McGUIREWOODS

JOHN B. PELLEGRINI
212.548.7020 Fax 212.715.2301
jpellegrini@mcguirewoods.com

VALUATION OVERVIEW

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The tariff laws of the United States provide generally for duties expressed as a percentage of the "customs or dutiable value" of the imported merchandise. Section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979, 19 U.S.C. § 1401a, prescribes the methods for determining the appraised value of imported merchandise.

The following is an overview of the valuation statute as interpreted by U.S. Customs and Border Protection ("Customs") and the customs courts.

I. Summary Description. The basic premise of Section 402 is that, in the absence of special circumstances, the customs value of imported merchandise is price agreed to between the buyer and seller. When an importation occurs as the result of a purchase, dutiable value is established by the selling price. This basis of valuation is known as transaction value, defined as the "price actually paid or payable for merchandise when sold for exportation to the United States."

The general rule is that all monies paid to the seller, regardless of the purpose, are considered part of the price paid or payable and dutiable under statutory transaction value. *Generra Sportswear Co. v. United States*, 905 F.2d. 377 (Fed. Cir. 1990).[1] The strong presumption is that all monies paid to the seller are dutiable. An example is testing costs, which, when paid to the seller are considered dutiable, but not dutiable when paid to a third party. HQ H256223 (August 20, 2014).

Certain additions are made to the "price actually paid or payable" to reach statutory transaction value. These are: 1) packing costs incurred by the buyer with respect to the imported merchandise; 2) any selling commission incurred by the buyer with respect to the imported merchandise; 3) the value, apportioned as appropriate, of any assist; 4) any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly, as a condition of the sale of the imported merchandise for exportation to the United States; and, 5) the

[1] There have been but very few exceptions to this general rule. A recent ruling held that certain community development fees paid to a foreign seller were not dutiable on the grounds that the use of the fees were within the ambit of the seller's employees and community representatives. An important element of the ruling was that local law prohibited a payment directly to the employee committee. HQ H262685 (March 23, 2015).

proceeds of any subsequent resale, disposal, or use of the imported merchandise that accrue, directly or indirectly, to the seller. These additions are to be made only to the extent that they are not included in the price.

Reasonable costs of construction, erection, assembly, technical assistance provided after importation, as well as United States customs duties and taxes are specifically excluded from transaction value if identified separately from the price actually paid or payable.

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 United States, if included in the price, are excluded from transaction value. This is not the case in most other countries where appraised value is calculated on a CIF basis and includes international transportation.

Finally, with few exceptions, rebates or decreases in the price paid or payable that are consummated between the buyer and seller after the date of importation are disregarded in determining transaction value.

Adjustments to take account of circumstances not enumerated in the statute are not permitted; an alternative basis of valuation must be applied.

Where no price exists upon which transaction value can be established, for example, where a manufacturer shifts inventory to a United States location for subsequent sale or for further manufacturing and sale, or where there is a condition or consideration for which a value cannot be determined, such as a tie-in, appraised value is determined by applying one of four alternative methods of valuation, applied sequentially. These are: 1) transaction value of identical merchandise (the price for identical merchandise from the same manufacturer in a direct sale to an unrelated United States customer at about the same time); 2) transaction value of similar merchandise (the price for nearly identical, commercially interchangeable, merchandise produced by the same manufacturer and sold for exportation to the United States); 3) deductive value (derived from the price at which the imported article is first sold in the United States less the included international freight, customs duties, clearance charges, Federal sales taxes, United States inland freight, and the commission earned by, or the usual general expenses and profit of, the importer and, if the article has been further manufactured, the costs of such further manufacture); and 4) computed value (ascertained by building up the manufacturer's actual costs for labor and materials plus the usual general expenses and profit realized by the manufacturer).

If none of the alternative methods are available, Customs must ascertain a value based upon one of the statutory methods. Any derivations or adjustments must: 1) be based upon fact; 2) not be prohibited by law; and, 3) reflect the actual experience of the manufacturer.

Inasmuch as transaction value is the customs value of a very substantial majority of the merchandise imported into the United States, the following discussion focuses on issues that arise in transaction value appraisements.

II. Related Parties. The concept of "related parties" found in the customs laws is similar to that found in other tax statutes. When common ownership or control creates opportunities for non-market influences to affect pricing, the law permits the authorities to minimize or eliminate these effects. In a related party transaction, Customs must accept the transfer price provided that the relationship did not affect the price. Section 402 anticipates that, in the normal course, prices between related parties will be accepted as representing transaction value. It further provides that if the transfer price approximates the deductive or computed value of the same merchandise as ascertained by Customs officials in other transactions, it must be accepted as transaction value. It is the responsibility of the importer to designate whether a transaction is between related parties. This is done by a statement on the entry summary, CBP Form 7501. Customs officials may not disregard a price simply because the parties are related. There must be some reason to believe that the relationship affected the price. The importer has an opportunity to demonstrate that the price was established on an arm's-length basis.[2]

Related parties frequently must adjust prices (increases and decreases) during or at the end of a fiscal year to maintain compliance with the income tax laws. The adjustments, even those that occur retroactively, *i.e.*, post entry, affect customs value. Customs has ruled that the adjustments do not limit the use of transaction value, and that both price increases and decreases can be recognized. HQ W548314 (May 16, 2012). Customs also states that using the reconciliation process to report these transfer price adjustments is not required, but is strongly encouraged.

III. Price Adjustments. From time to time, importers and their suppliers agree on price adjustments. This occurs for a number of reasons, such as late shipment, a drop in market price, a change in currency parities, etc. It will come as no surprise that Customs will take into account most price increases and, on the other hand, generally will not take into account price decreases.

Discounted prices agreed to prior to exportation are recognized as representing statutory transaction value. Customs will require documentary substantiation of the agreement. Normal commercial documents, such as a seller's invoice showing the discount may be sufficient for this purpose. *See,* HQ 057716 (June 30, 2009).

Section 402 provides that rebates and price adjustments agreed to after importation may not be taken into account in appraising imported merchandise. Accordingly, if an importer and its supplier agree to a price decrease, they must do so prior to importation.[3] There are two exceptions, a price decrease based on a formula and a price decrease to compensate the importer for defective or nonconforming merchandise.

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[2] The fact that the Internal Revenue Service has accepted the price for income tax purposes does not necessarily mean that it will pass muster for customs purposes.

[3] *See* HQ H048152 (April 30, 2009) and HQ H197899 (September 26, 2012) for examples of discount schemes accepted by Customs as reducing appraised value.

By regulation, 19 C.F.R. § 158.12, an importer is allowed to claim an allowance in value for merchandise damaged at the time of importation as long as the allowance sought is commensurate with the diminution in value caused by the defect. *Samsung Electronics America, Inc. v. United States*, 23 CIT 2 (1998). This is not automatic, the importer must establish the defect with specific information, including the nature of the defect, and that the defect violated the terms of the purchase agreement. HQ H130303 June 22, 2014). It is not sufficient simply to assert that the goods were unsatisfactory. *See* HQ 548635 (April 7, 2005).

There are a number of techniques of dealing with the late shipment situation to ensure that Customs will recognize the new price. These arrangements must be finalized prior to importation. For example, an importer's contract with the seller could provide that if merchandise is shipped after the required delivery date, the price of the goods shall be reduced by an amount equal to the difference between the estimated cost of shipping the goods by ocean and the actual cost of a faster means of transportation. Under these circumstances, Customs has held that the reduced price represents transaction value. C.S.D. 83-62, HQ 543014 (February 15, 1993).

There is another approach to this problem, but, again, it requires careful planning. In the case of late shipment, the importer's contract with the seller could require that the terms be changed to CIF, requiring air transportation with the price increased by an amount equal to normal ocean transportation charges. Since international freight is not dutiable, the dutiable value would be the price, albeit increased, less the international freight charges. This may result in an appraised value lower than the original price.[4] HQ 547069 (November 16, 1998).

On the other hand, any price increase, whether effected pre-importation or post-importation, should be reported to Customs and probably will be considered dutiable. However, when a price increase, as well as the reason for the increase, occurs after importation Customs has held that the increase does not affect the transaction value of the imported merchandise and is not dutiable. HQ 547027 (September 17, 1999)

IV. Sale for Exportation. The question of what constitutes a sale for exportation arises from time to time. Although the fact patterns are diverse, a typical pattern involves an importer who has purchased foreign components or materials to satisfy contractual obligations in the United States, for example, a foreign-based contractor who has undertaken to install machinery in a facility located in the United States. Another example would be a foreign firm, which purchases merchandise from various unrelated sources, imports it, and then sells it in the United States. The issue is which of the two sales, the sale between the importer and the foreign source, or the sale between the importer and the ultimate purchaser in the United States, is a sale for exportation. In some instances, Customs officials have stated that because the importer was a foreign entity, it was the sale from the importer to its customer in the United States that was the sale for exportation and the basis of transaction value. This can also occur

[4] Remember that, in the case of footwear, a lower appraised value does not always mean a lower duty.

when the importer is a subsidiary of the exporter and has a minimal presence in the United States.

V. First Sale Appraisements. It is not unusual for an importer to purchase merchandise from a middleman/seller rather than the actual manufacturer. Under appropriate circumstances, the dutiable value is the price charged by the manufacturer to the middleman/seller rather than the price paid by the importer. Generally, the manufacturer's price to the middleman/seller constitutes a viable transaction value when: 1) the goods clearly are destined for export to the United States pursuant to the purchase by the middleman/seller; 2) the manufacturer and middleman deal with each other at arm's length; and 3) non-market influences do not affect the legitimacy of the price in the transaction between the manufacturer and the middleman/seller; *i.e.* the manufacturer and the middleman/seller are not related.

Customs assumes that the price paid by the importer to the middleman is the basis for transaction value. To rebut this presumption, the importer must provide evidence establishing that, at the time the middleman purchased, or contracted to purchase, the imported merchandise, the goods clearly were destined for export to the United States and the manufacturer and the middleman deal with each other at "arm's length". Normally, the importer must establish that the middleman and the manufacturer are not related. The importer must provide copies of purchase contracts between the middleman and manufacturer. When these contracts are clear that the merchandise is for export to the United States and when the merchandise is shipped directly by the manufacturer to the importer, Customs, in the absence of factors which suggest that the price between the middleman/seller and the manufacturer was affected by non-market considerations will treat the price from the manufacturer to the middleman as representing appraised value.

On the other hand, where the middleman does not take title or does not assume risk of loss, or where you have flash title, Customs will take a very close look at the documentation and may take the position that there are not two sales and that the middleman is acting as a selling agent. As noted above, a selling commission is dutiable. Recently, Headquarters Office rulings have taken a harder line where flash title exist. This is particularly the case where the middleman and the importer are related parties

VI. Assists. Assists are among the costs added to the price paid or payable to reach transaction value. Assists include: 1) materials, components, parts, and similar items incorporated in the imported merchandise; 2) tools, dies, molds and similar items used in the production of the imported merchandise; 3) merchandise consumed in the production of the imported merchandise; and 4) 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. The value of an assist is its cost of acquisition, plus transportation to the site of production.

The items described above are treated as dutiable assists when they are supplied, directly or indirectly, and free of charge or at a reduced cost, by the buyer of the imported merchandise for use in connection with the production of merchandise exported for sale to the United States.

Most importers understand that when they supply materials or items such as molds to the seller for use in the production of imported merchandise, the items are dutiable. Many importers do not realize, however, that price tags, labels, packaging and similar "trim items" also are dutiable. With limited exceptions, this is true even when the items are manufactured in the United States.

United States-made trim items incorporated in the imported merchandise, such as sewn-in labels, are eligible for reduced-duty treatment under a tariff provision covering articles assembled abroad with United States-made components. Those United States-made items, such as packaging materials, that are not incorporated in the imported merchandise likely fall within another provision that accords duty-free treatment for products of the United States returned without having been advanced in value or improved in condition. United States-made packaging supplied to the seller at no cost is not treated as an assist because the packaging is classified separately as US-Goods Returned and is not dutiable. HQ 731806 (November 18, 1988).

Although the general rule is that merchandise, which is not imported, is not subject to duty, some waste materials are considered dutiable. In *Salant Corp v. United States*, 21 CIT 24 (2004), the Court of International Trade held that manufacturing waste, *i.e.*, materials discarded in the course of production, is included as part of the value of an assist.

The treatment of design work can be quite complicated. Keep in mind, however, that where the work is done in the United States it is not dutiable. In addition, work done abroad by a domiciliary of the United States who is an employee or agent of the importer is not dutiable. A good review of the design aspect issue is found in HQ 548540 (July 28, 2004). *See* HQ 563369 (January 11, 2006) for a ruling where Customs held that a sketch was not considered a design assist because the sketch merely facilitated the oral description of what the importer wanted to purchase. The rulings in this area are inconsistent.

It is common practice to report certain types of assists against a single entry or on a periodic basis. It is possible to amortize the value of the assist over its useful life. You also may allocate the assist to non-United States sales on a proportionate basis, value or units.[5] This would mean that an allocated portion of the value of the assist would be added to the price paid or payable for all merchandise made with the assist. This will always be done on a post-entry basis since until all the goods are shipped, the United States share will not be available. Another approach would be to load the assist charges into the first entry of merchandise. Where the assist costs are modest, this is probably the most efficient way to satisfy duty liabilities on the assist. On the other hand, where the costs are substantial, it may be appropriate to spread them out over a larger number of entries. Keep in mind that once the charges are fully depreciated there is no longer any assist, or, more accurately, the value of the assist is zero.

Not everything the importer supplies free of charge to the seller is dutiable. Only those articles and services described above are considered assists. For example, Customs frequently has held

[5] It should be noted that this approach might require that the importer use the reconciliation procedure.

that an importer who provides managerial or accounting services to the seller has not provided a dutiable assist. Those rulings go so far as to hold that providing a plant manager or other supervisory production personnel also is not considered a dutiable assist.

The laws, regulations and practices regarding assists are quite complicated. Importers who provide services, materials, and/or production machinery to vendors should review these transactions carefully to ensure they have not provided dutiable assists, which must be reported to Customs.

Keep in mind that mold charges paid to the seller are not assists but may be dutiable as part of the price. The issue comes up when the seller agrees to amortize molds over a given number of units and the importer does not purchase the required amortization quantity. If the importer picks up the difference, the payment may be dutiable. However, Customs has ruled that if the amortization schedule is reasonable and the agreement is reduced to writing the additional payments are not dutiable. *See* HQ W563531 (October 27, 2006).

VII. Royalties. On February 11, 1993, Customs issued a decision, which has had a major impact on the dutiability of royalties, whether for trademark, copyright or patent rights.

Customs ruled that the fact that a royalty is based on the resale price in the United States is not a sufficient basis to determine that the royalty is non-dutiable. This had been the principle in rulings holding that royalties, particularly trademark and copyright royalties, were not dutiable. The 1993 ruling lists three criteria for determining whether a royalty is dutiable. These are: 1) whether the imported merchandise was manufactured under a patent; 2) whether the royalty was involved in the production or sale of the imported merchandise; and 3) whether the act of importation created a requirement to pay a license fee. An affirmative answer to any of the three questions likely will result in a royalty being considered dutiable.

Generally, royalties paid by the importer to a third party not related to the seller for the right to use a trademark will not be dutiable. This is the case whether the royalty amount is based on the purchase price or the selling price of the imported merchandise.[6] On the other hand, royalties paid for the right to use a patent in the manufacture of imported merchandise will be dutiable. *E.g,* HQ H233376 (September 16, 2016). Many royalties fall between these two bright lines.

Customs position on the dutiability of many different types of royalties is not clear. What is clear, however, is that importers have an affirmative obligation to disclose the payment of royalties to Customs.

VIII. Proceeds. Transaction value includes any proceeds of the sale of the imported merchandise, which are shared with the seller. This provision has come into play most

[6] In HQ H047360 (July 31, 2009), Customs declared that a footwear trademark royalty based on the quantity purchased was dutiable. The royalty was paid to the licensee, the importer's buying agent. The importer sought reconsideration and that ruling has been modified. HQ H077919 (April 5, 2011)

frequently in the case of sales-based license fees or royalties paid, directly or indirectly, to the seller.

IX. Buying Commissions. The general rule is that a commission paid by the importer to an agent for services rendered in connection with the purchase of merchandise, inspecting and packing the goods, arranging shipment, preparing documentation, and making payment for the account of the buyer, no portion of which ensures to the benefit of the seller, is not part of appraised value. On the other hand, when the agent is in fact the seller, acting for its own account rather than on behalf of the buyer, or is a selling agent, acting on behalf of the seller, the commission is deemed part of appraised value.

No single factor determines whether the relationship between two parties, one of whom purchases merchandise in the service of another, is a *bona fide* agency. The existence of a *bona fide* principal-agent relationship can be ascertained only after all relevant factors have been examined. Further, it is important to keep in mind that the characterization of each relationship is governed by its peculiar facts. However, the primary consideration is the right of the principal (the importer-buyer) to control the agent's conduct with respect to the matters entrusted to it.

It is beyond the scope of a general memorandum of this nature to examine each of the factors, which the customs courts and Customs have examined in determining the true nature of an alleged principal-agent relationship. The following factors are frequently considered: 1) is there a written agreement between the principal and agent which describes the respective rights and obligations and which contains no elements which are inconsistent with the principal-agent relationship; 2) does the importer know the identity of the seller and does the entry package include an invoice from the seller; 3) are the agent and seller related; 4) does the importer have any direct contact with the seller; 5) does the agent have authority to make decisions such as changing the factory or seller or renegotiating price without the principal's approval; 6) does the agent receive any compensation from the seller or does the agent share any portion of its commission with the seller; 7) does the principal treat the agent as an insurer requiring that it make good on all defective merchandise, late shipment, etc. regardless of fault; and 8) is the commission uniform *i.e.* is it the same on all transactions or does it vary from transaction to transaction.

These are some of the considerations that Customs and the customs courts have relied on in determining the true nature of the relationship between the buyer and its agent. Although, as we note above, no single factor is determinative, we believe that the inability to supply the seller's invoice when requested by Customs would be fatal.

X. Foreign Inland Freight. The cost of transporting imported merchandise within the country of exportation, when included in the price, may be excluded from appraised value under certain circumstances. By regulation, 19 C.F.R. § 152.103(a)(5), foreign inland freight is deemed non-dutiable where: 1) it is identified separately; and 2), the charges occur after the merchandise has been sold for exportation to the United States. The preferred evidence of non-dutiability is a through bill of lading. As a practical matter, unless the sale is on ex-

factory terms and foreign inland freight is paid by the buyer directly to the carrier, not through the seller, it is not possible to avoid duties on foreign inland freight.[7]

The term foreign inland freight is sometimes misconstrued to mean all overland carriage. The term is limited to freight in the country of exportation by whatever means. Thus, the foreign inland freight for goods produced in one country and shipped overland to a seaport in a second country is limited to carriage in the first country, the country of exportation. The cost of overland carriage in the second country is not dutiable since it is international freight.

XI. Interest Charges. Customs has concluded that interest payments made to the seller should not be considered part of appraised value provided the following criteria are satisfied: 1) the interest charges are identified separately from the price actually paid or payable for the goods; 2) the financing arrangement in question is in writing; and 3) where required by Customs, the buyer can demonstrate that -

(a) the goods undergoing appraisement are actually sold at the price declared as the price paid or payable,
(b) the claimed rate of interest does not exceed the level for such transactions prevailing in the country where, and at the time the financing was provided, and
(c) the importer carries the payments on its books as interest.

The courts have affirmed Customs' position. *Luigi Boromioli Corp. v. United States*, 118 F.Supp. 2d. 1345 (CIT 2000), *aff'd.*, 304 F.3d 1362 (Fed.Cir. 2002).[8]

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In general, Section 402 provides relative certainty on questions of valuation. Further, as this overview suggests, a full understanding of the law may enable importers to reduce dutiable value.

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[7] HQ H179142 (November 21, 2011) describes a process that allows the deduction of charges that occur after the goods exit the factory but are included in the seller's price.

[8] Finance charges paid to a third party not related to the seller and which do not inure directly or indirectly to the benefit of the seller, are not dutiable. HQ H099255 (March 24, 2010).