Customs Related-Party Pricing for Trade, Tax, Finance & Accounting Professionals

Presented by:

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2025 ATCC Conference

Related Party Valuation Topics

- Transaction Value
  - Value 101 recap relevant to related party transactions
- Related Party Implications and Risks
- Transfer Pricing
- Related Party Circumstances of Sale Testing
- Related Party Testing Case Study

TRANSACTION VALUE

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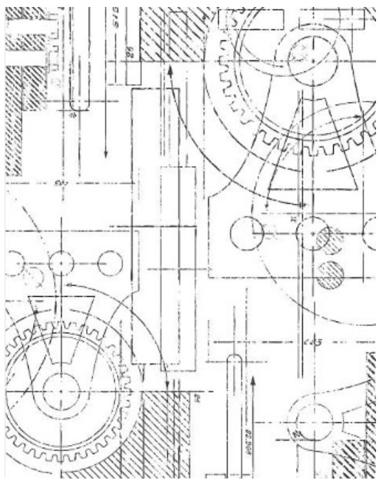
Customs Valuation Hierarchy – 19 CFR 152.101

- **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

Value 101 Recap - 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 related to the imported merchandise.
  - Generra Sportswear Case

Value 101 Recap - Additional Payments Made to the Seller



- Tooling, Die, Mold, or Equipment Charges
- Deposits and milestone payments
- Material acquisition charges (spot buy charges or metal surcharges)
- Rework charges
- Testing charges
- Design or development charges
- **Transfer price adjustments (true-ups)**
- Corporate Allocations
- Management Fees

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Value 101 Recap - Additions to Value

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

Transaction Value
=
PAPP
+
CRAPP

Value 101 Recap - Assists

- **Assist -** means 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 elsewhere than in the United States and are necessary for the production of the imported merchandise.

19 CFR 152.103 - Transaction Value

- Transaction Value
  - Price actually paid or payable for the merchandise when sold for exportation to the United States, plus certain statutory additions to the price.
- All imports must be appraised under transaction value unless there is a limitation that precludes the use of transaction value (e.g., transactions between related parties that are not at arms length)

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Transaction Value – 19 CFR 152.102(g)

- When are Parties Considered "Related"?
  - Members of the same family;
  - Any officer or director of an organization and such organization;
  - 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;
  - 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 such organization; and,
  - Two or more persons directly or indirectly controlling, controlled by, or under common control with, any person.

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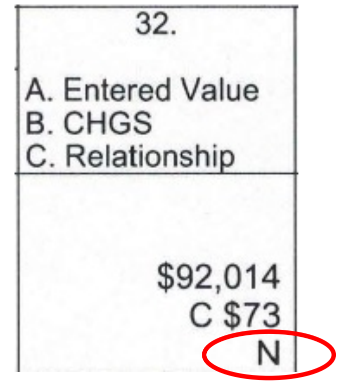
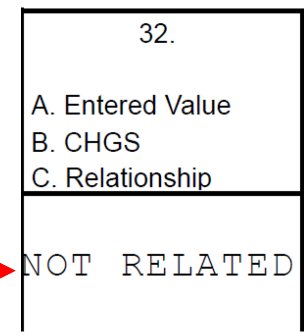
Related Party Indicator

- Per the CBP Form 7501 Instructions for Box 32 C:
  - Record whether the transaction was between related parties, as defined in 19 CFR 152.102(g), by placing a "Y" in the column for related and an "N" for not related (the words "related" and "not related" may be used in lieu of "Y" or "N").
  - Mistakes in the related party indicator are a red flag to CBP and are an indication of the following:
    - Importer may have valuation issues.
    - Importer is not demonstrating reasonable care and likely does not have a broker management or post-entry audit process.
    - Importer may have other serious issues.
    - Aggravating risk factor (CF-28/Audit)


32.

A. Entered Value
B. CHGS
C. Relationship

$92,014
C $73
N


32.

A. Entered Value
B. CHGS
C. Relationship

NOT RELATED

RELATED PARTY IMPLICATIONS AND RISKS

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Related Party Valuation Risks – CBP Audits

- Preliminary Assessment of Risk – What is CBP going to look at with respect to related parties?
  - Dun and Bradstreet reports, SEC filings, importer website, artificial intelligence tools, etc.
    - Identification of related parties
  - Importer Entry Line Data - Up to 5 Years
    - Volume of Activity with related parties
    - Discrepancies in the related party indicator for vendors
    - Types of HTS numbers utilized with related party transactions
      - Potential ADD/CVD impact
      - Potential 232/301 impact
    - Related party transactions with MX maquiladoras
      - Is the company filing reconciliation entries?

Related Party Valuation Risks – CBP Audits

- If CBP is looking at related party transactions in an audit, they are going to assume the importer's risk of valuation issues is high and they will have valuation issues.
  - Imports from related entities in Mexico should likely be appraised under computed value and the company should be filing reconciliation entries.
  - The importer likely has transfer price adjustments on its related party transactions.
  - The importer likely has additional payments or other additions to value (royalties, assists, other payments).
  - The importer should likely be flagging entries for value reconciliation.
  - The importer probably hasn't tested the validity of its related party transactions.

TRANSFER PRICING

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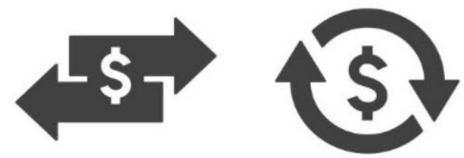
Transfer Pricing

- 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



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 policy meet the requirements of a “fixed formula” under HQ W548314?

HQ W548314 – Fixed Formula Requirements for Transfer Price Adjustments

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;
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.

RELATED PARTY CIRCUMSTANCES OF SALE TESTING

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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.

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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.

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:

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.

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.

Transfer Pricing Studies – Frequent Issues

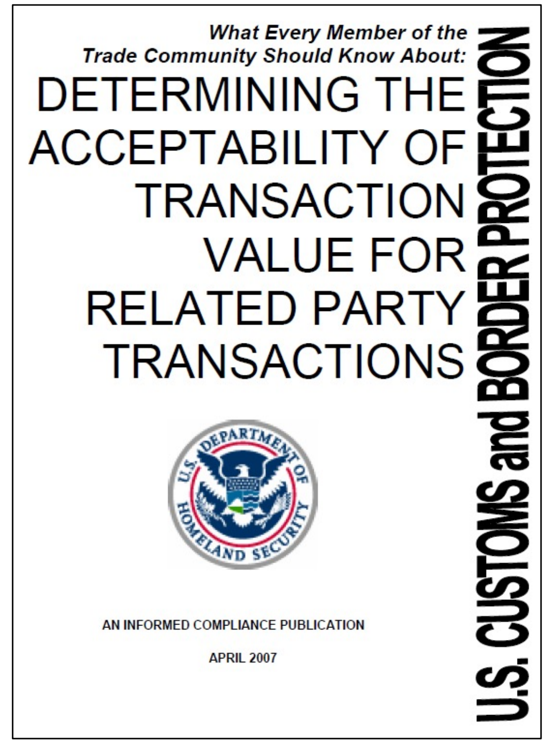
- The related seller is not following the transfer pricing policy
- The transfer pricing policy or study is outdated and no longer in line with company transfer pricing practices
- Study was not approved by IRS (less weight applied by CBP)
- Comparable products/companies were not of the same class or kind
- Study evaluates profits on comparable companies in the U.S. rather than selling prices to the U.S.
- Study used a profit analysis methodology that is not consistent with CBP criteria
  - IRS Comparable Profits Method (CPM) - CPM compares the profitability of the tested party to that of comparable companies that engage in similar business activities under similar circumstances but not necessarily goods of the same class or kind
- Importer relied on TP Study/APA completed for tax purposes and didn’t do any further analysis of the circumstances of sale

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

AN INFORMED COMPLIANCE PUBLICATION

APRIL 2007

U.S. CUSTOMS and BORDER PROTECTION

Transfer Pricing Studies for CBP Purposes

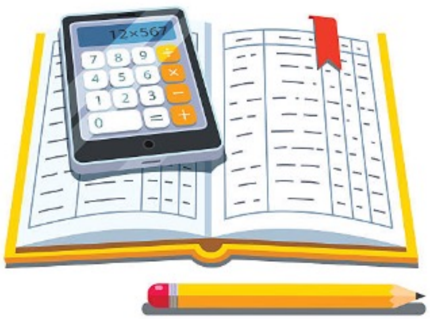
Comparable foreign companies can be screened based on CBP criteria instead of IRS criteria	• Similar companies in country of related affiliate seller (Controlled/Uncontrolled) • Goods of the same class or kind • Operating profit recognized falls within interquartile range of comparable companies
Risks	• Typically Expensive • Difficulty in identifying comparable companies from country of related party • No Guarantee of Successful Results

Circumstances of the Sale – Test 2

If the price has been settled in a manner consistent with unrelated buyers.

- If the seller sells the same products to other unrelated U.S. companies at the same price/markup.
- Sales to other countries or sales within the seller's home market will not be considered.

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.

What Profit Do I Use?

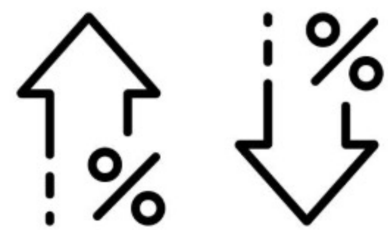
Gross Profit – Although it is not necessarily ideal, gross profit can be used in a circumstances of sale test, especially in instances where an operating profit comparison is unavailable.

Operating Profit – This is the preferred method of profit to be utilized in a circumstances of sale test. However, there are instances where operating profit cannot be calculated at a product level.

Net Profit – This level of profit would typically not be utilized in a circumstances of sales test, as it includes miscellaneous financial costs and extraordinary expenses that are not related to the products themselves and would typically not be available at a product level.

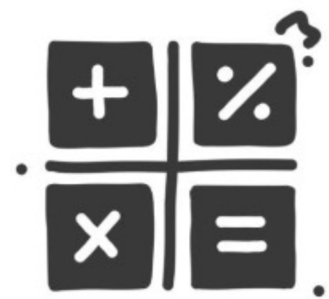
Gross Profit Calculations

- Gross Profit Calculation:
  - Financial Statement: Sales – Costs of Goods Sold (COGS)
  - Transaction: Selling Price – Manufacturing Costs
    - Manufacturing costs typically come from a costed Bill of Material (BOM)
- Gross Profit Margin (%):
  - Financial Statement: Gross Profit/Sales
  - Transaction: Gross Profit/Selling Price



Operating Profit Calculations

- <u>Operating Profit Calculation</u>:
  - Financial Statement: Gross Profit – Total Operating Costs
  - Transaction: Gross Profit – Operating Costs
    - In certain instances, operating costs are calculated on the Bill of Material (BOM); however, this figure typically needs to be determined by calculating an operating expense ratio (Total Operating Expenses/Sales) from the factory financial statement (if available).
- <u>Operating Profit Margin (%)</u>:
  - Financial Statement: Operating Profit/Sales
  - Transaction: Operating Profit/Selling Price



RELATED PARTY TESTING CASE STUDY

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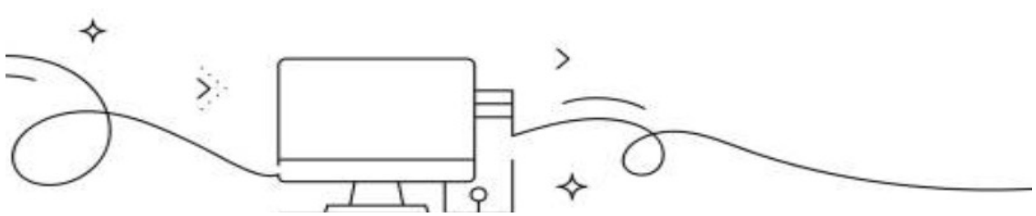
AFH U.S. Computers Inc.

- You are the Import Compliance Manager at AFH U.S. Computers Inc. and are undergoing an audit from CBP.
- CBP has requested that the company substantiate that transaction value is the appropriate basis of appraisement for the related party entry in question.
- Other Notes:
  - AFH U.S. Computers Inc. and the related supplier AFH Asia Computers Inc. are related affiliates under the parent company AFH World Computers Inc., which is based on the U.S.
  - The related supplier does not sell to unrelated companies in the U.S.
  - There is no information available that would prove that the transaction follows the normal pricing practices of the industry.
  - Questioned entry: $150,000 entered value; CO = China
  - Invoice, purchase order, and payment records support 500 units * $300 per computer = $150,000.

Case Study Details

Transfer Pricing Policy:

- Each AFH World Computers Inc. company, group and division must adhere to the transfer pricing policies contained in this Transfer Pricing Policy. The Transfer Pricing Policy is generally based on compliance with the OECD “Transfer Pricing Policies for Multinational Enterprises and Tax Administrations” and is subject to the Transfer Pricing laws in each country.
- The Global Tax/Transfer Pricing Office should be contacted with any questions or conflicts that may arise in interpreting and applying the Policy.
- The OECD transfer pricing methodologies have been evaluated by the Global Tax/Transfer Pricing Office. The Cost-Plus Method has been identified as the method that evaluates the arm’s length nature of the transfer prices for AFH World Computers Inc.



Case Study Details

Global Transfer Pricing Mark Up Table:

The percentage mark up below will be applied to the total cost of manufacturing to include cost of: material, labor, manufacturing overhead, and other variable manufacturing costs.

Region	**Europe**	**Asia**	**Australia**
Total Cost Mark Up % - Sales to **U.S.**	58.00%	60.00%	52.50%
Total Cost Mark Up % - Sales to **Europe**	65.00%	48.00%	62.00%
Total Cost Mark Up % - Sales to **Australia**	70.00%	55.00%	63.00%

AFH Asia Computers Inc. - Shenzen
Bill of Materials - Desktop Computer 7600 Series

		7600-1660
	Cost Component	Cost
1	Material Cost	$ 160.00
2	Material Overhead Cost	$ 5.00
3	Direct Labor Costs	$ 15.00
4	Machine Cost	$ 3.00
5	Manufacture Overhead Cost	$ 1.50
6	Variable Cost	$ 3.00
	Total	**$ 187.50**

Case Study Details

AFH Asia Computers Inc. - Shenzen Income Statement	2019
Revenue	$ 10,500,000.00
Cost of sales	$ 6,150,000.00
Gross profit	**$ 4,350,000.00**
Expenses	
Research & Development	$ 600,000.00
Selling and general administrative expenses	**$ 1,350,000.00**
Selling expenses	$ 675,000.00
General administrative expenses	$ 675,000.00
Other operating income	$ (50,000.00)
Other operating expenses	$ 475,000.00
TOTAL OPERATING EXPENSES	**$ 2,375,000.00**
Financial income, net - Non Operating	$ (150,000.00)
Interest income	$ (175,000.00)
Interest expenses	$ 25,000.00
INCOME BEFORE INCOME TAXES	**$ 2,125,000.00**
INCOME TAX EXPENSES	$ 145,000.00
INCOME FROM CONTINUING OPERATIONS AFTER TAXES	**$ 1,980,000.00**

AFH World Computers Inc. Income Statement	2019	Industry Segments			
	Consolidated	Desktop Computers (3 factories)	Home Electronics	Electrical Sensors	Total
Revenue	$ 31,000,000.00	$ 23,000,000.00	$ 5,000,000.00	$ 3,000,000.00	$ 31,000,000.00
Cost of sales	$ 18,450,000.00	$ 15,000,000.00	$ 2,000,000.00	$ 1,450,000.00	$ 18,450,000.00
Gross profit	$ 12,550,000.00	$ 8,000,000.00	$ 3,000,000.00	$ 1,550,000.00	$ 12,550,000.00
Expenses					
Research & Development	$ 1,800,000.00	$ 1,500,000.00	$ 200,000.00	$ 100,000.00	$ 1,800,000.00
Selling and general administrative expenses	$ 3,550,000.00	$ 3,100,000.00	$ 355,000.00	$ 95,000.00	$ 3,550,000.00
Selling expenses	$ 1,975,000.00	$ 1,900,000.00	$ 55,000.00	$ 20,000.00	$ 1,975,000.00
General administrative expenses	$ 1,575,000.00	$ 1,200,000.00	$ 300,000.00	$ 75,000.00	$ 1,575,000.00
Other operating income	$ (1,350,000.00)	$ (975,000.00)	$ (325,000.00)	$ (50,000.00)	$ (1,350,000.00)
Other operating expenses	$ 975,000.00	$ 825,000.00	$ 100,000.00	$ 50,000.00	$ 975,000.00
TOTAL OPERATING EXPENSES	$ 4,975,000.00	$ 4,450,000.00	$ 330,000.00	$ 195,000.00	$ 4,975,000.00
Financial income, net - Non Operating	$ (450,000.00)	$ (425,000.00)	$ (15,000.00)	$ (10,000.00)	$ (450,000.00)
Interest income	$ (525,000.00)	$ (475,000.00)	$ (30,000.00)	$ (20,000.00)	$ (525,000.00)
Interest expenses	$ 75,000.00	$ 50,000.00	$ 15,000.00	$ 10,000.00	$ 75,000.00
INCOME BEFORE INCOME TAXES	$ 8,025,000.00	$ 3,975,000.00	$ 2,685,000.00	$ 1,365,000.00	$ 8,025,000.00
INCOME TAX EXPENSES	$ 435,000.00	$ 350,000.00	$ 50,000.00	$ 35,000.00	$ 435,000.00
INCOME FROM CONTINUING OPERATIONS AFTER TAXES	$ 7,590,000.00	$ 3,625,000.00	$ 2,635,000.00	$ 1,330,000.00	$ 7,590,000.00

Key Questions

- Did the supplier properly follow the company's transfer pricing policy?
- Transaction:
  - What is the gross profit margin?
  - What is the operating profit margin (if available)?
- Financial Statements:
  - Which financial statement should we use for our circumstances of sale comparison?
  - What is the gross profit margin?
  - What is the operating profit margin?
- Can we support the validity of using transaction value?

Answer: Transfer Pricing Policy

- **Question:** Did the supplier properly follow the company's transfer pricing policy?
- **Analysis:**
  - Per the transfer pricing policy, the mark-up for sales from Asia to the U.S. should be cost + 60%.
  - Per the Bill of Material, the manufacturing costs for this item are $187.50.
  - $187.50 * 1.6 = $300.00
  - This matches the unit price on the invoice of $300/unit.
- **Answer:**
  - Yes, the supplier followed the transfer pricing policy.

AFH Asia Computers Inc. - Shenzen
Bill of Materials - Desktop Computer 7600 Series

		7600-1660
	Cost Component	Cost
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5	Manufacture Overhead Cost	$ 1.50
6	Variable Cost	$ 3.00
	Total	**$ 187.50**

QUANTITY	DESCRIPTION	UNIT PRICE	TOTAL
500	Desktop Computers 7600 Series, Product Number 7600-1660	$300.00	$150,000.00

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Answer: Gross Profit Margin

- **Question:** What is the gross profit margin for our transaction?
- **Analysis:**
  - Per the commercial invoice, which matches the purchase order and payment record, the selling price is $300/unit
  - Per the Bill of Material, the manufacturing costs for this item are $187.50.
  - <u>Gross Profit</u>: Selling Price – BOM Costs
    - $300 - $187.50 = $112.50
- **Answer:**
  - <u>Gross Profit Margin</u>: Gross Profit / Selling Price
    - $112.50 / $300 = 37.5%

Answer: Operating Profit (Part 1)

- **Question:** What is the operating profit margin for our transaction?
- **Analysis:**
  - The BOM does not include SG&A; therefore, our source of operating profit comes from the financial statement of the factory.
  - Operating expense ratio: Operating Expenses / Sales
    - $2,375,000 / $10,500,000 = 22.62%
  - Operating expenses for our transaction:

    Operating expense ratio of the factory * Selling Price
    - 22.62% * $300 = $67.86

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		2019
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Answer: Operating Profit (Part 2)

- **Question:** What is the operating profit margin for our transaction?
- **Answer:**
  - <u>Operating profit on our transaction</u> is calculated via the following formula: Gross Profit – Operating Expenses
    - \$112.50 - \$67.86 = \$44.64
  - <u>Operating profit margin for our transaction</u>:
    Operating Profit on our Transaction / Selling Price
    - \$44.64 / \$300 = 14.88%

Answer: Financial Statement

- **Question:** Which financial statement should we use for our circumstances of sale comparison?

Industry Segments			
Desktop Computers (3 factories)	Home Electronics	Electrical Sensors	Total

- **Analysis:**
  - We should be utilizing the financial statement which shows the profit recognized by the parent of sales of goods of the same class or kind.
    - Factory – not the parent's financial
    - Consolidated Parent – includes sales of goods that are not the same class or kind
    - Home Electronic & Sensors – not sales of goods of the same class or kind
- **Answer:**
  - The best financial statement to utilize for our circumstances of sale comparison is the Desktop Computers segment of the Parent

Answer: Gross Profit Margin

- **Question:** What is the gross profit margin for the Parent?
- **Analysis:**
  - Revenue: \$23,000,000
  - Costs of Sales: \$15,000,000
  - Gross Profit:

  \$23,000,000 - \$15,000,000 = \$8,000,000
- **Answer:**
  - Gross Profit Margin: Gross Profit / Revenue
    - \$8,000,000 / \$23,000,000 = 34.78%

	Consolidated	Desktop Computers (3 factories)
Revenue	$ 31,000,000.00	$ 23,000,000.00
Cost of sales	$ 18,450,000.00	$ 15,000,000.00
Gross profit	$ 12,550,000.00	$ 8,000,000.00
Expenses		
Research & Development	$ 1,800,000.00	$ 1,500,000.00
Selling and general administrative expenses	$ 3,550,000.00	$ 3,100,000.00
Selling expenses	$ 1,975,000.00	$ 1,900,000.00
General administrative expenses	$ 1,575,000.00	$ 1,200,000.00
Other operating income	$ (1,350,000.00)	$ (975,000.00)
Other operating expenses	$ 975,000.00	$ 825,000.00
TOTAL OPERATING EXPENSES	$ 4,975,000.00	$ 4,450,000.00
Financial income, net - Non Operating	$ (450,000.00)	$ (425,000.00)
Interest income	$ (525,000.00)	$ (475,000.00)
Interest expenses	$ 75,000.00	$ 50,000.00
INCOME BEFORE INCOME TAXES	$ 8,025,000.00	$ 3,975,000.00
INCOME TAX EXPENSES	$ 435,000.00	$ 350,000.00
INCOME FROM CONTINUING OPERATIONS AFTER TAXES	$ 7,590,000.00	$ 3,625,000.00

Answer: Operating Profit Margin

- **Question:** What is the operating profit margin for the parent?
- **Analysis:**
  - Operating Expenses - $4,450,000
  - <u>Operating profit</u>: Gross Profit – Operating Expenses
    - $8,000,000 - $4,450,000 = $3,550,000
- **Answer:**
  - <u>Operating Profit Margin</u>: Operating Profit / Revenue
    - $3,550,000 / $23,000,000 = 15.43%

	Consolidated	Desktop Computers (3 factories)
Revenue	$ 31,000,000.00	$ 23,000,000.00
Cost of sales	$ 18,450,000.00	$ 15,000,000.00
Gross profit	$ 12,550,000.00	$ 8,000,000.00
Expenses		
Research & Development	$ 1,800,000.00	$ 1,500,000.00
Selling and general administrative expenses	$ 3,550,000.00	$ 3,100,000.00
Selling expenses	$ 1,975,000.00	$ 1,900,000.00
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INCOME TAX EXPENSES	$ 435,000.00	$ 350,000.00
INCOME FROM CONTINUING OPERATIONS AFTER TAXES	$ 7,590,000.00	$ 3,625,000.00

Answer: Transaction Value Acceptable?

- **Question:** Can we support the validity of using transaction value?
- **Analysis:**
  - Operating Profit on Transaction – 14.88%
  - Operating Profit of Parent – 15.43%
  - 14.88% is slightly less than 15.43%

- **Answer:**
  - Because the operating profit on the transactions closely approximates the operating profit of the parent (i.e., within 1% in this case), transaction value would be an acceptable basis of appraisement in this case.

Additional CBP Issues with Related Party Pricing

- Circumstances of Sale
  - Importer cannot meet tests
  - Importer hasn't tested related party values
  - Calculation/Comparison Issues
    - Identifying financial information related to the same class or kind
    - Profit mix-ups: Gross to Operating
    - Comparing Profit to Markup

- Value Additions
  - The importer is not declaring transfer price adjustments to CBP
  - The importer is not declaring tooling payments, engineering, royalties, and other supplemental payments to CBP

Transaction Value – When It Doesn't Work

"So what do I do when transaction value is not an acceptable basis of appraisement?"

- It depends!
  - Move to another basis of appraisement in the hierarchy.
  - It should be noted that all bases of appraisement are based on the availability of sufficient information.

Examples:

- Appraising under deductive value (most commonly used in historical transactions)
- Moving to computed value
- Appraising under fallback and adjusting the profit on the import transactions to the firm's overall profit. (e.g., increasing value of import transaction from actual product profit of 5% to firm's overall profit of 18%) – HQ Ruling H309760

Summary Advice on Related Parties

- Evaluate the acceptability of transaction value on your imports before CBP does.
- Be mindful of transfer price adjustments/true-ups.
- Your APA or transfer pricing study does not exclude you from having to demonstrate the acceptability of your related party transactions through test values or through the circumstances of sale.
- Don't be afraid to ask for help. Related party transactions can get really complicated!

Thank You

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