(1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and

(2) which are also taken into account in computing the customs value of such property shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.

The legislative history of section 1059A indicates that Congress intended to preclude the ''whipsaw'' effect on U.S. revenue which occurs when a party is allowed to claim a price for ''computing the customs value of such property by the purchaser'' that is lower than the price claimed for tax purposes.

When section 1059A was enacted, Congress was aware that the Customs value statute recently had been amended to make price paid the critical cost factor taken into account by the Customs Service in valuing goods for duty purposes. The legislative history of section 1059A also indicates that Congress wanted section 1059A to address this situation by attempting to place a ceiling on ''the amount of any [such] costs'' that can be claimed for tax purposes. All of the applicable legislative reports indicate, without exception, that Congress intended that section 1059A would instill some *uniformity* on the amount of costs which may be claimed to the IRS for tax purposes by limiting the amount of such costs to the amount claimed to, and taken into account by, the Customs Service in computing the Customs value.

The legislative history did state that appropriate adjustments may be made in cases where customs pricing rules differ from appropriate tax rules—as, for example, with the inclusion or exclusion of freight charges. Finally, the history states section 1059A applies to transfer prices subject to section 482 of the Internal Revenue Code.

In July of 1994, the Internal Revenue Service (IRS) issued final regulations implementing 26 U.S.C. 482. The IRS subsequently began considering whether and to what extent the 1059A regulations should be amended in the context of the new section 482 regulations. The section 482 regulations, specifically 26 CFR 1.482–1(a)(3), permits a controlled taxpayer, if necessary to reflect an ''arm's length result'', to ''report on timely filed U.S. income tax return (including extensions) the results of its controlled transactions based upon prices different from those actually charged.'' The IRS is considering whether the 1059A regulations should be amended to allow the taxpayer, under appropriate circumstances, to make the upward section 482 adjustment.

This document announces a test that will facilitate the IRS/Customs decision as to whether reconciliation procedures provide a viable and appropriate circumstance for a taxpayer/importer to make a post entry upward adjustment to the price of imported merchandise.

Customs Value Law

For Customs purposes the appraised value of imported merchandise is determined pursuant to section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act (TAA) of 1979. Transaction value is the primary basis of appraisement. Transaction value is defined in section 402(b)(1) as the ''price actually paid or payable for the merchandise when sold for exportation to the United States'' plus specified statutory additions.

Pursuant to section 402(b)(2)(A)(iv) the transaction value of imported merchandise shall be the appraised value *only if* the buyer and seller are not related, or if the buyer and the seller are related, the transaction value is acceptable under 402(b)(2)(B). Section 402(b)(2)(B) provides that transaction value between a related buyer and seller is acceptable if the buyer demonstrates that the declared transaction value meets one of the following two tests: 1) Circumstances of the Sale or 2) Test Values.

The reconciliation test, announced in this document, is designed for participants that engage in related party transactions.

Related Party Transactions

Under section 402(g) of the TAA the following persons are treated as related:

(1) Members of the same family, including brothers and sisters (whether by whole or half blood), spouse, ancestors, and lineal descendants.

(2) Any officer or director of an organization and such organization.

(3) An officer or director of an organization and an officer or director of another organization, if each such individual is also an officer or director in the other organization.

(4) Partners.

(5) Employer and employee.

(6) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting stock or shares of any organization and such organization.

(7) Two or more persons directly or indirectly controlling, controlled by, or under common control with, any person.

For purposes of 402(g)(G), the phrase ''two or more persons directly or indirectly controlling, controlled by, or under common control with, any person'' is understood to cover the following situations:

(1) where one of them directly or indirectly controls the other;

(2) where both of them are directly or indirectly controlled by a third person; or

(3) where together they directly or indirectly control a third person.

For purposes of this test, Customs will consider the fact that the related party importer has reason to believe that an upward adjustment may be made to the price as evidence that the relationship may have affected the price actually paid or payable for the imported merchandise. Therefore, transaction value may not be acceptable.

Rather, the merchandise may be appraised under section 402(f). The appraised value pursuant to section 402(f) will be derived from the transaction value method. That is, the appraised value will be the price for the imported merchandise after the upward section 482 adjustment is undertaken by the importer/taxpayer plus the applicable statutory additions: packing, selling commissions, assists, royalties/license fees and proceeds of subsequent resale. In order to participate in the test, the importer/taxpayer must agree that 402(f) is the proper basis of appraisement, in the event an upward section 482 adjustment is, in fact, claimed for tax purposes.

Title VI of the North American Free Trade Agreement Implementation Act

In order for the importer to comply with Customs value law, when making upward adjustments, a mechanism must be established that permits the importer to submit information related to the upward adjustment after the time of entry. Customs has determined that the reconciliation provisions of the North American Free Trade Agreement Implementation Act (the Act) create a possible vehicle permitting these circumstances. Specifically, Title VI of the Act, Public Law 103–182, 107 Stat. 2057 (December 8, 1993), contains provisions pertaining to Customs Modernization (107 Stat. 2170). Subtitle B of Title VI establishes the National Customs Automation Program (NCAP), an automated and electronic system for the processing of commercial importations. Section 637 in Subtitle B of the Act amends Section 484 of the Tariff Act of 1930 by establishing a new subsection (b) entitled ''Reconciliation''. Reconciliation is a planned component of the NCAP. Section 631 of the Act authorizes tests of planned NCAP components. Section 101.9(b) of the