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Valuation of Goods in Related Party Import Transactions

Under Section 484 of the Tariff Act of 1930, as amended (19 U.S.C. § 1484), the Importer-of-Record[1] ("IOR") is the party responsible for using reasonable care[2] when making entry of goods, including providing United States Customs and Border Protection ("CBP") with information to release the merchandise from customs custody, provide the correct value, classification, duty rate, applicable to the imported merchandise, and provide any other information necessary to enable CBP to properly assess duties, collect accurate statistics, and determine whether any other applicable legal requirements of the has been met. This includes determining and reporting the value of goods using the proper basis of appraisement provided for under 19 USC 1401a(a) and 19 CFR 152.100-152.108.

As discussed *herein*, the "basis of appraisement" is the legal methodology by which the customs value of the article is determined. Determining and applying the correct basis of appraisement is transaction specific, and the applicable basis of appraisement may vary depending on the relationship between the parties, whether there is a "sale" of the imported merchandise for exportation to the United States, whether assists were provided free of charge or at less than fair value, or whether changes to invoice unit prices have occurred which can be identified[3].

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[1] The Importer-of-Record is defined by statute (19 USC § 1484) as the owner or purchaser of the goods.

[2] The obligation of the IOR is provided by 19 USC § 1484(a)(1). The meaning of the term "reasonable care" is defined in the Customs Modernization Act, enacted as Title VI of the North American Free Trade Agreement Implementation Act (Pub. L. No. 103-182). See also Appendix B to Part 171-Customs Regulations, Guidelines for the Imposition and Mitigation of Penalties for Violations of 19 USC § 1592.

[3] Importers through their customs brokers certify on each 7501 entry summary that the invoice unit prices are true and correct, and that CBP will be notified of any other invoices or payments, which includes intercompany transfer

While the "transaction value" is the most common method of appraisement, and the preferred method of appraising imported merchandise, there are important limitations on its use. The most common limitation applies when the buyer and the seller are related. When the buyer and the seller are related, Customs may examine the transaction to determine whether the relationship affects the price. If the importer fails to establish that the relationship does not affect the price, transaction value is precluded and another method of appraisement must be used. The customs value law has several methods for testing whether the relationship affects the price. The most commonly used method is "circumstances of sale." Until recently, CBP would frequently reject the use of intercompany transfer prices as the "transaction value" of the imported merchandise if the related party's intercompany transfer pricing policy allows for post-entry or end-of-year adjustments. In May 2012, however, CBP issued an administrative determination that reversed this longstanding position, and provided advice on when a related party's intercompany transfer pricing policy that allows for post-entry or end-of-year adjustments will be acceptable as a viable "transaction value."[4]

I. Statutory Methods of Appraisement

Section 402a(b) of the Tariff Act of 1930, as amended (19 U.S.C. § 1401a(a)), provides six acceptable methods for the appraisement of imported merchandise. These methods are listed in order of preference. The six statutory methods of appraisement are:

- Transaction value
- Transaction value of identical merchandise
- Transaction value of similar merchandise
- Deductive value
- Computed value
- A Derived method of valuation

Under the statute (19 U.S.C. § 1401a), the primary or preferred method of valuation is "transaction value." Other methods of valuation are subordinate and can be applied only if the preceding method of value is found not to apply.

price adjustments. The customs brokers must also identify on the 7501 whether the seller and importer are related parties.

[4] See HQ W548314, dated May 16, 2012.

A. "Transaction Value" and the Price Paid or Payable

"Transaction Value" is defined as the "price actually paid or payable for merchandise when sold for exportation to the United States," plus certain statutory additions, such as assists, royalties, and/or the proceeds of a subsequent resale in the U.S.[5]

As noted above, "Transaction Value" is the primary or preferred method of valuation. It is also the most straightforward and least complex of the six methods of appraisement to apply; however, Customs and Border Protection does not always agree with importers that transaction value is the appropriate "basis of appraisement" for the import in question. When this happens, the resulting process to resolve the matter of valuation can be intrusive, time consuming, and disruptive to on-going business activities.

The term "price actually paid or payable" (or "PAPP") is defined in 19 U.S.C. § 1401a(b)(4)(A) to mean:

> the total payment (whether direct or indirect, and exclusive of any costs, charges, or expenses incurred for transportation, insurance, and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation in the United States) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller.

Thus, the "price actually paid or payable" is "the total payment . . . made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller,"[6] It is to be considered "without regard to its method of derivation" (19 C.F.R. § 152.103(a)(1), meaning that importers and their suppliers have great latitude in establishing how the selling price is determined or arrived at. Section 152.103(a)(1) provides, in pertinent part:

> In determining transaction value, the price actually paid or payable will be considered without regard to its method of derivation. It may be the result of discounts, increases, or negotiations, or may be arrived at **by the application of a formula**, such as the price in effect on the date of export in the London Commodity Market. (Emphasis added.)

[5] The statute provides for additions to the transaction value for packing costs, selling commissions paid by the buyer, assists, royalties and/or license fees, and proceeds of any subsequent resale that accrue to the seller, if not already included in the declared value.

[6] 19 USC § 1401a(b)(4)(A).

Thus, a transaction value may be determined as a result of the application of formula, provided the formula is fixed or determinative at the time of importation even though the final price may not be known until later. While an intercompany transfer pricing policy can be considered a "formula," CBP has often rejected this as a "transaction value" if the intercompany transfer pricing policy allowed the parties to make periodic or end-of-year adjusts to that price.

When determining whether an intercompany transfer price is an acceptable transaction value, both of the following questions must be addressed:

(1) Is the company transfer price fixed at the time of importation or is it an acceptable "formula" within the meaning of 19 C.F.R. § 152.103(a)(1); and

(2) Do the transfer prices satisfy the requirement under 19 U.S.C. § 1401a of the Customs laws to show that the relationship did not influence the price.[7]

If a response to either question is negative, then the "transaction value" method is precluded and the next most viable method of appraisement must be considered.

B. Limitations on the Use of Transaction Value for Related Party Transactions

1. Is there a "Sale" for Exportation?

There are few limitations on the application of transaction value to imported merchandise. One obvious consideration in determining whether "transaction value" applies is whether there is a sale of goods for exportation to the United States. *VWP of America, Inc. v. United States*, 175 F.3d 1327 (Fed.Cir. 1999). If there is no sale then there is no "price actually paid or payable" or "PAPP." This often catches unwary importers by surprise, but there can be no "transaction value" if there is no sale (and more specifically no "sale for exportation to the United States"). Thus, it is often the case that goods that are imported "on consignment," loan, or lease, and goods shipped free of charge, such as samples, returns, or repairs, do not have a "transaction value," and the law also prohibits the use of minimum values; or arbitrary or fictitious values. See 19 U.S.C. § 1401a(f)(1)(2). As such, when dealing with imports of consignment, loaned, or leased goods, or goods shipped free of charge, such as samples, returns, or repairs, transaction value is excluded and one of the applicable alternative methods of valuation must be used.

[7] The position of CBP, as discussed herein, is that the obligations are not the same; therefore, merely because a company may be compliant with IRS obligations, it may not be compliant with CBP obligations.

In *VWP of America, Inc. v. United States*, 175 F.3d 1327 (Fed.Cir. 1999), the Court of Appeals for the Federal Circuit found that the term "sold" for purposes of 19 U.S.C. § 1401a(b)(1) means a transfer of title from one party to another for consideration (citing *J.L. Wood vs. United States*, 62 CCPA, 25, 33, C.A.D. 1139, 505 F.2d 1400, 1406 (1974). CBP has said that no one single factor is decisive in determining whether a bona fide sale has occurred. See HRL 548239, dated June 5, 2003. CBP will consider such factors as to whether the purported buyer assumed the risk of loss for, and acquired title to, the imported merchandise. Evidence to establish that consideration has passed includes payment by check, bank transfer, or payment by any other commercially acceptable means, including the use of standard costs updated on a current basis to reflect manufacturing variances.[8] CBP has also cautioned that payment must be made for the imported merchandise at issue; a general transfer of money from one corporate entity to another, which cannot be linked to a specific import transaction, does not demonstrate passage of consideration for the imported goods. See HRL 545705, dated January 27, 1995. For a more comprehensive understanding of the importance of a "sale for exportation," see CBP's Informed Compliance Publication on "*Bona Fide Sales and Sales for Exportation*" (2000).

2. Are the Parties "Related"?

Another limitation that can prevent the application of transaction value is when there is a sale between two related parties. Under the customs value law,[9] parties will be treated as related when:

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

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

(c) 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.

(d) Partners.

(e) Employer and employee.

[8] CBP, in TAA 25 (HQ 542315 (1981)), ruled that transfer prices updated to incorporate ongoing variances falls within the meaning of the price paid or payable. The burden is upon the importer to establish accuracy of the transfer prices to incorporate ongoing variances. All retroactive adjustments to the price paid or payable must be reported to CBP using the CBP formal reconciliation procedures.

[9] Title 19 USC § 1401a(b)(2)(A)(iv).

(f) 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.

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

When the parties are related, the transaction value is applicable only when the transaction value is found to be acceptable under the conditions set forth in Section 1401a(b)(2)(B).

C. Statutory Methods for Establishing that the Related Party Selling Price Is an Acceptable "Transaction Value"

When parties are related, § 1401a(b)(2)(B) and 19 CFR § 152.103(j)(2) provide that transaction value is *acceptable* only if:

(a) An examination of the circumstances of sale indicates that the relationship between the parties did not influence the price actually paid or payable, or

(b) The transaction value of the imported merchandise closely approximates the transaction value of identical or similar merchandise in sales to unrelated buyers in the U.S., or the deductive or computed value for identical or similar merchandise. This method is frequently referred to as the "test value" method.

(c) When there is non-compliance with any of these tests, another basis of value must be utilized.

1. The Test Value Method

One statutory approach is to use a "test value" to establish the transaction value. The test value method allows the importer to demonstrate the acceptability of transfer price if the transfer price closely approximates:

(a) The transaction value of identical or similar merchandise in sales to unrelated buyers in the U.S.;

(b) The *computed value* of identical or similar merchandise (cost of production, plus general expenses and profit); or,

(c) The *deductive value* of identical or similar merchandise (selling price to an unrelated third party, less overhead expenses, profit of the importer, cost of international freight and insurance, duties, fees and brokerage costs).

"Test values" refer to values previously determined pursuant to actual appraisements of imported merchandise under the test value method. Thus, for example, a deductive value calculation can only serve as a test value if it represents an actual appraisement of merchandise under Section 402(d) of the TAA. Headquarters Ruling Letter ("HRL") 543568, dated May 30,

1986. In order to use the "test value" method, however, an importer must notify Customs of its use of this methodology, and request that Customs liquidate one or more entries using the transaction value of identical or similar merchandise, the deductive, or the computed value method (the choice of which method to use is that of the importer's). The transfer price of subsequent imports of the same or similar products would then be compared to the "test values" to determine if the prices closely approximate one another.[10] Because of the need to have a formally appraised entry under the test value method has not a method used by importers to test the acceptability of its related party transfer prices.

2. The "Circumstances-of-Sale" Tests

Under the "circumstances-of-sale" test, a transfer price will be considered acceptable for transaction value purposes if an examination of the circumstances of the sale indicates that the relationship between the parties does not influence the price actually paid or payable. Under the circumstances-of-sales methodology:

> If the parties buy and sell from one another as if they were unrelated, transaction value will be considered acceptable. Thus, if the price is determined in a manner consistent with normal industry pricing practice or with the way the seller deals with unrelated buyers, the price actually paid or payable will be deemed not to have been influenced by the relationship. <u>Furthermore, the price will not be influenced if it is shown that the price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind</u>.

Statement of Administrative Action, reprinted in Customs Valuation under the Trade Agreements Act of 1979, Department of the Treasury, U.S. Customs Service (October 1981) at 54; 152.103(j)(2), Customs Regulations (19 C.F.R. § 152.103(j)(2)).

Thus, there are three methods in which a transfer price between two related parties will be considered acceptable under the *circumstances of sale* ("COS") method. These are:

1. COS-1: The price is determined in a manner consistent with normal industry pricing practice;
2. COS-2: The price is determined in a manner consistent with the way the seller deals with unrelated buyers; or

[10] Neither the statute nor the regulations define the term "equivalent" profit. See discussion, *infra*., section III.B.3.b. on meaning of "profit equivalency."

3. COS-3: The price is adequate to ensure recovery of all costs, plus a profit that is equivalent to the exporter's overall profit realized over a representative period of time in sales of merchandise of the same class or kind.

The first method, the "normal industry pricing practice," relies on evidence of publicly quoted commodity prices, standard product price lists, or evidence that the price is consistent with the practices of other unrelated companies in the same industry (as will be discussed, *infra*, this can be established using transfer pricing studies).

Method two looks at the way the foreign seller deals with unrelated buyers in the United States.

Method three looks at whether the transfer price for **each transaction** is adequate to ensure recovery of all costs, plus a profit equivalent to the exporter's overall profit.[11] An importer is free to select one or more of the three methods to establish the validity of the transfer prices.

II. Treatment of Transfer Prices as "Formulas" for Purposes of Meeting the Price Paid or Payable Condition of 19 U.S.C. § 1401a(b)(4)

As stated in Customs ruling HQ W563485, dated September 10, 2007, before determining whether a related party price meets the circumstances of sale or test values analysis for establishing a transaction value, there must be a price paid or payable.

CBP has determined that if the price is not **fixed** at the time of importation, transaction value is not applicable. See, e.g., HRL 545618, dated August 23, 1996; HRL 545242, dated April 16, 1995; HRL 545798, dated October 28, 1994; HRL 546231, dated February 10, 1997; and HRL 546421, dated March 27, 1998. CBP, however, has said that the fixed price rule is satisfied when the price is determinable by an objective formula agreed upon prior to importation. In applying this provision, CBP ruled in HRL 542701, dated April 28, 1982 (TAA No. 47), and subsequent rulings that, in situations in which the price paid or payable is determined pursuant to a formula, a firm price need not be known or ascertainable at the time of importation. Nevertheless, CBP has said that it is necessary for the formula to be fixed at the time of importation so that a final sales price can be determined at a later time on the basis of some event or occurrence over which **neither the seller nor the buyer has any control**.

[1111] See HQ 544579, dated September 30, 1993, wherein Customs Headquarters rejected an argument by an importer that the only way for the profit and G & A margin to be set was on an annual aggregate basis.

On the other hand, if the value reported to CBP at the time of entry is a provisional price and is capable of change, it is not a fixed price for the purposes of the valuation statute.

Until relatively recently,[12] CBP has been of the opinion that if a transfer price is subject to **post-importation adjustments that are within the control of either the buyer or the seller**, the formula exception to the fixed price rule would not apply. See HRL 547654, dated November 9, 2001, pertaining to transfer pricing and the acceptability of post-importation adjustments claimed pursuant to a formal transfer pricing policy; and HRL 544680, dated June 26, 1992. In May of 2012, however, Customs formally modified this position and said that under certain circumstances, a transfer price that is subject to **post-importation adjustments** will constitute an objective formula for purposes of finding a transaction value.

In HQ W548314, dated May 16, 2012, CBP identified five factors to consider when assessing whether a transfer price is an objective formula for purposes of determining whether the price is within the meaning of 19 C.F.R. § 152.103(a)(1). The five factors listed in HQ W548314 are:

> (1) A written "Intercompany Transfer Pricing Determination Policy" is in place prior to importation and the policy is prepared taking IRS Code § 482 into account;
>
> (2) The U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
>
> (3) The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted;
>
> (4) The company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the United States; and,
>
> (5) No other conditions exist that may affect the acceptance of the transfer price by CBP.[13]

[12] Customs Ruling HQ W548314, dated May 16, 2012.

[13] HQ W548314 states that the fifth factor is meant to address other considerations that can affect the price, such as those referred in 19 CFR § 152.103(j), as: (i) restrictions on the disposition or use of the imported merchandise by the buyer, other than restrictions which are imposed or required by law, limit the geographical area in which the merchandise may be resold, or substantially affect the value of the merchandise; (ii) the sale of the imported

In HQ W548314 CBP said that:

> [T]he factors listed are set forth to address the "payable" aspect of the price actually paid or payable in transaction value and whether potential post-importation adjustments, particularly downward adjustments, that under prior CBP decisions could not be taken into account, may now be accepted. If an import transaction involves post-importation adjustments, and an importer seeks to claim those downward adjustments (as upward adjustments always required reporting), then its transfer pricing policy must constitute a "formula" within the meaning of 19 C.F.R. 152.103(a)(1).

Assuming that the importer's transfer pricing policy constitutes an objectively fixed formula under the criterion of HQ W548314, notwithstanding post-importation adjustments being within control of the parties, we next consider whether the relationship between the parties affects the price.

III. Does the Agreement Satisfy the Requirement Under 19 U.S.C. § 1401a to Show that the Relationship Does Not Influence the Price?

A. Limited Relevance of Transfer Pricing Agreements and Transfer Pricing Studies under Section 482 of the IRS Code to Support the Circumstances of Sale Test

In various administrative rulings addressing this issue, CBP has determined that a transfer pricing study or even an Advance Pricing Agreement ("APA") with the IRS is not by itself sufficient to show that a related party transaction value is an acceptable transaction value. CBP has noted that although the broad goal of both the Customs and the tax law is the same, i.e., to ensure that related party transactions are at arm's length, there are substantial differences in the legal requirements. [14]

CBP points out in its Informed Compliance Publication on Related Party Transactions,[15] for example, that the law requires that a Customs value be determined for every imported article. Different rates of duty apply to specific imported goods on the basis of their classification and value. U.S. importers are, therefore, required to declare the Customs value on an entry-by-entry

merchandise is subject to a condition or consideration for which a value cannot be determined; (iii) any part of the proceeds of any subsequent resale, disposal, or use of the imported merchandise by the buyer will accrue directly or indirectly to the seller, unless an appropriate adjustment can be made under paragraph (b)(1)(v) of this section.

[14] See CBP Informed Compliance Publication (ICP): "*Determining the Acceptability of Transaction Value in Related Party Transactions* (April, 2007).

[15] *Id.*

and product-by-product basis. Moreover, CBP has said[16] that in order to determine whether a related party transaction value is acceptable, each import transaction must be considered. If an importer purchases different products from a related company, it is necessary to determine the correct Customs value for each product, not for all the products as a whole. Therefore, the determination of whether transaction value is acceptable must also be made on a product-by-product basis.

CBP also said in its ICP on Related Party Transactions that the IRS and CBP apply different methods to determine whether a transfer price is arm's-length. As indicated above, the statutory requirement under the Customs value law is to use the circumstances of sale or test value method for determining the acceptability of a related party transaction value. Although the transaction-based methods utilized by the IRS in determining an arm's length price under IRC Section 482 have some similarities to the Customs methods, they are not the same. [17] The comparable profits method ("CPM") has little similarity to the Customs methods. For example, the profitability of the related party is usually compared with the profitability of companies that perform similar functions, e.g., contract manufacturer. Most CPM cases apply an "interquartile range" test. That is, if the related party's profit falls within an acceptable range of profits for the comparable companies, the IRS arm's-length requirement is met. In contrast, under the Customs methods for determining the acceptability of transaction value, **product similarity is required**. For example, the all-costs-plus-profit method relevant to the application of circumstances of sale requires that the transfer price be adequate to ensure recovery of all costs plus a profit equivalent to the firm's overall profit realized over a representative period of time in sales of goods of the same class or kind. Likewise, the circumstances-of-sale test is met where the price was settled in a manner consistent with **the normal pricing practice of the industry in question**. The industry in question depends on the product that is imported and not the functions that the seller performs. In addition, the Customs value law requires consideration of Customs values relating to identical or similar merchandise.

[16] CBP Informed Compliance Publication (ICP): "*Determining the Acceptability of Transaction Value in Related Party Transactions* (April, 2007)."

[17] The legislative history to IRC § 1059 indicates that Congress acknowledged this dichotomy and intended that the two standards should apply. See H.R. Conf. Rep. No. 841, 99th Cong., 2nd Sess., Vol. II at 656 (1986), reprinted in 1986 U.S.C.A.N. 4089, 4744.

Based on these considerations, CBP has ruled on numerous occasions that although the importer's transfer pricing methodology may satisfy one of the IRS methods, it is not determinative of whether it is an acceptable transaction value for Customs purposes. Rather, a related party transaction value will be considered acceptable only if it satisfies either the circumstances-of-a-sale test or closely approximates one of the test values. CBP recognizes, however, that in some cases, the underlying facts and the conclusions reached in an APA or transfer pricing study may contain relevant information about the circumstances of sale and, thus, may be considered in applying the circumstances-of-sale test. For example, CBP states that the APA or transfer pricing study may contain pertinent information about how the related parties transact business and may include information about sales of similar products to unrelated purchasers.

The weight given to the facts and conclusions in an APA or transfer pricing study depends in large part on the particular circumstances presented and the transfer pricing methodology used.[18] For example, an APA that is based on the comparable uncontrolled price method (CUP) has the most relevance for Customs valuation purposes and would be given much more weight than an APA that is based on the comparable profits method (CPM), which, generally, has the least relevance for Customs valuation purposes.[19] In addition to the methodology used, other relevant considerations are whether the transfer pricing study has been considered by the IRS, whether the APA is bilateral or unilateral, and whether the products covered by the study are comparable to the imported products at issue. *See*, HRL 548095, *supra*; HRL 547672, May 21, 2002; and, HRL 546979, August 30, 2000.

If it is determined that transaction value cannot be applied, the merchandise must be appraised using one of the other valuation methods in 19 U.S.C. § 1401a. In a few cases, CBP has determined that when transaction value could not be applied because the transfer price was not "fixed," the merchandise should be appraised using a modified transaction value under the fallback method, e.g., HRL 545618, dated August 23, 1996; HRL 547654, dated November 8, 2001; and, HRL 544845, dated November 9, 1993. However, under the Customs value law, the

[18] *See* footnote 14.

[19] See Customs Ruling HQ W548314, dated May 16, 2012.

fallback method[20] may only be used if all prior valuation methods cannot be applied. Thus, it is necessary to review and reject each method of valuation before arriving at the fallback method.

B. Steps Required to Evaluate and Determine the Acceptability of Transfer Prices under *Circumstances-of-Sale* in Related Party Transactions

As discussed above the "normal industry pricing practice method" (Method one) relies on evidence of publicly available industry information on the price of the product; such as quoted commodity prices, standard product price lists, or evidence that the price is consistent with the practices of other companies in the same or a similar industry.

Method two looks to the way the related party seller deals with unrelated buyers in the United States.

Method three looks to whether the transfer price for **each transaction** is adequate to ensure recovery of all costs, plus a profit equivalent to the exporter's overall profit.

1. COS-1: Is the Price Determined in a Manner Consistent with Normal Industry Pricing Practices?

The first method to support the *circumstances-of-sale* test is whether the "price is determined in a manner consistent with normal industry pricing practices."

Under this method, the importer may use information compiled from various transfer pricing studies which establish that other producers and suppliers utilize the same or similar methodologies to establish a selling price and that the profit earned is within a range of profits earned by producers or suppliers within the same industry. CBP does not consider the industry in question to consist of other functionally equivalent companies if those companies do not sell goods of the same class or kind. See HQ 548482 (July 23, 2004).

CBP has noted that the Importer must have objective evidence on how prices are set in the relevant industry in order to establish the "normal pricing practices of the industry" in question, and present evidence that the transfer price was settled in accordance with these industry pricing practices. See HRL H029658, dated December 8, 2009; HRL 547672, dated May 21, 2002; HRL 548482, dated July 23, 2004; and, HRL 542261, dated March 11, 1981 (TAA No. 19) (stating that where the transfer price was defined with reference to prices

[20] *Id*. The fallback method provides that merchandise should be appraised on the basis of a value derived from one of the prior methods reasonably adjusted to the extent necessary to arrive at a value. See 19 USC § 1401a(f) and 19 CFR § 152.107.

published in a trade journal (the posted price) and the posted price was commonly used by other buyers and sellers as the basis of contract prices, the transfer price was acceptable).

Information provided to CBP in a transfer pricing study, however, can be relevant in examining circumstances of the sale, but the weight to be given this information will vary depending on the details set forth in the study. See HQ H037375, dated December 11, 2009; HQ 548482, dated July 23, 2004. A significant factor is whether the transfer pricing study has been reviewed and approved by the IRS. (See HQ H037375 and HQ 546979, dated August 30, 2000.) Whether products covered by the study are comparable to the imported products at issue has been required by CBP. See HQ H037375 (12-9-2009) and HQ 547672 of May 21, 2002. The methodology selected for use in a transfer pricing study is also relevant. (See HQ 548482, dated July 23, 2004.) ("All of the transfer pricing studies utilize the CPM [Comparable Profits Method] methodology to evaluate distribution and manufacturing activities of the buyer and the seller in the industry under consideration. Although Customs has, in the past, given some weight to an importer's transfer pricing methodology when it has been based on the CPM, special circumstances were present.") See HQ 032882, dated March 31, 2010.

2. COS-2: Is the Price Determined in a Manner Consistent with the Way the Seller Deals with Unrelated Buyers

This method applies in situations where the seller sells the same merchandise to both related and unrelated parties and determines the prices in a manner that is consistent for both. For example, if the importer establishes that the price paid by both unrelated and related buyers to the seller is the same, or that the price between the related parties was based on an arm's-length negotiation, this would be an indication that the relationship between the parties did not influence the price. Or, if the seller uses a specified formula for determining the price (for example, based on the quantity purchased or other specified criteria) and applies the same formula in both sales to related and unrelated buyers, this would be an indication that the price was settled in a manner consistent with the way the seller settles prices for sales to unrelated buyers.

For example, in HRL 547019, dated March 31, 2000, CBP determined that transaction value was acceptable where the foreign supplier grants various discounts based on established criteria from a price list and gives the same discounts based on matching ratings to both related buyers and unrelated buyers. As evidence of this practice, the importer presented invoices from its related foreign supplier to other unrelated foreign buyers showing that identical price discounts for merchandise identical to the imported merchandise were given to other unrelated parties.

Although CBP generally requires that the comparison sales to unrelated buyers be sales to buyers in the U.S., CBP will consider evidence regarding sales to unrelated buyers in other countries, provided the importer presents an adequate explanation as to why such sales are relevant to the transactions at issue. The weight given to such evidence depends on the specific facts and the explanation provided.

In HQ W548314, dated May 16, 2012, the importer submitted information concerning the prices of merchandise sold to related and unrelated buyers around the world, including detailed charts including data pertaining to the Seller's global sales of the imported products. The charts show the name of the customer, the country, the material number and name, the quantity, and unit prices. In addition, the charts include the total volumes and value as well as the average per unit sales price. They also include a weighted average-per-unit sale price. The charts allow a comparable product-by-product comparison of export sales to the United States (both related and unrelated customers) with export sales to third countries. CBP found that there were numerous examples of sales of identical products (identified by either material name or material number) at comparable unit prices to unrelated customers both in the United States and abroad.

An examination of the data also revealed that the price for a particular product can vary throughout the year even to the same customer. The Importer stated that the reason for this is that sales prices are driven by market conditions of supply and demand. In particular, most of the imported products are price sensitive, depending upon numerous considerations such as the quantity of product purchased, the timing of the demand, and availability as to alternative sources. Other considerations that may vary the price include whether the customer has a long-term purchase agreement or whether a sale is merely a "spot purchase." The importer explained that customers for such products are often in industries whose business is cyclical in nature and very sensitive to changes in general economic conditions. CBP said that these fluctuating market conditions are reflected in the varying sales prices for these products. "Notably, these price differences occur equally for sales to unrelated parties as well as to related parties." Therefore, it said, sometimes the prices can be lower for sales to parties that are not related than the prices for sales to related parties. Based on the importer's explanation of the differences in prices between related and unrelated parties and detailed documentation submitted to CBP, it determined that the related party prices are settled in a manner consistent with the way the seller settles prices in sales to unrelated buyers.

In HQ 546285 dated June 7, 1996, the buyer of the imported merchandise was a subsidiary of the foreign seller. The foreign seller was the related buyer's only foreign vendor. Using the same price list, the foreign seller sells its merchandise to the related buyer, unrelated U.S. distributors and unrelated U.S. retailers. Thus, it did not appear that the relationship affected the price of the merchandise; the parties buy and sell from each other as if they are unrelated. CBP concluded, therefore, the circumstances of sale indicate that transaction value was an acceptable method of appraisement.

In HQ 545800 dated June 28, 1996, the U.S. importer was related to the foreign seller in Canada. The related party seller provided information regarding sales in its home market of Canada, including total sales in Canadian dollars, total costs incurred on a yearly basis, and "net return" on sales of like merchandise to the importer. CBP concluded that the evidence of the foreign sales did not satisfy the circumstance-of-sale test.

In HQ 543257 dated September 26, 1984, CBP said that if a related buyer in the United States is purchasing merchandise from a foreign seller for approximately the same price that the merchandise is sold to unrelated buyers, this requires a finding that the transaction value is acceptable.

In summary, if the importer establishes that the price paid by unrelated and related buyers to the seller is the same or that the price was determined based on an arm's-length negotiation, this would be an indication that the relationship between the parties did not influence the price. Or, if the seller uses a specified formula for determining the price (for example, based on the quantity purchased or other specified criteria) and applies the same formula in both sales to related and unrelated buyers, this would be an indication that the price was settled in a manner consistent with the way the seller settles prices for sales to unrelated buyers.

Additionally, CBP has considered sales to other parties, both related and unrelated in foreign countries of comparable merchandise, although it is less certain that CBP would consider this information acceptable without sales to unrelated parties in the U.S.

3. COS-3: Discussion of the "All-Costs-Plus-a-Profit" Method

The Customs valuation statute and regulations provide that a port director may not disregard a transaction value solely because the buyer and seller are related. 19 C.F.R. § 152.103(l) interpretative note (iii) provides:

> (iii) Interpretative note 3. If it is shown that the price is adequate to ensure recovery of all costs plus a profit which is equivalent to the firm's overall profit realized over a representative period of time (e.g., on an annual basis), in sales of merchandise of the same class or kind, this would demonstrate that the price has not been influenced.

This method examines whether the related party price compensates the seller for all its costs plus a specified amount of profit (i.e., a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind). According to CBP, this is the most objective method of meeting the circumstances-of-sale test when there are no sales to an unrelated buyer.[21] This method does not rely on the existence of an APA or transfer pricing study to support the transfer price. It is concerned solely with whether the price includes all costs to manufacture the goods, plus an acceptable profit, with the amount of profit being equal to or greater than the firm's overall profit for sales of merchandise of the same class or kind.

a) "Overall Profits of the Firm" Means the Profit of the Parent Company

In applying the "all-costs-plus-a-profit" test, CBP considers the "firm's overall profit . . ." to be the **profit of the parent company**. In HQ H106603, dated July 25, 2011, CBP stated:

> A very important consideration in the all costs plus a profit example is the "firm's" overall profit. In applying the all costs plus a profit test, CBP normally considers the "firm's" overall profit to be the profit of the parent company. Thus, if the seller of the imported goods is a subsidiary of the parent company, the price must be adequate to ensure recovery of all the seller's costs plus a profit that is equivalent to the parent company's overall profit. See HRL 546998, dated January 19, 2000.

[21] CBP Publication: "Determining the Acceptability of Transaction Value for Related Party Transactions, April 2007, page 9.

Thus, the profits of the **parent entity** would be utilized for comparison with the profit on the intercompany sales by the foreign supplier to importer. This presents a challenge for many importers, as the parent may choose not to make information on its profit available to the importer or to U.S. Customs and Border Protection, even if CBP agrees to protect this information from disclosure.

b) Profit Equivalency

The regulations do not provide a definition of "equivalent" profit; if, however, the profit of the seller is equal to or higher on the U.S. imports than the firm's overall profit, the purchase price would not be artificially low for Custom's purposes. See HQ H106603, dated July 25, 2011. Furthermore, the foreign seller's profit on the sale of the subject item does not have to be exactly the same as the firm's overall profit, and can be somewhat lower. In HQ H065024, dated July 28, 2011, CBP said:

> With respect to the comparison between profit margins for the time in question, while 19 C.F.R. 152.103 does not set out a fixed percentage as to what difference in profit margin is acceptable, prior CBP rulings have established a general outline, while following the general rule that the seller's profit must be equal to or exceed the parent company's profit. HQ W563326, dated November 3, 2006, for example, addressed the transaction value where a United States-based manufacturing company obtained its parts from a foreign company that wholly owned the parent company of which the United States company was a subsidiary. There, analyzing the circumstances of sale, <u>CBP ruled that the subsidiary's 2.0% profit, as compared to the foreign parent's 2.5% profit margin, showed that the price paid by the U.S. Manufacturer was sufficient to ensure recovery of all costs plus a profit that was equivalent to the foreign company's overall profit realized over a representative period of time</u> in sales of merchandise of the same class or kind. By contrast, HQ H016585, dated December 30, 2008, addressed imported textile luggage bought by an importer from an unrelated wholesaler, who in turn bought the luggage from related parent company. The subsidiary showed a net profit of 0.95% and 0.84% for the years in question, while the parent corporation realized an operating profit ranging from 5.4% to 6.3% for the same period. There, CBP held that because the subsidiary did not realize an operating profit equivalent to the parent firms' profit over the same period of time, the transaction failed the circumstances of sale test. [Emphasis added.]

Therefore, if the profit of the seller is equal to or higher on the U.S. imports than the firm's overall profit, the purchase price would not be artificially low for Custom's purposes. See HQ H106603 July 25, 2011 and H236154 of April 8, 2015.

c) Evaluation of the "Same Class or Kind" of Merchandise

19 C.F.R. § 152.102(h) defines the merchandise of the same class or kind as merchandise, including, but not limited to, identical merchandise and similar merchandise, within a group or range of merchandise produced by a particular industry or industry sector. See 19 C.F.R. § 152.102(h).

Merchandise of the same class or kind is broader than identical or similar merchandise. It is sufficient if the sale is of merchandise which is within a group or range of merchandise produced by a particular industry or industry sector. In HQ 545842, dated March 12, 1996, CBP said:

> In this case, merchandise of the same class or kind as the uniforms at issue would not be limited to uniforms. We consider textile uniforms to be within the textile garment industry or industry sector. Thus, we may look to the sales of textile garments manufactured by other Honduran producers for comparison purposes in order to determine whether the manufacturer's "actual" profit and general expenses may be used.

Assuming the parent entity is willing to make profit information available, the language of this provision makes it clear that the profit comparison must relate to the profit realized *in sales of merchandise of the same class or kind*. See H236154 of April 8, 2015. If the firm sells different classes of merchandise, the relevant profit is the profit that pertains only to sales of merchandise of the same class or kind. Thus, it may not be possible to segregate the profits earned by the parent on the sale of product with that of profits earned on sales of *merchandise of a different class or kind.*

IV. Alternative Methods of Valuation

In Headquarters Ruling Letter ("HRL") 547654, dated November 9, 2001, CBP appraised the merchandise under Section 402a(f) of the TAA (19 U.S.C. § 1401a(f)), using a modified transaction value approach and permitted the importer to use its figures through the ACE reconciliation program. But it did so only after finding that the alternate methods of appraisement under 19 U.S.C. § 1401a(b) through (e) were not applicable due to the unavailability of information. Under the value law, if transaction value is precluded, the appraised value is determined by proceeding sequentially through the alternative bases of appraisement to the first such basis that can be determined. These alternative methods, listed in order of precedence are: transaction value of identical or similar merchandise, deductive value, and computed value.

A. Exclusion of Transaction Value of Identical or Similar Merchandise as a Means of Appraisement

Following transaction value, the next basis of valuation is transaction value of identical or similar merchandise. It is often the case in related party transactions that there are no sales of identical or similar merchandise by the selling entity that may be used for comparison, and that information by other producers in the country of production to the United States is otherwise not available. Thus, this would effectively eliminate transaction value of identical or similar merchandise as a means of appraisement.

B. The Importer's Option: Computed or Deductive Value

Moving on to either deductive value or computed value, 19 C.F.R. § 152.101(c) provides for the following:

> (c) Importer's option. The importer may request the application of the computed value method before the deductive value method. The request must be made at the time the entry summary for the merchandise is filed with the port director (see § 141.0a(b) of this chapter). If the importer makes the request, but the value of the imported merchandise cannot be determined using the computed value method, the merchandise will be appraised using the deductive value method if it is possible to do so. If the deductive value cannot be determined, the appraised value will be determined as provided for in § 152.107.

1. Computed Value

Under computed value, merchandise is appraised on the basis of the following:

(1) the cost or value of the materials and processing costs incurred in the production of imported merchandise, plus

(2) an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class or kind, and

(3) the value of any assists[22] if not included in 2 and

packing costs. 19 U.S.C. § 1401a(e) and 19 CFR 1`52.10

The Statement of Administrative Action ("SAA"), adopted by Congress with the passage of the TAA, provides that with respect to computed value:

> The cost or value of the materials and the fabrication and other processing of any kind employed in the production of the imported merchandise will be determined on the basis of information supplied by, or on behalf of, the producer and will be based upon the commercial accounts of the producer, if such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced.
>
> The "amount for profit and general expenses" will be determined on the basis of information supplied by, or on behalf of, the producer and will be based upon the commercial accounts of the producer, provided that such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced and unless the figures provided are inconsistent with those usually reflected in sales, of merchandise of the same class or kind as the imported merchandise, that are made by producers in the country of exportation for export to the United States.

Statement of Administrative Action, H.R. Doc. No. 153, Pt. II, 96th Cong., 1st Sess. (1979), reprinted in Department of the Treasury, *Customs Valuation under the Trade Agreements Act of 1979* (1981), at 62. Additionally, Section 152.106(c)[23] on computed value provides:

> (c) **Profit and general expenses**. The amount for profit and general expenses will be taken as a whole. If the producer's profit figure is low and general expenses high, those figures taken together nevertheless may be consistent with those usually reflected in sales of imported merchandise of the same class or kind.

The legislative history of the TAA stresses reliance on the producer's books to obtain figures from which a computed value can be calculated. Thus, a presumption exists that where such

[22] Computed value includes assists, where its value has not already been included as an element of computed value under subparagraphs (A) or (B) of 19 USC § 1401a(e)(1). See 19 USC § 1401a(e)(1)(C). The term "assist" includes "engineering, development, artwork, design work, and plans and sketches that are undertaken elsewhere than in the United States and are necessary for the production of the imported merchandise." 19 USC § 1401a(h)(1)(A)(iv).

[23] Limitation on comparison of profit and G & A expense with other companies: HQ 544736, August 26, 1992.

costs are reflected on the producer's books, these costs are included in the computed value of the imported merchandise.

Computed value is a very viable option for an importer to establish as the basis of appraisement of the products in question, if transaction value is eliminated. Suppliers, in many instances are already sharing detailed information cost or value of the materials and other processing employed in the production of the imported merchandise. The "amount for profit and general expenses" is determined on the basis of information supplied by, or on behalf of, the producer, and will be based upon the commercial accounts of the producer, and will be accepted unless it is established that such amounts are inconsistent with other producers of merchandise of the same class or kind from the country of exportation.

2. Use of Deductive Value

Deductive Value may perhaps be the least beneficial method of valuation that can be applied to the "merchandise concerned, which means the sale price at which the imported merchandise being appraised, or identical or similar merchandise. . In its simplest form, merchandise is appraised as follows:

(1) the unit price at which the merchandise concerned is sold in the U.S., in its condition as imported, in the greatest aggregate quantity, less:

(2) the cost of international transportation and Customs clearance,

(3) any commission usually paid or agreed to be paid, or the addition for the usual profit and U.S. selling expenses (including general and administrative expenses).

The deduction made for profit and general expenses (taken as a whole) will be based upon the importer's profit and general expenses, unless the profit and general expenses are inconsistent with those reflected in sales in the United States of imported merchandise of the same class or kind from all countries, in which case the deduction will be based on the usual profit and general expenses reflected in those sales, as determined from sufficient information. Any state or local tax imposed on the importer with respect to the sale of imported merchandise will be treated as a general expense.

Under the deductive value method, it is possible that the imported value of the goods will be higher than would otherwise be reported if the transfer price were used, because under the deductive value method, fewer expenses may be deducted and no deduction is allowed for

Research and Design (although this could be a basis on which to exclude the application of deductive value).

C. Use of Derived Value and the Authority of CBP to Use "All Reasonable Ways and Means"

Section 152.107 of the CBP Regulations (19 C.F.R. § 152.107) provides:

> Reasonable adjustments. If the value of imported merchandise cannot be determined or otherwise used for the purposes of this subpart, the imported merchandise will be appraised on the basis of a value **derived** from the methods set forth in §§ 152.103 through 152.106, **reasonably adjusted** to the extent necessary to arrive at a value. Only information available in the United States will be used. (Emphasis added.)

Section 500 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979 (TAA; 19 U.S.C. § 1500) is the general authority for Customs to appraise merchandise. Section 500(a) states that the appraising officer shall, under rules and regulations prescribed by the Secretary:

> …appraise merchandise by ascertaining or estimating the value thereof, under section 1401a of this title, by all reasonable ways and means in his power, any statement of costs of production in any invoice, affidavit, declaration, other document to the contrary notwithstanding ...

As noted in the Statement of Administrative Action:

> [S]ection 500 of the TAA authorizes the appraising officer to weigh the nature of the evidence before him in appraising the imported merchandise. This could be the invoice, the contract between the parties, or even the recordkeeping of either of the parties to the contract. For example, if information contained in an invoice is negated by sworn statements contained in affidavits, the appraising officer has the authority to appraise the merchandise based on information contained in the affidavits.

In HQ H167495, dated June 28, 2011, CBP explained that:

> In those transactions where no accurate invoice or other documentation is available, and the importer is unable, or refuses, to provide such information, then reasonable ways and means will be used to determine the appropriate value, using whatever evidence is available, again within the constraints of section 402.

> Statement of Administrative Action, H.R. Doc. No. 153, 96 Cong., 1st Sess., pt 2, reprinted in, Department of the Treasury, Customs Valuation under the Trade Agreements Act of 1979 (October 1981), at 67.

With respect to the fallback, or the derived valuation method, CBP has said:

> Here, because a modified computed value under Section 402(f) is being applied to appraise the imported merchandise, it can be administered flexibly. This means that in appraising the merchandise, the formal requirements of computed value do not have to be strictly followed. . . . In HQ W548164 dated September 20, 2002, CBP approved the appraisement of pharmaceutical products pursuant to Section 402(f), under a modified computed value method using a weighted average value as opposed to actual computed value.

Thus, if an evaluation of all previous methods of valuation fail to produce a value that is acceptable to CBP, it can, under Section 1500, ascertain the value of the imported goods under a derived value by applying all reasonable ways and means, which could include acceptance of the values as determined and reported by the importer, or by applying a profit margin calculation that is consistent with the profit margin of producers of goods of the same class or kind, based on its own research (i.e., as determined by CBP's own "Centers for Excellence and Expertise" ("CEE")).

V. Summary

Verification of the method of appraisement for imported products requires significant attention by company management. Under U.S.C. § 1485 the importer declares under oath at the time of entry that all of statements in the invoice or other documents filed with the entry, and in the entry itself, are true and correct. Thus, company management has an ongoing affirmative obligation to ensure that the value reported to CBP is supported by the appropriate basis of appraisement and that the values are correctly determined under that methodology. The Government can and does assess monetary penalties under 19 U.S.C. § 1592, for the failure to correctly declare the customs value of imported goods. The failure to correctly declare the customs value of goods in related party transactions is a false statement for purposes of the assessment of monetary penalties under 19 U.S.C. § 1592[24].

[24] The civil penalty statute at 19 USC § 1592(a)(1) provides that "no person, by fraud, gross

Most companies also import different classes of products (i.e., returns, parts and materials), which are subject to different methods of customs valuation, and not all classes of products may be covered by the transfer pricing agreement. As such, it is often not possible to resolve all valuation issues by a single analysis. Rather, importers will be required to examine each class of merchandise separately, and make an appropriate analysis and determination.

While many intercompany transfer pricing agreements will constitute a "fixed formula" for the purpose of establishing a "price paid or payable" amount, there is still the question of whether the import transaction meets the *circumstances-of-sale* test necessary to support a finding of transaction value. This would require a detailed review and access to information that a parent company may not wish to make available (i.e., profits of the parent). If there are no sales to unrelated parties in the U.S., COS-2 is of limited value. COS-1 may be applicable, provided information can be obtained on how unrelated companies in the same industry sell to the United States, and that the way in which the foreign entity sells to the importer is consistent

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negligence, or negligence –(A) may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of (i) any document … which is material and false." A material omission or false statement is the basis for CBP to allege a violation of 19 USC § 1592; to seek duties, fees, or taxes owing for the past five years; and to assess civil penalties based on a multiple of the actual or potential losses of duties, fees, taxes for revenue violations, or a multiple of the value of the goods for non-revenue violations. Under 19 USC § 1592(c), maximum penalties for fraud cannot exceed the domestic value; for gross negligence, four times the loss of revenue or 40% of the dutiable value, whichever is less; for negligence two times the loss of revenue or 20% of the dutiable value, whichever is less. These penalties are subject to mitigation under the guidelines set forth in CR 171, App. B. CBP has assessed penalties against corporate officers in closely held corporations where those parties participated in the false claim or omission.

In the decision of the Court of Appeals for the Federal Circuit in *United States v Trek Leather, Inc.*, Ct. No 2012-1527 (September 16, 2014), the court interpreted the word "introduce" as a separate act from the word "enter," which generally involves filing the customs entry document. This interpretation can result in potential separate individual liabilities for duties and penalties for persons involved with documents relating to the "introduction" of the merchandise prior to filing the entries.

The statute of limitations under 19 USC § 1621 is five years from the date of entry of the alleged negligent or gross negligent violations, and five years from the date of discovery of alleged intentional violations. A valid prior disclosure pursuant to 19 CFR § 162.74 will limit the civil penalties for alleged negligent violations to the compound interest determined owing for duties and fees or zero for non-revenue violations, and to one time the loss of revenue for intentional violations. Intentional violations, however, may be referred to the U.S. Attorney for criminal prosecution.

with that method. Finally, COS-3 is useful where the foreign selling company is willing and able to provide the necessary information to show that the individual price includes all costs to produce the product, and that the amount of profit earned by the foreign seller closely approximates the profited earned by the parent company on the sale if the same or similar goods.

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