CASE STUDIES

LIST OF CASE STUDIES

CASE STUDY 1.1

Report on a case study with special reference to Article 8.1 (b) (iv) : engineering, development, artwork, etc.

▪ **Facts of transaction***

1. The NAVAL company, domiciled in country of importation I, signs a contract with the BORG company, domiciled in country of exportation E, for the construction and sale by BORG or a processing plant for the production of liquid methane gas. The selling price of the plant to be paid by NAVAL to BORG, is 2,000 million currency units (c.u.). However, a clause in the contract provides for a further 500 million c.u. to be paid by NAVAL to BORG in respect of the engineering and development necessary for the plant's construction.

2. In addition, since the production of liquid gas requires a specific technology that BORG does not possess, the contract also stipulates that NAVAL will undertake to make available to BORG the materials and engineering services required for the design, construction and installation of aluminium liquid gas tanks. NAVAL also agrees in the contract to provide the technical studies and design work needed for the plant's pipeline system and for certain auxiliary equipment. The pipeline system will be supplied free of charge by NAVAL.

* The names used in this study are fictitious

3. For this purpose, acting on the advice of BORG (who prepared tender specifications and studied bids received), NAVAL :

(a) engages AMERICA, a company located in a foreign country, to supply from that country :

(i) the special materials required by BORG for the construction of the aluminium liquid gas tanks, at a selling price of 400 million c.u.;

(ii) plans, sketches and drawings, at a total price of 200 million c.u., for the construction of those tanks not only for the plant to be built by BORG, but also for three other plants to be built for NAVAL by the VIKING company in the country of importation;

(iii) technical assistance in respect of the construction of the tanks for each of the plants at a total price of 100 million c.u.;

(iv) 10 special machines for welding the aluminium tanks in BORG's factory, at a hire charge per unit of 1 million c.u.;

(v) 500 cylinders of gas employed by the machines for welding the tanks in BORG's factory, at a unit price of 10,000 c.u.;

(b) engages VESPUCIO, a company located in a foreign country, to supply from that country :

(i) the steam system for the four plants ordered by NAVAL, at a total price of 1,200 million c.u.;

(ii) technical collaboration through the provision of plans, drawings and technical documentation for the construction of the steam system, at a total price of 180 million c.u.;

(c) commissions CARTAGO, its foreign subsidiary, to execute the design work and supply plans and sketches for the auxiliary equipment common to the four plants at a total price of 600 million c.u., and orders it to send one set of them to BORG;

(d) commissions its foreign-based CRIMEA design centre to prepare drawings of the furnace system for the four plants and to send one set of them to BORG. The design center's records show that this work involves 8,000 man-hours, and its accounts indicate an hourly cost of 2,000 c.u.;

(e) commissions its engineering division to prepare a list of all the materials required for the plant's construction and to carry out pressure and temperature studies for a variety of production conditions. The graphs and drawings reflecting the results of these studies are prepared by the SERVO company, which has its headquarters in the country of importation and receives payment of 12 million c.u. from NAVAL.

NAVAL sends BORG one set of these engineering studies, graphs and drawings for use in the plant's construction.

4. All post-importation construction etc. work is undertaken by NAVAL on its own account.

▪ **Determination of Customs value**

5. NAVAL, the importing company, presents to the Customs of the country of importation a declaration of value based on the transaction value, together with all the commercial documentation and accounts relating to the construction and sale of the plant by BORG and to the contracts with the other companies for materials and services.

6. After considering the question the Customs arrive at the conclusion that the goods should be valued under Article 1.

7. The transaction value is calculated by adding the following amounts to the selling price of the plant, fixed in the contract with BORG at 2,000 million c.u. :

(a) 500 million c.u., payable to BORG in respect of the engineering and development necessary for the plant's construction (see paragraph 1 above).

This addition does not constitute an adjustment under Article 8 but is in fact part of the total price actually paid or payable under the contract. Very often the engineering supplied by the seller of the goods himself is invoiced separately. In some countries this distinction is due to the different kind of authorization for payments abroad (Trade Department for goods, Industry Department for technical assistance). The price actually paid or payable is the total payment made or to be made by the buyer to the seller for the imported goods.

(b) 400 million c.u., payable to AMERICA for supplying BORG with the special materials required for the construction of the aluminium tanks (see paragraph 3 (a) (i) above).

This adjustment is not added under Item (iv) of Article 8.1 (b), but under Item (i), because it involves materials and components which are incorporated in the imported plant at the time of valuation. The buyer of the plant supplied them free of charge to the seller for use in connection with the production and sale for export of the plant and their value is not included in the amount of 2,000 million c.u. fixed as the selling price of the plant.

(c) 50 million c.u., corresponding to one quarter of the 200 million c.u. payable to AMERICA for the plans, sketches and drawings for the construction of the tanks in four plants (see paragraph 3 (a) (ii) above).

This is an adjustment under Article 8.1 (b) (iv). It covers design work, plans and sketches undertaken outside the country of importation necessary for the production of the plant and supplied free of charge by the buyer. According to subparagraph (b) of Article 8.1, the value of this assistance, fixed at 200 million c.u., must be apportioned between the four plants which incorporate identical aluminium tanks.

(d) 25 million c.u., representing one quarter of the 100 million c.u. payable to AMERICA for technical assistance in respect of the construction of the tanks (see paragraph 3 (a) (iii) above).

The value of the technical assistance furnished by the staff of the firm AMERICA to BORG's factory and supplied free of charge by the importer, must be added to the price payable for the plant by virtue of Article 8.1 (b) (iv), which covers such engineering services. It must also be apportioned between the four plants.

(e) 10 million c.u., payable to AMERICA for supplying BORG with 10 special welding machines (see paragraph 3 (a) (iv) above).

This adjustment is not added under Item (iv) of Article 8.1 (b), but under Item (ii), because it involves tools used in the construction of the imported plant. The buyer supplied them free of charge to the seller solely for use in connection with the production and sale for export of the plant. The value of the tools is the cost of acquisition, which in this instance is represented by the hire charge.

(f) 5 million c.u., payable to AMERICA for the supply to BORG of the 500 cylinders of gas (see paragraph 3 (a) (v) above).

This adjustment is also not added under Item (iv) of Article 8.1 (b), but under Item (iii), because it involves materials consumed in the production of the plant, supplied free of charge by the buyer of the plant and the value of the materials is not included in the selling price of the plant.

(g) 300 million c.u., representing one quarter of the 1,200 million c.u. payable to VESPUCIO for supplying the steam system for the four plants (see paragraph 3 (b) (i) above).

In this case the addition is in accordance with the provisions of Article 8.1 (b) (i), because it involves materials, components and parts which are incorporated in the imported plant. The buyer of the plant supplies them free of charge to the seller for use in connection with the production and sale for export of the plant and their value is not included in the amount of 2,000 million c.u. fixed as the selling price of the plant.

(h) 45 million c.u., representing one quarter of the 180 million c.u. payable to VESPUCIO for the provision of plans, drawings and technical documentation for the steam system in the four plants (see paragraph 3 (b) (ii) above).

This is another adjustment under Article 8.1 (b) (iv). It applies to design work, plans and drawings for use in connection with the construction of the plant and to charges and costs for technical assistance undertaken before importation of the imported plant; these services are supplied indirectly by the buyer free of charge to the seller, and their value is not included in the selling price.

(i) 150 million c.u., representing one quarter of the amount payable to the CARTAGO subsidiary for design work, plans and sketches for the auxiliary equipment common to the four plants (see paragraph 3 (c) above).

This assistance is also covered by Article 8.1 (b) (iv). The buyer supplies these plans and sketches and pays for the design work undertaken outside the country of importation. The adjustment corresponds to one quarter of the amount paid by the importer to the foreign subsidiary.

(j) 4 million c.u., representing one quarter of the cost of preparing the plans for the furnace system of the four plants, calculated by multiplying 8,000 man-hours by the cost per hour of 2,000 c.u. (see paragraph 3 (d) above).

This adjustment under Article 8.1 (b) (iv) covers the value of the design work for the furnace system of the imported plant.

8. The 12 million c.u. paid by NAVAL to SERVO in respect of graphs and drawings are not added to the selling price, since this service is provided within the country of importation; on the same grounds, the cost of the engineering services furnished by the specialist division of NAVAL itself should not be taken into account when determining Customs value, both exclusions being in accordance with the provisions of the Note to Article 8.1 (b) (iv), subparagraph 7.

9. To summarize (and ignoring for the purposes of this case study the question of transport costs), the transaction value of the imported plant is made up as follows :

	million c.u.
Selling price of the plant	2,000
To BORG for engineering and development	500
To AMERICA for materials for tanks	400
To AMERICA for plans of tanks	50
To AMERICA for technical assistance	25
To AMERICA for welding machines	10
To AMERICA for cylinders of gas	5
To VESPUCIO for steam system	300
To VESPUCIO for plans	45
To CARTAGO for plans of the auxiliary equipment	150
To CRIMEA for plans of the furnace syste	4
CUSTOMS VALUE OF THE IMPORTED PLANT	3,489

CASE STUDY 2.1
Application of Article 8.1 (d) of the Agreement

▪ Facts of transaction

1. Importer M purchases and imports a shipment of lamb carcasses from unrelated exporter X. The shipment is invoiced at an f.o.b. port of exportation price. Under the terms of the contract M pays, in addition to the invoice price, all costs and charges of transport and insurance to the port of importation and Customs duties and taxes, and also remits to X 40% of the net profit realized on the resale of the meat in the country of importation. The contract does not specify the resale price, but it provides that the net profit shall be determined by deducting from the resale price all direct expenses but not administrative overheads.

2. At the time of importation M has arranged to sell a quantity of the lamb carcasses at one price to R1, a wholesale firm. He has also arranged to sell the remaining carcasses at a higher price to R2, a frozen food chain, after he has cut them into smaller joints and packed them.

3. The country of importation applies the Valuation Agreement on a c.i.f. basis.

▪ Determination of Customs value

4. In the circumstances set out above there is a sale for export and, provided that the other requirements of Article 1 are satisfied, Article 1 can be applied for determining the Customs value of the imported goods. An addition must be made to the invoice price, under Article 8.1 (d), to take into account that part of the net profit which accrues to the exporter. The actual determination of transaction value is demonstrated in the following example. (N.B. Where the necessary documentation is not available at the time of importation it will be necessary to delay for a reasonable period of time the final determination of the Customs value under Article 13 of the Agreement.)

- **Example**

1. In the calculation of the transaction value the following symbols and figures are adopted :

P	= Invoice price	2,000,000 c.u.
T	= Freight and insurance from the country of exportation to the port or place of importation	200,000 c.u.
D	= Customs duties and importation charges (representing in all 20% of Customs value)	
Ti	= Internal transport	100,000 c.u.
C	= Marketing expenses	150,000 c.u.
G	= Expenses for cutting and packing the quantity resold to R2	300,000 c.u.
Pr1	= Resale price to R1	2,700,000 c.u.
Pr2	= Resale price to R2	1,250,000 c.u.
B	= Net profit of resales	
V	= Transaction value	

2. Obviously, the net profit B has to be determined on the basis of the amount of Customs duties and importation charges D, and this amount, which depends on the Customs value of the goods, has to be determined in the light of the net profit. There is thus an interdependence between elements B and V.

3. The calculation of transaction value would be made as follows :

V = P + T + 40B/100

V = 2,000,000 + 200,000 + 40B/100; that is to say

(1) V = 2,200,000 + 0.4B

The amount of the net profit of the resales is :

B = (Pr1 + Pr2) − (P +T +Ti + C + G + D); that is to say

B = (2,700,000 + 1,250,000) − (2,000,000 + 200,000 +
100,000 + 150,000 + 300,000 + 20V/100)

(2) B = 1,200,000 − 0.2V

Replacing this value of B in (1) :

V = 2,200,000 + 0.4 (1,200,000 − 0.2 V)
= 2,200,000 + 480,000 − 0.08 V;

that is to say 1.08 V = 2,680,000; V = 2,680,000/1.08

V = 2,481,481 c.u.

B = 703,704 c.u.

Thus the transaction value on a c.i.f. basis is 2,481,481 currency units.

CASE STUDY 2.2
Treatment of proceeds under Article 8.1 (d)

1. Article 8.1 (d) provides that, 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 the value of any part of the proceeds of any subsequent sale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

2. This subparagraph is directly connected with Article 1.1 (c), which permits the use of transaction value in the valuation of imported merchandise provided 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. Accordingly, the condition in Article 1.1 (c) may become inapplicable through an adjustment made under Article 8.

3. Article 8.1 (d) sets out the principles for the addition of any such payments and the Agreement contains no Interpretative Note clarifying its scope and application. It must also be noted that there is no mention in the Agreement stipulating that such payments must be a condition of sale; the mere existence of such proceeds requires an adjustment under Article 8.

4. Another important factor that should be taken into account is Article 8.3 which states that additions to the price paid or payable shall be made only on the basis of objective and quantifiable data; if not, transaction value cannot be determined.

5. In applying Article 8.1 (d) proceeds of any subsequent resale, disposal or use of the imported goods should not be confused with the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods (see Articles 1 and 8, and the relevant Interpretative Notes thereto).

6. Where an adjustment for proceeds is required and the relevant information is not available at the time of importation, it will be necessary to delay for a reasonable period of time the final determination of Customs value under Article 13 of the Agreement.

7. C Taking into consideration the foregoing principles the following illustrates the application of Article 8.1 (d) with an assumption that other requirements of Article 1 have been met.

▪ **General facts of transaction**

8. Corporation C of country X owns a number of subsidiaries in different countries, all of which operate in accordance with corporate policies established by C. Some of these subsidiaries are manufacturing enterprises, others are wholesalers and still others are service oriented enterprises.

9. Importer I in the country of importation Y, a subsidiary of C is a wholesaler of men's, women's and children's garments; he buys men's garments from manufacturer M, another subsidiary of corporation C also located in country X, and women's and children's garments from unrelated manufacturers of third countries as well as from local manufacturers.

✓ Situation 1

10. In accordance with C's corporate policy concerning sales between subsidiaries, goods are sold at a price negotiated between the subsidiaries. However, at the end of the year, importer I will pay to manufacturer M 5% of the total annual resale of the men's garments which he buys from him during that year as a further payment for the goods.

11. In this case, the payment in question is a proceed of a subsequent resale of the imported goods which accrues directly to the seller and the amount is to be added to the price paid or payable as an adjustment under the provisions of Article 8.1 (d).

✓ Situation 2

12. It has been established that importer I pays to service company A, another subsidiary of corporation C, 1% of his gross profit realized over the annual total sales of men's, women's and children's garments purchased from all sources. Importer I produces evidence that this payment is not related to the resale, use or disposal of the imported goods but is a payment made in accordance with corporate policy to reimburse A for low interest loans and other financial services A provides for all the subsidiaries of corporation C.

13. Service company A is related to the seller of the imported goods and thus the payment could be considered as an indirect payment to the seller. It is, however, payment for a financial service which is unrelated to the imported goods. Therefore, the payment would not be considered as proceeds in the meaning of Article 8.1 (d).

✓ Situation 3

14. It has been established that at the end of the financial year, importer I remits to corporation C 75% of his net profit realized over that year.

15. In this case the remittance by I to corporation C cannot be considered as proceeds since it represents a flow of dividends or other payments from the buyer to the seller which do not relate to the imported goods. Therefore, in accordance with the Interpretative Note to Article 1 (price paid or payable) it is not a part of the Customs value.

CASE STUDY 3.1
Restrictions and conditions in Article 1*

▪ Facts of transaction

1. M, a foreign manufacturer of motor vehicles, has concluded a contract with wholesaler D in the country of importation I wherein D will act as his sole distributor.

2. The specific provisions of the sole distribution 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., country of importation I;

   (b) D shall fix his retail prices and the discount rate for dealers in his territory;

   (c) D shall maintain two to three months vehicle stock and a corresponding stock of spare parts;

   (d) D shall spare no effort to import and sell the maximum quantities of motor vehicles from M. In the event of the minimum turnover not being reached, M reserves the right to terminate the agreement. The minimum turnover of different brands and models of vehicles is fixed by M.

   However, the quantity fixed for each brand and model is flexible and negotiable even though the quantity is not reached. D also reserves the right to terminate the agreement by giving adequate notice to M;

   (e) D shall maintain showrooms, employ adequate staff of trained salesmen and establish a chain of dealers with workshops;

* This case study deals only with restrictions and conditions in Article 1 and not with other issues, such as any relationship between the parties in terms of Article 15.

(f) D shall carry on advertising for the vehicles within the territory;

(g) D shall provide after-sale servicing to all M's vehicles used in the territory;

(h) M shall not sell vehicles to any firm in D's territory; and

(i) D shall not be given any quantity discount on motor vehicles imported by him.

▪ Specific facts

3. M's selling price to D of the most popular model is 12,000 c.u. per car irrespective of quantity and owing to the fact that M does not normally sell his cars to third parties, there is no evidence that M varies his selling price according to commercial level in respect of sales to country I.

4. R, a car rental agency in country I wishes to purchase 10 units of the same make of motor car from M. R then enters into negotiations with M for the direct purchase of 10 units because he is not prepared to pay D's minimum tax exclusive price of 21,000 c.u. M indicates readiness to sell 10 of the same model cars to R at 12,600 c.u. each but M is precluded from doing so by the sole distributor agreement between him and D who fears that R, who is not subject to the obligations undertaken by him (D), could resell the cars in country I below D's selling price and so substantially affect his (D) business. At D's insistence, the sale between M and R is to be made subject to the following conditions :

(a) the cars shall be registered for use as rental cars by R; and

(b) they shall not be resold by R within one year of registration.

5. A few tourists who visit M's country purchase from him identical motor cars at a tax free export price of 13,900 c.u. each for export to country I. Such sales to tourists are not prohibited by the sole distributorship agreement.

▪ Determination of Customs value

✓ Importations by sole distributor

6. An examination of the sole distribution agreement gives the following results :

(a) D's selling right shall not extend to countries outside the distributor's territory, i.e., country of importation I.

This is a provision which limits the geographical area in which the goods may be resold, a restriction that is permissible under subparagraph 1 (a) (ii) of Article 1.

(b) D shall fix his retail prices and the discount rate for dealers in his territory.

This provision is not a restriction or condition within the meaning of Article 1.

(c) D shall maintain two to three months vehicle stock and a corresponding stock of spare parts.

This provision corresponds to a usual business practice which requires the maintenance of an adequate stock for anticipated salesand 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) D shall spare no effort to import and sell the maximum quantities of motor vehicles from M. In the event of the minimum turnover not being reached, M reserves the right to terminate the agreement. The minimum turnover of different brands and models of vehicles is fixed by M. However, the quantity fixed for each brand and model is flexible and negotiable even though the quantity is not reached. D also reserves the right to terminate the agreement by giving adequate notice to M.

This provision is not a restriction or condition within the meaning of Article 1.

(e) D shall maintain showrooms, employ adequate staff of trained salesmen and establish a chain of dealers with workshops.

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) D shall carry on advertising for the vehicles within the territory.

This provision corresponds to usual business practices and would be treated as a condition or consideration relating to the marketing of the imported goods.

(g) D shall provide after-sale servicing to all M's vehicles used in the territory.

This provision corresponds to usual business practices and would be treated as a condition or consideration relating to the marketing of the imported goods.

(h) M shall not sell vehicles to any firm in D's territory.

This provision is not a restriction or condition within the meaning of Article 1.

(i) D shall not be given any quantity discount on motor vehicles imported by him.

This provision is not a restriction or condition within the meaning of Article 1.

✓ **Importations by the car rental agency**

7. Before arriving at a conclusion as to what Article is to be used for determining the Customs value of the imported cars, it is necessary to examine M's selling procedure to R.

8. By examining the agreement between M and R, it appears that there are two restrictions as to the disposition and use of the goods by the buyer, i.e. :

   (i) the cars shall be registered for use as rental cars by R;

   (ii) they shall not be resold by R within one year of registration.

9. Since M is prepared to sell the cars to R at 12,600 c.u., if D permits him to do so, the restrictions imposed on R solely for safeguarding D's business do not affect the value of the cars. Consequently the value can be established under the provision of Article 1.

✓ **Importations by tourists**

10. With respect to importations by tourists of identical cars into country I, account should be taken of the fact that though the transaction is executed in the market of the country of export, the facts of the transaction characterize the price as of "sale for export" to the country of importation. Customs value for this category should therefore be based on the transaction value, i.e. 13,900 c.u. adjusted as necessary (see Study 1.1 – Treatment of used motor vehicles).

CASE STUDY 4.1
Treatment of rented or leased goods

▪ **Facts of transaction**

1. Firm I of country X, engaged in catering business enters into a mid-term catering contract with the national airlines to supply prepared food in special individual packings ready for serving to passengers.

2. Whereas the previous packings for such purposes used to be imported by another firm, in view of the duration of the contract and on the basis of preliminary cost effective studies firm I decides to lease the necessary packing machinery. It, therefore, concludes a contract with leasing firm A of country Y. On the basis of the specifications given by firm I, the leasing firm A buys the machinery from a local manufacturer B in country Y on its own account and firm I takes the delivery ex-works. The price paid by A to manufacturer B is the price of the goods on the domestic market of country Y.

3. At the time of clearance firm I furnishes the Customs with a copy of the leasing agreement.

4. The terms of the leasing agreement are as follows :

   (a) All the costs for delivery of the machinery, its assembly in situ as well as its dismantling and return to an address to be named by the lessor shall be borne by the lessee.

   (b) Engineering personnel for assembling and putting the machinery into operation shall be provided by firm B. Costs of these activities shall be borne by the lessee.

(c) The lessee shall insure the machinery for the full period (delivery ex-works up to the return to the lessor).

(d) Any fees, duties and taxes payable in connection with the leasing and the importation shall be paid by the lessee.

(e) The period of lease is 36 months, renewable.

(f) The monthly rental payment is 5,300 c.u. In case of extension the rental payment is reduced by 15% per month.

5. In addition to the leasing contract, the lessee provides to the Customs the following information and documents :

- the lessor is a subsidiary of a bank;
- documentary evidence indicating that the lessor includes in the rental payments of contracts of this nature an interest of 9% (a rate which is applicable to medium-term loans in country Y);
- a document showing that monthly rental charges also include the lessor's commission of 1.5% calculated over the total amount payable for the basic contract period;
- a copy of the invoice indicating the price for the machinery paid by the lessor to manufacturer B.

▪ Determination of Customs value

6. Since this is the first importation of such machinery into the country of importation X, the use of Articles 2 and 3 is precluded and on account of the nature of the transaction Article 5 cannot be applied. The data necessary for determining the computed value is not available. The Customs have to establish a value under Article 7.

7. Although various approaches exist to determine Customs value under Article 7, using reasonable means consistent with the principles and general provisions of the Agreement and Article VII of GATT 1994, it has been decided in this case to establish the Customs value on the basis of rental payments payable during the full economic life of the machinery. Through consultation between the Customs and the lessee this economic life is estimated to be 60 months.

8. The monthly rental payment is 5,300 c.u. for 36 months and 4,505 c.u. for the remaining 24 months (15% reduction). The interest element of 9% included in those amounts should be deducted insofar as the conditions set out in the Geneva Decision on interest are fulfilled.

9. It has been established that the 1.5% commission on the total amount payable over the basic contract period cannot be considered as a buying commission under the terms of Article 8.1 (a) (i). This commission is actually the lessor's mark-up and should not be deducted.

10. Depending upon the national legislation of each Party, the elements listed in Article 8.2 will be included in or excluded from the Customs value. Cost of the engineering personnel for assembly of the machinery, fees, duties and taxes payable in connection with leasing and importation are not part of the Customs value.

11. For arriving at the Customs value the rental amount, exclusive of interest can be determined on the basis of the following formulae for which certain symbols are adopted :

R_1 = Monthly rent payable over the basic contract period(36 months)

R_2 = Monthly rent payable over the remaining economic life of the machinery (24 months)

Q = 1 + i, where i represents rate of interest per month(0.0075)

N = Number of payments.

✓ **Calculation of the rental amount exclusive of interest over the basic contract period**

(a) If the rental payment is made in arrears :

$$\frac{R_1 \ (Q^N - 1)}{Q^N \ (Q - 1)}$$

The following calculation illustrates the above formula :

$$\frac{5{,}300 \ (1.0075^{36} - 1)}{1.0075^{36} \ (1.0075 - 1)} = \frac{5{,}300 \ (1.3086 - 1)}{1.3086 \ (1.0075 - 1)} =$$

$$\frac{5{,}300 \times 0.3086}{1.3086 \times 0.0075} = \frac{1{,}635.58}{0.0098} = 166{,}896$$

(b) If the rental payment is made in advance :

$$\frac{R_1 \ (Q^N - 1)}{Q^{N-1} \ (Q - 1)}$$

The following calculation illustrates the above formula :

$$\frac{5{,}300 \ (1.0075^{36} - 1)}{(1.0075^{36-1})(1.0075 - 1)} = \frac{5{,}300 \ (1.3086 - 1)}{1.2989 \times 0.0075} =$$

$$\frac{5{,}300 \times 0.3086}{1.2989 \times 0.0075} = \frac{1{,}635.58}{0.00974} = 167{,}924$$

✓ **Calculation of the rental amount exclusive of interest over the remaining economic life of the machinery**

(a) If the rental payment is made in arrears :

$$\frac{R_2\ (Q^{N\ -\ 1})}{Q^N\ (Q\ -\ 1)}$$

The following calculation illustrates the above formula :

$$\frac{4{,}505\ (1.0075^{24}\ -\ 1)}{1.0075^{24}\ (1.0075\ -\ 1)} = \frac{4{,}505\ (1.1964\ -\ 1)}{1.1964\ (1.0075\ -\ 1)} =$$

$$\frac{4{,}505\ \times\ 0.1964}{1.1964\ \times\ 0.0075} = \frac{884.782}{0.00897} = 98{,}638$$

(b) If the rental payment is made in advance :

$$\frac{R_2\ (Q^N\ -\ 1)}{Q^{N-1}\ (Q\ -\ 1)}$$

The following calculation illustrates the above formula :

$$\frac{4{,}505\ (1.0075^{24}\ -\ 1)}{(1.0075^{24-1})\ (1.0075\ -\ 1)} = \frac{4{,}505\ (1.1964\ -\ 1)}{1.1875\ \times\ 0.0075} =$$

$$\frac{4{,}505\ \times\ 0.1964}{1.1875\ \times\ 0.0075} = \frac{884.782}{0.0089} = 99{,}414$$

12. In the present case the total rental amount payable over the full economic life of the machinery, calculated as indicated above, would constitute the Customs value subject to the national legislation provisions with respect to the elements listed in Article 8.2.

CASE STUDY 5.1
Application of Article 8.1 (b)

(Assists in relation to armoured vehicles : the basic vehicles.)

- **Facts of transaction**

1. Importer I in country of importation Y presents for Customs clearance 10 armoured vehicles, which were the subject of an armoring operation by firm A in country of exportation X. The basic vehicles were purchased by I from manufacturer M, also in country X, at a total price of 17,400,000 c.u. and supplied free of charge to A, without having been used since purchase.

2. At the time of importation, I produces an invoice from A for the armoring operation for an amount of 43,142,000 c.u., and an invoice from manufacturer M for the basic vehicles invoicing I for an amount of 17,400,000 c.u.

- **Determination of Customs value**

3. In this case the armoured vehicles should be valued under the provisions of Articles 1 and 8 taken together. The cost of the basic vehicles should be added, as an adjustment under Article 8.1 (b)(i), to the price actually paid or payable for the armoring operation. Because A is providing armoring services, not selling armoured vehicles, the term "sale" as it applies to the transaction between I and A, will be regarded in its widest sense as a sale of goods, in accordance with paragraph (b) of Advisory Opinion 1.1. Thus, ignoring for the purposes of this case the question of transport costs and associated charges, the transaction value of the armoured vehicles would be 60,542,000 c.u.

CASE STUDY 5.2
Application of Article 8.1 (b).

(Assists in relation to the manufacture of racing cars : the carburettors ; the electronic check ing equipment ; the fuel for the race track tests; and the plans and sketches.)

- **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 by I. The equipment will be incorporated into 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 I to 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 county of importation, if this is provided for in the importing country's national legislation.

CASE STUDY 6.1
Insurance premiums for warranty

▪ **Facts of transaction**

1. Seller S, established in the country of exportation X, is the exporter of motor vehicles manufactured by M, also of country X. Seller S concluded a sales contract with buyer B of country of importation Y. According to one of the conditions of the sale contract, a two-year warranty (spare parts and repair work) is provided for the cars to be purchased by B. The costs for the first year of warranty are included in the price of the cars payable by B.

2. The contract of sale provides that the second year's warranty costs will be paid by buyer B to seller S by way of a separate payment calculated as a certain amount per car. The payment applicable to each shipment of cars will be invoiced following shipment. The amount payable is final regardless of whether there are claims and compensation during the second year's warranty.

3. Seller S negotiates an insurance contract for the second year's warranty with an insurance company N, established in country T. According to the contract, the insurance company will fully compensate buyer B directly for all claims relating to the second year's warranty that is given on the cars. The insurance company will receive the premium from the seller.

4. Claims and compensation during the first year of warranty are to be settled directly between the manufacturer and the buyer, and during the second year between the insurance company and the buyer.

▪ **Valuation treatment**

5. It should be pointed out that the price actually paid or payable is defined in the Note to Article 1 as the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. This definition is further amplified in paragraph 7 of Annex III which states that 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.

6. In this case, the first year's warranty cost is part of the price actually paid or payable. The second year's warranty cost, although paid for separately, is also part of the price actually paid or payable by the buyer to the seller for the imported cars.

CASE STUDY 7.1
Application of the price actually paid or payable

▪ **Facts of transaction**

1. An importer purchases a machine at a price of 10,000 c.u.

2. The machine in question, which is highly specialized and incorporates advanced technology, calls for the use of a sophisticated operating method. The seller has therefore prepared a training course to instruct buyers in the operation of the machine. The course is to be held, prior to importation, at the seller's premises in the country of exportation. The charge for the course is 500 c.u.

3. Prior to the Customs clearance of the machine, the importer/buyer presents an invoice of the price for the machine.

4. The importer, being uncertain as to whether the amount in respect of the course should or should not be included in the Customs declaration, informs Customs of the separate billing for the charge for the training course.

✓ **Situation 1**

5. According to the contract of sale, it is up to the buyer to decide whether he needs the course or whether he feels capable of operating the machine without attending the course. Payment for the course is due only if the buyer actually attended. By way of information, it is pointed out that, at the time of Customs clearance, the buyer has attended the course. Furthermore, the price of the machine can be verified as being 10,000 c.u.

▪ Determination of Customs value

6. 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 by the buyer to the seller as a condition of the sale of the imported goods.

7. The payment for the course is not a condition of sale if it is possible to purchase the machine without paying for the course. The fact that the charge for the course has been billed separately implies that the buyer has attended the course. In this case, the payment for the course is not for the imported goods because it is not a condition of the sale of the machine. In fact, the contract of sale comprises two elements, namely the provision of goods and providing the course. Insofar as the machine may be purchased without paying for the course, these two elements are separable.

8. Thus, the payment for the course is not part of the Customs value, under the provisions referred to in paragraph 6 above, because it is not a condition of the sale.

✓ Situation 2

9. The payment for the course is an explicit requirement in the contract of sale and must be made even if the buyer does not attend.

▪ Determination of Customs value

10. The payment for the course is a condition of sale; it is due even if the buyer has not actually attended the course and the machine cannot be purchased without paying for the course. In this case, the total payment, which includes the price of the course is, under the provisions referred to in paragraph 6 above, made for the imported goods, because it is made as a condition of the sale. This is so, even though the cost of the course appears on a separate billing.

✓ Situation 3

11. The contract of sale obliges the buyer both to attend and to pay for the course.

▪ Determination of Customs value

12. The payment for the course forms part of the Customs value of the goods for the same reasons as under Situation 2 above.

CASE STUDY 8.1
Application of Article 8.1

(Adjustments in relation to the garments : the licence fee that is required to be paid for the right to use the paper patterns.)

▪ **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 licence 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 both 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 for 40 c.u. per garment, in order to establish whether or not it forms part of the Customs value of the imported garment. 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 STUDY 8.2
Application for Article 8.1

(Adjustments in relation to the video laser disc : the licence fee that is required to be paid for the right to use the music video clips and master tape.)

▪ **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 1 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).

CASE STUDY 9.1
Sole agents, sole distributors and sole concessionnaires

▪ **Facts of transaction**

1. Autoex, a company established in the country of export X, manufactures "Auto" brand high performance motor vehicles. Autoex designates Auto Inc.(Inc), a newly established company in the country of importation I, to be its sole distributor inc country I. The Agreement signed between Autoex and Inc. provided that :

   (i) Autoex granted Inc. the exclusive right to sell and distribute "Auto" vehicles in country I;

   (ii) Autoex and Inc. shall annually set recommended retail selling prices for vehicles in country I on the basis of market trends and anticipated demand for vehicles:

   (iii) Autoex and Inc. will negotiate Inc.'s purchase price for vehicles on the basis of agreed recommended retail selling prices. In addition, Inc. will be entitled to a quantity discount, to be effected on the invoice, of 10% from agreed prices on orders of more than one vehicle;

   (iv) Inc. is to conduct its business entirely in its own account. Autoex will not indemnify or reimburse Inc. for any loss suffered in connection with the sale of "Auto" vehicles, including default of customers.

2. Paragraph 1 sets out the total agreement between the parties and that agreement is consistent with commercial practice

3. Inc. subsequently sells two "Auto" vehicles to PCO, a motor vehicle dealer established in country I. Both cars were manufactured by Autoex and shipped to Inc. for pre-delivery preparation.

4. Inc. is responsible for arranging Customs clearance and prior to importation, presents to Customs in country I all the documentation with respect to the transaction with a request for a ruling.

5. The examination of the circumstances surrounding the sale establishes the following :

   (a) That both Autoex and Inc. had issued invoices in respect of the motor vehicles.

      (i) The first invoice, issued by Autoex to Inc., required the payment of 200,000 c.u. less "discount" of 20,000 c.u., making a total 180,000 c.u. The terms of sale were f.o.b. (port of export) with payment by letter of credit at sight upon presentation of the bill of lading.

      (ii) The second invoice, issued by Inc. to PCO, required the payment of 300,000 c.u. (Customs duty and taxes included). The terms of sale were ex-yard from Inc.'s premises in country I. Payment was required 30 days after delivery.

   (b) The overseas freight and insurance charges paid by Inc. were 5,000 c.u.

▪ **Determination of Customs value**

6. The determination of Customs value in this case depends on the proper characterization of the role and legal status of each of the parties to the transaction.

7. An examination of the agreement between Autoex and Inc. and the conduct of the parties reveals that :

   (a) Inc. is an independent legal entity;

   (b) Inc. takes title to the goods and assumes the risk at the f.o.b. stage;

   (c) Inc. assumes the risk of non-payment by PCO.

8. These facts indicate that there is a sale for export to country I and Autoex is the seller and Inc. is the buyer of the imported goods.

9. There is nothing in the Agreement between Autoex and Inc. to suggest relationship in terms of Article 15.4, and in particular, Article 15.4(e). Similarly, the various elements of the agreement are not conditions or restrictions in terms of Article1.1.

10. The sale between Autoex and Inc. forms the basis for determining the Customs value under Article 1.

CASE STUDY 10.1
Application of Article 1.2

▪ **Facts of transaction**

1. ICO of country I purchased and imported two categories of ingredients used in the production of food flavorings from XCO of country X.

2. At the time clearing the goods, ICO declared to Customs in Country I that it was related to XCO as :

   (a) XCO held 22% of the shares of ICO; and

   (b) officers and directors of XCO were also represented on the Board of Directors of ICO.

3. After importation, Customs in country I decided to conduct a review of the circumstances surrounding the sale of goods between XCO and ICO, pursuant to Article 1.2 of the Agreement, because it had doubts about the acceptability of the price. To this end, Customs forwarded a questionnaire to ICO which sought information regarding the sale of products by XCO to other buyers in country I and, if necessary, justification of any price difference as well as information relating to XCO's cost of production and profit. At the request of ICO, Customs also forwarded a questionnaire to XCO. From the responses received, facts as set out below were established.

4. ICO purchased many of the ingredients required for the production of food flavorings from XCO. The ingredients sold by XCO to ICO fall into two categories:

   (a) ingredients manufactured by XCO; and

   (b) ingredients stocked by XCO which have been acquired from other manufacturers and suppliers. Ingredients in the category are not manufactured or processed by XCO. Some of these ingredients may, however, be packaged for resale by XCO.

5. In terms of Article 15.2 of the Agreement, ingredients in category (a) are not identical or similar goods to the ingredients in category(b).

6. Ingredients in category (a) are also sold to other unrelated buyers in country I. The prices charged by XCO in respect of category (a) ingredients are :

   (i) Sold to ICO 92 c.u. f.o.b.

   (ii) Sold to unrelated buyers 100 c.u. f.o.b.

7. In respect of the ingredients in category (a) Customs found that :

   (i) unrelated buyers purchased the ingredients at the same commercial level and in similar quantities as ICO an used the ingredients for the same purpose. Importations of these ingredients by unrelated buyers were appraised with a transaction value of 100 c.u.; and

   (ii) the costs incurred by XCO were the same in relation to sales to ICO and unrelated buyers in country I.

8. Customs also established that there was no seasonal influence on the price of ingredients which might explain the 8% difference in prices set out paragraph 6. Furthermore, after being asked to do so by Customs, ICO and XCO provided no additional information to explain the difference in prices.

9. Ingredients in category (b) are sold only to ICO in country I and there are no importations of identical or similar goods into country I.

10. In respect of the ingredients in category (b), Customs established that the prices charged to ICO were adequate to recover all XCO's costs, including the costs of acquisition plus the costs of repacking, handing and freight charges, as well as to recover a profit that was representative of the firm's overall profit over a representative period of time.

▪ Determination of Customs value

11. ICO and XCO are related persons in terms of paragraphs (a) and (d) of Article 15.4. As provided by Article 1.1 (d), read with Article 1.2, the transaction value of sales between XCO and ICO will form the basis for the determination of Customs value only where it is established that price was not influenced by the relationship.

12. Under Article 1.2 of the Agreement the responsibility for demonstration that relationship has not influenced price lies with the importer. While the Agreement requires Customs to provide reasonable opportunity to the importer to provide information that would indicate that prices are not influenced by relationship, it does not require the Customs administration to conduct an exhaustive enquiry for the purpose of justifying the price difference. Thus, any decision in this regard must, to a significant degree, be based on the information provided by the importer.

Ingredients of category (a)

13. The information available in this case shows that the transactions between ICO and XCO are at prices lower than the prices at which the sales are effected to unrelated buyers. When asked to do so, XCO and ICO have failed to explain the different prices.

14. The information obtained by Customs shows that ICO and the unrelated buyers purchase similar quantities of ingredients at the same commercial level and for the same purpose and that XCO's selling costs are the same for sales to ICO and the unrelated buyer. Based on the foregoing and on the nature of industry and goods, there are insufficient grounds to take the view that the price differential is not significant.

15. In respect of ingredients in category (a), therefore, the transaction value method would not be applicable. Recourse to an alternative method for determining the Customs value of category (a) ingredients would be necessary. In this regard, the transaction value of either identical or similar goods imported by unrelated buyers may form the basis of determination of Customs value.

16. It should, however, be noted that the impact of the specific price differential is unique to the facts as presented in the case. This price differential should not be taken as a standard or benchmark for determining whether a price difference is commercially significant in other cases. The Agreement makes it clear that the significance of any price difference should be considered on the basis of the nature of the goods and industry in the case in question.

Ingredients of category (b)

17. In respect of ingredients in category (b) which are sold only to ICO, the examination of the circumstances of the sale shows that the price is adequate to ensure recovery of all costs plus a profit representative of XCO's overall profit in goods of the same class or kind. In accordance with paragraph 3 of the Interpretative Note to Article 1.2, transaction values in respect of this category of ingredients may be acceptable for Customs purposes.

CASE STUDY 11.1
Application of Article 15.4 (e) – related party transactions

▪ **Facts of the transaction**

1. Company B in importing country I has entered into a sales, service and distribution agreement (the agreement) with Company C in exporting country X. Company C is a subsidiary of a large multi-national enterprise that manufactures heavy machinery and spare parts well known to consumers.

2. The agreement provides :

   (a) Both Company B's and Company C's primary purpose in entering into the agreement is to develop and promote the sale of products and to provide a high standard of parts availability and mechanical service to ensure the satisfaction of product users.

   (b) Company B shall be responsible for developing and promoting the sale of products to customers and prospective customers located within the agreed territory and for servicing the agreed range of products.

   (c) The agreement is a personal contract entered into by Company C in reliance on the capability of Company B to provide sales and service to customers. Without the express written consent of Company C, Company B agrees not to appoint others to perform such sales and service responsibilities.

   (d) Company C and Company B agree that Company B's effectiveness and ability in achieving the primary purpose for the agreement could be adversely affected by Company B's affiliation with another organization which is a substantial operator (end-user) of products. Company B agrees that during the life of the agreement it will avoid any such affiliation whether by way of capital investment, source of capital, common management, common ownership, or otherwise, except to the extent that Company C may otherwise agree in writing.

(e) Company C relies upon the qualifications and abilities of certain individuals employed by Company B to promote, sell and provide maintenance in country I. Company B agrees that those individuals will continue in the active management of Company B, or will continue to own a substantial financial interest in Company B. No substantial change shall be made in the management positions, ownership or voting control of those individuals without advance notice to and prior approval from Company C.

(f) Company B agrees that, unless Company C otherwise agrees in writing, its inventory of products purchased from Company C under the agreement shall remain unencumbered by security interests of any type in favour of any other creditor.

(g) Company B will maintain, to the satisfaction of Company C, a suitable place or places of business to provide an adequate source of products and mechanical service for the benefit of customers. Company B agrees to establish additional places of business or re-locate existing establishments in order to adequately service customers. The location of additional places of business and the relocation of existing places of business may only be made with the written consent of Company C. All places of business shall be maintained by Company B in a neat and attractive manner and stock adequate quantities of products to the satisfaction of Company C.

(h) Company B will employ an adequate number of qualified personnel to sell and service products to the satisfaction of Company C.

(i) Company B will maintain inventory and sales records in the manner specified by Company C and provide reports regarding inventory, sales and service to Company C at intervals specified by Company C.

(j) Within 30 days after the end of the fiscal year of Company C, and at any other time upon Company C's request, Company B will deliver to Company C such information as Company C may reasonably request respecting the ownership, financial condition and operations of Company B, together with any subsidiary and related companies.

(k) Unless otherwise agreed by Company C, within 90 days after the close of Company B's fiscal year Company B will deliver Company C audited financial statements and a statement of the results of operations for such fiscal year.

(l) It is the intention of the parties that the relationship between them shall be that of independent contractors and vendor and vendee; that nothing contained in the agreement or done pursuant thereto shall constitute Company B the agent of Company C for any purpose whatever; and that all the acts and things done or to be done by Company B pursuant to the agreement, unless expressly otherwise provided, shall be at Company B's own cost and expense.

(m) Either party may terminate the agreement, with or without cause, by notice of termination to the other party.

3. Other clauses of the agreement set out the manner in which goods are to be sold by Company C to Company B as well as the terms and conditions of each sale made in accordance with the agreement, including dealer prices, end user prices, passing of title, method of payment and warranty.

4. In accordance with the agreement, imports into country I of goods supplied by Company C fall into the following four categories :

(i) goods sold by Company C to Company B;

(ii) goods sold by Company C directly to customers (end users) pursuant to orders solicited by Company B;

(iii) goods sold by Company C to end users without the involvement of Company B or any other dealer; and

(iv) goods sold by Company C to two other dealers similar to the sales to Company B under category (i).

5. An examination of the circumstances related to the two other dealers reveals that Company B has a unique association with Company C. The other dealers :

   (a) are allowed to purchase goods only on their own account;

   (b) are not permitted to solicit orders from end-users of the type solicited by Company B under category (ii) (i.e., commission sales);

   (c) are not authorized to undertake diagnostic activities; or

   (d) do not receive commissions in respect of sales by Company C to other buyers in country I.

6. The terms of the contracts between these two dealers and Company C do not contain the clauses outlined in paragraph 2 above.

7. Customs has also established that Company B and Company C are not related persons in terms of paragraphs (a), (b), (c), (d), (f), (g) and (h) of Article 15.4 of the Agreement.

▪ Issue for Determination

8. In respect of the sales between Company C and Company B the issue for determination is whether they are related persons under Article 15.4 (e) because one of them directly or indirectly controls the other.

▪ Analysis

9. The Interpretative Note to Article 15.4 (e) provides that "one party 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 Technical Committee's Explanatory Note 4.1 endeavours to provide additional guidance on the application of Article 15.4 (e) and its Interpretative Note in relation to sole agency, sole concessionaire and sole distributor agreements. The same considerations of determining control arise in this case.

10. Explanatory Note 4.1 observes that all buyer/seller and distribution arrangements allocate rights and obligations that are legally enforceable between the parties. It also emphasizes the importance of distinguishing the rights and obligations normally associated with the international sale and distribution of goods from contractual rights and obligations that would establish a relationship between the parties as envisaged by Article 15.4 (e). Explanatory Note 4.1 states that "the wording of the Interpretative Note to Article 15.4 (e) must normally be taken to apply to situations which ... involve a position to exercise restraint or direction in respect of essential aspects relating to the management of the activities of the other person". To determine whether Companies B and C are related on the basis of the distribution agreement, it is necessary to critically examine the effect of the provisions of the distribution agreement against this principle, Article 15.4(e) and its Interpretative Note.

11. Many of the clauses contained in the distribution agreement between Companies C and B are typical of those usually encountered in distribution agreements and do not involve direction or restraint by one party over the other. For example, distribution agreements usually contain a termination clause (2 (m)); clauses allocating responsibility (2 (b)); a "best endeavours" clause (2 (h)); and a statement of independence to limit liability (2 (l)). However, a number of other clauses in the distribution agreement warrant closer analysis :

    (a) Clause 2 (d) – distribution agreements generally include provisions intended to prevent the establishment of associations by either party that may result in conflicts of interest. In this case, the parties have identified that any affiliation with end-users by Company B's might adversely affect its ability to achieve the primary purpose for the agreement. Company B agrees to avoid any such affiliations "by way of capital investment, sources of capital, common management, common ownership, or otherwise except to the extent that Company C may otherwise agree". Decisions regarding investment, sources of capital, management, and ownership may be essential aspects in the direction of an enterprise.

However, the actual extent of this limitation must be evaluated in the context of the primary purpose for the agreement and the prevention of conflicts of interest. This clause restricts Company B's right to affiliate with or obtain capital from "end-users". Company B is free to affiliate with other parties and to obtain capital from other sources without the prior agreement of Company C. In the circumstances, it is reasonable for Company C to have the right to accept or reject any affiliation with an "end-users" proposed by Company B because of its potential adverse impact on Company B's priorities and/or loyalty.

(b) Clause 2 (e) – distribution agreements typically contain clauses requiring either party to provide notice to the other party of any significant change in ownership or management. In many cases, such changes may provide grounds for termination of the agreement. However, Clause 2 (e) goes significantly further than a simple notification provision as it requires Company C's prior approval before any changes in management positions, ownership and voting control take place. Appointment of the management and decisions relating to the transfer of ownership and voting control are essential aspects relating to the management of Company B.

(c) Clause 2 (g) – requirements to maintain adequate places of business as well as adequate levels of stock and spare parts are commonly included in distribution agreements. In many cases the location of places of business may be discussed between the supplier and distributor. This clause, however, makes it clear that Company C ultimately has the right to decide on establishment of new places of business and on the re-location of existing places of business. Decisions relating to the location of business activities are essential aspects of the management of Company B.

(d) Clauses 2 (j) & (k) – while these clauses do not grant any specific decision making rights to Company C, they indicate that Company C monitors the financial status of Company B, its subsidiaries and related companies. Access to financial records is typically provided to enable one of the parties to audit and establish the accuracy of payments made to it by the other party (e.g., royalties, commission and proceeds). The precise nature of Company C's access to Company B's financial records is not clear from the information provided and further examination would be necessary to determine the practical extent and effect of this clause.

▪ **Conclusion and Reasons**

12. While all of the aspects of the agreement between Companies B and C are consistent with commercial practice, the agreement goes beyond usual buyer/seller and distribution arrangements. Through the agreement, Company C is in a position to exercise direction or restraint over Company B in respect of a number of essential aspects of it management (i.e., management positions; ownership or voting control; and the location of places of business). Companies B and C would be, therefore, related persons for the purposes of the WTO Customs Valuation Agreement because Company C has the capacity to directly or indirectly control Company B within the terms of Article 15.4 (e) of the Agreement.

13. In light of this conclusion, if there are doubts about the acceptability of the price, an examination into whether that relationship has influenced the price in accordance with Article 1.2 and its Interpretative Note should be undertaken by the Customs administration.

CASE STUDY 12.1
Application of Article 1 of the Valuation Agreement for goods sold for export at prices below their cost of production

▪ **Facts of transaction**

1. Importer A in Country B buys high quality components to be consumed within its manufacturing processes from Exporter S in Country T. Exporter S is a subsidiary of a multi-national conglomerate selling to a specific industrial sector. There is no relationship between buyer and seller. All negotiations were concluded by Exporter S advising Importer A that agreed price levels can only be maintained while current stocks last. Exporter S has no position within Country B and sees this sale as an opportunity to break into this market. Successful market penetration would have considerable long-term benefits for the company and would serve as a platform for the introduction of the more profitable related companies from within their group. Price levels were influenced by this opportunity.

2. Global economic circumstances have forced Exporter S to sell stock items at prices that are on average 30% below its cost of production in order to generate cash flow. The components orderedby Importer A fall into this category. However, because of the marketing opportunity Exporter S has agreed to sell at prices 40% below its cost of production.

✓ Question

3. Under the Valuation Agreement how should the Customs value be calculated?

▪ Determination of Customs value

4. The primary basis for the Customs value of imported goods is the transaction value, that is the price actually paid or payable for the goods adjusted in accordance with Article 8, subject to certain requirements (Article 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 (Note to Article 1).

5. The facts as presented indicate that a sale for export has been agreed between Exporter S and Importer A.

6. Within the case under consideration there are no indications that would provide grounds for rejection of the transaction value under Article 1, subject of course to the provisions of Article 17 of the Agreement. There are no restrictions recorded. There are no conditions or considerations for which a value cannot be determined with respect to the goods being valued. Exporter S and Importer A have agreed upon a price for the sale. That price is conditional only on the availability of stock. Likewise, there are no proceeds from subsequent sales that accrue to the seller. Neither is there any relationship provided for in Article 15.4 based on the given facts.

7. It follows therefore that there are no grounds under the provisions provided within Article 1 of the Valuation Agreement to reject the transaction value and move to another Article in order to determine the Customs value.

8. Advisory Opinion 2.1 concludes that the mere fact that a price is lower than prevailing market prices for identical goods is not sufficient grounds for rejection of the transaction value under Article 1. Similarly, the mere fact that the price in this case is below the seller's cost of production and does not return a profit to the seller, is not sufficient grounds for rejection of the transaction value.

▪ Conclusion

9. Based on the information provided, the Customs value should be calculated on the basis of the transaction value using the price Importer A pays Exporter S adjusted in accordance with Article 8.

CASE STUDY 13.1
Application of Decision 6.1 of the Committee on Customs Valuation

(Declared value of imported goods lower than identical goods)

▪ 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 commercial correspondence;

   (v) the sale was settled by telephone.

9. 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 good 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 therefore.

23. In this case, the Customs value was established under the provisions of Article 2 of the Agreement.

CASE STUDY 13.2
Application of Decision 6.1 of the Committee on Customs Valuation

(Declared value of imported goods lower than raw materials.)

▪ Facts of transaction

1. The Customs administration of country Y received a complaint alleging that spiral nails of country X origin were being imported and cleared on extremely low values ranging from 340 c.u./MT to 440 c.u./MT, while the price of raw material, i.e. steel wire rod used in the manufacturing of spiral nails in international market, ranged from 600 c.u./MT to 675 c.u./MT and the price of the wire rod in the local market was around 670 c.u./MT.

2. The complainant further stated that the actual import price of spiral nails was 1,250 c.u./MT. The complainant also furnished a copy of a Goods Declaration which showed that spiral nails were assessed at 750 c.u./MT against the declared value of 350 c.u./MT.

3. The Customs administration of country Y carried out a study and checked the data available on this case. The international market price of raw material (steel wire rod) was verified by examining the data reported in a reputed specialized journal published in London during the corresponding period and by the record of the physical import of steel wire rod into the country Y at 675 c.u./MT. The country of exportation/production of spiral nails and steel wire rod was the same, however, the producers/ exporters of spiral nails and steel wire rod were different.

4. The Customs administration found that there was a case in which Customs assessed the value of imported spiral nails at 750 c.u. /MT. This represented the computed value based on available information. (The declared value of 350 c.u. /MT was determined not to represent the transaction value and was rejected by Customs).

5. Five additional cases of importations of spiral nails were identified. The provisional values determined for purposes of Article 13 were 551 c.u. /MT, 551 c.u./MT, 539 c.u. /MT, 541.3 c.u. /MT and 565.7 c.u. /MT. These cases were forwarded to the Directorate General of Customs Valuation and Post Clearance Audit. That department performs the specialized function of deciding cases involving valuation disputes that cannot be resolved by the field offices.

6. The Customs administration held several meetings on these cases to give the importers an opportunity to demonstrate that their declared values represented the transaction value.

7. The importers were asked to provide proforma invoices, commercial invoices, copies of contracts, evidence of payment and all other documents relevant to the transaction, which could confirm that the declared price was indeed the price actually paid or payable. However, the importers provided only proforma invoices and commercial invoices issued by exporters. While the importers stated that they did not use Letters of Credit as a means of payment, they were unable to provide any evidence of payments for the goods. The importers also stated that there were no written sales contracts of the goods and that the goods were imported based on oral agreements with the exporters.

8. The Customs administration examined the accounting records of the importers during the course of consultations but found that they did not support the price actually paid or payable because the importers had not maintained detailed accounting records and financial books. The Customs administration could not find any evidence of payment for the goods nor any information or evidence about possible additions to the price, for example, assists.

▪ Determination of Customs value

✓ Transaction Value Method

9. 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.

10. 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.

11. This price may be represented by the invoice price, adjusted in accordance with the provisions of the Agreement and in this respect the commercial invoice could constitute sufficient proof of the truth or accuracy of the declared value subject to Article 17. This article provides that nothing in the Agreement shall be construed as restricting or calling into question the right of Customs administrations to satisfy themselves as to the truth or accuracy of any statement, document or declaration presented to Customs for valuation purposes.

12. 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 importers 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.

13. In this case, due to the fact that the declared value of the spiral nails was substantially lower than the prices on the International Market of raw materials used in the manufacture of spiral nails, the Customs administration had reason to doubt the truth or accuracy of the declared value as reflected in the commercial invoices. Therefore, in accordance with Decision 6.1, the Customs administration asked the importers to provide further evidence to confirm that the declared value was the price actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8. The importers were given several opportunities to provide additional information, but they could not provide the contract or any evidence of payment. In addition, the accounting records reviewed during the consultation revealed that they did not support the price actually paid or payable. The Customs Administration still had reasonable doubts about the truth or accuracy of the declared value.

14. The Technical Committee previously considered how Decision 6.1 of the Committee on Customs Valuation should be applied, including the appropriate procedures to be followed in Case Study 13.1, "Application of Decision 6.1 of the Committee on Customs Valuation." 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, bearing in mind the provisions of Article 11, be deemed that the Customs value of the imported goods cannot be determined under the provisions of Article 1. 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 of documents produced and the importer shall be given a reasonable opportunity to respond.

15. In this case, taking into account the facts that: (i) the declared value of the spiral nails was substantially lower than the prices on the International Market of raw materials used in the manufacture of spiral nails; (ii) the importers provided no evidence, including no evidence of payment, other than the commercial invoices and proforma invoices to substantiate that the declared value represented the price actually paid or payable for the imported goods, adjusted in accordance with Article 8; and (iii) the importers had not maintained nor provided detailed accounting records and financial books, the Customs administration still had reasonable doubts and concluded that the Customs value of the imported goods cannot be determined under the provisions of Article 1. Before taking a final decision, the Customs administration communicated its grounds for doubting the truth or accuracy of the submitted documents, both in writing and orally during several meetings. The Customs administration also provided the importers with opportunities to respond.

16. In light of the foregoing, the declared value was rejected taking into account Article 17, Decision 6.1, and Case Study 13.1. When a final decision was made, the Customs administration communicated to the importers in writing its decision and the grounds thereof. After rejection of the transaction value under Article 1, attempts were made to determine the Customs value by proceeding sequentially starting with Article 2.

✓ Identical/Similar Goods Method

17. The Customs administration next considered the application of Articles 2 and 3. Although there was one case in which the Customs administration determined the value of identical or similar spiral nails at 750 c.u./MT, this value could not be used for purposes of applying Articles 2 and 3 because it was a computed value rather than transaction value of identical or similar goods. The Interpretative Note to Articles 2 and 3 makes it clear that only those cases should be selected for identical or similar goods purposes where the declared values have already been determined under Article 1.

18. There were five other cases of imported spiral nails, for which the Customs administration provisionally assessed the value under Article 13. These provisional values could not be used as the basis of valuation under identical / similar goods method because Article 13 relates only to the release of imported goods upon deposit of a sufficient guarantee when it becomes necessary to delay the final determination of the Customs value.

19. Since there had not been any available transaction values of identical or similar goods in this case, the Customs value of the imported goods could not be determined under the provisions of Articles 2 and 3 and the next method of valuation had to be considered in accordance with the Agreement.

✓ Deductive Value Method

20. After exhausting the provisions of Articles 1, 2 and 3, the deductive value method under Article 5 was applied.

▪ Conclusion

21. In accordance with Decision 6.1 the Customs value could not be determined under Article 1.

CASE STUDY 14.1
Use of transfer pricing documentation when examining related party transactions under Article 1.2 (a) of the Agreement

▪ Introduction

1. This document describes a case where Customs took into account information provided in a company's transfer pricing study based on the Transactional Net Margin Method (TNMM) when examining whether or not the price of imported goods had been influenced by the relationship between buyer and seller in accordance with Article 1.2 (a).

   This case study does not indicate, imply, or establish any obligation on Customs authorities to utilize the OECD Guidelines and the documentation resulting from the application of the OECD Guidelines in interpreting and applying the WTO Valuation Agreement.

▪ Facts of Transaction

2. XCO, a manufacturer in country X sells relays to its wholly-owned subsidiary, ICO, a distributor of country I. ICO imports the relays and does not purchase any products from unrelated sellers. XCO does not sell relays or goods of the same class or kind to unrelated buyers.

3. In 2012, ICO entered its goods using the transaction value, based on the price stated on the commercial invoice, which was submitted to Customs of country I. There is no indication that special circumstances exist as set out in subparagraphs (a) to (c) of Article 1 of the Agreement that would prevent the use of transaction value.

4. After importation, Customs in country I decided to review the circumstances surrounding the sale of goods between ICO and XCO, pursuant to Article 1.2 (a) of the Agreement, because it had doubts about the acceptability of the price.

5. The importer did not provide test values in accordance with Article 1.2 (b) and (c), as a means of demonstrating that the relationship did not influence the price.

6. In response to Customs request for additional information, ICO presented a transfer pricing study for the period 2011, prepared by an independent firm on behalf of ICO.

7. The transfer pricing study used the Transactional Net Margin Method ("TNMM") that, in this case, compared ICO's operating margin with the operating margins of functionally comparable distributors of goods of the same class or kind, also located in Country I, that conducted comparable uncontrolled transactions in the same period of time.
   The transfer pricing study was prepared in order to comply with the requirements of Country I tax regulations and applied principles contained in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the Organization for Economic Cooperation and Development ("OECD Transfer Pricing Guidelines"). The transfer pricing study covered all relays purchased by ICO from XCO.

8. Relevant data for ICO, taken from the company's financial records :

– Sales	100.0
– Cost of Goods Sold (COGS)	82.0
– Gross profit	18.0
– Operating expenses	15.5
– Operating profit	2.5
– Operating profit margin (benchmarked)	2.5% of sales

9. The transfer pricing study, using data taken from ICO's company records, indicated that ICO's operating profit margin on the sale of relays purchased from XCO was 2.5 percent in 2011.

10. The study concludes that it is possible to find reliable comparables for ICO and, accordingly, ICO was selected as the tested party in the transfer pricing study.

11. ICO's transfer pricing study had been reviewed by the Tax authorities of countries I and X in the context of negotiating a bilateral Advance Pricing Agreement (APA). An APA was subsequently agreed between ICO, XCO and the Tax authorities of countries I and X with respect to all transactions between ICO and XCO. While in review by the Tax authorities of countries I and X, ICO provided information showing that the profit margins it earns on the sale of its relays are generally the same as those made by independent distributors in the electrical apparatus and electronic parts industries.

12. In the transfer pricing study, eight distributors, unrelated to their suppliers, were selected based on the substantial similarity of their functions, assets and risks, compared to ICO.

13. Information concerning these eight distributors was taken for fiscal year 2011 for purposes of the comparison. The range of operating profit margins earned by these unrelated distributors was 0.64 to 2.79 percent, with a median of 1.93 percent. In the context of the APA negotiations, this range was accepted by the Tax authorities as an arm's length range of operating profit margins for transactions comparable to ICO's transactions with XCO. This arm's length range was established using the operating profit margins of the eight comparable companies, using the financial records of these companies available in public databases. ICO's operating profit margin was 2.50 percent, thus falling within the range. The 2.50 percent margin achieved by the importer in the country of importation was a function of : a) the price actually paid or payable by ICO to XCO, b) ICO's own sales revenue, and c) ICO's own costs.

14. It was determined that no adjustments prescribed by Article 8 of the Agreement were required to be made to the price actually paid or payable. Additionally, ICO did not make compensating adjustments for tax purposes for the year 2011.

15. ICO sets its selling prices in order to allow the company to earn an operating profit that meets the target arm's length (interquartile) range as set out in the transfer pricing study. The price paid or payable to XCO has not undergone significant changes over the year.

▪ Issues for Determination

16. Does the transfer pricing study supplied in this case, prepared on the basis of the OECD Transfer Pricing Guidelines and used as the basis of a bilateral APA, provide information which enables Customs to conclude whether or not the price actually paid or payable for the imported goods is influenced by the relationship of the parties under Article 1 of the Agreement?

▪ Analysis

17. Under Article 1 of the Agreement, a transaction value is acceptable as the Customs value when the buyer and the seller are not related, or if related, the relationship does not influence the price.

    Where the buyer and seller are related, Article 1.2 of the Agreement provides two ways of establishing the acceptability of the transaction value when Customs have doubts concerning the price : (1) the circumstances surrounding the sale shall be examined to determine whether the relationship influenced the price (Article 1.2 (a)); or (2) the importer demonstrates that the value closely approximates one of three test values (Article 1.2 (b)). In this case, as indicated in paragraph 5, the importer did not provide test values therefore Customs examined the circumstances surrounding the sale.

18. The Interpretative Note to Article 1.2 of the Agreement provides that in examining the circumstances surrounding the sale, "the customs administrations 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."

19. Based on the information obtained from ICO, XCO does not sell the merchandise to unrelated buyers. Therefore, ICO is unable to demonstrate that the price was settled in the same manner as in sales to unrelated parties, specified in Note 1 to Article 1.2 (a) of the Agreement.

20. During its review of the circumstances surrounding the sale, Customs took into account the examination of information discussed in the transfer pricing study when determining whether the price had been settled in a manner consistent with the normal industry pricing practices under the Note to Article 1.2 (a). In this regard, the term "industry" includes the industry or industry sector that contains goods of the same class or kind (including identical or similar goods) as the imported goods.

21. Based on the information provided in Paragraph 8:

    - The Sales figure can be accepted since ICO is selling only to unrelated parties (and it is assumed ICO is rationally seeking to maximize its profits in its dealings with unrelated parties)

    - The Operating expenses amount has been examined and accepted as reliable since it is determined that these expenses are paid by ICO to unrelated parties, with ICO seeking to minimize its costs and these expenses have not been paid for the benefit of the seller

- The transfer pricing study confirms that ICO's operating profit margin is within the arm's length range (i.e. based on a study of comparable, but independent (unrelated) distributors)
- The Cost of Goods Sold of ICO reflects the price paid or payable to XCO and represents the transaction between ICO and its related party, XCO. This is the transfer price in question.

By working back from the arm's length range of operating profit margins and the other accepted information set out above, it could be deduced that the transfer price is an arm's length amount. This demonstrates that information relating to the transaction between ICO and unrelated distributors can be helpful and relevant to Customs when examining the circumstances surrounding the sale between XCO and ICO.

22. The functional analysis showed that there were no significant differences in functions, risks, and assets between ICO and the eight unrelated distributors. In addition, an adequate level of product comparability was observed. The comparable companies were chosen from the electrical apparatus, and electronic parts industries (companies that sell goods of the same class or kind as the imported goods). Thus, the operating profit margin on the resale of the imported goods was shown to be generally the same as in the electrical apparatus and electronic parts industries.* Specifically, the transfer pricing study found that the arm's length range of the comparable companies' operating profit margins was 0.64 % to 2.79 %. As previously noted, ICO's operating profit margin was 2.50 %. Accordingly, since all the comparable companies sell goods of the same class or kind, the transfer pricing study supports a finding that the price between ICO and XCO was settled in a manner consistent with the normal pricing practices of the industry.

* In this case, Customs accepted the operating profit margin as a more accurate measure of ICO's real profitability because it revealed what ICO actually earned on its sales once all associated expenses have been paid. Nevertheless, in certain circumstances, gross profit may be considered by Customs to illustrate the appropriately deducted associated expenses and the establishment of the accurate transfer price.

- **Conclusion**

23. After examination of the circumstances surrounding the sale in respect of related party transactions between ICO and XCO, Customs concluded, including by analysis of a transfer pricing study based on the TNMM and additional information concerning operating expenses as deemed necessary, that under the provisions of Article 1.2 (a) of the Agreement, the relationship between the parties did not influence the price.

24. As indicated in Commentary 23.1, the use of a transfer pricing study for examining the circumstances surrounding the sale must be considered on a case-by-case basis.

CASE STUDY 14.2
USE OF TRANSFER PRICING DOCUMENTATION WHEN EXAMINING RELATED PARTY TRANSACTIONS UNDER ARTICLE 1.2 (a) OF THE AGREEMENT

▪ Introduction

1. This document describes a case where Customs took into account information provided in a company's transfer pricing report, as well as additional information, when determining whether or not the price actually paid or payable for imported goods had been influenced by the relationship between buyer and seller under Article 1.2 (a) of the Agreement.

   This case study does not indicate, imply, or establish any obligation on Customs authorities to utilize the OECD Guidelines and the documentation resulting from the application of the OECD Guidelines in interpreting and applying the WTO Valuation Agreement.

▪ Facts of Transaction

2. XCO of country X sells luxury bags to ICO, a distributor of country I. Both XCO and ICO are wholly-owned subsidiaries of ACO, the headquarters of a multinational enterprise and the brand-owner of the luxury bags. Neither XCO nor other companies related to ACO sell the identical or similar luxury bags to unrelated buyers in country I. ICO is the only importer of the luxury bags sold by XCO to country I. Thus, all luxury bags imported into country I by ICO are purchased from XCO.

3. In 2012, ICO declared the price of imported luxury bags based on the value on the invoice issued by XCO. The commercial documents submitted to Customs of country I indicated that there was no special circumstances or additional payments which would prevent the use of the transaction value as set out in subparagraphs (a) to (c) of Article 1 of the Agreement or require an additional adjustment prescribed by Article 8 to the import price.

4. In 2013, Customs in country I conducted a Post-Clearance Audit to verify ICO's declared import price, because it had doubts about the acceptability of the price. ICO's transfer pricing policy showed that the import price of all luxury bags was determined using the Resale Price Method (in accordance with the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the Organisation for Economic Cooperation and Development). At the end of each year, ICO calculated the import price of luxury bags based on the resale price and the targeted gross margin for the next year as recommended by XCO. After the targeted gross margin for 2012 was determined at 40%, ICO then calculated the import price of luxury bags to be imported in 2012 by using the Resale Price Method according to the formula : Import Price = recommended Resale Price x (1 − Targeted Gross Margin) / (1 + Duty Rate).

5. ICO is a simple or routine distributor. The marketing strategy for the sales of bags in country I is in fact established by XCO. XCO also advises on the levels of inventory to be maintained, and establishes the recommended sales price of the bags sold by ICO, including the discounting policy to be used by ICO. XCO has also invested heavily in developing valuable intangible assets associated with the bags. As a result, XCO assumes the market risk and price risk in relation to the sales of the bags in country I.

6. The luxury bag market of country I where the imported goods were resold has been very competitive. However, in 2012, the actual sales income of ICO far exceeded the estimated income since more bags were sold at full price, and fewer at a discounted price, than anticipated. Consequently, ICO's gross margin in 2012 was 64 % which was higher than the targeted gross margin stated in ICO's transfer pricing policy. During the audit, Customs asked ICO to provide further information in order to review the acceptability of its declared import price.

7. ICO did not provide test values required for the application of Article 1.2 (b) and (c), as a means of demonstrating that the relationship did not influence the price. However, ICO submitted a transfer pricing report, which used the Resale Price Method that compared ICO's gross margin with the gross margins earned by comparable companies in their transactions with unrelated parties (i.e. comparable uncontrolled transactions). The transfer pricing report was prepared by an independent firm following the process set out in accordance with the OECD Transfer Pricing Guidelines.

8. According to the transfer pricing report, ICO does not employ any valuable, unique intangible assets or assumed any significant risk. The transfer pricing report submitted by ICO selected eight comparable companies located in country I. The functional analysis indicated that the eight selected comparable companies imported comparable products from country X, performed similar functions, assumed similar risks and did not employ any valuable intangible assets, just as ICO.

9. The transfer pricing report indicated that the arm's length (inter-quartile) range of gross margins earned by the selected comparable companies in 2012 was between 35 %-46 %, with a median of 43 %. Therefore, the 64 % gross margin earned by ICO did not fall within the arm's length inter-quartile range. At the time Customs conducted its valuation audit, it was established that, in this particular case, ICO had not made any transfer pricing adjustments in this regard.

▪ Issue for Determination

10. Does the transfer pricing report, supplied in this case, provide information which enables Customs to conclude whether or not the price actually paid or payable for the imported goods is influenced by the relationship of the parties under Article 1 of the Agreement?

▪ Analysis

11. Under Article 1 of the Agreement, a transaction value is acceptable as the Customs value when the buyer and the seller are not related, or if related, the relationship does not influence the price. Where the buyer and seller are related, Article 1.2 of the Agreement provides two ways of establishing the acceptability of the transaction value when Customs have doubts concerning the price : (1) the circumstances surrounding the sale shall be examined to determine whether the relationship influenced the price (Article 1.2 (a)); or (2) the importer demonstrates that the value closely approximates one of three test values (Article 1.2 (b)).

12. In this case, as indicated in paragraph 7, the importer did not provide test values therefore Customs examined the circumstances surrounding the sale.

13. The Interpretative Note to Article 1.2 of the Agreement provides that in examining the circumstances surrounding the sale, "the customs administrations 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."

14. When examining the circumstances surrounding the sale concerning companies using Resale Price Method, a comparison of the gross margin of the company in question with the gross margin of comparable companies could indicate whether or not the declared price had been settled in a manner consistent with the normal pricing practices of the industry.

15. Based on the functional analysis, there was no significant difference between ICO and all eight comparable companies because these comparable companies:

    · are all located in country I;

    · perform similar distribution functions, assume similar risks and do not employ any valuable intangible assets, which are similar to ICO;

    · import comparable products similarly manufactured in country X.

    In addition, an adequate level of product comparability was observed and these comparable companies are deemed to be suitable for Customs valuation purposes.

16. According to the transfer pricing report, the arm's length inter-quartile range of the gross margin earned by the comparable companies was between 35%-46% with a median of 43%. However, in 2012, ICO earned a gross margin of 64% which was much higher than the normal gross margins of comparable companies in this industry. It should also be noted that the luxury bag market of importing country I was competitive, so that the operating profit and expenses of ICO should be similar to those of the comparable companies given that there was no substantial difference between ICO and the eight comparable companies. Therefore ICO's high gross margin in 2012 was not commensurate with its functions, assets and risks.

17. Thus, by virtue of ICO earning a higher margin, and considering ICO has not made any compensating adjustments, Customs arrived at the conclusion that the import price was not settled in a manner consistent with the normal pricing practices of the industry in question. The Customs value of goods imported in 2012 had been declared at a lower price and should be re-determined accordingly by application of the alternative methods of valuation in a sequential order.

▪ Conclusion

18. In examining the circumstances surrounding the sale between ICO and XCO under the provisions of Article 1.2 (a) of the Agreement through the review of the transfer pricing report, Customs concluded that the declared import price was not settled in a manner consistent with the normal pricing practices of the industry and thus had been influenced by the relationship between the buyer and seller. Therefore, the Customs value should be determined by application of the alternative methods of appraisement in a sequential order.

19. It should be noted 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 as specified in Commentary 23.1.