

Could dividends justify a customs value adjustment?

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Abstract

This paper analyses whether dividends could justify an adjustment of customs value under the terms of Articles 1 and 8.1.d of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (hereinafter Customs Valuation Agreement or CVA). It concludes that this is not possible, since a *contrario sensu* interpretation of the Interpretative Note No. 4 to Art. 1 of the CVA could affect certainty, uniformity and neutrality with which the CVA should be applied by all the members of the World Trade Organization (WTO) and the current Principle of Legality in tax–customs matters in some of the member countries.

Introduction

Dividends are one of the social benefits that can be distributed among shareholders. They establish the main source of profitability of shares along with the possible capital earnings obtained by revaluation.

The profit, which enables dividends to be paid to shareholders, can have many causes. Among these causes are those derived from the use of merchandise imported for consumption by an import–export company. In this framework, the seller/exporter can be a shareholder of the buying or importing company, and be related in customs terms (CVA, Article 15.4) and receive dividends from the buyer after the payment for the sale from the merchandise has been received.

Pursuant to Articles 639–641 of the Argentine Customs Code (ACC), the import tax refers exclusively to importation for consumption and may be specific or *ad valorem*. The value of the *ad valorem* import duty is calculated as a percentage of the customs value of the merchandise (CVA, Article 15.1.a).

However, for member countries of the WTO, the customs value of the merchandise being imported is regulated by the CVA. On the other hand, for goods being exported, the value rules of the ACC and its Exhibition of Motives (arts. 733) are applied.¹

As defined in Article 1 of the CVA, the ‘transaction value’ paid or payable for the merchandise must be applied to determine the customs value of the imported merchandise (CVA, General Note, Interpretative Notes, Sequential Application of Valuation Methods).

Article 1 must be read with Article 8, which provides for adjustments to the price paid or payable where elements considered to form a part of the value for customs purposes are incurred by the buyer but are not included in the price paid or payable for the imported goods. Furthermore, as set out in the preamble of the CVA, ‘the basis for valuation of goods for customs purposes should, to the greatest extent possible, be the transaction value of the goods being valued’.

Among the various reasons that justify an adjustment of the customs value, Article 8.1.d of the CVA states:

In determining the customs value under the provisions of Article 1, there shall be added to the price actually paid or payable for the imported goods: ... d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

In addition, Interpretative Note No. 4 to Art. 1, states:

The price actually paid or payable refers to the price for the imported goods. Thus, the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods are not part of the customs value.

Although there are different ways of reading this interpretive note, it is most commonly considered that the dividends do not justify an adjustment of customs value—in terms of the referred norms—because they are not part of the payment for the sale of the merchandise (Lascano, 2003, p. 258; González Bianchi 2015, p. 219; Sherman & Glashow, 1987, p. 156). However, Herrera Ydañez (1986) interprets this note in a different way. *Contrario sensu*, the author understands that if the payments for dividends are related to the imported merchandise then they are part of the customs value of those and, therefore, it is possible to make an adjustment of customs value (p. 125).

On the issue of international transactions between affiliated companies, the International Monetary Fund (IMF) considers that transfer prices and professional consulting and administration services can be used as hidden dividends. In this context, the situation becomes more complex (IMF, 2009, p. 150).

In this paper, the author discusses whether the dividends can be considered to be part of the customs value of the merchandise imported by the terms of Art. 8.1.d of the CVA. This is followed by an analysis of the customs valuation treatment applicable to dividends that are hidden in transfer prices or in technical assistance services.²

Analysis

The dividend is the remuneration that partners receive as a return on their investments in the company. In Argentina, the distribution of dividends relies on:

- social investment
- realised and liquid earnings
- balance drawn up regularly and approved.

For other WTO member countries, the legal conditions for the distribution of dividends varies according to their national regulations, but there will be one element in common: the essential relationship that exists between dividend and investment. As can be seen below, there is no essential relationship, or cause–effect relationship, between the payment of the imported merchandise and the dividends of a company.

Q1. Can the dividends justify an adjustment of the customs value in the terms of Art. 8.1.d of the CVA?

In answering this question, the following must be considered:

1. Could the dividends of a company be related to the use of the imported merchandise? If this were possible, would that relationship be essential? Alternatively, could the promise of payment of future and uncertain dividends determine the sale of the merchandise for its subsequent import and use?
 2. Could the dividends be part of the payment for the sale of the merchandise?
 3. Does the *contrario sensu* interpretations of an international agreement fulfil the requirements of the principle of legality in tax-customs matters?
1. The dividend could be considered to be the result of the company's actions that include using imported merchandise. Consequently, there may be a relationship between dividends and the use of imported merchandise. However, the use of imported merchandise does not determine the generation of dividends. Indeed, if there are no dividends, then there cannot be an essential relationship between them and the use of the imported merchandise. However, it should be noted that this situation differs from the case of royalties agreed for the use of intellectual property related to imported merchandise because, in that case, there is an essential relationship between the use of intellectual property and the profit that results from that use.
 2. The previous point does not mean that the sale of merchandise for its subsequent importation cannot be a condition of the production under which the seller (exporter) will only sell the merchandise if the buyer (importer) undertakes the delivery of a part of the eventual dividends related to the use of that one. Nonetheless, objective and quantifiable data to measure 'that part' is not available. We do not know how, or to what extent, the benefits of using the merchandise determined the payment of dividends. It would be almost impossible to determine if the profits obtained from the use of the imported merchandise are related, even remotely, with the dividends of a certain period or with those of another period. And, as we know, the CVA is applied to achieve certainty and uniformity in terms of customs valuation (CVA, General Introductory Commentary and Article 8.3).
 3. In Argentina (Articles 4, 17 and 19 of the Argentine National Constitution), as in all countries where the Principle of Legality applies (e.g. Spain, the country where Herrera Ydañez is from)³, there are no taxes without a law that previously establishes them. Consequently, only dividends could be taxable if Article 8.1.d of the CVA prescribes that those profits can justify an adjustment of customs value. On the contrary Interpretative Note No 4 to Article 1 of the CVA would seem to deny such a possibility.

Futhermore:

- *Contrario sensu* interpretations of the law do not fulfill the requirements derived from the Principle of Legality, which requires that the law expressly describes the taxable aspects of the dividends.
- No WTO member country take a unilateral interpretation of the CVA because precisely what is intended is uniformity in its application and for this there is a competent international authority in charge of such activity: the Technical Committee on Customs Valuation (CVA, Annex II.1). As a result, a WTO member country could not tax dividends related to the use of imported merchandise or force a new interpretation of Article 8.1.d in that sense.⁴⁴

Based on the above discussions, dividends cannot justify an adjustment of customs value in the terms of Article 8.1.d. of the CVA.

Q2. What valuation–customs treatment is applicable where dividends are hidden in transfer prices or in technical assistance services?

The IMF outlines what adjustments should be made in relation dividends, paying attention to the flow of direct investment due to its strict relationship with the measures of direct investment income.

As set out in the IMF Manual:

11.101 Transfer pricing at values that differ significantly from arm’s length prices is usually associated with shifting resources between related enterprises, so it relates to direct investment income measures. Transfer pricing may be motivated by income distribution or equity buildups or withdrawals. Examples may be the provision of goods and services without explicitly charging, or at understated or overstated values. Where transfer pricing is identified and quantified with a high degree of certainty, the relevant entry should be adjusted to an arm’s length value...;

...In addition to the adjustment to the flow itself, there should be a corresponding entry, as stated below: (a) if a direct investment enterprise is overinvoiced on a good or service provided by the direct investor or (b) if a direct investor is underinvoiced on a good or service provided by the direct investment enterprise, then the transfer pricing acts as a hidden dividend from the direct investment enterprise, so dividends should be increased by the difference between the market value of the goods and services and the prices actually charged: (a) if a direct investment enterprise is underinvoiced on a good or service provided by the direct investor or (b) if a direct investor is overinvoiced on a good or service provided by the direct investment enterprise, then the transfer pricing acts as a hidden investment in the direct investment enterprise, so direct investment equity flows should be increased by the difference between the market value of the goods and services and the prices actually charged...’ (IMF 2009, p. 203).

Notwithstanding this, hidden resource transfers between related companies also have an impact on tax and customs matters.

Ad valorem taxes applicable to the importation of merchandise exchanged between related parties could be calculated in these cases on a basis that unduly included hidden dividends— that is, on the basis of a customs value obtained from a fictitious purchase price, which is expressly forbidden by the CVA (CVA, General Introductory Commentary and Article 7.2.g).

In these cases, the ‘transaction value’ (CVA, Article 1) should not be accepted as an appropriate basis for valuation since the relationship will have influenced the price (CVA, Article 1.2.a) to the extent that it was used to hide dividends. Given this situation, the CVA allows the importer to demonstrate that the value closely approximates any of the options that are regulated in Article 1.2.b in order to be able to value the merchandise in accordance with the first valuation method.

On the other hand, with a similar criterion to the one indicated by the IMF, it is possible to investigate whether, among related companies, the dividends can be hidden in contexts different from the case studied. For example, hiding in contexts in which the CVA expressly allows the possibility of adjusting the customs value under the terms of Articles 1 and 8 of the CVA, such as the case of royalties for technology transfer (CVA, Article 8.1.c). In such cases, notwithstanding the Principle of Legality, we understand that the conclusions mentioned in the previous paragraph also apply on this case. As in any case, the transaction value would be unacceptable as a valid basis for customs valuation given the influence of the customs relationship.

Finally regarding Argentine legislation, the concealment of dividends in transfer prices (or royalties) could result in the infringement of Article 954.1.c of the ACC, since it would have declared a fictitious price to the customs administration.

Conclusion

1. Dividends cannot be used for a customs value adjustment under the terms of Article 8.1.d. of the CVA. Otherwise, the Principle of Legality in tax–customs matters would be violated and the certainty and uniformity that is intended in the application of the Agreement would be undermined.
2. If, in the transactions between related companies, dividends are hidden in the price of the international sale of goods, we would have a fictitious transaction value that would not be acceptable as a basis for valuation due to the influence of the customs relationship. In this case, the importer should prove that the declared price is very close to those established by art. 1.2.b of the CVA. Otherwise, merchandise should be valued according to the method of customs valuation that is most appropriate to the specific case according to Articles 2 to 7 of the CVA.

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Notes

- 1 As a guide to the legal interpreter, it is maintained in the Exhibition of Motives of the ACC that the central idea of the articles of the Code refers to the real value of the merchandise. Therefore, if the exporter has agreed to the sale under conditions of commercial independence, it will be adjusted to the norm of the taxable value (Exhibition of Motives of the ACC, Chapter Six, point 13).
- 2 Remember that: ‘... the customs value shall not include the following charges or costs, provided that they are distinguished from the price actually paid or payable for the imported goods: a) charges for...technical assistance...’ (CVA, Note to Article 1.3.a).
- 3 Article 31.3 of the Constitution of Spain.
- 4 González Bianchi (2015, p. 199), affirms that the Customs of the Oriental Republic of Uruguay has adopted in some specific cases the position of Herrera Ydañez taxing the dividends in the terms of art. 8.1.d. of the CVA.

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