

## IMPORT ADMINISTRATION POLICY BULLETIN

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Topic: Calculation of Profit for Constructed Export Price Transactions

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### Statement of Issue

Section 772(d)(3) of the statute requires the Department, in determining the constructed export price (CEP), to identify and deduct from the starting price in the U.S. market an amount for profit allocable to selling, distribution and further-manufacturing activities in the United States. Section 772(f) provides the rule for determining the amount of CEP profit to deduct from the CEP starting price. This paper describes, in general, how we will compute the total actual profit for CEP and how we will allocate that profit to the respondent's U.S. activities.

### Analysis

Determination of the amount of profit to deduct from all CEP transactions is essentially a two-step process. In the first step, we calculate the "total actual profit" for all sales of the subject merchandise and the foreign like product. In the second step, we allocate the total profit derived in step one to individual CEP sales transactions based on the "applicable percentage," which we compute as the ratio of total U.S. expenses to total expenses.

The following example illustrates how we would determine profit under the applicable rule. The example assumes that, in addition to its U.S. and home market sales information, the respondent has also submitted constructed value (CV) and cost of production (COP) data for the subject merchandise and the foreign like product, respectively.<sup>(1)</sup>

### **Step 1 - Calculate the Total Actual Profit for Sales of the Subject Merchandise and the Foreign Like Product**

In this step, we calculate the total actual profit as described in section 772(f)(2)(D). Note that before we can combine the respondent's U.S. and home market profits, we must first convert all U.S. dollar-denominated sales revenue and expense amounts into the home market currency (local currency or "LC").<sup>(2)</sup> We do this for each U.S. sales transaction using the exchange rate generated by the Department's exchange-rate model for purposes of the antidumping price comparison (typically, the exchange rate in effect on the date of the U.S. sale).

U.S. Market Sales Revenue

6,250,000 (1)

Home Market Sales Revenue	<u>2,750,000</u> (2)
Total Revenue for Both Markets	9,000,000
Cost of U.S. Merchandise	(4,750,000) (3)
Cost of Home Market Merchandise	(1,900,000) (4)
U.S. Selling Expenses	(1,000,000) (5)
Home Market Selling Expenses	(250,000) (6)
U.S. Movement/Packing Costs	(250,000) (7)
Home Market Movement/Packing Costs	<u>(50,000)</u> (8)
Total Expenses for Both Markets	<u>(8,200,000)</u>
Total Profit for Both Markets	<u>800,000</u>

### (1) U.S. Market Sales Revenue

2,500,000 units x LC 2.50 per-unit U.S. sales price (net of discounts and rebates)

For each observation in the U.S. market sales data base, deduct any discounts and/or rebates from the gross unit price, and multiply the resulting net unit price by the quantity sold to derive total revenue received from the sale. Next, convert each sale's total revenue from U.S. dollars into LC using the applicable exchange rate from the exchange rate model. Then, sum the total revenues earned from all U.S. market sales. (Assume for this example that all U.S. sales are CEP sales.)<sup>(3)</sup>

### (2) Home Market Sales Revenue

1,000,000 units x LC 2.75 per-unit home market sales price (net of discounts and rebates)

For each observation in the home market sales data base, deduct any discounts and/or rebates from the gross unit price and multiply the resulting net unit price by the quantity sold to derive total revenue from the sale. Next, sum the total revenues earned from all home market sales.<sup>(4)</sup>

### (3) Cost of U.S. Merchandise

2,500,000 units x LC 1.90 per unit cost

For each observation in the U.S. market sales data base, compute the unit cost by adding the cost of manufacturing (COM), general and administrative expenses, and net interest expense from the constructed value (CV) data base. Multiply the unit cost by the quantity sold to derive the total cost of sale for each U.S. market transaction. Sum the total cost-of-sale figures for all U.S. market sales.

### (4) Cost of Home Market Merchandise

1,000,000 units x LC 1.90 per unit cost

For each observation in the home market sales data base, compute the unit cost by adding the COM, general and administrative expenses, and net interest expense from the cost of production (COP) data base.

Multiply the unit cost by the quantity sold to derive the total cost of sale for each home market transaction. Sum the total cost-of-sale figures for all home market sales.

#### **(5) U.S. Selling Expenses**

2,500,000 units x LC 0.40 per unit U.S. market selling expenses

For each observation in the U.S. market sales data base, compute the unit selling expense for the transaction by adding all direct and indirect selling expenses and any further manufacturing costs incurred in the United States. (Note that, at this point, it is unnecessary to distinguish direct and indirect selling expenses associated with activities in the United States from other U.S. selling expenses.) Exclude from the calculation imputed amounts for credit expense and inventory carrying costs.<sup>(5)</sup> Because U.S. selling expenses may be expressed in both LC (for expenses incurred in the home market) and U.S. dollars (for expenses incurred in the United States), all U.S. dollar denominated selling expenses must be converted to LC using the applicable exchange rate from the exchange rate model before they are combined with selling expenses reported in LC. Next, multiply the unit selling expense figure by the quantity sold to derive the total selling expenses associated with each U.S. market sales transaction. Then, sum the total selling expenses for all U.S. market sales.

#### **(6) Home Market Selling Expenses**

1,000,000 units x LC 0.25 per unit home market selling expenses

For each observation in the home market sales data base, compute the unit selling expense for the transaction by adding all direct and indirect selling expenses. Exclude from the calculation imputed amounts for credit expense and inventory carrying costs. Multiply the unit selling expense figure by the quantity sold to derive the total selling expenses associated with each home market sales transaction, then sum the total selling expenses for all home market sales.

#### **(7) U.S. Movement/Packing Costs**

2,500,000 units x LC 0.10 per unit U.S. market movement/packing charges

For each observation in the U.S. market sales data base, compute the unit movement/packing charges for the transaction. Multiply the unit movement/packing charges by the quantity sold to derive the total movement/packing charges associated with each U.S. market sales transaction and convert all U.S. dollar denominated expenses into LC using the applicable exchange rate from the exchange rate model. Then sum the total movement/packing charges for all U.S. market sales.

#### **(8) Home Market Movement/Packing Costs**

1,000,000 units x LC 0.05 per unit home market movement/packing charges

For each observation in the home market sales data base, compute the unit movement/packing charges for the transaction. Multiply the unit movement/packing charges by the quantity sold to derive the total movement/packing charges associated with each home market sales transaction, then sum the total movement/packing charges for all home market sales.

### **Step 2 - Determine Amount of Profit to Deduct from CEP Starting Price Based on Applicable Percentage**

In this step, we allocate profit to each of the U.S. CEP sales transactions based on the "applicable percentage" as defined under section 772(f)(2)(A). For purposes of this part of the example, assume the following with regard to a single U.S. CEP sale:

- Per unit U.S. credit expense is \$ 0.025.
- Per unit U.S. inventory carrying cost is \$ 0.020. Of that amount, \$ 0.005 is incurred before the merchandise arrives in the United States, and \$ 0.015 thereafter.
- Included in the per unit U.S. selling expenses of LC 0.40 are LC 0.05 of indirect selling expenses that are not associated with selling activities in the United States (e.g., the allocated portion of salaries for overseas strategic marketing staff operating in the producer's home market). Therefore, LC 0.05 of indirect selling expenses must be deducted from LC 0.40 to derive total U.S. selling expenses of LC 0.35.
- The exchange rate on the date of the U.S. sale is LC 2.5 to \$ 1.00.

Based on these assumptions, we would determine the amount of profit deducted from the CEP starting price by multiplying the total actual profit by the ratio of total U.S. expenses to total expenses as follows:

$$\begin{aligned} & \text{LC } 0.450 \text{ (1)} \\ & \text{LC } 8,200,000 \text{ (2)} \quad \times \text{ LC } 800,000 \text{ (3)} = \text{LC } 0.0439 \\ & \text{LC } 0.0439 / 2.5 \text{ exchange rate} = \$ 0.01756 \text{ CEP profit (6)} \end{aligned}$$

#### **(1) Total U.S. Selling Expenses (Sec. 772(f)(2)(B))**

LC 0.35 selling expenses + ((\$ 0.025 credit expense + \$0.015 inventory carrying cost) x 2.5 exchange rate).<sup>(7)</sup>

#### **(2) Total Expenses (Sec. 772(f)(2)(C))**

Total expenses incurred by the respondent with respect to sales of the subject merchandise and the foreign like product. (Computed in step 1 above.)

#### **(3) Total Actual Profit (Sec. 772(f)(2)(D))**

Total actual profit earned by the respondent with respect to sales of the subject merchandise and the foreign like product. (Computed in step 1 above.)

### **Calculation of CEP Profit in the Absence of a Sales Below Cost Investigation**

Section 772(f) provides three alternative methods for determining total expenses (i.e., cost of manufacturing and SG&A expenses) for purposes of computing CEP profit.<sup>(8)</sup> These alternatives form a hierarchy where the use of any one of the methods depends on the data available to the Department from the case record. In general, the first alternative under section 772(f)(2)(C)(i) reflects the expense data available to the Department when conducting a sales below cost investigation. The second and third alternatives rely on expense and profit information derived from financial reports prepared by the respondent. The distinguishing factor between the second and third alternatives is that the second is more narrowly focused on financial reports for production and sale of merchandise in the U.S. and exporting country markets whereas, under the third alternative, the Department could rely on financial reports for merchandise produced and sold by respondent in all countries.

To illustrate how to compute CEP profit from financial report data, assume that the Department is not conducting a sales below cost investigation and that, as a result, the only income and expense information available from the case record is the respondent's audited financial statements for the year that most closely corresponds to the period of investigation or review. Included as part of these statements is the following income statement that reflects sales and costs for the subject merchandise sold by the respondent in several worldwide markets, including the U.S. and exporting country market (in LC):

Net Sales	400,000
Cost of Sales	<u>316,000</u>
Gross Profit	84,000
Selling Expenses	30,000
General and Administrative Expenses	<u>37,000</u>
Income from Operations	17,000
Net Interest Expense	<u>2,500</u>
Income Before Taxes	14,500
Income Taxes	<u>5,800</u>
Net Income	8,700

In this example, profit for CEP would equal LC 14,500, that is, the "Income Before Taxes" figure from respondent's income statement.<sup>(9)</sup> Total expenses for purposes of profit allocation would equal LC 385,500, the sum of all expenses - cost of sales, selling expenses, general and administrative expenses, and net interest expense - used to derive profit.

The CEP profit would be allocated to each U.S. sale following the same methodology described in step 2 above. To illustrate this, assume that, as in the example above, the respondent incurred LC 0.45 in CEP selling expenses associated with economic activity in the United States.<sup>(10)</sup>

$$\begin{aligned} & \text{LC } \frac{0.450}{385,500} \quad \times \text{LC } 14,500 = \text{LC } 0.0169 \\ & \text{LC } 0.0169 / 2.5 \text{ exchange rate} = \$ 0.00677 \text{ CEP profit} \end{aligned}$$

### Calculation of CEP Profit in Non-Market Economy Proceedings

It has been established that a CEP profit deduction must also be made in cases involving "non-market economy" ("NME") countries. Since it is inappropriate to use financial report data of an NME respondent in calculating CEP profit, the calculation must be based on income and expense information provided by one or more surrogate producer(s). The CEP profit deduction in such cases must be based on the U.S. selling expense data and a profit ratio derived by utilizing the financial data of the surrogate producer(s).<sup>(11)</sup> For example, if the income statement shown on the previous page were that of the surrogate producer in an NME proceeding, the profit rate applicable to U.S. CEP expenses would be 3.76%, derived as follows:

$$\text{Surrogate Income} = \frac{14,500}{385,500} = 3.76\%$$

Surrogate Expenses = \*385,500

\* (Sum of cost (316,000), SG&A expenses (67,000) plus net interest expense (2,500)).

#### Statement of Policy and Implementation

The CEP profit allocation methodology described above should be applied in all administrative reviews and investigations that have not yet received preliminary determinations.

1. Alternative calculation methods are needed to compute CEP profit in situations where the respondent is not required to provide COP and CV data. These methods are also described in this memorandum. Note that, in the event the home market is not viable, CEP profit should be based on financial report data, as described in Section 772(f)(2)(C) of the Act. A discussion of how to calculate CEP profit based on financial report data is provided at page eight of this memorandum.
2. The Department's dumping margin computer program calculates profit using the local currency.
3. The calculation of total actual profit under section 772(f)(2)(D) includes all revenues and expenses resulting from the respondent's export price (EP) sales as well as from its CEP and home market sales (except for those sales not covered due to sampling and averaging). See Section 777A of the Act, 19 U.S.C. 1677f-1. The basis for total actual profit is the same as the basis for total expenses under section 772(f)(2)(C). The first alternative under this section (the alternative applied in this example) states that, for purposes of determining profit, the term "total expenses" refers to all expenses incurred with respect to the subject merchandise sold in the United States (as well as home market expenses). Thus, where the respondent makes both EP and CEP sales to the United States, sales of the subject merchandise would encompass all such transactions.
4. Section 772(f) requires the Department to use "total actual profit" in calculating the CEP profit deduction. Since the calculation of both total actual profit and total expenses includes sales (whether above or below-cost) that are made at a profit or at a loss, the calculation must include below cost sales in order to reflect actual profit. See 19 C.F.R. § 351.402 (d)(1); see also 62 Fed. Reg. 27,296, 27,354 (May 19, 1997) ("there is no provision in the statute for disregarding sales below cost in this context, and doing so would conflict with the statutory requirement to use 'actual profit'"). However, sales to affiliates made at non-arm's length prices, as determined on a case-by-case basis, are excluded from the CEP profit calculation because they do not reflect actual market prices and, thus, do not represent actual profit (or loss). Non-arm's length sales are not a reliable indicator of "actual profit," just as they are not treated as a reliable indicator of normal value or input costs. See Section 773(a)(5), 19 U.S.C. § 1677b(a)(5); Section 773(f), 19 U.S.C. § 1677b(f). Inclusion of non-arm's length sales would inappropriately distort the calculation of total actual profit. Therefore, we include below-cost sales but exclude non-arm's length sales for purposes of computing sales revenues and expenses for CEP profit. However, where respondents have provided data on downstream sales to unaffiliated customers, those sales should be included in the computation of CEP profit. (Note: the exclusion of non-arm's length sales to affiliates may not be possible when CEP profit is calculated pursuant to the alternative methodologies discussed below. Generally, there will be sufficient information to exclude non-arm's length sales from the CEP calculation only when the Department has conducted an investigation of sales below cost.)
5. Note that the unit cost figures in (3) and (4) above include net interest expense from the COP and CV data bases. Thus, there is no need to include imputed interest amounts in the profit calculation since we have

already accounted for actual interest in computing "actual profit" under section 772(f). In step two below, however, when allocating a portion of the actual profit to each U.S. CEP sale, we will include imputed credit and inventory carrying costs as part of the total U.S. expenses allocation factor. This is consistent with section 772(f)(1) which defines the term "total U.S. expenses" as those described under section 772(d)(1) and (2).

6. From a computer programming standpoint, it may be easier and more efficient to compute the amount of CEP profit using a single ratio of total actual profit to total actual expenses. This ratio would then be applied to the U.S. expenses denominated in dollars as follows (footnote continued on next page):

$$\begin{aligned} & (\text{LC } 0.35 \text{ selling expenses} / 2.5 \text{ exchange rate}) + \\ & \$0.025 \text{ credit expense} + \$ 0.15 \text{ inventory carrying cost} \\ & = \$0.18 \text{ total U.S. expenses} \\ & \qquad \qquad \frac{\text{LC } 800,000}{\text{LC } 8,200,000} \qquad \qquad \qquad \times \$ 0.18 = \$ 0.01756 \end{aligned}$$

7. The total U.S. expenses used to compute CEP profit excludes all movement charges. Section 772(f)(2)(B) provides that, in deriving the applicable percentage under section 772(f)(1), the term "total United States expenses" means the total expenses described under section 772(d)(1) and (2). Movement charges do not appear under either of these subsections. Instead, they are described under section 772(c)(2)(A) and, thus, would not be included in total U.S. expenses for purposes of computing CEP profit.

8. Section 772(f)(2)(C) provides that in calculating CEP profit, the term "total expenses" refers to all expenses incurred by or on behalf of the foreign producer and exporter and the affiliated seller in the United States with respect to the production and sale of the first of the following alternatives which applies:

- 1) the subject merchandise sold in the United States and the foreign like product sold in the exporting country (if the Department requested this information in order to determine the normal value and constructed export price);
- 2) the narrowest category of merchandise sold in the United States and the exporting country which includes the subject merchandise; or
- 3) the narrowest category of merchandise sold in all countries which includes the subject merchandise.

9. We rely on the respondent's pre-tax profit figure because the Department does not consider income taxes as an expense in its antidumping analysis.

10. LC 0.35 selling expenses + ((\$ 0.025 credit expense + \$0.015 inventory carrying cost) x 2.5 exchange rate).

11. This is true unless the Department has determined that the exporters comprise a market-oriented industry, in which case the Department would determine normal value under section 773(a) of the Act, and CEP profit would be calculated as if the exporters were market economy exporters.