

CHAPTER 3

Valuation of goods for customs purposes

Summary

When customs duties are levied on an ad valorem basis (e.g. 10 % of the value of imported goods), the actual incidence of duty depends on how Customs determines dutiable value. The Agreement on Customs Valuation requires Customs to determine the value on the basis of the price paid or payable by the importer in the transaction that is being valued. As a result of a Decision adopted in the Uruguay Round, Customs can reject transaction values when it has reasons to doubt the truth or accuracy of the value declared by importers or of the documents submitted by them. In order to protect the interests of importers in such situations, Customs is required to provide them with an opportunity to justify their price. Where Customs is not satisfied with the justifications given, it is obliged to give to these importers in writing its reasons for not accepting the transaction value they have declared.

When the transaction value is not accepted by Customs, the Agreement lays down five methods for establishing value. In determining value on the basis of these methods, Customs is required to consult the importers and take their views into account.

A number of developing countries currently use valuation systems based on the Brussels Definition of Value, developed by the World Customs Organization (WCO). These countries will have to modify their systems to bring them in conformity with the rules of the Agreement on Customs Valuation within the transitional period of five years (i.e. up to 1 January 2000) that has been accorded to developing countries for changing over to the system established by the Agreement.

Types of customs duties

Customs duties are levied on an *ad valorem* basis (e.g. 20% of the value of the imported product) or as specific duties (e.g. \$2 per kilogram or per litre). Combined or mixed duties containing both *ad valorem* and specific rates are also levied (10% of the value + \$2 per kilogram) on some products.

With a few exceptions, most countries levy *ad valorem* duties. Governments prefer to levy such duties for three broad reasons. First, it is easier for the authorities to estimate collectable revenue from *ad valorem* duties, which are assessed on the basis of value, than revenue from specific duties, which are levied on the basis of volume or weight. Second, *ad valorem* duties are more equitable than specific duties as their incidence is lower on cheaper products and higher on more expensive goods. For instance, a specific duty of \$2 per litre would have an incidence of 50% on a bottle of wine costing \$4, and 10% on a higher-priced wine costing \$20 a bottle. An *ad valorem* duty of 10% would have an incidence of \$0.20 on the cheaper bottle and \$2 on the more expensive

bottle. Third, in international negotiations for reductions in tariffs it is far easier to compare the level of tariffs and negotiate reductions if the duties are *ad valorem*.

However, the incidence of *ad valorem* duties depends to a large extent on the methods used to determine dutiable value. Thus, if Customs determines the dutiable value at \$1,000, an *ad valorem* duty of 10% will result in a duty of \$100. If, on the other hand, it determines value at \$1,200, the importer will have to pay an import duty of \$120 for the same goods. The benefits to the trade arising from tariff bindings could fall considerably if Customs uses prices other than invoice prices for determining values for customs purposes. The rules that are applied for the valuation of goods are therefore of crucial importance in ensuring that the incidence of duties as perceived by the importer is not higher than that indicated by the nominal rates shown in the importing country's tariff schedules.

Rules of the Agreement on Customs Valuation

Agreement on Customs Valuation, Preamble

The detailed WTO rules on the valuation of goods for customs purposes are contained in the Agreement on Customs Valuation (full title: Agreement on Implementation of Article VII of GATT 1994). The Agreement's valuation system is based on simple and equitable criteria that take commercial practices into account. By requiring all member countries to harmonize their national legislation on the basis of the Agreement's rules, it seeks to ensure uniformity in the application of the rules so that importers can assess with certainty in advance the amounts of duties payable on imports.

The main standard: transaction value

Agreement on Customs Valuation, Article 1:1

The basic rule of the Agreement is that the value for customs purposes should be based on the price actually paid or payable when sold for export to the country of importation (e.g. the invoice price), adjusted, where appropriate, to include certain payments made by buyers such as the costs of packing and containers, assists, royalties and license fees (*see* box 10). The rules exclude buying commissions and special discounts obtained by sole agents and sole concessionaires from being taken into account in arriving at dutiable value.

Agreement on Customs Valuation, Article 8:1

The Tokyo Round Agreement strictly limited the discretion available to Customs to reject transaction value to the small number of cases listed in box 11. This was a matter of concern to numerous developing countries. They considered that the rule unduly inhibited the ability of their customs administrations to deal with the traders' practice of undervaluing imported goods in order to reduce incidence on duties. This was one reason for the reluctance of a large number of developing countries to accede to the Agreement in the pre-WTO period.

Decision on Shifting the Burden of Proof, §1

The Decision Regarding Cases where Customs Administrations Have Reasons to Doubt the Truth or Accuracy of the Declared Value (also known as the Decision on Shifting the Burden of Proof), adopted as a result of the initiative taken by developing countries during the Uruguay Round, corrects this lacuna. The Tokyo Round Agreement placed the burden of proof on Customs if it rejected the transaction value declared by the importer. The Uruguay Round decision shifts the burden of proof on to the importers when Customs, on the basis of the information on prices and other data available to it, "has reason to doubt the truth or accuracy of the particulars or of documents produced in support" of declarations made by the importers.

Box 10***Determining customs value: permitted adjustments to the price paid for goods****(Agreement on Customs Valuation, Article 8)**In order to arrive at the transaction value, Article 8 of the Agreement on Customs Valuation provides that payments made for the following elements can be added to the price actually paid or payable (i.e. the invoice price) by the importer for the imported goods:*

- Commissions and brokerage, except buying commissions;*
- Costs of, and charges for, packing and containers;*
- Assists, i.e. goods (materials, components, tools, dies, etc.) or services (designs, plans, etc.) supplied free or at reduced cost by the buyer for use in the production of the imported goods;*
- Royalties and license fees;*
- Subsequent proceeds of any sale accruing to the seller as a result of the resale or use of imported goods;*
- The cost of transport, insurance and related charges to the place of importation, if the country bases its valuation on CIF prices.*

The Article further clarifies that no additions other than for the elements mentioned above shall be made to the price paid or payable in order to arrive at the transaction value. The Article, in addition, enumerates charges or costs that should not be added to customs value, if they can be distinguished from the price actually paid or payable. These are:

- Freight after importation into the customs territory of the importing country;*
- Cost of construction, erection, assembly, maintenance or technical assistance occurring after importation;*
- Duties and taxes of the importing country.*

Box 11***Instances when customs can reject the transaction value declared by the importer***

- 1. When there is no sale.*
- 2. When there are restrictions on the disposition or use of the goods by the buyer. The transaction value need not be accepted if the sales contract imposes some restrictions on the use or disposition of goods except where:*
 - The restriction is imposed by law (e.g. packaging requirements);*
 - The restrictions limit the geographical area in which the goods may be sold (e.g. distribution contract which limits sales to European countries);*
 - The restrictions do not affect the value of goods (e.g. the new model imported should not be sold before a particular date).*
- 3. When the sale or price is subject to some conditions for which the value cannot be determined (e.g. the seller establishes the price of the imported goods on condition that the buyer also buys other goods in specified quantities).*
- 4. When part of the proceeds of any subsequent resale by the buyer accrues to the seller.*
- 5. Where the buyer and seller are related and if the price is influenced by the relationship.*

In order to ensure that the transaction value is rejected by Customs in such cases on an objective basis, the Agreement on Customs Valuation stipulates that national legislation should provide certain rights to importers. First, where Customs expresses doubts as to the truth or accuracy of a declared value, importers should have a right to provide an explanation, including documents or other evidence to prove that the value declared by them reflects the correct value of the imported goods. Second, where Customs is not satisfied with the explanations given, importers should have a right to ask Customs to communicate to them in writing its reasons for doubting the truth or accuracy of the declared value. This provision is intended to safeguard the interests of importers, by giving them the right to appeal against the decision to higher authorities and, if necessary, to a tribunal or other independent body, within the customs administration.

Agreement on Customs Valuation, Article 2(a)

The rule that transaction values declared by importers should be used for valuation of goods applies not only to arms-length transactions but also to transactions between related parties. In the latter transactions, which generally take place among transnational corporations and their subsidiaries or affiliates, prices are charged on the basis of transfer pricing which may not always reflect the correct or true value of the imported goods. Even in such cases, the Agreement requires Customs to enter into consultations with the importer, in order to ascertain the type of relationship, the circumstances surrounding the transaction and whether the relationship has influenced the price. If Customs after such examination finds that the relationship has not influenced the declared prices, the transaction value is to be determined on the basis of those prices. Further, in order to ensure that in practice the transaction value is not rejected simply on the grounds that the parties are related, the Agreement gives importers the right to demand that the value should be accepted when they demonstrate that the value approximates the test values arrived at on the basis of:

Agreement on Customs Valuation, Article 2(b)

- Customs value determined in past import transactions occurring at about the same time between unrelated buyers and sellers of identical or similar goods, or
- Deductive or computed values calculated for identical or similar goods (see below).

Five other standards

Agreement on Customs Valuation, Annex I: General Note

How should Customs determine dutiable value when it decides to reject the transaction value declared by the importer? In order to protect the interests of importers and to ensure that the value in such cases is determined on a fair and neutral basis, the Agreement limits the discretion available to Customs to using the five standards it lays down. The Agreement further insists that these standards should be used in the sequence in which they appear in the text, and only if Customs finds that the first standard cannot be used should the value be determined on the basis of the succeeding standards.

The standards, presented in the sequence in which they are to be used, are discussed below.

Agreement on Customs Valuation, Article 2

The transaction value of identical goods

Where value cannot be determined on the basis of the transaction value, it should be established by using an already determined transaction value for identical goods.

Agreement on Customs Valuation, Article 3

The transaction value of similar goods

Where it is not possible to determine value on the basis of the above method, it should be determined on the basis of the transaction value of similar goods.

Under both these methods, the transactions selected must relate to imported goods that were sold for export to the country of importation and at about the same time as the goods being exported.

Box 12 describes the rules to be followed in determining whether the goods that are used for determining dutiable value are identical or similar to imported goods.

Box 12

Rules for determining whether goods are identical or similar

(Agreement on Customs Valuation, Article 15:2)

Whether the goods are identical or similar to those in the transaction to be valued is determined by taking into account the characteristics described below.

Goods are identical if they:

Are the same in all respects including physical characteristics, quality and reputation.

Goods are similar if they:

Closely resemble the goods being valued in terms of components, materials and characteristics;

Are capable of performing the same functions and are commercially interchangeable with the goods being valued.

In addition, in order to be treated as identical or similar, the goods must have been produced:

- in the same country*
- and by the same producer*

as the goods being valued.

Where, however, import transactions involving identical or similar goods produced by the same producer in the country of production of the goods being valued do not exist, goods produced by a different producer in the same country must be taken into account.

Deductive value

The next two methods are the deductive method and the computed value method.

Agreement on Customs Valuation, Article 5

Deductive value is determined on the basis of the unit sales price in the domestic market of the imported goods being valued or of identical or similar goods after making deductions for such elements as profits, customs duties and taxes, transport and insurance, and other expenses incurred in the country of importation.

Agreement on Customs Valuation, Article 6

Computed value

The computed value is determined by adding to the cost of producing the goods being valued “an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the country of importation.”

Agreement on Customs Valuation, Article 7

Fall-back method

Where customs value cannot be determined by any of the four methods described above, it can be determined by using any of the previous methods in a

flexible manner, provided that the criteria employed are consistent with Article VII of the General Agreement. The value so fixed should not, however, be based on the following factors, among others:

- The price of goods for export to a third country market,
- Minimum customs values,
- Arbitrary or fictitious values.

Agreement on Customs
Valuation, Article 6; Note
to Article 6

As a general rule, the Agreement visualizes that where a transaction value is not accepted, the value should be determined by using the above standards on the basis of the information available within the country of importation. However, it recognizes that in order to determine a computed value, it may be necessary to examine the costs of producing the goods being valued and other information which has to be obtained from outside the country of importation. The Agreement therefore suggests, in order to ensure that the importer is not subjected to unnecessary burdens, that the computed value standard should be used only when buyer and seller are related and the producer is prepared to provide to the customs authorities in the importing country the necessary cost data and facilities for their subsequent verification.

Developing countries and the Agreement

Agreement on Customs
Valuation, Article 20:1

Prior to 1 January 1995, only 11 countries were applying the Agreement's valuation system. When the Agreement was being negotiated, it was recognized that the majority of developing countries (which based their valuation systems on the Brussels Definition of Value⁷, a definition entirely different from that followed by the Agreement) would need some time to adopt the legislative and institutional framework and train the officials required for its implementation. The Agreement therefore gave a delay period of five years to developing countries which considered that an immediate change to the new system would be difficult for them.

A number of developing countries have now become members of the Agreement. However, about 50 countries (including some LDCs) have invoked the provisions on the delay period. This period will expire for all countries by early or mid 2000. In order to facilitate adoption of the system by the target date, the WTO and WCO Secretariats have stepped up their technical assistance in training officials in the methods of the Agreement.

A request to extend the delay period of five years may be made to the Committee on Customs Valuation, which has been established under the Agreement. The developing country making the request must demonstrate the difficulties it is encountering in adopting the system. Any extension must be approved by the Committee.

Business implications

The basic aim of the Agreement is to protect the interests of honest traders by requiring that Customs should accept for determining dutiable value the price actually paid by the importer in a particular transaction. This applies to both arms-length and related-party transactions. The Agreement recognizes that the prices obtained by different importers for the same products may vary. The mere fact that the price obtained by a particular importer is lower than that at which other importers have imported the product cannot be used as a ground

⁷ A system developed by the Customs Co-operation Council, now the World Customs Organization (WCO).

for rejecting the transaction value. Customs can reject the transaction value in such situations only if it has reasons to doubt the truth or accuracy of the declared price of the imported goods. Even in such cases, it has to give importers an opportunity to justify their price and if this justification is not accepted, to give them in writing the reasons for rejecting the transaction value and for determining the dutiable value by using other methods. Furthermore, by providing importers the right to be consulted throughout all stages of the determination of value, the Agreement ensures that the discretion available to Customs for scrutinizing declared value is used objectively.

In addition to the right of importers to be consulted at all stages of the determination of dutiable value, the Agreement requires national legislation on the valuation of goods to provide the following rights to importers:

- The right to withdraw imported goods from Customs, when there is likely to be a delay in the determination of customs value, provided they leave a sufficient guarantee in the form of a surety or deposit to cover the payment of customs duties for which goods may be liable.
- The right to expect that any information of a confidential nature that is made available to Customs shall be treated as confidential.
- The right to appeal, without fear of penalty, to an independent body within the customs administration and to a judicial authority against decisions taken by Customs.

Agreement on Customs
Valuation, Article 13

Agreement on Customs
Valuation, Article 10

Agreement on Customs
Valuation, Article 11