recently, the European Court of Justice (ECJ) seems to have spent a considerable amount of time (and effort) to work and reflect on cases where the secondary methods of valuation (e.g. the deductive value method) or the fall-back method had to be used. Some examples of these reflections can be taken from the judgments of the ECJ[1] of 09.06.2022 (FAWKES), of 20.06.2019 (Oribalt Riga) or of 09.11.2017 (LS Customs Services), to name but a few. Despite these recent decisions, it must be stressed (and not forgotten) that

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1 All ECJ judgments can be retrieved from https://www.curia.europa.eu

the transaction value of imported goods should be used to the greatest extent possible for customs valuation purposes as laid down in Advisory Opinion 1.1 of the Technical Committee on customs valuation at the WCO (WCO, n.d.). Consequently, the transaction value method is to be used even if the importer cannot submit all the information that is necessary to determine the customs value when the customs declaration is filed – or if the customs value is to be determined on the basis of a sale between related parties and may be subject to subsequent price adjustments, as in the famous Hamamatsu case (judgment ECJ of 20.12.2017), which has been discussed extensively by the customs valuation community since the ECJ published their decision. This article first describes the options laid down in the customs legislation in the European Union (namely the Union Customs Code – UCC – and its implementing provisions; European Commission [EC], 2013, 2015) and then takes a broader perspective and looks at how other customs administrations outside the European Union deal with the issue.

2. Analysis

Where goods are delivered to the customs territory of the European Union, they are generally placed under a certain customs procedure, for example, the release for free circulation or customs warehousing (customs procedures are defined in Article 5 (16) UCC and include the release for free circulation). This requires a customs declaration appropriate for the procedure (Article 158 (1) UCC). Generally, the importer files an electronic declaration in which they specify the kind of customs procedure. In the case where the goods are to be declared for free circulation the importer has to submit all the information that is necessary to calculate and levy the amount of customs duties that they are obliged to pay. Moreover, the importer is obliged to have all necessary documents (e.g. invoice, transport documents) in their possession and to submit them to the customs authorities if they so request (Article 163 UCC).

This obligation may lead to problems in situations where the importer does not have all the necessary information in their possession at the time they file the customs declaration. This is especially crucial in cases where the importer cannot submit the information that is necessary to determine the customs value as illustrated in the following examples.

Example 1: The importer, who is also the buyer, imports spare parts for automobiles into the European Union. They buy them from an unrelated seller who is also the manufacturer of the spare parts. This manufacturer needs certain tools to be able to produce the spare parts. These tools have been developed and produced by a third party according to the orders and specifications communicated by the buyer. The buyer purchases these tools and then delivers them to the manufacturer free of charge for use in connection with the production of the spare parts. Thus, the tools are considered as assists according to Article 71 (1) (b) (ii) UCC and their value, apportioned as appropriate, shall be added to the price actually paid or payable for the imported goods (i. e. spare parts). However, the company that has developed and produced the tools is not particularly well organised and therefore only

issues an invoice to the buyer after the first consignments of the spare parts have already been imported into the European Union. Thus, it is impossible to determine the value of the assists that needs to be added to the price actually paid or payable for the imported goods at the time the customs declaration is submitted by the importer.

Example 2: The importer, who is also the buyer, regularly imports shirts from a non-related supplier/seller. The imported shirts are trademarked. The buyer has the right to use this trademark based on a licence agreement that they have concluded with another company, the licensor. The licensor is not related to the seller. But the licence agreement provides for a manufacturer's agreement that the buyer/licensee must conclude with any manufacturer. When signing this manufacturer's agreement, the manufacturer agrees to produce the licensed goods only for the licensee and deliver them exclusively to the licensee.

After selling the shirts in the European Union, the buyer/licensee must pay licence fees to the licensor. These licence fees are to be included in the customs value according to Article 71 (1) (c) UCC and Article 136 (4) (c) UCC IA as they relate to the imported goods and are paid as a condition of sale, even though the amount to be included cannot be determined when the goods are imported.

Almost all licence agreements only require a payment of royalties after the licensed products have been resold by the licensee, so this is a very common scenario. However, the ECJ had to reflect on the question of whether royalties are to be included in the customs value even if it is not established, either at the time at which the contract was concluded or at the relevant date as regards the incurring of the customs debt that royalties or licence fees were owed. In the judgment GE Healthcare (09.03.2017) the ECJ stressed that the relevant provision on royalties and licence fees (then Article 32 (1) (c) CC) does not require 'the amount of royalties or licence fees to be determined at the time when a licence agreement was concluded or when the customs debt was incurred in order for those royalties or licence fees to be regarded as related to the goods being valued' – and consequently the royalties or licence fees are to be included in the customs value.

Example 3: The importer, who is also the buyer, only purchases goods from its parent company. At the beginning of every year, the parent company sets a provisional price for the goods, which is calculated according to the expected costs. When the importer declares the imported goods for free circulation, they consequently determine the customs value for these goods based on this provisional price. However, the parties have agreed to review the expected costs (and thus the provisional price) at the end of the year. In the case where the actual costs were higher than expected the importer will receive a debit note and consequently must make an additional payment to the parent company/seller. But if the actual costs turn out to be lower than expected, the importer

will receive a credit note. Thus, the kind of end-year adjustment (debit note or credit note) and the exact amount cannot be established at the time of importation.

Example 4: The importer, who is also the buyer, purchases materials (e. g. metals) for production in the country of importation. These materials are traded at the commodities exchange and thus are subject to variations in price. The importer and the supplier have agreed on fixing a provisional quarterly price for the goods, which is later adjusted according to the actual purchase price paid by the supplier. When the goods are imported the importer only knows the provisional price – the final price after the adjustment being the price actually paid or payable for the imported goods is only fixed later.

The scenarios in the above examples (and there are many more) have one thing in common: in all these scenarios the importer does not have all the information at hand that is necessary for the correct and final determination and declaration of the customs value. In some cases, information concerning the exact amount to be added to the price actually paid or payable according to Article 71 UCC is yet unknown while in others this price as such is not fixed yet.

3. Options according to the Union Customs Code

Article 166 UCC provides for the submission of a simplified customs declaration in such cases. This simplified declaration may omit certain particulars contained in the standard customs declaration or the supporting documents usually required. If this simplified declaration is to be used on a regular basis – which is most likely in the examples mentioned above – the importer needs an authorisation from the customs authorities. This authorisation may only be granted when the many conditions set out in Article 145 UCC DA are fulfilled. Thus, the requirements for this authorisation come very close to those of an authorized economic operator (AEO) status. Once the authorisation is granted, the importer may submit a simplified customs declaration to declare the imported goods for release for free circulation. But after that, the importer, of course, needs to submit a supplementary declaration 'within a specific time limit', and this supplementary declaration shall then contain the particulars and documents that were omitted in the simplified declaration (Article 167 UCC). However, there is no fixed definition of this time limit in the UCC and its implementing provisions. Thus, the German customs administration, for example, sets one month, which means that the supplementary declaration needs to be filed on the tenth day of the following month at the latest. This procedure in is conformity with the procedure laid out in Article 146 (3) UCC DA. However, Article 146 (3b) UCC DA, which was only recently added, provides for an exception in 'duly justified circumstances' – under such circumstances the time limit for the lodging of the supplementary declaration shall not exceed 120 days. In 'exceptional duly justified circumstances related to the customs value' the time limit may be further extended to up to two years from the release of the goods.

The general time limit of one month for submitting the supplementary declaration is neither particularly generous nor helpful in most of the scenarios described in the examples above. When, for example, dealing with royalties and licence fees or subsequent adjustments of transfer prices it is obvious that the exact amounts to be considered when determining the customs value will only be known later. The exceptions provided for in the new Article 146 (3b) UCC DA only apply in 'duly justified circumstances' or even 'exceptional duly justified circumstances' – but how to define these circumstances remains unclear. So it is hardly surprising that each customs administration in the European Union acts according to their own definitions. The European Commission is probably aware of this fact, but so far there is no guidance, or any other document aimed at a uniform application of this provision in the European Union.

3.1. Special cases relating to transfer price adjustments

Transfer price adjustments are not made to annoy customs administrations but are mainly made to adjust the returns on sale, that is, the profit margins, of the companies involved in related-party transactions to an arm's-length margin. In doing that, the companies avoid an adjustment of the incomes by their local tax authorities which could – if there is no corresponding adjustment in the other country – lead to double taxation.

Example: A German distribution company buys finished products from the parent company established in a different country and distributes these finished products on the German market. At the end of the year, the parent company reviews the profit this distribution company has made in the past year and finds that this profit (net margin) has been too low. Thus, the parent company issues a crebit note relating to the goods that the distribution company has purchased in this past year. As a result, the profit (net margin) is adjusted to an arm's-length level and the German tax administration is satisfied. At the same time, the profit earned by the parent company is reduced and double taxation is avoided. This, of course, also works the other way round: imagine the profit earned by the distribution company was much too high. The parent company will then issue a debit note and thus increase the price for the purchases made by the distribution company. This results in a reduction of the profits earned by the distribution company on the one hand and at the same time results in a higher profit for the parent company. The tax authorities will be satisfied as everybody gets what they are entitled to.

But the problem here is not only the tax issue. The question that has long been discussed in cases like these was how these adjustments affect the customs values of the goods that have been imported in the past by the distribution company, as in the example just mentioned. In cases like these, the German customs administration always made a clear distinction between (1) adjustments that were made with a clear view to individual products (and consequently individual imports) and (2) those adjustments that were made

in the form of a lump sum for a certain period and thus relating to all the products that have been imported in this particular period, meaning that the adjustments could not be linked to individual imports.

Where the adjustments could firstly be clearly linked to individual products and secondly have been agreed upon before the actual imports have taken place (in a written agreement between the parties concerned, for example) the transaction value method is deemed to apply. In cases like these, the transaction values of all goods are adjusted retroactively according to Article 70 UCC – the adjustment is then made upwards in cases of debit notes and downwards in cases of credit notes under the framework of a repayment procedure as provided for in Article 116 UCC.

However, where the adjustment takes the form of a lump sum, the German customs administration used to deny a refund in cases of credit notes (i. e. in cases where the prices originally invoiced for the imported goods turned out to be too high). This position was also taken by the ECJ in the famous case of Hamamatsu Photonics that has been discussed ever since it was published. In cases where the prices that were originally invoiced have turned out to be too low and the parent company issues a debit note, the German customs administration assumes that the prices have been influenced by the relationship between seller and buyer, which consequently renders the application of the transaction value method impossible. The prices originally invoiced thus cannot be accepted and must be adjusted in accordance with the debit note using secondary methods, usually the fall-back method described in Article 74 (3) UCC.

The retroactive adjustments of the prices originally invoiced and thus of the customs values originally determined when the goods were imported need to be done for each and every single declaration. It is obvious that this results in an enormous administrative burden, both for the importers and the customs administrations. Therefore, it seems advisable to look at how other administrations handle cases like these, which are very common in commercial reality. Let's look at the United States as an example.

4. The Reconcilation Programme – background

As mentioned before, the customs value is to be determined according to the transaction value method as provided for in Article 70 UCC. Thus 'the transaction value of imported goods should be used to the greatest extent possible for customs valuation purposes' as laid down in Advisory Opinion 1.1 of the Technical Committee on customs valuation at the WCO. To apply the transaction value method, the importer is obliged to have all necessary documents (e. g. invoice, transport documents) in their possession and to submit them to the customs authorities if they so request (Article 163 UCC). But if we look at the scenarios described in examples 3 and 4 above, the importer can only enter a provisional price in the declaration at the time they file this declaration. The importer does not yet know whether this provisional price is going to be adjusted at a later point in time, and they do not know either whether this adjustment will be made upwards or downwards. Strictly

speaking, in cases like these the importer cannot file a customs declaration based on the transaction value method. The price actually paid or payable being the basis for the determination of the customs value is in fact composed of the provisional price (which is known when the declaration is filed) and the subsequent adjustment (which is only calculated at a later stage). The same principle applies to the scenarios described in examples 1 and 2 above: where the amounts to be added to the price actually paid or payable cannot be quantified at the time the customs declaration is filed, the transaction value method is not applicable. Article 71 (2) UCC requires that additions are only to be made 'on the basis of objective and quantifiable data', and where these data do not exist the transaction value cannot be determined under the provisions of Article 70 UCC as laid out in the Interpretative Note to Article 71 (2) UCC included in the Compendium of Customs Valuation texts issued by the European Commission (these Interpretative Notes on Customs Valuation are based on the Notes included in the WTO Valuation Agreement) (EC, 2022).

However, the Reconciliation Programme (US Customs and Border Protection, 2020) offers a practicable solution for cases like these.

The Reconciliation Programme is a voluntary program and gives the importers the opportunity to correct certain elements of the customs declaration which are not yet known or fixed at the time the declaration is filed at a later point in time, that is, when such elements are definite. This may apply to the value of the imported goods or to classification. Thus, the importers may enter these elements into the customs declaration although they may be subject to changes (e. g. subsequent adjustments of the declared price or additions to this price). However, the importers need to flag these entries in the declaration to identify the indeterminable information to customs. As soon as the importers have the information about the final price or the amount to be added to the price actially paid or payable at their disposal they enter this information into the declaration by way of a reconciliation entry.

With the procedure of first flagging declarations and then resolving them using the Reconciliation Programme in mind, let's go back to the examples that were mentioned before.

Example 1: The importer taking part in the Reconciliation Programme first declares the price paid for the imported parts and flags these entries. After receiving the invoice issued by the manufacturer of the tools (assists), they file the reconciliation entry and add the value of the tools (assists) to the price.

Example 2: The importer taking part in the Reconciliation Programme first declares the price paid for the imported goods and flags these entries. After selling the goods and paying the royalties based on the net sales they file the reconciliation entry and add the royalties to the price.

Example 3: The importer taking part in the Reconciliation Programme first declares the provisional price paid for the imported goods and flags these entries. After receiving the credit note, which results in a downwards adjustment of the prices paid in the respective period, they file the reconciliation entry and declare the final price.

Example 4: The importer taking part in the Reconciliation Programme first declares the price paid for the imported goods and flags these entries. When the supplier submits the final settlement of the price, the importer files the reconciliation entry and declares the final price.

4.1. Prerequisites for participation and how it works in practice

Basically, all importers are eligible to participate in the Reconciliation Programme if they submit their declarations electronically and have a valid and adequate bond coverage.

Once the importer has filed the declaration and flagged the elements that are not yet final, the importer has 21 months to file the reconciliation entry, that is, enter the final prices or make the final additions. The importer may even combine several flagged declarations in one reconciliation entry. Thus, if we go back to the scenario described in Example 1, the importer can file one reconciliation entry for all imports of parts that have been flagged. The same applies in the scenario described in Example 2 above.

4.2. Practical cases – rulings published by US Customs

The US Customs and Border Protection publish rulings in complex customs valuation cases in a database that is open to the public (US Customs and Border Protection, n.d.). These rulings can be understood as advance rulings or binding valuation information, something the European Commission is currently working on to establish in the European Union as well. The rulings are basically valid without a time limit unless they are expressly revoked or adjusted due to changes in legislation or facts, for example. If that is the case, it is documented in a transparent way in the database. The cases described in the following paragraph are real-life cases published in the database and offer some insight into the Reconciliation Programme.

The ruling HQ W548314 was published in the year 2012, but is considered an excellent example of binding valuation information with rich and detailed information about the case at hand and the deliberations of the customs authority. In addition, it promotes the Reconciliation Programme, which is the main reason it has been chosen as an example.

In the case described, the buyer and the seller are related. According to the Transfer Pricing Policy and the Advanced Pricing Agreement (APA) the seller fixes the provisional prices according to the resale price method, which are then analysed on a quarterly basis. This analysis results in frequent adjustments.

After examining the transfer pricing policy and the APA the customs authority concluded that the prices were fixed according to the arm's length principle and thus have not been influenced by the relationship between the parties. Consequently, the transaction value method could be applied for the

determination of the customs values for the imported goods. The subsequent price adjustments could be considered when determining the customs values of the imported goods as they had been described in detail in the transfer pricing policy, which was in place prior to the importation of the goods to be valued. Moreover, the adjustments were made on an entry-to-entry basis and thus related to specific goods.

With respect to the Reconciliation Programme, note the following remarks in the ruling:

> Reconciliation allows the importer, using reasonable care, to file entry summaries with CBP [Customs and Border Protection] with the best available information, with the mutual understanding that certain elements, such as the declared value, remain outstanding. At a later date, when the specifics have been determined, the importer files a Reconciliation entry which provides the final and correct information. The Reconciliation entry is then liquidated, with a single bill or refund, as appropriate. Furthermore, the Reconciliation entry can be filed as late as 21 months from the date of the first entry summary filed under that Reconciliation with extensions of time as available to importers. This flexibility makes Reconciliation an ideal vehicle to declare all upward or downward post-importation adjustments within the timeframe allowed by in the APA or a transfer pricing study or policy that directly (or indirectly) relate to the value of the merchandise. Thus, the Importer should continue to report all of its adjustments to CBP via Reconciliation. (US Customs and Border Protection, 2020)

Further on in the text of the Ruling, the author gives a very clear recommendation: 'CBP strongly encourages importers who may anticipate post-importation adjustments to use the Reconciliation program' (US Customs and Border Protection, 2020).

A scenario which is quite like the scenario described in example 4 above forms the basis of HQ H302879 published in 2019. The ruling is based on the case of an importer of a certain car part. The (final) price for this part depends on the price of the raw materials used to produce this part and is thus not yet fixed at the time of importation. The importer utilises the Reconciliation Programme and has developed a certain formula to calculate the final price considering the subsequent adjustments. According to the author of the ruling 'The Reconciliation Program is a proper method for adjusting the final value of the imported car parts.'

5. Summary and conclusion

Customs administrations and importers are often confronted with situations where the importer does not have all information available to file a complete and final customs declaration when the goods are imported into the customs territory. The customs legislation in the EU and the way it is currently

interpreted does not offer satisfactory solutions for scenarios like these. This may lead to undesirable consequences, that is, the need to determine the customs value according to secondary methods in many cases, which is against the principles of the WTO Valuation Agreement. The Reconciliation Programmme as it is practised in the USA offers a way out. It gives the importers and the customs administration a tool to solve these cases in a straightforward way without posing unreasonable administrative burdens on either party. When utilising the Reconciliation Programme, it is up to the importer – after flagging the first entry in the declaration – to file the reconciliation entry without further intervention by the customs authority.

The German practice is quite different: when the goods are imported and released for free circulation, the importer needs to pay the customs duties. Where there is a need to correct the customs values later, the importer is bound to apply for repayment or inform the customs administration of an additional payment, which may result in a recovery procedure. Each and every customs value needs to be corrected individually; aggregation is not possible.

The simplification described in Article 73 UCC may be considered to ease the administrative burden, but it can only be applied under the transaction value method and in cases where the importer is faced with costs that need to be considered for customs valuation on a regular basis (as in example 2 mentioned above). At least, however, subsequent corrections of the customs values will not occur when this simplification is used.

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