

Office of Chief Counsel
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memorandum

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to:

from: Christopher J. Bello, Branch Chief, CC:INTL:6

subject: Applicability of Treas. Reg. § 1.1059A-1(c)(2)(iv)

This Legal Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether a difference between a taxpayer's valuations for customs law purposes and for income tax purposes that results from the taxpayer's correct application of the first sale rule under customs law always violates section 1059A or whether such difference may be permissible under Treas. Reg. § 1.1059A-1(c)(2)(iv).

CONCLUSION

A difference between valuations for customs law purposes and for income tax purposes that results from a correct application of the first sale rule does not violate section 1059A where such difference falls under the exception in Treas. Reg. § 1.1059A-1(c)(2)(iv).

LAW

I. Section 1059A

Section 1059A provides:

(a) In general.

If any property is imported into the United States in a transaction (directly or indirectly)

between related persons (within the meaning of section 482), the amount of any costs —

- (1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and
- (2) which are also taken into account in computing the customs value of such property,

shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.

(b) Customs value; import.

For purposes of this section –

(1) Customs value. The term “customs value” means the value taken into account for purposes of determining the amount of any customs duties or any other duties which may be imposed on the importation of any property.

(2) Import. Except as provided in regulations, the term “import” means the entering, or withdrawal from warehouse, for consumption.

Thus, generally, if a transfer price paid by an importer exceeds the value reported by the importer for customs purposes, the amount by which the transfer price exceeds the customs value may be disregarded for income tax purposes.

Congress, however, recognized that there are legitimate and material differences between customs and tax valuation principles and directed the Secretary of the Treasury to provide rules that acknowledge such differences. Specifically, the legislative history provides, in part:

In enacting [section 1059A], Congress did not express the view that valuation of property for customs purposes should always determine valuation of property for U.S. income tax purposes. Instead, Congress was concerned only with establishing a limit on the price an importer could claim for income tax purposes. . . . The Act provides that importers subject to U.S. tax may not claim a transfer price for U.S. income tax purposes that is higher than would be consistent with the value they claim for customs purposes. . . . Congress expected that the Secretary will provide rules for

coordinating customs and tax valuation principles, including provision of proper adjustments for amounts such as freight charges, items of American content returned, sales commissions where customs pricing rules may differ from appropriate tax valuation rules. . . . In addition, in no event does a customs declaration or customs valuation constrain the ability of the Commissioner to adjust transfer prices under section 482.

Joint Committee on Taxation, General Explanation of Tax Reform Act of 1986, at 1062 (1987); Committee on Finance, Senate, S. Rep. 99-313, at 419 (1986); Conference Report, House of Representatives, Rep. 99-841, at II-656 (1986). The Treasury Department responded by issuing regulations that include Treas. Reg. § 1.1059A-1(c)(2), which provides:

(2) *Adjustments to customs value.*—To the extent not otherwise included in customs value, a taxpayer, for purposes of determining the limitation on claimed basis or inventory cost of property under this section, may increase the customs value of imported property by the amounts incurred by it and properly included in inventory cost for—

- (i) Freight charges,
- (ii) Insurance charges,
- (iii) The construction, erection, assembly, or technical assistance provided with respect to, the property after its importation into the United States, and
- (iv) Any other amounts which are not taken into account in determining the customs value, which are not properly includible in customs value, and which are appropriately included in the cost basis or inventory cost for income tax purposes. See § 1.471-11 and section 263.

Thus, Treas. Reg. § 1.1059A-1(c)(2) recognizes that, where the differences result from real value added, a taxpayer may report different amounts for customs and income tax purposes without adjustment under section 1059A.

II. The First Sale Rule

Under customs law, if both the manufacturer's selling price and a middleman's selling price are statutorily viable transaction values for purposes of determining customs duties, the first sale rule permits a taxpayer to choose the manufacturer's lower

price, rather than the middleman's higher price, as the basis for determining transaction value. This is known as the first sale rule. The court in Nissho Iwai American Corp. v. United States, 982 F.2d 505 (Fed. Cir. 1992), confirmed the first sale rule as a proper interpretation and application of customs law for valuation purposes, and explained the circumstances in which it may be applied:

Once it is determined that both the manufacturer's price and the middleman's price are statutorily viable transaction values, the rule is straightforward: the manufacturer's price, rather than the price from the middleman to the purchaser, is used as the basis for determining transaction value. . . . The rule only applies where there is a legitimate choice between two statutorily viable transaction values. The manufacturer's price constitutes a viable transaction value when the goods are clearly destined for export to the United States and when the manufacturer and the middleman deal with each other at arm's length, in the absence of any non-market influences that affect the legitimacy of the sales price.

Given the option afforded by the first sale rule, importers often choose the first sale value because it minimizes customs duties. Use of the first sale rule generally results in a disparity between the customs valuation and the income tax valuation because the income tax valuation is based on a later, more valuable sale.

ANALYSIS

Section 1059A(a) caps the section 482 transfer price of goods at the customs value reported for the goods. For this purpose, section 1059A(b)(1) provides that customs value is the value taken into account for purposes of determining the amount of any customs duties or any other duties that may be imposed on the importation of any property.

Treas. Reg. § 1.1059A-1(c)(2) allows taxpayers to increase the customs value of imported property by certain amounts that are properly not included in customs value, but which are incurred by the taxpayer and properly included in the transfer price of the property for income tax purposes. Treas. Reg. § 1.1059A-1(c)(2)(i) through (iii) provide specific examples of such amounts. Treas. Reg. § 1.1059A-1(c)(2)(iv) further allows customs value to be increased by any other such amounts that are not specifically identified in Treas. Reg. § 1.1059A-1(c)(2)(i) through (iii).

Accordingly, we conclude that an adjustment under section 1059A with respect to a value differential that results solely from an importer's correct application of the first sale rule and subsequent real value added under Treas. Reg. § 1.1059A-1(c)(2)(iv) is not proper. However, other adjustments under section 1059A may nonetheless be appropriate, and section 1059A does not limit in any way the authority of the

Commissioner to adjust a taxpayer's transfer price under section 482 or any other appropriate provision of the law. See Treas. Reg. § 1.1059A-1(c)(7).

Please call Branch 6 at (202) 435-5265 if you have any further questions.