

FIRST SALE APPRAISEMENTS

August 2017

A. Background. When an importer purchases merchandise from a seller who, in turn, purchases from another, the question is whether the price paid by the importer, or, alternatively, the price paid by the seller, represents transaction value.¹ In these three-sided transactions (importer, middleman and manufacturer), Customs and Border Protection (“Customs”) assumes that the price paid by the importer represents transaction value. However, as a result of court decisions, the importer has the opportunity to rebut the presumption and pay duty on the price in the first sale.

In *Nissho Iwai American Corporation v. United States*, 982 F.2d 505 (Fed.Cir. 1992), the Federal Circuit held that in a three-tiered transaction, the manufacturer’s price represents statutory transaction value when the transaction between the manufacturer and the middleman falls within the terms of the statute. The court laid down three requirements:

- the sale must be one for exportation to the United States
- the sale must be on arm's length terms
- the price must be free from non-market influences.

Put another way, when there are two sales that represent a sale for exportation to the United States, the first of the two is to be used as the customs value.

B. Is There a Sale. The first factor in establishing a first sale appraisalment is to demonstrate that there was a sale between the manufacturer and the middleman/seller. Customs defines a sale as the transfer of property from one party to another for a consideration. Customs will look at the following factors in determining whether there is a sale from the manufacturer to the middleman.

- Purchase order from the middleman
- Invoice from the manufacturer to the middleman

¹ Merchandise imported into the United States is appraised in accordance with section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979, 19 U.S.C § 1401a. The preferred method of appraisalment is transaction value, which is defined as the “price actually paid or payable for merchandise when sold for exportation for the United States,” plus certain enumerated additions.

- Shipment from the manufacturer consigned to the middleman
- Payment from the middleman to the manufacturer
- The middleman is shown as the shipper on the transportation documentation addressed to the importer
- The middleman takes title and assumes risk of loss

In these three-party transactions is not unusual for title to pass from the manufacturer to the middleman and from the middleman to the importer simultaneously, so-called *flash title*. This factor may be viewed as an indication that the transaction between the manufacturer and the middleman was not a *bona fide* sale. The Headquarters Office addressed this issue in HQ 546253 (July 9, 1997), holding that even though title passes simultaneously, there may be a sale where the other factors support that conclusion. Recently, Customs has been taking a closer look at the title issue and denying first sale status where the middleman does not hold title and risk of loss for even a brief period. At a minimum, Customs will examine the documentation and the transaction flow with obsessive vigor. Where the middleman and the importer are related, the likelihood that first sale will be denied increases. *See*, HQ H273866 (April 5, 2017).

Some of the other factors that will be examined by Customs in this context are:

- Whether the middleman provides instructions to the manufacturer
- Whether the middleman is free to sell the merchandise at any price it desires
- Whether the middleman is able to sell to anyone without consulting the manufacturer
- Whether the middleman could order for its own inventory

Affirmative answers to these questions indicate that there is a sale between the manufacturer and the middleman. Negative answers suggest that the middleman is a selling agent acting on behalf of the manufacturer.

C. Sale for Export. Once it is established that there was a sale from the manufacturer to the middleman, the next step is to determine whether that sale was one for exportation to the United States. The question is whether, at the time the merchandise was purchased from the manufacturer by the middleman, the goods were destined for export to the United States. Affirmative answers to the following questions may be sufficient to satisfy this requirement.

- Does the middleman's purchase order specify delivery to the United States?
- Will the merchandise carry trademarks owned by the importer?
- Is the merchandise shipped to the buyer by the manufacturer?
- Do carton markings indicate shipment to the buyer in the United States?
- Is the merchandise labeled for distribution in the United States?

D. Validity of the Price. Once it is established that there was a sale and that the sale was one for exportation to the United States, the validity of the price is examined. Validity is based on whether the middleman and manufacturer are related and whether any non-market influences affected the price between the parties, *i.e.*, did the transaction occur at “arm’s length”.

Where the manufacturer and the middleman are not related parties as that term is defined in the value statute, there is a presumption that the sale was at “arm’s length.” T.D. 96-87, 30 Cust. Bull. 414, 416 (1997).

Although the court in *Nissho Iwai* seems to have found two separate requirements, in practice, where the manufacturer and middleman are not related, the non-market influences factor is not considered. There are, however, possible non-market influences, including tie-in sales, and set-offs for defective merchandise claims, which could have an adverse impact on the validity of a first sale appraisalment.

E. Related Party Transactions.

The value statute authorizes Customs to challenge the validity of prices in related party transactions.²

When the middleman and the manufacturer are related, Customs may require that the importer demonstrate that the relationship did not affect the price. This may be accomplished in a number of ways. These include establishing that the manufacturer’s markup is similar to that of other manufacturers in the same industry and region in sales to third parties or that the manufacturer’s price to the middleman is sufficient to ensure the recovery of all costs plus a profit equivalent to the manufacturer’s overall profit realized over a representative period.

In some situations it may be prudent to obtain the opinion of a qualified accounting firm that the price is acceptable.

If the middleman indicates that it and the manufacturer are not related, the importer should obtain a written certification to that effect.

F. Documentation.

In order to claim a first sale appraisalment successfully, the importer must be able to present to Customs a complete document trail describing the entire transaction. The documentation should include: purchase orders, invoices, proof of payment, contracts and any additional documents, such as correspondence, that

² A middleman is related to the manufacturer when; a) it owns, directly or indirectly, five percent or more of the voting stock of the manufacturer; b) the manufacturer owns directly or indirectly, five percent or more of the voting stock of the middleman; or, c) they are under common control.

demonstrates how the parties dealt with one another. The documentation must cover both transactions, manufacturer to middleman and middleman to importer.

The middleman's cooperation is crucial. The middleman must be willing to disclose its dealings with the manufacturer, including price and sales terms and to provide proof of payment.

The type of documentation necessary is illustrated in HQ H036078 (December 18, 2009). *Compare*, HQ H002823 (July 22, 2009)(documents held insufficient).

Customs has surfaced a proposed listing of the types of documents, including the middleman's financial records that it may need to examine to verify the middleman's price. The expectation is that these documents will be required only in the audit context and when the middleman and manufacturer are related. Whether these expectations will be realized and whether middlemen will be willing to cooperate is unclear. The proposal is not expected to be final or in effect until sometime in 2015.

G. Assists/Royalties.

Assists supplied by the middleman or the importer to the manufacturer are added to the manufacturer's price.

The treatment of royalties in these transactions is clearer. Royalties paid to the seller, whether as part of the price, or separately, are dutiable. Royalties paid to a party not involved in the transaction generally are not dutiable.

H. Dealing with Customs.

In deciding whether to assert that the manufacturer's price represents transaction value, you must consider whether, and how, to approach the subject with Customs.

By this time, the legal rules are relatively well understood. Accordingly, unless there are peculiar circumstances, it should not be necessary to obtain a ruling. Indeed, Customs has discouraged importers from seeking rulings on this issue.

The next question is whether port officials should be approached. Our view is that, as a general concept, local officials should be brought into the picture. This need not be an elaborate presentation, however. A simple letter stating that you intend to enter merchandise on the basis of the first sale principle should be sufficient.

We recommend that in making entry, both the manufacturer's invoice and the middleman's invoice be presented to Customs. By presenting both invoices to Customs, the importer makes it clear that it is asserting a first sale appraisalment. It

is up to Customs to request further information and documentation or otherwise challenge on the first cost appraisalment.

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