Top Valuation Strategies and Schemes: What’s Legal, What’s Not, and What Puts You at Risk

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Valuation Strategies vs. Schemes
Examples Ripped from the Headlines

- My supplier segregates product design separately from product cost so I only pay duty on the product.
- My related party parent purchases product from a 3rd party and sells it to me at cost under a first sale valuation method.
- My parent company carves out SG&A from the price of the goods and bills me separately for the SG&A as a service fee.
- My supplier tells me that he can carve out 20% off the selling price of the goods and bill it to me separately as an agency fee by which he can work for me to find new suppliers.

Valuation Strategies and Schemes - Topics

- Switching Basis of Appraisement
- Separating Payments
- Value Deductions
- Reducing Related Party Transfer Pricing
- First Sale
- Price Unbundling
  - Buying Agency Commissions
  - Management and Service Fees

SWITCHING BASIS OF APPRAISEMENT
YOU CAN'T JUST PICK THE ONE YOU WANT

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Customs Valuation Hierarchy – 19 CFR 152.101

- **Transaction Value** – price actually paid or payable (PAPP) plus certain additions
- Transaction Value of Identical - based on the transaction value of previously imported identical merchandise
- Transaction Value of Similar Merchandise - based on the transaction value of previously imported similar merchandise
- Deductive Value - selling price in the U.S. less certain post-importation costs
- Computed Value - Foreign supplier cost information for materials, processing, profit, general expenses, and U.S. assists and packing costs
- Value if Other Values Cannot Be Determined or Used (Fallback Method) - methodology derived from one of the first four methods with the rules being reasonably adjusted

Basis of Appraisement Rules

- Basis of Appraisement is a Hierarchy!
  - Exception – Computed value can be elected in front of deductive value
- <u>Trend 1</u> - Moving from transaction value to computed value
  - Has to be a valid reason to move out of transaction value
    - No sale – e.g., consignment, foreign owned inventory
    - Related Party sale doesn't meet circumstances of sale test or test values
  - No identical or similar TVs
- <u>Trend 2</u> – Skipping evaluation of deductive value to move to fallback
  - If imports are sold at or about time of importation, then deductive value cannot be skipped

SEPARATING SUPPLIER PAYMENTS
THE GOOD, THE BAD, AND THE FRAUDULENT

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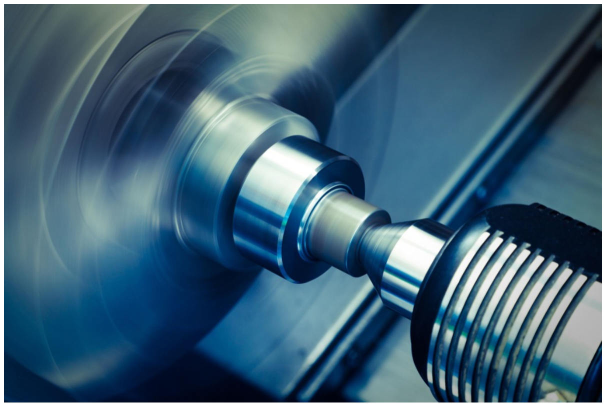
Transaction Value

- “Price Actually Paid or Payable” (PAPP)
  - The total payment (whether direct or indirect) for the imported merchandise from the buyer to the seller.
  - There is a general presumption that <u>all payments</u> from the buyer to the seller are dutiable, if <u>related to the imported merchandise</u>.
  - Generra Sportswear Case
- Chrysler case – Payments unrelated to the goods

Additional Payments Made to the Seller



- Tooling, Die, Mold, or Equipment Payments
- Material acquisition charges (spot buy charges, metal surcharges, and precious metal charges)
- Design and development payments
- Transfer price adjustments
- Warehousing Fees
- Freight Charges
- Selling, General, and Administrative Expenses (SG&A)
- Corporate Allocations
- Management Fees

Additions to Value

- Commissions (Selling)
- Royalties
- Assists
- Packing Costs
- Proceeds

<u>Assist</u> - any of the following if supplied directly or indirectly, whether free of charge or at reduced cost, by the buyer of imported merchandise for use in connection with the production or the sale for export to the United States of the merchandise:

i. Materials, components, parts and similar items incorporated in the imported merchandise.

ii. Tools, dies, molds and similar items used in the production of the imported merchandise.

iii. Merchandise consumed in production of the imported merchandise.

iv. Engineering, development, artwork, design work, and plans and sketches that are undertaken <u>elsewhere than in the United States</u> and are necessary for the production of the imported merchandise.

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Separate Payments

- Separate payments are a normal part of business and there is nothing inherently wrong with separating supplier payments provided:
  - Additional dutiable payments are declared (at entry or via reconciliation)
  - There is no intent to deceive CBP on declaring correct value
- But having separate payments does create significant **risk** in many instances:
  - Import compliance team (if there is one) and the Customs broker often have little to no visibility
  - Need to have procedures to identify, quantify, and declare additional dutiable payments (e.g., reconciliation)
- Some supplier payments are not dutiable provided certain criteria and documentation requirements are met (more on this later)
  - International freight, payments unrelated to the goods, etc.

VALUE DEDUCTIONS
DOCUMENTATION IS KEY

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Exclusions/Deductions from Transaction Value

INTERNATIONAL FREIGHT

POST-IMPORTATION CHARGES

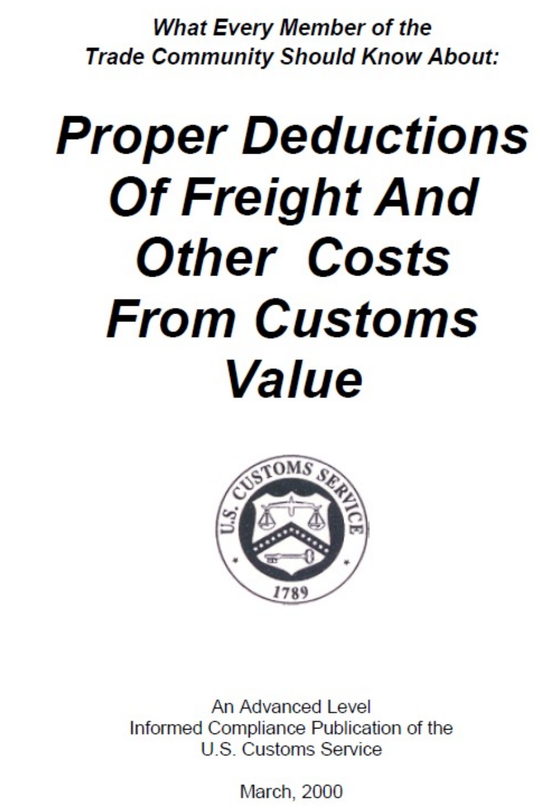
TRANSPORTATION OF MERCHANDISE AFTER IMPORTATION

DUTIES AND TAXES PAYABLE AFTER IMPORTATION

- **Deduction Requirements:**
  - Must be included in the price
  - Must meet documentation requirements
- **Best Practices:**
  - Broker Communication
  - Recordkeeping
  - Auditing

International Freight

- 19 CFR 152.102(f) states that the price actually paid or payable is exclusive of any charges, costs, 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.
- CBP regulations allow for the actual freight to be deducted from the declared value provided that certain requirements are met.


What Every Member of the Trade Community Should Know About:

Proper Deductions Of Freight And Other Costs From Customs Value

U.S. CUSTOMS SERVICE 1789

An Advanced Level Informed Compliance Publication of the U.S. Customs Service

March, 2000

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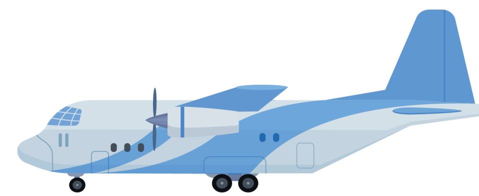
Freight Deduction Compliance Errors

- Freight estimates are utilized instead of actual costs
  - Freight bill doesn't match freight deduction
  - No documentation from freight provider (e.g., costed BOL available to substantiate actual costs)
- Freight charges are separately billed by supplier without supporting documentation (PAPP issue)
- The cost of international freight and/or insurance was not part of the invoice value, but a freight deduction was taken on entry
  - A "double deduction" of freight



Foreign Inland Freight

Foreign inland freight may be considered incident to the international shipment of that merchandise within the meaning of 152.102(f) if they are identified separately and placed with a carrier for through shipment to the United States, which is documented with a through bill of lading.

Sales other than Ex Works (e.g., FOB) - Generally Part of the Transaction Value whether or not itemized separately

Ex Works – Not part of the value (i.e., nothing to deduct)

REDUCING RELATED PARTY TRANSFER PRICING
DUTY MITIGATION OR DUTY EVASION?

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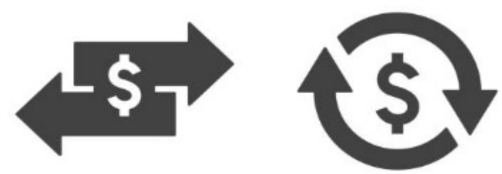
Transfer Pricing

- Companies establish transfer pricing (i.e., selling prices) for sales between related parties
  - Informal Agreement
  - Transfer Pricing Agreement, which could include a transfer pricing matrix
    - Cost Plus Examples
      - Europe to U.S. – Standard Cost + 80%
      - Asia to U.S. – Standard Cost + 65%
    - Resale Minus Example
      - Resale Price – 15%
        - Importer's selling price to its customer – commission/margin
        - Often used where price lists are established for end customers
  - Transfer Pricing Study and Advance Pricing Agreements
    - Frequently used as basis of setting pricing/markups
    - Can result in transfer price adjustments/true-ups if target profit is not achieved



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Transfer Pricing Studies/Advance Pricing Agreements (APA)

- Transfer Pricing Study - Provides the economic analysis necessary to support its transfer pricing decisions in case the company is challenged by the IRS or other foreign taxing authority.
- Advance Pricing Agreement – Unilateral, Bilateral, or Multilateral Agreement between the company and the IRS and/or other foreign taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time.

Transfer Price Adjustments

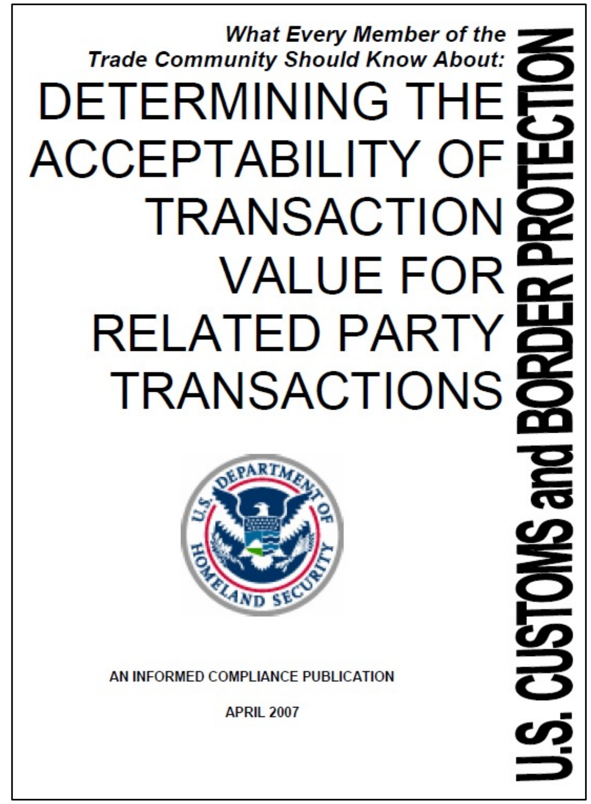
- Can occur based on transfer pricing agreements and studies
- Quarterly, Annually, or other Defined period
- Product, Segment, or Company specific
- Adjustments can be increases or decreases to the cost
  - Can be very significant
  - Undeclared transfer price adjustments are a common audit finding
  - Reconciliation often required to declare increases/decreases
  - Does the transfer price policy meet the requirements of a “fixed formula” under HQ W548314? (required to take reductions)

CBP Position On Transfer Pricing Studies

- “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.”


What Every Member of the Trade Community Should Know About:

DETERMINING THE ACCEPTABILITY OF TRANSACTION VALUE FOR RELATED PARTY TRANSACTIONS

U.S. DEPARTMENT OF HOMELAND SECURITY

AN INFORMED COMPLIANCE PUBLICATION

APRIL 2007

U.S. CUSTOMS and BORDER PROTECTION

Related Parties – 19 CFR 152.103(j)

- *Limitations on use of transaction value—(1) In general*. The transaction value of imported merchandise will be the appraised value only if:
- (iv) The buyer and seller are not related, or the buyer and seller are related but the transaction value is acceptable.
- The burden is on the importer to demonstrate that the relationship does not affect the price.

Acceptability of Transaction Value

- So how do I demonstrate that the value does not affect the price?
  - 19 CFR 152.103(j)(2) - The transaction value between a related buyer and seller is acceptable if an examination of the circumstances of sale indicates that their relationship did not influence the price actually paid or payable, or if the transaction value of the imported merchandise closely approximates a “test value”:
  - (A) The transaction value of identical merchandise; or of similar merchandise, in sales to unrelated buyers in the United States; or
  - (B) The deductive value or computed value of identical merchandise, or of similar merchandise.

Test values are not going to happen!

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Circumstances of the Sale

To support transaction value as an acceptable basis of appraisement, the importer must show that through an examination of the "circumstances of sale," the relationship between the buyer and seller did not influence the price of the imported merchandise.

Circumstances of the Sale Tests: <u>Importer needs to satisfy only one of the tests</u>

1	2	3
The price was settled in a manner consistent with the normal pricing practices of the industry in question;	The price was settled in a manner consistent with the way the seller settles prices for sales to buyers who are not related to it; or	The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's (meaning parent company's) overall profit realized over a representative period of time in sales of merchandise of the same class or kind.

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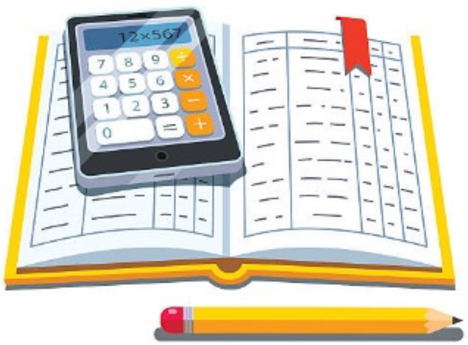
Circumstances of the Sale – Test 1

If the price has been settled in a manner consistent with the normal pricing practices of the industries in question.

- For example, the price of imported copper is determined based on the London Metals Exchange price at the date of export, which is consistent with industry practice.
- The importer has a transfer pricing study that establishes that the profits recognized by the company are in line with the pricing practice of the industry and the industry is specific to sales of comparable items.

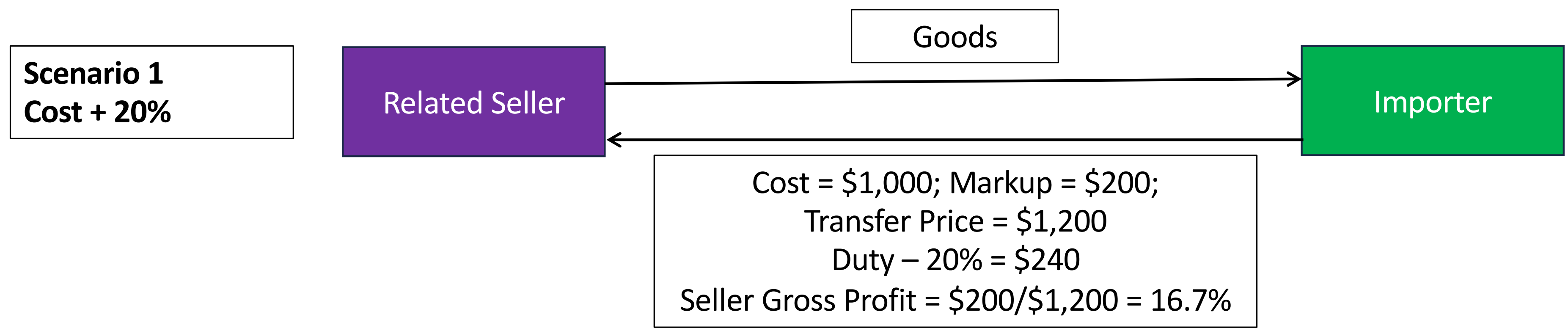
Circumstances of the Sale – Test 3

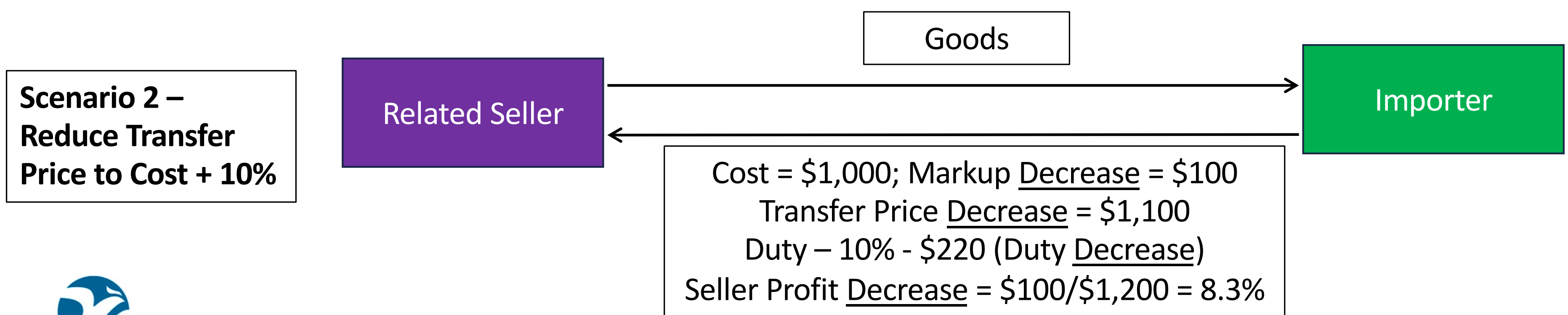


If it is shown that the price is adequate to ensure recovery of all costs plus a profit, which is equivalent to the firm's overall profit realized over a representative period of time (e.g., on an annual basis), in sales of merchandise of the same class or kind, this would demonstrate that the price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

- This is where most importers end up.
- Requires a comparison of the profit recognized on import transactions versus firm's overall profit recognized.
  - Firm's overall profit generally means that of the parent company.
  - You can't necessarily take the overall parent profit margin – it must be goods of the same class or kind as those imported.

Reducing the Intercompany Transfer Price





How Can I Reduce the Transfer Price?

- Importer must be able to meet <u>one</u> of the circumstances of sale tests after the reduction (example – profit on sale went down from 16.7% to 8.3%)
  1. Related seller's profit (e.g., 8.3%) still falls within interquartile range of other sellers in the same country on goods of the same class or kind
  2. Related seller sells goods to unrelated 3rd parties in the U.S. at the same profit (e.g., 8.3% - selling price of $1,100)
  3. Profit recognized on sale (e.g., 8.3%) by related seller has to meet or exceed the parent company's profit on sales of goods of the same class or kind
- Due to the increase in duties in 2025, most importers would either have to increase their selling prices in the U.S. or the foreign related seller would have to decrease the intercompany transfer price on sales to the U.S.; otherwise, the U.S. affiliate might fall outside the acceptable profit range for tax purposes, which could require a significant downward transfer price adjustment by the foreign seller for the importer to fall within the acceptable profit range

FIRST SALE VALUATION
GET READY FOR THE SCRUTINY

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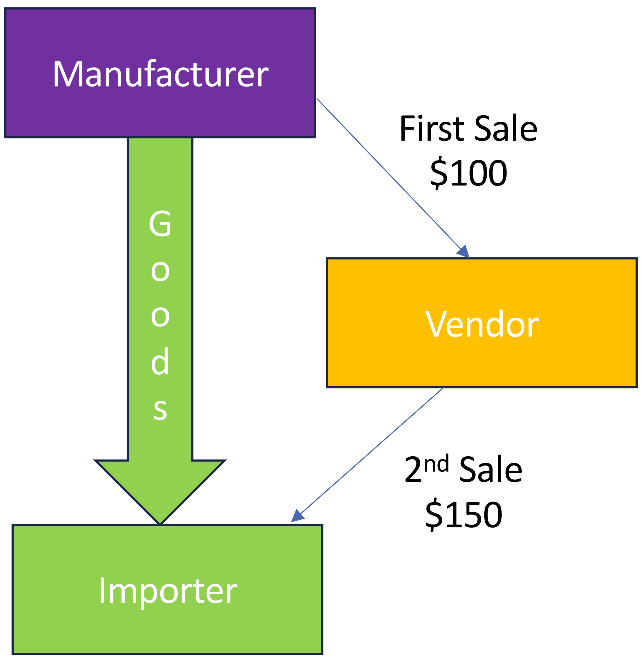
Elements of First Sale



The first sale must be a bona fide sale from the manufacturer/seller to the middleman.

Merchandise must be clearly destined for the United States at the time of the first sale.

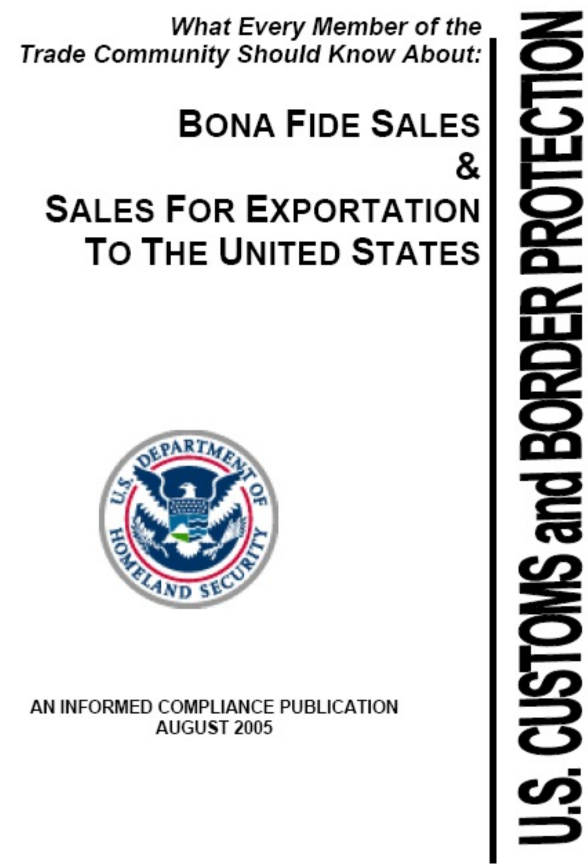
The first sale price must be an arm’s length price.

Statutory additions to the price actually paid or payable must be included in the first sale price.

The 2nd Sale, and all subsequent sales, must also be a viable Transaction Value (bona fide sale for export to the U.S and arm’s length price).

First Sale Scrutiny & Challenges

- CBP has been very strict on recent first sale rulings
- Bona fide sale – flash title is being heavily scrutinized
- Clearly destined for U.S. - Inconsistencies in documentation can lead to a rejection of first sale applicability
  - Incoterms
  - PO vs. Invoice vs. Contract
- Arm's length – substantiating related party pricing is challenging
- Additions to value – importers frequently overlook assists and other additions to value paid/provided by the middleman to the manufacturer


What Every Member of the Trade Community Should Know About:

BONA FIDE SALES
&
SALES FOR EXPORTATION
TO THE UNITED STATES

AN INFORMED COMPLIANCE PUBLICATION
AUGUST 2005

U.S. CUSTOMS and BORDER PROTECTION

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PRICE UNBUNDLING
BUYING COMMISSIONS & MANAGEMENT FEES
USUALLY DIFFICULT AND OFTEN IMPOSSIBLE

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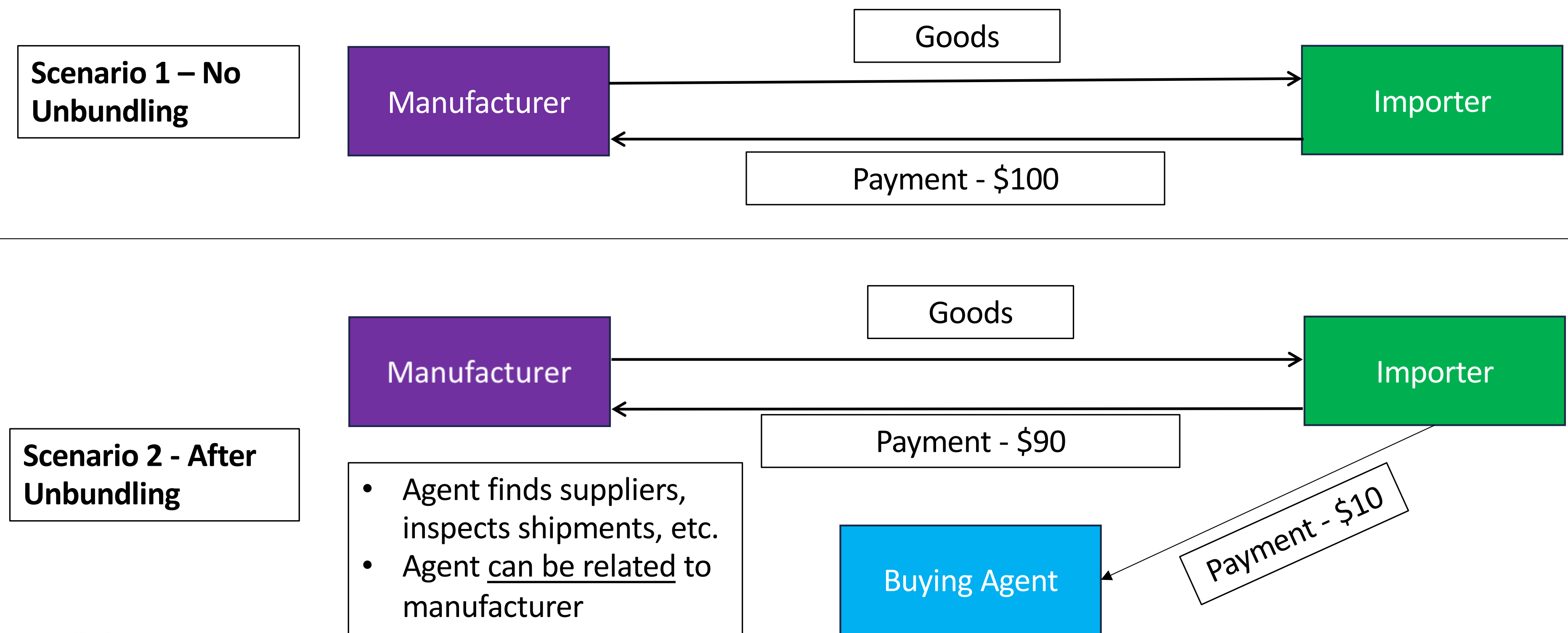
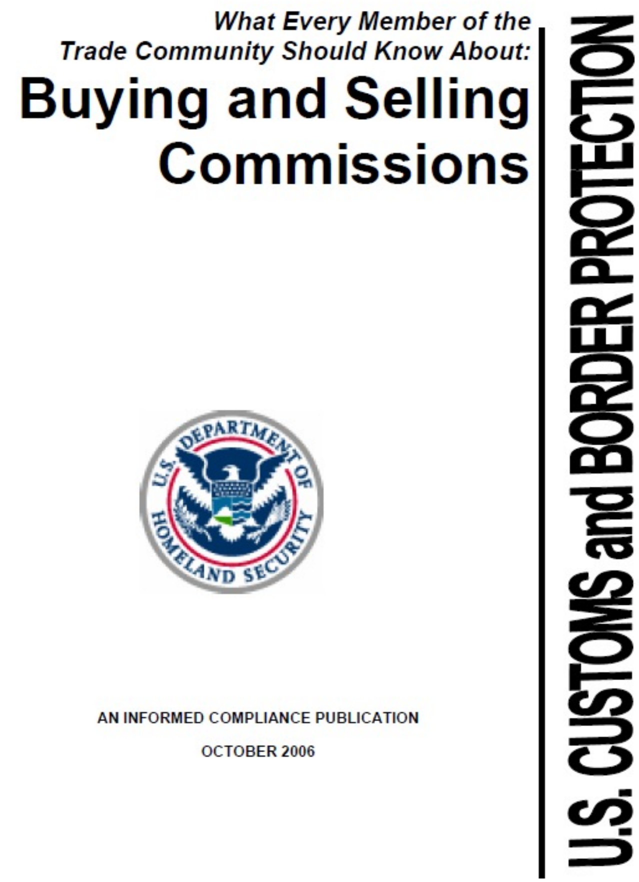
Unbundling an Import Transaction with a Buying Agent



Buying Commissions

- Buying commissions are not part of the value provided that the agent acts as a bona fide buying agent
- Agent performs limited activities – locating suppliers, placing orders at buyer's instruction, inspecting merchandise…
- Agent must be acting on behalf of the buyer and not the seller
- Agent should not be acting as an independent seller
- Buying agency agreement should be in writing and identify activities to be performed by agent
- "The importer has the burden of proving the existence of a bona fide buying agency relationship. Absent sufficient proof, commissions paid by the importer will be included in the transaction value of the imported merchandise."



What Every Member of the Trade Community Should Know About:

Buying and Selling Commissions

AN INFORMED COMPLIANCE PUBLICATION

OCTOBER 2006

U.S. CUSTOMS and BORDER PROTECTION

Payments Unrelated to the Goods – Management/Service Fees

CBP has ruled that certain management/service fees are not part of the customs value if the payment is not related to the goods but this is **very difficult** to substantiate:

- Must be tied directly to expenses incurred by the supplier related to activities unrelated to the goods
- The importer must have access to the supplier's accounting records.
- There can be no nexus between the service fee and payment of the goods.
- The importer cannot book the payments to cost of sales.
- The payments must be made and recorded separately.
- Activities performed should be documented in an intercompany service agreement.

Examples of some activities ruled not related to CBP value (provided certain conditions were met):

- Accounting
- Advertising
- Customer Relations
- Finance
- External/Internal Audit Support
- Human Resources
- Information Technology
- Legal
- Sales
- Supply Chain
- Tax

Summary Advice on Valuation Strategies

- Ensure you have processes to capture additions to value and separate payments.
- Be wary of suppliers presenting ways of saving you on duty.
- The substantiation of related party pricing is one of the most overlooked areas of testing by importers.
  - Be mindful of transfer price adjustments/true-ups.
- Documentation is very important for valuation deductions, exclusions, first sale claims, etc.

Thank You