In the Line of Duty: Custom-Made Solutions

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Carrie Brandon Elliot brings together leading tax professionals from around the world to share their practitioner, government, and academic perspectives on major international tax issues in an informal roundtable discussion.

In this installment of Crossing Borders, Elliot interviews Mariana Eguiarte of Garrigues in Mexico City; Stefanie Kavanagh of Alston & Bird in Washington; and Eugene Lim of Taxise Asia in Singapore.

Participants discuss intercompany transfer pricing and customs duty valuations in their jurisdictions. It is a link that has increased in relevance as import tariffs have become a major consideration in supply chain structures. Panelists discuss how taxpayers can adjust to the new tariff environment.

Carrie Brandon Elliot: Hello, everyone, and welcome to our second installment of Crossing Borders. Today we will discuss intercompany transfer pricing and customs duty valuations.

Mariana Eguiarte: It is common in every jurisdiction to discuss the interaction between transfer pricing and customs valuation because each has a different approach. While transfer pricing focuses on seeing the whole picture for a full fiscal year (by testing the profitability of related-party transactions), customs valuation focuses on a transaction-by-transaction basis (by testing the individual value of goods).

Mexico has a single tax authority with separate divisions that would oversee transfer pricing and customs matters, with different approaches in each case, given the applicable regulations:

- Mexican customs law generally follows the customs valuation methods recognized by the WTO's Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade. For customs purposes, the preferred valuation method is the transaction value that can be used in related-party transactions to the extent that the relationship has not influenced the value.
- Mexican income tax law follows the transfer pricing methods that are recognized by the OECD guidelines. For tax purposes, the comparable uncontrolled price method must be chosen as first alternative, and only if it is demonstrated that this is not the best method may others be used, giving preference to the other traditional transaction methods (for example, resale price method and cost-plus method).

Ideally, the value of a given good should align under the transaction value (for customs purposes) and the CUP (for transfer pricing purposes). In practice, lack of reliable CUP comparables or other transaction methods often leads to applying the transactional net margin method (TNMM). Also, although the transfer pricing analysis should be done on a transaction-by-transaction basis, the lack of reliable comparables frequently results in the necessity of using a combined transaction analysis.

It seems obvious that the transfer pricing setup should influence the transaction value of a good, but the abovementioned differences in the approaches taken for tax and customs purposes could create distortions in which transfer pricing and customs values would not necessarily align.

In addition, both tax and customs authorities have different objectives when analyzing a transaction. From a transfer pricing perspective, the tax authority wants higher profitability, which implies a lower customs value for the importer of record that is selling the goods. From a customs valuation perspective, the approach is the opposite because the customs authority wants a higher customs value to increase tariff revenue.

Because the United States has imposed tariffs around the world, this discussion of interaction between transfer pricing and customs valuation over the last months has become a tangible reality. During this time, those exporting products from Mexico into the United States have been considering strategies in which they can ameliorate the tariff impact while also fulfilling transfer pricing requirements. Although this obviously occurs in transactions between related parties, there are also others without a U.S. operation that are exporting products to the United States and encountering complexities on tariffs and the need for mechanisms to reduce the customs valuation.

Stefanie Kavanagh: Like what Mariana describes in Mexico, the tariff regime and the transfer pricing regime in the United States have similarities but also important nuances of which taxpayers must be mindful. It is important to price intercompany transactions correctly under both sets of rules. Over the last 10 months I have been working more closely than ever with my customs and trade colleagues because tariffs have become much more relevant, and I have seen many instances in which you can get something right for transfer pricing purposes and then a trade lawyer points out a customs law pitfall that necessitates going back to the drawing board.

One important subtlety is that for customs purposes you look at how much the foreign company earns on its exports to the United States, whereas for tax purposes you generally look at the less complex party, most likely the U.S. company that's purchasing and reselling products. Those are two entirely different perspectives. Another important difference is that under the customs rules, the focus is on individual import transactions and each imported product. Under the tax rules, there is an ability to aggregate transactions for testing, including aggregating transactions over multiple years, and offsetting transactions.

Companies often wonder whether it is safe to assume that they are all set for customs purposes because they have a transfer pricing study or an advance pricing agreement. While a transfer pricing study is helpful, it is insufficient to defend the customs values in related-party transactions. U.S. Customs will consider a transfer pricing study in applying the "circumstances of sale" test, so it can be helpful to have a transfer pricing study. But it is not conclusive evidence for customs purposes.

As for the utility of an APA when it comes to defending customs values, the deference that U.S. Customs gives to an APA can depend on the transfer pricing method used. An APA based on the CUP method has the most relevance for customs valuation purposes and would be given more weight because it is close to the transaction value method used for the majority of customs valuations. On the other hand, an APA based on a comparable profit method applied to the U.S. distributor selling products purchased from a foreign related party would likely be given the least deference because that method generally has the least relevance for customs valuation purposes.

As for recommendations to companies, there is no one-size-fits-all approach. There has been so much uncertainty, especially in light of the pending Supreme Court cases *Learning Resources v. Trump*[1] and *Trump v. V.O.S. Selections*.[2] It is difficult for companies to justify making major changes, like moving manufacturing operations

[1] *Learning Resources v. Trump*, No. 24-1287.

[2] Consolidated cases of *V.O.S. Selections Inc. v. United States*, 772 F. Supp. 3d 1350 (Ct. Int'l Trade 2025), and *Trump v. Oregon*, No. 25-520.

to the United States, without knowing whether the tariffs enacted by the Trump administration are legal. I have not seen many companies making major changes to address tariffs. Rather, companies are generally taking a wait-and-see approach because they do not want to do something costly and then find out a few months later that it was not necessary because the tariffs were illegal.

There are things that companies can do to mitigate tariff impacts without making major changes. One example is localizing manufacturing — if a company manufactures a product in the United States that is exported to Country A, and it also manufactures a similar product in Country A that is then exported to the United States, that company can consider rebalancing manufacturing operations to focus on manufacturing products locally that are destined for sale in the local market. I have also worked with my trade colleagues in recent months to help companies consider other less extreme ways of mitigating tariff impacts, including by optimizing customs valuations, using the "first sale" rule, reclassifying products to more favorable tariff classifications, changing how goods are imported, and changing the origin of goods.

It has become incredibly important for tax and trade advisers to work together to apply existing customs laws to reduce the tariff impacts while also maintaining transfer pricing compliance. Success depends on many factors, like having a carefully tailored strategy and memorializing rights and obligations in legal agreements. Changes in supply chain flows and pricing must be memorialized in legal agreements, and companies must operate in accordance with those legal agreements.

Eguiarte: Another strategy on exports from Mexico to the United States is unbundling product costs for customs valuation purposes. Certain items that are not per se part of the price of the goods are included within such price, thereby increasing the transaction value used for customs valuation purposes as the base for tariff calculation. It is possible for U.S. importers of record to unbundle these items from the price of the goods so that the tariffs are calculated on a lower base that includes only the value of the product. However, this strategy can be more difficult to apply for goods imported into Mexico, because many of these items (for example, commissions, packaging, insurance, transportation expenses related to the imported goods) should be included in the basis for duty calculation, regardless of whether they are part of the product value.

Kavanagh: Unbundling is another tool available to companies navigating this ever-changing tariff situation, although it is not always available reciprocally.

Eguiarte: Stefanie, you have mentioned tariff mitigation strategies that should not cause major changes to a company's operation. However, another strategy worth considering that does require a major change to the operation is moving the supply chain model from a full-fledged or contract manufacturing to a toll manufacturing (a maquiladora). In this case, the Mexican manufacturer is hired by the U.S. principal to manufacture the goods with raw material, machinery, and equipment owned by the principal. The principal pays a fee for the manufacturing services. Unlike full-fledged or contract manufacturing, there is no sale of goods from Mexico to the U.S. importer, but rather a contract for services to manufacture the goods. This can also help reduce the impact of the tariffs, although determining the pricing of the goods for customs valuation purposes can be tricky.

The apparent contradiction is that nowadays U.S. tax policy as reflected (at least on paper) in the One Big Beautiful Bill Act (P.L. 119-21) wants to encourage goods manufacturing in the United States. That also relates to tariff policy adopted in the United States this year. However, those conducting preliminary evaluations into how to respond are considering whether a maquiladora entity in Mexico could reduce the impact of the tariffs on goods produced in Mexico and exported to the United States.

Kavanagh: I have not seen many companies wanting to move manufacturing to the United States in response to the tariffs. While the OBBBA includes incentives for building new U.S. factories, there are so many nontax considerations, like workforce availability and immigration law changes, that make it difficult for a company to expand operations into the United States.

Eguiarte: That means, then, that the maquiladora structure is another strategy to consider.

Eugene Lim: I will comment on the interaction between customs valuation and transfer pricing from an Asia-Pacific perspective. Although Asia-Pacific is one region, it's comprised of many different countries, and each country has its own customs valuation and transfer pricing regimes. The good news is that there is a high degree of harmonization among the transfer pricing rules in the region. Many of the transfer pricing rules in the region follow the OECD transfer pricing guidelines. From a customs valuation perspective, countries in Asia usually adhere to the WTO customs valuation agreement.

That said, the earlier comments on the lack of coordination between transfer pricing and customs valuation rules resonate in Asia. In Asia-Pacific markets with aggressive tax and customs audits, like India, China, South Korea, Thailand, and Australia, clients get caught with intercompany pricing strategies that do not adequately address the interplay between transfer pricing and customs valuation rules.

Over the years, I've collaborated with my transfer pricing colleagues to address valuation queries from customs authorities. Often the issues arise because transfer pricing policies and documents were set with primarily a tax objective in mind, without considering the customs valuation implications. With high tariff rates, incorrect setting of intercompany values can result in a customs audit and a significant impact on the company because additional customs duty costs will be based on a percentage of turnover.

Earlier this year we organized a roundtable with a group of senior regional tax directors of multinational companies here in Singapore, and they were only interested in talking about customs and customs valuation rules — a very interesting change in mindset. It suggests that it is no longer possible to look at tax strategies in isolation, and often it is customs duty impacts that take precedence given the high rates of duty.

I'll highlight some of the common areas in which I've seen customs valuation and transfer pricing rules with material differences that resulted in complications in customs audits.

The first area is valuation methods. For transfer pricing, a company picks the best method to apply. For customs valuation, there's a hierarchy of methods. There aren't the same constraints on choice of valuation methods in transfer pricing. A company can be stuck with one of the previous customs methods before getting to the method that's been chosen by the transfer pricing team. This disconnect can affect the company's ability to explain its intercompany transactions from a customs valuation method that's consistent with their transfer pricing policy.

The second area is differences in the details of valuation methods. In Asia, manufacturing and distribution operations in high-tax jurisdictions often act as routine entities. Typically, the TNMM is used to determine the intercompany transfer price of goods or services. However, the net margin methods typically are problematic for customs valuation because the computed or deductive value methods look at gross margin as opposed to net margin. Often companies that use the TNMM must reconsider its use, especially if customs require a gross margin analysis.

The third area is that the use of profit-split methods in Asia is increasing, which reflects the fact that entities are becoming more complex and performing more entrepreneurial functions. Adopting a profit-split method is problematic for customs valuation because there is no similar method for determining customs values. A profit-split method for transfer pricing makes it difficult to explain the intercompany customs value under the accepted methods in the customs valuation rules.

A fourth area that causes difficulties is the use of internal CUPs — a robust method of ensuring an arm's-length price for transfer pricing purposes. However, internal CUPs often cause problems for customs valuations. There is a great degree of comparability required by customs valuation rules when applying the similar or identical goods methods, which is not the same for transfer pricing. For example, identical or similar goods valuation methods for customs purposes require the compared transaction to involve goods of the same or similar kind, grade, and quantity, from the same country of export to the same country of import, entering the country of import at or about the same time.

Fifth, the definition of related party for transfer pricing purposes often has a direct or indirect shareholding requirement that is higher than that required for customs valuation purposes. From a customs value perspective, only 5 percent of common share ownership is required to meet the related-party definition and invoke intercompany customs valuation rules.

Sixth, in many countries in Asia, the customs and transfer pricing authorities may not accept values determined by their counterparts. A notable exception is South Korea, in which the customs and tax authorities have together signed a memorandum of understanding. The Korea Customs Service has agreed in principle to accept intercompany prices that are supported by APAs. Likewise, the Korean Tax Service has in principle agreed to accept prices in an advance customs valuation agreement accepted by the Korean customs authorities to satisfy transfer pricing requirements.

Kavanagh: Eugene, have you seen companies in Singapore or other Asia-Pacific countries move manufacturing to the United States to address tariffs?

Lim: Southeast Asia continues to be a competitive place to manufacture for supply to the U.S. market. When the reciprocal tariffs were first announced in April, countries in the Indochina region like Vietnam were given significantly high tariff rates of close to 50 percent and more, while Indonesia and Malaysia had rates of about 20-30 percent. But these rates had all decreased by August. Vietnam now has a 20 percent reciprocal tariff rate and could continue to be competitive in supplying goods to the U.S. market. Also, businesses have adjusted pricing policies so that suppliers have reduced their selling costs to U.S. customers and distributors and absorbed a portion of the price increase from the tariffs. This has reduced the impact of higher prices to U.S. consumers. I haven't seen manufacturing move en masse into the United States in connection with the reciprocal tariffs outside of semiconductors.

However, the section 232 tariffs have significantly higher duty rates. For example, Trump threatened a 100 percent duty rate on pharmaceuticals, and a 50 percent rate on steel, aluminum, and copper. At those rates, companies have considered onshoring a portion of manufacturing for the U.S. market.

In many cases, if companies do decide to move manufacturing, often they would compare manufacturing in the United States for the U.S. market with manufacturing in Mexico or Canada because the United States-Mexico-Canada Agreement still allows duty-free access for qualifying goods into the United States.

Another issue relates to intellectual property. Because of the OBBBA, some companies have considered moving IP into the United States. Moving IP may change royalty flows, which may create challenges for customs valuation. Unlike Mexico, there is no fixed rule in Asia on whether royalties are dutiable. However, in much of the Asia-Pacific region, the customs valuation rules will include royalties in the dutiable value of goods if conditions are met (if royalties are a condition of sale and related to the imported goods, or if they are an assist).

Eguiarte: The U.S. and Mexican reconciliation processes are significantly different. Mexican companies sending goods to the United States have an advantage in using the reconciliation process that predetermines the items that must be considered for customs valuation purposes during a period of time. That creates an advantage for an origin-of-goods analysis because it is often not clear whether a manufacturer in Mexico complied with the origin rules in the USMCA and is therefore not subject to a tariff. Another advantage is additional time to review and properly classify the goods for tariff purposes (in some cases, a proper classification of goods results in a less burdensome tariff).

The U.S. reconciliation process is also advantageous for transfer pricing in certain industries. For example, TNMM is common in the retail industry, and it always produces transfer pricing adjustments, either upward or downward, that need also to be recognized for customs purposes. The U.S. reconciliation process lends certainty to the adjustments.

Conversely, if a Mexican company is the importer of record and it uses TNMM, there is no reconciliation process like in the United States. The downward or upward adjustments create practical complexities because a corresponding adjustment must also be made for customs purposes, affecting the taxable base for VAT on imports and for foreign trade duties by increasing or reducing it. An upward adjustment is usually easier to document because it entails payment of omitted VAT and duties to the tax administration, while a downward adjustment triggers more practical complexities because it entails recovering excess VAT and duties. If hundreds of goods are involved, as is often the case in retail, proper compliance regarding these adjustments can become burdensome.

The U.S. reconciliation process on imports from Mexico to the United States can be very helpful for compliance purposes, given the uncertainty around tariffs.

Lim: The U.S. reconciliation process is a lifesaver because of the ability to adjust values on a post-entry basis before finalizing them to ensure compliance with transfer pricing rules. It's not the same in the rest of the world. There is a range of different techniques in the Asia-Pacific region. In some countries it is done on an import-by-import, entry-by-entry basis. It is a nightmare for import-export staff in logistics departments. To change the values of intercompany shipments, they must review them on a per-shipment basis.

Some countries allow a lump sum pro rata adjustment. The average duty rate is applied to an adjustment to total imports for a defined period. For most Asia-Pacific countries, it is almost impossible to get a refund of duties paid when there is a downward value adjustment.

As a result, companies will consider whether they should make prospective adjustments as opposed to retroactive adjustments. However, prospective adjustments have their own challenges because they require predicting a future price. Companies must calculate the adjustments needed on future shipments to get to a target profitability.

Another concern is the frequency of transfer pricing adjustments. In some countries there is an assumption by customs that too many adjustments made too frequently are a red flag to question the accuracy of a company's customs declarations. This in turn triggers an audit.

Eguiarte: Companies are also considering how the tariff situation is going to affect their transfer pricing studies because transfer pricing is based on functions, risks, and asset allocations. They must analyze which party is bearing the tariff risk in the supply chain to determine its impact on the transfer pricing. For example, if the U.S. distributor bears the tariff risk, this could result in the need to have the Mexican affiliate reduce the price of the goods so that the distributor still earns an appropriate margin. The price adjustment will reduce the tariff base but needs to be properly documented from a transfer pricing perspective to make sure that it is indeed arm's length. The Mexican tax authority might question this because it would reduce profitability of the Mexican affiliate, while the U.S. customs authority would want to make sure that the relationship among parties did not influence the price.

In ensuring proper transfer pricing compliance, companies may also need to rethink the benchmarks and comparables to make sure they are in the same or similar tariff situation as the related-party transaction evaluated in the transfer pricing study.

Kavanagh: In the same vein, companies seeking APAs must work closely with the IRS to address the impact of tariffs on benchmarking and the selection of comparable companies.

Lim: We've discussed the U.S. market because it's the source of the new tariff rules. However, U.S. companies shipping their product to China also face challenges because China has retaliatory tariffs on U.S.-origin products.

An area of increasing interest will be the interaction between transfer pricing rules and origin. Some countries have an ad valorem rule of origin, which considers the percentage of value added from qualifying costs and components in that market to determine origin. In an intercompany delivery of raw materials and components to a manufacturer, whether under a contract manufacturing arrangement or an intercompany sale, there is an ability to use transfer pricing techniques to modify the input values in the ad valorem rule of origin calculation and possibly influence the origin determination.

Ad valorem origin rules were not intended to be manipulated by transfer pricing rules, and I expect there will be increased scrutiny on origin as companies and advisers consider how transfer pricing techniques can affect the origin determination. I expect more jurisprudence, regulations, and limitations on transfer pricing and origin determination. I suppose that's a topic for a future webinar. ■