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More Ammunition To Kill The 'First Sale Rule'?

Law360, New York (January 21, 2010) -- In January 2008, Customs and Border Protection issued a Federal Register notice proposing a "new interpretation of the phrase sold for exportation to the United States" for purposes of applying the transaction value method of valuation.

The so-called new interpretation was the elimination of the "first sale rule" in transactions where there are multiple sales of the imported goods prior to its entry into the United States.

The first sale rule, which is firmly rooted in judicial precedent and customs jurisprudence, permitted the importer to pay duty on the value of the first sale that evidenced that the goods were sold for exportation to the United States.

The benefits of the duty reduction by applying the first sale valuation were available only if the importer could establish the fact that at the first sale transaction the goods were destined to the United States and that all other elements necessary to establish transaction value were present.

Due to the adverse response to this CBP proposal from many diligent and compliant importers, who were benefitting from duty savings, and congressional concern over the apparent disregard of judicial precedent, a provision was added by Congress to the Food, Conservation and Energy Act of 2008 requiring the International Trade Commission to report to Congress, based upon monthly data submitted from CBP, on use of the first sale rule for a one-year period ending August 2010.

The ITC report, Use of the "First Sale Rule" for Customs Valuation of U.S. Imports, Investigation No 332-505, USITC Publication 4121, was submitted Dec. 23, 2009. Several things that are highlighted in the publication are the statistical elements which CBP will be inclined to use as a rationale for killing the first sale rule.

These include statistics that tend to minimize the impact of eliminating the first sale rule:

- Only 8.5 percent of importing entities reported using the rule.
- Only 2.4 percent of the dollar volume of imports report using the rule.
- Twenty-one percent of all first sale imports are on normally duty-free products.

What is more significant than these statistics, that tend to reduce the overall significance of the use of the first sale rule, is what is missing, not analyzed, or down-played by the report.

Missing from the report is any analysis of the duty impact of eliminating the first sale rule. The report does indicate a higher degree of use of the first sale rule in industries where duty rates are higher; because of this, there would be a substantial revenue burden placed upon certain industries.

Notably, the apparel and footwear industries, where duty rates tend to be higher, would be impacted; and those who have invested the time and expense of establishing a documented compliance program to establish the first sale valuation would be lumped together with the lax and noncompliant by denying the first sale valuation to which they are entitled.

No analysis is provided of what percentage of eligible transactions (those with more than one sale outside the U.S.) did use the first sale rule.

CBP did not ask the question of importers if there were multiple sales outside the U.S. for the goods they are importing; and, since CBP has abdicated any genuine emphasis on auditing importers or validating declared valuations, especially in related-party transactions, there is little or no current basis for CBP to assess the validity of any declaration of value, absent some great discrepancy from prior declarations.

Finally, one of the largest missing elements of the statistical report is that there is no accounting for importers who did not claim first sale eligibility at the time of entry; but, subsequently at reconciliation provided the requisite evidence of eligibility for first sale valuation.

It is frequently the case that at the time of importation, the importer simply does not have, or has some uncertainty about, whether the first sale can be sufficiently documented to satisfy the requirements.

Subsequently the information becomes available and can be verified by the importer, and at the time of reconciliation, a first sale value claimed.

Importers who for years have maintained a system of compliance and documentation, and conducted due diligence of their vendors in order to receive the benefits of the first sale rule will need to be vocal in documenting the actual impact on their business and industry and in pointing out the flaws in this report and the overall campaign by CBP to eliminate the first sale rule.

For those with their eyes open, CBP is beginning to reap the harvest of lax auditing and poor regulatory oversight of importers.

CBP hopes to offset the fact that revenue collections are down, civil penalties are down, and overall compliance is down, by shutting the door on sound valuation principles and punishing the most compliant and vigilant importers.

This is comparable to the IRS deciding that it will, of its own accord, eliminate certain tax deductions, because it no longer wants to make the effort to audit the claims.

While elimination of the first sale rule is a shortcut to improved revenue, CBP will once again punish and alienate the most compliant and diligent importers.

As with its deceptive sales pitch for C-TPAT and Importer Self-Assessment (ISA), CBP sends the distinct message that import compliance is really inconsequential. Importers were promised reduced CBP scrutiny by virtue of participation in C-TPAT and ISA; and, many importers incurred significant time and expense to do so.

The result has been that there has been reduced CBP scrutiny — focused assessments, audits, etc. — for everyone, not just importers who went to the time and expense to participate in these programs. It is the least compliant

importers, even the fraudulent, that have benefitted the most from CBP's policies since becoming part of the Department of Homeland Security.

Many importers, when customs officials were frequent visitors to importers, chose not to declare first sale valuation because of the difficulty in providing the credible evidence necessary. Importers who declared this value, made a demonstrated commitment to documentation and compliance.

The new CBP message is that CBP is going to collect more revenue on the backs of the compliant, while all others can declare whatever value they want, because CBP wants to be out of the business of regulatory enforcement of valuation laws.

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