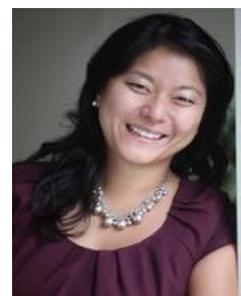


## The Rising Use Of Reference Pricing For Imported Goods

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Last month, the Mexican government published a new list of apparel and textile goods with “estimated prices.” These estimated prices are the minimum reference price that goods ranging from raw materials to finished products may be imported into Mexico. The list was categorized by Harmonized Tariff Schedule classification number. Companies should expect that shipments entered with customs values declared below these prices will be considered “undervalued” and likely subject to further investigation and potential penalties. The list also set a uniform floor and does not distinguish between unrelated or related party transactions, the country of origin of the merchandise or rely upon any allegations of dumping or subsidized costs. Rather, the list represents the authorities’ determination that open market prices simply cannot be below a certain value. This announcement follows a trend of countries publicly acknowledging the use of reference pricing or similar mechanisms to impute a customs value on import transactions.



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As background, the World Trade Organization Customs Valuation Agreement is the international framework that member countries have agreed to use to determine customs value of imported merchandise. Under the valuation agreement, the preferred method of appraisal is transaction value, which is defined as the “price actually paid or payable for the goods when sold for export to the country of importation.” The transaction value can be adjusted upwards or downwards in accordance with certain enumerated provisions. Commonly, the transaction value is simply the invoice price, which in theory should represent a value that covers all of the seller’s costs to produce the merchandise, plus a profit. As a seller’s costs change or as the market become more or less competitive, the buyer would accordingly expect to see the purchase order and invoice prices change. If a sale does not meet the criteria for transaction value, the valuation agreement lists alternative appraisal methodologies in descending order of preference.

Reference pricing is the practice by which customs authorities impute a customs value on the basis of some standard separate from the import transaction. Called by many names such as reference prices, minimum prices, pricing lists, indicative prices or criterion prices, the authorities use a valuation database whereby the customs value of the imported merchandise is compared to those of identical or similar merchandise from other transactions. Under Article 7 of the valuation agreement, member countries are specifically prohibited from using both minimum customs value and arbitrary or fictitious values as a basis for customs appraisal, which would seemingly encompass the use of such reference prices. They also contradict the ideas of open competition and free market economy. For example, a supplier may give a single purchaser a volume discount or discount for exclusivity, which may

result in a lower than average market price. Customs authorities, however, will counter that they use these prices as part of assessing risk in their ongoing efforts to combat undervaluation, smuggling and money laundering and not to determine the customs value of the imported merchandise. The loss of revenue threat to customs authorities is significant as customs duties, import taxes and fees are ad valorem, i.e., based on the value of the merchandise, and are a primary source of revenue for most countries. Using reference prices as a risk assessment tool is also a narrow and permissible exception in the valuation agreement.

In addition to Mexico's recent announcement, other countries have publicly acknowledged or been reproached for using reference prices in recent years re-raising the issue as a growing point of discussion between industry and customs authorities within the WTO and World Customs Organization. Since companies have increasing international footprints, either as an importer or exporter, the threat of reference prices can affect foreign and domestic companies equally. Initially, a company may hear of a country's use of reference pricing through their customs broker or freight forwarder who may refer to a customs authorities' known use of price lists or valuation databases. Also, companies in certain trade sensitive industries, like textile, footwear and apparel, or whose merchandise carries higher customs duties will be unsurprised that their shipments may be targeted for inquiry. If a shipment is questioned for customs valuation and reference pricing is raised, companies should expect: shipment inspections, delays and extensive and burdensome administrative inquiries. Moreover, once customs valuation is raised, inevitably additional questions regarding the company's customs valuation methodology follow touching on related topics such as transfer pricing and intercompany transactions if the parties are related entities, royalty and licensing agreements, and the other enumerated additions to the price actually paid or payable. Companies should consider sharing their opinions to their respective governments or through trade associations. Companies who receive reference pricing inquiries or actions should consider engaging outside counsel or other customs experts as counsel will be able to share knowledge gleaned from a broad spectrum rather than through the narrow prism of a single company's transactions.

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