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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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Proposal by U.S. Customs and Border Protection Likely to Increase Duties Owed by Many Companies

On January 24, 2008, U.S. Customs and Border Protection (CBP) published a [proposal](#) to interpret the phrase "sold for exportation to the United States" to mean the last sale in multi-tiered transactions involving imported goods.¹ This new interpretation of what constitutes "transaction value" for the purpose of determining the customs value of imported goods would result in higher customs values and increased duties for many companies. The proposal is important to all importers who take advantage of the so-called "first-sale" rule, which bases a shipment's dutiable cost on the price between a foreign factory and a middleman, who is often foreign as well, rather than the price between the middleman and the U.S. buyer. The first-sale rule has saved many companies millions of dollars in duty liability; if CBP's new interpretation is implemented, companies that have structured their import transactions around the first-sale rule may pay significantly more in customs duties.

Transaction Value

All merchandise imported into the United States must be appraised so that customs duties can be assessed. Transaction value is the preferred method to appraise imported merchandise and is defined by statute as "the price actually paid or payable for merchandise *when sold for exportation to the United States*," plus certain enumerated additions. This definition of transaction value is from the international Agreement on Implementation of Article VII of the General Agreements on Tariffs and Trade (GATT), which is generally known as the GATT Valuation Agreement. All World Trade Organization (WTO) members must implement the provisions of the GATT Valuation Agreement. Significantly, however, neither the GATT Valuation Agreement nor U.S. law defines "sold for exportation."

Because imported merchandise is frequently the subject of multiple buy/sell transactions prior to importation, determining which transaction constitutes the transaction value for

¹ <http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E8-1140.pdf>

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customs purposes can be complex. At present, in accordance with a line of judicial precedents, CBP allows importers to base transaction value on the earliest arm's length sale where it can be shown that the merchandise was clearly destined for exportation to the United States. Often this earliest sale occurs between a foreign manufacturer and a foreign middleman and is the first in a series of sales. Hence, establishing transaction value based on the first of a series of sales is commonly referred to as the "first-sale" rule.

Technical Committee on Customs Valuation

CBP proposes to reinterpret the application of the first-sale rule under U.S. law as a result of a recent commentary issued by the World Customs Organization (WCO) Technical Committee on Customs Valuation (Technical Committee). The purpose of the Technical Committee is to provide uniform interpretation and guidance on the application of the GATT Valuation Agreement.

In a commentary evaluating what "sold for exportation" means in multi-tiered transactions, the Technical Committee concluded, based upon the General Introductory Commentary and other provisions of the Agreement, that it was the intent of the drafters that transaction value would normally be based upon the sale that is subject to various adjustments to ensure that it constituted the price actually paid or payable by the buyer. In a series of sales, however, the buyer in the first sale is not necessarily the party who pays royalties or provides assists, allowing costs such as these to be excluded from transaction value. Further, the Technical Committee opined that it "was not envisaged [under the Agreement] that the determination of transaction value would diverge, depending on whether the import transaction involved a single sale or a series of sales." The Technical Committee concluded, therefore, that

[I]n a series of sales situation, the price actually paid or payable for the imported goods when sold for export to the country of importation is the price paid in the *last sale*

occurring prior to the introduction of the goods into the country of importation, instead of the first (or earlier) sale. This is consistent with the purpose and overall text of the [GATT Valuation] Agreement.

After considering the Technical Committee's interpretation of the "sold for exportation" provision, CBP states that it has decided that its current interpretation of transaction value in multi-tiered transactions is incorrect. The proposed CBP interpretation embraces the Technical Committee's interpretation and would bring the United States into conformity with the approach of most other WTO members. The European Union and Japan are the only other members currently using some form of the first-sale rule. Canada modified its definition of transaction value to eliminate the first-sale concept about ten years ago.

CBP's Interpretation

"CBP is of the view that basing transaction value on the last sale occurring prior to the introduction of the goods into the United States reflects the proper construction of the statute and carries out the legislative intent of the [valuation statute]."² CBP notes that when the first-sale rule is applied, CBP frequently forgoes collection of revenue based on the addition of certain royalties, selling commissions, and other statutorily mandated additions to the price paid or payable because the additions are not paid by the buyer in the first sale. In addition, CBP points out that Congress explicitly prohibited the use of "the price of merchandise in the domestic market of the country of exportation" elsewhere in the valuation statute.³ Thus, says CBP, "had Congress intended that under the transaction value statute the price actually paid or payable ought to be the price paid by a buyer in the first sale (usually a buyer located outside the U.S.) or that the required additions ought to be based on the costs incurred by that buyer in the first sale, it would have so provided."⁴

² Proposed Interpretation of the Expression "Sold for Exportation to the United States" for Purposes of Applying the Transaction Value Method of Valuation in a Series of Sales, 73 Fed. Reg. 4254, 4258 (Jan. 24, 2008).

³ 19 U.S.C. § 1401a(f)(2)(C).

⁴ 73 Fed. Reg. at 4258.

CBP Cites Benefits of Change

CBP defends its proposal on the ground that it will provide benefits to both the agency and international traders. By bringing its interpretation of “sold for exportation” in line with the Technical Committee, CBP promises a “straightforward” rule to determine customs value in multi-tiered transactions. CBP states that a “last-sale” rule will eliminate the “formidable fact-finding” and “foreign inquiries” required by first-sale transactions. In addition, CBP states that the proposed last-sale rule will allow those involved in international commerce to “predict with a reasonable degree of accuracy” the customs value of imported merchandise using information easily obtained in the United States.⁵ On the other hand, says CBP, use of the first-sale rule may make it difficult for an importer to satisfy its reasonable care obligations because the necessary valuation information may not be readily available to the importer. The last-sale rule establishes “a transparent standard for determining transaction value that is easily applied and based upon information available in the United States.”⁶

Implementation of Last-Sale

If CBP implements the proposed last-sale rule, it must 1) revoke a longstanding Treasury Decision, T.D. 96-87, *Determining Transaction Value in Multi-Tiered Transactions*, 31 Cust. B. & Dec. No. 1; 30 Cust. B. & Dec. No. 42 (Jan. 2, 1997), 2) modify or revoke

all prior administrative rulings and treatment previously provided to multi-tiered transactions under the first-sale rule, in accordance with the procedures required under Section 625(c) of the Tariff Act of 1930, as amended,⁷ and 3) successfully restrict the application of a series of federal court decisions that have expressly upheld the first-sale rule to the specific facts at issue in those cases.

Overcoming court challenges to the new interpretation may represent the greatest obstacle for CBP. It is unclear that the proposed last-sale rule could survive judicial scrutiny, which would be all but inevitable given how much companies have invested to structure their business models around the first-sale rule.

Conclusion

CBP is soliciting written comments on the proposed last-sale rule. All comments must be received by March 24, 2008. The comment period is an important opportunity for interested parties to be heard on this significant change to U.S. customs valuation law. Pending implementation of the proposed interpretation, companies conducting business under first-sale structures can continue to do so.

Sidley Austin LLP attorneys are available to discuss the proposed rule, the impact it may have on the structuring of international sales transactions, and any comments companies may wish to submit.

⁵ 73 Fed. Reg. at 4258.

⁶ 73 Fed. Reg. at 4260.

⁷ 19 U.S.C. § 1625(c).