MANAGING IMPORT & EXPORT

TOPIC EXTRACT

AN INSIDER'S GUIDE FOR THE BUSY EXECUTIVE

William C. Shayne and
Melvin E. Lazar

PLANNING FINANCIAL TRANSACTION

International Trade
Customs and Transportation

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MANAGING IMPORT & EXPORT

MANAGING IMPORT AND EXPORT OPPORTUNITIES AND RISKS
An Insider's Guide for the Busy Executive

Business Education

Third Edition

William Shayne & Melvin Lazar

Table of Contents

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INTRODUCTION TO THE BUSINESS EDUCATION EDITION

International Trade is, at the business and legal level, a term which covers a wide and diverse set of concepts and laws involving international and domestic business, as well as compliance issues.

The reality is that most businesses, even if not directly involved with international trade as a buyer, seller or service provider, are nonetheless affected by it, through the use of foreign made products and materials, or by competition.

Legal issues are an unavoidable part of business. Managing *Import and Export Opportunities and Risks* seeks to place those issues in the context of business practicalities.

This edition addresses business implications in the context of domestic and international laws, treaties and established commercial trade practices.

The goal of the Business Education Edition of *Managing Import and Export Opportunities and Risks*, is to provide a rich understanding of the issues affecting international trade today and to help you appreciate, and more importantly, identify the opportunities and risks affecting your business transactions.

OUTLINE

1. INTRODUCTION ... 1
2. PUSHING BACK THE BORDER ... 7
3. EXPORTER'S RESPONSIBILITIES ... 13
4. IMPORTER'S RESPONSIBILITIES & LIABILITIES ... 19
5. PLANNING THE TRANSACTION ... 25
6. PLANNING THE MERCHANDISE ... 27
7. PLANNING THE FINANCIAL TRANSACTION ... 29
8. PLANNING PAYMENTS - FINANCING THE TRANSACTION ... 35
9. PLANNING THE PROCEDURAL OPERATIONS ... 49
10. PLANNING THE DOCUMENTATION ... 67
11. VALUATION ... 75
12. CLASSIFICATION ... 83
13. CONDITIONAL VARIATIONS IN DUTY ... 111
14. COUNTRY OF ORIGIN ... 131
15. MARKING AND LABELING ... 135
16. RESTRICTIONS ON DOMESTICALLY PRODUCED GOODS & RE-IMPORTED GOODS ... 151
17. OBTAINING A FIXED LEGAL OPINION ... 157
18. IMPORT PROCESS OVERVIEW ... 159
19. POST ENTRY PROCEDURES & PROBLEMS ... 177
20. IMPORTER'S REMEDIES ... 197
21. PENALTIES & LIQUIDATED DAMAGES ... 203
22. BEST PRACTICES ... 211
23. FREE FROM THE AUTHORS ... 241

TABLE OF CONTENTS

1. INTRODUCTION 1
1.1. Who Should Read This Book 2
1.2. Why Read This Book 2
1.3. How to Use this Book 3
1.4. Links to Online Materials 4
1.5. Attention to Details – An Author's Caution 5
2. PUSHING BACK THE BORDER 7
3. EXPORTER'S RESPONSIBILITIES 13
3.1. Electronic Export Information and Principal Party In Interest 14
3.1.1. U.S. Principle Party In Interest (USPPI) 14
3.1.2. Foreign Principal Party in Interest (FPPI) 15
3.2. SOLAS Gross Weight Verification Filing 16
3.3. U.S. Export Licenses 17
3.3.1. Commerce Department 17
3.4. Supply Chain Security 18
4. IMPORTER'S RESPONSIBILITIES & LIABILITIES 19
4.1. Informed Compliance 19
4.2. Declared Goods 20
4.2.1. Provide Complete and Accurate Documentation 21
4.2.2. Comply with Legal Requirements 21
4.2.3. Pay Duties, Taxes and Charges 21
4.2.4. Maintain Records 23
5. PLANNING THE TRANSACTION 25
6. PLANNING THE MERCHANDISE 27
7. PLANNING THE FINANCIAL TRANSACTION 29
7.1. Agents & Commissions 29
7.2. Interest Charges 30
7.3. Quota 30
7.4. Tariff Rate Quotas 30
7.5. Foreign Charges 30
7.6. Transactions Between Related Companies - Transfer Pricing 31
7.7. First Sale Valuation 33
8. PLANNING PAYMENTS - FINANCING THE TRANSACTION 35
8.1. Open Account 35
8.2. Cash-in-Advance 36
8.3. Collection on Delivery (C.O.D.) 36
8.4. Cash Against Documents (C.A.D) 37
8.5. Drafts 38
8.6. Acceptance Financing Using Time Drafts 39
8.7. Letters of Credit 40
8.7.1. Confirmation and Irrevocability of Letters of Credit 42
8.7.2. Standby Letters of Credit 46
8.7.3. Transferable Letters of Credit 46
8.7.4. Assignment of Proceeds of a Letter of Credit 47
8.8. Factoring 47
8.9. Consignment Sales 48
8.10. Counter Trade (Barter) 48
9. PLANNING THE PROCEDURAL OPERATIONS 49
9.1. Transportation 49

9.2. Liability for Freight, Charges and Services. 51
9.2.1. Who Pays 51
9.2.2. The Shipment as Security for Payment 52
9.2.3. How much are you liable for 52
9.2.4. Undeliverable Cargo – Liabilities at the Foreign Port 54
9.3. Incoterms 54
9.3.1. Title to Goods 59
9.3.2. Risk of Loss or Damage 60
9.4. Insurance 60
9.4.1. Declaration of Higher Value 61
9.4.2. Self-Insurance 62
9.5. Pre-shipment Inspection 62
9.6. Customs Clearance, Forwarding and Other Services 63
9.7. Power of Attorney 64
10. PLANNING THE DOCUMENTATION 67
10.1. Invoicing 67
10.2. Documents of Transportation 68
10.3. Certificates of Origin 69
10.4. U.S. Export Licenses 69
10.5. U.S. Import Licenses 70
10.6. Visas 71
10.7. Intellectual Property 71
10.7.1. Trademarks and Trade Names 72
10.7.2. Copyrights 72
10.7.3. Patents 73
10.7.4. Required Documentation/Licenses 73
10.7.5. License Fees 73
11. VALUATION 75
11.1. Transaction Value for the Goods Being Imported 75
11.2. Additions to Transaction Value Appraisement 75
11.2.1. Packing Costs 76
11.2.2. Selling Commissions 76
11.2.3. Assists 76
11.2.4. Royalties and License Fees 77
11.2.5. Proceeds Of Subsequent Resale That Accrue To The Seller 77
11.3. Transaction Value Between Related Parties 78
11.4. First Sale 79
11.5. Alternatives When There Is No Transaction Value 79
11.5.1. Transaction Value of Identical or Similar Merchandise 80
11.5.2. Deductive or Computed Value 80
11.5.3. Fallback Value 81
12. CLASSIFICATION 83
12.1. Harmonized System of Classification 83
12.2. Principles of Classification –How Goods are Classified 84
12.2.1. U.S. Tariff Layout 85
12.2.2. Harmonized Tariff Schedule –Where International Ends and U.S. Begins 87
12.2.3. Conceptual Approach to Classification 90
12.2.4. Formal Approach to Classification 94
12.3. Interpretative Aids 109
13. CONDITIONAL VARIATIONS IN DUTY 111
13.1. Delayed Duty Payment 111
13.1.1. Bonded Warehouse 111

13.1.2. Foreign Trade Zone 112
13.2. Duty Reduction or Elimination 113
13.2.1. Security of Concession 114
13.2.2. Qualifications 114
13.2.3. Documentation 115
13.2.4. Direct Shipment 115
13.3. Temporary Duty Reduction or Remission Programs 115
13.3.1. Programs Benefitting Less Developed Countries 116
13.3.2. Product Specific Programs 116
13.3.3. Bi-lateral or multi-lateral agreements 117
13.4. Other Duty Reductions 118
13.4.1. Articles Not Advanced or Improved In Condition 118
13.4.2. Articles Advanced or Improved in Condition 119
13.4.3. Samples for Soliciting Orders 120
13.4.4. Duty Avoidance by Temporary Importation 121
13.4.5. Temporary Importation Under Bond (T.I.B.) 121
13.4.6. Carnet 122
13.5. Duty Refund 122
13.5.1. Drawback 122
13.6. Duty Adjustments 125
13.6.1. Anti-dumping Duties 125
13.6.2. Countervailing Duties 126
13.6.3. Temporary Legislation, Modification and Presidential Proclamations 127
14. COUNTRY OF ORIGIN 131
14.1. Rules for Determining the Country of Origin 131
15. MARKING AND LABELING 135
15.1. U.S. Customs Country of Origin Marking 136
15.1.1. Legible and Conspicuous 137
15.1.2. Permanence 138
15.1.3. Ultimate Purchaser 138
15.1.4. English Marking 139
15.1.5. Name of Country 139
15.1.6. Abbreviations 140
15.1.7. Form of Marking 141
15.1.8. Repacked Articles Subject to Marking 141
15.1.9. Confusing Origin Markings 141
15.1.10. Corrective Origin Marking 142
15.1.11. Exceptions to Marking Requirements 142
15.1.12. Opportunities through Trademark and Design 143
15.2. Other Marking Requirements 143
15.2.1. Registered Identification Numbers (RN) 145
15.2.2. Made in USA 146
16. RESTRICTIONS ON DOMESTICALLY PRODUCED GOODS & RE-IMPORTED GOODS 151
16.1. Marked Made in USA 151
16.1.1. Using “Made in USA” 152
16.1.2. "*ALL OR VIRTUALLY ALL*" Standard (Not Quite 100%) 152
16.1.3. 100% US Origin – Using Amplified Claims 153
16.1.4. “Made in California” 153
16.2. Goods Domestically Produced and Distributed 153
16.3. Goods Domestically Produced for Export 154
16.4. Consequence of Marking 154
16.5. Re-Import Restrictions 154

16.5.1. Duty Liability 154
16.5.2. Distribution Restrictions 154
17. OBTAINING A FIXED LEGAL OPINION 157
17.1. Customs Decisions 157
17.2. Opinions of Other Government Agencies 158
18. IMPORT PROCESS OVERVIEW 159
18.1. Pre-Shipment Advises 159
18.1.1. 24 Hour Rule 159
18.1.2. Importer Security Filing (ISF or 10+2) 159
18.1.3. SOLAS - Verified Gross Weight filings 160
18.1.4. Air Cargo Advanced Screening program (ACAS) 160
18.1.5. Office of Foreign Asset Control (OFAC) 160
18.2. Shipment arrival 161
18.3. Entry 161
18.3.1. Importer Security Filing (ISF) 162
18.3.2. Entry, Entry Summary (Immediate Delivery Entry) 163
18.3.3. Entry/Entry Summary (Live Entry) 164
18.3.4. Entry Processing 164
18.3.5. Automated Commercial Environment (ACE) 165
18.3.6. Centers for Excellence and Expertise ("Centers" or "CEEs") 165
18.3.7. Single Window Portal 166
18.4. Consequence of Delay 166
18.4.1. Demurrage, Storage, Per Diem, and Detention 166
18.4.2. General Order 168
18.5. Types of Entry 169
18.5.1. Consumption Entry 169
18.5.2. Warehouse Entry 169
18.5.3. Reconciliation Entry 169
18.5.4. Informal Entry 169
18.5.5. Transportation Entry 170
18.6. Customs Bonds 170
18.6.1. Single Transaction Bond (STB) 171
18.6.2. Continuous Bond 171
18.7. Inspection / Examination 172
18.8. Selection of Cargo to be Examined 172
18.9. C-TPAT 173
18.10. Trusted Trader 173
18.11. Broker Known Importer 173
18.12. Liability for Expenses 174
18.13. Damages and Losses 174
18.14. Release 174
19. POST ENTRY PROCEDURES & PROBLEMS 177
19.1. Liquidation 177
19.1.1. Notice as to the Liquidation Date 179
19.1.2. Not Liquidated 179
19.1.3. Liquidation by Operation of Law 179
19.1.4. Liquidation by Affirmative Action 180
19.1.5. Notice of the Date of Liquidation 180
19.2. Notices Requiring Prompt Action 180
19.2.1. Request for Information (CF 28) 180
19.2.2. Notice of Action (CF 29) 183
19.2.3. Notice to Mark and/or Notice to Redeliver (CF 4647) 185

19.2.4. Notice of Detention 187
19.3. Notices Requiring Immediate Attention 188
19.3.1. Focused Assessments and Audits 188
19.3.2. Seizure Notice 190
19.3.3. Administrative Summons 192
19.3.4. Grand Jury Subpoena 193
19.3.5. Search Warrant 194
20. IMPORTER'S REMEDIES 197
20.1. Petition 197
20.2. Protest and Claims 198
20.2.1. Protest 198
20.2.2. 520 Claims – Refunds for Errors 200
20.2.3. Post Entry Amendment 200
20.3. Judicial Review 201
20.3.1. Court of International Trade 201
20.3.2. U.S. District Courts 202
20.3.3. Appellate Courts 202
21. PENALTIES & LIQUIDATED DAMAGES 203
21.1. Confidentiality and Privilege 203
21.2. Civil 204
21.2.1. Voluntary Prior Disclosure - The Preemptive Strike 204
21.2.2. Fraud (19 U.S.C. 1592) 204
21.2.3. Importation in Violation of Law (19 U.S.C. 1595a(c)) 206
21.2.4. Liquidated Damages 206
21.2.5. Offers-in-Compromise 206
21.3. Criminal 208
22. BEST PRACTICES 211
22.1. Informed Compliance 212
22.1.1. Failure to Establish an Informed Compliance Program 213
22.1.2. Failure to Adhere to an established Informed Compliance Program 213
22.1.3. Compliance Evaluation 214
22.1.4. Failure to Achieve Compliance Levels 214
22.1.5. Support For Establishing a Compliance Program 215
22.1.6. Importer Self-Assessment 215
22.1.7. Sarbanes-Oxley (SOX) 216
22.1.8. Establishing the Informed Compliance Program 216
22.1.9. The Spiral Implementation Approach 217
22.2. Known Importer 220
22.2.1. Trusted Trader 220
22.2.2. Broker Known Importer Program (Trusted Trader Lite) 220
22.3. Recordkeeping 222
22.3.1. Obligation to Maintain Records 222
22.3.2. Documents to be Maintained and How 222
22.3.3. Obligation to Produce Records 223
22.3.4. Failure to Maintain or Produce Records 223
22.4. Protecting Your Business from Identity Theft in International Transactions 227
22.4.1. Protecting Against Identity Theft 227
22.4.2. Identity Theft and the Power of Attorney 227
22.4.3. Ferreting out Theft of Your identity in Import Transactions 228
22.4.4. Ferreting out Theft of Your identity in Export Transactions 229
22.5. Supply Chain Security 229
22.5.1. Customs Trade Partnership Against Terrorism 229
22.5.2. WCO International Security Framework and Mutual Recognition 232

22.5.3. Transportation Security Administration (TSA) Known Shipper Program 233
22.6. Sources of Assistance 233
22.6.1. Government Sources 233
22.6.2. Customs Broker 234
22.6.3. Forwarders 238
22.6.4. Carriers, Truckers, Consolidators 238
22.6.5. Customs Attorney 238
22.6.6. Consultants 238
22.6.7. NVOCC (NVO) 238
22.6.8. Deconsolidators 238
22.6.9. Trade Association and Journals 239
23. FREE FROM THE AUTHORS 241
23.1. Ferreting Out Identity Theft in your International Trade Transactions 241
23.2. Spiral Approach to Implementing an Informed Compliance Program 242

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7. PLANNING THE FINANCIAL TRANSACTION

When acquiring goods most planners focus on the product, its cost of production (the price paid for the goods) and the cost of landing it in the importing country. That view is generally product specific and often too narrow. It often ignores broader financial issues affecting transactions in general. This commonly occurs when product and financial executives act in isolation, and each is unaware of the implications of their action on the other. The way in which the financial transaction is structured can often have as great an impact as product design and price.

7.1. AGENTS & COMMISSIONS

It is not uncommon for an importer to use an agent to assist in acquiring goods or providing other services such as inspecting goods prior to shipment or arranging for shipment.

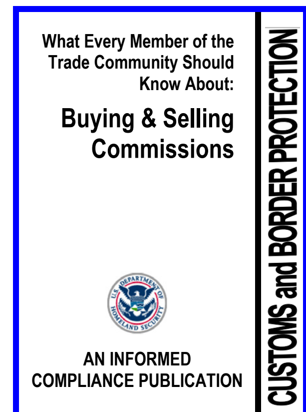
All commissions paid by the importer to an agent, in conjunction with its imported goods, must be declared to U.S. Customs. But that does not mean that the commission will necessarily be dutiable. Whether fees paid to an agent are dutiable is primarily dependent upon the type of agent and how the transaction is structured. Generally, two types of agents and commissions are encountered: buying and selling.

Just because someone says they are a Buying Agent does not mean that Customs will agree.

There is no legal requirement to have a written agency agreement, but it is better practice to have the terms in writing for several reasons:

1. It clarifies your agent's obligations to you, ensuring that they perform up to the level you are expecting.
2. It helps to establish to Customs that the fees you pay to the agent are non-dutiable as a buying as opposed to a selling commission.

BUYING AGENTS perform services for the buyer that the buyer could otherwise have performed for itself. The services that these agents provide and their expense are part of the "cost of goods sold" but are not part of the price paid for the goods. Commissions paid to a buying agent are usually not dutiable. The most common reasons that Customs sometimes treats buying commissions as dutiable are either that they are in excess of what would normally be expected for the services, typically 10% of the F.O.B. port of export value or less or that they are believed to actually be selling commissions.



Buying Agents can be independent companies or, as is often the case with large importers, a wholly owned company (which adds other tax planning benefits).

SELLING AGENTS work either directly or indirectly for the seller. If

the only way to purchase articles from a manufacturer is through a particular agent, that agent is probably a selling agent, regardless of how it describes itself. Commissions paid by the buyer to the seller's agent are dutiable.

If an agent provides services other than those of a selling agent, it is possible that those services are not dutiable; however, they would need to be individually examined - a task which should be undertaken at the time the transaction is being planned.

7.2. INTEREST CHARGES

If goods are purchased in a manner that does not require immediate payment, there is generally a cost associated with the privilege of delayed payment. Whether that added cost will be dutiable depends primarily upon how the transaction is structured. The distinction is, to a large extent, based upon whether the financing cost is included as part of the cost of goods, or is broken out by being invoiced as a financing charge.

When the cost of credit is built into the price of the goods, it is dutiable.

For example:

Take an invoice for $100.00 with the terms 2/10 net 30.

If the invoice is paid within 10 days, the price paid and the dutiable value is $98.00. If paid after 10 days the price paid and the dutiable value is $100.00.

If, instead, the price was negotiated at $98.00, net 10 days, accompanied by a separate agreement to pay interest if not paid timely, then the dutiable value remains $98.00. The price for the goods was $98.00 even though the total cost of acquiring the goods including the separate interest payment may have been $100.00 or more.

7.3. QUOTA

Voluntary Restraints, more commonly known as quotas, to the extent that they limited the quantity of a textile or textile products which could be imported into the United States, have essentially been eliminated as of 2005.

This should not be confused with Tariff Rate Quotas.

7.4. TARIFF RATE QUOTAS

Tariff Rate Quotas do not limit import quantities of goods that can be imported. Instead they provide for duty-free importation for a limited quantity of imports. Once that import volume is met, the duty rates revert to their normal rate. Tariff Rate Quotas are most commonly applied to imported agricultural and dairy products.

7.5. FOREIGN CHARGES

Goods imported into the United States are valued based upon their F.O.B. Port of Export price which, by definition, includes all the costs incurred up to, and including loading the shipment onto the exporting carrier. Foreign inland freight charges are the portion of the F.O.B. price incurred in bringing a shipment from the place of purchase, (usually the factory or a warehouse) to the port, and loading it on the carrier that will bring it to the U.S. However, there are ways by which these foreign inland freight charges can be made non-dutiable, depending upon how a transaction is structured.

If goods are purchased on an F.O.B. Port of Export basis or C.I.F. (Cost of Goods, Insurance, and International Freight) basis, then foreign inland freight charges are included in the price, and are therefore dutiable. [29]

If, however, goods are purchased on an Ex-Works or Ex-Factory basis, then by definition, the price does not include a charge for foreign inland freight. Inland freight charges that are separately invoiced and paid by the purchaser to someone other than the seller will be viewed as part of the cost of acquiring the goods, but not part of the price, and are therefore not dutiable. [30]

The total cost of acquiring the goods may remain the same, but the dutiable status of the foreign inland freight charges is dependent upon the way that the transaction was structured.

7.6. TRANSACTIONS BETWEEN RELATED COMPANIES - TRANSFER PRICING

Under the World Trade Organization (WTO), as well as U.S. Customs law, the preferred basis for valuing an import transaction is "Transaction Value". It is essentially the price paid or payable for goods when they are sold for export to the United States at a price freely negotiated between an unrelated buyer and seller - an arm's length transaction.

The term 'Related' has different meanings, depending upon the laws involved. These relationships may already exist, or they can be established specifically as a duty or tax planning device.

The invoice price between unrelated parties reflects what is thought of as the major component of *cost of goods*. The key to a lower dutiable value in transactions between related parties is most easily summed up in the distinction between *cost of goods* and the *cost of doing business*. The cost of the goods is dutiable; the cost of doing business may not be.

When a company formulates a price for an arm's length sale of its goods to an unrelated party, it wants to assure itself that all costs of doing business, including its profit, are covered. Consequently, the price includes many expenses of doing business which are not actually part of the cost of the article produced.

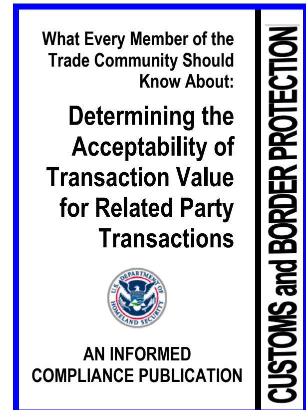
For example:

> Take a costing analysis for a shirt with 9 buttons. Since it is anticipated that a certain number of buttons will be lost or broken during manufacture, the cost of these lost or damaged buttons is covered by including 9-1/2 buttons in the costing of each 9 button shirt. The 1/2 button is a cost of doing business and a factor going into the price, but it is not part of the direct cost of the garment.

> Almost by definition, the existence of a legal relationship between a buyer and seller/manufacturer raises the question as to whether the relationship affects the price. Every buyer and seller/manufacturer hopes that there will be some monetary advantages associated with that relationship, including lower cost for goods. There is nothing wrong with that.
>
> Customs recognizes that prices between related parties may be lower than those between unrelated parties and, therefore, the resulting reductions in duty may be totally legitimate.

> Related Party pricing under Customs laws is not the same thing as Transfer Pricing under revenue and tax authority rules. In fact, the interests of the two agencies may be exactly the opposite, as an increase in revenue to one agency might result in a reduction to the other.
>
> Just because you have a Transfer Pricing Agreement that is acceptable for tax purposes does not mean that it will be acceptable for Customs' purpose.
>
> Depreciation and amortization illustrate this difference. For tax purposes, any number of accelerated write-off plans which front load deductions are acceptable. Customs, generally only accepts straight line depreciation which distributes the expense more equally over the imports.

The cost of the 1/2 button will undoubtedly be included in the arm's length price negotiated between unrelated parties and thus be subject to duty. Between related parties it need not be. In a properly structured transaction between related parties, the price need not include many of the costs of doing business that are not directly associated with the cost of producing the article.



Moreover, an arm's length price between unrelated parties also includes business expenses that do not necessarily exist in transactions between related parties, e.g., bad debt expense. When these costs are removed from the transaction, dutiable value is reduced, which usually translates directly into lower duty.

The reduction in duty liability can be used to realize additional profit or

to reduce domestic pricing. Realizing duty savings, however, is only half of the picture. Keeping those savings safe from other taxes is the other half of the picture. Having reduced duties under Customs laws, it becomes essential not to create a corresponding increase in taxes under Internal Revenue laws.

One of the most obvious methods of reducing tax liability is by increasing tax-deductible expenses. In transactions between related parties, it is often possible to shift certain operations off shore, or to break out certain services that are costs of doing business but are not part of the cost of production. These are the business costs that would normally be included in the price when goods are sold to unrelated parties.

The key to converting customs duties and taxes into a source of profit is planning and documentation. Properly structured and documented, these services can be an important element in the overall management of the U.S. and international operations. Undertaken without proper planning, they can lead to penalties.

> Transactions between related parties are always subject to increased scrutiny by both U.S. Customs looking for under-valuations and by the Internal Revenue Service looking for overvaluations.
>
> Related Party or Transfer Pricing Transactions should only be undertaken after careful planning, with the advice of both Customs Counsel and Tax Advisers.

Not every transaction or relationship qualifies for any or all of the benefits of a related party transaction, and it may not be the best or only way to proceed. But, due to the substantial benefits that may be available to a foreign supplier or domestic importer, it is well worth the time and effort to find out just what being a related party could mean.

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7.7. FIRST SALE VALUATION

Executive Briefing

Imports are valued on the price paid or payable to the seller "when sold for export to the United States." However, when there are intermediaries, there is more than one "sale." Specifically, there is one sale from the factory to the middleman and another sale from the middleman to the U.S. customer.

If properly structured, duty can be paid on the lower price from the factory to the middleman as opposed to the higher marked-up price from the middleman to you.

The key to paying duty on the lower First Sale transaction price is found in the words "sold for export to the United States."

In "Nissho-Iwai" (1992)[31], it was determined that the sale destined to the U.S., even if passing through a middleman, may be used for the basis of valuation. Thus, in a sale from a foreign factory to a middleman, who then sells to the U.S. customer, it is possible to use the "First Sale" or the sale of the factory to the middleman*, if the goods were clearly destined to the U.S. and other specific required conditions* are met (e.g., back to back sale of goods).

Since the government does not like the lower duty implications, there must be a very clear trail of documentation to substantiate that the sale from the factory to the middleman was "sale for export to the United Sates." Customs may not request the documentation until well after the transaction. If you do not have the proper documentation, this may lead not only to the denial of the "first sale" valuation of this specific transaction, but a denial of all prior transactions as well. Therefore, this is one of those transactions that you do not want to undertake without advice or assistance of experts.

The following are examples of documents that may generally be requested:

- ✓ A purchase order from the U.S. customer, indicating style number or product reference.
- ✓ A purchase order from the middleman to the factory indicating that the goods are being sold from the factory to the middleman with the intent that the goods are ultimately for sale to the United States.
- ✓ Invoice from the factory to the middleman showing the style number and indicating that goods are clearly destined to the U.S.
- ✓ An invoice from the middleman to the U.S. customer showing the style number.
- ✓ Proof of payment by each party.
- ✓ Shipping documents (e.g., Bill of Lading).

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