



U.S. Customs Service

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CATEGORY: Valuation

Field Director
Regulatory Audit Division
San Francisco Field Office
U.S. Customs Service
555 Battery St., Room 313
San Francisco, CA 94111

RE: Internal Advice; exclusion of freight and insurance charges; 19 U.S.C. § 1401a(b)(4)(A)

Dear Madam:

This is in response to your request for internal advice of November 14, 2001 (your file AUD-4-R:SF:ITS), received in our office on January 7, 2002, concerning the exclusion of freight and insurance charges by [Redacted] and Company, Inc. (hereafter "[Redacted]").

FACTS:

This request for internal advice arose from an audit of entries made by L. [Redacted] in 1999. Two prior disclosures were made in 2001, by the importer, which it states concerns certain errors that were made in the last 5 years. L. [Redacted] submitted an Offer in Compromise, proposing to settle the issues raised in the prior disclosures. The offer is still pending until you conclude the Compliance Assessment Audit, which encompasses some of the matters included in the prior disclosures and offer. One of the issues presented concerns the valuation of the subject importations, which are the 100 line items being audited, and one aspect of the valuation pertains to CIF deductions, which are the subject of this internal advice request.

TRADITION
SERVICE

Representing [Redacted] in this matter is the Law Offices of George R. Tuttle.

HONOR

They have made the following submissions concerning this request for internal advice: a letter to the Director, Compliance Assessment Branch, Headquarters, dated September 7, 2001; letters to your office dated December 11 and 12, 2001; and letters to our office dated December 28, 2001, and January 2, 2002. All of these letters, along with other evidence and documentation submitted with those letters, have been forwarded to us. In addition, we had a telephone conference on March 19, 2002, with a member of your staff and counsel representing [REDACTED] to discuss the issues raised. Subsequent to the telephone conference, counsel submitted a letter dated March 20, 2002. We have considered all of the above submissions and information in addressing the issues raised in the audit.

Three specific issues have been raised that you seek our advice on as a result of the audit: 1) whether the importer properly apportioned freight costs to the entry lines; 2) whether the importer properly deducted international cargo insurance; and 3) whether the documentation provided by the importer substantiates actual freight costs so that freight deductions by the importer were proper.

Apportionment of freight costs to the entry lines

[REDACTED] broker apportioned freight costs to entry lines by value. For example, you state that if an entry consisted of two tariff lines, the first having a value of \$100 and the second having a value of \$900, [REDACTED] would apportion 10% of the freight costs to the first line, and 90% of the freight costs to the second line. Another method would be to apportion freight costs by weight. Using this method for the example above, if the merchandise on the first line weighed 3 pounds and the merchandise on the second line weighed 7 pounds, 30% of the freight costs would be allocated to the first line and 70% of the freight costs would be allocated to the second line.

You believe that it is more accurate to apportion the cost of freight by weight, since freight companies normally charge based on weight, and not value. You state that by using the value method, the deduction may be overstated for items which are significantly lighter than the average for the shipment, and thus value and duty may be understated for those items. The duty consequence is most pronounced, you state, when there is a significant variation in duty rates on the entry. Counsel for the importer argues that apportionment of the international freight cost by value is a reasonable and acceptable method under 19 U.S.C. § 1401a(g)(3), as it is in conformity with generally accepted accounting principles. In addition, counsel states that Customs has not specified that a method other than value should be used to apportion freight costs.

Deduction of international cargo insurance

██████ deducted an estimated amount of \$0.50 per \$100 of CIF invoice value for international cargo insurance. The broker indicated that this deduction was taken because it was a standard deduction based on a conservative industry average. In addition, the broker indicated that this procedure is a common one in the industry and one which Customs has allowed. You believe that these deductions were improper because only actual insurance costs may be deducted, in accordance with T.D. 00-20 and numerous rulings.

Since your original internal advice request, counsel for the importer has submitted documentation attempting to support the claimed deduction. Much of the documentation consists of schedules summarizing insurance payments made by the vendor to insurance companies. Counsel states that most of those schedules indicate how the premiums were calculated, which was typically based upon a percentage (ranging from 0.50% to 0.65%) of 110% of the invoiced value. Counsel argues, therefore, that the declared insurance deductions were less than they should have been, resulting in an overpayment of duties. Other documentation submitted included copies of insurance policies, copies of receipts and listings of payments made.

Documentation supporting freight deductions

The issue here is whether documents entitled "Arrival Notices/Invoices" are sufficient to support a deduction for international freight costs. For the subject entries these notices were issued by U.S. freight forwarders. ██████ primarily used two U.S. freight forwarders and occasionally used another. Counsel states that these documents serve two purposes: first, to notify the consignee and its Customs broker of the arrival of the goods; and second, to serve as an invoice for the total international transportation charges excluding insurance. Information typically contained in these arrival notices are invoice dates, invoice numbers, bill party consignee, bill of lading, quantity, description, bill amount, and prepaid freight charges.

For one of the primary U.S. freight forwarders used by ██████, the prepaid freight costs are handwritten on the arrival notice. According to counsel, the prepaid freight charges represent what the shipper pays to the foreign freight forwarder. In its January 2, 2001, letter, Counsel states, "As the amount shown on the Arrival Notice/Invoice is the total amount actually paid by the foreign shipper to the foreign Freight Forwarder, it is the amount that is acceptable for purposes of [§] 1401a(b)(4)(A)."

Further information submitted shows that for the subject transactions, the Chinese freight forwarder arranged with the shipping company for the

international shipment and then billed the exporter for the cost. The Chinese freight forwarder would inform the U.S. freight forwarder of the freight charges. The U.S. freight forwarder would then note this freight amount on its Arrival Notice/Invoice. The U.S. freight forwarder did not incur any costs for international transportation, nor did it bill for such costs.

ISSUES:

1. Whether the importer properly apportioned freight costs to the entry lines.
2. Whether the importer properly deducted international cargo insurance.
3. Whether the documentation provided by the importer substantiates actual freight costs so that freight deductions by the importer were proper.

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 valuation, 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).

Concerning the exclusion of freight charges 19 U.S.C. § 1401a(b)(4)(A) provides the following:

The term "price actually paid or payable" means the total payment (whether direct or indirect, and exclusive of any costs, charges, or expenses incurred for transportation, insurance, and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation in the United States) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller.

See also, 19 CFR § 152.102(f).

T.D. 00-20, *The Proper Deductions for Freight and Other Costs Incident to International Shipment, Foreign Inland Freight, and Post Importation Transportation Costs from the Price Actually Paid or Payable in Determining Transaction Value*, Customs Bulletin and Decisions, Vol. 34, No. 13, March 29, 2000, at page 85, states the following concerning the proper deductions for international freight, insurance, and related costs:

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It has long been Customs position that the amount to be deducted from the price actually paid or payable for freight, insurance and other costs incident to the international shipment of merchandise, including foreign inland freight, are the actual, as opposed to estimated costs.

In addition, T.D. 00-20 states at page 87, the following:

The costs associated with freight and insurance are not the estimated costs, but the actual costs paid to the freight forwarder, transport company, etc. See, Headquarters Ruling Letter ("HRL") 542206, dated March 23, 1981, HRL 544538, dated December 17, 1982, and HRL 542467, dated August 13, 1981. However, in HRL 546226, dated March 25 1996, Customs determined that if the actual costs are not available or cannot be verified, costs for international transportation and insurance will not be excluded from transaction value.

Apportionment of freight costs to the entry lines

Customs Directive 099 3550-061, *Instructions for Preparation of CF 7501*, dated September 18, 1992, states concerning the apportionment of freight charges that "[t]his value [freight charges] shall be shown in whole numbers for each HTS item number beneath the entered value and identified with the letter "C" (e.g. C550). Charges are required for each line item valued over \$1250, and in certain special cases for each line item over \$250." A memorandum dated February 21, 2002, from the Office of Field Operations concerning GSN 1(b)(ii) and the reporting of freight charges states that "[a]ctual freight charges will be reported at the line level on the entry summary (CF7501) if they are known at the time of entry. It is acceptable to prorate these charges over all of the lines on the CF7501, as they are required to be reported at the line level."

The above are the only notices or instructions to the public of which we are aware concerning the apportionment of freight costs to entry lines. Although it is clear that freight charges are to be apportioned at the line level, we are unaware of any instructions on what method is to be used in apportioning these charges. Consequently, we agree with counsel's contention that Customs has not specified what method should be used to apportion freight costs. Absent a specified method, the use of value to apportion the freight costs to the entry lines for the subject entries was proper.

Counsel notes, however, that [REDACTED] will switch the method of apportionment for future entries if required. You argue that it is more

accurate to apportion the cost of freight by weight, since freight companies normally charge based on weight, and not value. We agree since freight deductions must be based on actual costs, and we concur that freight charges are typically made on the basis of weight. Consequently, for future entries, we will presume that the freight was charged on the basis of weight, and the apportionment at the line level should therefore be made using weight as the method. If another method is used to charge the freight, then that method should be used to apportion the freight at the line level.

Deduction of international cargo insurance

As stated above, it has been Customs longstanding position that the amount to be deducted from the price actually paid or payable for insurance incident to the international shipment of merchandise are the actual, as opposed to estimated costs. [REDACTED] deducted an estimated amount of \$0.50 per \$100 of CIF invoice value for international cargo insurance. It is clear, therefore, that the deduction for insurance made by [REDACTED] was improper. [REDACTED] has submitted documentation to attempt to demonstrate that the actual costs of insurance were higher than the declared amounts. Whatever this evidence shows does not change the fact that the declared and deducted insurance costs were estimates and thus improper.

Documentation supporting freight deductions

Concerning evidence of actual cost of freight, T.D. 00-20 states the following:

Customs considers actual costs to constitute those amounts ultimately paid to the international carrier, freight forwarder, insurance company or other appropriate provider of such services. Commercial documents to and from the service provider such as an invoice or written contract separately listing freight/insurance costs, a freight/insurance bill, a through bill of lading or proof of payment of the freight/insurance charges (i.e., letters of credit, checks, bank statements) are **examples** of some documents which typically serve as proof of such actual costs. Other types of evidence may be acceptable."

T.D. 00-20 further explains that in accordance with 19 U.S.C. § 1500, the acceptability of other documentary evidence is at the discretion of the appropriate Customs official. Customs may consider the best evidence available and the appraising officer may weigh the nature of the evidence before him in appraising merchandise. T.D. 00-20 concludes by stating, "Thus, a Customs official has discretion in accepting various types of evidence to verify the amounts deducted for freight."

T.D. 00-20 is consistent with prior rulings, e.g., Headquarters Ruling Letter (HRL) 544538, dated December 17, 1992, in which Customs held that pursuant to § 402(b)(4)(A), the cost of international transportation is to be excluded from the price actually paid or payable for imported merchandise. However, Customs explained that in determining the cost of the international transportation or freight, it always looked to documentation from the freight company, as opposed to the documentation between the buyer and the seller which often contains estimated transportation costs or charges. In essence, Customs requires documentation from the freight company because the actual cost, and not the estimated charges, for the freight is the amount that Customs excludes from the price actually paid or payable. *See also*, HRL 543827, dated March 9, 1987, in which Customs determined that the proper deduction from the price actually paid or payable for marine insurance was the amount actually paid to the insurance company by the seller, as opposed to the amount paid by the related importer/buyer; and HRL 542467, dated August 13, 1981.

Counsel argues that the language concerning evidence of actual freight costs stated above makes it clear that freight forwarder invoices are acceptable, by themselves, to show actual freight costs. Counsel argues that the language "invoice or" in T.D. 00-20 means that Customs must accept invoices as proof of actual freight costs, while acceptance by Customs of other types of evidence listed after the "or" is discretionary. Therefore, counsel states that since freight forwarder invoices have been submitted to Customs, they must be accepted as proof of actual freight costs.

The language referred to by counsel and stated in T.D. 00-20 includes a list of documents that are "**examples** of some documents which typically serve as proof of such actual costs." We see no distinction here in that some of the documents listed are required to be accepted by Customs, while the acceptance of others is at the discretion of Customs. The documents listed are examples, and although they typically serve as proof of actual costs, the specific transaction and all the documentation and evidence must be examined in order to make a determination whether the freight costs are deductible. Consequently, Customs is under no requirement to accept the subject freight forwarder arrival notices/invoices as evidence of actual freight costs.

As stated in T.D. 00-20, Customs longstanding position has been that actual freight costs are those costs paid to the provider of the transportation services. In addition, the evidence necessary to prove actual freight costs are commercial documents to and from the service provider. One of counsel's arguments is that you will not accept documentation from a freight forwarder to substantiate freight costs, but insist on documentation from an ocean carrier. The actual service provider here is a freight forwarder; however, it is the

Chinese freight forwarder. You have stated that you have accepted documentation from the Chinese freight forwarder to substantiate actual freight costs. The issue here is whether the arrival notices/invoices from the U.S. freight forwarder are acceptable to show actual freight costs. Since these documents are not from or to the provider of the services, the Chinese freight forwarder, we agree with you that they are not sufficient evidence to show actual freight costs.

Counsel states that the U.S. and Chinese freight forwarding companies are sister companies. Because of their common ownership, counsel argues that these two companies act as one company in their freight forwarding activities. In addition, counsel states that each company is authorized to act as an agent in its freight forwarding activities.

We have stated in rulings that "it is a basic principle of corporate law that a corporation is a separate and distinct legal being," and therefore, "a parent corporation and a subsidiary are in law separate and distinct beings." See HRL 223804, dated June 29, 1992. Similarly, we have stated that sister companies are in law separate and distinct beings. See HRL 114166, dated February 2, 1998. Although we recognize that for valuation purposes, prices can be affected if parties are related, counsel's argument goes far beyond that here. Counsel is arguing that sister companies are acting as one company, for which as stated in the rulings cited above, we cannot agree. In addition, we have no information concerning the scope of the purported agency relationship between the U.S. and Chinese freight forwarders. If, as counsel asserts, the companies have a close relationship either as sister companies or as agent and principal, we do not understand why the U.S. freight forwarder is unable to obtain documentation from the service provider, the Chinese freight forwarder, to substantiate its freight deductions.

Finally, counsel has stated that it can provide affidavits or declarations from the U.S. freight forwarders to substantiate actual freight. Not only would such evidence not be commercial documentation, it would not be documentation from the provider of the transportation services. Consequently, we agree with you that such documentation would not be sufficient to substantiate actual freight costs.

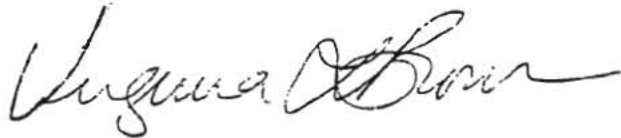
HOLDINGS:

1. Since Customs had not given guidance to importers on how to apportion freight costs to the entry lines, to do so by the use of value by the importer was not improper. However, for future transactions, these charges should be apportioned by weight, unless freight charges are calculated on a different basis.

2. The importer's use of estimates to deduct international cargo insurance was improper. The importer is required to use actual costs in making international cargo insurance deductions.
3. The documentation provided by the importer to substantiate actual freight costs for the subject entries was not to or from the service provider. Consequently, the deductions made by the importer for freight costs were improper.

You are to mail this decision to the internal advice applicant no later than 60 days from the date of this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Virginia L. Brown". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Virginia L. Brown
Chief, Value Branch