

# Japan Tax & Legal Inbound Newsletter

## Trends and considerations in post-import customs audits

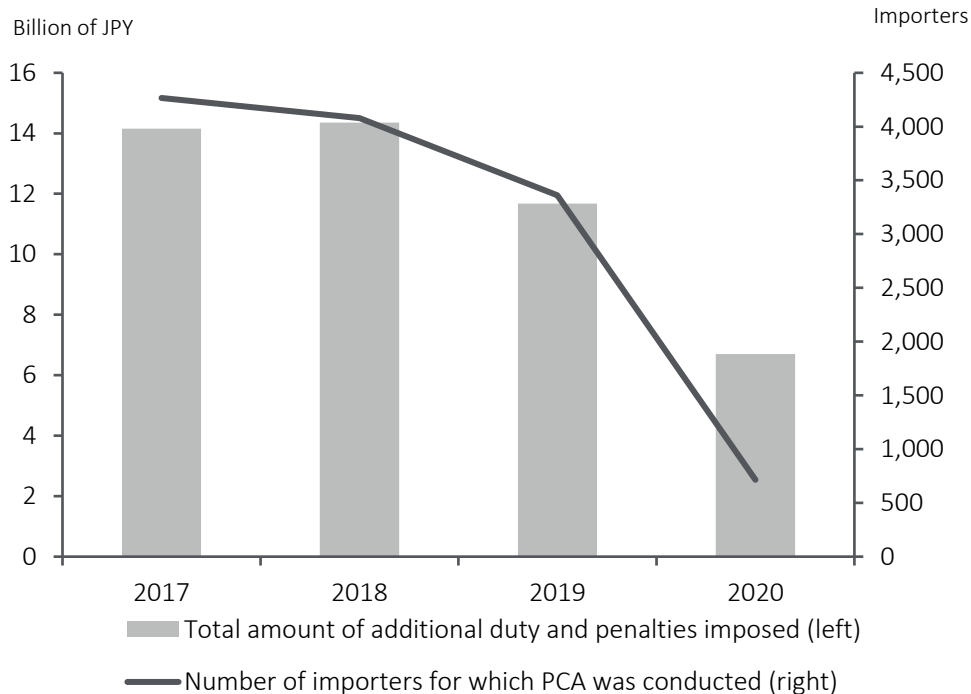
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### Recent trends in post-import customs audits

The unprecedented situation caused by COVID-19 disrupted nearly all professions around the world, with customs inspections being no exception. Prolonged mandatory lockdowns imposed in Japan meant that customs authorities had to reduce the number of in-person post-import customs audits (PCAs), which adversely affected their ability to collect tax revenue since fiscal year (FY) 2019.

According to Ministry of Finance statistics, the percentages of importers selected for PCAs in FYs 2019 and 2020 were 18% and 83%, respectively, less than the percentages of importers selected in FY 2018. Even as mandatory lockdown measures have eased, PCAs have not reached their pre-COVID-19 levels. Only in July 2022 have the customs authorities started to become more active in initiating PCAs. In light of this recent increase in activity, this article discusses what PCAs involve and how PCAs can impact an importer's business.

Recent trends of PCAs in Japan



Source: Ministry of Finance Japan

## What are PCAs?

PCAs are an examination of an importer's relevant commercial systems and processes, records, and stock as a way of improving compliance. For importers, this means having the value, origin, and classification of their goods reviewed by the customs authorities to ensure that the declarations are correct and the correct amount of import taxes has been calculated and remitted. If any declaration is found to be incorrect, an importer is required to prepare an amended declaration and pay any import tax shortfall. Where import taxes have been underpaid, a penalty of 10% of the shortfall amount could be imposed.

## How will the recommencement of PCAs affect importers?

### 1. Expanding the coverage of PCAs to five years

From the statutory payment date, there is a five-year statutory period of limitations on the right of the customs authorities to collect import taxes owed. In practice, customs authorities audit a company once every three years and generally review documents from the last three years. However, because there has not been much PCA activity during the pandemic, it is highly likely that customs authorities will start reviewing documents from the last five years.

### 2. Penalty amounts could increase because of the consumption tax rate increase in 2019

On 1 October 2019, the consumption tax (JCT) rate increased from 8% to 10%. This new rate is levied on goods (including machines and duty-free goods) imported into Japan as from 1 October 2019. Since penalties are imposed on the amount of underreported import taxes declared by an importer, the increased JCT rate (i.e., increased amount of JCT) could result in an increase in the base amount that the penalties are calculated on, further resulting in an increased penalty amount.

### 3. Use of big data to make it easier to detect inappropriate declarations

The customs authorities use big data analysis to assess import records in order to select an importer for a PCA. There are historic trends in the data that generally indicate import taxes have been underpaid. For example, if the cost of the use of patent rights, molds, or any other costs other than the invoice price have not been included in the customs value of the goods, this generally could indicate an incorrect declaration. These types of errors are easily spotted by the customs authorities, and companies must pay additional import taxes and penalties for understated values.

## Cases publicized as major undeclared cases in PCAs

### FY 2001

- Free supply of materials by importers
- Under billed and/or provisional invoice
- Royalties
- Commissions paid by the buyer

### FY 2011

- Molds cost not included
- Royalties
- Raw material cost
- Wrong application of EPA rate

### FY 2018

- Under billed and/or provisional invoice
- Transfer price adjustment
- Assembling cost
- Wrong application of EPA rate

## How should companies manage PCAs?

Importers should start preparing now for PCAs:

### ➤ Preparation before being selected for a PCA is ideal

It is important to have the right systems and processes in place in order to respond to a PCA in an effective and efficient manner. Delayed responses or the inability to provide the relevant documentation to substantiate a position taken can further add to the difficulties of a PCA. To mitigate the impact a PCA has on a business, importers should develop an action plan and implement necessary response measures.

### ➤ Penalty reducible for voluntary disclosures during a PCA

If an amended declaration is voluntarily made by an importer before the error has been identified by the customs authorities during a PCA, the imposed penalty on the tax shortfall will be reduced from 10% to 5%. Therefore, importers should be forthcoming in disclosing any incorrect declarations.



### Deloitte Japan's View

According to a survey by Deloitte Japan, only 30% of importers say that they are managing their customs duty compliance obligations correctly. Given that 70% of importers might not be managing such obligations correctly, this is “low-hanging fruit” for customs authorities from a tax revenue perspective. Unfortunately, implementing self-checking systems and software that reduce declaration errors is costly and time consuming.

Deloitte Japan can assist companies in reviewing system processes and documentation so that if selected for a PCA, the impact on the business will be minimal. Deloitte Japan also can advise importers on how to respond to a PCA.

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