Customs and International Trade Bar Association Quarterly Newsletter

Volume 8, Issue 1 | Winter 2010

In this issue:

CITBA & Related News

Upcoming Programs
- Winter Meeting and Dinner
- Georgetown 2010 International Trade Update

Save the Date
- ABA 2010 International Section Spring Meeting
- CITBA Spring Dinner
- Presentation on Section 337 Cases

Announcements
- News from the Clerk of the Court of International Trade

Feature Articles
- Canada seeks to impose Customs duties on Management Fees and Research and Development Payments
- Recent Adverse Facts Available Decision Underscores Concerns About Fraud in Antidumping and Countervailing Duty Proceedings
- U.S. Customs Issues First Advanced Pricing Agreement Ruling Since 2003

CITBA Online
Membership
Pro Bono Opportunities

Links of interest:

CITBA Homepage

US CIT Homepage

US Court of Appeals for the Federal Circuit Homepage

US Customs and Border Protection

Bureau of Industry and Security

Office of Foreign Assets Control

International Trade Administration

US International Trade Commission

CITBA is now on LinkedIn!
Join us at
www.**linkedin**.com

CITBA & Related News

UPCOMING PROGRAMS

Winter Meeting and Dinner

On February 25, 2010, in conjunction with the Georgetown University 2010 International Trade Update, CITBA will hold its winter dinner at Hotel George in Washington, D.C. The speaker for this event is Chief Judge Paul R. Michel from the U.S. Court of Appeals for the Federal Circuit. Registration information for this event is attached.

Georgetown 2010 International Trade Update

From February 25-26, 2010, Georgetown University Law Center will hold its annual International Trade Update in Washington, D.C. Additionally, a special program for Trade & Customs Law Basics will be held on Wednesday February 24, 2010. CLE will be available for this event. Details are available at https://www.law.georgetown.edu/cle/pdfs/227.pdf

Additionally, Georgetown CLE is pleased to offer CITBA members a special opportunity to save $100 on any new registrations for the program. For priority registration, CITBA members can visit www.georgetowncle.org. Please enter discount code QX4SCNRP to save $100 off the registration fee, or call 202-662-9890 with questions or to register.

SAVE THE DATE!

ABA 2010 International Section Spring Meeting

The American Bar Association will hold its annual Spring Meeting in New York City from April 13-17, 2010. Details regarding this event are available at http://www.abanet.org/intlaw/.

CITBA Spring Dinner

On April 20, 2010, CITBA will hold its annual meeting in New York. Watch for more information regarding this event.

Presentation on Section 337 Cases

On April 29, 2010, Chief Administrative Law Judge Luckern of the International Trade Commission is coming to New York to speak to the International Trade Committee of the New York City Bar Association about section 337 investigations. CITBA members will be welcome to attend. Watch for more information about this event!

ANNOUNCEMENTS

News from the Clerk of the Court of International Trade

By: Tina Potuto Kimble

Time Computation Rules: The Court of International Trade applies its own Rules and not the Federal Rules of Civil Procedure. As such, the new time computation rules that came into effect for the other federal courts DO NOT apply to cases pending at the Court of International Trade. The Court's Advisory Committee is working to update the Court's Rules and hopes to have new time computation rules in place by next year. This is a large undertaking and we should all, yet again, thank the Court's Advisory Committee for all their hard work. In the meantime, please continue to follow the prior methodology for time computation at the CIT, as reflected in the current version of the Court's Rules. Please contact the Clerk's Office with any questions you may have.

CM/ECF Upgrade: CM/ECF has been upgraded once again. There are several new features to CM/ECF that we hope will be helpful to members of the bar. There is a new single screen format that allows attorneys to add parties and attachments while docketing without having to navigate through multiple screens. Also, CM/ECF users can now receive RSS feeds to get notice of docketing events. Finally, the Bulky Document Standard size limitation has been increased to five megabytes (5 MB), which will greatly reduce the need to split your documents into multiple attachments while filing.

Feature Articles

CANADA SEEKS TO IMPOSE CUSTOMS DUTIES ON MANAGEMENT FEES AND RESEARCH AND DEVELOPMENT PAYMENTS

By: Peter E. Kirby

On July 8, 2009, the Valuation Division of the Canada Border Services Agency ("CBSA") issued a major new policy document that targets for inclusion in the value for duty of imported goods virtually all payments made between related parties. The document is published as Customs Memorandum D13-4-13, "*Post-Importation Payments or Fees – Subsequent Proceeds* (*Customs Act*, Section 48)". Canada Border Services Agency, *Post-Importation Payments or Fees – Subsequent Proceeds* (*Customs Act*, Section 48), Customs Memorandum D13-4-13, Ottawa, Public Safety Canada, July 8, 2009, http://cbsa-asfc.gc.ca/publications/dm-md/d13/d13-4-13-eng.html. It is the official announcement of a policy that has been gaining ground for several years among customs auditors that have sought to characterize various related party payments as part of the price paid or payable for imported goods and, therefore, subject to duty.

The starting point for CBSA is the notion of "subsequent proceeds". The WTO *Customs Valuation Code*, and national legislation in signatory countries require that in calculating the price paid or payable for imported goods, you must include "the value of any part of the proceeds of any subsequent resale, disposal or use of the goods (…) that accrues or is to accrue directly or indirectly, to the vendor". Given that customs duty is calculated as a percentage of the price paid or payable for the goods, "subsequent proceeds" are dutiable.

What is novel in the new Canadian policy is the broad interpretation of the notion of subsequent proceeds

that captures most inter-company transfers, no matter how they are described. Under the new policy, the following payments may be considered part of the price paid or payable for the imported goods and, therefore, dutiable:

(i) payments based on the resale of the goods that cannot be tied to services received;

(ii) management or administration fees paid by the importer, directly or indirectly to the vendor;

(iii) contributions to the parent's or an affiliate's research and development efforts;

(iv) contributions for worldwide marketing or promotion;

v) overhead expenses relating to the manufacture of the goods but not captured in the selling price;

vi) interest on deferred payments.

In case there was any misunderstanding about the scope of the new policy, the D-Memorandum states:

"Nowhere in the *Customs Act* or the World Trade Organization (WTO) International Valuation Agreement, (*sic*) is there a requirement that these subsequent proceeds must be a "condition of sale of the goods or be "in respect of the goods" being imported. Rather, the mere fact that such payments exist requires they be added to the price paid or payable." Guidelines and General Information, s. 9.

In other words, payments that are wholly unconnected to imported goods may still be considered part of the price paid for those goods. Much of the D-Memorandum is devoted to discussing how management and administrative fees will be treated. However, separate Appendices are devoted to the treatment of research and development fees, marketing and promotional fees and various other inter-company payments

Management and Administration Fees

From now on, CBSA will consider management or administration fees paid between related parties to be part of the price paid or payable for imported goods (and therefore part of the value for duty) unless three conditions are met:

1) the services must have been rendered for the operation of the business in Canada;

2) the amount of the charge must be comparable to an arms-length charge; and

3) the services provided are justified for the operation of the business in Canada.

The first requirement is that management or administration fees must be paid in respect of services actually rendered and the importer is responsible for keeping "sufficient and appropriate evidence, which establishes the nature of the services and proves that they were truly provided for the operation of the business in Canada". Without such evidence, the fees will be considered part of the value for duty of the goods. Id., s. 17-18.

CBSA will also subject the management fees to a two-part arms-length test that requires (i) that the amounts paid be comparable to the price that would be charged by an unrelated party and (ii) that the method of allocation of costs to the Canadian company must be reasonable and appropriate to the circumstances of the importer's business. Again, the burden is on the importer to substantiate that the amount of the charge in question is reasonable. The D-Memo advises that management fees and/or administration fees determined after the provision of the service are more likely to be challenged by CBSA. *Id.*, s. 23.

The final condition is that the services must be justified, in the sense that an unrelated Canadian business would be willing to pay for the management and/or administrative services because the services are needed and deliver some kind of benefit. As an example of an unjustifiable service, the D-Memorandum notes that a Canadian corporation would not normally bear the costs of a shareholders meeting of its parent corporation or pay for promotional services that did not take place in Canada for a product not sold in Canada. *Id.*, s. 26.

The overall approach that CBSA intends to take is summarized in the D-Memorandum as follows:

"CBSA will initially presume that service fees are dutiable with the provision that this can be rebutted with evidence from the importer indicating that the fees are in accordance with the arms-length principle, and that they relate to justifiable services that were actually rendered for the Canadian operation. Importers must be able to provide "sufficient information" pursuant to subsection 45(1) to justify exclusion of the fees from the value for duty." *Id.* s. 31.

Research and Development Fees

In an appendix to the D-Memorandum, CBSA sets out its policy with respect to the treatment of Research and Development fees as follows:

“In general, payments to the vendor of goods by the purchaser in a sale for export to Canada for research and development are considered as an addition to the price paid or payable for the goods and are to be included in the value for duty as prescribed by subsection 48(5) of the *Customs Act*. These would include research expenditures that can be regarded as part of a continuing activity required to maintain an enterprise’s business and its competitive position and development activities normally undertaken with a reasonable expectation of commercial success and future benefits arising from increased revenue or from reduced costs.” *Id.*, Appendix A, para. 9.

CBSA considers that the typical activities that would be included in research are: (i) laboratory research and the discovery of new knowledge; (ii) searching for commercial applications for new research findings; and (iii) conceptual formulation and design of possible product or process alternatives. Similarly, typical examples of development activity are: (i) testing in search for, or evaluation of, product or process alternatives; (ii) design, construction and testing of pre-production prototypes and models; and (iii) design of tools, jigs, moulds and dies involving new technology. *Id.*, Appendix A, para. 3-6.

Thus, a Canadian company’s contribution to the worldwide R&D efforts of its corporate group will be considered to form part of the price paid for imported goods, and will be subject to duty.

Marketing and Promotional Fees

The D-Memorandum distinguishes between two types of marketing and promotional fees that the parent corporation might charge to its subsidiaries. The first type of fee is in respect of marketing operations that are conducted on a global basis by multinationals to promote a particular product which is imported into Canada as well as distributed internationally. CBSA considers that these marketing fees are fees for services rendered (promotion in respect of a good that is imported into Canada). *Id.*, Appendix B, para. 2.

The second category relates to fees that are paid in respect of goods that are never imported into Canada and CBSA states that “if the marketing fee cannot be related to the specific product(s), which are imported and sold in Canada, then the fees cannot be identified as legitimate services the Canadian subsidiaries received”. Accordingly, this type of marketing or promotional fees would be found to be a “subsequent proceed” that must be added to the price paid or payable. *Id.*, Appendix B, para. 3.

Other Post-Importation Payments

The final appendix to the D-Memo brings together a number of specific examples of inter-company payments that may be considered to be part of the price paid for the goods and, therefore, subject to customs duty. It confirms that dividend distributions are not considered to form part of the value for duty of the imported goods, but only if the importer can provide substantiation that the amounts were in fact paid as dividends. *Id.*, Appendix C, Situations A and B. If the importer cannot provide such proof, the payments will be treated as part of the value for duty of the goods. Payments made by the Canadian subsidiary to its parent to repay debts, even those amounts are calculated as a proportion of the selling price in Canada likewise are considered financial transactions that do not form part of the value for duty of the goods, providing the amounts are reasonable. *Id.*, Appendix C, Situation C.

Finally, the appendix provides several examples of management fees structures which may or may not be acceptable and confirms that payments for the installation of imported goods and setup and service charges are not part of the value for duty of the goods. *Id.*, Appendix C, Situations D and F.

Conclusion

The D-Memorandum leaves no doubt that CBSA is looking to develop the law in this area and will scrutinize virtually all inter-company transfers with a view to including those payments to the value of imported goods. CBSA will also operate on the assumption that such payments are dutiable unless the importer can provide

evidence showing that the payments were in fact for services rendered, were justified and met an arms-length test.
Given the fact that CBSA can retroactively assess duty up to four years after goods were imported, the potential liability is significant. For that reason, related parties should re-examine all payment flows between its related entities to determine how best to structure and document such inter-company transactions to ensure that payments are not considered payments for imported goods and are not subject to duty.

Peter E. Kirby is a Partner at Fasken Martineau DuMoulin LLP.

Recent Adverse Facts Available Decision Underscores Concerns About Fraud in Antidumping and Countervailing Duty Proceedings

By: Stephen A. Jones and Sarah K. Davis

A recent antidumping determination underscores deepening concerns among international trade practitioners and their clients that respondents are increasingly attempting to submit false information to the Department of Commerce to minimize or eliminate dumping margins. In the 2007-2008 administrative review of *Pure Magnesium from the People's Republic of China* ("*Pure Magnesium*"), 74 Fed. Reg. 66,089 (Dec. 14, 2009), Commerce applied as adverse facts available the highest antidumping margin from the proceeding to a respondent reseller based on the failed verification of the unaffiliated producers of the subject merchandise. The verification report reads like a detective novel, including a surreal sequence of events highlighted by employees of the producers throwing documents out of the window to prevent discovery and fabricating documents that would be submitted as verification exhibits. Commerce's decision to impose AFA in the case underscores the respondent reseller's obligation to investigate and ensure the accuracy of all information submitted to Commerce, including information obtained from unaffiliated producers.

Background

Because the *Pure Magnesium* review involved export sales by a Chinese reseller, Commerce examined information concerning sales, obtained from the exporter, and production, obtained from unaffiliated producers of subject merchandise. Thus, it was necessary for Commerce to verify both the respondent reseller and its unaffiliated producers. During the verification of the unaffiliated producers, however, Commerce was significantly impeded in its investigation.

Commerce was unable to verify a majority of records at the factories of the producers. At one of the factories, Commerce officials were denied access to the factory statistician and the records kept by the statistician. At the other factory, Commerce officials were given access to the statistician and records, but, upon examination of what was said to be the factory computer, discovered that the data had been compiled only days before the verification and not throughout the period of review, as previously reported. Commerce officials asked about this apparent discrepancy, and the statistician fabricated a story about a computer virus that was contradicted by the person who allegedly fixed the computer.

During the examination of by-product sales, the producers withheld requested documents, and Commerce officials found that the producers had pasted worksheets into voucher books. Commerce officials also attempted to verify the authenticity of certain payment receipts for purported sales of by-products, but the producers locked them out of the accounting office and denied them entry even after repeated demands. The events culminated in the discovery that the producers were throwing the requested records out of the window of the accounting office to prevent detection. Commerce's verifiers witnessed this activity and actually retrieved the records and examined them.

When Commerce officials were finally granted entry to the accounting office, they found accounting books in various stages of alteration. Commerce officials also asked to examine the contents of bags stuffed with

altered documents. Although they were initially prohibited from examining the bags' contents, the producers eventually relented only after one of the producers' officials had examined each bag. The bags contained more records in various stages of alteration. Commerce officials specifically asked to see a book the producers were attempting to hide on a keyboard tray and a partially covered box, both of which clearly contained relevant records, but the producers forbade it -- saying the documents were "top secret." Commerce officials insisted that they be allowed to examine the relevant documents, but the producers' Deputy General Manager told them that they were not allowed to examine any more records within the accounting offices. This refusal effectively ended the verification.

Applicable Law

Commerce applies "facts otherwise available" when an interested party withholds requested information, fails to provide such information, significantly impedes the proceeding, or provides unverifiable information. *See* 19 U.S.C. 1677e(a). In *Pure Magnesium*, Commerce determined that the application of "facts otherwise available" was warranted. The producers withheld information when they, on various occasions, denied Commerce officials access to records and documents, including throwing documents out of the window. The producers also significantly impeded the proceeding by altering documents, locking Commerce officials out of the accounting office, attempting to hide the book on the keyboard tray and the contents of the box, prohibiting Commerce officials from examining requested documents, denying them access to necessary records at one factory, and fabricating a story regarding the recordkeeping at the other factory. Finally, given the events detailed above, Commerce officials not only were unable to verify certain information provided by the producers, but all other information provided by the producers became suspect and unreliable.

Pursuant to 19 U.S.C. 1677e(b), Commerce uses adverse inferences if it finds that an interested party "failed to cooperate by not acting to the best of its ability to comply with a request for information." To determine that a respondent has failed to act to the best of its ability, Commerce need not show intentional conduct but only (1) an objective showing that a "reasonable and responsible importer would have known that the requested information was required to be kept and maintained" and (2) a subjective showing that the failure is due either to a failure to maintain the required records or to put forth the maximum effort to obtain the information requested. *Nippon Steel Corp. v. United States*, 337 F.3d 1373, 1382-1383 (Fed. Cir. 2003). In *Pure Magnesium*, the producers' actions showed a clear failure to cooperate to the best of their ability. The producers never claimed that the information was not kept or maintained in their records, and their actions showed not only a failure to put forth their maximum effort, but an intention to deceive and mislead Commerce.

Commerce disagreed with the respondent reseller's argument that adverse facts available could not be applied to the respondent based on the actions of its unaffiliated producers. Because both the respondent reseller and the unaffiliated producer are "interested parties" under the statute, Commerce determined that it may apply adverse facts available if either party fails to cooperate to the best of its ability. *See* 19 U.S.C. §1677(28).

Furthermore, because the factors of production data were deemed unverifiable, Commerce had no basis for calculating normal value, which is then compared to the U.S. price. The factor of production information, therefore, is critical in determining an antidumping margin in a non-market economy case. In the absence of such information, Commerce was forced to resort to total facts available.

Implications

Commerce's determination makes clear that it is incumbent on a respondent reseller to investigate and ensure that the information it submits to Commerce is accurate, even information obtained from an unaffiliated producer. Commerce and the reviewing courts have consistently found that respondents are responsible for and bear the burden of creating an accurate record, because only the respondents possess the information necessary to calculate accurate margins. Respondents have a duty to investigate and confirm that the information they supply to Commerce is accurate and complete, even if a respondent is submitting its unaffiliated producers' information. Respondents must certify that their submissions are accurate and, therefore, they cannot simply "rubber stamp" the information they receive from their producers and then disavow responsibility for any errors in the data. Respondents are ultimately responsible for the accuracy of the record, and any failures on the part of their producers are attributable to the respondents.

If a respondent or its producer significantly impedes the proceeding by refusing to make records or people available or by altering records, as was the case in *Pure Magnesium*, the veracity and reliability of all submitted data is rendered suspect. Commerce cannot trust information on the record when it is clear that the interested parties have submitted false information. Commerce made it clear that such acts invalidate all information submitted by the respondent.

Pure Magnesium also demonstrates why it is imperative that Commerce have the ability to apply adverse inferences to a respondent reseller when an unaffiliated producer fails to cooperate. Commerce must have the power to obtain the information necessary to calculate dumping margins where exporters rely on unaffiliated producers for the subject merchandise shipped to the United States. Otherwise, there would be no recourse in cases such as this in which an unaffiliated producer refuses to provide requested information and there would be no means either to deter such actions or to incentivize cooperation.

Conclusion

The *Pure Magnesium* case is extraordinary, because Commerce's verifiers persevered in the face of efforts to deceive them and actually stayed on-site to document the extent of the scheme, instead of cancelling verification at the first sign of non-cooperation. The verifiers in this case remained far beyond the point when many verifiers would have ended the verification. Because of the verifiers' exceptional effort, the case provides a window into questionnaire response practices that many practitioners and their clients fear are just the tip of the iceberg. Commerce exercised its authority appropriately here by imposing the highest rate on the record of the proceeding -- 111.73 percent -- against the respondent reseller, and by making clear that a respondent has an obligation to investigate and ensure the accuracy and completeness of all information it submits, regardless of its source. This result is consistent with Commerce's longstanding practice. To accept the respondent's argument that it should not be held responsible for the actions of its unaffiliated supplier -- essentially, that it may "take at face value" information that it submits -- would have severely weakened Commerce's authority and undermined the congressional intent behind the facts available provision.

Notwithstanding Commerce's appropriate response here, *Pure Magnesium* highlights concerns about whether Commerce's authority under existing law is sufficient to deter behavior that is becoming all too common in AD/CVD cases, or whether Congress and/or Commerce should consider enhanced authority and penalties to address these issues. What shape the enhanced authority and penalties might take is beyond the scope of this case summary. The facts of *Pure Magnesium*, however, strongly suggest that the penalties provided under current law and practice are insufficient and should be enhanced.

Stephen A. Jones is a partner and the practice group leader of the international trade practice group at King & Spalding. Sara K. Davis is an associate in the international trade practice group at King & Spalding. The opinions expressed in this article are solely those of the authors and are not attributable to King & Spalding or any of its clients.

U.S. Customs Issues First Advanced Pricing Agreement Ruling Since 2003

By Damon V. Pike and Cylinda Parga

In a development sure to have implications for every major importer with related party transactions, U.S. Customs HQ issued an Internal Advice ruling on Dec. 8, 2009 (HQ H029658) which approved the use of transaction value when the import values were based on prices set pursuant to a bilateral Advance Pricing Agreement ("APA"). This ruling represents the first time that U.S. Customs HQ has issued a ruling involving transfer pricing rules under section 482 of the Internal Revenue Code and a bilateral APA since Nov. of 2003 (see HQ548223). It may signal a change in policy, i.e., that U.S. Customs is now ready to move forward and work with importers in finding a way to "bridge the gap" between the rules governing customs valuation of imported merchandise and the income tax rules governing inter-company pricing between related parties and the resulting allocation of profit and income on a global basis.

The facts surrounding HQ H029658 are important to understanding its outcome and significance. The

company at issue in the ruling was a U.S. corporation which functioned as the exclusive distributor of motor vehicles, parts, accessories, and service tools for its foreign-owned parent company. As part of a "Focused Assessment," the importer was asked to justify the arm's length nature of its vehicle and parts pricing to the audit team, which it explained and which was summarized in the ruling as follows:

The sales process between these two entities begins with the U.S. buyer/importer preparing a pricing proposal for each vehicle model that it will import during the upcoming year. This pricing proposal analyzes the market segment for each model and includes information on competitor's vehicles, sales plans, and suggested vehicle trim levels. The pricing proposal also includes recommendations regarding dealer margins and the Manufacturer's Suggested Retail Price ("MSRP"). A similar proposal is also prepared by the foreign parent seller/manufacturer, and includes recommendations for an FOB amount for the vehicles, dealer costs, and MSRPs based on sales and profit goals. Once these proposals are created, the two parties negotiate an acceptable price that the buyer will pay for the imported vehicles. The U.S. buyer/importer then uses this negotiated price on purchase orders it sends to the foreign seller/manufacturer, who in turn issues an invoice for the ordered vehicles that transfers title and risk of loss at the port of embarkation. HQ H029658 (Dec. 8, 2009), at 2.

The U.S. buyer/importer had previously applied for a bilateral APA with both the U.S. Internal Revenue Service ("IRS") and the foreign tax authority of the parent company. An APA is a prospective agreement between a taxpayer and the national tax authorities, and it establishes the correct transfer pricing methodologies to be applied to transactions between related parties. Having an APA allows taxpayers to avoid audits and disputes, and validates that the covered transactions between the related parties subject to the APA, like those at issue in this case, are priced at "arm's length," or as if the parties were unrelated. When an APA is bilateral, as it was here, the agreement has been examined and ratified by the tax authorities of the two countries involved, i.e., that of the distributor and the manufacturer. The APA in this case was approved for a five-year term, and the transfer pricing method selected was the "comparable profits method" ("CPM").

Pursuant to the CPM, an arm's length price range of operating profits was selected by comparing the profitability of the "tested party" (in this case, the U.S. buyer/importer/taxpayer) to that of a set of unrelated companies selected and refined through a sophisticated economic analysis performed by the importer's outside accounting firm. The comparable companies finally selected for examination in this APA were 21 companies identified as performing similar functions and assuming similar risks as the U.S. buyer/importer. None of the 21 companies selected were automobile distributors or manufacturers because pricing data for sales from vehicle manufactures to unrelated distributors did not exist. Instead, the final comparable set of companies included those selling a variety of products, from heating equipment to tires to roofing materials. Using the CPM, the APA set forth an acceptable arm's length range of operating profits for transactions between the two companies, which range was ratified by both the IRS and the foreign tax authorities. As with all APA's, the agreement also provided for reporting formal "compensating adjustments" should the profits fall outside of the range for any given year covered by the APA Term.

Upon this factual background, the audit team (working with the local import specialist) was unable to make a determination about the appropriate basis of appraisement. Thus, the importer's outside counsel prepared a request for Internal Advice for the Port Director to forward on to Customs HQ, posing the single issue for resolution: whether the prices paid between the related seller/manufacturer and the buyer/importer, established pursuant to the approved bilateral APA, were acceptable for the purposes of using the transaction value method of appraisement under the U.S. Customs regulations?

In answering this question, Customs first had to examine whether or not the transactions between the U.S. buyer and the foreign seller qualified as "*bona fide* sales." This determination was necessary because the Customs regulations only permit importers to value goods using transaction value when the transaction qualifies as a "*bona fide* sale." In examining whether or not *a bona fide* sale has occurred, Customs considers such factors as risk of loss, transfer of title, whether the goods were paid for, and whether the parties generally functioned as a buyer and a seller. In this case, Customs determined that a *bona fide* ***did*** occur, based in part on the preparation of the pricing proposals by both parties, the price

negotiations between the parties, the fact that the importer set the dealer cost and MSRP, and the overall "structure" of the transactions, which included the issuance of purchase orders and invoices that transferred title and risk of loss to the buyer at the port of embarkation.

After determining that the transactions between the U.S. buyer/importer and foreign seller/manufacturer were *bona fide* sales, Customs focused on the other requirement for using transaction value—whether or not the price actually paid or payable by the buyer to the seller was influenced by the relationship between the parties. Customs made this determination by examining the circumstances of the sale for signs that the parties' relationship influenced the sales price of the vehicles.

In examining the circumstances of the sales at issue, Customs focused on three main areas: (1) whether the sales prices of the transactions were settled in a similar manner to the way the seller settled prices with unrelated parties or with the normal pricing practices of the industry; (2) whether the sales prices were adequate to ensure the recovery of all costs plus a profit equivalent to the company's overall profit realized over a representative period of time; and (3) whether there were any other factors that indicated that the relationship between the buyer and seller did not influence the sales prices.

Customs first examined whether the sales prices of the transactions were settled in a similar manner to the way the seller settled prices with unrelated parties or with the normal pricing practices of the industry. Although the manufacturer at issue had some independent distributors of its vehicles in other jurisdictions (especially in South America), Customs agreed that because of different volumes, consumer preferences, and government regulations in those countries, using those prices as surrogates to determine whether transaction value was acceptable would yield a meaningless comparison. HQ H029658, at 7.

The ruling then turned to a discussion of whether the sales prices were set in a manner consistent with the normal pricing practices of the automotive industry. Customs noted that the importer's ruling request included a paper prepared by Ernst & Young entitled "Pricing Practices in the Automotive Industry," which provided a comprehensive overview of how prices are set in the automotive industry. Customs acknowledged that this paper provided evidence (although not "entirely objective" evidence, *id.*) describing the "market-driven" pricing of how the automotive industry sets it vehicle and parts pricing, and agreed that "vehicle pricing at all levels is based on the market driven MSRP. In other words, once a vehicle has been produced, pricing through the chain of manufacturing, assembly, marketing, and retail sale is based on actual retail prices paid by consumers, and not on some hypothetical and expected prices or costs used in the development stage." *Id.* Although the ruling then declined to address the validity of the comparables selected and approved by both the IRS and the foreign taxing authority, Customs nonetheless found that that the importer had submitted "some evidence that the price was settled in a manner consistent with the normal pricing practices of the industry." *Id.* at 8.

Customs next examined whether the declared import values were adequate to ensure the recovery of all costs plus a profit equivalent to the company's overall profit realized over a representative period of time in sales of merchandise of the same class or kind, as required by 19 C.F.R. § 152.102(i)(1)(iii) to demonstrate that the relationship between the parties did not influence the price paid for the merchandise. To support its claim that the sales prices were adequate the importer relied on the approved bilateral APA, in which the IRS and the foreign tax authority had approved the importer's submitted range of profitability based upon comparisons made between the importer's profitability and the profitability of the 21 "comparable" companies. The importer asserted that the IRS's approval of its profitability range would ensure that the company recovered "all costs plus a profit" as required by the Customs regulations, and that this in turn supported the importer's claim that the sales prices it paid to its parent company for the vehicles were set at arm's length and could properly be used with the transaction value appraisal method.

While Customs acknowledged that the APA's comparison between the importer's profitability and that of other companies "may provide some evidence that the price is adequate to ensure recovery of all costs plus a profit" *id.* at 9, Customs found this kind of information to be "less valuable since the companies are not engaged in the sale of the same class or kind of merchandise." *Id.* at *9.*

Customs also addressed the importer's argument that the *buyer's* overall profit over a representative period of time should be considered in determining whether the relationship between the seller/buyer influenced the price. Although the ruling noted that Customs has normally examined the *seller's* (manufacturer's) profit in addressing this part of the regulation, it also found that "the buyer's overall profit may be relevant," *id.*, and

that "the buyer's overall profit is one of the factors that may be considered to indicate that the relationship between the buyer and the seller did not influence the price." *Id.*

Finally, Customs focused its attention on whether any other factors indicated that the relationship between the parties did not influence the sales price. To begin this examination, Customs once again turned to the approved APA. Despite having expressed concerns about the aspect of comparing profits of "functionally equivalent" companies to those of an automotive importer for purposes of the "all costs plus a profit" examination, Customs stated that, overall, it found "that the information submitted to the IRS and the fact that there is a bilateral APA constitute valuable information in evaluating the circumstances of the sale*." Id.* at 9. Customs noted that the existence of an APA covering all of the buyer's imported products reduced the possibility of profit manipulation between the buyer and the seller. *Id.* Customs also stated that while CBP did not participate in the APA pre-filing conference that was held between the importer and the tax authorities, the importer did give CBP access to all of the documents submitted to the IRS during the APA approval process. *Id.* These documents provided Customs with additional support to substantiate the claims the U.S importer made in its Customs ruling request. Another factor showing that the parties' relationship did not influence the price, according to Customs, was the fact that a *foreign* tax authority approved the APA profit levels, indicating that the foreign seller also earned sufficient profit to cover its operating costs. *Id.* Finally, Customs identified the rigorous price negotiations between the buyer and the seller that set an FOB price which allowed the importer's operating profit to fall within the profit range established by referencing the unrelated comparable companies as another factor indicating the relationship between the parties did not influence the sales price. *Id.* at 10.

In conclusion, while HQ H029658 does not represent the "panacea" some may have hoped for in answering many of the vexing questions which have dogged the years-long debate over using transfer prices to support declared customs values, it nonetheless represents a significant step forward. U.S. Customs is now demonstrating some welcome flexibility in developing thoughtful approaches to this very complicated question, and further developments are certain to come in 2010.

Mr. Pike is President of The Pike Law Firm, P.C. in Atlanta, GA. Ms. Parga is a staff attorney with the firm.

CITBA Online –

Please look for further announcements and copies of past newsletters at http://www.citba.org.

Membership

CITBA is in the process of setting up dues payment through PayPal. PayPal allows members to send money without sharing financial information, with the flexibility to pay for membership using their account balances, bank accounts or credit cards. PayPal is an eBay company and is made up of three leading online payment services. More information about Pay Pal can be found at https://www.paypal.com.

Not a CITBA member? Apply for membership now! CITBA offers different membership levels - active, associate and retired/student. For additional information, check out the CITBA website http://www.citba.org/joinCITBA.php

Are you already a member, but late in paying your dues? Get current today and enjoy the benefits of membership. Contact Page Hall at hall@adduci.com for details.

Pro Bono Opportunities

The U.S. Court of International Trade has an ongoing need for attorneys who are able to serve as pro bono counsel for pro se plaintiffs in Trade Adjustment Assistance cases before the Court. There are two types of Trade Adjustment Assistance cases that call for pro bono representation. The first type arises when workers seek judicial review either after the U.S. Department of Labor's negative determination on the original petition or after the U.S. Department of Labor's negative determination on its reconsideration. The second type of case occurs when the U.S. Department of Agriculture denies a petitioner's claim seeking compensation for a decline in net farm income from one year to the next as a result of imports. The majority of these cases are filed by participants in the Alaska salmon industry and the Gulf Coast shrimp industry.

If you would like to volunteer to serve as pro bono counsel or if you would like more information about the pro bono program, please contact:

Case Management Operations Manager
Scott Warner
(212) 264-2031

You can also learn more about TAA by visiting the CITBA website at http://www.citba.org/announcements.php and reading the Executive Summary of a course first presented at "What You Need to Know About Trade Adjustment Assistance Cases – From All Sides" sponsored by the U.S. Court of International Trade, the American Bar Association, and the Customs and International Trade Bar Association, in April, 2005.

Additional and more detailed information can be obtained at the TAA Coalition web site (http://www.taacoalition.com), which includes a "Primer on TAA petition process," among other informative materials.

Please send questions or comments about this Newsletter to: Frances P. Hadfield at fhadfield@gdlsk.com.

The CITBA Quarterly Electronic Newsletter is published as a free service for members of the Customs and International Trade Bar Association. The Newsletter is for general information only and is not legal advice for any purpose. Neither CITBA and its officers and members nor Grunfeld, Desiderio, Lebowitz, Silverman & Klestadt, LLP assume liability for the accuracy of the information provided.

SUBSCRIBE/ UNSUBSCRIBE: Send requests to subscribe/ unsubscribe to: Frances P. Hadfield, CITBA Publications Chair at fhadfield@gdlsk.com

Copyright © 2008 CITBA. This Newsletter may be redistributed in its entirety.

citba.org
Customs and International Trade Bar Association

Customs and International Trade Bar Association Winter Dinner

In conjunction with the
Georgetown University
2010 International Trade Update

Date:	February 25, 2010
Time:	6:30 p.m.
Place:	Hotel George 15 E Street, N.W. Washington, D.C. 20001
Speaker:	Chief Judge Paul R. Michel U.S. Court of Appeals for the Federal Circuit
Price:	Members: $95 Non-Members: $120 Government attorneys: $10 discount

RSVP with Checks Payable to "CITBA"
by February 18, 2010 to:

Beth Ring, Esq.
Sandler, Travis & Rosenberg, P.A.
551 Fifth Ave., Suite 1100
New York, N.Y. 10176
Fax: 212-883-0068
Email responses to: Nkoosau@strtrade.com

Customs and International Trade Bar Association Winter Dinner

Registration Form

Please fill out the information below and forward it with your check payable to "CITBA" by February 18, 2010 to:

Beth Ring, Esq.
Sandler, Travis & Rosenberg, P.A.
551 Fifth Ave., Suite 1100
New York, N.Y. 10176
Fax: 212-883-0068

Name: ____

Firm/Organization: ____________________________________

Contact Information:

____

____

____

____

Member Non Member Government Attorney

Check Amount $ ____________