



Customs Special Valuation Branch

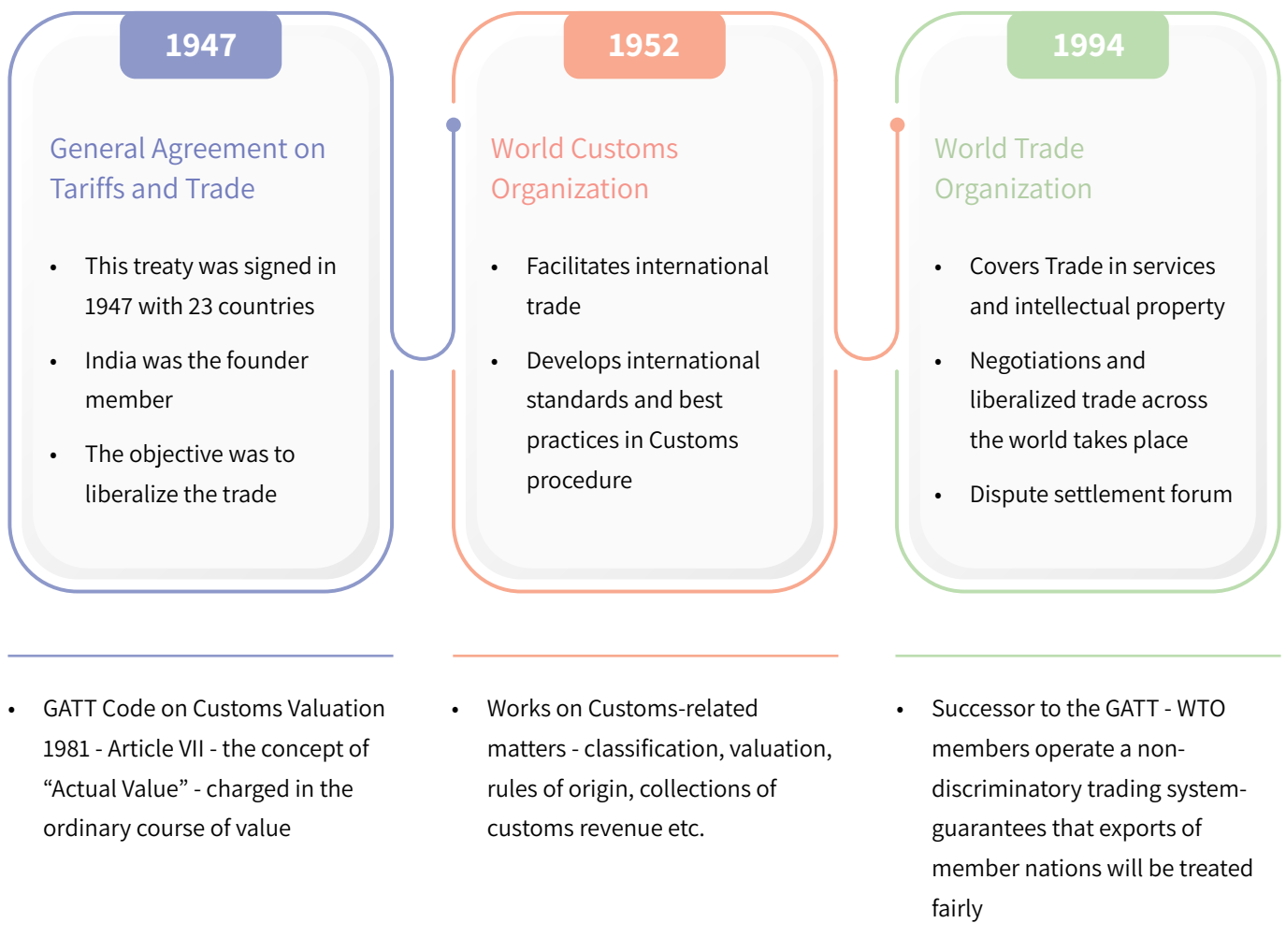
Simplifying Special Valuation

INTERNATIONAL JOURNEY OF CUSTOMS

The General Agreement on Tariffs and Trade (GATT), established in 1947 from the 1944 Bretton Woods Conference, played a pivotal role in shaping the modern global trading system by reducing the trade barriers and promoting economic recovery post war.

The World Customs Organisation (WCO), headquartered in Brussels, Belgium, was established in 1952 as Customs Co-operation Council (CCC) and renamed in 1994. The WCO has 183 members countries, representing over 98% of

international trade. WCO develops international standards and best practices, conducts research on trade trends, and coordinates efforts to combat cross-border crime through Customs Enforcement Network (CEN). It also conducts research and analysis on emerging trends and challenges in international trade and customs administration, providing guidance to its members. WCO also issues technical advisories from the issues raised by the member countries and generally customs authorities follow such advisories for the determination of the value of imported goods.



CUSTOM'S GOVERNANCE IN INDIA

The governance of Customs in India is overseen by Central Board of Indirect Taxes and Customs (CBIC), which operates under the Department of Revenue, Ministry of Finance, Government of India. CBIC formulates policies on customs and indirect taxes, implements customs laws, and prevents illicit activities like smuggling and tax evasion. Customs is enforced through the field formations of CBIC including Customs Commissionerate's, Central Excise Commissionerate and Directorates. CBIC also represents India in international customs forums and organisations, fostering cooperation and collaboration on customs matters

with other countries. CBIC has launched the Single Window Interface for Facilitating Trade (SWIFT) for electronic customs submissions and automated systems like the Indian Customs EDI System (ICES) and Indian Customs Risk Management System (ICRM) to enhance efficiency.

To ensure compliance with the Customs laws, CBIC conducts audits and inspections of customs records and premises. It also conducts anti-smuggling operations to prevent the illicit movement of goods across borders and protect national security and economic interests.

Following are the broad categories of advisory and litigation issues that arise under Customs:

Customs Valuation

Customs valuation is a subject matter of dispute and major challenges are found in determining the transaction value of imported goods, especially in cases involving related parties, royalties, or the inclusion of additional costs. Customs authorities may question the transfer pricing arrangements between related entities, leading to valuation disputes.

Classification issues

Classification issues may arise under harmonised system of nomenclature, impacting the applicable customs duties and tariffs. Further issues related to the origin of goods can lead to disputes regarding preferential tariff treatment, especially in cases involving free trade agreements or rules of origin requirement.

Other areas may involve anti-dumping and countervailing duties, safeguard measures, seizures and penalties, dispute resolution etc.



RULES OF CUSTOMS VALUATION

Customs valuation refers to the process of determining the customs value of imported goods for the assessment of customs duties and taxes. WCO provides guidelines and principles for customs valuation through its valuation agreement, also known as the agreement on implementation of Article VII of the GATT 1994. The Customs Valuation (Determination of Price of Imported Goods) Rules, 2007 ('Indian Customs Valuation Rules') are based on GATT 1994.

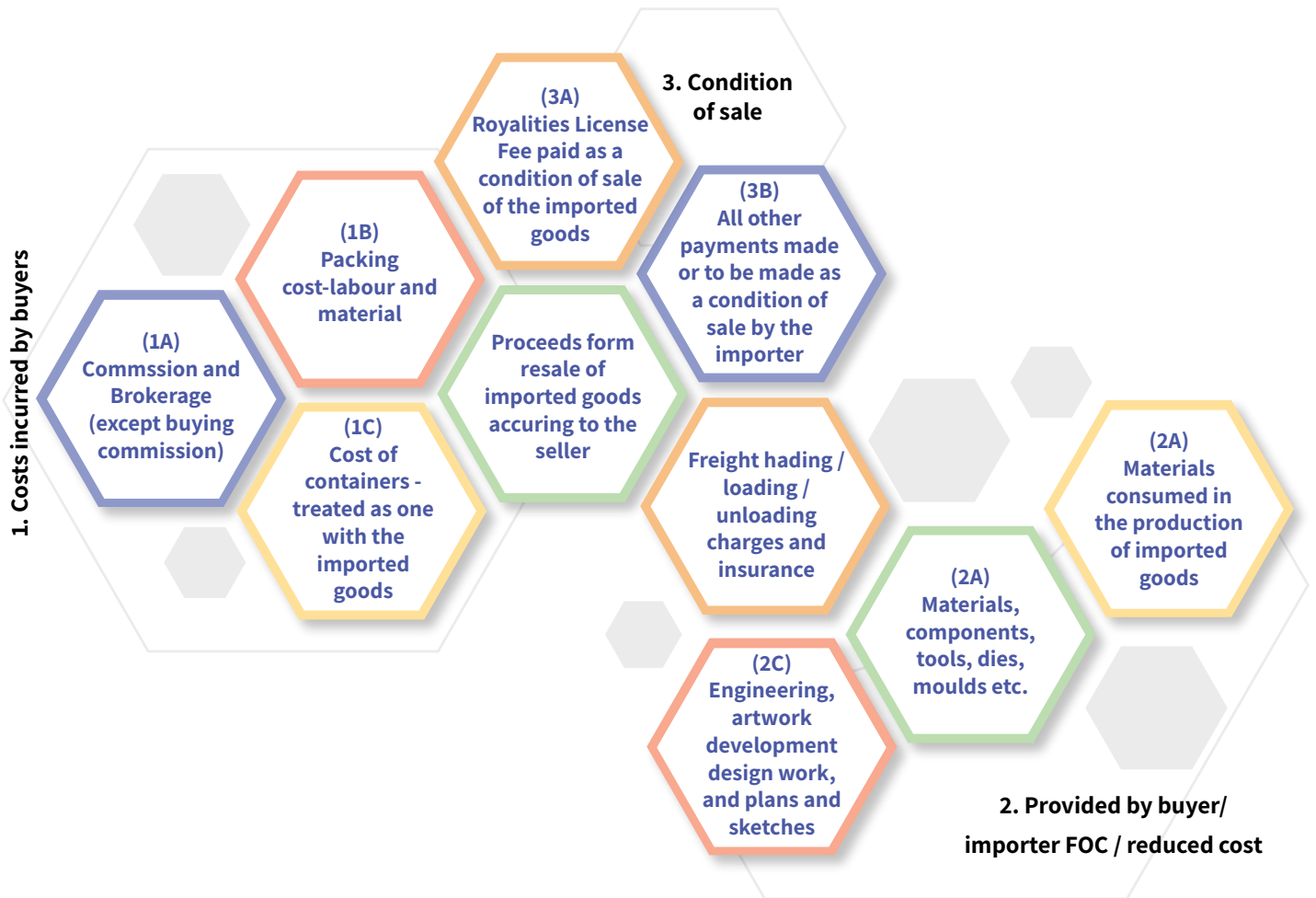
The Customs Act, 1962 provides for the transaction value to be the value of imported goods when they are imported from an unrelated party and the price of the goods is not impacted by such relationship.

WCO valuation agreement consists of six main Articles and Indian Customs Valuation Rules are summarised to depict how customs valuation rules align with WCO valuation agreement:

WCO Article	Indian Customs Valuation Rule	Valuation Method
Article 1 Transaction Value	Rule 3: Transaction Value	<p>It provides the primary method for determining the customs value, based on the transaction value of imported goods i.e. the price actually paid or payable for the goods when sold for export to the country of importation.</p> <p>The transaction value is acceptable only in cases where the relationship between the parties has not influenced the value.</p>
Article 2 Identical goods	Rule 4: Value of Identical Goods	For imported goods, the value of identical goods is to be adopted. Such goods are defined to be the same with respect of physical characteristics, quality, and reputation, produced in the same country by the same person at the same commercial levels and in the same quantity
Article 3 Similar Goods	Rule 5: Value of Similar Goods	For imported goods, the value of similar goods is to be adopted. Similar goods are not alike to the imported goods but have like characteristics and component materials, perform the same functions and are commercially interchangeable, produced in the same country by the same or different persons, and imported into India at or about the same time
Article 4 Deductive Value	Rule 7: Deductive Value Method	Where the transaction value cannot be determined, it allows the use of the deductive value method using sale price and deductions on account of various factors involved.
Article 5 Computed Value	Rule 8: Computed Value Method	It provides for the valuation of imported goods based on cost of material and overheads involved. This method is resorted when the value cannot be determined based on transaction or deductive value method.
Article 6 Fall back method	Rule 9: Residual Method	It allows customs administrations to use reasonable means consistent with the principles and general provisions of the agreement to determine the customs value when none of the above methods can be applied.



Further, Customs Valuation (Determination of Price of Imported Goods) Rules, 2007 also provides for Rule 10, which in addition to the value determined sequentially in accordance with the above rules, provides for including the specific expenditures into the value of the imported goods.



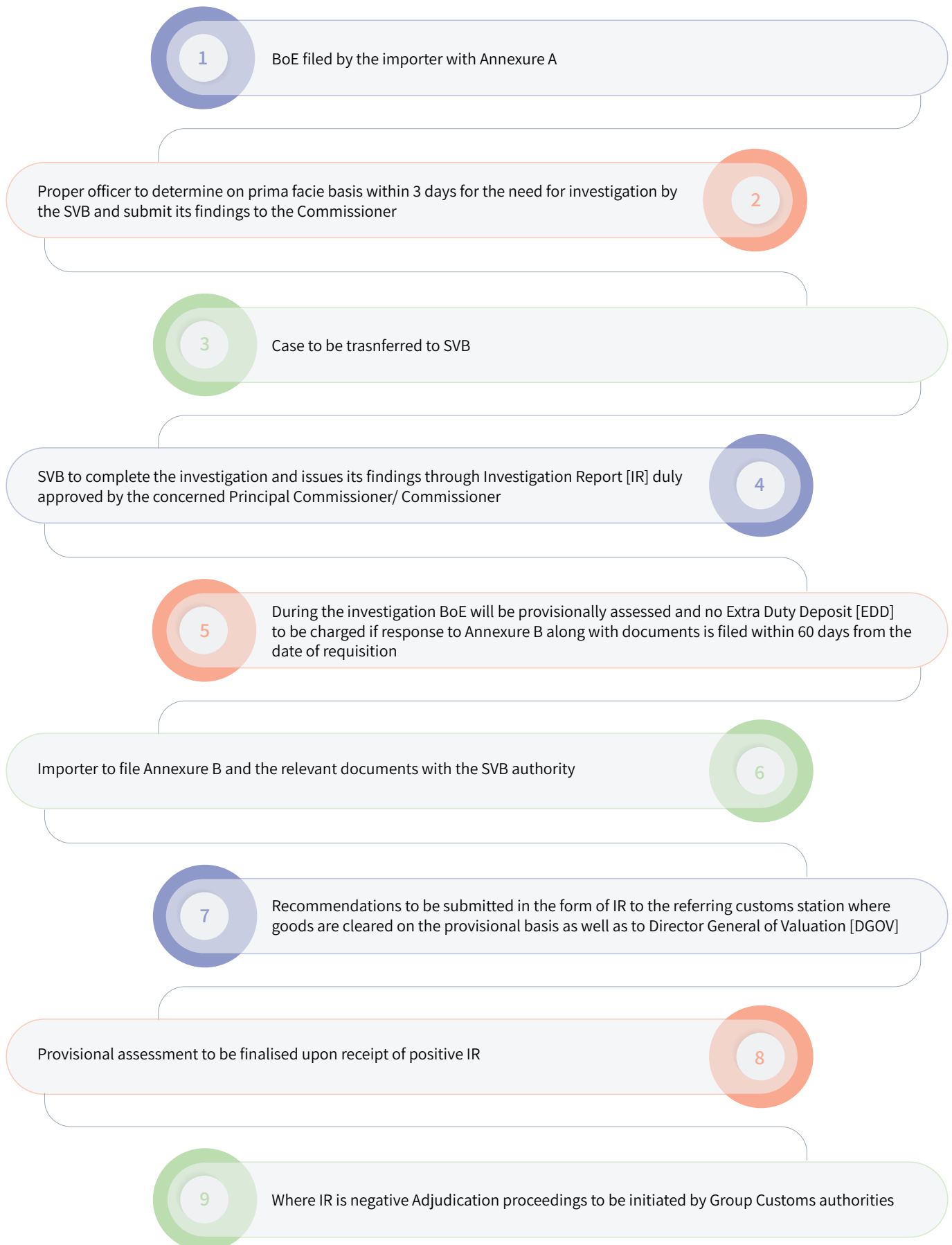
SPECIAL VALUATION BRANCH

India's Customs Department houses a specialized unit known as the Special Valuation Branch (SVB) for investigating and determining the assessable value of transactions involving related parties or special circumstances. SVB promotes transparency in the customs valuation, reducing the risk of disputes and ensuring compliance with international trade regulations. It helps prevent undervaluation or misdeclaration of imported goods, ensuring fair trade practices.

The SVB investigates related party imports and complex situations requiring adjustments in the declared transaction value, including instances of payment of royalties, license fees [as specified in Rule 10(1)(c)], and proceeds from subsequent sales [as specified in Rule 10(1)(d)/ 10(1)(e)] by the importer to the foreign seller or any other person at the behest of such foreign seller. CBIC vide Circular No. 05/2016-Customs dated 09.02.2016, revamped the entire SVB process. The Circular now provides a detailed guideline for the investigation of related party imports and other cases by SVB.



SVB PROCESS



Key Highlights:

- SVB functions under the jurisdictional Chief Commissioner/ Principal Commissioner/ Commissioner
- In case of imports at Mumbai/ Delhi/ Chennai/ Kolkata/ Bangalore, the importer shall have the option to select SVB of Customs House of Imports or Customs House most proximate to the corporate office. In other cases, jurisdiction continues to be governed by the location of corporate office.
- Requirement of 'Extra Duty Deposit' (EDD) has been done away with except in cases where the importer fails to furnish the requisite information/ documents within 60 days of requisition, in which case a security deposit at 5% shall be imposed strictly only for a period not exceeding three months. The importer can choose to provide the security deposit either in cash or a Bank guarantee.
- SVB shall convey its findings by way of an investigation report instead of an appealable order
- Imports of prototypes, exempt goods, or goods valued less than INR 1 lakh (cumulatively not exceeding INR 25 Lakhs in any financial year) cannot be taken up for investigation
- Renewal of SVB orders has been discontinued. In case of a change in circumstances or terms and conditions of the agreement, the importer shall declare the same at the place of import.

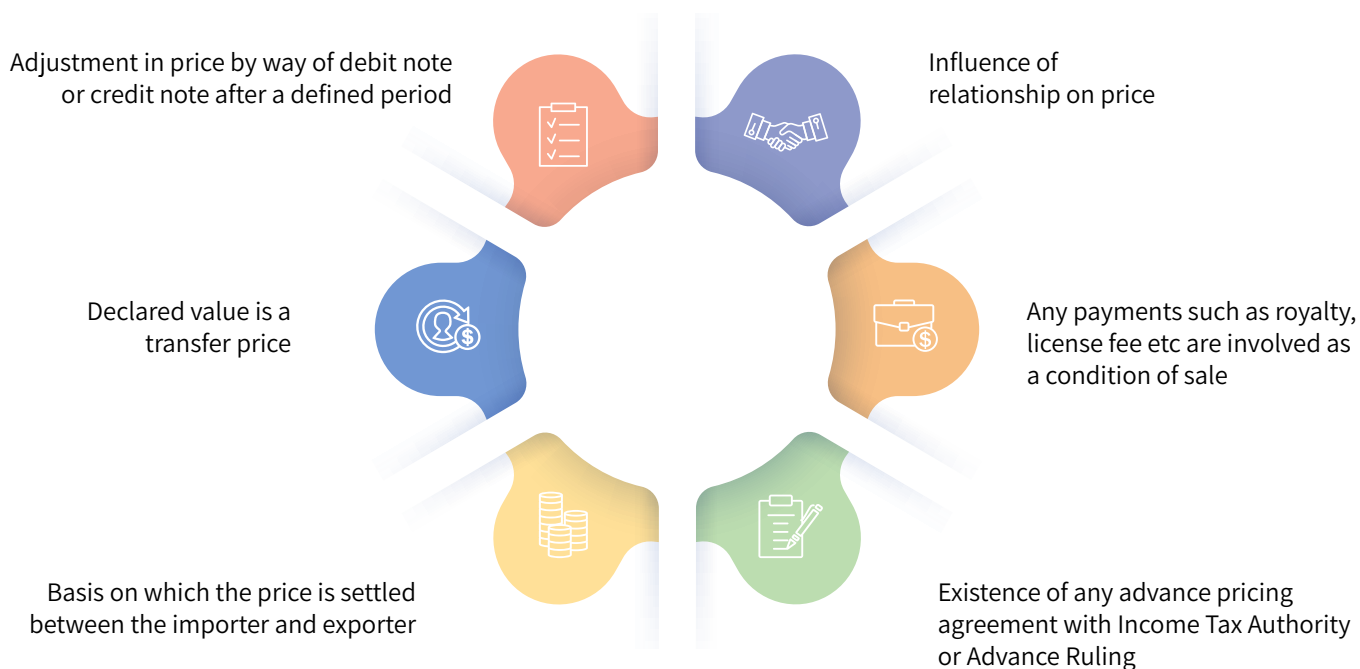


CRUCIAL ASPECTS INVOLVED IN SVB

As mentioned earlier, per the Customs procedure, where the importer and supplier of goods are related parties/ persons, then at the time of filing of bill of entry [BOE], the importer is required to make a declaration stating that the importer and supplier are related along with all the relevant

details pertaining to such relationship and the pricing of the imported goods in Annexure A as prescribed under Board Circular 5/2016 dated 9 February 2016.

The proper officer examines the 'circumstances surrounding the sale' and evaluates the case on the following parameters:



A. Circumstances of the sale

- Rule 3(3)(a) of the Customs Valuation Rules [CVR] provides that where the Indian importer and the foreign supplier are related, the circumstances surrounding the sale should be examined and the transaction value will be accepted as the value of imported goods only where the relationship did not influence the price. However, the existence of a relationship between the parties, in itself does not necessitate the examination of the circumstances and values in all instances and this examination is envisaged only where the Customs authorities doubt the acceptability of the price.
- The Interpretative Notes provide that whether or not the relationship has influenced the price can be examined by the Customs authorities by examining various relevant aspects of the transaction, including:
 - Manner in which the buyer and seller organize their commercial relations, i.e., whether 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 with independent third parties
 - The methodology of arriving at the price, for example, to demonstrate that the price is adequate to ensure recovery of all costs plus an appropriate profit or as per Rule 3(3)(b) of the CVR the transaction value closely approximates a "test" value previously accepted by the Customs authorities. For such determination, some important factors would be 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



Relevance of Transfer Pricing Study

- A transfer pricing study submitted by an importer may be a good source of information, as the purpose of a transfer pricing study is to establish that the prices negotiated between the parties are under normal business conditions and are an arm's length price. Also, various methods of Customs valuation are similar to the transfer pricing methods, for example, the deductive value method under Customs aligns with the resale minus method under transfer pricing, similarly, the computed value method is similar to the cost-plus method.
- It is relevant to note that the transfer pricing is looked at from the perspective of annual profitability, Customs is more concerned with the value of imported goods at a transaction level. Despite this, the SVB authorities also investigate whether the Company is earning the appropriate profit margin as per the benchmarking exercise carried out for transfer pricing purposes on an overall basis to accept the value under Customs. This may necessarily not be at a product level.
- One may argue that both laws [i.e., Customs and Transfer pricing] are at cross purpose as Customs wants to ensure that the imported values are not understated, while transfer pricing aims to ensure that inappropriate elements are not included in the price to overstate the prices. This may lead the Customs authorities to overlook the arm's length value accepted in a transfer pricing study. Courts in India¹ have held that when the pricing methodology is based on transfer pricing guidelines then even though the parties are related persons, it is to be accepted.
- However, a transfer pricing study might not be relevant or adequate in examining the circumstances surrounding the sale because of the differences that exist between the methods under Customs and those of the OECD Transfer Pricing Guidelines. The WCO also advises that the use of a transfer pricing report as a possible basis for examining the circumstances surrounding the sale should be considered on a case-by-case basis.
- Despite the aforesaid aspects, there is required to be a convergence between the determination of price under Customs and transfer pricing. The in-house tax teams handling transfer pricing and customs must work together to arrive at the arms-length price/transaction value of the imported goods.

1. Gemplus India Private Limited vs. Commissioner of Customs [2005 (185) ELT 269 (Tri-Bangalore)], Volvo India Private Ltd. vs. Commissioner of Customs [2005 (180) E.L.T. 489 (Tri. - Bang.)] and Hindustan Unilever vs Commissioner of Customs, Mundra [2023 (5) TMI 616 – (CESTAT Ahmedabad)].

B. Intricacies involved in the Deductive Value and Computed Value Method

- As mentioned, the Customs Valuation Rules provide for the determination of value. The Sub-Rules stated therein are to be followed in sequence for the determination of value. The complexity in determining value arises where there are no identical and similar goods that are being imported, and consequently, a resort is made to either the deductive value method under Rule 7 or the computed value method under Rule 8. The key aspects of both methods are briefly discussed below:
- of the import]. This method is particularly applicable to the import of traded goods /processed goods where the cost of value addition is accurately determinable, when there are no identical or similar goods imported to establish the customs value.
- The method starts with the retail price at which the goods are sold in the market of the importing country. The given price is adjusted to reflect deductions for the cost of transport, duties and taxes, and profit margin.

Deductive Value Method

- The deductive value method also known as the retail minus method is a customs valuation approach used to determine the value of imported goods based on the selling price in the country of importation [within 90 days

Documents to substantiate Deductive Value

- In addition to the standard documents as required to be submitted along with Annexures A and B, generally the following key documents would need to be submitted to substantiate the Retail minus/ Deductive value method:



- A certificate disclosing the back working from the retail price of imported goods [when sold in India] to the price of such when imported into India. The workings will deduct the landed cost, cost of value addition (if any) other general costs including the direct and indirect cost of marketing the goods and the profit margins to finally arrive at the ideal value of imported goods. The Customs authorities may insist that this certificate should be certified by an independent Chartered Accountant.
- Documents/details to substantiate the method of cost appropriation and method for deriving profit margins as reflected in the computation/certificate.
- Statement of goods imported during the investigation period
- Summary of high value imported goods.
- The transfer pricing report, if the retail minus method is used to arrive at the arm's length price.

Importers may face the following critical issues associated with applying the Deductive Value Method are:

- Difficulty in determining the highest quantities sold at a particular price, especially in cases where pricing fluctuates, due to customization of goods as per customer's need/requirement
- Difficulty in the determination of commission or profit and general expenses that could be considered as "usually paid or agreed to be paid". The WCO commentary on deductive value provides as under:

"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."

- Difficulty in providing product-specific margins for imported goods. Given that the risk profile of different products can vary, the profit margins may also differ

significantly across various product categories. The WCO commentary states that *"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"*.

- Accurately allocating / apportioning costs to specific products is challenging, especially for companies dealing with a broad range of goods. This complexity makes it strenuous for importers to comply with customs requirements and can lead to potential disputes or delays in the SVB process.
- Difficulty in determining the value addition for any further processing undertaken in India

Computed Value Method

- The computed value for customs valuation refers to the value of goods determined by first identifying the costs incurred by the supplier in the production and delivery of the goods. These costs include material costs, labour costs, and any other direct or indirect costs attributable to the production of the goods. An appropriate markup is then applied to these costs to account for the supplier's profit margin, which is to be determined by reference to the gross profit margin earned in comparable uncontrolled transactions between independent parties.
- The mark-up applied is examined by the Customs Authority which in turn reflects the margin a supplier would require to cover its operating expenses, considering the functions performed, assets employed, and risks assumed by the supplier.
- Common examples of the cost-plus method being successfully applied in practice inter alia include²:
 - Situations where a supplier of the goods or services in the controlled transaction(s) supplies similar goods or services to independent parties, but due to differences in the product or service the CUP method cannot be applied

2. WCO Guide to Customs Valuation and Transfer pricing



- Sales of products where the manufacturer does not contribute valuable intangibles or assume substantial risks (e.g., contract manufacturers, etc.)
- Intra-group services
- Contract research and development arrangements
- Summary of high value imported goods.
- In the case of traded items, supporting invoices showing the price at which goods were purchased by the supplier.

Documents to substantiate the computed value

- In addition to the standard documents as required to be submitted along with Annexures A and B, generally the following documents would need to be submitted to substantiate the Computed Value Method:
 - Transfer Pricing report reflecting gross profit margins at the global level
 - A statement showing a breakdown of various costs (i.e. material, labour, and overheads) related to the imported goods along with profit recovered on each product.
 - Declaration from the supplier on the profit margins maintained
 - Trend analysis of imports to substantiate that appropriate profit margins have been maintained across financial years
 - Product-wise gross margin to substantiate the cost computation method.
 - Statement of goods imported during the investigation period

Importers may face the following critical issues associated with applying the Computed Value Method:

- The transfer pricing report typically reflects a global profit margin, while customs authorities require a product-wise margin analysis. This difference can be particularly challenging for companies that operate across various segments, as it demands meticulous tracking and allocation of costs to each specific product.
- Fluctuation in values owing to market conditions, which raises additional concerns.
- Different profit margins for traded and manufactured products. The methodology for determining the profit margin for traded and manufactured products sold by the same foreign supplier may differ, thereby leading to allegations of undervaluation in certain instances
- Data confidentiality – many foreign suppliers are reluctant to disclose product-level profit margins owing to reasons of data confidentiality. The interpretative note to Rule 8, specifically provides that the use of the computed value method will generally be limited to those cases where the foreign supplier is prepared to supply to the Customs authorities the necessary costings and to provide facilities for any subsequent verification which may be necessary.

C. Inclusions in the value of imported goods under Rule 10 of the CVR

Another aspect that becomes important in determining value is the Rule 10 inclusions. Under Rule 10 of the CVR, if the price of the imported goods includes payments beyond the basic cost of the goods, such as royalties, commissions, or licensing fees, which are a condition of sale of the imported goods then such payments need to be included in the customs value.

- Condition of sale: Some important elements that determine whether a payment is a condition of sale, are as under:
 - The sale and import of imported goods by the importer are subject to such conditions, i.e., the importer would not be able to import the said goods without making the specified payments
 - In relation to licensing fee/know-how fee, the importer cannot use or operate the imported goods, more importantly, machinery/equipment without such licensing arrangement or know-how. However, payments made towards technical know-how relating to the manufacturing process or relating to the setting-up or commissioning of a plant in India would not be considered a “condition of sale” of imported goods



- Such payments include payments in respect of patents, trademarks, and copyrights. Royalties paid towards pre-recorded CDs and music disks are to be added to the value of such CDs and disks, as such royalties are payable to the artists and producers and become payable on the distribution and sale of such CDs and disks.
- License fee payable for use of software in case of packaged software and media packs are a condition of sale as a customer is unable to use such software without paying a license fee
- Payments made by the importer to a third party at the behest of the supplier, in lieu of the supply of the imported goods.
- Royalty related to the final product is paid on the net selling price, i.e., without including the cost of imported components, then such royalty is not the condition of sale of the imported goods.
- Payments made towards post-importation activity, which is not directly attributable to the imported goods or crucial to the use of such goods cannot be considered as payments made as, a condition of sale.
- Charges for the right to reproduce the imported goods in the country of importation, are not a payment made as a condition of sale and cannot be added to the price actually paid or payable for the imported goods in determining the customs value.
- These additional payments are considered part of the overall cost of acquiring the goods, and therefore, they are subject to import duties. Similarly, certain conditions attached to the sale, such as trade-in agreements or future payments tied to the transaction, are also includible in the customs valuation, as they represent indirect costs borne by the importer.
- The term “price actually paid or payable” would include all payments to be paid by the importer to the foreign supplier, directly and indirectly, whether in money or kind. However, the law does not merit the inclusion of any sums on a notional basis. Also, payments made by the importer to third parties on the importer’s own account cannot be considered as indirect payments to the foreign supplier, for example, marketing costs incurred in the country of import, etc.
- One of the more complex issues arises with contingent payments, which are tied to future events, such as performance-based incentives. These payments can be difficult to quantify at the time of import as data on actual payments to be made may not be available at the time of determining the customs value. Despite this, customs authorities may require such future payments to be factored into the valuation if they are connected to the imported goods.
- In such cases, importers face the challenge of ensuring compliance with customs regulations by providing detailed and transparent documentation, including clear evidence of any additional payments or conditions tied to the sale. Failure to account for these can result in the customs authorities rejecting the declared value, reassessing the duty payable, or initiating further inquiries or audits. Thus, it becomes essential for importers to carefully assess the full range of payments associated with a transaction to ensure accurate valuation and compliance with customs regulations.



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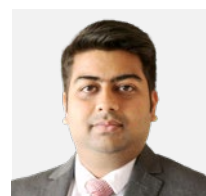
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