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Legal Alert
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Cross Border
Business Affairs

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First Sale Rule Transactions

A typical scenario for a company seeking first sale treatment uses the following three-tiered series of sale transactions:

1. Unaffiliated Foreign Manufacturer ("Manufacturer") sells apparel manufactured in Foreign Country to Middleman in Foreign Country.
2. Middleman sells the apparel to the US importer for importation into the U.S.

First Sale Requirements
Under the first sale rule, a US importer can achieve lower duty payments in a multi-tiered transaction as long as the following requirements are met and the importer can produce the *original invoice* covering the first sale.

(i) a middleman must serve as a buyer in the first sale (*i.e.*, from the manufacturer) and then as a seller in the second sale of goods exported to the US.

(ii) at the time of the first sale, the goods *must be clearly destined for export* to the US; and

(iii) the foreign manufacturer/seller and middleman/buyer must be unrelated or, if related, conduct their transactions at "*arm's length*."

Under the first sale rule, invoicing and payment remain similar to a typical customs transaction, but it is the invoice between the vendor and the factory that will be presented to Customs for purposes of merchandise appraisement and duty assessment.

The parties to the transaction must be prepared to substantiate (1) that the goods were subject to two bona fide sales, (2) that both sales were at arm's length, and (3) that the goods were destined for export to the U.S. at the time of the first sale. A careful review of documentation flow is necessary to ensure that the information presented to Customs is accurate and substantiated.

In order to establish that the first sale price is accurate, *the manufacturer, the middleman, and the importer* must be prepared to present the following:

- purchase orders with copies of terms between all parties;

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- invoices;
- written contracts or sales agreements;
- bills of lading for final products and materials;
- proof of payment (e.g. letters of credit);
- production orders and/or manufacturing instructions and other unique specifications of the merchandise to conform to the buyer's standards (e.g., industry standards, esp. US industry standards);
- examples of labels, logos, stock numbers, bar codes, and other unique merchandise or carton marks (indicating sales into the US); and
- examples of country of origin marking on finished goods, hang tags, labels, etc.

In addition, where the middleman and the manufacturer are related (and occasionally when the middleman and the US buyer/importer are related), it may be necessary to review the books and records of each to ensure that the transaction can be seen as one at "arm's length," i.e., that the relationship did not affect the purchase price of the goods.

The parties to the transaction must be prepared to substantiate (1) that the goods were subject to two bona fide sales, (2) that both sales were at arm's length, and (3) that the goods were destined for export to the U.S. at the time of the first sale.

One must show that the first sale was conducted at arm's length; that it was a bona fide sale and the Middle man negotiated prices, accepted title, risk of loss (etc.) from the manufacturer and did not merely act as an agent for the US importer.

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