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Customs Valuation and Post Clearance Audit

[Training Material Prepared only for Internal Training Course on Customs Valuation and Post Clearance Audit (PCA) for Nepalese Customs Officials]

Government of Nepal
Ministry of Finance
Department Of Customs
2016
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## Syllabus on Customs Valuation and PCA for Comprehensive Training

**[36 hours]**

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[Part I]

International Standards and Practices on Customs Valuation
(WTO Valuation Agreement)
Lesson 1
Introduction of Customs Valuation Systems

Evolution of Customs Valuation System

Customs Valuation is distinguished from Commercial Valuation in that, it brings in a third party, the Customs, who is concerned not only with the transaction between the buyer and the seller, but with all similar transactions between other buyers and sellers. The Customs have to ensure impartial application of ad-valorem duties, so as to avoid any discrimination between one importer and another. Thus a new third factor, the need for a standard was introduced in Customs Valuation. It is quite natural that the importers, looking only at their particular transaction, may have difficulty in understanding the responsibility of Customs Valuation for aligning the treatment of each particular transaction to a common standard. In order to obviate this difficulty, it is necessary that this subtle distinction between commercial valuation and Customs valuation is understood in its proper perspective.

With the rapid development of industry and technology, which resulted in emergence of various different products of different quality and value, the concept of Customs Valuation started giving rise to difficulties. In the post World War I period, the contemporary international scenario on trade front was restive, seeking uniformity and liberal attitude towards trade barriers. By that time, the Customs Valuation became a major instrument of raising the incidence of Customs duty with a view to giving protection to home industries. Some valuation methods even involved the use of arbitrary or fictitious values, and some others, values totally out of line with real price in international trade. It is not surprising therefore that Customs Valuation became the subject of discussion in international commercial circles and even in Government circles, particularly those of developed supplier countries, who found their export interests jeopardized and tariff negotiations vitiated by changes in valuation methods. During the post First World War period, the League of Nations organized the Economic Conference in Geneva in 1927 and 1930, where there was pressure for action on the lack of equity of certain valuation procedures. These first moves achieved no more than a statement that further enquiry was desirable. The trade, however, continued their campaign.

Historical Background of Development of Customs Valuation System

Birth of GATT, 1947

After the second Word War, the United Nations Conference on Trade and Labour examined different aspects of the matter, and several provisions relating to Customs matters were included in the draft for the establishment of an International Trade Organization (Havana Charter), as a specialized agency to exercise international control over trade restrictions. Finally on 30th October, 1947, the General Agreement of Tariffs and Trade (GATT), largely based on the Havana Charter was signed at Geneva by 23 Countries. This was to take effect from 1.1.1948. The specific Customs valuation provisions are in Article VII of the Agreement, titled “Valuation for Customs Purposes”.

After the World Trade Organization came into being on 1st January, 1995, the GATT1947
and WTO coexisted for a year and finally, on 31st December, 1995, GATT 1947 got terminated. Consequently, GATT Valuation Agreement also terminated one year after the coming into force of WTO Agreement. The WTO Agreement on Valuation is intended to implement Article VII of GATT 1994 and itself constitutes an Annexure to the WTO Agreement. It is commonly known as WTO Valuation Code (formerly known as GATT Valuation Code).

**Article VII of the GATT**

Article VII of the GATT brought forward revolutionary concepts of Customs Valuation. In brief, it calls for the standardization, as far as practicable, of definitions of value and procedures for determining value, and lays down certain principles in this connection. The value for Customs purposes could no longer be based on arbitrary or fictitious values; it has to be based on the actual value of the imported merchandise (goods) or of like merchandise. Even the value of goods of notional origin was ruled out. “Actual value” should be the price at which, at a designated time and place, such or like goods are sold or offered for sale in the ordinary course of trade under fully competitive conditions, and when it is not available as above, it should be based on the nearest ascertainable equivalent of such value. The Note to Article VII further emphasizes the importance and relevance of invoice value. The expression “in the course of international trade under fully competitive conditions” has been explained in the Note, so as to exclude any transaction wherein the buyer and seller are not independent of each other and price is not the sole consideration. Prices involving special discounts limited to exclusive agents need not be accepted. Value could be determined uniformly either on the basis of a particular exporter’s prices of the imported goods or on the basis of a particular level of like goods.

**Brussels Definition of Value (BDV)**

After the adoption of Article VII of the GATT, the first step in the development of international co-operation in valuation procedure was taken up by the European Customs Union Study Group, who first particularized the general principles of Article VII in the form of the “Brussels Principles”. Finally, the first uniform valuation code emerged in 1949 through a definition of value. This definition, known as Brussels Definition of value (popularly known as BDV) was incorporated in the “Convention on the Valuation of Goods for Customs Purposes”, signed in Brussels on 15th December, 1950. It came into force on 28th July 1953 under the auspices of the Customs Co-operation Council. The Brussels Definition of value, as laid down in Annexure I to the Convention was based on a notional concept which treats the Customs Value as the price at which in assumed condition, the goods would be sold (the price that the goods would fetch) in the course of international trade, the essential elements being price, time, quantity and commercial level. The emphasis was on the intrinsic value of the goods.

**Steps leading to GATT Valuation Code**

The different agencies dealing with Customs Valuation had been working on a continuous search for a standard in determining the Customs values – a standard which is equitable to all transactions whoever the parties to them may be and whatever their conditions. The
standard needed in Customs Valuation depends upon the concept of value adopted and different concepts call for the incorporation, in the standard, of different elements. The two concepts most generally in use were those of the price which, in stated conditions, (i) the imported goods *would* fetch (the Notional concept), and (ii) the like goods *do* fetch (the Positive concept). In every transaction the balance of interest of buyer and seller results in an agreed price. The concept of the Customs valuation in applying ad-valorem duties, while taking account of the price agreed between the buyer and the seller, must however, discount the influence upon this price of any special relationship which may exist between them, so as to avoid discrimination between different importers. This concept of an impartial third party i.e. Customs, may be Positive or Notional. A positive concept may, for instance, be formulated in terms of the price at which the goods to be valued are sold, or should that price be influenced by some special relationship between buyer and seller, the price, uninfluenced by such relationship, at which like goods are sold. The corresponding Notional concept would be the price at which, in assumed conditions (e.g. of independence between buyer and seller) the goods to be valued would be sold. So long as the concept of value for Customs purposes is not the same in all countries, it is not easy to formulate uniformly applicable valuation provisions. This was the position when GATT Valuation provisions were discussed while laying down Article VII of the GATT. The Article VII however did not establish a single standard for universal adoption, but laid down criteria (some of which offered a choice of alternatives), to which all standards used for Customs Valuation by Contracting Parties must conform. The first task, after the Brussels Principles of Valuation had been formulated, was therefore, to agree upon a common standard; but before a standard could be agreed, it had to be decided whether the concept, which it would express, shall take the “Positive”, or the ’Notional’ form. The authors of the BDV, which was the first uniform valuation code, made use of the Notional concept of value. While the EEC, the largest trading block adopted BDV, two of the largest trading nations, the USA and Canada stayed away from it. Besides, even amongst the countries adopting BDV, there were significant variations in application and interpretation. The Customs Cooperation Council (CCC), constituted primarily to promote uniformity of interpretation and application of BDV could not also help much. Thus, the notional concept adopted in BDV did not go well with the Trade, and in the background of other developments the Trade raised a demand for search of a different standard in determining the Customs Value.

Pursuant to the said demand, the GATT Secretariat prepared in 1973 a comprehensive study report titled “Trade Barriers arising in the field of Customs Valuation”. This study described in considerable details the valuation systems prevalent in the Developed as well as some Developing Countries. The study also highlighted the main problems arising from different valuation procedures at that time. Meanwhile in 1969, the Committee on Trade in Industrial Products (CTIP) was established in the GATT to examine *inter alia* the desirability of harmonization of valuation systems and special valuation procedures, the latter commonly referring to the cases where invoice values were not acceptable. The CTIP prepared two drafts, one of ‘draft principles’ and the other of ‘draft interpretation notes’.

During the Tokyo Round Negotiations which started in 1974, a sub-group of the Non Tariff measures (NTM) was setup in 1975 to examine certain aspects of valuation systems which were identified as problem areas. Finally in November 1977, the EC submitted a draft Valuation Code, and significantly the EC changed its stand and opted for the positive
concept by deserting the ‘notional’ concept of the BDV. The subsequent evolution of the EC’s draft through negotiations led to the Final Draft in 1979.

**Birth of GATT VALUATION CODE**

Finally, after reconciling the interest of both the developed and developing countries “the Agreement on Implementation of Article VII of the GATT” (GATT Valuation Code) came into being on 1st July, 1980. Thereafter, the Tokyo Round Agreement on Customs Valuation came into force on 1st January, 1981 and was accepted by all developed countries. The developing countries, Argentina, Brazil and India, acceded to it by invoking the provisions which delayed application for five years. Most other developing countries showed reluctance to accede to the Agreement. The problems voiced by many developing countries during the negotiation of the Code did not disappear and indeed became the stumbling blocks to wider accession to the code by contracting countries.

**GATT Valuation Code – The Agreement**

The text of the Agreement on Implementation of Article VII of GATT, 1979 comprised the General Introductory Commentary (GIC) and Preamble, 31 Articles in 4 parts in Part-I to Part-IV, Annex-I giving the Interpretative Notes, Annex-II dealing with the responsibilities of Technical Committee on Customs Valuation, Annex-III dealing with the Constitution and responsibilities of Ad hoc Panels and Protocol to the Agreement. It laid down that the primary basis for Customs valuation would be the “transaction value” thereby laying emphasis on the Positive concept of value. The Preamble also recognized 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. It however has also attempted to retain and harmonize the best features of the BDV and the US definition of value.

**General layout of the Agreement of 1979**

The areas covered by the Agreement may be categorized as follows:

i. General Introductory Commentary and Preamble.


iii. Administration, and Dispute Resolution in Articles 18, 19 and 20 of Part II. Responsibilities of Technical Committee on Customs Valuation under the auspices of the Customs Co-operative Council as given in Annex. I.

iv. Special and Differential Treatment for developing countries in Article 21 of Part III, and a Protocol dated 1st November, 1979 in recognition of particular problems of the developing countries in implementing the Agreement.

v. Final provisions about reservations, national legislation, review and secretariat, in Articles 21 to 24 of Part IV.
WTO Valuation Agreement, 1994

With the coming into effect of WTO in 1995, the WTO Agreement on Valuation came into being so as to implement Article VII of GATT, 1994. The previous GATT Valuation Code of 1979 was modified slightly and it came to be known as “Agreement on Implementation of Article VII of GATT, 1994” (also commonly known as WTO Valuation Code). The WTO Valuation Code retained the General Introductory Commentary and the contents of the erstwhile Preamble without however mentioning the word “Preamble”. Part - I comprising 17 Articles dealing with Rules on Customs Valuation and Annex-I containing the Interpretative Notes were left untouched. The nomenclature of Part-II was changed to “Administration, Consultation and Dispute Settlement”, and it contained only two Articles (Articles 18 & 19) in place of erstwhile three Articles. Part - III dealing with Special and Differential Treatment and containing Article 20 was largely unchanged. The Final Provisions dealt with in Part-IV were substantially reduced and it now contained only 4 Articles (Articles 21 to 24) in place of Articles in previous ‘Final Provisions’. As mentioned, Annex-I was retained as such, while Annex-II was changed slightly inasmuch as additional responsibility of the Technical Committee was included in clause (f) as follows:

“(f) to carry out an examination of a matter referred to it by a panel under Article 19 of this Agreement, and” Another significant change was that Annex-III dealing with the Constitution and Responsibilities of Ad hoc panels, and the Protocol to the Agreement of 1980 signed in recognition of particular problems of the developing countries were deleted in the new agreement. However, the substantive clauses of the protocol dealt with in clauses 2 to 8 were retained in a different form as Paras 1 to 7 of Annex III.

General Introductory Commentary

The General Introductory Commentary precedes Article 1 and it helps in interpreting and understanding the Code. It highlights the following basic themes of the Code:

(a) Primacy of Transaction Value (T.V.).-

Its fundamental proposition is that the transaction value under Article 1 subject to the adjustments under Article 8 is the primary basis for valuation under the code.

(b) Hierarchical nature of the Code,-

It introduces the hierarchical nature of the Code when it prescribes that “Articles 2 to 7 inclusive, provide methods of determining the Customs Value wherever it cannot be determined under the provisions of Article 1”.

(c) Procedural rights of the Importers,-

It envisages “a process of consultation between the Customs administration and importer with a view to arriving at a basis of value under the provisions of Articles 2 or 3”, where value cannot be determined under Article 1.

(d) Confidentiality of information,-

While spelling out the importers’ right to be consulted, it also alerts about the commercial confidentiality, when it says that “a process of consultation between
the two parties will enable information to be exchanged, subject to the requirement of commercial confidentiality…”

(e) Option of the importer,-

While recognizing that both the methods of valuation under Article 5 (Deductive Value) and Article 6 (Computed Value) present certain difficulties, it gives the importer the option under the provisions of Article 4, to choose the order of application of these two methods. Besides, it also gives the importer the option to have Article 5 applied even if the goods are not resold in the country of importation until they have been further processed.

Preamble of The GATT VALUATION CODE

The Preamble provides further guide to interpreting and understanding the Code. The Preamble recognizes, interalia;

a) the need for fair, uniform and neutral system for the valuation of goods which precludes the use of arbitrary or fictitious Customs value.

b) that the basis for valuation of the goods for Customs purposes should, to the greatest extent possible, be the transaction value of the goods.

c) that the Customs value should be based on simple and equitable criteria consistent with commercial practices,

d) that the valuation procedures should be of general application without distinction between sources of supply and should not be used to combat dumping.

Main Technical Provisions – Article 1 to 8

Articles 1 to 7 read with Article 8 define how the Customs value of the imported goods is to be determined under the provisions of the Agreement. These articles provide a revised set of valuation rules, expanding and giving greater precision to the provisions of Customs Valuation already found in the Article VII of the GATT, which did not at that time set forth the elements of a complete valuation standard.

The articles set out five valuation methods, with one fall back method, ranked in a hierarchical order, which must be followed by Customs officers of all signatory countries. Only when no valid Customs value can be found under the first method, can the second method be used, and so on. There is an exception provided in Article 4, which authorizes the reversing of the order of application of Articles 5 and 6.

Under the Agreement, the primary basis for Customs value is the “transaction Value”, defined in Article 1. The transaction value of imported goods has been defined as the price actually paid or payable for the goods and sold for export to the country of importation adjusted in accordance with the provisions of Article 8, provided certain well defined conditions and restrictions are met. Article 1 has to be read together with Article 8, which provides, interalia, for adjustment to the price actually paid or payable in cases where certain specific elements which are considered to form part of the value for Customs purposes are incurred by the buyer but are not included in the price actually paid or payable for the imported goods. Article 8 deals with certain other considerations/elements
which are to be included or excluded into or from the Customs value. An important
departure from many previous Valuation Systems is that the Article 1 also provides that
even in related party transaction, the price actually paid or payable is to be accepted for
transaction value, provided it is demonstrated that the relationship has not influenced the
price.

Articles 2 and 3 deals with the Customs Value being the transaction value of identical
goods and similar goods respectively, sold for export to the same country of importation
and exported at or about the same time as the goods being valued.

Articles 5 and 6 deal with the “deductive value” and “computed value” methods
respectively. These articles provide two ways for determining the Customs value where it
cannot be determined on the basis of transaction value of the imported goods or of
identical or similar goods. Under Article 5.1, the Customs value is determined on the basis
of the price at which the imported goods or identical or similar goods are sold in the
condition as imported to an unrelated buyer in the country of importation. Article 5.2 is
about the application of this deductive method of valuation to goods which are further
processed after importation. It is the importer who has the right to have such goods valued
under Article 5.2. However, the protocol recognizes that developing countries may wish to
make a reservation with respect to Article 5.2, so as to provide that it shall be applied in
accordance with the provisions of the relevant notes thereto, whether or not the importer
so requests.

Under Article 6, Customs value is determined on the basis of the computed value, which
shall consist of (a) the cost or value of materials and fabrication or other processing
employed in producing the imported goods’ (b) 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 or exportation for export to the
country of importing; and (c) the cost or value of all other expenses necessary to reflect
the valuation option relating to cost of transportation etc. chosen by the Contracting Party
under Article 8.2. Article 6.2 expressly provides that contracting Party may require or
compel any person not resident in its own territory to produce for examination or to allow
assess to, any account or other records for the purpose of determining a computed value.
However, information supplied by the producer of the good for the purposes of
determining the Customs value under Article 6 may be verified in another country by the
authorities of the country of importation with the agreement of the producer and provided
they give sufficient advance notice to the government of the country in question and the
latter does not object to the investigation.

Article 7 sets out the fall back method as to how to determine the Customs value in cases
where it can not be determined under the provisions of any of the preceding Articles 1 to
6. Under Article 7.1, Customs Value will be determined using reasonable means consistent
with the principles and general provisions of the Agreement and of Article VII of the
GATT, and on the basis of data available in the country of importation. Article 7.2 lists
seven methods expressly forbidden for use in valuation under the agreement.

Other Technical Provisions – Article 9 to 17

Amongst the other technical provisions, Article 9 is about the conversion of currency and
Article 10 is about the confidentiality of information collected for the purpose of Customs
valuation. Article 15 provides definition of certain important terms and expressions like “Customs value of imported goods”, ‘identical goods’, ‘similar goods’, “goods of the same class or kind”, related persons’ etc. Article 16 is about the importer’s right to have an explanation from Customs Administration as to how the value has been determined. Article 17 authorizes the Customs Administration to have the right to satisfy themselves as to the truth or accuracy of any statement, declaration or document presented for Customs Valuation purposes. It is further agreed in the Protocol that Article 17 acknowledges that enquiries may be made which are, for example aimed at verifying that the elements of value declared or presented to Customs in connection with a determination of Customs value are complete and correct, and that the Contracting Parties, subject to their national laws and procedures have the right to expect the full cooperation of importers in these enquiries. The WCO Technical Committee on Customs Valuation set up under the Agreement has opined vide Advisory Opinion 10.1 that imported goods have to be valued under the Agreement on the basis of actual facts. Therefore any documentation which contained false information as to the facts would be contrary to the intention of the Agreement. In the context of Article 17 and paragraph 7 of the Protocol, it has further been opined that Customs Administration cannot be required to rely on fraudulent documentation, and should documentation prove to be fraudulent subsequent to the determination of a Customs value, invalidation of that value would be a matter for national legislation.

**Administrative and Miscellaneous Provisions – Article 18 to 24**

Articles 18 and 19 of the Agreement cover the areas of Administration, Consultation and Dispute settlement. The Agreement vide Article 18 has set up two permanent committees on valuation – (i) a Committee on Customs Valuation (also known as the GATT Committee) under the GATT Secretariat, Geneva, and

(ii) a Technical Committee on Customs Valuations (also known as Technical Committee) under the auspices of the Customs Co-operation Council, Brussels.

The GATT Committee is to deal with the matters relating to administration of Customs Valuation system and matters of policy and principles. It is also to deal with the valuation disputes between Contracting Parties; if a dispute is technical in nature, the GATT Committee may refer it to the Technical Committee for examination and report. Alternatively, the GATT Committee may appoint a panel of experts drawn from the countries which are not to the dispute to examine and report. Reports from the Technical Committee or the panel of experts, as may be the case, would thereafter be discussed in the GATT Committee which will make recommendation to the Countries which are in dispute.

Article 20 deals with the Special and Differential Treatment for developing countries. Developing countries may delay application of the provisions for a period not exceeding five years. Further, liberty has been given in Article 20 for delaying application of Article 6 (Computed value method) and Article 1.2 (b) (iii) Test value for related party transaction based on the Customs value of identical or similar goods as determined under Article 6 for a period not exceeding three years following their application of all other provisions of the Agreement. Article 20 also provides that developed countries shall furnish on mutually agreed terms, technical assistance to developing countries on request, so as to help the developing countries to set up new valuation systems based thereon.
Final Provisions in Articles 21 to 24 deal sequentially with the reservations, national legislation, review, and secretariat. Article 23 provides that reservations may not be entered in respect of any of the provisions of the Agreement without the consent of other parties. In terms of Article 22, each Government accepting or acceding to the Agreement shall ensure the conformity of its laws, regulations and administrative procedures with provisions of the Agreement. Further, each contracting party shall inform the Committee of any changes in its laws and regulations relevant to the Agreement and in the administration of such laws and regulations.

The Agreement on Implementation of Article VII of the GATT, 1994 is thus a complete valuation code, which has been the culmination of a continuous search of international bodies for a valuation standard which is fair, uniform and neutral.

**WCO Technical Committee on Customs Valuation (TCCV)**

The responsibilities of the Technical Committee have been described in Annexure II to the Agreement. The Technical Committee has been established with an aim, at the technical level, towards uniformity in interpretation and application of this Agreement. It is to consider the matters referred to it by the GATT Committee and also the questions of interpretation and implementation raised by member-countries. The conclusions reached by it may take the form Advisory opinions, Commentaries, Explanatory Notes, Studies or Case-studies. Such conclusions reached by the Technical Committee are thereafter to be submitted for confirmation, first to the full council of the Customs Co-operation Council and then to the GATT Committee in Geneva. Such conclusions, unless referred back by either of the aforesaid two bodies, are thereafter published and they become effective.

**Valuation Practices and Procedures in Nepal : Historical Prospective**

During Rana regime the Customs duties were collected both in import and export of goods. Customs duties on Nepal India Trade were collected at Chisapani in the central sector. After the construction of Birgunj town in late 1890s late Rana Prime Minister Chandra Samsher sanctioned the collection of Customs duties at Birgunj Customs point in 1901. In the year 1923 Peace and Friendship treaty was signed between Nepal and British government in India. Since 1923 the Customs duties were levied in both specific and ad-valorem basis. There were different rate of duties for different Customs points. Rate of Customs duties were different in western, mid western and central sectors of Nepal. Similarly tariff rates were different in trade with Tibet, India and third countries. For the commodities which were subject to specific tariff rates, there was no need of Customs valuation. The duties were collected according to the nature of trade and rates mentioned in the Order (Sanad) issued by Rana Prime Ministers.

No elaborate procedures were in place for Customs valuation in Nepal before the promulgation of Customs Act, 1962. Until the Rana regime, 1950 AD, Customs rates were based on loads carrying by a porter/person for the goods imported from Tibet, while ad-valorem/specific duty was levied for the goods imported from India depending on the nature of the goods. Customs duty used to be collected basically by making contractual arrangement except at Kathmandu Goswara Customs and other major entry points. After the end of Rana Rule and until the enactment of Customs Act 1962, efforts were directed towards the institutional set-up of the Customs administration.
Valuations provisions before 1950:
In Rana regime there were Sanads to regulate Customs. Free of charge transit and foreign exchange facilities were provided to Nepal in accordance with the provisions of Peace and Friendship Treaty concluded in the year 1923 between British government in India and Nepal. Customs duties in such import were levied at the rate of 3 percent of the value of the goods imported. British Government objected to the lower custom tariff; so to address the objection, surcharge of 1.5 percent was levied.

In the year 1945 all old Sanads and Istihars were replaced by single Sawal for Customs purpose. For the first time the declaration of goods in Customs point by the importer was started. New Trade Treaty was concluded in the year 1950 with India. After the treaty the border Customs offices were established and Bazar Adda Customs were dissolved. The Indian excise duty refund system was started.

Customs Valuation after 1950
New era of the rule of law was started after the establishment of democratic system in country in the year 1950. Tariff board was formed to recommend tariff rate for the first time. Ministry of Finance became centrally responsible agency for Customs. In the year 1957 Customs commissioner office was established in centre to look after all Customs affairs. Later on it was replaced by The Directorate of Excise and Customs in the year 1962.

Customs Act 1962 was promulgated in the year 1962. The legal provisions of Customs valuation was incorporated under Section 13(2) of Customs Act 1962. In accordance with the Act the Customs values were determined on the basis of invoice submitted by the importers. If the importer failed to submit the invoice the value of the goods was to be 5 percent in addition to the price in the local market.

The second amendment in the Customs Act 1962 provided authority of value determination to HMG. Department of Customs had to publish a set of values in advance. The amendment stipulated that the 15 higher values would be accepted if set values were lesser than the invoice values. The Customs officer required maintaining record of values for further use. If records were not available the Customs officer used to determine the values of the goods up to the amount of Rs. 25000 and for more he had to get approval of the Director General of Customs.

Fourth Amendment of the Act empowered the Director General of Custom to purchase the undervalued goods by paying the cost, freight and insurance and 5 percent profit to the importer if it was undervalued more than 50 percent of recorded value.

The Fifth Amendment gave the right to custom officer to determine the estimated value of goods not exceeding Rs. 125000/- If the value exceeded, he was to get approval of Director General of the Customs.

In the year 1973, HMG formed Central Valuation committee comprising traders and officers of different sectors for Customs valuation.

The sixth amendments in the Act continued the previous valuations provisions. It defined the term 'undervaluation' for the first time.
The above mentioned valuation system was the hybrid of BDV and Nepal’s traditional system.

The Seventh Amendment in Customs Act was made in the year 1997. The Act made provisions of the transaction value as a basis of value determination. The detail of Section 13(ka) is given in legal provisions. Since 2000 Nepal started adopting WTO valuation agreement. After being the member of WTO in Jan 23, 2004 it is mandatory to make valuation system compatible to WTO system.

Determination of Customs value for Customs purpose is a technical and complicated task. The Customs valuation procedures were developed with the evolution of legal provisions in the country. As mentioned in above paragraphs the Customs valuation procedures are moving forward gradually in line with the WTO Valuation Agreement. The legal provisions and procedures for the Customs valuation were not treated separately until the seventh amendment to the Customs Act. Seventh amendment to some extent underlined the procedures for value determination trying to make it compatible to WTO/GATT system.

The Finance Act 2005/2006 states that the transaction value mentioned in Section 13 shall mean the total declared amount by the importer which is actually paid or payable by the buyer to the seller for the goods being valued. It also includes the amount incurred or likely to be incurred for freight, insurance, and all other expenses up to the border Customs points. In the absences of documents of freight and insurances the Customs officer shall determine the expenses. The Director General of Customs may fix the norms for such expenses.

If the importer is not satisfied with the valuation decisions of Customs officer, he may appeal within 15 days to the Director General directly or through the concerned Customs office. The Director General normally gives his decision with necessary consultation of expert committee within 21 days. If the declared value is less than the actual transaction value, a fifty percent additional duty of the chargeable duty is levied on the differences of the value, or with the prior approval of Director General of Customs such goods could be purchased on the declared value plus, freight insurance, and five percent profit on it.

In case the transaction value could not be determined in time, the importer may request for provisional valuation. The Customs officer may decide to make the provisional valuation and shall permit the goods to be released by placing deposit of adequate Customs duty. The transaction value of such goods has to be determined within thirty days of release of the goods.
Lesson 2
Structure of WTO Valuation Agreement 1994

GENERAL INTRODUCTORY COMMENTARY

1. The primary basis for customs value under this Agreement is "transaction value" as defined in Article 1. Article 1 is to be read together with Article 8 which provides, *inter alia*, for adjustments to the price actually paid or payable in cases where certain specific elements which are considered to form a part of the value for customs purposes are incurred by the buyer but are not included in the price actually paid or payable for the imported goods. Article 8 also provides for the inclusion in the transaction value of certain considerations which may pass from the buyer to the seller in the form of specified goods or services rather than in the form of money. Articles 2 through 7 provide methods of determining the customs value whenever it cannot be determined under the provisions of Article 1.

2. Where the customs value cannot be determined under the provisions of Article 1 there should normally be a process of consultation between the customs administration and importer with a view to arriving at a basis of value under the provisions of Article 2 or 3. It may occur, for example, that the importer has information about the customs value of identical or similar imported goods which is not immediately available to the customs administration in the port of importation. On the other hand, the customs administration may have information about the customs value of identical or similar imported goods which is not readily available to the importer. A process of consultation between the two parties will enable information to be exchanged, subject to the requirements of commercial confidentiality, with a view to determining a proper basis of value for customs purposes.

3. Articles 5 and 6 provide two bases for determining the customs value where it cannot be determined on the basis of the transaction value of the imported goods or of identical or similar imported goods. Under paragraph 1 of Article 5 the customs value is determined on the basis of the price at which the goods are sold in the condition as imported to an unrelated buyer in the country of importation. The importer also has the right to have goods which are further processed after importation valued under the provisions of Article 5 if the importer so requests. Under Article 6 the customs value is determined on the basis of the computed value. Both these methods present certain difficulties and because of this the importer is given the right, under the provisions of Article 4, to choose the order of application of the two methods.

4. Article 7 sets out how to determine the customs value in cases where it cannot be determined under the provisions of any of the preceding Articles.
Members,

Having regard to the Multilateral Trade Negotiations;

Desiring to further the objectives of GATT 1994 and to secure additional benefits for the international trade of developing countries;

Recognizing the importance of the provisions of Article VII of GATT 1994 and desiring to elaborate rules for their application in order to provide greater uniformity and certainty in their implementation;

Recognizing the need for a fair, uniform and neutral system for the valuation of goods for customs purposes that precludes the use of arbitrary or fictitious customs values;

Recognizing 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;

Recognizing that customs value should be based on simple and equitable criteria consistent with commercial practices and that valuation procedures should be of general application without distinction between sources of supply;

Recognizing that valuation procedures should not be used to combat dumping; Hereby agree as follows:
PART I
RULES ON CUSTOMS VALUATION

Article 1
1. The customs value of imported goods shall be the transaction value, that is 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 other than restrictions which:
      (i) are imposed or required by law or by the public authorities in the country of importation;
      (ii) limit the geographical area in which the goods may be resold; or
      (iii) do not substantially affect the value of the goods;
   (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; and
   (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.

2. (a) In determining whether the transaction value is acceptable for the purposes of paragraph 1, the fact that the buyer and the seller are related within the meaning of Article 15 shall not in itself be grounds for regarding the transaction value as unacceptable. In such case the circumstances surrounding the sale shall be examined and the transaction value shall be accepted provided that the relationship did not influence the price. If, in the light of information provided by the importer or otherwise, the customs administration has grounds for considering that the relationship influenced the price, it shall communicate its grounds to the importer and the importer shall be given a reasonable opportunity to respond. If the importer so requests, the communication of the grounds shall be in writing.
   (b) In a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of paragraph 1 whenever the importer demonstrates that such value closely approximates to one of the following occurring at or about the same time:
      (i) the transaction value in sales to unrelated buyers of identical or similar goods for export to the same country of importation;
      (ii) the customs value of identical or similar goods as determined under the provisions of Article 5;
      (iii) the customs value of identical or similar goods as determined under the provisions of Article 6;
In applying the foregoing tests, due account shall be taken of demonstrated differences in commercial levels, quantity levels, the elements enumerated in Article 8 and costs incurred by the seller in sales in which the seller and the buyer are not related that are not incurred by the seller in sales in which the seller and the buyer are related.

(c) The tests set forth in paragraph 2(b) are to be used at the initiative of the importer and only for comparison purposes. Substitute values may not be established under the provisions of paragraph 2(b).

**Article 2**

1. (a) If the customs value of the imported goods cannot be determined under the provisions of Article 1, the customs value shall be the transaction value of identical goods sold for export to the same country of importation and exported at or about the same time as the goods being valued.

(b) In applying this Article, the transaction value of identical goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the customs value. Where no such sale is found, the transaction value of identical goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or a decrease in the value.

2. Where the costs and charges referred to in paragraph 2 of Article 8 are included in the transaction value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the identical goods in question arising from differences in distances and modes of transport.

3. If, in applying this Article, more than one transaction value of identical goods is found, the lowest such value shall be used to determine the customs value of the imported goods.

**Article 3**

1. (a) If the customs value of the imported goods cannot be determined under the provisions of Articles 1 and 2, the customs value shall be the transaction value of similar goods sold for export to the same country of importation and exported at or about the same time as the goods being valued.

(b) In applying this Article, the transaction value of similar goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the customs value. Where no such sale is found, the transaction value of similar goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or a decrease in the value.
2. Where the costs and charges referred to in paragraph 2 of Article 8 are included in the transaction value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the similar goods in question arising from differences in distances and modes of transport.

3. If, in applying this Article, more than one transaction value of similar goods is found, the lowest such value shall be used to determine the customs value of the imported goods.

**Article 4**

If the customs value of the imported goods cannot be determined under the provisions of Articles 1, 2 and 3, the customs value shall be determined under the provisions of Article 5 or, when the customs value cannot be determined under that Article, under the provisions of Article 6 except that, at the request of the importer, the order of application of Articles 5 and 6 shall be reversed.

**Article 5**

1. (a) If the imported goods or identical or similar imported goods are sold in the country of importation in the condition as imported, the customs value of the imported goods under the provisions of this Article shall be based on the unit price at which the imported goods or identical or similar imported goods are so sold in the greatest aggregate quantity, at or about the time of the importation of the goods being valued, to persons who are not related to the persons from whom they buy such goods, subject to deductions for the following:

   (i) either the commissions usually paid or agreed to be paid or the additions usually made for profit and general expenses in connection with sales in such country of imported goods of the same class or kind;

   (ii) the usual costs of transport and insurance and associated costs incurred within the country of importation;

   (iii) where appropriate, the costs and charges referred to in paragraph 2 of Article 8; and

   (iv) the customs duties and other national taxes payable in the country of importation by reason of the importation or sale of the goods.

(b) If neither the imported goods nor identical nor similar imported goods are sold at or about the time of importation of the goods being valued, the customs value shall, subject otherwise to the provisions of paragraph 1(a), be based on the unit price at which the imported goods or identical or similar imported goods are sold in the country of importation in the condition as imported at the earliest date after the importation of the goods being valued but before the expiration of 90 days after such importation.

2. If neither the imported goods nor identical nor similar imported goods are sold in the country of importation in the condition as imported, then, if the importer so requests, the customs value shall be based on the unit price at which the imported goods, after further processing, are sold in the greatest aggregate quantity to persons in the country of importation who are not related to the persons from
whom they buy such goods, due allowance being made for the value added by such processing and the deductions provided for in paragraph 1(a).

**Article 6**

1. The customs value of imported goods under the provisions of this Article shall be based on a computed value. Computed value shall consist of the sum of:
   (a) the cost or value of materials and fabrication or other processing employed in producing the imported goods;
   (b) 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;
   (c) the cost or value of all other expenses necessary to reflect the valuation option chosen by the Member under paragraph 2 of Article 8.

2. No Member may require or compel any person not resident in its own territory to produce for examination, or to allow access to, any account or other record for the purposes of determining a computed value. However, information supplied by the producer of the goods for the purposes of determining the customs value under the provisions of this Article may be verified in another country by the authorities of the country of importation with the agreement of the producer and provided they give sufficient advance notice to the government of the country in question and the latter does not object to the investigation.

**Article 7**

1. If the customs value of the imported goods cannot be determined under the provisions of Articles 1 through 6, inclusive, the customs value shall be determined using reasonable means consistent with the principles and general provisions of this Agreement and of Article VII of GATT 1994 and on the basis of data available in the country of importation.

2. No customs value shall be determined under the provisions of this Article on the basis of:
   (a) the selling price in the country of importation of goods produced in such country;
   (b) a system which provides for the acceptance for customs purposes of the higher of two alternative values;
   (c) the price of goods on the domestic market of the country of exportation;
   (d) the cost of production other than computed values which have been determined for identical or similar goods in accordance with the provisions of Article 6;
   (e) the price of the goods for export to a country other than the country of importation;
   (f) minimum customs values; or
   (g) arbitrary or fictitious values.
3. If the importer so requests, the importer shall be informed in writing of the customs value determined under the provisions of this Article and the method used to determine such value.

**Article 8**

1. In determining the customs value under the provisions of Article 1, there shall be added to the price actually paid or payable for the imported goods:

   (a) the following, to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the goods:

      (i) commissions and brokerage, except buying commissions;

      (ii) the cost of containers which are treated as being one for customs purposes with the goods in question;

      (iii) the cost of packing whether for labour or materials;

   (b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:

      (i) materials, components, parts and similar items incorporated in the imported goods;

      (ii) tools, dies, moulds and similar items used in the production of the imported goods;

      (iii) materials consumed in the production of the imported goods;

      (iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary for the production of the imported goods;

   (c) royalties and licence fees 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 fees are not included in the price actually paid or payable;

   (d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

2. In framing its legislation, each Member shall provide for the inclusion in or the exclusion from the customs value, in whole or in part, of the following:

   (a) the cost of transport of the imported goods to the port or place of importation;

   (b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation; and

   (c) the cost of insurance.

3. Additions to the price actually paid or payable shall be made under this Article only on the basis of objective and quantifiable data.
4. No additions shall be made to the price actually paid or payable in determining the customs value except as provided in this Article.

Article 9

1. Where the conversion of currency is necessary for the determination of the customs value, the rate of exchange to be used shall be that duly published by the competent authorities of the country of importation concerned and shall reflect as effectively as possible, in respect of the period covered by each such document of publication, the current value of such currency in commercial transactions in terms of the currency of the country of importation.

2. The conversion rate to be used shall be that in effect at the time of exportation or the time of importation, as provided by each Member.

Article 10

All information which is by nature confidential or which is provided on a confidential basis for the purposes of customs valuation shall be treated as strictly confidential by the authorities concerned who shall not disclose it without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings.

Article 11

1. The legislation of each Member shall provide in regard to a determination of customs value for the right of appeal, without penalty, by the importer or any other person liable for the payment of the duty.

2. An initial right of appeal without penalty may be to an authority within the customs administration or to an independent body, but the legislation of each Member shall provide for the right of appeal without penalty to a judicial authority.

3. Notice of the decision on appeal shall be given to the appellant and the reasons for such decision shall be provided in writing. The appellant shall also be informed of any rights of further appeal.

Article 12

Laws, regulations, judicial decisions and administrative rulings of general application giving effect to this Agreement shall be published in conformity with Article X of GATT 1994 by the country of importation concerned.

Article 13

If, in the course of determining the customs value of imported goods, it becomes necessary to delay the final determination of such customs value, the importer of the goods shall nevertheless be able to withdraw them from customs if, where so required, the importer provides sufficient guarantee in the form of a surety, a deposit or some other appropriate instrument, covering the ultimate payment of customs duties for which the goods may be liable. The legislation of each Member shall make provisions for such circumstances.

Article 14

The notes at Annex I to this Agreement form an integral part of this Agreement and the Articles of this Agreement are to be read and applied in conjunction with their respective notes. Annexes II and III also form an integral part of this Agreement.
Article 15

1. In this Agreement:
   (a) "customs value of imported goods" means the value of goods for the purposes of levying ad valorem duties of customs on imported goods;
   (b) "country of importation" means country or customs territory of importation; and
   (c) "produced" includes grown, manufactured and mined.

2. In this Agreement:
   (a) identical goods" means goods which are the same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance would not preclude goods otherwise conforming to the definition from being regarded as identical;
   (b) "similar goods" means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. The quality of the goods, their reputation and the existence of a trademark are among the factors to be considered in determining whether goods are similar;
   (c) the terms "identical goods" and "similar goods" do not include, as the case may be, goods which incorporate or reflect engineering, development, artwork, design work, and plans and sketches for which no adjustment has been made under paragraph 1(b)(iv) of Article 8 because such elements were undertaken in the country of importation;
   (d) goods shall not be regarded as "identical goods" or "similar goods" unless they were produced in the same country as the goods being valued;
   (e) goods produced by a different person shall be taken into account only when there are no identical goods or similar goods, as the case may be, produced by the same person as the goods being valued.

3. In this Agreement "goods of the same class or kind" means goods which fall within a group or range of goods produced by a particular industry or industry sector, and includes identical or similar goods.

4. For the purposes of this Agreement, persons shall be deemed to be related only if:
   (a) they are officers or directors of one another's businesses;
   (b) they are legally recognized partners in business;
   (c) they are employer and employee;
   (d) any person directly or indirectly owns, controls or holds 5 per cent or more of the outstanding voting stock or shares of both of them;
   (e) one of them directly or indirectly controls the other;
   (f) both of them are directly or indirectly controlled by a third person;
   (g) together they directly or indirectly control a third person; or
(h) they are members of the same family.

5. Persons who are associated in business with one another in that one is the sole agent, sole distributor or sole concessionaire, however described, of the other shall be deemed to be related for the purposes of this Agreement if they fall within the criteria of paragraph 4.

Article 16

Upon written request, the importer shall have the right to an explanation in writing from the customs administration of the country of importation as to how the customs value of the importer’s goods was determined.

Article 17

Nothing in this Agreement shall be construed as restricting or calling into question the rights of customs administrations to satisfy themselves as to the truth or accuracy of any statement, document or declaration presented for customs valuation purposes.
PART II
ADMINISTRATION, CONSULTATIONS AND DISPUTE SETTLEMENT

Article 18

Institutions

1. There is hereby established a Committee on Customs Valuation (referred to in this Agreement as "the Committee") composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall normally meet once a year, or as is otherwise envisaged by the relevant provisions of this Agreement, for the purpose of affording Members the opportunity to consult on matters relating to the administration of the customs valuation system by any Member as it might affect the operation of this Agreement or the furtherance of its objectives and carrying out such other responsibilities as may be assigned to it by the Members. The WTO Secretariat shall act as the secretariat to the Committee.

2. There shall be established a Technical Committee on Customs Valuation (referred to in this Agreement as "the Technical Committee") under the auspices of the Customs Co-operation Council (referred to in this Agreement as "the CCC"), which shall carry out the responsibilities described in Annex II to this Agreement and shall operate in accordance with the rules of procedure contained therein.

Article 19

Consultations and Dispute Settlement

1. Except as otherwise provided herein, the Dispute Settlement Understanding is applicable to consultations and the settlement of disputes under this Agreement.

2. If any Member considers that any benefit accruing to it, directly or indirectly, under this Agreement is being nullified or impaired, or that the achievement of any objective of this Agreement is being impeded, as a result of the actions of another Member or of other Members, it may, with a view to reaching a mutually satisfactory solution of this matter, request consultations with the Member or Members in question. Each Member shall afford sympathetic consideration to any request from another Member for consultations.

3. The Technical Committee shall provide, upon request, advice and assistance to Members engaged in consultations.

4. At the request of a party to the dispute, or on its own initiative, a panel established to examine a dispute relating to the provisions of this Agreement may request the Technical Committee to carry out an examination of any questions requiring technical consideration. The panel shall determine the terms of reference of the Technical Committee for the particular dispute and set a time period for receipt of the report of the Technical Committee. The panel shall take into consideration the report of the Technical Committee. In the event that the Technical Committee is unable to reach consensus on a matter referred to it pursuant to this paragraph, the panel should afford the parties to the dispute an opportunity to present their views on the matter to the panel.
5. Confidential information provided to the panel shall not be disclosed without formal authorization from the person, body or authority providing such information. Where such information is requested from the panel but release of such information by the panel is not authorized, a non-confidential summary of this information, authorized by the person, body or authority providing the information, shall be provided.

PART III

SPECIAL AND DIFFERENTIAL TREATMENT

Article 20

1. Developing country Members not party to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade done on 12 April 1979 may delay application of the provisions of this Agreement for a period not exceeding five years from the date of entry into force of the WTO Agreement for such Members. Developing country Members who choose to delay application of this Agreement shall notify the Director-General of the WTO accordingly.

2. In addition to paragraph 1, developing country Members not party to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade done on 12 April 1979 may delay application of paragraph 2(b)(iii) of Article 1 and Article 6 for a period not exceeding three years following their application of all other provisions of this Agreement. Developing country Members that choose to delay application of the provisions specified in this paragraph shall notify the Director-General of the WTO accordingly.

3. Developed country Members shall furnish, on mutually agreed terms, technical assistance to developing country Members that so request. On this basis developed country Members shall draw up programmes of technical assistance which may include, inter alia, training of personnel, assistance in preparing implementation measures, access to sources of information regarding customs valuation methodology, and advice on the application of the provisions of this Agreement.

PART IV

FINAL PROVISIONS

Article 21

Reservations

Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.
Article 22
National Legislation

1. Each Member shall ensure, not later than the date of application of the provisions of this Agreement for it, the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement.

2. Each Member shall inform the Committee of any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations.

Article 23
Review

The Committee shall review annually the implementation and operation of this Agreement taking into account the objectives thereof. The Committee shall annually inform the Council for Trade in Goods of developments during the period covered by such reviews.

Article 24
Secretariat

This Agreement shall be serviced by the WTO Secretariat except in regard to those responsibilities specifically assigned to the Technical Committee, which will be serviced by the CCC Secretariat.
ANNEX I
INTERPRETATIVE NOTES

General Note

Sequential Application of Valuation Methods

1. Articles 1 through 7 define how the customs value of imported goods is to be determined under the provisions of this Agreement. The methods of valuation are set out in a sequential order of application. The primary method for customs valuation is defined in Article 1 and imported goods are to be valued in accordance with the provisions of this Article whenever the conditions prescribed therein are fulfilled.

2. Where the customs value cannot be determined under the provisions of Article 1, it is to be determined by proceeding sequentially through the succeeding Articles to the first such Article under which the customs value can be determined. Except as provided in Article 4, it is only when the customs value cannot be determined under the provisions of a particular Article that the provisions of the next Article in the sequence can be used.

3. If the importer does not request that the order of Articles 5 and 6 be reversed, the normal order of the sequence is to be followed. If the importer does so request but it then proves impossible to determine the customs value under the provisions of Article 6, the customs value is to be determined under the provisions of Article 5, if it can be so determined.

4. Where the customs value cannot be determined under the provisions of Articles 1 through 6 it is to be determined under the provisions of Article 7.

Use of Generally Accepted Accounting Principles

1. "Generally accepted accounting principles" refers to the recognized consensus or substantial authoritative support within a country at a particular time as to which economic resources and obligations should be recorded as assets and liabilities, which changes in assets and liabilities should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and which financial statements should be prepared. These standards may be broad guidelines of general application as well as detailed practices and procedures.

2. For the purposes of this Agreement, the customs administration of each Member shall utilize information prepared in a manner consistent with generally accepted accounting principles in the country which is appropriate for the Article in question. For example, the determination of usual profit and general expenses under the provisions of Article 5 would be carried out utilizing information prepared in a manner consistent with generally accepted accounting principles of the country of importation. On the other hand, the determination of usual profit and general expenses under the provisions of Article 6 would be carried out utilizing information prepared in a manner consistent with generally accepted accounting principles of the country of production. As a further example, the determination of an element provided for in paragraph 1(b)(ii) of Article 8 undertaken in the country
of importation would be carried out utilizing information in a manner consistent with the generally accepted accounting principles of that country.

**Note to Article 1**

**Price Actually Paid or Payable**

1. The price actually paid or payable is the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. The payment need not necessarily take the form of a transfer of money. Payment may be made by way of letters of credit or negotiable instruments. Payment may be made directly or indirectly. An example of an indirect payment would be the settlement by the buyer, whether in whole or in part, of a debt owed by the seller.

2. Activities undertaken by the buyer on the buyer's own account, other than those for which an adjustment is provided in Article 8, are not considered to be an indirect payment to the seller, even though they might be regarded as of benefit to the seller. The costs of such activities shall not, therefore, be added to the price actually paid or payable in determining the customs value.

3. The customs value shall not include the following charges or costs, provided that they are distinguished from the price actually paid or payable for the imported goods:

   (a) charges for construction, erection, assembly, maintenance or technical assistance, undertaken after importation on imported goods such as industrial plant, machinery or equipment;

   (b) the cost of transport after importation;

   (c) duties and taxes of the country of importation.

4. The price actually paid or payable refers to the price for the imported goods. Thus the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods are not part of the customs value.

**Paragraph 1(a)(iii)**

Among restrictions which would not render a price actually paid or payable unacceptable are restrictions which do not substantially affect the value of the goods. An example of such restrictions would be the case where a seller requires a buyer of automobiles not to sell or exhibit them prior to a fixed date which represents the beginning of a model year.

**Paragraph 1(b)**

1. If the sale or price is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued, the transaction value shall not be acceptable for customs purposes. Some examples of this include:

   (a) the seller establishes the price of the imported goods on condition that the buyer will also buy other goods in specified quantities;

   (b) the price of the imported goods is dependent upon the price or prices at which the buyer of the imported goods sells other goods to the seller of the imported goods;
(c) the price is established on the basis of a form of payment extraneous to the imported goods, such as where the imported goods are semi-finished goods which have been provided by the seller on condition that the seller will receive a specified quantity of the finished goods.

2. However, conditions or considerations relating to the production or marketing of the imported goods shall not result in rejection of the transaction value. For example, the fact that the buyer furnishes the seller with engineering and plans undertaken in the country of importation shall not result in rejection of the transaction value for the purposes of Article 1. Likewise, if the buyer undertakes on the buyer’s own account, even though by agreement with the seller, activities relating to the marketing of the imported goods, the value of these activities is not part of the customs value nor shall such activities result in rejection of the transaction value.

Paragraph 2

1. Paragraphs 2(a) and 2(b) provide different means of establishing the acceptability of a transaction value.

2. Paragraph 2(a) provides that where the buyer and the seller are related, the circumstances surrounding the sale shall be examined and the transaction value shall be accepted as the customs value provided that the relationship did not influence the price. It is not intended that there should be an examination of the circumstances in all cases where the buyer and the seller are related. Such examination will only be required where there are doubts about the acceptability of the price. Where the customs administration have no doubts about the acceptability of the price, it should be accepted without requesting further information from the importer. For example, the customs administration may have previously examined the relationship, or it may already have detailed information concerning the buyer and the seller, and may already be satisfied from such examination or information that the relationship did not influence the price.

3. the customs administration is unable to accept the transaction value without further inquiry, it should give the importer an opportunity to supply such further detailed information as may be necessary to enable it to examine the circumstances surrounding the sale. In this context, the customs administration should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and seller organize their commercial relations and the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price. Where it can be shown that the buyer and seller, although related under the provisions of Article 15, buy from and sell to each other as if they were not related, this would demonstrate that the price had not been influenced by the relationship. As an example of this, if the price had been settled in a manner consistent with the normal pricing practices of the industry in question or with the way the seller settles prices for sales to buyers who are not related to the seller, this would demonstrate that the price had not been influenced by the relationship. As a further example, where it is shown that the price is adequate to ensure recovery of all costs plus a profit which is representative of the firm's overall profit realized over a representative period of time (e.g. on an annual basis) in sales of goods of
the same class or kind, this would demonstrate that the price had not been influenced.

4. Paragraph 2(b) provides an opportunity for the importer to demonstrate that the transaction value closely approximates to a "test" value previously accepted by the customs administration and is therefore acceptable under the provisions of Article 1. Where a test under paragraph 2(b) is met, it is not necessary to examine the question of influence under paragraph 2(a). If the customs administration has already sufficient information to be satisfied, without further detailed inquiries, that one of the tests provided in paragraph 2(b) has been met, there is no reason for it to require the importer to demonstrate that the test can be met. In paragraph 2(b) the term "unrelated buyers" means buyers who are not related to the seller in any particular case.

**Paragraph 2(b)**

A number of factors must be taken into consideration in determining whether one value "closely approximates" to another value. These factors include the nature of the imported goods, the nature of the industry itself, the season in which the goods are imported, and, whether the difference in values is commercially significant. Since these factors may vary from case to case, it would be impossible to apply a uniform standard such as a fixed percentage, in each case. For example, a small difference in value in a case involving one type of goods could be unacceptable while a large difference in a case involving another type of goods might be acceptable in determining whether the transaction value closely approximates to the "test" values set forth in paragraph 2(b) of Article 1.

**Note to Article 2**

1. In applying Article 2, the customs administration shall, wherever possible, use a sale of identical goods at the same commercial level and in substantially the same quantities as the goods being valued. Where no such sale is found, a sale of identical goods that takes place under any one of the following three conditions may be used:

   (a) a sale at the same commercial level but in different quantities;

   (b) a sale at a different commercial level but in substantially the same quantities; or

   (c) a sale at a different commercial level and in different quantities.

2. Having found a sale under any one of these three conditions adjustments will then be made, as the case may be, for:

   (a) quantity factors only;

   (b) commercial level factors only; or

   (c) both commercial level and quantity factors.

3. The expression "and/or" allows the flexibility to use the sales and make the necessary adjustments in any one of the three conditions described above.

4. For the purposes of Article 2, the transaction value of identical imported goods means a customs value, adjusted as provided for in paragraphs 1(b) and 2, which has already been accepted under Article 1.
5. A condition for adjustment because of different commercial levels or different quantities is that such adjustment, whether it leads to an increase or a decrease in the value, be made only on the basis of demonstrated evidence that clearly establishes the reasonableness and accuracy of the adjustments, e.g. valid price lists containing prices referring to different levels or different quantities. As an example of this, if the imported goods being valued consist of a shipment of 10 units and the only identical imported goods for which a transaction value exists involved a sale of 500 units, and it is recognized that the seller grants quantity discounts, the required adjustment may be accomplished by resorting to the seller's price list and using that price applicable to a sale of 10 units. This does not require that a sale had to have been made in quantities of 10 as long as the price list has been established as being bona fide through sales at other quantities. In the absence of such an objective measure, however, the determination of a customs value under the provisions of Article 2 is not appropriate.

**Note to Article 3**

1. In applying Article 3, the customs administration shall, wherever possible, use a sale of similar goods at the same commercial level and in substantially the same quantities as the goods being valued. Where no such sale is found, a sale of similar goods that takes place under any one of the following three conditions may be used:
   (a) a sale at the same commercial level but in different quantities;
   (b) a sale at a different commercial level but in substantially the same quantities; or
   (c) a sale at a different commercial level and in different quantities.

2. Having found a sale under any one of these three conditions adjustments will then be made, as the case may be, for:
   (a) quantity factors only;
   (b) commercial level factors only; or
   (c) both commercial level and quantity factors.

3. The expression "and/or" allows the flexibility to use the sales and make the necessary adjustments in any one of the three conditions described above.

4. For the purpose of Article 3, the transaction value of similar imported goods means a customs value, adjusted as provided for in paragraphs 1(b) and 2, which has already been accepted under Article 1.

5. A condition for adjustment because of different commercial levels or different quantities is that such adjustment, whether it leads to an increase or a decrease in the value, be made only on the basis of demonstrated evidence that clearly establishes the reasonableness and accuracy of the adjustment, e.g. valid price lists containing prices referring to different levels or different quantities. As an example of this, if the imported goods being valued consist of a shipment of 10 units and the only similar imported goods for which a transaction value exists involved a sale of 500 units, and it is recognized that the seller grants quantity discounts, the required adjustment may be accomplished by resorting to the seller's price list and
using that price applicable to a sale of 10 units. This does not require that a sale had to have been made in quantities of 10 as long as the price list has been established as being bona fide through sales at other quantities. In the absence of such an objective measure, however, the determination of a customs value under the provisions of Article 3 is not appropriate.

**Note to Article 5**

1. The term "unit price at which ... goods are sold in the greatest aggregate quantity" means the price at which the greatest number of units is sold in sales to persons who are not related to the persons from whom they buy such goods at the first commercial level after importation at which such sales take place.

2. As an example of this, goods are sold from a price list which grants favourable unit prices for purchases made in larger quantities.

<table>
<thead>
<tr>
<th>Sale quantity</th>
<th>Unit price</th>
<th>Number of sales</th>
<th>Total quantity sold at each price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-10 units</td>
<td>100</td>
<td>10 sales of 5 units</td>
<td>65</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 sales of 3 units</td>
<td></td>
</tr>
<tr>
<td>11-25 units</td>
<td>95</td>
<td>5 sales of 11 units</td>
<td>55</td>
</tr>
<tr>
<td>over 25 units</td>
<td>90</td>
<td>1 sale of 30 units</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 sale of 50 units</td>
<td></td>
</tr>
</tbody>
</table>

The greatest number of units sold at a price is 80; therefore, the unit price in the greatest aggregate quantity is 90.

3. As another example of this, two sales occur. In the first sale 500 units are sold at a price of 95 currency units each. In the second sale 400 units are sold at a price of 90 currency units each.

In this example, the greatest number of units sold at a particular price is 500; therefore, the unit price in the greatest aggregate quantity is 95.

4. A third example would be the following situation where various quantities are sold at various prices.

(a) Sales

<table>
<thead>
<tr>
<th>Sale quantity</th>
<th>Unit price</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 units</td>
<td>100</td>
</tr>
<tr>
<td>30 units</td>
<td>90</td>
</tr>
<tr>
<td>15 units</td>
<td>100</td>
</tr>
<tr>
<td>50 units</td>
<td>95</td>
</tr>
<tr>
<td>25 units</td>
<td>105</td>
</tr>
<tr>
<td>35 units</td>
<td>90</td>
</tr>
<tr>
<td>5 units</td>
<td>100</td>
</tr>
</tbody>
</table>
(b) **Totals**

<table>
<thead>
<tr>
<th>Total quantity sold</th>
<th>Unit price</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>90</td>
</tr>
<tr>
<td>50</td>
<td>95</td>
</tr>
<tr>
<td>60</td>
<td>100</td>
</tr>
<tr>
<td>25</td>
<td>105</td>
</tr>
</tbody>
</table>

In this example, the greatest number of units sold at a particular price is 65; therefore, the unit price in the greatest aggregate quantity is 90.

5. Any sale in the importing country, as described in paragraph 1 above, to a person who supplies directly or indirectly free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods any of the elements specified in paragraph 1(b) of Article 8, should not be taken into account in establishing the unit price for the purposes of Article 5.

6. It should be noted that "profit and general expenses" referred to in paragraph 1 of Article 5 should be taken as a whole. The figure for the purposes of this deduction should be determined on the basis of information supplied by or on behalf of the importer unless the importer's figures are inconsistent with those obtained in sales in the country of importation of imported goods of the same class or kind. Where the importer's figures are inconsistent with such figures, the amount for profit and general expenses may be based upon relevant information other than that supplied by or on behalf of the importer.

7. The "general expenses" include the direct and indirect costs of marketing the goods in question.

8. Local taxes payable by reason of the sale of the goods for which a deduction is not made under the provisions of paragraph 1(a)(iv) of Article 5 shall be deducted under the provisions of paragraph 1(a)(i) of Article 5.

9. In determining either the commissions or the usual profits and general expenses under the provisions of paragraph 1 of Article 5, the question whether certain goods are "of the same class or kind" as other goods must be determined on a case-by-case basis by reference to the circumstances involved. Sales in the country of importation of the narrowest group or range of imported goods of the same class or kind, which includes the goods being valued, for which the necessary information can be provided, should be examined. For the purposes of Article 5, "goods of the same class or kind" includes goods imported from the same country as the goods being valued as well as goods imported from other countries.

10. For the purposes of paragraph 1(b) of Article 5, the "earliest date" shall be the date by which sales of the imported goods or of identical or similar imported goods are made in sufficient quantity to establish the unit price.

11. Where the method in paragraph 2 of Article 5 is used, deductions made for the value added by further processing shall be based on objective and quantifiable data.
relating to the cost of such work. Accepted industry formulas, recipes, methods of construction, and other industry practices would form the basis of the calculations.

12. It is recognized that the method of valuation provided for in paragraph 2 of Article 5 would normally not be applicable when, as a result of the further processing, the imported goods lose their identity. However, there can be instances where, although the identity of the imported goods is lost, the value added by the processing can be determined accurately without unreasonable difficulty. On the other hand, there can also be instances where the imported goods maintain their identity but form such a minor element in the goods sold in the country of importation that the use of this valuation method would be unjustified. In view of the above, each situation of this type must be considered on a case-by-case basis.

Note to Article 6

1. As a general rule, customs value is determined under this Agreement on the basis of information readily available in the country of importation. In order to determine a computed value, however, 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. Furthermore, in most cases the producer of the goods will be outside the jurisdiction of the authorities of the country of importation. The use of the computed value method will generally be limited to those cases where the buyer and seller are related, and the producer is prepared to supply to the authorities of the country of importation the necessary costings and to provide facilities for any subsequent verification which may be necessary.

2. The "cost or value" referred to in paragraph 1(a) of Article 6 is to be determined on the basis of information relating to the production of the goods being valued supplied by or on behalf of the producer. It is to be based upon the commercial accounts of the producer, provided that such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced.

3. The "cost or value" shall include the cost of elements specified in paragraphs 1(a)(ii) and (iii) of Article 8. It shall also include the value, apportioned as appropriate under the provisions of the relevant note to Article 8, of any element specified in paragraph 1(b) of Article 8 which has been supplied directly or indirectly by the buyer for use in connection with the production of the imported goods. The value of the elements specified in paragraph 1(b)(iv) of Article 8 which are undertaken in the country of importation shall be included only to the extent that such elements are charged to the producer. It is to be understood that no cost or value of the elements referred to in this paragraph shall be counted twice in determining the computed value.

4. The "amount for profit and general expenses" referred to in paragraph 1(b) of Article 6 is to be determined on the basis of information supplied by or on behalf of the producer unless the producer's figures are inconsistent with those 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.
5. It should be noted in this context that the "amount for profit and general expenses" has to be taken as a whole. It follows that if, in any particular case, the producer's profit figure is low and the producer's general expenses are high, the producer's profit and general expenses taken together may nevertheless be consistent with that usually reflected in sales of goods of the same class or kind. Such a situation might occur, for example, if a product were being launched in the country of importation and the producer accepted a nil or low profit to offset high general expenses associated with the launch. Where the producer can demonstrate a low profit on sales of the imported goods because of particular commercial circumstances, the producer's actual profit figures should be taken into account provided that the producer has valid commercial reasons to justify them and the producer's pricing policy reflects usual pricing policies in the branch of industry concerned. Such a situation might occur, for example, where producers have been forced to lower prices temporarily because of an unforeseeable drop in demand, or where they sell goods to complement a range of goods being produced in the country of importation and accept a low profit to maintain competitiveness. Where the producer's own figures for profit and general expenses are not consistent with those 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, the amount for profit and general expenses may be based upon relevant information other than that supplied by or on behalf of the producer of the goods.

6. Where information other than that supplied by or on behalf of the producer is used for the purposes of determining a computed value, the authorities of the importing country shall inform the importer, if the latter so requests, of the source of such information, the data used and the calculations based upon such data, subject to the provisions of Article 10.

7. The "general expenses" referred to in paragraph 1(b) of Article 6 covers the direct and indirect costs of producing and selling the goods for export which are not included under paragraph 1(a) of Article 6.

8. Whether certain goods are "of the same class or kind" as other goods must be determined on a case-by-case basis with reference to the circumstances involved. In determining the usual profits and general expenses under the provisions of Article 6, sales for export to the country of importation of the narrowest group or range of goods, which includes the goods being valued, for which the necessary information can be provided, should be examined. For the purposes of Article 6, "goods of the same class or kind" must be from the same country as the goods being valued.

Note to Article 7

1. Customs values determined under the provisions of Article 7 should, to the greatest extent possible, be based on previously determined customs values.

2. The methods of valuation to be employed under Article 7 should be those laid down in Articles 1 through 6 but a reasonable flexibility in the application of such methods would be in conformity with the aims and provisions of Article 7.

3. Some examples of reasonable flexibility are as follows:
(a) **Identical goods** - the requirement that the identical goods should be exported at or about the same time as the goods being valued could be flexibly interpreted; identical imported goods produced in a country other than the country of exportation of the goods being valued could be the basis for customs valuation; customs values of identical imported goods already determined under the provisions of Articles 5 and 6 could be used.

(b) **Similar goods** - the requirement that the similar goods should be exported at or about the same time as the goods being valued could be flexibly interpreted; similar imported goods produced in a country other than the country of exportation of the goods being valued could be the basis for customs valuation; customs values of similar imported goods already determined under the provisions of Articles 5 and 6 could be used.

(c) **Deductive method** - the requirement that the goods shall have been sold in the "condition as imported" in paragraph 1(a) of Article 5 could be flexibly interpreted; the "90 days" requirement could be administered flexibly.

**Note to Article 8**

**Paragraph 1(a)(i)**

The term "buying commissions" means fees paid by an importer to the importer's agent for the service of representing the importer abroad in the purchase of the goods being valued.

**Paragraph 1(b)(ii)**

1. There are two factors involved in the apportionment of the elements specified in paragraph 1(b)(ii) of Article 8 to the imported goods - the value of the element itself and the way in which that value is to be apportioned to the imported goods. The apportionment of these elements should be made in a reasonable manner appropriate to the circumstances and in accordance with generally accepted accounting principles.

2. Concerning the value of the element, if the importer acquires the element from a seller not related to the importer at a given cost, the value of the element is that cost. If the element was produced by the importer or by a person related to the importer, its value would be the cost of producing it. If the element had been previously used by the importer, regardless of whether it had been acquired or produced by such importer, the original cost of acquisition or production would have to be adjusted downward to reflect its use in order to arrive at the value of the element.

3. Once a value has been determined for the element, it is necessary to apportion that value to the imported goods. Various possibilities exist. For example, the value might be apportioned to the first shipment if the importer wishes to pay duty on the entire value at one time. As another example, the importer may request that the value be apportioned over the number of units produced up to the time of the first shipment. As a further example, the importer may request that the value be apportioned over the entire anticipated production where contracts or firm commitments exist for that production. The method of apportionment used will depend upon the documentation provided by the importer.
4. As an illustration of the above, an importer provides the producer with a mould to be used in the production of the imported goods and contracts with the producer to buy 10,000 units. By the time of arrival of the first shipment of 1,000 units, the producer has already produced 4,000 units. The importer may request the customs administration to apportion the value of the mould over 1,000 units, 4,000 units or 10,000 units.

Paragraph 1(b)(iv)
1. Additions for the elements specified in paragraph 1(b)(iv) of Article 8 should be based on objective and quantifiable data. In order to minimize the burden for both the importer and customs administration in determining the values to be added, data readily available in the buyer's commercial record system should be used insofar as possible.
2. For those elements supplied by the buyer which were purchased or leased by the buyer, the addition would be the cost of the purchase or the lease. No addition shall be made for those elements available in the public domain, other than the cost of obtaining copies of them.
3. The ease with which it may be possible to calculate the values to be added will depend on a particular firm's structure and management practice, as well as its accounting methods.
4. For example, it is possible that a firm which imports a variety of products from several countries maintains the records of its design centre outside the country of importation in such a way as to show accurately the costs attributable to a given product. In such cases, a direct adjustment may appropriately be made under the provisions of Article 8.
5. In another case, a firm may carry the cost of the design centre outside the country of importation as a general overhead expense without allocation to specific products. In this instance, an appropriate adjustment could be made under the provisions of Article 8 with respect to the imported goods by apportioning total design centre costs over total production benefiting from the design centre and adding such apportioned cost on a unit basis to imports.
6. Variations in the above circumstances will, of course, require different factors to be considered in determining the proper method of allocation.
7. In cases where the production of the element in question involves a number of countries and over a period of time, the adjustment should be limited to the value actually added to that element outside the country of importation.

Paragraph 1(c)
1. The royalties and licence fees referred to in paragraph 1(c) of Article 8 may include, among other things, payments in respect to patents, trade marks and copyrights. However, the charges for the right to reproduce the imported goods in the country of importation shall not be added to the price actually paid or payable for the imported goods in determining the customs value.
2. Payments made by the buyer for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable for the imported goods if such payments are not a condition of the sale for export to the country of importation of the imported goods.
**Paragraph 3**

Where objective and quantifiable data do not exist with regard to the additions required to be made under the provisions of Article 8, the transaction value cannot be determined under the provisions of Article 1. As an illustration of this, a royalty is paid on the basis of the price in a sale in the importing country of a litre of a particular product that was imported by the kilogram and made up into a solution after importation. If the royalty is based partially on the imported goods and partially on other factors which have nothing to do with the imported goods (such as when the imported goods are mixed with domestic ingredients and are no longer separately identifiable, or when the royalty cannot be distinguished from special financial arrangements between the buyer and the seller), it would be inappropriate to attempt to make an addition for the royalty. However, if the amount of this royalty is based only on the imported goods and can be readily quantified, an addition to the price actually paid or payable can be made.

**Note to Article 9**

For the purposes of Article 9, "time of importation" may include the time of entry for customs purposes.

**Note to Article 11**

1. Article 11 provides the importer with the right to appeal against a valuation determination made by the customs administration for the goods being valued. Appeal may first be to a higher level in the customs administration, but the importer shall have the right in the final instance to appeal to the judiciary.

2. "Without penalty" means that the importer shall not be subject to a fine or threat of fine merely because the importer chose to exercise the right of appeal. Payment of normal court costs and lawyers' fees shall not be considered to be a fine. 3. However, nothing in Article 11 shall prevent a Member from requiring full payment of assessed customs duties prior to an appeal.

**Note to Article 15**

**Paragraph 4**

For the purposes of Article 15, the term "persons" includes a legal person, where appropriate.

**Paragraph 4(e)**

For the purposes of this Agreement, one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter.
ANNEX II

TECHNICAL COMMITTEE ON CUSTOMS VALUATION

1. In accordance with Article 18 of this Agreement, the Technical Committee shall be established under the auspices of the CCC with a view to ensuring, at the technical level, uniformity in interpretation and application of this Agreement.

2. The responsibilities of the Technical Committee shall include the following:
   (a) to examine specific technical problems arising in the day-to-day administration of the customs valuation system of Members and to give advisory opinions on appropriate solutions based upon the facts presented;
   (b) to study, as requested, valuation laws, procedures and practices as they relate to this Agreement and to prepare reports on the results of such studies;
   (c) to prepare and circulate annual reports on the technical aspects of the operation and status of this Agreement;
   (d) to furnish such information and advice on any matters concerning the valuation of imported goods for customs purposes as may be requested by any Member or the Committee. Such information and advice may take the form of advisory opinions, commentaries or explanatory notes;
   (e) to facilitate, as requested, technical assistance to Members with a view to furthering the international acceptance of this Agreement;
   (f) to carry out an examination of a matter referred to it by a panel under Article 19 of this Agreement; and
   (g) to exercise such other responsibilities as the Committee may assign to it.

General

3. The Technical Committee shall attempt to conclude its work on specific matters, especially those referred to it by Members, the Committee or a panel, in a reasonably short period of time. As provided in paragraph 4 of Article 19, a panel shall set a specific time period for receipt of a report of the Technical Committee and the Technical Committee shall provide its report within that period.

4. The Technical Committee shall be assisted as appropriate in its activities by the CCC Secretariat.

Representation

5. Each Member shall have the right to be represented on the Technical Committee. Each Member may nominate one delegate and one or more alternates to be its representatives on the Technical Committee. Such a Member so represented on the Technical Committee is referred to in this Annex as a "member of the Technical Committee". Representatives of members of the Technical Committee may be assisted by advisers. The WTO Secretariat may also attend such meetings with observer status.

6. Members of the CCC which are not Members of the WTO may be represented at meetings of the Technical Committee by one delegate and one or more alternates. Such representatives shall attend meetings of the Technical Committee as observers.
7. Subject to the approval of the Chairman of the Technical Committee, the Secretary-General of the CCC (referred to in this Annex as "the Secretary-General") may invite representatives of governments which are neither Members of the WTO nor members of the CCC and representatives of international governmental and trade organizations to attend meetings of the Technical Committee as observers.

8. Nominations of delegates, alternates and advisers to meetings of the Technical Committee shall be made to the Secretary-General.

**Technical Committee Meetings**

9. The Technical Committee shall meet as necessary but at least two times a year. The date of each meeting shall be fixed by the Technical Committee at its preceding session. The date of the meeting may be varied either at the request of any member of the Technical Committee concurred in by a simple majority of the members of the Technical Committee or, in cases requiring urgent attention, at the request of the Chairman. Notwithstanding the provisions in sentence 1 of this paragraph, the Technical Committee shall meet as necessary to consider matters referred to it by a panel under the provisions of Article 19 of this Agreement.

10. The meetings of the Technical Committee shall be held at the headquarters of the CCC unless otherwise decided.

11. The Secretary-General shall inform all members of the Technical Committee and those included under paragraphs 6 and 7 at least 30 days in advance, except in urgent cases, of the opening date of each session of the Technical Committee.

**Agenda**

12. A provisional agenda for each session shall be drawn up by the Secretary-General and circulated to the members of the Technical Committee and to those included under paragraphs 6 and 7 at least 30 days in advance of the session, except in urgent cases. This agenda shall comprise all items whose inclusion has been approved by the Technical Committee during its preceding session, all items included by the Chairman on the Chairman’s own initiative, and all items whose inclusion has been requested by the Secretary-General, by the Committee or by any member of the Technical Committee.

13. The Technical Committee shall determine its agenda at the opening of each session. During the session the agenda may be altered at any time by the Technical Committee.

**Officers and Conduct of Business**

14. The Technical Committee shall elect from among the delegates of its members a Chairman and one or more Vice-Chairmen. The Chairman and Vice-Chairmen shall each hold office for a period of one year. The retiring Chairman and Vice-Chairmen are eligible for re-election. The mandate of a Chairman or Vice-Chairman who no longer represents a member of the Technical Committee shall terminate automatically.

15. If the Chairman is absent from any meeting or part thereof, a Vice-Chairman shall preside. In that event, the latter shall have the same powers and duties as the Chairman.
16. The Chairman of the meeting shall participate in the proceedings of the Technical Committee as such and not as the representative of a member of the Technical Committee.

17. In addition to exercising the other powers conferred upon the Chairman by these rules, the Chairman shall declare the opening and closing of each meeting, direct the discussion, accord the right to speak, and, pursuant to these rules, have control of the proceedings. The Chairman may also call a speaker to order if the speaker's remarks are not relevant.

18. During discussion of any matter a delegation may raise a point of order. In this event, the Chairman shall immediately state a ruling. If this ruling is challenged, the Chairman shall submit it to the meeting for decision and it shall stand unless overruled.

19. The Secretary-General, or officers of the CCC Secretariat designated by the Secretary-General, shall perform the secretarial work of meetings of the Technical Committee.

**Quorum and Voting**

20. Representatives of a simple majority of the members of the Technical Committee shall constitute a quorum.

21. Each member of the Technical Committee shall have one vote. A decision of the Technical Committee shall be taken by a majority comprising at least two thirds of the members present. Regardless of the outcome of the vote on a particular matter, the Technical Committee shall be free to make a full report to the Committee and to the CCC on that matter indicating the different views expressed in the relevant discussions. Notwithstanding the above provisions of this paragraph, on matters referred to it by a panel, the Technical Committee shall take decisions by consensus. Where no agreement is reached in the Technical Committee on the question referred to it by a panel, the Technical Committee shall provide a report detailing the facts of the matter and indicating the views of the members.

**Languages and Records**

22. The official languages of the Technical Committee shall be English, French and Spanish. Speeches or statements made in any of these three languages shall be immediately translated into the other official languages unless all delegations agree to dispense with translation. Speeches or statements made in any other language shall be translated into English, French and Spanish, subject to the same conditions, but in that event the delegation concerned shall provide the translation into English, French or Spanish. Only English, French and Spanish shall be used for the official documents of the Technical Committee. Memoranda and correspondence for the consideration of the Technical Committee must be presented in one of the official languages.

23. The Technical Committee shall draw up a report of all its sessions and, if the Chairman considers it necessary, minutes or summary records of its meetings. The Chairman or a designee of the Chairman shall report on the work of the Technical Committee at each meeting of the Committee and at each meeting of the CCC.
ANNEX III

1. The five-year delay in the application of the provisions of the Agreement by developing country Members provided for in paragraph 1 of Article 20 may, in practice, be insufficient for certain developing country Members. In such cases a developing country Member may request before the end of the period referred to in paragraph 1 of Article 20 an extension of such period, it being understood that the Members will give sympathetic consideration to such a request in cases where the developing country Member in question can show good cause.

2. Developing countries which currently value goods on the basis of officially established minimum values may wish to make a reservation to enable them to retain such values on a limited and transitional basis under such terms and conditions as may be agreed to by the Members.

3. Developing countries which consider that the reversal of the sequential order at the request of the importer provided for in Article 4 of the Agreement may give rise to real difficulties for them may wish to make a reservation to Article 4 in the following terms:

"The Government of ............... reserves the right to provide that the relevant provision of Article 4 of the Agreement shall apply only when the customs authorities agree to the request to reverse the order of Articles 5 and 6."

If developing countries make such a reservation, the Members shall consent to it under Article 21 of the Agreement.

4. Developing countries may wish to make a reservation with respect to paragraph 2 of Article 5 of the Agreement in the following terms:

"The Government of ............... reserves the right to provide that paragraph 2 of Article 5 of the Agreement shall be applied in accordance with the provisions of the relevant note thereto whether or not the importer so requests." If developing countries make such a reservation, the Members shall consent to it under Article 21 of the Agreement.

5. Certain developing countries may have problems in the implementation of Article 1 of the Agreement insofar as it relates to importations into their countries by sole agents, sole distributors and sole concessionaires. If such problems arise in practice in developing country Members applying the Agreement, a study of this question shall be made, at the request of such Members, with a view to finding appropriate solutions.

6. Article 17 recognizes that in applying the Agreement, customs administrations may need to make enquiries concerning the truth or accuracy of any statement, document or declaration presented to them for customs valuation purposes. The Article thus acknowledges that enquiries may be made which are, for example, aimed at verifying that the elements of value declared or presented to customs in connection with a determination of customs value are complete and correct. Members, subject to their national laws and procedures, have the right to expect the full cooperation of importers in these enquiries.

7. The price actually paid or payable includes all payments actually made or to be made as a condition of sale of the imported goods, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller.
Lesson 3
TRANSACTION VALUE METHOD

Transaction Value (Article 1), Principles and Primacy of Transaction Value and its Adjustments (Article 8)

Important Elements of Transaction Value

It is reiterated, under the WTO Valuation Code, the method of valuation that must be tried first is the Transaction Value method of Article 1. The Transaction Value referred to in Article 1 has the following basic elements:
- it relates to ‘imported goods’;
- there has to be a ‘sale’;
- the price relates to the ‘goods when sold’;
- the sale has to be ‘for export to the country of importation’, i.e. Nepal
- the sale has to be subjected to certain conditions as stipulated at clauses (a) to (d) of Article 1.1
- it has to be adjusted in accordance with the provisions of Article 8.

These basic elements are discussed below with the help of Interpretative notes and WCO Technical Committee instruments.

In order to apply the Transaction Value (T.V.) method, there must be a sale, and the price agreed upon by the parties to the particular sale of goods is the most important term of a sales agreement. If however the transaction is not a sale but a gift or a loan or a lease or a transfer of property from one place to another by the same owner, there will naturally not be any question of a price relevant for establishing a T.V. The Agreement does not provide any definition of ‘sale’. The concept of ‘sale’ in the Agreement has been discussed in WCO Advisory Opinion 1.1 on “The Concept of ‘sale’ in the Agreement”

This Advisory Opinion deals with the concept of ‘sale’ in the Agreement with an illustrative list of seven cases where the transaction would not be treated as ‘sale’. These illustrations help in understanding the concept of ‘sale’. The Advisory Opinion 1.1 is extracted below.

The Technical Committee on Customs Valuation expressed the opinion that:

a) The Agreement on implementation of Article VII of the General Agreement on Tariffs and Trade 1994, hereinafter called the “Agreement”, contains no definition of “sale”. Article 1, paragraph 1, merely stipulates a specific commercial operation satisfying certain requirements and conditions.

b) Nevertheless in conformity with the basic intention of the Agreement that the transaction value of imported goods should be used to the greatest extent possible for Customs valuation purposes, uniformity of interpretation and application can be
achieved by taking the term “sale” in the widest sense, to be determined only under the provisions of Articles 1 and 8 read together.

c) It would however be useful to prepare a list of cases which would not be deemed to constitute sales meeting the requirements and conditions of Articles 1 and 8 taken together. In these cases the valuation method to be used should of course be determined in accordance with the order of priority laid down by the Agreement.

The list prepared pursuant to this opinion is appended. It is not exhaustive and will be added to in the light of experience. List of situations in which imported goods would not be deemed to have been the subject of a sale.

i. **Free consignments**

   Where transactions do not involve the payment of a price they cannot be regarded as sales under the Agreement.

   Examples: gifts, samples, promotional items.

ii. **Goods imported on consignment**

   Under this trading practice, the goods are dispatched to the country of importation not as a result of a sale, but with the intention that they would be sold for the account of the supplier, at the best price obtainable. At the time of importation no sale has taken place.

iii. **Goods imported by intermediaries, who do not purchase the goods and who sell them after importation.**

   A distinction must be made between the importations envisaged under this heading and importations of goods on consignment, dealt with under the previous heading; the latter constitute a separate and specific trading practice. The present category covers a whole range of situations encountered in commercial practice, whereby goods are delivered to intermediaries without having been the subject of a sale and in international usage are not universally considered as importations on consignment.

IV. **Goods imported by branches which are not separate legal entities**

   In cases where a branch cannot be regarded as a separate legal entity under the legislation concerned, there can be no sale, bearing in mind that a sale necessarily involves a transaction between two separate persons.

V. **Goods imported under a hire or leasing contract**

   Hire or leasing transactions by their very nature do not constitute sales, even if the contract includes an option to purchase the goods.

VI. **Goods supplied on loan, which remain the property of the sender**

   Goods (often machinery) are sometimes loaned by the owner to a customer. These transactions do not involve sales.

VII. **Goods (waste or scrap) imported for destruction in the country of importation, with the sender paying the importer for his services.**

   This case relates to waste or scrap imported for destruction. As costs are incurred in connection with this destruction, the exporter pays the importer an amount for his services.
As the importer does not pay for the imported goods but, on the contrary, is paid for accepting and destroying them, no sale can be considered to have taken place under the terms of the Agreement."

‘When sold’
The expression ‘when sold’ referred to in Article 1 does not indicate the time of sale. The English grammatical construction indicates that the expression ‘when sold’ used in Article 1 relates only to the fact of sale of the goods imported and being valued, and not to any other transaction.

The time element in relation to Article 1 of the Agreement has been discussed in the WCO Explanatory Note 1.1.

This Explanatory Note deals with the time element in relation to Articles 1, 2 and 3 of the Agreement. The Explanatory Note 1.1 is so far as it relates to Article 1 is extracted below.

1. Article 1 of the Agreement on Customs Valuation stipulates that the Customs value of the imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for export to the country of importation, subject to any necessary adjustments and provided that certain conditions are satisfied.

2. Neither in this Article nor in the corresponding Interpretative Notes is there any reference to a time standard external to the actual transaction, which would need to be taken into consideration when deciding whether the price actually paid or payable is a valid basis for the calculation of the Customs value.

3. Under the valuation method in Article 1 of the Agreement, the basis for establishing Customs value is the actual price made in the sale giving rise to the importation, the time at which the transaction took place being immaterial. In this connection the expression “when sold…” in paragraph 1 of Article 1 is not to be regarded as giving any indication of the time to be taken into consideration when deciding whether a price is valid for the purposes of Article 1; it merely indicates the type of transaction involved, namely one in which the goods were sold for export to the country of importation.

4. Consequently, provided that the conditions prescribed in Article 1 are fulfilled, the transaction value of imported goods should be accepted irrespective of the time at which the sale contract was concluded, and hence, irrespective of any market fluctuations after the date when the contract was concluded.

5. Article 1 does make a subsidiary reference to a time standard in paragraph 2(b); this relates only to ‘test’ values and thus does not influence the situation that there is no time element involved in determining transaction value under Article 1.

6. Paragraph 2(b) provides that in a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of paragraph 1 whenever the importer demonstrates that such value closely approximates to one of three alternatives occurring at or about the same time. But if the term “occurring at or about the same time” were the only reference to be taken into consideration, there could in some cases be a substantial difference between the conditions affecting the goods being valued and those affecting the
goods furnishing the test value, and an inappropriate comparison could result.

7. The application of paragraph 2(b) must be in a manner consistent with the principles of the Agreement. The time of export, which is the standard of comparison for the purposes of Articles 2 and 3 would be one approach.

8. Other measures within the frame work of the Agreement would also be possible, in particular time standards adapted to the principles underlying the test values in question, namely: for subparagraph 1.2 (b) (i) the time of export to the country of importation of the goods being valued, for subparagraph 1.2(b)(ii) the time of sale in the country of importation of the goods being valued, and for subparagraph 1.2(b)(iii) the time of import of the goods being valued."

‘Sold for export to the country of importation’

In order to apply transaction value method in terms of Article 1, there must be a sale of the imported goods for export to the country of importation i.e. Nepal. The WCO Advisory Opinion 14.1 has expressed an opinion on the interpretation of this expression.

The Advisory Opinion 14.1 is extracted below

1. What interpretation should be given to the expression "sold for export to the country of importation” in Article 1 of the Agreement?

2. The Technical Committee on Customs Valuation expressed the following opinion.

The Council’s Glossary of International Customs Terms defines the term importation as “the act of bringing any goods into a Customs territory” and the term exportation as “the act of taking any goods out of the Customs territory”. Therefore, the fact that the goods are presented for valuation of itself establishes their importation which, in turn, establishes the fact of their exportation. The only remaining requirement then, is to identify the transaction relating thereto.

In this respect, there is no need that the sale takes place in a specific country of exportation. If the importer can demonstrate that the immediate sale under consideration took place with the view to export the goods to the country of importation, then Article 1 can apply. It follows that only transactions involving an actual international transfer of goods may be used in valuing merchandise under the transaction value method.

‘Price actually paid or payable’

The phrase ‘price actually paid or payable’ in Article 1 is a very important one, and it makes it clear that the Customs value is to include the entire price, whether it has been paid or yet to be paid, in part or in whole. What is relevant is that it must be the price agreed between the parties. The agreed price need not necessarily be endorsed by a written contract, but it can also be evidenced by letters, telexes, fax messages or actual performances of transaction and payment. The agreed price may also hang before the goods reach the country of importation. If the parties agree on a revised price before the goods reach the country of importation, it would mean that a new agreement has superseded the old, and T.V. has to be based on the new price, whether higher or lower than the old agreed price.

This important expression has been further explained below with the help of Interpretative Note and WCO Technical Committee Instruments.
Interpretative Note to Article 1.

The Interpretative Note to Article 1 explains the ‘price actually paid or payable’ as the total payment made or to be made by the buyer to or for the benefit of the seller of the imported goods. It is therefore indisputably clear that ‘payable’ means ‘to be paid’, and that the payment may be made directly or indirectly. The second part of the Interpretative Note deals with the elements that will not form part of the price actually paid or payable. Finally, the Note clarifies that certain post-importation charges or costs are not to be included as part of the Customs Value.

The Interpretative Note to Article 1 relating to the Price Actually Paid or Payable is extracted below:

"1. The price actually paid or payable is the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. Payment may be made by way of letters of credit or negotiable instruments. Payment may be made directly or indirectly. An example of an indirect payment would be the settlement by the buyer, whether in whole or in part, or a debt owed by the seller.

2. Activities undertaken by the buyer on his own account, other than those for which an adjustment is provided in Article 8, are not considered to be an indirect payment to the seller, even though they might be regarded as of benefit to the seller. The costs of such activities shall not, therefore, be added to be price actually paid or payable in determining the Customs value.

3. The Customs value shall not include the following charges or costs, provided that they are distinguished from the price actually paid or payable for the imported goods.
   a) charges for construction, erection, assembly, maintenance or technical assistance, undertaken after importation of imported goods such as industrial plant, machinery or equipment;
   b) the cost of transport after importation;
   c) duties and taxes of the country of importation.

4. The price actually paid or payable refers to the price for the imported goods. Thus the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods are not part of the Customs value."

Explanatory Note 5.1 on Confirming Commissions in the context of 'price actually paid or payable'

This Explanatory Note 5.1, while defining 'Confirming Commissions' through illustrations has dealt with its valuation treatment in the context of the expression 'price actually paid or payable'. The same is extracted below:

General remarks

1. Exporters protect themselves against the financial risk of non-payment for goods and services supplied in international trade, through the use of financial services, including those which provide confirmation to guarantee payment. Various forms of financial services are available to exporters to guarantee against the risk of non-payment or insolvency on the part of a buyer. While these services can vary from country to country, they generally give rise to a payment to an intermediary (often a bank),
which, for a fee, will accept the risk on behalf of the exporter. The payment made for such services are often known as "confirming commissions". They may, however, be denoted by other names in various countries.

**Confirming commissions**

2. The confirmation or the guarantee of the payment for the goods by the buyer can be undertaken through normal banking channels, government agencies, insurance companies or specialized commercial companies dealing with such matters.

3. The situation is as follows: a buyer opens a letter of credit with his own bank. However, the seller may lack confidence in the status and reliability of the letter of credit raised by the buyer's bank. He seeks to confirm the letter of credit through another bank (usually in his own country) which guarantees the seller against the commercial risk of non-payment by the buyer's bank. The fee charged by the bank for this service is a confirming commission.

4. There are specialized commercial companies called confirming houses, which act either for buyers or for sellers. Among the variety of services performed by them is the guarantee of payment. The commission charged for the service is often called a confirming commission.

**Determination of the valuation treatment**

5. The determination of the valuation treatment to be given to confirming commissions is a complex question inasmuch as the issue related to a variety of financial practices which may not be defined uniformly among countries.

6. It would be normal practice that a seller, incurring this expense, would seek to recover his confirming commission costs from a buyer. In the great majority of cases, he would do this by including the commission cost directly in his price for the goods. In such cases, the confirming commission would be included in the price actually paid or payable for the goods and there is no provision under the Agreement which would allow for its deduction in determining the transaction value.

7. Situations will occur where the charge for confirming commissions is separately identified, either by the seller in the invoice of sale for the goods, or in a separate invoice sent to the buyer by the seller or by the confirming institution.

8. In examining the above situations, it seems that the type of activity giving rise to the payment of a confirming commission is not one envisaged under the provisions of Article 8 of the Agreement either as a "commission" under Article 8.1 (a) or as 'insurance' under Article 8.2 (c). Confirming commissions are more in the nature of premiums for insurance against the risk of non-payment for the goods, rather than commissions in the strict sense of the word. Similarly, the insurance referred to under Article 8.2 (c) would be that incurred for the transport of the imported goods only, as noted in Advisory Opinion 13.1. Therefore, the question which needs to be addressed is whether the payments for confirming commissions are part of the price actually paid or payable for the imported goods.

9. The Interpretative Note to Article 1 and paragraph 7 of Annex III make it clear that the price actually paid or payable is the total payment made or to be made directly or indirectly by the buyer to or for the benefit of the seller for the imported goods. That price includes all payments actually made or to be made as a condition of sale of the
imported goods by the buyer to the seller or by the buyer to a third party to satisfy an obligation of the seller. Subject to paragraph 10 of this Explanatory Note, if a confirmation of the instrument of payment for the imported goods is considered to be for the benefit of the seller because it insures the seller against the risk of non-payment by the buyer's bank, and if confirming commissions are paid by the buyer to the seller or to a third party as condition of the sale of the imported goods, the price actually paid or payable would include any confirming commission.

10. There may be cases where a buyer undertakes on his own initiative to provide a seller with an irrevocable and confirmed letter of credit, the primary purpose being to ensure the conclusion of the contract of sale. Any commission charges arising in those cases could be paid by the buyer directly to the confirming institution. In these circumstances, there being no condition imposed in the sale contract and the benefit being realized by the buyer rather than the seller, the amount paid for the confirming commission would not be part of the price actually paid or payable."

Advisory Opinion 8.1 on 'Credit in respect of earlier consignment'

This Advisory Opinion deals with the question as to how would the credits in respect of previous transactions be treated when valuing the goods which have received the benefit of the earlier credit. The A.O. 8.1 is extracted below:

1. How are credits made in respect of earlier transactions to be treated under the Valuation Agreement when valuing goods that have received the benefit of that credit?

2. The Technical Committee on Customs Valuation expressed the following view.

The amount of the credit represents an amount already paid to the seller and accordingly is covered by the Interpretative Note to Article 1 on "price actually paid or payable" which specifies that the price actually paid or payable is the total payment of the imported goods made, or to be made, to the seller. Thus the credit is part of the price paid and for valuation purposes must be included in the transaction value.

The treatment to be accorded by Customs to the previous transaction which gave rise to the credit must be decided separately from any decision on the proper Customs value of the present shipment. The decision whether adjustment may be made to the value of the previous shipment will depend on national legislation.

Decision 3.1 on includibility or otherwise of interest charges as 'price actually paid or payable'.

The Decision 3.1 has categorically clarified that interest charges under a financing arrangement will not be included in Customs value, subject to certain conditions. The decision 3.1 is extracted below:

During its Ninth Meeting held on 26 April 1984, the Committee on Customs Valuation adopted the following decision:

The Parties to the Agreement on Implementation of Article VII of the GATT agree as follows:

(a) the charges are distinguished from the price actually paid or payable for the goods:
(b) the financing arrangement was made in writing:
(c) where required, the buyer can demonstrate that:
   □ such goods are actually sold at the price declared as the price actually paid or payable, and
   □ the claimed rate of interest does not exceed the level for such transactions prevailing in the country where, and at the time when the finance was provided.

This Decision shall apply regardless of whether the finance is provided by the seller, a bank or another natural or legal person. It shall also apply, if appropriate, where goods are valued under a method other than the transaction value.

Each party shall notify the Committee of the date from which it will apply the Decision."

Explanatory Note 1.1 on 'acceptability of transaction value irrespective of any market fluctuation'

The Explanatory Note 1.1 which has also been discussed at para 3.1.3.1 clarifies at para 2 of the Note that neither in Article 1 nor in the Interpretative Notes is there any reference to a time standard external to the actual transaction, which would need to be taken into consideration when deciding whether the price actually paid or payable is a valid basis for the calculation of the Customs value. It therefore refers at para 4 of the Explanatory Note as follows:

"4. Consequently, provided that the conditions prescribed in Article 1 are fulfilled, the transaction value of imported goods should be accepted irrespective of the time at which the sale contract was concluded, and hence, irrespective of any market fluctuations after the date when the contract was concluded."

Advisory Opinion 2.1 on 'acceptability of a price below market prices for identical goods'

On the issue of acceptability of a price below market price for identical goods, the Advisory opinion 2.1 concludes that it is acceptable subject to the provisions of Article 17, which deals with the rights of the Customs administration regarding verifying the truth of the declaration. The Advisory Opinion is given below:

1. The question has been asked whether a price lower than prevailing market prices for identical goods can be accepted for the purposes of Article 1 of the Agreement on implementation of Article VII of the General Agreement on Tariffs and Trade 1994.

2. The Committee considered this question and concluded that the mere fact that a price is lower than prevailing market prices for identical goods should not cause it to be rejected for the purposes of Article 1, subject of course to the provisions of Article 17 of the Agreement."

Commentary 9.1 on 'Treatment of costs of Activities taking place in the country of Importation.

1. This commentary examines the treatment of costs of activities taking place in the country of importation within the context of Article 1 and its Interpretative Note.

2. In dealing with this question, a listing of activities in the country of importation and
their treatment for valuation purposes would not be a useful approach. Such a listing could not be exhaustive and moreover, in many instances, the valuation treatment of any given activity would differ depending on the circumstances of the transaction. On the other hand, a brief statement of principle would cover a wide range of possibilities.

3. In this respect, in the determination of the Customs value under Article 1 of the Agreement, when the costs of activities occurring after importation are not included in the price actually paid or payable, they are not to be included in the Customs value unless it is specifically provided for by virtue of Article 8. This includes those which might be regarded of benefit to the seller but undertaken by the buyer on his own account.

4. Conversely, when such costs are included in the price actually paid or payable for the imported goods, they are not to be deducted from that price unless there is compliance with the relevant provisions of the Interpretative Note to Article 1 of the Agreement which states that:

“The Customs value shall not include the following charges or costs, provided that they are distinguished from the price actually paid or payable for the imported goods:

a) charges for construction, erection, assembly, maintenance or technical assistance, undertaken after importation on imported goods such as industrial plant, machinery or equipment,

b) the cost of transport after importation,

c) duties and taxes of the country of importation” (considered to be by their nature distinguishable, see Advisory Opinion 3.1).

5. The meaning of the term “importation” needs to be clearly established. In the Customs Co-operation Council’s Glossary of International Customs Terms, the term importation is defined as “the act of bringing or causing any goods to be brought into a Customs territory”. It is noted however that various national legislations provide more specific definitions to the term than the one above. Therefore any reference to that term must be within the context of the national legislation of the country in question.

6. With respect to subparagraph (a) of the Interpretative Note to Article 1, the phrase “undertaken after importation” should be flexibly interpreted as covering activity carried out in the country of importation. In that context, the cost of activities covered in subparagraph (a) would also be excluded from the Customs value even if they take place prior to importation so long as they are carried out as part of the installation of the imported goods. An example of this would be a charge for the laying of a concrete foundation undertaken prior to the importation of the machinery which is subsequently erected on that foundation.

7. On the specific question regarding transport, it is worth noting that while subparagraph (b) of the Interpretative Note to Article 1 refers to the cost of transport after importation, it would be consistent with the overall thrust of the Interpretative Note as it relates to post importation charges and costs to encompass within this expression loading, unloading and handling costs taking place after importation. The
same rationale would also apply to post importation insurance charges."

Commentary 16.1 on "Activities undertaken by the Buyer on his own account after purchase of the goods but before importation"

"1. This commentary examines the circumstances under which the cost of the activities undertaken by the buyer on his own account after purchase of the goods but before importation would or would not be considered as part of the Customs value determined under the provisions of Article 1.

2. The second paragraph of the Interpretative Note to Article 1, “Price actually paid or payable”, establishes the principle in the Agreement with respect to activities that are undertaken by the buyer on his own account. The cost of these activities shall not be added to the price actually paid or payable unless an adjustment is provided under Article 8.

3. An example which illustrates such a situation would be as follows:
Importer I of country of importation Y purchases a machine from seller S of country of exportation X for an amount of 30,000 c.u. In order to confirm that the machine meets the specifications in the sales contract, buyer I, after purchasing the machine, entrusts an additional testing of it to expert T, also in country X, and pays T 500 c.u. for this test. Additional testing in this context, means testing which is not considered as part of the manufacturing process of the goods. The additional testing is not a condition of the sale between I and S.
The payment for testing the machine by I to T, who is unrelated to S, is not made, either directly or indirectly, to or for the benefit of S. It is not therefore part of the price actually paid or payable. Furthermore, this activity undertaken by the buyer is not one of those for which an adjustment is provided in Article 8. If the other conditions of Article 1 are fulfilled, the machine would be valued on the basis of Article 1, provided that the goods have not been altered, adjusted, improved or in any way changed in nature.

4. In commercial practice, the activities that a buyer could undertake after the purchase of the goods but before importation can vary. In the context of Articles 1 and 8 and their Interpretative Notes, these may include activities undertaken with the aim of promoting the sale and distribution of the goods in the country of importation; The cost of these activities when they are undertaken by the buyer on his own account should not be considered an indirect payment to the seller, even though they might be regarded as for the benefit of the seller. The following example illustrates this principle:

Firm A is a dealer in electrical goods in country 1. He markets these goods through a network of dealers (retail outlets and service centers) operating under franchise agreements with him. Firm A concludes a long-term contract with foreign manufacturer S for the supply of a new type of electrical appliance. Under the terms of the contract, the appliance is to be marketed under S’s trademark and A undertakes to bear on his own account the cost of all marketing in the country of importation. Firm A places an order for an initial stock of the appliances and, prior to importation, conducts an advertising campaign.

5. In the above example, the cost of the advertising campaign is not a part of the Customs value nor shall it result in rejection of the transaction value, as these activities are
those related to marketing the imported goods as stated in the final sentence of paragraph I (b) of the Interpretative Note to Article 1.

Advisory Opinion 3.1 on "Meaning of 'Are Distinguished' in the Interpretative Note to Article 1 of the Agreement"

The advisory opinion 3.1 was given in the context of includibility of duties and taxes of the country of importation in the Customs value of the imported goods. The same is extracted below:

1. When the price paid or payable includes an amount for the duties and taxes of the country of importation, should these duties and taxes be deducted in those instances where they are not shown separately on the invoice and where the importer has not otherwise claimed a deduction in this respect?

2. The Technical Committee on Customs Valuation expressed the following view.

   Since the duties and taxes of the country of importation are by their nature distinguishable from the price actually paid or payable, they do not form part of the Customs value."
Lesson 4
Concept of Assists Royalties and License Fees

Assists

Article 8.1 (b) deals with the situation where the goods and/or services are supplied directly or indirectly by the buyer free of charge or at a reduced cost to the supplier of imported goods for use in producing the imported goods being valued. Obviously such supply free of charge or at a reduced cost would result in a lower price for the imported goods than the price that the supplier would have charged if such goods/services (also known as ‘assists’) were to be paid for in full. Article 8.1(b) provides for inclusion, in the transaction value of the imported goods, of the values of such ‘assists’ to the extent that they have not been included in the price actually paid or payable. In cases, where such goods/services have gone to produce more than the goods which have been imported and which are being valued, the rule provides for apportionment of the value of the ‘assists’ as appropriate.

Thus Article 8.1(b) has the following distinctive elements:

i. The specified goods and services must have been supplied directly or indirectly by the buyer free of charge or at a reduced cost. The goods and services can be supplied to the exporter from a third country and/or by a third party. It is not essential that these must originate in the country of importation i.e. Nepal, and that the buyer has to make or own the assists.

ii. The assists must be for use in connection with the production and sale for export of imported goods.

iii. Value of the assists has not been already included in the price actually paid or payable.

iv. Where the assists cover certain other goods in addition to the goods being valued, the value of such assists would have to be ‘apportioned as appropriate’ to determine the amount properly attributed to the goods being valued.

v. The assists have been specified to be of four categories. Certain other categories of assists like the one of providing financial assistance by the buyer to the seller have been kept outside the list of assists.

Four types of goods/services which have been specified as includible assists in sub clauses (i) to (iv) are as follows:

i) material, component, parts and similar items incorporated in the imported goods.

ii) Tools, dies, moulds and similar items used in the production of the imported goods.

iii) Materials consumed in the production of the imported goods.

iv) Engineering, development, art work, design work, and plans and sketches undertaken elsewhere than in India and necessary for the production of the imported goods.
Materials, components etc of Article 8.1(b)(i)

In respect of sub-clause (i) no interpretative note has been provided since the position is very clear. This sub-clause covers only tangible items which physically exist in the imported item. The appropriately apportioned value of materials, components, parts and similar items incorporated in the imported goods would be includible in the transaction value, subject to other conditions discussed in foregoing paragraph. In terms of EEC published practice, the materials and components etc. for the purpose of this sub-clause would include even price tags and labels.

Tools, dies, moulds etc. of Article 8.1(b)(ii)

It is very much the trade practice that assists like tools, moulds and dies are some time provided by the buyer to the seller for production of tailor made goods as per buyer’s requirements. For example a vehicle manufacturer provides the dies and moulds to various job worker manufacturer for production of castings to be used in their vehicles as per their requirements. These assists are thus used in production, and their value enters into the importer goods to the extent that they are consumed in the presence of production of goods.

Interpretative Note to Article 8.1 (b) (ii)

The issue of establishment of a value for the assists as a whole and its apportionment has been dealt with in the following interpretative Notes;

"1. There are two factors involved in the apportionment of the elements specified in Article 8.1 (b) (ii) to the imported goods – the value of the elements itself and the way in which that value is to be apportioned to the imported goods. The apportionment of these elements should be made in a reasonable manner appropriate to the circumstances and in accordance with generally accepted accounting principles.

2. Concerning the value of the element, if the importer acquires the element from a seller not related to him at a given costs, the value of the element is that cost. If the element was produced by the importer or by a person related to him, its value would be the cost of producing it. If the element had been previously used by the importer, regardless of whether it had been acquired or produced by such importer, the original cost of acquisition or production would have to be adjusted downward to reflect its use in order to arrive at the value of the element.

3. Once a value has been determined for the element it is necessary to apportion that value to the imported goods. Various possibilities exist. For example, the value might be apportioned to the first shipment if the importer wishes to pay duty on the entire value at one time. As another example, the importer may request that the value be apportioned over the number of units produced upto the time of the first shipment. As a further example, he may request that the value be apportioned over the entire anticipated production where contracts or firm commitment exists for that production. The method of apportionment used will depend upon the documentation provided by the importer.

4. As an illustration of the above, an importer provides the producer with a mould to be used in the production of the imported goods and contracts with him to buy 10,000 units. By the time of arrival of the first shipment of 1,000 units, the producer has already produced 4,000 units. The importer may request the proper officer of Customs to apportion the value of the mould over 1,000 units, 4,000 units or 10,000 units."
Captive Consumption Materials – Article 8.1 (b) (iii)

Sometimes the buyer may provide assists in the form of items like catalysts, lubricants etc. which do not become a part of the imported goods but which are consumed in the production of imported goods. The provisions in sub-clause (iii) are very clear about inclusion of value of materials consumed in the production of the imported goods. There is no Interpretative Note to this sub-rule. In terms of EEC published practice, the value of abrasives, lubricants, catalysts, reagents etc. which are supplied by the buyer and which are used up in the manufacture of the imported goods, but are not incorporated in them, are to be included in the value of the imported goods. As regards the materials wasted in such captive consumption, it would be advisable not to deduct the value of such waste materials, unless it can be proved that a specified amount of proceeds of the sale of such waste was remitted back to the buyer (importer) by the seller (supplier).

Engineering, development, artwork etc. – Article 8.1 (b) (iv)

The includibility of the intangible assists like engineering, development, art work, design work, plans and sketches in the value of the tangible goods has generally been a matter of dispute between the importer and the Customs Department. Article 8.1 (b) (iv) provides for addition of elements like engineering, development, art work etc. in the value, subject to the condition that these activities are to be undertaken elsewhere than in the country of importation i.e. Nepal, and that these activities are necessary for the production of the imported goods. On isolation, Article 8.1 (b) (iv) would read as follows:

'In determining the Customs value, there shall be added to the price actually paid or payable for the imported goods, the value, apportioned as appropriate, of the following services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of imported goods, to the extent that such value has not been included in the price actually paid or payable, namely:

Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in the country of importation i.e. Nepal and necessary for the production of the imported goods.'

Thus, under Article 8.1 (b) (iv) the relevant conditions for inclusion of the value of services in the value of the imported goods would be as follows:

a. The value of the services has not already been included in the price actually paid or payable for the imported goods.

b. The services were supplied directly or indirectly by the buyer free of charge

c. The services have to be undertaken elsewhere than in Nepal.

d. The subject services fall in any of the categories like engineering, development, art work, design work, plans, sketches.

e. The services were supplied by the buyer for use in connection with the production and sale for export of the imported goods.

f. The services are necessary for the production of the imported goods.
Interpretative Note to Article 8.1 (b) (iv)

The Interpretative Note to Article 8.1 (b) (iv), while dealing with the value of tangible assists like tools, dies & moulds etc. has clarified that the value of the assist is to be cost, to the importers, of purchasing or producing it. As discussed earlier, this Note also deals with the apportionment of value of such assists. The Interpretative Note to Article 8.1 (b) (iv) further deals with the apportionment of value of the tangible assists like engineering, design etc. In the matter of apportionment of value, GAAP (Generally Accepted Accounting Principles) should not be lost sight of. Interpretative Note to Article 8.1 (b) (iv) is reproduced below:

"1. Additions for the elements specified in Article 8.1 (b) (iv) should be based on objective and quantifiable data. In order to minimize the burden for both the importer and proper officer of Customs in determining the values to be added, data readily available in buyer's commercial record system should be used in so far as possible.

2. For those elements supplied by the buyer which were purchased or leased by the buyer, the addition would be the cost of purchase or the lease. No addition shall be made for those elements available in the public domain, other than the cost of obtaining copies of them.

3. The case with which it may be possible to calculate the values to be added will depend on a particular firm's structure and management practice, as well as its accounting methods.

4. For example, it is possible that a firm which imports a variety of products from several countries maintains the records of its design center outside the country of importation in such a way as to show accurately the costs attributable to a given product. In such cases, a direct adjustment may appropriately be made under the provisions of Article 8.

5. In another case, a firm may carry the cost of the design center outside the country of importation as a general overhead expense without allocation to specific products. In this instance, an appropriate adjustment could be made under the provisions of Article 8 with respect to the imported goods by apportioning total design center costs over total production benefiting from the design center and adding such apportioned cost on a unit basis to imports.

6. Variations in the above circumstances will, of course, require different factors to be considered in determining the proper method of allocation.

7. In cases where the production of the element in question involves a number of countries and over a period of time, the adjustment should be limited to the value actually added to that element outside the country of importation."
'Development' – Decision 5.1
The sub-clause 8.1 (b) (iv) deals with the specific intangibles which have assisted in the production of the goods being valued. The intangibles which are specified are engineering, development, artwork and plans & sketches. All these items are well understood, except that at the initial stage, there was some doubt as to whether or not research would be included in the term 'development'. The Committee on Customs Valuation, at its meeting in May, 1995 clarified vide DECISION 5.1 that the term 'development' used in Article 8.1 (b) (iv) should be understood to exclude 'research'.

'Undertaken elsewhere than in the country of Importation
The restriction with regard to "undertaken elsewhere than in the country of importation" is there only in sub-clause (iv) relating to engineering, development, design work etc. This restriction however is not there in respect of the preceding three sub-clauses relating to materials, components, parts, tools & dies etc. Thus, if certain components and parts or certain tools & dies are provided from the country of importation, the cost of such elements will still be includible in the value of the goods.

Assists in the form of services
From the foregoing discussions, it may be seen that Assist is a term used to describe the goods or services, specified in Article 8.1 (b), supplied free or at a reduced cost by the buyer for use in the production of the imported goods. The value of the assists is to be added to the 'value' to the extent that their full value has not been included in the price, provided that if the assist is in the form of services, the activities relating to these services have to be undertaken elsewhere than in Nepal.

WCO Instruments on Assists
The basic principles of application of Articles 8.1 (b) have been lucidly discussed in three Case Studies 1.1, 5.1 and 5.2 by the CCC Technical Committee, which bring out the application of sub-clauses (i) to (iv) of Article 8.1 (b) under different situations. It also shows how the normal additional payment made by a supplier to the contractor for engineering and development work is not to be confused with the situation envisaged in Article 8.1 (b) (iv). While the Case Study 1.1 deals with treatment of 'tangible assists' the Case Study 5.2 deals with application of all the sub-clauses in Article 8.1 (b). While Royalty & License fees covered by Article 8.1 (c) has been dealt with separately, the two Case Studies 8.1 and 8.2 has dealt with treatment of license fee as an 'assist' under Article 8.1 (b) (ii) and Article 8.1 (b) (iv) respectively.

ROYALTY AND LICENSE FEE
General Discussion
Royalty and licence fee have not been defined in the WTO Valuation Agreement. The
Interpretative Note to Article 8.1 (c) gives only an inclusive definition of royalty and licence fee inasmuch as these have been said to include among other things payments in respect of patents, trademarks and copyrights. In terms of Black’s Law Dictionary, ‘Royalty’ refers to compensation for use of property, usually copyrighted material or natural resources, expressed as a percentage of receipts from using the property as an account per unit produced. It is similar to payment which is made to an author or composer by an assignee, licensee or copyright-holder in respect of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent. Royalty is share of product or profit reserved by the owner for permitting another to use the property. The OCED Model Double Taxation Convention on Income and on Capital (1977) explains the term royalty in Article 12, para 2 as payments of any kind received as a consideration for the use of, or the right to use, any copyright a literary artistic or scientific work including cinematographic films, any patent, trademark, design or model, plan secret formula or process or for the use of or the right to use, industrial commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The information mentioned above is commonly called ‘know-how’. The term ‘royalty’ and ‘licence fee’ are always used together in the Valuation Code and the Interpretative Notes. The EEC Regulation No. 2454/93 defines royalty and licence fee “to mean in particular payment for the use of rights relating:

- to the manufacture of imported goods (in particular, patents, designs, models and manufacturing know-how), or
- to the sale for exportation of imported goods (in particular, trade marks, registered designs), or
- to the use or resale of imported goods (in particular, copyright, manufacturing process inseparably embodied in the imported goods).”

It is the trade practice that traders often have to pay for the right to manufacture, use or sell the licensor’s goods or for technical knowledge and assistance. In the absence of specific definition of royalty and licence fee in the Valuation Code, it would thus be in order to conclude in the context of the definitions discussed above that the terms royalty and licence fee would cover payments to a person for use of that person’s patent or design rights, processes, trademarks, copyrights or for know-how.

Thus the rights relate to these areas - manufacture, marketing and use of the imported goods. The manufacturing rights may include patents, know-how, rights of reproduction, rights of construction etc. The marketing rights may include the use of trade mark, brand name, registered designs, customer lists, market surveys, payments for exclusive rights in particular market etc. The right of use would include use of the imported goods as an ingredient in a patented product or process and the use of an imported machine to make a patented product or practice a patented process. Thus, the subject matter of royalty payment may be put in three categories - rights, information and services. Some rights may be explicitly created and regulated by law e.g. patents and trade marks, whereas some rights like information, know-how etc. may not be created or protected by law. One thing should always be remembered that payment for rights, information and services in the form of royalty or licence fee will be added to the value of the goods being valued, subject to the condition that the payments must be related to the goods, and payment must be a condition of the sale of the goods. Therefore, payment for all the rights, information and services specified hereinabove will not automatically be includible in the value.
The trading arrangements involving payment of royalties and licence fee are very complex and vary with royalty/license fee arrangement. It is therefore essential that the license arrangement and the terms of contract of sale are examined carefully since it is the license agreement and terms of contract which would give sufficient indication as to whether or not the royalty/license fee needs to be included in the value of the imported goods.

**Conditions for includibility of royalty to value.**

In terms of Article 8.1 (c), royalty and licence fee payable by the buyer to the seller directly or indirectly are to be added to the value subject to the two conditions - (a) that these are related to the imported goods and (b) that these are payable as a condition of the sale of the goods being valued.

(a) *Expression “Related to the goods being valued”*

The Note to Article 1 provides that the price actually paid or payable for the imported goods is the total payment made or to be made by the buyer to or for the benefit of the seller. Royalties and licence fees included in the transaction value of the imported goods under Article 8.1 (c) would therefore be payments for intellectual and other rights related to the goods, which would be separate from the price actually paid or payable for the imported goods. That is to say, the royalty and licence fees are essentially payments which are separate from the payment made to obtain title to the goods. The word “related” would be synonymous with the words ‘connected’ or ‘associated’ as per Webster’s New 20th Century Dictionary. Generally speaking, a royalty or licence fee may be related to imported goods mainly in two ways. First, the royalty or licence fee payment may be related to the imported goods themselves. For example the payment will be related to the imported goods, if it is calculated on the basis of the revenue derived from the sale or use of the imported goods. Secondly, the rights for which the payment is made may be related to the imported goods. This will be the case where the royalty or licence fee is for the right to use a particular trademark, copyright, patent, know-how, design etc. which is either reflected in or inherent to the imported goods. For example, a royalty or licence fee would be related to the imported goods if it is paid for the use of trade mark that is attached to the goods. A royalty or licence fee paid for a patented process used by an imported machine to manufacture goods in the country of importation would also be related to the imported goods, as given in the Advisory Opinion 4.3 to be discussed shortly.

In many situations, there will be a clear relationship between the payment of royalties or licence fees and the imported goods, since the royalty or licence agreement will contain a clear description of the goods or a list of goods covered by the royalty or licence fee payment. Further, a royalty payment calculated on the basis of the revenue derived from the sale or use of the imported goods, which is not for intellectual rights that are related to the goods, cannot be added to the price actually paid or payable by virtue of Article 8.1 (c). Conversely, where intellectual rights are related to the imported goods, the fact that the royalty or licence fee is calculated without reference to the imported goods, as in the case of lumpsum payment, would not be a bar to application of Article 8.1 (c) to that royalty or licence fee. Where the imported goods undergo, subsequent to their importation, minor processing which does not alter their essential characteristics, the royalty or
licence fee would still be related to the imported goods. For example, a royalty paid for the right to use a particular trademark in association with the sale of beverages made by using a particular imported concentrate would still be related to the imported goods, as has been opined in Advisory Opinion 4.6. A royalty paid for the use of a trademark on a machine which, for ease of transportation, is imported unassembled and assembled subsequent to importation, would also be related to the imported goods. Where the imported goods undergo a significant processing or where they are used as components in the manufacture of other goods, it would be advisable to closely examine why the royalty or licence fee is paid. If the imported goods are a minor component in the final product, the royalty or licence fee would seem to be related more to the final product and not to the imported goods. If however the use of imported goods, howsoever minor, in the manufacture of other goods is the basis for the obligation to pay the royalty or licence fee, that payment would be related to the imported goods.

Thus in determining whether a particular royalty or licence fee relates to the imported goods for the purpose of Article 8.1 (c), what is most important to be examined is why royalty or licence fee is paid. It is not really essential to examine how the royalty or licence fee is calculated or when it is paid. An answer to the question ‘why it is paid’ will lead to the conclusion whether royalty or licence fee is related to the imported goods. In order to find this answer, one will have to determine, in the first place, the type, scope and value of the rights, information or services covered by the royalty/licence fee. As has been explained in the interpretative notes, a right to reproduce imported goods is not related to those goods being valued but to other goods to be reproduced in future in the country of importation. Therefore, a royalty payment for this right is not a payment for the imported goods themselves. One important point in ascertaining the relationship of goods, the tangible, to the payment for the royalty, the intangible would be to find out whether the importer could have bought the tangible without buying the intangible. This point is again connected with the second condition of Article 8.1 (c), the discussion on which follows.

(b) **Expression payable as condition of the sale of the goods being valued**

The second requirement under which royalty or licence fee payments are to be added to ‘value’ is that these payments must be paid by the buyer as a condition of sale of the goods being valued. The determination of whether such payments are made as a condition of the sale may not always be easy in view of the complexities involved in royalty and licence fee arrangements and the different ways in which agreements are concluded between buyer and seller. If the payment is made to the seller in the fulfillment of the contract of a sale, it is clearly a condition of the sale of goods. But there could be cases where the contract of sale does not explicitly mention about payments to be made, and the obligation to make such payments could arise from a separate agreement made before or after the sale and even under a different title. Even the terms of a separate royalty agreement may not explicitly refer to the obligation to pay a royalty or licence fee. In such cases, the entire financial circumstances, surrounding the transaction would have to be examined so as to see the material aspects of the commercial arrangement between buyer and seller regarding the imported goods. For example, if the seller would not sell the goods without the royalty or licence fee being paid or the buyer could not buy the
goods without paying the royalty or licence fee, such an obligation should constitute a condition of sale. The position would be similar even where the royalty or licence fee is paid to a third person. This payment may be as a result of an obligation arising out of the sale contract between the seller and buyer or it may be in terms of a separate agreement between the buyer and seller.

Royalties or licence fees that a buyer is required to pay to a licensor are fees related to the exclusive use and sale of goods embodying the intellectual property, and as such these are payments related to the intellectual property rights associated with the purchase and sale of the goods in question. The commercial reality is that if the royalty payment is not made, the licence giving access to the goods comes to an end, and the importer no longer has the legal right to use the goods. It has to be kept in mind that the intellectual property owner owns property in the goods and agrees to sell that property for a price, that is the royalty. Purchasing goods containing another person’s intellectual property without that person’s permission, would in effect turn out to be stealing the property of the intellectual property owner. Thus, if an agreement for purchase of this intellectual property is not in place, the importer cannot legally access those goods which contain or embody the property of another party. The contract of sale of the goods gives the importer access to the tangible i.e. the goods, and the licence agreement gives access to the intangible i.e. intellectual property, without which the goods would be of no use. Since one cannot be dissociated from the other, the purchase of one cannot occur without the other. The royalty is paid to obtain the intellectual property embodied or inherent in the goods, as it is this which makes the goods desirable to the buyer.

Finally, therefore, the matter boils down to the separability or inseparability of the purchase of the goods being valued from the payment of the royalty for the intangible. The facts of separability will depend upon the technological feasibility, business practice and on the terms of contract. As regards terms of contract, a careful examination of the alternatives which are available to the importer in the circumstances of a particular transaction will decide whether royalty payment is a condition of sale. The question is whether the seller would have sold the tangible at the agreed price if the importer had opted to omit the purchase of intangible: The related question would be - will there not be an infringement of IPR (Intellectual Property Rights) laws in purchasing the goods containing intellectual property of another, without separate agreement with owner of the intellectual property? Further, if a royalty is paid for a right, or information or service which is necessary for the manufacturer of the goods in the country of exportation, or for their sale for export, it would naturally represent costs of the exporter- seller which he must cover in the price of the goods being sold for export, and thus any such royalty will be a condition of sale of the goods and a part of their Customs Value.

Summing up, the essence of ‘condition of sale’ is that it introduces into a contractual arrangement a legal obligation of performance, the non-fulfillment of which would entitle the affected party to legal remedies. A payment of royalty could be provided in many ways - by way of explicit agreement between buyer and seller, by way of agreement between the manufacturer (seller) and the licensor or holder of a patent, by way of an agreement by which the licensee’s customer pays the royalty to the licensor, and so on. Along with the question as to whether or not the seller would sell the goods to the buyer without royalty being paid, an equally
important question should be - does the buyer have the right to acquire the goods containing the intellectual property of another from any seller, without an agreement in place with the owner of the intellectual property? The answer would seem to be in the negative. Thus, where a buyer could not have purchased and imported the goods without having agreed to pay a royalty or license fee, the fee should clearly be a condition of the sale for the goods. It, therefore, follows, where a royalty is paid to an owner of intellectual property, and that property is embodied in the imported goods, the payment would always be a 'condition of sale'.

**Direct or Indirect Payment of Royalty**

In terms of Article 8.1 (c), royalty and licence fee paid to a third party can also be added to T.V. When royalty or licence fee is paid to the seller in kind, this also constitutes an indirect payment to the seller. In both the cases i.e. whether payment is made to a third party or payment is made in kind, the seller must require the buyer to make that payment on behalf of the seller, i.e. it has to be based on a condition of sale. Following situations are illustrative of indirect payment:

(a) In a transaction between different units of multinational company situated in different countries, an affiliate in Nepal may be required by the selling parent in USA to pay royalty on the technology involved directly to another affiliate in USA or UK, as a condition of sale of the machine. This is an indirect payment.

(b) The seller of the goods has acquired a trademark right from the owner of the trademark who is a third party, and thereafter the seller requires the buyer to purchase the trademark rights along with the goods. This is also indirect payment of royalty.

It is however doubtful whether the following situation will be a case of indirect payment of royalty:

The importer on his own initiative purchases the manufacturing rights and manufacturing know-how by paying royalty to a third party who is the owner of these rights. He, thereafter, makes these rights and know-how available to the manufacturer-exporter free of charge. The question is whether this payment to the third party would be includible in the value as indirect payment of royalty under Article 8.1 (c) or as a dutiable assist under Article 8.1 (b) (iv). In this context, Advisory opinion 4.8 discussed later may be referred to.

**Types of Royalties and License fees**

As discussed hereinbefore there is no precise definition of royalties and licence fees in the WTO Valuation Agreement. In practice these terms are defined on a case to case basis with reference to the reason why the payment is made. To this end there has been 13 Advisory Opinions (4.1 to 4.13) of WCO on various situations of payment of royalty. These would be discussed later in this chapter. The contracts or agreements, -commonly known as “licence agreements”, generally include a precise description of the product which is the subject of the licence (the “licensed product”), the nature of the rights assigned, the obligations of the licensor and the licensee, and the methods to be used for the calculation and payment of the royalties or licence fees. These information can be used to group royalties and licence fees into a number of categories as follows:
(i) **With reference to the nature of the rights assigned:**

The interpretative Note to Article 8.1 (c) refers, in particular, to payments in respect to patents, trade marks and copyright. In addition, it specially excludes from the Customs value:

- charges for the right to reproduce the imported goods in the country of importation;
- payments for the right to distribute the imported goods, if such payments are not a condition of the sale of those goods.

A distinction can be made between the rights in respect of:

- the manufacture of the imported goods (patents, designs, etc);
- the sale of the imported goods (particularly trade marks and models);
- use or resale (for example, copyright).

Licence agreements dealing with a single right are rarely encountered. It is generally necessary to examine the rights in detail in order to check the conditions of application of Article 8.1(c). Only royalties which are directly related to the imported goods are covered by Article 8.1 (c) and are dutiable, thus ruling out, for example, payments made for services such as training the licensee’s staff, or technical assistance in the areas of management, administration, marketing, accounting etc. It is possible to break down a royalty in order to pick out those elements which do not form part of the Customs value, provided that objective and quantifiable data are available for the purpose.

(ii) **With reference to the licensed product and the imported product:**

Advisory Opinions 4.1 to 4.13 demonstrate that the imported goods may:

a) themselves be the subject of a licence agreement (similar to the facts in A.O. 4.1);

b) be ingredients or constituent parts of the licensed product (similar to the facts in A.O. 4.4);

c) themselves produce or manufacture the licensed product (similar to the facts in A.O. 4.12).

(iii) **With reference to the parties to the sales contract and the licence agreement:**

Royalties may be paid by the buyer, directly or indirectly, to the seller of the imported goods, to a person related to the seller, or to a licensor belonging to the same multinational group as the seller. Also the buyer, the seller and the licensor may, or may not be totally independent.

Where relationships do exist, they must be taken into account for the purposes of establishing that the royalty is a condition of sale

(for example, when a royalty must be paid to the manufacturer’s parent company, as in Advisory Opinion 4.11).
(iv) **With reference to the arrangements for calculating and paying the royalties and licence fees:**

The amount of the royalty may be calculated as a percentage of the sale price or of the proceeds of the resale of the goods. The payments may be made in installments, or as a single lumpsum, or a combination of the two. These factors do not have any bearing on the issue of inclusion in the Customs value - only the reasons for paying the royalty are to be taken into account.

Finally, there are cases of “crossed licences”, i.e. licences obtained subject to the granting of a licence in return; this may mean that objective and quantifiable data are not available, thus making it impossible to include the royalties in the Customs value, thereby ruling out the application of Article 1.

(v) **With reference to the place of residence of the beneficiary of the royalties and licence fees:**

The question of whether the beneficiary has his place of residence in or outside the country of importation does not normally have any bearing on the issue of whether the royalties are to be included in the Customs value.

(vi) **With reference to the industrial sector or economic factors:**

Depending on the sector, different types of assigned rights may be encountered; for example, licences to manufacture products and use trade marks in the food industry, patent concessions in pharmaceuticals, design, model and trade marks in the textiles field, patents and know-how in industry, etc. Other economic or fiscal factors may have a bearing on the existence of royalties. Thus, between related companies within a multinational group, the invoicing method may be determined by the tax legislation applicable, either with a view to attracting lower Customs duties or to boosting profits.

**Different categories of royalty**

Payment of royalty or licence fees may be related to the value addition to the imported goods or due to use of the imported goods in manufacture of licensed product - on account of technical assistance or information obtained for production of the licensed goods mentioned in the royalty agreement. There may be separate royalty payments for different rights to intellectual property; ‘the cake of the intellectual property rights may be cut in many ways and in many slices, each representing a separate right that may be assigned on separate royalty payment’ - for import of goods or processes or knowledge, for selling or reselling, or otherwise disposing of goods, for use of machinery, for distributing or selling the goods produced by the patented machine and/or by patented processes, for reproducing the imported goods etc. The elements for which royalty/licence fees are paid may include one or more of the following:

(a) **Trademark Rights:**

A trademark indicates a specific product of a specific manufacturer or distributor and this marketing device conveys a promise of the quality associated with that mark. The trademark rights are rights under the law of the country of importation and the importer pays for the rights to use the trademark in marketing the product.
in the country of importation. For Customs purpose, what is important is whether the goods are to be marketed with the mark, and if so, whether the importer was obliged to take the mark and pay royalty in order to purchase the goods. If so, payment of trademark royalty is a condition of sale of the goods for export and hence includible in the value. There may be three situations of ownership of trademark in the country of importation:

i. The trademark is owned by the importer, in which case there is no question of any royalty payment to anyone.

ii. The trademark is owned by a third person, in which case while the payment for the goods goes to the exporter, the payment for the trademark royalty goes to the third person.

iii. The trademark is owned by the manufacturer-exporter, in which case the payment for the goods as well as for trademark royalty goes to the same person i.e. the exporter.

**EEC Provisions on Trademark:**

On the issue of trademark royalty, there being no explanation from the interpretative notes, it may be useful to refer to EEC provisions on the matter. Article 159 of Regulation 2454/93 provides that a royalty or licence fee paid for the right to use a trademark is to be included in the Customs value when:

- The royalty or licence fee refers to goods which are resold in the same state or which are subject to only minor processing after importation.
- The goods are marketed under the trademark, affixed before or after importation, for which the royalty or licence fee is paid, and
- The buyer is not free to obtain such goods from the other suppliers unrelated to the seller.

**Know-how**

There are basically three categories of know-how - technical, marketing and administrative. OECD Commentary on Article 12 of OCED Model Double Taxation Convention on Income and on Capital (1997) defines ‘know-how’ as “all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, know-how represents what a manufacturer cannot know from mere examination of the product and mere knowledge of the progress of technique.” Know-how provided under a licence agreement will often involve the supply of designs, recipes, formulae and basic instructions as to the use of licensed product. Where such know-how applies to the imported goods, any royalty or licence fee payment will need to be considered for inclusion in the Customs value - as observed in a EEC commentary on incidence of royalty and licence fee in Customs value. Some licence agreements however (for example in the area of franchising) involve the supply of services such as the training of the licensee’s staff in the manufacture of the licensed product or in the use of the machinery/plant. There may also be technical assistance in the areas of management, administration, marketing, accounting etc. The aforesaid EEC commentary makes it clear that royalty or
licensure fee for these services would not be includible in the Customs value.

Thus when a particular information or know-how is unrelated to the imported goods but it is in connection with marketing of the end product, the royalty paid for that know-how will not be includible in the value. If however the payment is made for the seller providing the importer technical information necessary to assemble and/or use the goods for the purpose for which they are designed, that payment would be includible in value. It is to be noted that technical know-how is in many respects similar to a process patent but with a significant difference; there is no legal bar to the licensee developing the know-how for himself without paying anyone else for the technology. A payment made for technical information concerning a process or operation would not be includible in value if the importer shows that the process could be carried out by similar goods obtained from other suppliers, who manufacture them without specialized information from the licensor or the importer.

(c) Patent Right:

Patent right is an authority to an individual or a company conferring the sole right to make use or sell some invention. An invention or technological process is thus protected by a patent. The patent right can give rise to different situations as follows:

i. The most common situation would be where the imported goods or the process by which the goods are manufactured is covered by a patent which is owning by or licensed to the manufacturer-exporter. Here the manufacturer could not make the goods without the patent rights - either by owing it or by getting the licence from the third party patent owner. Therefore, the costs associated with the patent rights have to be included in Customs value, since patents are essential for manufacture of the goods and these cannot be separated from the imported goods.

ii. In a situation where the imported goods are manufactured under a process patent owned by a third party, the seller would normally require the importer to pay royalty or licence fee to the third party, who holds the process patent. This payment would be includible in value.

iii. In a situation where the imported goods, whether or not produced under patent process, are covered by a product patent and the importer has to pay royalty as a condition of sale, this payment would be added to value.

iv. Where the patent used by the manufacturer is owned by importer there is no payment for the patent licence, and no question of any addition to value. If however, the importer has acquired the patent right against a payment to the third party patent holder, so as to enable the manufacturer to produce the goods, such indirect payment would have to be included in value.

v. Where the patents are to be used in the country of importation after importation of the goods, these would relate to post-importation activity and the imported goods will not be involved. Such patents may be product-patents used for the production or assembling of new patented products out of the imported goods, or they may be process patents for manufacture of new products. The royalty paid for such patents cannot be related to imported goods. However, if the
process patent can only be used with the imported machine, then a royalty paid to the foreign manufacturer will necessarily be for the imported machine as a condition of sale. In such a case the process patent can be said to be incorporated in the goods and the royalty paid for it will be included in value.

It would be useful to refer to the Advisory Opinions 4.1, 4.3, 4.4 and 4.12 on the subject matter of patent rights discussed later in this chapter.

(d) Copyright & Reproduction Rights:

The right to reproduce imported goods in the country of importation, including the right to manufacture from a model and to multiply has to be regarded as being basically related to the other goods yet to be produced and not to the imported goods. Therefore, there is no question of inclusion of payment for reproduction in the Customs value. This has been confirmed in interpretative note to Article 8 (1) (c). Reference to Advisory Opinion 4.2 would also be useful.

(e) Distribution Rights:

An importer who purchases the goods would naturally like to sell or distribute the imported goods unless it is meant for his own consumption. The interpretative note states that the payment made for the right to distribute or resell the imported goods would not be included in the value if such payments are not a condition of the sale. In practice, in majority of cases, where importations are not for personal consumption and for resale/distribution, the payments for right to resell or distribute are made as a condition of sale between the buyer and the seller and must therefore be included in value. In this context, Advisory Opinion 4.2 and 4.10 may be referred to.

Forms of Royalty Payment

The royalty/licence fee payments may be in different forms - one time lumpsum, repeated installments (monthly, quarterly or annually), or sometimes an initial lumpsum followed by repeated installments. The installments are usually calculated as a percentage of the sale-proceeds of the licensed product. The method of calculating the royalty payment is less material than the purpose of payment. The key issue is not how the royalty is calculated, but why it is paid, i.e. what the importer receives in return for the royalty payment.

Includibility of Royalty vis-à-vis Art.8.3 – Interpretative Note Art. 8.3

It is to be noted that a combined reading of Article 8.1 (c) and 8.3 would indicate that only the quantifiable royalty payments in respect of imported goods would form part of Customs value. Royalty payments have to be quantified and allotted to the individual consignments on a per unit basis of the imported goods for addition to the invoice price. If however, it is not quantifiable in terms of Article 8.3, no adjustment of invoice price can be made under Article 8, thereby rendering Article 1 inapplicable altogether.

In such an event, ‘value’ will have to be determined by any of the subsequent methods - and the question of making additions for ‘royalty’ would become irrelevant. The Interpretative Note to Article 8.3 clarifies as illustration that, if the royalty is based partially on the imported goods and partially on other factors which have nothing to do with the imported goods, or when the royalty cannot be distinguished from special financial arrangements between the buyer and the seller, it would be inappropriate to
attempt to make an addition for the royalty.

**Interpretative Note to Article 8.1 (c) – Payments not includible**

The Interpretative Notes to Article 8.1 (c) in respect of royalties and licence fees explain as follows:

1. “The royalties and licence fees referred to in Article 8.1 (c) may include among other things, payments in respect to patents, trademarks and copyrights. However, the charges for the right to reproduce the imported goods in the country of importation shall not be added to the price actually paid or payable for the imported goods in determining the Customs value.

2. Payments made by the buyer for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable for the imported goods if such payments are not a condition of the sale for exports to the country of importation of the imported goods.”

The Interpretative Notes thus debar specifically two types of charges from being included in the value; these are (a) the charges for the right to reproduce the imported goods (prototypes/models etc.) in the country of importation and (b) the payments made for the right to distribute or resell the imported goods, if such payments are not a condition of the sale.

**Commentary 19.1 on "Meaning of the Expression, 'Rights to Reproduce the Imported goods' within the meaning of the Interpretative Note to Article 8.1 (c)"**

1. This commentary seeks to provide guidance on the types of activities intended to be covered by the phrase “right to reproduce”. The Interpretative Note to paragraph 1 (c) of Article 8 provides that the terms “royalties” and “license fees” appearing in Article 8.1 (c) include, among other things, “payments in respect to patents, trademarks and copyrights”. The Interpretative Note goes on to say that “the charges for the right to reproduce the imported goods in the country of importation shall not be added to the price actually paid or payable for the imported goods in determining the Customs value”.

2. As it appears in the Interpretative Notes to Article 8.1(c), the term “right to reproduce” would seem to refer not only to the physical reproduction of the imported goods (e.g., a sample article is imported and a mould is produced by the importer which is used to manufacture exact copies of the original imported article) but also to the right to reproduce an invention, creation, thought or idea incorporated in the imported goods. Examples of the latter would include an importation of a schematic diagram containing newly developed circuitry to be etched onto circuit boards (invention), an importation of a sculpture by a museum to be reproduced into miniature versions for resale (creation) and an importation of a transparency embodying a drawing of a cartoon character to be reproduced on to greeting cards (thought or idea).

3. It would also refer to originals and copies of scientific works (such as the importation of a new strain of bacterium which will be reproduced into a form necessary for the production of a vaccine), originals of literary works (such as an importation of a manuscript for the purpose of reproduction into a book), models (importation of a scaled down model of a new type of automobile to be reproduced into other identical models), prototypes (a prototype of a new toy which will be reproduced into exact copies of the new toy) and animal or plant species (a genetically altered insect which will be reproduced
to combat the spread of the original species).

4. With respect to the right of reproduction, an analysis of the following elements may provide some direction:

   a. whether an idea or original work is incorporated in the imported goods;
   b. whether the reproduction of the idea or work is the subject of a reserved right;
   c. whether the right of reproduction has been assigned to the buyer in the contract of sale or through a separate agreement;
   d. whether the holder of the reserved right has required a remuneration for the assignment of the right of reproduction.

5. The acquisition of goods covered by a reserved right usually does not, of itself, confer the right to reproduce those goods. In many cases, that right is obtained through a special agreement.

6. In conclusion, each situation involving the right of reproduction should be considered on a case by case basis."

**WCO Advisory opinions on treatment of Royalty & License fee**

There are thirteen Advisory Opinions on Royalty and Licence fee. These are reproduced below serially:

**A.O.4.1**

"1. When a machine manufactured under a patent is sold for export to the country of importation at a price exclusive of the patent fee, which the seller has required the importer to pay to a third party who is the patent holder, should the royalty be added to the price paid or payable under the provisions of Article 8.1 (c) of the Agreement?

   2. The Technical Committee on Customs Valuation expressed the following view.

   The royalty should be added to the price actually paid or payable in accordance with the provisions of Article 8.1 (c) since the payment of the royalty by the buyer is related to the goods being valued and is a condition of sale of those goods."

**A.O.4.2**

"1. Phonograph records of a musical performance are purchased by an importer from a manufacturer. Under the laws of the country of importation when he resells the records the importer is required to pay a royalty of 3% of the sale price to a third party, the author of the musical composition, who holds a copyright. No part of the royalty accrues directly or indirectly to the manufacturer, nor is it paid as an obligation under the contract of sale. Should the royalty be added to the price actually paid or payable?

   2. The Technical Committee on Customs Valuation expressed the following view.

   The royalty should not be added to the price actually paid or payable in determining the Customs value; payment of the royalty is not a condition of the sale for export of the imported goods but arises from a legal obligation on this importer to pay the copyright holder when the records are sold in the importing country."
A.0.4.3

"1. Importer I acquires the right to use a patented process for the manufacture of certain products and agrees to pay the patent holder H a royalty on the basis of the number of articles produced using that process. In a separate contract, I designs and purchases from foreign manufacturer E a machine which is specially intended to perform the patented process. Is the royalty on the patented process part of the price paid or payable for the imported machine?

2. The Technical Committee on Customs Valuation expressed the following view.

Although the payment of the royalty in question is for a process embodied in the machine and one which constitutes the sole use of the machine, this royalty is not part of the Customs value since its payment is not a condition of the sale of the machine for export to the importing country."

A.0.4.4

"1. A patented concentrate is purchased by importer I from manufacturer M who is also the patent holder: the imported concentrate is simply diluted with ordinary water and consumer- packed before it is sold in the importing country. In addition to the price of the goods, the purchaser is required to pay to manufacturer M, as a condition of sale, a royalty for the right to incorporate or use the patented concentrate in products intended for resale. The amount of the royalty is calculated on the sale price of the finished product.

2. The Technical Committee on Customs Valuation expressed the following view.

The royalty is a payment related to the imported goods that the buyer is required to pay as a condition of sale of those goods and accordingly should be added to the price actually paid or payable in accordance with Article 8.1 (c). This opinion refers to a royalty paid for the patent incorporated in the imported goods and is without prejudice to other situations."

A.0.4.5

"1. Foreign manufacturer M owns a trademark protected in the country of importation. Importer I makes and sells under M’s trademark six types of cosmetics. I is required to pay M a royalty calculated as 5% of his annual gross sales of all cosmetics sold under M’s trademark. All of the cosmetics are manufactured to M’s formula from ingredients obtained in the country of importation, with the exception of one for which the essential ingredients are normally purchased from M. How is the royalty to be treated with respect to the imported ingredients?

2. The Technical Committee on Customs Valuation expressed the following view.

The royalty is payable to M irrespective of whether I uses M’s ingredients or those from local suppliers; it is therefore not a condition of sale of the goods, and for valuation purposes cannot be added by virtue of Article 8.1 (c) to the price actually paid or payable."

A.0.4.6

"1. An importer makes two separate purchases of a concentrate from foreign manufacturer M. M owns a trademark which may or may not be applied to the goods when they are sold after dilution depending on the terms of a particular sale for importation. The fee for use of the trademark is paid on a per unit basis. The imported concentrate is simply
diluted with ordinary water and consumer-packed before sale. In the first purchase, the concentrate is diluted and resold without trademark with no requirement that the fee be paid. In the second case, the concentrate is diluted and resold with trademark and as a condition of the sale for import there is a requirement for payment of the fee.

2. The Technical Committee on Customs Valuation expressed the following view. Since the goods in the first purchase are resold without the trademark and no fee is paid, an addition is not appropriate. In the second purchase the fee required to be paid by M must be added to the price actually paid or payable for the imported goods."

A.0.4.7

"1. An agreement is entered into between record company R and artist A, both established in country of export X. According to the agreement, A is to receive a royalty payment for each recording sold at retail in consideration for A's assignment of worldwide reproduction, marketing and distribution rights. R subsequently enters into a distribution and sales agreement with importer I to supply I with records which reproduce a performance by the artist A for resale in the country of importation. As a part of that agreement, R subassigns the marketing and distribution rights to I and requires from I, in return, a royalty payment of 10% of the retail selling price of each record purchased and imported into the country of importation. I submits the 10% payment to R.

2. The Technical Committee on Customs Valuation expressed the following view. The royalty payment is a condition of sale because I is required to pay this amount as a consequence of the distribution and sales agreement with R. In order to protect his commercial interests R would not have sold the records to I if I had not agreed to those terms.

The payment is related to the goods being valued as it is made for the right to market and distribute the particular imported goods and the amount of the royalty will vary according to the actual selling price of a particular record.

The fact that R is obliged, in turn, to pay a “royalty” amount to A in respect of worldwide sales of A’s performances, is not relevant vis-à-vis the contract between R and I. I is making the payment directly to the seller and it is of no concern or interest to I how R allocates his gross income receipts. The 10% royalty payment, therefore, should be added to the price actually paid or payable."

A.0.4.8

"1. Importer I enters into a license/royalty agreement with license holder L established in country X under which I agrees to pay L a fixed sum of royalty for each pair of shoes bearing the trademark of L imported into the country of importation. License holder L provides art and design work relating to the trademark. Importer I concludes another agreement with manufacturer M of country X for the purchase of shoes bearing the trademark of L affixed to the shoes by M, supplying M with the art and design work provided by L. Manufacturer M is not licensed by L. This sales agreement does not contain any reference to the payment of royalty. The manufacturer, the importer and the licensor are all unrelated.

2. The Technical Committee on Customs Valuation expressed the following view. The importer is required to pay a royalty to obtain the right to use the trademark. This
obligation results from a separate agreement unrelated to the sale for export of the goods to the country of importation. Goods are purchased from a supplier under another contract and payment of royalty is not a condition of sale of these goods. Therefore, the royalty payment in this case is not to be added to the price actually paid or payable.

Whether the supply of the art and design work relating to the trademark would qualify as dutiable under the provisions of Article 8.1 (b) is a separate consideration."

A.0.4.9

"1. An agreement is entered into between the manufacturer/trademark holder of certain veterinary preparations and an import company. Under the agreement, the manufacturer grants the importer the exclusive right to manufacture, use and sell in the country of importation, “Licensed Preparation”. These licensed preparations containing imported cortisone in a form suitable for veterinary use, are made from hulk cortisone supplied to the importer by or on behalf of the manufacturer. Cortisone is a standard, non-patented, anti-inflammatory agent, available from different manufacturers and is one of the main ingredients of the licensed preparations.

The manufacturer also grants the importer the exclusive right and license to use the trademark in connection with the manufacture and sale of licensed preparations in the country of importation.

The payment provisions of the agreement provide for the importer to pay the manufacturer a royalty at the rate of 8% of the first 2 million c.u. net sales of licensed preparations in any one calendar year, and 9% of the next 2 million c.u. net sales of licensed preparations in the same calendar year. A minimum royalty of 100,000 c.u. per year is also provided for. Under various circumstances outlined in the agreement, both parties could convert the importer’s exclusive rights to non-exclusive rights. In which case, the minimum royalty would be reduced by 25% or, in some cases by 50%. Royalties based on sales could also be reduced under certain circumstances.

Finally, royalties based on sales of licensed preparations are payable within 60 days following the end of each quarter of the calendar year.

2. The Technical Committee on Customs Valuation expressed the following view.

The royalty payment is made for the right to manufacture the licensed preparations containing the imported product and eventually for the use of the trademark for the licensed preparation. The imported product is a standard, non-patented anti-inflammatory agent. The use of the trademark, therefore, is not related to the goods being valued. Payment of royalty is not a condition of the sale for export of the imported goods but a condition for manufacture and sale of the licensed preparations in the country of importation. Accordingly, it would not be appropriate to add this payment to the price actually paid or payable."

A.0.4.10

"1. Outer garments are purchased by importer I in country P from manufacturer M located in country X. M is also the holder of a trademark related to certain comic strip characters. According to the provisions of the license agreement between I and M, M would produce the garments only for I and affix the comic strip characters and the trademark before the importation and I would resell these garments in country P. In consideration of this right. I agrees to pay M, in addition to the price for the garments. a
license fee calculated as a percentage of the net selling price of the garments to which the comic strip characters and the trademark are affixed.

2. The Technical Committee on Customs Valuation expressed the following view. The payment of the license fee for the right to resell the imported garments containing trademarked material is made a condition of the sale and relates to the imported goods. The imported goods can not be bought and resold without the comic strip characters and the trademark. Therefore, this payment should be added to the price actually paid or payable."

A.0.4.11

"1. Sportswear manufacturer M and importer I are both related to parent company C which owns the rights of a trademark which is affixed to the sportswear. In the sales contract between M and I there is no requirement for the payment of royalty. I, however, in accordance with a separate agreement with C is obliged to pay a royalty to C in order to obtain the right to use the trademark which is affixed to the sportswear I purchased from M. Is the royalty payment a condition of sale of, and related to, the imported sportswear?"

2. The Technical Committee on Customs Valuation expressed the following view. The sales contract between M and I covering trademarked goods does not contain specific conditions with respect to royalty payments. However, the payment in question is a condition of sale as I is obliged to pay the royalty to the parent company as a result of buying the goods. I does not have the right to use the trademark without payment of the royalty. The fact that there is no written contract with the parent company does not detract from the obligation of I to make a payment as required by the parent company. For reasons stated above, payments for the right to use the trademark are related to the goods being valued and the amount of the payments should be added to the price actually paid or payable."

A.0.4.12

"1. Importer I and seller S enter into a sales contract for the supply of rolling mill equipment. This equipment is to be incorporated into a continuous copper rod plant already existing in the country of importation. Incorporated in the rolling mill equipment is technology involving a patented process which the rolling mill is intended to perform; The importer, in addition to the price of the equipment has to pay 15 million c.u. as license fee for the right to use the patented process. Seller S will receive payment for the equipment and the license fee from the importer, and will then transfer the entire amount of the license fee to the licensor.

2. The Technical Committee on Customs Valuation expressed the following view. The license fee is for a technology incorporated in rolling mill equipment which enables it to perform the patented process. The rolling mill equipment has been purchased specifically to carry out the patented production process. Thus, since the process for which the 15 million c.u. license fee is paid is related to the goods being valued and is a condition of the sale, it should be added to the price actually paid or payable for the imported rolling mill equipment."

A.0.4.13

"1. Importer I purchases sports bags from foreign manufacturer M, as well as from
other suppliers. Importer I, manufacturer M and other suppliers are all unrelated.

Importer I, on the other hand, is related to company C which holds the right of a trademark. Under the terms of a contract between I and C, C transfers the right to use the trademark to I against a royalty payment. Importer I furnishes manufacturer M and other suppliers with labels bearing the trademark which are affixed to the sports bags before the importation.

Is the royalty related to the goods being valued? Does the payment from I to C form part of a condition of sale between M and I, and I and other suppliers?

2. The Technical Committee on Customs Valuation expressed the following view.

Although the importer is required to pay a royalty to obtain the right to use the trademark, this results from a separate agreement unrelated to the sale for export of the goods to the country of importation. The imported goods are purchased from various suppliers under different contracts and the payment of the royalty is not a condition of the sale of these goods. The buyer does not have to pay the royalty in order to purchase the goods. Therefore, it should not be added to the price actually paid or payable as an adjustment under Article 8.1 (c). Whether the supply of labels evidencing a trademark would qualify as dutiable under the provisions of Article 8.1 (b) is a separate consideration."

**Delivery Costs – Article 8.2**

**General Discussion**

Article 8.2 authorizes the Members to have the option of including or excluding from the Customs value, in whole or in part certain elements of Delivery Costs, viz cost of transport, loading, unloading and handling charge and the Cost of Insurance. Nepal has opted for including these Delivery Costs in the Customs value.

**Elements of Delivery Cost**

The different elements of Delivery Costs are:

a) Cost of transport to the port or place of importation
b) Loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation
c) Cost of Insurance

**a) Cost of Transportation**

The cost of transport of the goods to the place of importation will also include all inland transport costs in the country of exportation, apart from the freight charges that would have been paid for transportation from the place of export to the place of importation. Even where it is a case of gratis transport or where the buyer’s own transport is used and therefore transport costs are not included in the price actually paid or payable for the goods, an amount for transport costs to the place of importation is to be included in the Customs value.

Transport costs within the country of importation will however have to be
deducted in cases where such transport costs are included in the total freight charges. This has been made clear in Interpretative Note to Article 1 also, where it has been *inter alia* explained that the value of the imported goods shall not include the cost of transportation after importation, provided such costs are distinguished from the price actually paid or payable.

In order to avoid any problem in the matter of importation by road, it may be worthwhile to have a look at the EEC practice in this regard, since a good quantity of importation takes place by road in Nepal. On this matter, the Article 15 of the EEC regulation No. 1224/80 is reproduced below:

"1. The Customs value of imported goods shall not include the cost of transport after importation into the Customs territory of the Community provided that such cost is distinguished from the price actually paid or payable for the imported goods.

2. (a) Where goods are carried by the same means of transport beyond the place of introduction into the Customs territory of the Community, transport cost shall be assessed in proportion to the distance covered outside and inside the Customs territory of the Community, unless evidence is produced to the Customs authorities to show the costs that would have been incurred under a general compulsory schedule of freight rates for the carriage of the goods to the place of introduction into the Customs territory of the Community.

The preceding paragraphs shall not apply to goods sent by post. Special provision may be adopted for such goods in accordance with the procedure laid down in Article 19, in view of the special nature of charges in international postal services.

(b) Where goods are invoiced at uniform free domicile price which corresponds to the price at the place of introduction, transport costs within the community shall not be deducted from that price. However, such deduction shall be allowed if evidence is produced to the Customs authorities that the free-frontier price would be lower than the uniform free domicile price."

In order to take care of exigencies where transportation costs are not ascertainable, it may be necessary to provide for such costs on the basis of a certain percentage of the f.o.b. value which would be different for sea freight, airfreight, truck transportation etc.

b) **Loading, unloading and handling charges:**

Nepal, having opted for including the Delivery Costs in the Customs value, the loading unloading and handling charges associated with the transport of the goods to the place of importation would be includible in value. Nepal, being a land-locked country, the goods freighted by sea arrive here finally through land routes. Therefore, there is no dispute about includibility of the loading, unloading and handling charges at the sea-port of the neighboring country through which the transit takes place, because these expenses are incurred much before the importation into Nepal takes place.

The inclusion of 'loading' charges refers to the possibility that carriage and freight charges may not be all-inclusive from the point of origin to the place of importation. There may also be expenses prior to the commencement of the
journey of the goods to which these 'loading' charges would relate. In addition, there may also be container terminal expenses at the place of exportation, which might not have been included in the carriage and freight charges. The container terminal costs in the country of importation, which are separately charged, will however not be includible in the value. The words "unloading" and "handling" charges would refer to the activities of unloading and handling before the goods are delivered at the place of importation. In term of Article 8.2 (b) therefore, the unloading and handling charges both at the place of exportation, as well as the place of importation would have to be included in value, if the carriage and freight charges do not already include such unloading and handling charges.

Depending on the point upto which loading, unloading and handling charges for delivery at the place of importation are to be included under clause (b), the freight and carriage charges should be analyzed to ascertain if any of those charges are already included therein, and if so, to what extent: the uncovered part thereof would need to be added. It goes without saying that all these considerations mainly relate to importation by sea, that the further additions to be made under clause (b) would depend on the nature of the freight contract and the port usages including carriage to temporary storage centres and handling charges there.

c) Cost of Insurance

The CCC Technical Committee vide their Advisory Opinion 13.1 on the scope of the word "Insurance" under Article 8.2 concerns charges connected with the shipment of the imported goods (cost of transport and transport related costs). Hence the word "Insurance" should be interpreted as referring solely to insurance costs incurred for the goods during the operations specified in clauses (a) & (b).

Therefore, where the goods are insured against loss or damage in transit in such a way that there is a separate insurance cover for the journey after the arrival of the goods at the place of importation, the cost of this separate insurance cover is not to be included in the Customs value.

**Obligation to use objective and quantifiable data – Article 8.3**

While the Articles 8.1 and 8.2 deal with the elements of payments that would have to be included in value, Article 8.3 makes it clear that additions to the price actually paid or payable, envisaged in Article 8, shall be made on the basis of objective and quantifiable data. Therefore, in cases where objective and quantifiable data are not available, no addition can be made under Article 8, notwithstanding the provisions of Article 8.1 and 8.2. The Interpretative note to Article 8.3 clarify that where objective and quantifiable data do not exist for the purpose of Article 8, the transaction value cannot be determined under the provisions of Article 1. While the expression "objective and quantifiable data" has not been defined in the Valuation Code, the illustration given in the Interpretative Note to Article 8.3 in respect of royalty payment amount gives some idea as to what this expression means in the context of Article 8.

The **Interpretative Note to Rule 8.3** is reproduced below:

"Where objective and quantifiable data do not exist with regard to the additions required to be made under the provisions of Article 8, the transaction value cannot be determined under the provisions of Article 1. As an illustration of this, a royalty is paid on the basis of the price in a sale in the importing country of a litre of particular product that was
imported by the kilogram and made up into a solution after importation. If the royalty is based partially on the imported goods and partially on other factors which have nothing to do with the imported goods (such as when the imported goods are mixed with domestic ingredients and are no longer separately identifiable, or when the royalty cannot be distinguished from the special financial arrangements between the buyer and the seller) it would be inappropriate to attempt to make an addition for the royalty. However, if the amount of this royalty is based only on the imported goods and can be readily quantified, an addition to the price actually paid or payable can be made."

Embargo not to go beyond Article 8 – Article 8.4

In reference of price adjustments, Article 8.4 puts an embargo in clear terms that no addition shall be made to the price actually paid or payable in determining the transaction value except as provided in Article 8. In fact Article 8.4 complements Article 1 which inter alia states that the transaction value would be the price actually paid or payable, adjusted in accordance with the provisions of Article 8. In respect of price adjustments thereof, there is no scope to go outside the purview of Article 8.1 to 8.3. Enforcement of Article 8.3 in both letter and spirit also thus attains special significance.
Lesson 5
Transaction Value Method: Restrictions, Conditions and Related Parties
(General Rules)

General Discussion on Conditions of Article 1.1(a) to (d)

Article 1 stipulates that the transaction value method as given at Article 1.1 shall be used for determination of value, provided the four conditions specified in clauses (a) to (d) of Article 1 are satisfied. The first condition at clause (a) relates to the restriction, as to the disposal or use of the goods by the importer. The second condition related to monetary value of a consideration. The third condition relates to related party transaction, and the fourth condition relates to receipt by the foreign seller of part of the proceeds of resale or disposal of the imported goods. It is only when a transaction does not satisfy any of the said four conditions that the transaction value under Article 1 cannot be determined, and the Customs value as to be determined with the help of subsequent methods by proceeding sequentially.

Condition stipulated at Article 1.1 (a) relating to certain Restrictions

In terms of Article 1.1 (a) transaction value under Article 1 shall be accepted provide that there are no restrictions as to the disposition or use of the goods by the buyers; certain permissible restrictions have however been specified in sub-clauses (i) to (iii) of Article 1.1 (a). These permissible restrictions are those which:

(i) are imposed or required by law or by the public authorities in the country of importation i.e. Nepal.

(ii) limit the geographical area in which the goods may be resold.

(iii) do not substantially affect the value of the goods.

This proviso relating to restriction has been adopted in the Code from the old US Customs Valuation Law, in terms of which if the goods were sold subject to a restriction, it was considered as being sold for a price less than the one it should have been sold for, and therefore that price was not accepted as ‘value’.

The restriction proviso thus attempts to clarify that the sale should be a normal sale. It also suggests that the sale is one which should give full title to the buyer. If there are tight restrictions in the transaction, then the full ownership of the goods by the importer and consequently the existence of a ‘sale’ within the meaning of the Valuation Code can be questioned. It is also noteworthy that this proviso, applies only to restrictions on “disposition or use” of the goods by the buyer; there is no mention of restriction on ‘subsequent resale’. It may be seen that in contrast Article 1.1 (c) which covers the proviso relating to ‘proceeds’, uses the expression “the proceeds of any subsequent resale, disposal or use” of the goods by the buyer. The omission of restrictions on subsequent resale would thus seem to permit application of T.V. despite certain restriction on resale, e.g. as in the case of sales to Original Equipment Manufacturer (OEM). For example, a T.V. Remote Control manufacturer, while selling his item for export to a T.V. manufacturer, may put a restriction that the T.V. manufacturer will sell the remote control only as part of the T.V. and he will not sell it separately as replacement. Such restrictions on the marketing of the imported goods, which are usual in trade should not come in the way of application of
T.V.

**Interpretative Note to Article 1.1 (a) (iii) – Restrictions**

This Interpretation Note makes only a brief reference to the restriction with regard to a permissible restriction. The Interpretative Note is as follows:

“Among the restrictions which would not render a price actually paid or payable unacceptable are restrictions which do not substantially affect the value of the goods. An example of such restrictions would be the case where a seller requires a buyer of automobiles not to sell or exhibit them prior to a fixed date which represents the beginning of a model year.

The example given in this note may be too obvious, but at least it gives an indication that the scope of the restriction proviso should not be usually enlarged.

The Code permits such restrictions which do not substantially affect the value of the goods. The word ‘substantial’ is significant and has to be appropriately construed. Even where the price may be affected by a certain otherwise non-permissible restriction [i.e. other than those covered by sub-clauses (i) and (ii)], it has necessarily to be examined in the context of business considerations whether value for the importer has been substantially affected. The following WCO Commentary 12.1 would throw more light on this matter.

**Commentary 12.1 on "Meaning of the term 'Restrictions' in Article 1.1 (a) (iii)"**  The Commentary 12.1 is extracted below:

1. Under the provisions of Article 1 of the Agreement the Customs value of imported goods shall be the transaction value provided, inter alia, there are no restrictions as to the disposition or use of the goods by the buyer other than those which:
   i. are imposed or required by law or by the public authorities in the country of importation;
   ii. limit the geographical area in which the goods may be resold; or
   iii. do not substantially affect the value of the goods.

2. Due to their nature, identification of the first two exceptions noted above would not normally create problems. In the case of the third exception, however, a number of factors may have to be taken into consideration to determine whether the restriction has substantially affected the value or not. These factors include the nature of the restriction, the nature of the imported goods, the nature of the industry and its commercial practices, and whether the effect on the value is commercially significant. Since these factors may vary from case to case, it would not be proper to apply a fixed criterion in this respect. For example, a small effect on the value in a case involving one type of goods may be treated as substantial while a much greater change in the value of goods of another type may not be treated as substantial.

3. An example of restrictions as to the disposition or use of the goods which do not substantially affect the value of the goods is mentioned in the Interpretative Notes to Article 1, i.e. : where a seller requires a buyer of automobiles not to sell or exhibit them prior to a fixed date which represents the beginning of a model year. Another
such example would be where a manufacturing firm of cosmetics imposes through contractual provisions a requirement on all importers that its product be sold to consumers exclusively through individual sales representatives undertaking house-to-house sales since its whole distribution system and advertising approach is based on this kind of sales effort.

4. On the other hand, a restriction which could have a substantial effect on the value of the imported goods is one that is not usual in the trade concerned. An example of such a restriction would be the case where a machine is sold at a nominal price on condition that the buyer uses it only for charitable purposes."

**Conditions in Article 1.1 (b)**

The condition for applying the transaction value method, as provided in Article 1.1 (b) is based on the principle of the doctrine of impossibility. The determination of circumstances under which one can conclude that a value for the consideration cannot be determined is a grey area. The Interpretative Note to Article 1.1 (b) clarifies this grey area to a great extent.

**Interpretative Note to Article 1.1 (b) is extracted below:**

"**Paragraph 1 (b)**

1. If the sale or price is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued, the transaction value shall not be acceptable for customs purposes. Some examples of this include:

   a) the seller establishes the price of the imported goods on condition that the buyer will also buy other goods in specific quantities;
   
   b) the price of the imported goods is dependent upon the price or prices at which the buyer of the imported goods sells other goods to the seller of the imported goods;
   
   c) the price is established on the basis of a form of payment extraneous to the imported goods, such as where the imported goods are semi-finished goods which have been provided by the seller on condition that he will receive a specified quantity of the finished goods.

2. However, conditions or considerations relating to the production or marketing of the imported goods shall not result in rejection of the transaction value. For example, the fact that the buyer furnishes the seller with engineering and plans undertaken in the country of importation shall not result in rejection of the transaction value for the purposes of Article 1. Likewise, if the buyer undertakes on his own account, even though by agreement with the seller, activities relating to the marketing of the imported goods, the value of these activities is not part of the customs value nor shall such activities result in rejection of the transaction value."

**Advisory Opinion 16.1 on "Treatment of a situation where the sale or price is subject to some condition or consideration for which a value can be determined with respect to the goods being valued."**

"1. What treatment should be given to the situation where the sale or price is subject to some condition or consideration for which a value can be determined with respect to the goods being valued?"
2. The Technical Committee on Customs Valuation expressed the following view.

According to clause (h) of Article 1.1 the Customs value of the imported goods cannot be established on the basis of the transaction value if the sale or price is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued.

The provision of clause (b) of Article 1.1 should be interpreted to mean that if the value of a condition or consideration can be determined with respect to the goods being valued, the Customs value of the imported goods should, subject to the other provisions and conditions of Article 1, be the transaction value as determined under that Article. Interpretative Notes to Article 1 and Annex III make it very clear that the price actually paid or payable is the total payment made by the buyer to or for the benefit of the seller, that the payment may be made directly or indirectly and that the price includes all payments actually made or to be made by the buyer to the seller, or by the buyer to a third party. Thus the value of the condition, when it is known and relates to the imported goods, is a part of the price actually paid or payable.

It should rest with individual administrations as to what they consider would be sufficient information to specifically determine the value of a condition or consideration."

Commentary 2.1 relating to the valuation treatment of "goods subject to Export Subsidies or Bounties", which was discussed at previous paragraph 3.1.5.6 is again extracted below in the context of application of the condition of Article 1.1 (b).

"1. Broadly speaking, export subsidies and bounties are instruments of trade policy which take the form of economic aid granted by governments to natural or legal persons or to administrative bodies, either directly or indirectly; they are intended to promote the production, manufacture or exportation of a product. In this respect the Agreement on Subsidies and Countervailing Measures refers.

Conditions in Article 1.1 (c)

In terms of the condition specified in clause (c) of the Article 1.1, the seller must not receive such part of proceeds of resale, use or disposal of the goods by the buyer, the share of which cannot be evaluated. In other words, if the seller receives, directly or indirectly, part of the proceeds of the buyer’s resale, use or disposal of the imported goods, the buyer must be able to quantify the amount and make an appropriate addition under Article 8, so as to be able to account for this flow-back.

This provision is yet another application of the doctrine of impossibility. Plainly speaking, if proceeds of subsequent resale, use or disposal are received by the seller, an addition of such proceeds will have to be made under Article 8 if it can be quantified, and if such evaluation of such repatriated proceeds cannot be made, T.V. has to be rejected. This provision will be better understood when read in conjunction with the provisions of Article 8.1(d) dealing with price adjustments for proceeds. It is also important to note that Article 1.1 (c) refers to those situations where the proceeds are dutiable under Article 8.1(d) but whose quantification cannot be done.

Related Party Transactions.

This being an important subject is being dealt with separately later in this chapter at paragraph 3.1.8.
**Price to be adjusted in accordance with the provisions of Article 8 General Discussion**

The root of Article 8 of the Agreement can be traced to the Draft Valuation Code prepared by the European Community (EC) in November, 1977. While submitting the Draft Valuation Code, the EC delegate had stated that Article 1 states that the price paid or payable for the imported goods shall be accepted as the basis for determining the Customs value provided that the buyer and seller are not related. The delegate however recognized that buyers and sellers, even when unrelated may be tempted to arrange the transactions in such a way that the price itself reflects only a small element of the value of the goods, and that the remainder is transferred between them by some indirect method. It is for this reason that the EC draft provided for certain additions to be made to the price paid or payable, if these have not been included in the basic price. However the basic concept is that if the price paid or payable fully reflects everything which the buyer has to pay to get the goods, then that is accepted as the basis for the Customs value. The EC proposal in Article 7 of their draft was finally incorporated as Article 8 of the GATT Valuation Code.

The price actually paid or payable for the goods, as provided in Article 1.1 includes, whatever way they are described, all payment made by purchaser to the seller or for the benefit of the seller in respect of goods being valued. Thus, the provisions of Article 8 regarding additions to price so as to arrive at T.V. may be said to be an amplification of the aforesaid fundamental provision. These additions are only to be made to the extent that a certain element is actually paid or payable by the buyer and not already included in the price.

The different elements to be included in the invoice value for arriving at the transaction value have been individually serialized in Article 8 of the Agreement. The same is reproduced below:

"**Article 8**

1. In determining the Customs Value under the provisions of Article 1, there shall be added to the price actually paid or payable for the imported goods:

   (a) the following, to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the goods:

      (i) commissions and brokerage, except buying commissions;

      (ii) the cost of containers which are treated as being one for Customs purposes with the goods in question.

      (iii) the cost of packing whether for labor or materials;

   (b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:

      (i) materials, components, parts and similar items incorporated in the imported goods;

      (ii) tools, dies, moulds and similar items used in the production of the imported goods;
(iii) materials consumed in the production of the imported goods;
(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary for the production of the imported goods;
(c) royalties and licence fees 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 fees are not included in the price actually paid or payable;
(d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

2. In framing its legislation, each Member shall provide for the inclusion in or the exclusion from the Customs value, in whole or in part, of the following:
   (a) the cost of transport of the imported goods to the port or place of importation;
   (b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation; and
   (c) the cost of insurance.

3. Additions to the price actually paid or payable shall be made under this Article only on the basis of objective and quantifiable data.

4. No additions shall be made to the price actually paid or payable in determining the Customs value except as provided in this Article.

Commissions and Brokerages except Buying Commission

General Discussion

Commission and Brokerage except Buying Commission are some elements of services which are specified in Article 8.1 (a) (i). The provisions of Article 8.1(a) (i) deal with the expenses incurred in intangibles like services viz. commissions and brokerages. While the Interpretative Note defines buying commission, the Explanatory Note 2.1 deals with commissions and brokerages in the context of Article 8. This Explanatory Note recognizes that the treatment of commission and brokerage for valuation depends upon the exact nature of services rendered by the intermediaries. After identifying the common characteristics of intermediaries, it concludes that national administration will need to take necessary reasonable measures to ensure the proper application of the provision, since the nature of the services rendered by the intermediaries are often not apparent from the commercial documents. Commentary 17.1 while dealing with “Buying Commission” provides guidelines regarding circumstances under which fees paid by a buyer to an intermediary can be considered as a buying commission. The interpretative Note and the aforementioned instruments are given below:

Interpretative Note to Article 8.1 (a) (i)

Definition of Buying Commission: The term “buying commissions” means fees paid by an importer to his agent for the service or representing him abroad in the purchase of the goods being valued.
Explanatory Note 2.1 on Commission and brokerage in the context of Article 8 of the Agreement is reproduced:

**Introduction**

1. Article 8, paragraph 1(a)(i) of the Agreement states that, in determining Customs value under the provisions of Article 1, commissions and brokerage, except buying commissions, shall be added to the price actually paid or payable to the extent that they are incurred by the buyer but are not included in the price.

   According to the Interpretative Note to Article 8, the term “buying commissions” means fees paid by an importer to his agent for the service of representing him abroad in the purchase of the goods being valued.

2. Commissions and brokerage are payments made to intermediaries for their participation in the conclusion of a contract of sale.

3. Although the legal position may differ between countries with regard to the designation and precise definition of the functions of these intermediaries, the following common characteristics can be identified.

**Buying and selling agents**

4. The agent (also referred to as an “intermediary”) is a person who buys or sells goods, possibly in his own name, but always for the account of a principal. He participates in the conclusion of a contract of sale, representing either the seller or the buyer.

5. The agent’s remuneration takes the form of a commission, generally, expressed as a percentage of the price of the goods.

6. A distinction can be made between selling agents and buying agents.

7. A selling agent is a person who acts for the account of a seller; he seeks customers and collects orders, and in some cases he may arrange for storage and delivery of the goods. The remuneration he receives for services rendered in the conclusion of a contract is usually termed “selling commission”. Goods sold through the seller’s agent cannot usually be purchased without payment of the selling agent’s commission. These payments can be made in the ways set out below.

8. Foreign suppliers who deliver their goods in pursuance of orders placed through a selling agent usually pay for the latter’s services themselves, and quote inclusive prices to their customers. In such cases, there is no need for the invoice price to be adjusted to take account of these services. If the terms of the sale require the buyer to pay, usually direct to the intermediary, a commission that is additional to the price invoiced for the goods, this commission must be added to the price when determining transaction value under Article 1 of the Agreement.

9. A buying agent is a person who acts for the account of a buyer, rendering him services in connection with finding suppliers, informing the seller of the desires of the importer, collecting samples, inspecting goods and, in some cases, arranging the insurance, transport, storage and delivery of the goods.

10. The buying agent’s remuneration which is usually termed 'buying commission' is paid by the importer, apart from the payment for the goods.
11. In this case, under the terms of paragraph 1 (a) (i) of Article 8, the commission paid by the buyer of the imported goods must not be added to the price actually paid or payable.

**Brokers (and brokerage)**

12. There is a somewhat theoretical difference between the terms “brokers” and “brokerage” on the one hand and the terms “buying/ selling agent” and “commissions” on the other; in practice there is no clear-cut distinction between the two categories. Moreover, in some countries the terms “broker” and “brokerage” are seldom, if ever, employed.

13. Where the term “broker” is in use, it generally refers to an intermediary who does not act for his own account; he acts for both buyer and seller and usually has no role other than to put both parties to the transaction in touch with each other. The broker’s remuneration is known as brokerage which is usually a percentage on the business concluded as a result of his activities. The percentage received by a broker is commensurate with his rather limited responsibilities.

14. Where the broker is paid by the supplier of the goods, the total brokerage will normally be included in the invoice price; in such cases, no problem arises with regard to valuation. In case it is not so included, and yet incurred by the buyer, it should be added to the price paid or payable; On the other hand, the broker may be paid by the buyer, or each of the parties to the transaction may pay part of the brokerage; in these cases, the brokerage should be added to the price and does not constitute a buying commission.

**Conclusion**

15. To sum up, when determining the transaction value of imported goods it will be necessary to include in that value commissions and brokerage incurred by the buyer, except buying commissions. Accordingly the question of whether or not payments made to intermediaries by the buyer and not included in the price actually paid or payable should be added to that price will depend, in the final analysis, on the role played by the intermediaries and not on the term (“agent” or “broker”) by which he is known. It is also clear from the provisions of Article 8 that commissions or brokerage payable by the seller but which are not charged to the buyer could not be added to the price actually paid or payable.

16. It may also be worth pointing out that the existence and nature of services rendered by intermediaries in connection with a sale are often not apparent from the commercial documents presented with the Customs declaration. In view of the importance of the interests at stake, national administrations will need to take whatever reasonable measures they consider necessary to ascertain the existence and precise nature of the services in question”

**Commentary 17.1 on Buying Commission**

The Commentary 17.1 whole dealing with the subject of Buying Commissions concluded that various avenues are available to Customs to verify the nature of the service in question. The Commentary 17.1 is reproduced below:

“1. The valuation treatment and the definition of buying commissions are stated in
paragraph 1(a) (i) of Article 8 of the Agreement and in its relevant Interpretative Note.

2. While the provisions of the Agreement are clear and raise no particular question of principle, the treatment of commissions for Customs valuation purposes depends upon the exact nature of services rendered by the intermediaries.

3. Explanatory Note 2.1 of the Technical Committee on Customs Valuation examines commissions and brokerage in the context of Article 8, identifying the common characteristics of intermediaries, and concludes that, since the nature of the services rendered by the intermediaries are often not apparent from the commercial documents, national administrations will need to take necessary reasonable measures to ensure the proper application of this provision of the Agreement.

4. This commentary provides guidelines on the question of the evidence necessary to establish under what circumstances fees paid by a buyer to an intermediary can be considered as a buying commission.

5. In this context, all relevant documents necessary to ascertain the existence and precise nature of the services in question should be made available to Customs.

6. Among such documents, one would be the agency contract between the agent and the buyer, stating the formalities and the activities which the agent may have to perform in the discharge of his duties up to the time that he puts the goods at the disposal of the buyer. The agency contracts should accurately reflect the terms of the agreement between the buyer and the agent and other documentary evidence such as purchase orders, telexes, letters of credit, correspondence etc. which clearly supports the bonafides of the agency contract are to be produced should Customs so request.

7. In cases where written agency contracts do not exist alternative documentary evidence, such as mentioned in paragraph 6 above, which clearly establishes the existence of an agency relationship is to be produced should Customs so request.

8. In cases where sufficient evidence establishing an agency relationship is not produced, Customs may conclude that no buying agency relationship exists.

9. Sometimes, the contracts or documents do not clearly represent or reflect the nature of the activities of the so-called agent. In such circumstances, it is essential that the actual facts of the case be determined and various factors, as explained below, be examined.

10. One of the questions which could be the subject of an enquiry is whether the so-called buying agent assumes any risk or performs additional services other than those which are indicated in paragraph 9 of Explanatory Note 2.1 and would normally be carried out by a buying agent. The extent of these additional services could affect the treatment of the buying commission. An example could be where the agent uses his own funds for the payment of the imported goods. This opens the possibility of the so-called buying agent sustaining a loss or gaining a profit arising from ownership of the goods rather than receiving an agreed fee from acting as a buying agent. In this situation, the totality of the circumstances which apparently establishes a buying agency arrangement may be examined.

11. The result of this enquiry could indicate that the agent is acting on his own account and/or that he has proprietary interest in the goods. In this respect, attention is drawn to export houses or so-called independent agents who carry out similar activities but, unlike buying agents have proprietary interest in the goods and exercise control over
the transaction or over the price paid by the importer. In these cases, the so-called intermediary in question cannot be considered as a buying agent.

12. Another factor to be examined is the relationship, within the meaning of Article 15.4, of the parties involved in the transaction. For instance, the relationship of the agent with the seller or with a person related to the seller has a bearing on the ability of the alleged agent to represent the buyer’s interest. Despite the existence of an agency contract, the Customs is entitled to examine the totality of the circumstances to determine whether the so-called agent is, in fact, acting on behalf of the buyer and not on the account of the seller, or even on his own account.

13. In certain transactions, the agent concludes the contract, re-invoices the importer distinguishing the price of the goods and his fee. The mere act of re-invoicing does not make him the seller of the goods. However, since the price paid to the supplier is the basis for the transaction value under the Agreement, the Customs may require the declarant to produce the invoice issued by the supplier and other documents to substantiate the declared value.

14. Failure by the importer to supply Customs with the commercial invoice from the supplier to the agent, or other satisfactory evidence of sale, may prevent Customs from verifying the price actually paid or payable in the purported sale for export to the country of importation and could preclude Customs form considering that sale as the bona fide sale for export.

15. The compatibility of fees charged in relation to services rendered could also be the subject of scrutiny. At times, a buying agent may perform other services which are outside the scope of the usual functions of a buying agent. These additional services would affect the fees charged to the buyer. For example, a buying agent instead of arranging the transport of the goods from the factory to the port or place of exportation, transports the goods himself and his charges include the cost of transport. In the above example, the total fee charged cannot be considered as buying commission; however, the identifiable portion of the fee that relates to the buying agency services may be considered as a buying commission.

16. On the basis of the above considerations it could be concluded that various avenues are available to Customs to verify the nature of the services in question. During this process administrations expect the full co-operation of the importers to establish the truth and accuracy of any statement, document or declaration as provided for in Article 17 of the Agreement and paragraph 6 of Annex IV. In this respect it is recognized that some of the information required by the Customs may be considered commercially confidential by the parties involved. In such cases Customs would be governed by the provisions of the Article 10 of the Agreement and by the legislation of the importing country.

**Cost of Containers and Packing –Article 8.1 (a)(ii)(iii)**

**Cost of Containers**

In terms of Article 8.1 (a) (ii), the cost of only those containers, 'which are treated as being one for Customs purposes with the goods’ to be assessed, will be includible in the transaction value. The containers covered by the sub-clause (ii) are distinguished from the
freight containers, the hire cost of which forms part of transport costs and delivery costs and thus are covered by Article 8.2. The sub-clause (ii) would also not relate to container terminal charges, that is charges for a variety of services in connection with the handling storage of freight containers at container depots; these charges would also be covered by Article 8.2.

The containers referred to in Article 8.1 (a) (ii) are generally items which have economic value of their own and are classified under the tariff item of the goods, contained in those containers. For example, in case of a whisky bottle, the cost of bottle will naturally be included in the price of the whisky. This clause ensures that the cost of the bottle is not excluded from the T.V. for whisky, in the event of an argument that it is only the whisky which is the “goods” referred to in the definition of T.V.

**Cost of Packing**

In terms of Article 8.1(a) (iii), the cost of packing, whether for labour or materials would be includible in the transaction value. The WTO valuation code thus makes a distinction between ‘container’ and ‘packing’ inasmuch as while the cost of packing in respect of labor or raw materials is includible in the transaction value without any reservation, the cost of containers is includible only when the containers are to be treated as being one with the goods being valued. Cost of packing is normally shown in invoices or other commercial documents as part of the price of the goods. Article 8.1 (a)(iii) ensures that the packing costs, in respect of both labor as well as raw materials, (to the extent that they are incurred by the buyer but not included in the invoice) are not left out from the transaction value of the goods.

**Related Party Transaction**

**General Discussion**

The transaction value in terms of Article 1 can be accepted as the Customs value provided all the four conditions set out in clauses (a) to (d) of Article 1 are satisfied. The fourth condition at Article 1.1(d) requires that the buyer and seller should not be related; and should they be related, the transaction value would be acceptable subject to the provisions of the Article 1.2 being satisfied. This textual construction means that the relationship between buyer and seller raises a question which serves to alert the importer and Customs as to the acceptability of the price as the basis of the transaction value. But that by itself would be no ground for rejection of transaction value. Thus the problem of related party transactions have been dealt with in a three-tier way. First, it has been defined in Article 15.4, as to what would constitute special relationship between the buyer and the seller and such relationships have been listed out. Secondly, it has been provided in Article 1.2 that relationship per se would not be a taboo so as to declare inapplicability of transaction value method. Thirdly, the different means of establishing the acceptability of a transaction value in case of related party transactions have been provided in Article 1.2. Two clauses (a) and (b) of Article 1.2 deal with two different means.

**Certain Basic Principles relating to valuation treatment of Related Party Transaction**

Certain basic principles are given below:

i. Relationship or its absence will have to be determined within the parameters laid down in Article 15.4 and 15.5.
ii. Even if buyer and seller are related (as defined), that’s still does not automatically rule out the use of price paid or payable for establishing the Customs value.

iii. Only where the relationship is proved to have influenced the ‘price’ such use as mentioned at ii above can be ruled out.

iv. On being alerted on the issue of relationship, the importer has the opportunity to adduce evidences to prove that relationship has not influenced the price.

v. Alternatively, the importer can rely upon ‘test values’ i.e. already accepted transaction value to unrelated buyer or deductive value, to identical or similar goods, so as to show that his own price closely approximates the same.

vi. Where a test value is met, it is not necessary to examine the question of influence on price.

vii. Article 2 (a) and 8 (b) provide different means to establish the acceptability of transaction value between related parties.

viii. Which method needs to be adopted would depend on availability of the required information concerning relationship, organization, marketing and prices.

ix. The ‘test value’ cannot be used as ‘value’ of the imported goods.

x. If the Customs officer, after consultation, does not accept the importer’s submissions and rejects the proposed transaction value, the determination of Customs value will then be made under one of the subsequent methods of valuation sequentially.

**Definition of Related Persons – Article 15.4**

Eight situations where the persons shall be deemed to be related have been specified in Article 15.4 which is reproduced below:

"For the purposes of this Agreement, persons shall be deemed to be related only if:

a. they are officers or directors of one another’s businesses;

b. they are legally recognized partners in business;

c. they are employer and employee;

d. any person directly or indirectly owns, controls or holds 5 percent or more of the outstanding voting stock or shares of both of them;

e. one of them directly or indirectly controls the other;

f. both of them are directly or indirectly controlled by third person;

g. together they directly or indirectly control a third person; or

h. they are members of the same family."

**Sole Agent, Sole Distributor, Sole Concessionaire**

It has further been clarified at Article 15.5 that,

“Persons who are associated in business with one another in that one is the sole agent, sole distributor or sole concessionaire, however described, of the other shall be deemed to be related for the purposes of this Agreement if they fall within the criteria of Paragraph 4.”
WTO Ministerial Decision 7.1 and Para 5 of Annex III

The clarification at Article 15.5 had created some controversy. Some of the developing countries had demanded the deletion of the clause, 'If they fall within the criteria of Paragraph 4' in Article 15.5 so that the sole agent, sole distributor etc. could be considered as related persons without going into the criteria laid down in Paragraph 4 (a) to (h) of Article 15. This was however not agreed to. Ultimately a Protocol was added to the agreement, which in Paragraph 6 Stated that the parties to the Agreement recognized that certain developing countries have expressed concern that there may be problems in the implementation of Article 1 of the Agreement insofar as it relates to importations into their countries by sole agents, sole distributors and sole concessionaires. The parties to the Agreement agreed that, if such problems arise in practice in developing countries applying the Agreement, a study of this question shall be made, at the request of such countries, with a view to finding appropriate solutions. This provision is now Annex – III, Paragraph 5 of the current version of the Agreement.

Subsequently, there was a Ministerial Decision 7.1 concerning sole agents, sole distributors and sole concessionaires. The text of the Decision as adopted, emphasizes that while developing countries could continue without changing their existing practices relating to discounts for such agents during the five-year delay period, during this period, however, these countries could, with the assistance of the CCC (WCO), conduct appropriate studies on the importation of sole agents as well as in other areas identified as being of potential concern to them. The text urges the CCC to provide technical assistance to the requesting developing countries for this purpose, in accordance with the provisions of Annex – II of the WTO Agreement.

Further Discussion on Definition of Related Persons

The clauses (a) to (h) of Article 15.4 give separate criteria to establish relationship. There would therefore be no warrant to combine or otherwise modify any of them. Further Article 15.5 does not widen the scope of definition; it is only clarificatory in nature. The use of the words ‘they’ and “one another’s” in clause (a) relating to officers or directors make it clear that the relationship must be reciprocal. If A is an officer in B’s company, B’s company also must have representation in A’s company so as to make A and B related. However, such reciprocity is not envisaged in sub-clause (e) of Article 15.4 relating to the control by one over the other. The expression ‘legally recognized partners’ as used in clause (b) has been explained in detail in Advisory Opinion 21.1 to be discussed shortly. As regards clause (c) the transaction between an employer and employee would be within a single company and thus that transaction would not be a sale. Clause (d) dealing with common ownership of 5 percent or more of the voting stock or shares clarifies implicitly that a common ownership of non-voting stock or shares will not create a relationship. Clause (f) deals with common control by a third person and clause (g) deals with common control of a third person. Clause (h) uses the expression "members of the same family" without any attendant explanation.

The issue of Control at Article 15.4 (e)

In the context of relationship, it is important to understand the issue of ‘control'. In respect of clause (e) of Article 15.4, there is no requirement of reciprocity with regard to control,
inasmuch as the moment it is shown that one of them controls the other, relationship would be established, without having to prove that the other also controls the one referred to just now. It means that in order to prove the relationship there is no requirement of reciprocity when one is on the issue of control. Further, as regards the legal and operational control referred to in the Interpretative Note to Article 15.4(e), the interpretative note explains that one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or directions over the latter. The use of the words ‘legally’ and ‘operationally’ in the interpretative note gave rise to certain doubts. One person can operationally, by the authority of his chair, exercise control over another only within one and the same company, but there can be no sale in respect of transactions within one and the same company. Further, even in the case of a very simple contract, one party will be in a position to legally exercise some restraint or direction over the other; but it cannot be the intention to create a relationship out of every contract. The Explanatory Notes 4.1 which basically deals with the “consideration of relationship under Article 15.5 read in conjunction with Article 15.4”, has also dealt with the issue of ‘control’ at paras 11 to 15. WCO Case Study 11.1 has also dealt with the issue of ‘control’.

Explanatory Note 4.1 on Relationship Under Article 15.5, read in conjunction with Article 15.4

The Explanatory Note 4.1 is reproduced below

1. Article 15.4 of the Agreement sets out 8 situations only where, for the purposes of the Agreement, persons shall be deemed to be related.

2. In Article 15.5 the Agreement further provides that persons who are associated in business with one another in that one is the sole agent, sole distributor or sole concessionaire (hereinafter referred to for brevity as sole agent), however described, of the other shall be deemed to be related for the purposes of the Agreement only if they fall within the criteria of paragraph 4 of Article 15.

3. The wording of Article 15.5 of the Agreement has two objectives. The first is to provide a clear departure from the concept held in certain valuation systems that sole agents are by their nature related to their suppliers.

4. On the other hand it is recognized that parties who have been established as being sole agents should not on that basis alone be considered as being unrelated if, in fact, they meet one of the criteria in Article 15.4. Therefore, the second objective of Article 15.5 is to direct consideration of the relationship of parties solely within the provisions of Article 15.4.

5. The persons who wish to become associated in business in that one will become the sole agent of the other, will contact each other through a variety of means such as notices in business and trade journals and other avenues available in trade circles. Negotiations will be undertaken and, in most cases, written contracts will result which specify the terms and conditions of the sole agency agreement.

6. It can be expected that three situations will be encountered. The first involves an established and reputable manufacturer/seller whose products are much sought after in the markets of the importing country. Obviously, in these circumstances, the manufacturer/seller will be in the stronger negotiating position and the terms of the contract will weigh more heavily in his favour in terms of the conditions and
requirements placed upon the sole agent. Parenthetically, however, this inevitably is accompanied by a higher price for the goods.

7. The second situation is the reverse, wherein the importer is a large enterprise with many distribution, sales and service locations in a lucrative market. In this instance the importer would have more influence in the negotiating process in terms of the conditions and requirements placed upon the supplier. The supplier, moreover, would be likely to accept a somewhat lower price to gain access to the advantages of the importer’s large distribution and sales structure. The third situation is between these two extremes where the parties open and conclude their negotiations on a more equal footing.

8. In such cases the resulting contract becomes critical, recognizing that such contracts are freely entered into, usually have termination or renewal provisions, and are enforceable under the civil laws of the countries concerned in the event of a breach of a condition by one of the parties.

9. The question which must be considered is whether the terms or conditions of the contract are such as to meet one of the provisions of Article 15.4. There will be instances where the contract establishing a sole agency does establish a relationship, such as when the contract includes a provision relating to persons appointed as officers or directors of one another’s businesses under Article 15.4 (a), or where there is an exchange of stock (5% or more) under Article 15.4 (d). It could be envisaged that some contracts could create a third entity which might bring in the provisions of Articles 15.4(f) and (g), while others could create a partnership under 15.4(b). On the other hand, it is reasonable to assume that such contracts would not usually create an employer/employee relationship under Article 15.4 (c) nor a family relationship under Article 15.4 (h).

10. It can therefore be concluded with some assurance that the specific provisions of the contract can be expected to give a clear indication of the applicability or non-applicability of the provisions of the Agreement in question.

11. The remaining provision of Article 15.4 defining relationships is that of 15.4 (e) wherein one person directly or indirectly controls the other. The Interpretative Note to Article 15.4 (e) provides that “for the purposes of this Agreement, one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter”.

12. Obviously, caution must be exercised in this respect to ensure that unintended results do not occur through improper interpretations of this provision when considering the terms and conditions of contracts which have been freely entered into by otherwise unrelated parties. The examples given in paragraphs 6 and 7 above represent situations wherein the terms and conditions of the contracts are weighted in favour of one party over the other and the former would be legally in a position to enforce its contractual rights over the latter. However, in any contract, verbal or written, even of the most simple type, one party is always in a position to specify certain rights, obligations and other expectations which are legally enforceable on the other.

13. For example, in a basic contract to deliver at a given price, both parties have an expectation that their legal rights and obligations will be honoured, that is, one
must deliver and one must pay a certain price. This, however, would not create a relationship under Article 15.4 (e). Even in a more complex contractual arrangement where the seller, because of royalty payments on the imported goods, has the right to establish and audit the accounting systems the importer must use to account for the royalties, the exercise of this right would not in itself create a relationship under Article 15.4 (e).

14. It can be concluded that it is not the intent of the Agreement to create a relationship out of every contract or agreement which of their very nature establish legal rights or obligations enforceable under national laws. Therefore, the wording of the Interpretative Note to Article 15.4 (e) must normally be taken to apply to situations which go beyond usual buyer/seller or distribution arrangements and involve a position to exercise restraint or direction in respect of essential aspects relating to the management of the activities of the other person.

15. The consideration of control and the existence of a position to exercise restraint or direction requires the determination of questions of fact and degree which must be based on the particulars of each individual situation.

Advisory Opinion 21.1 on "Interpretation of the Expression 'Partners in Business' in Article 15.4 (b)"

The Advisory Opinion is reproduced below.

"1. Are sole agents, sole distributors and sole concessionaires “legally recognized partners in business” in terms of Article 15.4 (h) of the Agreement?

2. The Technical Committee on Customs Valuation expressed the following view.

The Technical position in regard to sole agents, sole distributors and sole concessionaires is set out in Article 15.5 of the Agreement, which provides that persons associated in business as sole agents, sole distributors or sole concessionaires are only deemed to be related persons under the Agreement if they fall within the criteria of Article 15.4. Article 15.4 (b) deems persons to be related if “they are legally recognized partners in business”. The Webster’s Dictionary defines the word “partner” as:

“One who is associated with one or more persons in the same business and shares with them its profits and risks; a member of a partnership”.

The word “partnership” is in turn defined as:

“An association of two or more people who contribute money or property to carry on a joint business and who share profits and losses in certain proportions”.

In commercial law, the simple definitions set out above are usually backed up by a complex set of legal provisions and principles intended to define, interpret and codify through contract, tax and other laws the legal relationship implied in the term “partner”.

An association would be a partnership only where the national legal requirements for the creation of a partnership are satisfied. Thus, persons are not related under the Agreement simply because one person is the sole agent, sole distributor or sole concessionaire of the other.

While it is true that sole agents, sole distributors, etc. may have a close association with
their suppliers, this fact alone would provide no reason to treat them differently from any other unrelated party.

For the purpose of clarification, a Member may choose to incorporate or refer to its national law of partnership in the valuation provisions of its Customs law. However, it would not be appropriate for a Member to devise a different definition of partnership specifically for the interpretation of the valuation provisions of its Customs law.

**Agency Agreements, including Collaboration Agreements**

In general, an importing company may be related with the foreign suppliers by way of agreement to work as any of the following:


An importing company's agreements with the foreign company for transfer of technology, foreign equity participation etc. are know as Collaboration Agreements. Collaboration Agreements again are normally of the following types:

a) Agreement for outright purchase of design, drawings, basic engineering, process know-how etc.

b) Licence Agreement.

c) Joint Ventures.

In case of outright purchases of category (a) above, the importing company has to make one-time payment to foreign company as consideration for the respective purchases. This being a one-time contract, the importing company does not acquire any intellectual property rights like use of patents, trade marks etc.

The Licence Agreements are collaboration agreements for transfer of technical know-how with the permission to use patents, designs, buy-back arrangements etc. It involves a regular contract between the parties for the period of agreement. However, in this type of agreement, the foreign company does not acquire any equity participation, and his relations with the importing company are business relations.

Joint Ventures are the companies incorporated in the importing country by companies in collaboration with foreign companies, where the foreign companies have equity participation. Besides, these Agreements have conditions regarding appointment of the representatives of the foreign collaborators on the Board of Directors of the Joint Venture company.

The collaboration agreements generally contain the clauses for the following provisions

(i) Transfer of technical know-how.

(ii) Grant of licence for manufacturing the patented goods.

(iii) Right to use the registered patents.

(iv) Right to use trade mark.

(v) Right to use logo / legend /monogram.

(vi) Right to use – 'In technical collaboration with M/s __________ ’ on all the advertising materials, catalogues etc.
(vii) Supply of designs, drawings, plans, layouts etc.
(viii) Agreement to share the research and development.
(ix) Details of product under collaboration.
(x) Details of area in which the importing company can sell their products.
(xi) Area in which the importing company can export the goods.
(xii) Clauses regarding royalty payment.
(xiii) Clauses regarding quality control.
(xiv) Supervision by the representative of foreign principals on production in the importing country.
(xv) Conditions regarding equity participation by foreign company or their associated companies in importing company.
(xvi) Appointment of representatives of foreign collaborators on Board of Directors of importing company.
(xvii) Appointment of importing company as sole agent/sole distributor/sole concessionaire etc.
(xviii) Supply of capital goods, equipments, components, raw materials, spares etc.
(xix) Training of Personnel.
(xx) After sales service of the goods supplied by collaborators in importing country.

(xxi) Advertisement, marketing, sales promotion for the products manufactured by foreign principals.
(xxii) To represent foreign principals while filing tenders with the Govt. and other organizations.

(xxiii) Consultancy Services - managerial or technical.

In consideration for above, a running royalty or lumpsum fees or both are paid by the importing Company to the foreign Collaborator. Now, on the issue of valuation treatment in respect of collaboration agreements, a question would arise as to whether the importing party to collaboration agreement would become a related person of the foreign collaborator merely on the ground that he is to depend on the latter for quality control, supply of know-how etc. In the light of the discussions in the Explanatory Note 4.1, it may be said that a contractual obligation can hardly be taken to confer operational or legal control on the obliging party. Control can not be given such a wide meaning as is sometimes sought to be given. ‘Control’ can flow only from the terms of the agreement, which the importer has with the supplier abroad, and unless specific control areas are mentioned therein, it may be held that there is no control, operational or legal, exercised by the foreign suppliers over the importer. Similarly, in the case of joint-ventures, it would be necessary to go into the share-holding and management of the joint-ventures importing company to see if the foreign party to the joint-venture (in case he is also the goods suppliers) is a related party to the joint ventures company under Article 15.4. Any agreement or provision about procurement or supply of goods, and the share-holding,
and nomination of Directors, Board of Management or the like would be relevant in this context.

Influence of Relationship on Price – Article 1.2

Article 1.2 (a) provides for acceptance of transaction value even in case of related party transactions provided that the examination of circumstances of the sale of the imported goods indicated that the relationship did not influence the price.

Article 1.2 (a) is reproduced below:

"1. In determining whether the transaction value is acceptable for the purposes of Paragraph 1, the fact that the buyer and the seller are related within the meaning of Article 15 shall not itself be grounds for regarding the transaction value as unacceptable. In such case the circumstances surrounding the sale shall be examined and the transaction value shall be accepted provided that the relationship did not influence the price. If, in the light of information provided by the importer or otherwise, the Customs administration has grounds for considering that the relationship influenced the price, it shall communicate its grounds to the importer and the importer shall be given a reasonable opportunity to respond. If the importer so requests, the communication of the grounds shall be in writing."

The Interpretative Note to Article 1.2 (a) further explains the examination of the circumstances surrounding the sale. The same is reproduced below:

"2. Paragraph 2 (a) provides that where the buyer and the seller are related, the circumstances surrounding the sale shall be examined and the transaction value shall be accepted as the Customs value provided that the relationship did not influence the price. It is not intended that there should be an examination of the circumstances in all cases where the buyer and the seller are related. Such examination will only be required where there are doubts about the acceptability of the price. Where the Customs administration have no doubts about the acceptability of the price, it should be accepted without requesting further information from the importer. For example, the Customs administration may have previously examined the relationship, or it may already have detailed information concerning the buyer and the seller, and may already be satisfied from such examination or information that the relationship did not influence the price.

3. Where the Customs administration is unable to accept the transaction value without further inquiry, it should give the importer an opportunity to supply such further detailed information as may be necessary to enable it to examine the circumstances surrounding the sale. In this context, the Customs administration should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and the seller organize their commercial relations and the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price. Where it can be shown that the buyer and seller, although related under the provisions of Article 15, buy from and sell to each other as if they were not related, this would demonstrate that the price had not been influenced by the relationship. As an example of this, if the price had been settled in a manner consistent with the normal pricing practices of the industry in question or with the way the seller settles prices for sales to buyers who are not related to him, this would demonstrate that the price had not been influenced by the relationship. As a further example, where it is shown that the price is adequate to ensure recovery of all
costs plus a profit which is representative of the firm's overall profit realized over a representative period of time (e.g. on an annual basis) in sales of goods of the same class or kind, this would demonstrate that the price had not been influenced.

Thus, a conjoint reading of Article 1.2 (a) and its' Interpretative Note conveys the following:

(i) Customs has to conduct an enquiry so as to answer the question whether the relationship has influenced the price. It thus brings in the notional (deemed value) concept indirectly by suggesting that this question can be answered by finding as to what the price would have been if the parties were not related, which is only a deemed price.

(ii) Examination of circumstances surrounding the sale is again not required in all cases, and when there is no doubt, value should be accepted without any such examination. Certain examples have also been given in the note.

(iii) The procedural provision in the Note provides for the importer to be heard and he is offered the opportunity to supply further information.

(iv) After talking about some 'relevant aspects of the transaction' which the Customs should examine, the Note explains that the Customs should be satisfied if it is found that the related parties 'buy from and sell to each other as if they were not related'.

(v) The Note also suggests three ways by which it can be shown that the dealings of related parties are like those of unrelated ones –

   a. When the dealings are in a manner consistent with the normal pricing practices;

   b. When the seller settles the price as he does for sales to unrelated buyers;

   c. When it is shown that the price is adequate to ensure recovery of all the selling costs plus a profit which is representative of the firm's overall profit in sales of goods of the same class or kind.

Test Values – Article 1.2 (b) & its Interpretative Note.

Article 1.2 (b) provides another means of establishing the acceptability of the transaction value. It supplements the general examination of circumstances surrounding the sale as explained in Article 1.2 (a). Article 1.2 (b) suggests three tests, all involving the basic principle of acceptance of T.V. if value of identical or similar goods has already been accepted. Article 1.2 (b) is reproduced below.

"(b). In a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of Paragraph 1 whenever the importer demonstrates that such value closely approximates to one of the following occurring at or about the same time:

(i) the transaction value in sales to unrelated buyers of identical or similar goods for export to the same country of importation;

(ii) the Customs value of identical or similar goods as determined under the provisions of Article 5;
(iii) the Customs value of identical or similar goods as determined under the provisions of Article 5;

In applying the foregoing tests, due account shall be taken of demonstrated differences in commercial levels, quantity levels, the elements enumerated in Article 8 and costs incurred by the seller in sales in which the seller and the buyer are not related that are not incurred by the seller in sales in which the seller and the buyer are related."

**Interpretative Notes to Article 1.2 (b)** further explains the propositions set out in Article 1.2 (b) as follows:

"4. Paragraph 2 (b) provides an opportunity for the importer to demonstrate that the transaction value closely approximates to a "test" value previously accepted by the Customs administration and is therefore acceptable under the provisions of Article 1. Where a test under Paragraph 2 (b) is met, it is not necessary to examine the question of influence under Paragraph 2 (a). If the Customs administration has already sufficient information to be satisfied, without further detailed inquiries, that one of the tests provided in paragraph 2 (b) has been met, there is no reason for it to require the importer to demonstrate that the test can be met. In Paragraph 2 (b) the term "unrelated buyers" means buyers who are not related to the seller in any particular case.

Paragraph 2 (b)

A number of factors must be taken into consideration in determining whether one value "closely approximates" to another value. These factors include the nature of the imported goods, the nature of the industry itself, the season in which the goods are imported, and, whether the difference in values is commercially significant. Since these factors may vary from case to case, it would be impossible to apply a uniform standard such as a fixed percentage, in each case. For example, a small difference in value in a case involving one type of goods could be unacceptable while a large difference in a case involving another type of goods might be acceptable to determining whether the transaction value closely approximates to the 'test' values set forth in Article 1.2 (b)."

It is thus clarified that where a 'test value' as in Article 1.29b) is met, there is no question of examining the effect of the relationship on the invoice price as per Article 1.2 (a). Further the expression 'closely approximates' as used in Article 1.2 (b) is rather complex, and the Interpretative Note gives some guidance in this regard. It must be borne in mind that under Article 1.2 (b), the close approximation has to be to one of the values in sub clauses (i), (ii) & (iii), ascertained at or about the same time.

Four Requirements of Test Value

Thus, there are four requirements of test values as follows:

(a) T.V. of the goods being valued must closely approximate to the test values.

(b) The test values must be the ones which have previously been accepted by the Customs.

(c) The goods taken for comparison must be either identical or similar.

(d) The transaction taken for comparison must have been previously accepted by the Customs.
Time Element in Test Value – Explanatory Note 1.1

The time element in test values has been explained clearly in Explanatory Note 1.1 at paragraphs 5 to 8. The explanation at paras 7 and 8 are of particular importance:

"5. Article 1 does make a subsidiary reference to a time standard in paragraph 2 (b); this relates only to "test" values and thus does not influence the situation that there is no time element involved in determining transaction value under Article 1.

6. Paragraph 2 (b) provides that in a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of paragraph 1 whenever the importer demonstrates that such value closely approximates to one of three alternatives occurring at or about the same time. But if the term "occurring at or about the same time" were the only reference to be taken into consideration, there could in some cases be a substantial difference between the conditions affecting the goods being valued and those affecting the goods furnishing the test value, and an inappropriate comparison could result.

7. The application of paragraph 2 (b) must be in a manner consistent with the principles of the Agreement. The time of export, which is the standard of comparison for the purposes of Articles 2 and 3 would be one approach.

8. Other measures within the framework of the Agreement would also be possible, in particular time standards adapted to the principles underlying the test values in question, namely: for sub-paragraph 1.2 (b) (i) the time of export to the country of importation of the goods being valued, for sub-paragraph 1.2 (b) (ii) the time of sale in the country of importation of the goods being valued, and for sub-paragraph 1.2 (b) (iii) the time of import of the goods being valued."

Advisory Opinion 7.1 on "Acceptability of Test Values under Article 1.2 (b) (i) of the Agreements."

A question was raised as to whether a price below prevailing market prices for identical or similar goods can be used as a test value for the purpose of Article 1.2 (b) (i) [Rule 4 (3) (b) (i)]. The Advisory Opinion 7.1 has answered in the affirmative as follows:

"When a price between unrelated parties has satisfied the conditions prescribed in Article 1 and with any necessary adjustments in accordance with the provisions of Article 8, has been accepted by Customs as a transaction value, that value can be used as a test value. That is not of course the case where a price is still the subject of an enquiry or where the final determination of the Customs value otherwise remains provisional (see Article 13 of the Agreement)."

Adjustments for Difference in Commercial Level and in Quality.

Article 1.2 (b) specifies that while applying the values used for comparison, due account must be taken of the demonstrated differences inter alia in commercial levels and quantity. Such a requirement is also provided in Articles 2 & 3 dealing with Transaction Value of Identical and Similar Goods. This has been explained with seven illustrative examples in Commentary 10.1, which will be discussed later in the chapter meant for Identical and Similar goods.
Commentary 14.1 on "Application of Article 1.2"

"The right and obligations of Customs Administrations and importers with respect to the treatment to be accorded to related party transactions in the application of Article 1.2 have been examined in Commentary 14.1. The Commentary recognizes that in cases where it can be shown that the provisions of paragraph 2 (b) of Article 1 can be met (i.e. transaction value closely approximates to one of the three "test" values provided therein) this would establish the acceptability of the price as the basis of transaction value and preclude the need for any enquiry under paragraph 2 (a) of Article 1 into the circumstances surrounding the sale of those goods being imported. In order to deal with the situations where such test value is not available, the Commentary 14.1 has illustrated certain questions and answers which provide guidance to Customs Administrative and to importers vis-à-vis the application of sub-paragraph 2 (a) of Article 1.

The Commentary 14.1 which contains answers to seven questions are reproduced below.

"1. This commentary examines the rights and obligations of Customs administrations and importers under the Agreement with respect to the treatment to be accorded to related party transactions in the application of Article 1.2.

2. The General Introductory Commentary to the Agreement recognizes that the basis for valuation of goods for Customs purposes should, to the greatest extent possible, be their transaction value. The transaction value is, however, pursuant to Article 1, only acceptable as the Customs value if all of the four limitations set out in sub paragraphs 1 (a) to 1 (d) of Article 1 are satisfied. The fourth limitation, 1 (d), requires that the buyer and the seller not be related, although it does provide that where they are related the transaction value is acceptable subject to the provisions of paragraph 2 of Article 1 being satisfied. This textual construction means that the existence of a relationship between buyer and seller raises a question which serves to alert the importer and Customs as to the acceptability of the price as the basis of the transaction value.

3. However, in cases where it can be shown that the provisions of paragraph 2 (b) of Article 1 can be met (i.e., transaction value closely approximates to one of the three “test” values provided therein), this would establish the acceptability of the price as the basis of transaction value and preclude the need for any enquiry under paragraph 2 (a) of Article 1 into the circumstances surrounding the sale of those goods being imported.

4. In the absence of such a test value, the following questions and answers provide guidance to Customs administrations and to importers vis-à-vis the application of subparagraph 2 (a) of Article 1.

Question No. 1

5. Does the existence of a relationship, as defined in paragraph 4 of Article 15, between the buyer and the seller give Customs the right to reject the transaction value?

Answer

6. No. Relationship, in itself, is not grounds to reject transaction value. Subparagraph 2 (a) of Article 1 is clear on this point. The existence of a relationship does, though, serve to alert Customs to the fact that there may be a need to enquire as to the
circumstances surrounding the sale.

**Question No. 2**

7. Does Customs need to have grounds to enquire into the circumstances surrounding the sale?

**Answer**

8. No. Subparagraph 2 (a) of Article 1 directs that the circumstances surrounding a sale between related persons shall be examined. However, the Interpretative Notes to Article 1, paragraph 2 provide, in paragraph 2 thereof, that an examination of the circumstances will not be required in every case but only in those where Customs has doubts about the acceptability of the price.

**Question No. 3**

9. Does the Agreement provide detailed guidance as to the doubts about the acceptability of a price that would cause Customs to enquire into the circumstances surrounding the sale?

**Answer**

10. No. However, the very structure of the Agreement is such that the existence of a relationship itself gives cause to question whether the price between the seller and the buyer is or is not influenced by the relationship as the price can only be used as the basis of transaction value in circumstances where the relationship has not influenced that price. In addition Article 17 provides that nothing in the Agreement shall prevent Customs from satisfying itself as to the truth or accuracy of any statement, document or declaration. Such a declaration would include that made by the related buyer, explicitly or implicitly depending upon the documentation and declaration requirements of the importing country, when the transaction value method is used, i.e., “the price is not influenced because of my relationship with the seller”.

**Question No. 4**

11. Does Customs have to communicate its “doubts” to the importer when seeking information on the circumstances surrounding the sale or on whether the price has been influenced by the relationship between the buyer and the seller?

**Answer**

12. No. Nothing in the Agreement requires Customs to justify the reasons for it requesting information from an importer with regard to an import transaction. Indeed, paragraph 6 of Annex III and Article 17 recognize that Customs may need to make enquiries concerning the truth or accuracy of any statement, document or declaration presented to them for Customs valuation purposes and have the right to expect the full cooperation of importers in those enquiries. There is no pre-condition placed upon Customs to the effect that it must justify its reasons for enquiring into a transaction. There is, however, nothing to prevent Customs from informing an importer of the reasons for its doubts. This would be desirable if it is able to do so.

**Question No. 5**

13. If Customs has grounds for believing that the price of goods in a transaction has been influenced by the relationship, does it have to advise the importer of the reasons
why it so believes?

**Answer**

14. Yes, Subparagraph 2 (a) of Article 1 provides that, where Customs has grounds for considering the transaction value is unacceptable because the relationship has influenced the price and that Article 1 does not therefore apply to the transaction, Customs shall communicate its grounds to the importer. Moreover, the importer must be given a reasonable opportunity to respond and is entitled to be advised in writing of the grounds for Customs’ beliefs.

**Question No. 6**

15. Is the importer responsible for ensuring that the price has not been influenced by the relationship before declaring the goods to be valued under the provisions of Article 1?

**Answer**

16. Yes. When declaring the Customs value under the transaction value method the importer has an obligation to ensure to the greatest extent possible that the price is not influenced. This is placed upon the importer by virtue of Article 1 which stipulates that the transaction value shall be used provided that the buyer and seller are not related or, where the buyer and seller are related, it can be shown that the relationship did not influence the price.

**Question No. 7**

17. If Customs has previously examined the circumstances surrounding a sale and the relationship between the buyer and seller in general and has found that the relationship had not influenced the price, is Customs precluded from requesting the same or further information at a later date?

**Answer**

18. No. Although it s not intended that Customs examine the circumstances surrounding each and every sale, whenever Customs has a doubt about the acceptability of a price it may direct a new enquiry to the importer.

**Restrictive Use of Test Value- Article 1.2 (c)**

Article 1.2 (c) makes it clear that substitute values shall not be established under the provisions of Article 1.2 (b). Article 1.2 (c) is reproduced below.

"(C) The tests set forth in Paragraph 2 (b) are to be used at the initiative of the importer and only for comparison purposes. Substitute values may not be established under the provisions of Paragraph 2 (b)."

Thus while introducing the concept of "test value" for helping in the determination of transaction value in case of related party transactions, a simultaneous embargo has been put to the effect that substitute values are not to be established under the provision of test value, i.e. the test value cannot be used as value of the imported goods. The test values are only for confirming (or otherwise) the transaction value based on the price actually paid or payable for the goods being valued.
Transfer Pricing – amongst Related Partner

'Transfer Pricing' is the act of pricing transactions between related parties. With globalization, the recent trend is to break up the production process across the international borders so as to take advantage of commercial considerations in terms of cheap labor, availability of raw materials, big consumption market etc. Globalization and liberalization have helped in lowering the tariff and non-tariff barriers, and have thus helped the break-up of production process across the borders. Obviously the parties involved in this fragmented production process across the border are all related. On a rough estimate, almost 60 percent of global transactions are between related parties. Such is the growing importance of related party transactions and consequently of transfer pricing.

Transfer pricing is the main mechanism for intra-firm fund flow between parent and affiliate company. It is, therefore, the apprehension of the Customs authorities that transfer prices may be arbitrarily fixed to lower the value so as to reduce the Customs duty burden. Similar apprehension is there by the income tax authority also. While most of the developed countries are mainly concerned with the transfer pricing within the multinational corporations from the point of view of Income tax on corporate profits, the concern of the developing countries, mostly relate to Customs valuation. The law relating to transfer pricing in most of the developed countries are based on arms length principle i.e. the transactions are valued at prices which the company would have charged to another unrelated company. The same arms length principle is also the hallmark of WTO Valuation Code in respect of related party transactions.

With the lifting of trade-barriers, the role of Multinationals in international trade would be more prominent. Consequently, the valuation treatment of transfer-pricing should be more and more relevant. In this regard, there would be strong need for close cooperation between Customs and Income tax authorities. While an importer may seek to lower the value of an imported machine for paying less Customs duty, he may disclose a higher value for the same machine to the Income tax authority for showing less profit and thus paying less Income tax. It is therefore necessary to ensure that such importers declare the same value for the same machine before the two authorities. Revenue authorities (both Customs and Income Tax) all over the world are increasingly having a closer scrutiny on the intra-firm transfer of tangibles and intangibles within the multinational corporations across border. The problems associated with transfer pricing can however be minimized through transparency, by producing all the relevant transfer pricing documents to the Revenue authorities – Customs and Income Tax at the earliest.

Authority of the Customs to seek explanation

from importers about truth or accuracy of value declaration, where there are reasons to doubt and to reject the transaction value in terms of Article 1, if the importer's explanation is not satisfactory, - Decision 6.1

Background

In the course of Uruguay Round Negotiations the developing countries stressed that more flexibility was needed in the Agreement to enable Customs administrations to shift the
burden of proof to the importer, when the declared price was significantly less than that noticed in earlier transactions of the identical or similar goods. The inability of Customs administration to deal effectively with the problem of undervaluation resulted in considerable loss of revenue. The developing countries argued that their experience with implementing the Agreement showed that the rule that transaction value must be accepted had further accentuated the trend towards undervaluation, as the importers were certain that the Customs would not be able to reject the declared lower collusive prices. This position was supported by most of the developing countries. These Members maintained that the provisions like Article 17 of the Agreement and Paragraph 7 of the Tokyo Round Code’s Protocol were insufficient to deal with the problem of undervaluation as there was often collusion between exporters and importers. The negotiated result of these concerns was the 'Ministerial

Decision 6.1 Regarding Cases Where Customs Administrations Have Reasons to Doubt the Truth or Accuracy of the Declared Value'. It is important to note that while this flexibility was requested by developing countries, the text has been worded in such a way that its provisions can be invoked by all signatory countries, including the developed country members. In fact Japan has also included this provision in their valuation rules.

WTO Ministerial Discussion 6.1

The WTO Valuation Committee at its first meeting in 1995 gave a decision regarding the Customs Administration's course of action in cases where Customs Administrations have reasons to doubt the truth or accuracy of the declared value. The Decision 6.1 is reproduced below:

"The Committee on Customs Valuation,

Reaffirming that the transaction value is the primary basis of valuation under the Agreement on Implementation of Article VII of GATT, 1994 (hereinafter referred to as the "Agreement");

Recognizing that the Customs administration may have to address cases where it has reason to doubt the truth or accuracy of the particulars or of documents produced by traders in support of a declared value;

Emphasizing that in so doing the Customs administration should not 'prejudice' the legitimate commercial interests of traders;

Taking into account Article 17 of the Agreement, Paragraph 6 of Annexure III to the Agreement, and the relevant decisions of the Technical Committee on Customs Valuation;

Decides as follows:

1. When a declaration has been presented and where the Customs administration has 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 further explanation, including documents or other evidence, that the declared value represents the total amount actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8. If, after receiving further information, or in the absence of a response, the Customs administration still has reasonable doubts about the truth or accuracy of the declared value, it may, bearing in mind the provisions of Article
be deemed that the Customs value of the imported goods cannot be determined under the provisions of Article 1. Before taking final decision, the Customs administration shall communicate to the importer, in writing if requested, its grounds for doubting the truth or accuracy of the particulars or documents produced and the importer shall be given a reasonable opportunity to respond. When a final decision is made, the Customs administration shall communicate to the importer in writing its decision and the grounds thereof.

2. It is entirely appropriate in applying the Agreement for one Member to assist another Member on mutually agreed terms."

A careful reading of the Decision 6.1 will show that, while specifying the course of action for the Customs authorities in cases where there are reasons to doubt the truth or accuracy of the declared value, the Decision 6.1 finally provides for arriving at the conclusion that it may 'be deemed that the Customs value of the imported goods cannot be determined under the provisions of Article 1. It may be recalled that hitherto the transaction value under Article 1 could be rejected only when the transaction was hit by any of the provisos given at clauses (a) to (d) of Article 1. In view of the Decision 6.1, there is now an additional condition for rejection of transaction value. Such is the importance of Decision 6.1 from the point of view of Customs Control.

The Decision however provides for certain elements so as to safeguard the interest of the Trade. First of all, the proper officer must have reason to doubt the truth or accuracy of the value and secondly, those reasons or grounds for doubting the truth have to be intimated to the importer in writing. Thirdly, the importer would be given due opportunity to furnish further information including documents or other evidences. Finally for the purpose of rejecting declared value the proper officer must still have reasonable doubt about the truth or accuracy of the value. Thus, while the proper officer may start the enquiry the on basis of 'reason to doubt', he can finally reject the declared value only when he has 'reasonable doubt'. It is settled how that strict conditions are put to determine whether the doubt is 'reasonable' as against the simple requirement of the officer having 'reason to doubt' when he starts the enquiry. For example, a variation of price could provide a reason to doubt the truth of the declared value; but if that variation of price is shown to be marginal, it will not constitute a reasonable doubt for rejection of the transaction value.

Another important aspect is that this Decision 6.1 empowers the Customs to reject the declared value; but it does not provide a new method of valuation. After rejection of declared value of Article 1 by virtue of Decision 6.1, the Customs officer will necessarily have to go back to the subsequent methods of valuation sequentially starting from Article 2 method.
Treatment of Trade Discounts

TREATMENT OF QUANTITY DISCOUNTS

The Advisory Opinion 15.1 which deals with the question relating to valuation treatment of Quantity Discounts is reproduced below.

1. How are quantity discounts to be treated with reference to Article 1 of the Agreement?

2. The Technical Committee on Customs Valuation expressed the following opinion.

Quantity discounts are deductions from the price of goods allowed by the seller to customers according to the quantities purchased over a given basic period. The WTO Valuation Agreement makes no reference to a standard quantity which would need to be taken into consideration when deciding whether the price actually paid or payable for the imported goods is a valid basis for the determination of the Customs value under Article 1.

It therefore follows that for Customs valuation purposes it is the quantity which has determined the unit price of the goods being valued when they were sold for export to the country of importation that is relevant. Thus quantity discounts arise only when it is shown that a seller sets the price for his goods according to a fixed scheme based upon the quantity of the goods sold. Such discounts fall into two broad categories:

(1) those established prior to the importation of goods, and

(2) those established subsequent to the importation of goods.

These considerations are illustrated by the following examples.

General Facts
There is demonstrated evidence that the seller offers the following quantity discounts on the goods purchased within a given specified period e.g. a calendar year.

I to 9 units - no discount
10 to 49 units - 5% discount
Over 50 units - 8% discount

In addition to the above discounts a further discount of 3% is granted at the end of the specified period calculated retrospectively by reference to the total quantity purchased in that period.

Example 1
First situation: Importer B in country X purchases and imports 27 units in a single shipment. The invoice price reflects a 5% discount.
Second situation: Importer C in country X purchases 27 units in a single transaction at a price which reflects a 5% discount but imports them in 3 separate shipments each comprising 9 units.

Valuation treatment
In both situations, the Customs value is to be determined on the basis of the price actually paid or payable for the imported goods. i.e. those prices reflecting a 5% discount which contributed to the setting of those prices.

Example 2
Subsequent to the purchase and importation of the 27 units, importers B and C purchase and import within the same calendar year a further 42 units (i.e. a total of 69 units each). The price charged to both B and C for the second purchase of 42 units reflects an 8% discount.

First situation: Importer B’s first purchase of 27 units and the second purchase of 42 units are the subject of two separate contracts which are entered into in the context of an initial general agreement which provides for the cumulative progressive discounts between the buyer and the seller.

Second situation: The position is as in the first situation above except that importer C’s purchases are not the subject of an initial general agreement. The cumulative progressive discounts are however offered by the seller as a feature of his general terms of sale.

Valuation treatment
With respect to both situations the 8% discount on the 42 units is a feature of the seller’s price; it contributed to the setting of the unit price of the goods when they were sold for export to the country of importation. It therefore follows that it should be allowed in determining the Customs value of those goods. In this respect the fact that the quantity discount is granted by the seller taking into account quantities purchased previously by the buyer does not mean that the provisions of Article 1.1 (b) apply.

Example 3
In this example, the position is as in example 2 above except that the discounts are also granted retrospectively. In each case the importer purchases and imports 27 units and a further 42 units within the same calendar year. For the first shipment of 27 units B is charged a price which reflects a 5% discount and for the second shipment of 42 units, the price charged reflects an 8% discount with an additional reduction representing a further discount of 3% on the first shipment of 27 units.

Valuation treatment
The 8% discount on the 42 units should be allowed in determining the Customs value of the imported goods. However, the additional 3% discount granted retrospectively should not be allowed for the second importation as it did not contribute to the setting of the unit price of 42 units being valued but relates to the previously imported 27 units. As to the treatment to be accorded by Customs to the 27 units, guidance is already provided in
Advisory Opinion 8.1 on credits in respect of earlier transactions and Commentary 4.1 on price review clauses.

Example 4
After all importations during the specified period have been completed, an accounting is taken. On the basis of the total quantity which had been imported during the period, the importer qualifies for an additional 3% discount.

Valuation treatment
The discount of 3% granted retrospectively cannot be taken into account for the reasons set out in paragraph 16. However, it should be noted that the Committee has already provided guidance in Advisory Opinion 8.1 on credits in respect of earlier transactions and in Commentary 4.1 on price review clauses.

TREATMENT OF CASH DISCOUNT UNDER THE AGREEMENT

There are three Advisory Opinions 5.1, 5.2 and 5.3 on the treatment of Cash Discounts under the Agreement. All these Advisory Opinions are reproduced below.

a) Advisory Opinion 5.1
1. When, prior to the valuation of imported goods, a buyer has availed himself of a cash discount offered by the seller, should that cash discount be allowed in determining the transaction value of the goods?

2. The Technical Committee on Customs Valuation expressed the following view.

Since the transaction value under Article 1 of the Valuation Agreement is the price actually paid for the imported goods, the cash discount should be allowed in determining the transaction value."

b) Advisory Opinion 5.2
"1. When a cash discount offered by the seller is available but payment for the goods has not yet been made at the time of valuation, would the requirements of Article 1.1 (b) of the Agreement preclude using the sale price as a basis for the transaction value?

2. The Technical Committee on Customs Valuation expressed the following view.

The fact that a cash discount, although available, has not been availed of because payment has not yet been made at the time of valuation, does not mean that the provisions of Article 1.1 (b) apply; there is. Thus, nothing that precludes using the sale price in establishing transaction value under the Agreement."

c) Advisory Opinion 5.3
"1. When a cash discount is available to the buyer but payment has not been made at the time of valuation what amount should be accepted as a basis for transaction value under Article I of the Agreement?
The Technical Committee on Customs Valuation expressed the following view. When a cash discount is available but payment has not yet been made at the time of valuation, the amount the importer is to pay for the goods should be taken as the basis for transaction value under Article 1. Procedures for determining what is to be paid may vary; for example a statement on the invoice might be accepted as sufficient evidence or a declaration by the importer as to the amount he is to pay could be the basis for action, subject to verification and to possible application of Articles 13 and 17 of the Agreement.

Answers to Common Questions that a field-officer may ask on Special Valuation Issues.

1. How are barter deals to be treated for valuation purposes?
Ans: Barter deals consist of an exchange of goods or services of approximately equal value. The barter may or may not be settled in monetary terms. In the former case, there is no transaction value nor any objective or quantifiable data for determining the value. Hence, methods other than the transaction value method have to be applied. In the latter case also where a barter transaction is expressed in monetary terms, the same will be subject to the provisions of Article 1, paragraph 1 (b) of the ACV. Here again, application of a method other than the transaction value method will be appropriate.

2. How are baggage items to be valued?
Ans: Valuation of articles imported by a passenger or a crew member in his/her baggage cannot be done using the transaction value method when importation of baggage articles may not involve any sale. Valuation of such goods has to be generally done using available values for identical or similar articles.

3. How are discounts to valuation purposes?
Ans: Since the price actually paid or payable is the primary basis of valuation under the ACV, actual price exclusive of trade discounts has to be taken as the basis for determining the Customs value. The following discounts can, therefore, be allowed for deduction:
   i. Cash discounts;
   ii. Quantity discounts;
   iii. Discount in kind;
   iv. Bonus for purchase exceeding certain quantity; and
   v. Special introductory discount.

   When the contract for sale provides for the following discounts, the same may also be allowed for deduction:
   i. Late shipment allowance;
   ii. Breakage allowance (for fragile goods);
   iii. Contractual discount (a kind of quantity discount);
   iv. Negotiated discount (special discounts justified in the special circumstance of the sale).

   There are certain other discounts that require to be examined carefully in the light of the valuation provisions and may have to be disallowed:

   (i) Discount for brokerage: This is a form of brokerage or commission when the sale is negotiated through a broker. Such discounts are to be added to the invoice value. However, buying commission is not to be added.
(iii) **Cash discount** given to agents of importers in the country of importation: These are special discounts given to sole agents, sole concessionaires etc. When the imports are by third party and the sole agent gets a commission, the same is to be added to the price to determine value. When the import is by the sole agent himself, it is to be seen whether he is related to the supplier and the relation has influenced the price. If so, the discount may not be allowed to be deducted. Otherwise, imports by sole agents have to be treated under the ACV at par with any other normal imports.

(iii) **Service stocking discount**: This is a discount for allowing storage facility by the importer. This being in the nature of a compensation for some post-importation activity to be undertaken by the importer, the same may not be allowed to be deducted. Moreover, the contract of sale has to be seen in detail to determine whether the transaction value method is at all applicable to such a sale.

(iv) **Discount on account of loss by exchange**: Such discounts are at times allowed by banks with the concurrence of shippers on account of fluctuations in exchange rates. These are allowed through separate arrangements and are in the nature of compensation outside the sale contract. Therefore, such discounts may not be allowed to be deducted while determining the Customs value.

4. How are retrospective quantity discounts to be treated for valuation purposes?

   Ans: Quantity discounts are allowed by a seller according to a fixed scheme based upon the quantity of the goods sold over a basic period. Normally these are allowed as deductions from the price according to the quantity sold. Such discounts are to be normally allowed while determining the Customs value.

A situation may arise where such discounts are granted retrospectively in respect of importation already made. For example, a seller grants 5% discount on purchases up to 100 units in a year and 10% discount if purchases exceed 100 units in a year. A buyer receives 5% discount on his first purchase of 100 units. Subsequently, he makes a second purchase of 100 more units on which he receives 10% discount and in addition, another 5% discount retrospectively towards the first purchase. In such a case, 5% additional discount on the subsequent importation cannot be deducted for determining the Customs value. Such amounts are in the nature of credits in respect of earlier transactions and as such represent part of the price already paid. Hence, such amounts have to be included in the Customs value of the second importation, being part of the price paid or payable. As far as the first transaction is concerned, the same has to be decided separately. In case the same was assessed provisionally, the assessment can be reopened and the value re-determined.
Lesson 6:
Alternative Methods

TRANSACTION VALUE METHOD OF IDENTICAL AND SIMILAR GOODS

General Discussions

If the Customs value of the imported goods cannot be determined under the transaction value method of Article 1, i.e. where the transaction value of Article 1 is rejected by the Customs administration, the next method to be attempted for determination of Customs value is the transaction value of identical goods method of article 2. If one fails to determine the Customs value even in terms of Article 2, then the next method for determination of Customs value should be the transaction value of similar goods method of Article 3. In terms of Articles 2 and 3, the transaction value which has already been accepted by Customs administration, of identical/similar goods sold for export to Nepal, and exported at of about the same time as the goods being valued, is to be taken as the Customs value, subject to certain adjustments and conditions mentioned in Articles 2 and 3.

Definition of Identical and Similar goods.

"Identical goods" has been defined in Article 15.2 (a) of the Agreement as follows:

"Identical goods means goods which are the same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance would not preclude goods otherwise conforming to the definition from being regarded as identical."

"Similar goods" has been defined, in Art 15.2(b) as follows:

"Similar goods" means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. The quality of the goods, their reputation and the existence of a trademark are among the factors to be considered in determining whether goods are similar"

Article 15.2 (c) to (e) further elaborates about identical and similar goods as follows:

"(c) the term "identical goods" and "similar goods" do not include, as the case may be, goods which incorporate or reflect engineering, development, artwork, design work, and plans and sketches for which no adjustment has been made under Paragraph 1 (b) (iv) of Article 8 because such elements were undertaken in the country of importation;

(d) goods shall not be regarded as "identical goods" or "similar goods" unless they were produced in the same country as the goods being valued;

(e) goods produced by a different person shall be taken into account only when there are no identical goods or similar goods, as the case may be, produced by the same person as the goods being valued."

Summing up, therefore, "Identical Goods" are those goods that are same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance like the difference in color of a book cover, do not preclude goods otherwise conforming
"Similar goods" are goods which, although not alike in all respect, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. When determining whether goods are similar, consideration is to be given, among other factors, to the quality of the goods, their reputation and the existence of a trademark. The requirement of commercial interchangeability suggests that quite a high degree of identity is required between the goods being compared if they are to qualify as similar. Goods bearing a well known trademark will not be similar to goods without any trademark or goods bearing trademark which is not so well known. In short, similar goods must be of more or less equal in value to buyers, sellers or users.

The definitions also provide that only goods produced in the same country as the goods being valued can be considered identical or similar to those goods, and it is also specified that goods produced by person other than the producer of the goods being valued be taken into account only when there are no identical or similar goods made by producers of the goods being valued. It is further provided that imported goods where engineering, development, artwork, design work, and plans and sketches undertaken in importing country were completed by the buyer gratis or at reduced cost for use in connection with the production and sale for export of the imported goods are not covered by the terms "identical goods" and "similar goods".

**Transaction value of Identical goods – Second Method of Valuation**

Article 2 provides for the transaction value of identical goods to be used for determination of the Customs value of the goods being valued, in a situation where the transaction value method of Article 1 cannot be applied. The provision of Article 2 is reproduced below:

"1. (a) If the Customs value of the imported goods cannot be determined under the provisions of Article 1, the Customs value shall be the transaction value of identical goods sold for export to the same country of importation and exported at or about the same time as the goods being valued.

(b) In applying this Article, the transaction value of identical goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the Customs value. Where no such sale is found, the transaction value of identical goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or a decrease in the value.

2. Where the costs and charges referred to in Paragraph 2 of Article 8 are included in the transaction value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the identical goods in question arising from differences in distances and modes of transport.

3. If, in applying this Article, more than one transaction value of identical goods is found, the lowest such value shall be used to determine the Customs value of the imported goods."
Interpretative Note to Article 2.

The Interpretative Note to Article 2 explains the scope of Art 2 and lays down the precautions to be taken in applying the Transaction Value of Identical goods method of valuation. The Interpretative Note is reproduced below:

"1. In applying Article 2, the Customs administration shall, wherever possible, use a sale of identical goods at the same commercial level and in substantially the same quantities as the goods being valued. Where no such sale is found, a sale of identical goods that takes place under any one of the following three conditions may be used:

   a. a sale at the same commercial level but in different quantities;
   b. a sale at a different commercial level but in substantially the same quantities; or
   c. a sale at a different commercial level and in different quantities.

2. Having found a sale under any one of these three conditions adjustments will then be made, as the case may be, for:

   a. quantity factors only;
   b. commercial level factors only; or
   c. both commercial level and quantity factors.

3. The expression “and/or” allows the flexibility to use the sales and make the necessary adjustments in any one of the three conditions described above.

4. For the purposes of Article 2, the transaction value of identical imported goods means a Customs value, adjusted as provided for in Paragraphs 1 (b) and 2 of this Article, which has already been accepted under Article 1.

5. A condition for adjustment because of different commercial levels or different quantities is that such adjustment, whether it leads to an increase or a decrease in the value, be made only on the basis of demonstrated evidence that clearly establishes the reasonableness and accuracy of the adjustment, e.g. valid price lists containing prices referring to different levels or different quantities. As an example of this, if the imported good valued consist of a shipment of 10 units and the only identical imported goods for which a transaction value exists involved a sale of 500 units, and it is recognized that the seller grants quantity discounts, the required adjustment may be accomplished by resorting to the seller’s price list and using that price applicable to a sale of 10 units. This does not require that a sale had to have been made in quantities of 10 as long as the price list has been established as being bona fide through sales at other quantities. In the absence of such an objective measure, however, the determination of a Customs value under the provisions of Article 2 is not appropriate."

Conditions for Application of Article 2 Method of Valuation.

The conditions for application of Transaction Value of Identical goods Method can be summed up as follows:

i. the reference goods were produced in the same country and otherwise satisfies the definition of ‘identical goods’;
ii. the reference goods were sold for export to Nepal and imported at or about the same time as the goods being valued;

iii. adjustment is possible in respect of any differences between the transaction being valued and the one with which it is being compared, in regard to quantity and/or commercial level and in respect of any differences in costs of transport and similar expenses for which adjustment has to be made to the price actually paid or payable;

iv. the country of production may be a different one from the country of export, e.g. in the case of re-exported goods;

v. the importation having to be at or about same time, there is nothing to prevent a lower price obtained from an importation a month ago being accepted in preference to a higher one obtained from an importation a week ago if, depending on market conditions, one month can be deemed to be ‘at or about the same time’;

vi. reference goods produced by different producers may be taken into account only if comparison cannot be made with goods produced by the same producer. This implies that application of the valuation method under Rule 5 will take precedence over going to the next valuation method in hierarchical order if reference goods by a different producer are available as identical goods;

vii. as already mentioned, if examination reveals more than one acceptable value of reference goods, the lowest value identified should be used for valuation purposes.

**Transaction Value of Similar goods Third Method of Valuation – Article 3**

Article 3 provides for the transaction value of similar goods to be used for determination of Customs value of the goods being valued, in a situation where the transaction value method of Article 1 and Article 2 cannot be applied. The provisions of Article 3 are reproduced below:

"1. If the Customs value of the imported goods cannot be determined under the provisions of Articles 1 and 2, the Customs value shall be the transaction value of similar goods sold for export to the same country of importation and exported at or about the same time as the goods being valued.

   (b) In applying this Article, the transaction value of similar goods in a sale at the
same commercial level and in substantially the same quantity as the goods being valued shall be used to determine the Customs value. Where no such sale is found, the transaction value of similar goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity, shall be used, provided that such adjustments can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustment leads to an increase or a decrease in the value.

Where the costs and charges referred to in Paragraph 2 of Article 8 are included in the transaction value, an adjustment shall be made to take account of significant differences in such costs and charges between the imported goods and the similar goods in question arising from differences in distances and modes of transport.

If, in applying this Article, more than one transaction value of similar goods is found, the lowest such value shall be used to determine the Customs value of the imported goods."

Interpretative Note to Article 3

"1. In applying Article 3, the Customs administration shall, wherever possible, use a sale of similar goods at the same commercial level and in substantially the same quantities as the goods being valued. Where no such sale is found, a sale of similar goods that takes place under any one of the following three conditions may be used:

a. a sale at the same commercial level but in different quantities;
b. a sale at a different commercial level but in substantially same quantities; or
c. a sale at a different commercial level and in quantities

2. Having found a sale under any one of these three conditions adjustments will then be made, as the case may be, for:

a. quantity factors only;
b. commercial level factors only; or
c. both commercial level and quantity factors.

3. The expression “and/or” allows the flexibility to use the sales and make the necessary adjustments in any one of the three conditions described above.

4. For the purpose of Article 3, the transaction value of similar imported goods means a Customs value, adjusted as provided for in Paragraphs 1(b) and 2 of this Article, which has already been accepted under Article 1.

5. A condition for adjustment because of different commercial levels or different quantities is that such adjustment, whether it leads to an increase or a decrease in the value, be made only on the basis of demonstrated evidence that clearly establishes the reasonableness and accuracy of the adjustment, e.g. valid price list containing prices referring to different levels or different quantities. As an example of this, if the imported goods being valued consist of a shipment of 10 units and the only similar imported goods for which a transaction value exists involved a sale of 500 units, and it is recognized that the seller grants quantity discounts, the
required adjustment may be accomplished by resorting to the seller's price list and using that price applicable to a sale of 10 units. This does not require that a sale had to have been made in quantities of 10 as long as the price list has been established as being bona fide through sale at other quantities. In the absence of such an objective measure, however, the determination of a Customs value under the provisions of Article 3 is not appropriate."

**Conditions for application of Article 3 Method of Valuation**

It can not go unnoticed that the conditions for application of Article 3 are almost identical to those for application of Article 2, the only difference is that Article 2 refers to 'identical goods' while Article 3 refers to 'similar goods.'

**Some basic considerations for application of Articles 2 & 3**

The Customs value of the goods being valued under Articles 2 and 3 is based on the Customs value of identical/similar goods already accepted by the Customs administration under Article 1. Where there is a sale at the same commercial level and in the same quantity that sale must be used as the reference transaction. If more than one reference value is available, the lowest is to be used. This provision has been put basically to help the importers so that he is not put in a worse situation than one of his competitors whose value taken as a reference value is the lowest. However, the effectiveness of this provision will depend on how efficiently is the information about other transactions obtained – both by Customs and the importers. In this context, the Agreement's requirement of "demonstrated evidence" acquires special significance. Further, when there are no sales at the same level or in the same quantity, sales at a different commercial level or in different quantities may be used but, for arriving at the Customs value, the buyer must take into account any effect that these differences have on the price. Account should be taken of differences between the costs of delivering the identical goods/similar goods and delivering the goods to be valued. The reference documents/evidences like Bills of Entry, invoices and associated value declaration for reference goods imported within recent times would be necessary so as to satisfy the requirements of Articles 2 and 3.

**Commentary 1.1 on "Identical or Similar Goods for the purpose of the Agreement."**

The commentary 1.1 examines the question of identical and similar goods in the general context of application of Article 2 & 3 with seven illustrative examples.

The Commentary 1.1 is reproduced below:

"1. This commentary examines the question of identical and similar goods in the general context of the application of Articles 2 and 3

2. The principles in question are set out in Article 15; they provide that “identical goods” are those goods that are the same in all respects, including:
   a) physical characteristics.
   b) quality, and
   c) reputation.
   Minor differences in appearance do not preclude goods otherwise conforming to the definition from being regarded as identical.

3. “Similar goods” are goods which, although not alike in all respects, have:
a) like characteristics, and  
b) like component materials which enable them to:  
c) perform the same function, and  
d) be commercially interchangeable.

When determining whether goods are similar, consideration is to be given, among other factors, to the quality of the goods, their reputation and the existence of a trademark.

4. Article 15 also provides that only goods produced in the same country as the goods being valued can be considered identical or similar to those goods, and it specifies that goods produced by persons other than the producer of the goods being valued be taken into account only when there are no identical or similar goods made by producers of the goods being valued. It further provides that goods incorporating or reflecting engineering, development, artwork, design work, and plans and sketches undertaken in the country of importation are not covered by the term “identical goods” or “similar goods”.

5. Before considering the application of those principles, it would be useful to examine the determination of identical and similar goods in the general context of the application of Articles 2 and 3. Those two Articles are not expected to come into question frequently since Article 1 will be applied to the vast majority of importations. In those instances in which Article 2 or 3 are applied, there may have to be consultations between Customs and the importer with a view to arriving at a value under one of those Articles. These consultations, together with information from other sources, should enable Customs to determine what, if any, goods might be considered identical or similar for purposes of the Agreement. Obviously, there will be many instances where the answer is self-evident and no market enquiries or consultations with importers are necessary.

6. The principles in Article 15 must be applied on the basis of the particular facts in the market in question with respect to the goods being compared. The questions that might arise in making such determinations will vary because of the nature of the goods being compared and because of differences in market conditions. A careful analysis of the facts in each case, in the light of the principles set out in Article 15, will be necessary to arrive at sound decisions.

7. The following examples are intended to illustrate application of the principles for determining whether goods are identical or similar in accordance with Article 15; they are not meant to form part of a series of decisions on specific cases. Each example is limited in its scope: in addition to the conditions set out in each of them any remaining requirements of Article 15 would of course have to be fulfilled before goods could be considered as identical or similar.

*Example No. 1*

*Steel sheets of identical chemical composition, finish and size imported for different purposes*

Although the importer is to use some of the sheets for automobile bodies, and others for furnace liners, the goods are nevertheless identical.

*Example No. 2*
Wallpaper imported by interior decorators and by wholesale distributors

Wallpaper which is identical in all respects remains identical for the purposes of Article 2 of the Agreement even if it is imported at different prices by interior decorators on the one hand and by wholesale distributors on the other.

Although differences in price might indicate differences in quality or reputation which are factors to be taken into account in considering whether goods are identical or similar, price itself is not such a factor. Adjustment for commercial level and/or quantity may of course be necessary in applying Article 2.

Example No. 3

Garden insecticide sprayers which are unassembled and goods of identical design already assembled

The sprayer consists of two dismountable parts: (1) a pump and nozzle affixed to a lid and (2) a container for the insecticide. In order to use the sprayer it is disassembled, the container is filled with insecticide, and the lid is screwed on; the sprayer is then ready for use. The sprayers being compared are identical in all respects including physical characteristics, quality and reputation, except that in one case they are assembled and in the other unassembled.

An assembly operation will normally preclude treating assembled and unassembled goods as identical or similar, but when, as in this case, the goods are designed to be assembled and disassembled in the ordinary course of their use, the nature of the assembly operation would not preclude them from being considered identical.

Example No. 4

Tulip bulbs of the same size but of different varieties, producing flowers of approximately the same shape and size and of the same colour

Since the bulbs are not of the same variety, they are not identical goods; however, because they produce flowers of approximately the same size and shape and of the same colour, and they are commercially interchangeable, they are therefore similar goods.

Example No. 5

Inner tubes imported from two different manufacturers

Rubber inner tubes in the same range of sizes are imported from two different producers, both located in the same country. While each producer uses a different trademark, the inner tubes made by both are to the same standard, are of the same quality, enjoy equivalent reputations and are used by motor vehicle manufacturers in the country of importation.

As the inner tubes bear different trademarks they are not the same in all respects and should not be regarded as identical in terms of Article 15.2 (a).

Although not alike in all respects, the inner tubes do have like characteristics and component materials which enable them to perform the same functions. As the goods are made to the same standard, are of the same quality, have equivalent reputations and carry trademarks, they should be considered similar, even though the trademarks are different.
Example No. 6

Normal grade sodium peroxide for bleaching purposes compared with a special grade of sodium peroxide used for analytical purposes

The special grade of sodium peroxide is manufactured by a process using very pure raw material in dust form; it is thus much more expensive than the normal grade. The normal grade sodium peroxide cannot be used in place of the special grade because the normal grade is not pure enough to meet analytical specifications and neither is it clearly soluble nor in dust form. Since the goods are not the same in all respects they are not identical; With respect to similarity, the special grade would not be used for bleaching purposes, or for the large scale production of chemicals, as the price of the special grade is prohibitive for these applications. While both kinds of sodium peroxide certainly have characteristics and like component materials, they are not commercially interchangeable since the normal grade could not be used for analytical purposes.

Example No. 7

Ink of paper quality and ink of paper and textile quality

To be similar for the purposes of Article 3 and 15.2 (b) of the Agreement, goods must inter alia be commercially interchangeable with each other. Ink of a quality suitable only for paper printing would not be similar to ink of a quality for paper and textile printing, even though the latter would be commercially acceptable in the paper printing trade.

Adjustment for difference in commercial Level and Quantity

It has been discussed earlier in the context of application of Article 1.2 (b) (Test Values) that it is mandatory to take due account of the demonstrated differences, inter alia, in commercial levels and quantity while applying the values for comparison. Articles 2 & 3 also stress the requirement of making an adjustment so as to take account of demonstrated differences in commercial level and quantity.

Commentary 10.1 on "Adjustment for Difference in Commercial Level and Quantity under Article 1.2 (b) and Article 2 & 3 of the Agreement:
The Commentary while dealing with the adjustment for difference in commercial level and quantity, explains that although the wording in Article 1.2 (b) is somewhat different from that found in Articles 2.1 (b) and 3.1 (b), it is clear that the principles involved are the same; account has to be taken of differences attributable to commercial level or quantity and it must be possible to make the necessary adjustment on the basis demonstrated evidence which clearly establishes its reasonableness and accuracy.

The Commentary 10.1 which gives seven examples, is reproduced below:

"General

1. When applying the Agreement, it may be necessary to make an adjustment to take account of demonstrated differences in commercial level and quantity in respect of Articles 1.2 (b) (test values), 2.1(h) (identical goods) and 3.1(h) (similar goods). Although the wording in Article 1.2 (b) is somewhat different from that found in Articles 2.1 (b) and 3.1 (b), it is clear that the principles involved are the same: account has to be taken of differences attributable to commercial level or quantity and it must be possible to make the
necessary adjustment on the basis of demonstrated evidence which clearly establishes its reasonableness and accuracy.

2. When Customs is made aware of a transaction which may be used to establish a test value under Article 1.2 (b) or the transaction value of identical or similar goods under Articles 2 and 3, it must be established whether that transaction was made at the same commercial level and in substantially the same quantities as that of the goods being valued. If the commercial level and quantities are comparable in terms of the transaction no adjustment for these factors is necessary.

3. However, if there are differences in commercial level and quantity it will then be necessary to determine whether the price or value is affected by those differences. It is important to bear in mind that the mere existence of a difference in commercial level or quantity would not of itself require that an adjustment be made; an adjustment will be necessary only if a difference in the price or value results from a difference in commercial level or quantity and then the adjustment must be made on the basis of demonstrated evidence which clearly establishes its reasonableness and accuracy. If this requirement cannot be met, the adjustment cannot be made.

4. The following examples illustrate situations involving questions of adjustments only for different commercial levels and quantities and do not include other adjustments such as for differences in distances and modes of transport. For the purpose of the examples on Articles 2 and 3, it is presumed that the Customs value of the imported goods cannot be determined under the provisions of Article 1 and is to be determined on the basis of the previously accepted transaction value of identical or similar goods.

Different commercial level or different quantity – Adjustment

10. In those instances where a difference in price is attributable to commercial level or quantity, an adjustment must be made in order to arrive at a value at the same commercial level and for substantially the same quantities as the goods being valued. When making such adjustment, the sales practices of the seller of the identical or similar goods is the governing factor.

11. If an adjustment is necessary because of differences in quantity, the amount of the adjustment should be readily determinable; With respect to commercial level, however, the criteria used may not be that evident. Customs will have to examine the sales practices of the seller of the identical or similar goods. Once the seller’s practice is clear, an examination of the activities of the importer of the goods to be valued should provide a basis for determining what commercial level the seller of the identical or similar goods would accord to the importer. Development of this information, as noted in the general introductory commentary, will require consultation with the parties concerned.

13. As previously noted Articles 2 and 3 require that an adjustment must be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment.

14. The Notes to Articles 2 and 3 provide as an example of such evidence that of price lists which contain prices referring to different levels or different quantities. The determination as to the bona fides of price lists will have to be made on a case-by-case basis. In the absence of such an objective measure, the determination of Customs value
under the provisions of Articles 2 and 3, as the case may be, would not be appropriate.

Application of Article 1.2 (b)

Different commercial level, same quantity - Comparable test value

16. In a sale between related parties, Article 1.2 (b) provides the importer the opportunity to demonstrate that his value closely approximates one of the test values set out in the subparagraphs of that provision: it follows that the test value must be demonstrated in all its aspects, including where appropriate, level and quantity. The principles involved in Article 1.2 (b) for adjustments for these factors are the same as those for Articles 2 and 3 except that the adjustments to the transaction value of identical or similar goods are for the purpose of establishing the Customs value of the imported goods while under Article 1.2 (b), the adjustments are made to the test value only for comparison purposes.

The amount of the adjustment in this case would be 1 c.u. The test value, after taking account of the difference attributable to level, would be 5 c.u. Since the related-party price equals the test value as determined above, that price can be accepted as transaction value under Article 1.

Lack of demonstrated evidence - Test value rejected

Since E has made no sales to unrelated wholesalers, but merely indicates a willingness to do so at the indicated price, there is a lack of demonstrated evidence which would establish the reasonableness of the adjustment. Because no adjustment can be made for the difference in level, the test value presented by I is not acceptable for comparison purposes.

19. In order to value the goods under Article 1 when there is a question of relationship, or under Article 2 or 3, there should normally be consultations between the importer and Customs. These consultations, and information from other sources should enable Customs to determine whether an adjustment need be made and whether it can be made on the basis of demonstrated evidence."

Explanatory Note 1.1 dealing with the Time Element in Articles 2 & 3, as different from that in Article 1

The Explanatory Note 1.1 recognizes that the time element is treated differently in Articles 2 & 3. Unlike Article 1, in which the valuation of imported goods is based on an autonomous element, namely the price actually paid or payable for the goods, the Articles 2 & 3 refer to values previously established in accordance with Article 1 namely transaction values of identical or similar imported goods.

The relevant extracts of Explanatory Note 1.1 in so far as it concerns Articles 2 & 3 are reproduced below:

"Articles 2 and 3"

9. The time element is treated differently in Articles 2 and 3 of the Agreement. Unlike Article 1, in which the valuation of imported goods is based on an autonomous element, namely the price actually paid or payable for the goods, Articles 2 and 3 refer to values previously established in accordance with Article 1, namely transaction values of identical or similar imported goods.

11. To provide uniformity of application, Articles 2 and 3 state that the Customs value determined under the provisions of these Articles is the transaction value of identical or
similar goods exported at or about the same time as the goods being valued. Thus these Articles establish an external time standard to be taken into consideration for their application.

12. It should be noted that the external time standard applicable under Articles 2 and 3 is the time when the goods to be valued are exported, and not the time when they are sold.

13. This external time standard must allow for practical application of the Article in question. Hence, the words “or about” should be regarded as intended simply to make the terms “at the same time” somewhat less rigid. In addition, it should be noted that according to its General Introductory Commentary, the Agreement seeks to base Customs value on simple and equitable criteria consistent with commercial practice. Starting from these principles “at or about the same time” should be taken to cover a period of time, as close to the date of exportation as possible, within which commercial practices and market conditions which affect price remain the same. In the final analysis, the question must be decided on a case by case basis within the overall context of the application of Articles 2 and 13.

The requirements in respect of time of course cannot alter the strict hierarchical order of the Agreement which requires that Article 2 must be exhausted before Article 3 can be invoked. Thus, the fact that the time of exportation of similar goods (as opposed to identical goods) is closer to that of the goods to be valued can never reverse the order of application of Articles 2 and 3.

The material time for Customs valuation

14. The foregoing remarks on the role of the time element in the application of Articles 1, 2 and 3 of the Agreement do not, of course, have any bearing of the material time for Customs valuation. Article 9 makes provision for the time to be taken into consideration for conversion of currency only.”

Practical Application of T.V. Method of Identical Goods and Similar Goods – Article 2 & 3.Introductory Discussion

1. Definition of identical goods:
   a. identical goods are defined as goods which are:
      i. the same in all respects including:
         □ physical characteristics,
         □ quality, and
         □ reputation,
      ii. produced in the same country as the goods being valued, and
      iii. produced by the producer of the goods being valued;
   b. the definition of identical goods excludes imported goods for which engineering, artwork, etc. is undertaken in the country of importation and is provided by the buyer to the producer of the goods free of charge or at a reduced cost;
   c. where there are no identical goods produced by the same person in the country of production of the goods being valued, identical goods produced by a different
person in the same country may be taken into account;

d. minor differences in appearance would not preclude goods which otherwise
conform to the definition from being regarded as identical.

2. The transaction value of identical goods can be adjusted upwards or downwards to
account for demonstrated differences between the goods being valued and the
identical goods, to take account of:

a. trade level differences;
b. quantity differences; and
c. commercially significant differences for transportation costs due to variances in
   the mode and/or distance of transport.

3. When this method is used, the identical goods must have been exported to the
country of importation at or about the same time as the goods being valued. Where
there is more than one transaction value of identical goods which meets all
requirements, the lowest such value is to be used.

Introductory Discussion on Practical Application of the Transaction Value Method
of Similar Goods

1. Definition of similar goods:

a. similar goods are defined as goods which:
   i. closely resemble the goods being valued in terms of component materials
      and characteristics,
   ii. are capable of performing the same functions and are commercially
       interchangeable with the goods being valued,
   iii. are produced in the same country as the goods being valued,
   iv. are produced by the producer of the goods being valued;

b. the definition of similar goods excludes imported goods for which
   engineering, artwork, etc. is undertaken in the country of importation and is
   provided by the buyer to the producer of the goods free of charge or at a
   reduced cost;

c. where there are no similar goods produced by the same person in the country of
   production of the goods being valued, similar goods produced by a different
   person in the same country may be taken into account.

2. The same adjustment as in paragraph 5.1.2.1 (2) above are to be made where
appropriate.

3. The similar goods used must have been exported to the country of importation at
the same or substantially the same time as the goods being valued. Where there is
more than one transaction value similar goods which meets all the requirements,
the lowest such value is to be used.

VERIFICATION OF METHOD 2 OR 3 ENTRIES of Article 2 & 3

1. Confirm that the goods could not have been valued under Transaction Value
Method. If Method 1 should have been used, obtain a complete value declaration
and check in accordance with steps explained at Chapter 4. If Method 2 or 3 is confirmed, continue as follows.

2. Confirm that the goods being valued are identical or similar to the goods valued under Method 1 by referring to specifications and/or by physical examination (if possible). Identify any differences.

3. Confirm that the declared values are based upon values of identical or similar goods exported at or about the same time as the goods being valued. The date of export is the date on which the goods are shipped from the country of exportation to the country of importation. The expression “at or about the same time” could be taken to mean a period extending 30 days prior to and 30 days following the exportation of the goods being valued. However, if the market or manufacturing conditions are such that the price of the goods in question remains relatively stable over a longer period of time than one month, the transaction value of goods exported outside that period may be considered in using Method 2 or 3. Conversely, if the market or manufacturing conditions result in frequent changes in the price of identical or similar goods, a shorter period of time may be more appropriate (for example, perishables, such as fruits and vegetables). However, for certain administrations, the declared value could be based on values accepted under Method 1 not more than three months before the date of entry being verified. The entry of identical or similar goods made more than three months before can be considered only if the market or manufacturing conditions are such that the price of the goods in question remains relatively stable over a long period of time.

4. Confirm whether an adjustment is necessary to take account of different quantities or a different commercial level, and obtain full details of the basis of calculation. Wherever possible, the sale of identical or similar goods to be used should be that which corresponds most closely in respect of quantity and commercial level to that of the goods being valued. If such conditions do not exist, the sale of identical or similar goods to be used may be:
   a. a sale at the same commercial level but in different quantities;
   b. a sale at a different commercial level but in substantially the same quantities;
   c. a sale at a different commercial level and in different quantities.

5. Check that the amounts declared as International transport and insurance costs are correct, and that the difference in costs has been adjusted correctly.

6. Confirm whether any other adjustment is necessary to take account of, for example differences between the transportation and associated costs incurred within the country of exportation with respect to the imported goods and the identical and similar goods, and obtain full details of what they are for and how they have been calculated.

Answers to Common Questions that a field officer may ask – Article 2 & 3.

1. When can one apply the method of valuation based on the transaction value of identical goods?

   Ans: The method of valuation based on transaction value of identical goods can
be used when the transaction value method fails or is not applicable and when transaction value of identical goods imported at or about the same time is available.

2. What are identical goods?
   Ans: Identical goods have been defined in the ACV as goods that are:
   a. the same in all respect including physical characteristics, quality ad reputation;
   b. produced in the same country as the goods being valued; and
   c. produced by the producer of the goods being valued.

   Minor differences in appearance which do not affect the value would not preclude goods which otherwise conform to the definition from being considered as identical goods. Where identical goods produced by the same producer are not available, identical goods produced by a different producer can be considered.

   The definition of identical goods excludes imported goods for which engineering, development, artwork, design work, plans or sketches are undertaken in the country of importation and are provided by the buyer to the producer of the goods free of charge or at a reduced cost.

   Examples of identical goods are steel sheets of identical chemical composition, finish and size, imported for automobile bodies in one case and for furnace lining in another; wallpaper imported by interior decorators and wholesalers etc.

3. When can one apply the method of valuation based on the transaction value of similar goods?
   Ans: The method based on transaction value of similar goods is to be applied if the transaction value method and the method based on the transaction value of identical goods fail or do not apply. Similar goods used in this method should have been imported at or about the same time as the goods being valued.

4. What are similar goods?
   Ans: Similar goods have been defined in the ACV as goods which
   a. closely resemble the goods being valued in terms of characteristics and component materials;
   b. can perform the same functions and are commercially interchangeable with the goods being valued;
   c. are produced in the same country as the goods being valued; and
   d. are produced by the producer of the goods being valued.

   Where similar goods produced by the same producer are not available, similar goods produced by a different producer can be considered.

   The definition of similar goods excludes imported goods for which engineering, development, artwork, design work, plans or sketches are undertaken in the country of importation and are provided by the buyer to the producer of the goods free of charge or at reduced cost.
An example of similar goods is interchangeable rubber tubes imported from two different producers with different trademarks but of same standard, quality and equivalent reputation as well as similar characteristics, components and functions for use by motor vehicle manufacturers. Normal grade sodium peroxide for bleaching and special grade pure sodium peroxide for analytical purposes are not similar goods as they have different specifications and are not interchangeable.

5. What adjustments have to be made while adopting values of identical or similar goods?

Ans: The transaction values of identical or similar goods have to be adjusted upwards or downwards if there are differences between the goods being valued on the one hand and the identical or similar goods on the other hand to take account of:

   a. commercial level differences;
   b. quantity differences; and
   c. significant differences in the transport costs, insurance charges etc., due to variance in mode of transport and distance.

6. Which value is to be used if there are a number of transaction value of identical or similar goods?

Ans: If there are more than one transaction value of identical or similar goods, the lowest of such values has to be used.
Lesson 7
Alternative Methods
[DEDUCTIVE VALUE, COMPUTED VALUE AND FALL BACK METHOD]

General Discussion

When the Customs value of the imported goods cannot be determined in terms of the
transaction Value Method of Articles 1, 2 of 3 the next method to be attempted for
determination of the Customs value is the Deductive Value Method (DVM) of Article 5.
In this method of valuation, the starting print is the resale price in the country of
importation i.e. Nepal Thereafter, appropriate deductions are made to arrive at the
Customs value at the place of importation. The deductions are generally speaking, post-
importation expenses, the agent's commission etc. after the goods entered Nepal and the
Customs duties and taxed on resale. If however the imported goods are resold only after
further processing then the deductions are made for the processing cost from the resale
price after processing.

Article 5 of the Agreement

Article 5 of the Agreement which sets out the Deductive Value Method (DVM) is
reproduced below.

"1 (a) If the imported goods or identical or similar imported goods are sold in the country
of importation in the condition as imported, the Customs value of the imported
goods under the provisions of Article shall be based on the unit price at which the
imported goods or identical or similar imported goods are so sold in the greatest
aggregate quantity, at or about the time of the importation of the goods being
valued, to persons who are not related to the persons from whom they buy such
goods, subject to deductions for the following:

(i) either the commissions usually paid or agreed to be paid or the additions
usually made for profit and general expenses in connection with sales in
such country of imported goods of the same class or kind;

(ii) the usual costs of transport and insurance and associated costs incurred
within the country of importation;

(iii)where appropriate, the costs and charges referred to in Paragraph 2 of
Article 8; and

(iv)the Customs duties and other national taxes payable in the country of
importation by reason of the importation or sale of the goods.

(b) If neither the imported goods nor identical nor similar imported goods are sold at
or about the time of importation of the goods being valued, the Customs value
shall, subject otherwise to the provisions of Paragraph 1(a) be based on the unit
price at which the imported goods or identical or similar imported goods are sold
in the country of importation in the condition as imported at the earliest date after
the importation of the goods being valued but before the expiration of 90 days after
such importation.

2. If neither the imported goods nor identical nor similar imported goods are sold in the
country of importation in the condition as imported, then, if the importer so requests, the Customs value shall be based on the unit price at which the imported goods, after further processing, are sold in the greatest aggregate quantity to persons in the country of importation who are not related to the persons from whom they buy such goods, due allowance being made for the value added by such processing and the deductions provided for in Paragraph 1 (a)."

"Profit and general expenses" has been explained as follows:

"6. It should be noted that "profit and general expense" referred to in Article 5.1 should be taken as a whole. The figure for the purposes of this deduction should be determined on the basis of information supplied by or on behalf of the importer unless his figures are inconsistent with those obtaining in sales in the country of importation of imported goods of the same class or kind. Where the importer's figures are inconsistent with such figures, the amount for profit and general expenses may be based upon relevant information other than that supplied by or on behalf of the importer.

7. The 'general expenses" include the direct and indirect costs of marketing the goods in question.

8. Local taxes payable by reason of sale of the goods for which a deduction is not made under the provisions of Article 5.1 (a) (iv) shall be deducted under the provisions of Article 5.1 (a) (i).

9. In determining either the commissions or the usual profits and general expenses under the provisions of Article 5.1, the question whether certain goods are "of the same class or kind" as other goods must be determined on a case-by-case basis by reference to the circumstances involved. Sales in the country of importation of the narrowest group or range of imported goods of the same class or kind, which includes the goods being valued, for which the necessary information can be provided, should be examined. For the purposes of Article 5, "goods of the same class or kind" includes goods imported from the same country as the goods being valued as well as goods imported from other countries."

As regards the time element the Note explains as follows:

"10. For the purposes of Article 5.1 (b), the "earliest date" shall be the date by which sales of the imported goods or of identical or similar imported goods are made in sufficient quantity to establish the unit price."

On objective and quantifiable data the Note explains as follows:

"11. Where the method in Article 5.2 is used, deductions made for the value added by further processing shall be based on objective and quantifiable data relating to the cost of such work. Accepted industry formulas, recipes, methods of construction, and other industry practices would form the basis of the calculations."

The Note has dealt with the situation where further processing is done before resale as follows:

"12. It is recognized that the method of valuation provided for in Article 5.2 would normally not be applicable when, as a result of the further processing, the imported goods lose their identity. However, there can be instances where, although the identity of the imported goods is lost, the value added by the processing can be determined accurately without unreasonable difficulty. On the other hand, there can also be instances where the
imported goods maintain their identity but form such a minor element in the goods sold in the country of importation that the use of this valuation method would be unjustified. In view of the above, each situation of this type must be considered on a case-by-case basis."

"Goods of the same class of kind"

It may be recalled the expression 'goods of the same class of kind' used in Article 5.1 (a) (i) has been separately defined at Article 15.3 as follows:

"In this Agreement "goods of the same kind or class" means goods which fall within a group or range of goods produced by a particular industry or industry sector, and includes identical or similar goods."

Further Discussions on DVM: Practical Utility

Considering the practical usefulness of the deductive value method, it deserves further detailed discussion. The Customs administrations can find the DVM quite useful in re-determination of value in cases where the declared value is found to be significantly lower compared to either the price quoted in the international commodity/metal/plastic bulletin or the cost of raw material and manufacturing of the imported goods, but where there are no higher contemporaneous import price of identical of similar goods. In such situations, the rejection of transaction value may not be difficult in terms of Decision 6.1 But value cannot be re-determined under any of the methods at Article 2 or Article 3, since there are no contemporaneous higher price. In such a situation, the Customs administration can take recourse to the provisional clearance of such goods by assessing the goods provisionally at the declared transaction value against the bond backed by suitable cash security or bank Guarantee.

After provisional clearance, the Customs can undertake a quick investigation for application of Deductive Value Method. A market enquiry may be undertaken with regard to the unit price at which the imported goods or identical/similar goods imported previously are sold in the greatest aggregate quantity to persons who are not related to the importers/subsequent sellers. On ascertaining such unit price on the basis of appropriate market enquiry, the Customs can determine the Assessable value after allowing deductions as provided under Article 5.1. If however after undertaking an exercise as explained above, it is found that the value arrived at in terms of Article 5 is not significantly higher than the declared invoice price, in that case the transaction value can be accepted. This procedure can be followed basically in respect of certain consumer items imported through third countries, where the declared value is found to be ridiculously low and there is no contemporaneous importation of higher price because of formation of cartel by those importers. The methodology is further explained below:

Goods Resold in condition as Imported

(i) Start with the Resale Price in Nepal:

In DVM, the starting point is the resale price in Nepal. Thereafter, appropriate deductions are made to arrive at a value at the place of importation. If however, the imported goods are resold only after further processing, then the resale price after processing is taken as the base and then further deductions are made for the value added during the processing. In the case of goods resold in the condition as imported, the first consideration is to find the Resale Price. The Resale Price is based on the resale of the goods being valued or resale of identical or similar goods only if they are also resold in the condition as
imported.

The term ‘identical’ and ‘similar’ have the same meanings as laid down in Article 15. There is however, no special preference given to resale of the goods being valued. One may straightaway go in for resale price of identical or similar goods by disregarding the resale of the goods being valued, while fixing the unit prices.

The clause ‘in the condition as imported’ has to be so interpreted that natural changes like evaporation, shrinking, weathering etc. and simple acts like unpacking to remove the overseas packing material etc. are not to be regarded as changes in condition if they are usual. But repacking, putting trademark or any other processing, howsoever minor, will alter the condition of the goods.

The DVM also prescribes certain criteria regarding the buyer to whom the goods are to be resold. First, there must not be any relationship between the importer and the buyer in the country of importation. Here one is not talking about the relationship between importer and exporter. Secondly, the Notes put two requirements regarding the buyer, - the buyer must be ‘at the first commercial level after importation’ and any resale must be disregarded if the buyer supplied any assist specified in Article 8.1(b) to the manufacturer or exporter for use in connection with production of the goods. As regards ‘first commercial level’, any first sale after importation will automatically be a sale at the first commercial level after the event of importation. In ordinary commerce, the importer would sell to wholesalers who would sell to retailers, who in turn would sell to consumer. Only the sales from the importers to their unrelated wholesalers are to be considered. If the importer has a mix of customers including wholesalers and retailers, only the sales to wholesalers will have to be taken into account, so as to avoid the risk of mixing deductions, which are not comparable.

As regards time of resale, first requirement is that it must take place at or about the time at which the declaration for determination of value is presented. The Code provides for considering resale price of identical or similar goods so as to avoid delay in valuation until the imported goods being valued are resold. If there is no sale as per the first requirement, sales at ‘the earliest date’ after the importation have been provided for use. The expression ‘the earliest date’ has again been explained in the Notes to be the date by which the resales are made in sufficient quantity so as to establish the unit price. In deciding this, due consideration and cooperation between the Customs and the importer would be essential.

The concept of ‘the greatest aggregate quantity’ has been introduced to deal with sales at different prices and the Notes explain this with three examples.

(ii) **Undertake the Deductions:**

Article 5 provides for three basic categories of deductions:

a. **Agent's commission, Distributor's profits and General Expenses which are usual.**

The idea is that the mark-up, which usually gets added to the value in the first resale after importation would need to be deducted. The commission of an agent will normally be lower than the mark-up of a distributor and it should not be difficult to quantify these. The agent’s commission may be based on a percentage of sales or may be a fixed amount or any combination of the two. Advertising expenses incurred by the agent but reimbursed by the exporter are not incurred by the agent ‘for his own account’, and therefore, would not be deductible. The
general expenses would cover all overhead and selling expenses, as distinct from manufacturing expenses. Since in this case there is no question of manufacturing expenses, all his expenses being selling expenses would be deductible. If general expenses are reduced, the distributor’s profit increases correspondingly. Therefore, the Notes provide that profit and general expenses should be taken as a whole, and that the general expenses include the direct and indirect costs of marketing the goods in question.

It is also significant to note that the commissions and mark-ups to be deducted must be those, which are ‘usually paid’ in connection with ‘sales in Nepal of imported goods of the same class or kind.’ Article 15.3 has defined the expression “goods of the same class or kind”. The notes have however cautioned that the class or kind test ‘must be determined on a case by case basis’, by considering sales of ‘narrowest group of imported goods of the same class or kind, which includes the goods being valued for which necessary information can be provided...” As regards the expression “usually paid", para 6 of the Notes gives certain guidelines for determining the usual commission for the class or kind of goods. The Note further explains that the figures provided by the importer should be accepted unless Customs produce figures on the basis of experience of others which have a better claim to being termed “usual.” It is also to be noted that the concept of ‘class or kind’ is much broader than the narrow concepts of identical or similar goods.

b. *Usual costs of Transport, Insurance etc after the goods enter Nepal:*

These costs represent value added to the goods after the point of importation and therefore, would need to be deducted in DVM. Usual cost of transportation should be, to the extent possible, the actual average inland cost incurred in resale of the imported goods. The insurance cost would need apportionment so that insurance charges for events after importation only is deducted. The expression ‘associated costs’ would refer to costs associated with the process of transport and would include charges for handling and storage.

c. *Customs deductions and taxes on resale:*

Duties and taxes are deductible if they are included in the resale price. The Note further provides that if they are not deducted under Article 5.1 (iv), they would be deducted under Article 5.1 (a) (i), as part of the usual general expenses or commission.

**Goods Resold After Further Processing**

Article 5.2 provides for DVM in cases where goods are resold only after further processing. This method which is also known as "Super-deductive Value Method" (SDVM), applies only where neither the goods being valued nor identical or similar goods are sold in the condition as imported. It is however to be noted that SDVM is based on the resale price after further processing of only the imported goods being valued, and not of identical or similar goods similarly processed. The requirements as to the greatest aggregate quantity and unrelated buyers and the conditions of deductions are the same as under Article 5.1. The additional deduction factor would be the question of value added to the imported goods by such processing.
Commentary 15.1 on "Application of Deductive Value Method"

The Commentary 15.1 has dealt with the issues that may arise in application of FVM in an exhaustive manner. It is reproduced below:

"1. This commentary addresses questions of a general nature that may arise in administering the provisions of Article 5.1. In this regard, it is recognized that the Interpretative Notes to that Article already provide considerable guidance.

2. In general, the application of the deductive value method under Article 5 of the Agreement may differ in one set of circumstances from another. Therefore, the practical application of Article 5 requires a flexible approach, having regard to the circumstances in each case.

3. In determining the sales in the greatest aggregate quantity, the first question that may arise is whether the application of Article 5.1 is restricted to sales of the imported goods or identical or similar imported goods made by the importer of the imported goods or would the Article permit taking into consideration sales of identical or similar goods imported by other importers?

4. While paragraph 1 (a) of Article 5 and its Interpretative Notes does not appear to prohibit taking into consideration sales of identical or similar goods imported by other importers, as a practical measure, if sales of the imported goods or identical or similar goods have been made by the importer, it may not be necessary to look for sales of identical and/or similar goods made by other importers.

5. Customs would have to decide, having regard to the circumstances of each individual case, whether sales made by other importers need to be taken into consideration when there are sales of the imported goods or sales of identical or similar imported goods by the importer of the imported goods being valued.

6. Another question, closely related to the first one, is whether in applying Article 5.1, there is any hierarchy in using sales of the imported or identical or similar imported goods in determining the price per unit.

7. A practical application of paragraph 1 (a) of Article 5 would require that if sales of the imported goods are available, it may not be necessary to take into consideration sales of identical or similar imported goods for the purpose of arriving at the price per unit of the sales in the greatest aggregate quantity. When sales of the imported goods are not available, sales of identical or similar goods may be taken in sequential order.

8. After determining the price per unit under Article 5.1, it is necessary to deduct the elements provided for in the said Article.

9. In the practical administration of this provision, several factors need to be considered. One relates to the criteria necessary to determine the amount of commission or profit and general expenses that could be considered as usually paid or agreed to be paid”.

10. The wording of Article 5 and its Interpretative Notes makes it clear that the deduction to be made is for the amount of commission or profit and general expenses that is usually obtained in sales in the country of importation of imported goods of the same class or kind. This deduction should be based on figures supplied by or on behalf of the importer.
unless these figures are inconsistent with the usual.

11. The usual amount for commission or profit and general expenses could constitute a range of amounts which probably would vary according to the class or kind of the goods being valued. In order for a range to be acceptable, it should be neither too wide nor too deficient in population. The range should be obvious and easily discernible in order for it to be the “usual” amount. Other approaches might also be possible, e.g. the use of a preponderant amount (where such an amount exists) or an amount derived by simple - or weighted averaging.

12. Another consideration is that Article 5 merely stipulates that the deduction will be for either commission or profit and general expenses but it does not establish the criteria for determining which of those is to be deducted. In dealing with this issue and having regard to the General Introductory Commentary of the Agreement which recognizes that Customs value should be based on simple and equitable criteria consistent with commercial practices, a deduction for commission would normally occur where the sale in the country of importation of the goods being valued was or is to be made on an agency/commission basis. The deduction for profit and general expenses would normally be resorted to in transactions which do not involve commissions.

13. Another question has to do with collecting and maintaining up-to-date data on the usual amounts of commission and profit and general expenses.

14. As a practical matter, it would not appear useful that data necessary for ascertaining the usual amounts for commission or profit and general expenses be obtained and maintained on an ongoing basis. Where need arose, such data could be generated only to meet specific requirements. In many instances, practical application will require Customs to consider situations involving multi-product companies, small industries with a limited number of importers, industries with a large number of related party transactions, etc. on a case by case basis. In this context, Customs could have recourse to its own records. The data could also be obtained from trade organizations, other importers, accounting firms, government agencies responsible for commerce and fiscal affairs or any other reliable source.

15. The methodology for obtaining the data may vary according to national considerations but may include, inter alia, surveys of known importers of goods of the same class or kind, who, upon request, may supply that data on a courtesy basis and valuation reviews involving known importers. Considering that companies may not maintain information on profit and general expenses by specific product, administrations may have to follow the principle of examining profits and general expenses from the narrowest group or range of goods for which sufficient information can be obtained.”

Advisory Opinion 9.1 on "Treatment of Antidumping and Countervailing Duties when applying the Deductive Value Method."

The Advisory Opinion 9.1 is reproduced below:

"1. When imported goods which are subject to anti-dumping or countervailing duties fall to be valued by the deductive method under Article 5 of the Agreement, should those duties be deducted from the selling price in the country of importation?

2. The Technical Committee on Customs Valuation expressed the following opinion.

In the determination of Customs value under the deductive method, anti-dumping and
countervailing duties should be deducted under Article 5.1 (a) (iv) as Customs duties and other national taxes."

**Practical Application of Deductive Value Method**

**Introductory Discussion**

i. By this method, the Customs value is determined on the basis of sales in the country of importation of the goods being valued or of identical or similar imported goods, less certain specified expenses resulting from the importation and sale of the goods.

ii. The sales in the country of importation must meet the following conditions:

   a. the goods have been resold in the country of importation in the same condition as imported;

   b. sales of the goods being valued or of identical or similar goods have taken place at the same or substantially the same time as the time of importation of the goods being valued;

   c. if no sales took place at or about the time of importation, it is permitted to use sales up to 90 days after importation of the goods being valued;

   d. if there are no sales of identical or similar imported goods in the condition as imported that meet all the above requirements, the importer may choose to use sales of the goods being valued after further processing;

   e. the purchaser in the country of importation must not have supplied assists, either directly or indirectly;

   f. the purchaser must not be related to the importer from whom he buys goods at the first commercial level after importation.

iii. The unit price at which the greatest number of units is sold must be established. Commercial invoices will serve as the primary basis for establishing the price per unit.

iv. A deductive value is determined by making a deduction from the established price per unit for the aggregate of the following elements:

   a. commissions generally earned on a unit basis in connection with sales in the country of importation for goods of the same class or kind;

   -OR-

   b. profit and general expenses generally reflected on a unit basis in sales in the country of importation for goods of the same class or kind;

   -AND-

   c. the usual transport, insurance and associated costs incurred within
the country of importation; i.e. Nepal

d. Customs duties and taxes of the importing country. i.e. Nepal.

e. Value added by assembly or further processing, when applicable;

**Verification of Entries for determination of value Under DVM - General Checks**

h. Confirm that the goods could not have been valued under Methods 1, 2 or 3. If one of these methods should have been used, proceed in accordance with the appropriate method. If Method 4 is appropriate, continue as follows.

ii. Check that the signatory of the value declaration is entitled to sign. Confirm that the details on the declaration agree with the entry and supporting documents.

iii. Confirm that there is evidence of a sale, e.g. sales contract, invoice and evidence of payment, etc.

iv. Confirm that the goods were sold after importation to persons who:

a. were not related to the persons from whom they buy goods;

b. had not supplied, directly or indirectly, free of charge or at a reduced cost, any of the goods or services for use in connection with the production and sale for export of the imported goods listed in subparagraph 8.1 (b) of the WTO Valuation Agreement.

**Unit Price Verification**

i. Confirm the prices paid by the domestic purchaser by reference to the trader’s records, computer printout of sales and payments, photocopy of sales ledger, inventory records, sales invoices and documentary evidence submitted to the internal revenue agency.

ii. Confirm that the unit price has been calculated correctly:

a. if there is one sale of the imported goods being valued or of identical or similar imported goods, the unit price of the goods will be calculated from that sale;

b. if there is more than one sale, the unit price will be calculated from the first commercial-level sales of the imported goods or of identical or similar imported goods, which involve the greatest number of units sold at a common price;

c. in determining the price per unit, no account is taken of the trade level, i.e. whether the sale is to a wholesaler, a distributor or a retailer.

iii. Confirm that the imported goods or identical or similar goods have been sold, either at or about the time of the importation of the goods being valued, or in the condition as imported before the expiration of 90 days after they have been imported.
iv. Confirm that a sufficient number of units have been sold. The decision as to what is a sufficient number will be made on a case-by-case basis, depending on the circumstances and the marketing practices surrounding the importation and the sales in the country of importation. For example, the price per unit at which the greatest number of goods is sold might not be acceptable if the number of goods sold within the time-limits established in foregoing paragraph iii above is only a small percentage of the total sales of those goods. However, these sales may be acceptable for the purposes of establishing a price per unit if the price at which they are sold is consistent with the usual selling price of the goods.

v. Confirm that the use of sales of goods being processed further after importation is justifiable:
   a. when the imported goods lose their identity as a result of the further processing, Method 4 would normally not be applicable;
   b. when the value added by the processing can be determined accurately without unreasonable difficulty, although the identity of the imported goods is lost, the application of Method 4 may be justified;
   c. sales of goods further processed should be made within a certain period (e.g. 180 days) from the time of importation of the goods being valued;
   d. the importer must indicate selection of this method in writing.

Deductions

i. Establish that the amount of commission or profit and general expenses is one usually obtained in sales in the country of importation of imported goods of the same class or kind. This usual amount could constitute a range of amounts which is obvious and easily discernible in order for it to be the ‘usual” amount. The usual amount can be calculated, for example, by simple or weighted averaging, or by the use of a preponderant amount.

ii. Establish whether the sale in the country of importation of the goods being valued is or is not made on a commission basis. The deduction for profit and general expenses would normally be resorted to in transactions which do not involve commissions.

iii. Confirm that other deductions, e.g. transportation costs within the country of importation, duties and taxes, overseas freight charges, have been calculated correctly.

iv. Confirm that costs of further processing have been calculated correctly.

Computed Value Method

General Discussion

When the Customs value of the imported goods cannot be determined in terms of methods described in Article 1, 2, 3 and 4, the next method to be attempted for determination of the Customs value is the Computed Value Method (CVM) of Article 6. Determination of value under CVM would entail examination of costs of production, usual profit and general expenses and finally the delivery costs.
Article 6 is reproduced below:

"1. The Customs value of imported goods under the provisions of this Article shall be based on a computed value. Computed value shall consist of the sum of:

a) the cost or value of materials and fabrication or other processing employed in producing the imported goods;

b) 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;

c) the cost or value of all other expenses necessary to reflect the valuation option chosen by the Member under Paragraph 2 of Article 8.

2. No Member may require or compel any person not resident in its own territory to produce for examination, or to allow access to, any account or other record for the purposes of determining a computed value. However, information supplied by the producer of the goods for the purposes of determining the Customs value under the provisions of this Article may be verified in another country by the authorities of the country of importation with the agreement of the producer and provided they give sufficient advance notice to the Government of the country in question and the latter does not object to the investigation."

Interpretative Note to Article 6

The Interpretative Note to Article 6 in its first paragraph explains the limitations in applying this method of valuation. It thereafter elaborates on certain expressions used in Article 6. The expression are "cost or value" at paragraph 2 & 3; "amount for profit and general expenses" at paragraph 4 & 5; "general expenses" at paragraph 7; "goods of the same class or kind" at paragraph 8.

The Interpretative Note is reproduced below:

"1. As a general rule, Customs value is determined under this Agreement on the basis of information readily available in the country of importation. In order to determine a computed value, however, 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. Furthermore, in most cases the producer of the goods will be outside the jurisdiction of the authorities of the country of importation. The use of the computed value method will generally be limited to those cases where the buyer and seller are related, and the producer is prepared to supply to the authorities of the country of importation the necessary costings and to provide facilities for any subsequent verification which may be necessary.

2. The “cost or value” referred to in Article 6.1(a) is to be determined on the basis of information relating to the production of the goods being valued supplied by or on behalf of the producer. It is to be based upon the commercial accounts of the producer, provided that such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced.

3. The “cost or value” shall include the cost of elements specified in Article 8.1(a) (ii) and (iii). It shall also include the value, apportioned as appropriate under the provisions of
the relevant note to Article 8, of any element specified in Article 8.1(b) which has been supplied directly or indirectly by the buyer for use in connection with the production of the imported goods. The value of the elements specified in Article 8.1(b)(iv) which are undertaken in the country of importation shall be included only to the extent that such elements are charged to the producer. It is to be understood that no cost or value of the elements referred to in this paragraph shall be counted twice in determining the computed value.

4. The “amount for profit and general expenses” referred to in Article 6.1(b) is to be determined on the basis of information supplied by or on behalf of the producer unless his figures are inconsistent with those 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.

5. It should be noted in this context that the “amount for profit and general expenses” has to be taken as a whole. It follows that if, in any particular case, the producer’s profit figure is low and his general expenses are high, his profit and general expenses taken together may nevertheless be consistent with that usually reflected in sales of goods of the same class or kind. Such a situation might occur, for example, if a product were being launched in the country of importation and the producer accepted a nil or low profit to offset high general expenses associated with the launch. Where the producer can demonstrate that he is taking a low profit on his sales of the imported goods because of particular commercial circumstances, his actual profit figures should be taken into account provided that he has valid commercial reasons to justify them and his pricing policy reflects usual pricing policies in the branch of industry concerned. Such a situation might occur, for example, where producers have been forced to lower prices temporarily because of an unforeseeable drop in demand, or where they sell goods to complement a range of goods being produced in the country of importation and accept a low profit to maintain competitiveness. Where the producer’s own figures for profit and general expenses are not consistent with those 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, the amount for profit and general expenses may be based upon relevant information other than that supplied by or on behalf of the producer of the goods.

6. Where information other than that supplied by or on behalf of the producer is used for the purposes of determining a computed value, the authorities of the importing country shall inform the importer, if the latter so requests, of the source of such information, the data used and the calculations based upon such data, subject to the provisions of Article 10.

7. The “general expenses” referred to in Article 6.1(b) covers the direct and indirect costs of producing and selling the goods for export which are not included under Article 6.1(a).

8. Whether certain goods are “of the same class or kind” as other goods must be determined on a case-by-case basis with reference to the circumstances involved. In determining the usual profits and general expenses under the provisions of Article 6, sales for export to the country of importation of the narrowest group or range of goods, which includes the goods being valued, for which the necessary information can be provided should be examined. For the purposes of Article 6, “goods of the same class or kind” must be from the same country as the goods being valued."
Further Discussion of CVM

As may be seen from the Interpretative Note, determination of computed value would entail examination of costs of producing the goods where in most cases the producer will be outside the jurisdiction of the proper officer. Therefore, the use of the computed value method will generally be limited to those cases where the buyer and seller are related and the producer is prepared to supply the information. The provisions of Article 6.1 and its Interpretative Note are rather specific as to what information is required and how it may be obtained, and there is an emphasis on the use of generally accepted accounting principles.

Difficulties may however arise in respect of rights of access to confidential cost and profit information, and in the areas of accounting methods to be employed. On the first point, it is clear from the Notes that there is no compulsion for the producer to furnish sensitive information and permit verification. But if they do so, the Customs in the importing country is obliged to keep such information confidential. On the second issue, it has been clarified that the accounting questions would be governed by the Generally Accepted Accounting Principles (GAAP) and by the methods of accounting and record keeping as employed in practice by the concerned parties.

The cost or value of materials and fabrication/processing is the first of the three elements that would constitute the computed value. Here, the idea is to ascertain the actual figures relating to the production of the imported goods, and not the current cost at the time of importation. The Notes have explained that the cost or value is to be based upon the commercial accounts of the producer, provided that such accounts are consistent with GAAP in the country of production. The Notes also specify the addition of cost of packing and container and dutiable assists. In respect of assists covered by Article 8.1 (b) (iv) and undertaken in Nepal, these will be added only to the extent that such elements are charged to the producers.

In CVM, the second element of addition is the usual profit and general expenses. The discussions made earlier in this Chapter in respect of profits and general expenses and class or kind in DVM will also be relevant in CVM, only with the difference that in respect of CVM, the considerations would be limited to the same country of exportation and same country of importation as the goods being valued. The Notes have specified that the ‘amount for profit and general expenses’ has to be taken as a whole. This aspect has been explained with a few illustrative situations. While recognizing the producer’s right to demonstrate the reasons for his low profit, the Notes also provide for determining the amount of profit and general expenses based on relevant information other than that supplied by producer. As regards ‘general expenses’ the Notes have provided wide coverage by saying that general expenses would cover such direct and indirect costs of producing and selling the goods which are left uncovered by clause (a) of Article 6.1. There may be certain border-line cases where the same element may in some cases be treated as production cost and in some cases as general expenses; the depreciation in plant and machinery is one such example. Care has to be taken not to include any item twice. This may particularly happen when production costs are based on figures provided by the producer, whereas profit and general expenses figures are taken from the experience of others.

In view of CIF option chosen by Nepal, the third element for inclusion in CVM comprises cost of transportation, insurance, loading, unloading and associated activities as specified in Article 8.2.
Because of certain inherent difficulties like access to information, reluctance to cooperate with enquiring agency of another country, CVM may not be a popular method of valuation. Examination of confidential data regarding a business or industry of another country by the Customs of one country may not be that effective. The inquiries from another country as to production costs and profit margins may sometimes be viewed as commercial or industrial espionage. It is for these reasons that the Agreement provides for the right of the producer to refuse to give information and to permit subsequent verification. In fact because of these difficulties, at the request of the developing countries, the Agreement provided for deferment of implementation of this particular provision.

Reversal of the order of application of Article 5 & Article 6 - Article 4

Article 4 while authorizing determination of Customs value by Deduction Value Method of Computed Value Method in the event of failure to apply the earlier methods of Articles 1, 2 and 3, also gives an option to the importer to request for reversing the order of application of Article 5 & Article 6.

The text of Article 4 is reproduced below:

"If the Customs value of the imported goods cannot be determined under the provisions of Articles 1, 2 and 3, the Customs value shall be determined under the provisions of Article 5 or, when the Customs value cannot be determined under that Article, under the provisions of Article 6 except that, at the request of the importer, the order of application of Articles 5 and 6 shall be reversed.

Practical Application of Computed Value Method

Introductory Discussion

(i) Under this method, the Customs value is determined on the basis of the cost of production of the goods being valued, plus an amount for profit and general expenses usually reflected in sales from the country of exportation to the country of importation of goods of the same class or kind.

(ii) The Customs value may be calculated as follows:

(a) first, determine the aggregate of the relevant costs, charges and expenses or the value of:

(i) materials employed in producing the imported goods, and

(ii) production or other processing costs for the imported goods (direct and indirect labor, factory overheads);

(b) the following are to be added if not included in (i) and (ii) above:

(i) packing costs and charges,

(ii) assists (apportioned in a reasonable manner in accordance with generally accepted accounting principles

(iii) engineering work, artwork, etc., undertaken in the country of importation and charged to the producer;
(c) add amounts for profit and general expenses usually reflected in export sales to the country of importation by producers in the country of export of goods of the same class or kind;

(d) add the cost of transport, insurance and related charges to the port or place of importation, since Nepal bases its valuation law on c.i.f.

Verification of entries for determination of value under Computed Value Method.

General Checks

i. Confirm that the goods could not have been valued under Methods 1, 2, 3 or 4 (if the importer requests to change the order of application of Methods 4 and 5, Method 5 must be applied before Method 4). If one of these methods should have been used, proceed in accordance with the appropriate method. If Method 5 is appropriate, continue as follows.

ii. Confirm that the producer is prepared to supply to Customs the necessary costing and to provide facilities for any subsequent verification which may be necessary. If Customs is unable to satisfy itself as to the truth or accuracy of the information presented, this Method may not be used.

iii. Confirm that the declared “cost or value” under this method is based upon the commercial accounts of the producer, and that such accounts are consistent with the generally-accepted accounting principles applied in the country where the goods are produced.

Cost of Material:

(i) Check that the cost or the value of materials used in producing the imported goods has been identified correctly.

Note: Materials would include:

(a) raw materials, such as lumber, steel, lead, clay, textiles, etc.;
(b) costs associated with the transportation of the raw materials to the place of production;
(c) partly assembled or semi-finished goods such as integrated circuits;
(d) components which will eventually be assembled or used in the production of the finished product.

Cost of Production

Check that the cost of the production or other processing of the imported goods has been identified correctly.

Note: The cost of production would include:

(a) the costs for direct and indirect labor;
(b) any costs for assembly where there is an assembly operation instead of a manufacturing process;
(c) indirect costs such as factory supervision, plant maintenance, overtime, etc.;
(d) the amount of internal tax imposed by the country of exportation that is directly applicable to the materials or their disposition. However, if the tax is remitted or refunded upon the exportation of the merchandise, it should not be included in the Customs value.

Cost of Container & Packing

i. Check that the cost of containers which are treated as one with the imported goods for Customs purposes has been identified correctly.

ii. Check that the cost of packing, whether for labor or materials, has been identified correctly.

Value of Assists:

Check that the value of assists has been calculated correctly and that the seller has not included the value of an assist in his selling price. Note that the value of any assist is not to be counted twice.

Note:

(a) the value of engineering, development, art work, design work, and plans and sketches undertaken in the country of importation must be included if the value of such assists is charged to the producer;

(b) apportionment of the values of assists is referred to in paragraph 4.7.5 of Chapter 4.

Delivery Cost

Check that the costs of transport, insurance and related charges have been calculated correctly, particularly since Nepal’s valuation is on a c.i.f. basis.

Profit and General Expenses

Confirm that the amount for profit and general expenses been identified correctly.

Note:

(a) the amount for profit and general expenses must be determined on the basis of information supplied by or on behalf of the producer, unless his figures are inconsistent with those usually reflected in sales of goods of the same class or kind;

(b) the amount for profit and general expenses has to be taken as a whole. It follows that if in any particular case, the producer’s profit figure is low and his general expenses are high, his profit and general expenses taken together may nevertheless be consistent with that reflected in sales of goods of the same class or kind;

(c) where the producer can demonstrate that he is taking a low profit on his sales of the imported goods because of particular commercial circumstances, his actual profit figures should be taken into account if he has valid commercial reasons to justify them (such as an unforeseeable drop in demand) and his pricing policy reflects usual pricing policies in the branch of industry concerned.

Importer's right

Where information other than that supplied by or on behalf of the producer is used for the
purpose of determining a computed value, Customs should inform the importer, if the latter so requests, of the source of such information, the data used and the calculations based upon such data, subject to the provisions of Article 10 of the WTO Valuation Agreement.

Answers to common questions that a field officer may ask on DVM and CVM

1. When can one apply the deductive value method and what are its salient features?

   **Ans:** The deductive value method comes next in the hierarchy of valuation methods to be applied where the ones described earlier fail. By this method, the value for assessment is determined on the basis of sales in the country of importation of the goods being valued or of identical or similar imported goods, less certain specified expenses resulting from the importation and sale of the goods.

   The sale in the country of importation should satisfy the following conditions:
   - the goods have been resold in the same condition as imported;
   - sales of the goods have taken place at or about the time of importation of the goods being valued;
   - if there are no sales at or about the time of importation, sales made at the earliest date, but not later than 90 days, after importation of the goods being valued can be used;
   - if there are no sales of identical or similar imported goods in the same condition as imported, sales of goods being valued after further processing can be used; and
   - the purchaser must not be related to the seller in the country of importation.

   The unit price at which the greatest number of units is sold must be found. Deductive value is determined by deducting from such unit price the following:
   - Commissions usually paid or profits and general expenses usually added for sale in the country of importation of imported goods of the same class or kind;
   - Usual transport, insurance and other associated costs incurred within the country of importation;
   - Customs duties and other taxes payable in the country of importation on import and sale; and
   - Value added by processing when applicable.

2. When can one apply the computed value method and what are its salient features?

   **Ans:** The computed value method is the next method of valuation in the hierarchical sequence. However, there is a provision for reversing the sequence of application of the computed method with that of deductive value method at the option of the importer.

   Under this method, the value for assessment is based on computed value which
shall be the sum of:

- The cost of materials, fabrication and processing;
- An amount for profit and general expenses for sales of goods of the same class or kind in the country of exportation for export to the country of importation; and
- The cost of transport, insurance and loading, unloading and handling charges since these are required to be added to the Customs value under the law in Nepal.

The use of this method will be generally limited to those cases where the buyer and seller are related, and the producer is prepared to supply the necessary costing and facilities for subsequent verification to the Customs authorities in the country of importation. Under paragraph 2 of Article 6 of the ACV, the information supplied by the producer can be verified by the Customs authorities of the importing country in another country only with the agreement of the producer and only if the government of that country does not object to such investigation.

**FALL BACK METHOD**

**General Discussion**

Article 7 provides the Fall-Back Method of determination of Customs value, in a situation where all other preceding methods of determination of Customs value have failed. Article 7 provides for using reasonable means, consistent with the five preceding methods of valuation given at Article 1, 2, 3, 5 and 6, and also consistently with Article VII of the GATT, 1994. Further, the reasonable means would have to be used on the basis of data available in the country of importation i.e. Nepal. The second paragraph of this Article lists out the forbidden methods; there are seven prohibitory clauses (a) to (g) in Article 7.2. Thus a two-fold fall-back position has been adopted in Article 7, one by permitting flexible application of the preceding valuation methods, and the principles and general provisions of Article VII of the GATT 1994, and the other by forbidding certain methods and approaches.

**Article 7 and its Interpretative Note**

Article 7 is reproduced below:

1. If the Customs value of the imported goods cannot be determined under the provisions of Articles 1 through 6, inclusive, the Customs value shall be determined using reasonable means consistent with the principles and general provisions of this Agreement and of Article VII of GATT, 1994 and on the basis of data available in the country of importation.

2. No Customs value shall be determined under the provisions of this Article on the basis of:
   
   a. the selling price in the country of importation of goods produced in such country;
   
   b. a system which provides for the acceptance for Customs purposes of the higher of two alternative values;
   
   c. the price of goods on the domestic market of the country of exportation;
d. the cost of production other than computed values which have been determined for identical or similar goods in accordance with the provisions of Article 6;

e. the price of the goods for export to a country other than the country of importation;

f. minimum Customs values; or

g. arbitrary or fictitious values.

3. If the importer so requests, the importer shall be informed in writing of the Customs value determined under the provisions of this Article and the method used to determine such value."

The Interpretative Note explains that the valuation methods employed under Article 7 may make use of the methods provided in Articles 1 to 6, inclusive, but with a reasonable flexibility. Further, valuation under Article 7 will have to be based on previously determined Customs value. A few examples of reasonable flexibility have also been given in the Note. The examples suggest that values of identical or similar goods could be accepted even if they came from a different country or even if the time of importation is different – earlier or later than the goods being valued. They could also be valued under DVM or CVM. In case of DVM, the Notes provide for flexibility regarding 'condition as imported' and the requirement of 90 days. Article 7 basically provides for reexamination of each limitation specified in the preceding methods of valuation at Articles 1 to 6, and arrive at a value by a little stretching of these limitations while at the same time staying as close as possible to the methods and data in the preceding methods of valuations.

The **Interpretive Note to Article 7** is reproduced below:-

"1. Customs values determined under the provisions of Article 7 should, to the greatest extent possible, be based on previously determined Customs values.

2. The methods of valuations to be employed under Article 7 should be those laid down in Article 1 to 6, inclusive. But a reasonable flexibility in the application of such methods would be in conformity with the aims and provisions of Article 7.

3. Some examples of reasonable flexibility are as follows:-

   a. *Identical goods*: the requirement that the identical goods should be exported at or about the same time as the goods being valued could be flexibly interpreted; identical imported goods produced in a country other than a country of exportation of the goods being valued could be the basis for Customs valuation; Customs values of identical imported goods already determined under the provisions of Articles 5 and 6 could be used.

   b. *Similar goods*: the requirement that the similar goods should be exported at or about the same time as the goods being valued could be flexibly interpreted; similar imported goods produced in a country other than the country of exportation of the goods being valued could be the basis for Customs valuation; Customs values of similar imported goods already determined under the provisions of Articles 5 and 6 could be used.

   c. *Deductive method*: the requirement that the goods shall have been sold in the "condition as imported" in Article 5.1 (a) could be flexibly interpreted; the ninety day's requirement could be administered flexibly."
Important elements of Article 7

The important elements of Article 7 are discussed below:

(A) Determination of Customs value using reasonable means consisted with

i. the principles and general provisions of the Agreement i.e. valuation methods of Articles 1 to 6, inclusive; and

ii. the principles and general provisions of Article VII of GATT, 1994.

As for the element at (a) (i) above, the different preceding methods of valuation have already been discussed in preceding chapter.

As for the element at (a) (ii) above, it would be necessary to reproduce below the extracts of those provisions of Article VII and its Note, which are relevant to the method of valuation.

Accordingly, the relevant provisions of Article VII of GATT and Note to Article VII are reproduced below:

"(a) 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, and should not be based on the value of merchandise of notional origin or on arbitrary or fictitious values.

(b) "Actual value" should be the price at which at a time and place determined by the legislation of the country of importation, such or like merchandise is sold or offered for sale in the ordinary course of trade under fully competitive conditions. To the extent to which the price of such or like merchandise is governed by the quantity in a particular transaction, the price to be considered should uniformly be related to either (i) comparable quantities, or (ii) quantities not less favorable to importers than those in which the greater volume of the merchandise is sold in the trade between the countries of exportation and importation.

(c) When the actual value is not ascertainable in accordance with sub-paragraph (b) of this paragraph, the value for Customs purposes should be based on the nearest ascertainable equivalent of such value."

"Note to Article VII
Paragraph 2

1. 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.

2. It would be in conformity with Article VII, paragraph 2 (b), for a Contracting Party to construe the phrase "in the ordinary course of trade……under fully competitive conditions", as excluding any transaction wherein the buyer and the seller are not independent of each other and price is not the sole consideration.

3. The standard of "fully competitive conditions" permits a contracting party to
exclude from consideration prices involving special discounts limited to exclusive agents.

4. The wording of sub-paragraphs (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 merchandise, or (2) on the basis of the general price level of like merchandise."

In may be noted that while the principles and general provisions of the Agreement are based on the concept of transaction Value, the principles and general provisions of Article VII of the GATT, 1994 are based on the concept of Deemed Value. The question can therefore naturally arise – Can Customs administration fall-back on the deemed value concept of Article VII of the GATT while resorting to Fall-back Method of Article 7? While the opinion is divided on this issue, one thing is clear that the deemed value concept of Article VII of the GATT cannot be used to reject the transaction value. The principles and general provisions of Article VII of the GATT can be of help only in determination of value in terms of Article 7, after the preceding methods failed.

(B) Data available in the country of importation i.e. Nepal

This element makes it very important for the Customs Administration to setup an extensive database, without which the Fall-back method of valuation cannot be applied. In this context, Advisory Opinion 12.3 clarifies an important issue. It would be discussed shortly.

(C) Forbidden elements

Seven forbidden elements have been unambiguously specified in Paragraph 2. In this context, the Advisory Opinion 12.1, which would be discussed below would also be relevant.

Advisory Opinion 12.1 on "Flexible Application of Article 7" is reproduced below:

"1. In the application of Article 7, can methods other than those set out in Articles 1 to 6 be used, if they are not prohibited by Article 7.2 (a) to (f) and are consistent with the principles and general provisions of the Agreement and of Article VII of the GATT 1994?

2. The Technical Committee on Customs Valuation expressed the following opinion. Paragraph 2 of the Interpretative Note to Article 7 provides that the methods to be employed under Article 7 should be those laid down in Articles 1 to 6 inclusive but applied with a reasonable flexibility.

However, if a Customs value cannot be determined by using these methods even in a flexible manner, as a final resort the Customs value may be determined using other reasonable methods provided that such methods are not precluded by Article 7.2.

In determining the Customs value under Article 7, the method used must be consistent with the principles and general provisions of the Agreement and of Article VII of the GATT 1994."
Advisory Opinion 12.2 on "Hierarchical Order in Applying Article 7" is reproduced below:

"1. When applying Article 7, is it necessary to follow the hierarchical order with respect to the methods of valuation in Articles 1 to 6?

2. The Technical Committee on Customs Valuation expressed the following view.

There is no provision in the Agreement that specifically provides that the hierarchical order of Articles 1 to 6 should be followed when Article 7 is applied. However, Article 7 requires the use of reasonable means consistent with the principles and general provisions of the Agreement and this indicates that where reasonably possible, the hierarchical order should be followed. Thus where several acceptable methods can be used to determine Customs value under Article 7, the hierarchy should maintained."

Advisory Opinion 12.3 on "Use of Data from Foreign Sources in Applying Article 7" is reproduced below:

"1. When applying Article 7 can Customs use information furnished by the importer but obtained by him from foreign sources?

2. The Technical Committee on Customs Valuation expressed the following view.

It is to be expected, in dealing with transactions which originate outside the country of importation, that a certain amount of data would come from foreign sources. However, Article 7 is silent as to the original source of information to be used in its application, merely requiring that such data be available in the country of importation. The source of the information would therefore not in itself be a bar to its use for the purposes of Article 7 provided that the information was available in the country of importation and Customs were able to be satisfied as to its truth or accuracy."

Practical Application of Fall-back Method

Introductory Discussion:

(i) When Customs value cannot be determined under any of the previous methods of valuation, it may be determined by applying in a flexible manner whichever of the previous methods most readily enables calculation of the Customs value. In determining Customs value under this residual method, no arbitrary, fictitious or prohibited methods of valuation are to be used. The Customs value should be fair, reasonable, uniform and neutral, and should reflect commercial reality to the extent possible.

(ii) Under the fall-back method, the Customs value must not be based on:

a. the selling price of goods produced in the country of importation;

b. the higher of two alternative values;

c. the price of goods on the domestic market of the country of exportation;
d. the cost of production, except under the computed value method;
e. the price of goods for export to a third country;
f. minimum Customs values; and
g. arbitrary or fictitious values.

(iii) The following are examples of various uses which could be made of the fall-back method:
a. a trotting horse, imported by a buyer three years after its purchase in the country of export was valued by an expert at importation at two times the purchase price on the basis of expert evaluation;
b. when there is no price actually paid or payable (and therefore no transaction value) for certain foreign-made components purchased as part of a system which also includes domestically-manufactured components, and there is no basis on which the price for the foreign components can be quantified, in the absence of an alternative basis of valuation, a method of valuation derived from computed value could be used to value the foreign components;
c. transaction value may not be used to value merchandise imported pursuant to a lease agreement, with an option to buy. However, where other bases of valuation may also not be used, a value may be based on the transaction value approach using the “option-to-buy” price in the lease agreement, reasonably adjusted to arrive at a value;
d. the Customs value of used machines could be determined on the basis of an expert’s estimation of the value of the machines in the condition as imported. No other methods were available in this case, as the machines were disassembled and used partly as spare parts by the importer in the country of importation;
e. a series of second-hand machines and appliances for a specific treatment of metal surfaces are sold at a nominal price of 5 currency units on the condition that the buyer demolishes the machines, neutralizes and destroys the chemicals used in the process and carries away the machines and appliances. These activities are carried out in the country of importation. The machines have been used for 15 to 20 years and can be used only after a fundamental repair. The Customs value of this equipment could consist of the cost of demolishing the machines, neutralizing and destroying the chemicals, and transporting the machines to the place of importation;
f. in the absence of data for the application of any other method, including the computed value method, the Customs value of video cassettes imported on hire terms for rehiring to private homes could be determined by applying flexibly the provisions for the transaction value of the goods imported. In that case the Customs value could be based on the amount of the royalties payable by the importer to the lessor during the hire period, including the cost of delivery of the cassettes to the place of importation.
g. waste oil was collected by an importer from foreign service stations,
industrial plants, etc. and transported to the country of importation to be used for heating the importer’s greenhouses. There was no charge for the waste oil, and its transportation in the country of importation was effected using the importer’s own vehicles. The Customs value was determined under Article 7 of the Agreement, by flexibly applying Article 6, and was composed of the cost of collecting the waste oil plus the cost of transportation to the place of importation.

Note: These examples are not WCO instruments, but only national conclusions on specific cases. Some of these examples have been summarized from the index of Rulings in the CCC Valuation Compendium. No conclusions should be drawn with respect to the inclusion or exclusion of an element in the determination of a Customs value solely on the basis of the description of these examples.

(iv) In applying the fall-back method, if more than one method can be applied flexibly, the normal sequence for using Methods 1 to 5 must be taken into account.

Verification of entries for determination of Customs value under Fall-back Method:

General Checks

(i) Confirm that the goods could not have been valued under Methods 1 to 5.

(ii) Establish how the declared value was calculated.

Note: The following are examples of how Method 6 might be used:

a. If there are no sales of similar goods produced in the same country as the country in which the goods being valued were produced but there are sales of similar goods produced in another country, it may be possible to use the latter as the basis for determining the Customs value under Method 6, provided the requirements of Method 3 are otherwise met.

b. If there are no sales which meet the 90-day requirement under Method 4 but there are sales which occurred, for example, 100 days after the importation of the goods being valued, it may be possible to use the latter as the basis for determining the Customs value under Method 6, provided the requirements of Method 4 are otherwise met.

Check relating to Para 1 of Article 7

i. Method 6 permits the requirements of previous methods to be applied flexibly but not disregarded completely. In applying the previous methods flexibly, the principles of valuation must be respected and care taken to ensure that the value derived from the method of valuation is not distorted either upwards or downwards.

Check relating to Para 2 of Article 7

i. Confirm that the declared value is not based on a prohibited method under the WTO Valuation Agreement
Other Checks

Confirm that all transport and insurance costs and related charges associated with the imported goods have been correctly taken into account.

ii. Confirm that any additions (e.g. tooling costs, materials supplied) that have been incurred are declared.

Answers to common questions that a field officer may ask:

1. When can one apply the fallback method and what are its salient features?

   Ans: When Customs value cannot be determined under any of the other methods of valuation, the same has to be determined applying those methods in a flexible manner and in accordance with the principles and general provisions of Article VII of GATT, 1994, on the basis of data available in the country of importation.

   The value of imported goods determined under this method should be based on previously determined Customs values to the extent possible. Since this method allows a flexible approach, some of the requirements under the earlier methods can be flexibly interpreted. For example, the value of identical and similar goods produced in other countries can be used. The requirements of identical and similar goods imported at or about the same time can be flexibly interpreted. The requirements of goods being sold in the condition as imported and the 90 days period under the deductive value method can be flexibly interpreted.

   In applying the fall-back method, if more than one of the previous methods can be applied flexibly, the normal sequence for using those methods should be taken into account.

2. Are there any restrictions under the fall-back method in using some value standards?

   Under the fall-back method, it is not permissible to base the value on:
   - the selling price in the country of importation of goods produced in such country;
   - the higher of two alternative values;
   - the price of goods in the domestic market of the country of exportation;
   - the price of goods for export to a country other than the country of importation;
   - minimum Customs values; or
   - arbitrary or fictitious value.
Lesson 8

[Conversion of Currency, Confidential Information, Appeal Systems, Right of Customs Administration, Right of Importers]

Valuation to be done in foreign currency

[From Valuation Manual Nepal]

The transaction value of the goods imported in Nepal should normally be determined in a foreign currency. Where the valuation of goods on which the duty has to be paid at the time of import is made in a foreign currency, the conversion of such currency into the Nepalese Rupees should be made according to the selling rate of that foreign currency prescribed by the Nepal Rastra Bank for the day on which the declaration form is registered in the Customs Office or received in the Customs Office in electronic medium through the computer system. In the case of a foreign currency of which exchange rate is not prescribed by the Nepal Rastra Bank, such foreign currency should be converted into American dollar and the selling rate of American dollar should be taken as the base.

Confidentiality

[from agreement between US and Korean Customs]

1. Where a Party providing information to the other Party in accordance with this Chapter designates the information as confidential, the other Party shall maintain the confidentiality of the information. The Party providing the information may, in accordance with its domestic law, require written assurances from the other Party that the information will be held in confidence, will be used only for the purposes specified in the other Party’s request for information, and will not be disclosed without the Party’s specific permission.

2. A Party may decline to provide information requested by the other Party where the other Party has failed to act in conformity with assurances provided under paragraph 1.

3. Each Party shall adopt or maintain procedures in which confidential information, including information the disclosure of which could prejudice the competitive position of the person providing the information, submitted in connection with the Party’s administration of its customs laws shall be protected from unauthorized disclosure.

Right of Importers

- Right to information as per customs act, right to information act
- right to reversal of the order of application of article 5 and article 6.
- Right to appeal
- Appointment of customs agent
Right of customs administration
Authority of the customs to seek explanation from importers about truth or accuracy of value declaration where there are reasons to doubt and to reject the transaction value

From Revised Koyoto Convention

CHAPTER 10 APPEALS IN CUSTOMS MATTERS
A. RIGHT OF APPEAL
10.1. Standard
National legislation shall provide for a right of appeal in Customs matters.
10.2. Standard
Any person who is directly affected by a decision or omission of the Customs shall have a right of appeal.
10.3. Standard
The person directly affected by a decision or omission of the Customs shall be given, after having made a request to the Customs, the reasons for such decision or omission within a period specified in national legislation. This may or may not result in an appeal.
10.4. Standard
National legislation shall provide for the right of an initial appeal to the Customs.
10.5. Standard
Where an appeal to the Customs is dismissed, the appellant shall have the right of a further appeal to an authority independent of the Customs administration.
10.6. Standard
In the final instance, the appellant shall have the right of appeal to a judicial authority.

B. FORM AND GROUNDS OF APPEAL
10.7. Standard
An appeal shall be lodged in writing and shall state the grounds on which it is being made.
10.8. Standard
A time limit shall be fixed for the lodgement of an appeal against a decision of the Customs and it shall be such as to allow the appellant sufficient time to study the contested decision and to prepare an appeal.
10.9. Standard
Where an appeal is to the Customs they shall not, as a matter of course, require that any supporting evidence be lodged together with the appeal but shall, in appropriate circumstances, allow a reasonable time for the lodgement of such evidence.
C. CONSIDERATION OF APPEAL

10.10. Standard
The Customs shall give its ruling upon an appeal and written notice thereof to the appellant as soon as possible.

10.11. Standard
Where an appeal to the Customs is dismissed, the Customs shall set out the reasons therefor in writing and shall advise the appellant of his right to lodge any further appeal with an administrative or independent authority and of any time limit for the lodgement of such appeal.

10.12. Standard
Where an appeal is allowed, the Customs shall put their decision or the ruling of the independent or judicial authority into effect as soon as possible, except in cases where the Customs appeal against the ruling.
Lesson 9
Outstanding Issues on International Practices
[WTO valuation committee decision 4.1, Advanced Ruling, Importers profiling, Information Exchange]

Decision 4.1

The Decision 4.1 which throws more light on the matter is reproduced below.

The Decision 4.1 of the Committee on Customs Valuation on this subject is reproduced below:

1. It is reaffirmed that transaction value is the primary basis of valuation under the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (the Agreement) and that its application with regard to data or instructions (software) recorded on carrier media for data processing equipment is fully consistent with the Agreement.

2. Given the unique situation with regard to data or instructions (software) recorded on carrier media for data processing equipment, and that some Parties have sought a different approach, it would also be consistent with the Agreement for those Parties which wish to do so to adopt the following practice:

   In determining the Customs value of imported carrier media bearing data or instructions, only the cost or value of the carrier medium itself shall be taken into account. The Customs value shall not, therefore, include the cost or value of the data or instructions, provided that this is distinguished from the cost or the value of the carrier medium.

   For the purpose of the Decision, the expression “carrier media” shall not be taken to include integrated circuits, semiconductors and similar devices; the expression “data or instructions” shall not be taken to include sound, cinematic or video recordings.

3. Those Parties adopting the practice referred to in paragraph 2 of this Decision shall notify the Committee of the date of its application.

4. Those Parties adopting the Practice in paragraph 2 of this Decision will do so on a most-favoured-nation (m.f.n.) basis without prejudice to the continued use by any Party of the transaction value practice.”

Commentary 13.1

Certain problems were however faced in the application of paragraph 2 of the aforesaid Decision 4.1. The Commentary 13.1 which has dealt with those problems is reproduced below.

1. This commentary examines the question of the valuation of carrier media bearing software for data processing equipment in the specific context of the application of paragraph 2 of the decision adopted by the Committee on Customs Valuation.

2. The principle to be taken into consideration in this respect is that in determining the Customs value of imported carrier media bearing data or instructions, only the cost or value of the carrier medium itself shall be taken into account. The Customs value shall not, therefore include the cost or value of the data or instructions, provided that this is distinguished from the cost or the value of the carrier medium.

3. A problem encountered in applying this decision relates to the provision to distinguish the cost or value of the data or instructions from the cost or value of the carrier medium; sometimes, only one price of the software and the carrier medium is available; at other times, only the price of the carrier medium is invoiced or only cost or value of the data or instructions is known.

4. As there is an option to apply or not to apply paragraph 2 of the decision, countries which choose to apply that decision should interpret this paragraph in the widest possible terms so as not to negate the intention of the decision. Therefore, the expression “distinguish” should be interpreted in such a manner that if only the cost or value of the carrier medium is known the cost or value of the data or instructions should be considered as distinguished.

5. If for any reason an administration considers that a separate declaration of the two costs or values is necessary and only one of the two is available, the second one could be determined by estimation, using reasonable means consistent with the principles and general provisions of the Agreement and of Article VII of the General Agreement. Similar estimation for arriving at separate values could be done in cases where only the total price of the two elements is available. Customs administrations which choose to follow the practice of estimation may find that consultation with the importer is necessary in arriving at a reasonable solution.

6. When at the time of importation the importer is not in a position to furnish sufficient information for this purpose, the provisions of Article 13 may apply.

7. The practice recommended in this commentary is applicable to the valuation for Customs purposes of carrier media bearing software and does not take into account other requirements such as the collection of statistics."

**Importer profiles and trade segmentation**

It is strongly recommended that importer profiles are developed which record historic compliance records and other relevant data on the business in question. This should include details of previous irregularities, under-declarations, penalties imposed, etc., as well as information on trade volumes and nature of the business. Risk ratings can then be allocated to each importer accordingly.
An important consideration when managing risk is to bear in mind that it is not efficient for Customs to invest disproportionate resources in controlling smaller operations where the potential revenue at risk is low, even though the risk of irregularities may be high. It is often the case, for example, that a small number of operators are importing a large percentage of the trade.

Some administrations are developing the concept of trade segmentation as an important element of their risk programme. This is based on assessing the size of importers in terms of trade volume, by value, which helps to determine the possible revenue risk and optimum type of control. The following tables show information provided by the Zambian Revenue Authority which uses this approach.

**TABLE 1**

<table>
<thead>
<tr>
<th>Importer Category</th>
<th>Annual Customs Value (Zambian Kwacha - billions)</th>
<th>% of total value</th>
<th>Number of companies</th>
<th>% of total number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>&gt; 70</td>
<td>89.6%</td>
<td>322</td>
<td>1.6</td>
</tr>
<tr>
<td>Medium</td>
<td>&gt; 10 &lt; 70</td>
<td>6.8%</td>
<td>790</td>
<td>3.0</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 10</td>
<td>3.6%</td>
<td>23,044</td>
<td>95.4</td>
</tr>
</tbody>
</table>

**TABLE 2**

<table>
<thead>
<tr>
<th>Importer Category</th>
<th>Risk</th>
<th>Treatment Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>1. Systemic errors</td>
<td>1. Audit-based control</td>
</tr>
<tr>
<td></td>
<td>2. Transfer pricing</td>
<td>2. Customs to Business Partnership</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Client education on identified weakness</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(informed compliance)</td>
</tr>
<tr>
<td>Medium</td>
<td>1. Limited/poor systems and internal controls</td>
<td>1. Audit-based control</td>
</tr>
<tr>
<td></td>
<td>2. Poor recordkeeping</td>
<td>2. Pre-entry risk-based control</td>
</tr>
<tr>
<td></td>
<td>3. No TPIN*</td>
<td>3. Client education on identified weakness</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(informed compliance)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Agent focus and control</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. TPIN* registration</td>
</tr>
<tr>
<td>Small</td>
<td>1. No fixed trading address/location</td>
<td>1. TPIN* registration</td>
</tr>
<tr>
<td></td>
<td>2. No TPIN*</td>
<td>2. Pre-entry risk-based control</td>
</tr>
<tr>
<td></td>
<td>3. Non-existence of internal controls</td>
<td>3. Client education (informed compliance)</td>
</tr>
<tr>
<td></td>
<td>4. Poor recordkeeping</td>
<td>4. Agent focus and control</td>
</tr>
</tbody>
</table>

*TPIN = Tax payer identification number

**CACP = Customs Accredited Clients Program (AEO)**
Table 1 demonstrates that although small importers represent over 95% of all importers, they are responsible for only 3.6% of the value of all imports.

Table 2 describes the varying risks of large, medium and small traders and allocates appropriate treatment and controls, based on those risks.

A number of administrations have set up teams devoted solely to the control of a specified group of large businesses (known as Large Business Teams or Units). This allows Customs to develop a deeper knowledge of those operators and enables risk to be evaluated more accurately and compliance to be improved more effectively. This concept has been extended further by some revenue authorities to facilitate the control of all tax and duty matters by one team.

**Advance Rulings**

[from www.wcoomd.org]

The WTO Agreement on Trade Facilitation includes in its Article 3 provisions on advance rulings. With the aim of providing advance and predictable information to stakeholders in order to facilitate compliance with Customs requirements, a number of Customs administrations have already established a binding ruling programme, in accordance with the provisions of Standard 9.9 of the revised Kyoto Convention and the WCO recommendations and guidelines.

The expression “binding ruling” (or “advance ruling”) generally designates the option for Customs to issue a decision, at the request of an economic operator planning a foreign trade operation, relating to the regulations in force. The main benefit for the holder is the legal guarantee that the decision will be applied at the moment of the importation or exportation.

Although tariff classification is the most common area for binding rulings, origin and valuation rulings are also common. With regard to tariff classification, for example, this system helps operators obtain the correct tariff classification for the goods they plan to import or export. This is clearly an important factor, given that the tariff heading of the goods determines the rate of the Customs duties as well as the application of the different legal provisions (import/export licenses, rules of origin, anti-dumping duties, security standards, etc.).

The use of such a ruling will also help importers and exporters in facilitating the clearance formalities for their goods and will consequently expedite the goods’ release.

The basic elements of this procedure can be summarized as follows:

The request must supply the administration with all the information required (detailed description of the goods, information enabling the determination of the origin or the customs value of the goods, possible inclusion of samples, plans, various documents, etc.). Should the request contain inaccurate or incomplete information, the ruling based on such information could be revoked;

The ruling must be issued by the competent authority in writing within a specified period;

The ruling is binding on the administration following its issue and is valid for a specified period. However, in some cases (issuing of a new regulation, amendment of the
interpretation of the nomenclature at international level, etc.), this decision ceases to be valid. The ruling may also be made binding on the applicant;

Only the holder of the binding ruling can call upon its application, provided that he/she demonstrates that the goods presented and the goods described in the decision correspond in every respect;

These decisions are generally made public (except from confidential information) to ensure transparency and equality of treatment of operators as well as the uniform application of the regulations.

GUIDE TO THE EXCHANGE OF CUSTOMS VALUATION INFORMATION

Preamble

This Guide is designed to facilitate the exchange of valuation information among Customs administrations. It consists of (1) a checklist regarding valuation verification actions to be taken by the Customs administration of the importing country before requesting information from the Customs administration of the exporting country and (2) a set of recommended procedures, applicable to the Customs administrations of both the importing and exporting countries, for the exchange of valuation information.

In accordance with the terms of the WTO Valuation Agreement, the basis for the valuation of goods for Customs purposes should, to the greatest extent possible, be the transaction value of goods. If (taking into account Decision 6.1 of the Committee on Customs Valuation and Case Study 13.1 of the Technical Committee on Customs Valuation on the Application of Decision 6.1) the Customs administration of the importing country has reasonable grounds to doubt the truth or accuracy of the declared value, the administration may conclude that the Customs value of the imported goods cannot be determined under the provisions of Article 1.

The exchange of valuation information between Customs administrations may be used when there are reasonable grounds to doubt the truth or accuracy of the declared value and fraud is suspected. The information should not be used as a basis for the determination of Customs value.

Exchange of information is only part of the solution to effective valuation control and should form part of a more comprehensive approach. Successful valuation control depends on a long-term strategy of reform and modernisation of Customs administrations. In particular, Customs administrations should rely on a control mechanism, using intelligence-based risk assessment and post-clearance auditing systems, which are fundamental to improving Customs valuation control regimes. Focused capacity building and technical assistance efforts are also called for.

In requesting valuation information, the requesting administration needs to bear in mind the associated resource and cost implications for the requested administration. The proportionality between the fiscal interest involved in a request and the efforts to be
made in providing the information should be considered and frivolous requests should be avoided.

Any information provided under the procedures of this Guide should be treated in accordance with the applicable confidentiality provisions.

Checklist regarding valuation verification actions to be taken by the Customs administration of an importing country before requesting information from the Customs administration of the exporting country

1. Before requesting information from the Customs administration of the exporting country, the requesting administration should ensure that, to the extent possible, all appropriate verification procedures in the importing country have been undertaken. The following listing, although not exhaustive, provides requesting administrations with a checklist that confirms the substance of the request being made. Checks in regard to the value declaration or Customs entry.

(a) That all appropriate documentation has been made available to the Customs administration and has been inspected. This may include:
   (i) Customs entries;
   (i) bills of lading;
   (iii) commercial invoices;
   (iv) contracts of sale;
   (v) valuation declarations;
   (vi) payment and bank records;
   (vii) other legal documents, such as licence and warranty agreements;
   (viii) relevant correspondence.

(b) That internal (Customs) research and analysis has been conducted. This may include:
   (i) Records of previous importations by the same importer have been checked
      • Customs entries;
      • declared values;
      • duties paid;
      • method of valuation;
      • other historical records.
   (iii) Risk assessment and risk analysis procedures have been fully undertaken; this may include the use of appropriate database resources.

Checks relating to the status of the importer. This may include:

   (a) Customs offence records have been examined;
   (b) compliance with the tax authorities has been checked;
   (c) the WCO CEN database has been checked.
Contacts with the importer.

(a) The importer has been advised in writing of the administration’s reasons for doubt.

(b) The importer has been requested to supply additional information and advised of the level of proof to be supplied, including copies of all correspondence between the exporter and the importer.

(c) The importer has been interviewed, as appropriate.

Checks to be conducted during post importation audit (where appropriate).

(a) Verification of financial records pertaining to the transaction.

(b) Verification of trader's systems.

(c) Examination of commercial records, including contracts.

(d) The importer has been interviewed.

2. If, after following the relevant checklist items, to the extent possible, there are still reasonable grounds to doubt the truth or accuracy of the declared value and fraud is suspected, assistance from the Customs administration of the exporting country may be sought, in accordance with the following recommended procedures.

**Recommended procedures for the exchange of valuation information**

1. Valuation-related information to be requested from the Customs administration in the country of exportation should be limited to information which is necessary for verifying the truth or accuracy of the Customs value declared by the importer and fraud is suspected. The requested information may include the value of the goods stated in the export declaration/entry presented to the Customs administration of the exporting country.

2. The use of bilateral or multilateral mutual administrative assistance agreements to delineate the appropriate terms for the exchange of valuation information among Customs administrations is recommended.

3. Communication in regard to the exchange of valuation information should take place between appropriate offices designated for this purpose. The designated offices should be notified to the Secretary General of the WCO by the Customs administrations concerned.

The Secretary General will make the information concerning designated offices available to Members on the WCO Members Web site.

4. Requests for information should be made in writing or electronically. The requested Customs administration may require written confirmation of electronic requests. Where the circumstances so require, requests may be made verbally. Such requests shall be confirmed as soon as possible either in writing or, if acceptable to the requested and requesting administrations, by electronic means.

5. Requests for information should specify:

(a) the purpose of the request and the type of information requested;
(b) the measures taken by the requesting Customs administration in accordance with the “Checklist”; 

(c) the information necessary to identify the goods and their export declaration/entry, which may include:

   (i) details regarding the goods (name, quantity, tariff code number, shipping marks, number of packages, invoice number, etc.);
   (ii) name and address of the importer/buyer/consignee;
   (iii) name and address of the exporter/seller/consignor;
   (iv) means of transportation and transport document number;
   (v) date and place of departure/exportation;
   (vi) date and place of arrival/importation;
   (vii) any other information deemed useful by the requesting administration.

6. The requested Customs administration should notify the requesting Customs administration of the receipt of the request as soon as administratively possible.

7. The requested information should be provided as quickly as possible, preferably on the basis of a mutually agreed time frame, in accordance with national legal and administrative provisions in the country of exportation and within the limits of the Customs administration’s competence and available resources. The response to the request for information should provide the requested information as fully and accurately as possible. The response could also include, as appropriate, the following information:

   (a) whether the export consignment has been identified;
   (b) whether the export entry documents have been verified;
   (c) whether the Customs administration’s records have been consulted;
   (d) whether relevant information has been sought from other government agencies concerned;
   (e) whether the exporter/seller/consignor has been consulted.

8. Where the requested Customs administration cannot provide the information expeditiously, it shall notify the requesting Customs administration of the reasons for its inability or delay in providing the information.
[Part II]

National Legislative Provisions on Customs Valuation
Lesson 10
Provisions of valuation in Customs Act 2007

Customs Valuation Provisions in Customs Act 2007 are as follows:

**Section 2(b)** "transaction value" means the total amount to be set by adding freight, insurance and other related costs incurred or incurable in the transportation of goods imported by an importer up to the border of Nepal to the price actually paid or payable, directly or indirectly, by the importer to the seller of such imported goods.

**Section 13. Bases for determination of customs value of goods to be imported:**


2. The customs value of goods to be imported shall be determined on the basis of the transaction value of such goods, subject to sub-section (1).

3. The importer shall declare the transaction value, attaching therewith the description and documents proving the value of goods imported.

4. If the transaction value declared by the importer pursuant to sub-section (3) is in conformity with sub-section (1), the Customs Officer shall determine the customs value of the goods on the basis of such transaction value. If such transaction value does not appear to include freight, insurance and other related expenses, the Customs Officer shall determine the transaction value by adding an estimated amount likely to be incurred for the same.

5. The Director General may prescribe bases for fixing the estimated amount referred to in sub-section (4).

6. If there is a reasonable ground to believe that the value declared by the importer pursuant to sub-section (3) is doubtful, the Customs Officer may ask the importer to produce additional documents or evidence in writing to prove that such value is the actual transaction value. It shall be the responsibility of such importer to provide documents so asked.

7. If the customs value of any goods cannot be determined on the basis of the transaction value declared by the importer pursuant to sub-section (3) or the bills, invoices and documents submitted by the importer, the Customs Officer shall give a notice, accompanied by the reason for the same, to the concerned importer.

8. If the customs value cannot be determined on the basis of the transaction value pursuant to sub-section (2), the customs duty of such goods shall be determined on the basis of the transaction value of identical goods already imported into Nepal prior to the import of such goods.

Explanation: For the purposes of this Section, "identical goods" means goods which are the same in all respects, including physical characteristics, quality and reputation.
(9) If the customs value cannot be determined on the basis of the transaction value of identical goods pursuant to sub-section (8), the customs duty of such goods shall be determined on the basis of the transaction value of similar goods already imported into Nepal prior to the import of such goods.

Explanation: For the purposes of this Section, "similar goods" means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable.

(10) If the customs value cannot be determined on the basis of the transaction value of similar goods pursuant to sub-section (9) and such goods have already been imported into Nepal and sold at market to a person who is not related to the importer, the customs value of such goods shall be determined on the basis of deductive value method, by deducting the tax, duty levied in Nepal on the selling price of each unit of the maximum unit so sold, and other related costs and profits.

(11) If the customs value cannot be determined pursuant to subsection (10), the customs value shall be determined on the basis of computed value method, also calculating the costs incurred in the production or manufacturing of such goods and profits made or likely to be made by the seller while selling such goods to the importer.

(12) If the customs value cannot be determined pursuant to subsection (11), the Customs Officer shall so determine the customs value of such goods on a reasonable basis as not to be contrary to the provisions of sub-sections (2), (8), (9) and (10).

(13) Notwithstanding anything contained in sub-sections (10) and (11), if the importer makes a request for the determination of customs value by adopting the procedures set forth in subsection (11) prior to adopting the procedures set forth in subsection (10), the Customs Officer may determine the customs value in accordance with the provisions of sub-section (11).

(14) Notwithstanding anything contained elsewhere in this Section, if the owner of the goods imported under the Luggage and Baggage Order for personal purposes or the goods received as a gift or specimen/model and imported from a foreign country makes an application for the valuation of such goods, showing the reason for failure to indicate the transaction value thereof and if the Customs Officer considers the matter to be appropriate, he or she may determine a reasonable customs value of such goods.

(15) If the value declared by an importer pursuant to sub-section (3) is less than the customs value determined by the Customs Officer pursuant to this Section, the Customs Officer may do the following in relation to such goods:

(a) Clearing such goods by collecting fifty percent additional customs duty on such difference value, or

(b) With the prior approval of the Director General, purchasing, or causing to be purchased, such goods in a manner to pay the amount to be set by adding five percent amount to the value so declared to the importer.

(16) In determining the customs value of goods in accordance with the provisions of this Section, the customs value shall normally be determined in a foreign currency. Where the valuation of goods on which the duty has to be paid at the time of import is made in
a foreign currency, the conversion of such currency into Nepalese rupees shall be made according to the selling rate of foreign currency which is prescribed by the Nepal Rastra Bank and prevailing on the day of customs clearance of such goods. In the case of a foreign currency of which exchange rate is not prescribed by the Nepal Rastra Bank, such foreign currency shall be converted into American dollars, and the selling rate of American dollars shall be taken as the basis. Provided that in converting the customs value of the goods of which duty is paid subsequent to the importation thereof under the diplomatic facility, duty facility or full or partial exemption of duty, such conversion shall be made according to the selling rate of foreign currency which is prescribed by 21 the Nepal Rastra Bank and prevailing on the day of payment of the remaining duty.

(17) Notwithstanding anything contained in this Section, in case it is found that the customs value determined by the Customs Officer pursuant to this Section was found determined without following the method and procedure mentioned in this Section or there is a valid reason to believe that the amount determined is doubtful, the Director General shall give an order to reassess the amount pursuant to this Section.

(18) If any order is received pursuant to subsection (17), Custom Officer shall reassess the customs value after conducting necessary investigation and inform thereof shall be provided to the Director General within thirty days.

(19) Director General shall give an order pursuant to subsection (17) within ninety days from the date of clearance of such goods.

Section 14. Power to determine customs value provisionally:

(1) Notwithstanding anything contained elsewhere in this Act, the Customs Officer may, subject to Section 13, determine a reasonable provisional customs value of imported goods if:

(a) the importer makes an application, along with a reasonable reason, that he or she is not able to forthwith provide necessary documents and other related information as required for the valuation of goods,

(b) the customs value has to be or can be determined only after carrying out the laboratory test or other examination of goods or there appears a need to make further inquiry into the documents and information provided by the importer.

(2) Where, after the determination of provisional customs value in accordance with the provisions of sub-section (1), the importer wishes to clear the goods by furnishing a deposit of the duty chargeable on such goods, the Customs Officer shall make clearance of such goods.

(3) The Customs Officer shall determine the customs value of the goods under the provisions of Section 13 no later than thirty 22 days after the date of determination of the provisional value pursuant to sub-section (1).

(4) If the customs value determined pursuant to sub-section (3) is more than the provisional customs value determined pursuant to sub-section (1), the Customs Office shall recover from such importer the duty chargeable on such excess value, and if it is less than that, the duty collected in excess shall be refunded to the importer.
Section 15. Power to fix estimated amount of freight, insurance or other related costs:

(1) Where, owing to a circumstance beyond his or her control, an importer is not able to forthwith submit documents of cost, insurance or related costs incurred in the importation of any goods, the importer may submit an application, accompanied by the reason for the same, to the Customs Officer for the fixation of the estimated amount of such freight, insurance or other related expenses.

(2) Where, in inquiring into the application referred to in subsection (1), the contents appear to be reasonable, the Customs Officer may fix the estimated amount for freight, insurance or other related expenses likely to be included in the transaction value of such goods.

(3) The concerned importer shall submit documents and evidence relating to the actual freight, insurance and other related expenses no later than ninety days after the date of fixation of the estimated amount of freight, insurance or other related costs pursuant to sub-section (2). If the amount set forth in the documents and evidence so submitted is more than the estimated amount fixed pursuant to sub-section (2), the importer shall pay the duty chargeable on such excess value, and if it is less than that, the Customs Office shall refund the remaining amount, upon deduction of the chargeable duty, to the importer.

(4) Where the concerned importer fails to submit documents and evidence within the period referred to in sub-section (3) or unless it is proved otherwise, the estimated amount fixed by the Customs Officer pursuant to sub-section (2) shall be considered as the final amount of such freight, insurance or other related costs.

Section 16. Determination of customs value of goods to be exported:

(1) The invoice value declared by an exporter shall be the customs value of the goods to be exported.

(2) Notwithstanding anything contained in sub-section (1), the Government of Nepal may, if considers necessary, determine separate customs value of any goods of specific nature to be exported, by notification in the Nepal Gazette. Where separate customs value is so determined, the customs value of such goods shall be the invoice value declared by the exporter 24 or the customs value so determined by the Government of Nepal, whichever is higher.

(3) The customs value referred to in sub-section (1) or (2) shall be the free on board (fob) value.

Explanation: For the purposes of this sub-section, “free on board (fob) value” means a value which includes the factory price of the goods to be exported and costs incurred in movement of such goods up to the concerned Customs Office of Nepal.

(4) The value of goods to be determined pursuant to this Section shall be determined in foreign currency. Such foreign currency shall be converted into the Nepalese rupees according to the buying rate of foreign currency which is prescribed by the Nepal Rastra Bank and prevailing on the day in which the goods were declared pursuant to this Act.
From Customs rules 2007

Rule 29. Arrangements for the purchase of goods imported under invoicing:

(1) As per clause (b) of sub section (15) of section 13 of the Act the importers declared price of the goods is less than the price determined by the customs officer, the customs officer may purchase such goods, with the prior approval of the Director General, by paying the total amount of additional 5 percent to the price declared by the importer. Government of Nepal may maintain a fund for this purpose. The amount allocated in the fund will not be freezed.

(2) The amount of fund as per sub-rule (1) will be as determined by the Ministry of Finance.

(3) A Committee will be formed to manage and operate the Fund, as per sub-rule (1), with the following membership:
   (a) Director General -Chairperson
   (b) Director in charge of valuation -Member
   (c) Account Chief of the Department -Member Secretary

(4) The Committee formed under sub-rule (3) will decide on its work procedure.

Rule 30 Purchased goods may be auctioned or may be used for the government:

(1) The goods purchased from the fund created under rule 29, may be auctioned following the procedure laid down in Chapter 7 or use the goods for government purpose.

(2) The government should immediately replenish the fund used for the purchase of goods, in case the goods are used for the government purpose as per sub rule (1).

Rule 31. Information to be given to importer:

The customs officer should notify in writing, in the format of Schedule 4, to the importer or their customs agent in case the goods are being purchased from the fund created under rule 29.
Lesson 11
Provisions of Review and Appeal in Customs Act and Rules
[Review and Appeal on Customs Act 2007 (Article 61 & 62) And Customs Rules ]

Chapter-12 Provisions Relating to Review and Appeal

Section 61. Provisions relating to valuation review committee:

(1) A person who is not satisfied with any decision or order made by the Customs Officer pursuant to Section 13 may, for the review of such decision or order, file an application, as prescribed, to the valuation review committee formed pursuant to sub-section (2) no later than fifteen days after the date of such decision or order.

(2) For the purpose of sub-section (1), the Government of Nepal shall form the following valuation review committee:

(a) At least Gazetted First Class officer of the Civil Service who has knowledge and experience in the field of revenue administration -Chairperson

(b) One person who is incumbent in the office of at least Gazetted Second Class and has gained at least three years of experience in the Gazetted post on customs administration or who has retired from the office of that Class and has gained the said experience –Member

(c) One person who is incumbent in the office of at least Gazetted Second Class and has gained at least three years of experience in the Gazetted post on international trade -Member

(3) The term of the chairperson and members of the valuation review committee referred to in sub-section (2) shall be of three years.

(4) Notwithstanding anything contained in sub-section (3), the Government of Nepal may, by providing an opportunity for defense, remove, at any time, the chairperson or any member of the valuation review committee from the office on grounds of his or her incompetence or misbehavior or failure to discharge the duties of his or her office honestly.

(5) The valuation review committee shall, while making review pursuant to this Section, inquire into whether the customs valuation determined by the Customs Officer pursuant to Section 13 is accurate or not and may approve or void the valuation determined by the Customs Officer or make valuation of such goods pursuant to this Act. The valuation review committee shall also assign clear reasons and bases while so approving, voiding valuation or making valuation.

(6) The other functions, duties, powers and procedures of the valuation review committee formed pursuant to sub-section (2) and the remuneration and terms and conditions of service of the chairperson and member of that committee shall be as prescribed.

(7) A person who files an application pursuant to sub-section (1) shall, prior to making such application, furnish with the Customs Officer a deposit of the duty chargeable according to the valuation determined by the Customs Officer pursuant to Section 13.
Section 62. Appeal:

(1) A person who is not satisfied with the customs duty determined by the Customs Officer or other employee under this Act or with any order or punishment or decision issued or made by the Customs Officer, except any decision or order referred to in Section 13, or with any decision made by the valuation review committee formed pursuant to Section 61 may make an appeal to the Revenue Tribunal within thirtyfive days after the date of the determination of such customs duty or the imposition of punishment or the making of decision.

(2) A person who files an appeal pursuant to sub-section (1) may make such appeal by making payment of or furnishing a deposit of the duty and amount of fine and penalty chargeable pursuant to that decision or order against which such appeal is to be made, to or with the concerned Customs Office.

(3) A person who files an appeal pursuant to sub-section (1) shall give a copy of such appeal to the concerned Customs Office no later than seven days after the filing of such appeal.

(4) In the event of not being satisfied with any decision made by the valuation review committee formed pursuant to Section 61, the Customs Officer may file an appeal to the Revenue Tribunal no later than thirtyfive days after the making of such decision.

From Customs Rules 2007

Rule 2(c) “Valuation Review Committee” means Committee constituted under the subsection (2) of section 61 of the Act,

Chapter 9 Arrangement for the review of Valuation

Rule 41. Application for the review of valuation:

The person may apply to the Valuation Review Committee in the format as prescribed in Schedule 7 against the decision or the instruction of the Customs officer as per section 13 of the Act. The copy of the application should also be forwarded to the concerned customs office within seven days from the date of application.

Rule 42. Function, duty and authority of the chairman and the members of the Valuation Review Committee:

(1) Function, duty and authority of Valuation Review Committee shall be as follows:

(a) To examine into the evidence presented by the applicant,

(b) To approve the decision of the customs officer or revoke the decision and take decision on behalf of the customs officer,

(c) To ask to the applicant for submitting additional documents or evidence,

(d) To collect necessary information for valuation of the goods.

(2) Valuation Review Committee’s decision should be communicated within seven days from the date of the decision to the applicant, Department and concerned customs offices.

(3) Monthly progress report of the Valuation Review Committee should be submitted to the Ministry of Finance. 117
Rule 43. Valuation Review Committee’s work procedure:
(1) All the three members of the committee will exercise their authority collectively and the majority decision is considered as the committee’s decision.
(2) At the time of Valuation Review Committee’s final decision on the application on the review of the valuation, the presence of Chairman and the two members are necessary.

Rule 44. Period for the final decision:
Valuation Review Committee should take final decision within ninety days from the date of registration of the application.

Rule 45. Remuneration for the Chairperson and the members of the Valuation Review Committee:
The remuneration for the Chairperson and the members of the Valuation Review Committee shall be as fixed by the Ministry of Finance.

Rule 46 Ministry of Finance to make necessary arrangement:
Ministry of Finance will make arrangement for the Valuation Review Committee’s office, physical facilities and necessary staff.

Rule 54. Valuation Committee:
(1) The following valuation committee is formed to determine the value of vehicles and means of transportation deposited in the customs office, goods to be auctioned as per this regulation, and the goods under the sub section (3) of section 71 of the Act.
   (a) Chief of the Customs Office or in his absence officiating Chief-Coordinator
   (b) Representative from the concerned District Administration Office-Member
   (c) Representative from the concerned Federation of Industry and commerce-Member
   (d) Representative from the concerned Treasury Office-Member
   (e) Mechanical technician in case of vehicle and means of transportation-Member
(2) The Committee constituted under sub rule (1), should consider physical condition, local demand, usefulness, usable period, depreciation, and market price while determining the value of the goods. While fixing the value of the goods purchased under clause (b) of sub section (15) of section 13 of the Act, the purchase price of the goods, the customs duty for the import of such goods, and the market price of the goods should be considered.
(2a) Notwithstanding anything contained in sub rule (1), the customs officer can determined the value of the goods, except motor vehicles, for auction purpose considering the conditions stipulated in sub rule (2), presented to customs office which to be auctioned as per this rule, bearing the value up to fifty thousand. If the customs officer considers that the value of the goods is mentioned in the report unusually high while presenting the goods to the customs office for auctioning, he or she can auction such goods by determining the value by the valuation committee as per sub rule (1).
(3) The Valuation Committee constituted under sub rule (1) may invite other people to the meeting if the committee considers appropriate.

(4) The quorum of committee constituted under sub rule (1), is fulfilled if the Coordinator and other two members are present and the majority decision is considered the decision of the Committee.

(5) The remuneration of the committee members is as determined by the Ministry of Finance.
Lesson 12

Provisions on Customs Valuation Directive


Section 3. Provision for value declaration:

(a) The importer should declare the value of the imported goods according to the format of the Annex-1 or the Annex-2 in the customs office.

(b) The following particulars and documents should be attached while declaring the value mentioned in (a) above according to the sub-article 3 of the article 13 of the Act.

(i) Name and address of the importer.

(ii) Name and address of the supplier.

(iii) Name of the goods (including the trade name), quantity, measure, shape, weight, model, brand, design, specification, tariff specification code also.

(v) Name and address of the sales agent if any.

(v) Name of the country producing the goods.

(vi) Shipping harbour/port of the goods.

(vii) Bill of lading or airway bill or bill no. and date of the freight forwarder or transporter in the case of land route.

(viii) Contract letter/paper of buy/sale of the goods with date.

(ix) Nature of transaction (sale, translocation, gift, sample etc.).

(x) Performa invoice, commercial invoice no. and date.

(xi) Conditions of payment and payment modality.

(xii) Paying or paid foreign currency and its exchange rate.

(xiii) Relationship between the buyer and the seller established as of the Article 8 of the Agreement.

(xiv) Particulars of restrictions of terms and conditions if any for selling out of the goods.

(xv) Method of Valuation

(xvi) Cost to be adjusted not mentioned in the invoice (according to the Article 8 of the Agreement).

(xvii) Broker's fees and commission.

(xix) Packing Charges.

(xx) Value of the subsidiary materials to be used in the production of the goods if dispatched by the exporter.
(xxi) Royalties and license fees.
(xxii) The amount which the supplier gets from the sales of the goods.
(xxiii) Freight charges inclusive of container rent.
(xxiv) Insurance premium.
(xxv) Loading/Unloading expenses.
(xxvi) Other expenses.
(xxvii) Tariff value (in NRs.)
(xxviii) Relationship between the buyer and the seller and its impact on the price of the goods.
(xxix) Information on the valuation if any

Section 5. Verification and analysis of the declared value

The Customs Officer should follow the procedures mentioned below while examining the value of the goods and make analysis according to the article 20 and 21 of the Act.

(a) Information, if possible, from the internet, price list of the international market, price bulletin and the price of the goods published in the newspaper or magazine, price information collected and communicated by the Department of Customs and the MRP of the goods in valuation published publicly by the importer can be taken into consideration. Also the latest records of the ninety days as available from the ASYCUDA data should be analyzed for the determination of the transaction value of the identical and similar goods according to the sub-articles (8) and (9) of the article 13 of the Act.

(b) According to the sub-article (3) of the article 8, it should be checked in the course of examination, whether the amount is adjusted or not in the value by the importer and it should also be examined, even though the amount is reconciled, whether the supporting documents or evidences are attached or not.

(c) If the goods were in transit prior to import and certain amount was paid for it, it should be ascertained whether the importer has declared or not every kind of amount thus paid for.

(d) It should be ascertained whether the rent amount, insurance premium and other associated expenses have been adjusted or not in the declared value of the imported goods.

(e) The declared value should be verified and analyzed on the basis of the customs valuation of the identical goods determined by the customs office itself prior to the recent import of the goods in valuation.

(f) The declared value should be matched and analyzed with the value of the identical goods imported through other Customs Offices also.
(g) The decision made by the Valuation Review Committee on the value of the identical goods can be taken as information, while making an examination and analysis of the goods in valuation.

(h) The value of the identical goods determined by the Post Clearance Audit can be used as information while making an examination and analysis.

(i) The Customs Officer may ask for the additional documents and details if not satisfied by the documents presented in the course of value analysis.

Section 8. Method for the determination of customs value on the basis of transaction value:

(a) Transaction value means price actually paid or payable to the seller abroad by the buyer of Nepal for the importation of the goods into the country. Price actually paid or payable is understood as the total amount paid or payable by the buyer to the seller or paid or payable for the benefit of the seller for the imported goods. There is not necessary to make payment by cash transfer. The payment can be made through letter of credit or negotiable instrument. The payment may be direct or indirect. For an example, the payment of any of the loans of the seller paid wholly or partially by the buyer is also a kind of indirect payment.

(i) In Article 15(4) of the Agreement, provisions are made about the people deemed to the related in the conditions give below

   i. They are officers or directors of one another's business.
   ii. They are legally recognized partners in business.
   iii. They are employer and employee.
   iv. Any person directly or indirectly owns, controls or holds 5 percent or more of the outstanding voting stock or shares of both of them.
   v. One of them directly or indirectly controls the other.
   vi. Both of them are directly or indirectly controlled by a third person.
   vii. Together they directly or indirectly control a third person, or
   viii. They are members of the same family.

(j) For the purpose of paragraph (8) of Sub-article (i) of Article 8 above, member of the same family according to the prevailing Nepal laws means individuals having the relation as follows and their members of the joint family in a common kitchen:

   i. Husband/Wife
   ii. Father, Mother and Sons, Daughters.
   iii. Elder sister, Younger sister and Elder brother, Younger brother.
   iv. Grand-father, Grand-mother and Grand-son, Grand-daughter
   v. Uncle, Aunt and Nephew, Nice.
   viii. Husband's elder brother, Husband's elder brother's wife, Husband's younger brother, Husband's younger brother's wife, Husband's younger sister, Husband's younger sister's husband, Husband's elder sister.
x. Maternal uncle, Maternal uncle's wife and Sister's son, Sister's
daughter.

xi. Father's sister, Father's sister's husband and Wife's brother's son, Wife's
brother's daughter.

(k) The fact that the importer establishes that the relations has not affected the
price actually paid or payable and such value closely approximants the test
price, such price may be accepted as the transaction value, though the buyer
and the seller are related to each other.

Explanation:
For the purpose of this Article "Test Value" means the transaction value of
the identical goods or similar goods sold to unrelated importer for the sell
in the country of importation or deductive value or computed value. Such
test value should be produced by the initiation of the importer himself and
the test value should not replace the transaction value.

(n) Expenses to be adjusted in the transaction value:

(i) Customs value must be assessed by adding transport charges up to
the exporting point of the country of the export of the goods and up
to the concerning customs point of Nepal from there, according to
the terms of the delivery of the goods, if such transaction expenses
are not adjusted in the transaction price. If the documents
supporting the transport charges are not submitted, such expenses
should be adjusted as prescribed by the Director General pursuant to
sub-clause (5) of the clause 13 of the Act.

(ii) The clearing charges of the container carrying goods should be
added in the transaction value as a transport cost, if it is not added.

(iii) The additional repacking cost of the goods incurred in the course
of export is not generally included in the price of the goods, though the
packing charges in the series of production is added in the sales
price. Such expenses should be added in the transaction value of the
goods.

(iv) Insurance premium according to the terms of delivery of the goods
up to the exporting point of the country of export and up to the
concerning customs point of Nepal if not shown, such expenses
must be added in the transaction value of the goods while
determining the transaction value. If the document regarding
premier payment is not submitted, such charges should be added on
the basis as prescribed by the Director General pursuant to sub-
clause (5) of the clause 13 of the Act.

(v) Commissions and brokerages paid by the buyer on the purchase of
any of the goods should be included in the transaction value.
But the purchase commissions and fees paid to the agent
representing the buyer in the country of export should not be added
in the transaction value.

(vi) The price of assisting materials supplied from any of the countries
abroad directly or indirectly by the buyer free of charge or at the
reduced price for use in connection with the production of the
imported goods should be added in the transaction value. As for
example label, guide book, packing materials, button, motor parts,
dies, moulding block, design, blueprint fall in those materials. The following expenses are also to be included in the price of those materials, their calculated proportionate price should be included in the transaction value of the imported goods:

(I) Cost incurred in the purchase or production of the goods.
(ii) Cost incurred in the transportation and exportation.
(iii) Value added price due to the materials used in the production of the imported goods.

(vii) Royalties and license fees are referred together in the Article relating to the Rules on Customs Valuation and in the explanatory note of the Agreement. Provision has been made in the explanatory note of Article 8.1(c) of the Agreement to include payments, among other things, made in respect to patents, trademarks and copyright in the transaction value. Whereas in reference to the imported goods the royalties and license fees paid by the buyer as of the terms of sales are not included in the price actually paid or payable, such amount should be adjusted in the transaction value of the goods imported.

(viii) Any fraction of the profit amount from the sale or disposition/use of the imported goods in Nepal has to be returned to the seller of the goods by the importer directly or indirectly, as laid down in the terms of the agreement, such payment should be adjusted in the transaction value.

(ix) Expenditures like rent, fees, taxes, demurrage charges, broker/agent fees, loading/unloading/handling charges of the airways, of the shipping yard or of the dry port incurred by the importer should be adjusted in the transaction value.

Section 14 (b) For the purpose of sub-clause (a) identical goods means the goods as follows:

(i) Having physical Characteristics, quality and reputation the same in all respects,

(ii) Having the same country of origin of the goods in valuation.

(iii) The goods in valuation should be produced by the same producer.

In the case of non-availability of the goods by the same producer, identical goods produced by other producers of the same country can be taken as reference.

(c) Notwithstanding anything elsewhere written above, if the normal differences of the goods in valuation have no implication on the price of the goods and other conditions remain the same for this purpose, such goods can be taken into consideration for comparison purpose as identical goods.

(d) If engineering, development, artwork, design work and plans and sketches are undertaken in Nepal and such works are provided under reduced cost or free of cost by the seller to the producer, such goods should not be taken as an identical goods.

(e) According to this sub-clause, comparison should made between the identical goods imported at or about the same time with same commercial level and in substantially the same quantity while comparing the goods at the time of valuation.
Explanation:

(i) "At or about the same time" means the exported time or time of export not affecting the price due to commercial practice and market condition. Such time in general, may be of prior to one month. In such condition other rules on customs valuation should not be applied by interpreting the goods not being identical due to non-significant different.

(ii) "At the same commercial level" means the condition of the sale of the identical goods, where no such sale is found, at the same commercial level (wholesale, retail, ultimate user or consumer) but in different quantities or at a different commercial level and in different quantities. Having found a sale under any of these three conditions, adjustments should be made, as of the case, for the factors given below:

   (a) Quantity factors only,
   (b) Commercial level factors only, or
   (c) Both commercial level and quantity factors.

Section 15 (b) For the purpose of sub-article (1), similar goods means the goods as follow:

(i) Not alike in all respects, but having like characteristics and like component materials, able to perform the same functions equally to the goods to the valued and commercially interchangeable.

(ii) The goods to be valued produced in the country of production.

(iii) The goods to be valued produced by the producer. The goods produced by a different person of the same country can be taken into account only when the goods produced by the same producer is not available.

(c) Notwithstanding anything stated above if the general difference seen in the comparing goods makes no difference in the price of the goods and for this purpose if other definitions are similar, those goods can be taken as similar goods for the comparison.

(d) If engineering, development, outwork design work or sketches are undertaken in Nepal and such works have been provided to the producer by the importer in a reduced price or free of cost as such those goods should not be accepted/considered as similar goods. Some examples of similar goods are as follows:

   (i) Produced by two different producers, having different trade marks but capacity and characteristics similar.

   (ii) Commode (sanitary fixtures) for bath room, produced by two separate producers, able to perform the same functions equally because of the
similar standard, characteristics and reputation should be accepted as a similar goods installed of identical goods.

(e) According to this clause, while comparing the goods comparison must be made with the goods of equal commercial level and with approximately equal quantities exported to Nepal from the third country at or about the same time of valuation of the goods.

Explanation:

(a) "At of about the same time" means the exported time and time of export not affecting the price due to commercial factice and market condition. Such time, in general, may be of prior to one month. In such condition other rules on customs valuation should not be applied by interpreting the goods not being similar due to non-significant differences.

(b) "At the same commercial level" means the condition of the sale of the similar goods, where no such sale in fount, at the same commercial level (wholesale, retails, ultimate user or consumer) but in different quantities & at a different commercial level and in different quantities. Having fours a sale under any of there three conditions, adjustments should be made, as of the case, for the factors given below:

(i) Quantity factors only,
(ii) Commercial level factors only, or
(iii) Both commercial level and quantities factors.

Section 17 (b) If the customs value could not be determined according to Article 8, 14 or 15, then only deductive value method according to sub-article (1) should be applied.

(c) While applying Articles 8, 14 or 15, the customs value is determined before selling of the imported goods in Nepal, while applying this clause the customs value is determined by deducting certain expenditure and profit from sales price from importation to selling out stage of the imported goods or identical goods or similar goods sold to unrelated person.

(d) While determining the value according to this clause, the following point must be kept in mind and if the terms and conditions are not fulfilled, the value should not be determined according to this method:

1. The following conditions fulfilled while welling in Nepal:

   (i) Those goods must have been sold in Nepal at the time of importation,

   (ii) The imported goods or identical goods or similar goods should have been sold in similar condition and at or about the same time in Nepal.
(iii) If the goods is not sold at the time of importation or at of about the same time, the sale of the greatest agitate quantity within the nearest period of 90 days of the importation of the goods to be valued must be applied.

(iv) If sold out not fulfilling the conditions of sub-clause (i), (ii) and (iii) and the goods be sold only after processing, sales of goods after processing can be utilized on the request of the importer for the goods to be valued and processing cost must be reconciled.

(v) The importer or buyer of Nepal should not have provided any assistance directly or indirectly to the supplier for the goods to be valued.

(vi) After importation the buyer of the first commercial level both buyer and importer should not be the related person.

2. Unit price of the goods sold is the greatest aggregate quantity should established. The commercial invoice should have acted as a primary base for the establishment of those unit price.

3. Customs value should be determined after the deduction of following factors.

(a) Additional profit and normal expenses related to commission or sales actually paid or payable for the similar group or category of the goods imported in Nepal.

(b) Transportation cost, insurance and associated expenses of the goods after entering into Nepal.

(c) Expenses and fees deemed necessary according to the paragraph 2 of Article 8 of the Agreement.

(d) Customs duties and other taxes to be paid in Nepal because of the importation or selling of the goods.

(e) Value added amount incurred by the installation and processing of the goods.

Section 18. Computed Value Method:

(a) Customs value can be determined by calculating the expenditure of production or manufacturing costs and profit taken or to be taken by the seller while selling the goods to the importer. This method should be applied when the value could not be determined according to Articles 8, 14, 15 and 17.

But, if the importer requests for the determination of the value by applying this method before applying the valuation method according to Article 17, the Customs officer will accept accordingly and apply Article 17 again if the value could not be determined by this method.
(b) While determining the customs value according to this clause, the exporting country should sale same class kind of goods to the importing country on the bases of production costs, profit amount and general expenditures.

(c) According to the clause, the customs value should be calculated as follows:

(i) First of all the total value of cost price and expense as follows should be determined:

(a) Materials employed in producing the imported goods, and,
(b) Production and other processing costs, direct or indirect labour cost, other expresses of the factory of the imported goods.

(ii) The following expenses should be added if not added in (a) and (b) above:

(a) Cost or fees of packaging
(b) Assist expenditure in totality with a logical way according to the accepted provable of the account.
(c) Expenses of engineering, outwork etc finished in Nepal and recovered from the producer.

(iii) Profit of expert and general expenditure as shown by the producer on the same class or kind of goods exported to Nepal

(iv) Transportation issuance, loading, unloading and handling charges up to the shipping yard/ harbour and to Nepal border

Section 19. Fallback Method:

(a) Where the customs value could not be determined by the methods given is other Articles then only this clause is applied for determined the Value.

(b) If the value of the imported goods could not be determined by any of the rules on customs valuation, this clause should be applied as a last tool for the valuation. Conditions by which other methods of valuation could not be applied are as follows:

(i) Transaction under lease or rent rather than permanent input export.
(ii) Goods identical and similar not personably imported.
(iii) thus imported not sold in Nepal or re-exported.
(iv) Goods thus imported not identified or unwilling to give identification.

(c) The following points should be taken into consideration while determining the value according to this clause:

(i) Customs value should be determined logically without any controversy on the basis of notice and information collected.
(ii) Keeping in view to provisions made in other clauses relation to valuation and the value determined thereof, the value should be determined with flexibility. Some examples of which given below:

(a) The value of the similar goods produced in other country rather than the country of importation may be taken as base by accepting the flexibility presently on time factor "on or about the sometime" and on provision "the product or the same country".

(b) The value can be determined by agreeing the felicity on the provisions of deductive value method according to the clause 17 and of computed value method according to the clause 18.

(c) Without making base to sequential application of other rules on customs valuation, the value can be determined by applying this method giving logical liberate/flexibility to any of the methods of valuation.

(d) The value of the imported goods should not be determined according to this clause on the points given below:

(i) Selling price in the country of importation of goods produced in such country.

(ii) Higher of two alternative values for customs purposes.

(iii) Domestic market price of the goods of exporting country.

(iv) The cost of production of the goods (except the value determined by the computed value method of identical or similar goods according to the clause 18.

(v) Export price of the goods to a country rather than the country Nepal.

(vi) Minimum customs value, or

(vii) Arbitrary or fictitious values.

Section 20. Condition of provisional valuation:

According to the value 14 of the Act, the provisional valuation should be made on the conditions given below:

(a) If the importer makes an affliction with a reasonable reason stating not being able to provide necessary documents and other related information as required for the valuation of the imported goods to be valued according to the clause 8.

(b) If the documents and information provided by the importer need further investigation/inquiry.

(c) If the valuation has to be or can be determined only after carrying-out the lab test or other examination of the goods, or

(d) If the value has to be decided by the deductive value method according to the clause 17.
Section 21. **Re-valuation of the provisional value of the goods:**

The Customs officer shall determine the customs value of the provisional value of the imported goods within the thirty days from the date of the determination of the provisional value of the goods furnishing/comprising investigation or enquiries.

Section 22. **The director general may order for the valuation of customs value**

(a) While implementing the provision of the order to be given by the Director General for the revaluation of Customs Value according to sub-cleansed (17), (18) and (19) of the clause 13 of the Act, consideration should be taken as follows:

(b) The Director General may take base any of the information as follows while giving order to the customs officer for the reassessment of the customs value determined pursuant to sub-clause (1):

(i) Compliant or grievance received in the Ministry of Finance or is the Department of Customs.

(ii) Information received from direct monitoring system.

(iii) Information received from the ASYCUDA system.

(iv) Information received from the Department of Revenue Investigation or other regulatory Agencies.

(v) Information received from inter-customs effluence.

(vi) Information received from inspection and monitoring.

(vii) Information and particulars received from the reliable website.

(viii) Transaction value determined within the latest ninety days.

(ix) Any information received by any means.

(c) The customs officer should reassess the customs value within thirty days of the order received on the basis of the information given below, according to the sub-clause (1):

(i) Rules on Customs Valuation are strictly followed or not according to the clause 13 of the Act while determining the customs value of those goods.

(ii) Whether the value determined uniformity or not with the value previously date remind by the office itself or by other customs officer for those goods.

(iii) Whether information are available or not in the website related to those goods.

(iv) Whether information regarding the value of those goods are received or not from other authentic agencies.

(v) Any information on the value of those goods is received from the Post Clearance Audit office of from the Inland Revenue Officer.

(vi) Whether the value of the goods determined previously matches or not with the available national or international market price.

(vii) Other information and based for the determination of customs value.
Lesson 13
Valuation Issues and way forward

Contemporary issues and ways forward on existing Valuation Methods and Procedures in Nepal (i.e. submission of evidence of Payment documents at the time of importation, automatically updated valuation database e.t.c.)

- Implementation of ASYCUDA world
  - Application of Tariff Specification code at least risky items
  - Self-updating valuation database
- Provision of importers Profiling and Trade segmentation
  - Profiling: record of historic compliance such as previous irregularities, under declaration, penalties imposed, trade volumes, nature of business etc.
  - Trade segmentation: on the basis of trade volume, traders can be segmented into different categories e.g large, medium and/or small and facilitation and/or control mechanism can be applied accordingly
- Provision of compulsory use of banking system (import from India is not compulsory adopting banking payment, other than India, less L/C transaction in practice)
- Provision of exchanging value information sharing system/ mechanism (between/among relevant authorities/ stakeholders, no practice/functional CMAA)
- Provision of using available value information tool in major commercial goods e.g. MRP
- Provision of dedicated unit/team for collecting/updating value information (e.g. market survey, MRP, internet/web site price, pre imported valuation database, publication etc.)
- Use of fully automated system (existing ASYCUDA++ has no features of automatically updating the pre importation valuation information/central valuation database.
- Provision of advance rulings system in accordance with article 3 of WTO TFA, standard 9.9 of RKC standards and WCO recommendations and guidelines (need to submit detailed description of goods, origin, Customs value, sample, related documents etc.)
- Controlling unauthorized trade mainly due to open border with India
- Under invoicing and lack of proper billing in real transaction values (billing is mainly based on database (not transaction base), doubtful invoicing, less use of documentation (such as airways bill, shipping doc, bilty etc. and other related costs)
- Updating central valuation database automatically (to verify/accept/reject the declared value
- Proper/sequential use of valuation methods (giving reason to reject the declared value and to apply the next method).
- Conducting consumer/stakeholder awareness programme (enhancing the knowledge, ensuring the impact of Customs value in internal market)
- Proper declaration of associated expense specifically Airway bill/transport/shipping docs. Bill.
- Conducting sustainable capacity development programme in a regular basis
- Developing and implementing transfer and retention policy (frequent transfer/improper responsibility)
- Enhancing compliance (orientation/proper implementation of penalties)
- Effective monitoring system in the internal market (under invoicing/no invoicing)
- Proper implementation of PCA (no practice in field audit)
- Regular and proper feedback mechanism (tax audit/PCA/DRI investigation/higher authority monitoring etc.)
- Effective implementation of specific declaration and single item declaration
- Functionalization of catch-up effect (basically in VAT)
[Part III]
Practical Case Studies: Valuation
Lesson 14 - 17
Case Studies Valuation

Introduction of cases and exercise of basic cases

[different types of cases found from customs clearance and exercise of basic cases]

Examples taken from International Standards

PROBLEM 1

You have before you for valuation two shipments of canned tomatoes. From seller S, the invoice price is 15.00 c.u. per carton and from seller T, the price is 20.00 c.u. per carton.

The shipment from seller S arrived three weeks earlier than the shipment from T. Your records indicate that the sellers and the importer are unrelated as defined in Article 15.4 of the Agreement. There are no restrictions as to the disposition or use of the goods by the buyer.

In the same period there have been shipments from four other sellers of identical goods. These shipments are being imported by unrelated firms as well. The values of these shipments are 17.90 c.u., 18.00 c.u., 18.05 c.u. and 18.10 c.u. per carton, respectively.

Value the shipments from sellers S and T and explain your answer.

Answer: There is nothing to indicate that the invoice prices from S and T are not acceptable as transaction value. Since the importer is unrelated to both sellers, the fact that other sellers have prices for identical merchandise that are higher or lower does not preclude the acceptance of the invoice prices (price paid or payable) as the transaction value.

Value at 15.00 c.u. per carton for S and 20.00 c.u. per carton for T.

PROBLEM 2

Importer I has been doing business with seller S for many years. Every year, I purchases approximately 25% of the total production of S. Because I has agreed to purchase all its requirements of toys from S only, S has granted to I a discount of 5%. While there are other importers of toys from S in the country of importation, only I has such an agreement with S. A typical invoice to I accompanies a shipment before you for valuation:

<table>
<thead>
<tr>
<th>Style</th>
<th>Quantity</th>
<th>Price</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doll</td>
<td>1,000</td>
<td>8.45 c.u. each</td>
<td>8,027.50</td>
</tr>
<tr>
<td>No. 255</td>
<td></td>
<td>less 5 %</td>
<td></td>
</tr>
</tbody>
</table>

You also have a shipment by importer B before you for valuation. B buys merchandise which is identical to that purchased by I. B's invoice reads as follows:
Style | Quantity | Price  | Total  \\
---|---|---|---
Doll | 1,000 | 8.45 c.u. each | 8,450.00

No. 255

Value each shipment and explain your answer.

**Answer:** For the shipment imported by I, the loyalty discount is deducted to arrive at the price actually paid or payable. Value the goods at 8.45 c.u. per unit less 5 %.

For the shipment imported by B, the price actually paid or payable is 8.45 c.u. per unit, net.

**PROBLEM 3**

Importer I generally imports fishing rods directly from a foreign manufacturer M. However, a shipment before you for valuation has been purchased through an export trading house established in the country of export. The exporting trading house has paid to the manufacturer M all charges ex-works, packed the merchandise for export, paid the inland and international freight and loading charges, and has added a commission of 10 % to the ex-works price.

You have a shipment before you invoiced as follows:

1,000 rods at 4.17 c.u. each, c.i.f.

**Charges Included:**

- Price ex-works: 3.50 c.u.
- f.o.b. and loading: 0.05 c.u.
- Commission: 0.35 c.u.
- Ocean Freight: 0.20 c.u.
- Marine insurance: 0.02 c.u.
- Export packing: 0.05 c.u.

The importer advises that he is able to purchase direct from the manufacturer and usually does, but in this particular case, he purchased through the agent.

How would you value the shipment on a c.i.f. basis? Explain your answer.

**Answer:** In this instance, valuation is determined on a c.i.f. basis; thus all costs for freight will be included in the value. The agent is a commercial agent and his commission is part of the price actually paid or payable. The goods should be valued at 4.17 c.u. each.
PROBLEM 4

A shipment of picture frames was purchased in the following styles and quantity per style: style A, 50 units; style B, 75 units; style C, 300 units; style D, 95 units; and style E, 1,000 units. They are imported by a distributor in your country at price list prices, less 25 % trade discount, applicable quantity discount, and a 2 % discount for cash payment within 10 days.

This is the initial importation of these picture frames into your country. All frames are manufactured by the same firm in a foreign country. The price list below shows prices for different sizes of the same style of picture frame. The importer pays the invoice amount in cash within 10 days.

EXPORT AND HOME MARKET PRICE LIST

<table>
<thead>
<tr>
<th>Style</th>
<th>Price per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>5.00 c.u</td>
</tr>
<tr>
<td>B</td>
<td>4.15 c.u</td>
</tr>
<tr>
<td>C</td>
<td>7.00 c.u</td>
</tr>
<tr>
<td>D</td>
<td>8.00 c.u</td>
</tr>
<tr>
<td>E</td>
<td>6.00 c.u</td>
</tr>
</tbody>
</table>

TRADE DISCOUNTS EXPORT ONLY

<table>
<thead>
<tr>
<th>Wholesalers</th>
<th>20 %</th>
<th>1 - 50</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributors</td>
<td>25 %</td>
<td>51 - 100</td>
<td>10 %</td>
</tr>
<tr>
<td>Retailers</td>
<td>15 %</td>
<td>101 - 500</td>
<td>20 %</td>
</tr>
<tr>
<td></td>
<td></td>
<td>501 - 1,000</td>
<td>25 %</td>
</tr>
<tr>
<td></td>
<td></td>
<td>over 1,000</td>
<td>30 %</td>
</tr>
</tbody>
</table>

Value each style of frame and give an explanation for your answer.

**Answer:** In this transaction, all three discounts, namely, the trade discount, quantity discount and cash discount are allowable. The values for each would be as follows:

A. 5.00 c.u., less 25 % trade discount, less 2 % cash discount (no quantity discount for 50 units)

B. 4.15 c.u., less 25 % trade discount, less 10 % quantity discount, less 2 % cash discount.

C. 7.00 c.u., less 25 % trade discount, less 20 % quantity discount, less 2 % cash discount.
D.  8.00 c.u., less 25 % trade discount, less 10 % quantity discount, less 2 % cash discount.

E.  6.00 c.u., less 25 % trade discount, less 25 % quantity discount, less 2 % cash discount.

PROBLEM 5
Seller S in country of export E, opens a branch office in country of import I. Seller S then exports goods to the branch office in country I where the goods are cleared through Customs, duty paid and then stored in a private warehouse owned by the branch office. Title to the goods remains with seller S. When the branch office receives orders from various buyers in country I, they forward the orders to seller S. Seller S then confirms the orders and instructs the branch office to withdraw the goods from the warehouse and ship them to the buyer. Payment for the goods is received by the branch office who deducts their expenses and remits the remainder back to seller S.

At the time that the goods are imported into country I, is there a sale for export within the meaning of Article 1 ?

**Ans:** At the time the goods are imported into country I, they are not the subject of a sale. Title to the goods remains with the exporter. The goods are not sold until after they have been imported. Therefore, there is no transaction value for these goods.

PROBLEM 6
Seller S in country X resells ornamented handkerchiefs made in country Y for export to several purchasers in your country at 3.44 c.u. per dozen, c.i.f. Although the manufacturer makes no export sales himself except to S, he does sell the same handkerchiefs within country Y at 3.50 c.u. per dozen, ex-factory.

If no transaction value can be determined, it is conceded that deductive value is 3.35 c.u. per dozen.

What is the basis of value and the c.i.f. value for a shipment of handkerchiefs sold by S to a purchaser in your country at 3.44 c.u. per dozen, c.i.f., but shipped directly from the manufacturer in country Y ?

**Answer:** The transaction value is 3.44 c.u. per dozen. The goods left country Y, destined for your port, so Y is the country of exportation. There is no requirement in the Agreement that the goods be sold from the country of exportation.

PROBLEM 7
You have a shipment of transformers imported by I. The transaction involved in this importation is the subject of a contract between importer I and exporter E. The contract
specifies a fixed price for the transformers at a particular level of performance and it also includes bonus or penalty payments if that level of performance is exceeded or not reached. The imported transformers exceeded the level of performance and the importer, in accordance with the contract, was required to pay an additional 5% for each transformer. What is the transaction value for these transformers?

Answer: The transaction value will be the original contract fixed price plus the 5% bonus. The contract establishes a fixed formula and the contract price plus the 5% represents the price actually paid or payable, i.e., the total payment made or to be made for the goods by the buyer to the seller.

PROBLEM 8
You have before you for valuation a shipment of 1,000 wigs from seller S in country X, imported by an importer in your country. The wigs are invoiced at 5.00 c.u. each, c.i.f. in your country. Your records indicate "second quality" wigs generally cost 5.00 c.u. each, but after you examine the wigs, you discover that they are of "first quality". Your records show several previous shipments of identical "first quality" wigs at a transaction value of 10.00 c.u. each.

In response to an inquiry, the importer explains that the wigs in the present shipment are indeed "first quality" but that he paid only 5.00 c.u. each. The manufacturer reduced the price by 5.00 c.u. in compensation for a previous importation of wigs for which the importer paid 10.00 c.u. as "first quality", but were subsequently discovered to be "second quality".

At what price would you value the wigs and why? On what basis?

Answer: The transaction value for the wigs will be 10.00 c.u. each. This price consists of a direct payment of 5.00 c.u. and the indirect payment of 5.00 c.u., as the seller is settling a debt he owes to the buyer. The price paid or payable consists of the total payments, directly or indirectly, paid to the seller by the buyer.

PROBLEM 9
Seller S prices its merchandise, greeting cards, on a seasonal basis adhering strictly to the following schedule:

April, May and June accorded a 15% discount; July, August and September accorded a 25% discount; all other months accorded no discount.

Would a 25% discount be allowed for a shipment of greeting cards purchased in September but imported in November?

Answer: Yes, you would allow the 25% discount. This price represents the price actually paid or payable for the goods when they were sold for export to the country of import. We are not concerned with the price that was in effect when the goods were exported.
PROBLEM 10
The shipment before you for valuation consists of one scientific instrument. The invoice price for the combined unit is 57,000 c.u. The terms of the transaction indicate that the price is net, ex-factory, packing included. Under the heading of "charges included", the invoice indicates a fee of 10,000 c.u. for assembly, calibration and testing of the instrument after importation. The manufacturer of the instrument is M, a large manufacturer of scientific instruments.

Since this is an initial shipment of this type of instrument, and because of the large amount for testing and calibration, you request certain information from the importer. In response to your request, the importer advises you that his firm has purchased this instrument for its own use to do research on the effects of chemical on sample tissue. As to the technical services provided, the importer advises that this was the amount paid by the seller to an independent engineering firm in your country to cover the cost of sending an engineer to the importer's premises, setting up the instrument, calibrating it to measure exactly what the importer required and finally, to monitor the operation of the instrument. Based on the foregoing, would you include the 10,000 c.u. fee in your valuation?

Answer: The transaction value included an amount for erection and technical services and the Agreement provides for a deduction of the costs and charges of this service if they are undertaken after importation and are distinguishable from the price actually paid or payable for the imported goods. The 10,000 c.u. is distinguishable as "costs incurred" and would not be included in the dutiable value.

PROBLEM 11
Importer X is a producer of electrical goods in country of import I. He has an opportunity to sell 1,000,000 c.u. of electrical goods to automobile manufacturer M in country J. M does not possess sufficient hard currency to pay for the electrical equipment, so he offers to X its choice of the first 25,000 vehicles it produces in its automobile plant. However, X has no need for these automobiles. Instead, X has managed to trade these automobiles to plywood manufacturer P in country Y in exchange for 100,000 kilograms of plywood, which X will then import into country I.

Do you have enough information to establish a transaction value for the imported plywood? If yes, at what price? Explain your answer, yes or no.

Answer: No, you do not have enough information in order to establish a transaction value. The imported goods, i.e., the plywood, is obtained from manufacturer p but is not the subject of a sale for export. There is no "price" for the plywood. The "price" or "cost" of the plywood is subject to a condition or consideration for which a value cannot be determined. That is, the price of the goods is established on the basis of a form of payment extraneous to the goods (e.g., the barter of 25,000 automobiles).
PROBLEM 12
M, a foreign manufacturer of motor vehicles, has concluded a contract with wholesaler D in country of importation I wherein D will act as his sole distributor. The specific provisions of the sole distributors agreement between manufacturer M and distributor D are as follows:

a) D's selling right shall not extend to countries outside the distributor's territory, i.e., the country of import;
b) D shall fix his retail prices and the discount rates for dealers in his territory.
c) D shall maintain two or three month's vehicle stock and a corresponding stock of spare parts;
e) D shall spare no effort to import and sell the maximum quantity of motor vehicles from M and in the event of the minimum number of vehicles not being reached, M reserves the right to cancel the agreement;
d) D shall maintain showrooms, employ adequate staff of trained salesmen and repair mechanics;
f) D shall carry on advertising for vehicles within the territory.

Are the situations described in a through f restrictions or considerations which would preclude the use of transaction value?

Answer: The responses to the situations outlined are as follows:
a. This is a provision which limits the geographical area in which the goods may be resold, a restriction which is permissable under subparagraph 1 (a) (ii) of Article 1.
b. This provision is not a restriction or condition within the meaning of Article 1 as it does not significantly affect the value of the imported goods.
c. This provision corresponds to a usual business practice which requires the maintenance of an adequate stock for anticipated sales and repairs. It is not a condition of sale that implies that other goods have to be bought, but rather is a condition or consideration relating to the marketing of the imported goods, governed by the provisions of the second paragraph of Interpretative Note to paragraph 1 (b) of Article 1.
d. This provision is not a restriction or condition within the meaning of Article 1. Again, it is a common business practice relating to the marketing of the goods.
e. This provision corresponds to usual business practices and would be treated as a condition or consideration relating to the marketing of the imported goods.
f. This provision corresponds to usual business practices and would be treated as a condition or consideration relating to the marketing of the goods.
**PROBLEM 13**

You have an importation of two products, product A and B, which are invoiced at 1,000 c.u. The invoice specifically allocates 350 c.u. to product A and 650 c.u. to product B. After further inquiry, you learn that products A and B were purchased in a package deal, that is, both were purchased for a total of 1,000 c.u. The importer advises you that since product A is subject to a 15% duty rate and product B is subject to a 6% duty rate, he allocated the costs between the two products in an effort to reduce his duty liability. Can these values be used to establish the transaction value?

**Answer:** In this situation, the prices have been set or modified, some upwards, some downwards, to inappropriately reduce liability for Customs duties. This type of offsetting arrangement represents a condition or consideration for which a value cannot be determined with respect to the goods being valued. Therefore, the provisions of Article 1.1 (b) apply and valuation cannot be based on the transaction value of the imported goods.

**PROBLEM 14**

In an entry before you for valuation, Importer I in importing country Y has declared the price of a complete second-hand steel rolling mill to be 65,000 c.u. The contract and the invoice produced by him show that the importer had purchased the complete mill from Exporter E in country X in a dismantled condition.

Enquiry into the transaction revealed that an agent in country of exportation X had acted on behalf of the importer and after locating a second-hand steel rolling mill, the type of which required by the importer, had negotiated the price with the seller. For his part in the transaction, the agent received from the importer a 2% commission on the selling price.

The inquiry further revealed that the exporter had sold the dismantled mill on an "as-is-where-is" basis. With labor costs in the exporting country being higher, the importer sent from the importing country one technician and 10 laborers to the exporting country to make the heavy wooden crates and to pack the complete mill in the crates. The importer had also purchased packing material in the exporting country. Detailed cost figures for this packing operation are as follows:

- **Cost of going and return air fare** (of one technician and 10 laborers) 4,750 c.u.
- **Hotel charges for the above** 3,500 c.u.
- **Daily allowances and wages for the period** 4,400 c.u.
- **Cost of packing materials** 1,300 c.u.
What is the Customs value? Explain.

Answer: 78,950 c.u.

Add to the price of the mill (65,000 c.u.) all the costs incurred in packing the mill (4,750 + 3,500 + 4,400 + 1,300 c.u.). The agent represents the importer and would therefore be considered as a buying agent and hence, the commission would not be added to the price actually paid or payable.

**PROBLEM 15**
Importer I in your country has imported a shipment of red wine from wine exporter E in country X. The wine has been exported in metal drums at a price of 30 c.u. per litre which includes the price of the metal drums.

After importation, the wine is to be bottled by the importer and sold with the exporter's trademarked label.

The importer also purchases the bottles as well as the labels for the bottles. They are shipped in separate boxes along with the drums of wine. There is a combined invoice declaring the price as follows:

- red wine: 30 c.u. per litre
- empty one-litre bottles: 600 c.u. per hundred
- labels: 40 c.u. per hundred

What is the Customs value of 1,000 litres of wine imported by I? Explain your answer.

Answer: 30,000 c.u.

The price of the wine (1,000 x 30 c.u.), including the costs of the metal drums would be the price actually paid or payable as the drums would be considered as one with the goods.

Since the bottles and labels are imported empty, they are separate articles of commerce and would be separately classified and valued:

**PROBLEM 16**
Importer I in country Y imports color film in rolls. Exporter E in country X sells the film only through selling agent A who is located in the country of importation. Agent A is exporter E's sole agent but they are not otherwise related.
According to the terms of the sales contract, the exporter requires all importers of his colour film to pay an additional 2% of the invoice value directly to selling agent A.

To maximize the benefits of his advertising efforts, importer I tasks agent A with a nationwide advertising campaign to promote the sale of this film. He separately pays agent A an additional 1.5% of the invoice price to cover A’s marketing expenses on his behalf.

What is the Customs value of a shipment of 2,000 rolls of colour film imported by I at an invoice price of 20 c.u. per roll? Explain your answer.

Answer: 40,800 c.u.

The price actually paid or payable (2,000 x 20 c.u.) should be increased by the 2% selling commission (800 c.u.). The charge of 1.5% for the advertising campaign does not form a part of the Customs value of the goods because it is not a part of the price actually paid or payable, i.e., it is not a part of the total payment made by the buyer to the seller (it is paid to the agent) and it is not one of the adjustments listed in Article 8.

PROBLEM 17

Importer I regularly imports liquid nitrogen from exporter E of exporting country X at a price of 50 c.u. per kg. Specialized metal containers for the liquid nitrogen had been supplied free of cost to I by E.

Your inquiry reveals that I had purchased these containers in the home market at a price of 1,000 c.u. each which carry 10 kg. of liquid nitrogen. Following a strict safety requirement, each container can be used for transportation of liquid nitrogen 20 times.

What is the Customs value of 30 kg of liquid nitrogen? Explain your answer.

Answer: 1,650 c.u.

Cost of nitrogen 1,500 c.u.
Cost of 3 containers 150 c.u.
Original cost of one container 1,000 c.u.;
(to be used 20 times; thus, for one time, it would be 1,000 divided by 20 or, 50 c.u.).

PROBLEM 18

Importer I in country Y enters into negotiations, through a broker, for the purchase of corn oil. The broker puts exporter E in country X in touch with the importer and acts as a middleman between them for finalization of the price and the terms of payment. The transaction is finalized for delivery of 8,000 tons of oil at a price of 100 c.u. per ton.
The importer agrees to pay the broker 0.50% of the price as his brokerage. In addition, because of their long-standing business relationship, the broker provides the importer with a financial guarantee for the loan the importer obtained for the entire amount of 800,000 c.u. to pay for the present shipment. The broker makes a separate charge of 2% for the loan guarantee to the importer.

The broker has also separately charged a brokerage of 0.3% of the invoice price to the exporter. Without adding it to the invoice price, the exporter agrees to pay the brokerage because of large orders being placed through the broker.

What is the Customs value of the shipment of 8,000 tons of oil imported by I? Explain your answer.
Answer: 804,000 c.u.

To the price actually paid or payable (8,000 x 100 c.u.) you will add the brokerage of 2% (800,000 x .02). The additional 2% charge for the financial guarantee is not to be added to the transaction value because it is not part of the price actually paid or payable by the buyer to the seller (i.e., it is paid to the broker), nor does it qualify as either commission or brokerage or any other adjustment under Article 8. The amount of brokerage (0.3%) paid by the exporter will also not be added to the price as it is not included in the price actually paid or payable and it cannot be added under Article 8 as it was not incurred by the buyer.

PROBLEM 19

Importer I enters into an agreement to import from exporter E in country X, a supply of 5,000 kg of frozen shrimp per month. The invoice shows the following price breakdown:

<table>
<thead>
<tr>
<th>Description</th>
<th>Price Breakdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shrimps</td>
<td>40 c.u. per kg</td>
</tr>
<tr>
<td>Packing fresh shrimps in polyethylene</td>
<td></td>
</tr>
<tr>
<td>bags of 1 kg</td>
<td>2 c.u. per bag</td>
</tr>
<tr>
<td>Freezing the packed shrimps</td>
<td>1.5 c.u./bag</td>
</tr>
<tr>
<td>Packing ten bags (1 kg each bag) in</td>
<td></td>
</tr>
<tr>
<td>plastic foam boxes</td>
<td>5 c.u./box</td>
</tr>
<tr>
<td>6 days hiring charges for a refrigerated</td>
<td>600 c.u./day</td>
</tr>
<tr>
<td>transport container in which 500 boxes</td>
<td></td>
</tr>
<tr>
<td>(5,000 kgs) could be packed (transport</td>
<td></td>
</tr>
<tr>
<td>time is normally 6 days)</td>
<td></td>
</tr>
</tbody>
</table>

Assuming that your country provides for the exclusion of those types of containers enumerated in Article 8.2, what would be the Customs value of the shipment of 5,000 kg of shrimps? Explain your answer.
Answer: 220,000 c.u.

To the price actually paid or payable (5,000 x 40 c.u.) will be added the polyethylene bags (5,000 x 2 c.u.), freezing (5,000 x 1.5 c.u.) and the plastic foam boxes (500 x 5 c.u.). There will be no addition for the refrigerated transport container which is used as a means of transport.

PROBLEM 20

A shipment of 500 tons of greasy wool is exported from country X at the invoice price of 7,500 c.u. The ocean freight charges are at the rate of 2 c.u. per ton, minus 10 % discount (on account of regular bookings being made on the same shipping lines by the importer). The importer also pays an insurance charge of 0.50 % of the invoice value.

After importation but before the Customs clearance, the goods were stored in a warehouse for a period of three months for which a monthly rent of 1 c.u. per ton was paid by the importer to the warehouse owner.

What is the Customs value ?

NOTE : For the purpose of this problem, assume that the national Customs law provides for the inclusion of all the costs and charges referred to in Article 8.2 (a), (b) and (c).

Answer:

Customs value = 8,437 c.u.

7,500 - invoice price

900 - freight

37.5 - insurance

8,437.5

No addition for warehousing charges as this is the cost incurred by the buyer in the country of importation for which no adjustment is provided for in Article 8.
PROBLEM 21

NOTE : For the purpose of this problem, assume that the national Customs law provides for the inclusion of all the costs and charges referred to in Article 8.2 (a), (b) and (c).

A shipment of stainless steel exported from land-locked country X and imported in overseas country Y by importer I is invoiced at 22,000 c.u., ex-factory, plus freight and insurance of 500 c.u. The freight and insurance are composed as follows : 200 c.u. for the road transport carrier bringing the goods to the port of loading on the seagoing vessel in transit country T and 300 c.u. for the ocean freight and insurance to the place of importation in country Y. Awaiting loading in the seagoing vessel, the goods were temporarily stored in country T for two days by the transit carrier for which the importer was separately charged 180 c.u. Though the ocean freight included the charges for unloading at the port of importation, the importer being in urgent need of the goods, hired the port authority's cranes as the ship's derrick would have taken longer in unloading the merchandise. An amount of 40 c.u. was paid by the importer to the dock authorities for using the cranes.

What would be the Customs value ?

Answer:

Customs value = 22,720 c.u.

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>22,000</td>
<td>invoice price</td>
</tr>
<tr>
<td>500</td>
<td>from X to Y, the cost of transport should be from country of export to the port or place of import</td>
</tr>
<tr>
<td>180</td>
<td>storage is incidental to transport</td>
</tr>
<tr>
<td>40</td>
<td>part of unloading charges</td>
</tr>
</tbody>
</table>

PROBLEM 22

NOTE : For the purpose of this problem, assume that the national Customs laws provide for the inclusion of all the costs and charges referred to in Article 8.2 (a), (b) and (c).

Facts of the case : 

Exporting country = X
Importing country = Y (land-locked)
Transit country = T
Invoice value of the goods = 5,000 c.u.

Payment made by the importer to a combined transport and freight broker, the details of which are as follows:

(a) ocean freight from the port in country X up to the port in country T 800 c.u.
(b) unloading, handling and documentation charges at the port in country T 75 c.u.
(c) road transport from the port in country T to the land border of country Y 300 c.u.
(d) from Y’s border station up to the importer’s factory 150 c.u.

1,325 c.u.

Insurance charges from the exporting country X to the delivery point, i.e., the importer’s factory (breakdown of the various stages are not available) = 2% of invoice price.

What is the Customs value ?

Answer:

Customs value = 6,275 c.u.

5,000 - invoice value

1,175 - transport and related costs: 1,325 - 150 = 1,175.

An amount of 150 c.u. is deducted as this is the transport cost within the country of importation.

100 - insurance; since the break-up is not available, the whole of insurance charges may be added although it also covers the goods from Y’s border to the importer’s factory.

PROBLEM 23

NOTE: For the purpose of this problem, assume that the national Customs laws provide for the exclusion of all costs and charges referred to in Article 8.2 (a), (b) and (c).

Importer I is undertaking installation of a cement plant. He negotiates importation of certain heavy machinery items from exporter E of country X.

According to the construction schedule of the plant, importer I calculated that it would require the delivery of the machinery by the first of July. Since transport time is about 15 days, he entered into a contract with the exporter which provided for the shipment of the machinery by 15 June at a price of 28,000 c.u.

There was, however, a strike of the construction workers delaying the construction schedule by 3 months. Keeping in mind that a direct delivery of the heavy machinery
may be desirable and considering that the storage expenses in the importing country are higher, the importer requested the exporter to store the machinery in the exporting country itself.

When the machinery was finally shipped, the exporter added to the invoice value, 1,500 c.u. for storage expenses.

The importer also paid to the shipping company 4,000 c.u. for ocean freight and 80 c.u. for insurance.

What is the Customs value?

Answer:

Customs value = 29,500 c.u.

Storage having taken place in the country of export and its charges included in the price paid by the importer to the exporter, is to be included in the Customs value. No transport cost or insurance charge need be added.

NOTE: Explain that in situation in which importer I would have warehoused the goods himself for his own account in country of exportation X, the warehouse costs would not have been a part of Customs value.

PROBLEM 24

NOTE: For the purpose of this problem, assume that the national Customs laws provide for the exclusion of all the costs and charges referred to in Article 8.2 (a), (b) and (c).

A shipment of 5,000 tons of explosive material is imported by I from country Y at a contract price of 10 c.u. per ton, c.i.f. It was ascertained that the cost for freight and insurance was 1.50 c.u. per ton.

The vessel carrying the cargo was not allowed to enter the docks due to the nature of the cargo. From the anchorage in mid-stream, the merchandise was unloaded in barges and taken to the hazardous cargo warehouse. The additional cost of transporting the cargo from the ship to the warehouse came to 0.10 c.u. per ton. Rent for the warehouse came to 0.25 c.u. per ton per week. The cargo was in the warehouse for three weeks before the importer filed the Customs clearance documents.

What would be the Customs value?

Answer:

Customs value = 42,500 c.u.
Invoice value minus the freight and insurance charges. No addition for transporting the merchandise to warehouse and also warehouse charges.

**PROBLEM 25**

NOTE: For the purpose of this problem, assume that the national Customs laws provide for a partial exclusion of the costs and charges referred to in Article 8.2 (a), (b) and (c). All charges for international freight are to be excluded from the Customs value (international freight occurs when the goods leave the country of exportation destined for the country of import).

A shipment of electric motors manufactured and sold in country X is entered at your port in country Z, at 2,000 c.u. each, c.i.f. your port. Because country X is land-locked, the motors were trucked from the plant to the border with country Y. After crossing the X-Y border, the goods were taken to the port in country Y, loaded on a vessel, and were shipped to country Z.

The invoice reads as follows:
10 electric motors at 2,000 c.u. each = 20,000 c.u., c.i.f. your port
Charges included in the price:
- Packing = 200 c.u.
- Inland freight (truck) to X-Y border = 75 c.u.
- Inland freight (truck) from Y border to port = 80 c.u.
- Ocean Freight = 300 c.u.

What is the Customs value?

**Answer:**
Customs value = 19,620 c.u.

Because only international freight is excluded, the costs for freight within country X (inland freight) would remain in the Customs value. Once the goods cross the border into Y, exportation has occurred and the trucking cost of 80 c.u. and the ocean freight of 300 c.u. would be deducted.

**PROBLEM 26**

NOTE: For the purpose of this problem, assume that the national Customs laws provide for the inclusion of all costs and charges referred to in Article 8.2 (a), (b) and (c),

Importer I contracted for the import of 10 tons of tanning material from exporter E of country X at a price of 1,000 c.u. which included freight and insurance charges of 200 c.u.

As a result of fire in the warehouse of the importer, who is a tanner, existing stocks of tanning material were destroyed.
So as to fulfil his commitment to supply the finished leather, importer I was in urgent need of the tanning material and therefore, he contacted exporter E to send 5 tons of tanning material by air, with the remainder being shipped by sea. The exporter accordingly shipped 5 tons by air and made an additional charge of 35 c.u.

What is the Customs value of.

(a) 5 tons imported by sea ?

(b) 5 tons imported by air ?

Answer:

(a) importation by sea: Customs value = 500 c.u.

(b) importation by air. Customs value = 535 c.u.

500 c.u. - invoice price

35 c.u. - airfreight and insurance

535 c.u.

PROBLEM 27

Importer I in your country has imported 1,000 sets of hand tools exported by E of country X at an invoice price of 20 c.u. per set. It is known that the exporter E of country X is a subsidiary of company S of country X and that S also controls 9 % of the shares of importer I in your country. Having regard to the relationship between importer I and exporter E and considering that the price is about 15 to 20 % lower than the price of what appears to be similar hand tools, imported by other importers, you ask the importer to justify the declared price.

The importer produces documents showing that there are no financial ties between him and the exporter and that the two operate completely independent of each other. The importer further produces copies of correspondence with the exporter which indicates price negotiations under competitive conditions.

The answer to your objection that the price of the imported hand tool sets appears low, the importer demonstrates that although they appear to be similar they are in fact much inferior to the ones imported by other importers, considering that most of the latter items are made of polished steel while in his case the items are made of semi-polished steel. Thus, the other tools which appear to be similar are in fact of much superior quality. Further, the importer shows that while other importations of hand tools were imported along with tool boxes, his shipment is without tool boxes and that the tool boxes would be indigenously manufactured by him which itself would add 10 % to the price of each tool set.

What is the Customs value of the shipment imported by I ?
Answer:

Customs value = 20 c.u. per set.

Examination of the circumstances of sale has shown that the relationship has not influenced the price.

PROBLEM 28

Importer I in your country has contracted for regular importations of roller shaft bearings from his subsidiary, exporter E of country X, at an invoice price of 16 c.u. per bearing. The first shipment of 1,000 bearings is before you for valuation.

Your information shows that importer I has been the only importer in your country of these specialized roller shaft bearings. Further, I had been importing identical bearings from a different unrelated exporter T, also of country X, at an assessed Customs value of 20 c.u. per bearing, and a shipment from exporter T at this price was imported only one and a half months prior to the importation of the shipment under valuation.

The importer produces details of previous transactions with exporter T as well as the present transaction with E which shows that exporter T had been supplying roller shaft bearings to importer I for a long time. However, as a result of the closure of T's factory, no supply to I was available from that source.

Negotiations took place between importer I and its subsidiary, exporter E. Exporter E is a manufacturer of roller bearings but was reluctant to manufacture roller bearings with shafts. Importer I, being in a position to supply the shafts, proposed to E that the shafts would be supplied by him. Accordingly, it was agreed that the shafts be supplied, free of cost, by the importer and that the roller bearings would be coupled to the shaft by exporter E. Importer I further demonstrates that the cost of the shaft which was supplied free of cost to exporter E was 4.45 c.u. which included freight, insurance and all other costs for free delivery to E's factory.

On what basis should the Customs value be determined? What is the Customs value?

Answer:

Customs value = 20.45 c.u. per unit

The invoice price of 16 c.u. has been accepted and the cost of the assist, 4.45 c.u., has been added. The importer has shown that the transaction value of 20.45 c.u. closely approximates the transaction value of 20 c.u. occurring at or about the same time for identical goods in sales to an unrelated buyer of identical goods for export to the same country of import.
PROBLEM 29

A textile manufacturing company I has imported a shipment of 5,000 spindles from its fully owned subsidiary E of country X at an invoice price of 8 c.u. per spindle.

In the past, E has supplied some machinery parts without the addition of any profit and for those shipments, the transaction value had not been accepted as the Customs value.

In view of the relationship and considering the past transactions, you ask the importer to justify the invoice price. Importer I explains, with documentary evidence, that as per agreement between him and his fully owned subsidiary E, whenever any spares are supplied by E, the price only includes the cost of manufacturing; it does not include any profit margin. The present shipment, however, is required for the expansion of an existing textile mill. Since the spindles are not being supplied as spares, their pricing has been established as if no relationship existed.

Importer I also demonstrates that identical spindles have been imported at or about the same time in a shipment of 1,150 spindles by importer K in your country, from another exporter S, also of country X, at an assessed Customs value of 8.75 c.u. per spindle. It has also been established that S’s acceptable price list gives the following discount schedule:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 2,000</td>
<td>No discount</td>
</tr>
<tr>
<td>2,000 - 4,000</td>
<td>5 % discount</td>
</tr>
<tr>
<td>Over 4,000</td>
<td>10 % discount</td>
</tr>
</tbody>
</table>

What is the basis on which you would determine the Customs value of 5,000 spindles imported by I? What is the Customs value?

**Answer:**

Customs value = 8 c.u. per unit

The importer has demonstrated that the transaction value closely approximates the transaction value, adjusted for quantity, of identical goods.

PROBLEM 30

A publishing house I in your country has imported a shipment of newsprint at an invoice price of 823 c.u. per roll of 500 meters from exporter E of country X. The Managing Director of I holds 25 % of the shares of exporter E.
In order to satisfy that the relationship has not influenced the price, you ask the importer to produce correspondence relating to the transaction. Instead of showing the correspondence, the importer cites the following importations of identical newsprint:

<table>
<thead>
<tr>
<th>Importer</th>
<th>Exporter</th>
<th>exportation</th>
<th>Customsvalue andbasis</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>T</td>
<td>X</td>
<td>895 c.u. per roll on the basis of transaction value</td>
</tr>
<tr>
<td>C</td>
<td>M</td>
<td>X</td>
<td>800 c.u. per roll on the basis of deductive value</td>
</tr>
<tr>
<td>D</td>
<td>N</td>
<td>Z</td>
<td>795 c.u. per roll on the basis of computed value</td>
</tr>
</tbody>
</table>

What is the Customs value?

Answer:

Customs value = 823 c.u. per roll

The importer has shown that the transaction value closely approximates the Customs value of importations by C occurring at or about the same time. Shipment from D is from a different country of production and it does not closely approximate the identical goods from B.

PROBLEM 31

A shipment of 5,000 electric motors of less than 1/2 horsepower are imported at an invoice price of 28 c.u. per motor is before you for valuation. Importer I who imports these motors, is a manufacturer of household appliances. Exporter E of country X is the father of importer I. The appliances are sold by I with the trademark of E and a percentage of the sale of these appliances accrues to E.

Importer I demonstrates that at a different port in your country, a shipment of identical motors has been imported three weeks previously with particulars as follows:

- Imported by B, a manufacturer of garden appliances
- exported by E of country X
- importer B is the second son of exporter E
- garden appliances manufactured by B are sold with E’s brand name and a percentage of sale accrues to E
the price of 22 c.u. having been influenced by the relationship, was not accepted and
the Customs value of 27.10 c.u. per motor was determined on the basis of the computed
method

According to the information available to you, a shipment of identical motors of below
1/2 horsepower was imported through your port several weeks previously by unrelated
importer T. The transaction price of 30 c.u. per motor was accepted as the Customs value
under Article 1.

What is the Customs value of the motors imported by I?

Answer: 
Customs value = 28 c.u. per motor

The importer has shown that the transaction value closely approximates the Customs
value of identical goods determined under Article 6.

PROBLEM 32

You have for valuation a shipment of steel beams produced and sold by manufacturer M
in country X and imported by company I in country Y. The importer is a wholly owned
subsidiary of the manufacturer. The steel is invoiced at 300 c.u. per ton. Because of the
relationship, no profit is realized on the sale of the steel.

You have evidence of four recent shipments of identical steel beams manufactured in
country X and sold to non related buyers in country Y at 320 c.u., 318 c.u., 325 c.u. and 319

c.u. per ton. All of these prices represent valid transactions under Article 1. You also
have record of another shipment of steel exported from country X which is identical in
all respects to the shipment being valued except that it was produced in country Z. It was
valued at 310 c.u. per ton on the basis of transaction value.

In addition to the above, you have record of a shipment of similar goods imported
through another port in your country from country X. That product, however, was also a
sale between related parties and the Customs value was 305 c.u. on the basis of Article 6.

What is the Customs value?

Answer: 
Customs value = 300 c.u. per ton

It has been demonstrated that the transaction value closely approximates a test value of
similar goods valued under Article 6 at 305 c.u. per ton.
PROBLEM 33

You have a shipment of electronic calculators which was produced in country X by manufacturer M. The goods were destined for company I in country Y. M owns 10% of the voting stock of company I. The calculators are invoiced at 310 c.u. per dozen. I is not able to establish that the price was not influenced by the relationship. The price of the same calculators sold by M to other importers in country Y who are not related to him is 366 c.u. per dozen. This price includes a full warranty handled by M and it is estimated to be worth approximately 20% of the invoice price. Company I handles its own warranty.

You have record of another producer of electronic calculators in country X who sells similar calculators in country Y to unrelated buyers at 398 c.u. per dozen.

You have recently established transaction values for M's sales to unrelated buyers at 366 c.u. per dozen and for the producer of similar goods in country X at 398 c.u. per dozen.

What is the transaction value?

Answer:

Customs value = 310 c.u. per dozen

It has been demonstrated that the transaction value closely approximates a test value of identical goods. You must make an adjustment for warranty considerations which are incurred by non-related buyers but not incurred by related buyers. A price of 366 c.u. adjusted for 20% warranty would be 305 c.u. which closely approximates 310 c.u.

PROBLEM 34

You have a related party transaction before you to value. The goods were produced in country X by manufacturer A. The sale is for 10,000 units and is invoiced at 40 c.u. each. Manufacturer A sells only at the wholesale level. The importer cannot establish that the price was not influenced by the relationship. You have record of a recent shipment of similar merchandise produced in country X by manufacturer B which was valued at 50 c.u. each on the basis of transaction value. That sale, a sale between unrelated parties, was in a quantity of 500 units. You have a copy of Manufacturer B’s price list, which shows that prices vary according to the amount purchased as follows:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 100</td>
<td>60 c.u. per dozen</td>
</tr>
<tr>
<td>101 - 5,000</td>
<td>50 c.u. per dozen</td>
</tr>
<tr>
<td>over 5,000</td>
<td>42 c.u. per dozen</td>
</tr>
</tbody>
</table>

What is the Customs value?
Answer:

Customs value = 40 c.u. each

It has been demonstrated that the transaction values closely approximates a test value. You have similar goods appraised under transaction value; you must make an adjustment for quantity, the adjusted price would be 42 c.u. (over 5,000 units) which closely approximates the invoice price.

PROBLEM 35

You have a related party transaction to value for goods produced in country X by manufacturer A in a quantity of 1,000 units and invoiced at 20 c.u. each. The importer is a wholesaler. The importer cannot establish that the price was not influenced by the relationship. You have records of a recent importation of similar goods produced in country X by manufacturer B which was valued on the basis of transaction value at 26 c.u. each. That sale was in a quantity of 100 units and was purchased by a retail department store. You obtain a copy of manufacturer B’s price list which shows that prices vary according to the level of purchaser as follows:

<table>
<thead>
<tr>
<th>Level of purchaser</th>
<th>Unit price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td>21 c.u. per unit</td>
</tr>
<tr>
<td>Retail</td>
<td>26 c.u. per unit</td>
</tr>
<tr>
<td>End user</td>
<td>31 c.u. per unit</td>
</tr>
</tbody>
</table>

What is the Customs value?

Answer:

Customs value = 20 c.u. per unit

It has been demonstrated that the transaction value closely approximates a test value. You have similar goods sold at or about the same time and valued under transaction value. However, since the commercial level is different and there is a demonstrated difference due to the level of purchaser, you must make an adjustment. The adjusted value would be 21 c.u. per unit (wholesale) which closely approximates the invoice price of 20 c.u.
Case studies taken from International Standards

Case 1

CASE STUDY 5.2 on Application of Article 8.1 (b) (i) to (iv)

The Case Study is given below:

"Facts of transaction"

1. Firm I, established in country of importation Y, orders three identical racing cars from automobile manufacturer M in country of exportation X. These cars must be manufactured according to certain technical specifications imposed by I; the specifications are as follows:
   a. the carburettors for the cars will be manufactured by firm A in country Q and supplied free of charge to M by I. Their cost per unit is 10,000 c.u.;
   b. the testing of the car engines will be done in factory M by electronic checking equipment manufactured by firm B in country P, which, rented by I from B, will be supplied free of charge to M’s production line. The engines that pass the testing procedures will be incorporated into the auto body; however, the equipment will discard the engines that fail the test. The hire charge for the equipment delivered and installed at M’s factory is 60,000 c.u.;
   c. the racetrack testing to ensure that the performance of the cars meets the manufacturing specifications will be carried out by M, using 5,000 litres of special fuel produced by company C in country Q. This will be supplied by I to M at a special price equal to 40% of the price invoiced by C to I, which is 10 c.u. per litre;
   d. the bodywork of the cars will be constructed by M according to plans and sketches prepared by firm D in country R; these will be furnished to M free of charge, their cost to I being 12,000 c.u.;
   e. the gearbox of the cars will be manufactured by M according to plans and sketches undertaken by I’s technical service department located in county of importation Y and supplied to M free of charge. The cost of production of these plans and sketches is 8,000 c.u.

2. At the time of importation of the three cars, I presents to the Customs authorities of the country of importation Y a declaration of value based on the transaction value, together with all the commercial documentation and accounts relating to the manufacture of the cars by M and to the contracts for the materials and other goods and services supplied.
Determination of Customs value

3. The declared value is based on the invoice price by M for the three cars, 900,000 c.u., to which the following amounts (ignoring for the purpose of this case study the question of transport costs and associated charges related to the goods and services supplied) are added as adjustments:
   a. 30,000 c.u. paid by Ito A in respect of the carburettors, as components incorporated in the imported cars; this adjustment is made under Article 8.1(b) (i);
   b. 60,000 c.u. paid by I to B for supplying M with the electronic checking equipment, as tools, dies, moulds and similar items used in the production of the imported goods; this is an adjustment under Article 8.1 (b) (ii);
   c. 30,000 c.u. corresponding to the 60% of the price invoiced by C to I for the fuel supplied to M for the racetrack tests, as material consumed in the production of the imported cars, it being understood that the 40% of the price was already included in the invoice price; this is an adjustment under Article 8.1 (b) (iii);
   d. 12,000 c.u. paid by I to D for the plans and sketches of the bodywork of the cars, undertaken in country R and necessary for the production of the imported cars; this adjustment is added under Article 8.1(b) (iv).

4. The Customs authorities accept the exclusion from the transaction value of the 8,000 c.u., cost of production of the plans and sketches for the gearbox of the cars, since this assistance is provided within the country of importation by I’s technical service; the exclusion is in accordance with the provisions of Article 8.1 (b) (iv).

5. The value ex-factory M. for Customs purposes, of the three cars is 1,032,000 c.u., to which would be added the cost of transport and associated charges to the country of importation, if this is provided for in the importing country’s national legislation."
Case 2

CASE STUDY 8.1 on Application of Article 8.1 – License fee to be treated as Assist.

This Case Study deals with a situation where the license fee has to be treated for valuation purpose as the payment for an assist in terms of Article 8.1 (b) (ii). The case Study is given below:

"Facts of transaction"

1. ICO sells high fashion men’s garments to retailers in the country of importation. All garments are imported from one overseas supplier, XCO. XCO manufactures the garments using paper patterns supplied free of charge by LCO on behalf of ICO. LCO, which is located in a third country, specializes in designing high fashion men’s garments. There is no relationship, within the meaning of Article 15.4, between ICO, XCO and LCO.

2. ICO has a license agreement with LCO under which ICO is granted:
   (1) an exclusive licence to distribute garments incorporating LCO’s designs in the country of importation;
   (2) the right to use paper patterns, incorporating designs, developed by LCO.

3. The licence agreement also provides that LCO will supply designs and paper patterns to whomever ICO nominates. ICO instructed LCO to supply XCO with multiple copies of the paper patterns (incorporating the designs) necessary to manufacture garments in the various sizes.

4. ICO pays XCO 200 c.u. for each garment. In consideration for the licence granted, ICO pays to LCO a licence fee equal to 10% of ICO’s gross sales price of the garments. At the time of importation, all the garments have been sold to retailers for 400 c.u. each. Therefore, it is known at the time of importation that a licence fee of 40 c.u. will be paid to LCO for each garment.

Determination of Customs value

5. The importer presents to the Customs of the country of importation a declaration of value based on the transaction value, together with all the documentation relating to the licence agreement with LCO and the payment made for the rights granted under this licence agreement.

6. All the provisions of Article 1 (a) to (d) are satisfied and the Customs value is to be determined under the transaction value method.

Price actually paid or payable

7. The price actually paid or payable for each garment under Article 1 is 200 c.u. as this is the total payment made by the buyer to or for the benefit of the seller in respect of each garment.
Adjustments

8. It is for the Customs administration to determine the exact nature of the additional payment of 40 c.u. per garment, in order to establish whether or not it forms part of the Customs value of the imported garments. If the facts show that the payment referred to as a licence fee relates to an element of Article 8.1 (b) (an “assist”), then Article 8.1 (b) would apply. Otherwise, Customs should examine whether the payment satisfies the conditions laid down in Article 8.1 (c).

9. The paper patterns perform a similar function to a mould or die. The buyer sends the paper patterns free of charge through the licensor LCO and they are used in the production and sale for exportation of the imported goods. These patterns therefore constitute an assist under Article 8.1 (b) (ii) and their value, which also includes the cost of the designs, should be added to the price actually paid or payable for the imported goods.

10. The Interpretative Note to Article 8.1 (b) (ii) contains two methods of determining the value of an item. First, if the importer acquires the element from a seller not related to him at a given cost, the value of the element is that cost. Second, if the element was produced by the importer or by a person related to him, its value would be the cost of producing it. In this case, ICO is not related to LCO; therefore, the value of the paper patterns would be ICO’s cost to acquire the patterns from LCO. ICO acquired the patterns through the licence agreement with LCO. In consideration for the licence, ICO must pay LCO an amount equal to 10% of ICO’s gross sales price of the garments. Thus, ICO’s cost to acquire the patterns is 10% of the gross sales price (400 c.u.) or 40 c.u. for each garment.

11. Given that the additional payment of 40 c.u. is to be included in the Customs value of the imported garments under the terms of Article 8.1 (b), it is not necessary to consider its possible addition to the price actually paid or payable under the terms of Article 8.1 (c).

Conclusion

12. The transaction value per garment is 240 c.u., that is to say 200 c.u. as the price actually paid or payable and 40 c.u. as the adjustment provided for under Article 8.1 (b) (ii) insofar as the licence fee in this case has to be treated, for valuation purposes, as the payment for an assist.
Case 3

[CASE STUDY 8.2 on Application of Article 8.1 – License fee as Assist]

The Case Study provides for valuation treatment of license fee as Assist in terms of Article 8.1 (b) (iv).

The Case Study is reproduced below:

Facts of transaction

1. ICO imported multiple copies of a video laser disc which is purchased from XCO. The discs, which incorporated a selection of copyright music video clips, were manufactured by XCO in the country of exportation. ICO obtained the right to use the music video clips incorporated on the discs under a separate licence agreement with LCO in a third country. In accordance with its licence agreement with ICO, LCO compiled a master tape of the selection of music video clips to be incorporated in the discs. ICO then supplied the master tape to XCO free of charge. There is no relationship, within the meaning of Article 15.4, between ICO, XCO and LCO.

2. The master tape formed the basis of XCO’s production process. The master tape conveyed images which were reproduced in an identical form on a laser disc stamper. Multiple copies of the disc were made from the stamper. Thus, each disc was an identical reproduction of the master tape and XCO would not have been able to manufacture the discs without the master tape.

3. ICO was required to pay XCO 1,000 c.u. for producing the stamper and 28,000 c.u. for 4,000 copies of the disc. In consideration for the right to use the music video clips and master tape, ICO is required to pay to LCO a licence fee of 5% of the gross sales price of the discs in the country of importation.

Determination of Customs value

4. The importer presents to the Customs of the country of importation a declaration of value based on the transaction value, together with all the documentation relating to both the licence agreement with LCO and the payment made for the rights granted under this licence agreement.

5. All the provisions of Article 1 (a) to (d) are satisfied and the Customs value is to be determined under the transaction value method.
Price actually paid or payable

6. The price actually paid or payable under the Note to Article 1 is 29,000 c.u. as this sum is the total payment made or to be made to or for the benefit of the seller for the laser discs. The 1,000 c.u. paid for the laser disc stamper must form part of the price actually paid or payable because the buyer was required to pay this amount to the seller in order to obtain the imported goods.

Adjustments

7. It is for the Customs administration to determine the exact nature of the additional payment of 5% of the gross sales price of the discs in the country of importation, in order to establish whether or not it forms part of the Customs value of the imported discs. If the facts show that the payment referred to as a licence fee relates to an element of Article 8.1 (b) (an “assist”), then Article 8.1(b) would apply. Otherwise, Customs should examine whether the payment satisfies the conditions laid down in Article 8.1 (c).

8. As the master tape was used in connection with the manufacture of the discs and supplied by the buyer to the seller free of charge, its value will be added to the price actually paid or payable if it falls within the class of goods and services set out in paragraphs 8.1(b) (i) to (iv).

9. As previously stated in paragraph I of this case study, LCO compiles music video clips on the master tape, which is furnished to XCO. The compilation is part of the design and development phase for the imported video laser discs. This design and development was undertaken elsewhere than the country of importation; therefore, it is added to the price actually paid or payable for the merchandise pursuant to Article 8.1 (b) (iv).

10. The value of the assist is the 5% licence fee as this was the cost to ICO of obtaining the music video clips and master tape.

11. Given that the additional payment of 5% of the gross sales price of the discs in the country of importation is to be included in the Customs value of the imported discs under the terms of Article 8.1 (b), it is not necessary to consider its possible addition to the price actually paid or payable under the terms of Article 8.1 (c).

Conclusion

12. The transaction value of the 4,000 imported discs is the price actually paid or payable (29,000 c.u.) plus the assist (5% of the gross sales price of the discs in the country of importation).
Cases studies- Nepalese prospective

Case 1: ARE 1 Issue import from India

- Importer A purchase a motor vehicle from Newdelhi India, and submitted declaration form on customs point Nepal - details are as follows.
- Price declared on declaration form and valuation form IRS 1,85,000 and freight and insurance cost IRS 15,000.00
- ARE 1 form (Excise purpose) shows the vehicle price IRS 2,00,000.00
- Commercial invoice shows that goods price IRS 1,85,000 ; freight charge IRS 10,000 and insurance IRS 5000.00. Here exporter/seller make invoice and claimed that ARE 1 price included goods price freight and insurance up to Nepal border..
- Bill of export (Indian customs declaration form) shows the FOB value IRS 2,00,000.00

Answer: Customs act 2064 section 13(4) clearly mentioned that if the transaction value declared by the importer does not appear to include freight, insurance and other related expenses, the Customs Officer shall determine the transaction value by adding an estimated amount likely to be incurred for the same. In given case ARE 1 form and bill of export form both are issued from governmental institutions of exporting country India. Bill of export is issued Land customs stations Raxual which is bordered with Birjung Customs and showed as FOB price for the same consignment. And the importer declared the goods of same consignment as CIF at Nepal border which is seems to be unrealistic. So customs officer should follow section 13(6) and 13(7) process and determine the transaction value by adding freight charge and insurance amount (i.e. 200,000+10,000+5,000= 215000 IRS).

Case 2 SAPTA certificate FOB price, import from India

- Importer B purchase 10 MT of dust glucose from Mumbai India, and submitted declaration form on customs point Nepal - details are as follows.
- Price of goods declared on declaration form and valuation form IRS 13,10,000.00 and freight and insurance cost IRS 40,000.00
- SAPTA certificate (Issued by SAPTA secretariat for tax rebate purpose) shows the goods price FOB IRS 13,50,000.00
- Commercial invoice shows that goods price IRS 13,10,000 ; freight charge IRS 33,000 and insurance IRS 7000.00
- Bill of export shows the FOB value IRS 13,10,000.00

Answer: Even if bill of export showed the FOB value as mentioned in commercial invoice i.e. IRS 13,10,000.00 SAPTA certificate showed same consignment goods price FOB IRS
13,50,000.00. The importer also claimed duty rebate by using same SAPTA issued bill. Based on the difference price of same goods on two submitted document Customs officer definitely has came to a reasonable doubt on the transaction value. As Customs act 2064 section 13(4) clearly mentioned that if the transaction value declared by the importer does not appear to include freight, insurance and other related expenses, the Customs Officer shall determine the transaction value by adding an estimated amount likely to be incurred for the same. That's why, in given case customs officer should follow section 13(6) and 13(7) process and determine the transaction value by adding freight charge and insurance amount (i.e. 13,50,000+33,000+7,000= 13,90,000 IRS).

Case 3 Information exchange with tax department:

- Rice importer import 100 MT rice from India declare as follows:
- Rice price per MT IRS 43000.00, total price 43,00,000 freight insurance 3,00,000, non L/c payment, only Local bill submitted.
- Customs has database shows (similar goods) per MT IRS 50,000.00,
- Therefore, customs officer valued goods as per customs act 13(9) similar goods method. valued the goods price of goods 50,00,000.00, freight and insurance cost 3,00,000; (=Total Nrs 84,80,000.00)
- Importer paid duty and cleared goods same day then booked his expanses in P/L as:
  - Cost of good 43,00,000.00*1.6= 6880,000.00
  - Freight and insurance cost 300000.00*1.6=4,80,000.00
    - customs duty and
    - Other expenses after customs NRS 200000.00
  - Selling and distribution NRS 1,00,000.00
  - total cost 75,60,000.00
  - Selling price NRS 79,60,000.00

Tax office questioned that selling price should be based on customs value 50,00,000.00*1.6=80,00,000.00 the difference amount (84,80,000.00-79,60,000.00=5,20,000.00 should be treated as extra sale.

Answer: This is the case after valuation. However in the valuation stage, based on the reasonable doubt on customs declaration, customs officer should follow the due process as prescribed by customs act section 13 (6) before deciding as per 13(9) similar goods method.
Practical Exercise: on preparation of valuation decision memos (Tippani/parcha)

From Annex-4 of valuation manual

(Related to Sub-clause (a) of Clause 12)

Specimen letter for demanding additional documents

(Specimen of the letter to be issued to the importer asking for the submission of the additional evidences and documents justifying the declared value in case the declared value is seen suspicious, according to the sub-clause (3) of clause 13 of the Customs Act. 2064)

Date:

Mr./Mrs. . . . . .

PANN NO.

The transaction value declared by you according to the sub-clause (3) of clause 13 of the customs Act, 2064 for the goods imported from . . . . with/under the invoice no. . . . . seems to be suspicious on the season/s given below. so, you are requested to submit additional documents or evidences if any to justify your declared transaction value within . . . . . days according to the sub-clause (f) of clause 13 of the Act.

Reasons for considering the value as suspicious:

1. . . . . .
2. . . . .
3. . . .

Customs Officer
From Annex-3 of Valuation manual

Customs Value Determination Paper

(Related to Clause 7)

Customs value determined by the chief customs Administrator/Chief Customs Officer/Customs Officer Mr./Mrs . . . . of the . . . . . . . Custom office:

1. Name of the importer and PAN No.
2. Invoice No. and Date:
3. Valuation application registered no. and date:
4. Particulars:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Description of the goods</th>
<th>quantity</th>
<th>Brand/Model</th>
<th>size/Art no.</th>
<th>country of origin</th>
<th>per unit declared value</th>
<th>per unit determined value</th>
<th>Rent</th>
<th>Insurance</th>
<th>Other expresses</th>
<th>Total value</th>
<th>Remarks</th>
</tr>
</thead>
</table>

5. Brief description of the declared value:
6. Method applied for the determination of customs value:
7. Method applied for the value determination incase the declared value not accepted:
8. Brief statement of the decision about the based taken for the customs value determination with evidences:

Officer determining the customs value

Signature

Date:
[Part IV]
International Standards on PCA (WCO Guidelines)
Lesson 18
Introduction of Post Clearance Audit

INTRODUCTION

The traditional public image of the Customs official is often portrayed as the uniformed man or woman at a frontier post or airport. The physical presence of Customs at the gateway to a country means checks can be conducted in real time before a decision is made to release a consignment of goods. It can also act as a deterrent to would-be fraudsters.

Border controls still have a part to play in a modern Customs service; however, excessive and time-consuming checks at the point of clearance can be counterproductive. Modern international commerce works to tight deadlines and national economic benefits can be derived as the result of the smooth and timely clearance of goods. Furthermore, the majority of international trade involves large corporations with global networks and complex business systems and supply chains. The limited documentation required to be produced at the time of importation does not provide the whole picture and context of a commercial transaction, which is necessary to properly determine, inter alia, the correct Customs value, classification and entitlement to preferential origin.

It becomes unfeasible, therefore, for Customs to make conclusive decisions regarding duty liability in the narrow time frame available. Neither is it appropriate to delay clearance of goods whilst resolving such enquiries, unless fraud is suspected. Many administrations, therefore, now concentrate their controls on the post-importation environment, whilst retaining selective and targeted checks at the frontier.

By application of a post-clearance, risk-based approach, Customs are able to target their resources more effectively and work in partnership with the business community to improve compliance levels and facilitate trade. The Post-Clearance Audit (PCA) process can be defined as the structured examination of a business’ relevant commercial systems, sales contracts, financial and non-financial records, physical stock and other assets as a means to measure and improve compliance.

Objectives of PCA

The key objectives of PCA can be summarized as follows:

- To assure that Customs declarations have been completed in compliance with Customs requirements, via examination of a trader’s systems, accounting records and premises;
- To verify that the amount of revenue legally due has been identified and paid;
- To facilitate international trade movements of the compliant trade sector;
To ensure goods liable to specific import/export controls are properly declared, including prohibitions and restrictions, licenses, quota, etc.;

To ensure conditions relating to specific approvals and authorizations are being observed, e.g., pre-authenticated transit documents, preferential origin/movement certificates, licenses, quota arrangements, Customs and excise warehouses and others simplified procedure arrangements.

Benefits derived from PCA

- Compliant trade is facilitated at the point of Customs clearance as border controls can be reduced;
- Enables Customs to gain better information on and understanding of clients’ business;
- Risk levels can be more easily assessed and reviewed: a premises visit provides the opportunity to identify risks and weaknesses in traders’ systems;
- Facilitates client education, long-term and comprehensive compliance management focus;
- Customs administrations’ resources are more effectively deployed;
- Customs can promote the concept of voluntary compliance and self-assessment;
- Suspected fraudulent activities may be identified and referred to enforcement unit for appropriate action;
- Provides a platform for evaluating continued entitlement to Authorized Economic Operator status, where applicable.

Types of audit/verifications

Post-importation transaction verification

As mentioned in the introduction, administrations that have newly implemented post-importation controls may first consider introducing checks on individual transactions. This can work in two ways: 1) Referrals from the port/border post when an officer has doubts concerning a particular declaration at the time of clearance. If it is deemed that significant duty may be at stake, an enquiry is then referred to the appropriate Customs office to further examine the declaration, normally in consultation with the importer. The goods in question may be released or other action may be taken as appropriate. 2) A targeting team scrutinizes individual Customs declarations after clearance and selects those where doubts arise regarding their accuracy. These declarations are then verified as above, normally in consultation with the importer, and action is taken as appropriate. In each case, it is highly recommended that risk-based selection criteria are used to determine which Customs declarations will be verified. At a later stage, the administration can consider developing a post-import, systems-based audit approach.
Office/desk audit or verification
Certain audits may be conducted by correspondence or telephone, typically where straightforward or single issues are involved. An office audit may be deemed appropriate as a result of the pre-audit survey. Although it is not as thorough as a field audit, it uses fewer resources and acts as a reminder to business that Customs are monitoring their activities. It should also be noted that a desk audit may subsequently involve a field audit, if deemed necessary, in order to examine an issue in more detail.

Field / On-site audit
This type of audit takes place at the premises of the auditee. The amount of information to be examined by auditors is potentially large and will depend on the length of time since the previous audit of the business in question. A complete picture of the business can be captured during the audit, including details of business systems, trading methods and partners, etc.
Lesson 19
WCO PCA Guidelines Volume I

[Legal and operational framework, strategic planning, risk management, liaison with domestic and foreign customs units, tax and other related departments]

**LEGAL AND OPERATIONAL FRAMEWORK FOR PCA**

**Legal framework and essential powers**

To facilitate PCA, it is necessary to implement legislation which provides Customs with the legal basis to conduct an audit and also sets out the rights and obligations of the auditee. Each Customs administration will develop laws and regulations based on national requirements or, in cases where a Customs union exists, at a regional level.

Customs laws and regulations should provide the following:
- definition of PCA coverage (persons/company subject to PCA)
- authority and powers of Customs officials/auditors conducting PCA
- obligations and rights of auditees
- penalty scheme
- right of appeal

**PCA scope and coverage**

The scope and coverage of PCA - namely, which persons may be subject to an audit - should be clearly defined in Customs laws and regulations. Potentially, all businesses involved in the import and/or export of goods or in the receipt, storage, manufacture and delivery of goods subject to Customs controls may be audited. This may include:
- importers;
- declarants;
- consignees of the imported goods;
- owners of the imported goods;
- subsequent acquirers of the imported goods;
- Customs clearing agents of the imported goods;
- storage agents of the imported goods;
- transporters of the imported goods;
- other persons/companies directly or indirectly involved in the transaction of the imported goods.
Authority and powers of Customs officers

Customs laws and regulations should provide officers conducting PCA with the authority to conduct an audit at the premises of the auditee. Necessary powers include:

- the right to access auditee’s premises;
- the right to examine business records, business systems and commercial data relevant to Customs declarations;
- the right to inspect auditee’s premises;
- the right to uplift and retain documents and business records;
- and the right to inspect and take samples of goods.

Obligations and rights of auditees

Customs laws and regulations should set out the rights and obligations of persons/companies involved in international trade. Provisions should include:

- a requirement to maintain specified documentation, information and records. The duration for retaining such records should be no less than the maximum period after importation when Customs may legally demand underpaid duty and make refunds for overpaid duty;
- a requirement to make such documentation, information and records available in a timely manner;
- a right to appeal
- a right to an explanation from Customs concerning determination of Customs value;
- a right to expect confidential treatment of business documentation;
- and a right to clearance of goods at the frontier with provision of security.

When the scope of auditees is expanded to persons other than declarants and importers, it will come into question whether a legal obligation for keeping records can be imposed on all persons/companies designated as complementary auditees. The problem is whether it is reasonable to impose a legal obligation for keeping business records on persons/companies other than those who have close relation to import transactions and Customs clearances such as the importer, a Customs clearing agent, a transporter, etc. under the Customs laws and regulations. Other national legislations regarding the business activities, such as income tax laws, may stipulate their obligation. The adequacy of powers available to Customs administrations under national law needs to be kept under review and powers should be modified where necessary to respond to new national and international commitments. Other non-Customs legislation may be of relevance and interest to Customs in the course of conducting a PCA. For example:

- regulation of business entities and their activities, such as commercial law, company law, income tax law, etc.
- import/export licensing requirements
- foreign currency control, etc.
obligations deriving from binding UN Security Council Resolutions: Chapter VII UNCharter (e.g. embargos, export controls).

Organizational structure

PCA has an interface with many other areas within the Customs department, including risk management and intelligence, enforcement, debt / revenue collection and legal support. The organizational and management structure should therefore reflect this and facilitate close working and effective communication among these areas.

Normally, a PCA programme will be driven by a central policy team responsible for managing the audit program. Depending on the demographics of a particular country, an administration will set up one or more operational PCA units. The need for Customs staff to be able to visit a trader’s premises means Customs offices should be located accordingly. For example, a small island economy may have just one main business centre and require just one PCA office. A large country, on the other hand, may have many centres, separated by long distances and time zones.

A number of administrations have set up dedicated teams responsible for the control of large businesses. In this model, a number of officers will be appointed to the large business team with a unique responsibility for ensuring the continued compliance of those businesses. It can also be useful to develop trade sector specialists; e.g. car industry, textiles, chemicals, etc. within a large business team.

The actual organizational structure and allocation of responsibilities will vary between administrations.

STRATEGIC PLANNING FOR PCA

General

Once a PCA structure and system is in place, the next step is to develop an audit plan. This will determine how many audits will be conducted and who will be audited over a specified period, normally one year. The development of an audit plan should also be linked to the overarching strategy for conducting pre-arrival controls and controls at the time of clearance. This ensures a unified strategy to the complete Customs control cycle.

Targeting: selection for audit

This work is normally carried out by a dedicated risk analysis/targeting team. The selection should be based on risk assessment and take into account the human resources available to conduct audits. The team will then present or propose a plan to the PCA team who will be responsible for carrying out the audits. The frequency for auditing a particular business entity will vary depending on the perceived risk.

It is important that the results from an audit are fed back to the risk analysis/targeting team so that the risk rating of the business in question can be adjusted accordingly. This information will also help to determine the need for follow-up/repeat audits.

Special exercises may be conducted in particular areas (e.g. trade sectors or countries of origin) for a limited period where high levels of irregularities are anticipated. This can be an effective use of resources and help to improve compliance.
Promoting improved compliance via self-assessment

PCA provides an opportunity for Customs to encourage commercial operators to comply with Customs requirements through self-assessment and to provide advice accordingly. Customs administrations should actively promote the benefits of compliance to the business community and provide information and advice via telephone enquiry lines, Internet or other publicity. Some administrations offer advance rulings in the areas of classification, Customs valuation and preferential origin as a further means to provide greater certainty to the importer, prior to the arrival of the goods. In the course of an audit, auditors should make recommendations that encourage auditees to establish, maintain, and improve their internal controls and systems. This can be effective in a number of areas such as the reliability of financial accounting and compliance with applicable laws and regulations. Internal controls can also detect and prevent fraud, negligence, or operational errors which may have affected Customs declarations. When auditors judge that the auditee's internal controls are well designed and performing effectively, this should be reflected in the business' risk rating.

Where internal control is sufficient to fulfill the conditions set by Customs, such a person/company may be considered eligible for a facilitated Customs procedures as stipulated in the Transitional Standard 3.325 (Authorized Trader) of the Revised Kyoto Convention/RKC.

Importers and brokers can also be given the opportunity to voluntarily request an amendment of a Customs declaration without penalty when errors have been identified, even after clearance of the declaration. When PCA is newly introduced, Customs may prepare a publicity or education program to disseminate necessary information to make importers aware of the objectives of PCA, raise awareness and improve the level of cooperation. Initially, there may be some resistance as some commercial operators may not understand how they can benefit from PCA, and they may be unfamiliar with the idea of visits from Customs officers.

In order to improve the compliance level of Customs declarations through self-assessment, it is effective to inform declarants, including brokers and importers, about typical and frequent errors found on Customs declarations, and assist them in avoiding such errors in future. It is also important to encourage a mutual responsibility between importers and their brokers to ensure declarations are accurate; the importer should provide all necessary information to his broker and, likewise, the broker should actively challenge the information provided by an importer if he considers it to be inaccurate or incomplete.

Resource management

The redirection of controls from the border towards the post-importation environment possesses significant resource implications for a Customs administration. The increase in PCA activities should coincide with a commensurate decrease in border controls; based on an adequate risk assessment, it may be considered to reduce the number of staff in ports and border posts and to increase staff in PCA teams. New offices may also need to be set up.
This raises a number of considerations, including the need to retrain officials, upgrade I.T. infrastructure and consider a number of human and financial resource issues.

**Training needs/professional skills**

A combination of skills, knowledge and experience is required to carry out PCA effectively. With the increased use of electronic recordkeeping and the complexity and diversity of global trade, the need for higher standards of training becomes increasingly important. Customs administrations should be committed to providing auditors with the levels of training necessary to equip them to perform their duties. Training departments have an important part to play in ensuring that officers acquire the required skills to conduct an audit.

All auditors need a range of general skills relevant to the task of auditing. These skills include:

- Accounting techniques and principles, based on Generally Accepted Accounting Principles (GAAP);
- Knowledge of auditing standards and procedures;
- Familiarity with Customs laws and regulations;
- General knowledge of Customs procedures (valuation, classification, origin, etc.);
- Knowledge of computer-based accounting systems;
- And a commercial awareness and knowledge of business strategies in international trade.

It is also recommended that certain staff working in audit have specialist skills for particular technical areas, such as:

- Customs Valuation, Rules of Origin, Tariff Classification.
- I.T.-based accounting
- Multinational corporation accounting, including transfer pricing
- Specialist trade sector knowledge

Customs recruitment and training policy should address the above needs. In some cases, external support may be necessary to provide the specialist skills. With regard to knowledge of transfer pricing, assistance may be sought from direct tax officials.

**Ethical standards for auditors**

Auditors must maintain high professional standards when conducting PCA.

(a) **Integrity**

The WCO has developed a Model Code of Ethics and Conduct that sets out the minimum required attitude and behaviour expected of all Customs officers. The Code of Conduct should be respected in the context of conducting PCA.
(b) Confidentiality
Auditors must maintain adequate levels of confidentiality when accessing and examining auditees’ records. Auditors should not disclose any business information they have acquired during the performance of their duties, unless national laws provide for disclosure of information in specific cases. Likewise, they should not disclose information confidential to Customs outside of their administrations.

(c) Professional competence, due care and diligence
Auditors should act diligently and in accordance with applicable technical and professional standards. Further, they should take due care of the auditee’s property and respect company health and safety policies and requirements (e.g. wearing of safety helmets).

(d) Equity/Impartiality
Auditors are required to be objective, maintain fair and just judgment over similar cases and not to treat them arbitrarily or allow bias, conflicts of interest or undue influence of others to override professional or business judgments. They should not misuse their authority over the auditee.

Limitations of PCA
It is recognized that PCA is the most effective means of ensuring compliance with Customs requirements. Particularly in such areas as Customs valuation, effective verification requires access to the importer’s records and accounting system which is not possible at the time of clearance. Customs administrations should therefore continually strive to implement PCA to the greatest extent possible. However, many countries have significant levels of informal trade, characterized by poor or nonexistent accounting systems, cash-based trading and lack of permanent premises. In such cases, PCA is not the most practical tool; there may be problems locating the trader and, once located, there is often a lack of a structured accounting system and supporting books and records, etc. Therefore, border controls are the only realistic opportunity to conduct controls, which should be targeted via risk management techniques. Notwithstanding this, Customs should continue to encourage greater compliance and ensure that those operating in the informal sector are given opportunity and incentive to formalize their procedures in line with Customs requirements.

RISK MANAGEMENT
The WCO Risk Management Compendium defines risk management as “coordinated activities undertaken by administrations to direct and control risk.” When adopted as a management philosophy, it enables Customs to carry out its key responsibilities effectively and organize and deploy its resources in a manner which improves overall performance and facilitates trade. A risk-based approach is often driven by necessity, as Customs administrations are often required to deliver better results with the same or fewer resources.
Outline of the risk management process

The risk management process comprises:

1. Establishing the context
2. Risk assessment
   2.1. Risk identification
   2.2. Risk analysis
   2.3. Risk evaluation and prioritization
3. Risk treatment
4. Recording, communication and consultation
5. Monitoring and review

The following diagram outlines the process to be followed in managing risk, both for a high-level examination of risk in regard to PCA planning at a national level, or lower-level operational activities like the selection of auditees within a monthly audit plan. Establishing the risk management context involves establishing the goals, objectives, strategies, scope and parameters of the activity or part of the organization to which the risk management process is being applied.

This step is also about establishing the risk criteria, i.e., criteria against which risk will be measured. Examples of risk criteria are revenue leakage, Customs’ image and delivery of government policy intent. These will form a fundamental basis for decisions made in the later steps of the cycle. These criteria should be used to determine acceptable and unacceptable levels of risk (i.e., what level of revenue leakage is acceptable, what negative effects on Customs’ image can be tolerated, what level of movement away from government policy intent is acceptable). Risk management within the PCA context can be: (a) strategic; (b) tactical; and (c) operational. The risk management process can apply across all of these levels.

(a) Strategic risk management

Strategic risk assessment is based on Customs being able to identify the overall risk posed by an entire sector or a group of importers. By identifying such a group, a Customs administration will be able to target all or selected companies within an industry sector as high risk.

An industry sector may be classified as high risk for various reasons, such as:
- the strategic importance of the industry to the national interest;
- the international trade agreements which govern the industry;
- public health and safety considerations;
- intellectual property rights;
- and the economic impact of the imports.

Studies on specific commercial sectors
A general study of the commercial sector or goods involved will help the officer deal with the information in context. The use of specific sector studies is a reliable source for collecting information in the field. For example, sector studies may be on specific program areas such as:

- valuation;
- textile transhipment;
- intellectual property rights, etc.

The sector would be targeted in advance according to criteria such as:

- estimates of the value of the commodity;
- sensitivity of nationals or industry to illegal activity, etc.

Once the sector is chosen, information must be defined and collected on the various components, at both macroeconomic (sector size, production, consumption, etc.) and microeconomic levels (the number of firms involved, their technological capacity, structure, the type of fraud to which they are exposed, etc.). This information may be complied and maintained in a database or other electronic format.

(b) Tactical risk management

This is the process of identifying groups of high-risk transactions by particular importers. Considerations when identifying these groups include:

- importer’s volume of imports
- total value of imported goods
- types of goods imported
- prior importer or compliance problem
- first time importer/exporter

(c) Operational risk management

Factors to consider when identifying high-risk transactions include:

- who the importer is
- what commodity is involved
- prior discrepancies or violations involving the commodity
- high value importation
- country of origin
- whether any special regulations or programs apply to this type of import (such as quotas)
- value declared for the commodity is outside the previously established high-low range
- other factors which could increase the level of risk in any of the above mentioned types of risk assessment are:
- referral information from other Customs units;
- potential of revenue recovery;
- risk of revenue loss;
Risk identification
The following elements can assist in identifying risk:
- performance of an industry against legislative/administrative requirements;
- performance of individual auditees;
- elements of individual auditees’ operations (e.g., internal control, separation of duties/tasks, results of external reviews if appropriate.).

Risk analysis
The WCO Risk Management Compendium defines risk analysis as the systematic use of available information to determine how often defined risks may occur and the magnitude of their likely consequences. Likelihood and consequence can be determined using a rating scale (e.g. high, medium and low or 1-6, etc.). These two measures, likelihood and consequence, taken together determine the overall level of risk, once again rated as high, medium or low.

Monitoring and reviewing risk
Monitoring and review are integral steps in the process of managing risk. This is necessary to:
- determine if previously identified risks are still current;
- identify new risks;
- reevaluate risk levels assigned previously in the light of updated information;
- and evaluate the effectiveness of compliance activity undertaken.

Establishment of risk intelligence systems
Intelligence can be defined as a product, derived from the collection and processing of relevant information, which acts as a basis for evaluating risk and making informed decisions when developing an audit plan. Each Customs administration should establish its own intelligence network and systems, tailored to its own needs and based on perceived risks. This network is likely to include both local intelligence units based in ports and airports and a central intelligence unit that is able to collect and collate information and disseminate it throughout the entire service. As well as receiving information, intelligence officers should proactively seek information from all available sources.

Risk and intelligence
A risk and intelligence team may serve the whole Customs department. The team’s role will normally include the following:
- identify, manage and cultivate information sources
- contribute to the identification and measurement of risk
- communicate with operational colleagues enabling them to take effective and appropriate action in a timely manner

and government program priorities or specific intelligence.
LIAISON WITH OTHER/FOREIGN CUSTOMS UNITS AND TAX DEPARTMENTS

As previously mentioned, PCA is not a standalone system but one function of the Customs organization optimally linked to the other relevant functions.

Suspected fraud

Where a potential Customs offense is discovered during the course of the audit, the audit team should withdraw from the audit without alerting the auditee and communicate and coordinate with the appropriate enforcement unit, who will decide whether to start a formal investigation.

Legal advice

If, during the course of the audit, issues arise which require further legal interpretation, the auditor may seek advice from the Customs’ legal department. Auditees also may seek reconsideration of the specific rulings provided by Customs as they are applied to specific transactions. In the event that disputes regarding the audit findings cannot be resolved by dialogue with the importer, the option should be available for requesting a formal review of the decision in question and the right of appeal in accordance with the procedures provided in national legislation.

Other Customs units

It is recommended that communication channels are established with Customs clearance units and other control, risk and enforcement units to share knowledge and information on a particular commercial operator.

Liaison with Tax and VAT departments

Benefits can be had by exchanging knowledge and information with departments responsible for VAT, excise and direct taxes, to the extent that national legislation allows.

Liaison with foreign Customs administrations

Cooperation with foreign Customs administrations may be sought using the pertinent tools for Mutual Administrative Assistance.
Implementation of PCA

The PCA process as outlined in these guidelines consists of the following steps:
1. Development of audit programs and standardized audit procedures;
2. Identification of potential subjects for audit (Scope and coverage from Vol I)
3. Selection process;
4. Planning the audit;
5. Conduct of the field audit;
6. Conclusion of the audit/Reporting
7. Evaluation and follow-up.

Development of audit programs and standardized audit procedures

The contents of audit programs may vary depending on the identified scope of PCA; however, they should contain the following essential elements:

<table>
<thead>
<tr>
<th>Scope of PCA</th>
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<tbody>
<tr>
<td>Potential risks in the PCA scope</td>
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<tr>
<td>Objectives</td>
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<tr>
<td>Annual/Monthly Working Plan</td>
</tr>
<tr>
<td>Selection of the audit approach</td>
</tr>
<tr>
<td>Standardized PCA procedures/techniques</td>
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</tbody>
</table>

Annual/Monthly working Plan

Audit planning may take place on an annual basis, taking into account resource availability and the work in progress. Each audit area could be assigned standard hours of completion and each available auditor or audit team hour could be calculated in order to
estimate how many audits could be performed in a year. Planning could also take place on a monthly basis. It is recommended that each stage of PCA implementation is broken down into time blocks in order to measure productivity against time spent. It should include issues such as number of auditors required to conduct an audit.

Selection of the audit approach

Systems-based audit

This methodology is commonly referred to as a “top-down” approach. The audit starts with an evaluation of the high-level company structure and its business objectives, usually involving a dialogue with a senior company representative. This is followed by an assessment of the company’s systems and accounting records. Poor systems and weak audit trails often indicate low levels of compliance. An examination of individual transactions then follows as the next stage to test the systems and determine the level of compliance. The strength of the systems determines the level of substantive testing and, consequentially, the audit approach.

Comprehensive audits

This approach looks at the entire business control environment and the impact this might have on Customs compliance. Analytical procedures are used heavily and substantive testing reduced where control environment and corporate governance systems are good. This kind of audit takes place at the premises of the auditee. The amount of information to be examined by auditors is potentially large although it depends on frequency of PCA for one auditee. A complete picture of the business can be captured by the field audit, including its business systems, trading methods and partners.

Focused audits

This approach only concentrates one area of Customs e.g. valuation. Tests on related systems and controls and substantive tests may also be carried out.

Criteria will be necessary to decide which type of audit is appropriate in each case, based on the most effective use of resources and the desired objectives.

Standardized PCA procedures/techniques: To ensure that audits are carried out effectively and consistently, Customs should prepare standardized procedures, which may include an ethical code for PCA officers, the audit procedure, and recommended collaboration between the PCA unit and other Customs units. The detailed procedures and techniques of PCA may vary from one Customs administration to another.

Selection process : Risk-based selection and risk indicators

The selection of potential subjects for audit should be based on risk profiles. The selection criteria for audit candidates should be developed taking into account intelligence, trade trends, and high-risk priority areas. It is highly recommended that a risk database is maintained for this purpose which is regularly updated and accessible only to authorized personnel. Depending on the risk profile of the auditee and its business (e.g. type of business, goods, revenue involved, etc.) the audit may be conducted on a continuous, cyclical or occasional basis. The audit frequency should also take into account the legal time limit for recovering or refunding revenue. Depending on the results of the audit, the
frequency can be increased or decreased. At this time, third-party audits may also be considered as part of the audit cycle for a specific trader.

Given that the main objective of the PCA is to assess the compliance levels of the auditee and verify the accuracy of declarations via traders’ commercial data, the following risk indicators may be used for the assessment of risk and the targeting of traders for PCA

Profile of importers
- Capital
- Company structure
- Business partners (suppliers, agents, customers etc.)
- Type of transaction
- Method of payment, etc.

Trade data
- Volume of importations
- Amount of duties paid
- Tariff classification of imported goods and duty rates
- Valuation declarations
- Country of Origin of imported goods
- Ports of loading
- Transportation type, etc.

Past records of the auditee
- Audit records
- Customs entry errors
- Offense records
- Tax, VAT compliance information, if available

Related information/Intelligence
- Common irregularities in the same business sectors
- High-risk countries of origin
- High-risk goods, etc.

Collaboration with other Customs units
It is essential that the PCA structure facilitates close contact and cooperation with other Customs units, in particular units dealing with topics such as valuation, cargo clearance,
investigation and intelligence in order to maintain an effective exchange of information during this stage. These units could provide information which can complement the data already available for the identification and selection of subjects to audit.

Pre-audit research

Pre-audit research is a preliminary examination which serves two main purposes:

- to focus on specific risk areas of an auditee's systems and import declarations, through analysis of available data; and
- to draft an audit plan that includes the audit objectives, scope, methodologies and assignment of auditor/team members.

As a general starting point, before undertaking the site visit, the auditor should:

- Study any specific points to be scrutinized;
- Study selected declarations and supporting documents carefully. Note any features which may require further attention;
- Obtain the following information concerning the importer:
  - Past importation statistics
  - Prior Customs rulings related to the importer, e.g. on classification or valuation
  - Similar rulings which may be applicable to the case under review
  - Previous visit reports concerning the importer and details of irregularities detected
  - Information from other sources, e.g. internal taxation
  - Ongoing legal proceedings

Preparatory checklists

As a part of the preparatory process, checklists could be used as a practical tool to assist Customs in carrying out an audit. These checklists will facilitate recording of the key questions to be considered during the audit. It aims to ensure that all significant risk areas are being taken into account. The preparatory checklists can be filled in as far as possible on the basis of information available during the preparation phase and then be verified and completed during the audit itself.

INFORMATION GATHERING ABOUT THE SUBJECT OF THE AUDIT (AUDITEE)

1. Why was the person / company selected?
2. State the suspected risks.

CHECKLIST ON THE ORGANIZATIONAL CHARACTERISTICS

1. Identification: name, national company’s registration number, fiscal identification (e.g. VAT number), head-office address, warehouses’ or plants’ address.
2. What is its legal structure (e.g. limited liability, partnership, etc.)?
3. Have there been any changes in legal structure lately (e.g. merger, split, etc.)?
4. Information about ownership, directors and managers in the operator’s enterprise.
5. Volume of turnover, profits and losses.
6. Who has legal power to act on behalf of the operator?
7. Amount of capital stock.
8. Have the operator, its managers or stockholders any relationship with others?
   8.1. If yes, who are these others? (name, fiscal number, address).
   8.2. What is the nature of the relationship?
9. How is the operator’s accounting system organized?
   9.1. Is it internal or bought in?
   9.2. Is there prior information on the type of system in use?
10. Does the operator have a system for training the employees on Customs matters? If so, what are the details?
11. What is the internal organization structure of the operator? List the departments or functions relevant to the Customs audit.
12. What, if any, are the Customs authorizations granted, refused or revoked to the operator?
13. Does the operator use simplified procedures in import, export or operate Customs procedures?
14. Is the operator a producer, trader or both?
15. What are the operator’s main business activities?
16. Has the operator storage facilities and, if so, what is their capacity?

C. LEVEL OF COMPLIANCE
1. Has the operator been previously audited?
   1.1. If so, what were the results?
2. Are there any suspicions of fraud or irregularities concerning the operator or stockholders, partners or managers?
   2.1. If yes, what are they?
   2.2. Where did the alert come from?
3. Have the operator, stockholders, partners or managers been convicted of fraud or irregularities?
   3.1. If yes, what are the details?
4. Has the operator already been audited by Customs or other authorities?
   4.1. Have there been controls relevant to this audit?
   4.2. If so, what are the results?
5. Do the available financial/fiscal indicators concerning the operator indicate a healthy business?

6. Have there been or are there ongoing recovery procedures concerning debts incurred by the operator?

D. AUDITEE’S INTERNAL PROCEDURES/CONTROL SYSTEMS

1. Does the operator have an internal section or person responsible for Customs matters?
   1.1. Which persons are responsible for the different areas, for example tariff classification, Customs procedures, valuation, and contact with the suppliers, etc.?
   1.2. What is the nature of the communication between the person doing the declaration and other sections within the operator (accounting, product specialists, incoming goods, etc.)?
   1.3. How does the operator keep up with changes in the legislation?
   1.4. What are the routines when the competent employee is on leave, either temporary or permanent?
   1.5. What is the procedure in case of discrepancies, for example differences in quantities supplied, damaged goods, returned goods, price differences, incorrect entries in stock, and who is in charge of this procedure?
   1.6. Are the key operator’s personnel aware of the contact points within Customs that they can use for support in meeting the operator’s Customs obligations?

2. Does the operator have a Customs broker?
   2.1. If so, who is the broker?
   2.2. What is the broker’s history with Customs?
   2.3. What is the kind of mandate given to the broker, i.e. direct or indirect representation?

3. Does the operator utilize forwarding/shipping agents to prepare and present import declarations on their behalf? If so, list parties.

4. Have there been any changes in persons mentioned in questions 1 or 2 lately?

5. What is the payment method for the Customs duty, for example cash, guarantee, etc.?

6. Does the operator have an internal control system (including regular checking) to ensure also the correctness of Customs declarations?
   6.1. Are there internal written guidelines concerning the operator’s Customs routines / procedures?
   6.2. Are there any flaws or errors in them?
   6.3. Were errors in routines or lack of routines found when testing (walk-through)?
   6.4. What is the nature of these errors or omissions?
   6.5. What are the manual routines in case of computer failure?

7. Describe how corrections are made to declarations and how often?
8. Does the operator store the accompanying documents to the declaration?

9. Does the operator have auditors, internal or external, and are the reports available?

9.1. Is the operator ISO-certified?

9.2. Does the operator still have the ISO handbook?

10. What are the procedures for receiving and registering the goods in the operator’s accounts?

10.1. How does the operator ensure that all goods received are declared?

11. Where are the accounting records physically kept?

12. Does the operator have an internal or external accountant/bookkeeper?

13. Does the operator have stock records?

13.1. Do the records contain information that can be used for the audit?

13.2. How is stock management undertaken?

14. Is it possible to make a direct link between the accounts and the Customs declarations and vice versa?

15. What accounting system does the operator use?

15.1. What is the fiscal year?

15.2. Has the chart of accounts been checked by the Customs auditor?

15.3. What accounts are used for import/export transactions?

15.4. Does the operator use subsidiary ledgers?

15.5. Are any of the parts of the accounting system integrated? Which parts?

15.6. Specify which software package the operator uses.

16. List the main points of the organization of the operator’s computerized environment of significance to this audit.

17. What are the procedures regarding backup and recovery of data?

17.1. How long are records kept online?

E. OPERATOR TRANSACTIONS

1. Number of Customs declaration presented to Customs during the period of control.

2. How are the Customs declarations presented to Customs (manually, by file transfer, etc.)?

3. Type of declarations presented to Customs during the period of control (Customs procedures, import, export, release for free circulation, etc.). What are the most important procedures used in terms of value and quantity?

4. Types of goods — tariff classification

4.1. Ascertain if there are tariff classification related risks.

4.2. What are the main commodity codes used?
4.3. Are there variations over time?
4.4. Has binding tariff information (BTI) been given to the operator?
4.5. Are there separate files or lists made by operators in which each product number is linked with a commodity code?
5. Are the declared procedure codes consistent with the operator’s type of business?
6. Customs value declared for the goods
6.1. Ascertain if there are valuation related risks.
6.2. What is the total value declared by the operator during the audit period?
6.3. Are there significant variations in value declared for the same kind of goods from the same or other operators during the period?
6.4. What are the general terms of payment for imported goods? (e.g. prepaid, payment after approval, letter of credit, etc.).
7. Origin declared
7.1. Ascertain if there are origin related risks.
7.2. What are the main origin countries declared?
7.3. Are there variations over time?
8. Who are the main suppliers?
9. Are there any changes in the pattern of trade detected (e.g. changes of declaration place, suppliers, etc.)?
10. In case of an exporter, who are the clients?
11. What means of transport is normally used by the operator (e.g. by sea, air, road, etc.)?
11.1. Who are the transporters involved?

F. CONCLUSION
1. Is it necessary to have a preparatory meeting with the operator?
2. Does the operator appear to be suitable for an audit?
3. What are the conclusion concerning the risk areas?
4. Were the results of risk analysis for selecting the enterprise verified? If not, why not?
5. Were there additional risks detected?
6. Extent of the audit, i.e. period to be audited, transactions to be checked, etc.
7. Make a list of outstanding questions to be clarified during the execution phase.

An internal peer review of the pre-audit preparation is an example of a useful quality assurance control. Peers may highlight risks that might have been overlooked, experiences from similar audits, appropriate and more effective audit procedures.
Notification of audit
Reflecting the compliance-based approach to PCA, the trader should be contacted in advance to arrange a convenient date for the audit. The auditee should also be advised of the following:

☐ The general procedure for the visit and its objectives
☐ Details of the documentation to be made available (specifying the period to be examined, if known)
☐ Names of personnel who will carry out the audit
☐ Facilities to be made available for the auditor/s (e.g. adequate working area)

Conduct of the Field Audit
The general procedure for the conduct of field audit is as follows:
**Initial audit meeting**

The first step of the field audit is the initial meeting. Auditors should first meet with a senior representative of the audited company who has the authority to facilitate the needs of the auditors and to ensure a high level of cooperation. Occasionally, an auditee may request the attendance of consultants, accountants, or lawyers at the meeting which would normally be acceptable to Customs.

On arrival at the trader’s premises the auditor should:

- Introduce and identify themselves to the relevant personnel;
- Explain the broad method of the audit (i.e. a combination of statistical and selected transaction verification aimed at identifying the overall degree of compliance with revenue requirements);
- Refer to the estimated duration of the audit. Note that this is only an estimate and is subject to change if obstacles, discrepancies or irregularities are identified;
- Request that an official from the company be made available at all times to facilitate the audit;
- Mention the fact that the financial controller/company accountant may be required to answer certain questions; and
- Verify that the trader is in possession of all the supporting documents requested in the letter of notification.

**Audit techniques and tools**

**Basic guidelines**

When conducting the PCA, auditors should observe some basic guidelines, which can help to achieve a successful audit.

1) Foster a cooperative relationship, recognizing that coordination and cooperation with the auditee is essential to a successful audit. From the initial contact until the completion and report finalization, open communication through continuous dialogue with the auditee ensures that all findings and other issues pertinent to the audit should be fully shared and discussed.

2) Auditors should critically examine and assess the auditee’s records and supporting documentation. Auditors should remember that discovering contradictory information and abnormality is a possible indication of an irregularity.

3) Auditors should positively guide the auditee regarding declaration errors caused by a lack of understanding of laws and regulations which help to improve degree of compliance. When the auditee raises a question for which the auditor does not immediately know the answer, the auditor should refer such question to the audit team leader or supervisor / specialist for a response.

4) Auditors must refrain from revealing their provisional impressions to the auditee during the course of the audit, especially any tentative assessment of findings, until the whole
process is concluded. This may cause problems, for example, if a negative assessment is reached after the auditee was given a more positive assessment beforehand.

5) Maintain a professional and courteous attitude towards the auditee.

**Interviewing techniques**

The following good practices are recommended for conducting a successful interview:

- Stay in control of the interview
- Follow a pre-arranged path of questioning but be flexible where necessary
- Explain questions clearly and check that the question has been understood
- Avoid leaving questions unfinished or unresolved
- Listen carefully and observe reactions
- Don’t interrupt unless the interviewee appears to be deliberately changing the subject
- Avoid ambiguous and leading questions
- Display confidence and put the auditee at ease
- Summarize the interview at the end and seek clarification, where necessary

The auditor may obtain useful and relevant information from a casual line of questioning. In general conversation, the auditee may reveal important facts concerning his business operations which have implications, for example, to Customs valuation issues such as relationships with suppliers, supply of components to a foreign manufacturer/seller, etc.

When the auditee tries to avoid answering questions directly, the auditor should persist in order to obtain the necessary information.

Repeat visits are commonly necessary where all relevant information has not been examined during the first visit or where longer more complex systems exist.

**Checklists on specific issues**

These checklists on specific issues are of practical use to the auditor in carrying out his/her tasks. Depending on the risks detected and the extent of the audit, specific checklists can be chosen as applicable.

**A. CUSTOMS VALUE**

1. What knowledge does the importer have of Customs valuation methodology (in particular, the elements to be included in the transaction value in accordance with the WTO Valuation Agreement)?

2. Does the operator have adequate internal controls and accounting systems which ensure all payments made in relation to imported goods are recorded and identified in order to facilitate reconciliation with Customs value declarations?
3. Is the declared value supported by purchase orders, sales contracts, invoices, etc.? Bank statements and proof of payment may also be checked.

4. Is the importer related to any of his suppliers (as defined in Article 15.4 of the WTO Valuation Agreement? If so, has the relationship influenced the price for Customs purposes (Article 1 of the WTO Valuation Agreement refers)?

5. Where a CIF value system is used, have freight and insurance costs been properly included? Do the delivery terms on invoices and freight contracts (INCOTERMS) match freight charges declared? Is the freight prepaid by the operator (risk of omission from the Customs value)?

6. Where an FOB value system is used (i.e. the country has made such a decision under Article 8.2 of the WTO Valuation Agreement), have freight and insurance charges been properly excluded from the Customs value?

7. Have commissions been properly declared and accounted for? (Buying commissions may be omitted and selling commissions should be included in the transaction value.)

8. Has a correct exchange rate for a foreign currency been applied?

9. If a Customs value declaration form has been completed (in addition to the Customs declaration), is it supported by the importer’s records?

10. Where discounted prices have been declared, are they genuine discounts which have been earned? Are the discounts freely available to all potential buyers?

11. Are any payments made in advance for imported goods which have not been included in the declared value?

12. Is the Customs value declared very low in comparison with an onward sale of the goods to a third party? (This is not conclusive, but an unusually large profit margin for the goods concerned may indicate that the import value was under declared).

13. Is payment for the imported goods transferred through a third company? If yes, have the appropriate amounts been included in the Customs value?

14. Have any materials, components, etc. been provided free of charge or at a reduced price to the manufacturer/seller for incorporation into the imported goods? (possible “assist” under Article 8.1(b) of the WTO Valuation Agreement)

15. Is the importer party to any royalty or license agreement relevant to the imported goods? (possible inclusion of royalties or license fees in the transaction value under Article 8.1 (c) of the WTO Valuation Agreement).

16. Did the importer use a valuation method other than transaction value? If so, confirm that a transaction value cannot be determined. If no sale has taken place, this will be evident. Importers should be encouraged to consult with Customs before using an alternative method of value.

17. Are the annual payments made by the buyer to a particular seller higher than the value of annual sales made by the seller? (if available)
B. COUNTRY OF ORIGIN

1. Are there any imports of products in which the country of origin declared has changed in the last year? Does the operator always use the same suppliers for the same origins or are there any changes?

2. Is the country of origin declared close to countries for which an anti-dumping duty or a countervailing duty has been introduced for identical goods or where a license is needed to import the goods?

3. Are the goods imported from geographically risky areas in terms of trade measures (e.g. anti-dumping duties, quotas, etc.)?

4. Is the same product imported from different countries?

5. Does a proof of origin exist? Has the appropriate proof been properly filled in? Is it valid? Are the proofs original documents (and not just photocopies)? Is the proof recorded in the Customs declaration?

6. Do the nature and quantity of the imported goods match the information in the proof of origin?

7. Have proofs of origin of goods imported by the operator systematically been issued retroactively?

8. Does the seal or stamp on the proof of origin match the available list?

9. If the exporter is an approved one, is the approval number given?

10. Has a binding origin information (BOI) been issued to the operator? Do the products and the origins match the BOI?

11. Verify the transport route to establish if the rule about direct transport is fulfilled and/or if the transport route is suspicious/unexpected.

12. Is the country of dispatch/export inconsistent or in some way incompatible with the country of origin declared?

13. Does it seem likely that the country of origin is capable of producing the specific goods in the quantities imported?

14. Is the supplier/manufacturer entered as a creditor in the accounts?

15. Is the forwarding documentation consistent with the declared country of origin?

16. Have the payments been made to a party in a country that is different from the declared country of origin? Have the payments been made to a party other than the seller of the goods? (If possible, go through the stock and see the declared origin and barcodes on boxes, packing, wrappings and the goods.)

17. Is the supplier a trader or a producer? Is there any information that indicates that the goods have been sold many times before the import or that many different companies have been involved?

Is there anything that indicates that this has been done to get better treatment by Customs than is correct (preferential treatment, no anti-dumping duties, no restrictions, etc.)?
C. TARIFF CLASSIFICATION

1. Has previous investigation concerning tariff classification been made? If so, what was the result of the investigation?

2. What are the routines used for classification of goods (pre-entry stage classification information/ruling, classification at the declaration processing stage, post-entry stage classification or a combination thereof)?

3. What categories of products does the operator import/export (e.g., food/chemicals/textiles/ machinery/etc. or parts/unassembled/incomplete/finished products)?

4. What products have the biggest volume? What products have the biggest value?

5. Are the commodity codes which are used consistent with the operator’s business?

6. Have any pre-entry binding tariff information/BTI/classification rulings been issued to the operator? Does the operator classify the goods in accordance with the BTI?

7. Has the operator been changing the classification pattern? What is the reason for such changes in tariff classification?

8. Is it possible to classify the goods declared under alternative codes?

9. Does the operator import/export products that could be subject to different duty treatment (e.g., higher or anti-dumping or countervailing duty), prohibitions, restrictions, laboratory or physical tests, technical standard certification, origin requirements, etc.? If so, who is the manufacturer? Has a correct certificate been issued?

10. Does the operator use commodity codes with low or zero duty rates?

11. Does the operator use commodity codes with tariff suspension? If so, are all the requirements for the suspension fulfilled?

12. Does the operator use commodity codes with preferential rate of duty or duty free treatment under trade agreements?

13. Are the operator’s products declared/classified under subheading codes that cover ‘other’ goods? Is this correct?

14. Does the operator declare parts where there are different duty measures/restrictions/etc. on the products assembled/completed/finished by using these parts?

15. Does the operator declare products where there are different duty measures/restrictions/etc. on the parts from which the declared product is assembled/completed/finished?

16. Is a sample taken by the auditor? Are brochures, technical descriptions, etc. requested? What was the result of the investigation?

17. Have the products been tested by a laboratory? Is the test done by Customs or by the operator? What was the result of the test? Are there any correspondences with the suppliers that allow the identification of the goods?
D. END-USE

1. Does the end-use authorization exist? Is it valid? Are all the requirements for granting the authorization fulfilled?

2. Check the internal control system

2.1. What records are maintained by the operator?

2.2. Is the end-use record in accordance with the authorization and is it updated? (Check whether production and stock accounts have been kept. Check whether the stocks are present. Check whether the goods are described as end-use goods in the relevant document.)

2.3. Do the nature and quantity of the goods imported match those stated in the end-use authorization?

2.4. Does the operator have exports and/or internal sales of the same products?

2.5. How does the operator ensure the correctness of the Customs declarations?

2.6. Analysis of the transaction chain, i.e. contract order of raw materials confirmation order invoicing payment/reception of goods/entry to stock/Customs declaration for entry into the procedure/production process rate of yield results (including waste and loss) Customs declaration of discharge from the procedure.

2.7. Is there a quality control system and does it includes all goods?

3. Controls — Reception of the goods

3.1. Check whether there have been purchases of end-use products from other authorization holders within the country.

3.2. How does the operator ensure that all raw materials received are declared to Customs and immediately recorded in the stock account?

4. Controls — Production

4.1. Has the estimated period for assigning the goods to their end-use been met?

4.2. Are the resulting products covered by the authorization? (Check whether, in addition to the manufacture of the main products, other products (including waste) are generated.)

5. Controls — Destination

5.1. If the goods are transferred before the use, is the transferee an authorized holder? Has the operator proof that the receiver has indeed received the goods?

5.2. In case of export or destruction of the goods, have the Customs authorities approved and, if necessary, supervised these operations?

Examination

The audit of traders’ systems aims to provide assurance that a particular activity or process is being carried out in accordance with Customs rules and regulations. A systems audit, as the name implies, involves an examination of the entire business cycle rather than just the transactions themselves. Weaknesses in the systems are good indicators of possible non-
compliance and can then be followed up with examination of specific transactions to test
the system and establish the actual level of compliance.

Verification of supporting documents is one of the core PCA procedures in order to
determine the completeness, correctness, accuracy and authenticity of Customs
declarations. This examination will include paper documents and electronic data,
depending on the auditee’s record system, as well as related material from business
partners and third parties involved in the transactions. In addition to accounting books,
slips, worksheets and source documents being kept by the auditee, records could also
include background information and internal audits information.

If, during the course of an audit, the auditor suspects that a Customs offense has been
committed, the audit team should communicate to the appropriate enforcement unit and
provide relevant information needed to decide whether a formal investigation should be
launched. It is important not to alert the importer of any such suspicions.

All commercial and related information which is deemed confidential or which is provided
on a confidential basis for the purposes of PCA shall be treated as such.

**Inspection of books and records**

Books and records to be inspected may be grouped as follows:

- Business-related books and records - e.g., sales and purchase contracts, technical
  assistance contracts, commission contract, order sheets, processing instruction,
  manufacturing report, correspondences and other records relevant to Customs, including
  Customs declarations, commercial invoices, packing lists, bills of lading, product
  specification sheets, product brochures and other information needed to verify the
  accuracy of Customs declarations.

- Account-related books and records – e.g., sets of account books, and all source
  documents such as L/Cs, bank statements, overseas remittance applications, and
  debit/credit notes.

The formalities of recordkeeping depend on national legal provisions on recordkeeping
and will vary between businesses. Therefore, it is necessary to develop an understanding
of the specific systems maintained by the auditee via information acquired during the pre-
audit preparation and the audit itself, which can then be verified and tested accordingly.

When books and records which are normally maintained by business entities are said to be
not maintained or not available, the auditee should be asked for an explanation.

Regarding the appearance of presented books and records, the auditor should note the
following points:

- As for books and records of the loose-leaf type, check page numbers or other sequential
  numbers in order to identify replacements and extraction of pages.

- As for business-related documents, check whether all records of requested period are
  presented without omission.

The following general guidelines are recommended to be observed in the inspection of
business-related books and records:
Pay attention to the order of filing. Extreme interval of date on sequential pages and a missing number of pages or other sequential numbers indicate extraction of documents;

Pay attention to differences in types and quality of paper used, styles, and signature. The quality and type of paper, form and signatures used for documents relating to intentional misconduct may be different to those of legitimate/genuine documents;

Pay attention to the source of documents. It should be noted that external documents, which are created by unrelated third parties, provide higher a higher level of reliability;

Pay attention to notes that are handwritten in a margin and inserted paper; matters relating to fraud and errors are often written in this way;

Pay attention to peculiar appearances on a page, such as an abnormally broad blank, an unusual crease, and unnecessary punch holes;

Examine the original document. Copies and duplicates have high risk of falsification;

Start the examination from documents which are for daily use, in case the auditee denies existence of records, or refuses them to present.

**Verification of the Customs value**

*Note: Customs valuation is a complicated subject and it is highly recommended that Customs valuation experts are consulted in cases of doubt or in more complex situations. Customs is required to provide an opportunity to the importer to respond to doubts concerning the declared Customs value and provide the importer with written explanation regarding final determination of the value.*

Books and relevant business records retained by the auditee are of major importance for the verification of Customs value. These books and records should indicate all business transactions. Through the examination of records, auditors are able to capture a comprehensive picture of a transaction which may indicate, for example, incorrect invoice price, undeclared separate/indirect payments and other omitted dutiable costs. As a result, auditors will be able to verify the Customs value.

**Price negotiations and discounts**

In cases where the buyer and seller are not related, there is an assumption that the price of imported goods was freely negotiated in order achieve the most favorable terms for the parties. The main driver will be the normal rules of supply and demand. Additionally, other pricing practices may be commonly used as part of a sales transaction. Discounts, for example, may be extended by the seller to the buyer under certain situations, including:

- purchase of a certain quantity
- prompt payment
- cash payment
- discount pricing for end of line/discontinued items
- promotional pricing for new products

Such discounts are normal commercial practice and may be allowed when determining the Customs value. The audit gives the opportunity to verify the legitimacy of the discount.
The importer can be asked to produce information, often contained in the sales contract, which sets out the discount terms and conditions. Commercial literature may also be available which confirms the discount in question was freely available to any potential buyer who fulfills the criteria. The auditor can also confirm whether a discount has been taken up by the buyer, for example, where a prompt payment discount was offered, did the importer pay within the specified time and thus qualify for the discount?

Where buyer and seller are related within the meaning of Article 1 of the WTO Valuation Agreement, there may be grounds for examining whether the price has been influenced by the relationship. Typically, it is difficult to prove price influence and it is recommended that Customs valuation specialists are consulted in such cases.

**Commercial price lists and related literature**

During the audit, the sellers’ pricing information may be obtained, including price lists, advertising literature or details of special offers. Although such information cannot be used to conclusively disprove a declared value, it may give an indication that an under declaration has occurred and the importer can be asked for an explanation.

**Payment terms**

Terms of payment should be verified through the examination of contracts, shipping documents, and payment records. Terms of payment may include advance payments, payment on delivery, deferred payment and the payment by installments. The method of payment may be specified as cash bill of exchange, depending on the means of payment. As for the bill of exchange, it is divided into the Letter of Credit (L/C), the Document against Payment (D/P), and the Document against Acceptance (D/A), depending on the existence of L/C and the time of payment.

**Terms of Sale**

Terms of sale should be verified in order to determine whether additional costs are properly included or excluded in/from the declared value.

**Additional terms**

Additional conditions obligated to the buyer in the sales contract should be taken into account when verifying the Customs value, for example, where a buyer agrees to offset a seller's debt to him by reducing the price of the imported goods. Through examination of contracts and correspondence, the existence of additional conditions that affect the Customs value should be identified and considered in the context of Article 1 of the WTO Valuation Agreement.

**Separate payments**

The existence of separate payments related to the transaction in question, but not reflected in the invoice price, may be identified in the accounting books and records. Such payments may be includable as part of the transaction value and should be examined to check:
- The purpose of the separate payment, which may be detailed in books and records such as contracts, correspondence and a payee's bills; and

- The involvement of persons/companies other than the exporter in the import transactions such as a buying/selling agent, to whom payments have been made.

- It is important not only to take into account payments made by the importer, but also payments made by the importer’s partners and shareholders.

**Examination of accounting records**

In the examination of accounts-related books and documents, the following points may indicate a low level of compliance and/or the possible existence of fraud:

- Contradictions between figures and descriptions in account books and records
- Records that have not been treated in accordance with generally accepted accounting principles. For instance, credit entries of purchase account, which usually has many debit entries, indicate the possibility that a transaction price was discounted or offset after the price was fixed
- Related accounts should be examined. Under the double-entry-booking system, the information of one transaction is entered into at least two account titles. A debit entry of an account appears as a credit entry of another account. Therefore, it is important to trace the information from one account to the others to detect possible fraud and errors
- The existence of second or “double” invoices for the same consignment
- Poor recordkeeping, arithmetical errors, untidy bookkeeping
- Missing pages in accounts books
- The importer is reluctant to respond to enquiries and gives misleading or unclear answers

**Inspection of computer-based accounts systems**

Customs personnel are routinely encountering information stored on computers or other electronic media. This media may contain information that may be hidden, protected from discovery or that can be easily destroyed. Specialist skills may be needed to examine data contained on computer systems maintained by the commercial operator.

**Physical inspection of the goods and premises**

The level of physical inspection of goods at the time of importation has drastically decreased over recent years in many countries. Selective physical checks can still be useful where based on credible risk intelligence. Physical checks during an audit are not normally a priority; in many cases, the goods will have been resold and are no longer in the possession of the auditee. Nevertheless, if the imported goods are still in the possession of the auditee at the time of the audit, a physical inspection could be considered to test the accuracy of import declarations in connection with such areas as quantity, classification and origin. If a physical inspection is not possible, quantity declarations can also be checked against the warehouse inventory documentation.
A survey of the trader’s premises enables the auditor to compare physical operations with the description of the business derived from accounts and prior intelligence. The “life-cycle” of the goods can be followed from arrival through storage/warehousing, production/processing to eventual disposal. The auditor may also note other activities which may be of relevance and interest to Customs, for example, the presence of goods not associated with the company's normal business or the expansion and development of new facilities which may indicate a diversification or changes to the business.

**Expansion of the audit to third parties**

A third-party audit is the examination of the business records kept by persons/companies other than the declarants in order to supplement an audit of the importer.

In principle, the audit should achieve its objectives by examination of the importer. However, if the auditor encounters the following indications, a third-party audit should be considered:

- The importer has not retained sufficient records to secure conclusive evidence;
- The auditor is unable to rely on records presented by the importer, because the records are false or manipulated;
- The auditor is unable to determine whether the importer has made proper declarations, due to lack of evidence.

Possible subjects of a third-party audit may include the following persons/companies:

- Customs clearing agents
- Persons/companies who consign goods to the importer
- Persons/companies who acquire goods imported by the importer
- Intermediary, broker and other agents involved in import transactions

**Recording, review of findings and conclusions**

It is essential that the findings of an audit are thoroughly documented. Notes, calculations, and written records of procedures performed during the audit should be adequate to allow a comprehensive report to be written. Auditors should obtain sufficient relevant and reliable evidence to form a sound basis for conclusion.

Ensure that any documentation relevant to the audit and any notes taken are maintained safely and securely. Receipts should be issued both in respect of documentation removed and samples taken as an aid to classification.

Having concluded the examination of the trader’s books and records, the auditor should summarize the findings to date, considering all aspects of the audit, including the inspection of the premises, results of physical checks and review all the working papers, etc. in preparation for the audit report to the trader.

A formal meeting should be held with the auditee to present and discuss the conclusion and findings. Where appropriate, the auditor/audit team explains his/her observations on the causes of problem areas and recommends specific actions to remedy them. It also

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provides an opportunity for the auditee to give any explanations needed to assist preparation of the final report.

The trader should be made aware of the fact that:

☐ The meeting is to convey the results of the audit to the trader, and will be followed by a written report;

☐ The results only apply to the period audited;

☐ Where documents/samples have been taken for verification, the audit may be re-opened;

☐ They may be liable to audit again at any time in the future.

The auditor should present a summary of the audit findings to the company officials. Any negligence and errors should be brought to their attention and the necessary action to avoid repetition of these should be discussed.

Where errors in relation to a trader’s procedures have been discovered and documented they must be discussed during the final meeting. The auditor should make recommendations to ensure that corrective action is taken. The auditor should also agree an implementation timetable with the trader for the necessary changes. The trader should be requested to reply in writing within the time set by Customs, indicating the action management has taken, or intends to take, as a result of the audit.

In most cases, agreement is reached once the auditee accepts the auditor’s conclusion. If formal agreement is not reached, the auditor should respect the auditee’s right to request a review or appeal as provided in national legislation and provide any reasonable assistance requested to facilitate the process.

**Reporting**

The auditor/audit team should prepare a final report and present a copy to the auditee, if in line with national laws and provisions. A copy should also be sent to the responsible Customs offices and units for the settlement of any issue which has arisen.

The documentary form of the audit report may differ in accordance with the manner of official documentation of respective countries. The contents of the audit report may also vary depending on the PCA objectives of respective countries. In general, the report should contain key findings and a conclusion.

**Evaluation and follow-up**

It is Customs’ responsibility to take appropriate action based upon the audit findings.

Customs administrations should develop a mechanism to assess and evaluate the success of the PCA program. This may include:

☐ An improvement of compliance levels;

☐ Additional revenue collected;

☐ Number of investigation referrals;

☐ Cost/benefit analysis.

If the audit report recommends that the auditee or Customs takes specific actions, a follow-up review should be conducted to determine if the corrective action was taken and
whether the desired results were obtained. As appropriate, the PCA unit may carry out follow-up checks via a desk audit or a further visit to the auditee's premises.

IRREGULARITIES

Irregularity means the breach of laws and regulations, regardless of its cause, such as deliberate intention (fraud), negligence, or simple mistake (error).

Awareness of the various types of irregularities is crucial to implement efficient and effective PCA for the following reasons:

- It contributes to identifying potential risk areas. Existence of possible fraud, negligence and errors already indicates potential risk areas.
- It contributes to clarifying types of information that should constitute the auditee’s profile, which is necessary for appropriate assessment of an auditee’s risk.
- It contributes to clarifying types of records that should be examined in field audits.

Fraud, negligence and errors

Fraud means the willful intent of a taxpayer to evade a tax. More specifically, in terms of fraud against Customs laws and regulations, "commercial fraud" can be described as follows:

“Any offense against statutory or regulatory provisions which Customs are responsible for enforcing, committed in order to:

(a) Evade, or attempt to evade, payment of duties/levies/taxes on movements of commercial goods; and/or
(b) Evade, or attempt to evade, any prohibition or restrictions applicable to commercial goods; and/or
(c) Receive, or attempt to receive, any repayments, subsidies or other disbursements to which there is no proper entitlement; and/or
(d) Obtain, or attempt to obtain, illicit commercial advantage injurious to the principle and practice of legitimate business competition.”

Negligence means a lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the given circumstances. The term covers:

(a) Omission of something that a reasonable person, guided by the considerations that ordinarily regulate the conduct of human beings, would do, and
(b) Doing something that a prudent, reasonable person would not do.

The difference between fraud and negligence is that under fraud, there must be intent to commit tax/duty evasion. There may be penalties for negligence according to respective national legislation. In these Guidelines, error means a mistake in a Customs declaration.

Indication of serious offense

In the course of an audit, an auditor will from time to time encounter strong indicators suggesting a serious offense. Two main types of evidence arise in tax offenses: - i.e. (1) documentary evidence; and (2) statements by the taxpayer. As auditors are not involved in
the investigation of cases with a view to criminal prosecution, they should deal with such evidence with a different approach.

Subject to the in-house arrangements, documentary evidence of an offense should be immediately referred via the Head of the PCA Unit to the competent investigation authority for consideration whether or not the case is suitable for investigation with a view to prosecution. If the case is considered suitable to be so investigated, the audit is terminated.
Lesson 21

Outstanding Issues on International practices

[Enhancement of compliance through PCA, Importer Based Profiling and Targeting]

Quality assurance, filing and using audit results

Ensuring quality and integrity of the PCA

The PCA methodology outlined in this Guide regularly refers to the role of an audit manager. This is a key position, requiring someone with considerable experience in reviewing business systems in the context of risk to compliance and the skills and ability to ensure that the members of the PCA team are making judgments and recommendations based on appropriate testing and sound audit evidence. Responsibilities of the audit manager include:

• ensuring the audit is conducted to the standards set by the administration, including those which apply to the qualification of audit team members, the planning, testing, and the opinions and recommendations to be expressed in the audit report;

• reviewing and approving the work of auditors at each stage of the PCA before progressing to the next;

• ensuring that the audit working papers containing the audit evidence are properly completed, reviewed, signed and filed, and eventually stored securely for future use;

• taking responsibility for delivering the audit on time and within budget using appropriate resources, including external specialists when required;

• dealing with any issues arising with the trader during PCA, particularly those which are sensitive, or where there may be disagreement between the auditor and the trader in areas such as materiality of errors, opinions on compliance and recommendations;

• establishing formal contact with the trader, including chairing the entrance interview and exit interview; and

• delivering the finalized audit report to the trader at the completion of the PCA process.

Critical to the integrity of the PCA is the preparation and accurate completion of working papers at each stage of the audit. These must be completed in a logical order, matching the processes that are being reviewed, with a clear reference to the relevant business system. To facilitate this, the various working papers should be cross-referenced with other working papers relating to the business system under review. Each document should also identify which member of the PCA team has prepared and reviewed the worksheet.

Working papers, once completed, should be filed together with other working papers from the same business systems and then filed against an index which enables future users to readily identify any part of the audit. A sample of a working paper index which follows the above methodology can be found at Annex 4.

Safe care of audit working papers
Once the PCA has been completed, and working papers appropriately filed, audit evidence and reports should generally be accorded an ‘audit-in-confidence’ status, and be kept under lock and key, with restricted access. Where one or more documents of a higher security classification such as commercially sensitive materials or details of IT system access, etc, are included in the working papers or audit report, then the audit file and associated working papers will require a higher security classification, and may require a more secure storage and retrieval system. It should be noted that such PCA working papers are likely to be used again as the starting point should the trader be selected for PCA subsequently, including follow-up activities on certain recommendations requiring action from the trader. As previously noted, PCA working papers may also be required by investigators should the trader come under suspicion at a future point and may become evidence in possible investigation and prosecution proceedings.

Consequently audit working papers need to be readily accessible to future users, who must have confidence that all materials are present, i.e. that none are missing or stored elsewhere.

It should also be noted that, in the case of civil or criminal prosecutions, the ability to demonstrate that PCA working papers have been properly and safely filed adds to their eight as reliable evidence.

Use of PCA working papers

At the end of the PCA process it is important to feed the results of the audit into the agency’s broader compliance management process. This assists planning by updating a trader’s risk assessment and identifying trader or sector specific compliance issues that the PCA has identified. Compliance analysts will be examining errors and other issues that have been identified across a range of audits, and it is therefore essential to provide a high degree consistency in the way in which audit results are communicated. Adoption of the following general principles when creating audit reports and databases will enhance their usefulness:

• Industry segregation of information should be provided, to enable monitoring of issues within and across industry sectors. This will require assigning all companies to a particular industry groupings (and sub-groupings if desirable).

For example, the automobile industry grouping could be broken down further into sub-groupings of importers of finished vehicles; manufacturers using imported components; importers of components; free zone manufacturers; vehicle distributors, etc.

• Stratification of companies by size, or volume of trade e.g. large businesses, medium businesses and small businesses

• Identification of risk areas. For example, importer risks may include valuation, tariff classification, origin, suspension regimes, import permits and licenses; while manufacturer risks may include classification, valuation, quantities, undeclared production, permits, licenses, losses, etc.
• Nature and value of detected errors, with a capacity to give a narrative on the errors detected and to quantify the extent of those errors in sufficient detail to allow for later analysis.

In essence, PCA results need to be captured in a format consistent with the risk management needs of the administration so that trends and other patterns in errors may become apparent or begin to emerge, allowing for better targeting in future compliance planning processes. Whilst an audit report will highlight an area of risk, the actual working papers can provide an excellent insight into how traders make the errors and how they can be detected, and this point emphasizes the importance of keeping good working papers which are properly linked to the relevant business systems in the audit file, and are easily accessed from the agency’s database.

Note that, in addition to material errors, the database should also contain details of required follow-up action such as the need for a follow-up audit resulting from adverse findings in a PCA which require the trader to take immediate remedial action to business systems and controls.

Finally, the database should contain adequate referencing to enable location of PCA working papers and files.

**Developing a National PCA Plan from PCA Results**

As noted above, PCA results should be fed into the agency’s broader compliance management process, and the best way to achieve this is in the formulation or modification of the agency’s national PCA plan.

In particular, the major findings from PCA activity should be reviewed for emerging issues, trends towards or away from compliance, and commonly occurring errors, all of which will inform the next national PCA planning and development process.

For example, a change in eligibility criteria for use of a particular duty concession may have generated a large number of under-statements of duty liability from traders who have been using the concessional arrangements for several years. The administration’s risk response, which is incorporated into its current national PCA plan, may have been to target large users of the duty concession, and also to increase education and awareness of the criteria changes. However, if having reached the end of its current national PCA plan, material errors are still being discovered, then the agency should identify this as a high risk in its next national PCA plan and perhaps consider additional risk responses.

Alternatively, towards the end of a national PCA plan, risks identified at the outset of the plan may not be as apparent, and indeed higher levels of compliance are observed during PCA activity. Using the duty concession example, such findings are likely to indicate that the trading community has appropriately responded to the change in criteria as a result of the national PCA strategy. Therefore, the risk may now be reduced to an acceptable level and will not be specifically targeted in the next iteration of the national PCA plan. Rather, that particular issue will form part of the general risk analysis when reviewing a trader’s business systems in the context of PCA. Emerging risks, which can be fed directly into the planning process of the next PCA plan, may include the type and nature of material errors, and from which types of traders and in which types of industries they are occurring. For example:
• Types of material errors being detected. For example non-compliant origin certificates, certain cost elements being excluded from valuation, unauthorized access to IT systems that generate agency transactions, or unauthorized personnel accessing the bond-store;

• Types of trader making material errors. For example mid-sized importers, large exporters, or traders not visited for 5 years, etc; and

• An industry sector or industry sub-sector that is making an increased number of errors, or making common material errors.

In summary, the following details of the completed PCA should be capable of being taken directly from the PCA results database and fed into the next iteration of the national PCA plan:

• High risk in current PCA plan confirmed—yes or no;

• Success of responses to identified high risks;

• Emerging areas of risk;

• Ongoing areas of risk; and

• Required follow up activities.

This information then adds to the new information on risk emanating from other areas of the administration such as intelligence, cargo examinations; industry complaints, hot-lines; and legislative or administrative changes, in the preparation of the next PCA plan.
[Part IV]
National Legislative Provisions on PCA
(Customs Act, Customs Rules,
PCA procedure)
Lesson 22

legal provisions of PCA

[PCA provisions in Customs Act and Customs Rules Nepal section 2, 4a, 34, 57(15a) 62 and customs rule 26-28]

Section 2 (i) "post clearance audit" means the audit referred to in Section 34.

Section 2 (r) "Customs Officer" means the Chief Customs Administrator, Post Clearance Audit Administrator, Chief Customs Officer, Chief Customs Examiner, Customs Officer or Customs Examiner and this expression includes the Chief of customs office or Sub-customs Office and the Official designated by the Ministry of Finance pursuant to Section 84.

(u) "Post Clearance Audit Office" means the office established under section 34 for the purpose of post clearance audit.

Section 4A. Establishment of Posts Clearance Audit Office:

(1) Post Clearance Audit Office may be established as necessary by the Government of Nepal by notification in Nepal Gazette.

(2) Post Clearance Audit Office established before the commencement of this Section shall be deemed to be established under this Section

Section 34. Power to make post clearance audit:

(1) In order to ascertain whether the goods cleared by the Customs Office are the same as declared by an importer or confirm to the declaration made by the importer or not, the Director General or customs officer may audit, inter alia, the importer's books relating to the purchase, import or sale of goods, records, books of accounts or similar other documents, bank records, computer system and all records related to his or her business.

(2) If, upon audit made pursuant to sub-section (1), it is found that the goods imported by the importer are different than those declared by the importer or are inconsistent with the declaration made by the importer or the transaction value or the quantity of the goods has been declared less and by virtue thereof lesser duty has been recovered, the Customs Officer shall immediately recover from the importer the duty chargeable on such less value or quantity at the time of import and take action against such importer for the declaration of less transaction value or quantity, pursuant to this Act.
However, when less transaction amount is declared hundred percent of the duty chargeable will be collected as fine.

(3) If, upon audit made pursuant to sub-section (1), it appears that less duty has been recovered by the reason of difference in sub-heading of commodity classification, the concerned Customs Office shall recover such shortfall amount of duty and fine equivalent to that of shortfall amount from the importer.

(3a) The Director General or the Custom Officer while taking action pursuant to this section, shall use and follow the power and procedure with respect to it, to collect additional amount pursuant to existing laws, summon the concerned person, take his or her deposition, examine the evidence, require the submission of documents, issue notice.

(3b) If, upon audit made pursuant to this section, the importer does not appear within the given time or does not submit the document and evidence, the Director General or the Customs Officer shall audit on the basis of available documents and evidence, by imposing a fine pursuant to Sub-section (15a.) of Section 57 and withholding the import export transactions.

However, if additional document evidence is found with respect to the importer after audit is made pursuant to this section, this section shall not be deemed to prohibit conducting re-audit based on such additional documents.

(3c) While determining duty pursuant to this section, concerned person shall be provided fifteen days time to submit the clarification.

(3d) The duty and fine amount determined under this section shall be deposited within thirty-five days from receiving the order to deposit the amount by the person so ordered. Duty and fine amount not paid within mentioned time shall bear interest at the rate of fifteen percent annually for the period beginning with the date of order and ending with the date on which the payment is made.

(3e) If, any importer does not deposit the amount that should be deposited pursuant to sub-section (3d), Customs officer shall freeze moveable or immovable property of such importer and collect such amount from the said property.

(3f) If any amount cannot be collected Pursuant to subsection (3e), the due amount shall be collected as government debt.

(3g) Pursuant to this section, The director general or the customs officer shall, if necessary, require submission of documents relating to the importer, businesses owned by the importer, payment of goods, bank accounts, profit and loss statement, tax details, invoices or other such required documents from concerned bank or Financial institution, and any other organization or individual related to importers’ business. When asked upon, the organization or individual should compulsory furnish the documents as required.

(4) The audit referred to in this Section may be made until four years after the date of clearance of goods.
Section 57 punishment

(15a) If the documents required for audit according to section 34 are not presented within stipulated time, Director General or Customs Officer can determine a penalty of Rs. 10,000 each time from the importer.

Section 62. Appeal:

(1) A person who is not satisfied with the customs duty determined by the Customs Officer or other employee under this Act or with any order or punishment or decision issued or made by the Customs Officer, except any decision or order referred to in Section 13, or with any decision made by the valuation review committee formed pursuant to Section 61 may make an appeal to the Revenue Tribunal within thirty five days after the date of the determination of such customs duty or the imposition of punishment or the making of decision.

(2) A person who files an appeal pursuant to sub-section (1) may make such appeal by making payment of or furnishing a deposit of the duty and amount of fine and penalty chargeable pursuant to that decision or order against which such appeal is to be made, to or with the concerned Customs Office.

(3) A person who files an appeal pursuant to sub-section (1) shall give a copy of such appeal to the concerned Customs Office no later than seven days after the filing of such appeal.

(4) In the event of not being satisfied with any decision made by the valuation review committee formed pursuant to Section 61, the Customs Officer may file an appeal to the Revenue Tribunal no later than thirty five days after the making of such decision.

Custom rules 2007 rule 26-28

Chapter 5 Arrangement for Post Clearance Audit

Rule 26. Importers need to keep the documents safely:

In accordance with section 34 of the Act, the importers should keep the following documents and papers relating to the import for the purpose of post clearance audit for four years from the date of import:

(a) Import Declaration form, customs receipt, and purchase document;
(b) Sales invoice and sales document;
(c) Stock list with specific amount;
(d) Banking transaction relating to import and sales of goods;
(e) Balance Sheet and Profit and loss account and relating document;
(f) If the transaction is done through computer system, such a system;
(g) Any other documents relating to import, export and sales

Rule 27. Other provisions for post clearance audit:

(1) For the purpose of sub section (2) of section 34 of the Act, in order to determine whether the transaction value of the goods as declared by the importer is realistic
or not, the value may be determined through the application of the all or any methods as stipulated in section 13 of the Act.

(2) For the purpose of sub section (2) of section 34 of the Act, in order to determine whether the quantity of the goods as declared by the importer is correct or not, the quantity may be determined by physical verification of the stock.

(3) In order to determine the reality of the value as declared in the customs office at the time of import, the ledger of transaction may be checked from the sales of the product up to the retail level.

(4) In order to do post clearance audit, the customs officer or the Director General should notify the concerned importer about the date and time of audit in advance, to the extent practicable.

**Rule 28. Power to demand documents:**

(1) Post Clearance Auditor, the Director General or the customs Officer may ask for the documents as required, for the purpose of auditing from the bank, financial institution, any person or institution relating to the importer’s business transaction or goods regarding the payment, Bank deposit, profit and loss account, tax returns, invoices, and other documents etc.

(2) It is the duty of the concerned bank, financial institution or other agencies to make available the documents as per sub-rule (1).

(3) .................
Lesson 23
Current PCA Procedure
[PCA Manual 2016]

Section 3 Selection and Audit

- Audit will be performed by PCA office and various customs offices
- Audit Targets of number of consignments/firms/products as well as additional duty assessment shall be fixed by Department of Customs
- Selection for PCA shall be based on single consignments or particular firms or particular products of the importers.
- Fifty percent of targeted importer shall be selected by selection committee and rest of importers shall be selected by respective customs offices.
- A Committee will be formed for selection importers for PCA as well as policy feedback for selection. Composition of selection committee will be as follows:
  
  Coordinator- Deputy Director General Department of customs  
  Member - Chief Customs Audit Administrator, PCA office  
  Member- Director, Valuation Section  

- The composition of PCA selection committee in each customs offices are as follows:
  
  Coordinator- Deputy Director General Department of customs  
  Member - Chief Customs Audit Administrator, PCA office  
  Member- Director, Valuation Section  

- Selection could be done through selectivity module of ASYCUDA

Section 4: Risk indicators for PCA selection are as follows:

(a) Goods having high tariff.
(b) Goods having quantitative restrictions.
(c) Goods prone to revenue risk.
(d) Reliability of the importer.
(e) Country of origin of the goods.
(f) Declared value and the quantity of the imported goods.
(g) Change of customs point.
(h) Nature of the declaration of the goods.
(i) Country of shipment and shipment date of the goods.
(j) Analysis basis of the statistics available in the different sections of the department.
(k) Goods having price difference by model and brand.
(l) Monopolistic representative type goods.
(m) Information and details received from other agencies.
(n) Comparative assessment of information received from different sources.
(o) Government policy and priority.
(p) Comparative analysis of transaction with other importers.
(q) Other bases of risks perceived by the auditor.
(r) Declared amount of insurance and freight being more than the value of the goods.
(s) Goods having highly advertised and high administrative costing.
(t) Bases undertaken by the Inland Revenue Department and the Inland Revenue Offices in the course of final tax audit.
(u) Information received from the selectivity module launched in the customs office and statistical analysis result.

Section 6 Documents and details to be audited:

Following documents/records may be audited.

(a) Customs import declaration form, customs duties paid receipt and purchase ledger.
(b) Sales invoices and sales records.
(c) Stock records with quantity and value.
(d) Bank statement relating to the import and sales of the goods/commodities.
(e) Balance sheet and profit/loss account, inventory details and other records.
(f) Computer system, if the importer has been undergone the transaction through computer system.
(g) Other documents/records relating to import, procurement and sales.
(h) Tax and income filing of the importer submitted to the Inland Revenue Office.
(j) Physical verification of the stock of the importer.
(k) Cash flow records.
(l) Expenditure records.
(m) Bill of lading (B/L)/Airway bill (AWB).
(n) Copy of letter of credit/bank statement
(o) Copy of advance payment or payment record.
(p) Insurance paper.
(q) Packing list
(r) Import and purchase invoices
(s) Other documents/records related to the transaction of the goods in auditing.

Section 8 Post Clearance Audit Plan
- formulation of audit team
- distribution of audit works among audit teams
- collection of documents and information
- informing to importer
- fixing date time place of audit

Section 9: Conducting PCA
- request for documents from importer
- discussion and interaction with importer
- verification of documents and reports
- verification of stocks if necessary
- cost and selling price analysis

Section 10 Preparation for reporting
- preparation of notes of audit
- collecting document proof
- conforming duty assessment amount if any
- report preparation as prescribed format
- reporting and decision process
- implementation of decision

Section 12 implementation of audit report and follow up
- further clarifications letter send to importer within three days of decision date in case of additional duty assessment
- final duty assessment considering importers further clarifications and documents
- follow-up for duty collection

Section 13 Reporting to Department
- in DOC within 5 days of the end of the month
- respective customs and Inland Revenue Offices
- other agencies- i.e DRI, DMLI, if necessary
Lesson 24
General Knowledge on Accounting Standards
[Introduction of accounting Standards (Generally Accepted Accounting Principles-GAAP)
Applied in Nepal ]

From Nepal Accounting Standards

Scope

(7) Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, an income statement, a statement of changes in financial position (which may be presented in a variety of ways, or example, as a statement of cash flows or a statement of funds flow), and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about industrial and geographical segments and disclosures about the effects of changing prices.

Underlying assumptions financial statements

Accrual Basis

22. In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Going concern

23. The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Qualitative characteristics of financial statements

24. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.
**Understandability**

25. An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

**Relevance**

26. To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

**Materiality**

30. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

**Reliability**

32. Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the entity to recognise the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

**Faithful representation**

34. Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that entities generally would not recognise them in the financial statements; for example, although most entities generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.
Substance over form

35. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the entity continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Neutrality

36. To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

37. The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognized by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements.

Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Completeness

38. To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.
Comparability

39. Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.

The elements of financial statements

Financial position

49. The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

(b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Assets

53. The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

54. An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

55. The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

(a) used singly or in combination with other assets in the production of goods or services to be sold by the entity;

(b) exchanged for other assets;

(c) used to settle a liability; or

(d) distributed to the owners of the entity.
56. Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

57. Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.

58. The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.

59. There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet; for example, items that have been donated to the entity may satisfy the definition of an asset.

Liabilities

60. An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

61. A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally
arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the assets. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

62. The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;
(b) transfer of other assets;
(c) provision of services;
(d) replacement of that obligation with another obligation; or,
(e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

63. Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery) and the receipt of a bank loan results in an obligation to repay the loan. An entity may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.

64. Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

65. Although equity is defined in paragraph 49 as a residual, it may be sub classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the receipt of dividends or the repayment of capital.
66. The creation of reserves is sometimes required by statute or other law in order to
give the entity and its creditors an added measure of protection from the effects
of losses. Other reserves may be established if existing tax law grants exemptions
from, or reductions in, taxation liabilities when transfers to such reserves are
made. The existence and size of these legal, statutory and tax reserves is
information that can be relevant to the decision-making needs of users. Transfers
to such reserves are appropriations of retained earnings rather than expenses.

67. The amount at which equity is shown in the balance sheet is dependent on the
measurement of assets and liabilities. Normally, the aggregate amount of equity
only by coincidence corresponds with the aggregate market value of the shares of
the entity or the sum that could be raised by disposing of either the net assets on
a piecemeal basis or the entity as a whole on a going concern basis.

68. Commercial, industrial and business activities are often undertaken by means of
entities such as sole proprietorships, partnerships and trusts and various types of
government business undertakings. The legal and regulatory framework for such
entities is often different from that applying to corporate entities. For example,
there may be few, if any, restrictions on the distribution to owners or other
beneficiaries of amounts included in equity. Nevertheless, the definition of equity
and the other aspects of this Framework that deal with equity are appropriate for
such entities.

Performance

69. Profit is frequently used as a measure of performance or as the basis for other
measures, such as return on investment or earnings per share. The elements
directly related to the measurement of profit are income and expenses. The
recognition and measurement of income and expenses, and hence profit, depends
in part on the concepts of capital and capital maintenance used by the entity in
preparing its financial statements. These concepts are discussed in paragraphs
102 to 110.

70. The elements of income and expenses are defined as follows:

(a) Income is increases in economic benefits during the accounting period in the
form of inflows or enhancements of assets or decreases of liabilities that result
in increases inequity, other than those relating to contributions from equity
participants.

(b) Expenses are decreases in economic benefits during the accounting period in
the form of outflows or depletions of assets or incurrences of liabilities that
result in decreases inequity, other than those relating to distributions to equity
participants.

72. Income and expenses may be presented in the income statement in different ways
so as to provide information that is relevant for economic decision making. For
example, it is common practice to distinguish between those items of income and
expenses that arise in the course of the ordinary activities of the entity and those
that do not. This distinction is made on the basis that the source of an item is
relevant in evaluating the ability of the entity to generate cash and cash equivalents in the future; for example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way consideration needs to be given to the nature of the entity and its operations. Items that arise from the ordinary activities of one entity may be unusual in respect of another.

73. Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed. These have differing degrees of inclusiveness. For example, the income statement could display gross margin, profit from ordinary activities before taxation, profit from ordinary activities after taxation, and net profit.

Income

74. The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

75. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this Framework.

76. Gains include, for example, those arising on the disposal of non current assets. The definition of income also includes unrealized gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.

77. Various kinds of assets may be received or enhanced by income; examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.
Expenses

78. The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

79. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this Framework.

80. Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an entity in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.
NAS 01 NEPAL ACCOUNTING STANDARDS ON PRESENTATION OF FINANCIAL STATEMENTS

As per the decision of the Council, the following Nepal Accounting Standards have been made Mandatory for Compliances.

<table>
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<th>S.N.</th>
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The following Nepal Accounting Standards are for voluntary compliances

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Source: http://www.ican.org.np/nepaccstd.php
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<tr>
<th>Type</th>
<th>Entities Requiring adoption of NFRS</th>
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| A    | 1. Listed Multinational Manufacturing Companies  
2. Listed State Owned Enterprises (SOEs) with minimum paid up capital of Rs. 5 billions (except Banks and Financial Institutions under BAFIA Act, 2006) | 2014-15 |
| B | 1. Commercial Banks, including State Owned Commercial Banks;  
   2. All other Listed State Owned Enterprises (SOEs) | 2015-16 |
|---|---|---|
| C | 1. All other Financial Institutions not covered under A & B above  
   2. All other SOEs  
   3. Insurance Companies  
   4. All other Listed Companies  
   5. All other Corporate Bodies/Entities not defined as SMEs or entities having borrowing with minimum of Rs. 500 million. | 2016-17 |
| D | NFRS for SMEs (SMEs as defined and classified by ASB) | 2016-17 |

**NOTE:**
1. Early implementation of NFRSs is encouraged/recommended.
2. Until the implementation of NFRS as per above schedule, existing NASs shall continue to be effective to such entities.

Lesson 25
General Knowledge on Auditing Standards
[Introduction of auditing Standards applied in Nepal]

Nepal Standards on Auditing
As per the decision of 197th Council meeting, the following Nepal Standards on Auditing revised and drafted based on IAASB hand book 2012 edition, are applicable voluntarily from 1st Sharwan 2072 (July 17, 2015) & Mandatory from 1st Sharwan 2073(July 17,2016).

Nepal standards on Auditing (Based on IAASB Hand Book 2012 Edition)

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**NEPAL AUDITING PRACTICE NOTES**

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**AUDITS AND REVIEW OF HISTORICAL FINANCIAL INFORMATION**

**2000-2699 NEPAL STANDARDS ON REVIEW ENGAGEMENTS (NSREs)**

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**ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION**

**3000-3699 NEPAL STANDARDS ON ASSURANCE ENGAGEMENTS (NSAEs)**

**3000-3399 APPLICABLE TO ALL ASSURANCE ENGAGEMENTS**

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**3400-3699 SUBJECT SPECIFIC STANDARDS**

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**4000-4699 NEPAL STANDARDS ON RELATED SERVICES (NSRSs)**

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NSQC 1: NEPAL STANDARD ON QUALITY CONTROL
QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF FINANCIAL STATEMENTS, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

Nepal Standard on Quality Control (NSQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements” should be read in conjunction with NSA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Nepal Standards on Auditing.”

Objective

11. The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

(b) Reports issued by the firm or engagement partners are appropriate in the circumstances.

Elements of a System of Quality Control

16. The firm shall establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:

(a) Leadership responsibilities for quality within the firm.

(b) Relevant ethical requirements.

(c) Acceptance and continuance of client relationships and specific engagements.

(d) Human resources.

(e) Engagement performance.

(f) Monitoring.

Considerations specific to public sector audit organizations

A51. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.
NEPAL STANDARD ON AUDITING 200

OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH NEPAL STANDARDS ON AUDITING

(Effective for audits of financial statements for periods beginning on Shrawan 1, 2072 Voluntary Compliance and Mandatory Compliance from Shrawan 1, 2073)

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Overall Objectives of the Auditor

11. In conducting an audit of financial statements, the overall objectives of the auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the NSAs, in accordance with the auditor’s findings.

12. In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor’s report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the NSAs require that the auditor disclaim an opinion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation.

Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Misstatement – A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

(k) Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

(l) Professional skepticism – An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

(m) Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.
(n) **Risk of material misstatement** – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

(i) **Inherent risk** – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(ii) **Control risk** – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control.

**An Audit of Financial Statements**

*Scope of the Audit (Ref: Para. 3)*

A1. The auditor’s opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor’s opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some within the country, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the NSAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

*Preparation of the Financial Statements (Ref: Para. 4)*

A2. Law or regulation may establish the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting. However, the extent of these responsibilities, or the way in which they are described, may differ across within the country. Despite these differences, an audit in accordance with NSAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility:

(a) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;

(b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide the auditor with:

(i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and

Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Considerations Specific to Audits in the Public Sector

A11. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management’s responsibilities, on which an audit of the financial statements of a public sector entity is conducted may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation or other authority.

Form of the Auditor’s Opinion (Ref: Para. 8)

The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor’s opinion, however, will depend upon the applicable financial reporting framework and any applicable law or regulation. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the applicable financial reporting framework includes presentation.

The Code of Ethics For Professional Accountants are:

(a) Integrity;
(b) Objectivity;
(c) Professional competence and due care;
(d) Confidentiality; and
(e) Professional behavior.

Professional Skepticism (Ref: Para. 15)

A18. Professional skepticism includes being alert to, for example:

• Audit evidence that contradicts other audit evidence obtained.
• Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
• Conditions that may indicate possible fraud.
• Circumstances that suggest the need for audit procedures in addition to those required by the NSAs.

19. Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

• Overlooking unusual circumstances.
• Over generalizing when drawing conclusions from audit observations.
• Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

A20. Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

A21. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the NSAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

A22. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

Professional Judgment (Ref: Para. 16)

A23. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the NSAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk.
- The nature, timing and extent of audit procedures used to meet the requirements of the NSAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the NSAs and thereby, the overall objectives of the auditor.
- The evaluation of management’s judgments in applying the entity’s applicable financial reporting framework.

Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a
nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

**Sufficient Appropriate Audit Evidence and Audit Risk** (Ref: Para. 5 and 17)

*Sufficiency and Appropriateness of Audit Evidence*

A28. Audit evidence is necessary to support the auditor’s opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit17) or a firm’s quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity’s accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management’s assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management’s refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor’s work in forming the auditor’s opinion consists of obtaining and evaluating audit evidence.

A29. The *sufficiency and appropriateness of audit evidence* are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor’s assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A30. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A31. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion, is a matter of professional judgment. NSA 500 and other relevant NSAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor’s considerations in obtaining sufficient appropriate audit evidence.

**Audit Risk**

A32. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

A33. For purposes of the NSAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated.
Risks of Material Misstatement

A34. The risks of material misstatement may exist at two levels:

- The overall financial statement level; and
- The assertion level for classes of transactions, account balances, and disclosures.

A35. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

A37. The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the financial statements.

A38. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

A39. Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity’s objectives relevant to preparation of the entity’s financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The NSAs provide the conditions under which the auditor is required to, or may choose to,
test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.

A40. The NSAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement.” However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

Detection Risk

A42. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

A43. Detection risk relates to the nature, timing and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

• adequate planning;
• proper assignment of personnel to the engagement team;
• the application of professional skepticism; and
• supervision and review of the audit work performed, assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

Inherent Limitations of an Audit

A45. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.

The inherent limitations of an audit arise from:

• The nature of financial reporting;
• The nature of audit procedures; and
• The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.
The Nature of Audit Procedures

A47. There are practical and legal limitations on the auditor’s ability to obtain audit evidence. For example:

• There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

• Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

• An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

A49. Consequently, it is necessary for the auditor to:

• Plan the audit so that it will be performed in an effective manner;

• Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and

• Use testing and other means of examining populations for misstatements.

A50. In light of the approaches described in paragraph A49, the NSAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

• Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities; and

• Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population

Other Matters that Affect the Inherent Limitations of an Audit

A51. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor’s ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

 Fraud, particularly fraud involving senior management or collusion. See NSA 240 for further discussion.
• The existence and completeness of related party relationships and transactions. See NSA 55023 for further discussion.

• The occurrence of non-compliance with laws and regulations. See NSA 25024 for further discussion.

• Future events or conditions that may cause an entity to cease to continue as a going concern. See NSA 57025 for further discussion. Relevant NSAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A52. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with NSAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with NSAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with NSAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor’s report based on an evaluation of that evidence in light of the overall objectives of the auditor.

Conduct of an Audit in Accordance with NSAs

Nature of the NSAs (Ref: Para. 18)

A53. The NSAs, taken together, provide the standards for the auditor’s work in fulfilling the overall objectives of the auditor. The NSAs deal with the general responsibilities of the auditor, as well as the auditor’s further considerations relevant to the application of those responsibilities to specific topics.

A54. The scope, effective date and any specific limitation of the applicability of a specific NSA is made clear in the NSA. Unless otherwise stated in the NSA, the auditor is permitted to apply an NSA before the effective date specified therein.

A55. In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the NSAs. The NSAs do not override law or regulation that governs an audit of financial statements. In the event that such law or regulation differs from the NSAs, an audit conducted only in accordance with law or regulation will not automatically comply with NSAs.

A56. The auditor may also conduct the audit in accordance with both NSAs and auditing standards of a specific within the country. In such cases, in addition to complying with each of the NSAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that within the country. Considerations Specific to Audits in the Public Sector

A57. The NSAs are relevant to engagements in the public sector. The public sector auditor’s responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other
authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with the NSAs. These additional responsibilities are not dealt with in the NSAs. They may be dealt with in the pronouncements of the Auditor General or Auditing Standard Board, or in guidance developed by government audit agencies.

**Failure to Achieve an Objective (Ref: Para. 24)**

A75. Whether an objective has been achieved is a matter for the auditor’s professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the NSAs, and the auditor’s evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the NSAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an NSA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example, due to a limitation in the available audit evidence.

A76. Audit documentation that meets the requirements of NSA 230 and the specific documentation requirements of other relevant NSAs provides evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor’s evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.
Lesson 26
Audit plan and field audit

[Audit plan, pre-visit Survey, preparation, procedures on field audit]

PRE-VISIT PLANNING

1. Factual information concerning the importer

When an enterprise has been selected for an audit visit it is essential that all available internal information is gathered and read thoroughly by the Customs Auditor. Current information comes from reports on the importer’s imports and exports, reports on the importer’s payments of duties and taxes, and copies of the importer’s import declarations. All correspondence in the importer’s file should be read as well as any report of a previous audit visit.

The record of compliance of the enterprise in respect of the preparation of Customs import declarations and making payments of Customs duties, taxes and fees should be noted. As well the Customs Auditor should take into account the enterprise’s record of compliance for other taxes. The more information a Customs Auditor can gather before the audit visit the better prepared he will be.

2. Arranging the Audit Visit.

Unless it is felt unwise to warn the enterprise of the forthcoming visit, for example if fraud is suspected, it is preferable to make an appointment and ensure that the person in charge of the enterprise is available. The Customs Auditor must also ensure that all of the accounting records will be available during the audit visit. The Customs Auditor’s request for the records as prescribes PCA manual 2016.

3. Final Preparations.

In preparing to call on the importer, the Customs Auditor should be fully prepared for all contingencies. The Customs Auditor should take:

- credentials to prove he/she is an authorised Customs official and has been instructed to make the visit;
- a copy of relevant file information concerning the importer/transporter of goods;
- copies of applicable Customs Laws, Decrees and Orders; and
- any guidance notes and public notices to advise the importer

STAGE 2 – INITIAL INTERVIEW WITH THE IMPORTER

The procedure adopted on visits will vary according to various factors, including the size of the enterprise, the frequency of visits, the complication of the accounting system, the volume of records kept, and the revenue reputation of the registered enterprise. However there are certain basic procedures that should always be carried out and the order in which they are carried out is important.
**Initial Interview:** On commencing an audit visit the Customs Auditor should contact a person in authority (director, partner, manager, proprietor, etc. as appropriate). This first contact is of great importance as it establishes the seriousness of the matter, gives the Customs Auditor a status link with the top management, and provides a reliable source of information concerning the business. This person should be asked to confirm that the information concerning the business held in official records is still correct.

The Customs Auditor should ask if the enterprise has any problems concerning import or export processes. He should always help the importer with genuine problems. The entrepreneur should be asked to identify the person who has been given the responsibility for completion of import declarations, and whether authority for that has been given in writing.

It is not essential that the person first seen accompanies the Customs Auditor for the whole of the visit but the initial interview is important.

2.7 A suggested format of the initial interview, although not exhaustive, is set out below:

(i) About Enterprise:
   - who owns the enterprise;
   - are there any other premises;
   - what are the names/TINs of any associated enterprises;
   - how many employees;

(ii) About Activities:
   - what are the trading activities;
   - what type of goods/works/services does it provide;
   - what are the main purchases/expenses;
   - what are the main capital assets;
   - who are the main suppliers; and
   - are there any major customers and who are they?

(iii) About Accounts:
   - what sort of accounting records are maintained;
   - who prepares the accounting records;
   - who prepares/signs the import declarations;
   - who are the external audit/controllers;
   - how many bank accounts are kept;

**STAGE 3 – CUSTOMS AUDIT PROCEDURES**

Customs Post-Clearance Audit is not intended to be a full financial audit. It is not the place of the Customs Auditor to ensure that the enterprise has met the demands of International Accounting Standards. Audit is intended to ensure that the enterprise makes correct declarations to Customs and pays the correct amount of duty and taxes on imported goods. It is not possible to check all of the records of an enterprise for accuracy as is sometimes done in a financial audit. Selective checks need to be made to the extent necessary to ensure that the figures on the Customs declarations are based on the records of the enterprise.
It is easy for audit visits to become pointless checking exercises. Nevertheless there is a need to carry out some basic checks although these should, initially, be on a selective basis.

It is not always necessary in the conduct of an audit to attempt to make a full check of every entry in the import and export declarations of an enterprise. The auditor should begin by making percentage checks of any type of entry. If these are correct no further checking of these types of entry will normally be necessary. However, if the selective checking reveals significant numbers of errors the checking must be extended.

It is necessary to find out if the errors cause any loss of duty or taxes. If the duty or tax loss can be isolated and calculated precisely or if it extends over a longer period a special assessment will need to be made. At the stage in the audit visit when the Customs Auditor has completed the basic checks he should consider the value of extending his audit to more in-depth checks, further credibility checks and into carrying out one or more special selective enquiries.

If the importer furnishes inadequate books and records, the Customs Auditor will also need to extend his audit to in-depth checks, further credibility checks and more selective enquiries. Inadequate books and records are indicative of transactions and other matters being suppressed and he will need to keep this in mind as he extends his audit. A record of the basic checks carried out and the results should be made in the visit report of the Customs Auditor.

**Subsidiary Records.**

As subsidiary records are the working documents of the enterprise, they should all support each other, and the information that they contain should have a direct relevance to the outputs of the enterprise. During audit visits Customs Auditors should take the opportunity to examine the available subsidiary records and make an attempt to test whether the information that they contain seems to confirm what is held in the other records, and in particular the financial records. Whenever an inconsistency is found in the subsidiary records the matter should be fully investigated in a discrete manner.

It is not possible to give precise directions on how Customs Auditors should proceed in the examination of subsidiary records. These records will vary from one importer to another and it will be for the Customs Auditor to decide the manner in which they should be checked to best advantage. Experience will be the best tutor. Nevertheless the examination of the subsidiary records is closely related to credibility.

**Determination of Customs Value**

The Customs Law and Regulations, determination of the Customs value of imported goods is based upon the price paid or payable. The importer shall submit the purchase contract or commercial invoice documenting the sale of the goods to the importer to identify the price paid or payable for the goods.

The first objective of a post-clearance audit of the Customs value presented on an import declaration is to confirm if the price paid or payable shown on the purchase contract or commercial invoice attached to the import declaration can be corroborated (conformed) by the financial records and subsidiary records of the importer. This corroboration can be made in one or more of the following ways:
- Comparison of the invoice value to the importer’s payment or expense records – do the records reflect a payment to the vendor in the amount shown on the invoice?
- Comparison of the invoice value to the bank transaction records for the importer’s bank account – do the records reflect a credit to the vendor in the amount shown on the invoice?
- Comparison of the invoice value to relevant entries in the importer’s accounting records for the cost of goods sold or the cost of goods manufactured.
- Comparison of the invoice value to relevant entries in the importer’s profit tax declarations with respect to the cost of goods sold or the cost of goods manufactured.

The second objective of a post-clearance audit of the Customs value of imported goods is to determine

- if the importer has made any royalty payments that should be incorporated into the Customs value, or
- if the importer has provided any input materials or other support to the exporter in the production of the imported goods, the value of which has not been reflected in the commercial invoice for the imported goods.

This determination is made through an examination of the financial records of the importer for payments (either to the exporter or to others) for royalty rights or for input materials, engineering costs, etc. that might pertain to the imported goods.

**Preparation of a Risk Assessment Sheet**

In a number of countries with well-developed customs systems, the Customs Auditor who reviews the importer’s customs value declaration prepares a risk assessment sheet. The mentioned areas are the areas where incorrect information could be declared which would result in revenue losses. Applying this assessment method, the officer, based on the information that he has on a number of factors that relate to the process of importation (importer, exporting country, specific feature of the product, etc.), shall identify the risks of incorrect or incomplete declaration. Based on the risk factors identified by the Customs Authority, those importations that have higher risk indicators will require further examination.
<table>
<thead>
<tr>
<th>Risk areas</th>
<th>Risk assessment</th>
<th>Source: Morley, 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Undervaluation (reliable invoice)</td>
<td></td>
<td></td>
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<tr>
<td>2 Situations without sales</td>
<td></td>
<td></td>
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<tr>
<td>3 Further sale</td>
<td></td>
<td></td>
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<tr>
<td>4 Packaging transactions/split deliveries</td>
<td></td>
<td></td>
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<tr>
<td>5 Discounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Financial agreement (indirect payment)</td>
<td></td>
<td></td>
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<tr>
<td>7 Averaging</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Deposits- partial payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Loans- previous transactions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Exchange rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Use of the local currency in the declaration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Purchase/sale brokerage fees</td>
<td></td>
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<tr>
<td>13 Brokerage fees</td>
<td></td>
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<tr>
<td>14 Services- advertisement, guarantee payment</td>
<td></td>
<td></td>
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<tr>
<td>15 Supplementary goods and services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Testing and examination fees</td>
<td></td>
<td></td>
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<tr>
<td>17 Packaging fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 Equipment expenses, etc</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19 Trademark fees, etc.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 Transportation and insurance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

LOADING

TOTAL
How to use the Risk Assessment Sheet

Where no risks are identified, the sheet is not filled in. Where the level of the risk is low, “1” shall be completed. In case of medium risk level, “2” is completed. Where the risk level is high, “3” is completed. A very high level of risk shall be divided into 2 levels: serious and very serious. If “4” is completed for 2 and more areas, that means that the importation shall be subject to further close examination. Total amount shows the priorities of the review of the importation and the requirement for a close examination.

Verification of Declarations Assessed under Method 1:

Examine the customs value details declaration. Confirm that the person who signed the declaration has the appropriate authorities. If no, then a new customs value details declaration shall be obtained from the legitimate importer. Check if all columns in the customs value details declaration are appropriately completed. Check the accuracy of the value shown in the customs value details declarations and other relevant documents and how accurately it is reflected in the SAD. Verify the fact of the sale of goods in the country of export. The fact of the sale of the imported goods may be verified through the relevant contracts, commercial invoices, purchase invoices, etc. Where there was no sale, the determination of customs value of the goods by method 1 is impossible. Identify that the importation of the assessed goods is based on the following conditions. If yes, then no sale transaction took place:

- The buyer and the seller are the same legal entity,
- Goods are imported by brokers on behalf of the supplier, no facts of sale are indicated,
- Goods are imported on conditions other than their sale,
- Goods are sold under a lease or a rent contract,
- The sale transaction includes a compensation, a trade-in or a mutual trade arrangement,
- Other conditions, when goods remain under the supplier’s ownership.

Identify if some goods were sold in transit, before they were imported. Indicate the parties of the transaction: the buyer and the seller: Was any third party involved in the transaction – a purchase or a sales broker? The third party may be the main party of the transaction. Instead of establishing legal relations between the buying and the selling parties, the broker can buy the goods from the seller and resale them to the buyer. In such circumstances the broker shall be deemed as the seller.

The importer may be the owner of the assessed goods. If a person other than the buyer makes importation, then it is possible that the sale agreement is not taken as a relevant sale transaction used for customs valuation purposes.

Identify if a sale for export to Nepal has really taken place. Identify if there are other official or non-official agreements or other arrangements besides the primary sale agreement. Other arrangements may appear as a result of services provided in relation with goods and their value may be included in the customs value.
There may be the following examples of the buyer’s payments and/or undertakings under the mentioned supplementary agreements, contracts and arrangements:

- Supply of articles, components, parts and materials registered with the imported goods,
- Stamping, sealing and checking
- Design, decoration, plans,
- Transfers between the companies against management, advertisement, research and development assessment costs,
- Concluding activities and processing,
- Trademark use and license fees,
- Sale brokerage fees, brokerage fees.

**Verification of the declared customs value:**

- Review the importer’s records for all the details of the sale transaction: from ordering to making the final payments.
- Check payment details, the amount paid, the date and the form of payment, to whom the payment was made.
- Make sure that all the invoices for the concerned goods were included in the customs value.
- Examine all the records related to the goods concerned, check if there are still amounts to be paid to the supplier.
- Check if terms of supply declared at the moment of importation comply with the terms mentioned in the invoice.
- Make sure that transportation and insurance costs are included in the customs value, where they are not indicated in the accompanying invoices.
- Verify the accuracy of conversion of the amount shown in foreign currency into the currency of the importing country.
- Make sure that the deductions are acceptable and accurately calculated.
- Review all the correspondence related to the given transaction.
- Identify any amounts that shall be paid to a third party. Obtain the details on the amounts paid and the reasons of payment. Obtain the copies of those documents that present the details of the reasons of payment.

**Verification of Declarations Assessed under Methods 2 or 3**

Make sure that valuation under Method 1 was impossible. Where a customs value details declaration has been submitted with the import declaration, verify if the importer had all the appropriate information to fill in. Where methods 2 or 3 are approved, the following steps shall be taken.

Make sure, by the comparison of features and/or physical examination, that assessed goods are similar or identical to the goods assessed under Method 1. Indicate any differences.
Confirm that the declared customs values are based on the customs values of similar or identical goods exported within the timeframes established in the relevant Articles of the Executive Regulations of the Customs Law.

Confirm the need for any adjustments, taking into account differences in quantities or trade levels, and obtain detailed information on the principles on which the calculation is based. If possible, similar or identical goods shall be sold taking into account the quantitative and trade level similarity of the goods to the assessed goods. In the absence of these conditions the sale of similar or identical goods may be taken as a basis if:

- trade level is the same, but quantity is different,
- trade level is different, but quantity is the same,
- trade level and quantity are different,

Verify the accuracy of costs declared as international transportation and insurance costs and the accuracy of differences in these costs.

Identify the need for other verifications, taking into account the differences in transportation and other associated costs between the imported goods and goods similar or identical to them in the country of export, and obtain detailed information on the purposes of these costs and the method of their calculation.

**Verification of Declarations Assessed under Method 4**

Make sure that the valuation under Methods 1, 2 and 3 was impossible. Where method 4 is acceptable, the following steps shall be taken.

Make sure whether the person who signed the customs value declaration has the appropriate authority. Confirm the compliance of information presented in the customs value declaration with information presented in subsidiary records.

Confirm the sale actually has taken place: check the invoice, sale contract and other payment documents.

Check if the imported goods were sold to the persons who:

- are not related to the sellers,
- didn’t supply, directly or indirectly, free or at a smaller price the goods and services which will be used for production and sale for export of goods subject to importation under Paragraph 1b of Article 8 of the WTO Customs Valuation Agreement.

**Unit price**

Verify the price paid by the in-country buyer by checking the importer’s correspondence, sale and payment documents, copies of sales register, sale invoices and profit certificates presented to tax authorities.

Make sure that the unit price was calculated correctly:

If there is one fact of sale of imported goods or goods similar or identical to them, for which customs value will be determined, its price per unit shall be calculated based on that one sale.
If there are more facts of sale, then the price per unit will be calculated based on the sale of the imported goods or goods similar or identical to them on the first commercial level, which includes the biggest quantity of units sold for a common price.

Trade level is not taken into account while determining the price per unit, which means that goods may be sold to a wholesale trader, distributor or a retailer. Confirm that imported goods or goods similar or identical to them were sold within the same or almost the same period of time or within 90 days before the importation of the assessed goods.

Confirm that a sufficient number of units were sold. Sufficient number shall be determined based on a specific case, subject to the conditions of importation and market processes, as well as the marketing situation in the country of import. E.g., the price per unit for which the biggest quantity of goods is sold, can be deemed acceptable if the number of goods sold within the same or almost the same period of time constitutes only a small part of general sales of this product. Therefore, these sales can be used to determine the price per unit if the price for which they are sold is compatible with the usual selling price of the goods.

Confirm that basing on the sale transaction of processed goods after the importation is justified if:

- after processing the imported goods change their identity, and Method 4 is usually not applied,
- value added after processing can be easily determined, although the identity of the imported goods is different, and the application of Method 4 for can be grounded,
- Further sale of the processed goods shall take place within a specific period of time after the moment of importation of the assessed goods (e.g., within 180 days). The importer shall indicate in writing the application of this method.

Deductions

Confirm that information on the amount of the brokerage fee, profit or overall costs are normally obtained in the country of import based on the sale of goods belonging to the same group or category. This amount can be presented as a range of amounts, which is considered to be an “ordinary” amount, as it is obviously perceived. The ordinary amount can be calculated, e.g. by simple averaging or by a dominantly repeated amount.

Find if the assessed goods were sold with a brokerage fee in the importing country. The application of the deduction made for the profit or overall costs is generally optional for those transactions that do not include brokerage fees.

Confirm that other deductions, e.g. transportation costs in the importing country, customs duties and taxes and transportation fees paid abroad, are calculated correctly.

Make sure that costs of further processing are calculated correctly.

Verification of Declarations Assessed under Method 5

Make sure that the valuation under Methods 1, 2, 3 or 4 was impossible (if the importer suggests changing the order of application of methods 4 and 5, then method 5 should precede method 4). Where the application of method 5 is appropriate, the following steps shall be taken.

Confirm that the importer is ready to provide Customs with documents necessary for further checks with respect to his expenses. If Customs considers the provided information
insufficient, then method 5 cannot be applied. Confirm that the value or the price declared under this method is based on the commercial calculations of the producer and that these calculations are compatible with general accounting principles of the given country. Check if the value of materials used for the production of the imported goods was determined correctly.

Materials used and costs include:

- Raw materials, e.g. wood, steel, clay, textiles, etc.
- Costs of transportation of the raw materials to the production site.
- Partially assembled or half-finished products, e.g. integrated circuits. Components that will be used in the production of the final product.

Make sure that production and other processing costs on the imported goods are indicated correctly.

Production costs include:

- Costs of direct and indirect work.
- Costs of assembling, when assembly takes place and not production.
- Indirect costs, e.g. production management, storage, overtime payment costs, etc.

The amount of the internal tax collected in the exporting country, which is directly applied to the materials or their use. If there is a tax exemption or a refund in case of export, it shall not be included in the customs value.

Check if costs for containers, which for customs purposes are considered to be parts of the imported goods, are determined correctly. Check if packaging costs, incl. labor and materials used, are determined correctly. Check if the value of supplementary materials and services is calculated correctly and that the seller didn’t include it in the selling price. You should know that the value of supplementary materials and services should not be calculated twice. Costs mentioned in Article 14 of the Executive Regulations of the Customs Law shall be included in the customs value if they were not included in the purchase price and were originated by the buyer.

The value of specialized projects, designs, design work, plans and sketches made in the importing country shall be included in the customs value if costs of supplementary materials and services used is covered by the producer.

Check that transportation, insurance and other related costs are calculated correctly.

Check that the amount of the profits and total costs presented is correct.

The amount of the profit and total costs shall be determined based on the producer’s brand name or the information he provides, except for cases when the figures he presents are not compatible with the figures reflected in the sale of goods of the same category or group.

The amount of the profit and total costs should be taken as a whole. Therefore, if the figure representing the producer’s profit is low and total costs are high, then his profit and total costs in total may be incompatible with the figures reflected in the sale of goods of the same category or group.

If the producer states that his profit from the sale of the imported goods is low for some trade-related reasons, then the figures representing his actual profit shall be taken into account, if there are justified reasons for that (e.g. an unexpected decrease of demand)
and his price policy complies with the general price policy applied in that particular branch of industry.

If, apart from the records presented by the producer or on his behalf, other information is used for the determination of calculated value, then Customs shall, upon the producer’s request, inform the latter on the source of that information, information used and the calculations made based on that information, pursuant to the provisions of Article 10 of the WTO Customs Valuation Agreement.

**Verification of Declarations Assessed under Method 6**

Confirm that the valuation under Methods 1 - 5 was impossible. Find out how the declared value was calculated. *The following examples show how Method 6 can be applied:*

*Where there is no sale of similar goods produced in the country of production of the assessed goods, but instead there is a sale of similar goods produced in some other country, the latter may be used as a ground for customs valuation under method 6, if all other conditions required for method 3 were met.*

*Where there is no sale the circumstances of which comply with the requirements of method 4 (90 day’s period), but there are sale transactions that, for example, took place 100 days before the importation of the assessed goods, the latter may be used as a ground for customs valuation under method 6, if all other conditions required for method 4 were met.*

If previously mentioned methods are applied flexibly, due regard should be given to the principles of valuation, trying to avoid distortions of customs value determined under the selected method.

Confirm that the declared value is not based on any of the prohibited methods specified in the WTO Customs Valuation Agreement.

Confirm that all transportation, insurance and other costs alike related to the imported goods were taken due account of.

Confirm that all additions (e.g. transaction related expenses, supplied materials) are declared.
Lesson 27

Report writing
[report preparation, approval and implementation]

Preparation for reporting
As mentioned on section 10 of valuation manual following procedures should be made:

- preparation of notes of audit when field/ desk audit
- preparing memos note if formal interview is taken
- collecting documents proof
- conforming duty assessment amount if any
- discussion with audit team and supervisor
- report preparation as prescribed format, writing report as prescribed annex 1 of PCA manual
- Approval from Chief Audit administrator/ chief customs officer
- implementation of decision

Section 12 implementation of audit report and follow up

- further clarifications letter send to importer within three days of decision date in case of additional duty assessment
- Preparation of decision memo "Parcha" considering importers further clarifications and documents if any
- Issue final duty assessment order as prescribe annexes
- Follow-up for duty collection
Lesson 28

Issues and ways forward

[Issues and way forward on existing PCA practice and procedure in Nepal (i.e. training in risk management/risk analysis techniques and other PCA matter, proper connectivity system with other stakeholders such as banks and airlines, training and exposure to field audits, expanding the scope of PCA activities, creating understanding on the part of stakeholders etc)]

1. Existing PCA practice
   a. legal based- Customs act, rules, PCA procedure
   b. intuitional set-up
      i. separate PCA office Kathmandu
      ii. PCA units in major customs offices
      iii. policy support through, Ministry, Department of customs, selection committee
      iv. around 40 staffs in PCA Office and 20 staffs working on PCA units
   c. Scope of PCA (Importer, Customs Agent, warehouse agent, transporter, wholesaler, retailer, intermediaries, bank and financial institution, other prescribed related person and entity/importer.
   d. difficult to get Importers supports in PCA process

2. Lacks on existing practice
   a. Importers profiling and trade segmentation
   b. limited audit- consignment based audit
   c. Practice on desk audit
   d. Manual updating risk indicators and selection practice
   e. Conducting specific training and implementation of retention of trained/experienced human resource
   f. ASYCUDA software do not cover other stakeholders'
   g. Stakeholders orientation (understanding among stakeholders PCA as one of the main Customs procedure-audit based customs control tool)
   h. Data sharing between concerned entities due to lack of automated/webbased system.
   i. Provision of non-banking import transaction
   j. Proper and systematic coordination/cooperation between concerned government and private sector organization.

3. way forward
   a. develop and implement automatic updating risk indicators
   b. expansion of scope of PCA - firm audit, product audit
   c. shifting desk audit to field audit
   d. system based selection- through ASYCUDA world
   e. Preparation of well trained and motivated manpower and implement retention of trained staffs.
   f. proper connectivity system with other stakeholders such as banks and airlines
   g. Implement all import through banking channel
h. creating enabling environment among various stake holders

[Part VI]
Practical Case Studies PCA
Case Studies and exercise on PCA

Case Studies on PCA Nepalese prospective

Problem 1

Importer A declared his consignment at Birjunj customs Offices on 2015 Aug 15 as follows:

- Invoice of Bringham India Ltd shows 10 Mt energy drink per lt. price IRS 100 total price paid IRS 10,00,000.00
- Draft TT of Nepal Bank shows the payment amount IRS 10,00,000.00
- Declaration includes Everest Insurance bill of NRS 5000.00 and Balajee transport bill of IRS 10,000.00
- Birjunj Customs clearance the goods as per transaction value method including freight and insurance amount.

The consignment is selected for PCA.

When field visit for PCA following information is seen:

The declared freight amount was only one truck, however the other truck freight amount (which is related to the same consignments) IRS 10,000.00 also booked in importer's P/L Account and customs clearance in Raxual is charged IRS 5000 by Indian customs Agents also missing in the declaration time.

Answer: Customs auditor/officer should incorporate the following fact in audit report and take necessary action to recover the missing duty.

Customs act 2064 section 13(4) clearly mentioned that if the transaction value declared by the importer does not appear to include freight, insurance and other related expenses, the Customs Officer shall determine the transaction value by adding an estimated amount likely to be incurred for the same. In given case, importer's P/L Account showed that freight amount IRS 10,000 and customs clearance (in Raxual) charged IRS 5000 by Indian customs Agents missing in the declaration time.
Section 2(b) defined "transaction value" means the total amount to be set by adding freight, insurance and other related costs incurred or incurable in the transportation of goods imported by an importer up to the border of Nepal to the price actually paid or payable, directly or indirectly, by the importer to the seller of such imported goods.

And section 34 (2) has clearly given the power to the customs auditor/customs officer to make post clearance audit. And, if it is found that the goods imported by the importer are different than those declared by the importer or are inconsistent with the declaration made by the importer or the transaction value or the quantity of the goods has been declared less and by virtue thereof lesser duty has been recovered, the Customs Officer shall immediately recover from the importer the duty chargeable on such less value or quantity at the time of import and take action against such importer for the declaration of less transaction value or quantity, pursuant to this Act. So, freight amount IRS 10,000 and customs clearance (in Raxual) charged IRS 5000 by Indian customs Agents which were missing in the declaration time should be included in transaction value.

**Problem 2:**

Importer B imported Sugar from Bangladesh and declared at Mechi Customs on 2015 Sep 1 as follows:

Sugar 15 MT @ US$ 300 total price US$ 4500.00

Freight charge Bangladesh Taka (1 Taka =NRS 1) 60,000.00

Insurance charge NRS 20,000.00

The consignment is cleared same day on transaction value.

**Selected for PCA and following records found during the audit.**

Selling price of sugar per kg NRS 50.0 per kg, GP ratio in P/L account is seen 12 percent.

Freight charge 60,000 taka was only for Dhaka- Phulbari, however, IRS 20,000.00 freight for Phulbari- kakarvitta was missing for declaration.

PCA office has already found the database in ASYCUDA Sugar (similar to the consignment within one month period) imported from Bangladesh was per MT US$ 370.

**Answer:**

Customs Auditor/officer should clearly mentioned (above mentioned answer of problem 1) customs act provision of section 2(b), and 34(2). Besides; here information of similar goods, GP ratio and selling price also given. Customs Rules 2064 rule 27 mentioned as some other provisions for post clearance audit:
"(1) For the purpose of sub section (2) of section 34 of the Act, in order to determine whether the transaction value of the goods as declared by the importer is realistic or not, the value may be determined through the application of the all or any methods as stipulated in section 13 of the Act.

(2) For the purpose of sub section (2) of section 34 of the Act, in order to determine whether the quantity of the goods as declared by the importer is correct or not, the quantity may be determined by physical verification of the stock.

(3) In order to determine the reality of the value as declared in the customs office at the time of import, the ledger of transaction may be checked from the sales of the product up to the retail level."

Hence, missing freight amount taka 20,000 should be included in transaction value. Furthermore, audit team should try to verify the declared transaction value; whether it is actually paid or payable by verifying available documents and transaction records of the importer. After verification of the transaction records, documents and clarification by exporter, if audit team has reached the conclusion for reasonable doubt on declared value and rejecting transaction value then, alternative method of transaction value of similar goods or other alternative methods could be applied. However, it should be clearly mentioned on audit report and should be completed the section 34(3c) process.

**Problem 3:**

A tea producer imports a tea processing machinery from China and declared at TIA customs on 15 March 2015, as follows.

<table>
<thead>
<tr>
<th>Machine price US$</th>
<th>50,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurances INR</td>
<td>20,000.00</td>
</tr>
<tr>
<td>Air fright US$</td>
<td>5000.00</td>
</tr>
</tbody>
</table>

Customs cleared the consignment as per transaction value declared at customs point.

**The consignment is selected for PAC and found following information** during PAC: Importer has already done agreement with Chinese supplier and extra payment of US$ 2000.00 has also sent for machine installation and trial run.

China customs clearance cost Chinese Y 5000.00 (1Y =Rs 10) is booked on the importer PL Account.

**Answer:**

Writing audit report, please refer relevant legal sections and rules as necessary for this problem also.

China customs clearance cost Chinese Y 5000.00 (1Y =Rs 10) has to be included on the transaction value of the consignment. Machine installation and trail run will be done after
importation of the machine in Nepal. As per GATT agreement and customs act 2064 cost after importation shall not be included on transaction value.

Problem 4:
A importer imports 1000 pcs dell laptop from Japan on 10 sep 2015 and declared in TIA customs as follows:

Laptop Dell 1 GH processor 1000 pcs @Us$ 500.00 total price Us$ 5,00,000.00
Air freight US$ 500.00
Insurance Nrs 5000.00

Customs cleared as transaction value method.

Selected for PCA and following information is seen during the PCA.
Same product (identical goods) was imported by another importer (1100 pcs) on 12 Aug 2015 Per Piece US$ 600.00 from same company of Japan. Further, importer paid Japanese yen (10Y =1Nrs) 10,000 paid to Japanese customs agent for clearing same consignment.

Answer:
In the audit report, please refer relevant legal sections and rules as necessary for this problem also.
Missing amount ( declaration in customs) Japanese yen (10Y =1Nrs) 10,000 paid to Japanese customs agent for clearing the consignment should be added transaction value as per section 2(b) and section 34(2). And given information of identical goods is sufficient for reasonable doubt for audit team and need to further investigation. After verifying available documents transaction records and importer clarifications; if audit team found sufficient ground for rejecting the transaction value and applying transaction value of identical goods; then has to complete the section 34 (3c) provisions before final decision.
Case 1 Firm Audit

ABC and company, a sole importer of TOSIBA juice from Japan. Selected for PCA for the period 2014 Aug-2015 July, during the period, following information is found:

- Importer imports 50 consignments, per consignment 50 MT goods,
- price of goods is seen as decreasing trends. First 4 consignment per MT price paid US$ 1000.00, next 20 consignment per MT price US$ 800.00, remaining 26 consignment imported period (2015, June 10-Aug 7) per MT price declared as Per MT Us$ 550.00
- Freight charge declare in customs point is seems decreasing trends. First 20 consignments shows per consignment( same quantity import all consignments) US$ 1200.00, in next 20 consignments per consignment US$ 800.00 and remaining 10 consignment per consignment Us$ 500.00
- During the audit, importers bank account showed that last 10 consignments’ freight charge payment is seen as US$ 800.00 per consignment basis.

Answer:

While preparing firm audit report, please mentioned the relevant legal provision. In addition, due care should given for appropriate sample selection method, i.e. if there are 50 consignments, whether audit team verified all consignments or taken some of the samples. If team choose some of the sample, then clearly mentioned the sample selection method and bases of sample selection. In case of firm audit more documents like P/L accounts, B/S and other relevant documents should be verified properly as per necessary.

In the given situation, no doubt, the undeclared freight charge (declare only $500 in place of $800) should be added in transaction value of relevant consignments. This wrong declaration could be one of the reasonable doubts for audit team for further suspect on decreasing trends on declare price and further investigate the consignments. After rigorous investigation and document and records verifications, clarification from importer also incorporated on the audit report. If any reasonable ground is seen and audit team came to the conclusion for amendment on declared transaction value of goods on relevant consignments, then after completing the legal process of customs act section 34(2) and 34(3c), audit team could apply the necessary alternative customs valuation methods of section 13 of Customs act 2064.
Case 2 price subsidy

Importer B import instant coffee from Nesley India ltd. Declared at Birjung customs on 2015 June 23.

- Invoice shows 100 MT Instant coffee classic (packed per 200 gram) per mt price IRS 1000.00, Insurance receipt of NRs 10000.00, Balaji transport bill IRS 1,50,000.00

- Customs cleared same day transaction value method 1.

- Selected for PCA

Following information seen during audit:

A MOU shows: Company B and Nesley India ltd has agreed as following price strategies:

- Company B has to worked as sole importers of the product in Nepal and price will be fixed from Delhi India by Nesley India Ltd. And consumer price will be same as Indian Market.

- Operating cost, transportation cost and marketing cost will be borne by Nesley India Ltd. in case of normal profit margin 10 percent not covered selling price.

- Regarding this consignment, PL account shows that administration cost IRS 1,00,000.00, and price subsidy of IRS 2,00,000.00 is reimbursed by the Nesley India ltd.

Answer:

Same ways, please mentioned the relevant provisions of customs act as above mentioned examples (cases).

In this consignment, exporter reimbursed the administration cost of IRS 100000.00 and price subsidy of IRS 2,00,000.00 which is sufficient ground to suspect the transaction value. What would happen if there was not subsidy system? Whether the exporter or importer are related as mentioned customs act 2064 section 13(1), Valuation procedure 2068 section 8(8) and GATT valuation system article 15(4). If audit team found justifiable reasons for rejecting declare transaction value, further process of section 34 (3c) should to completed and alternative methods of customs valuation could apply.
**Case 3 wrong HS classification**

A Importer import Frozen Basa Fish Fillet import from India and declared at Birjunj Customs Office on 20144-06-06 as follows:

Goods description: Other fish fresh or chilled , frozen (fish)  
HS code: 3025900  
Duty Paid  
- Customs duty @ 10%  
- Value added Tax exempt  
Cleared as transaction value method.

Selected for PCA and following facts found during the PCA:

Importer declared freight insurance and other cost relating to the consignment was Nrs 2,78,204.00, however records showed that such cost was Nrs.3,24,908.00.

The declared goods was wrongly classified in HS 3025900, the actual classification should be 3044900 and the importer shouldn't get VAT exempt facility.

PCA report approved and assessment of extra duty and VAT(including penalty) of NRS. 29,47,807.00 was assessed by Customs Auditor.

Importer appeal at revenue tribunal, case not yet decide.

**Answer:**

Answer already mentioned in the question part. As customs act 2064 section 34(3) clearly mentioned that "if, ... it appears that less duty has been recovered by the reason of difference in sub-heading of commodity classification, the concerned Customs Office shall recover such shortfall amount of duty and fine equivalent to that of shortfall amount from the importer"
Case 4 wrong Hs classification

A Tobacco Industry import dust tobacco import from India and declared at Mechi Customs from five consignments as follows:

Goods description: Tobacco partially or wholly stemmed (Dust tobacco)
HS code: 2401200
Duty Paid
  Customs duty @ 15%
  Value added Tax 13%
  Excise duty per kg 60.00
Cleared as transaction value method.

Selected for PCA and following facts found during the PCA:

The declared goods was wrongly classified in HS 2401200, the actual classification should be 24039900.
Implication:
Customs duty should be paid @30% instead of 15%
And excise amount and VAT implication on it.

PCA report approved and assessment of extra duty and VAT(including penalty) of NRS. 2,17,20,231.00 was assessed by Customs Auditor.

Answer:
Answer already mentioned in the question part. As customs act 2064 section 34(3) clearly mentioned that "if, ... it appears that less duty has been recovered by the reason of difference in sub-heading of commodity classification, the concerned Customs Office shall recover such shortfall amount of duty and fine equivalent to that of shortfall amount from the importer "

322
PCA cases from International Standards

Case 1

[Case Study 13.1 on "Application Decision 6.1 of the Committee on Customs Valuation ]

The following WCO Case Study on the application of Decision 6.1 will give an illustrative example as to the circumstances under which Decision 6.1 can be applied for rejection of transaction value

"Facts of transaction:

1. Company ICO, in country I, imported 2,000 (two thousand) units of consumer goods from exporting country X. ICO presented the following information in the import declaration:

   (i) the seller of the merchandise is company XCO, domiciled in country of exportation X,
   (ii) the manufacturer of the imported goods is company MCO, domiciled in country M;
   (iii) the declared value was calculated using the transaction value specified in Article 1 of the Agreement;
   (iv) no adjustments were made to the price under Article 8.1 of the Agreement;
   (v) in accordance with the provisions of Article 15.4, there is no relationship between ICO, XCO or MCO;
   (vi) according to the commercial invoice, the unit price of the imported goods was .9.30 c.u. (FOB value);
   (vii) payment was made in cash.

2. After release of the goods, the Customs risk analysis system selected ICO for an import audit.

3. Prior to the audit and as part of the process of constructing a profile of the importer, the Customs administration analyzed all imports of identical goods and obtained the following information:

   (i) nine other buyers imported identical goods at or about the same time as the goods being valued;
   (ii) the Customs values of the identical goods were determined under the transaction value method;
   (iii) the unit prices of the identical goods varied from 69.09 c.u. to 85.00 c.u. (FOB);
(iv) the quantity of goods imported in each transaction was almost the same (between 1,800 and 2,300 units) as in the transaction between ICO and XCO (2,000 units);
(v) the payments for the imports of identical goods were also made in cash, except in the case where the goods cost 85.00 c.u. (FOB).

4. The Customs administration conducted enquiries of the other importers and obtained the price lists of several suppliers in country of exportation X. The unit prices of the identical goods in these lists varied from 80.00 c.u. to 140.00 c.u. (FOB), according to the quantity sold. The origin of all imported goods was country M, although the main suppliers of these goods to import country I were domiciled in country of exportation X.

5. The Customs administration of country I had not signed a mutual assistance agreement with the Customs administrations of countries X or M. The Customs administration wrote to supplier XCO and manufacturer MCO asking for information on the price of the goods. No answer was received.

6. The Customs administration searched for suppliers on the Internet and found many offers for the sale of identical goods, whose retail sale prices for export were between 123.99 c.u. and 148.00 c.u.

7. The Customs administration notified ICO, in writing, that it had reasons to doubt the truth of the declared transaction value based on the facts set out above, but primarily based on the low value. The administration asked the importer to present any further evidence, i.e., commercial correspondence and/or any other document confirming that the invoice price was the total price actually paid or payable for the imported goods.

8. ICO replied that:

(i) all the particulars of the transaction had been detailed in the commercial invoice supplied;
(ii) there was no special trade condition such as those referred to in Article 1 of the Agreement applying to the transaction;
(iii) the transaction was based upon an ordinary offer by XCO;
(iv) there was no written contract of sale and no correspondence;
(v) the sale was settled by telephone.

1. The Customs administration decided to carry out an audit on the premises of Company ICO. At its first visit, the Customs administration obtained the following information:

(i) there was no commercial correspondence with XCO;
(ii) ICO had sold all the goods to company BCO in country I at a unit price of 281.00 c.u.;
(iii) the accounting records were neither in order nor up to date and could not substantiate the amount paid for the imported merchandise at issue.
10. The Customs administration granted a reasonable period to enable Company ICO to update its accounting records and put them in order. When the records were provided, the audit did not find any further evidence concerning the price actually paid or payable for the goods, adjusted in accordance with the provisions of Article 8. The only information presented was that which had previously been provided to Customs.

11. The audit revealed that a credit card payment had been made by one of the employees of Company ICO to a third person, during business travel to country X, which was registered in the accounting records as an administrative cost. The importer had provided no acceptable explanation as to the nature of this payment. Therefore, doubts were raised as to the low profit earned, considering that the resale price of the goods was much higher than the price declared at importation, and as to the amount of the administrative costs registered.

12. The audit report concluded that:

(i) the importer did not provide any further evidence that would demonstrate that the declared value represented the total price actually paid or payable for the imported goods, adjusted as necessary in accordance with Article 8;
(ii) the audit did not disclose any new information and did not dispel Customs’ doubts as to the truth or accuracy of the transaction value declared;

_Determination of Customs value:_

13. The primary basis for Customs value is the transaction value, that is, 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.

14. The price actually paid or payable should not be subject to any condition or consideration that could prevent the value from being determined on the basis of the provisions of Article 1.

15. This price may be represented by the invoice price, adjusted in accordance, with the provisions of the Valuation Agreement and, in this respect, the commercial invoice could constitute sufficient proof of the truth or accuracy of the declared value subject, of course, to Article 17 of the Agreement.

16. In accordance with Decision 6.1 of the Committee on Customs Valuation, where the Customs administration has reason to doubt the truth or accuracy of a declared value, it may ask the importer to provide further explanation, including documents or other evidence, that the declared value represents the total amount actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8.

17. In this case, due to the fact that the declared value was substantially lower than the declared values of identical goods imported by nine other buyers at or about the same
time, the Customs administration had reason to doubt the truth or accuracy of the declared value as reflected in the commercial invoice. Therefore, in accordance with Decision 6.1, the Customs administration properly asked the importer to provide further evidence to confirm that the declared value was the total price actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8.

18. In such cases, both parties should seek to strengthen the spirit of co-operation and dialogue encouraged by the Agreement with a view to finding solutions which harm neither the legitimate interests of the importer nor those of the Customs administration.

19. In determining Customs value under the Agreement, Customs administrations should not be required to rely on documents which are incomplete in respect of relevant information, particularly if there are doubts concerning other charges and payments which may form part of the transaction value.

20. Specifically, Decision 6.1 provides that if, after receiving further information, or in the absence of a response, the Customs administration still has reasonable doubts about the truth or accuracy of the declared value, it may, taking in account the appeals provisions of Article 11, be deemed that the Customs value of the imported goods cannot be determined under the provision of Article 1. However, before taking a final decision, the Customs administration shall communicate to the importer, in writing if requested, its grounds for doubting the truth or accuracy of the particulars or documents produced and the importer shall be given a reasonable opportunity to respond.

21. In this case, taking into account the facts that: (i) the importer provided no evidence other than the commercial invoice to substantiate that the declared value represented the price actually paid or payable for the imported merchandise, adjusted in accordance with Article 8; and (ii) the accounting records reviewed during the audit revealed a questionable expense, the Customs administration accordingly concluded that it still had reasonable doubts about the truth or accuracy of the declared value and notified the importer of its grounds for such conclusion.

**Conclusion:**

22. So, in accordance with Decision 6.1, the Customs administration may properly conclude that the Customs value of the imported goods cannot be determined under the provisions of Article 1. The Customs administration shall communicate to the importer, in writing, its decision and the grounds thereof.

23. In this case, the Customs value was established under their provisions of Article 2 of the Agreement.
1. Sample of Audit Report

Annex - 1

(The Specimen of the Audit Report)
Government of Nepal
Ministry of Finance
Department of Customs
Post Clearance Audit Office

Report of the Post Clearance Audit

Post Clearance Audit report according to the clause 34 of the chapter 8 of the Customs Act, 2009.

1. Description/particulars of the Importer:

<table>
<thead>
<tr>
<th>Name</th>
<th>PAAN No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Address</td>
<td>Post Office Box No:</td>
</tr>
<tr>
<td>Tel. No.:</td>
<td>Fax No:</td>
</tr>
<tr>
<td>Date of registration:</td>
<td>Date of registration:</td>
</tr>
<tr>
<td>Office of registration:</td>
<td>e-mail address:</td>
</tr>
<tr>
<td>Short description of transaction:</td>
<td></td>
</tr>
<tr>
<td>Nature of ownership:</td>
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</tr>
</tbody>
</table>

2. Description of Proprietor/Director/Manager/Responsible person:

<table>
<thead>
<tr>
<th>Designation</th>
<th>Name</th>
<th>Tel. No.</th>
<th>Mobile No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
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<td>3.</td>
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<td>4.</td>
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<tr>
<td>5.</td>
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</tbody>
</table>
3. **Description of the customs agent:**

<table>
<thead>
<tr>
<th>Name</th>
<th>Agent License No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Address</td>
<td>Post Office Box No:</td>
</tr>
<tr>
<td>Tel. No.</td>
<td>e-mail address:</td>
</tr>
<tr>
<td>Fax No:</td>
<td></td>
</tr>
</tbody>
</table>

4. **Kind of audit:**

5. **Details of section/sub-section:**

6. **Account system (e.g. manual, computerized etc.):**

7. **Contacted person in the course of audit:**

<table>
<thead>
<tr>
<th>Name</th>
<th>Designation</th>
<th>Phone No.</th>
</tr>
</thead>
</table>

8. **Auditor:**

<table>
<thead>
<tr>
<th>Name</th>
<th>PAAN No. :</th>
</tr>
</thead>
<tbody>
<tr>
<td>Address</td>
<td>e-mail address:</td>
</tr>
<tr>
<td>Tel. No.</td>
<td>Practitioner Certificate No:</td>
</tr>
<tr>
<td>Fax No.</td>
<td></td>
</tr>
</tbody>
</table>

9. **Description of Audit:**

   (a) Registered No. of Import Declaration Form:

   (b) Date of Import:

   (c) Customs point of Import:

   (d) Shipping country and date:

   (e) L/C No. and date:

   (f) L/C opening bank with address:

   (g) L/C amount and currency:

   (h) Condition of supply: CIF/FOB/CNF
(i) Name and address of supplier: 

(j) Invoice Number and date: 

(k) Main details of the goods: 

(l) Total invoice value and currency: 

(m) Destination of the goods: 

10. **Preliminary details of the audit:**

   (a) Place and date of audit: 

   (b) Quantity/number of the goods audited:

      (i) Of all the goods declared in the customs declaration form: …. 

      (ii) Any one of the goods □ (specify): …. 

      (iii) As a partial, some of the goods □ (specify): …. 

   (c) Import details: Entered in the purchase book: Yes No 

   (d) Sales details: Entered in the sales book: Yes No 

11. **Particulars of Procurement:**

   (A) According to VAT:

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>Amount</th>
<th>Description</th>
<th>Quantity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td></td>
<td>Sales</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase</td>
<td></td>
<td>Closing stock</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
According to income details:

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>Amount</th>
<th>Description</th>
<th>Quantity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td></td>
<td></td>
<td>Sales</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase</td>
<td></td>
<td></td>
<td>Closing stock</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12. Particulars of Value:

(A)

<table>
<thead>
<tr>
<th></th>
<th>Description of the commodity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Description of the commodity</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Quantity</td>
<td></td>
</tr>
</tbody>
</table>

(B)

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>CIF Kolkata value</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Expenses from Kolkata to the Customs Point</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Value declared by the importer</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Value assessed by the customs point</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Total cost up to the customs point excluding VAT (unit price as per the invoice)</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Per unit cost up to the customs point</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Total expenses (per unit) incurred and incurring up to wholesaler from the customs point</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Total cost per unit (on the basis of invoice)</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Wholesale price (per unit)</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Retailer price (per unit)</td>
<td></td>
</tr>
<tr>
<td>(C)13</td>
<td>Percentage change (11 with the comparison of 10)</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Percentage change (12 with the comparison of 10)</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Percentage change (12 with the comparison of 11)</td>
<td></td>
</tr>
</tbody>
</table>
13. **Details of accounts, ledger books, sales invoices and records audited and discussions held:**

Document as shown below of the aforesaid firm were studied and audited according to the clause 34 of the chapter 8 of the customs Act, 2007 selected for post clearance audit on the decision of the date 20../.../ of the department or of the office.

<table>
<thead>
<tr>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Import customs declaration form</td>
</tr>
<tr>
<td>(b) Proforma Invoice</td>
</tr>
<tr>
<td>(c) Bill of lading/Airway bill</td>
</tr>
<tr>
<td>(d) Insurance paper</td>
</tr>
<tr>
<td>(e) L/C (copy)</td>
</tr>
<tr>
<td>(f) Freight receipt</td>
</tr>
<tr>
<td>(g) Costing details</td>
</tr>
<tr>
<td>(h) Purchase ledger book</td>
</tr>
<tr>
<td>(i) Sales book</td>
</tr>
<tr>
<td>(j) Stock book</td>
</tr>
<tr>
<td>(k) Sales invoices</td>
</tr>
<tr>
<td>(l) Packing list</td>
</tr>
<tr>
<td>(m) Balance sheet and profit/loss account and related documents of the last fiscal year.</td>
</tr>
<tr>
<td>(n) Details of clarification and statement made on behalf of the firm and person about the above mentioned import on the date .................. in this office.</td>
</tr>
<tr>
<td>*</td>
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<td>*</td>
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</tbody>
</table>
14. **Remarks indentified during the course of audit:**

Following remarks are made on behalf of the consignment mentioned above by studying the records stated in the serial no. 5 above and the statement given by . . . . . . . . on behalf of the firm and person in this office on 20…/..../....

(a) . . . . . . . . . . . . .

(b) . . . . . . . . . . . . .

15. **Auditor's conclusion and opinion:**

* * *

* * *

* * *

Auditor's signature: Auditor's signature:

Name: Name:

Designation: Customs Auditor Designation: Customs Auditor

Date: Date:

Approved by:
Signature:
Name:
Designation: Chief of the office
Date:
Annex - 2
(Related to the point 15(1) "(i)" of the Procedure)

Government of Nepal
Ministry of Finance
Department of Customs
Post Clearance Audit Office

Date:

Sub: **Submit testimonial evidence.**

Mr. . . . . . . . .

Importer's Name:

PAAN No.:

Address:

With reference to........................... (the goods) imported and customs cleared by you on 20.../..../.... with the customs declaration form registration number .......... of the............................. Customs Office selected for the post clearance audit, the following remarks have been made in the audit report of the audit team assigned for audit resulting in the addition of the additional taxes according to the prevailing Financial Act, Customs Act and Customs Regulation. If you have any evidences, proofs or reasons to justify against the assessed additional amount you are requested to submit documents to this office or to the auditing team within the fifteen days of the notice received, failing of which additional taxes will be assessed for recovery according to the prevailing rules and regulation.

Particulars
1.
2.
3.
4.
5.

......................

Customs Auditor
Annex - 3
(Related to the point 15(a) "(iii)" of the Procedure)
Government of Nepal
Ministry of Finance
Department of Customs
Post Clearance Audit Office

Sub: Tariff assessment order.

Date:

Mr. . . . . . .

1. Name of the importer:
2. Address of the importer:
3. PAAN No.:
4. Tariff assessed consignment:

With reference to the goods imported and customs cleared by you on 20.../.../....with the customs declaration form registration number ........ Of the.......................... Customs Office and with reference to the audit made by this Post Clearance Office and also by the evaluation of the testimonials submitted by you, the difference in the customs duties of NRs. ........, local development tax of NRs. ............., excise of NRs. ............ and VAT of NRs................ with a total of NRs. .............. has been added for recovery from you for which this order has been issued. The amount as mentioned should be deposited in the consolidated Account No. ...... within the thirty-five days of this order issued. If failed of which the amount will be recovered according to the prevailing laws.

Reasons for tariff assessment:
1.
2.

Details of tariff calculation:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Customs Declaration form Regd. No.</th>
<th>Date</th>
<th>Base value for tariff</th>
<th>Tariff amount</th>
<th>Penalty amount</th>
<th>Local development tax</th>
<th>Excise duty</th>
<th>VAT</th>
<th>Total amount</th>
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</thead>
<tbody>
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</table>

...……………………

Customs Auditor

Name of the order recipient:

Date:

Designation:
References