HQ W548453

March 8, 2005

RR:IT:VA 548453 GG

CATEGORY: Valuation

Area Port Director
Los Angeles International Airport
U.S. Customs and Border Protection

RE: Request for Internal Advice; Valuation of Refurbished Disk Drives

Dear Madam:

This is in response to your internal advice request dated December 5, 2003, inquiring about the proper appraisement of refurbished disk drives that are imported by Maxtor Corporation (Maxtor). We apologize for the delay.

FACTS:

Maxtor, of Milpitas, California, is an importer and distributor of hard disk drives and network storage units. It manufactures most of its products at its factory located in Singapore, with the rest being made by Matsushita-Kotobuki Electronics of Japan (MKE). Maxtor also maintains a customer repair and warranty replacement program in which customers return hard disk storage units that appear to be defective or non-operational, and Maxtor replaces them with a comparable in-stock refurbished product.

Customers generally return defective or non-operational drives to Maxtor collection sites that are geographically proximate to the customer. From there, Maxtor ships the returned drives to Teleplan Technology Services Sdn Bhd (Teleplan), an independently owned and operated test and repair facility located in Penang, Malaysia. This facility is under contract with Maxtor to test and, if necessary and possible, repair or refurbish defective disk drives. It then makes them available to Maxtor for worldwide distribution as replacement disk drives.

Maxtor pays Teleplan a service charge for evaluating and repairing drives. The repair charge is set by contract, based on a number of factors, including a forecast of the number of drives to be repaired per period, the nature of the repair, and the number of drives tested with no defect found. The amount charged for repairs includes direct and indirect labor, overhead, operating expenses, and profit. Under the repair agreement, Maxtor also makes separate payments to Teleplan for:

1) Reimbursement of capital equipment depreciation expenses incurred by Teleplan related to equipment purchased and used to repair Maxtor product;

2) Quarterly variance adjustments in the repair fee paid to account for variations in the actual quantities tested and repaired against the forecast amount; and

3) Parts and components sent to Teleplan and used in the repair of Maxtor disk drives.

Following testing and repair, Teleplan ships refurbished drives to locations specified by Maxtor, including those in the United States. Previously, Maxtor declared to U.S. Customs and Border Protection (CBP) the amount shown on the commercial invoice, which reflects only the contract repair fee based on the quarterly forecast. Upon reexamination Maxtor determined that the declared value of these imports did not include:

1) An appropriate value (if any) for the returned unit;

2) Quarterly reimbursement of capital equipment depreciation expenses incurred by Teleplan related to equipment purchased and used to repair Maxtor product;

3) Variance adjustments in the repair fee paid to account for actual quantities tested and repaired;

4) Parts and components sent to Teleplan and used in the repair of Maxtor disk drives; and

5) The cost of international transportation of the defective unit to Teleplan for evaluation and repair.

Although disk drives are duty free most of Maxtor's imported drives were subject to the merchandise processing fee (MPF). MPF is calculated based on the value of the imported goods. As a result, upon discovering possible inaccuracies in the reported value Maxtor submitted a prior disclosure to CBP.

For internal accounting purposes, Maxtor also places a value on the defective drives at the time of their receipt and acceptance into the warranty replacement program. This value is $30 for ATA drives and $60 for SCSI drives. This value remains for the life of the product until it is scrapped, in which case it is written off. Maxtor uses the $30 and $60 book values because it maintains that these values closely approximate the costs associated with the handling and refurbishment of these products. Maxtor records the value of the drives at these amounts when they are taken in, and the drives retain that value throughout the repair, refurbishment and stocking process. Maxtor emphasizes that the $30 and $60 book value does not represent the value of the defective product but the value of the fully refurbished product, with transportation and Maxtor U.S. overhead costs included.

Maxtor on July 18, 2003, requested internal advice on the proper valuation of the drives that have been refurbished and returned to the United States. The company sought confirmation that the defective drives were assists and should be valued accordingly. It based this opinion on HQ 544241 , dated January 12, 1989, which concerned the appraisement of defective watches which were sent overseas for repair and were then returned. In HQ 544241 , CBP concluded that the defective watches were assists, and that their value was the cost incurred for transporting them to the repair facility. After evaluating Maxtor's internal advice request, CBP in Los Angeles on October 7, 2003, advised Maxtor that the defective drives were not assists and should be valued under 19 U.S.C. 1401a(f) at their full original price less a depreciation allowance. Upon receipt of this response, Maxtor on October 14, 2003, requested in writing that the matter be referred to CBP Headquarters for resolution. This resulted in the December 5, 2003, internal advice request being made from CBP Los Angeles to the Office of Regulations and Rulings (OR&R). Maxtor further supplemented the internal advice request with a letter dated February 26, 2004.

Upon receipt of the internal advice request and all related correspondence, OR&R determined that the ruling on which Maxtor relied, HQ 544241 , was in error. Therefore, OR&R published a notice of proposed modification of that and another similar ruling in the *Customs Bulletin* on August 18, 2004. The modification, which became effective on January 9, 2005, corrected the erroneous assumption that the defective watches were assists. The modification of HQ 544241 cleared the way for CBP to appraise correctly Maxtor's imported refurbished disk drives.

ISSUE:

What is the correct method of appraising disk drives that are returned after having been refurbished overseas?

LAW AND ANALYSIS:

Merchandise imported into the United States is appraised in accordance with section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979 (TAA: 19 U.S.C. 1401a). The preferred method of appraisement is transaction value, which is defined as the "price actually paid or payable for merchandise when sold for exportation to the United States," plus five statutorily enumerated additions. 19 U.S.C. 1401a(b)(1). In Maxtor's situation the refurbished disk drives are not sold by Teleplan to Maxtor. Rather, Maxtor retains title to the disk drives and simply pays Telelpan a service charge for evaluating and repairing the drives. The absence of a sale precludes appraisement under transaction value.

When imported merchandise cannot be appraised on the basis of transaction value, it is appraised in accordance with the remaining methods of valuation, applied in sequential order. 19 U.S.C. 1401a(a)(1). The alternative bases of appraisement, in order of precedence, are: the transaction value of identical or similar merchandise (19 U.S.C. 1401a(c); deductive value (19 U.S.C. 1401a(d); computed value (19 U.S.C. 1401a(e); and the "fallback" method (19 U.S.C. 1401a(f).

The transaction value of identical or similar merchandise is based on sales, at the same commercial level and in substantially the same quantity, of merchandise exported to the United States at or about the same time as that being appraised. (19 U.S.C. 1401a(c). In this case, we assume there are no sales of similar or identical merchandise made at or about the same time as the merchandise imported. Thus it is not possible to appraise on the basis of transaction value of identical or similar merchandise.

Under the deductive value method, merchandise is appraised on the basis of the price at which it is sold in the U.S. in its condition as imported and in the greatest aggregate quantity either at or about the time of importation, or before the close of the 90th day after the date of importation. 19 U.S.C. 1401a(d)(2)(A)(I)-)ii). This price is subject to certain enumerated deductions. 19 U.S.C. 1401a(d)(3). The imported merchandise is not sold in the U.S. but instead is placed in Maxtor's inventory for distribution to its customers under the warranty replacement program. Consequently, the merchandise cannot be appraised under the deductive value method.

Under the computed value method, merchandise is appraised on the basis of the material and processing costs incurred in the production of imported merchandise, plus an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class or kind, and the value of any assists and packing costs. 19 U.S.C. 1401a(e)(1). Since there is no information on which to base computed value, this method is also unavailable.

When merchandise cannot be appraised under the methods set forth in 19 U.S.C. 1401a(b)-(e), its value is to be determined in accordance with the "fallback" method set forth in section 402(f) of the TAA. The fallback method provides that merchandise should be appraised on the basis of a value derived from one of the prior methods reasonably adjusted to the extent necessary to arrive at a value. 19 U.S.C. 1401a(f)(1). CBP in Los Angeles recommends that the returned disk drives be appraised at their full original price, with a depreciation allowance for age and condition of repair under the fallback valuation method. Maxtor objects to this proposed appraisement, claiming in its letter of October 14, 2003, that it does not know and would not on a practical basis be able to determine the original selling price of each refurbished drive. The company also argues that depreciation is not applicable, because the drives have not just simply been used but have also been found to be defective.

CBP has ruled on a similar issue in HQ 544377 , dated September 1, 1989. In that particular case equipment was imported from a related company in Canada, where it had been repaired. The importer declared a repair/refurbished value, which represented 50 to 60 percent of the list price

1

for new equipment. This amount was on the Canadian company's books as a receivable, and on the importer's books as a payable. CBP agreed that this was a reasonable appraisement method for the imported merchandise under 19 U.S.C. 1401a(f)(1). In Maxtor's case, there are book values that are said to represent the value of the fully refurbished disks. In accordance with HQ 544377 , we agree that the book values represent a reasonable appraisement method for the imported merchandise under 19 U.S.C. 1401a(f).

HOLDING:

The refurbished disk drives may be appraised in accordance with 19 U.S.C. 1401(f). The value of the refurbished disk drives on Maxtor's books is a reasonable value, under the circumstances presented, under the fallback valuation method.

Sincerely,

Virginia L Brown

Chief

Value Branch