

**Customs Duty for Tax and Accounting Executives
Installment #1 – Introduction to Customs Valuation and Related Issues**

I. Introduction

Everyone knows that the amount of customs duty payable is determined based on the following simple formula:

$$\text{Customs Duty} = \text{Value of Goods Imported} \times \text{Applicable Duty Rate}$$

But in reality, arriving at “value of goods imported” and “applicable duty rate” is not as simple as it appears at a first glance. PricewaterhouseCoopers’ Worldtrade Management Services (WMS), a network of PricewaterhouseCoopers, specializing in international trade and customs duty consulting, will be presenting, in a series of articles to follow, the basic rules of customs valuation and associated issues for non-customs professionals, including finance and tax executives.

II. International Standards: WTO and GATT Valuation Code

Most major trading nations (including Japan) are now signatories of the World Trade Organization (WTO), and thus in principle must adhere to its underlying agreements. One such agreement is the so-called GATT Valuation Agreement (“Valuation Agreement”), adopted by the international community during the GATT Tokyo Round, and it establishes the international standards for customs valuation. Although each signatory of WTO implements its own national customs valuation laws, rules, and regulations, which at time vary greatly from each other and may even conflict with the Valuation Agreement, we will begin our discussions with the basic principles of customs valuation set forth in the Valuation Agreement.

1. Primary Valuation Method: Transaction Value

Under the Valuation Agreement, the value of goods for customs purposes are to be determined, to the extent possible, based on “transaction value”. The Valuation Agreement defines “transaction value” as follows:

“the price actually paid or payable for the goods when sold for export to the country of importation...”

The Valuation Agreement goes on to state that the following, to the extent not included in the “*price actually paid or payable*”, must be added to the “*price actually paid or payable*” to determine the proper customs value:

- 1) commissions and brokerage, except buying commissions;
- 2) the cost of containers;
- 3) the cost of packing;
- 4) goods and services provided by the buyer free of charge or at reduced cost;
- 5) royalties and license fees;
- 6) proceeds of subsequent resale, etc. that accrue directly or indirectly to the seller; and
- 7) the cost of transportation to the port/place of importation, including loading, unloading and handling charges, and insurance.

2. Secondary Valuation Methods:

If a transaction value or clear sale price is not available (e.g., import of merchandises subject to a consignment sale, etc.), then the alternative methods of appraisement under the Valuation Agreement must be applied in a sequential order as follows:

- 1) the transaction value of identical goods;
- 2) the transaction value of similar goods;
- 3) deductive value (sales prices to unrelated parties in the country of importation, less certain deductions);
- 4) computed value (cost of production, plus “usual profit and other expenses”); and
- 5) the so-called “fall-back” method (i.e., any reasonable method consistent with the principles and general provisions of the GATT Valuation Code).

*Generally speaking, the order of application of deductive value method and computed value method may be reversed at the request of importers.

III. Risks and Opportunities for Japan-Based Multinational Enterprises

Although often overlooked by Japan-based MNEs, the proper determination and declaration of the customs value is critical for those engaged in international trades for several reasons:

1. Risk Management Issues

Inaccurate valuations could result in assessments of underpaid duties and penalties upon post-entry audits conducted by customs authorities. But Japan-based MNEs should be cognizant of the fact that customs valuation issue sometimes could develop into more serious business issues. For instance, if disagreements with customs authorities on “valuation” and/or subsequent issues with customs authorities are not handled properly, customs authorities could take the ultimate sanction against importers by denying the import clearance, which could result in a major (sometimes fatal) disruption to the supply chains of MNEs.

2. Risks Management Issues (China and ASEAN)

It should be pointed out that these troubles with customs authorities are very common and increasing in certain parts of the world (e.g., PRC and the ASEAN). We will discuss the PRC and ASEAN issues in greater detail in future installments, but a quick overview of what’s behind these increasing audit activities and subsequent troubles in the regions is described below.

Customs authorities in these regions tend to take more aggressive positions (and issue larger assessments) than the authorities in developed nations, since they are under significant pressure to maintain the level of import customs duties collected (which represent a significant portion of the total national tax revenues collected for most countries in these regions) against the background of generally falling duty rates mandated by their accession into the WTO. As Japan-based MNEs move their manufacturing bases to these countries, and expand their sales operations into these countries, we are expecting an increase in disputes and controversies between Japan-based MNEs and customs authorities in these regions.

3. Opportunities

The amount of duty payments often make up a significant portion of Cost of Goods Sold, and thus have a significant impact on the competitiveness and operating profit of MNEs. MNEs based in the U.S. and Europe have been actively managing the customs duty through variety of

planning techniques. Unfortunately, Japan-based MNEs have not been as proactive as their U.S. and Europe competitors in this area. We will be introducing basic duty reduction planning and techniques in future installments of GETS.

IV. Conclusion

In sum, although customs valuation represents an increasingly significant area both in terms of regulatory compliance and cost saving opportunities for Japan-based MNEs, it is often overlooked by finance and tax executives of Japan-based MNEs, perhaps due to over-reliance on customs brokers, and, perhaps because customs may be considered the sole responsibility of their counterparts in logistics or sales groups. It is important, however, that finance and tax executives familiarize themselves with the basic rules of the customs valuation, and understand the associated exposures and cost saving opportunities associated with the international operations they oversee.

Please “stay tuned” for future “Gets” articles speaking to customs valuation planning techniques and updates on audit activities around the globe, including the ASEAN and PRC. In the interim, please do not hesitate to contact our WMS professionals located in Tokyo, Japan, should you have any questions regarding this article or any other customs issues impacting your company.

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