With You Today

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Transfer Pricing and International Tax Considerations
Transfer Pricing and International Considerations

- Efficient cash movement in this environment
- Impact to profit splits
- TP adjustments
- Enforcing IC agreements
- Impact to cost sharing arrangements
- How limited risk really is a LRD, contract manufacturing, etc.
- How to support loss making companies
- Comparables
- Supply chain structures
- BEPS 2.0 applicability
- Impact on foreign income inclusions (Subpart F, GILTI, 956)
- Impact on foreign derived intangible income deduction (250 deduction)
- Impact on foreign tax credit utilization
- Tax implications of repatriation
- NOL Carryback
Cash Management Planning
Transfer Pricing and International Tax Considerations

- Cash Repatriation
- Losses
- NOL Carrybacks

Transfer Pricing

International Tax
Transfer Pricing and International Tax Considerations

- Local Transfer Pricing Constraints
- Repatriation Needs
Case Study - Transfer Pricing and International Tax Example
Cash Management Planning - Case Study

Opportunity Assessment

- Review existing profit targets and policies for intercompany transactions
  - Adjustment to another point in interquartile range (or below)?
  - Who should bear risks and losses?
  - Intercompany contractual terms

- Services transactions - review cost base and allocation methodology
  - Identify costs not previously allocated
  - Reassess allocation approach and methodology

- Identify potentially unremunerated transactions
  - Royalty-free use of intangibles
  - Support services
  - Intercompany financing

Potential Estimated Benefit

- Cash Repatriated to US - $16 million
- Tax Savings - $1.9 million
Global Management Fee Model - Estimated Charge-out Adjustments

- Using Company A’s 2020 Admin projected costs and foreign affiliate sales, BDO revised the management services allocation (20% rather than 15% for all service areas) and mark-up applied (10% rather than 8%). The table below illustrates the figures accounting for these factors along with the potential tax benefit arising from rate differentials.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub A</td>
<td>1,356,464</td>
<td>1,967,159</td>
<td>+610,695</td>
<td>97,711</td>
</tr>
<tr>
<td>Sub B</td>
<td>682,044</td>
<td>923,148</td>
<td>+241,104</td>
<td>34,386</td>
</tr>
<tr>
<td>Sub C</td>
<td>1,740,739</td>
<td>2,272,021</td>
<td>+531,282</td>
<td>58,441</td>
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<tr>
<td>Sub D</td>
<td>1,446,694</td>
<td>1,857,174</td>
<td>+410,480</td>
<td>45,153</td>
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<tr>
<td>Sub E</td>
<td>326,336</td>
<td>499,623</td>
<td>+173,287</td>
<td>20,794</td>
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<tr>
<td>Sub F</td>
<td>905,598</td>
<td>1,252,864</td>
<td>+347,266</td>
<td>43,756</td>
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<tr>
<td>Sub G</td>
<td>-</td>
<td>1,006,021</td>
<td>+1,006,021</td>
<td>48,976</td>
</tr>
<tr>
<td>Total</td>
<td>6,457,875</td>
<td>9,778,010</td>
<td>+3,320,135</td>
<td>349,218</td>
</tr>
</tbody>
</table>
Global Trademark Royalty - Feasibility

- Using Company A's 2020 projected foreign trade sales, BDO analyzed the impact of a potential global royalty (2.0% outside sales) for use of the trademark, trade name, and/or any related marketing intangibles. The table below presents potential tax benefit based on tax differentials.

<table>
<thead>
<tr>
<th>Potential Licensee</th>
<th>Projected 2020 Trade Sales</th>
<th>Royalty Income to US</th>
<th>Potential Tax Benefit/(Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub A</td>
<td>186,405,000</td>
<td>+3,728,100</td>
<td>410,092</td>
</tr>
<tr>
<td>Sub B</td>
<td>97,826,000</td>
<td>+1,956,520</td>
<td>313,044</td>
</tr>
<tr>
<td>Sub C</td>
<td>150,462,000</td>
<td>+3,009,240</td>
<td>331,016</td>
</tr>
<tr>
<td>Sub D</td>
<td>37,433,673</td>
<td>+748,674</td>
<td>89,840</td>
</tr>
<tr>
<td>Sub E</td>
<td>14,627,119</td>
<td>+292,542</td>
<td>58,508</td>
</tr>
<tr>
<td>Sub F</td>
<td>9,879,365</td>
<td>+197,588</td>
<td>23,710</td>
</tr>
<tr>
<td>Sub G</td>
<td>20,042,155</td>
<td>+400,844</td>
<td>64,134</td>
</tr>
<tr>
<td>Sub H</td>
<td>28,314,248</td>
<td>+566,284</td>
<td>79,280</td>
</tr>
<tr>
<td>Sub I</td>
<td>25,361,316</td>
<td>+507,226</td>
<td>25,362</td>
</tr>
<tr>
<td>Sub J</td>
<td>18,822,281</td>
<td>+376,446</td>
<td>26,338</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>+11,783,464</td>
<td>1,421,324</td>
</tr>
</tbody>
</table>
Limited Risk Distributor - Potential Adjustment

Current Transfer Pricing Policy

<table>
<thead>
<tr>
<th>Entity</th>
<th>US Headquarters</th>
<th>Canadian Distributor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entity Characterization</td>
<td>Entrepreneur</td>
<td>Limited-risk Distributor</td>
</tr>
<tr>
<td>Current Transfer Pricing Policy</td>
<td>Residual profit/loss</td>
<td>Target operating margin - 7%</td>
</tr>
</tbody>
</table>

LRD Benchmarking analysis results -
Lower Quartile 3% - Upper Quartile 10%, Median 7%

<table>
<thead>
<tr>
<th>LRD Adjustment (in thousands USD) - Adjustment to 3% Target OM</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$23,936</td>
</tr>
<tr>
<td>EBIT at 7% OM</td>
<td>$1,676</td>
</tr>
<tr>
<td>EBIT at 3% OM</td>
<td>$718</td>
</tr>
<tr>
<td>Residual Profit (Cash) to US</td>
<td>$958</td>
</tr>
<tr>
<td>Potential Tax Benefit*</td>
<td>$115</td>
</tr>
</tbody>
</table>
Cash Management Planning

**Additional International Tax Considerations**

- Do foreign jurisdictions impose withholding taxes on related party transactions?
- Do related party transactions increase foreign derived intangible income deduction?
- Do related party transactions reduce global intangible low-taxed income inclusion and GILTI 250 deduction?
- How does the change in related party transaction arrangements impact foreign tax credit utilization?
Cash Management Planning

Additional Transfer Pricing Considerations and Requirements

► TP Documentation
  • Ensure documentation is in place in required jurisdictions
  • Tell the “story” through tailored industry and functional analysis
  • Identify and address inconsistencies

► Intercompany agreement framework
  • Are all necessary agreements in force?
  • What does the contract say for changing policies?

► Treatment of Losses
  • Results should align with functional and risk profiles
  • NOL carryback may open closed tax year(s)

► Audit Activity
  • Identify risks (by transaction, jurisdiction) and document proactively
Regulatory Updates and Ongoing Work
### Regulatory Updates and Ongoing Work*

**Tax Treaties & Impact of COVID-19 - OECD Guidance Issued April 3, 2020**

<table>
<thead>
<tr>
<th>Area of Concern</th>
<th>Specific Issue</th>
<th>Guidance Offered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permanent Establishments (PE)</td>
<td>Home Offices</td>
<td>The exceptional and temporary change of the location where employees exercise their employment because of the COVID 19 crisis, such as working from home, should not create new PEs for the employer. Also, a home office needs to be “at the disposal” of the employer before it could constitute a PE, which would not be the case in the majority of those cases.</td>
</tr>
<tr>
<td>Agency PE</td>
<td>Temporary conclusion of contracts in the home of employees or agents because of the COVID 19 crisis should not create PEs for the businesses.</td>
<td></td>
</tr>
<tr>
<td>Construction Site</td>
<td>A construction site PE would not be regarded as ceasing to exist when work is temporarily interrupted.</td>
<td></td>
</tr>
</tbody>
</table>

*Section adapted from OECD May 2020 Tax Talks Presentation*
## Regulatory Updates and Ongoing Work

### Tax Treaties & Impact of COVID-19 - OECD Guidance Issued April 3, 2020

<table>
<thead>
<tr>
<th>Area of Concern</th>
<th>Specific Issue</th>
<th>Guidance Offered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence of a company</td>
<td>Place of effective management</td>
<td>An extraordinary and temporary change in location of the chief executive officers and other senior executives due to the COVID-19 crisis should not trigger a change in residency.</td>
</tr>
<tr>
<td>Residence status of individuals</td>
<td>Tie breaker rule</td>
<td>Unlikely that a person would acquire residence in the country where the person is temporarily because of extraordinary circumstances. But even if he or she does, if a tax treaty is applicable, the person would not be a resident of that country for purposes of the tax treaty.</td>
</tr>
<tr>
<td>Income paid by employers to cross-border workers during crisis</td>
<td>Article 15</td>
<td>Where a government has stepped in to subsidize the keeping of an employee on a company’s payroll during the COVID-19 crisis, the income should be attributable to the place where the employment used to be exercised. Other employment income would normally be taxed where employment is performed. OECD is working with countries to mitigate the compliance and administrative costs for employees and employers.</td>
</tr>
</tbody>
</table>
Regulatory Updates and Ongoing Work

Pillar 1 (Unified Approach) and Pillar 2 (GloBE Proposal)

Current Impact Assessment Preliminary Results

- Pillars 1 and 2 together are expected to generate substantial global net revenue gains for tax authorities
- The initiatives are projected to lead to a significant reduction in profit shifting

Ongoing Work

- Estimates and projections are being refined for:
  - Ongoing discussions on overall scope and design
  - Impacts of proposals on investment costs
  - Failure to reach consensus solution
  - Trends and consequences of COVID-19 (e.g., extraordinary profits/losses for certain companies, increased digitalization, and demand for additional government revenue)
Overview of Proposal

Pillar 1 would grant countries the right to tax profits of international businesses regardless of whether they have a physical presence in the country or not (i.e., new nexus)

Proposed scope is broad to include all consumer-facing businesses which meet to-be-determined thresholds (e.g., revenue, time in a market, etc.)

Proposal partially departs from arm’s length principle and revises global profit allocation rules, into the following:
- Amount A: Portion (%) of deemed residual profit, allocated to market jurisdictions
- Amount B: Fixed return for routine functions
- Amount C: Return for functions beyond Amount B, and a mechanism for dispute resolution
# Pillar 1 - Unified Approach Ongoing Work

<table>
<thead>
<tr>
<th>Amount A</th>
<th>Other Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong> - Which companies will fall under the proposal, and in which jurisdictions?</td>
<td><strong>Amount B Scope</strong> - Define baseline activity and routine return</td>
</tr>
<tr>
<td><strong>Nexus</strong> - Thresholds and other determining factors</td>
<td><strong>Dispute Resolution</strong> - Mechanism to offer certainty and resolve cross-border disputes</td>
</tr>
<tr>
<td><strong>Tax Base</strong> - Measure of profits, use of segmentation/allocation, treatment of losses</td>
<td><strong>Implementation</strong> - Provide tools to assist jurisdictions to implement</td>
</tr>
<tr>
<td><strong>Allocation</strong> - Profitability thresholds, re-allocation percentages and allocation keys</td>
<td><strong>Safe Harbors</strong> - Simplifying measures for ease of administration</td>
</tr>
<tr>
<td><strong>Double Taxation</strong> - Develop simplified system to relieve double tax</td>
<td></td>
</tr>
</tbody>
</table>
Pillar 2 - GloBE Proposal

Overview of Proposal

- Pillar 2, the global anti-base erosion proposal, seeks to counter profit-shifting by multinationals who are subject to low or zero taxation, by imposing a global minimum tax (yet to be determined), applied at the level of the taxpayer rather than the level of the country.

- Aims to provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights of income or payments otherwise subject to low levels of effective taxation.

- Guided by four rules:
  1. Income inclusion rule
  2. Switch-over rule
  3. Undertaxed payments rule
  4. Subject to tax rule
## Pillar 2 - GloBE Proposal Ongoing Work

<table>
<thead>
<tr>
<th>Proposed Rule</th>
<th>Considerations</th>
</tr>
</thead>
</table>
| **Income inclusion rule** - Income taxed at a rate below a specified minimum would be taxable for the shareholder in a corporation | • Thresholds  
• Tax base  
• Covered taxes  
• Blending  
• Timing differences  
• Scope/Carve-outs  
• Simplifications  
• Minimum tax rate |
| **Undertaxed payments rule** - Would deny deductions or make equivalent adjustments of certain payments | • Scope  
• Trigger  
• Effect  
• Minimum tax rate |
| **Switch-over rule** - Designed to apply income inclusion rule to foreign branches exempt under double tax treaties | • Rule order, interaction, and status |
| **Subject to tax rule** - Could work by subjecting payments to withholding taxes or denying treaty benefits |                                      |
OECD is still targeting year-end deadline to deliver consensus-based solution

- Work is ongoing and committees are meeting virtually
- Key policy features are expected to be agreed in October
- Consensus solution to be delivered at November G20 Leaders Summit
ATAD II
Neuturalizing the Effects of Hybrid Mismatches

- To prevent an outcome where is a:
  - Double deduction
  - A deduction with no income inclusion arising from the use of a hybrid entity or hybrid instrument

- EU member states required to implement most of the provisions of the Directive by January 1, 2020

- Types of Hybrid mismatches

- Financial Instrument mismatches
- Hybrid Entity mismatches
- Reverse Hybrid mismatches
- Permanent Establishment mismatches
- Dual Resident mismatches
- Imported mismatches
Description
- DRE pays interest, management fee, and royalty payments to USP.

Analysis
- Effect is a deduction is claimed for the expenses in the UK with no corresponding income inclusions in the US.
- Deduction for expenses may be disallowed for UK tax purposes.
Common Structures

**Description**
- DRE provides services to USP under a cost plus arrangement.
- DRE does not receive any other revenue.

**Analysis**
- Effect is a deduction is claimed for the expenses in two different jurisdictions.
- The Service fee is only included in UK taxable income.
- Deduction for expenses may be disallowed for local country tax purposes.
Common Structures

Description
- DRE1 purchases goods for resale to DRE2.
- DRE2 sells goods to 3rd party customers.
- DRE1 does not receive any other revenue.

Analysis
- Effect is a deduction is claimed for the COGS in two different jurisdictions.
- Income is only included in DRE2’s taxable income.
- Deduction for expenses by DRE1 may be disallowed in Country A.
Agenda - Customs and Trade

- Customs & Int’l Trade Services (‘CITS’): **Who Are We?**
- U.S. Customs & Border Protection: **What Is It?**
- Customs 101: **What Do We Do?**
  - U.S. Customs Overview
  - “Reasonable Care” Standard
  - Section 592 Penalties
  - “Customs Triangle”
- International Trade Updates - Section 301 & 232 Tariffs Overview
- Q&A
Learning Objectives

- Identify risks and opportunities using reported data elements.

- Define the Harmonized System and how it is used throughout the major trading countries of the world.

- Understand how Transfer Pricing and Customs Valuation factor into the amount of duties paid to CBP.
Customs & Int’l Trade Services (“CITS”): Who Are We?
CUSTOMS & INT’L TRADE SERVICES (“CITS”)

WHO WE ARE?

► Specialized group within BDO’s International Tax Services focusing on government regulations covering the cross-border movement of merchandise;

► Became an official part of BDO on Jan. 2, 2019 when BDO acquired a BRN Alliance Firm; and

► Consists of the following customs practitioners:

- DAMON V. PIKE (Principal / West Palm Beach, FL) - dpike@bdo.com;
- JAMES PAI (Senior Manager / Costa Mesa, CA) - jpai@bdo.com;
- YUN GAO (Manager / New York City) - yun.gao@bdo.com;
- TRAVIS FOURNIER (Manager / Troy, MI) - tfournier@bdo.com; and
- JAY CHO (Manager / Miami, FL) - jcho@bdo.com.
U.S. Customs & Border Protection: What Is It?
U.S. Customs Overview

- **U.S. Customs & Border Protection ("CBP")**
  - One of the world’s largest law enforcement organizations, whose focus is the security of U.S. borders and enforcement of U.S. international trade law.
  - Fully operational branch of law enforcement with employees ranging from forensic accountants and scientists to uniformed officers and trade specialists.

- **CBP Centers of Excellence and Expertise ("CEEs")**
  - Hub of CBP Import Specialist teams among the various CBP ports of entry in the U.S.
  - Ten CEEs located around the country, each specializing in an industry and range of commodities.
    - Hence, local CBP port authorities have limited impact on trade compliance matters, but still have complete control of the physical entry of cargo, e.g., seizures, etc.
CBP Centers of Excellence & Expertise

San Francisco
Apparel, Footwear & Textiles

Los Angeles
Electronics

Laredo
Machinery

Houston
Petroleum, Natural Gas & Minerals

Chicago
Base Metals

Memphis
Automotive & Aerospace

Buffalo
Industrial & Manufacturing Materials

New York
Pharmaceuticals, Health & Chemicals

Atlanta
Consumer Products & Mass Merchandising

Miami
Agriculture & Prepared Products
“Reasonable Care” Standard

- Who is responsible for customs compliance?
  - The Importer of Record is principally responsible for using “Reasonable Care” to report accurate information to CBP, pay the correct amount of duty, and maintain all required records.

- Risks associated with non-compliance:
  - Inadequate internal controls to monitor imports/exports can result in fines, penalties, overpayment of duties, and supply chain delays if goods are held up at the border.
  - “My broker did it” is not a valid defense to a penalty case.
  - Liability generally flows to the corporate entity acting as the importer of record, but recent legal developments may result in individuals sharing personal liability for customs violations in future penalty cases. See Trek Leather court case.
Customs Form 7501 - The “Transactional Tax Return”
“Section 592” penalties are imposed for violations resulting from material or false errors or omissions in information reported to CBP.

Three levels of culpability exist for 592 penalty cases:

- **Fraud:**
  - “Revenue” violations: 5 to 8 times the loss of duty
  - “Non-Revenue” violations: 50% to 80% of the dutiable value

- **Gross Negligence:**
  - “Revenue” violations: 2.5 to 4 times the loss of duty
  - “Non-Revenue” violations: 25% to 40% of the dutiable value

- **Negligence:**
  - “Revenue” violations: 0.5 to 2 times the loss of duty
  - “Non-Revenue” violations: 5% to 20% of the dutiable value
Customs 101: What Do We Do?

I. Classification
II. Valuation
III. Country of Origin
I. Tariff Classification

- Imported Goods must be classified under the **Harmonized Tariff Schedule of the United States** ("HTSUS") - based on global Harmonized System ("HS").

- HTSUS classification determines duty rates, eligibility for Free Trade Agreements, import quotas, etc.

- Determining the correct tariff code is a highly technical analysis reliant on a thorough understanding of a significant number of laws, regulations, and rulings.
I. Tariff Classification (Cont’d)

The HS consists of approximately 5,000 tariff descriptions that are organized into headings and subheadings. The headings and subheadings are organized into chapters and sections.

- Headings (four-digit) are general categories of merchandise;
- Within each heading are multiple subheadings (six-digit with more specific categories of goods); and
- Any digits beyond subheading level are country-specific, e.g., the HTSUS assigns 10 digits as the full tariff code, while the European Union (“EU”) only assigns eight digits.
I. Tariff Classification (Cont’d)

**EXAMPLE**: Pineapple HS Code **0804.30.XXXX**

Section II: Vegetable Products

**Chapter 08**: Edible fruit and nuts; peel of citrus fruit or melons

**Heading 0804**: Dates, figs, pineapples, avocados, guavas, mangoes and mangosteens, fresh or dried

**Subheading 0804.30**: Pineapples

Country-specific tariffs and statistical breakdown
I. Tariff Classification (Cont’d)

The HS uses **General Rules of Interpretation (‘GRIs’)** and section and chapter notes for use in classification of merchandise.

When classifying goods, GRIs are applied in sequential order (Rule 1 is applied first, and then Rule 2, then Rule 3, and so on).

- GRI 1 states that goods must be classified according to the language of the headings and the instructions of the chapter and section notes.

- GRI 2 states that goods imported that are unfinished, incomplete, or disassembled should be classified as complete if they exhibit the **essential character** of the complete, finished article.

- GRI 3 states that an item should usually be classified into the **four-digit heading** that most **specifically describes it**. It also states that mixtures or composite goods are classified according to the component that imparts the essential character to the finished item.
I. Tariff Classification (Cont’d)

EXAMPLE: Machine tools for working metal v. machines with individual functions not specifically listed v. laser welding machines:

I. **Tariff Classification (Cont’d)**

**Heading 8515**

<table>
<thead>
<tr>
<th>8515</th>
<th>Electric (including electrically heated gas), laser or other light or photon beam, ultrasonic, electron beam, magnetic pulse or plasma arc welding, brazing or welding machines and apparatus, whether or not capable of cutting; electric machines and apparatus for hot spraying of metals or cermets; parts thereof: Other machines and apparatus</th>
<th>Free</th>
</tr>
</thead>
<tbody>
<tr>
<td>8515.80.00</td>
<td>Other machines and apparatus</td>
<td></td>
</tr>
<tr>
<td>40</td>
<td>Ultrasonic welding machines</td>
<td>No.</td>
</tr>
<tr>
<td>80</td>
<td>Other</td>
<td>No.</td>
</tr>
</tbody>
</table>

**Heading 8463**

<table>
<thead>
<tr>
<th>8463</th>
<th>Other machine tools for working metal or cermets, without removing material: Other</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>8463.90.00</td>
<td>Other</td>
<td>4.4%</td>
</tr>
</tbody>
</table>

**Heading 8479**

<table>
<thead>
<tr>
<th>8479</th>
<th>Machines and mechanical appliances having individual functions, not specified or included elsewhere in this chapter; parts thereof: Other</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>8479.89.94</td>
<td>Other</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

CUSTOMS AND TRADE, TRANSFER PRICING, AND INTERNATIONAL TAX UPDATES
II. Customs Valuation

- Goods imported into the U.S. must be properly valued at the time of import in order for CBP to assess the proper amount of import duties.

- Most duties are assessed *ad valorem*, so a lower value means lower duties.

- The “dutiable value” is a calculation usually based on the “price actually paid or payable” (Transaction Value, or “TV”) for the goods when sold for export to the United States.
II. Customs Valuation (Cont’d)

- If you cannot use TV, other bases of appraisement must be applied in the statutory sequential order -- TV of identical merchandise; TV of similar merchandise; the deductive value; the computed value; and “fall-back” method.

- Additions to TV that must be reported: “SCRAPP”
  - Selling Commissions (other than Buying Commissions);
  - Royalties;
  - Assists;
  - Proceeds from subsequent sales; and
  - Packing Costs.
II. Customs Valuation - Related Party Transaction

The transaction value between related parties is acceptable if an examination of the circumstances of the sale ("COS") of the imported merchandise indicates that the relationship between the buyer and the seller did not influence the price. CBP regulations list three illustrative examples of tests to examine the COS:

- Normal pricing practices of the industry;
- All costs plus a profit; and
- Seller settles prices to related buyers in same manner as it does unrelated ones.

CBP has broadened its approach to "totality of the evidence," i.e., it examines all facts and circumstances when applying COS.
II. Customs Valuation & Transfer Pricing

- **Transfer Pricing & Conflict:** Customs vs. Income Tax = “whipsaw” effect.
  - Historically, CBP concerned about transfer prices because of a possibility the seller will charge buyer lower prices for goods that attract duty - and charge higher prices for duty-free goods.
  - IRS also concerned about transfer prices because of a possibility seller will manipulate them in an effort to shift profits to countries with lowest tax rates.

- **Any post-importation price adjustments** may form part of the transaction value:
  - TP policy must be in writing, be set before importation, and actually followed by the importer. In such cases, TP policy may be considered an “objective formula” for TV purposes.
  - Such adjustments must be reported to CBP if the adjustment meets the requirements of the “5-factor” test enumerated in CBP HQ Ruling W548314 (May 16, 2012).
II. Customs Valuation - First Sale Rule ("FSR")

The First Sale Rule ("FSR"): FSR applies where merchandise is imported into the U.S. as a result of multiple sales prior to import. However, CBP normally now examines whether all sales are arm’s length (including intercompany ones) before permitting use of FSR.

FSR has three requirements:
1. A *bona fide* sale must exist for each transaction;
2. The merchandise must be clearly destined for export to the U.S. at the time of the first sale; and
3. All prices (especially the first sale price) must be arm’s length.
   - If any sales take place between related parties, the transfer price must be supportable under COS.
II. Customs Valuation - FSR Illustration

Dutiable Value would be $100,000 instead of $150,000.

If duty rate is 5%, total duty owed will be $5,000 instead of $7,500 - saving $2,500.
III. Country of Origin ("COO") / Marking

- COO is typically the last country of manufacture - NOT country of export or country where vendor is located.

- Must be shown on the commercial invoice.

- Normally determined by “substantial transformation” rule: the finished/imported good in the last country of assembly/processing must have a different name, character, or use than the starting materials.

- Country of origin must be marked clearly and in English on the article or its container/package; if packaged individually, each item must be marked.
III. Country of Origin ("COO") / Marking (Cont’d)

► Articles imported as intermediate materials for further manufacturing are normally exempt from marking.

► Ten percent marking duties apply if rules are not met.

► Add requirements for marking and HS codes into purchase orders.

► Ensure that the proper country of origin is listed on the invoice.

► Receiving personnel should regularly “spot-check” physical marking and report up the chain if items are not marked.
Preferential Origin: Free Trade Agreements ("FTAs")

- U.S. has 20 FTAs which provide for duty reduction or duty exemption when goods “originate” from certain countries. Examples include:
  - North American Free Trade Agreement ("NAFTA") - soon to be replaced by the U.S.-Mexico-Canada Agreement ("USMCA")
  - U.S.-Korea Free Trade Agreement ("KORUS")
  - U.S.-Australia Free Trade Agreement
  - U.S.-Israel Free Trade Agreement
  - Dominican Republic-Central America Free Trade Agreement ("CAFTA-DR")

- In addition to FTAs, the U.S. has trade preference programs covering many countries, such as:
  - African Growth & Opportunity Act ("AGOA")
  - Generalized System of Preferences ("GSP")
Preferential Origin: NAFTA 2.0 - USMCA

- The new United States-Mexico-Canada Agreement ("USMCA") to replace NAFTA will soon go into effect. (Implementing legislation was passed by Congress on January 17, 2020.)

- What are the major changes?
  - New country of origin rules for automobiles: 75 percent of components must be manufactured in North America to qualify for duty-free treatment.
  - Labor provisions: 40 to 45 percent of automobile parts have to be made by workers who earn at least $16 an hour by 2023.
  - Canada will open up its dairy market to U.S. farmers.
  - Stronger & longer protection for certain intellectual properties.
  - 16-year sunset clause.

- Obstacles to final implementation:
  - U.S. Senate approval as of January 16, 2020; to be signed by President to sign into law.
  - Canada expected to ratify after parliament returns on January 27, 2020
International Trade Updates:
Section 301 & 232 Tariffs
Section 301 - Investigation on China

- Under Section 301 of the Trade Act of 1974, the President can take all appropriate action to restrict/penalize a foreign government’s policies or actions that violate an international trade agreement and that burden U.S. commerce.

- Beginning in July 2018, the Administration (through the Office of the U.S. Trade Representative ("USTR")) imposed tariffs on Chinese-origin goods under Section 301.

- The tariffs were imposed via 3 lists; each list contains 8-digit tariff subheadings, i.e., the new tariffs are imposed based on specific tariff codes.
Section 301 - Investigation on China (Cont’d)

- **List 1:** Additional *ad valorem* duty of 25% (on top of Normal Trade Relations duties, as well as antidumping/countervailing duties) on annual trade value of $34 billion (818 tariff subheadings of Chinese origin goods) effective on July 6, 2018
  - Product exclusion petition deadline expired on October 9, 2018.
  - USTR received 10,845 List 1 exclusion requests. 7,167 were denied and 3,666 were granted.

- **List 2:** Additional *ad valorem* duty of 25% on $16 billion (284 tariff subheadings of Chinese origin goods) effective on August 23, 2018
  - Product exclusion petition deadline expired on December 18, 2018.
  - USTR received 2,868 List 2 exclusion requests. 1,794 were denied and 1,075 were granted.

- **List 3:** Additional ad valorem duty of 10% on $200 billion (5,745 tariff subheadings of Chinese origin goods) effective on September 24, 2018; The duty rate increased to 25% effective on May 10, 2019
  - Product exclusion petition deadline expired on September 30, 2019.
  - USTR reviewing process is still ongoing. To date, six rounds of exclusions have been granted by USTR.
Section 301 - Investigation on China (Cont’d)

**List 4A:** Beginning Sept. 1, the U.S. began imposing an additional *ad valorem* duty of 10% on virtually all of the remaining $300 billion worth of Chinese origin goods which were not already subject to the Section 301 tariffs. The duty rate was later increased to 15%.

- The current List 4A duty rate will drop from 15% to 7.5% effective Feb. 14, 2020.
- If approved, Section 301 tariffs on “unique products” covered by approved petitions are exempt from the 15% or 7.5% tariff for one year after the approval date and all past duties are refunded with interest.

**List 4B** duties have been eliminated under the “U.S.-China Phase One” trade deal that was signed on Jan. 15, 2020.
Section 301 - Investigation on European Union

- USTR determined that the European Union (EU) and certain member States have denied the U.S. rights under the World Trade Organization (WTO) Agreement and have failed to implement WTO Dispute Settlement Body recommendations concerning certain subsidies to the EU large Civil aircraft industry.

- On October 2, 2019, the WTO authorized the U.S. to impose additional tariffs on approximately $7.5 billion worth of EU goods.

- On October 9, 2019, USTR published the final list of tariff subheadings of goods originating in the EU became subject to a duty rate of 10% or 25%, effective October 18, 2019.
  - USTR indicates it remains open to discuss related matters with the EU and EU member States.
  - No exclusion process has been announced yet.
Section 301 - Investigation on E.U. (Cont’d)

- USTR has determined that the France Digital Services Tax is unreasonable or discriminatory and burdens or restricts U.S. Commerce.

- On December 6, 2019, USTR published a tariff list of French goods worth approximately $2.4 billion and proposed to levy additional duties of up to 100 percent. The proposed tariff list covers 63 tariff subheadings and includes a variety of French products, including yogurt, butter, cheese, champagnes, beauty products, handbags, and tableware.

- USTR will publish the final tariff list after it completes a public comment and hearing process in early 2020.
Section 232 Investigation on Steel & Aluminum Products

- Under Section 232, Commerce can conduct an investigation to determine the effect of imports on national security. Using this tool, the Administration announced new duties on imports of steel and aluminum materials, which became effective on March 23, 2018:
  - 25% for steel items; and
  - 10% for aluminum items.

- The Section 232 duties apply to specific tariff subheadings.
Section 232 Investigation on Steel & Aluminum Products (Cont’d)

- Country-Based Exclusions:
  - Steel: All countries of origin except Australia and South Korea - but subject to quotas (unless granted relief).
  - Aluminum: No exemptions.

- Product Exclusion:
  - The request must include detailed information about the imports, products, etc.
  - There is no deadline; petitions can be filed at any time.
  - If granted, the exclusion applies only to the petitioner and to no other importer.
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