

Retroactive transfer pricing adjustments: treatment from customs perspective and points to note

November 2024

In brief

Recently, transfer pricing adjustments (TP adjustment) made retroactively between related companies at the end of the fiscal year are increasing for the purpose of ensuring arm's length prices under transfer pricing taxation rules. In most cases where a Japanese importing company pays a TP adjustment to an overseas related company, the TP adjustment is considered to be a part of the "price paid or payable" that constitutes the customs value on the import declarations for the relevant fiscal year from the customs perspective.

When the TP adjustment constitutes part of the customs value, the importer should declare the TP adjustment in the customs value by filing an amended customs declaration and paying additional customs duty and import consumption tax. If an amended customs declaration is omitted, there is a possibility that penalties against duty and/or tax shortfall will be charged at the time of a post clearance customs audit; caution is therefore required. It is important to file an amended customs declaration in a timely manner in order to mitigate the risk of penalties imposed on the payment of TP adjustments.

This newsletter explains the necessity for voluntary disclosure to Customs, filing of amended customs declarations regarding TP adjustments paid retroactively, and the process for doing so.

In detail

1. Customs treatment of TP adjustments

TP adjustments are generally made at the end of a fiscal year to ensure that transaction prices between related parties are at arm's length, and to achieve an appropriate profit margin from a corporate tax perspective. When a company that imports goods from overseas and resells them in Japan pays a lump sum amount to the overseas seller for the purpose of making a retroactive TP adjustment, such amount is usually recorded as cost of goods sold (COGS). In this case, from a customs perspective, the TP adjustment is considered to be a part of "the price actually paid or payable" that the buyer actually paid to the seller for the sales transaction of the imported goods. Since the customs value to be declared on the customs import declaration should be the "the price actually paid or payable", the customs value for the target period needs to be amended.

2. Process of amended customs declarations for retroactive TP adjustments and points to note

When filing amended customs declarations for TP adjustments that were made in a lump sum, it is possible to add these TP adjustments to a limited number of representative import declarations without amending the customs value of all individual import declarations filed in the target year, provided that the importer prepares

the appropriate document package and consults with customs in advance. The general process necessary for filing an amended declaration for TP adjustments including advance consultations are as follows:
Process for voluntarily filing amended customs declarations

- (1) Collect relevant documents and data
- (2) Consider how to file amended declarations
- (3) Consult with customs and get greenlight on how to file amended declarations
- (4) Align with the customs broker
- (5) Submit amended declaration based on the prior agreement with customs
- (6) Pay relevant duties and taxes

After filing amended declarations based on the prior agreement with customs, and paying relevant duties and taxes, the amended declarations related to the TP adjustment are complete.

Please note that the above process may take several months, depending on the number of the import declarations, where they were filed, and the variety of goods imported. When notification of a customs audit is issued before completing all the necessary procedures, the importer may still be charged with penalties for duty/tax shortfall. Therefore, it is highly recommended that importers complete the amended declaration in a timely manner after paying the TP adjustment.

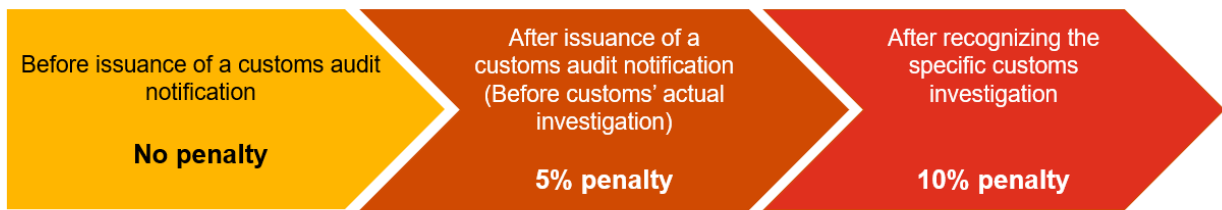
Further, collecting necessary documents and data sometimes requires a lot of time. This is especially true in cases where preparations for the amended declaration are started only after paying the TP adjustments. Given that it is difficult to predict when notification of a customs audit could be issued, it is highly recommended to understand in advance how TP adjustments are dealt with from a customs perspective and know what the relevant processes are before actually making TP adjustments.

3. Penalties for duty/tax shortfall due to undeclared TP adjustments

Penalties under the Custom Act are charged based on the additional tax amount to be paid when an amended customs declaration or customs assessment is made after the initial import declaration. There is a special provision, that may apply in some cases, where penalties may not be imposed for duty/tax shortfall due to “unavoidable circumstances”. However, failure to complete the process of amendments for TP adjustments in a timely manner is generally not considered to be “unavoidable circumstances”.

The timing of penalty assessment and its rate varies depending on when the amended customs declarations are filed:

- (1) **Before issuance of a customs audit notification: No penalty will be imposed**
If the importer voluntarily discloses the TP adjustments and completes the amended declaration before the notification, no penalties will be imposed.
- (2) **After issuance of a customs audit notification (before customs’ actual investigation): 5% penalty**
If the amended declaration is not completed before receiving a customs audit notification, the penalty will be imposed even when prior consultation for the amendment with customs has been started. However, if the facts are voluntarily disclosed before the actual investigation by Customs, the additional tax will be reduced from the original 10% to 5%. If you plan to disclose the facts on the opening day of the customs on-site audit, it must be done before specific questions by customs are asked.
- (3) **After recognizing the specific customs investigation: 10% Penalty**
If the importer recognizes that the specific customs examination or investigation was already carried out due to the customs examination of import declarations, or customs having pointed out irregularities, the importer is considered to have foreknowledge of Customs’ assessment. Therefore, amended declarations filed after specific investigations or questions by the customs authorities are, in principle, subject to an 10% additional tax.



Furthermore, if the amount of duty/tax payable for the amended declaration exceeds the amount of duty/tax declared in the initial import declaration or 500,000 yen, whichever is greater, an additional 5% of the excessive amount will be imposed.

The takeaway

A lump sum TP adjustment paid at the end of the fiscal year can be large, and therefore the impact of penalties imposed can also be large. To mitigate the risk of the penalties that may be imposed by customs authorities, it is highly recommended that companies voluntarily file amended customs declarations promptly after making TP adjustments. In addition, importing companies that are making TP adjustments, as well as companies considering introduction of a TP adjustment mechanism, are also recommended to take into account customs post clearance audits and customs amended declaration processes in advance.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

PricewaterhouseCoopers WMS Pte. Ltd.

Otemachi One Tower, 1-2-1 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan

Email: jp_tax_pr-mbx@pwc.com

www.pwc.com/jp/e/customs

Robert Olson
Partner

Mio Hamada
Senior Manager

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