



PwC Tax Supply Chain Transformation

First Sale – Related Middlemen



What is First Sale?

Where there are multiple sales of goods prior to their importation into the United States, the First Sale rule allows importers, in certain circumstances, to use the price paid in the “first or earlier sale” as the basis for the customs value of the goods rather than the price the importer ultimately paid for the goods. Under U.S. law, the preferred method of valuing imported goods for customs purposes is transaction value of the goods sold. When such transaction value is required and the goods are sold more than once before they are imported (e.g., in sales involving middlemen), the First Sale rule allows an earlier sale to be used in declaring customs value if that sale can be documented as a sale for exportation to the United States and the importer meets all other Customs requirements.

The option to choose the earlier sales price as the transaction value is known as the First Sale rule.

What is First Sale?

For example, the U.S. importer may assign a product's customs value based on the transaction between the manufacturer and the middleman (\$80), instead of the transaction between the middleman and the U.S. importer (\$100). Consequently, application of the First Sale rule may result in the transaction value being determined based on the price paid by a foreign buyer to a foreign seller. When the last sale valuation is higher than a first or earlier sale, use of the First Sale rule may reduce the customs value of the product and hence lower the duty assessed on an imported item.



Any importer may request valuation based on the price paid by a middleman to a foreign manufacturer in situations where the middleman is not the importer. However, it is the importer's responsibility to show that the "first sale" price is acceptable under the standard set forth.

What is required to prove first sale?

In a General Notice, published as T.D. 96-87 (December 13, 1996), US Customs (CBP) identified the following three conditions which must be satisfied for an importer to declare the value of imported goods for customs purposes on the basis of the price of sale of that goods from the foreign manufacturer to a third country intermediary:



There must be a **bona fide** sale of the goods by the manufacturer to the intermediary.



The manufacturer and the intermediary must deal with each other with respect to the purchase and sale of the goods at "**arm's length**".

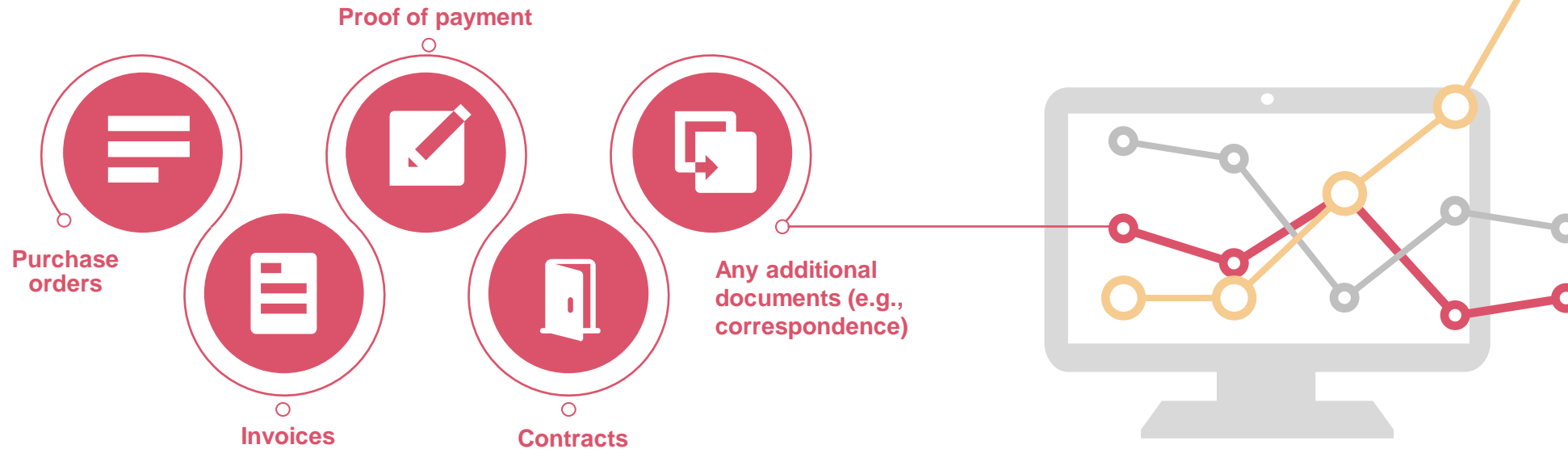


At the time of the sales transaction between the manufacturer and the intermediary, the goods must be **clearly destined** (irrevocably committed) to exportation to the United States.



What is required to prove first sale?

US Customs have advised that the importer must provide a description of the roles of the parties involved and must supply relevant documentation addressing each transaction that was involved in the exportation of the goods to the United States. The documents may include, but are not limited to:



That establishes how the parties deal with one another. The objective is to provide US Customs with “a complete paper trail of the imported goods showing the structure of the entire transaction.”

For a transaction to be viable for transaction value purposes, it must be a sale negotiated at arm’s length, free from any non-market influences. There is a presumption that a transaction will meet this standard if the buyer and seller are unrelated.

If a United States company that imports Chinese origin products that are subject to Section 301 duties in a multi-tier procurement arrangement can demonstrate that the procurement arrangements satisfy the foregoing conditions, that United States company may effectively reduce the burden of the Section 301 duties by declaring the value of the imported Chinese products based on the (lower) price paid or payable by the intermediary in the first sale.

Sales to middleman related to seller



In sales to a related middleman, US Customs will examine the way the buyer and seller organize their commercial relations and the way in which the price in question was derived to determine whether the relationship influenced the price. If it can be shown that the price was settled in a manner consistent with the normal pricing practices of the industry in question, or with the way in which the seller settles prices with unrelated buyers, this will demonstrate that the price has not been influenced by the relationship. In addition, Customs will consider the price not to have been influenced if the price was adequate to ensure recovery of all costs plus a profit **equivalent to the firm's** (i.e., the parent companies) overall profit realized over a representative period of time.

In evaluating all costs plus profit test Customs will examine the [seller and related middleman] companies' income statements, transfer pricing studies, and other financial information relating to companies' profits and losses.



First Sale not Accepted

From careful study of US Rulings, we list a few of the most common reasons for Customs to deny the First Sale where the middleman is a related party.



- Incoterms do not match the circumstances of the sale.



- Middleman does not take title to the goods.



- Middleman, does not receive title to the goods produced by related manufacturers and shipped directly from the manufacturer to the U.S.



- Middleman and manufacturer share the same business address.



- As per the purchase orders title to the goods passes on receipt at destination [in the US]



- Flash title transfer between the parties at the port of export, there is no evidence that the middleman ever held title to the goods or bore the risk of loss.



- Audited financial statement for the middleman states that the amounts due to related companies “have no fixed terms of repayment.” Parties do not appear to operate at arms-length.



- Failure by the middleman to insure against the possible loss of the goods may draw into question whether the middleman ever truly assumed that risk.



- Failed to submit evidence of a complete paper trail showing the structure of the entire transaction, including the roles of the parties, terms of sale between the parties, and evidence of the passage of consideration between parties

From the above it is evident that US importers have difficulty with the bona fide sale and arms-length requirement in meeting the First Sale conditions.



Conclusion

To remain competitive and reduce the dutiable cost China based companies may be asked by their US customers to support them in the use of the First Sale.

The use of the First Sale requires an in-depth study of the totality of the circumstances surrounding the proposed multi-tier transaction, PwC can help you in this regard, please reach out to us if you require any assistance.

Contact us



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