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Customs & Trade

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The Customs Law Status of Duties and Taxes Paid on Imports

Last month's column returned to the familiar theme of the interplay between customs duties and other taxes, principally income tax, but also state and local taxes.[1] As promised, this month's column comes back to that topic, this time focusing on the customs valuation law status of various taxes either paid on the imported goods themselves or ultimately linked to the imported goods.

These taxes include withholding taxes, excise taxes, and, of course, customs duties. An issue will arise whenever the buyer has paid these duties and taxes: whether the amounts so paid might be deducted from the amount paid to the seller to arrive at dutiable value, or whether they must be added to the amount paid to the seller to arrive at dutiable value.

One starting point is to refer to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Valuation Agreement).

Valuation Agreement

The Valuation Agreement specifically provides for duties and taxes that are internal to the country of importation at two points. The first statement is in the precepts of the deductive value method (Article 5) and the second is in the discussion on Transaction Value (Article 1).

Deductive value (Article 5). The Valuation Agreement provides that a deduction is permissible for "[t]he customs duties and other national taxes payable in the country of importation by reason of the importation or sale of the goods" (Article 5.1(a)(iv)). Note the qualifying term "national" in regard to the deductible taxes. The Technical Committee on Customs Valuation (TCCV) issued Advisory Opinion 9.1 at its fourth session in 1982. This instrument held that antidumping and countervailing duties were to be treated as normal duties for purposes of the deductive method.[2]

As expected, the U.S. implementing legislation, 19 U.S.C. section 1401a(d)(3)(A)(iv), is consistent with the Valuation Agreement. A deduction is allowable only for "customs duties and Federal taxes currently payable on the merchandise by reason of its importation and Federal excise taxes on, or measured by the value of, such merchandise for which vendors in the United States are ordinarily liable."[3]

Finally, in regard to deductive value, a state or local tax imposed on the importer with respect to the sale of the imported merchandise is not to be ignored altogether. Rather, such a tax will be treated as a general expense.[4]

Transaction value (Article 1). Of greater relevance is the text of paragraph 3 of the Note to Article 1, Price actually paid or payable for the imported goods (PAPP): "The customs value shall not include the following charges or costs, provided that they are distinguished from the price actually paid or payable for the imported goods: ... (c) duties and taxes of the country of importation."

In the United States, the statutory authority is in 19 U.S.C. section 1401a(b)(3)(B), with language that tracks the above-cited deductive value text. Thus, the statute recognizes only customs duties and federal taxes.[5] In ruling no. 542512 (July 21, 1981), TAA

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No. 36, a Puerto Rican excise tax that was included in the invoice price was not a deductible charge. In a subtle distinction, however, a state sales tax that is paid on the post-importation erection and installation of the goods is not dutiable.[6]

Some have commented that this Article 1 Note and its reference to "duties and taxes" refers only to duties and taxes that are imposed as a result of bringing goods into a customs territory and not to taxes imposed on the sellers on income generated through resales of the goods in the country of importation. There is no authority cited for this assertion, which would preclude some Article 8 review. (Article 8 of the WTO Valuation Agreement provides the five categories of costs that might be added to the PAPP to make dutiable value.) Indeed, as shown below, the TCCV itself has referred to the Article 1 Note as pertaining to activities taking place in the country of importation and has sanctioned the Article 1 Note for review under both Articles 1 and 8. Accordingly, the Article 1 Note cannot be read in a narrow Article 1-only fashion and, instead, must be analyzed with a broader perspective that covers both Articles 1 and 8, as discussed below.

Beyond the text of the Valuation Agreement itself,[7] World Customs Organization (WCO) interpretations of the text should be examined.[8]

WCO Instruments

A review of relevant instruments in Part I of the Conspectus of the TCCV of the WCO leads to Advisory Opinion 3.1, in which the TCCV has spoken rather sweepingly: "(1) When the price paid or payable includes an amount for the duties and taxes of the country of importation, should these duties and taxes be deducted in those instances where they are not shown separately on the invoice and where the importer has not otherwise claimed a deduction in this respect? (2) The Technical Committee on Customs Valuation expressed the following view: Since the duties and taxes of the country of importation are by their nature distinguishable from the price actually paid or payable, they do not form part of the Customs value."

This 1981 instrument, was first adopted at the second session of the TCCV of the Customs Cooperation Council, the predecessor of the WCO. It says directly that an amount that is paid as a tax on imports would not be considered part of the PAPP.

There is, however, a possible anomaly here. The Article 1 Note is inserted at a point in relation to PAPP. Nonetheless, the paragraph addresses not the PAPP but "customs value," which is defined in Article 1.1 of the Valuation Agreement as the PAPP plus any Article 8 adjustments that may apply. Moreover, it is clear from its context that the text refers to duties and taxes that are "distinguished from" the PAPP. Therefore, the text refers to duties and taxes that are not inextricably subsumed within the PAPP.

The TCCV returned to the topic in 1984 and issued Commentary 9.1, and this must be consulted in tandem with Advisory Opinion 3.1. In Commentary 9.1, the TCCV makes an important statement. In paragraphs 1 and 2, the TCCV takes the view that the listing of the post-importation activities in the Article 1 Note is illustrative only.[9] Moreover, an inference can be drawn from para. 4 of Commentary 9.1 that the TCCV concludes that the payment of duties and taxes per subparagraph 3. (c) of the Note to Article 1 constitutes a post-importation activity.

Finally, the Commentary, which discusses both Article 1 and Article 8, serves to clarify any confusion about the placement of the Article 1 Note. Customs value under Article 1 comprises the PAPP plus any adjustments that are permitted under Article 8. Accordingly, Commentary 9.1 analyzes the payment of duties and taxes as well as payments associated with other post-importation activities, whether or not they are included in the PAPP. Indeed, the TCCV says that the following dispositions are appropriate:

When the costs of activities occurring after importation[10] [including the payment of duties and taxes] are not included in the PAPP, they are not to be included in the customs value unless it is specifically provided for in Article 8 (para. 3 of Commentary 9.1).

When such costs are included in the PAPP for the imported goods, they are not to be deducted from that price unless there is compliance with the relevant provisions of the Note (para. 4).

Duties and taxes in the country of importation are by

their very nature distinguishable from the PAPP and are not inextricably buried in the PAPP, citing Advisory Opinion 3.1 (para. 4).

This text indicates that if the duties and taxes are not subsumed within the PAPP, an Article 8 analysis is the only recourse. However, it is possible that the authority of Annex III, paragraph 7, text on the PAPP ("includes all payments actually made or to be made as a condition of sale of the imported goods, by the buyer to the seller, or by a buyer to a third party to satisfy an obligation of the seller"), which was adopted after the 1984 Commentary, might continue to validate an Article 1 analysis, and that Article 8 would not be the only basis for dutiability. This would require a view of the PAPP expanded to include payments made long after the importation and expressed as a percentage of resales.

Distinguished From the PAPP

A key element in the analysis is the notion that the duties and taxes must be distinguished from the PAPP when they are included within the PAPP. According to the TCCV, the duties and taxes are distinguished by virtue of their very nature. This suggests that, with a fully loaded price, one that includes duties and taxes, such as sales with the INCOTERM[11] delivery duty paid (DDP), the importer should be able to "back out" or deduct the amount of duties and taxes subsumed to get to the PAPP. Otherwise, the importer will be forced to pay duty on duty.

Sherman and Glashoff's early comment on the Valuation Agreement takes the same view as the TCCV—that (1) it hardly seems necessary to point out that if the duty is not included in the price, it is not part of the customs value; (2) the Note would have used other language if it meant to say that the customs value should not include these items if they are excluded from the price; and (3) the Note says instead that the duties and taxes need only be "distinguished from" the price. Finally, they said that the very levy of the duties and taxes by the importing country distinguishes them sufficiently.[12] In this last regard, surely the customs authority cannot argue that they are not aware of the duties and taxes that the importer has paid to that customs authority or a related tax agency.

This sanguine perspective is not shared by the United States, however, where the duties and taxes must be either (1) separately stated on the face of the invoice, or (2) shown to have been included in the invoice price by virtue of the sales term being DDP or the invoice bearing the phrase "duty paid." In other words, the U.S. position is that the duties and taxes must not only be distinguished (or distinguishable); they must be identified separately at the time of the entry.[13]

The leading case is *Century Importers, Inc.*,[14] a 2000 Federal Circuit reversal of a 1998 CIT decision. In a two-to-one decision, the appellate court held that the importer was not able to correct its failure to show CBP by petition[15] that the invoice price was actually a duty paid price because there was no statutory authority to make that refund[16] and, in any event, the failure to do so was intentional or negligent. As a result, even though the amount of duty paid by the importer was actually ascertained—and obviously it was distinguished from the PAPP to use the language of the Note—there was no deduction allowed. In effect, the importer paid duty on duty.

One "workaround" solution might be to change the sales terms, e.g., to delivered at place (DAP), which was substituted for delivered duty unpaid (DDU) with the 2010 INCOTERMS. This would effectively isolate the duty payment from the PAPP because the duty is not included in a DAP price and the buyer would have to pay duty as a separate matter to clear customs.

Most of the time, this issue has arisen in the context of an importer seeking to deduct the cost of customs duties from the declared value. But there is an even more interesting case to consider—withholding taxes paid by the importer.

Withholding Taxes

It will probably come as a surprise, but the status of withholding taxes on payments by a buyer to a seller of imported goods is relatively unclear.

1 "Chile and Other Stopping Points on the Customs and Tax Playing Field," 25 JOIT 19 (August 2014).

2 The status of antidumping and duties was the subject of an earlier article in this column, "Antidumping Duties: Status, Interest, and Liquidation Questions," 25 JOIT 18 (May 2014).

3 Canadian legislation is consistent, allowing for adjustment to the price per unit by treating duties and federal level taxes as nondutiable. Clause 51(4)(d) of the Customs Act cites the duties and levies identified in the statute and cited in note 5, *infra*.

4 Valuation Agreement, Note to Article 5, para. 8; 19 U.S.C. section 1401a(d)(3)(B)(ii).

5 The corresponding customs legislation in Canada, Clause 48(5)(b)(ii)(B) of the Customs Act, extends nondutiable treatment to amounts levied under the Customs Tariff, Excise Act, 2001, Excise Tax Act, and Special Import Measures Act, or any other law relating to customs.

6 *Cf.* ruling nos. 542451 (June 4, 1981) TAA No. 27 and 543263 (September 5, 1985) with 543161 (January 3, 1984).

7 Article 14 of the Valuation Agreement makes the Notes thereto an integral part of the Agreement.

8 Article 18 of the Valuation Agreement established both the Committee on Customs Valuation of the World Trade Organization (WTO) (Article 18.1) and the TCCV of the Customs Cooperation Council (CCC) (now the WCO) (Article 18.2).

9 This is similar to the TCCV position that "illustrative examples" are in the Interpretative Note to Article 1.2 to show that the relationship between the buyer and the seller does not influence the price in related-party transactions. Commentary 23.1, para. 6.

10 That duties and taxes in the country of importation are covered specifically in paragraph 4, and that duties and taxes are discussed at all in this Commentary on "Treatment of activities taking place in the country of importation," creates an inference that duties and taxes must be eligible for inclusion in paragraph 3.

11 A set of predefined commercial terms published by the International Chamber of Commerce (ICC).

12 Sherman and Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code* (Wolters Kluwer Law and Business, 1988), para. 502.

13 See ruling nos. 546111 (March 1, 1996), 545304 (January 4, 1994), and 543963 (September 11, 1987).

14 205 F.3d 1308 (2000) (vigorous dissent), *rev'g* 22 CIT 821 (1998).

15 The U.S. customs law previously contained a provision for filing a petition within one year of entry to correct a clerical error, mistake of fact, or other inadvertence, 19 U.S.C. section 1520(c) (repealed in 2004).

16 This analysis is consistent with the U.S. position on the treatment of transportation charges. See ruling nos. H004683 (April 12, 2007) and 544501 (October 18, 1991).

17 19 U.S.C. section 1401a(b)(1)(D); Valuation Agreement Article 8.1(c).

18 As noted, the Valuation Agreement does refer to duties and taxes in the country of importation as not forming part of the customs value.

19 Another question would be the status of a withholding tax that is netted out from the PAPP itself. For example, what is the dutiable value if an article is sold for cu1000 but the buyer remits only cu750, paying a withholding tax of cu250 to the tax authorities?

Example. An importer/buyer/licensee makes a royalty payment of 5% of net sales of the imported goods (actually on resales of the imported goods) to the exporter/seller/licensor. The PAPP was cu1000 and the resale price of the goods was cu2000. The license agreement calls for a royalty payment of 5%, which is cu100 in this example. The country of importation has a withholding tax regime of 25%. As a result, the buyer remits cu75 to the party who is exporter/seller/licensor. The buyer also pays cu25 withholding tax to the tax authorities in the country of importation.

In this example, assume there is no question that the royalty is related to the imported goods and is being paid as a condition of sale. Consequently, there is no question but that the royalty payment is dutiable.[17]

But the question that is open is how much of the royalty payment is dutiable? In other words, should the amount that is added to the cu1000 invoice price for the goods be net of the withholding tax, the cu75 paid to the seller, or the gross amount paid by the importer, cu100?

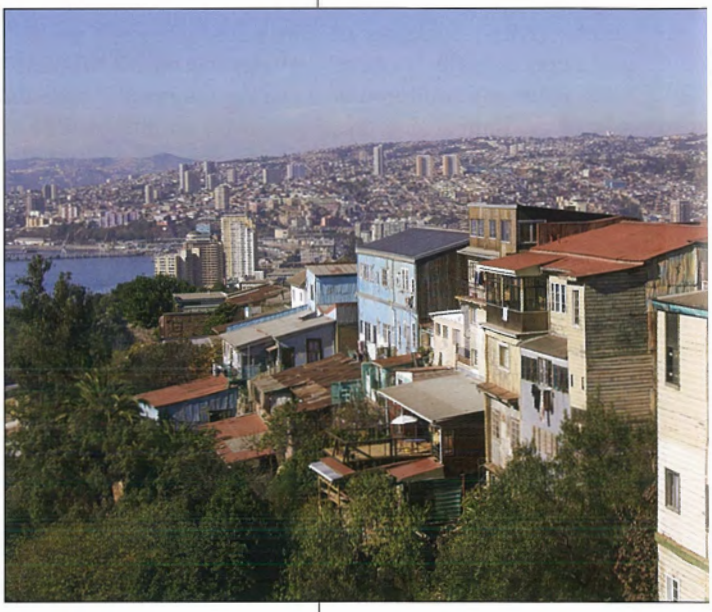
There is no definitive answer. It is quite astonishing that more than 30 years into application of the Valuation Agreement, there have been no rulings or other pronouncements on a question as basic as the effect of withholding taxes in these dutiable value inquiries. The Valuation Agreement does not speak directly to the issue of withholding taxes,[18] and there have been no TCCV instruments or U.S. rulings directly on this point.

Nondutiable status of withholding tax. On the one hand, one might argue that the licensor only receives cu75, so the addition should be limited to that amount. It is unfair that the importer is being made to pay duty on monies that are not received by the seller.

Perhaps a stronger argument that might be made against the inclusion of the cu25 withholding tax payment is that the withholding tax payment, which is being made after the importation and is not included within the PAPP, meets the Article 1 Note standard, already discussed. Obviously, withholding taxes on royalty payments meet the Advisory Opinion 3.1 standard of not being subsumed in the PAPP.[19]

Research of U.S. sources reveals only some indirect support for the dutiability of the net cu75 amount in the hypothetical case. In ruling no. 545094 (April 1, 1993), CBP was dealing with a PAPP issue and more specifically with a question about interest payments. The facts there were stated: "The [sales] agreement provides that protestant will pay seller an amount equal to five percent (calculated on a 360 day basis) of the c.i.f. [cost, insurance, freight] price of the imported merchandise as the financing cost of said merchandise. Invoices will show the total c.i.f. amount, inclusive of interest, from which five percent interest will be deducted in order to arrive at the total net c.i.f. amount. From this figure will be deducted IRS withholding tax of 10 percent, yielding the net invoice value. The net invoice value represents the amount due and payable to the seller."

The ruling was devoted to the issue of the dutiable status of interest charges and there was no follow-up discussion, but the excerpt quoted suggests that the PAPP was based on the net invoice value, i.e., an amount that is net of withholding tax. In another Headquarters ruling, no. W563562 (November 20, 2008), CBP considered the dutiability of ongoing royalty payments on software sales. In this case, there was a 10% withholding tax, but the effect of that tax was never considered in the course of issuing the ruling, which concluded that the royalty payments were not dutiable. Arguments can be marshaled on both sides of the question.



This position is critiqued below after several contrary points are discussed.

Dutiable status of withholding tax. First and foremost, it could be argued that the valuation law text speaks only about the adjustment being made for a royalty or license fee that the buyer "must pay," and not about the amount being received by the buyer. This is a crucial distinction, and it is the basis for the dutiable status of royalty or license fees paid to third parties.

Next, it could be argued that the cu25 withholding tax is being paid on behalf or for the benefit of the seller/licensor and that the entire cu100 should, therefore, be dutiable. In this regard, the Valuation Agreement looks to "royalty or license fees that the buyer must pay either directly or indirectly." Applying this logic would mean that the amount paid as a withholding tax by the buyer, whose role in this respect is a "withholding agent," is an indirect payment to the buyer.

In that same regard, it could be argued that the very nature of a withholding tax is such that it is simply a convenient way for tax authorities to ensure that the payment of a tax that is owed by a taxpayer located outside the jurisdiction and in a foreign country is in fact made. Absent a withholding tax, the alternative would be for the royalty to be paid in full to the foreign tax-

payer, who would then be called on to remit the applicable tax to the tax authorities in the country of importation. As a tax accounting measure, the amount that is netted as a foreign withholding tax is included as income to the taxpayer, but the taxpayer is then credited with the foreign tax payment to avoid double taxation.

Pending Technical Question

The foregoing discussion on withholding taxes is drawn from a technical question that is pending at the TCCV, so an instrument addressing this matter may be issued by that body.

Possible Resolution

Meanwhile, here is my analysis. The proper starting point should be Commentary 9.1, which, as stated previously, provides a straightforward methodology. There are two significant points: (1) Are duties and taxes not included in the PAPP? If not included, apply Article 8 review. (para. 3); and (2) If such costs are included in the PAPP for the imported goods, they are not to be deducted from that price unless there is compliance with the relevant provisions of the Article 1 Note. Further, in the context of this para. 4, duties and taxes in the country of importation are by their very nature distinguishable, citing Advisory Opinion 3.1. (para. 4)

Article 1 Review

Unless there is a dynamic that otherwise would apply, on the facts in example above, per Commentary 9.1, an Article 1 application might not be possible because the payment is not included within the PAPP. As noted above, however, it may still be within an Article 1 review due to the expansion of the meaning of PAPP by Annex III, paragraph 7.

If an Article 1 review is undertaken, and Advisory Opinion 3.1 and Commentary 9.1 are controlling, the dutiable value could be cu1075, composed of a PAPP of cu1000 plus a cu75 royalty payment as an Article 8.1(c) adjustment. This is because the cu25 withholding taxes are to be distinguished from the PAPP, per those TCCV instruments.

If Advisory Opinion 3.1 and Commentary 9.1 are held not to apply, or are regarded as having been superseded by Annex III, paragraph 7, the total dutiable value would be cu1100, composed of cu1025 PAPP (cu1000 invoice price for the goods and the cu25 withholding tax paid on behalf of the seller), to which would be added the cu75 royalty payment as an Article 8.1(c) adjustment.

If there is no Article 1 review of the withholding tax as part of the PAPP, the withholding tax must still be reviewed under the tenets of Article 8.

Article 8 Review

Such a review is entirely appropriate because withholding tax is being imposed on a royalty payment that is dutiable under Article 8.1(c). The notion of being distinguishable might be read as applying only to an Article1 analysis under paragraph 4. In turn, that would mean that it is irrelevant for an Article 8 analysis whether the duty and tax being paid is distinguished from the PAPP.

Under Article 8, the cu25 withholding tax might be dutiable under Article 8.1(c) along with the cu75 actually remitted to the seller/licensor, as the buyer must pay that withholding tax as a condition of the sale. Article 8.1(c) does not anticipate that customs authorities are limited to an adjustment for payments made to or received by the seller. Even if that were not true, however, and the text were interpreted as requiring a payment to the seller for a payment to be cognizable under this provision, the text foresees both direct and indirect payments. In that case, the payment of the withholding tax might be seen as an indirect payment to the seller. Total dutiable value would be cu1000, composed of a PAPP of cu1000 and dutiable royalty of cu100.

Alternatively, if the withholding tax is considered distinct from the cu75 royalty payment, that tax payment might be interpreted as being subject to an Article 8.1(d) adjustment as a part of the proceeds of the subsequent resale of the imported goods. Total dutiable value would be cu1100, composed of a PAPP of cu1000, a dutiable royalty of cu75, and a subsequent proceed of cu25.

Conclusion

Certainly a major element in the application of the Article 1 Note will be the criterion that the duty or tax in question is distinguished from the PAPP. It should be a best practice to separately identify any such amount, especially if the amount otherwise would be "bundled" or subsumed with the PAPP.

With respect to the withholding tax, much might be made of the buyer, in acting as the withholding agent, paying the withholding tax for the seller/licensor, who is receiving the benefit of that payment. A key issue in resolving this question is the effect of Annex III, paragraph 7, on the TCCV instruments.

Another basic question that apparently has not been the subject of a TCCV instrument has to do with foreign exchange controls. What if the PAPP calls for a payment of cu1000 for the imported good, but the buyer is not permitted to remit more than cu800 due to restrictions that the country of importation imposes? Even though a price of 1000 was negotiated, indeed was expected to be paid and received, only cu800 can be paid and received. What is the dutiable value? That some of these basic questions are unresolved over 30 years into the life of the Valuation Agreement is surprising. ●