

*What Every Member of the
Trade Community Should Know About:*

**DETERMINING THE
ACCEPTABILITY OF
TRANSACTION
VALUE FOR
RELATED PARTY
TRANSACTIONS**



AN INFORMED COMPLIANCE PUBLICATION

APRIL 2007

U.S. CUSTOMS and BORDER PROTECTION

NOTICE:

This publication is intended to provide guidance and information to the trade community. It reflects the position on or interpretation of the applicable laws or regulations by U.S. Customs and Border Protection (CBP) as of the date of publication, which is shown on the front cover. It does not in any way replace or supersede those laws or regulations. Only the latest official version of the laws or regulations is authoritative.

Publication History

First Published: April 2007

PRINTING NOTE:

This publication was designed for electronic distribution via the CBP website (<http://www.cbp.gov>) and is being distributed in a variety of formats. It was originally set up in Microsoft Word97[®]. Pagination and margins in downloaded versions may vary depending upon which word processor or printer you use. If you wish to maintain the original settings, you may wish to download the .pdf version, which can then be printed using the freely available Adobe Acrobat Reader[®].

PREFACE

On December 8, 1993, Title VI of the North American Free Trade Agreement Implementation Act (Pub. L. 103-182, 107 Stat. 2057), also known as the Customs Modernization or “Mod” Act, became effective. These provisions amended many sections of the Tariff Act of 1930 and related laws.

Two new concepts that emerge from the Mod Act are “**informed compliance**” and “**shared responsibility**,” which are premised on the idea that in order to maximize voluntary compliance with laws and regulations of U.S. Customs and Border Protection, the trade community needs to be clearly and completely informed of its legal obligations. Accordingly, the Mod Act imposes a greater obligation on CBP to provide the public with improved information concerning the trade community’s rights and responsibilities under customs regulations and related laws. In addition, both the trade and U.S. Customs and Border Protection share responsibility for carrying out these requirements. For example, under Section 484 of the Tariff Act, as amended (19 U.S.C. 1484), the importer of record is responsible for using reasonable care to enter, classify and determine the value of imported merchandise and to provide any other information necessary to enable U.S. Customs and Border Protection to properly assess duties, collect accurate statistics, and determine whether other applicable legal requirements, if any, have been met. CBP is then responsible for fixing the final classification and value of the merchandise. An importer of record’s failure to exercise reasonable care could delay release of the merchandise and, in some cases, could result in the imposition of penalties.

Regulations and Rulings in CBP’s Office of International Trade (“OT”) has been given a major role in meeting the informed compliance responsibilities of U.S. Customs and Border Protection. In order to provide information to the public, CBP has issued a series of informed compliance publications on new or revised requirements, regulations or procedures, and a variety of classification and valuation issues.

This publication, “Determining the Acceptability of Transaction Value for Related Party Transactions”, prepared by the Commercial and Trade Facilitation Division of Regulations and Rulings, is intended to educate the public regarding certain aspects of the customs valuation requirements for related party transactions. We sincerely hope that this material, together with seminars and increased access to rulings of U.S. Customs and Border Protection, will help the trade community to improve voluntary compliance with customs laws and to understand the relevant administrative processes.

The material in this publication is provided for general information purposes only. Because many complicated factors can be involved in customs issues, an importer may wish to obtain a ruling under Regulations of U.S. Customs and Border Protection, 19 C.F.R. Part 177, or to obtain advice from an expert who specializes in customs matters, for example, a licensed customs broker, attorney or consultant.

Comments and suggestions are welcomed and should be addressed to the Executive Director at the Office of Regulations and Rulings, U.S. Customs and Border Protection, 1300 Pennsylvania Avenue, NW, (Mint Annex), Washington, D.C. 20229.

Sandra L. Bell
Executive Director, Regulations and Rulings
Office of International Trade

(This page intentionally left blank)

BACKGROUND	6
I. TRANSACTION VALUE - TESTS FOR DETERMINING THE ACCEPTABILITY OF TRANSACTION VALUE FOR RELATED PARTY TRANSACTIONS	6
A. Circumstances of Sale	7
B. Test Values.....	10
II. RELEVANCE OF TRANSFER PRICING AGREEMENTS AND TRANSFER PRICING STUDIES PERTAINING TO SECTION 482 OF THE INTERNAL REVENUE CODE TO THE APPLICATION OF THE CIRCUMSTANCES OF SALE TEST.	11
A. Summary of IRS Transfer Pricing Requirements.....	12
B. Relevance of APA's and Transfer Pricing Studies to Customs Valuation	14
III. THE IMPORTER'S OBLIGATIONS REGARDING THE DECLARATION OF VALUE IN RELATED PARTY TRANSACTIONS AND INFORMATION AND DOCUMENTATION NEEDED TO SUPPORT AN ENTRY OR RULING REQUEST BASED ON A RELATED PARTY TRANSACTION VALUE	16
A. Obligation to use reasonable care to determine the value of imported merchandise.....	17
B. Examination of related party transactions by CBP and information and documentation needed to support an entry or ruling request based on a related party transaction value	17
ADDITIONAL INFORMATION	20
The Internet.....	20
Customs Regulations	20
Customs Bulletin.....	20
Importing Into the United States	21
Informed Compliance Publications.....	21
Value Publications	22
"Your Comments are Important"	23

BACKGROUND

This Informed Compliance Publication is intended to educate the public regarding certain aspects of the customs valuation requirements for related party transactions. Specifically, in this Publication, U.S. Customs and Border Protection (CBP) will summarize:

- the tests for determining the acceptability of transaction value for related party transactions;
- CBP's application of the related party tests, including information and evidence needed to substantiate claims that transaction value is acceptable under these tests;
- the relevance of Advance Pricing Agreements (APA's) and Transfer Pricing Studies to the circumstances of sale test in determining the acceptability of transaction value; and,
- the importer's obligations regarding the declaration of value in related party transactions.¹

I. TRANSACTION VALUE - TESTS FOR DETERMINING THE ACCEPTABILITY OF TRANSACTION VALUE FOR RELATED PARTY TRANSACTIONS

Merchandise imported into the United States is appraised for customs purposes 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, the "value law"). The implementing regulations are contained in Part 152 of the CBP Regulations (19 CFR Part 152). The primary method of appraisement is transaction value, which is defined as "the price actually paid or payable for the merchandise when sold for exportation to the United States," plus amounts for certain statutorily enumerated additions to the extent not otherwise included in the price actually paid or payable. See 19 U.S.C. §1401a(b)(1). When 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.

There are special rules that apply when the buyer and seller are related parties, as defined in 19 U.S.C. §1401a(g).² As provided in 19 U.S.C. §1401a(b)(2)(A)(iv),

¹ This ICP does not address the issue of the applicability of transaction value when the related party price is subject to adjustment after importation or the proper treatment of post-importation adjustments in the determination of transaction value.

² The following persons are considered related: members of the same family, including brothers and sisters, spouse, ancestors, and lineal descendants; any officer or director of an organization and such organization; an officer or director of an organization and an officer or director of another organization, if each such individual is also an officer or director in the other organization; partners, employer and employee; any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting stock or shares of any organization and such organization; and, two or more persons directly or indirectly controlling, controlled by, or under common control with, any person.

transaction value can only be applied if “[t]he buyer and seller are not related, or the buyer and seller are related but the transaction value is acceptable.” Transaction value between a related buyer and seller is acceptable if the importation meets either of two tests: 1) circumstances of sale or 2) test values. See 19 U.S.C. §1401a(b)(2)(B).

A. Circumstances of Sale

Under the “circumstances of sale” test, the transaction value between a related buyer and seller is acceptable if an examination of the circumstances of the sale of the imported merchandise indicates that the relationship between the buyer and the seller did not influence the price actually paid or payable. 19 U.S.C. §1401a(b)(2)(B). Under this test, the relevant aspects of the transaction are analyzed, including: 1) the way in which the buyer and the seller organize their commercial relations, and 2) the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price. Statement of Administration Action, H.R. Doc. No. 103-316, 103rd Cong, 2d Sess. (1994) reprinted in Customs Valuation Under the Trade Agreement Act of 1979, at 53-54; See *also* 19 CFR. §152.103(l)(1)(i).

The circumstances of sale test by its very nature must be applied case-by-case. As provided in 19 CFR §152.103(l), the following circumstances demonstrate that the relationship has not influenced the price:

The price was settled in a manner consistent with the normal pricing practices of the industry in question;

The price was settled in a manner consistent with the way the seller settles prices for sales to buyers who are not related to it; or

The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm’s overall profit realized over a representative period of time in sales of merchandise of the same class or kind.

See *also* Statement of Administration Action.

CBP has issued a number of rulings on the application of the circumstances of sale test.³ Some of the issues that have arisen are discussed below.

1. *The price was settled in a manner consistent with the normal pricing practices of the industry in question.*

When the importer claims that transaction value is acceptable because the transfer price was settled in a manner consistent with the normal pricing practices of the industry in question, the importer must have objective evidence of the normal pricing practices of

³ CBP’s rulings from 1989 to the present are included in the Customs Rulings Online Search System (CROSS) which is available on CBP’s website, www.cbp.gov. These rulings should be consulted for further guidance regarding the application of the circumstances of sale test.

the industry in question and present evidence that the transfer price was settled in accordance with these industry pricing practices.

For example, objective evidence was presented in Headquarters Ruling Letter (HRL) 542261 (March 11, 1981) (TAA No. 19), where CBP determined that the transfer price was defined with reference to prices published in a trade journal (the posted price) and other buyers and sellers commonly used the posted price as the basis of contract prices.

The pricing practices must relate to the “industry in question” which generally includes the industry that produces goods of the same class or kind as the imported merchandise. See HRL’s 546998, January 19, 2000 and 548095, September 19, 2002.⁴ Same class or kind determinations necessarily take into account factors relating to the specific type of goods at issue.

CBP does not consider the industry in question to consist of other functionally equivalent companies if those companies do not sell goods of the same class or kind. In this regard, CBP has ruled that the mere fact that the importer allegedly earned an operating profit comparable to other *functionally equivalent companies* (as shown in a transfer pricing study) was not sufficient to establish either the normal pricing practice in the industry in question or that the related party price was settled in a manner consistent with the normal pricing practices of the industry in question. See HRL’s 548482, July 23, 2004 and 548095, *supra*.

2. *The price was settled in a manner consistent with the way the seller settles prices for sales to buyers who are not related to it.*

This method applies in situations where the seller sells the same merchandise to both related and unrelated parties and determines the prices in a consistent way. For example, if the importer establishes that the price paid by unrelated and related buyers to the seller is the same or that the price was determined based on an arm’s length negotiation, this would be an indication that the relationship between the parties did not influence the price. Or, if the seller uses a specified formula for determining the price (for example, based on the quantity purchased or other specified criteria) and applies the same formula in both sales to related and unrelated buyers, this would be an indication that the price was settled in a manner consistent with the way the seller settles prices for sales to unrelated buyers.⁵

⁴ Merchandise of the same class or kind means merchandise (including but not limited to, identical merchandise and similar merchandise) within a group or range or merchandise produced by a particular industry or industry sector.

⁵ For example, in HRL 547019, March 31, 2000, CBP determined that transaction value was acceptable where the foreign supplier grants various discounts based on established criteria from a price list and gives the same discounts based on matching ratings to both related buyers and unrelated buyers. As evidence of this practice, the importer presented invoices from its related foreign supplier to other unrelated foreign buyers showing that identical price discounts for merchandise identical to the imported merchandise were given to other unrelated parties.

Although CBP generally requires that the comparison sales to unrelated buyers be sales to buyers in the U.S., CBP will consider evidence regarding sales to unrelated buyers in other countries, provided the importer presents an adequate explanation as to why it is relevant to the transactions at issue. How much weight will be given to such evidence depends on the specific facts and the explanation provided.

3. *The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind.*

This method, which is often referred to as the “all costs plus profit method”, examines whether the related party price compensates the seller for all its costs plus a specified amount of profit (i.e., a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind). This method is especially useful when there are no sales to unrelated buyers that can be used as a point of reference. It is the most objective method of meeting the circumstances of sale test when there are no sales to an unrelated buyer. In applying this test, CBP normally considers the “firm's overall profit . . .” to be the profit of the parent company. Thus, if the seller of the imported goods is a subsidiary of the parent company, the price must be adequate to ensure recovery of all the seller's costs plus a profit that is equivalent to the parent company's overall profit. See HRL 546998, *supra*. In addition, as the language of this provision makes clear, the profit must relate to the profit realized over a representative period of time (e.g., one year) *in sales of merchandise of the same class or kind*.⁶ If the firm sells different classes of merchandise, the relevant profit is the profit that pertains only to sales of merchandise of the same class or kind.

To substantiate an all costs plus profit claim, the importer should be prepared to provide records and documents of comprehensive product related costs and profit, such as financial statements, accounting records including general ledger account activity, bills of materials, inventory records, labor and overhead records, relevant selling, general and administrative expense records, and other supporting business records.

Information and Evidence to Substantiate a Circumstances of Sale Claim

In CBP's rulings applying the circumstances of sale test, the determination of whether the relationship between the parties influenced the price depends on a review of all the relevant circumstances of sale and the supporting documentation.

The application of the circumstances of sale test generally presents two issues: 1) whether there is sufficient evidence to establish the alleged circumstances of sale; and 2) whether such circumstances demonstrate that the relationship between the buyer and the seller did not influence the price.

⁶ See Note 5 for definition of merchandise of the same class or kind.

The importer should be prepared to provide a thorough explanation of the circumstances surrounding the sale, supporting evidence, and an explanation of why the importer believes that such circumstances establish that the relationship did not influence the price.

CBP often rejects circumstances of sale claims because the allegations are conclusory and not supported by evidence. For example, the claim will be rejected when the importer alleges that the transfer price is negotiated at arm's length, but does not submit any evidence, such as correspondence between the parties, that reflects such negotiation. Similarly, the claim will be rejected where the importer alleges that the price was settled in a manner consistent with sales to unrelated buyers, but does not provide documentation, such as contracts and invoices, regarding both the related and unrelated party sales. An all costs plus profit claim should be supported by information and documentation regarding both the seller's costs and the firm's profit. The documents referenced in Section A.3 should be available to substantiate a claim of this nature.

B. Test Values

An alternative method to establish the acceptability of transaction value is to demonstrate that it closely approximates certain test values pertaining to identical or similar goods exported at or about the same time as the imported merchandise under review.

Specifically, under the test value method the transaction value between a related buyer and seller is acceptable if the transaction value of the imported merchandise closely approximates one of the following "test values":

- (i) the transaction value of identical merchandise, or of similar merchandise, in sales to unrelated buyers in the United States;
- (ii) the deductive value or computed value for identical merchandise of similar merchandise;
- (iii) but only if each value referred to in clause (i) or (ii) that is used for comparison relates to merchandise that was exported to the United States at or about the same time as the imported merchandise.

19 U.S.C. §1401a(b)(2)(B).

CBP has issued a number of rulings on the application of the test value method. Two issues that frequently arise are whether the test values must be actual appraised values of previously imported merchandise and whether the test values can be substituted for the transfer price.

CBP requires that the test values must be values previously determined by CBP pursuant to an actual appraisal of imported merchandise. For example, a computed value calculation can only serve as a test value if it represents a previous

actual appraisal of merchandise under 19 U.S.C. §1401a(e). See HRL 546052, October 27, 1995; and HRL 545960, August 16, 1995 citing HRL 543568, May 30, 1986 and HRL 544686, August 31, 1994.⁷ Importers often mistakenly believe that transaction value is acceptable for the imported goods when it is the same as the value calculated by the importer under the deductive value or the computed value method for those same imported goods. This is not the case. If there are no previous importations of identical or similar merchandise that were appraised under the transaction, deductive or computed value methods, there are no test values that can be applied.

With regard to the proper use of test values, the value law indicates that they are to be used for comparison purposes. See 19 U.S.C. §1401a(b)(2)(C). In other words, test values are used solely to determine whether the related party transaction value is acceptable. If the related party transaction value closely approximates a test value, the merchandise is appraised based on the related party transaction value. If the related party transaction value does not closely approximate a test value, then transaction value is acceptable only if the circumstances of sale test is met. Otherwise, the merchandise must be appraised using the next applicable valuation method in the hierarchy.

If the importer has information regarding possible test values pertaining to the related party transaction, this information should be brought to CBP's attention.

II. RELEVANCE OF TRANSFER PRICING AGREEMENTS AND TRANSFER PRICING STUDIES PERTAINING TO SECTION 482 OF THE INTERNAL REVENUE CODE TO THE APPLICATION OF THE CIRCUMSTANCES OF SALE TEST.

The U.S. tax law requires that related party transactions satisfy the arm's length principle. A question that has arisen is what weight, if any, should CBP give to information an importer prepares for tax purposes in determining whether a related party transaction value is acceptable for customs purposes under the application of the circumstances of sale test. Increasingly, importers are asking CBP to rule that a related party transaction value is acceptable under the circumstances of sale test because it meets the arm's length principle for tax purposes. In some cases, the importer provides evidence that the Internal Revenue Service (IRS) has agreed that the importer's transfer pricing methodology is the "best method," as defined in Treasury regulations under IRC section 482, for tax purposes through an Advance Pricing Agreement (APA), or audit. In other cases, the importer provides a transfer pricing study prepared for IRC section 6662 purposes that demonstrates that the transactions are arm's length under one of the IRS methods.

⁷ 19 U.S.C. §1401a is the U.S. implementation of the Agreement on Implementation of Article VII of GATT 1994 (the Customs Valuation Agreement). CBP's interpretation of the test value provision is based on a provision in the Customs Valuation Agreement. Specifically, the Note to Article 1 states that with regard to the application of the test value method, the importer must demonstrate that "the transaction value closely approximates to a 'test' value previously accepted by the customs administration."

In order to put this issue in context, some background information about the tax requirements for related party transactions and the documents used by importers to satisfy these requirements is provided below.⁸ This summary is followed by CBP's views reflected in rulings regarding the relevance of these documents for customs determinations under 19 U.S.C. §1401a.

A. Summary of IRS Transfer Pricing Requirements

1. Section 482 – Internal Revenue Code: Arm's Length Requirement

The IRS regulates transfer pricing for tax purposes through Section 482 of the Internal Revenue Code (IRC), 26 U.S.C. §482, and the Section 482 regulations, which require the application of the arm's length principle to related party transactions. The arm's length principle is designed to ensure that the taxpayer's income is clearly reflected on the taxpayer's tax return.

IRC Section 482 grants the IRS the authority to "distribute, apportion, or allocate" gross income, deductions, credits, or allowances among related taxpayers to the extent deemed necessary to prevent the evasion of taxes or to "more clearly reflect" the income of the involved taxpayers. The IRS can adjust gross income, deductions, credits or allowances reported on the taxpayer's return and impose penalties if the taxpayer's income is understated.

Section 482 and the applicable regulations provide transfer pricing methods for determining whether related party transactions meet the arm's length principle. These include three transaction-based methods and several profit-based methods.

Many of the methods compare in some manner the related company's financial results with the financial results of comparable unrelated companies. In general, comparable companies are companies that engage in similar business functions in similar circumstances. The transaction-based methods in particular compare the related party transactions to particular comparable unrelated party transactions.⁹ In contrast, the comparable profits method looks at whether the overall profits of the related party is

⁸ This information is based on CBP's understanding of the IRS requirements and has not been formally approved by the IRS.

⁹ The three transaction based methods are the comparable uncontrolled price method (CUP), the resale price method, and the cost plus method. The CUP method compares the related party transfer price to the prices in transaction with uncontrolled party transactions. The circumstances, including the products, must be substantially the same. The resale price method is typically used to evaluate a reseller. It compares the gross margin earned by the reseller in controlled transactions to the gross margin earned in comparable uncontrolled transactions. Exact comparisons are not necessary and adjustments may be made to account for differences. The cost plus method is ordinarily used to evaluate a manufacturer. It compares gross margin earned by the manufacturer in controlled transactions to gross margin earned in comparable uncontrolled transactions. Adjustments must be made to account for differences.

consistent with the overall profits of comparable unrelated parties on an aggregate basis.¹⁰

Section 482 does not specify any preferred method. Rather, it requires the application of the best transfer pricing method. The best method is the one that provides the most reliable measure of an arm's length result. Two primary factors that determine the most reliable measure are the degree of comparability between the controlled transaction and any uncontrolled comparable transaction and the quality of the data and the assumptions used in the analysis.

2. Advance Pricing Agreements

A U.S. taxpayer may request an APA regarding its transfer pricing methodology. An APA is a prospective binding agreement between the taxpayer and the IRS regarding the correct transfer pricing methodology under section 482. It may either be unilateral or bilateral. A unilateral APA is an agreement between the taxpayer and the IRS. A bilateral APA is an agreement resulting from negotiations between the U.S. Competent Authority and the tax/revenue agency of the foreign country in which the related party is located. A bilateral APA establishes arm's length prices acceptable to both the IRS and the tax/revenue agency in the foreign jurisdiction.

In order to obtain an APA, a taxpayer must propose a transfer pricing method (the best method) and demonstrate that such method produces an arm's length result between the taxpayer and the involved related parties. The taxpayer generally must support the request with pricing data from uncontrolled transactions, or comparables based on the financial results of unrelated parties. The IRS will evaluate the proposal by analyzing the data supplied by the taxpayer together with other pertinent information. The APA specifies the best transfer pricing method (TPM) and establishes an acceptable transfer pricing methodology. The APA may apply a TPM based on a range of expected arm's length results for given transactions.¹¹

3. Transfer Pricing Studies

¹⁰ The comparable profits method (CPM) focuses on the overall profit on an aggregate basis rather than on specific transactions. It compares the overall profitability of the tested party to the overall profitability of comparable companies. In selecting comparable companies, the CPM emphasizes functional similarity as opposed to strict product similarity. The tested party may be any of the related parties involved in the transactions. For a transfer price evaluated under this method to be acceptable to the IRS, the price must generate a profit for the controlled taxpayer that falls within the arm's length range of comparable companies. The CPM uses a more flexible standard for comparability than the transaction-based methods.

Other profit-based methods are the comparable profit split and residual profit split methods. These methods evaluate each party's share of the combined profits earned in the controlled transaction and then split the profit among the parties on the basis of their respective contributions.

¹¹ For further information about APA's, see IRS Rev. Proc. 2006-09, 2006-2 I.R.B. 278 (Jan. 9, 2006).

Multinational companies often prepare their own transfer pricing studies based on the application of section 482 principles to support their transfer pricing practices. These transfer pricing studies generally include a description of intercompany transactions, the company's transfer pricing methodology, a discussion of section 482 transfer pricing methods and the selection of the best method, and conclusions regarding the arm's length nature of the intercompany pricing.

B. Relevance of APA's and Transfer Pricing Studies to Customs Valuation

- 1. An APA or Transfer Pricing Study by itself is not sufficient to show that a related party transaction value is acceptable for Customs purposes.*

Importers sometimes claim that a related party transaction value is acceptable because it satisfies the Section 482 arm's length principle as determined using the best transfer pricing method. Sometimes, a copy of an APA or transfer pricing study is submitted along with the claim. In various rulings addressing this issue, CBP has determined that an APA or transfer pricing study by itself is not sufficient to show that a related party transaction value is an acceptable transaction value. CBP has noted that although the broad goal of both the relevant provisions of the customs and the tax law is the same, *i.e.*, to ensure that related party transactions are at arm's length, there are substantial differences in the legal requirements.

For example, the customs laws require that a customs value must be determined for every imported article.¹² Different rates of duty apply to specific imported goods on the basis of their classification and value. Therefore, U.S. importers are required to declare the customs value on an entry-by-entry and product-by-product basis. Moreover, in order to determine whether a related party transaction value is acceptable, each import transaction must be considered. If an importer purchases different products from a related company, it is necessary to determine the correct customs value for each product, not for all the products as a whole. Therefore, the determination of whether transaction value is acceptable must also be made on a product-by-product basis.

In contrast, Section 482 seeks to properly allocate income between related parties to prevent the evasion of taxes and achieve the clear reflection of income. The IRS's goal of clear reflection of income does not necessarily require a valuation of each transaction for each product, and the IRC section 482 regulations allow for aggregation of transactions and offsetting adjustments in appropriate circumstances. This is consistent with the fact that U.S. taxpayers are required to file annual income tax returns based on aggregate tax results for the year.

In view of these significant differences between the two determinations of value, it is difficult to make any direct comparisons between those made under the tax laws and those laws made under the customs laws.

¹² See 19 U.S.C. sections 1401a, 1481, 1484 and 1485.

In addition, under the applicable laws, the IRS and CBP must apply different methods to determine whether the transfer price is arm's length. As indicated above, the customs value law requires the use of the circumstances of sale and test value methods for determining the acceptability of a related party transaction value. Although the transaction-based methods utilized by the IRS in determining an arm's length price under Section 482 have some similarities to the customs methods, they are not the same. The comparable profits method (CPM) has little similarity to the customs methods. For example, the profitability of the related party is usually compared with the profitability of companies that perform similar functions, e.g., contract manufacturer. Most CPM cases apply an "interquartile range" test. That is, if the related party's profit falls within an acceptable range of profits for the comparable companies, the IRS arm's length requirement is met.

In contrast, under the customs methods for determining the acceptability of transaction value, product similarity is required. For example, the all costs plus profit method relevant to the application of circumstances of sale requires that the transfer price be adequate to ensure recovery of all costs plus a profit equivalent to the firm's overall profit realized over a representative period of time in of *sales of goods of the same class or kind*. Similarly, the circumstances of sale test is met where the price was settled in a manner consistent with the normal pricing practice of the *industry in question*. The industry in question depends on the product that is imported and not the functions that the seller performs. In addition, under the test value method, the customs value law requires consideration of customs values relating to *identical or similar merchandise*.

Based on these considerations, CBP has ruled that the fact that the importer's transfer pricing methodology satisfies one of the IRS methods is not determinative of whether it is an acceptable transaction value for customs purposes. Rather, a related party transaction value will be considered acceptable only if it satisfies either the circumstances of sale test or closely approximates one of the test values as provided in customs value law. See, e.g., HRL 548095, *supra*.

2. The underlying facts and conclusions of an APA or transfer pricing study may contain relevant information regarding the application of the circumstances of sale test. However, the burden of identifying this information is on the importer.

CBP recognizes that in some cases, the underlying facts and the conclusions reached in an APA or transfer pricing study may contain some relevant information about the circumstances of sale and thus may be considered in applying the circumstances of sale test. For example, they may contain pertinent information about how the related parties transact business and may include information about sales of similar products to unrelated purchasers. The weight given to the facts and conclusions in an APA or transfer pricing study depends in large part on the particular circumstances presented and the transfer pricing methodology used. For example, an APA that is based on the comparable uncontrolled price method (CUP) has the most relevance for customs valuation purposes and would be given much more weight than an APA that is based on

the comparable profits method (CPM), which generally has the least relevance for customs valuation purposes.¹³

In addition to the methodology used, other relevant considerations are whether the transfer pricing study has been considered by the IRS, whether the APA is bilateral or unilateral, and whether the products covered by the study are comparable to the imported products at issue. See, HRL 548095, *supra*; HRL 547672, May 21, 2002; and, HRL 546979, August 30, 2000.¹⁴

If an importer believes that any information or finding contained in an APA or transfer pricing study is relevant to the application of the circumstances of sale test, it is up to the importer to identify that information, explain why it is relevant, and submit supporting documentation to CBP. If the importer simply submits a copy of an APA or transfer pricing study without further explanation and documentation, the circumstances of sale claim will be rejected.

It should be noted that an APA or transfer pricing study would not ordinarily establish the normal pricing practices of the industry for purposes of determining whether the price was settled in a manner consistent with the normal pricing practices of the industry in question under the circumstances of sale test. See HRL 547672, *supra*. CBP determined in that case that the study did not provide any objective criteria regarding how the industry sets its prices or that the data presented actually pertained to the pricing practices of the pertinent industry.

Summary

In summary, the mere fact that an importer provides CBP with an APA or transfer pricing study is not sufficient to establish that a related party transaction value is acceptable. The importer must provide information and evidence regarding the circumstances of sale and/or test values. If the importer believes that information in an APA or transfer pricing study and/or in the supporting documentation is relevant to the application of the circumstances of sale test, the importer should identify that information, explain why it is relevant, and submit the relevant documentation to CBP.

III. THE IMPORTER'S OBLIGATIONS REGARDING THE DECLARATION OF VALUE IN RELATED PARTY TRANSACTIONS AND INFORMATION AND DOCUMENTATION NEEDED TO SUPPORT AN

¹³ This is because the CUP method compares the transfer price to the prices in transactions with uncontrolled parties that are similar to those of the controlled party. The circumstances, including the products, must be substantially the same. In contrast, the CPM compares the overall profitability of the test party to the overall profitability of comparable companies on an aggregate basis and uses a more flexible standard for comparability than the CUP method.

¹⁴ Other factors relied on in HRL 546979, *supra*, were that Customs participated in the APA pre-filing conference between the importer and the IRS, that Customs had access to the information provided to the IRS throughout the APA process as a result of a waiver provided by the importer to Customs, and that all of the importer's products were covered by the APA.

ENTRY OR RULING REQUEST BASED ON A RELATED PARTY TRANSACTION VALUE

A. Obligation to use reasonable care to determine the value of imported merchandise

Under section 484 of the Tariff Act of 1930, as amended, 19 U.S.C. §1484, the importer of record is responsible for using reasonable care to enter, classify and determine the value of imported merchandise and to provide any other information necessary to enable CBP to properly assess duties, collect accurate statistics and determine whether other applicable legal requirements, if any, have been met. CBP is responsible for fixing the final value of the merchandise. When the import transaction is a related party transaction, the importer must use reasonable care to determine whether transaction value is acceptable based on either the application of the circumstances of sale test or the test value method. This determination is necessary so that the importer can declare the proper value upon entry.

The importer must have sufficient information available to demonstrate how it meets the particular test upon which it is relying before a declaration is made based on a related party transaction value. As explained above, the mere fact that the importer has satisfied the requirements of Section 482 IRC, either through an APA or otherwise, does not mean that transaction value is acceptable under 19 U.S.C. §1401a. It is still necessary for the importer to analyze whether the related party sale satisfies the circumstances of sale test or the test value method described above before making a value declaration based on transaction value.

The exercise of reasonable care includes an analysis of whether there is sufficient information and documentation to establish that the related party transaction value satisfies the circumstances of sale or test value method, as set forth in 19 U.S.C. §1401a, 19 CFR Part 152, CBP rulings and this Informed Compliance Publication. An importer that relies solely on an APA or transfer pricing study to conclude that transaction value is acceptable would not be exercising reasonable care.

B. Examination of related party transactions by CBP and information and documentation needed to support an entry or ruling request based on a related party transaction value

When the importation involves a related party transaction, CBP may examine the declared value by asking the importer to supply information concerning the method used to determine the declared value and if it is transaction value, to provide information (and in some cases documentation) regarding the specific method used to determine the acceptability of transaction value. In addition, CBP may examine related party transactions in the context of a focused assessment. Although CBP does not examine all related party transactions, importers should be prepared to provide information supporting the declared value to CBP when requested.

CBP encourages any party that may be concerned about whether transaction value is the proper basis of appraisement for its imported merchandise to discuss the transactions with the appropriate field personnel and/or submit a ruling request under 19 CFR 177.1 et. seq. to the Commissioner of CBP, Attention: Office of International Trade, Regulations and Rulings, Commercial and Trade Facilitation Division, 1300 Pennsylvania Avenue, NW., Washington, D.C. 20229.

The same analysis and documentation is needed whether the importer requests a prospective ruling from CBP that a related party transaction value is acceptable or simply makes entry based on the related party transaction value. In both cases, information and documentation are required to demonstrate that one of the two related party tests is satisfied.

(This page intentionally left blank)

ADDITIONAL INFORMATION

The Internet

The home page of U.S. Customs and Border Protection on the Internet's World Wide Web, provides the trade community with current, relevant information regarding CBP operations and items of special interest. The site posts information -- which includes proposed regulations, news releases, publications and notices, etc. -- that can be searched, read on-line, printed or downloaded to your personal computer. The web site was established as a trade-friendly mechanism to assist the importing and exporting community. The web site also links to the home pages of many other agencies whose importing or exporting regulations that U.S. Customs and Border Protection helps to enforce. The web site also contains a wealth of information of interest to a broader public than the trade community. For instance, on June 20, 2001, CBP launched the "Know Before You Go" publication and traveler awareness campaign designed to help educate international travelers.

The web address of U.S. Customs and Border Protection is <http://www.cbp.gov>

Customs Regulations

The current edition of *Customs Regulations of the United States* is a loose-leaf, subscription publication available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402; telephone (202) 512-1800. A bound, 2003 edition of Title 19, *Code of Federal Regulations*, which incorporates all changes to the Regulations as of April 1, 2003, is also available for sale from the same address. All proposed and final regulations are published in the *Federal Register*, which is published daily by the Office of the Federal Register, National Archives and Records Administration, and distributed by the Superintendent of Documents. Information about on-line access to the *Federal Register* may be obtained by calling (202) 512-1530 between 7 a.m. and 5 p.m. Eastern time. These notices are also published in the weekly *Customs Bulletin* described below.

Customs Bulletin

The *Customs Bulletin and Decisions* ("Customs Bulletin") is a weekly publication that contains decisions, rulings, regulatory proposals, notices and other information of interest to the trade community. It also contains decisions issued by the U.S. Court of International Trade, as well as customs-related decisions of the U.S. Court of Appeals for the Federal Circuit. Each year, the Government Printing Office publishes bound volumes of the *Customs Bulletin*. Subscriptions may be purchased from the Superintendent of Documents at the address and phone number listed above.

Importing Into the United States

This publication provides an overview of the importing process and contains general information about import requirements. The February 2002 edition of *Importing Into the United States* contains much new and revised material brought about pursuant to the Customs Modernization Act ("Mod Act"). The Mod Act has fundamentally altered the relationship between importers and U.S. Customs and Border Protection by shifting to the importer the legal responsibility for declaring the value, classification, and rate of duty applicable to entered merchandise.

The February 2002 edition contains a section entitled "Informed Compliance." A key component of informed compliance is the shared responsibility between U.S. Customs and Border Protection and the import community, wherein CBP communicates its requirements to the importer, and the importer, in turn, uses reasonable care to assure that CBP is provided accurate and timely data pertaining to his or her importation.

Single copies may be obtained from local offices of U.S. Customs and Border Protection, or from the Office of Public Affairs, U.S. Customs and Border Protection, 1300 Pennsylvania Avenue NW, Washington, DC 20229. An on-line version is available at the CBP web site. *Importing Into the United States* is also available for sale, in single copies or bulk orders, from the Superintendent of Documents by calling (202) 512-1800, or by mail from the Superintendent of Documents, Government Printing Office, P.O. Box 371954, Pittsburgh, PA 15250-7054.

Informed Compliance Publications

U.S. Customs and Border Protection has prepared a number of Informed Compliance publications in the "*What Every Member of the Trade Community Should Know About:...*" series. Check the Internet web site <http://www.cbp.gov> for current publications.

Value Publications

Customs Valuation under the Trade Agreements Act of 1979 is a 96-page book containing a detailed narrative description of the customs valuation system, the customs valuation title of the Trade Agreements Act (§402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979 (19 U.S.C. §1401a)), the Statement of Administrative Action which was sent to the U.S. Congress in conjunction with the TAA, regulations (19 C.F.R. §§152.000-152.108) implementing the valuation system (a few sections of the regulations have been amended subsequent to the publication of the book) and questions and answers concerning the valuation system. A copy may be obtained from U.S. Customs and Border Protection, Office of Regulations and Rulings, Value Branch, 1300 Pennsylvania Avenue, NW, (Mint Annex), Washington, D.C. 20229.

Customs Valuation Encyclopedia (with updates) is comprised of relevant statutory provisions, CBP Regulations implementing the statute, portions of the Customs Valuation Code, judicial precedent, and administrative rulings involving application of valuation law. A copy may be purchased for a nominal charge from the Superintendent of Documents, Government Printing Office, P.O. Box 371954, Pittsburgh, PA 15250-7054. This publication is also available on the Internet web site of U.S. Customs and Border Protection.

The information provided in this publication is for general information purposes only. Recognizing that many complicated factors may be involved in customs issues, an importer may wish to obtain a ruling under CBP Regulations, 19 C.F.R. Part 177, or obtain advice from an expert (such as a licensed Customs Broker, attorney or consultant) who specializes in customs matters. Reliance solely on the general information in this pamphlet may not be considered reasonable care.

Additional information may also be obtained from U.S. Customs and Border Protection ports of entry. Please consult your telephone directory for an office near you. The listing will be found under U.S. Government, Department of Homeland Security.

“Your Comments are Important”

The Small Business and Regulatory Enforcement Ombudsman and 10 regional Fairness Boards were established to receive comments from small businesses about Federal agency enforcement activities and rate each agency’s responsiveness to small business. If you wish to comment on the enforcement actions of U.S. Customs and Border Protection, call 1-888-REG-FAIR (1-888-734-3247).



Visit our Internet web site: <http://www.cbp.gov>