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# Basic Principles of Customs Valuation: Part 1

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# Current Hot Topics in Customs Valuation

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- What is covered in this Webinar?
  - Basic Principles of Customs Valuation
  - Transaction Value and the concept of “Price Paid”
  - Valuation for Related Party Transactions
  - The First Sale Rule (Multi tiered transactions)
  - Treatment of Payments for Commissions

# Valuation Fundamentals

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## ➤ Key Resources

- Customs Valuation Law 19 USC 1401a
  - <http://www.law.cornell.edu/uscode/text/19/1401a>
- Customs Regulations 19 CFR 152
  - <http://www.law.cornell.edu/cfr/text/19/part-152>
  - <http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&tpl=%2Findex.tpl>
- Customs Rulings
  - <http://rulings.cbp.gov/>

# Valuation Fundamentals



## ➤ Key Resources, cont.

- Customs Informed Compliance Publications
  - <http://www.cbp.gov/trade/rulings/informed-compliance-publications>
    - Customs Value
    - **Customs Valuation Encyclopedia (1980 - 2010)**
    - Determining the Acceptability of Transaction Value for Related Party Transactions
    - Bona Fide Sales & Sales for Exportation to the United States
    - Proper Deductions for Freight & Other Costs
    - Buying & Selling Commissions
    - Reasonable Care

# Valuation Fundamentals

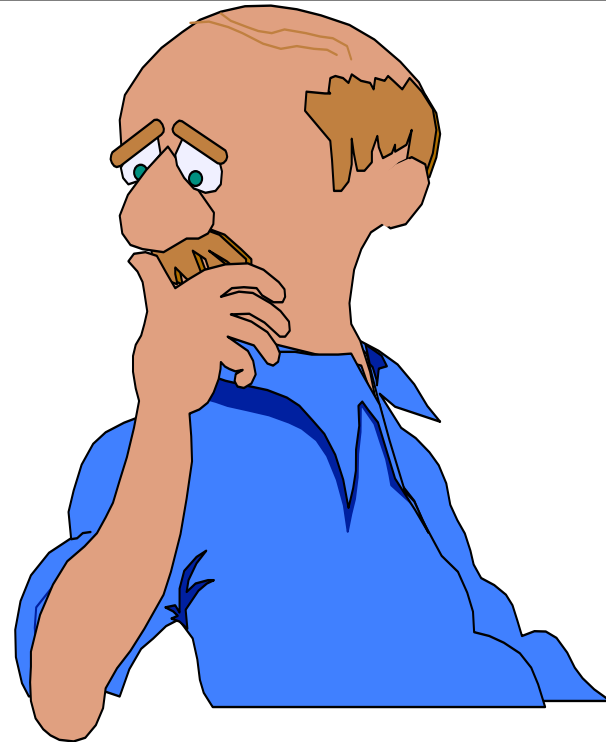


- The Law (19 U.S.C. 1484) requires importers (and their agents) to use “**reasonable care**” when providing Customs with information regarding:
  - Classification
  - Value
  - Rate of duty
  - Admissibility
  
- Civil Penalty Provisions 19 U.S.C. § 1952--
  - . . . No person . . . may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of—
    - (i) any document, written or oral statement, or act which is material and **false**, or
    - (ii) an omission which is material . . .

# Valuation Fundamentals



- Customs Value law (1401a) provides for five methods of **appraisement** of merchandise
- Must be applied in sequential order:
  - Transaction value
  - Transaction value of identical or similar merchandise
  - Deductive value
  - Computed value
  - a derived (fall-back) method reasonably adjusted to circumstances



# Valuation Fundamentals



## ➤ What is Transaction Value?

- Defined as:

“transaction value of imported merchandise is the price actually paid or payable for the merchandise when sold for exportation to the United States”, plus . . . [statutory additions]

- The word "payable" refers to situations in which the price has been agreed to, but payment has not been made at the time of importation.
- Payment must be made for the imported merchandise in question -- General transfers of money from one corporate entity to another, which cannot be linked to a specific import transaction, does not demonstrate passage of consideration. HQ 545705 , dated January 27, 1995. HQ H246429, January 7, 2014

# Valuation Fundamentals

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## ➤ When determining a transaction value:

- It may be the result of discounts, increases, negotiations, or may be arrived at by the application of a formula.
- A formula, however must be “fixed” or capable of determination at the time of importation.
- If the price is not “fixed” at the time of importation, transaction value is not applicable.
- Decreases in the price actually paid or payable made or effected after the date of importation are disregarded. 19 U.S.C. 1401a(b)(4)(B).



# Valuation Fundamentals



## ➤ What is a “sale”?

- A "sale" is generally defined as a transfer of ownership in property from one party to another for a price or other consideration.
- J.L. Wood v. United States, 62 CCPA, 25, 33, C.A.D. 1139, 505 F.2d 1400, 1406 (1974)
- VWP of America, Inc. v. United States, 175 F.3d 1327 (Fed.Cir. 1999),
- No sale, e.g., consignments, intercompany transfers, samples, goods provided free of charge, goods on loan or for trial or demonstration.

## ➤ Next question

- Did the sale “**cause**” the export of the goods the United States?

# Valuation Fundamentals



- When is transaction value appropriate?
  1. Must have a sale of the goods for export to the United States.
  2. No restrictions on disposition or use, except those
    - Imposed by law
    - Geographical resale territory
  3. **Value** and all additions must be **capable** of determination
  4. Are the parties **related**?

# Related Party Transactions

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## ➤ When are Parties “related”?

- Members of the same family, including . . . ancestors, and lineal descendants
- An officer or director of one organization and is an officer or director of another organization
- Partners
- Employer and employee
- 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 the other organization.
- Two or more persons directly or indirectly controlling, controlled by or under common control with, any person.

# Related Party Transactions



- 
- 1401a (b)(2)(A) provides that transaction value shall be the appraised value of merchandise only if -
    - \*\*\* (iv) the buyer and seller are **not** related, or
    - the buyer and seller are related but the transaction value is found to be acceptable
  - Burden is on importer to show that the relationship does not affect the price

## CF-28 Request for Information

DEPARTMENT OF HOMELAND SECURITY U.S. Customs and Border Protection		OMB No. 1651-0023 Exp. 03-31-2014	
<b>REQUEST FOR INFORMATION</b> 19 CFR 151.11		1. Date of Request	
		2. Date of Entry and Importation	
3. Manufacturer/Seller/Shipper	4. Carrier	5. Entry No.	
5a. Invoice Description of Merchandise	5b. Invoice No.	6. HTSUS Item No.	
7. Country of Origin/Exportation		8. CBP Broker and Reference or File No.	
9. TO:		10. FROM:	
Production of Documents and/or Information Required by Law: If you have provided the information requested on this form to U.S. Customs and Border Protection at other ports, please indicate the port of entry to which it was supplied, and furnish a copy of your reply to this office, if possible.		11a. Port	11b. Date Information Furnished
<b>General Information and Instructions on Reverse</b>			
12. Please Answer Indicated Question(s)		13. Please Furnish Indicated Item(s)	
<input type="checkbox"/> A.	Are you related (see reverse) in any way to the seller of this merchandise? If you are related, please describe the relationship, and explain how this relationship affects the price paid or payable for the merchandise.	<input type="checkbox"/> A.	Copy of contract (or purchase order and seller's confirmation thereof) covering this transaction, and any revisions thereto.
		<input type="checkbox"/> B.	Descriptive or illustrative literature or information explaining what the merchandise is, where and how it is used, and exactly how it operates.
		<input type="checkbox"/> C.	Breakdown of components, materials, or ingredients by weight and the actual cost of the components at the time of assembly into the finished article.
		<input type="checkbox"/> D.	Submit samples: Article number and description _____ _____ from container _____ mark(s) and number: _____ Samples consumed in analysis, and other samples whose return is not specifically requested, will not normally be returned.
		<input type="checkbox"/> E.	See item 14 below.
Name and Title/Position of Signer (Owner, Importer, or Corporate/Company Official)		16b. Signature	
17. CBP Officer		16c. Telephone No.	16d. Date
18. Team Designation		19. Telephone No.	
CBP Form 28 (03/11)			

General Information and Instructions on Reverse	
12. Please Answer Indicated Question(s)	
<input type="checkbox"/> A.	Are you related (see reverse) in any way to the seller of this merchandise? If you are related, please describe the relationship, and explain how this relationship affects the price paid or payable for the merchandise.

# Related Party Transactions



## ➤ Sec. 1401a(b)(2) Related Party Test

- The transaction value between a related buyer and seller will be acceptable if:
  - The value of the imported merchandise closely approximates an acceptable **“test value”**
    - Customs will not accept “test values” as a means of verifying value unless there has been an actual appraisal entry at the test value
    - HRL 543568 , dated May 30, 1986; HQ H246651, February 5, 2014
  - Satisfies the “circumstances of sale” test



# Acceptability of Related Party Pricing

## ➤ The “circumstances of sale” Test

- An examination of the “circumstances of sale” of the imported merchandise indicates that the relationship between the buyer and seller did not influence the price.
- Illustrative examples:
  - Price reflects the normal pricing practice for the industry
  - Evidence that the parties negotiated over price
  - Price settled in a manner consistent with the way in which the seller settles prices with unrelated buyers
  - Selling price includes all costs plus an amount for profit and general expenses (most common method)
  - Other methods may be considered (“totality of circumstances”)



## Related Party Pricing: “IRS” Transfer Pricing Studies

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- April 2007, CBP published informed Compliance guide on: TRANSACTION VALUE FOR RELATED PARTY TRANSACTIONS
  - “The mere fact that the importer has satisfied the requirements of Section 482 IRC, either through an APA or otherwise, does not mean that transaction value is acceptable under 19 U.S.C. §1401a.”
  - “It is still necessary for the importer to analyze whether the related party sale satisfies the circumstances of sale test or the test value method ... before making a value declaration . . .”
  - “An importer that relies solely on an APA or transfer pricing study to conclude that transaction value is acceptable would not be exercising reasonable care.”
- “While the goal of both the TAA and section 482 of the Tax Code is to ensure that the transactions between related parties are at arms length, the method of making that determination is different under each law.” HQ 546979, August 30, 2000



# “IRS” Transfer Pricing Studies



- APA or Transfer Pricing Study *by itself* is not sufficient to establish that a related party transfer price is an acceptable transaction value for Customs purposes
- Relevant considerations:
  - Has the transfer pricing study has been evaluated by the IRS?
  - Is there an APA? Is the APA is bilateral or unilateral?
  - Are the products/ Companies covered by the study comparable to the imported products at issue?
  - The methodology selected for use for the transfer pricing is also relevant. “CPM is the least relevant method for customs purposes.” See HRL 548482, dated July 23, 2004.
  - Are all of the Importer's imported products were covered by the **Study**?
  - See, HRL 548095; HRL 547672, May 21, 2002; and, HRL 546979, August 30, 2000.

# “IRS” Transfer Pricing Studies



## ➤ Relevant considerations:

- Transfer pricing study "tested party" may not necessarily be the right party for customs valuation purposes
  - Customs is concerned with the transaction causing the importation (typically manufacturer or seller) whereas the TP tested party could be the importer/reseller in the country of importation
- TP Studies Often Too Broadly based
  - Comparable companies and products for transfer pricing study look at industry Standard Industrial Classification (SIC) or North American Industry Classification System (NAICS) codes to identify producers in the same industry or industry sector
  - CBP comparable requirements are much **narrower** than most TP studies
  - Must be in same industry or industry sector **and** produce same "**class or kind of product**"
  - Should consider information on competitor companies and products. HQ H138203 (2011)
  - See also HQ H176775, March 6, 2014: used financial information from competitor companies to validate Importer Profit margin

# Post Importation TP Adjustments



## ➤ HRL H037375, December 11, 2009:

- CBP noted . . . companies used in the transfer pricing study were direct competitors of the company being examined and all companies sold merchandise of the same class or kind.
- CBP held . . . that the transfer pricing study supported a finding that the company's price was settled in a manner that was consistent with the normal pricing practices of the industry.

## ➤ Transfer Pricing Adjustments

- Related party importations can involve transfer prices that are **subject to adjustment** after importation (i.e., true-ups or end of year cost or profit adjustments).
- Initial import value set based on estimated costs and adjustments are made at the end of a period or year based on the actual costs incurred.
- If a transfer price is subject to post-importation adjustments and adjustments are **within the control of either the buyer or the seller**, the formula exception to the fixed price rule does not apply. **HRL 547654 dated November 9, 2001**

# Post Importation TP Adjustments



- Does your transfer pricing policy qualify as a “fixed formula”?
- Revocation of HRL 547654 -- [HQ W548314, May 16, 2012](#):
  - When there are post-importation adjustments, certain factors should be examined to determine whether there is a “fixed price” pursuant to a formula
  - Five factors for determining whether an objective formula is in place prior to importation:
    - (1) A written “Intercompany Transfer Pricing Determination Policy” is in place prior to importation and the policy is prepared taking IRS code section 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;

# Post Importation TP Adjustments



## ➤ Revocation of HRL 547654 -- HQ W548314, cont:

- (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.
- Still need to demonstrate that the Transfer Price is acceptable using “circumstances of sale” test.

# Acceptability of Related Party Pricing

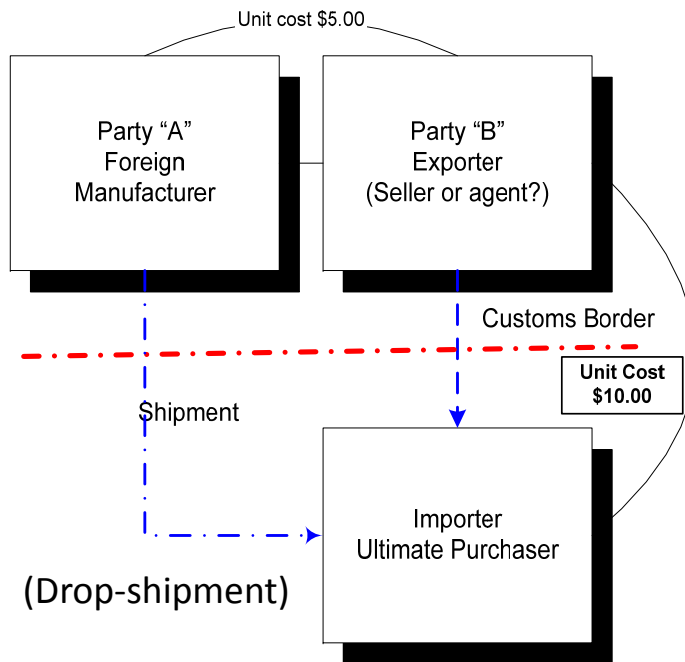


## ➤ “All Costs Plus Profit” Method

### ➤ 19 C.F.R. 152.103(l)(1)(iii)

- An importer may demonstrate that the relationship does not influence the price by establishing 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 . . ."
  - HQ 563400 March 29, 2006; good discussion of "circumstances of the sale" test

# Use of the “First Sale” For Customs Valuation



## ➤ Nissho Iwai American Corporation vs. U.S., 982 F.2d 505 (1992)

- Court held that Mfg selling price to middleman is an acceptable “TV” when:
  - There is a **sale** (i.e., transfer of ownership of the goods)
  - negotiated at arm's length, free from any non-market influences
  - goods are **clearly destined for export** to United States

➤ Reaffirmed in Target Stores v. United States, 31 CIT 154, 157, 471 F. Supp. 2d 1344, 1347 (2007).

➤ CBP Informed Compliance Publication: "Bona Fide Sales and Sales for Exportation."

## “First Sale” For Customs Valuation



- T.D. 96-87, Determining Transaction Value in Multi-Tiered Transactions, Vol. 30/31, Customs Bulletin No. 52/1 (January 2, 1997)
- CBP presumes that transaction value is based on the price paid by the importer
- Importer must request appraisement based on the price paid by the middleman to the foreign Manufacturer
- Importer must present sufficient evidence that:
  - First sale was a bona fide "arm's length sale;" and
  - clearly destined for export to the United States at the time it was sold to the middleman.



# Title and Transfer Issues



## ➤ Simultaneous or flash transfer of Title

- where the middleman and the buyer obtain title at virtually the same moment, as evidenced by both parties having the **same terms of sale** may cause CBP to more closely scrutinize a transaction.
- By itself, flash transfer of title does not equate to a failure to show a bona fide sale (for instance, see HRL W563605, dated November 19, 2009)
- but this factor along with who carries **the risk of loss** are considered by CBP in its determination of whether or not a bona fide sale has occurred.

## ➤ HRL H016966, dated December 17, 2007

- "Whenever there is a purported series of sales, and the same terms of sale are used in both transactions, there is a concern that the middleman obtains risk of loss and title only momentarily or never at all, **and thus has nothing to sell** to the ultimate purchaser."
- "In such situations the middleman **may be a buying or selling agent** rather than an independent buyer/seller and the sale will be said to occur between the party identified as the first seller and the ultimate U.S. purchaser."
- A determination of when title and risk of loss pass from the seller to the buyer in a particular transaction depends on whether the applicable contract is a "shipment" or "destination" contract. HQ H246429, January 7, 2014

# Title and Transfer Issues

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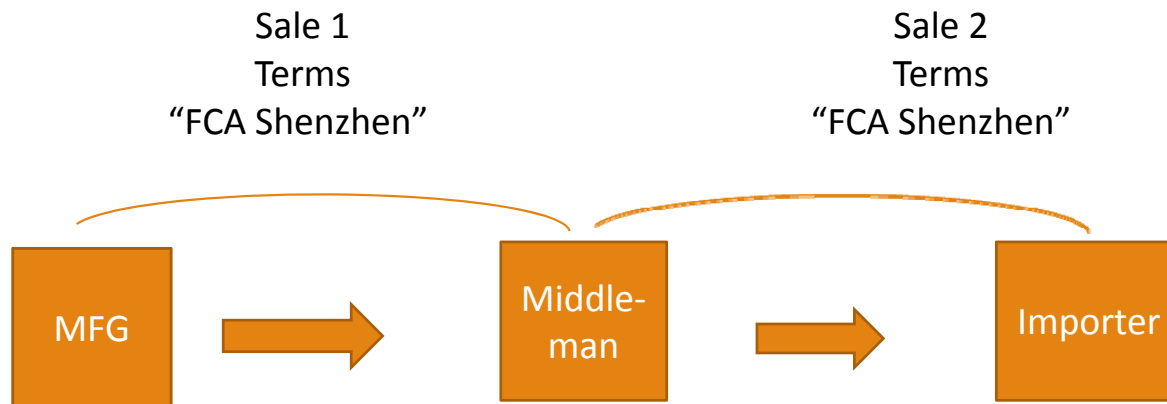


## ➤ Title transfers

- In a shipment contract, when Seller completes physical delivery to the carrier
  - Ex works
  - F-terms (FCA, FAS, FOB, etc.)
  - C-terms (CIF, C & F, etc.)
- In a destination contract, when goods are physically delivered to the location required
  - D-Terms (i.e., DDU and DDP)

# Simultaneous or flash transfer of Title

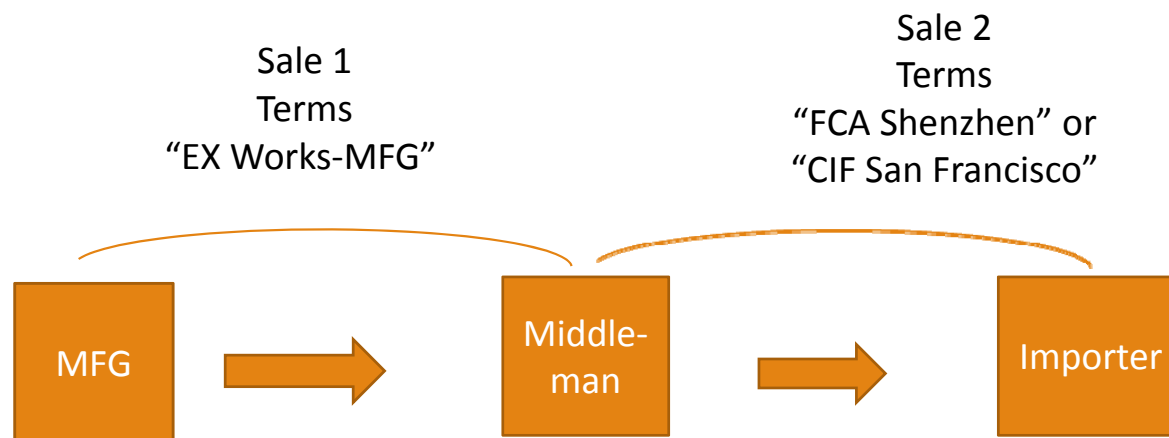
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Middleman does not have “possession of goods”

# Consecutive transfer of Title

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Middleman has "possession of goods"

## “First Sale” For Customs Valuation



### ➤ “Clearly destined for export to the United States”

- Goods shipped directly to the United States. HQ 547382, February 14, 2002.
- Purchase order and invoices specify the goods are for/destined to the U.S.
- Manufacture, design, and other unique specifications or characteristics of the merchandise; labels, logos, stock numbers, or unique marks are in conformity with U.S. buyer's standards;
- Marking, visas, warranties or other types of certification or characteristics required for entry or operation in the U.S.

# “First Sale” For Customs Valuation



## ➤ information and Documentation Requirements

- Importer must describe
  - Roles of all parties and furnish relevant documents pertaining to each transaction that was involved in the exportation of the merchandise to the United States.
  - Relevant documents include:
    - purchase orders, invoices, proof of payment, contracts and any additional documents (e.g. correspondence), demonstrating how the parties dealt with one another and which support the claim that the merchandise was **clearly destined** to the United States.
    - CBP looking for complete paper trail of the imported merchandise showing the structure of the entire transaction
- HQ H246429, January 7, 2014

# Additions To Value: Commissions

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- Section 1401a (b)(1) provides that:
  - Amounts equal to any selling commissions incurred by the buyer with respect to the imported merchandise must be added to the price actually paid or payable
  - An Agent is an intermediary who assists either the buyer or seller in the purchase or sale of the imported merchandise
  - A "selling commission" is any commission paid to the seller's agent, who is related to or controlled by, or works for or on behalf of, the manufacturer or the seller. 19 C.F.R. 152.102(b).
  - Typically receives a commission based on the value of the items purchased, but may have other compensation
  
- What is the difference between buying and selling agents?
  - Selling agents act under the control of the seller
  - Buying agents act under the control of the importer, Agent may be located abroad or in the U.S.
  - Buying commissions are not dutiable but must be reported.

# Additions: Buying Agents

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- Shipments may come from
  - Seller with a commission paid separately which must be reported
  - Seller with commission included on invoice or in price
  - Agent, with commission included on invoice or in price
- Buying Agent may be related to the importer or the seller
- Review Commercial Invoices to determine if a buyer or ship to party is identified, other than the importer



# When is the intermediary a bona fide buying agent?

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- No single factor determinative
- Factors considered are:
  - Which party bears the risk of loss for lost or damaged merchandise? (generally, a buying agent does not bear the risk of loss);
  - Who absorbs the cost of shipping and handling? (buying agents generally do not absorb such costs);
  - Which party controls the manner of payment for the goods? (generally, a buying agent would not control how and when the seller is paid);
  - Could the buyer purchase from the manufacturers without using the services of the agent (if the answer is no, the agent may be a selling agent);
  - Was the intermediary operating an independent business primarily for its own benefit? (if the answer is yes, it is possible that the intermediary is not an agent but an independent seller);
  - Is the intermediary financially detached from the manufacturer or seller? (if not, it is possible that the intermediary may not be acting on behalf of the buyer, but on behalf of the seller);
  - What do commercial documents show? (*e.g.*, how are the parties referred to in the commercial documents; is there a buying agency agreement; is there a purchase agreement and if so, who are the parties thereto).
- A bona fide buying agent depends upon the all the relevant facts and totality of the evidence

# Buying Commissions: issues

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- Is purported Agent acting on its own as a seller or on behalf of another party (either buyer or seller)?
- Questions:
  - A seller takes possession or control of goods
  - Agents acts only through and on behalf of buyer or seller
  - Seller orders goods for its own use or disposition
  - Seller takes title to goods
  - Difference in price is more that a “reasonable” amount for a commission

# Buying Agents

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- Could the importer have purchased the goods directly from the seller?
- Who is controlling the terms of the transaction?
- Buying agents may be related to the importer, or the seller
- The commercial invoice should identify the agent

# Written Buying Agency Agreements

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- A written agreement is not required but is helpful
- Documents that the agent purchases merchandise on behalf of the importer and evidences:
  - the control by the importer of the agent,
  - the manner of payment for the goods
  - who bears risk of loss
- CBP will evaluate whether actions of “agent” comport with terms of agreement

# Buying Agents

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- An invoice or other documentation from the actual foreign seller to the alleged agent is required in order to establish that the agent is not the seller of the imported merchandise, as well as to determine the price actually paid or payable to the seller.
  - **545174 dated Sep. 7, 1994.**
- No invoice or other documentation from the actual seller of the imported merchandise.
- The commission is included in the price actually paid or payable for the imported merchandise.
  - **545846 dated Dec. 9, 1994; 546604 dated Aug. 8, 1997.**