



## The Customs Practice of Sidley Austin LLP

Sidley's Washington, D.C.- and Brussels-based customs practice is well versed in the full range of customs issues facing companies and industries. Our attorneys address the most current and pressing issues in trade policy, while also being adept at the "nuts and bolts" of customs issues.

Our members have served in numerous U.S. government, European Commission and international organization roles. Through our representation of prominent trade associations, foreign sovereigns and multinationals, we stay at the front lines of customs reform, trade facilitation, and the challenging integration of the new customs mission of cargo security.

A substantial part of our practice is in the trade compliance arena. We have assisted companies in the development of import compliance programs. We also regularly conduct internal reviews and devise remedial measures as warranted.

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## CBP Issues Import Guidance on Related-Party Transactions

### Importers Put on Notice to Exercise Reasonable Care: Compliance with IRS Not Sufficient

The Department of Homeland Security's U.S. Customs and Border Protection (CBP) recently issued an Informed Compliance Publication (ICP) directed at importers entering into the United States merchandise purchased from related parties. The ICP, [\*What Every Member of the Trade Community Should Know About: Determining the Acceptability of Transaction Value for Related Party Transactions\*](#), clarifies what an importer must do to exercise reasonable care in determining the value of imported merchandise when it purchases the merchandise from a related party. While CBP is charged with assessing customs duties and determining whether various legal requirements have been met, customs laws impose a duty on importers to exercise reasonable care in declaring to CBP at the time of entry the value of their imported merchandise. Failure to exercise reasonable care can result in the imposition of fines and penalties and delays in the release of the merchandise. *(continued on page 2)*

### Asian Border Authorities Enforcing Environmental Laws

Customs agencies across Asia are stepping up their efforts to halt illegal trade in environmentally sensitive goods such as illegal timber, hazardous waste, endangered wildlife and ozone depleting substances. In recent high profile busts, officials in China, India, Indonesia and elsewhere have seized significant quantities of illicit dichlorodifluoromethane (CFC-12), the skins and body parts of tigers and other endangered wildlife, and valuable shipments of illegally harvested timber. Their efforts are being aided by training and resources provided by the Green Customs Initiative, a joint project of the United Nations Environment Programme, Interpol, the World Customs Organization and the secretariats for several treaties. Major importing countries are also scrutinizing trade in such environmentally sensitive items. The European Union and United States, for example, are each exploring bilateral agreements with timber exporting countries to address trade in illegal timber.

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## Transaction Value of Goods Purchased from Related Parties

Under the customs laws of the United States, importers are required to declare the value of imported merchandise using one of five methods. The primary method of valuation is Transaction Value (TV), which is the “price actually paid or payable for the merchandise when sold for exportation to the United States,” plus certain other statutorily enumerated additions. While TV is the preferred method of valuation, if the buyer and seller are “related” (*i.e.*, companies owning, controlling, or holding five percent or more of the outstanding voting stock of the other company, *etc.*), TV can be used only if the TV is “acceptable.” CBP’s concern is that related parties may create artificially low values to reduce customs duties, which are typically applied to imported merchandise on an *ad valorem* basis. For related-party transactions, Customs law provides that TV is acceptable if the importation meets either of two tests, (1) Circumstances of Sale; or (2) Test Values.

The recent ICP clarifies these two tests and specifies the evidence importers must collect and retain in their exercise of reasonable care in declaring the value of merchandise from related parties to be an acceptable TV. Although an importer is not required to present such evidence at the time of entry of merchandise, CBP is authorized to examine the value declared by the importer by asking the importer to supply additional information and documentation. CBP may also request such information long after time of entry, for example, in the context of a Focused Assessment audit.

### Circumstances of Sale

Under the “circumstances of sale” test, the TV is acceptable if the circumstances of the sale indicate that the relationship between the buyer and seller did not influence the price actually paid or payable. Though the test is applied on a case-by-case basis, CBP has listed the following methods that can be used to demonstrate that the relationship has not influenced the price:

1. The price was settled in a manner consistent with the normal pricing practices of the industry in question;
2. The price was settled in a manner consistent with the way the seller settles prices for sales to unrelated buyers; or
3. The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm’s overall profit (“all costs plus profit” method).

The ICP emphasizes that importers relying on the circumstances of sale test to show that TV is acceptable are required to collect and retain evidence sufficient to establish the alleged circumstances of sale. Conclusory allegations that are not supported by such evidence will be rejected. Sufficient evidence includes correspondence between the parties, as well as contracts and invoices concerning sales to both related and unrelated parties. In addition, if the importer relies on the “all costs plus profits” method above, it should collect and retain cost and profit information (such as financial statements, accounting records, bills of material, inventory records, general and administrative expense records, and other supporting business records).

### Test Values

An importer may also use TV in a related-party transaction by demonstrating that TV closely approximates one or more “test values” of identical or similar goods. Customs law specifies that the relevant “test values” are (i) TV of identical or similar merchandise in sales to unrelated buyer in the United States; or (ii) “deductive” or “computed” value (as defined in the Customs regulations) for identical or similar merchandise, but only if (i) or (ii) related to merchandise that was exported to the United States at or near the time as the imported merchandise.

In this ICP, CBP has clarified two important issues that have arisen frequently in importers’ reliance on test values. First, CBP has reiterated that the test values being relied upon must be values from an actual appraisalment by CBP of previously imported merchandise. For example, it is not enough for the importer to compare the TV of the imported merchandise at

issue to the deductive or computed value for *that same* merchandise or transaction at issue. Second, CBP has noted that the test values are to be used for comparison purposes only to determine whether TV is acceptable — the test values may not be used as independent bases of valuation. In sum, these restrictions seem to mean that test values will rarely be helpful in establishing that a TV is acceptable.

### **IRS Transfer Pricing Agreements Are Not Dispositive**

CBP has also clarified that transfer prices established in Advance Pricing Agreements (APA) or Transfer Pricing Studies (TPS) conducted for tax purposes by or with the Internal Revenue Service (IRS) are insufficient to show that the price in a related-party sale is an acceptable TV. CBP explains that the differences in purposes of and legal requirements for the transfer pricing provisions of Customs and IRS law (such as the fact that customs transactions must be valued on an entry-by-entry basis while for tax purposes aggregate periodic reporting is the norm) render APAs and TPSs unsuitable for establishing that the price in a particular related-party sale is acceptable for CBP purposes. Instead, the underlying facts and conclusions in an APA or TPS may contain information that is relevant for establishing that TV is acceptable. The burden of showing such relevance, however, rests with the importer.

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The recent ICP provides helpful clarification of CBP regulations and policies concerning related-party transactions, and importers facing these issues need to ensure that their pricing practices and value declarations at entry are consistent with the additional information and clarification in the recent ICP. Importers should also be aware that the ICP does not address all issues that may be relevant to related-party transactions, such as retroactive price adjustments in related-party transactions. These and other issues should be raised with CBP field personnel or with CBP in the context of a ruling request.

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