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Customs' 1st-sale rule can reduce costs

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Customs duties often represent an overlooked indirect tax on a company's foreign sourced products. Finding ways to lessen that indirect tax can add value to a company's supply chain and have a positive impact on its cost of doing business.

Customs and Border Protection's "first-sale rule" provides importers with a viable means of reducing a company's landed costs for its foreign-sourced goods.

The rule provides that where there is a multiple sale of goods destined for the United States - a multi-tiered transaction - importers may, under certain circumstances, pay customs duty on the lower first-sale price between the manufacturer and middleman rather than on the higher sale price between the middleman and the importer.

For example, if an importer typically pays a middleman a 20 percent markup over the manufacturer's price, that company may be able to affect a 20 percent savings on duty expenses.

A carefully drafted and properly documented ruling request, typically filed with the assistance of a Customs House Broker or counsel versed in CBP valuation methodologies, can assist a business in obtaining these savings. While utilization of the first-sale rule can reduce the duty payable to CBP, importers should understand its history and guidelines.

CBP's acceptance of the first sale has been grudging at best. It took a series of court cases brought by importers before CBP issued guidelines for according FSR treatment to imports in 1996.

In January 2008, CBP issued a proposed new interpretation of its guidelines that would have resulted in a de facto revocation of the FSR. The resulting uproar from the trade community and an act of Congress compelled CBP to withdraw its proposed interpretation in September 2010.

FSR treatment remains available to businesses prepared to prove that it is following CBP's FSR guidelines. A business seeking FSR treatment must be able to show that:

1. There was a "bona fide sale" for value from the manufacturer to the middleman.

2. The merchandise was "clearly destined" for export to the United States at the time of the first sale.

3. The first-sale price represents a "viable transaction value" acceptable to CBP.

To establish that there was a "bona fide sale," an importer must be able to establish that its middleman took actual title and assumed the risk of loss of the goods somewhere along the supply chain. The importer must also establish that the middleman actually paid for the specific goods at issue. CBP will not accept evidence of generic fund transfers or payments not related directly to the sale of the goods.

CBP also requires that the importer provide a "complete paper trail" sufficient to show that the middleman:

a) Provided or could provide instructions to the seller.

b) Was free to resell the merchandise at a price set by the middleman.

c) Selected its own buyers.

d) Could order the merchandise for its own inventory.

An importer can establish that the goods were "clearly destined" solely for the United States at the time of shipment from the initial seller by producing documents sufficient to support the assertion that the manufacturer knew at the time it received its order that the goods were destined only for the U.S.

Critical elements of proof include: U.S.-centric design specifications, purchase orders indicating final destination U.S., SKU numbers or barcodes of the U.S. importer, labels, logos or other U.S.- related markings. Ocean bills of lading showing that shipments are made directly from the country of origin to the ultimate consignee in the U.S. also serve as supporting evidence.

CBP generally assumes that the sales price between the manufacturer and middleman are arm's length transactions if the parties have no corporate affiliation. If the parties are related, the middleman will need to submit documentation sufficient to show that the transfer price between the affiliated entities is a viable transaction value acceptable to CBP. That can best be shown by companies that have established transfer pricing policies in place.

CBP's guidelines are perfectly clear and provide an easy-to-follow road map for importers who may qualify for first-sale treatment or who think they can tweak the supply chain to fall under these guidelines. A successful ruling request, however, is contingent upon the cooperation of the importers' middleman and its manufacturers.

Foreign distributors and manufacturers may be reluctant to disclose what they consider to be proprietary price and other data to the ultimate buyer. A business seeking documentary back-up from distributors and manufacturers may advise its vendors that an importer can request confidential treatment in a ruling request to CBP. A U.S. business can also agree to a non-disclosure agreement that would limit the importer's use of the data to the ruling request only.

Any business whose supply chain relies in part or in whole on a middleman or distributor for sourcing foreign products should take a close look at its supply chain to see if FSR treatment may be applicable to its imports.

Obtaining a favorable FSR ruling could take some time and effort but the reduction in a corporation's landed costs in a tough competitive environment could have a beneficial impact on its bottom line.

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