

## **Customs valuation: theory and practice**

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The purpose of this article is to analyze the current practice of determining the customs valuation of goods imported into Ukraine for compliance of such practice with the principles of the World Trade Organization (the WTO), analysis of the approach of the State Customs Service on this matter and providing recommendations for improvement of the customs valuation methodology.

Determining the customs value of goods being imported to Ukraine is of vital importance, primarily for purposes of taxation. For example:

- In accordance with the Law of Ukraine On Unified Customs Tariff, ad valorem import duties are imposed at a percentage rate of the customs value of the goods and other items subject to duty.
- According to the Law of Ukraine On Value Added Tax for goods being imported to Ukraine by taxpayers, the taxable basis includes the contractual value of such goods, but not less than the customs value indicated in the customs declaration including certain expenses.

In addition to taxation purposes, data regarding customs value is used for keeping statistical records, and in corresponding cases, for the calculation of fines provided by Ukrainian legislation.

### **Consequences of improper determination of customs value**

Erroneous determination of the value for customs purposes may result in

- essential delays in customs clearance as the customs administration will require additional documentary evidence. Underpayment of taxes, or excessive payment, if the customs administration recognizes improper customs valuation after releasing the goods.
- underpayment of taxes being collected during customs clearance will result in fines of up to 100% of the underpaid tax. Taxes paid in excess cannot be refunded.

### **Correlation between customs and invoiced value**

The value for customs purposes may differ from the invoiced value, i.e. the price of the goods indicated in the invoice. In many instances the customs value differs from that of the invoiced value. The disparity can be caused by

- objective factors, e.g. when applying the method of customs value determination by the transaction value, in which case the customs value may be adjusted by adding or subtracting certain expenses;
- subjective factors when the customs administration compares the declared customs value with the values of identical or similar goods which have been already customs cleared. In this case, more often than not the customs administration appoints the customs value on the basis of the customs value of identical or similar goods, if higher. Even providing additional documentary

evidence does not give the declarant the accuracy of fixing the customs value as transaction value.

So, there is a question of how to determine customs value correctly. Theoretically, the rules of determination of the customs value of imported goods generally correspond to the requirements of the WTO. The main source of customs valuation here is Article VII of the GATT "Valuation for customs purposes" and the Agreement on Implementation of Article VII of the GATT.

In other more developed countries, members of the WTO, the customs value is determined as transaction value in around 95% of all cases. In Ukraine, the percentage is between 70% and 80% of all cases according to figures from the State Customs Service. Accordingly, in 20-30% of all cases the customs authorities reject the declared customs value and determine it at a significantly higher level which results in excessive payment of taxes by importers.

### **Theory: customs valuation by the rules of the WTO**

The customs valuation rules are stated in chapter XI of the Customs Code of Ukraine (CCU). On the whole, these rules correspond to the requirements of the WTO, especially to the Agreement on Implementation of Article VII of GATT.

The general provisions for determining the customs value of imported goods in Ukraine are as follows:

- The customs value is determined by the declarant.
- The customs administration checks the accuracy of the customs value, including an audit after the goods are released.
- Determination of the customs value should be based on information prepared in a manner consistent with the principles of accounting that are acceptable in a corresponding country and are appropriate for the used method of valuation.
- The declared customs value of goods and the sources lodged for purposes of valuation have to be formed on objective, properly documented and quantifiable data.
- If a declared customs value attestation is required, the declarant should present all necessary information to the customs administration in order to ensure verification.
- The customs administration is entitled to be convinced of the reliability and accuracy of any statement, document or declaration presented for purposes of determination of the customs value.

Determination of the customs value of imported goods in Ukraine is performed through the following methods:

- 1) Based on the transaction value of the goods being valued;
- 2) Based on the transaction value of identical goods;
- 3) Based on the transaction value of similar (analogous) goods;
- 4) Deductive method;

- 5) Computed method;
- 6) Fallback method.

The primary basis for customs value is based on the transaction value. The other methods are applied as follows:

- If customs value cannot be determined by method 1, there should be a process of consultation between the customs administration and the declarant with a view to arriving at a basis of value using methods 2 or 3. During such consultations, customs and the declarant may exchange information in confidence.
- If methods 2 and 3 cannot be used to value the goods, then they may be determined either by method 4 based on the valuation of similar or identical goods that have been sold to unrelated buyers, or correspondingly, to method 5;
- Each method subsequent to the transaction value (method 1) can only be used if the method previous to it cannot be used;
- The deductive (method 4) and computed (method 5) methods may be reversed by the declarant;
- If it's not possible to apply any of the first 5 methods, then the customs value should be determined by the fallback method (method 6).

### **Theory: application of the transaction value method (method 1)**

Determining the customs value by method 1 is performed as follows:

- The customs value of imported goods shall be the transaction value, i.e. the price actually paid or payable for the goods when sold for export to Ukraine, adjusted for some expenses as defined by the CCU, if required.
- The price actually paid or payable is the total payment made or to be made by the buyer for the benefit of the seller and/or for the benefit of the seller through third parties and/or to the parties related to the seller. Such payments may be made directly or indirectly by way of money transfer, letter of credit, collection or other payments (e.g. promissory notes, transfer of securities, etc.).
- The price actually paid or payable refers only to the price of valuated goods. Thus, the flow of dividends or other payments of the buyer for the benefit of the seller that do not relate to the imported goods are not part of the customs value.
- Additions to the price actually paid or payable shall be made only on the basis of objective, documented and quantifiable data.
- In determining the customs value, there should be added to the price actually paid or payable certain other expenses if they were not included to the price actually paid or payable.

The most common additions to the price actually paid or payable include

- expenses of loading, unloading and handling charges associated with the transport of the imported goods to the airport, port or other place of entry to the customs territory of Ukraine;
- the cost of insurance and transportation expenses of the valuated goods to the airport, port or other place of entry to the customs territory of Ukraine;
- royalty and licence payments related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and licence fees are not included in the price actually paid or payable. The mentioned payments may include payments for patents, trademarks and copyrights.

No other additions other than those defined by the CCU to the price actually paid or payable are allowed.

### **How customs value is determined in practice**

As mentioned above, in 20% - 30% of cases the customs administration do not accept the customs value declared by a declarant according to method 1. As a result, the value is determined by the customs administration at a higher level, and such value is a ground for duty and VAT rating. Accordingly, in many cases, importers are paying excessive taxes imposed on imported goods.

The reason for disagreement of the customs administration is that there are higher prices listed in the price database of the State Customs Service. In other words, during a customs inspection a comparison is made between the level of the declared customs value with that of identical or similar goods that have already been cleared and available in the price database of the State Customs Service.

If there are higher prices in the price database, they are almost automatically used by the customs administration as the customs value of the declared goods based on methods 2-6 for the determination of the customs value.

In most cases, an appeal to the State Customs Service on a determined customs value is pointless. Moreover, an appeal to the court system is a long-term procedure that may complicate customs clearance.

### **Position of the State Customs Service**

To prove its position concerning the usage of information about the customs value of identical or similar goods, the State Customs Service makes reference to Article VII of the GATT, which establishes that:

- the value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed or of like merchandise (subparagraph 2 (a) of Article VII of the GATT);

- “actual value” should be the price at which at a time and place defined by the legislation of the country of importation, such or like merchandise is sold or offered for a sale in the ordinary course of trade under fully competitive conditions (subparagraph 2 (b) article VII of the GATT);
- when the actual value is not ascertainable in accordance with subparagraph (b) of this paragraph, the value for customs purposes should be based on the nearest ascertainable equivalent of such value (subparagraph 2 (c) article VII of the GATT);
- the wording of subparagraphs (a) and (b) permits a contracting party to determine the value for customs purposes uniformly either (1) on the basis of a particular exporter's prices of the imported goods, or (2) on the basis of the general price level of like merchandise (Annex I to article VII of the GATT).

Thus, a comparison of the amount of the declared customs value to the amount of the customs value of identical or similar goods already cleared is conducted in order to be convinced that the declared customs value is based on the “actual value”. Such information is located in the price database of the State Customs Service. If there are prices of a higher level in the database, even in case of additional explanations of the declarant, they are used as the base of the customs valuation of the goods.

There is no way to agree with such a position of the State Customs Service as it is not based on a system-defined analysis of article VII of the GATT and the Agreement on Implementation of Article VII of the GATT. Article VII of the GATT particularly establishes that:

- it would be in conformity with Article VII to presume that "actual value" may be represented by the invoice price, plus any non-included charges for legitimate costs which are proper elements of "actual value" and plus any abnormal discount or other reduction from the ordinary competitive price (Annex I to Article VII of the GATT);
- the customs value of imported goods should not be based on arbitrary or fictitious values (subparagraph 2 (a) of Article VII of the GATT).

The purpose of adopting the Agreement on the Implementation of Article VII of the GATT is, among other things:

- Recognizing the need for a fair and neutral system for the valuation of goods for customs purposes that precludes the use of arbitrary or fictitious customs values;
- The recognition that the basis for valuation of goods for customs purposes should, to the greatest extent possible, be the transaction value of the goods being valued.

The Agreement on the Implementation of Article VII of the GATT establishes that:

- the primary basis for customs value is defined in Article 1 (i.e. by a transaction value of the goods being imported) and the imported goods should be valued according to the clauses of this article if the provided conditions are fulfilled;

- the customs value of the goods imported shall be the transaction value; in other words, the price actually paid or payable for the goods when sold for export to the country of importation, adjusted in accordance with the provisions of article 8 provided:
  - (a) that there are no restrictions as to the disposition or use of the goods by the buyer;
  - (b) that the sale or price is not subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued;
  - (c) that no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the seller, unless an appropriate adjustment can be made in accordance with the provisions of Article 8;
  - (d) that the buyer and seller are not related, or where the buyer and seller are related, that the transaction value is acceptable for customs purposes under the provisions of paragraph 2 of Article 1.
- if the mentioned conditions are not fulfilled, the customs value cannot be determined according to the transaction value of the imported goods and that the subsequent valuation methods are applied in sequential order.

It is further necessary to mention Decision 6.1 of the WTO Customs Valuation Technical Committee on “Cases where customs administrations have reasons to doubt the truth or accuracy of the declared value”. According to this decision:

- If the customs administration, after the lodging of a declaration, has a reason to doubt the truth or accuracy of the particulars or of documents produced in support of this declaration, the customs administration may ask the importer to provide additional explanations, including documents or other evidence, that the general declared value represents the total amount actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8 of the Agreement on the Implementation of Article VII of the GATT.
- If after receiving further information, or in the absence of a response, the customs administration still has reasonable doubts about to the truth or accuracy of the declared value, it may be deemed that the customs value of the imported goods cannot be determined under a transaction value of the imported goods.

Decision 6.1 of the WTO Technical Committee on Customs Value was applied primarily to prevent customs fraud. The key issue is customs’ doubts of truth or accuracy of the declared customs value.

Current customs legislation of Ukraine implements the mentioned Decision 6.1, though not in full. It’s particularly unclear when customs’ doubts begin to emerge. Following worldwide practice, such doubts should begin to emerge in cases such as the following:

- There are signs of fraud in the documents.
- There are inaccuracies in the documents.

- There are arithmetical mistakes in the documents.
- There are differences in the documents.

In cases such as these, the customs administration should properly substantiate the reasons for doubting the declared customs value. Lack of justification of doubts results in arbitrary defining of the customs value, which is contrary to the provisions of the Agreement on the Implementation of Article VII of the GATT.

In such a way, based on the regulations of the WTO, at the time of control of the customs value defined by the transaction value of imported goods (method 1) the customs administration should be convinced that:

- all the conditions of applying method 1 hold true (points (a) – (b) above);
- there is accuracy in the declared customs value. In other words, all the provided adjustments were included;
- the documents of the declared customs value are trustworthy. In other words, there is a lack of counterfeit documents and misrepresentation of data about the customs value.

If observations are absent, the customs administration should accept the transaction value as a basis for determining the customs value, irrespective of the existence of any other prices in the database.

### **The customs value is lower than the goods' direct manufacturing costs**

According to article 265 of the CCU, if the customs administration comes to the conclusion that the declared customs value is lower than the direct costs of the manufacturing of such goods, including raw materials and/or components forming a part of the goods, customs is empowered to oblige the declarant to determine the customs value in another way than has been used.

Based on this provision, the customs administration practices inquiries to the declarant with the requirement to provide the calculations of the goods' price. It is practically impossible to receive the calculation of the price. In case of not providing such documentation, the customs administration is entitled to determine the value independently on the basis of the existing information (mostly from the price database). It's necessary to note that the mentioned provision of article 265 does not correspond with the rules of the WTO in the following ways:

- Comparison of the customs value with direct costs is not anticipated by the Agreement of the Implementation of Article VII of the GATT.
- The primary method of determining the customs value is the transaction value of the imported goods (method 1). But comparison of the customs value with the direct costs is in fact applying method 5, computed value. Such method may be applied only if the previous four methods before it cannot be used.

### **Appeal on decisions of defining the customs value**

The appeal procedure on decisions of determining the customs value is not perfect. But in case of a disagreement with such a decision, the declarant is entitled to turn to the customs administration with an application to release the declared goods into free circulation with payment of the taxes corresponding to the customs value determined by the customs office. Such a possibility is anticipated by article 264 of the CCU.

The term of warranty obligations should not exceed 90 calendar days from the moment of the release of the goods into free circulation. If after the declarant paid the taxes corresponding to the customs value defined by the customs office a decision on accepting the customs value declared by the declarant will be adopted by customs, the amount of overpaid taxes will be returned to the declarant within 30 days from the day of the decision was adopted as provided by legislation.

The declarant is entitled to appeal the decision of customs on determination of the customs value to the customs administration of a higher level and/or to the courts. Appeal by judicial procedure however can take a very long time – up to a year and longer.

The procedure of release under warranty is recommended to apply when a judicial appeal is anticipated. The release of goods under warranty will be additional evidence of the declarant's disagreement with the decision of customs on determination of the customs value for the court.

Also, if the decision to appeal to the court is adopted by the importer, it's necessary to document certain facts which may impact the court's decision – to prove the impossibility to present customs with additional documents or to offer to explain to customs in writing how the customs value was defined, etc.

It is recommended to expedite the documents endorsing the customs value while clearing the goods in order to reduce the risk of rising disputes with customs on the determination of the customs value.