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# **GATT/WTO Customs valuation**

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# 1 Background

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## Specific and ad valorem customs duties

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Customs duties can be designated in either specific or ad valorem terms or as a mix of the two. In case of a specific duty, a concrete sum is charged for a quantitative description of the good, for example USD 1 per item or per unit. The customs value of the good does not need to be determined, as the duty is not based on the value of the good but on other criteria. In this case, no rules on customs valuation are needed and the Valuation Agreement does not apply. In contrast, an ad valorem duty depends on the value of a good. Under this system, the customs valuation is multiplied by an ad valorem rate of duty (e.g. 5 per cent) in order to arrive at the amount of duty payable on an imported item.

## Definition

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Customs valuation is a customs procedure applied to determine the customs value of imported goods. If the rate of duty is ad valorem, the customs value is essential to determine the duty to be paid on an imported good.

## Short historical overview

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### Article VII GATT

Article VII of the General Agreement on Tariffs and Trade laid down the general principles for an international system of valuation. It stipulated that the value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values. Although Article VII also contains a definition of "actual value", it still permitted the use of widely differing methods of valuing goods. In addition, 'grandfather clauses' permitted continuation of old standards which did not even meet the very general new standard.

### Brussels definition of value

Starting in the 1950s, customs duties were assessed by many countries according to the Brussels Definition of Value (BVD). Under this method, a normal market price, defined as "the price that a good would fetch in an open market between a buyer and seller independent of each other," was determined for each product, according to which the duty was assessed. Factual deviations from this price were only fully taken into account where the declared value was higher than the listed value. Downward variations were only taken into account up to 10 per cent. This method caused widespread dissatisfaction among traders, as price changes and competitive advantages of firms were not reflected until the notional price was adjusted by the customs office after certain periods of time. New and rare products were often not captured in the lists, which made determination of the "normal price" difficult. The USA never became part of the BVD. It was clear that a more flexible and uniform valuation method was needed which would harmonize the systems of all countries.

## **Tokyo Round Valuation Code**

The Tokyo Round Valuation Code, or the Agreement on Implementation of Article VII of the GATT, concluded in 1979, established a positive system of Customs Valuation based on the price actually paid or payable for the imported goods. Based on the "transaction value", it was intended to provide a fair, uniform and neutral system for the valuation of goods for customs purposes, conforming to commercial realities. This differs from the "notional" value used in the Brussels Definition of Value (BVD). As a stand-alone agreement, the Tokyo Round Valuation Code was signed by more than 40 contracting parties.

## **2 The WTO Agreement**

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### **The new Agreement**

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The Tokyo Round Code was replaced by the WTO Agreement on Implementation of Article VII of the GATT 1994 following conclusion of the Uruguay Round. This Agreement is essentially the same as the Tokyo Round Valuation Code and applies only to the valuation of imported goods for the purpose of levying ad valorem duties on such goods. It does not contain obligations concerning valuation for purposes of determining export duties or quota administration based on the value of goods, nor does it lay down conditions for the valuation of goods for internal taxation or foreign exchange control.

### **Basic principle: Transaction value**

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The Agreement stipulates that customs valuation shall, except in specified circumstances, be based on the actual price of the goods to be valued, which is generally shown on the invoice. This price, plus adjustments for certain elements listed in Article 8, equals the transaction value, which constitutes the first and most important method of valuation referred to in the Agreement.

### **The 6 Methods**

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For cases in which there is no transaction value, or where the transaction value is not acceptable as the customs value because the price has been distorted as a result of certain conditions, the Agreement lays down five other methods of customs valuation, to be applied in the prescribed hierarchical order. Overall the following six methods are considered in the Agreement:

- Method 1: transaction value
- Method 2: transaction value of identical goods
- Method 3: transaction value of similar goods
- Method 4: deductive method
- Method 5: computed method
- Method 6: fall-back method

### **Other provisions**

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The sequence of methods 4 and 5 can be switched at the request of the importer (not, however, at the discretion of the customs officer). Moreover, the Agreement contains provisions for special and differential treatment of developing countries and for technical assistance. Since this Agreement is an integral part of the single WTO undertaking, all WTO Members are Members of the Customs Valuation Agreement.

## **3 Method 1 - Transaction value**

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### **Definition of transaction value**

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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, and includes all payments 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.

### **Conditions to be fulfilled**

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The customs value is the transaction value if all of the following conditions have been fulfilled:

#### **Evidence of sale**

There must be evidence of a sale for export to the country of importation (i.e. commercial invoices, contracts, purchase orders, etc.).

#### **No restriction on the disposition or use**

There must be no restriction on the disposition or use of the goods by the buyer, other than restrictions which:

- are imposed or required by law in the country of importation;
- are limited to the geographic area in which the goods may be resold;
- do not substantially affect the value of the goods.

#### **Not subject to additional conditions**

The sale or price must not be subject to conditions or considerations for which a value cannot be determined with respect to the goods being valued. Some examples are provided in Annex I, Note to Article 1:1(b):

- the seller establishes the price of the imported goods on the condition that the buyer will also buy other goods in specified quantities;
- the price of the imported goods is dependent upon the price or prices at which the buyer sells other goods to the seller;
- the price is established on the basis of a form of payment extraneous to the imported goods.

#### **Full prices, unless...**

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 adjustment can be made in accordance with provisions in Article 8.

## **Sufficient information for adjustments**

Sufficient information is available to enable the specific adjustments to be made under Article 8 to the price paid or payable such as;

- commissions and brokerage, except buying commission
- packing and container costs and charges
- assists
- royalties and license fees
- subsequent proceeds
- the cost of transport, insurance and related charges up to the place of importation if the Member bases evaluation on a C.I.F. basis
- but not: costs incurred after importation (duties, transport, construction or assembly), [Annex I, Note 3 to Article 1].

## **Buyer and seller not related, otherwise ...**

The buyer and seller are not related, but even if so, the use of the transaction value is acceptable if the importer demonstrates that:

- the relationship did not influence the price, or
- the transaction value closely approximates a test value.

## **Related parties**

The definition of related persons is found in Article 15 of the Agreement, which states that persons are to be deemed to be related only if:

- they are officers or directors of one another's businesses;
- they are legally recognized partners in business;
- they are employer and employee;
- 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;
- one of them directly or indirectly controls the other (the Interpretative Note to Article 15 provides that for the purposes of the 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. The note also states that "persons" includes a legal person, where appropriate).
- both of them are directly or indirectly controlled by a third person; or they are members of the same family.

## **Cases where Customs Administrations have reasons to doubt the truth or accuracy of the declared value**

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Customs valuation based on the transaction value method is largely based on documentary input from the importer. Article 17 of the Agreement confirms that customs administrations have the right to "satisfy themselves as to the truth or accuracy of any statement, document or declaration." A "Decision Regarding Cases Where Customs Administrations Have Reasons To Doubt The Truth Or Accuracy Of The Declared Value" taken by the Committee on Customs Valuation pursuant to a Ministerial Decision at Marrakesh spells out the procedures to be observed in such cases. As a first

step, customs may ask the importer to provide further explanation that the declared value represents the total amount actually paid or payable for the imported goods.

If the reasonable doubt still exists after reception of further information (or in absence of a response), customs may decide that the value cannot be determined according to the transaction value method. Before a final decision is taken, customs must communicate its reasoning to the importer, who, in turn, must be given reasonable time to respond. In addition, the reasoning of the final decision must be communicated to the importer in writing.

## 4 Methods 2 and 3

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### Method 2: Transaction value of identical goods (Article 2)

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The transaction value is calculated in the same manner on identical goods if the goods are:

- the same in all respects including physical characteristics, quality, and reputation;
- produced in the same country as the goods being valued;
- and produced by the producer of the goods being valued.

For this method to be used, the goods must be sold for export to the same country of importation as the goods being valued. The goods must also be exported at or about the same time as the goods being valued.

#### Exceptions

Some exceptions are accepted, in particular:

- 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.
- minor differences in appearance would not preclude goods which otherwise conform to the definitions from being regarded as identical.

The definition excludes imported goods which incorporate engineering, artwork etc, provided by the buyer to the producer of goods free of charge or at a reduced cost, undertaken in the country of importation for which no adjustment has been made under Article 8.

### Method 3: Transaction value of similar goods (Article 3)

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The transaction value is calculated in the same manner on similar goods if:

- goods closely resembling the goods being valued in terms of component materials and characteristics
- goods which are capable of performing the same functions and are commercially interchangeable with the goods being valued
- goods which are produced in the same country as and by the producer of the goods being valued. For this method to be used, the goods must be sold to the same country of importation as the goods being valued. The goods must be exported at or about the same time as the goods being valued.



## **5 Method 4 - Deductive value**

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### **Deduction of value from the price of the greatest aggregate quantity sold**

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The Agreement provides that when customs value cannot be determined on the basis of the transaction value of the imported goods or identical or similar goods, it will be determined on the basis of the unit price at which the imported goods or identical or similar goods are sold to an unrelated buyer in the greatest aggregate quantity in the country of importation. The buyer and the seller in the importing country must not be related and the sale must take place at or about the time of importation of the goods being valued. If no sale 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.

### **Determination of the greatest aggregate quantity sold**

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Under Article 5.1, the unit price at which the imported goods or identical or similar imported goods are sold in the greatest aggregate quantity is to be the basis for establishing the customs value. The greatest aggregate quantity is, according to the Interpretative Note to that Article, the price at which the greatest number of units is sold to unrelated persons at the first commercial level after importation at which such sales take place. To determine the greatest aggregate quantity all sales at a given price are taken together and the sum of all the units of goods sold at that price is compared to the sum of all the units of goods sold at any other price. The greatest number of units sold at one price represents the greatest aggregate quantity.

### **Deductions from the price at the greatest aggregate quantity**

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Since the starting point in calculating deductive value is the sale price in the country of importation, various deductions are necessary to reduce that price to the relevant customs value:

- commissions usually paid or agreed to be paid, the sum of profits and general expenses added in connection with sales must also be deducted;
- the usual transport costs and corresponding insurance are to be deducted from the price of the goods when these costs are usually incurred within the country of importation;
- the customs duties and other national taxes payable in the country of importation by reason of the importation or sale of the goods are also to be deducted;
- value added by assembly or further processing, when applicable.

## **6 Method 5 - Computed value**

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### **Definition: Production cost and profits and expenses**

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Computed value, the most difficult and rarely used method, determines the customs value 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. Computed value is the sum of the following elements:

### **Production cost = value of materials and fabrication**

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The cost or value of materials and fabrication or other processing employed in producing the imported goods. Materials would include, for example, raw materials, such as lumber, steel, lead, clay textiles, etc.; costs to get the raw materials to the place of production; subassemblies, such as integrated circuits; and prefabricated components which will eventually be assembled. Fabrication would include the costs for labour, any costs for assembly when there is an assembly operation instead of manufacturing process, and indirect costs such as factory supervision, plant maintenance, overtime, etc. Cost or value 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. If not included above, packing costs and charges, assists, engineering work, artwork, etc. undertaken in the country of importation would be added.

### **Profit and general expenses**

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Profit and general expenses usually reflected in export sales to the country of importation, by producers in the country of importation on the basis of information supplied by the producer, of goods of the same class or kind. The latter phrase 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. The amount of profit and general expenses has to be taken as a whole (i.e. the sum of the two). General expenses could include rent, electricity, water, legal fees, etc.

### **Other expenses to be added**

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Finally, other expenses should be added to the price such as the cost of transport of the imported goods to the port or place of importation, loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation, and the cost of insurance.

## 7 Method 6 - Fall-back method

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### Definition

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**"Customs value determination based on "reasonable means consistent with the principles and general provisions of the Agreement, Article VII GATT and on the basis of available data".**

When the customs value cannot be determined under any of the previous methods, it may be determined using reasonable means consistent with the principles and general provisions of the Agreement and of Article VII of GATT, and on the basis of data available in the country of importation. To the greatest extent possible, this method should be based on previously determined values and methods with a reasonable degree of flexibility in their application.

### Valuation criteria not to be used

Under the fall-back method, the customs value must not be based on:

- the selling price of goods in the country of importation (i.e. the sale price of goods manufactured in the importing country);
- a system which provides for the acceptance for customs purposes of the higher of two alternative values (the lowest should be used);
- the price of goods on the domestic market of the country of exportation (valuation on this basis would go against the principle in the Preamble that "valuation procedures should not be used to combat dumping");
- the cost of production other than computed values which have been determined for identical or similar goods (valuation must be arrived at on the basis of data available in the country of importation);
- the price of goods for export to a third country (two export markets are always to be treated as separate and the price to one should not control the customs value in the other);
- minimum customs value (unless a developing country has taken the exception which allows for use of minimum values);
- arbitrary or fictitious values (these prohibitions are aimed at systems which do not base their values on what happens in fact in the marketplace, as reflected in actual prices, in actual sales, and in actual costs, reason of the importation or sale of the goods are also to be deducted;

# **8 Special and differential treatment**

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## **Delay of application of the Agreement for five years for developing countries**

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Article 20.1 allows developing country Members, not party to the Tokyo Round Code, to delay application of the provisions of the Agreement for a period of five years from the date of entry into force of the WTO Agreement for the Member concerned.

## **Delay of application of the computed value method for three years following the application of all other provisions of the Agreement**

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Article 20.2 allows developing country Members, not party to the Tokyo Round Codes to delay application of the computed value method for a period not exceeding three years following their application of all other provisions of the Agreement. In practice, this means that developing country Members, not party to the Tokyo Round Code, can delay the computed value method a total of 8

## **Extension of the transition period**

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Paragraph 1 of Annex III of the Agreement allows developing country Members for whom the five-year delay in the application of the provisions of the Agreement provided for in Article 20.1 is insufficient to request, before the end of the five-year period, an extension of such a 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.

## **Reservations to retain established minimum values**

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Paragraph 2 of Annex III provides that developing country Members may make a reservation to retain an already-existing system of officially established minimum values on a limited and transitional basis under such terms and conditions as may be agreed to by the Committee (even though minimum prices are prohibited under the Agreement).

## **Reservation against Article 4**

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Paragraph 3 of Annex III allows developing country Members the right to make a reservation permitting them to refuse the request of importers (allowed under Article 4 of the Agreement) to reverse the order of the deductive and computed value methods.

## **Special application of the deductive method**

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Paragraph 4 of Annex III allows developing country Members the right to value the goods under the deductive method even if the goods have undergone further processing in the country of importation, whether or not the importer so requests.

## **Technical assistance**

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Under Article 20.3 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 the Agreement.

## **9 Institutions**

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### **Committee on Customs Valuation**

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The Agreement establishes a Committee on Customs Valuation composed of representatives from each of the Members for the purpose of affording Members the opportunity to consult on matters relating to the administration of the customs valuation system by any Member or the furtherance of the objectives of the Agreement.

### **Technical Committee on Customs Valuation**

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The Agreement also establishes a Technical Committee on Customs Valuation under the auspices of the World Customs Organization with a view to ensuring, at the technical level, uniformity in interpretation and application of the Agreement. The responsibilities of the Technical Committee include advising on specific technical matters as requested by Members or by a panel in a dispute.