

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:FSH:BRK:TL-N-5072-00
TKerrigan

date:

to: Large & Mid-Size Business Division
Attention: Manager Group 1577 - Income/International
E:E:F:1577

from: Associate Area Counsel
CC:LM:FSH:BRK

subject:

Taxable years [REDACTED]
U.I.L. No. 1059A.05-00

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This memorandum is in response to your request for advice, dated August 30, 2000, with respect to the Federal tax consequence of voluntary payments of customs duties made by the taxpayer after liquidation.

FACTS

The relevant facts, as we understand them, are as follows:
[REDACTED] (" [REDACTED] ") is a [REDACTED] % owned subsidiary of [REDACTED], a Netherlands corporation. [REDACTED] is the North American distributor of [REDACTED] manufactured by the parent company in Holland. Prior to the tax years at issue, [REDACTED] was owned by an unrelated U.S. taxpayer. On [REDACTED], [REDACTED] acquired the company after the previous owner filed for bankruptcy.

[REDACTED] purchases three general categories of [REDACTED] from the parent company. The first category includes [REDACTED] manufactured by the parent company that are

invoiced and paid for in U.S. dollars. The value of these [REDACTED] are the same for both customs and tax purposes. The second category consists of [REDACTED] imported by [REDACTED], which are manufactured by an unrelated company located in [REDACTED]. The remaining category consists of [REDACTED] manufactured by the parent company, which are invoiced in U.S. dollars but payments are made in Dutch guilders using a fixed exchange rate of [REDACTED] Dutch guilders per U.S. dollar. [REDACTED] paid U.S. customs duty based on the U.S. dollar price reflected on the invoices from [REDACTED]. The invoice amount, however, did not take into account the fact that the taxpayer was required to make its payments to [REDACTED] in Dutch guilders and not U.S. dollars. For purposes of determining the value for tax accounting purposes, the taxpayer converted the Dutch guilders paid into U.S. dollars based on the prevailing exchange rate on the actual date of payment. During the [REDACTED] tax year, the exchange rate fluctuated between [REDACTED] and [REDACTED] Dutch guilders to the U.S. dollar. The difference between the prevailing exchange rate and the fixed exchange rate of [REDACTED] Dutch guilders to the U.S. dollar resulted in the taxpayer reporting a significantly higher value for inventory purposes than for customs purposes. The international examiner reviewed the customs entry paperwork relating to the shipments at issue and has proposed the following I.R.C. § 1059A adjustment for the [REDACTED] taxable year for the difference between the value used for inventory purposes and the value used for customs purposes:

Value for inventory purposes	\$ [REDACTED]
Value used for customs entry purposes	[REDACTED]
I.R.C. § 1059A adjustment	\$ [REDACTED]

After the international examiner identified this issue and advised the taxpayer of the discrepancy between the value used for inventory purposes and the value used for customs entry purposes, taxpayer's counsel contacted the U.S. Customs Service giving notice of a potential violation of 19 U.S.C. § 1592. In a letter, dated [REDACTED], counsel made a disclosure to Customs on the taxpayer's behalf stating that the taxpayer had undervalued the imported [REDACTED] because the shipments should have been valued for entry purposes according to the published exchange rate for Dutch guilders as of the date of exportation rather than the invoiced U.S. dollar amount. On [REDACTED], the taxpayer tendered payment to the U.S. Customs Service in the amount of \$ [REDACTED] for additional duties owed for customs entries made from [REDACTED] to [REDACTED]. The taxpayer asserts that its prior disclosure and voluntary tender of additional customs duties increased the "dutiable value" for purposes of I.R.C. § 1059A and that no adjustment is warranted in this instance.

ISSUE

Whether the "dutiabale value" for purposes of I.R.C. § 1059A is increased as a result of the voluntary tender of customs duties pursuant to 19 U.S.C. § 1592(c)(4).

LEGAL ANALYSIS

I.R.C. § 1059A, which was added by § 1248 of the Tax Reform Act of 1986, P.L. 99-514 provides that a U.S. taxpayer that imports property into the U.S. in a transaction (directly or indirectly) from a person or persons related to the taxpayer, within the meaning of I.R.C. § 482, may not claim, for purposes of computing the basis or inventory cost of the property, value in excess of the amount claimed for customs valuation purposes. I.R.C. § 1059A effectively limits a taxpayer's inventory costs for merchandise imported from a related party for income tax purposes once the appraised value for customs purposes becomes final.

Prior to the enactment of this statute, the Tax Court held that imported value for customs purposes and value for income tax purposes need not be equivalent. See Brittingham v. Commissioner, 66 T.C. 373 (1976), aff'd, 598 F.2d 1375 (5th Cir. 1979) [Importers could claim a transfer price for income tax purposes that was higher than would be consistent with the transfer price claimed for customs purposes]. The provision codified as I.R.C. § 1059A was specifically enacted to overrule the holding in Brittingham. See S. Rep. No. 313, 99th Cong., 2d Sess. 418-19 (1986); Conference Report, H.R. Rep. No. 841, 99th Cong., 2d Sess. 11-656 (1986). Although Congress recognized that customs value and inventory value might not be equivalent in all cases, it imposed a "ceiling" on the inventory basis for income tax purposes equal to the "dutiabale value".

Treas. Reg. § 1.1059A-1(d) defines a "final determination of value" by Customs as follows:

(d) Finality of Customs Value and of Other Determinations of the U.S. Customs Service. For purposes of Section 1059A and this section, a taxpayer is bound by the finally-determined customs value and by every final determination made by the U.S. Customs Service, including, but not limited to, dutiable value, the value attributable to the cost or value of products of the United States, and classification of the product for purposes of imposing any duty. The customs value is considered to be finally determined, and all U.S. Customs Service determinations are considered final, when liquidation of the entry becomes final. For this purpose, the term "liquidation" means the ascertainment

of the customs duties occurring on the entry of the property, and liquidation is considered to become final after 90 days following notice of liquidation to the importer, unless a protest is filed. If the importer files a protest, the customs value will be considered finally determined and all other U.S. Customs Service determinations will be considered final either when a decision by the Customs Service on the protest is not contested after expiration of the period allowed to contest the determination or when a judgment of the Court of International Trade becomes final. For purposes of this section, any adjustments to the customs value resulting from a petition under 19 U.S.C. section 1516 (requests by interested parties unrelated to the importer for redetermination of the appraised value, classification, or the rate of duty imposed on imported merchandise) or reliquidation under 19 U.S.C. section 1521 (reliquidation by the Customs Service upon a finding that fraud was involved in the original liquidation) will not be taken into account. However, reliquidation under 19 U.S.C. section 1501 (voluntary reliquidation by the Customs Service within 90 days of the original liquidation, to correct errors in appraisement, classification, or any element entering into a liquidation or reliquidation) or reliquidation under 19 U.S.C. section 1520(c)(1) (to correct a clerical error, mistake of fact, or other inadvertence within one year of a liquidation or reliquidation) will be taken into account in the same manner as, and take the place of, the original liquidation in determining customs value.

Accordingly, the general rule is that I.R.C. § 1059A prohibits an importer from increasing its inventory value for tax purposes, thereby decreasing its income, once liquidation becomes final.

The controlling regulation places substantial weight to the event of liquidation. Liquidation refers to the process by which the declared value and duty assessment become final. See 19 U.S.C. § 1504. Liquidation occurs automatically one year after an entry, unless the entry is held open by Customs. See 19 U.S.C. § 1504(a). The regulation specifies the following three post-liquidation events, none of which are applicable in this case, potentially bearing upon appraised or liquidated value that may give rise to a change in the liquidated value for purposes of I.R.C. § 1059A: (1) a final judgment of the Court of International Trade overturning Customs' denial of a customs protest with respect to valuation [19 U.S.C. § 1503]; (2) reliquidation pursuant to 19 U.S.C. § 1501

[voluntary reliquidation within 90 days of the liquidation, to correct errors in the liquidation]; and (3) reliquidation pursuant to 19 U.S.C. § 1520(c)(1) [reliquidation within one year of liquidation to correct an error, mistake of fact, or other inadvertence]. The regulation also identifies two post-liquidation events bearing upon appraised or liquidated value that do not give rise to a change in liquidated value for purposes of I.R.C. section 1059A. The two post-liquidation events are (1) adjustments resulting from a petition by parties unrelated to the importer for redetermination of the value, classification, or other element of a liquidation [i.e., domestic interested party petition pursuant to 19 U.S.C. § 1516]; and (2) reliquidation upon a finding that fraud was involved in the original liquidation [19 U.S.C. section 1521]. Treas. Reg. § 1.1059A-1(d). The regulation, therefore, comprehensively and systematically prescribes whether relevant provisions of customs law potentially bearing upon appraised or liquidated value may, or may not, give rise to a change in the liquidated value for purposes of I.R.C. § 1059A.

The taxpayer contends that its voluntary tender pursuant to 19 U.S.C. § 1592(c)(4) effectively increased the "dutiabale value" finally determined for purposes of I.R.C. § 1059A. The taxpayer relies on TIE Communications, Inc. v. United States, 18 C.I.T. 358, 362 (1994) in support of its proposition that 19 U.S.C. § 1592(d) duty payments constitute a statutory exception to the concept of finality of liquidation. In addition, the taxpayer asserts that a strict application of I.R.C. § 1059A in this instance would be inequitable since it was not the taxpayer's intent to evade paying the correct duty. For the reasons discussed below, we believe the statutory language of I.R.C. § 1059A and the regulation promulgated thereunder expressly limit the value for tax purposes to the value determined by Customs at the time of liquidation.

First, the taxpayer's position simply is not supported by the plain meaning of I.R.C. § 1059A or the statutory provisions governing liquidation and voluntary tenders. Since I.R.C. § 1059A, as interpreted by the regulation, defines the limitation on the taxpayer's inventory cost by reference to customs value, which is the value determined by Customs at the time of liquidation, there is no statutory authority to substitute the value as reflected by the post liquidation voluntary tender of duties. Treas. Reg. § 1059A-1(d). In the present case, therefore, the limitation amount for purposes of I.R.C. § 1059A consists of the final "dutiabale value," i.e., the "appraised value" of the merchandise as determined upon liquidation. See 19 U.S.C. § 1503.

Second, the taxpayer's reliance on dicta contained in TIE Communications is misplaced. 19 U.S.C. § 1592(d) is a specific grant of authority that permits Customs to assess penalties and/or to collect "lawful duties," notwithstanding the fact that liquidation has taken place and has become final pursuant to 19 U.S.C. § 1514. The provisions of 19 U.S.C. 1592 are separate and independent from the finality of liquidation provisions contained in 19 U.S.C. § 1514. Moreover, the narrow issue addressed in TIE Communications was whether the five-year statute of limitations applied to both subsections 19 U.S.C. § 1592(a) and 19 U.S.C. § 1592(d). We note that the analysis contained in that opinion does not even address any purported interplay between 19 U.S.C. § 1592 and I.R.C. § 1059A. Thus, the taxpayer's expansive reading of TIE Communications is out of context and has no application to the facts presented in this case. The taxpayer's act of voluntarily tendering such duties, therefore, has no effect on the "dutiable value" as determined at liquidation.

Third, the taxpayer's attempt to rely on equitable considerations is not persuasive. The narrow focus of I.R.C. § 1059A is to prevent taxpayers from claiming a low valuation for customs purposes and a higher valuation for tax purposes and this. In this case, the duty rate on the imported goods was █%. While we concede that it does not appear that the taxpayer was attempting to manipulate its transfer pricing solely to lessen its taxes and Customs duties in an improper manner, this fact is immaterial. There is nothing in the legislative history of I.R.C. § 1059A, however, to suggest that Congress intended to alter the well-established concept of finality of liquidation in the situation described herein. Treas. Reg. § 1.1059A-1 specifically enumerates the only circumstances where adjustments to the inventory costs are permitted. Therefore, we are constrained by the clear and unambiguous language contained in the controlling regulation notwithstanding the taxpayer's equitable argument to the contrary. Accordingly, the taxpayer's position that its voluntary tender of duties serves to "re-open" liquidations that are otherwise final, and equitable argument that I.R.C. § 1059 should not be applied literally since it did not engage in the conduct that I.R.C. § 1059A seeks to prevent, are without merit.

CONCLUSION

Treas. Reg. § 1.1059A-1(d) definitively states that, "[t]he customs value is considered to be finally determined,

and all U.S. Customs Service determinations are considered final, when liquidation of the entry becomes final." Based on the fact that liquidation has taken place and become final with respect to the imported merchandise at issue, we conclude that the taxpayer's subsequent voluntary tender of additional duties did not increase the "dutiabale value" of the imported merchandise for purposes of the I.R.C. § 1059A limitation. Since the value used for Customs purposes was lower than the value reported for income tax purposes, the proposed adjustment under I.R.C. § 1059A is warranted.

This opinion is based upon the facts set forth herein. It might change if the facts are determined to be incorrect. If the facts are determined to be incorrect, this opinion should not be relied upon. You should be aware that, under routine procedures, which have been established for opinions of this type, we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office. In the meantime, the conclusions reached in this opinion should be considered to be only preliminary.

If you have any questions or require further assistance, please contact Thomas Kerrigan at (516) 688-1742.

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