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Customs Proposes Reversing "First Sale" Rule

In the January 24, 2008, *Federal Register*, U.S. Customs and Border Protection proposes to prohibit use of the "First Sale" rule in determining the transaction value of imported merchandise. This proposed change represents a dramatic alteration of current Customs valuation law and could result in massively increased duties for U.S. importers that currently utilize the rule.

The "First Sale" rule was established by the court in *Nissho Iwai American Corp. v. United States*, 982 F.2d 505 (Fed. Cir. 1992) and set forth in Treasury Decision 96-87 ("T.D. 96-87"). It applies in instances where merchandise is imported into the United States as a result of "back-to-back" sales. Typically, the first sale is from a foreign manufacturer to a foreign middleman and the second sale is from the foreign middleman to the U.S. importer. Under the "First Sale" rule, an importer can base the transaction value (or the appraised value) of the imported goods on the lower price that the middleman paid to the foreign manufacturer rather than on the higher price that the importer paid to the middleman, if a two-pronged test is met. The court in the *Nissho Iwai* case ruled (1) that the goods must be "destined for the U.S. at the time of the first sale" and (2) that the sale represents a "viable transaction value." In practice, this meant that if the sale was an arm's length sale and an importer could produce documentation that the goods were sold to the middleman as a result of a U.S. purchase order, the two-pronged test was met. The use of this rule has become increasingly popular since 1993 and has allowed U.S. importers significant duty savings over the past 15 years.

Customs' proposed change was triggered by an April 2007 decision issued by the Technical Committee on Customs Valuation (Commentary 22.1, Meaning of the Expression "Sold for Export to the Country of Importation" in a Series of Sales). In its commentary, the Technical Committee analyzed various provisions of the international Valuation Agreement and concluded that the "First Sale" rule currently practiced in the United States is contrary to the Technical Committee's definition of transaction value (specifically, to its interpretation of the phrase "sold for exportation to the United States"). The Technical Committee pointed out the necessity for uniformity in international application of value law and cited the difficulties that would be encountered in applying the "First Sale" rule outside of the United States. In supporting the Technical Committee's decision and its own proposed change, Customs includes in its *Federal Register* Notice a lengthy review of the U.S. legislative history of transaction value that it concludes is contrary to the "First Rule" interpretation of transaction value, as well as a history of CIT and CAFC deference to Technical Committee opinions.

Customs is accepting comments on its proposed rule on or before March 24, 2008. Companies that will be affected by this proposed rule change should seriously consider filing comments with Customs.

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