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Richard DiNucci
Acting Assistant Commissioner
Office of International Trade
U.S. Customs and Border Protection
1300 Pennsylvania Avenue, N.W.
Washington, DC 20229

Dear Assistant Commissioner DiNucci,

Thank you for the opportunity to provide comments on the draft Informed Compliance Publication (ICP) on Bona Fide Sales and Sales for Exportation to the United States. We believe this is the first instance of U.S. Customs and Border Protection (CBP) providing an opportunity for the trade community to offer feedback on a draft ICP before it is published, and we welcome the transparency and prospect for constructive dialogue on this important issue. The First Sale Rule (FSR) is very important to RILA members, and many retailers utilize it to reduce their duty bills as envisioned by the statute. We also recognize CBP's legitimate need to be able to verify FSR claims and believe that further clarification of the ICP would be helpful for both CBP and the trade community.

As background, RILA is the trade association of the world's largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

Appendix I

RILA welcomes increased clarity on the documents listed in Appendix I that *may* be required to be provided to validate a FSR claim. At the same time, RILA believes it is critical that the ICP should be clear that Appendix I is not a checklist for auditors and that the mere presence of a document in the Appendix does not mean that it is relevant in every review of a first sale transaction. CBP should acknowledge that a subset of the documents listed in Appendix I may, by themselves or in combination, provide sufficient evidence. RILA strongly believes that CBP must avoid situations where port officials or auditors invariably request all of the documents listed rather than tailoring the request to specific circumstances.

RILA would also like clarification on how CBP defines a First Sale audit. For example, the draft ICP raises these questions:

- Does "audit" pertain to Focused Assessment, Quick Response, CF 28 and/or informal request for information?
- In Section 22, there are statements that can be interpreted to suggest there is an understanding within CBP that different transactions and middleman relationships warrant a different level of documentary proof, yet the word "required" is used multiple times when referring to the

documents, which could suggest that specific documents will be required instead of allowing the importer to substantiate the claim as they see fit. If this point is not clarified, the proposed revisions to the ICP will likely result in more confusion, rather than less.

- Who is required to keep records? RILA suggests that importers should have access to records needed to support a FSR claim, but should not be expected to maintain documents.
- How would CBP handle non-disclosure agreements (NDAs) when in place? A neutral 3rd party would need to have access to records and submit them directly to CBP.

Moreover, RILA believes that the list of documents included in Appendix I needs to be better defined. RILA believes it is critical for CBP to clarify in the ICP and with auditors in the field that the documents in Appendix I will not all be required to verify every transaction that uses the First Sale Rule. The scope of documents that would be required during an audit will be case specific and dependent upon the facts of the case.

Additionally, there are certain documents included in Appendix I that may not be able to be obtained, depending on the relationship between the importer and the manufacturer. For example, certain manufacturing records and financial records may be difficult to obtain from unrelated parties. As examples:

(6) Transportation Records—Unless an importer is shipping via FCA Origin Factory Address terms, foreign inland freight will be difficult, if not impossible to obtain from the foreign manufacturer or middleman. They are not obligated to provide this information and will want to protect their product profit margins.

(9) Inventory Records—The middleman most likely will not share proprietary inventory records for the receipt of goods into inventory and storage of merchandise prior to sale and importation by the U.S. importer-of-record.

Moreover, RILA agrees that the proper accounting treatment of the transactions is material to the determination that a bona fide sale for export is present, as stated in *VWP of America v United States*, 175 F.3rd 1327 (Fed. Cir. 1999). We believe, however, that this is the incorrect inquiry for the proper accounting treatment. The applicable inquiry as to whether or not a transaction constitutes a purchase and resale is made under Accounting Standards Codification (ASC) 605-45 for US GAAP, and International Accounting Standards (IAS) 18.14. The appropriate determination of whether a transaction should be treated as a sale, which requires gross income from the resale to be recorded on the books, as opposed to an agency relationship, which mandates that only the net proceeds from resale be recorded on the books, is made looking at a variety of factors which are quite similar to those reviewed by CBP to determine whether or not a bona fide sale exists. One of these factors is general inventory risk (although there are separate accounting standards on whether and how inventory should be carried when there is general inventory risk, and hence the reference to inventory records misses the critical analysis), but as with the CBP assessment, it is one of several factors. Particularly where the financial statements of the middleman have been attested by an independent auditor applying one of these (or a similar local country GAAP) standards, CBP should find the accounting determination very

instructive. Reference to the appropriate standard and determination, however, is critically important, and is missing in the Appendix. (See also the Appendix to IAS 18 discussing principal versus agency relationships and). Whether in an ICP appendix or in the text, we would encourage CBP to acknowledge the appropriate inquiry into the accounting treatment as material.

(14) Importer's financial records—We would like clarification on why CBP needs importers' financial records.

(15-17) Manufacturer Accounting and Financial Records—Manufacturers and middlemen will most likely not share their proprietary accounting and financial records with the U.S. importer-of-record. Moreover, financial records are not necessary when there are unrelated parties as it is assumed pricing is at arm's length if there is not a relationship between the manufacturer and the vendor. If complete financial statements are not available, we suggest that alternatives should be developed. Moreover, the need for these documents is case-specific, and all of these documents may not be needed or apply in all related party scenarios.

- Will CBP request for a specific timeframe? In terms of a time period, the ICP states "for the applicable period", which would presumably cover the period of time that includes the transaction(s) in question. Suppliers' accounting years can differ greatly, and in many cases, takes a significant amount of time to get an audited financial statement that covers the time period under review.

(19) Cost Sheets and Production Specification Sheets—It will be difficult, if not impossible, to obtain cost of materials/cost sheets for BOM from the origin manufacturers and middlemen.

In determining which documents would need to be provided given the circumstances of a particular case, RILA believes it would be helpful for CBP to organize the list of documents in Appendix I to relate to the specific information that auditors are seeking to validate—whether: (1) there is a bona fide sale, (2) it is clearly destined for the United States, (3) there are statutory additions, and (4) if the parties are related, demonstrating the arm's length nature of the transaction.

- Will CBP differentiate what is needed for a related party vs. unrelated party analysis? Will CBP take importers' word that the transaction is unrelated or will they request documentation to support? If so, what documentation would be requested?

Further, it would also be helpful for CBP to clarify what is seeking with some of the listings in Appendix I, such as (21) industry pricing practices, (22) marketing studies, (23) sales to unrelated parties of similar or identical merchandise, (25) suppliers manuals, (26) vendor guidelines, and (33) correspondence records. Moreover, the lists of accounting and financial records stated in items 14-17, and 24, are extremely broad. In any given instance, some of these might be relevant, but many will not be. For example, other than in an instance where profits-based transfer pricing is being used by related first and second sellers which has resulted in price adjustments, we can think of no instance where a tax return would be relevant to any first sale factor. There may also be situations in which financial statements are not audited because there is no requirement to do so, yet the list could be read to suggest audited financial statements are required.

Finally regarding Appendix I, RILA believes that some of the listed documents may not be instructive when evaluating a FSR claim. For example, item (8) insurance for the imported merchandise to the port of importation, is rarely if ever material to a determination that the first sale value may be used. Insurance is never required. Particularly with local trucking, it may be the responsibility of the carrier without further charge. When transportation is provided by company owned means of either the manufacturer or the middleman, there will often not be separate insurance. As with the determination of whether or not any sale is a sale for export eligible for transaction value, it is difficult to come up with scenarios where payment records for insurance factor in to the analysis. If this is intended to remind importers that actual international freight and insurance charges are properly excluded from transaction value, it is no different in the first sale context than any other, and the ICP should say so directly.

Questions and Answers

RILA also provides specific comments related to certain items in the Questions and Answers section of the ICP that require further clarification.

Section 10 on page 5:

"The meaning of all such shipping or trade terms will be construed consistent with the "Uniform Commercial Code" and "Incoterms 2010."

This sentence also appeared in the prior ICP. Definitions of trade terms in the UCC and Incoterms are not consistent. To avoid confusion, as the transactions being reviewed are international, the UCC reference should be eliminated, and the sentence should read "The meaning of all such terms will be construed consistently with Incoterms (2010) unless the context requires otherwise, or unless the transacting parties demonstrate through contracts, other legally enforceable documents, or course of dealing, that they have afforded different meanings to the terms."

Section 22 on page 12:

"For example, CBP may require the ultimate consignee, importer, middleman, agent and factory records to determine the proper valuation of the imported goods and if amounts related to statutory additions have been declared."

We believe that the use of the phrase "may require" is misplaced. The summary to T.D. 96-87 states that the Treasury Decision "sets forth the documentation and information needed to support" a ruling request. The Treasury Decision goes on to state that use of the importer's purchase price as the basis for transaction value is a rebuttable presumption, and the burden is on the importer to present evidence which rebuts the presumption and supports use of the first sale value. With the burden on the importer, it is unnecessary, and misleading, to suggest that CBP should, or may, "require" any particular document or set of documents. Language similar to the Treasury Decision should be used.

Section 22 on page 12:

"Specifically the importer would be required to provide a different level of documentation to support the claim that "first sale" should apply where the manufacturer and the middleman are not related than when they are related. Secondly, the importer would also be required to provide a different level of documentation to support the claim that "first sale" should apply where the manufacturer and the

middleman are related but there is another non-US party who is the parent than will either when either the manufacturer or the middleman are the parent."

The first sentence is presumably referring to the fact that CBP presumes unrelated party transactions arm's length, so that there is more evidence needed in related party situations. If this is in fact what is intended, it should be stated directly, perhaps with reference to the ICP on related party sales, instead of using the more ambiguous phrase "different level of documentation."

Moreover, the second sentence is inaccurate. It should be made clear that the importer is responsible to demonstrate that the price paid to a related party is arm's length. There are regulatory examples of how this may be accomplished, as well as many rulings and an ICP.

Aside from the imprecision of the language "different level of documentation," there should be no difference in the approach CBP takes with regard to support for any related party pricing, first sale or not. So, for example, in a situation in which the importer chooses to demonstrate arm's length pricing by reference to the seller's sales of similar merchandise to unrelated parties, there would be no difference between the documentation that should be acceptable regardless of how the parties are related, and the jurisdiction of the parent. Similarly, an importer may be able to establish that the seller settles prices consistent with industry practice regardless of how the parties are related or where the parent resides.

We suggest that this paragraph should be rewritten to state: "Whenever the first sale transaction involves related parties, the importer should maintain supporting documentation substantiating the arm's length price, consistent with CBP guidance on use of transaction value in related party transactions."

Section 22, page 13, Second example, possible solutions:

"The importer could provide a transfer pricing study that was used in setting the price of the imported goods and demonstrate that the price was settled in a manner consistent with industry practice."

We commend CBP for providing "possible solutions" to better inform the trade community. We also agree that this solution is viable. We note, however, that the example provided in Regulation 152.103(l)(1)(i) simply states: "[i]f the price is settled in a manner consistent with normal pricing practices of the industry . . . this will demonstrate that the price has not been influenced by the relationship." There is no conjunctive also requiring a transfer pricing study. While we believe that the intent is to provide helpful guidance, it is possible that this sentence could be misconstrued to require more than is required by the regulation. We suggest that the sentence drop the direct reference to the transfer pricing study, and perhaps add citations to some recent rulings detailing the use of industry practices.

Moreover, when discussing Middlemen and Manufacturer Related issues, an example of HO16585 is provided in which CBP denies protest because the information submitted does not support a finding that the sale was arm's length. CBP offers up that the importer could provide a transfer pricing study to help support pricing was at arm's length. Transfer pricing studies traditionally have not been accepted for this purpose by CBP. As an alternative to the first suggestion, if transfer pricing studies are now acceptable, it would be good to include them in Appendix I of possible documents that *may* be required.

Section 22, final sentence:

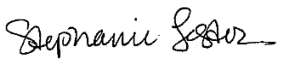
"NOTE: When seeking an advance ruling, requesting internal advice or filing a protest, the above-mentioned documentation must be submitted with the advance ruing request, internal advice or protest."

T.D. 96-87 makes it clear that documentation of other evidence of a complete audit trail must be submitted in to support a ruling request. However, the reference in Section 22 to "above mentioned documents" is quite troubling, as Section 22 also includes reference to Appendix I, which as explained below, references documents that may or may not be helpful, and in every case a complete audit trail will be demonstrated by only subset (and perhaps a small subset) of documents listed in the Appendix. T.D. 96-87 deals specifically with ruling requests, and if it is CBP's intention to make clear that the same standard applies for internal advice requests and protests, it should say so directly, and not potentially imply that more is required.

Conclusion

We thank you for the opportunity to provide comments on the draft ICP. The effort by CBP to proactively engage with the trade on this important issue is welcome and appreciated. We look forward to working with you to address the observations and concerns mentioned above. Please do not to hesitate to contact me at 703-600-2046 or stephanie.lester@rila.org you have any questions.

Sincerely,



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