

THE EFFECT OF COVID-19 ON CUSTOMS VALUATIONS

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Introduction

In the past year, sea freight prices have risen sharply, in an increase that has not been seen for many years. For example, about a year ago, renting a container for sea transportation from China to Israel cost about USD2,000, and today, the same transportation costs about USD15,000.¹

The reason for this significant increase is, among other things, the COVID-19 crisis, global shortages of ships, declining competition in the field, and global demand for containers. In addition, there is a 'Made of Israel' reason, since due to the congestion at ports in Israel, there are ships that prefer not to dock in Israel, and then the number of ships that can dock in Israel is even smaller.

Apart from the increase in transportation costs, which is expected to lead to a wave of price increases in the sale of products in Israel, there is also an increase in the value of goods for customs purposes (which is itself due to rising transportation prices). This increase in prices leads to further collection of customs duties, purchase tax and import taxes, due to the increase in value.

In most countries worldwide, including Israel, collection of duties is based on the cost, insurance and freight ('CIF') value, including transport costs. Therefore, in those countries, any raise in transportation costs, lead to additional collection of duties.

The United States, Australia and New Zealand, however, impose duties on the free on board ('FOB') value, without transportation, therefore, transport costs changes do not lead to additional duties. COVID-19 effects on transportation costs are a global issue and may last for a long time. Therefore, governments which impose customs on the CIF value, should consider waiving the COVID-19 extra shipping costs, for customs valuation purposes, until we are back to a 'normal' period.

The valuation of the goods for customs purposes in Israel

Israeli law stipulates that the value of the transaction is: 'the price paid or to be paid for the goods, when sold for export to Israel ... plus the expenses and amounts specified in section 133'.²

The relevant section which refers to those expenses and amounts, also known as 'assists' to be added to the transaction price for customs purposes³, includes a large number of examples, one of which relates to transportation costs:⁴

The following costs are involved in bringing the goods to the port of import or place of import:

The cost of transporting the goods to the port of import or place of import, excluding such costs incurred due to special circumstances beyond the control of the importer and the Director determining not to include them in the transaction; This includes types of goods, types of transportation and other services.

...

The cost of insurance.⁵

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¹ Brendan Murray, 'Shipping container rates top \$10,000 from Asia to Europe', *Bloomberg* (Web Page, 28 May 2021) <<https://www.bloomberg.com/news/articles/2021-05-27/shipping-container-rates-top-10-000-from-asia-to-europe>>.

The cost is even higher than USD20,000 from the US to China: Roslan Khasawneh and Muyu Xu, 'China-U.S. container shipping rates sail past \$20,000 to record', *Yahoo Finance* (Web Page, 5 August 2021) <<https://finance.yahoo.com/news/china-u-container-shipping-rates-094312464.html?guccounter=1>>.

² *Israeli Customs Ordinance* s 132(a).

³ *Israeli Customs Ordinance* s 133.

⁴ *Israeli Customs Ordinance* s 133(a)(5)(a).

⁵ *Israeli Customs Ordinance* s 133(a)(5)(c).

If we compare this to the terms of sale of Incoterms,⁶ it seems that Israel has determined that the customs duty will be levied on the value of CIF, i.e. the value of the goods including transport and insurance.

Customs valuation worldwide

It should be noted that there is no uniform rule on this matter worldwide. Most countries are members of the World Trade Organization ('WTO') and the World Customs Organization ('WCO'), and by virtue of their membership, have signed an international agreement on the valuation of goods for customs purposes.⁷

The agreement sets out a number of rules regarding the way goods are valued for customs purposes, but it does not stipulate any binding rules regarding transportation. The GATT *Customs Valuation Agreement* states as follows:⁸

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

- (a) the cost of transport of the imported goods to the port or place of importation;
- (b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation; and
- (c) the cost of insurance.

There are countries where the value on which the customs duty is imposed is FOB, that is, without the international transport cost – this includes the United States, Australia and New Zealand, as will be discussed below, and well as Canada⁹. However, the majority of countries have chosen to impose customs duties on the CIF value of the goods, including the international transport cost – this includes Israel (as discussed above), Singapore¹⁰, the European Union¹¹, and many more, as is clearly indicated by the 2018 WCO review:¹²

The majority of WTO Members made the one-off decision to include these elements in the Customs value; known as CIF (cost, insurance, freight) basis. The system used by the few Members who chose not to include these elements is known as FOB (free on board).

Customs valuation in the United States

In the United States, customs duties are imposed on the value without international transportation cost. Thus, the corresponding section in the United States law to the section of the Israeli *Customs Ordinance* discussed above, which deals with the 'transaction price', states that: 'the transaction value of imported merchandise is the price actually paid or payable for the merchandise when sold for exportation to the United States'.¹³

As for transportation costs, United States law goes on to declare that the value to customs will not include them:¹⁴

The transaction value of imported merchandise does not include any of the following, if identified separately from the price actually paid or payable and from any cost or other item referred to in paragraph (1): (A) Any reasonable cost or charge that is incurred for —(ii) the transportation of the merchandise after such importation .

⁶ See the International Chamber of Commerce website for more information: <<https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-2020/>>.

⁷ *Customs Valuation Agreement (Implementation of Article VII of the GATT)*, available at <https://www.wto.org/english/res_e/publications_e/ai17_e/cusval_e.htm>.

⁸ *Customs Valuation Agreement*, section 8.2.

⁹ Canada Border Services Agency, *Customs Valuation Handbook* (Online, 2019) <<https://www.cbsa-asfc.gc.ca/import/valuation-valeur/customs-val-douane-eng.pdf>>, pages 10 and 11.

¹⁰ Singapore Customs, 'Establishing Customs Value for Import' (Web Page, undated) <<https://www.customs.gov.sg/businesses/valuation-duties-taxes-fees/establishing-customs-value-for-imports>>.

¹¹ European Commission, *Compendium of Customs Valuation Texts* (Online, 2021) <https://ec.europa.eu/taxation_customs/document/download/9a13b89e-9e5e-482e-be0b-f593d96bc815_en>, page 50.

¹² World Customs Organization, *Guide to Customs Valuation and Transfer Pricing* (Online, 2018) <<http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/key-issues/revenue-package/wco-guide-to-customs-valuation-and-transfer-pricing.pdf?la=en>>, page 11.

¹³ United States *Tariff Act of 1930* 19. U.S.C. §1401(a)(b)(1).

¹⁴ *Ibid* §1401(a)(b)(2).

Customs valuation in Australia

Customs duties in Australia are imposed on the FOB value, similarly to the United States. The *Customs Act 1901* (Cth) states:¹⁵

Unless the contrary intention appears in this Act or in another Act, the value of imported goods for the purposes of an Act imposing duty is their customs value and the Collector shall determine that customs value in accordance with this section.

The Act further defines the customs value as the transaction value: ‘Where a Collector can determine the transaction value of imported goods, their customs value is their transaction value’.¹⁶ It also provides that the transaction value should be adjusted as follows:¹⁷

The transaction value of imported goods is an amount equal to the sum of their adjusted price in their import sales transaction and of their price related costs to the extent that those costs have not been taken into account in determining the price of the goods.

Following this, the *Customs Act 1901* (Cth) defines the price related costs which should be added to the transaction value as including ‘foreign inland freight and foreign inland insurance in relation to the goods paid or payable, directly or indirectly, by or on behalf of the purchaser’.¹⁸

Given that the Act only states that inland freight and insurance should be added to the customs value, marine or aerial transportation costs are therefore excluded from the customs value. This point is well explained in the Australian customs valuation guide which notes:¹⁹

... the above provisions are aimed at assessing the total amount paid for the goods, packed and in export condition, at their place of export.

FOB (“free on board”) contracts often require little adjustment.

CIF (“cost, insurance, freight”) contracts will require adjustments in respect of: (1) overseas inland freight and insurance after the place of export; (2) overseas freight and shipping charges; and (3) other charges imposed after the place of export.

Customs Valuation in New Zealand

In New Zealand, the *Customs and Excise Act 2018* (NZ) defines the customs valuation method as follows: ‘[t]he primary basis for determining the Customs value of imported goods is the transaction value of the goods’.²⁰

The Act notes that several adjustments should be made to the customs value:²¹

The transaction value of imported goods is to be calculated by—

- (a) taking the price paid or payable for the goods when sold for export to New Zealand; and
- (b) on the basis of sufficient information, adding amounts (to the extent that each amount is not included in the price paid or payable for the goods when sold for export to New Zealand) equal to the following:

...

- (vii) the costs of transportation and insurance of, and the loading, unloading, and handling charges, and other charges and expenses associated with the transportation of, the imported goods until the goods

¹⁵ *Customs Act 1901* (Cth) s 159(1).

¹⁶ *Ibid* s 159(2).

¹⁷ *Ibid* s 161(1).

¹⁸ *Ibid* s 154.

¹⁹ Department of Immigration and Border Protection, *Instructions and Guidelines – Customs Valuation* (Online, September 2011) <<https://www.abf.gov.au/help-and-support-subsite/files/instructions-guidelines-customs-valuation.pdf>>, page 25.

²⁰ *Customs and Excise Act 2018* (NZ) Sch 4, s 4.

²¹ *Ibid* Sch 4, s 7.

have left the country of export if those costs, charges, and expenses are paid or payable by the buyer, directly or indirectly, to or for the benefit of the seller as a condition of the transaction;"

The *Customs and Excise Act 2018* (NZ) also defines the exclusions and deductions which should be made to the customs value, which include:²²

(c) on the basis of sufficient information, deducting amounts (to the extent that each amount is included in the price paid or payable for the goods when sold for export to New Zealand) equal to the following:

- (i) the costs of transportation and insurance of, and the loading, unloading, and handling charges, and other charges and expenses associated with the transportation of, the imported goods from the time the goods have left the country of export, other than any cost, charge, or expense referred to in subparagraph (ii)(B) ...

Accordingly, the customs valuation method adopted by New Zealand is similar to the method adopted by the United States and Australia.

Comparison

As shown above, in the United States, Australia and New Zealand, the customs valuation method is based on the FOB value. This means that an increase in international freight rates will not increase the value of the goods for customs purposes.

However, in Israel, Singapore, and most other countries, because the customs valuation method is according to the CIF value, any increase in international freight also leads to an increase in value for customs purposes and increases the customs burden imposed on the importer. For example, if we assume that a spare part for a car is subject to a purchase tax of about 20% of the value to customs, then any increase of US\$1,000 in transportation prices embodies an additional purchase tax of US\$200, collected by Israel. Since this is an indirect tax, it will, by its very nature, ultimately be passed on to the entire public, in the form of rising prices.

Importers in any country which imposes duties on the CIF value will encounter the same issue.²³

How has Israel dealt with such similar situations in the past?

Price increases in transportation can be caused by a wide variety of reasons, including wars, closures, sanctions, and strikes. In this regard, the Israeli law stipulates that in exceptional situations, the director of customs may not include in the value of customs certain transportation costs: 'such costs incurred due to special circumstances over which the importer has no control and the manager has determined that they should not be included in the value of the transaction'.²⁴

These are, in fact, transportation costs that are the result of a kind of 'force majeure' event that the importer did not have the ability to prevent. The director of custom's power under this section has been employed in the past.

On 24 April 2006, the Israeli customs authority ruled that transportation costs due to war and security incidents would not be included in the customs value:

In accordance with my authority under section 133(a)(5)(a) of the Customs Ordinance, I stipulate that war levies and additional transportation costs incurred by importers due to the security incidents in the north of the country, should not be included in the value of the transaction for the purpose of calculating the import taxes. It is clarified that these are additional transportation, unloading and loading costs listed in the cargo account that were caused due to the security incidents"

²² Ibid Sch 4, s 7(c). See also New Zealand Customs Service, *Guide to applying for a customs valuation ruling on imported goods* (Online, October 2018) <<https://www.customs.govt.nz/globalassets/documents/guides/guide-apply-customs-valuation-ruling-on-imported-goods.pdf>>.

²³ For example, importers in Peru, a state which imposes duties on the CIF value, face the same problem: see the article (in Spanish) by Cristian Calderón (Web Page, 11 October 2021) <<https://lacamara.pe/cristian-calderon-mitigando-los-efectos-de-la-crisis-mundial-del-flete-maritimo/>>.

²⁴ *Israeli Customs Ordinance* s 133(a)(5).

On 6 June 2008, the Israeli customs authority ruled that a container demurrage fee beyond that agreed would not be included in the customs value: '[t]he demurrage fee in the importing country, which is charged for the use of the container beyond the agreed period between the ship's agent and the importer, will not be included for import taxes.'

On 7 September 2008, the Israeli customs authority exempted certain transportation costs in respect of strikes from being included in the customs value, stating:

In accordance with my authority under section 133(a)(5)(a) of the Customs Ordinance, I provide that additional transportation costs incurred by importers due to sanctions in the ports of Israel, will not be considered for the transaction value for the purpose of calculating import taxes. It is clarified that these are additional transportation, unloading and loading costs listed in the cargo account, which were caused due to the sanctions and the importer has no control over them. The importer must prove the existence of such additional costs.

Conclusion

The Israeli Chamber of Commerce recently appealed to the Israeli director of customs to exercise his authority and set a ceiling on which customs would be imposed, even if in practice transport costs are currently more expensive (as in the current pandemic).²⁵ This application was denied. The director of customs stated that this was a request to reduce the actual cost of transportation paid, not a request to eliminate 'additions' to the cost of transport, such as strike and demurrage costs, as in the past.

However, the Israeli customs authority distinguished the general rise in transport costs from vessels that declared their 'end of journey' in Cyprus and refrained from entering Israel due to the COVID-19 crisis. This 'end of journey' declaration caused Israeli importers extra costs of transportation to Israel, and in March 2020, customs decided to exempt the importers from those 'end of journey' extra transport costs, stating that these costs were beyond of the importers' control, according to the Israeli law.²⁶

The Israeli customs authority further stated that it had not been proven that the general increase in transportation prices was due to the COVID-19 pandemic or an unforeseen situation, therefore no reduction could be made under s 133(a)(5) of the *Customs Ordinance*. The customs authority even claimed that to find otherwise would be a breach of the *Customs Valuation Agreement*.

So, the question is essentially whether transportation costs raised by tens or hundreds of percent – caused by the global COVID-19 crisis, a shortage of ships, heavy loads in Israeli ports, and shortage of containers – constitute 'special circumstances beyond the importer's control' under s 133(a)(5)? If war, security events, sanctions, strikes and declarations of 'end of journey' in Cyprus satisfy this test, then it is hard to see why this situation would not also satisfy the test.

Indeed, a ruling given in the Israeli court on another issue, but which is pertinent to the global COVID-19 crisis stated, found that the COVID-19 crisis is certainly an unexpected event:²⁷

It is hard to believe that the reasonable person could or should have expected the full far-reaching consequences of the Corona epidemic, including on the economy and commercial life, in Israel and around the world. We are dealing with an unparalleled epidemic which has no precedent in the last hundred years (at least since the Spanish Flu epidemic which caused many deaths around the world between the years 1918 - 1920).

The same reasoning can and should be applied in the field of international trade and customs valuation.

In the end, the legal solution, which in Israel already exists, is to relieve the importers of the customs duty imposed on the transport that has become more expensive. Globally speaking, in any country which imposes duties on the CIF value, extremely raised due to COVID-19 crisis, governments should act in good faith and try to find an appropriate solution until the pandemic effect on freight charges is over. Otherwise, a new trend may be created whereby importers divert business to import goods from FOB customs valuation countries, in which the COVID-19 pandemic does not have the same effect on the duties collected.

²⁵ See <<https://www.chamber.org.il/foreigntrade/1109/1111/116962/>>.

²⁶ See <https://www.chamber.org.il/media/162560/aluiot_hovala_mehes_corona.pdf>.

²⁷ Hdlt (Tel-Aviv) 26076-02-20 Adv. Israel Bachar vs. comfortability systems (2007) Ltd. (8 July 2020).