

Regulatory Impact Statement

Customs and Excise Act Review: Valuation of imported goods

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the New Zealand Customs Service (Customs).

It provides an analysis of options to address several issues about the requirements for importers to determine and declare to Customs the value of goods imported into New Zealand.

The following are constraints on the analysis:

- There is a lack of quantitative information in some areas. For example, Customs does not collect information from importers about which valuation method has been used to value imported goods. In some instances quantitative information was also not provided through the consultation process. This RIS therefore makes assumptions and uses anecdotal evidence and comparative information in some areas where data is not available.
- The analysis of the risks is based on subjective judgments about the magnitude of these risks. This subjectivity is due to the lack of real examples of these risks eventuating in the New Zealand context and the inability to reliably predict the potential of these risks eventuating.
- the impacts, including the financial impacts, of some options in this RIS are estimated based on assumptions about the proportion of imported goods or importers that may be affected by the change.

The impacts discussed in this paper are primarily on importers, customs brokers, and Customs in its role of managing risks and revenue collection at the border while facilitating trade.

Customs will report back to the Cabinet Economic Growth and Infrastructure Committee in November 2015 with recommendations about penalties for declaring an inaccurate value for imported goods, or failing to meeting reporting requirements about the value of imported goods. Options regarding these penalties are not contained in this RIS, and will be outlined in the RIS associated with the policy recommendations in November 2015.

Signed by Michael Papesch on 14 September 2015

Michael Papesch
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14 September 2015

Executive summary

1. This Regulatory Impact Statement (RIS) provides an analysis of options in order to:
 - modernise the legislation to respond to the realities of modern trade while balancing the need for Customs to obtain accurate information about the value of imported goods for revenue collection, risk management, and statistical purposes
 - make the valuation of goods imported into New Zealand clearer and easier for importers, brokers, and for Customs to administer
 - ensure that the rules for valuing imported goods apply consistently to all importers.
2. The recommendations in this RIS are:
 - to allow importers in some circumstances to declare a provisional value for imported goods, and require importers to make a reassessment of the value of goods to Customs within a prescribed timeframe (**Section 1**)
 - for Customs to introduce binding valuation rulings on goods, and provide more guidance for traders to support certainty of their obligations at the border. (**Section 2**)
 - to continue to require importers to exclude international freight and insurance costs when valuing imported goods (**Section 3**)
 - to define in legislation the sale in a supply chain that determines the value of imported goods (**Section 4**).
3. Businesses have been consulted on the proposals. In late 2014 Customs established a Stakeholder Reference Group made up of key business stakeholders. The Group provided input into the development of options for the public discussion paper on the Customs and Excise Act Review.
4. In May 2015 Customs released a discussion paper presenting options for regulation and seeking information from the public and business. From April through to May 2015 Customs held workshops to discuss problems, to develop and refine options, and to test recommendations. Relevant feedback from businesses is reflected in comments on these proposals.

5. Key considerations have been given to:
 - New Zealand’s obligations under the World Trade Organization’s Customs Valuation Agreement¹ (WTO CVA) which aims for a fair, uniform system for the valuation of goods for customs purposes
 - legislation and practice of customs administrations in other countries including Australia, the United States of America, Canada, and the European Union
 - align proposals with the Customs 2020 strategy to protect and promote New Zealand through world class border management, including to:
 - make compliance easy to do and hard to avoid
 - deliver efficient and effective revenue collection
 - enhance customer experience, value and confidence
 - increase Customs’ ability to identify risk, detect non-compliance, and carry out enforcement.
6. Some of the proposals will reduce compliance cost for importers by increasing certainty about the valuation of imported goods, or reflecting and aligning Customs processes with modern business practice.
7. Some of the proposals are expected to impose some additional costs on certain importers, but are considered justified according to international guidance and practice, and to ensure consistency of application of the law across the import market.
8. Importers are required to declare the value of goods coming into New Zealand. It is important that the value declared to Customs is accurate. The value of goods declared by importers is used to identify risks at the border, collect revenue, and is collated by Statistics New Zealand and used for trade statistics, and key economic indicators such as the Balance of Payments and Gross Domestic Product.
9. The Act currently has a range of penalties to encourage importers and customs brokers to provide accurate information to Customs.

¹ Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994

1 Declaring and adjusting the value of imported goods

Background

10. Anyone who imports goods into New Zealand is required to declare the value of the goods to Customs. For goods valued \$1,000 or more an import entry is required to be submitted to Customs. An import entry contains information about the goods including, amongst other details, the value, volume, origin, and tariff classification of the goods.
11. Importers must establish the value of imported goods according to the methods prescribed by the Act that comply with New Zealand's obligations under the WTO CVA. The WTO CVA sets out several prescribed methods for valuing imported goods, to promote uniformity of the valuation of trade by WTO members.

Status Quo

12. In some situations an importer will not know the final value of goods at the time an import entry is required to be made. The legislation does not explicitly allow an importer to make a provisional assessment of the value of goods on a standard import entry.
13. In practice, Customs accepts adjustments to the value of goods declared by importers if the adjusted value meets WTO CVA requirements. Operationally this scheme is referred to as the Uplift Programme. Adjustments are deemed by Customs to be voluntary disclosures.

Problems

14. The legislation does not explicitly allow an importer to declare a provisional value when importing goods. The Act allows importers to make 'voluntary disclosures' about errors or omissions concerning information they have provided to Customs. But the Act does not clearly cover changes that are expected by importers at the time of lodging an import entry.
15. Although Customs currently deems all updates by importers to valuation information to be 'voluntary disclosures', some of the changes are neither errors nor omissions. They are intentional, expected changes because the final value of goods was not known at the point in time when an import entry was required.
16. Customs has received feedback that operational practice works well to facilitate adjustments to value. However traders can be uncertain about whether a provisional value, or later information updating the value of goods, could be subject to penalties.
17. From a Customs perspective, importers are not required to provide updated valuation information within a specific timeframe. This can potentially affect the

timeliness of information provided by importers to Customs, and is out of line with practice by other countries (the United States and Canada).

Magnitude of the changes to value

18. From 1 July 2014 to 30 June 2015, 54 companies made adjustments that increased the value declared on import entries during that year. Most of these companies were part of Customs' Uplift Programme, so periodic changes were expected by Customs.
19. The amount of extra Crown revenue collected due to changes to the value of imported goods is comparatively minor compared with the total duty collected by Customs. In 2014/2015 Customs collected \$2.4 billion in duties and \$8.1 billion in GST on imported goods. The table below illustrates the amount of extra import tariff duty, GST, and excise-equivalent duty required as a result of adjustments in the last financial year.

**Extra duty collected due to adjustments that increased the value of goods
(1 July 2014 to 30 June 2015)**

Tariff duty	\$ 276,867
GST	\$ 13,568,775
Excise-equivalent	\$ 13,563,366

20. There are several scenarios when an importer will expect the value of imported goods, as declared to Customs, to change. The main reasons are described below.

Royalty payments

21. The main method used to determine the value of imported goods for Customs purposes is the Transaction Value method. The Transaction Value is the price paid or payable for the goods when sold for export to New Zealand, subject to certain adjustments.
22. Under the Transaction Value method, the value of royalty payments between the buyer (the importer) and the seller needs to be included in the total value of the goods. Goods that are usually subject to royalties are branded goods. Examples include footwear, clothing, and movie merchandise.
23. Often when an import entry is required, an importer will not know the exact value of the royalty payment. The amount of royalties owed by an importer to a seller will often depend on the volume of the goods sold in New Zealand, after an import entry is due to be made. In these circumstances an importer will generally make an informed estimate of the royalties for import entry purposes, and provide updated information to Customs later if necessary.

Transfer pricing adjustments

24. Transfer pricing adjustments are common features of pricing strategies adopted by multi-national entities (MNEs). For tax purposes, Inland Revenue and an MNE may come to agreed methodologies for the treatment of transactions between related branches of the MNE, as required by OECD Transfer Pricing Guidelines. In New Zealand these are 'Advance Pricing Agreements' (APAs).
25. When an importer has an Advance Pricing Agreement with Inland Revenue, an MNE might adjust the value of goods bought and sold between related branches in the global company, in order to meet the methodologies agreed under the APA. This can affect the value of goods that has been declared to Customs. These changes may occur on a quarterly or annual basis.

Additional fees

26. 'Additional fees' are additional expenses that may be incurred or determined by an importer in respect of the goods after the import entry has been made. Examples are marketing fees and freight costs.

Use of the Deductive Value method to value goods

27. Another WTO CVA method for valuing goods is the Deductive Value method. This method is used infrequently compared with the Transaction Value method. The Deductive Value method is based on the sale price of the goods after importation. Often this sale will not have occurred until after an import entry is made. An import entry can currently be made up to 20 days following importation of the goods into New Zealand.
28. Under the review of the Act, there is a recommendation to bring the timeframe forward for making import entries (refer Regulatory Impact Statement: Timeframes for Import Entries). Importers would, in principle, be required to submit an import entry before arrival of goods in New Zealand.
29. It is expected that this change will not affect the majority of importers. However traders that do not have complete, accurate information about goods prior to importation may face some difficulties. A clear legislative process for importers to declare changes to the value of goods will help to mitigate some of the impacts of the change in timeframes for some importers.

Objectives

30. The Act takes modern business practice and the realities of trade into account, while balancing the need for Customs to obtain accurate valuation information for revenue collection, risk management, and statistical purposes.
31. Customs used the following criteria to assess the options:

- **Complies with international obligations:** The legislation complies with the WTO CVA
 - **Consistency:** Consistent with the approach taken by comparable countries
 - **Clarity:** The rules are clear for importers
 - **Effectiveness:** The appropriate amount of tax is collected for the Crown.
32. Options that meet these criteria are likely to address the problems that have been identified. The criteria have been accorded different weights when analysing the options. The criteria are listed in order of importance. Consistency with international law is the most important criterion.

Options and impact analysis

33. Customs considered the following options:
- **Status quo:** The ability for importers to declare a provisional value is not clearly permitted by legislation. Importers can adjust the value of goods by making a voluntary disclosure.
 - **Alternative option 1:** The legislation clearly allows importers to declare a provisional value in some circumstances. Importers can adjust the value of goods by making a voluntary disclosure.
 - **Alternative option 2:** The legislation clearly allows importers to declare a provisional value in some circumstances. Importers are required to reassess the value of goods and declare this information to Customs within a prescribed timeframe.
34. The following table sets out analysis of the regulatory options according to the criteria.

Criteria	Status quo <ul style="list-style-type: none"> Provisional value not explicitly permitted Voluntary disclosure for adjustments 	Alternative option 1: <ul style="list-style-type: none"> Provisional value permitted Voluntary disclosure for adjustments 	Alternative option 2: <ul style="list-style-type: none"> Provisional assessment of value permitted in certain circumstances Reassessment required within prescribed timeframe
Complies with international obligations.	✓✗ Consistent with the WTO CVA.	✓✗ Consistent with WTO CVA.	✓✗ Consistent with the WTO CVA.
Consistency Consistent with the approach taken by comparable countries.	✓✗ Could be consistent with Australia if guidance was published on Customs' practice.	✗✗ Not similar to comparable countries because there is no requirement on importers to update valuation information within a specific timeframe.	✓✗ Approach is similar to the Reconciliation Programme in the United States which allows a provisional value to be declared. Canadian legislation also explicitly allows for corrections to the value of goods declared to Customs.
Clarity: The rules are clear for importers.	✓✗ Does not clearly allow provisional declarations about value. Does not make it clear to importers that there is an obligation to provide post-entry adjustment information about the value of imported goods to Customs. Allows voluntary disclosures.	✓✗ Rules are clearer for importers than the status quo because the legislation would be explicit that a provisional value can be declared on an import entry, subject to certain criteria.	✓✓ Rules are clearly set out in legislation around the requirements for importers to provide information about the value of goods to Customs, including situations when there are adjustments to value after goods are imported.
Effectiveness: The appropriate amount of tax is collected for the Crown.	✓✗ Voluntary disclosures are accepted by Customs in practice, so adjustments are made and duty refunded or required on a case-by-case basis. No explicit requirement for importers to provide re-assessments so this can affect the accuracy of the information that is provided to Customs.	✗✗ Potentially creates issues with collecting the right amount of tax (import tariff duty and GST), because provisional information can be provided but there is no obligation on importers to follow up with final, accurate valuation information within a certain timeframe.	✓✗ Because the onus is on importers to provide the best information they have at the time an import entry is made, and then make a re-assessment to Customs if there are later adjustments, this is likely to ensure accurate and timely information to Customs. This supports Customs revenue collection obligations, risk management functions, and more accurate information for statistical purposes.
Conclusion	Partially meets the criteria. Consistent with international obligations. Rules are not clear and transparent for importers.	Partially meets the criteria. Potentially creates issues for revenue collection and risk management. May affect statistical reporting.	This is the preferred option. Partially meets the criteria. Clearly provides for adjustments to value, which supports modern business practice and the realities of trade. Supports Customs to meet revenue collection obligations, conduct risk management, and provide accurate information to Statistics New Zealand.

Stakeholders' views

35. Several accounting firms and some large traders made submissions sharing the view that Customs could improve its processes and legislation to be clearer, more transparent, and to align more closely with Inland Revenue. Submitters supported:
- amendments to the legislation to explicitly allow businesses to adjust the value of imported goods reported to Customs
 - assurance that businesses will not be penalised when they voluntarily disclose an adjustment to the value of imported goods
 - acknowledgement in guidance or legislation that Customs will take Advance Pricing Agreements into consideration when determining whether customs valuation requirements have been met.

Non-regulatory options

36. Customs has also considered non-regulatory options to address some of the issues faced by importers, as highlighted during consultation on the Act review. Customs considers there is value in publishing more guidance on valuation matters, including guidance acknowledging that Customs takes Advance Pricing Agreements into consideration on a case-by-case basis in the context of customs valuation of imported goods.

Penalties

37. Customs will report back to the Cabinet Economic Growth and Infrastructure Committee in November 2015 with recommendations about penalties for declaring an inaccurate value for imported goods to Customs, or for failing to meeting reporting requirements about the value of imported goods, including declaring a reassessment of the value of imported goods to Customs.

Impacts

38. The options would have the following impacts on importers, brokers and Customs.

	Status quo: <ul style="list-style-type: none"> Provisional value not explicitly permitted Voluntary disclosure for adjustments 	Preferred option: <ul style="list-style-type: none"> Provisional assessment of value permitted in some circumstances Reassessment required within a prescribed timeframe
Impact on importers and brokers	Negative There is a lack of transparency regarding Customs processes, and uncertainty about obligations.	Positive Greater transparency about Customs processes and clarity about importers' obligations.
Impact on Customs	Neutral/Negative Possible issues with the timeliness of adjustments to value.	Neutral Reassessments can involve complex revenue assurance work for Customs. However the number of reassessments is not expected to increase significantly because this process is already in place.

Recommended option:

- Introduce a framework in the legislation for declaring and adjusting the Customs value of imported goods.
- Under this framework a provisional value can be declared, in certain prescribed circumstances, by an importer (or their agent). A reassessment of the value must be declared to Customs within a prescribed timeframe.
- Prescribe the circumstances and timeframe in regulations.

2 Binding rulings

Status quo

39. Under the Act Customs is authorised to issue advance binding rulings on a range of specified matters. A person can apply for a ruling on the origin of a good, the tariff or excise classification of a good, and whether a good is subject to a duty concession.

Problem

40. Under the Act Customs is not required to provide binding valuation rulings. Customs gives informal advice to traders on valuation issues, including the appropriate methodology to value imported goods according to the Act and the WTO CVA. But this is advice not binding on Customs, and the advice is not publicly available.
41. Although non-binding valuation advice is currently provided ad-hoc by Customs to importers, the lack of binding advice can lead to a lack of certainty for importers. Importers can be unsure of how to meet Customs valuation requirements, and whether following the informal advice will be accepted in practice by Customs.
42. The value of goods declared to Customs is used to determine revenue collection. If importers are uncertain about the methods to use to value imported goods, this can lead to uncertainty about duty liabilities.
43. Uncertainty can prevent importers from correctly reporting the value of goods to Customs using the appropriate valuation method. This has the potential to be problematic for Customs and wider government because accurate valuation information is relied upon to identify risks at the border, collect revenue, and for statistical purposes (discussed further in **Section C**).

Objective

44. The objective is to give importers certainty about the appropriate method to use to value imported goods.
45. Customs used the following criteria to assess the options:
- **International best practice:** Complies with New Zealand's international obligations and international best practice (World Trade Organization Trade Facilitation Agreement (WTO ATF)).
 - **Makes compliance easier for importers:** Makes valuation of imported goods easier for importers by providing certainty. Reduces the frequency of requests for advice.

- **Effectiveness:** Desired outcomes actually achieved. Value is declared correctly therefore the correct amount of revenue is collected for the Crown. Costs are proportionate to benefits.
 - **Consistency:** Advice received from Customs and the application of the law is consistent, supports public confidence in Customs and the revenue collection system.
46. Options that meet these criteria are likely to address the problems that have been identified.

Options and impact analysis

47. Customs considered the following options:
- **Status quo:** Customs provides advice on valuation, but not binding rulings.
 - **Alternative option 1:** Customs provides binding valuation rulings.
48. The following table sets out analysis of the options according to the criteria.

Criteria	Status quo: Customs provides advice on valuation but not binding rulings.	Alternative option 1: Customs provides binding valuation rulings
<p>International best practice:</p> <p>Complies with New Zealand’s international obligations and international best practice (World Trade Organization Trade Facilitation Agreement (WTO ATF)).</p>	<p>xx</p> <p>The WTO ATF states that member countries are encouraged to provide valuation rulings, but it is not mandatory to do so.</p>	<p>✓✓</p> <p>Binding valuation rulings are considered best practice and are provided by customs administrations such as Australia and the United States.</p> <p>Cabinet has already agreed that New Zealand can accept a customs chapter in the Trans-Pacific Partnership Agreement that includes a requirement to issue binding rulings on valuation issues [CAB Min (12) 15/7 refers].</p>
<p>Makes compliance easier for importers:</p> <p>Makes valuation of imported goods easier by providing certainty for importers. Reduces frequency of requests for advice.</p>	<p>xx</p> <p>Advice is provided, but this advice is ad-hoc and not published. The advice is not binding and this affects the level of certainty provided to importers.</p>	<p>✓-</p> <p>If valuation rulings were published, this would make valuation advice available to a larger number of importers. Publication will be considered further by Customs during policy development on the Regulations.</p>
<p>Effectiveness:</p> <p>Desired outcomes actually achieved. Value is declared correctly therefore the correct amount of revenue is collected for the Crown. Costs are proportionate to benefits.</p>	<p>✓x</p> <p>Valuation advice will clarify valuation issues, but the advice reaches a limited audience, generally only the importer directly receiving the advice.</p>	<p>✓-</p> <p>Implementing valuation rulings will have resource implications for Customs. Stakeholders have indicated willingness for rulings to be subject to cost recovery. Customs will further consider how its current cost recovery model can provide for this.</p> <p>Published valuation rulings would better achieve this objective. Publication of rulings will be considered further by Customs.</p>
<p>Consistency:</p> <p>Advice received from Customs and the application of the law is consistent, supports public confidence in Customs and the revenue collection system.</p>	<p>xx</p> <p>The status quo does not promote consistency.</p>	<p>✓-</p> <p>Publication of valuation rulings would support consistent application of the law by importers and Customs. Publication of rulings will be considered further by Customs.</p>
<p>Conclusion</p>	<p>Does not meet most criteria.</p>	<p>Partially meets the criteria. This is the preferred option.</p>

Impacts

49. The main impact for importers would be greater clarity about their obligations to value imported goods, and greater assurance about the status of a ruling on valuation from Customs. Importers would also have an ability to appeal Customs’ decision through the Customs Appeal Authority.

50. The main impact for Customs will be the implementation costs associated with providing binding valuation rulings, both in establishing the capability and capacity within Customs and to maintain processes. Throughout the consultation process on the Act review stakeholders have indicated willingness for rulings to be subject to cost recovery. Customs will further consider how their current cost recovery model can apply to valuation rulings.

Stakeholders views

51. Valuation rulings were not proposed in the public discussion document but Customs received eleven submissions from accounting firms and large traders supporting the introduction of binding valuation rulings. The theme from the submissions was that valuation rulings would benefit business by providing greater clarity and certainty, and would align with Inland Revenue’s approach.

Recommended option: Customs introduces binding valuation rulings on goods.

Interpretative rulings

Status Quo

52. Customs does not currently provide binding interpretative rulings. Interpretative rulings explain the application of specific legislative provisions to particular transactions or business arrangements. An example is permitted activities which could take place in a Customs Controlled Area.

Problem

53. In some circumstances Customs' clients can be uncertain about whether their existing or proposed business arrangements are compliant. This lack of certainty is a barrier to complying voluntarily with Customs' requirements.
54. Customs received three submissions supporting the introduction of binding interpretative rulings by Customs. No quantitative data was provided from submitters on compliance costs as a result of uncertainty about legal requirements.
55. Customs has not estimated the direct costs for business due to uncertainty about the application of the law to particular businesses or types of business arrangements. Customs does not have data on the base level of non-compliance nor the extent to which that can be linked to uncertainty.

Objective

56. The objective is to provide greater certainty for business to support voluntary compliance of Customs' requirements. Customs used the following criteria to assess the options:
 - **Makes compliance easier for importers:** Makes compliance with Customs requirements easier by providing certainty for traders. Reduces the frequency of requests for advice.
 - **Cost effective:** Costs are proportionate or less than the expected benefits.
 - **Consistency:** Advice received from Customs and the application of the law is consistent, supports public confidence in Customs and the revenue collection system.
57. International best practice has not been used as a criterion to assess the options, because interpretative rulings are not specifically required nor encouraged as best practice for customs administrations under the World Trade Organization Trade Facilitation Agreement (WTO ATF).

Options and impact analysis

58. Customs considered the following options:

- **Status quo:** Customs does not provide binding rulings or formal guidance on interpretative issues.
- **Alternative option 1:** Customs provides binding interpretative rulings.
- **Alternative option 2:** Customs provides published guidance on interpretative issues for traders.

59. The following table sets out analysis of the options according to the criteria.

Criteria	Status quo: Customs does not provide binding rulings or formal guidance on interpretative issues.	Alternative option 1: Customs provides binding interpretative rulings	Alternative option 2: Customs provides published guidance on interpretative issues for traders.
<p>Makes compliance easier for importers:</p> <p>Makes compliance with Customs requirements easier by providing certainty for traders. Reduces frequency of requests for advice.</p>	<p>xx</p> <p>A lack of guidance on interpretative issues can cause uncertainty for traders.</p>	<p>✓-</p> <p>If interpretative rulings were published, this would make interpretations available to a larger number of importers.</p>	<p>✓x</p> <p>Published guidance on interpretative issues will help to increase certainty for traders. However the advice is not binding - this may affect the level of certainty provided to importers.</p>
<p>Cost effective:</p> <p>Costs are proportionate to the benefits, or less than the expected benefits.</p>	<p>✓✓</p> <p>No direct costs associated with this option.</p>	<p>xx</p> <p>Implementing interpretative rulings will have resource implications for Customs. Customs views the costs as outweighing the potential benefits. Other legislative regimes have a broader range of binding rulings, but those regimes are more expansive and complex (for example tax legislation).</p>	<p>✓x</p> <p>Producing published guidance involves costs for Customs, but less costs than implementing and maintaining a formal statutory ruling process.</p>
<p>Consistency:</p> <p>Advice received from Customs and the application of the law is consistent, supports public confidence in Customs and the revenue collection system.</p>	<p>xx</p> <p>The status quo does not promote consistency.</p>	<p>✓-</p> <p>Publication of interpretative rulings would support consistent application of the law by importers and Customs.</p>	<p>✓✓</p> <p>Producing published guidance on interpretative can also be utilised by Customs staff which can support consistency of Customs processes.</p>
<p>Conclusion</p>	<p>Does not meet most criteria.</p>	<p>Partially meets the criteria.</p>	<p>Partially meets the criteria. This is the preferred option.</p>

Recommended option: Customs provides published guidance for traders on interpretative issues.

3 Determining value: Whether to include international freight and insurance costs

Status quo

60. Under the WTO CVA each country can choose to include or exclude international freight and insurance costs from the value of imported goods. New Zealand has excluded international freight and insurance costs since the 1980s. Australia, the United States, and Canada also take this approach. However most other WTO members include international freight and insurance costs.
61. On an import entry, although the value of imported goods does not include international freight and insurance costs, these costs are still required to be declared (as separate components) because Statistics New Zealand needs to be able to determine the value of imported goods with and without freight and insurance costs. Statistics New Zealand uses this data to meet international statistical reporting requirements. The data is also used to produce a range of key economic indicators (explained further below).

Problem

62. Two issues complicate compliance for some importers, and make import entry obligations and determining the value of imported goods and duty liability less straightforward.
63. The first problem is that two different values are needed to fill out an import entry and determine tax liabilities. This can be confusing, particularly for small to medium sized importers. To determine Goods and Services Tax (GST) the value including international freight and insurance is required. To determine import tariff duty and the Customs value of goods, the value excluding international freight and insurance is required.
64. Secondly, compliance with import entry requirements is difficult for importers that do not receive actual international freight and insurance costs as separate components on an invoice for the goods. Importers may only receive an invoice showing the total price of the goods (including freight and insurance costs). Freight costs can be commercially sensitive to overseas exporters that make a profit margin on the freight. Therefore some importers and their brokers are unable to declare actual freight and insurance costs to Customs. Brokers face uncertainty about whether Customs will apply penalties if freight costs are estimated.

Objective

65. The objective is to make the import entry process and the valuation of imported goods easier for importers and business. Customs considered whether changing the valuation of imported goods to include freight and insurance costs would make

compliance with import entry requirements clearer and easier for importers and brokers. Customs used the following criteria to assess the options:

- **Meets New Zealand’s international obligations:** complies with WTO and Free Trade Agreement (FTA) obligations.
- **Cost effective:** costs are proportionate to the benefits, or less than the benefits.
- **Compliance is easier:** compliance is easier for most importers, customs brokers, accounting firms.
- **Feasibility:** workable over time (taking into account changes in tariff duty due to free trade agreements). Implementation is not insurmountable.

66. Options that meet these criteria are likely to address the problems that have been identified. The criteria have been accorded different weights when analysing the options. The criteria are listed in order of importance. Meeting international obligations is the most important criterion.

Options

67. Customs has considered the following regulatory options:

- **Status quo:** Continue to exclude freight and insurance costs from the Customs value of goods.
- **Alternative option 1:** Include international freight and insurance costs in the Customs value for imported goods.
- **Alternative option 2:** Split values: continue to exclude freight and insurance costs for goods that are subject to tariff duty, but include freight and insurance costs for imported goods that are not subject to tariff duty.
- **Alternative option 3:** Remove the requirement for importers to declare freight and insurance costs on an import entry.

68. Customs considered whether to remove the requirement on importers to declare freight and insurance costs on an import entry (Alternative option 3). However Statistics New Zealand advised that freight and insurance costs need to continue to be obtained in order for New Zealand to meet international statistical reporting requirements. The value of goods declared by importers is collated by Statistics New Zealand and used for trade statistics, and key economic indicators such as the Balance of Payments and Gross Domestic Product. These statistics are inputs into a range of economic and fiscal policy decisions such as the Reserve Bank of New Zealand’s Official Cash Rate.

69. Statistics New Zealand needs to be able to determine the value of goods both excluding *and* including freight and insurance costs. Collecting this information on

import entries appears to have the least compliance burden for business, compared with alternative methods (surveys).

70. Customs also considered non-regulatory options to achieve the objective. Customs has determined that providing guidance on the application of penalties could provide more certainty for brokers about Customs treatment of information declared on import entries, for example when a broker declares estimates of international freight and insurance costs.
71. The following table sets out the analysis of the remaining options according to the criteria.

Criteria	Status quo	Alternative option 1: Include freight and insurance costs	Alternative option 2: Split values
<p>Meets New Zealand’s international obligations:</p> <p>Complies with WTO and FTA obligations.</p>	<p>✓✓</p> <p>Complies with WTO CVA and Free Trade Agreement (FTA) obligations.</p>	<p>✓✗</p> <p>Complies with WTO CVA obligations.</p> <p>New Zealand has agreed to bound ‘ceiling’ tariff rates under the WTO GATT². These bindings are negotiated as a percentage of the value of goods (which currently excludes freight and insurance costs). New Zealand’s applied tariff rates are, in practice, lower than the bound tariff rates. However, including these costs would involve consulting WTO members and potentially recalculating the bound tariff rates.</p> <p>FTA partners may react negatively to an increase in Customs value and perceive this as contrary to New Zealand’s position of liberalising trade.</p>	<p>✗✗</p> <p>Does not align with WTO CVA principles of uniformity.</p>
<p>Cost effective:</p> <p>Costs are proportionate to benefits, or less than the benefits.</p>	<p>✓✓</p> <p>Will not impose any additional costs due to system changes.</p>	<p>✗✗</p> <p>Tariff duty would increase if the Customs value included freight and insurance costs. Customs estimates that importers would pay at least an additional NZ\$7million in 2017 if freight and insurance costs were included. This represents an approximate 7.13% increase in tariff duty costs for some importers. One importer estimated a possible 6.1% increase in tariff duty.</p> <p>Due to an increase in tariff duty, there would also be an increase in the base figure that GST is calculated on. The GST increase would be cash-flow restrictive rather than being an actual cost for importers.</p> <p>Because the value of goods would increase, a lower proportion of goods would fall under the de minimis. This means that a greater proportion of goods would be subject to tariff duty and GST.</p>	<p>✗✗</p> <p>This option would avoid an increase in tariff duty, but implementation would be complex and therefore compliance costs would likely be higher for importers.</p>

2 Article 3, The General Agreement on Tariffs and Trade (GATT) 1947 states that “No contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the concessions provided for in the appropriate Schedule annexed to this Agreement.”

<p>Compliance is easier: Import entry requirements are easier to comply with for most importers.</p>	<p>xx Won't make compliance easier for importers.</p>	<p>✓ x The benefits of this option, (simpler import entry requirements) are outweighed by the increased cost for importers (higher tariff duty).</p>	<p>xx Compliance would be more complex than the status quo, and administration more burdensome for Customs.</p>
<p>Feasibility: Workable over time. Implementation issues are not insurmountable.</p>	<p>✓ x As tariff duty reduces under FTAs, the value to determine tariff duty (excluding freight and insurance costs) will become less relevant. The value for determining GST will remain relevant as long as the method for determining GST is not changed.</p>	<p>✓ x This option is more practical over time than the status quo. As tariff duty reduces, the value which is used to determine tariff duty (excluding freight and insurance costs) will become less relevant, while the value for determining GST will remain relevant.</p>	<p>xx This option would complicate valuation obligations for importers and make tax liability uncertain for importers. This option would be complex for Customs to administer.</p>
<p>Conclusion</p>	<p>This is the preferred option. Partially meets the criteria. Although compliance will not be easier for importers, importers' and brokers' systems are already built to comply with the current value. This option will not pose risks in terms of meeting WTO and FTA obligations.</p>	<p>Partially meets the criteria. This option is not preferred because there are risks with how this change would be perceived by New Zealand's trading partners, an increase in costs for some importers, and the benefit is not clear. Potential risks and likely costs outweigh the benefits.</p>	<p>Does not meet the criteria.</p>

Impacts

72. The following table shows the impacts of the different options. Alternative option 1 would have negative net impacts for importers and brokers. Alternative option 2 would have negative net impacts for importers, brokers and Customs.

	Status quo	Alternative option 1: Include freight and insurance costs
Impact on importers and brokers	<p>Neutral</p> <p>Two different values will continue to be required to meet import entry requirements and determine duty and GST liability. Freight and insurance costs will continue to be required.</p>	<p>Negative</p> <p>Compliance with import entry requirements may be more straightforward for some importers. But importers would continue to be required to declare freight and insurance costs. More tariff duty and GST for some importers. A larger proportion of goods over the de minimis threshold and subject to duty. Implementation costs for brokers (system changes).</p>
Impact on Customs	Neutral	Neutral

Stakeholders views

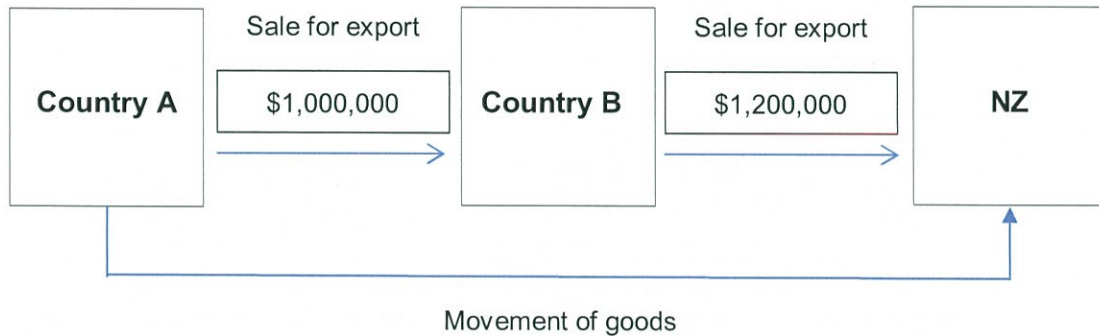
73. Twenty four submissions were received on this issue. All of the submitters support retaining the status quo, continuing to exclude international freight and insurance costs. Most submitters cited additional import tariff duty costs as the main impact of the option to change to including international freight and insurance costs.

Recommended option: Retain the status quo. International freight and insurance costs continue to be excluded from the valuation of imported goods for Customs purposes.

4 Determining value: Defining the sale in a supply chain that determines the value of imported goods

Status quo

74. The primary method used to determine the Customs value of imported goods is the Transaction Value method. The Transaction Value is the price paid or payable for the good when sold for export to New Zealand, subject to certain adjustments (such as the costs of international freight and insurance). Many countries have reported that the Transaction value is used in 90 to 95% of all importations.³
75. Currently the Act does not define which sale in a supply chain determines the value of imported goods. New Zealand case law⁴ has found that in a series of successive sales, the importer can select any of those prices for the purpose of determining the transaction value, as long as the sale can be evidenced. The ability to use an earlier sale in a supply chain is generally limited to multinational enterprises (MNEs) that can evidence earlier sales between related branches of the MNE.
76. The diagram below illustrates two possible sales which could determine the Customs value.



Problem

77. The main issues that arise due to the use of earlier sales in a supply chain include:
- importers apply valuation inconsistently which can result in different tariff duty and GST obligations between importers importing similar goods, giving multi-nationals an advantage over small importers
 - auditing difficulties for Customs due to the complexities associated with obtaining evidential documents from traders in an earlier part of the supply chain.

³ WCO Guide to Customs Valuation and Transfer Pricing.

⁴ *Sigma Agencies Ltd v Collector of Customs (Northern Region)*, High Court, Auckland, 1996.

Inconsistent application of the valuation rules

78. Small to medium sized businesses will generally not be able to evidence earlier sales between unrelated parties in a supply chain. On the other hand, MNEs are able to value goods using an earlier sale in a supply chain because an MNE will be in a position to evidence earlier sales between related entities in the MNE. Determining the value of goods in an earlier sale can translate into lower tariff duties and GST in respect of those goods.
79. The magnitude of the problem is not possible to determine because New Zealand Customs does not require importers to declare which valuation method has been used to value their goods, or which sale has been used as the basis for the value of goods. Customs is therefore unable to assess the exact proportion of imported goods or importers that would be affected by defining the sale that determines value as the last sale in the supply chain.
80. A report on this issue found that in the United States 2.4% of total imports were valued using earlier sales, which meant that 8.5% of all importers used an earlier sale as the value declared to the US Customs and Border Protection.⁵ Textiles, apparel, and footwear sectors had above average use of earlier sales to value goods.

Auditing complexities for Customs

81. Auditing earlier sales in a supply chain can make the auditing process more complex for Customs. This can increase costs for Customs, can affect revenue assurance, and in some cases can increase compliance burden for traders. The issues are that:
 - access to evidential documents can be difficult when sales are between traders located outside of New Zealand, which can affect assurance about accurate revenue collection
 - earlier sales in a supply chain between related parties involve greater auditing responsibilities for Customs. The WTO CVA states that the Transaction Value method should only be used when the relationship between the seller and buyer of the goods has not influenced the price. Testing whether the relationship has influenced the price of goods can involve time and cost for Customs, and increase compliance costs for an importer.

Objective

82. The objective is to clarify the sale in a supply chain that determines the value of imported goods, to ensure that a consistent value is used by all importers to

⁵ Use of the "First Sale Rule" for Customs Valuation of U.S. Imports United States International Trade Commission Publication 4121, 2009.

determine duty liability, and to make valuation clearer for importers and easier for Customs to administer.

83. Customs used the following criteria to assess the options:

- **Meets New Zealand’s international obligations:** The option needs to comply with the WTO CVA.
- **Consistency:** Application of the law is consistent across all importers. New Zealand’s legislation is consistent with the practice of other comparable countries (such as Australia, the United States, Canada, and the European Union), and is consistent with guidance from international bodies (World Customs Organization (WCO) guidance).
- **Clarity:** The requirements are clear for importers.
- **Administrative burden:** The requirements are more straightforward for Customs to administer.

84. Options that meet these criteria are likely to address the problems that have been identified. In selecting the preferred option, the criteria have been accorded different weights. The criteria are listed in order of importance. Meeting international obligations is the most important criterion for assessing the options.

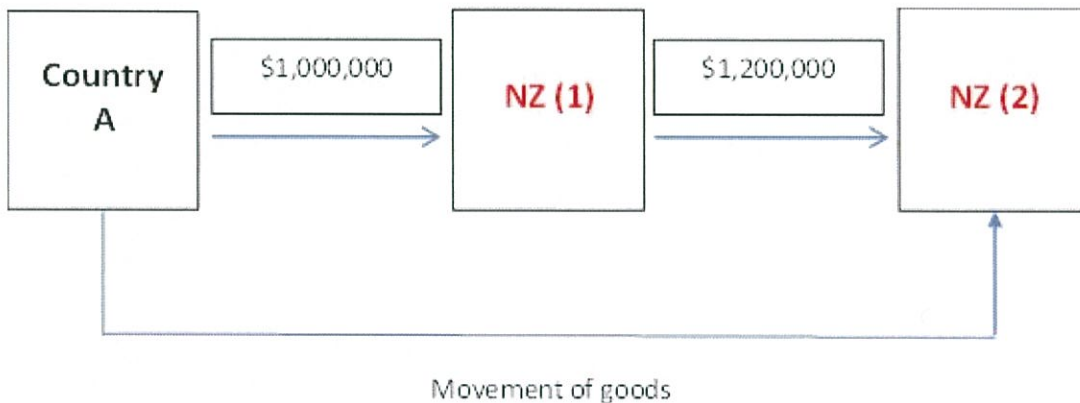
Options and impact analysis

85. Customs considered the following options.

- **Status quo:** No definition of ‘sold for export to New Zealand’ in the Act. An importer can choose the sale that determines the value of imported goods.
- **Alternative option 1:** Define the sale for export as ‘the last sale prior to the introduction of the goods into New Zealand’. This is also known as the ‘last sale’ definition.
- **Alternative option 2:** Define the sale for export as the sale that was entered into last. The value of imported goods would be determined by the price of goods in the most recent sale and purchase of the goods. The following diagram illustrates a supply chain where the most recent sale (dated 10/10/2016) is not the last sale in the supply chain before importation into New Zealand.



- Alternative option 3:** Define the sale for export as the sale to a purchaser in New Zealand. This would mean that the value of imported goods is determined by a sale in the supply chain that is between a buyer (in any country) and a purchaser in New Zealand. The following diagram illustrates a supply chain with two purchasers in New Zealand.



- None of the options described above are inconsistent with the WTO CVA requirements because the WTO CVA does not define the sale for export that determines the value of goods. However, the World Customs Organization Technical Committee on Customs Valuation has published non-binding guidance on the interpretation of sale for export under the WTO CVA. The guidance states that 'in a series of sales situation, the price actually paid or payable for the imported goods when sold for export to the country of importation is the price paid in the last sale occurring prior to the introduction of the goods into the country of importation, instead of the first (or earlier) sale'.
- The table below sets out analysis of the options according to the criteria.

	Status quo: Importers can choose the sale that determines the value of goods.	Alternative option 1: The last sale prior to the introduction of the goods into New Zealand.	Alternative option 2: Define the sale for export as the sale that was entered into last.	Alternative option 3: Define the sale for export as the sale to a purchaser in New Zealand.
<p>Consistency:</p> <p>Application of the law is consistent across all importers.</p> <p>New Zealand's legislation is consistent with the practice of other comparable countries and WCO guidance.</p>	<p>✓✓✗✗</p> <p>Importers' approach to valuation is inconsistent.</p> <p>Consistent with the United States.</p> <p>Inconsistent with WCO guidance.</p>	<p>✓✓✓</p> <p>Importers' approach to valuation is consistent.</p> <p>Consistent with WCO guidance.</p> <p>Consistent with the approach the EU is reportedly adopting in 2016.</p>	<p>✓✗✗</p> <p>Importers' approach to valuation may be more consistent than the status quo, but will still vary depending on the situation and the supply chain.</p> <p>Consistent with Australia.</p> <p>May have a different effect to the WCO guidance in some instances. This definition may lead to the last sale in some instances, and an earlier sale in others.</p>	<p>✓✓✗</p> <p>Importers' approach to valuation may be more consistent than the status quo, but will still vary depending on the situation and the supply chain.</p> <p>Consistent with Canada.</p> <p>May have a different effect to the WCO guidance in some instances. This definition may lead to the last sale in some instances, and an earlier sale in others.</p>
<p>Clarity:</p> <p>The requirements are clear for importers.</p>	<p>✓✗</p> <p>The sale that determines value is not established in legislation.</p> <p>Sale for export is not as clear as it could be.</p> <p>This gives some MNE importers flexibility.</p>	<p>✓✗</p> <p>This option is likely to clarify the requirements for some importers, but may reduce clarity for others.</p> <p>In some cases, importers already use the last sale in the supply chain to determine the value of goods. For those importers, a definition will confirm that their approach is correct. This will give importers and their agents (customs brokers) certainty that their approach is compliant.</p> <p>In other cases, particularly for MNE importers that currently use an earlier sale in the supply chain to value goods, the 'removal' of the option to use an earlier sale to value goods may reduce flexibility for those importers. The remaining options for valuing goods would be the price paid for the goods in the last sale prior to importation, or one of the other five</p>	<p>✓✗</p> <p>May pose further interpretation issues for importers.</p> <p>No submissions supported this approach.</p>	<p>✓✗</p> <p>May pose interpretation issues. One issue importers may face is how to interpret 'purchaser' in the importing country.</p> <p>A small number of submissions on the Act review discussion paper preferred this definition over the status quo.</p>

		methods of valuing imported goods. Valuation rulings will help to provide traders with more certainty in complex valuation matters (refer Section B).		
Administrative burden: The requirements are more straightforward for Customs to administer.	xx Customs encounters auditing complexities.	✓✓ Easier for Customs to administer.	✓✓ May be more difficult for Customs to administer.	✓x May be more difficult for Customs to administer.
Conclusion	Partially meets criteria.	Meets most criteria. This is the preferred option.	Partially meets criteria.	Partially meets criteria.

Impacts

88. The following table sets out the impacts of each option.

	Status quo	Alternative option 1: The last sale prior to the introduction of the goods into New Zealand.
Impact on importers and brokers	<p>Neutral/Positive</p> <p>Some MNE importers may benefit from lower tariff duty.</p> <p>Small to medium sized importers may pay higher tariff duty than MNE importers due to not being able to evidence earlier sales in the supply chain.</p>	<p>Negative and Positive</p> <p>Some MNE importers may face higher tariff duty if they had previously used earlier sales to value goods.</p> <p>There will be a consistent rule for all importers.</p>
Impact on Customs	<p>Negative</p> <p>Auditing complexities.</p>	<p>Positive</p> <p>Auditing may be more straightforward in some cases.</p>

Stakeholders views

89. Submitters had divided opinions. Seven submitters support the status quo - the ability to choose which sale in the supply chain determines the import value of goods. Submitters are concerned that a definition may introduce complexity, such as brokers having to determine which sale is the last sale.
90. Four submitters support a definition of ‘sale for export’ in the legislation, to give clarity about which sale should determine the value of imported goods. Three of those submitters favoured the ‘last sale’ definition; the last sale before the introduction of goods into New Zealand.
91. One submitter supports the definition of ‘sale for export to New Zealand, to a buyer in New Zealand’. This is Canada’s approach. The emphasis is on the buyer being in the importing country, rather than the sale being the last sale in the supply chain before importation to New Zealand.

Recommended option: Alternative option 1: define the sale for export as ‘the sale prior to introduction of the goods into New Zealand’.

Implementation plan

Declaring and adjusting the value of imported goods

92. Parts 6 and 8 of the Act will require amendment in order to implement the recommended changes.
93. Implementation is likely to require changes to the Customs IT system so that importers can notify Customs that a provisional value has been declared on an import entry. There are a range of possible IT system options. The most probable option that will create the least compliance burden for business and the least administrative burden for Customs is for importers to enter text into a text field which already exists in electronic import entries in the Joint Border Management System. The text will signal that the value on that import entry is provisional.
94. It is likely that reassessments will continue to be provided to Customs in a non-electronic format. Currently, aggregate adjustments to value are declared to Customs in the form of a letter from an importer, an importer's accountant, or importer's law firm. This involves administrative burden for Customs through the revenue assurance work associated with processing a reassessment.
95. No change is proposed to the current IT system to allow aggregate changes to value declared on import entries by Customs or by importers. This was considered during the establishment of the Joint Border Management System but not progressed due to complexities associated with this system change.
96. Implementation will require changes in operational practice. Operational procedures will need to be developed to guide consistent application of the new policy by Customs officials.

Valuation rulings

97. Part 9 of the Customs Act will require amendment in order to implement valuation rulings. Customs already has a specialist unit that issues binding rulings and provides valuation advice. It is estimated that two to four additional Customs officials will be needed in this unit to provide rulings regarding imported goods. Some specialist skills or experience will be required. For example, accounting skills to determine an application that covers transfer pricing and related parties issues.

Determining value: Defining the sale in a supply chain that determines the value of imported goods

98. A definition would be inserted through the legislative reform process. The main implementation issue would be informing importers and brokers so that they are aware of the change and how to meet the new requirements. During the implementation phase of the Act review Customs will assist importers and brokers

with this transition. This would include publishing guidance on interpreting the definition.

Monitoring, evaluation and review

99. An evaluation and review process will be established by Customs after a period of implementation of the legislative amendments.
100. The following information would help to monitor and evaluate the outcomes of the recommendations in this RIS:
- Adjusting value:
 - the number of adjustments made to value of imported goods, by type of adjustment (eg royalty payment, transfer pricing)
 - the total number of importers making adjustments each year
 - the number of import entries affected by aggregate reassessments of the value of goods (Customs currently does not record this data)
 - asking importers for feedback about whether the legislation and Customs' processes are more transparent and consistent, and what the outcomes have been for business, including whether compliance cost or burden has decreased.
 - Valuation rulings:
 - the number of requests for valuation rulings received by Customs
 - the time it takes Customs to issue the rulings
 - the cost of the rulings (for the importer and for Customs).
 - Sale for export:
 - evaluate the number of disputes between Customs and importers to ascertain whether there has been a decrease in disputes following the insertion of a legislative definition of sale for export
 - compare the value of identical goods from the same MNE importer before and after the legislative change, to ascertain whether different sales (and therefore different prices) have been used, noting that the value of goods can fluctuate for a variety of reasons
 - consult importers to seek feedback about the last sale definition, the impacts for importers and whether customs valuation is clearer and easier to comply with.

