# Update: Customs Issues Further Guidance on Valuation for Managed Inventory Programs*

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## I. Introduction

Managed Inventory programs continue to be an important tool in supply chain operations. Whenever the goods must cross an international border, Customs issues become important. In a recent ruling, U.S. Customs and Border Protection has clarified some areas of concern.

A previous article ("Customs Issues with Vendor Managed Inventory Programs", accessible on the author's website[1]) discussed how delaying the shift in ownership (passage of title) can affect the right to make entry, can have an impact on determining the appropriate Customs value, may create certain tax responsibilities and can subject a foreign vendor to the legal jurisdiction of the delivery location. The recent Customs ruling addresses the first two of these issues, reaffirming the right to make entry, and further elucidating the applicability of transaction value.

## II. The Ruling Request

The importer requesting the ruling was a wholly owned sales subsidiary of the foreign manufacturer and seller. For a number of years the subsidiary had purchased the goods from the parent, with prices determined prior to exportation, DDP shipping terms, and title also passing upon delivery to the subsidiary. Prices were established at a level that gave the subsidiary a guaranteed margin between the purchase price and the resale price in effect on the date the goods were exported to the US. The subsidiary then resold the merchandise to end customers, and bore the risk of gain or loss in the resale price between the export date and the resale date. Customs had previously concluded that the sales between the related parties were acceptable as transaction values.

In order to better regulate the cash flow of the subsidiary, the parties proposed adoption of a Managed Inventory Program. Shipping terms would remain DDP, but the parent would retain title, and the sales price between the parent and subsidiary would not be determined, until the date of the resale to the end customer, or 120 days after the goods entered the subsidiary's inventory, whichever came first. The subsidiary would be obligated to take title to the goods from the manufacturer on that date, at a price providing the guaranteed margin based on the actual resale price. Payment terms would be based on the date of transfer of title, rather than the date of import. The subsidiary would continue to be the reseller of the goods to the end customers. For some products on which additional processing was performed in the US prior to the resale, the price would also reflect the standard cost of processing.

The parties indicated their intention to continue to invoice the goods at the time of shipment to the US at the then current resale prices to end customers for identical goods, adjusted for the guaranteed margin and processing costs when applicable. They noted that the vast majority of sales to customers would be made at the same price as in effect on the import date, but that some would reflect price reductions in the interim. Only a limited number of customer price increases (based on previous history) were contemplated.

The ruling request sought guidance on two issues: the right to make entry and valuation of the merchandise. Headquarters Ruling H092448 dated May 4, 2010 addressed this request.

## III. Right To Make Entry

Customs easily disposed of the issue of right to make entry. The United States restricts the right to make entry of merchandise into the country to the owner or purchaser of the goods, or a formally authorized party with a financial interest in the goods, such as a commission agent; or to a licensed customs broker.[2] Customs found that the subsidiary would retain its role as a purchaser and reseller of the imported merchandise, either in its condition as imported or after further processing. As a purchaser, it "would be entitled to serve as the importer of record on the entry documents for the merchandise at issue".

## IV. Customs Value

Customs next turned to the question of the proper valuation of the goods for Customs purposes. Customs first noted that transaction value is the preferred method of appraisement, and that for it to apply a sale for exportation must be found to exist. While it had already found that the subsidiary was a "purchaser" of the goods for purposes of right to make entry, it was now necessary to consider whether the transfer of the goods from the manufacturer to the subsidiary involved a *bona fide* sale, and if so whether that sale was a "sale for exportation to the U. S.".

Customs noted that the term "sold" means a transfer of title from one party to another for consideration.[3] It went on to point out that "several factors may indicate whether a *bona fide* sale occurs between a potential buyer and seller of imported merchandise." This includes assumption of the risk of loss, passage of title, payment for the goods, the roles of the parties, and the circumstances of the transaction.[4]

Customs cited two rulings involving managed inventory arrangements where the importer not only did not take title, but was not obligated to pay until the goods were withdrawn from a third party warehouse, and/or not obligated to ever withdraw the goods from the third party warehouse. In those circumstances no price was set, or obligation to pay created, until withdrawal of the goods in the US, so no *bona fide* sale for exportation occurred. These were contrasted with an arrangement where a pro forma invoice was issued by the seller when the goods left its plant, but the seller retained title until delivery to the buyer (withdrawal from warehouse) or until the invoice has aged 63 days. At that time the buyer/importer had to issue payment for the goods. In that instance, Customs found that the other factors present outweighed the delayed transfer of title, and a sale for exportation existed.[5]

Examining the proposed program, Customs found that risk of loss passed on delivery to the buyer (DDP shipping terms); that the importer was obligated to take title to the goods by a date certain (withdrawal from warehouse or 120 days); and that a payment obligation, although delayed, came into effect at the time of delivery. Although not expressly stated, the fact that the roles of the parties as seller, buyer, and reseller remained essentially unchanged from an acceptable prior arrangement was most likely considered. Analogizing to the earlier ruling, Customs found that the totality of the other factors outweighed the delayed transfer of title, and found that transaction value was appropriate.

The next question was determining the amount of that value. Because most resale transactions were expected to be made at the resale price from which the import transfer price invoices were calculated, most import values would be unchanged. Where price increases at the resale level occurred, however, there would be additional amounts due to the seller. The seller had agreed to prepare revised invoices for these situations, and the importer would file Post Entry Adjustments reflecting such amounts. Citing to authority that price increases must be included in the price paid or payable, Customs confirmed the requirement to report any price increases.[6]

In the event of a price decrease at the resale level the amount to be paid by the buyer to the seller would also be decreased. In this situation, however, the provisions of 19 CFR 152.103(a)(4) would apply, and the decrease would be treated as a rebate or reduction in the price paid or payable effected after the date of importation, and accordingly disregarded. (Customs noted that there was no indication that the final price, even though not determined until after importation, had been established by a formula prior to the date of exportation.)

## V. Conclusion

The effect of the ruling for the parties involved was to allow them to continue to use transaction value as a basis of appraisement, based on the risk of loss passing on delivery, and the importer undertaking the certain obligation to take title to and pay for the goods in a fixed time period. Although the importer would not be able to claim any benefit from a resale price reduction subsequent to entry, and would be obligated to report and pay any duties and fees that might be due with regard to any price increases, it could continue to conduct its operations without significant change despite the introduction of the managed inventory program.

The potential effect of the ruling on other managed inventory situations should be to allow a wider use of transaction value, provided that the basic requirements are met. While the role of the parties and the circumstances of the transactions will be important in each instance, Customs has indicated that a delayed passage of title after the date of importation, a common aspect of managed inventory programs, can still be consistent with the use of transaction value, provided that the risk of loss passes on delivery to the importer (if not before), and the importer undertakes specific obligations to take title to the goods and make payment therefore within a fixed time period after entry. Customs is likely to continue to review the issues on a case by case basis. Whether delay of the passage of title for periods longer than 120 days will be permissible remains to be seen.



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**ENDNOTES**

[1] *www.swbakerlaw.com*

[2] 19 USC 1484

[3] Citing *VWP America Inc. v. U.S.*, 175 F.3d 1327 (Fed. Cir. 1999)
[4] Citing HQ 547197; HQ546602
[5] HQ 548236, HQ 548273; HQ H012659
[6] HQ 547395; *Generra Sportswear Company v. U. S.*, 905 F.2d 377, 380 (Fed Cir.1990)