

US Customs Rulings Highlight Importance of Arm's Length Valuation Requirement

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Companies that import merchandise into the United States must exercise reasonable care when determining the dutiable value of the merchandise they are entering, calculating duties owed on the shipment based on that dutiable value and applicable duty rates, and submitting payment for total duties owed to US Customs. In doing so, importers must properly apply the valuation statute and associated guidance to the circumstances of their transaction to minimize tariff liability and avoid penalties for providing inaccurate information to US Customs. In multi-tiered transactions that involve related parties, there are multiple transactions that can potentially serve as a basis for valuation of a given entry. Furthermore, the arm's length requirement must be satisfied to render transactions between related parties usable for valuation purposes. The two recent US Customs rulings discussed in this article show that in the context of multi-tiered transactions, importers have the opportunity to limit tariff liability on imports of commercial merchandise so long as they properly apply the valuation statute. The discussion underscores the practical importance of satisfying the arm's length requirement for transactions between related parties and clearly presenting the associated legal reasoning and documentation to US Customs.

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Companies that import merchandise into the United States must exercise reasonable care in declaring the proper dutiable value of the merchandise upon entry. Satisfying this legal obligation serves two purposes: it shields the importer against penalties imposed by US Customs and Border Protection ('US Customs' or 'Agency') for violations of import requirements,¹ and it concurrently ensures that the importer receives the most favourable duty treatment available under the specific circumstances.

In multi-tiered transactions there are multiple sales that can potentially serve as a basis for valuation. If a transaction in the chain involves related parties, the arm's length requirement must be satisfied for that sale to be usable for valuation purposes.² To complicate matters further, in a recent decision the Court of International Trade states that a transaction in the chain must also be unaffected by distortive nonmarket influences to be a viable basis for valuation,³ suggesting that valuation of multi-tiered transactions involving China or Vietnam will be even more closely scrutinized.

In this context, exercising reasonable care is crucial to remaining compliant with US Customs' requirements while keeping tariff costs as low as possible. To exercise reasonable care in relation to the appraisal of merchandise, an importer must be able to correctly apply the valuation statute and arm's length requirement to its particular situation and clearly present its legal justification for doing so along with associated documentation to US Customs.

I THE ROLE AND IMPORTANCE OF THE VALUATION STATUTE

The valuation statute at 19 U.S.C. §1401a lists and describes the various acceptable methods that importers can use to appraise their merchandise for US Customs and Border Protection ('US Customs' or 'Agency') purposes.⁴ Importantly, since most duties levied by US Customs are assessed on an ad valorem basis, the dutiable value of commercial shipments entering the United States along with the

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¹ See 19 U.S.C. § 1592(a)(1)(A)(i).

² 19 U.S.C. § 1401a(b)(2)(B).

³ *Meyer Corporation v. United States*, No. 13–00154, 2021 WL 777788, 777789 (Cr. Inr'l Trade 1 Mar. 2021).

⁴ 19 U.S.C. § 1401a(a).

particular duty rates applicable to the merchandise in question determine an importer's duty liability for a given entry.

In light of this system, US importers strive to identify and legally justify use of the valuation method that will result in the lowest appraisal of merchandise destined for importation into the United States. Applying the appropriate ad valorem duty rates to this lowest legally-justifiable dutiable value will in turn result in the lowest duty liability on a given shipment of merchandise into the United States. In this way using the lowest legally-justifiable dutiable value allows the company acting as importer, along with its partners in the transaction, to limit US tariff costs and improve the bottom line.

As a result of its central role in calculating tariff liability and the (limited) flexibility it offers to importers in calculating the dutiable value of their shipments into the United States, proper interpretation of the valuation statute is key to identifying opportunities for lowering tariff costs. However, as with many analyses related to assessing the characteristics of merchandise entering the United States, taking advantage of opportunities to save on duties based on valuation requires a case-specific application of the valuation statute's requirements to the particular circumstances of a company's multi-tiered import transaction. And as is often the case, US Customs' standard of 'reasonable care' applies to issues of valuation in related party transactions to place the burden of legally justifying the use of the applicable valuation method on the importer of record⁵ (the company that is listed as such on entry documentation and legally liable for the duties owed to US Customs on a given entry of merchandise into the United States⁶).

Meeting US Customs' reasonable care standard in valuing merchandise involves preparing suitable documentation to support the use of the desired valuation method and compiling and clearly presenting the relevant industry – , transaction – and shipping-related documents along with the specific calculations that result in the duty value provided to US Customs and used to determine tariff liability.⁷ Companies that fail to exercise reasonable care in applying the valuation statute and calculating dutiable value expose themselves to potential challenges from US Customs that could result in revaluation of the merchandise by the Agency prior to liquidation and a higher ultimate tariff bill, as well as penalties for inaccurate entry information to the Agency.⁸

The first US Customs ruling discussed in Section 3 of this article provides an example of an importer failing to properly apply the valuation statute and satisfy its arm's length requirement for related party transactions to limit the tariff liability on its entries into the United States. In HQ H309839, the US importer failed to justify use of the lowest transaction value in its multi-tiered transaction to appraise its imported merchandise despite the fact that the 'first sale' in question was between two related parties. The company further failed to properly apply the valuation statute to justify use of the deductive value method. This resulted US Customs assigning a higher dutiable value to the shipments in question based on the transaction value of the sale to an unrelated US customer and a higher tariff bill for the importer.⁹

The second Customs ruling discussed in Section 4 of this article describes how a US importer succeeded in properly applying the valuation statute, satisfying its arm's length requirement for related party transactions, and suitably supporting its rationale to limit the tariff liability on its entries into the United States. In HQ H311666, the US importer provided the documentary evidence and reasoning required to demonstrate that the sourcing services provided to the importer by one of its associated entities and the fees paid to that associated entity for those services constituted an arm's length transactions. This resulted in a determination by US Customs confirming that the sourcing service fees do not contribute to the total dutiable value of the associated entries and a lower tariff bill for the importer.¹⁰

Taken together, these recent US Customs rulings show how importers can properly apply the valuation statute in multi-tiered import transactions to identify and pursue opportunities to limit tariff liability on imports of commercial merchandise. In doing so, the rulings underscore the practical importance of satisfying the arm's length requirement for transactions between associated parties.

2 THE VALUATION STATUTE'S ARM'S LENGTH REQUIREMENT

The valuation statute lists all the available methods of appraising merchandise imported into the United States in hierarchical order.¹¹ Before an importer uses a method

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⁵ See 19 U.S.C. § 1484(a)(1)(B). See also *What Every Member of the Trade Community Should Know: Reasonable Care*, An Informed Compliance Publication, US Customs and Border Protection 3 (Sept. 2017).

⁶ 19 C.F.R. § 101.1.

⁷ See *What Every Member of the Trade Community Should Know About: Determining the Acceptability of Transaction Value For Related Party Transactions*, An Informed Compliance Publication, US Customs and Border Protection 17 (Apr. 2007).

⁸ 19 U.S.C. § 1592.

⁹ *Multi-tiered Transaction; Two Sales for Export to the United States*, HQ H309839 (US Customs 9 Sept. 2020), <https://rulings.cbp.gov/search?term=HQ%20H309839&collection=ALL&sortBy=RELEVANCE&pageSize=30&page=1> (accessed 12 Mar. 2021).

¹⁰ *Dutiable of Certain Sourcing Fees; Related Parties*, HQ H311666 (US Customs 15 Dec. 2020), <https://rulings.cbp.gov/search?term=HQ%20H311666&collection=ALL&sortBy=RELEVANCE&pageSize=30&page=1> (accessed 12 Mar. 2021).

¹¹ 19 U.S.C. § 1401a(a).

that appears further along in the statute's hierarchy, the importer first must ensure that the methods that are listed prior to it are not available in the importer's particular case.¹² The language of the valuation statute instructs that prior-listed valuation methods cannot be used either because a value cannot be determined using that method, or because the values determined using that method are invalid for one of numerous reasons listed in the statute itself.¹³

US Customs guidance on the interpretation and application of the valuation statute states that '[t]he primary method of appraisement is transaction value' and that '[w]hen there is no transaction value, the other valuation methods (transaction value of identical or similar goods, deductive value, computed value, and the fallback method), are to be applied in sequence'.¹⁴ Therefore, when it is available, a transaction value, or 'the price actually paid or payable for the merchandise when sold for exportation to the United States'¹⁵ plus certain statutorily enumerated amounts,¹⁶ is the preferred method of appraising merchandise for US Customs purposes.

In multi-tiered import transactions, the valuation statute generally prohibits use of transaction values for merchandise appraisal purposes when the buyer and seller are related entities.¹⁷ Yet the valuation statute also provides for an exception to this general prohibition 'if an examination of the circumstances of the sale of the imported merchandise indicates that the relationship between such buyer and seller did not influence the price actually paid or payable'.¹⁸ Put differently, the transaction value can be used for merchandise appraisal purposes even if the buyer and seller are related, so long as the importer can prove the transaction between the related buyer and seller was conducted at arm's length.

While US Customs determines if transactions between associated parties satisfy the arm's length requirement on a case-by-case basis,¹⁹ under the reasonable care standard established by the Agency, the burden is on the importer to demonstrate that the arm's length requirement has

been met.²⁰ Importers can prove that a transaction between related parties was conducted at arm's length (and that it can therefore be used to appraise the merchandise for duty purposes based on transaction value) using any one of a number of methods permitted by US Customs.²¹ Two such methods involve demonstrating that the details of the transaction are consistent with the normal pricing practices of the particular industry in question or the normal price settlement practices the seller uses with other unrelated buyers.²²

In demonstrating that the arm's length requirement has been met, importers must be thorough and clear regardless of the method used to prove that the relationship between the buyer and seller did not affect the price: conclusory statements that are not supported by documentary evidence and a step-by-step analysis will not be accepted as proof that a transaction between associated parties was carried out at arm's length.²³ Instead, such unsubstantiated claims will result in a determination that the arm's length claim lacks support. This opens the door for US Customs to value the imported merchandise based on another available transaction value or if one is not available, the next applicable valuation method in the valuation statute's hierarchy.²⁴ As the discussion in the next section regarding ruling HQ H309839 demonstrates, this often results in a less-favourable (higher) valuation of merchandise for duty purposes.

3 HQ H309839 – THE ARM'S LENGTH REQUIREMENT AND CORRECT APPLICATION OF THE VALUATION STATUTE

US Customs issued ruling HQ H309839²⁵ in response to the importer's protest against US Customs' decision to appraise its entered merchandise based upon the price the importer's US customers paid to the importer, instead of the 'first sale' price the importer paid to its associated manufacturer. In rejecting the importer's arguments supporting the use of the lower (and

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¹² See *What Every Member of the Trade Community Should Know About*, *supra* n. 7, at 6.

¹³ 19 U.S.C. § 1401a(a).

¹⁴ *What Every Member of the Trade Community Should Know About*, *supra* n. 7, at 6.

¹⁵ 19 U.S.C. § 1401a(b)(1).

¹⁶ *Ibid.*

¹⁷ 19 U.S.C. § 1401a(b)(2)(A)(iv).

¹⁸ 19 U.S.C. § 1401a(b)(2)(B).

¹⁹ *What Every Member of the Trade Community Should Know About*, *supra* n. 7, at 7.

²⁰ *Ibid.*, at 17.

²¹ *Ibid.*, at 6–11.

²² *Ibid.*, at 9–11. The other acceptable methods of proving that a transaction between related parties was conducted at arm's length are the 'all costs plus profit' method and the 'test value' method.

²³ See *Ibid.*, at 10.

²⁴ See 19 U.S.C. § 1401a(a).

²⁵ *Multi-tiered Transaction; Two Sales for Export to the United States*, *supra* n. 9.

thus more favourable) 'first sale' price, the Agency identified two ways the importer fell short of satisfying its burden of exercising reasonable care. The importer (1) failed to prove that the sale of the merchandise by its associated manufacturer was conducted at arm's length; and (2) failed to properly apply the valuation statute to justify use of deductive value over transaction value.

In HQ H309839, US Customs analysed a multi-tiered transaction between US importer World Wide Packaging, LLC (WWP US), its related manufacturer in China, World Wide Packaging (Suzhou) Co., Ltd. (WWP Suzhou), and its US customers. WWP US, whose sales associate's email signature includes an information video regarding WWP Suzhou's manufacturing facility, received six purchase orders from its US customers for merchandise consisting of plastic tubes used for personal care products. WWP US then placed six corresponding purchase orders with WWP Suzhou that included the US customer's purchase order number, among other information.²⁶

WWP US submitted commercial invoices, packing lists, and evidence of payment to demonstrate that a *bona fide* sale occurred between WWP Suzhou and WWP US. WWP US also maintained that this *bona fide* sale price should be the transaction value used to appraise the merchandise. Importantly however, WWP US did not submit any documentation or reasoning to prove that the arm's length requirement needed to support the use of transaction value between related parties for merchandise appraisal purposes²⁷ was satisfied. In fact, WWP US 'conceded that the transaction does not meet the "arm's length" requirement for the use of transaction value between related parties'.²⁸

In light of these facts, US Customs confirmed long-standing precedent established in *Nissho Iwai American Corp. v. United States*²⁹ (*Nissho Iwai*) when it pointed out that while 'an importer may request appraisal based on the price paid by a middleman to a foreign manufacturer in a sale earlier in time than the last sale in a multi-tier transaction',³⁰ the burden is on the importer to show that this 'first sale' price can be used for merchandise valuation purposes.³¹ As *Nissho Iwai* instructs, to use this 'first sale' price (in this case, the price paid by WWP US to WWP Suzhou), 'the importer must present sufficient evidence that the alleged sale was a bona fide

"arm's length sale", and that it was "a sale for export to the United States" within the meaning of 19 U.S.C. § 1401a'.³² Since WWP US conceded that the transaction was not conducted at arm's length, US Customs determined that the requirement was not met and that as a result, the price paid by WWP US to WWP Suzhou could not be used for merchandise appraisal purposes.³³

WWP US further argued that the price it charged its US customer cannot serve as the transaction value basis for appraisal of the merchandise because both parties to this particular sale were US companies located in the United States. In response, US Customs appealed to precedent established in *Nissho Iwai* once again to confirm that 'the fact that WWP US is the importer of record and a US company does not negate consideration of these sales'.³⁴ Once US Customs confirmed that this remaining transaction value could be the basis for appraisal of the merchandise, US Customs also rejected WWP US' secondary appeal to use the deductive method to appraise the merchandise as inconsistent with the proper application of the valuation statute to the particular circumstances of the case. Since transaction value is the preferred method of appraising merchandise,³⁵ US Customs concluded that the only remaining transaction value in the multi-tiered transaction, namely the price paid to WWP US by its US customers, should serve as the basis for merchandise appraisal.

As a result of its failure to satisfy the arm's length requirement and to consider the valuation methods in proper sequential order, the importer failed to obtain approval from US Customs to use the lower, more favourable 'first sale' price or a lower value based on the deductive method to appraise its merchandise. Instead, WWP US was ultimately liable for the additional duties owed as a result of the higher transaction value US Customs used as a basis for appraisal of the merchandise.

4 HQ H311666 – THE BENEFITS OF PROVING ARM'S LENGTH PAYMENTS BETWEEN ASSOCIATED PARTIES

Unlike ruling HQ H309839 discussed in the previous section, HQ H311666³⁶ shows how an importer can

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²⁶ *Ibid.*, at 2.

²⁷ 19 U.S.C. § 1401a(b)(2)(B).

²⁸ *Multi-tiered Transaction; Two Sales for Export to the United States*, *supra* n. 9, at 4.

²⁹ *Nissho Iwai American Corp. v. United States*, 16 C.I.T. 86, 786 F. Supp. 1002, reversed in part, 982 F.2d 505 (Fed. Cir. 1992).

³⁰ *Multi-tiered Transaction; Two Sales for Export to the United States*, *supra* n. 9, at 7.

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*, at 8.

³⁴ *Ibid.*

³⁵ *Multi-tiered Transaction; Two Sales for Export to the United States*, *supra* n. 9, at 6.

³⁶ *Dutiability of Certain Sourcing Fees; Related Parties*, *supra* n. 10.

successfully satisfy the arm's length requirement to limit its duty liability. In HQ H311666, US Customs considered whether the importer, BMW of North America, LLC (BMW NA), could exclude sourcing fees paid to its parent company, Bayerische Motoren Werke Aktien-gesellschaft of Munich, Germany (BMW AG) from the dutiable value of its auto part imports.

Under the Sourcing Assistance Agreement in place between BMW NA and BMW AG, BMW NA pays its parent a sourcing fee to negotiate prices with vendors based on BMW AG's superior experience and volume leverage.³⁷ Once BMW AG and the vendors agree to prices, BMW NA submits purchase orders directly to the vendors, who in turn deliver the merchandise and issue invoices directly to BMW NA.³⁸

Importantly, these sourcing services are also provided in relation to purely domestic auto part purchases.³⁹ Furthermore, in addition to describing the way the sourcing fee relationship is set up, BMW NA explained the formula used to calculate the sourcing fee to US Customs.⁴⁰ The fact that BMW NA proactively met the reasonable care standard by providing its rationale and associated documentary evidence to US Customs allowed the importer to obtain approval from the Agency to exclude sourcing fees paid to its parent company from the dutiable value of its auto parts imports.⁴¹

Customs determined that despite the fact that no agency relationship was claimed or present,⁴² BMW AG was acting 'somewhat like a buying agent'⁴³ for BMW NA. Since buying commissions are not dutiable under the valuation statute,⁴⁴ the Agency concluded that the fees paid to BMW AG are not dutiable additions to the appraised value of the merchandise.⁴⁵ In this case, the importer's ability to establish that its sourcing-related transactions with its parent were conducted at arm's length facilitated a favourable outcome for the company in the form of a lower appraised value of its merchandise and a lower tariff bill.

5 BEST PRACTICES – EXERCISING REASONABLE CARE

While valuation analyses are reviewed and assessed by US Customs on a case-by-case basis, in every case importing companies must exercise reasonable care in declaring the proper value of merchandise upon entry.⁴⁶ In multi-tiered transactions that involve related parties, there are multiple transactions that can potentially serve as a basis for valuation. Furthermore, the arm's length requirement must be satisfied to render transactions between related parties usable for valuation purposes. In such a context, exercising reasonable care is of the utmost importance as doing so can lead directly to a lower tariff bill for the importer. Conversely, failing to do so can lead to a higher revaluation of entered merchandise by US Customs prior to liquidation and additional tariff costs.

In the context of multi-tiered import transactions, reasonable care generally involves preparing suitable documentation of the analysis justifying the use of the applicable valuation method, compiling all associated documentation, and identifying the specific calculations that gave rise to the value provided to US Customs and used to determine duty liability. In striving to meet the reasonable care standard and obtain favourable duty treatment through proper application of the valuation statute, importers should consider the following practical recommendations:⁴⁷

- When seeking US Customs approval for use of a particular valuation method, provide a complete set of documents regarding the import transaction the first time in a clear, concise and easily digestible format; include purchase orders, invoices, sales agreements, shipping documents, and proof of payment;
- Consider the available valuation methods in the order specified in the valuation statute and identify and employ relevant US Customs rulings and precedent to present, explain, and support the reasoning behind application of the statute to the circumstances of the particular case;

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³⁷ *Ibid.*, at 2.

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ *Ibid.*, at 3.

⁴¹ *Ibid.*

⁴² *Ibid.*, at 2.

⁴³ *Ibid.*, at 3.

⁴⁴ See 19 U.S.C. § 1401a(b)(1).

⁴⁵ *Dutiability of Certain Sourcing Fees; Related Parties*, *supra* n. 10, at 3.

⁴⁶ *What Every Member of the Trade Community Should Know About*, *supra* n. 7, at 17.

⁴⁷ See *What Every Member of the Trade Community Should Know: Reasonable Care*, An Informed Compliance Publication, US Customs and Border Protection 10–11 (Sept. 2017).

Arm's Length Valuation Requirement

– Avoid submitting unsupported requests for US Customs approval for use of a particular valuation method and use of conclusory statements therein, as this may result in an unfavourable binding determination from the Agency; consult a customs expert to

formulate a comprehensive legal argument for use of a particular valuation method that addresses applicable rules, such as the arm's length requirement for transactions between related parties, to maximize chances of a favourable US Customs determination.