

HQ 547654

November 8, 2001

RR:IT:VA:547654 KDW

Christopher E. Pey
Coudert Brothers
1114 Avenue of the Americas
New York, NY 10036-7703

RE: transfer pricing, transaction value, related parties, reconciliation, post importation price adjustments

Dear Mr. Pey:

This is in response to your letter dated February 10, 2000, filed on behalf of [****] (“E”) requesting a prospective ruling regarding transfer prices on imports from related vendors, [*****] and [****] (collectively referred to herein as “S”). Per your letter dated April 19, 2001, we have reviewed your request for confidentiality pursuant to section 177.2(b)(7) of the Customs Regulations chapter 19, with respect to the information submitted. As that information constitutes privileged or confidential matters, it has been bracketed and will be deleted from any published versions.

FACTS:

E imports and distributes [*****] products from its related vendors. Since the parties are related, E uses a transfer price to report its transaction value to Customs. E states that the prices for the imported goods are negotiated between it and S on an annual basis as set forth in its [*****] Policy. An English translation of the Policy was submitted for our review. The policy applies to all but two of the product lines imported by E, [*****]. E claims that the policy ensures it will earn enough to cover its costs and incur a reasonable profit, similar to a third-party distributor. Further, E states that the policy aims to result in a price similar to that of unrelated parties.

Currently, E’s transfer price and reported transaction value is calculated by subtracting the following from the anticipated resale price in the United States: transportation costs to the United States, U.S. customs duties, fixed costs of E’s U.S. operations, and E’s profit. E states that its current prices under the Policy provide a valid

basis for appraisal using transaction value even though the parties are related. Further, E asks that we assume for purposes of this ruling, that the policy ensures that E earns a reasonable net profit comparable to other unrelated third-party distributors.

S wishes to change its billing system [*****

*****]. Under the current system, variations in sales prices and volumes require frequent management intervention in order to cover fixed costs and achieve the requisite profit. S proposes to change its calculations by deferring certain deductions from the resale price until after the actual resale in the United States. Under those circumstances, E will make entry at the resale price less freight costs, customs duties and E's profit. The deduction for E's U.S. fixed costs will occur after resale in the United States. Entries from all shipments to the United States between S and E would be flagged for reconciliation with Customs. For those costs not known at the time of entry, i.e. E's fixed costs in the United States, E proposes to file reconciliation entries with Customs to adjust its prices for the actual costs quarterly. As part of the quarterly reconciliation filing, the sum of the fixed cost would be allocated by product group to individual shipments made during the quarter based on the ratio of fixed costs to sales for each product grouping.

E states that the new method would not amend or alter the current policy. Also, E states that the new method arrives at the same budgeted prices and profits, but in a more predictable way. E anticipates that the new method will require less managerial intervention, and will eliminate the need for price adjustments each time selling prices or sales volumes fluctuate. E believes that there will ultimately be no change in the overall amount of duties paid to Customs with the new method. Lastly, E claims that customs should consider the transfer price for the imported merchandise under the contemplated method an acceptable transaction value.

ISSUE:

- 1) Is the proposed transfer price acceptable for purposes of transaction value?
- 2) If not, what is the appropriate method of appraisalment?

LAW AND ANALYSIS:

As you are aware, 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; TAA). The preferred method of appraisalment of imported merchandise for customs purposes is transaction value.

Transaction value is the price actually paid or payable for the merchandise when sold for export to the United States, plus certain enumerated additions. 19 U.S.C. 1401a(b)(1). The term 'price actually paid or payable' means the total payment (whether direct or indirect, and exclusive of any 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 place of importation in the United States) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller. 19 U.S.C. §1401a(b)(4)(A).

In determining transaction value, the price actually paid or payable is considered without regard to its method of derivation. It may be the result of discounts, increases, or negotiations, or may be arrived at by the application of a formula, such as the price in effect on the date of export in the London Commodity Market. The word “payable” refers to a situation in which the price has been agreed upon, but the actual payment has not been made at the time of importation. 19 CFR § 152.103(a).

Pursuant to section 402(b)(2)(A)(iv), the transaction value of imported merchandise shall be acceptable only if the buyer and the seller are not related, or if the buyer and the seller are related, the transaction value is acceptable under section 402(b)(2)(B). In this case, we are asked to assume that the current transfer pricing method yields an acceptable transaction value. We note that the provisions of the Policy alone would not satisfy the tests in 402(b)(2)(B). Thus assuming you can otherwise substantiate the original transfer price consistent with one of the related party tests set forth in 402(b)(2)(B), we turn our analysis to the proposed change in billing for adjustments to the price and whether those adjustments would alter the applicability of transaction value.

In this case, the proposed transfer price is ultimately contingent on the final costs incurred by E for sales in the United States, [*****]. E proposes that it make quarterly adjustments to Customs through the reconciliation program after it has finalized its fixed costs in the United States. No formula for the proposed adjustments is provided for in the Policy or in your description of the pricing structure. We have consistently held that where the price is not fixed at the time of importation or determinable by an objective formula agreed upon prior to importation, transaction value is not applicable.

In a case similar to this, Headquarters Ruling Letter (“HRL”) No. 545242, dated April 16, 1996, we found that a price, derived by factors controlled by the parties and determined after importation, was not “fixed” at the time of importation of the merchandise. In HRL 545242, as here, the price for the goods was arrived at pursuant to a methodology that included an initial sum subject to adjustments. Customs concluded that the parties to the agreement knew the pricing structure took into consideration possible, if not probable, price adjustments due to changing conditions and market pressures existing in the U.S. automobile industry. However, the control by the parties as to whether and to what degree the price was to be adjusted in response to changing competitive pricing conditions, could not be considered a “formula” within the meaning of 19 C.F.R. §152.103(a)(1). Accordingly, transaction value did not exist. See also HRL 545618, dated August 23, 1996.

Here, although the elements of the proposed transfer price appear to be the same as those in the current transfer price, the proposed price is not fixed or determinable by some formula at the time of importation. Accordingly, the use of transaction value is precluded for the proposed billing structure, and we move to the succeeding alternate

methods of appraisement for the imported merchandise in the hierarchy provided under 19 U.S.C. § 1401a(b) through (e). However, we have insufficient information to determine whether the alternate methods set forth in those provisions would be acceptable. Therefore, we find that the merchandise may need to be appraised under 402(f) of the TAA (19 U.S.C. § 1401(a)(f)) using a modified transaction value approach. This will allow the use of the importer's figures through reconciliation. Again, our finding is based on the assumption that the former transfer pricing structure as well as the proposed structure yields a price that meets one of the related party tests. We are not ruling on the acceptability of the price itself.

HOLDING:

As set forth above, the proposed method for the transfer price does not yield a transaction value. A modified transaction value based on the provisions of 402(f) of the TAA (19 U.S.C. § 1401a(f)) could be an acceptable method of appraisement. For information or clarification regarding the use of Customs Reconciliation Program you may contact the Reconciliation Team at 202-927- ext. 0915, 0032, or 2293.

Sincerely,

Virginia L. Brown
Chief, Value Branch