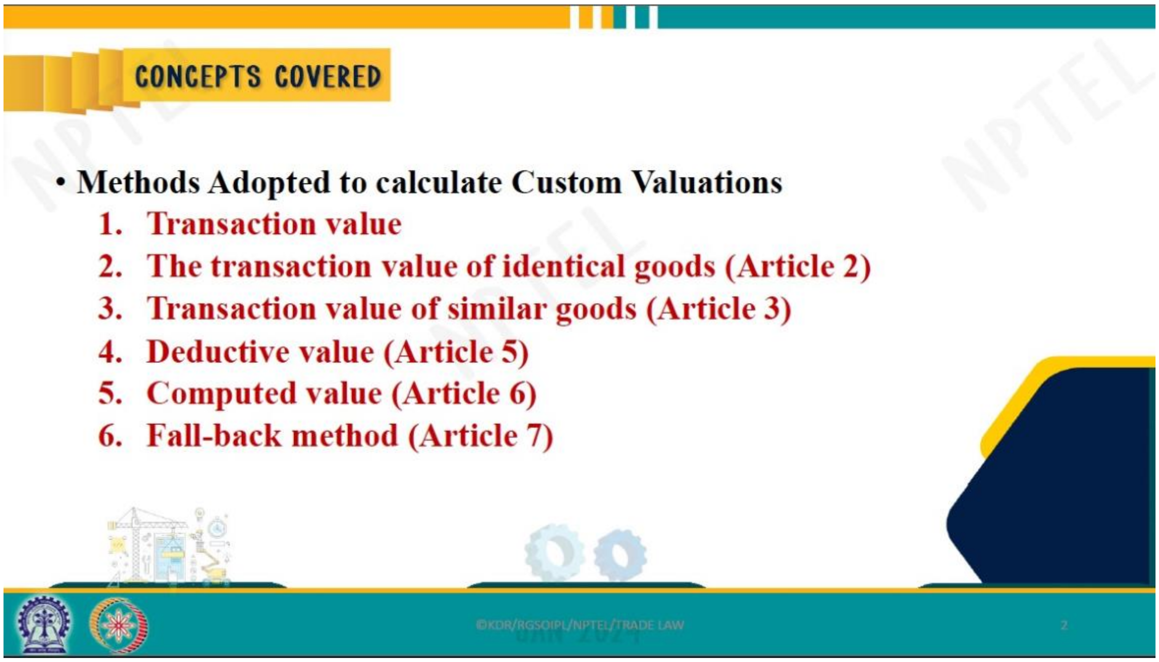
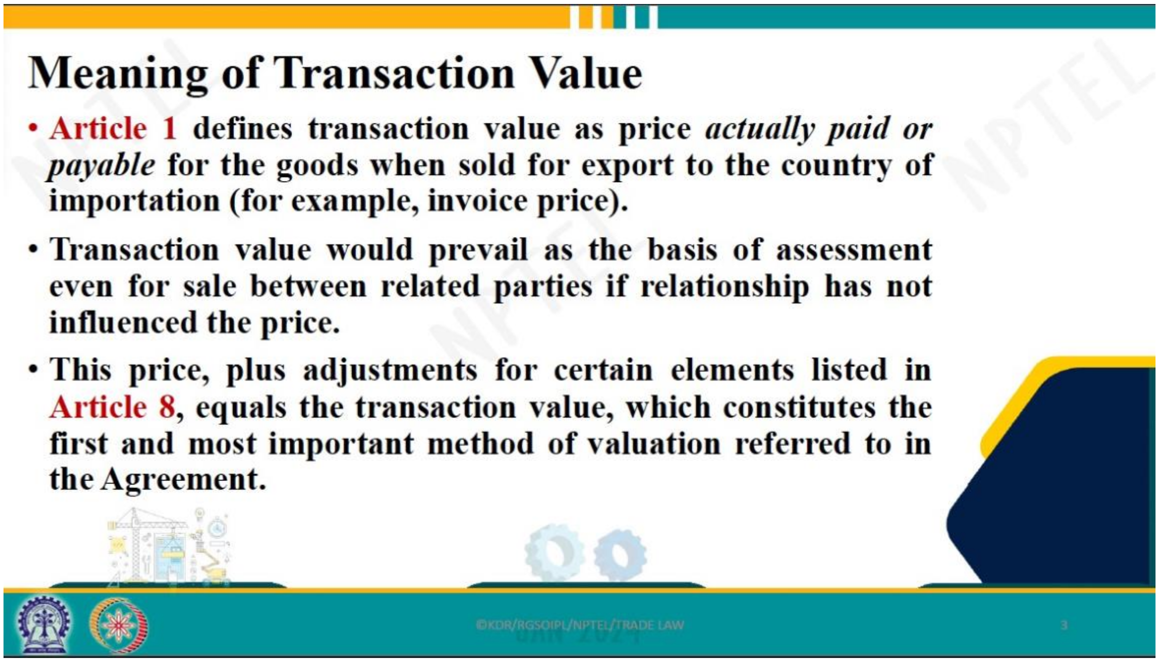
Lecture 28: Different Methods of calculating Customs Valuation

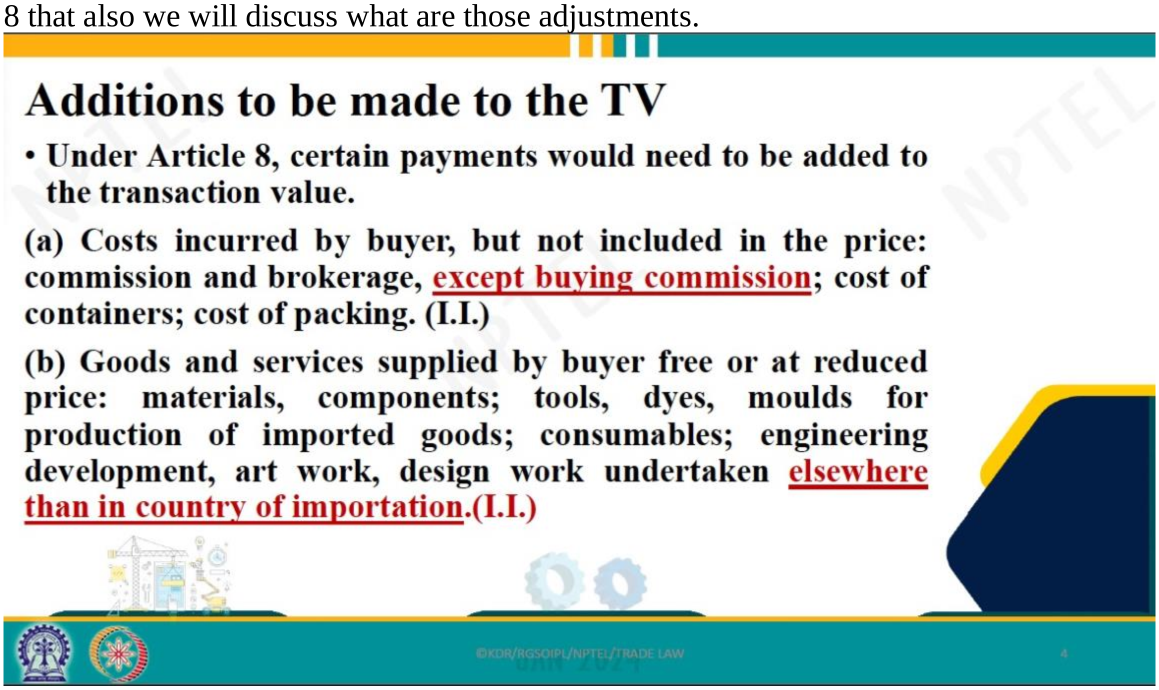
Dear students and we are going to discuss about the various method of customs valuation in this particular class. So we already talked about this customs valuation and its importance and this particular class is specifically on the six different methods of calculation.



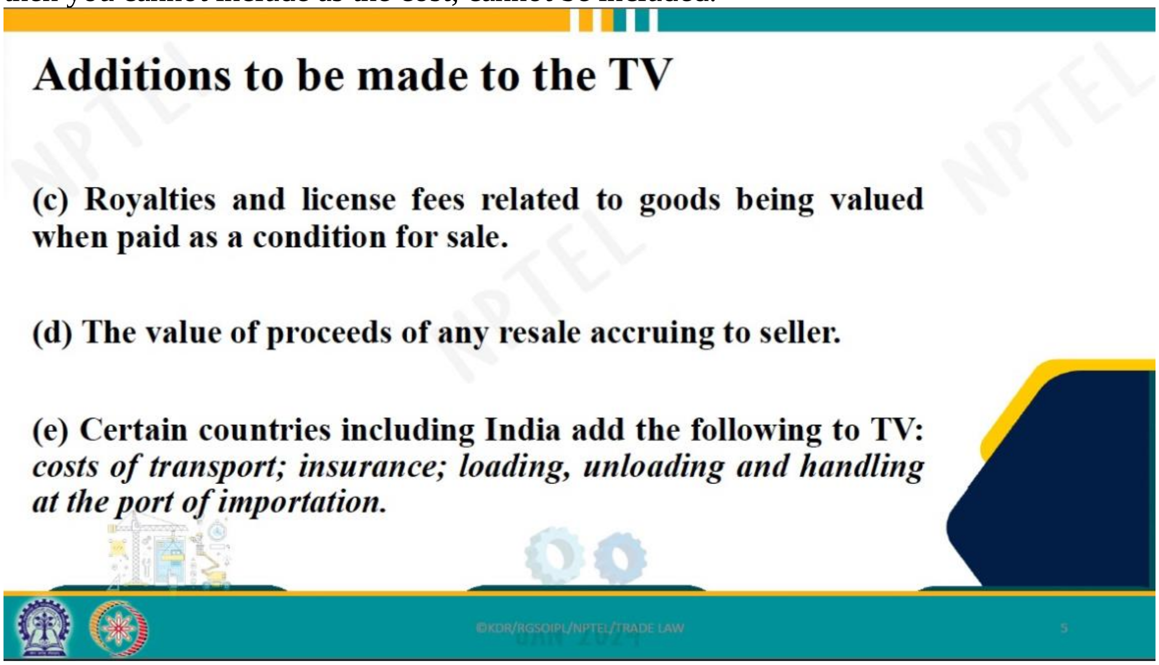
How exactly the customs authorities calculate the customs? how they are going to calculate the valuation of the goods? So the different methods are common to all WTO member countries and there are six methods which are described under customs valuation code and the first one is the transaction value and the second one is the transaction value of identical goods and third is the transaction value of similar goods and fourth is the deductive value and fifth is the computed value and sixth or the last one is the fall-back method. These are the six methods of customs valuation mentioned in the customs valuation code. So we will examine one by one and how this valuation is made.



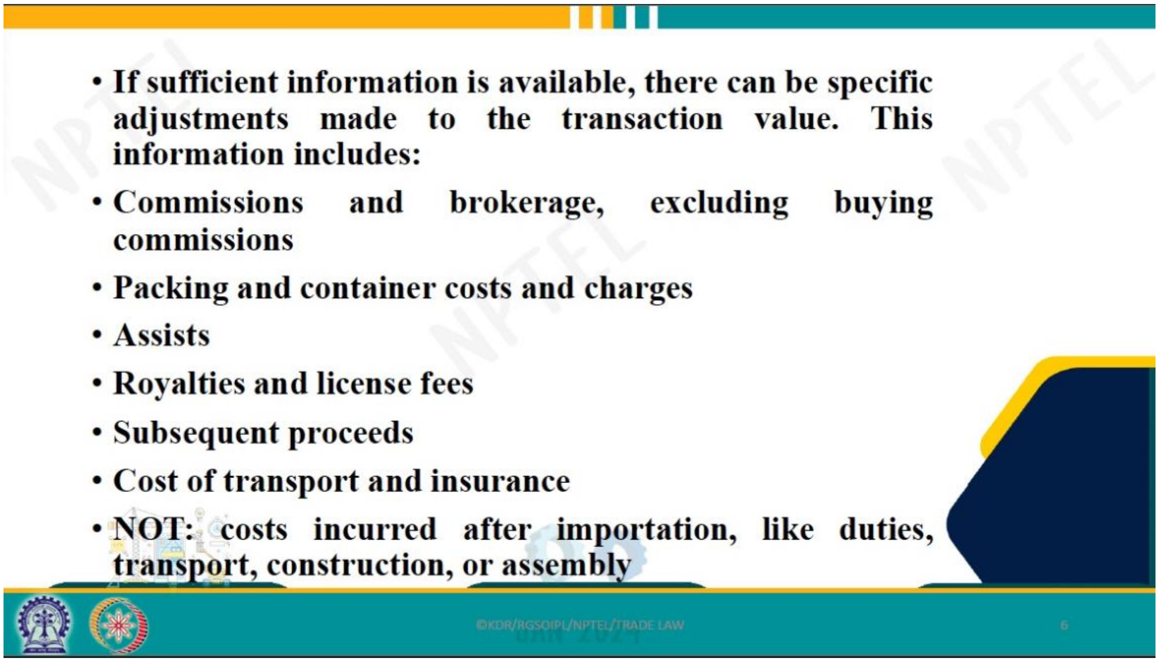
So the first one is the transaction value. What is the transaction value? The transaction value is the price actually paid or payable to the goods in the country of importation. So we call it usually it is the invoice price. So what is the transaction value? Transaction value is the invoice price and this invoice price is in the usual course of business not between related parties and we will explain what is related parties and there can be a price adjustments. So there can be certain price adjustments also we can do under article 8 that also we will discuss what are those adjustments.



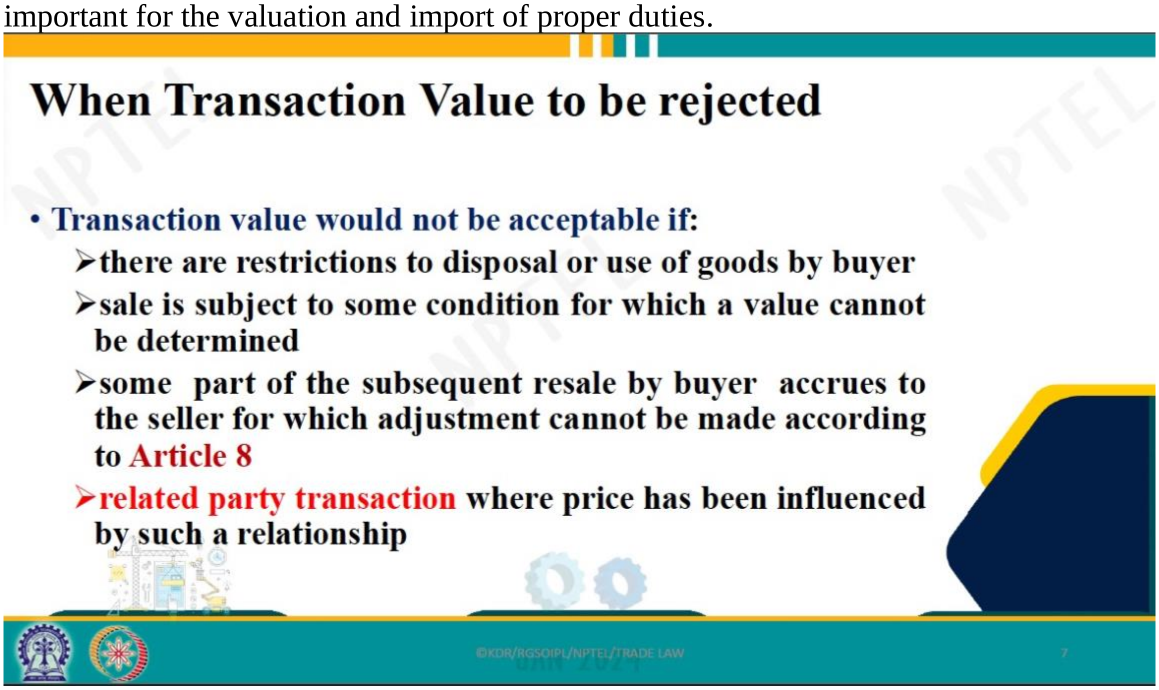
So here certain additions can be made to the transaction value, certain payments. For example the cost incurred by buyer but the brokerage cannot be included, the commission cannot be included but buying commission can be included in the cost. So the cost of containers, cost of packaging all these cannot be included in the price and then goods and services supplied by the buyer free or at reduced price. For example materials, components, tools, dies, mold and other production of imported goods including consumables, engineering development, artwork, design work elsewhere than the country of importation. It means all these are happened outside the country of importation then you cannot include as the cost, cannot be included.



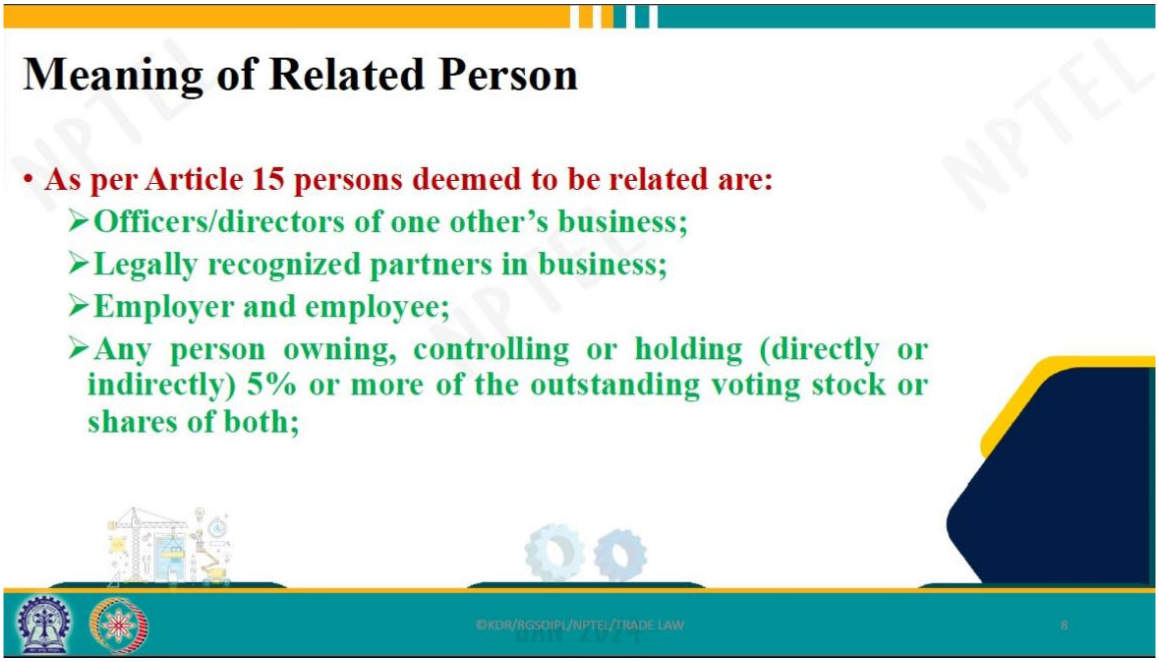
Then royalties, so royalties and license fees so if it is paid as a condition for sale then that is to be added to the transaction value. So usually royalties are added to the transaction value and the value of proceeds of any resale accruing to seller. So for example the transaction value most of the countries adopted the transaction value India is also adopted the transaction value and India usually adds the cost of transport, insurance, loading, unloading, handling charges at the port of importation. So these are the things which India usually adds to the transaction value. So the transaction value should not be completely the invoice price but invoice price plus these components can be added.



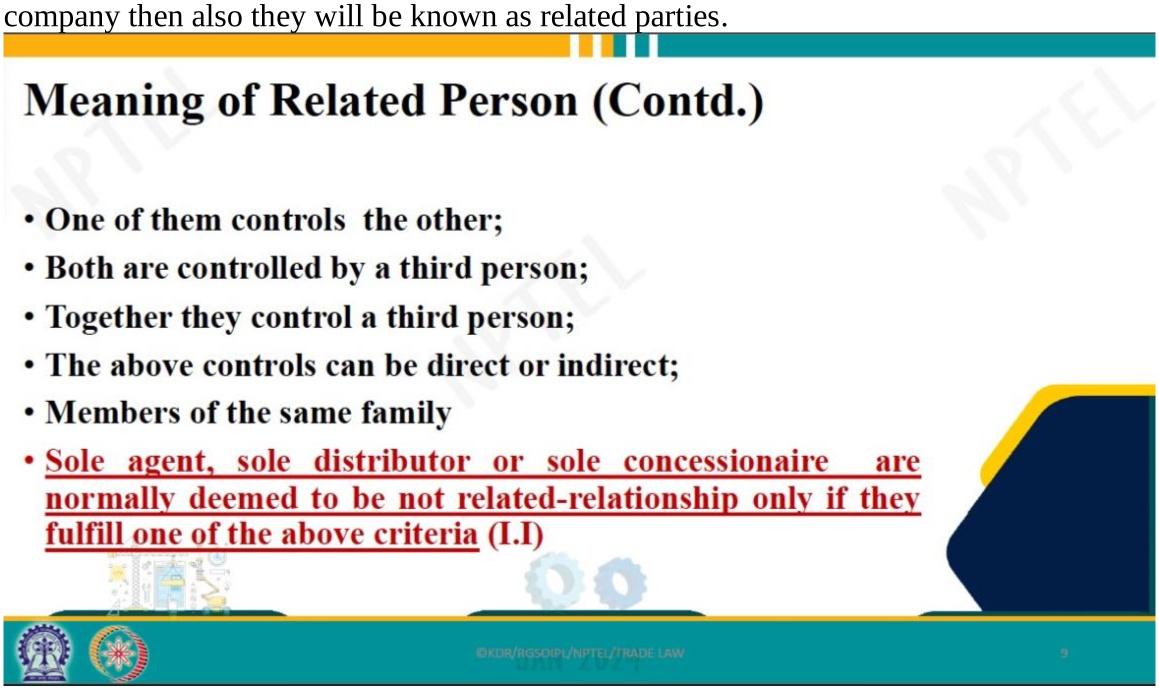
So here so this we already said that the information with regard to brokerage because you want to know what is the brokerage so you exclude this commissions, other commissions, container cost then royalties will be added and then cost of transportation and insurance. So all these information will be asked by the customs authorities and this is very important for the valuation and import of proper duties.



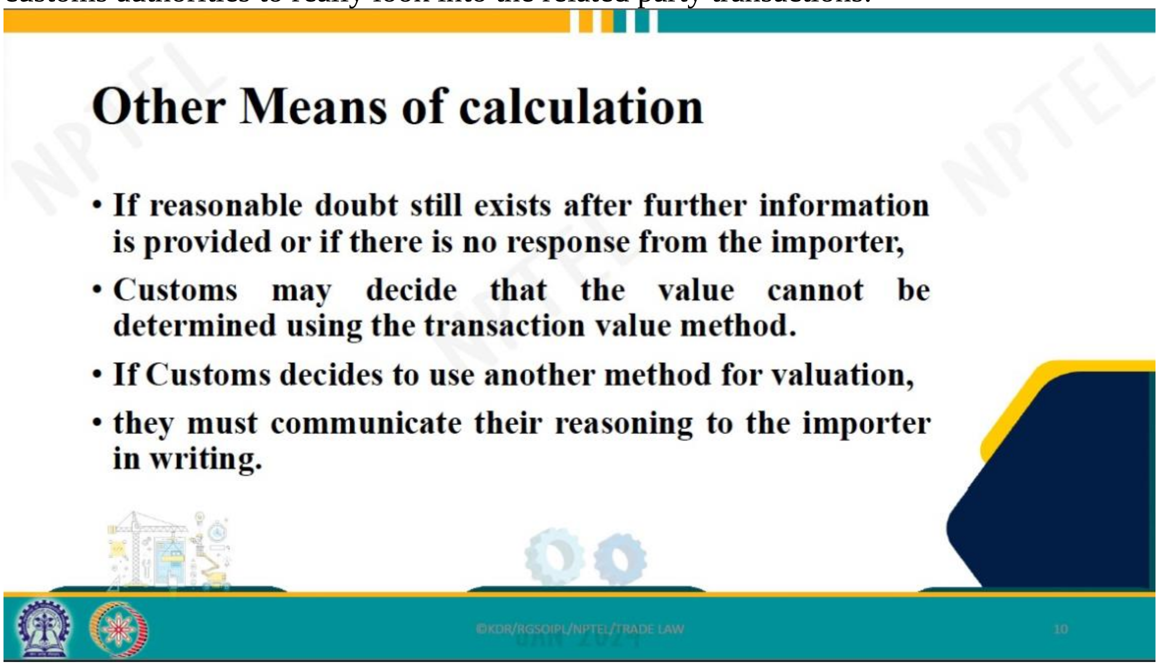
And also the question is so everything goes fine with transaction value. So the problems comes when the transaction value is not reliable and that transaction value to be rejected. So when this transaction value is rejected there are restrictions to disposal or use of goods by buyer. Sale is subject to some conditions where the value cannot be given, the value cannot be determined at that point of time. Then resale, subsequent resale by buyer accrues to the seller for adjustment which cannot be made. Then most importantly related party transactions, definitely related party transactions is the price can be influenced that relationship can influence the prices. So these are some of the circumstances where the transaction value cannot be taken into consideration.



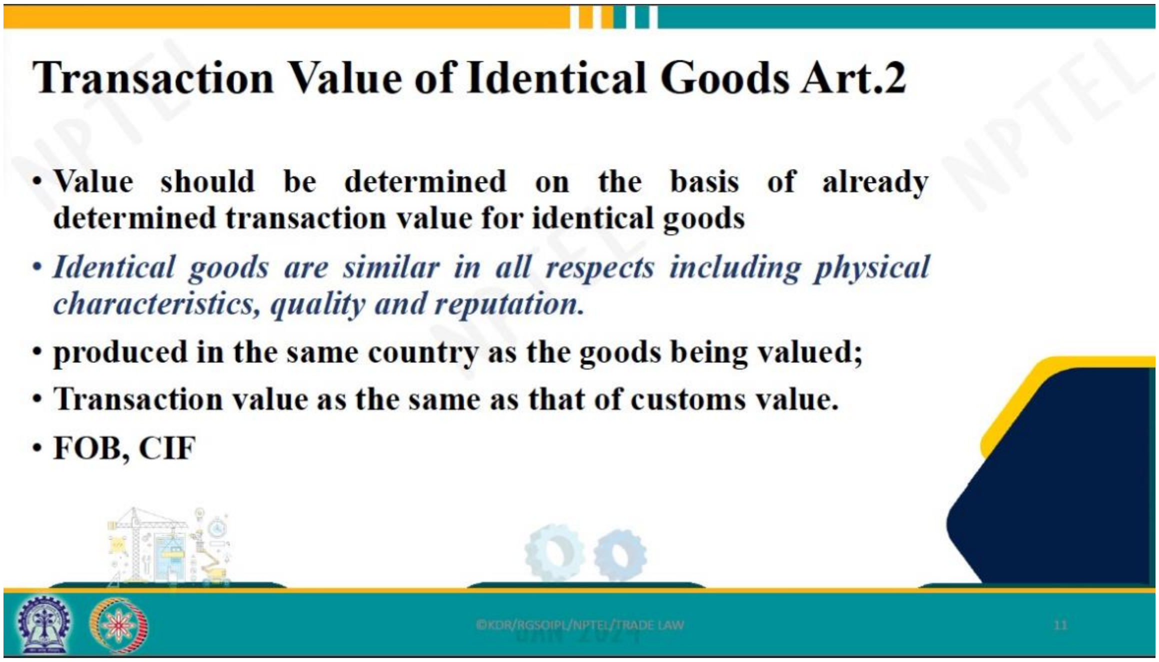
And we said most of the related party transactions are under the scrutiny of the customs valuation authorities. So, who are these related parties? The related parties can be, so the directors of both the companies are same or officers of one company is the officer in another company. Director of one company is the director in the other company as well exporting and importing. Then they are partners in both the businesses and they may be employer and employee then any person having controlling or holding 5% or more of the voting stock in both the companies - the exporting company as well as the importing company then also they will be known as related parties.



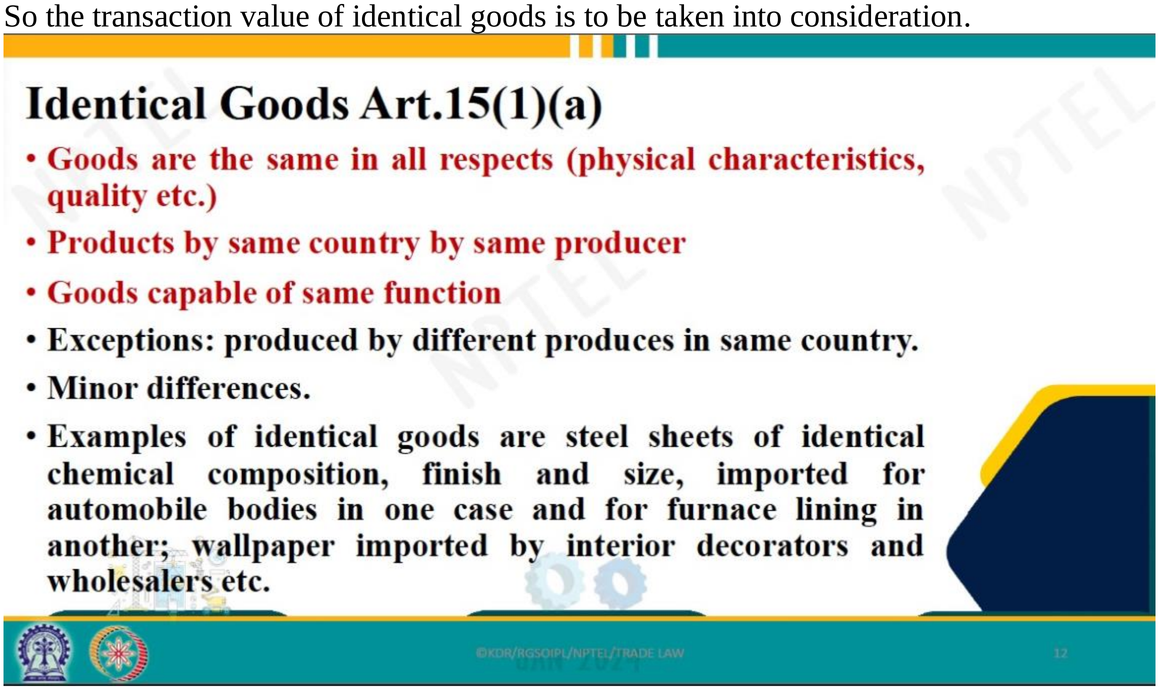
And then one controls the other company as well. That means exporting company and importing company he controls both exporting and importing companies. Both are controlled by third person. So together the exporter and importer controls a third company that also is a related party. So these controls can be proved directly or indirectly. Members of the same family, so all these relationships are considered to be related parties. So, if the transaction between related parties are considered to be it cannot be considered as a transaction value, then what method is to be used? So the customs authorities to really look into the related party transactions.



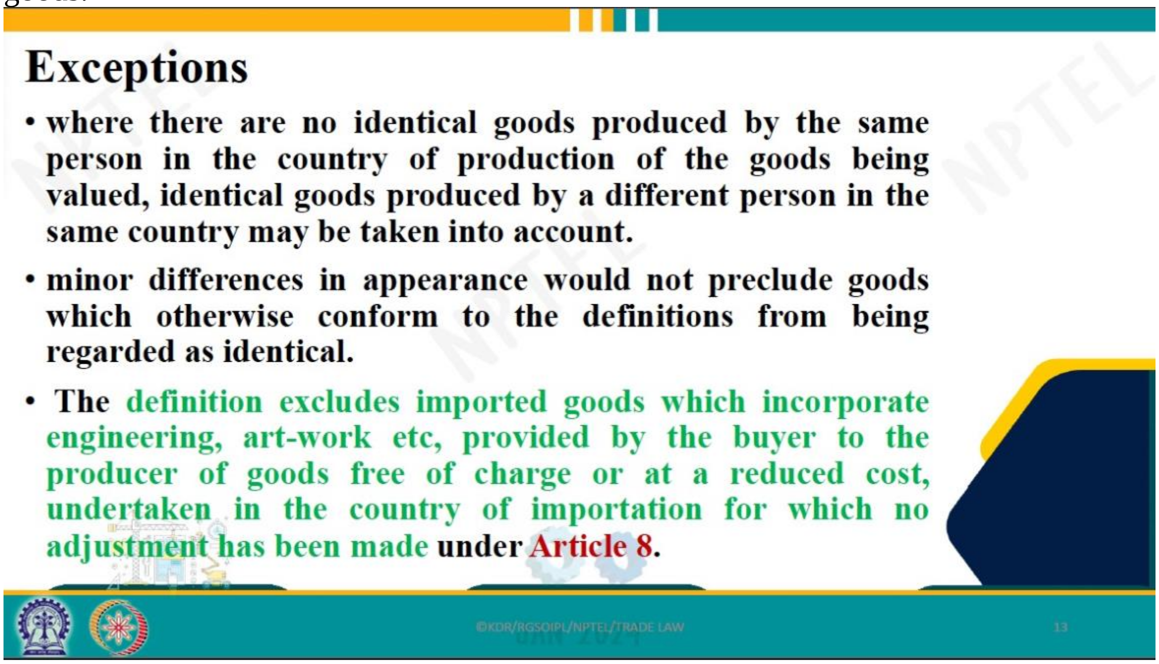
That means if there is any doubt about the transaction, this doubt can come from various tsources, related party transactions and then other sources. So if the customs decides that the transaction value cannot be calculated, the transaction value method cannot be adopted, then they will communicate to the parties, and they will go ahead with the next method of calculation, that is the transaction value of identical goods.



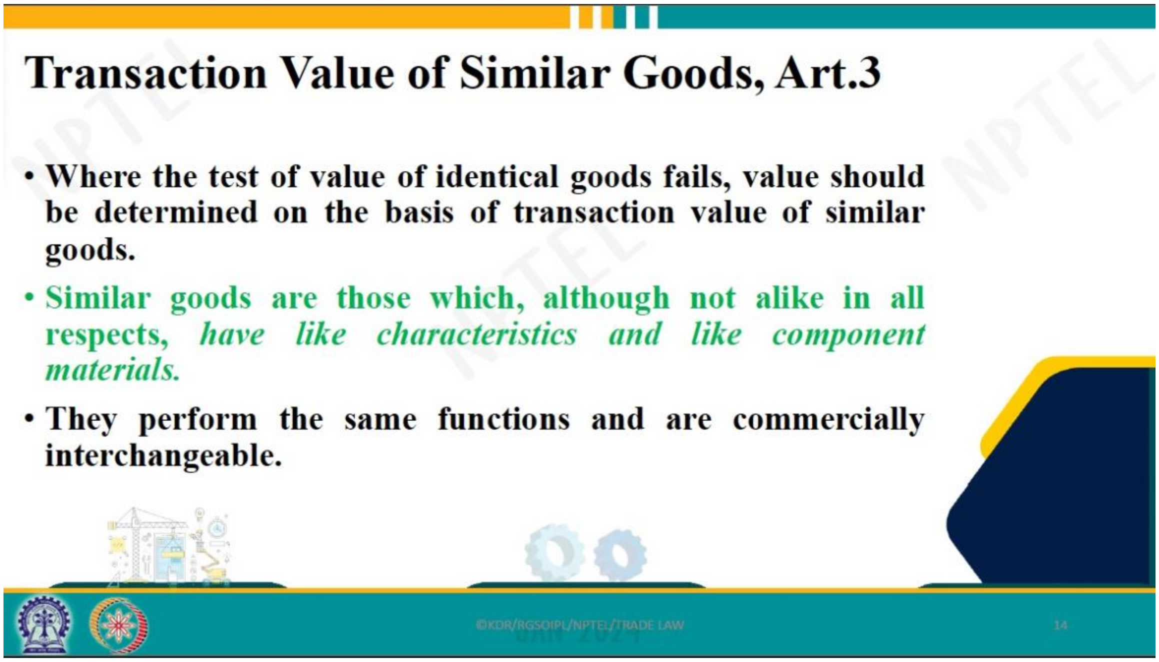
Transaction value of identical goods - And what is this identical goods? Identical goods are similar in all respects, including physical characteristics, quality, reputation, very simple example, various kinds of apples. Identical goods and these identical goods are produced in the same country, and the transaction value is the same; the transaction value is to be considered the same method of the identical goods as well. So Free on Board(FOB) contracts and Cost Insurance Freight(CIF) contracts. These are two methods; in one, the insurance is included, and in the other, the insurance is not included. So the transaction value of identical goods is to be taken into consideration.



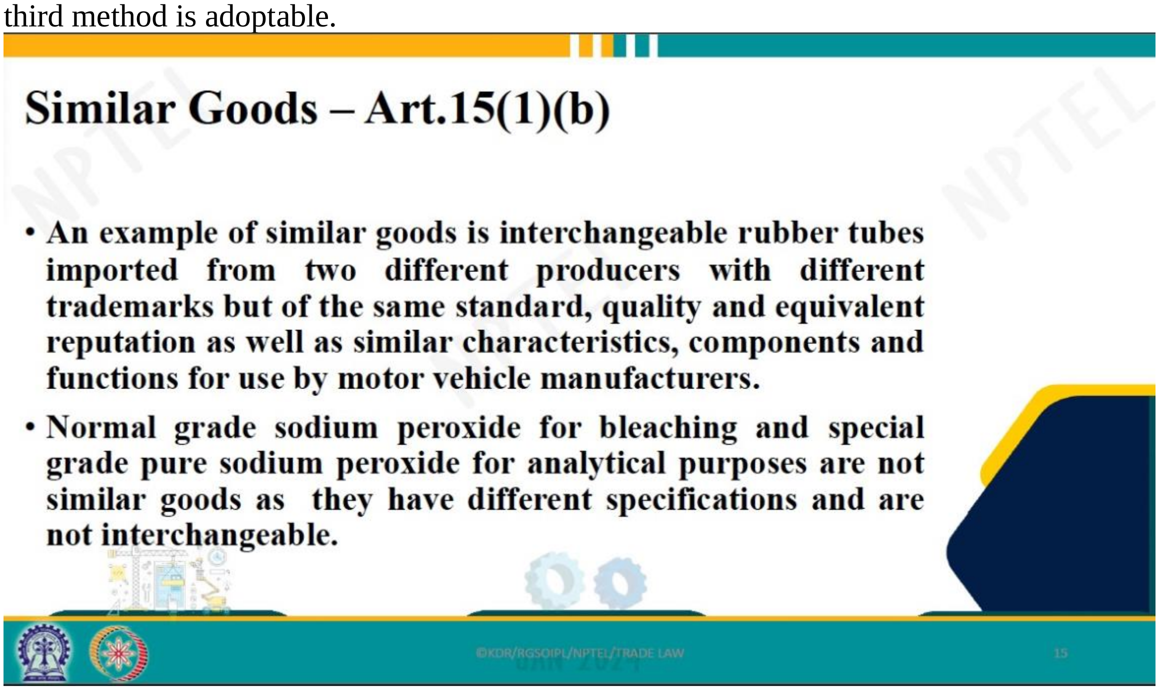
And identical goods they are same in all respects physical characteristics, quality etc. And second condition is the products from the same country, same producer and same function. But if the goods are produced by a different producer, then they cannot be included. And identical goods, for example, steel sheets of identical chemical composition, finish, size. So this will be taken into consideration for steel sheet a product which we have shown as an example. So this may be used for automobile bodies and for also the furnace lining in another. And wallpapers - wallpaper for decorations all kind of wallpapers can be considered as identical goods. So if the transaction value cannot be calculated then you will go to the next step that is the calculation of value on identical goods.



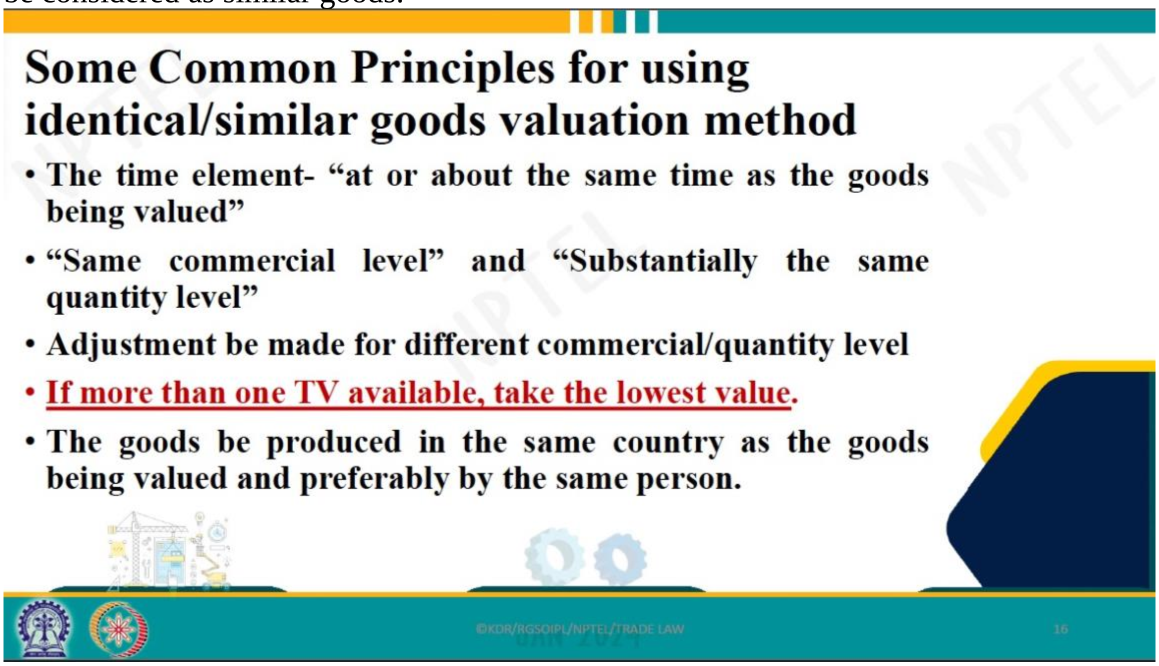
And some of the exceptions are, if there are no identical goods produced by the same producer, it must be produced by the same producer, the country of production. And if he is not producing the identical goods then identical goods produced by a different person in the same country may be taken to account. So that means the same exporter is not producing the identical goods another exporter is producing the identical goods can be taken into consideration. Minor differences can be also taken into consideration. So minor differences are not a disqualification. And the definition excludes imported goods with engineering, art-work, etc. So that means the intellectual property rights here again, the engineering drawings, artwork etc, are not included. So no adjustments can be made with regard to this kind of intellectual property rights including know how.



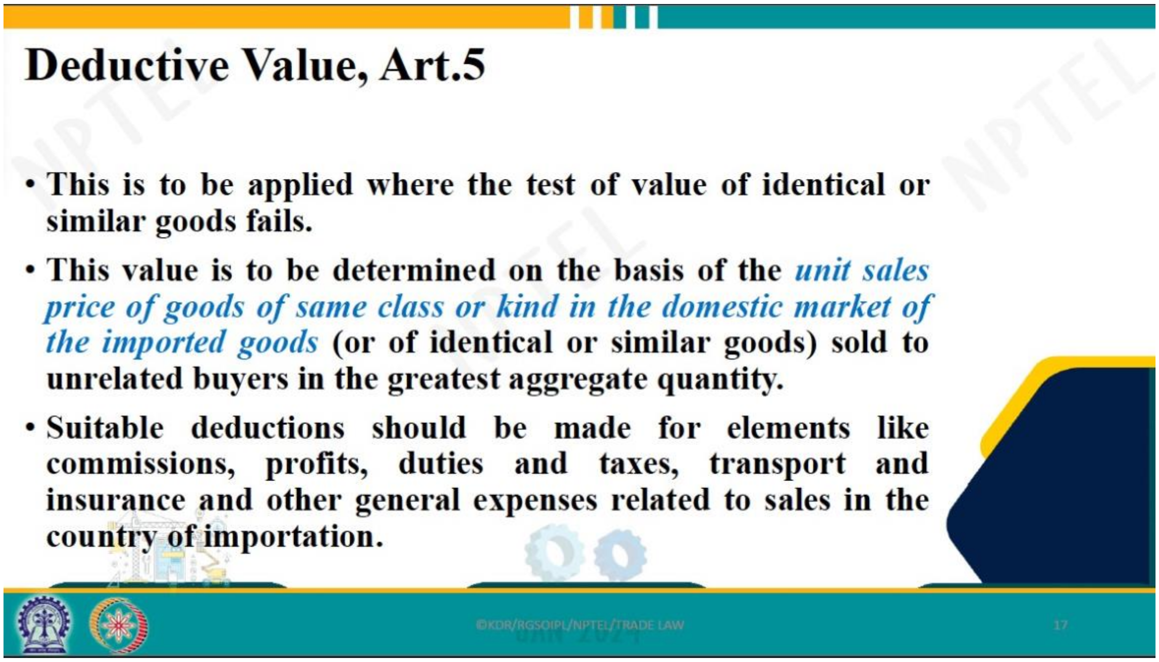
Then, if the second method value cannot be calculated, then they will go to the third method. And the third method is transaction value of similar goods. We said ***Identical Goods***, now ***Similar Goods***. So what is this similar goods? the third method will only go when the value of identical goods fails. Then the value should be based on the similar goods. What are similar goods? Similar goods are those which not alike in all respects have like characteristics and like component materials. Similar goods - like characteristics and like component materials and most importantly they perform the same functions. That means commercially interchangeable and do the same function. Then the third method is adoptable.



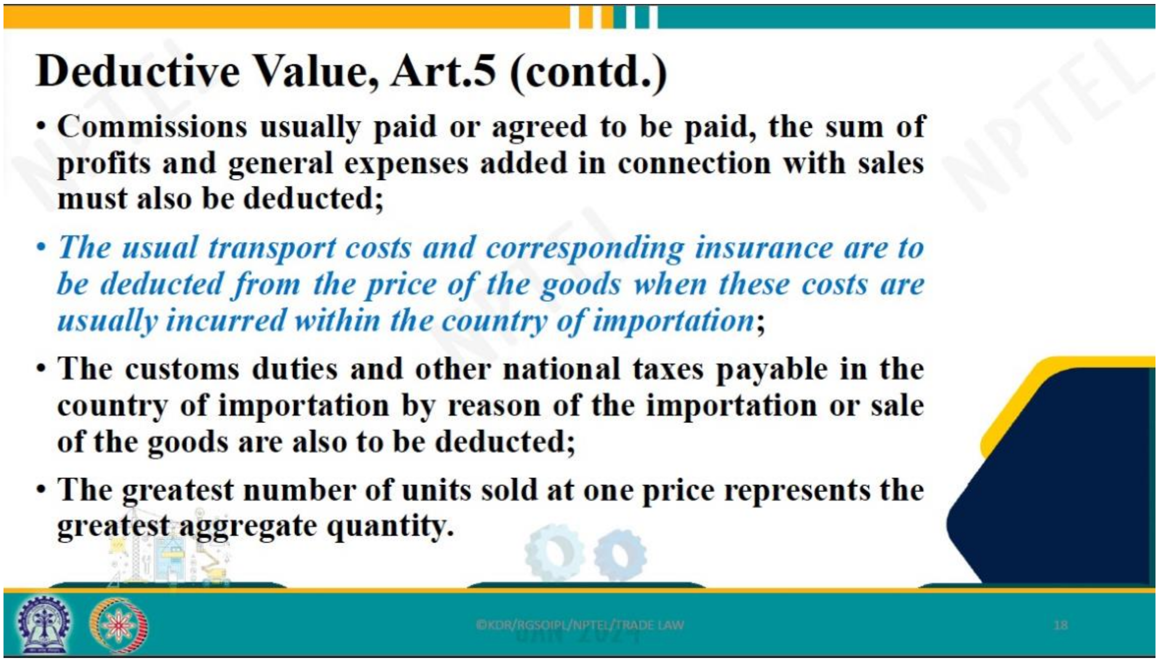
So similar goods is different from identical goods. For example, rubber tubes are imported from two different producers with different trade mark, but with the same standard, quality and equivalent reputations and similar characteristics in the component functions, for example, which can be used for vehicle manufacturers. So this can be considered as similar goods. So we said that the sodium peroxide for bleaching and special grade pure sodium peroxide for analytical purposes and one is for bleaching purposes and another one is for laboratory purposes are they are not similar goods because their specifications are different and they are not interchangeable. So the characteristics are very clear: it must be interchangeable, it must have the same function, and also, the quality must be the same and equivalent in reputation. If it is not, it cannot be considered as similar goods.



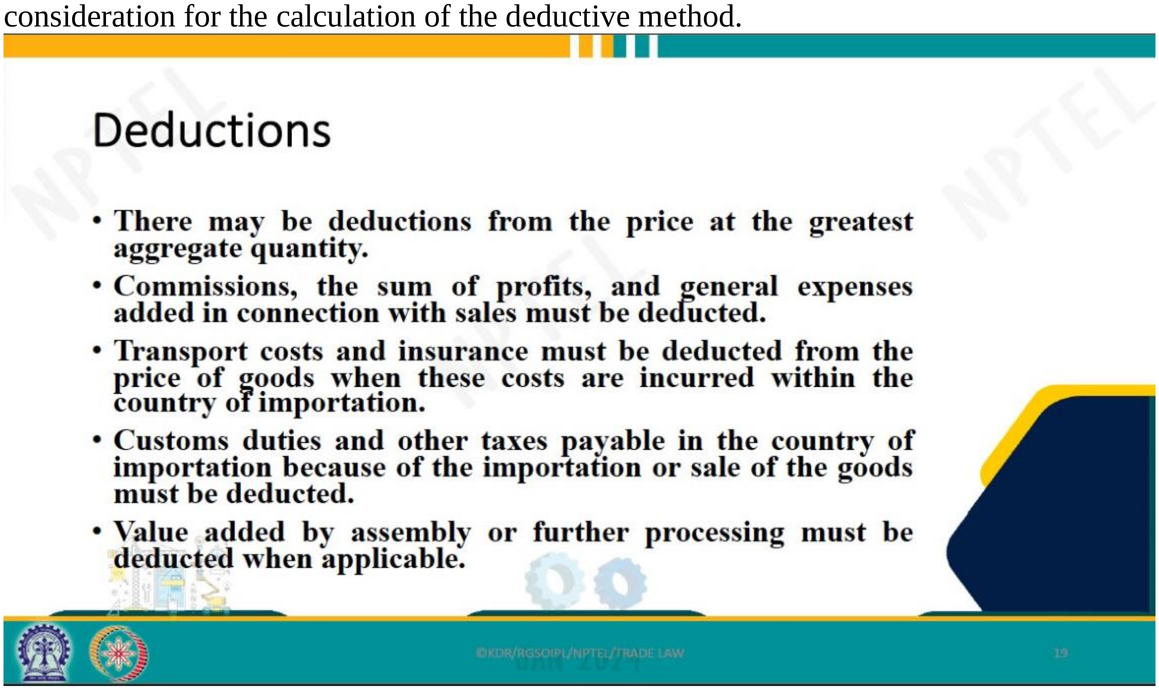
Some of the common principles which is applicable for the calculation of identical goods and similar goods; The time period for taking into consideration should be the same. Same time as goods being valued so that means the transaction time which is taken should be the same. Same commercial level that means, the same quantity level. So we already said that the wholesale, the bulk quantities and small quantities the prices may be different so that also is to be taken into consideration. So, the lowest transaction value we take. So the goods must be produced by the same country, the goods being valued and preferably by the same person. If the same person is not producing an identical good then you can take the person who is producing an identical good from the same country. So these common principles apply to the identification of identical and similar goods.



Then if the three methods are not possible then comes the fourth method that is the deductive value. So here also the test of identical or similar goods should fail then only you will go for the third method that is the deductive value. So here we can see that the value is to be determined based on unit sales, the price of goods of same class. So first we said the identical goods then we talked about similar goods. Now thirdly we are talking about the same class of goods or same kind of goods in the domestic market. So, even if the same person is not producing the same class of goods, then, an unrelated buyer is also taken into consideration. Unrelated buyer can also be taken into consideration. So the name itself says so suitable deductions can be made. So we talked about additions in the beginning and now we are talking about deductions and these deductions include commissions, profits, duties, taxes, transport, insurance, other general expenses to sales. So first we talked about additions and now we talked about deductions. So, these charges can be deducted from the class of if you are considering a class of goods. So the fourth method can be used when all the three methods are failed.



So the deductive value method which shows and deductions and other charges connection with sales, transport charges, insurance charges will be deducted and transport charges and the insurance charges are mandatory in most of the countries. So this will be deducted in the deductive method and customs duties and other national taxes payable in the country of importation and that also can be deducted and then the number of quantity of selling. So, one price which is showing the greatest quantity that is to be also taken into consideration. The aggregate or greatest aggregate quantity is also taken into consideration for the calculation of the deductive method.



So it is very simple the name itself says deductions, commissions, profits, general expenses and that will be deducted. Transport cost, insurance must be deducted and then customs duties and other taxes incurred at the country of importation and then value added by assembly or for further processing, value addition that also will be deducted. So in deductive method, so many taxes, so many charges will be deducted and finally the value is calculated.

Computed Value, Art.6

- This is to be applied where the earlier stated methods of valuation fail.
- This value is determined by taking into account cost of production plus usual amount of profit and general expenses incurred in sale of goods of same class or kind.
- Other elements of cost as required in Article 8 (transport, insurance, loading/unloading charges)
- Normally to be used for related party transactions

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Then comes the computed value. All the earlier methods fails, all the valuation fails then comes the computed value. So here it is an entirely different method. It takes the account of cost of production plus usual amount of profit and other general expenses. Cost of production plus general expenses incurred for that particular good or class of goods so other elements cost like transport, insurance, loading, unloading charges are also included. So, these also to be taken into consideration. So computed method - cost of production plus other charges to be included in the computed value method.

Computed Value

- The computed value is the sum of the following elements:
- Production cost: The value of materials, fabrication, and other processing involved in producing the imported goods.
  - Materials: raw materials, costs to get the raw materials to the place of production, subassemblies, and prefabricated components that will eventually be assembled.
  - Fabrication: the cost of labor, assembly costs when there is an assembly operation instead of the manufacturing process, and indirect costs like factory supervision, plant maintenance, or overtime.
  - Packing costs, assists, engineering work, or artwork undertaken in the country of importation would be added.

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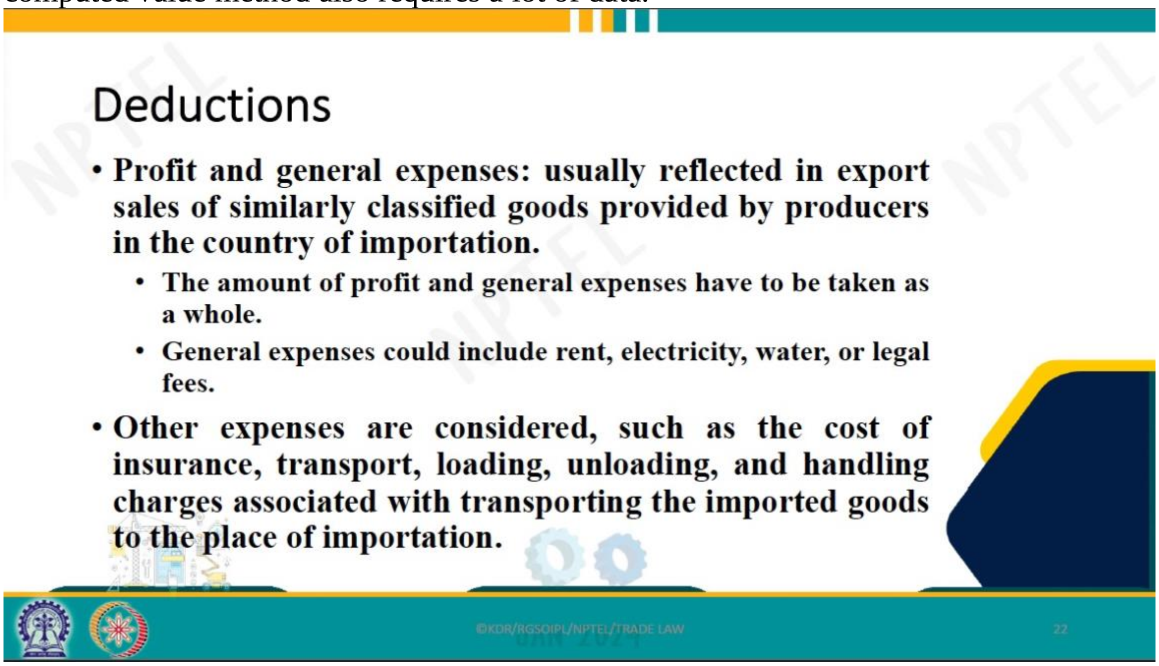
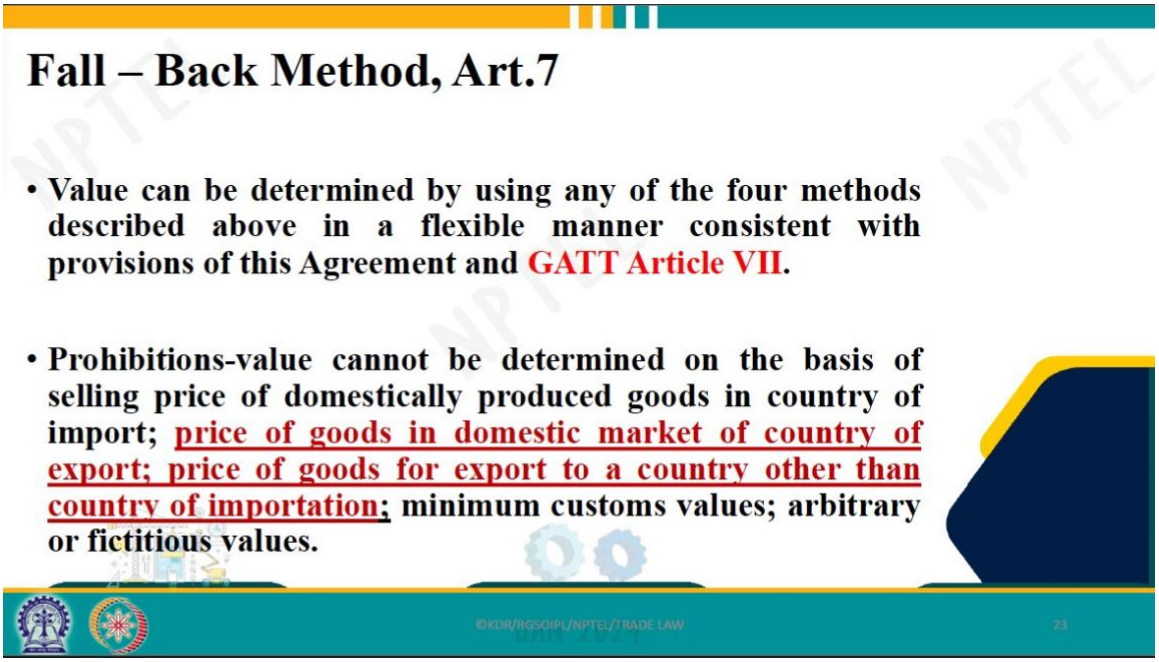
And then you can see the elements; the production cost - what are the production cost to be included. Production cost is the value of materials and fabrication because the computed value of most of the components is the production cost. So value of materials, fabrication cost, other processing cost and the materials includes the raw materials, cost of raw materials, the place of production. Also these prefabricated components, assembling, fabrication, fabrication: cost of production and also the factory supervision, plant maintenance, etcetera. Packing cost, engineering work, art-work undertaken that will also be added to the cost of production. So the cost of production also have lot of components including the raw material plus fabrication, labor cost, etcetera. So, the computed value method also requires a lot of data.



And what is to be deducted: profit and general expenses and then general expenses including rent, electricity, water, legal fees, etcetera. So many charges can be detected also. Other expenses that is the cost of insurance, transport, loading, unloading, handling charges and associated with the transport of that particular goods also can be taken into consideration. So there is a long list of deductions which is there in the computed value method also.

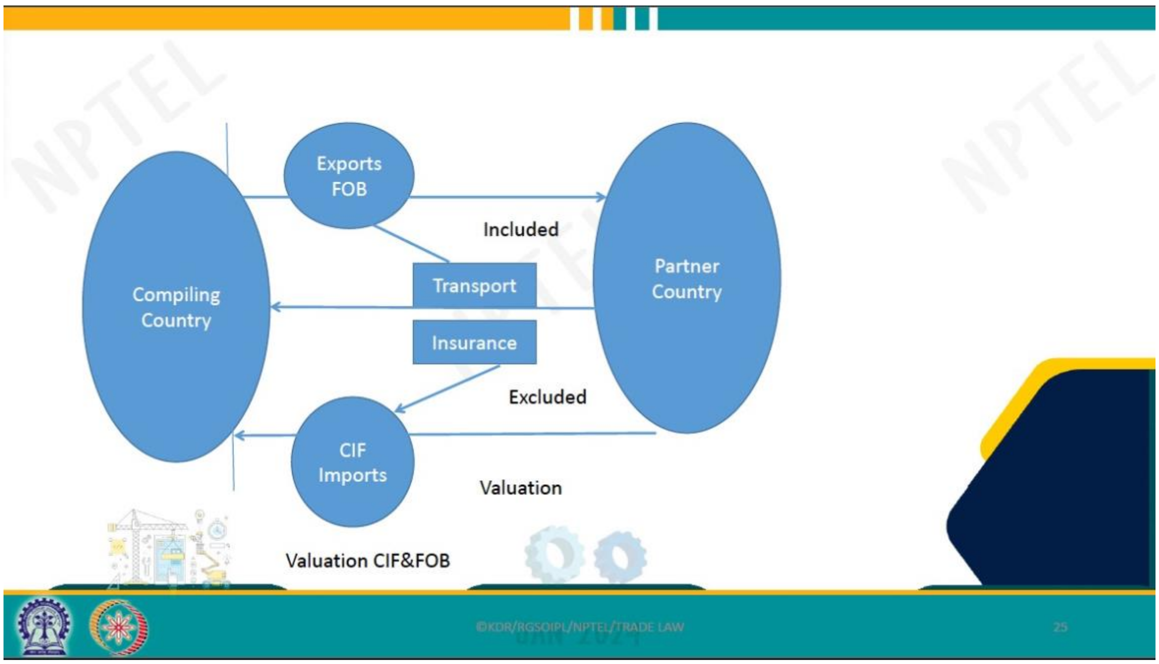


So all these five methods fail then comes the sixth method which is known as Fall-Back method. So here the name itself is fall back, go back, fall back. If all other methods are failed then you can pick and choose any one of the above methods. So that means it must be according to the Article 7 but any one of these methods can be used. The only prohibition is that domestically produced goods should not be taken into consideration. So prices of goods in the market of country of export, prices of goods for export to a country other than the country of importation. So this leads to arbitrary and fictitious prices. So any one of the methods can be used, that is fall back, you fall back on any one of the methods. So this is the last choice and if none of these will be possible then the member countries can calculate according to using any of the four methods, any of the methods. So the countries have the absolute freedom to use which method is to be used under the fall back method.

Fall – back

- **Valuation criteria not to be used –**
- **Selling price of goods manufactured in the country of importation.**
- **Higher of two alternate values**
- **Price of goods in the country of exportation**
- **Cost of production**
- **Price of goods for export to a third country**
- **Minimum customs values (developing countries)**
- **Arbitrary or fictitious values.**

So here the valuation criteria is not to be used in certain cases that is the selling price of the country of importation. So higher of the two alternate values, the price of goods in the country of exportation, the cost of production, and the cost of production will be calculated in the computed value method. Then minimum customs values, then arbitrary or fictitious values cannot be taken into consideration in fall back method.



So we can see that there are so many components, six methods. So usually the exports are with Free on board (FOB) or CIF. So here those who are usually included methods are transport charges and then excluded are insurance. Then finally the valuation is done. So all these will be compiled by one country and there will be partner countries and it will be exchanged. This information will be exchanged and finally the valuation is made under the present customs valuation agreement using the six methods.

Price Actually Paid

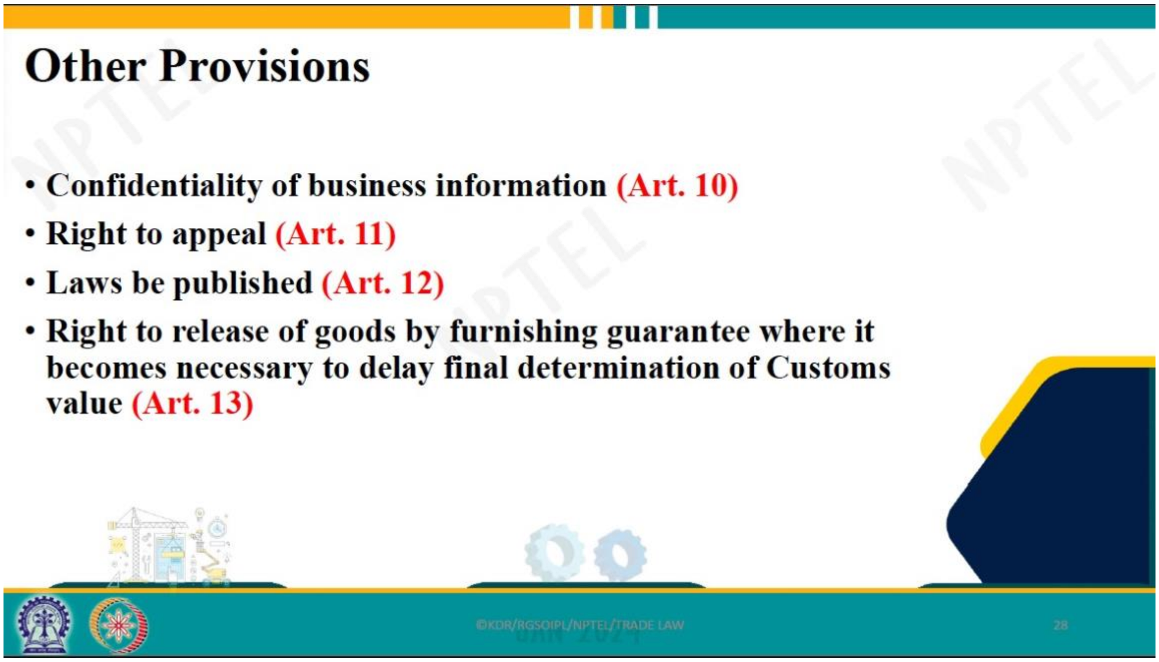
- Evidence of sale
- Full price
- Sufficient price information for price adjustments
- Buyer and seller not related
- Related parties (S.15).

So in transaction value also you must produce the evidence of sale. The evidence of sale is prima facie, nothing but the invoice price. Sufficient price information should be given to the authorities. So if there is an allegation of related parties then the transaction value is not taken into consideration - related party transactions.

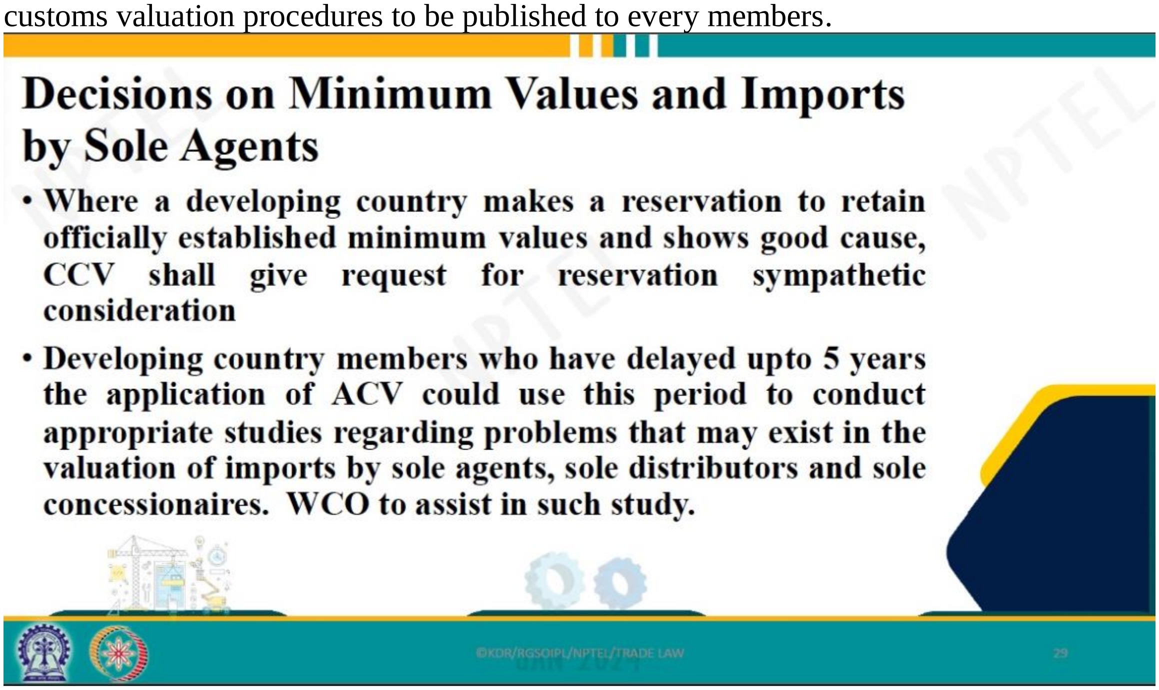
Payments that can be added

- Commissions, brokerage
- Cost and charges for packaging and containers
- Royalties and license fees
- Cost of transport, insurance and other charges at the place of importation.
- But not freight after importation
- Duties and taxes in the importing country

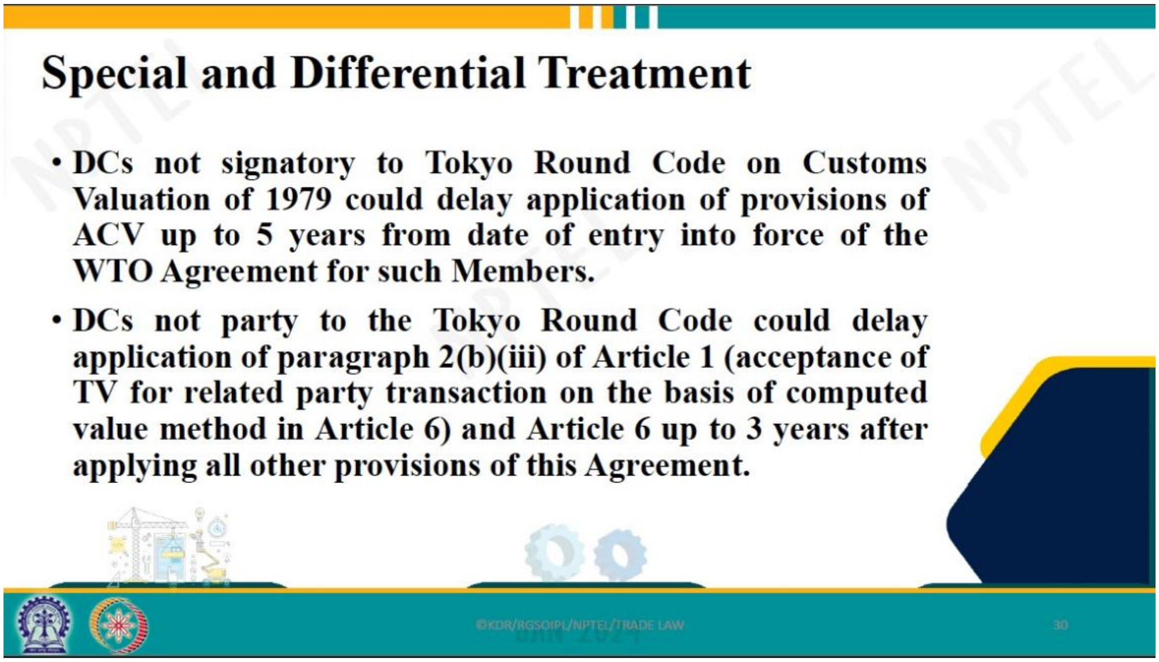
So payments usually that can be added are commissions, brokerage, cost and charges of packaging containers, royalties and license fees, cost of transport, insurance, other charges and place of importation but not freight after importation, duties and taxes in the importing country.



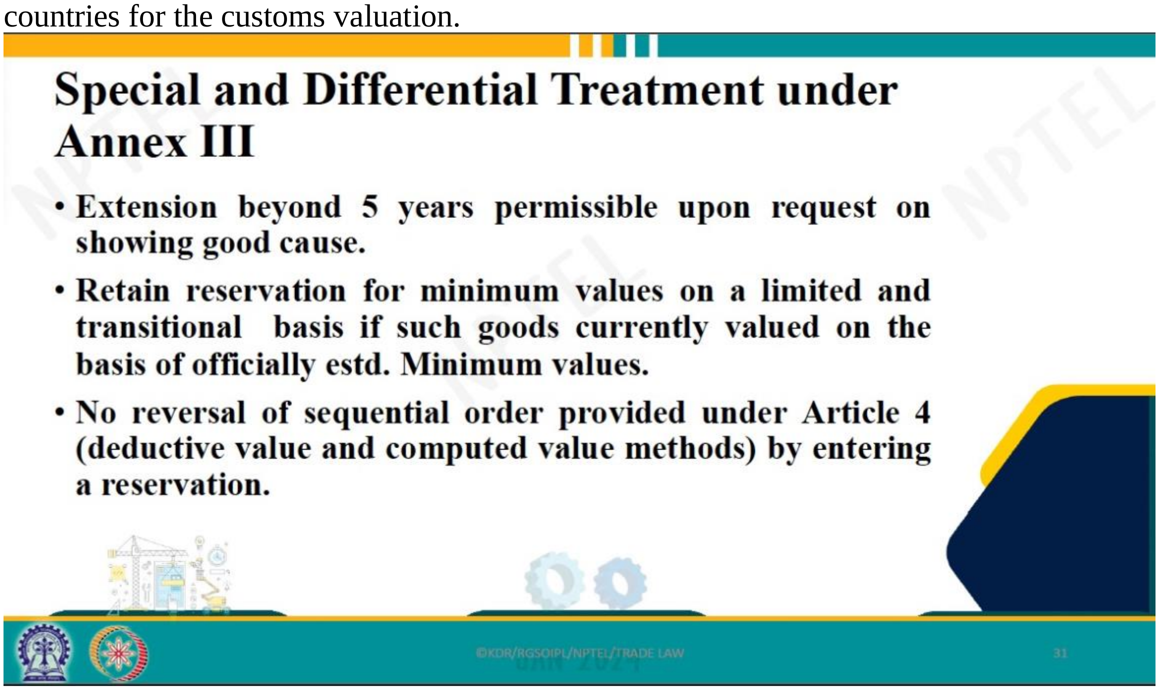
And the customs valuation code says that whatever the data information submitted to the customs authorities must keep confidential business information so intellectual property protection. So it is the duty of the customs valuation authorities to keep all the data confidential and there must be a provision for appeal from the decision of customs authorities and all the laws, as a transparency clause, all the laws to be published. All the customs valuation procedures to be published to every members.



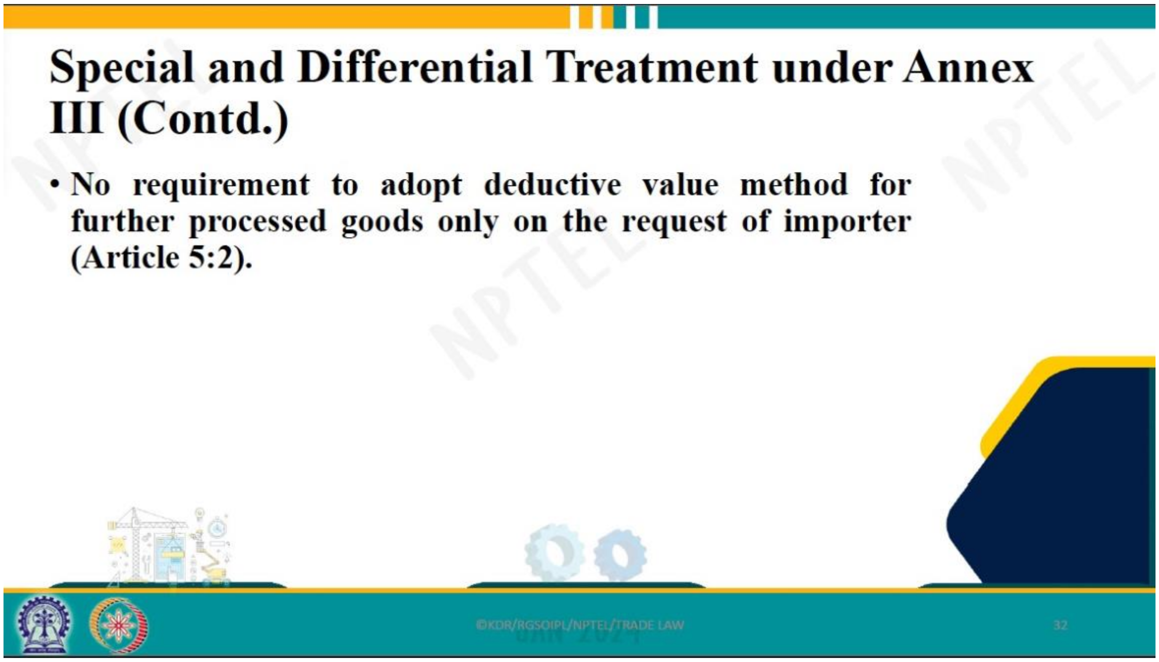
And then developing countries' minimum values that shows good cause. So in customs valuation sympathetic consideration should be given to the developing countries. So I think the agreement on customs valuation now implemented by every country because the transaction period is over so the other provisions are not applicable.



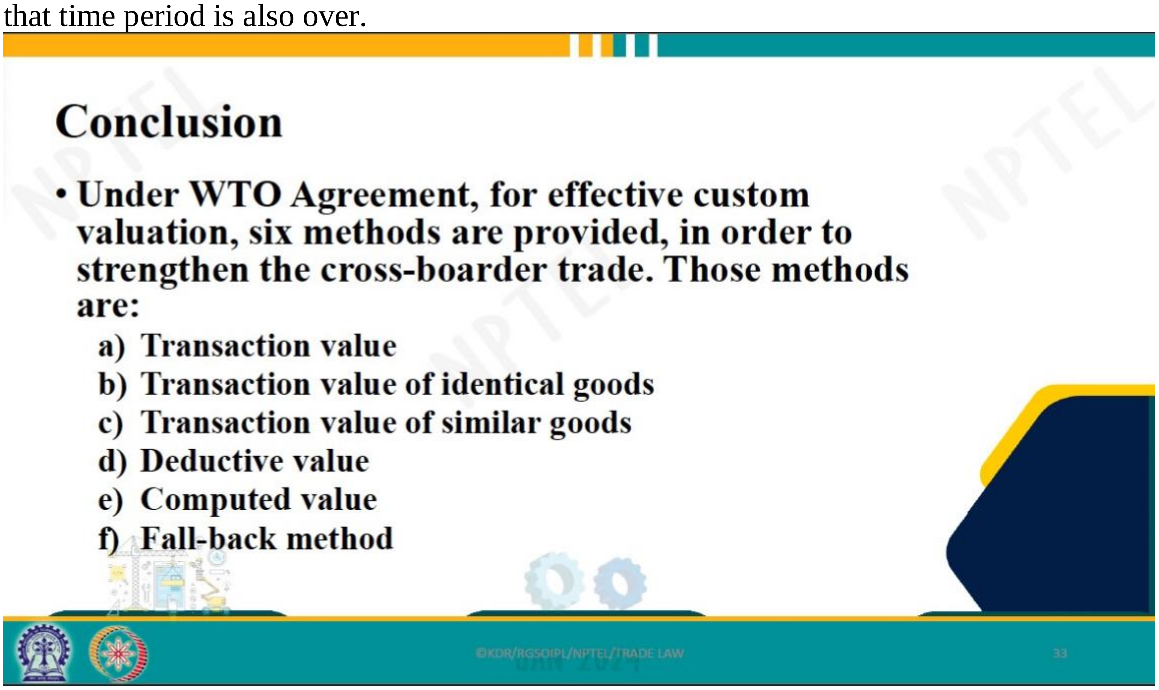
But in all the agreements, the special and differential treatment provision is there for developing countries. But the question is whether, again, the developed countries will give any kind of special and differential treatment for developing countries, and so far, the developing countries have not received any special consideration from the developed countries for the customs valuation.



And Annex III says good cause, all these extension periods are over, transition periods are over and no more extensions are allowed under the customs valuation code. Now every country must compulsorily implement the customs valuation code of WTO.



So we said that certain concessions were given up to five years to certain countries but that time period is also over.



And I would say that customs valuation code the methods are very precise and clearly given in the customs valuation code. All the WTO member countries, 164 presently, has to follow the six methods of customs valuation that is transaction value, transaction value of identical goods, transaction value of similar goods, deductive value, computed value and fallback method. They have to follow this very strictly. So there is a uniform minimum standard of customs valuation all over the world now and the process is also standardized. And with the exchange of information with the advent of information technology there is exchange of information as well between the parties. So now the importation of goods is very smooth in the ports. There is no discrimination among the members because of this particular agreement.

So, you have to see the customs valuation procedures of every country before exporting a particular product to any other country. Now, it is very important for every country to publish its laws and regulations. So, these provisions are very important for the customs valuation, to understand these particular provisions.

Thank you.