TRADE GLOBALISATION AND THE REFORM OF CUSTOMS VALUATION AND VAT ON IMPORTATION OF GOODS: THE EXAMPLE OF THAILAND

By

PETCHARAT SUPANIMITKULKIT

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ABSTRACT

The purpose of this thesis is to reform customs valuation law and VAT on importation of goods under trends in trade globalisation, using Thailand as the example. To achieve this purpose, a number of related topics (e.g. the 'notional' and 'positive' concepts of value, international customs valuation systems - the Brussels Definition of Value and the WTO Customs Valuation Agreement, the destination and origin principles, VAT on importation, and the ASEAN Free Trade Area (AFTA)) are brought to analysis in a comprehensive way.

The research findings indicate that the existing system of customs valuation in Thailand is arbitrary and constitutes a significant barrier to trade. Such problems will be reduced (or eliminated) under the new customs valuation legislation, based on the WTO Customs Valuation Agreement. However, the system of the WTO customs valuation is complicated, creating some difficulties for developing countries like Thailand to apply. In this connection, co-operation among ASEAN customs administrations should be enhanced. The 'regional minimum values' should also be applied for determining the customs value where the transactions within the ASEAN region are between related parties.

With regard to VAT on importation, it is found that, in the two countries (the UK and Thailand) surveyed, there is no particular problem inherent in the destination-based VAT. Most problems relate to the administration as well as the base of VAT on importation in Thailand. Reforms on these matters have to be undertaken unilaterally and voluntarily to improve prospects for attracting foreign investment and increasing trade.

This thesis is based upon law and agreements in force at 31 December 1999.

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List of Abbreviations

AEM	ASEAN Economic Ministers Meeting
AFTA	ASEAN Free Trade Area
APA	Advanced Pricing Agreement
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of Southeast Asian Nations
ASP	American Selling Price
ATA	Admission Temporaire/Temporary Admission
BDV	Brussels Definition of Value
BE	Buddhist Era
BOI	Board of Investment
c.i.f.	cost, insurance, and freight
CCC	Customs Co-operation Council
CEPT	Common Effective Preferential Tariff
CET	Common External Tariff
CFZ	Customs Free Zone
CUP	Comparable Uncontrolled Price
EC	European Commission
ECJ	European Court of Justice
EFTA	European Free Trade Association
eg	exempli gratia
EPZ	Export Processing Zone
EU	European Union
f.o.b.	free on board

FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GBP	Great Britain Pound Sterling
GDP	Gross Domestic Product
GIZ	General Industrial Zone
GNP	Gross National Product
GSP	Generalised System of Preferences
GST	Goods and Services Tax
HM	Her Majesty
HS	Harmonised Commodity Description and Coding System
IBCC	International Bureau of Chamber of Commerce
IBFD	International Bureau of Fiscal Documentation
ICC	International Chamber of Commerce
ie	id est
IEAT	Industrial Estate Authority of Thailand
IMF	International Monetary Fund
ITO	International Trade Organisation
MFN	Most-Favoured Nation
MNCs	Multinational Corporations
MST	Manufacturer Sales Tax
MTN	Multilateral Trade Negotiation
NAFTA	North American Free Trade Agreement
NEDO	National Economic Development Office
NIC	Newly Industrial Country

NIRC	National International Revenue Code
NNI	Net National Income
OECD	Organisation for Economic Co-operation and Development
OJ	Official Journal of the European Communities
PTA	Preferential Trading Arrangement
RST	Retail Sales Tax
SET	Selective Employment Tax
THB	Thai Baht (the Thai currency unit)
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USTR	United States Trade Representative
VAT	Value-Added Tax
VATA	Value Added Tax Act
Vol.	Volume
WCO	World Customs Organisation
WST	Wholesale Sales Tax
WTO	World Trade Organisation

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INTRODUCTION

I. Recognising Global Trade Structure

'With respect to...progressive societies...social necessities and social opinion are always more or less in advance of law... Law is stable; the societies we are speaking of are progressive. The greater or less happiness of a people depends on the degree of promptitude with which the gulf is narrowed.'[1]

The most commented-on feature of international trade relations has been the accelerated 'globalisation' of productions and markets.[2] The term 'globalisation' refers to the international economic system that has evolved into a global economy - an interdependent system of trade, investment, and development that connects nearly all regions around the world.

To be more precise, the development of international economic system has come about by virtue of the fact that economic contacts between countries are steadily becoming more intensive and more multifarious: international tariffs on trade in goods and the international interchange of capital, services and labour are closely interconnected.

Since the First World War, national markets were increasingly sealed off from each other, principally through the medium of indirect taxes. The result was a growing paralysis of world trade. After the Second World War, accordingly,

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[1] Sir Henry Maine, *Ancient Law,* Everyman's Library, London, 1965, p. 15

[2] Globalisation of trade has grown rapidly in the period since the end of the Second World War. In 1948, the nominal volume of world trade in goods and services was roughly US$ 53 million, but by 1992 had reached a figure of US$ 4,640,000 million. See William A. Kerr and Nicholas Perdikis, *The Economics of International Business,* Chapman & Hall, London, 1995, p. 6.

largely under the impulse of the United States of America, liberal trade and economic policies opened up national markets. These changes were both mirrored and implemented by changes in indirect taxes as they affected trade policies and flows. These trends were more strongly marked in developed countries (Maine's 'progressive societies') than in developing countries.

After the collapse of Soviet-style communism, there has been no ideological alternative to liberal free market economics, though this encompasses a wide spectrum of policies running from shades of neo-liberalism to neo-corporatism. This in turn has encouraged the assimilation of developing countries to economic liberalisation, both domestically and externally. Changes to their tax systems are important monitors and motors of this process.

A. Trends in International Trade Relations: Development between the 1980s and 1990s

The last two decades witnessed a number of changes on international trade relations that should be noted as follows.

- First, as will be mentioned again in Chapter 1, the theoretical idea of free trade, or liberalisation of trade, has been widely recognised around the world. Essentially, trade liberalisation ensures that cross-border trade should not be subject to any restrictions or barriers. In this regard, the 'rules of the game' for international trade relations have typically established and altered by both bilateral and multilateral negotiations and agreements among firms, industries, countries and

regions. At present, the key role in this issue falls to **the World Trade Organisation** (WTO). As one might observe, the idea of trade liberalisation arises from the **Ricardian** principle of comparative advantage. It is believed, at least in theory, that the WTO's objectives, such as the reduction of tariffs and non-tariff barriers, would lead to prosperity and encourage global trade flows. These would also bring about an efficient price structure and choices through price mechanisms;

- Second, following the first, a number of developing countries have taken step towards the liberalisation of policies governing trade flows, as well as flows of investment, technology and finance capital. Most of them basically involve the implementation of outward-oriented trade strategies as well as a reversal of import-substitution strategies. Accordingly, tariff structures have undergone drastic changes as part of trade reforms: the main directions of these changes have been the reduction in average protection rates and the convergence in tariff rates across different imports. As observed by Escolano (1995)[3], developing countries that adopted strongly outward-oriented trade policies showed consistently better economic performance than those whose policies were inward oriented or only moderately outward oriented. In 1974 – 1992, developing countries with strongly outward-oriented trade policies experienced, on average, an annual real per capita GDP growth of 6 per cent and an increase in factor productivity

[3] See Julio Escolano, 'International Trade Taxes', in Parthasarathi Shome (ed.), *Tax Policy Handbook*, IMF, Washington D.C., 1995, p. 199.

of more than 3 per cent. In contrast, the set of all developing countries experienced, on average, 1.6 per cent real per capita GDP growth and about 1 per cent factor productivity growth;

- Third, the development and completion of the Single European Market (by the end of 1992) is undoubtedly one of the driving force behind the spread of regionalism in the world. In the early 1990s, it was evident that countries in other regions began exploring options for their co-operation and integration, especially in Southeast Asia (i.e. the ASEAN Free Trade Area - AFTA) and North America (i.e. the North American Free Trade Agreement - NAFTA). Undoubtedly, the emergence of regional integration arrangements, for example a free trade area or a customs union[4], is a new phenomenon among independent countries. These countries (i.e. participants) focus particularly on geographically discriminatory tariff-based arrangements between them. At the level of the customs union (e.g. the European Union - EU), it includes indeed no exports and imports.
- Lastly, with rapid technological advances, the world has been evolving from an industrial era to an information era. During the first period of the industrial era, the focus shifted from agriculture to industry. This

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[4] The formation of a free trade area is based on an agreement between independent countries. Among the participating countries, customs duties and other internal tariff barriers to trade are removed, but the countries retain their freedom to determine their own customs duties and trade restrictions to products imported from outside the area (the non-participants). There is no common external tariff in a free trade area. Rules of origin then are required to ensure that only goods originating within the participating countries of the free trade area are exempt from customs duties.
The customs union is similar to free trade areas except that member countries must conduct and pursue common external commercial relations, i.e. they have to adopt common external tariffs on imports from non-member countries. See Ali M. El-Agraa, *The Theory and Measurement of*

was the turning point where capital-intensive industries became of central, economic, social and political importance in comparison with the unskilled labour-intensive industries that had formerly predominated. In the information era, the focus shifted from capital-intensive industries to knowledge-intensive ones. The critical area of trade competition will be in developing the technology to create high value-added products and high-wage jobs.

II. Existing Problems of the Global Trading System: Developing Countries' Perspectives

Despite the GATT's success, the major concern about the development of the global trading system is that most developing countries still maintain high levels of protection.[5] In particular, they tend to apply their own rules for determining customs valuation of importation, whilst in developed countries, on the other hand, the methods stated in **the WTO Customs Valuation Agreement** (or 'the Code') appear to be norms.

International Economic Integration, MacMilan Place, UK, 1989, pp. 1-4. The rules of regional integration arrangements are provided in Article XXIV of the GATT 1994.

[5]Very often, trade strategies for the industrialisation of developing countries comprise of both outward-oriented trade and import-substituting policies. The former concentrates on the promotion of local industries that can be sold in world markets. The latter focuses on replacing imports by domestically produced substitutes. In fact, the strategy of import substitution is contrast with that of outward-oriented trade. In practice, and because of the WTO's obligation of tariff reductions, most developing countries tend to simplify their tariff structures with fewer nominal rates differentiated by degree of industrial processing, and lowering average rates. On the export side, in addition, zero rating of industrial exports has generally been accepted. Nevertheless, in some developing countries, taxation of primary and universal agricultural exports continues. It can be argued that such impositions lead to increasingly negative attitudes towards free trade, and distort the relation between domestic and international prices prompting an inefficient allocation of resources.

In Thailand, for example, the survey made by the GATT in 1995[6] clearly indicated that tariffs remained high and disparate, with substantial escalation and tariff peaks for many product categories. There was also discrimination between imports and domestic products under the general sales taxation (i.e. so-called business taxation, which was replaced by a value-added tax (VAT) in 1992). More specifically, the lack of transparency in Thailand's procedures for customs valuation was prominently noted.[7] This issue will be discussed and analysed in Chapter 3.

In addition to the issue of customs valuation, critics of the operation of the WTO also emphasise the lack of rules governing the issue of VAT in relation to international trade flows.[8] As one may observe, the applications of the WTO and the national VAT are considered in isolation. Therefore, it can be accordingly suggested that, as regards the positive role of globalisation of trade in fostering innovation, competition and productivity, reforming both policies and procedures in relation to VAT and customs valuation seem unavoidable.

III. Research Hypotheses

In the past, few researches had been done on the conditions that contribute to the notion of trade liberalisation as well as indirect tax reform. This paper thus examines the potential for reforming customs valuation system and VAT on

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[6] See GATT, *Trade Policy Review in Thailand*, GATT, Geneva, 1995.
[7] Details of comments are available in *http://www.tradecompass.com*.
[8] The distorting effects on interjurisdictional trade are accordingly visible. An excess tax burden occurs when the rate of VAT imposed on imported goods is higher than that on similar

importation from a developing-country perspective, in particular Thailand. Accordingly, a number of hypotheses will be tested in this study as follows:

First, that, trends in globalisation lead to the demand for reforming legal aspects of both VAT and customs valuation. The basis of reform should be made in accordance with the overall framework of the WTO.

Second, that, the Brussels Definition of Value operates on a purely theoretical level and thus is losing touch with commercial realities. The implementation of the Code would improve the notions of certainty as well as transparency in each country's customs law. Nevertheless, some parts of the Code are in practice problematic, which may encourage indirectly evasion of duty by dishonest importers, especially the so-called 'multinational enterprises' (MNEs), located in developing countries.

Third, that, those defects of the Code would be improved by harmonising customs valuation systems and procedures at the regional level. These would reduce a degree of protectionism against extra-regional imported goods, and thus would promote the aim of free trade within the region.

Fourth, that, a flat rate should be imposed equally under the principle of destination-based VAT among countries. Unnecessary charges or fees should be excluded from the base for calculating VAT liability on imported goods.

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domestically produced goods, or when domestic tax incorporated in the export price is not fully rebated at the export stage through border tax adjustments.

Fifth, that, the uniformity of VAT laws in the ASEAN region is far from being politically acceptable. Accordingly, reform of VAT should be made at the level of each individual country.

Sixth, that, international efficiency of VAT would be improved if national VAT laws limit the scope of exempt goods.

Seventh, that, inconsistency between the bodies governing the appeal procedures of both the VAT on importation and customs valuation, i.e. the Inland Revenue and the Customs Departments, undermines administrative simplicity.

IV. Objectives and Originality of the Study

This thesis aims to contribute towards

- specifying the range of potential problems associated with customs valuation and VAT on importation of goods in developing countries, as illustrated by the example of Thailand;
- commenting on the meagre empirical evidence in relation to the actual practice of the Thai fiscal authorities;
- analysing, in considerable details, the systems and procedures of VAT on importation in the UK and Thailand, and the development of a single international customs valuation system under the GATT/WTO;
- discussing the implications of regional trade integration schemes (e.g. the AFTA) on the Thai fiscal policies;

- suggesting some avenues along which progress could be made towards bringing the VAT and customs valuation procedures in a developing country like Thailand closer to international practice, both conceptually and operationally. As one may observe, the exchange of comparative experience of VAT between two countries of different economic levels, i.e. the UK and Thailand, can be helpful in narrowing the gap within the global trading system.

In this respect, this paper differs from other studies in a number of ways. The originality of the study therefore derives from various sources as follows:

1. Apart from the EU, there has been little academic study on the issue of VAT on importation of goods in the ASEAN region;
2. the national tax implications and consequences of GATT/WTO are evaluated;
3. the study brings together a number of related topics - customs valuation and VAT on importation of goods - which are more commonly looked at in isolation rather than in their totality;
4. it considers the impact of globalisation on national systems of customs valuation, which in particular draws on experience of the Thai Finance Ministry.

V. Summary of Contents

Chapter 1 presents a unique prescription on how the structure of international trade relations is supposed to influence tax reform in countries. It contains a description of important characteristics of indirect taxes on importation. The basic philosophies of trade liberalisation, for example the most-favoured-nation principle, the national treatment, and border tax adjustments, are also discussed in this chapter. This chapter is mainly descriptive by nature, providing background information rather than original research.

Chapter 2 deals with an application and operation of the WTO Customs Valuation Agreement. Special attention is given to the methods and criteria of customs valuation set forth in the Code. Chapter 3 examines the current problems and implications of customs valuation in Thailand. Also included in this chapter is fiscal incentive schemes of the Royal Thai government dealing with the importation of goods.

Chapter 4 presents a thorough comparative analysis of major research findings in relation to VAT on importation of goods in Thailand and the UK respectively. Chapter 5 studies the development of trade integration in the Southeast Asia region, which provides a great impact on reforming indirect tax laws in Thailand.

Finally, chapter 6 summaries certain points made in the preceding chapters and draws conclusions with regard to trade globalisation and its impact on customs valuation. This chapter also suggests the possible basis for reforming customs valuation law and VAT on importation of goods in Thailand.

CHAPTER 1

INTERNATIONAL TRADE ASPECTS AND RELATED INDIRECT TAXATION: GLOBAL PERSPECTIVES

I. Development of International Trade Relations

As the earth and its 5.3 billion inhabitants spin towards the 21st century, a number of issues can be raised with respect to the development of international trade relations. The term 'international trade relations' in this regard refers to the exchange of goods and services between countries through exports and imports.

At the initial stage, Adam Smith in the Wealth of Nations, published in 1776, created the principle of absolute advantage. He considered that if one of two countries could produce one product at lower cost, and the other, a second product at lower cost; each country would benefit from trade.[9] Since Adam Smith, there has been remarkably progress in theories of trade relations between countries. And the most remarkable doctrine was outlined by the principle of political economy and taxation written by David Ricardo in 1821. In this respect, Ricardo considered that a country has a comparative advantage in producing a good, relative to another country or the rest of the world, if the relative cost of

[9] See Adam Smith, *The Wealth of Nations*, in Andrew Skinner (ed.), Penguin, UK. 1776.

producing the good, that is, its opportunity cost in terms of other goods forgone, is lower than it is abroad. According to the theory of comparative advantage, it would enable countries to consume some goods and services more cheaply by importing them, and to obtain some resources and products from other countries which would otherwise be totally unavailable because domestic producers are unable to supply them. In this regard, inter-country variations in comparative advantage are reflected both in terms of their differential cost structures (i.e. price competitiveness) and different skill levels (i.e. product differentiation competitiveness). These, in turn, are determined in large measure by the country's basic factor endowments (natural resources, labour and capital) and degree of economic maturity (level of per capita income, general cost and price levels, scientific and technical skills, etc.) [10]

The theory of comparative advantage would accordingly be beneficial both for a country and in the world as a whole if international trade follows the lines suggested by the idea of liberalisation or free trade. In other words, free trade would help encourage consumption of goods, full employment as well as complete factor mobility amongst countries.

Since the end of World War II, the development of international trade has been crucially transformed. This is due to the new order of international economic system that has evolved into a truly global economy, i.e. an interdependent system of trade, investment, and development that connects nearly all regions around the world. Unlike the past two centuries, the rules of international

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[10] See *supra* note 2, p. 21.

economic relations are typically established and altered by both bilateral and multilateral negotiations and arrangements among companies, industries, nations, and regions. For example, there are the GATT/WTO and the International Monetary Fund (IMF). In this era, trade and investment flows between countries remain vitally interconnected. In other words, the globalisation of trade and industry is currently a reality for economic development. The rapid growth of global business operations, i.e. MNEs, means most countries have had large investment inflows and outflows between them (Table 1.1). The formation of MNEs reduces transaction costs and trade-related barriers, thus fostering global industry efficiency and trade growth. Yet the implications of MNEs for international trade relations have begun to receive serious attention by academics, in particular economic theorists.

Table 1.1 Principal Investment Flows, 1975-92 (Billions of Dollars)

	1975	1980	1985	1986	1987	1988	1989	1990	1991	1992
Outflows of investment by investor										
Developing countries	**0.2**	**0.6**	**2.7**	**3.2**	**5.1**	**7.6**	**11.0**	**10.0**	**11.1**	**11.4**
Asia	0.1	0.2	2.6	2.6	4.9	7.4	10.7	11.4	9.5	10.4
Latin America	0.1	0.3	0.1	0.6	0.2	0.2	0.7	1.0	0.8	1.0
Developed countries	**27.0**	**57.0**	**59.0**	**86.0**	**132.0**	**162.0**	**203.0**	**213.0**	**171.1**	**147.1**
US	14.0	22.0	15.0	14.0	28.0	14.0	29.0	32.7	27.1	35.3
Japan	2.0	3.0	6.0	15.0	20.0	34.0	44.0	48.0	30.7	17.2
EC	9.3	26.1	23.9	42.0	64.0	77.0	89.0	99.4	90.0	82.5
Total	**27.2**	**57.6**	**61.7**	**89.2**	**140.1**	**168.6**	**212**	**223**	**182.2**	**158.5**
Inflows of investment by destination										
Developing countries	**6.3**	**10.1**	**11.5**	**14.0**	**25.0**	**30.0**	**30.0**	**29.8**	**41.5**	**41.0**
Asia	1.6	3.2	4.5	6.7	11.6	15.0	16.2	18.6	24.0	28.0
Latin America	3.3	6.2	4.5	5.4	10.8	11.4	8.4	7.3	12.0	13.0
Developed countries	**15.2**	**42.1**	**37.8**	**64.1**	**107.9**	**128.6**	**165.4**	**156.2**	**101.8**	**83.9**
US	2.6	16 9	19.2	34.1	58.1	59.4	70.6	45.1	11.5	-3.9
Japan	0.2	0.3	0.6	0.2	1.2	-0.5	-1.1	1.8	1.4	2.7
EC	9.7	21.0	14.7	20.0	36.4	54.3	75.5	86.0	68.6	70.3
Total	**21.5**	**52.2**	**49.3**	**78.1**	**132.9**	**158.6**	**195.4**	**186.0**	**143.3**	**124.0**

Source: BIS, 1993; UNCTAD, 1993b; UNCTC, 1988; IMF, 1990, quoted in Page (1994)

Another important factor in the development of international trade is the formation of regional trading arrangements, which may either create or divert trade.[11] The EU, for example, has eliminated internal customs duties, thus enabling manufacturers to treat the whole EU as their domestic market. The Common External Tariff (CET) is applied on goods entering the EU, after which they can enter free circulation. At present, the EU accounts for one third of global exports, more than the USA and Japan together.[12]

It should be noted that, at present the world is evolving from an industrial era to an information era. Thus, the crucial area of competition in the 21st century will be the development of technologies, creating high value-added products and high-wage jobs. In relation to international trade, technologies would improve productivity, resulting in a decrease of the labour cost as a proportion of total costs in many industries. At the same time, technologies and modern design allow MNEs to save on materials. Thus, these are a major threat for developing countries that have based their trade and investment strategies on cheap labour and/or material costs. It is possible to see a number of MNEs have shifted back

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[11] Theoretically, trade creation comes from a shift away from high-cost domestically produced goods to lower-cost imports from regional partner countries. Other things being equal, the trade creation effect, combined with greater opportunities to exploit economies of scale, implies a regional expansion in real income.
Trade diversion, on the other hand, arises from a shift of trade with third countries to internal trade within the group. This occurs because the tariff-inclusive prices of goods from member countries are lower than the tariff-inclusive prices of non-member countries who formerly supplied them. Trade diversion thus involves shifting the source of imports from lower to higher cost suppliers, and is generally welfare-decreasing. See Raed Safadi and Vera Nicholas, 'Suggested Issues For Discussion', in OECD, *Regionalism and Its Place in the Multilateral Trading System,* OECD, France, 1996, p. 19. See also John Black, *A Dictionary of Economics,* Oxford University Press, Oxford, 1997, p. 472.
[12] See Roger Martin-Fagg, *Making Sense of the Economy*, International Thomson Business Press, UK, 1996, p. 134.

their labour-intensive operations from developing countries to industrialised countries.

Lastly, an observation can be made that the benefits of international trade are unequally divided between countries. This is because the real world does not operate free markets. The real world trade is currently affected by, for example, tariffs, subsidies and state monopolies. This inevitably tends to produce situations where national self-interest is put before international obligations, resulting in the unilateral imposition of protectionist measures. Although tariffs are being reduced as part of the GATT/WTO obligations, there are still a number of non-tariff barriers that have grown rapidly. Such non-tariff barriers, for example differences in customs valuation systems between countries, have now become more important than tariffs as an impediment to international trade. In addition, the manner in which would trading patterns have developed has not benefited certain developing countries who have specialised in a narrow range of commodities for which would demand has grown slowly.

II. Significance of Customs Valuation and Summary of Import Documents

A. Significance of Customs Valuation

Customs valuation is an integral part of the trade transaction process, and plays a major role in facilitating or hindering trade. This is because it is the value of imported goods, as determined at the border, that gives effect to rates of duties

that are assessed (usually) on an *ad valorem* basis.[13] However, the aim of customs valuation is not confined to the levy of import duties. It can be used for the various purposes, such as levying of other taxes on importation, collecting statistics of foreign trade, and establishing amounts of penalties, fines, and forfeitures. It is also one of the most important factors in the writing off on import licences and import quotas as far as these are based on the value of goods.

In this connection, customs valuation can be a major trade policy instrument for protecting domestic markets against foreign products. Under this policy, the valuation bases, mainly, rely on arbitrary or fictitious values.[14] In other words, a system of customs valuation applied has scarcely any relation to the price actually paid. From the economic viewpoint, customs valuation under this system is more harmful than the import duty. It artificially inflates the import duty. The import duty is considerably higher than is shown by the percentage by itself. In addition, a change in the rate of import duty is clearly visible, while an increase in the rate of duty as a result of changes in the system of valuation is considerably less noticeable and more difficult to prove.

It is apparent that trade facilitation is an important instrument for the growth of the country economy in this era. Methods of customs valuation that is transparent, simple, stable, and equitable (i.e. fair), and most important of all,

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[13] For details of *ad valorem* duties, see section IV.A.1 below.

[14] Examples are the existing customs valuation system in Thailand (see Chapter 3), and the former US methods for customs valuation, in particular the American Selling Price method (see Chapter 2).

consistent with commercial practices are desirable. These standards are inherent in the WTO Customs Valuation Agreement (see Chapter 2).

B. Summary of Import Documents

Many of the customs documents required in international trade arise from the need for both governments and trade operators to monitor and control the movement of goods and to safeguard the legitimate interest of all parties. Undoubtedly, the customs requirements in this respect are complex and, sometimes, can be different from country to country. It is therefore important for importers to have a good understanding of all documents involved in the import process. Failure to understand them can result in delivery delays.

Apart from the basic import documents (e.g. import declarations, invoices, freight and payment documents on imports), there are a number of specific documents which are relevant for clearance. This section, therefore, gives a brief introduction to the specific import documents that would be of interest to all traders.

1. Import Quotas and Import Licensing

An import quota is one of the most common kinds of quantitative restriction on trade. It involves governments putting a physical limit on the quantity of a particular product which may be imported over a specified period of time – normally one year. The import quota is enforced to protect domestic import-competing industries.

The import quota may be global, applied to all imports of a particular product regardless of source. Alternatively, many quotas are bilateral, confined to imports coming from a specific source.[15] It should be noted that in principle, the WTO prohibits the use of quotas or other measures other than tariffs to restrict trade.[16] However, there are two major exceptions permitted the WTO member countries to deviate from this basic rule. The first covers agricultural or fishery products and is utilised primarily to restrict domestic supply or to remove a temporary surplus of the like domestic product.[17] The second exception is to permit the use of quotas on imports for the purpose of safeguarding a country's balance of payments.[18] The existence of exceptions, therefore, makes the import quotas remain an important barrier to trade.

In practice, the country imposing the import quotas issues import (or quota) licences to importers permitting them to import a specified quantity of the product. Licences may be issued administratively or auctioned to the highest bidder. If the latter, a further possibility is that the quotas are tradable between importers.

Interestingly, the import licensing procedures were initially negotiated in the Tokyo round. The outcome was an Agreement on Import Licensing Procedures.[19] This agreement is embodied in the text of the Uruguay round

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[15]See Nigel Grimwade, *International Trade Policy: A Contemporary Analysis*, Routledge, London, 1996, p. 61.
[16] Article XI of the GATT 1994
[17] Article XI, paragraph 2.C of the GATT 1994
[18] Article XII of the GATT 1994
[19] See Agreement on Import Licensing Procedures, GATT BIDS 26 Supp.154 (1980).

Agreement, found in the annexes to the WTO. Briefly, it establishes requirements to enhance transparency of licensing systems, including publication requirements, the right of appeal against decisions, and the length of licence validity.[20]

2. Preferences

Preference in duty terminology means that importers pay a lower rate of import duty or none at all on the goods they import. This is one of the most important exceptions to the MFN principle of the GATT/WTO where it requires equal treatment among different nations.[21]

Generally, preferential duty rates for imported goods arise in two circumstances. One is where developed countries grant tariff preferences to certain less developed countries under what is known as the 'Generalised System of Preferences' (GSP).[22] Another is between countries in the regional integration arrangements (e.g. customs unions or free trade areas). In this respect, an importer looking for sources of supply should check whether the goods he requires are

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[20] See *supra* Articles 2 and 3.

[21] See Article I of the GATT1994. See also section III:B below.

[22] Historically, the GSP scheme had originated in the 1960s with United Nations Conference on Trade and Development (UNCTAD). At its first conference in 1964, a group of less developed countries known as 'the Group of 77', moved a resolution calling for changes in the international economic order, including a lowering of tariffs on goods coming from developing countries. In 1968 at UNCTAD 2, agreement was reached on a scheme for granting tariff preferences on imports from developing countries. In 1971, the GST programme to favor trade of less developed countries initially operated under the benefit of a waiver from the GATT MFN. This waiver was granted for a ten-year period, provided that any preference granted to any one developing country was extended to all. At present, the rules of GSP are included in Part IV of the GATT, and the Tokyo Round Decision of 28 November 1979 [L/4903] Differential and Most Favoured Nation Treatment Reciprocity and Fuller Participation of Developing Countries, GATT, BISD 26 Supp. 203 (1980). The latter provides a legal basis for extending the GSP beyond ten years without the need to secure a further waiver from the MFN clause. In other words, it gives to the GSP scheme a permanent legal basis. See *supra* note 15, pp. 161-162. See also Bernard Hoekman and Michel Kostecki, *The Political Economy of the World Trading System: From GATT to WTO,* Oxford University Press, Oxford, 1997, p. 237.

available under the preference rules from one of the preference receiving countries and whether or not they are subject to duty from other sources.

Documents covering the import of goods to which preference applies differ between countries and vary depending on the origin of products. In the UK, for example, three main types of preference documents are used. They are Form EUR1, an invoice declaration, and Form A. The last is used for goods imported from the GSP countries. All other preference countries use the Form EUR1. The invoice declaration is a simplified form of documentation that can be used in place of the EUR1.[23]

3. Certificates of Origin

Treatments of imports are different, depending on their origin. For example, if six WTO member countries form a free trade area so as to free all trade among them from tariffs, then at least three levels of tariffs may apply to goods imported into one of those six: the bound-tariff level for the WTO member countries that are not in the free trade area; tariff-free treatment for free-trade-area goods; and tariffs on goods from other countries that are not member countries of the WTO. In this regard, the certificate of origin is required so as to determine from which of the three groups of countries the goods originated and at what rate imports are applied.[24]

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[23] See HM Customs and Excise, *Tariff Preferences: Imports*, Notice 826, Customs and Excise, UK, June 1999.

[24] See John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, 2nd ed., The MIT Press, Massachusetts, 1997, p. 167. Notably, the rules for determination of the country of origin for internationally traded commodities do not have to be the same in each country. The same country may have several different rules of origin, depending on the purposes of the regulation governing the particular imports. Nevertheless, there is a

Certificates of origin are usually issued by a local chamber of commerce in the exporting country. In principle, the wording of certificates has to match exactly that in the other documents. It includes the names and addresses of the exporter and importer, a description of the goods and their country of origin, and the signature and the seal or stamp of the authorising body.[25]

D. ATA Carnets

The "Admission Temporaire/Temporary Admission" (ATA) Carnet is an international customs document which may be used for the temporary duty free importation of most types of temporary goods, except goods entered for processing and repair. This is in lieu of the usual customs documents required for entry. The carnet serves as a guarantee against the payment of duties (and other import taxes) which may become due if the goods listed in the carnet are not re-exported as intended. It, therefore, facilitates international business. The importer can normally obtain the ATA Carnets from the local chamber of commerce.

The only convention dealing with the ATA Carnets is the "Customs Convention on the ATA Carnet for the Temporary Admission of Goods", concluded under the auspices of the Customs Co-operation Council (CCC), now the World Customs Organisation (WCO), in December 1961. Carnets are issued and guaranteed by national groups, which administer the ATA Carnet System

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multilateral convention dealing with rules of origin. The Kyoto Convention (negotiated under the auspices of – and administered by- the World Customs Organisation in Brussels) contains, in Annex D:2, certain rules for the determination of origin. This Convention is officially called the International Convention on the Simplification and Harmonisation of Customs Procedures, signed at Kyoto, 18 May 1973, entered into force on 25th September 1974.

[25] See John R. Wilson, *Getting Started in Importing: A Practical Guide,* 2nd ed., Kogan Page, London, 1998, p. 47.

under a set of conditions set up by the International Bureau of Chambers of Commerce (IBCC). The IBCC is an integral part of the International Chamber of Commerce (ICC). Up to now, over 50 countries have become the contracting parties to this convention. These include, for example, the United States, the UK, South Africa, and Thailand. It was evident that in 1995 about 200,000 carnets were issued worldwide covering goods valued at $10 billion.[26]

III. The GATT/WTO and Indirect Taxation on Importation

The opening up of international trade in the last fifty-two years has been mainly due to the efforts made in the GATT. Historically, the GATT, signed in 1947, was initially intended as an interim measure until a formal institutional body, the International Trade Organisation (ITO), could be established. The negotiations on the charter of such an organisation, although concluded successfully in Havana in 1948, did not lead to the establishment of the ITO because the US Congress refused to ratify the charter. As a result, the GATT was left to set up and develop a contract between sovereign states providing for a set of mutually agreed rules on the conduct and co-ordination of international trade. Because the GATT was neither an institution nor a treaty, countries that acceded to the GATT were known as "contracting parties" rather than as members.

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[26]See the US Customs Services, "What's It Mean? – ATA Carnet- An International Customs Document", November-December 1995, available in *http://www.imex.com*

The GATT had been gradually developed by the results of a number of multilateral trade negotiations, which were known as 'rounds'. Since the GATT began, there have been eight rounds of multilateral trade negotiations in all.[27] The outcome of the Uruguay round, the last multilateral trade negotiations concluded in 1994, was significant. It includes not only a framework agreement on services, agreement on intellectual property rights and trade-related investment measures, a timetable for phasing out all quantitative restrictions on trade, and the first steps towards bringing agriculture more firmly under a multilateral discipline, but also the establishment of the WTO, giving that body the same international status as the IMF and the World Bank.

Although the GATT no longer exists, the substantive obligations of the GATT and its many ancillary documents and codes remain a central part of the rule structure of the world trading system.[28] Among the complexities and details of the GATT/WTO rules, there are, at least, three fundamental principles dealing with indirect taxation on importation.

Before considering the details of each principle, it is important to classify the term of indirect taxation. Generally, an 'indirect tax' means a tax that is

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[27] From 1948 to 1994, there were eight rounds in total: the Geneva round (1947), the Annecy round (1949), the Torquay round (1951), another Geneva round in 1956, the Dillon round (1960-1), the Kennedy round (1964-7), the Tokyo round (1973-9), and the most recently the Uruguay round (1986-94). See also note 34 below.

[28] The WTO Agreement is composed of the Agreement Establishing the WTO and four very important groups of Annexes. Briefly, Annex 1 contains the "multilateral agreements", which are considered mandatory (i.e. all member countries must accept them). Annex 1 is divided into three parts that correspond to the three major basic agreements, namely, goods (the GATT 1994 and its related agreements and other texts); services (the GATS and its annexes); and trade-related aspects of intellectual property rights. All member countries are also required to accept Annex 2 (the Dispute Settlement Understanding) and Annex 3 (the Trade Policy Review Mechanism). Annex 4,

collected from persons other than those expected to bear the burden. This definition is based on the assumption regarding the shifting of the tax, that is, that indirect taxes are fully shifted forward from which they are collected –importers and domestic sellers- to the consumer of the product taxed. Accordingly, customs duties, excise taxes, sales taxes, and a miscellaneous item such as stamp taxes are regarded as indirect taxes.

Direct taxes, on the other hand, are ones collected directly (or via withholding) from the person expected to bear the burden of the tax, in the sense of reduction of real income. In this regard, the assumption is universally made that direct taxes are fully shifted backward to the producer. Thus, taxes on wages, profits, interests, rents, royalties and all other forms of income, and taxes on the ownership of property are regarded as direct taxes.[29]

With regard to the GATT/WTO, the term 'indirect taxation' is defined in a note annexed to the 1979 Subsidies Code as: "sales, excise, turnover, value-added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes *other than* direct taxes and import charges".[30] Due to the exclusion of 'import charges', the scope of indirect taxes in the WTO Subsidies Agreement is narrower than that of indirect taxes in the general definition mentioned above.

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entitled Plurilateral Trade Agreements, consists of Tokyo round codes that were not multilateralised in the Uruguay round, and that therefore bind only signatories.

[29] See Asif H. Qureshi, 'Trade-Related Aspects of International Taxation: A New WTO Code of Conduct?', 30*Journal of World Trade*, 2, February 1996, p. 163.

[30] See *supra*.

It is apparent that the general framework of the GATT/WTO code as it pertains to taxation is more orientated towards indirect taxes – at any rate insofar as express provisions are concerned.[31] The reason is not only because such taxes directly affect product prices in an obvious fashion, but also because it is necessary to regulate them in order to preserve the integrity of tariff concessions negotiated between member countries. The relevant provisions of the GATT/WTO in the context indirect taxes are as follows:

A. Tariffs

Tariffs are paradoxical. On the one hand, they give many advantages for the country of importation. For example, they can: (a) provide significant amounts of revenue for countries; (b) help to keep the level of imports consistent with the other balance of payments components; (c) influence the structure of imports so as to free valuable foreign exchange for essential or developmental imports; (d) grant protection to domestic producers of goods that are also imported; and (e) redistribute incomes.[32]

On the other hand, tariffs are a major factor that creates barriers to trade and impedes trade liberalisation. Many countries, particularly those with low/middle incomes and ineffective governments, have difficulties in raising adequate revenues via the usual route of taxing incomes and/or the sale of goods

[31] The focus on direct taxes in the GATT/WTO is very limited, despite the fact that direct taxes can operate as fiscal barriers. The GATT/WTO has an impact on direct taxes, mainly insofar as these operate as subsidies. There are no provisions dealing with the double taxation (including methods of relieving double taxation) in the GATT/WTO, although it impinges on international trade.

or services. By taxing imports, they are able to supplement their sources of tax revenue and for many developing countries this has a prime source of funding.[33] Obviously, tariffs raise the price of both imports and domestic products, which restrict the consumer choice, and reduce the volume of trade.

Accordingly, tariffs were the first policy to be addressed in the rounds of trade negotiations under the GATT, and, in fact, they have been part of all the successive rounds of multilateral trade negotiations.[34] The principle of tariff concessions and binding tariff commitments is provided in Article II of the GATT 1994. Basically, the binding of tariffs on a product provides the maximum, not minimum, level of duties that may be applied to that product.[35] In this regard, the increase in levels of tariff bindings can create a more transparent and predictable environment for traders and will contribute to facilitating trade flows.

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[32] See Lue DeWulf, 'Taxation of Imports in LDCs; Suggestions for Reform', *Journal of World Trade Law*, 1981, p. 346.
[33] See note 49 below.
[34]

Date	Venue/name	Subject
1947	Geneva	Tariffs
1949	Annecy	Tariffs
1951	Torquay	Tariffs
1956	Geneva	Tariffs
1960-61	Geneva (Dillon round)	Tariffs
1964-67	Geneva (Kennedy round)	Tariffs and anti-dumping measures
1973-79	Geneva (Tokyo round)	Tariffs, non-tariff measures, "framework" agreements
1986-94	Geneva (Uruguay round)	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc.

Source: The Economist (October 1998)

[35] However, the GATT agreement allows contracting parties to raise a bound rate (Articles XXVIII and XXVIII *bis* of the GATT 1994). On doing so, the contracting parties are required to provide compensation to affected parties by reducing the duties in another product of an equivalent value. This may sound straightforward, but it has often turned out to be very difficult to reach agreement between contracting parties on the economic implication of the concessions and on what

It should be noted that a binding may pertain to the applied rate (i.e. the actual rate a country applies on its imports (from any country)) or the bound (or scheduled) rate that is usually higher than the applied rate. Undoubtedly, differences between applied and bound rates may create uncertainty in trade, as governments maintain the right, at any time, to increase the duty up to the level of binding without formally affecting levels of obligations and commitments in the GATT/WTO. In this connection, the significance of the tariff concessions may be reduced (since the bound (not the applied) rate provides the basis for the reductions).[36]

According to GATT studies, the overall levels of tariff bindings, after the implementation of the Agreements of the Uruguay round, had been increased. For example, in the industrial products the proportion of trade subject to bound tariffs was to be increased from 78 per cent to 99 per cent in developed countries and from 21 to 73 per cent in developing countries.[37]

In addition to the success of tariff bindings, it was evident that, after the completion of the Uruguay round, the level of industrial tariffs in developed countries declined from 6.3 to about 3.9 per cent, whereas in developing countries it reduced only slightly, i.e. from 15.3 to 12.3 per cent (Table 1.2).

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constitutes reasonable compensation. See Maarten Smeets, 'Tariff Issues in the Uruguay Round: Features and Remaining Issues', 29*Journal of World Trade,* 3, 1995, p. 95.

[36] See *supra* p. 94.

[37] See GATT, *The Results of the Uruguay Round of Multilateral Trade Negotiations,* GATT Secretariat, Geneva, April 1994. It should be noted that the data on developing countries cover twenty-six participants; those twenty-six participants account for approximately 80 per cent of the merchandise imports, and roughly 30 per cent of the tariff lines, of the ninety-three developing country participants in the Uruguay round.

Table 1.2 Average Tariff Reductions Achieved in the Uruguay Round for Industrial Goods

		Trade-weighted average tariff (%)		
Country group	*Imports from MFN origin (US$bn)*	*Pre-Uruguay Round*	*Post-Uruguay Round*	*Average tariff cut (%)*
Developed Countries	**736.9**	**6.3**	**3.9**	**38**
-Canada	28.4	9.0	4.8	47
- EU	196.8	5.7	3.6	37
- Japan	132.9	3.9	1.7	56
- USA[(a)]	420.5	4.6	3.0	34
Developing Countries[(b)]	**305.1**	**15.3**	**12.3**	**20**

Source: OECD (1994), quoted in Grimwade (1996)
Notes : [(a)] Based on data provided by USTR
[(b)] Based on bound rates, not applied rates.

Up to this point, it can be said that successive rounds of multilateral tariff negotiations through the GATT have been very successful in cutting tariffs and increasing in the proportion of binding tariffs in industrial products. However, this does not mean that tariffs no longer matter. As observed by McDonal (1998) [38], many tariff structures contain low tariffs on the raw materials used by domestic producers, but higher tariffs on the product that is processed, depending on the stage of processing or value added. For example, a major sugar exporter such as Thailand faces a 20.0 per cent tariff if she exports refined sugar to developed countries but only a 1.0 per cent tariff if she exports raw sugar. This situation is usually known as 'tariff escalation'.

Generally, a group of products where tariff escalation has often been a source of particular concern are natural-resource-based products (including non-

ferrous metals and minerals), forestry products, and fish and fishery products.[39] These product groups are of particular interest to most developing countries. In this respect, tariff escalation results in discouraging developing countries from moving to a higher level in the value-added chain, and therefore shutting developing countries into an export structure that is heavily dependent on unprocessed primary products.

However, as a result of the Uruguay round, tariff escalation was reduced and eliminated for many product categories.[40] Nevertheless, there are a number of high tariff escalation in particular categories, most notably textiles, which remain to be tackled in subsequent multilateral trade negotiations.[41]

B. Protecting Discrimination

The principle of non-discrimination is a fundamental tenet of the international trading system. Essentially, two kinds of discrimination in relation to indirect taxes are prohibited. First, all such taxes must not discriminate according to the origin or the destination of products (the most-favoured-nation standard (Article I of the GATT 1994)). Indirect taxes under this provision of the GATT mean to include customs duties and charges of any kind imposed on importation or exportation of a like product. Thus, at the border, if the best treatment offered to a trading partner supplying a specific product is a tariff of, say, 7 per cent, then

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[38] Brian McDonald, *The World Trading System: The Uruguay Round and Beyond*, St. Martin's Press, New York, 1998, pp. 75-76.
[39] See Hoekman and Kostecki, *supra* note 22, p. 94.
[40] Tariff escalation was to be eliminated for paper products, products made from jute and from tobacco, and reduced for products made from wood and metals. See *supra* note 15, p. 49.
[41] See *supra*.

this rate must be applied immediately and unconditionally to the imports of this good originating in all WTO member countries.

Second, indirect taxes must not discriminate between like domestic products and foreign products, nor should they be applied in a manner so as to afford protection to domestic goods (the national treatment (Article III of the GATT 1994)). Indirect taxes under this provision apply only to 'internal taxes' (e.g. excise taxes, sales taxes - VAT, etc.) and other internal charges but not to customs duties. This distinction is not based on the policy underlying the charge, but rather on whether it is due when imported or at the time or point of importation, or whether the charge is collected internally.[42] The objective of this standard is to ensure a 'level playing field' once the goods have been cleared through customs, and to prevent domestic tax and regulatory policies from being used as protectionist measures that would defeat the purpose of tariff bindings.

It should be noted that the national treatment obligation of Article III is linked to the MFN obligation contained in Article I of the GATT 1994. This means that a WTO member cannot use its internal indirect taxes to discriminate between any two foreign countries. Further, it must accord all foreign products national treatment, that is, it must treat all foreign products, regardless of origin, in the same way as it treats its own products.[43]

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[42] See 1952 Panel Report: *Belgian Family Allowance,* BISD, 1st Supplement; 1978 Panel Report: *EEC- Measures on Animal Feed Proteins,* BISD 25S/49; 1985 Panel Report: *Canada- Measures Affecting the Sale of Gold Coins*; 1988 Panel Report: *Canada-Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies,* BISD 35S/88; 1990 Panel Report: *EEC-Regulation on Imports of Parts and Components,* BISD37S/132. See also GATT, *Guide to GATT Law and Practice: Analytical Index,* GATT, Geneva, 1994, pp. 182-184.
[43] See David W. Williams, *EC Tax Law,* Longman, London, 1998, p. 71.

C. Border Tax Adjustments

In the context of international trade, it is essential to ensure, on the one hand, that goods exported from one country to another are not subject to the same kinds of taxes in both countries, and on the other hand that they do not escape taxation altogether. The situation of double-taxation or non-taxation can be avoided by subjecting the goods either to the taxes of the exporting country (the country of origin) or to the taxes of the importing county (the country of destination).

However, border tax adjustments (i.e. the fiscal adjustments upon the export and import of goods) are allowed in accordance with the destination principle.[44] The destination principle involves the relieving of exported products from tax charged in the exporting country in relation to like domestic products sold in the home market, and the charging of a tax on imported goods equivalent to that levied in the importing country on similar domestic products.[45]

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[44] See *Working Party on Border Tax Adjustments,* L/3464, adopted on 2nd December 1970, BISD 18S/97. However, Westin (1998) views that "the term "border tax adjustments" is an oversimplification, because the adjustment is determined by each country in its own way. Thus, they need not occur at the border. For example, a country such as the US with extensive retail sales tax may impose no tax until the imported good is first sold to a retail customer. Conversely, a retail tax will not be rebated at the border because ultimate retail customers do not normally export their goods in international commerce..." See Richard A. Westin, *Environmental Tax Initiatives and Multilateral Trade Agreements: Dangerous Collisions,* Kluwer Law International, The Netherlands, 1998, p. 67.

[45] To illustrate the functioning of the destination principle applied to indirect taxes, imagine that country A imposes a 17.5 per cent tax on cars and country B imposes a 7 per cent tax. Under the destination principle, country A will impose a 17.5 per cent on cars imported from Country B as it is imported into country A, just as it imposes 17.5 per cent tax on its own cars. Country B will remit the 7 per cent tax on cars exported from country B. Similar adjustments will occur in relation to exports of cars from country A to country B. For further details, see Chapter 4.

It should be noted that there is no unified GATT provision dealing exclusively with border tax adjustments. However, there are number of GATT clauses supporting the border tax adjustment system (the destination principle).

On the import side, two Articles of the GATT 1994, i.e. Articles II, paragraph 2(a) and III, should be taken into account. As mentioned earlier, Article II, paragraph 2(a) explicitly allows the imposition of taxes and other internal charges on imported goods, however taxes on imports must be consistent with Article III paragraph 2 (the national treatment principle). Notably, both provisions of the GATT refer to taxes on products.

On the export side, an interpretative note to Article XVI paragraph 4 provides that a rebate of international taxes on products shall not be deemed to be a *subsidy* for purposes of the obligation against export subsidies.[46] Along the same lines, Article VI, paragraph 4 states that no anti-dumping or countervailing duty shall be imposed in respect of the remission of indirect taxes on a product on its export from its country of origin. Like Articles II, paragraph 2(a) and III, Articles XVI and VI of the GATT 1994 apply to taxes on products.

The reference to taxes on products implies that border tax adjustments apply only to indirect taxes.[47] Direct taxes, which are considered to be imposed

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[46] See the GATT Annex I, Ad Article XVI, GATT, BISD vol. 4, 1969. Article XVI, paragraph 4 stipulates:
'The exemption of an exported product from duties and taxes borne by the like products when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.'

[47] See John H. Jackson, 'National Treatment Obligations and Non-tariff Barriers', 10*Michigan Journal of International Law*, 1, Winter 1989, p. 215. It should be noted that none of GATT/WTO

on the producer rather than the product, are not eligible for border tax adjustments, and thus subject to the origin principle.[48] It seems to be fair to impose product taxes at the destination on a basis equal to that imposed there on like domestic products. In other words, domestic producers in the country of importation will perceive unfairness if the imported products are not taxed equally to their products.

IV. The Nature and Character of Taxation on Importation: An Overview

There are four major different kinds of indirect taxes imposed on foreign goods at the border of importing countries: customs duties, sales taxes, excise taxes and dumping levies. Each has its own character as follows:

A. Customs Duties

A customs duty is one of the oldest form of indirect taxation, applied only at importation. In fact, governments may levy duties on imports and exports, but import duties are by far the most important in practice. It is evident that custom duties today are not an important source of revenue in developed countries, but they are important in developing countries. They yield 20 per cent or more of

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provisions obliges a member country to, in fact, remit taxes on the export of products, and similarly, an importing country is not obliged to consider whether indirect taxes on the product in the country of origin have, in fact, been remitted. See, for example, the Report of the GATT Panel, "United States-Taxes on Petroleum and Certain Imported Substances" (June 17, 1987), BISD 34S/136, 27 I.L.M. 1601 (1988), paragraph 5.2.5. As a result, double taxation may legitimately arise under the GATT/WTO law.

[48] See *supra* note 24, p. 219.

total national tax revenue in most developing countries,[49] whereas in developed countries they normally account less than 5 per cent of total tax revenue, and sometimes much less.

Notably, the low amount of customs revenues in most developed countries does not always happen. In the initial stage of development in many developed countries, the ratio of customs duties was high, and the principal purpose of levying tariffs was mainly to raise revenue. For example, in the United States customs duties accounted for over 25 per cent of total tax collections in 1890, though only 1.55 per cent in 1994. In Germany they accounted for 16 per cent of all tax revenues in 1914, though only 0.08 per cent in 1985.[50]

Are customs duties classified as indirect taxation?

The term 'customs duties' is not easy to classify. With regard to the collection standpoint, customs duties in some respects resemble fees or charges rather than taxes because they must be paid before goods can be imported into the country. However, they are always regarded as taxes, since they bear no relation to the costs of particular government services.

As described earlier, customs duties are usually classified as indirect taxes, i.e. taxes levied from persons other than those expected to bear the tax

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[49] In some countries, customs duties constitute a major source of revenue, yielding more than half of all government tax revenues. For example, customs represent 73 per cent of total tax revenue in Lesotho, 67 per cent in Gambia, 67 per cent in Bahamas, 60 per cent in Benin, 57 per cent in Sudan, 56 per cent in Yemen, and 51 per cent in Jordan, St. Vincent, and Botswana. See John F. Due, *Indirect Taxation in Developing Economies,* revised edition, The Johns Hopkins University Press, Baltimore, 1988, pp. 22, 35.

burden, based on the assumption that customs duties are meant to be fully shifted forward to the consumer and, thus, are fully reflected in the sales price of products. Regardless of the economic reality which does not guarantee full forward shifting[51], it is interesting to note that customs duties are also levied directly from any person who imports articles for end use. In addition to this, the indirect character of a tax, which guarantees remittance on exportation of goods, is not upheld in all cases, since a refund of import duties is generally not allowed and, as noted above, sometimes customs duties are imposed on exports.[52]

Although it may be assumed that customs duties are reflected in the final price to consumers, it is still doubtful on the type of consumption taxes of customs duties. Should they be classified as general or selective taxes on consumption? Terra (1995)[53] views on this point that it is difficult to classify customs duties as a general consumption tax because "the extensive rate variations do not fit neatly into such a qualification, nor does the extensive use of exemptions. Furthermore, the qualification as consumption tax would not explain why exclusively imported or exported goods are burdened by taxation." In addition, many economists treat import (and export) duties as the selective sales tax rather than the general consumption tax, since they are pure border taxes –

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[50] See W.M.Corden, *Trade Policy and Economic Welfare,* Clarendon Press, Oxford, 1978, p. 59. See also IMF, *Government Finance Statistics Yearbook,* IMF, Washington D.C., 1986 and 1995.
[51] Economists view that 'in practice indirect taxes are not fully shifted forward in product prices possibly because of the fall in factor prices, tax evasion, or other causes'. See Ben Terra, *Sales Taxation: the Case of Value Added Tax in the European Community,* Kluwer Law International, The Netherlands, 1988, p. 12.
[52] See Ben Terra, *A Guide to the Customs Rules on Trade between the (Enlarged) EU and Third Countries*, Kluwer Law International, The Netherlands, 1995, p. 4.
[53] See *supra.*

that is they are imposed only on imported (or exported) goods, not on others.[54] In this respect, customs duties may be classified as taxes *sui generis.*

1. Ad Valorem *Versus* Specific Rates

Customs duties may be assessed upon the value of imported goods, *ad valorem* duties, or on a specific standard (a fixed currency amount per unit of the goods, e.g. £2.5 per litre of liquor), or by a combination of these two methods (e.g. 5 per cent *ad valorem* plus £5 per litre of wine). In practice, most tariffs are primarily, but not solely, *ad valorem.*

The duties, either *ad valorem* or specific, have advantages and disadvantages in specific situations. Specific tariffs are easy to levy because customs authorities do not need to know the value of goods in order to determine the amount of duty. In this regard, evasion of duty through understating values is difficult to make. Also, there is a little scope for customs authorities to inflate the amount of duty by setting an arbitrary value in the product. A major disadvantage of specific duties is that they are regressive, falling proportionately more lightly on richer consumers who can afford better quality and more expensive goods, and proportionately more heavily on poorer consumers who can only afford lower quality and cheaper varieties.[55]

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[54] See for example Carl S. Shoup, *Public Finance,* Aldine, Chicago, 1969; See also Bernard P. Herber, *Modern Public Finance,* 4th ed., Richard D. Irwin Inc., USA, 1979.

[55] See John F. Due, 'Customs Duties in Developing Countries', in Richard M. Bird and Oliver Oldman (eds.), *Reading on Taxation in Developing Countries*, 3rd ed., The John Hopkins University Press, London, 1974, p.182.

Ad valorem tariffs, on the other hand, are transparent in the sense that their effect on the price is readily calculated. In addition, they are directly comparable across goods since they are stated in percentage terms. Comparability is important when countries seek to negotiate tariff reductions. Comparing specific duties across products are problematic because they depend on the units in which products are measured. However, one of the few important disadvantages of an *ad valorem* tariff is that it is applied to the value of imported goods, and what constitutes the appropriate 'value of duty' is then subject to interpretation or abuse. Accordingly, the GATT/WTO provides uniform rules on 'customs valuation' so as to limit the discretion of customs authorities in setting a value for duty.[56]

In addition, *ad valorem* tariffs can be calculated on different base prices. For example, they can be calculated on a price which includes the 'cost, insurance and freight' (c.i.f.) associated with moving the good to the importer's port of entry. They can also be based on the 'free on board' (f.o.b.) price, which is the price of the good once it is loaded onto the ship, plane, train or truck in the exporter's country. When tariffs are calculated on an *ad valorem* basis and an expensive transportation mode -e.g. air freight- is used, the cost of the tariff will be considerably higher when it is calculated on a c.i.f. basis.[57]

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[56] See Harry P. Bowen, Abraham Hollander, and Jean-Marie Viaene, *Applied International Trade Analysis,* Macmillan Business, Hong Kong, 1998, p. 44.

[57]See *supra* note 2, pp. 108-109. Most countries apply the c.i.f. valuation because the c.i.f. base of the duty is larger than that of the f.o.b., and thus low duty rates are required so as to yield a given revenue. In addition, by using a base closer to the figure of consumer expenditures on the goods, c.i.f. provides a more uniform ratio of duty to these expenditures. Because transport is part of the real costs of supplying the goods, it is logical to include it in the taxable price. Furthermore, the c.i.f. can also be used as an instrument to protect domestic producers in an importing country. See

B. Sales Taxes[58]

Sales taxes take various forms: the turnover tax, the manufacturer's tax, the wholesale tax, the retail tax, and the VAT. Among them, the VAT is a major form of sales taxation currently applied in most countries. According to the destination principle, as mentioned above, imports are subject to tax at the border at the same time as customs duties. In this respect, a compensating import tax requires so as to put foreign and domestic goods on an equal tax footing. VAT on importation is, therefore, characterised by its equivalent nature. The indirect character of VAT is exemplified by the fact that VAT is remitted on exportation in accordance with the rules of the GATT/WTO.[59] A discussion on structure of VAT (and other forms of sales taxes) is given in the following section.

C. Excise Taxes

Excise taxes are distinguished from sales taxes in their structure and coverage. In general, sales taxes are a broad-based tax applied to a wide variety of goods whereas excise taxes are a narrow-based tax levied on the consumption of selected goods, often luxury or non-essential goods (e.g. alcoholic beverages, tobacco products, etc.). Accordingly, the coverage of typical sales taxation is much greater than that of the usual excise system.

Lue DeWulf, *Customs Valuation Principles and Practices,* International Bureau of Fiscal Document, 1979, p. 243.

[58] The OECD defines the term 'sales taxes' as: taxes levied on the production, lease, transfer, delivery, or sales of a wide range of goods and on the rendering of a wide range of services, irrespective of whether they are domestically produced or imported and irrespective of the stages of production and distribution at which they are levied. See OECD, *Revenue Statistics of OECD Member Countries 1964-1985,* OECD, Paris, 1985, p. 45.

[59] See details in section III:C.

Similar to the sales taxation, particularly VAT, the levy of excise duties on importation is equally characterised by its equivalent nature. They are meant to compensate for the internal levy on identical or similar goods. It is worth noting that excise duties are often imposed on a specific basis (such as on weigh, quantity, alcohol content, etc.) whereas import duties and VAT are usually levied on an *ad valorem* basis. Furthermore, the indirect character of excise taxes is that they are remitted on exportation as permitted by the GATT/WTO.[60] The excise duties however fall beyond the scope of this study.

D. Dumping Levies

Imported products are subject to dumping levies only when it is found that they are sold at an unfairly low price. In this regard, governments of importing countries can use customs duties as protective duties to counteract the low import price. The main objective of doing this is to ensure fair competition and fair trade between foreign and local goods. The form of protective duties, allowed by the GATT/WTO, may be anti-dumping[61] or countervailing duties.[62]

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[60] See *supra* note 52, p.5.

[61] Anti-dumping duties are permitted to counteract dumping –'by which products of one country are introduced into the commerce of another country at less than the normal value of the products', if the dumping 'causes or threatens material injury to an established industry...or materially retards the establishment of a domestic injury'. See Article VI, paragraph 1 of the GATT 1994.

[62] Countervailing duties are introduced with the purpose of offsetting export subsidies implemented in the exporting countries. Under the GATT rules, countervailing duties are permitted only to the extent that they are 'of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular subsidy', for example by an excessive tax rebate, by a counteracting import duty. See Article VI, paragraph 3 of the GATT 1994. See also *supra* note 43, p. 57.

Focusing on the character of dumping levies on importation, it appears that dumping duties cannot be classified as general taxes, since they increase the cost price of particular products. Clearly, they are compensatory levies, but different from VAT or other sales taxes in that the compensation is not meant to cover a legally created gap in prices between the imported goods and those locally produced based on the destination principle, but rather to equalise an illegally created difference.[63] Again, discussions on details of dumping duties are beyond the scope of this study.

V. Systems of Levying a Sales Tax

Generally speaking, a sales tax is a general indirect tax on consumption. In this regard, the imposition of a sales tax generally takes two major forms: the cascading and the non-cascading form.

A. The Cascading System of Sales Taxes

1. The Turnover or General Cascade Tax

This form of sales tax was widely adopted by many countries in the past.[64] The tax is generally imposed on all or at several stages of the production and distribution chain without any mechanism to remove tax on business input. The great advantage of this system of sales tax is that it is simplicity in operation: all transactions are taxable, and there is no need to delineate taxable and non-taxable

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[63] See *supra* note 52, pp.5-6.

[64] It was adopted by many European countries (such as the Austria, Belgium, Germany, Italy, Luxembourg, and the Netherlands) and other countries in different parts of the world (such as Korea, Peru, Chile, Republic of China, and some states of India). See OECD, *Taxing*

transactions on the basis of the nature of the business of the purchaser or seller. This advantage is, however, overshadowed by the following disadvantages.

First, the tax is cumulative. The greater the number of stages of production and distribution a product passes through before reaching the final consumer, the grater the number of times taxed inputs would be subject to multiple taxation, and therefore, the higher the degree of the resultant cascading.[65]

Second, the tax artificially promotes integration of industries and is economically inefficient. It induces, for example, manufacturers to produce their own parts and materials instead of buying them from independent specialised enterprises. Many independent wholesale merchants might be eliminated because manufacturers could sell directly to retailers (or consumers).

Third, since the tax element in costs is variable, it is not possible to calculate precisely the amount of export rebates. In practice, where countries operating cascade systems attempt to repay tax levied at earlier stages on the home market on goods which are exported, they calculate average rates of refund for particular classes of goods rather than calculate the tax levied on the particular exportation. As a result, there is great danger of under-rebating, with harm to the domestic industry selling in foreign markets, or over-rebating, with danger of

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Consumption, OECD, Paris, France, 1988, p. 77. See also Joh F. Due, 'Alternative Forms of Sales Taxation for a Developing Country', &*Journal of Development Studies,* 2, January 1972, p. 264.
[65]An example of computing the cascade or turnover system is provided in Appendix I:1.

retaliation because an excessive rebate is in effect an export subsidy. International competition is thereby distorted. [66]

B. The Non-Cascading Systems of Sales Taxes

1. The Suspension or Single-Stage Sales Tax

The single-stage sales taxes arise so as to avoid the disadvantages of the turnover tax. It is clear from the word 'single' that the tax applies only at one stage of the production or distribution chain. Single-stage systems vary between those where tax is levied on sales by manufacturers ("MST")[67], those where tax is levied on sales by wholesalers ("WST") [68] and those where it is levied by retailers ("RST").[69]

Basically, the single-stage sales tax is suspended on sales between, and imports by, registered traders (who may be manufacturers, wholesalers, or retailers, depending upon the stage at which the tax is levied) but takes effect on

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[66]As observed by the OECD, this factor, among others, rendered the cascade tax as particularly unsuitable in a common market. See OECD, *supra* note 64, p. 79.

[67] The MST is normally accompanied by a similar sales tax on imports in order not to discriminate against domestic production. Therefore, this tax is sometimes known as a manufacturer/importer sales tax. The manufacturer/importer sales tax was adopted by many countries, such as Canada (1923) Argentina (1935), the Philippines (1936), Pakistan (1951), Thailand (1961), Columbia (1965), South Africa (1969), and Indonesia (1985). See *supra* note 49, pp. 96-101, 108.

[68]The use of 'wholesale tax' may not be correct, as the characteristic feature of the wholesale sales tax is the application of the tax on the sale to retailers (or to final consumers if there is no retail stage). Therefore, the tax is collected from wholesalers, where they exist in the distribution chain, or from manufacturers when they sell directly to retailers. The wholesale taxes were used in many countries, such as New Zealand (1933), Portugal (1986), Denmark (1967), and the United Kingdom (known as a 'Purchase Tax') (1973). At present, these countries apply the VAT system. See *supra* note 49, p. 66.

[69] At present, the United States and some provinces of Canada are two major countries apply the RST. Examples of the provincial retail sales tax in Canada are: Newfoundland, Price Edward Island, Nova Scotia, New Brunswick, Ontario, Manitoba, Saskatchewan and British Columbia. Canada has a federal VAT (GST), whereas the United States has no federal consumption tax at all. See Pierre-Pascal Gendron, Jack M.Mintz and Thomas A. Wilson, 'VAT Harmonisation in Canada: Recent Development and the Need for Flexibility', 7*VAT Monitor*, 6, November-December 1996, p. 334. See also Jeffrey Owens, 'The Move to VAT', 24*Intertax*, 2, 1996, p. 46.

sales to non-registered persons (usually consumers). The tax also becomes due if registered traders use the goods for their own purposes, whether or not in connection with their own business, but materials for making goods can usually be bought by registered traders free of tax.

The theoretical literature unequivocally prefers the RST to the MST or the WST for a number of reasons. Firstly, because the RST is imposed at the final sale to the consumer, numbers of taxpayers are much larger than with any tax collected at pre-retail levels. In this respect, the revenue capacity of the RST tends to be high and the tax may prove an adequate tool to meet the revenue requirements of governments.

Secondly, with regard to the MST, the amount of the tax included in the price of similar goods selling at similar retail price may vary greatly because of variations in manufacturers' prices to different trade levels (wholesalers, retailers, consumers). Accordingly, the tax burden on identical goods is not always the same. Legal neutrality, therefore, is not guaranteed in this form of sales tax. This problem, however, does not exist in the system of RST because the basis of taxation is the retail price.[70]

Thirdly, in order to reduce the amount of tax due, the wholesale form of tax encourages the large retailers to purchase the goods directly from manufacturers or to import them directly. Therefore, the tax will apply to prices that are relatively low, compared to taxes applying to purchases by smaller

retailers from typical wholesalers.[71] The RST, by contrast, avoids problems of distribution channels, since the tax levies at the final sale to the consumer, and thus the tax liability will be the same in any distribution.

Finally, it is widely recognised that uniform treatment of domestic and imported products is difficult to achieve under the MST. Imported goods gain a potential tax advantage over domestic goods because the latter tends to incur more distribution costs prior to the point of imposition of the tax than the former. Such distribution costs include advertising, warranty, and other distributional activities. To meet this problem, a markup to the taxable price on imported goods may be used, but equal treatment is not possible.[72]

Problems of non-uniform treatment of imported and domestic goods under the wholesale sales tax are not as serious as what happened under the manufacturer sales tax. This is because the costs of selling and promotion incurred after importation are basically included in the taxable value. However, as observed by Cnossen (1990)[73], the non-neutral treatment under the wholesale tax

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[70] See *supra* note 51, pp. 22-24.

[71] As was the experience in New Zealand before adopting the VAT in 1986, for example, it was estimated that in 1982 over half of all sales to retailers did not make through the wholesale distributors. The growing volume of complaints from many retailers and the loss in revenue that resulted from the application of the tax to lower prices prompted the government to require a 15 per cent uplifting of prices for tax purposes on direct sales from manufacturers to retailers. This rule led to many complaints, however, that numerous exceptions were made, particularly in fields in which there were no wholesale distributors. See John F. Due, 'The New Zealand Goods and Services (Value-Added) Tax – A Model for Other Countries', 36 *Canadian Tax Journal*, 1, January-February 1988, p. 131.

[72] See Sijbren Cnossen, 'Interjurisdictional Coordination of Sales Taxes', in Malcolm Gillis, Carl S. Shoup, and Gerarado P. Sicat (eds.), *Value Added Taxation in Developing Countries*, Washington D.C, World Bank, 1990, p. 49. See also Malcolm Gillis, 'A Value-Added Tax to Replace the Federal Sales Tax', *Canadian Tax Foundation: 36th Tax Conference Report*, November 1984, p. 468.

[73] See Cnossen *supra*.

system still occurs with regard to the importation of fully manufactured goods by non-registered traders such as retailers and consumers. In valuing such goods for sales tax purposes at the import stage, the domestic wholesale margin needs to be taken into account. Australia, for example, makes the adjustment by adding 15 per cent to the duty-paid value before calculating sales tax liability. Although such rough adjustment procedures are inevitable, they remain highly arbitrary (and excessive). Again, it is inability to treat imported and domestic goods equally.[74]

As to the RST, import transactions present fewer problems than other forms of single-stage sales taxes since final consumers and unregistered traders do little importing. Most imports are thus taxed in the same fashion as domestic goods at the time of sale within the country. Border tax adjustments are, thus, hardly necessary.

2. The Value-Added Tax

The VAT has increased in popularity since the early 1960s. It is an acceptable device for harmonising tax structures among countries in an economic community or a customs union. In addition, it is economically neutral, because ideally it would be levied at a single, uniform rate, on the entire consumption base.[75] It does not distort choices among products or methods of production.

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[74] It should be noted that the Australian government decided to replace the wholesale sales tax with the GST. The Australian GST law will enter into force on 1 July 2000. Markups applied to the imported goods under the current system will not be allowed under the new tax system. See Richard Krever, 'GST Transitional Rules', 10 *VAT Monitor*, 5, September-October 1999, p. 192.

[75] This neutrality is, in practice, not possible to achieve. This is because if the VAT applied to all goods and services at a uniform rate, the tax would be regressive with respect to annual income.

The neutrality of VAT mainly arises from its characteristic: the tax is collected at each stage of the production and distribution of goods, from the purchase of raw materials to the final sale of the product to the consumer. In this regard, VAT is similar to a multi-stage non-cascading tax. [76]

In general, there are three possible variants of a tax on value-added: consumption type, income type, and gross product type.

Under the gross product type, businesses are allowed to deduct only the taxes they paid on purchases of raw materials, but cannot make any deduction of taxes already paid on capital goods. The term 'gross product' is given to this version because the tax base includes virtually everything that businesses

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There are many methods used to alleviate the regressivity of VAT, e.g. reducing the tax rate, or zero-rating necessities.

[76] According to the point of view of economics, a country applying the RST or the VAT system could yield the same revenue if the same tax rate and tax base apply. The sum of values added at all stages in the production and distribution of a good is equal to the total retail sales of the good, and thus of consumption expenditures on the good (see Appendix I:2). However, there are many differences between the RST and the VAT. For example,

(a) the RST is a single-stage levy applied to sales at the retail (not to sales by retailer per se in the usual sense of that term) whether made by a retailer, a wholesaler, or a manufacturer. Basically, the tax applies in two types of situations: (i) when a registered firm sells to a non-registered buyer – that is, a final consumer- and (ii) when a registered firm sells to another registered firm for taxable use, that is, for use or consumption and not for resale. The VAT, by contrast is a multistage levy collected on sales at all or nearly all stages of production and distribution. In other words, no distinctions have to be made between the sales to different types of purchasers; all sales are taxable with certain exceptions.

(b) Because the VAT is collected at every stage, when in any tax period one registered trader (e.g. retailer - the last stage) does not remit the tax on the value added to the revenue authorities, only the tax on that stage will be lost. As to the RST, no revenue accrues to the revenue authorities until a taxable sale is made from the retailer to the consumer. In this regard, if the retailer or consumer evades or avoids the retail sales tax, the tax authorities will have lost the whole amount of the tax.

See David W. Williams, 'Value-Added Tax', in Victor Thuronyi (ed.), *Tax Law Design and Drafting*, Vol. 1, IMF, Washington D.C., USA, 1996, p. 196. See also Sijbren Cnossen, 'VAT and RST: A Comparison, 35*Canadian Tax Journal*, 3, May-June, 1987, pp. 575-76; Ronald T. Mcmorran, 'A Comparison between the Sales Tax and a VAT', in Parthasarathi Shome (ed.), *Tax Policy Handbook*, IMF, Washington D.C., 1995, p. 85.

produce, and, thus, is equivalent to a country's Gross National Product (GNP). One of the rare examples is the tax in China.[77]

The second type of VAT, the income type, does not allow deduction of the VAT on the purchase price of durable capital goods in the period of purchase, but instead allows the deduction of an annual depreciation charge arising from such a purchase. The subtraction of depreciation converts the aggregate base of the income VAT from GNP to Net National Product (NNP). Currently, some Latin American countries, e.g. Peru, use this form of VAT.[78]

McLennan (1991)[79] observes that the two types of VAT discussed above are rarely applied in practice because they tend to discourage savings and investment, discriminate against capital intensive investment and (in case of the gross product VAT, in particular) cause businesses to delay modernisation of plant and equipment by minimising the expenditure of capital assets. Furthermore, it is also difficult to administer these two types of VAT because businesses must distinguish between capital and non-capital assets, and, in case of the income VAT, compute depreciation allowances.

The third and the most common form of VAT is the consumption VAT. For this type of VAT, all purchases (with minor exceptions) for use in production

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[77] See *supra* note 51, pp. 31-33. See also Pierre Maugue, 'Imposition of VAT and Customs Duties on the Importation of Capital Equipment by Foreign Investment Enterprises, *Asia-Pacific Tax Bulletin,* October 1996, p. 295.
[78] See Ernst & Young, *VAT & Sales Taxes Worldwide: A Guide to Practice and Procedures in 61 Countries,* John Wiley & Sons, Chicester, 1995, pp. 572-580.
[79]See Barbara McLennan, 'The Process of Harmonisation of the Value-Added Tax in the European Community', 29*Columbia Journal of Transnational Law*, 1991, p. 72.

(i.e. non-consumption), including purchases of durable capital goods, are deductible in determining tax liability in the period in which they are purchased. Thus, the tax is actually applied only to the total private consumption. No distinction is made between parts and materials physically incorporated into the product, supplies and fuel, and durable capital goods. Because all purchases for use in production are deductible, the tax does not penalise capital investment by placing an additional tax burden on capital equipment purchases. Therefore, the tax is neutral between methods of production since substituting capital for labour (or vice versa) does not affect a business's total taxes.[80]

Although the types of VAT vary, there are two main methods of computation VAT: an addition method; and a subtraction method.

2.1 Addition Method

This method involves the addition of the sum of all the elements that comprise value added: wages and salaries, interest, rent, profit and the like. At first sight, this method is rather attractive and simple: the tax is assessed through the trader's annual accounts; a taxable operation gets used to the concepts of profit and of wages in the businesses; and the costs of compliance of traders are low because they do not have to provide invoices.[81]

However, there are two outstanding disadvantages found in this method. Firstly, only a single rate would be levied on an additive basis because company

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[80] See *supra* note 51, p. 32.
[81] See Alan A. Tait, *Value Added Tax*, McGraw-Hill Company, Exeter, UK, 1972, p. 9.

accounts do not usually divide sales by different product categories coinciding with different sales tax rates. If the multiple rates were applied, it would cause problems for taxable persons in computing accurately VAT liability from accounting records.[82] Secondly, due to book accounts, a tax period is not based on a month or a quarter basis, but on an annual basis. This would, accordingly, reduce the revenue flow. [83]

2.2 Subtraction Method

The VAT is derived from the difference between the value of the business's output (the price at which it sells its goods and services) and that of its input (the price it pays for the goods and services it buys from its suppliers). Two types of subtraction method are:

2.2.1 The Direct Subtraction Method

Similar to the addition approach, the direct subtraction method also relies on an enterprise's books of account. Admittedly, the way of calculating the VAT under this method is simple: it requires taxable persons to apply the applicable VAT rate to the difference between the total value of sales (outputs) and the total value of purchases (inputs).

A taxable person generally uses the existing account system to substantiate claimed input tax credit. This is different from the invoice method

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[82]See Barry M. Freiman, 'The Japanese Consumption Tax: Value-Added Model or Administrative Nightmare?', 40*American University Law Review*, 3, Spring 1990-91, p. 1286.
[83] See Alan A. Tait, *Value-Added Tax: Administrative and Policy Issues*, IMF, Washington D.C., USA, 1991, p. 4.

which requires the taxable person to substantiate the claimed input tax credit with supporting tax invoices.[84] Only few countries adopt this method of VAT. These include, for example, Benin, Mauritania and Japan[85]

Like the addition method, an advantage of this method is that the simple tax structure can minimise administrative and compliance costs.[86]However, this method is difficult to operate where more than one tax rate is levied. A producer or distributor of a product would have to tax each component of value-added in the product at the appropriate rate. To administer a higher tax rate on cars, for example, the washers which go into a car would have to be taxed at a higher rate than washers going into other products. This, in turn, would be done through differential taxation of the value-added attributable to the producer of washers. Such a tax is not possible to operate in practice, and this inability to have multiple rates on a product basis is one of the factors that has forced many countries to abandon any idea of introducing the direct subtraction method.[87]

2.2.2 The Indirect Subtraction Method (The Invoice or Credit Method)

This method of the VAT is commonly used in both developed and developing countries. Invoices are the most important evidence for the transaction and for tax liability in this method. A taxable person, such as a trader or manufacturer, is required to charge tax on his sales (outputs), stating the exact

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[84] See details of the invoice method below.
[85] See Alan A. Tait, *Value Added Tax: International Practice and Problems,* IMF, Washington, D.C., 1988, p. 5.
[86] See *supra* note 82, p. 1287.
[87] See Johh Whalley and Deborah Fretz, *The Economics of the Goods and Services Tax,* Canadian Tax Foundation, Toronto, 1990, p. 98.

amount on sale invoices. Conversely, he is also required to pay tax on his purchases (inputs), which, in turn, is indicated on supplier's invoices. For each tax period, the net amount of VAT liability remitted to tax authorities is the difference between the total amount of VAT shown on all sale invoices and the total amount of VAT shown on all purchase invoices.[88] If, in any tax period, the taxable person finds that the amount of input tax exceeds the amount of output tax, then he will be entitled to reclaim credit for the excess from the tax authorities.

There are many advantages inherent in the tax credit method. Firstly, the compulsory issue of invoices under this approach greatly facilitates cross-checks. For example, Company X indicates on its tax return that it has paid £3,000 in VAT on purchases from supplier Y. When Y's own VAT return is audited, a check will be made to see if Y has actually reported and paid the £3,000 on its sales to Company X (less credits).[89]

Secondly, the use of invoices under the tax credit method also creates a self-policing mechanism. The buyer has an interest in having the invoice show a high purchase price because a high price will entitle him to a high tax credit. The seller, on the other hand, has an interest in keeping the sale price as low as

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[88] See Sijbren Cnossen, 'Issues in Adopting and Designing a Value-Added Tax', *Bulletin of International Bureau of Fiscal Document*, 1993, p. 75.

[89] In practice, the system of matching of invoices is difficult to monitor, particularly in case where both the buyer and the seller have incentives to evade the tax. A seller, for example, can issue counterfeit invoices showing tax collected from the buyer when it was not actually collected. (This type of behaviour can, in fact, be checked by audit, but audits are frequently not complete). In this respect, the issuance of invoices is equivalent to the printing of money. See *supra* note 87, p. 88.

possible so as to minimise his tax liability. This can help the revenue authorities to detect tax evasion.

Thirdly, the tax credit method greatly facilitates the handling of exemptions and rate differentiation. The amount to deduct is indicated by the taxes shown on the purchase invoices, provided that tax paid on purchases to produce exempt or zero-rated goods is deductible.[90]

Perhaps the greatest drawback of this approach is the compliance and administrative costs. The payment of taxes to the government at each stage in the production process, with an implicit refund through credits, is too costly from the standpoint of tax collection. At the same time, to receive tax money and then repeatedly to refund it through credits is clearly more costly than using a tax collection mechanism in which transactions flow only in one direction.

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[90]See John F. Due, Value-Added Taxation in Developing Economies, in N.T. Wang, (ed.), *Taxation and Development,* Praeger Publisher, New York, 1976, p. 94.

CHAPTER 2

THE GATT/WTO CUSTOMS VALUATION SYSTEM

I. Raising Problematic Issues

From the beginning of the new millenium, the WTO Customs Valuation Agreement (or the Code) will be one of the most prominent issues in the context of international trade taxation. The Code is regarded, at least in theory, as a significant step towards co-ordination in customs valuation between countries. The assertion of the so-called 'actual price' under the Code prevents arbitrariness, uncertainty, discrimination and effective protection policies placed by national customs laws. This system would therefore encourage the development of international trade on a global scale, by increasing the profitability of importation and the efficiency of firms in the country concerned.

However, the Code itself is plagued with a number of problems. As compared with the Brussels Definition of Value system, described below, the valuation criteria of the Code are more complex. Developing countries may find that the provisions of the Code are, in practice, difficult to apply, especially rules of related parties, identical and similar goods, computed value, royalties and licence fees. In addition, it is difficult for national customs authorities to

challenge a false declaration of value, providing an incentive to tax avoidance by dishonest importers.

The concept of 'actual price' under the Code operates on a theoretical level. The Code does not take into account differences in economic levels between developing and developed countries. This may entail that the balance of comparative advantage arising from free trade in a global market will enure to developed countries. Local products in developing countries will primarily be affected from the implementation of the Code.

Moreover, as described in Chapter 1, customs duties are a major source of revenue in many developing countries. As to the 'positive concept' inherent in the Code, developing countries fear that the implementation of the Code would make their customs revenue decline. In this regard, the Customs Co-operation Council has suggested that developing countries which accede to the Code may have to restructure their trade policy, including increased duty rates to compensate for the possible loss of revenue.[91]

This chapter reviews theoretical concepts of valuation and studies the development of a single international valuation system. It then analyses closely the provisions of the Code. The last section provides an evaluation of the Code and identifies problems left unresolved by the negotiators.

II. Concepts of Valuation

The notion of value plays a major role of the customs law throughout the world. Customs duties are usually based on the 'true' value of the imported goods. Although the notion of value is an elusive concept that is not easy to determine, particularly in a legal context, there are two different standards most generally in use to determine the value of imported goods for customs purposes.

The first is the so-called '**positive concept**': the dutiable value of a product is the price at which the good *is* sold under specific conditions. The invoice amount is generally accepted as the basis of assessment when this concept is used. However, some people view that the positive concept would be difficult to apply. They believe the complications, caused by the need to take into account economic and commercial reality correctly so as to guarantee just and equal taxation, cannot be overcome. For this reason, the second standard, namely the '**notional concept**', is used to determine the value of particular goods.

The notional concept employs the 'normal price' as the basis of assessment, i.e. the dutiable value of a product is the price at which the good *would* be sold under specific conditions. The use of "would" enables one to establish the customs value under all circumstances, even if the goods have not been sold but have been delivered free of charge.[92]

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[91] Customs Co-operation Council, *A Single International Valuation System*, Brussels, 1992, p. 9.
[92] See Henk De Pagter and Richard Van Raan, *The Valuation of Goods for Customs Purposes*, Kluwer Law and Taxation, The Netherlands, 1981, p. 5.

III. Development of a Single International Valuation System

Before considering the complex structure of the Code, it is important to summarise the historical origins of the Code which may be helpful for an understanding of how current issues have emerged.

A. The 1947 General Agreement on Tariffs and Trade

At the beginning of the 20th century, groups wishing to promote international trade began to study ways of replacing unstable and arbitrary methods of valuation with an international system which would be neutral in its effects on competition and on trade policy. After several fruitless attempts organised under the auspices of the League of Nations, the first agreement on the general principles of customs valuation was reached in 1947 and embodied in Article VII of the first round of GATT tariff negotiations in Geneva in 1947 (hereafter referred to as 'Article VII of the GATT-1947').[93]

Article VII of the GATT-1947 provides that the standards of valuation used by each contracting party should conform to certain principles. It states that the customs value of goods:

- should be based on the "actual value" (sometimes known as the 'positive or invoice price') of the goods;

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[93] General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, Article VII, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187. See also *supra* note 91, pp. 2-3.

- should not be based on the value of merchandise of national origin or on arbitrary or fictitious values;
- should be the price at which, at the time and place determined by the legislation of the country of importation, such or similar goods are sold or offered for sale in the ordinary course of trade under fully competitive conditions.[94]

However, many scholars criticise that the principles set out in Article VII of the GATT-1947 are too general to achieve the international uniformity in the valuation of goods for duty purposes. The provisions do not require any particular methods of computing "actual value", leaving the contracting parties free to establish differing customs valuation systems. As a consequence, the same nominal tariff rate may result in entirely different effects in different countries, making it very difficult for traders to predict the amount of customs duty they may owe.

Another significant problematic area found in Article VII of the GATT-1947 is that the importing country is given the legislative discretion to specify the "time and place" of determining the price. By delegating this decision to the importing country, Article VII permits use of, among others, the price of the goods in the exporting country, the price in the importing country, or the export price, which may be higher or lower (depending, for example, on the exporter's pricing practices) than the price for like goods on domestic sales in the exporting

[94] See Article VII of the GATT-1947, paragraph 2 (a) and (b).

country.[95] Whatever the place chosen, the time for determining the relevant price may vary from the date of the making of the contract through the date of shipment to the date of clearance through customs.[96]

B. The Brussels Definition of Value

Alongside Article VII of the GATT-1947, the European Customs Union Study Group (the 'Study Group') was set up in 1947 in Brussels in order to draft a c.i.f. definition of value for use in the European Customs Union. The Study Group took full account of the valuation principles laid down in Article VII of the GATT-1947 as a starting point for its work.

The work was completed in 1949, and then incorporated in the **Convention on the Valuation of Goods for Customs Purposes** (hereafter cited as 'the Convention') [97] which was signed in Brussels in December 1950 and entered into force in July 1953. The Convention obliges the contracting parties to adopt the Definition of Value (commonly known as the 'Brussels Definition of Value' – the BDV) contained in Annex I of the Convention and to conform to the Interpretative Notes set out in Annex II. The text of the BDV may be adapted either by inserting provisions of the Notes, or by giving the text such legal form as may be essential to render it operative in its domestic law, if necessary by adding complementary provisions clarifying the purport of the Definition.[98]

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[95] See Annex I, Interpretative Note 4 to Article VII of the GATT-1947. It should be noted that this requirement is contrast to the WTO Customs Valuation Agreement. See details below.
[96] See Kenneth W. Dam, *The GATT Law and International Economic Organisation,* The University of Chicago Press, 1970, p. 188.
[97] See 171 UNTS 305, Cmd 9233.
[98] See Article IV of the Convention.

The Customs Co-operation Council, established in 1953, has been entrusted with the supervision of the operation of the Convention which, to this end, provides for the establishment of a Valuation Committee. The functions of the Valuation Committee are to make recommendations and advice to the contracting parties, and to prepare explanatory notes as a guide to the application of the BDV.[99]

Under the BDV, the basis for valuation is to be the 'normal' price of the goods, i.e. the price which the goods *would* fetch at the time of valuation in a sale on the open market between a buyer and seller independent of each other.[100] The sale is deemed to include the delivery of the goods by the seller at the place of introduction into the importing country (c.i.f. sale).[101]

The BDV assumes that the price is the sole consideration for the sale and is not influenced by a relationship, other than that created by the sale itself, between the seller (or any person associated in business with him) and the buyer (or any person associated in business with him).[102] It is also assumed that no part

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[99] See Articles V and VI of the Convention. See also Edmond McGovern, *International Trade Regulation: GATT, the United States, and the European Community,* Exeter Globefield Press, UK, 1986, pp. 151-152.

[100] See Annex I, Article I (1) of the Convention. In practice, when imported goods are the subject of a *bona-fide* sale, the price paid or payable (invoice price) on that sale can be considered as a valid indication of the normal price mentioned in the BDV. Customs administrations are recommended to accept this price as the value of the goods, subject to safeguards against evasion of duty, and to adjustments to take account of circumstances of sale different from those envisaged in the BDV. See Interpretative Note 5 to Article I of the Convention. Upward adjustments or 'uplifts' are commonly used under this system. See also Dominik Lasok, *The Trade and Customs Law of the European Union,* 3rd ed., Kluwer Law International Ltd., London, 1998, p. 277-278.

[101] See Annex I, Article I (2) of the Convention.

[102] See note 172 below for the meaning of 'persons associated in business'.

of the proceeds of any subsequent resale, other disposal, or use of the goods will accrue to the seller or any person associated in business with him.[103]

The BDV system has several disadvantages, of which the following may be mentioned:

- the notional character of the BDV leaves too much discretion to national customs administrations. This can be seen, for example, in the case of discounts. Basically, an open market price looks for by the BDV cannot be reduced by privileged or abnormal discounts, so that where valuation is based on the price paid or payable any such discounts given to the importer have to be added back for purposes of customs duties. In order to establish the customs value, customs officials need to decide whether a discount is abnormal, or whether there is a reduction from the ordinary competitive price. This leads to a certain arbitrariness and uncertainty which is detrimental to trade [104];
- the system of BDV is not consistent with commercial realities. In practice, before the price of the imported goods is accepted as the basis for determining the customs value, it is often tested by comparing it to 'usual' open market price. In other words, Customs in the importing country will check whether the price is 'normal';
- where the transaction price lies below the price for which identical or similar goods are bought by other buyers, the price is uplifted to

[103] See Annex I, Article II (1)(c) of the Convention.

obtain the normal price. Since the BDV fails to provide clear standards as to when the price should be accepted or how the 'uplifts' should be calculated, equal treatment between importers is therefore difficult to achieve.[105]

The BDV was widely applied by a number of countries in different parts of the world. It was evident that by 1980, only 33 countries, mostly European, were contracting parties to the Convention[106]and approximately 70 countries were applying it *de facto.* However, some major trading countries, for example the United States[107] and Canada[108], rejected both the BDV and GATT systems and applied their own valuation rules.

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[104] See Customs Co-operation Council, *The Brussels Definition of Value and the GATT Valuation Agreement: A Comparison,* Customs Co-operation Council, Brussels, 1985, pp. 8-9.

[105] See Izumi Hara, "Canadian customs valuation moving towards compliance with the MTN code", 16*Law and Policy in International Business,* 3, 1984, p. 1052.

[106] See Saul L. Sherman, 'Reflections on the New Customs Valuation Code', 12*Law & Policy International Business*, 1980, p. 121. The European Community (EC), the largest trading bloc applying the BDV, adopted an extensive regulation to promote uniformity interpretation among Member States. The BDV system was introduced into EC law by Council Regulation No. 803/68 of 27 June 1968. However, this system had been superseded by Council Regulation No. 1224/80 which adopted the provisions of the GATT Customs Valuation Code of 1979 concluded as part of the Tokyo round. Notably, as a result of the Uruguay round, the Council Regulation No. 1224/80 was replaced by the Council Regulation No. 2913/92. It is supplemented by Commission Regulation No. 2454/93, which refers to Article VII of the GATT and complements, in considerable details, the provisions of the Code. According to Article 189 of the Treaty of Rome, these two Regulations are directly applicable in all European Member States, without the need for any endorsement at national level.

[107] The system of valuation of goods for customs purposes which was applied in the US up to 1 July 1980 in fact consisted of six different sub-systems. The system to be used was determined by the article to be valued. Each sub-system contained primary and alternate valuation standards. In all, there were nine such standards, some of which differed only slightly from each other. Seven standards were based on the value of the goods in the country of exportation, and two were based on the selling price in the US of the domestic counterpart of the imported article (American selling price or ASP). Those standards that were based on the value of goods in the exporting country related either to the value of goods sold for export to the US or to the value of goods sold for domestic consumption. These values could be obtained in three ways: (a) actual sale price minus the insurance and freight elements, (b) through building up of foreign costs, or (c) the U.S. selling price of such or similar imports, minus the expenses of bringing such goods into the U.S. These standards clearly opted for the f.o.b. basis. The ASP standards based the dutiable value on the price of like or similar competing domestic articles in the U.S. market. See DeWulf, *supra* note 57, p. 245. For details of the ASP, see note 208 below.

C. The GATT/WTO Customs Valuation Code

The issue of international customs valuation system had been discussed during the Tokyo Round Multilateral Trade Negotiations (MTN) because the negotiating participants recognised that diverse customs valuation systems effectively constituted non-tariff barriers to international trade. After a five-year discussion, the participants presented a draft of a new system of customs valuation that would be uniformly applied.

The new customs valuation code entered into force on 1 January 1981, namely the **"Agreement on the Implementation of Article VII of GATT"**.[109] This GATT valuation agreement as revised became part of the single package mandatory text (WTO Annex 1A) in 1994 and thus is binding on all WTO member countries.[110] It is important to understand that the Code augurs greater uniformity in valuation methodology, but not necessarily uniform values. The aim of the Code, like its predecessor, is to ensure that different customs authorities in the WTO member countries use the same approach to determine the value of an

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[108]Prior to1 January 1985, Canada was based customs value on prices for home consumption in the exporting country (fair market value). It also relied on ministerial prescriptions which gave the Ministry of National Revenue the ability to protect domestic industries as needed by allowing inflation of the value of duty. The decision of the Ministry of National Revenue was final and conclusive since there was no system of appeal for ministerial prescriptions. See *supra* note 105, p. 1061.

[109] Done April 12, 1979, MTN/NTM/W/229/Rev.1.

[110]However, developing countries that were not party to the GATT Customs Valuation Code of 1979 are given the right to delay implementing the provisions of the Code until 2000 (the Code allows developing countries to request extension). Application of the computed value method (Article 6 of the Code) may be delayed for a maximum of three years from the actual entry into force, and reservations may be entered in respect of any of the provisions of the Code if other member countries consent. Furthermore, developing countries which valued goods on the basis of officially established minimum values can request a reservation to retain such values on a limited and transitional basis, subject to the terms and conditions required by the other member countries. Requests for derogations require approval, and are likely to be conditional. See the WTO Customs Valuation Agreement, Article 20.

article for purposes of applying a tariff, not to ensure that they always reach the same value with respect to a given article.

The Code expresses the positive concept of valuation presumptively based on the price actually paid or payable for the imported goods. This system conforms to commercial realities and outlaws the use of arbitrary or fictitious customs values. From the customs administration's point of view, the precision and clarity of Code rules as regards valuation methods and price adjustments help to minimise disputes between importers and Customs, thereby rendering customs administration more efficient. The reduction in disputes also serves the Code's objective of improving relations between the business community and customs authorities –without this gain in co-operation, the benefits of the Code for both sides would be diminished.

From the exporter's point of view, to have a single valuation system applied to all countries of destination can be a great boon to an exporter, although his problems or products differ in the various countries. It is believed that the exporter's planning should always be governed by the same set of rules, and the same advisers could assist him more readily with his problems wherever they might arise.

IV. Analytical Reviews of the Code

A. Objectives

According to Paragraph 4 of the general introductory commentary of the Code, four major objectives can be underlined as follows:

1. ensuring a single international valuation system (i.e. worldwide uniformity and certainty);
2. promoting fairness, equity and efficiency of the valuation system internationally;
3. avoiding arbitrary or fictitious customs values imposed by each member country;
4. providing simple and transparent rules consistent with international business practice.

Needless to say, the Code is a considerable improvement on both the BDV and Article VII of the GATT-1947[111]. The Code is neutral in that it prohibits discrimination and stipulates that, in principle, customs authorities should interfere as little as possible in trade practice.[112] More importantly, it is transparent, providing that laws, judicial decisions and administrative rulings

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[111] The Code implicitly extends the scope of Article VII of the GATT-1947, which applies to all duties or other charges or restrictions on importation and exportation based upon or regulated in any manner by value, but excludes internal taxes or equivalent charges imposed on or in connection with imported products. Mc.Govern (1986) notes that the system established in the Code can also be regarded as imparting a specific content to Article VII of the GATT-1947 rule which requires that the use of actual value, that being the price at which the goods is sold or offered for sale in the ordinary course of trade under fully competitive conditions. The major innovation of the Code is its explicit emphasis on the price of the transaction in question as providing the basis for valuation of imported goods. It thus creates a 'positive' standard in contrast to the 'notional' standard of the BDV. See McGovern, *supra* note 99, p. 153.

[112] WTO Customs Valuation Agreement, General Introductory Commentary. See also *supra* note 91, p. 6.

concerning customs valuation should be published by the authorities of the importing countries.[113] Perhaps the major disadvantage of the Code is that it is applicable only in case of the prevailing trade environment, where the majority of transactions were carried out under fully competitive conditions.

B. Application of the Code

Imports of goods are valued according to a series of alternative methods. But they are not alternative methods in the sense that Customs may use any method it chooses. Nor may Customs reject information provided if based on the use of generally accepted accounting procedures.[114] The six methods of valuation are arranged in a hierarchical order which is to be followed by Customs in all cases.[115] Only when no valid customs value can be found under the first method, can the second method be applied, and so on.

The flow charts in Appendix II are intended to provide a straightforward guide to how to value imported goods under the six methods. Notably, in practice, the first valuation method, i.e. the transaction value, is applied in the vast majority of cases.[116]

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[113] See WTO Customs Valuation Agreement, Article 12.
[114] See WTO Customs Valuation Agreement, Annex I, Interpretative Notes (General Note)(Use of Generally Accepted Accounting Principles).
[115] See WTO Customs Valuation Agreement, General Introductory Commentary, paragraph 1.
[116] **Table 2.1 : Application of the Customs Valuation Methods in the GATT Customs Valuation Code in 1982 (in Percentages)**

	Transaction Value (Article 1)	Transaction Value of identical goods (Article 2)	Transaction Value of similar goods (Article 3)	Deductive Value (Article 5)	Computed Value (Article 6)	Reasonable means (Article 7)
EEC	95.4	0.3	0.2	2.1	-	2.0
Finland	93.1	0.3	0.1	-	-	6.5

1. The Transaction Value of the Imported Goods (Method 1)

1.1 General Definitions

It is widely accepted that determining the customs valuation based on the invoice price is simple, as long as the duty values of the imported goods are readily available. The actual price being used under the transaction value method reflects the positive theme. In this connection, customs authorities may not reject a value on the ground that the price is too low (or too high) or is lower (or higher) than the price in other transactions.[117] The use of objective facts in determining value, obviously, minimises the discretion of customs authorities and promotes uniformity and predictability.[118]

The transaction value of imported goods is broadly defined in Article 1 of the Code as the price (subject to certain adjustments) actually paid or payable for the goods when sold for exportation to the country of importation.[119] For the purpose of this Article, the term 'price actually paid or payable' means the total amount paid or to be paid by the buyer to, or for the benefit of, the seller for the imported goods.[120] The 'price' includes all payments made, or to be made,

Japan	**96.6**	**1.4**	**0.1**	-	-	-
Romania	**100.0**	-	-	-	-	-
Sweden	**99+**	-	-	-	-	-
U.S.	**94.0**	**1.0**	**0.5**	**1.0**	**2.0**	**1.5**
Norway	**98.5**	**0.4**	-	-	-	**1.0**

See Saul L. Sherman and Hinrich Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code*, Kluwer Law and Taxation Publishers, New York, 1988, p. 199.

[117] See *supra*, p. 66. The authors note that:
"Each shipment will be valued in according to its own price, whether the prices differ because the quantities are different, because the level of trade is different, or because the sales agreements were entered into at different times - or even if one importer gets a low price simply because he drives a hard bargain or the exporter chooses to favor him."

[118] See WTO Customs Valuation Agreement, General Introductory Commentary, paragraph 4.

[119] The transaction value method is sometimes known as the 'invoice value'. Customs generally accepts the invoice as the basis for assessment if the declared price is not over or understatement.

[120] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 1.

directly or indirectly[121] by the buyer to the seller or a third party on behalf of the seller in respect of the sale of the imported goods.

A number of activities which are enumerated in Article 8 of the Code (discussed below) are considered to be indirect payments to the seller and will result in an addition, provided that they are undertaken by the buyer and are not already included in the price. Notably, this is an exhaustive enumeration. Activities not listed are not considered to be indirect payments, even though they are performed by the buyer to the advantage of the foreign seller or have been undertaken by the buyer on his own account. Examples include advertising, marketing, and similar expenses.[122]

However, if the fact shows that the exporter agrees to pay the costs of advertising or marketing himself and recovers them through the price, these costs are part of the price of the goods concerned, and there is no provision in the Code for excluding them from the transaction value. The result is the same if the exporter invoices the importer separately for advertising expenses. These payments are, thus, regarded as an indirect payment constituting an additional element of the price paid by the importer to the exporter.

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[121] Nevertheless, care should be taken where payments of the goods being valued are made 'indirectly' to exporters. Importers have to declare and include the amount of indirect payments (in cash or kind) in the total actual payment for the imported goods, even if not shown on the invoice. Some examples of indirect payments are when the buyer settles all or part of a debt owes by the seller, or when the seller reduces the price on a current importation to settle a debt he owes the buyer.

[122] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 2 to Article 1. Sherman and Glashoff note that the treatment of advertising expenditures in the BDV is different from the Code:

The BDV had been widely interpreted as requiring many such expenditures to be included in the customs value even if the payment was made by the buyer, for the expenditures were often

1.2 Identifying Problems of the Transaction Value: Different Interpretations and Applications

Unlike simplicity of its meaning, the application of the transaction value method is not, however, without problem. As noted earlier, the Code was erected as a new structure, establishing a fair, uniform and neutral system for the valuation of goods for customs purposes, and replacing the use of arbitrary or fictitious customs values. The most important question is whether uniformity in terms of interpretation and application of the Code throughout member countries is ensured, since a harmonised and uniform understanding of the Code in all countries concerned is the key to an effective, successful implementation and operation of the Code.

However, the Code has not been uniformly implemented and applied. Indeed, there exist controversial cases that have been subject to different interpretations between and/or among major trading countries, resulting in disharmony and uncertainty in the interpretation and implementation of the Code. Two major areas that create conflicts of interpretation and application of the Code by some member countries should be mentioned.

The first area deals with the matter of successive sale transactions. As noted above, Article 1 of the Code provides that the transaction value can be established when there is a 'sale for export'[123] to the country of importation. In

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regarded as an indirect benefit to the exporter which, under the notional concept of the BDV, ought to be included in the 'normal price' See *supra* note 116, p. 75.

[123] Examples of the imported goods which are not regarded as 'a sale for export' are:

1. the goods are imported as a gift, a sample, or a promotional item;

the commercial practice, the goods may be sold either directly from the seller established outside the country of importation to the buyer established within the country of importation, or resold to one or more subsequent buyers before valuation. There is in principle no difficulty in determining the transaction value in the former situation, since only one sale (contract) is involved in the import transaction.

However, the latter situation, namely 'successive sales', can give rise to discussions. Assuming that a manufacturer C (located in country X) produces the Air Odysseus model of athletic shoes for export to country M. However, it does not sell the shoes directly to an importer in country of importation M. Instead, it sells them to an independent distributor D (located in country Y) who then sells them to E company (located in country Z). E company then sells them to an importer in the country of importation M. The question is which of the three possible sales prices, i.e. the price paid by (1) the manufacturer C to the distributor D; (2) the price paid by the distributor D to the company E; or (3) the price paid by the company E to the importer in country M, should be used as the basis for appraising the transaction value.

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2. the same person may simply transfer goods from one country to another, being the owner before and after. For example, the goods are exported from the principal company in one country to a branch of the same company in another country; or
3. the goods are consigned to a commission agent in the county of importation. There is no sale of the goods in this case because the ownership of the goods is still with the exporter. The commission agent only sells the goods in question on behalf of the seller in the country of importation. Thus, there is no transaction value.
See Advisory Opinion of the Technical Committee on Customs Valuation, in *supra* note 116, Annex III, pp. 280-282.

It should be noted that the Code and the Interpretative Notes are silent regarding successive-sale situations. The matter is left to the law of the country of importation. In practice, rules dealing successive sales before valuation are different between member countries of the WTO. For example, in the EU, the European Court of Justice (ECJ), in the *Unifert* case[124], ruled that 'in the case of successive sales of goods...the importer is at liberty to select from the prices agreed for each of the sales the price which he will take as a basis for customs value...'. As applied to the example above, this would mean that the importer in the country of importation could use the transaction value of the sale by the manufacturer C to the distributor D as the basis for the transaction value.

However, as of 1 July 1995 the law concerning the determination of the transaction value where there has been a series of successive sales transactions prior to introduction of the goods into the EU has been changed. In this regard, Article 147 of the Implementing Regulation (as amended)[125] stipulates that only the last sale occurring in the commercial chain prior to introduction of the goods into the customs territory of the Community will be used in valuing merchandise under the transaction value method. However, the declarant can ask Customs to accept an export price of an earlier sale if he can demonstrate that there are specific and relevant circumstances which led to export of the goods to the customs territory of the Community.[126] If the declarant cannot demonstrate to

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[124] Case C-11/89, *Unifert Handels GmbH v. Hauptzollamt Munster,* [1990] ECR I-2275.

[125] See Commission Regulation (EEC) No. 2454/93, Article 147(1), OJ 11.10. 93 L253/1, as amended by Commission Regulation (EEC) No. 1762/95, OJ 21.7.95 L171/8.

[126]There are several ways for the declarant to demonstrate to the customs authorities. For examples,

- the goods are manufactured according to EU specifications;

Customs, the last sale which took place prior to introduction of the goods into the customs territory of the Community is applied.[127]

Unlike the EU customs law, Article 4 of **the Tariff Act** of Japan simply states that in the case of successive sales the transaction price at the time of arrival of the imported goods at customs territory in Japan should be used as the basis for determining the customs value.

Another legal issue that discourages the goal of uniformity of the Code is a quota charge. For example, in the US quota charges paid by the seller (exporter) on behalf of the importer (buyer) are regarded as part of the price 'actual paid or payable' for the imported goods. The US Court held in *Generra Sportswear Company* v. *United States*[128] that quota charges were properly part of the 'total payment ...made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller', if quota payments were paid to the seller (or any person designated by him). Unlike the US, the ECJ, in the *Ospig* case[129], ruled that quota charges connected with the acquisition of export quotas in the context of a quota system might not be taken into account for the calculation of the valuation of goods for customs purposes.

- the goods are identified (according to the marks etc. they bear) as having no other use or destination;
- the goods are manufactured or produced specifically for a buyer in the EU;
- the goods are specifically ordered from an intermediary who sources the goods from a manufacturer and the goods are shipped directly to the EU from that manufacturer.

See European Commission, *Compendium of Customs Valuation Texts of the Customs Code Committee: Customs Valuation Section,* XXI/1229/96-EN Rev.3, European Commission, Brussels, 1997, pp. 34-35

[127] See Commission Regulation (EEC) No. 2454/93, Article 147, paragraph 2.

[128] See 8 Fed. Cir. 132, 905 F.2d 377 (1990).

1.3 Adjustments to be Made to the Transaction Value

In order to arrive at the transaction value, adjustments (either upward or downward) to the price actually paid or payable, set out in Article 8 (see flow chart in Appendix II:7) and Interpretative Notes to Article 1, should be made.

1.3.1 Additional Costs

Additions are necessary when the costs are actually paid or payable by the buyer and are not already included in the price of the goods. Basically, additions can be made only 'on the basis of objective and quantifiable data'.[130] Where the objective and quantifiable data are not available, the transaction value cannot be determined and the next basis of value, in order of precedence, must be considered for appraisement. [131] For example, when it cannot be exactly known whether the mould used in the production of the imported goods will be provided by the buyer or seller, and how much for that mould the buyer has to pay for, etc. In such circumstances, no value should be added to the price payable for the goods.

Although additions which are to be made to the price actually paid or payable in order to arrive at the transaction value are enumerated exhaustively in Article 8, detailed rules of certain items are complex and difficult to apply. This

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[129] See Case 7/83 *Ospig Textilgesellschaft KGW Ahlers v Hauptzollant Bremen-Ost [1984] ECR 609*, Paragraphs 14-17.
[130] See WTO Customs Valuation Agreement, Article 8.3.
[131] See WTO Customs Valuation Agreement, Annex I, Interpretative Note to Article 8.3

section will examine the basic rules and principles of each item of additions and identify some important problems inherent in certain items.

1.3.1.1 Elements Chargeable to the Buyer

- Commission and Brokerage, except Buying Commission[132]

Many import transactions involve an intermediary (or a middleman) who assists either the buyer or seller in the purchase or sale of the imported goods. When the intermediary is acting as an agent, the actual sale is between the foreign seller and the buyer with the agent acting as a facilitator. In this respect, the issue to be decided is whether commissions the agent receives for its services are part of the transaction value of imported goods.

The Code clearly states that only selling commissions and brokerage incurred by the buyer with respect of the imported goods are included in the transaction value. In theory, selling commissions are fees paid to a selling agent for the service he/she performs on behalf of the seller or the manufacturer in the sale of the imported goods. A brokerage fee, on the other hand, relates to a broker – an intermediary who acts for both buyer and seller and usually has not role other than to put both parties to the transaction in touch with each other.[133]

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[132] See WTO Customs Valuation Agreement, Article 8.1(a)(1). "Buying commissions" are defined as fees "paid by the importer to his agent for the service of representing him abroad in the purchase of the goods being valued". See WTO Customs Valuation Agreement, Annex I, Interpretative Note to Article 8.1(a)(i).

[133] See Explanatory Note 2.1 of the Technical Committee on Customs Valuation, in *supra* note 116, p. 324.

In practice, the selling commission can be paid by the foreign seller or the buyer of the imported goods. If the seller pays his agent the commission and includes this fee as a cost in calculating his selling price, there is no need for the invoice price to be adjusted in determining transaction value. In case it is not so included, and the terms in the contract of sale require the buyer to pay, usually direct to the intermediary, the commission, separate from the invoice price. In effect, the buyer relieves the seller of an obligation, and the payment of commission, regarded as the indirect payment to the seller, must be added to the price actually paid or payable.

The greatest area of potential abuse lies in the buying commissions. The exclusion of commissions paid by the buyer to his representative from the customs value might lead an importer, unsure of the precise nature of the commissions being charged, to label them as buying commissions on the invoice forwarded to the customs authorities. In some circumstances, the buyer intentionally declares the commissions as non-dutiable buying commissions, despite the fact that the intermediary is not functioning as the buying agent, but rather as the independent buyer/seller. In this connection, Customs should examine the written buying agency agreement, the existence and the nature of services rendered by the agent in question, and the buying agent's functions.

- Cost of Containers and Cost of Packing

For purposes of customs valuation, 'containers' means items which are treated as being one with the goods being valued.[134] Examples of these containers include beer barrels, beer bottles, etc. The amount charged for containers is added to the customs value when the costs of containers are paid by the buyer directly to the seller, apart from the actual price.

As to the packing costs, these are generally included in the price of the imported goods. If this is not the case and these costs are still charged to the buyer, they are added to the transaction value in order to find the customs value.[135]

1.3.1.2 Activities Considered to be Indirect Payment

The value of goods or services (or 'assists'), described below, is to be added to the price in arriving at the transaction value, if the following conditions are met:

(a) the buyer supplies goods or services, directly or indirectly, free of charge or at reduced cost;

(b) the assist must be used in connection with the production or sale for export of the imported goods;

(c) the addition for the assist is only be made to the extent that the value is not already included in the price;

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[134] See WTO Customs Valuation Agreement, Article 8.1(a)(ii). It is worth noting that the Code and the Interpretative Notes do not address how to treat the containers which are subject to be repeated importation (i.e. repeated used – e.g. reusable boxes, reusable bottles, etc.). The EU, however, holds this position in Commission Regulation (EEC) No. 2454/93, Article 154. It provides that the costs of such containers must, at the request of the declarant, be apportioned, as appropriate, in accordance with generally accepted accounting principles (GAAP).

[135] WTO Customs Valuation Agreement, Article 8.1(a)(iii). See also *supra* note 92, p. 26.

(d) the value of the assist must be apportioned in a reasonable manner appropriate to the circumstances.[136]

The list of dutiable assists comprises four categories of goods and services as follows:

(i) materials, components, parts, and similar items incorporated in the imported goods[137];

(ii) tools, dies, moulds and similar items used in producing the imported goods[138];

(iii) materials consumed in producing the imported goods[139];

(iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary for the production of the imported goods[140].

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[136] See WTO Customs Valuation Agreement, Article 8.1(b).

[137] See WTO Customs Valuation Agreement, Article 8.1(b)(i). This provision covers only tangible items which physically exist in the imported goods. However, the customs law of some countries, in particular the EU, extends the scope of this provision. For example, in the *Baywa AG* case, the Court ruled that 'licence fees which are provided to grow harvest seed thereafter imported into the Community are considered as materials, components, parts and similar items incorporated in the imported goods'. See *Baywa AG v. Hauptzollamt,* C-116/89, [1991] ECR I-1095.

[138] See WTO Customs Valuation Agreement, Article 8.1(b)(ii). Items under this provision are used in the process of production of the imported goods. The use of assists normally spread over a great many units of output and a considerable period of time. It is, therefore, necessary to apportion the value of assists to the particular units being imported.
In this respect, Interpretative Notes 1, 3, and 4 to Article 8.1(b)(ii) provide that assists should be apportioned in any reasonable manner appropriate to the circumstances and consistent with generally accepted accounting principles. The method of apportionment actually accepted by Customs will depend upon the documentation submitted by the importer. If the entire anticipated production using the assist is for exportation to the country of importation, the total value may be apportioned over (i) the first shipment, if the importer wishes to pay duty on the entire value at once, (ii) the number of units produced up to the time of the first shipment, or (iii) the entire anticipated production. (For example, an importer provides the producer with a mould to be used in the production of the imported goods and contracts with him to buy 10,000 units. By the time of arrival of the first shipment of 1,000 units, the producer has already produced 4,000 units. The importer may request the customs administration to apportion the value of the mould over 1,000, 4,000 or 10,000 units.)

[139] See WTO Customs Valuation Agreement, Article 8.1(b)(iii). Unlike Article 8.1(b)(i), the materials in this category are used up, not incorporated, in the manufacture of the goods.

The last category is the most complex and difficult of assists. This is because the element relates to the intangibles, and only the designated intangibles require additions to the price in arriving at the transaction value. For instant, the Code includes engineering and development costs performed outside the country of importation, but excludes 'research' from the list. Perhaps the major reason is that it is difficult in practice to state in advance and in general terms what will be deemed so basic and general in application that it will qualify as (non-dutiable) research.[141]

In addition, as mentioned above, the value of the element specified in the last category of assists is to be included in the customs value if the element is 'undertaken elsewhere than in the country of importation' and 'necessary for the production of the imported goods'. Both conditions must be fulfilled. However, the second condition would open debate between Customs and importers. From

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Examples include abrasives, lubricants, catalysts, and other similar materials which do not become a part of the imported goods.

[140] See WTO Customs Valuation Agreement, Article 8.1(b)(iv). See also WTO Customs Valuation Agreement, Annex I, Interpretative Note to Article 8.1(b)(iv). It should be noted that this provision of the Code differs from that of the BDV. Under the BDV, the costs of engineering, development and design work, etc. are to be added to the price for duty purposes regardless of where the work is undertaken. See Interpretative Note 2 to Annex I, Article 1 of the Convention. See also *supra* note 104, p. 11.

Sherman observes that the exclusion from duty value of the cost of development and design work undertaken in the country of importation eliminates, at least, two difficult problems:

'It will no longer be necessary for importers and Customs to debate whether the specifications in an order go beyond a proper buyer's function and thus constitute a design or engineering assist. Likewise, if the importer's engineer visits the supplier's plant to check the quality of the product (a proper buyer's function), it would make no difference in the future if he steps over the line into advising on the application of production techniques, so long as the production techniques were furnished by the purchasing importer and derive from work done in the country of importation. Trading interests were unsuccessful in their efforts to have engineering and design services supplied by the importer excluded regardless of where the work was done. Thus, many cases will remain in which it will be necessary to segregate the engineering and design costs according to the country in which the work was "undertaken", a test which may be more elastic than a simple test of where the work was done.'

See *supra* note 106, pp. 145-146.

[141] See *supra* note 116, p. 115.

the author's point of view, Customs should interpret the concept 'necessary for the production' in the narrowest sense.[142]

1.3.1.3 Royalties and Benefits of Subsequent Resale

- Royalties and Licence Fees

Sherman (1980) observes that "the treatment of royalties or licence fees is one of the most difficult areas in customs valuation law. Partly because of time pressure, and partly because of the difficulty of reaching agreement, the Code and its Notes ... touch upon this subject only lightly".[143]

There is no definition of 'royalties and licence fees' in the Code and the Interpretative Notes. In general, royalties and licence fees mean 'any payment for the use of rights or privileges or for intangibles such as information or services.' [144] There are many types of rights to which royalty and licence fees typically pertain. These include, for example, trademarks, patents, copyrights, and know-how.[145] The question is of when payments of such rights will be added to the invoice price of the goods in determining duty value.

It is clear from the Code that royalties and licence fees payable to the seller are to be included in the customs value if and when two conditions set out in Article 8.1(c) are satisfied.

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[142] For example, the preliminary design work which comes before the definite design supplied by the buyer is not covered by the assist provisions because it is not necessary for the production of the goods; or the importer furnishes five sketches to the manufacturer, who chooses and uses only one. In this respect, only the cost of that one is to be included in the customs value. See *supra* note 92, p. 27. See also *supra* note 116, p. 117.
[143] See *supra* 106, p. 147. See also WTO Customs Valuation Agreement, Article 8.1(c).
[144] See *supra* note 116, p. 121.

The first requirement is that the royalty or licence fee must be 'related to the goods being imported'. An examination from the fact of each case is needed for determining of what the payment for royalty or licence fee is being paid for. If, from the examination, there is only a partial relation, additions of royalties or licence fees can only be made on the basis of objective and quantifiable data. Because of the words 'related to the goods being imported', the charges for the right to reproduce the imported goods in the country of importation are thus not part of the price in determining the customs value.[146]

The second fundamental condition is that the payment must be a 'condition of sale' of the goods. In determining whether or not the payment of a royalty or licence fee is a condition of sale, Customs should consider not only from the wording of the written agreement which governs but also from the circumstances of each case. Therefore, if the fact shows that goods are offered for sale by the exporter *with or without* the rights in respect of which the royalty is paid, the payment of the royalty for those rights is not a condition of sale, and thus is not included in the customs value.[147]

However, the payment made by the buyer for the right to distribute or resell the imported goods is not added in the price in arriving at the transaction value as long as it is not a condition of the sale.[148]

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[145] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 8.1(c).
[146] See *supra*. Notably, the EU includes this Interpretative Note in its Customs Code. See Council Regulation (EEC) No. 2913/92, Article 32(5).
[147] See *supra* note 116, p. 125.

Apart from the two conditions required by the Code, care should also be needed in the situation in which the payments for the imported goods and for the royalty used in the country of importation are made to the same person. The parties may arbitrarily designate a portion of the price as a royalty in an attempt to exclude it from the duty value, e.g. by claming that the amount of royalty is not a condition of sale of the imported goods. It is, in practice, difficult for Customs to determine whether the amount the price and the royalty is truly separate and not just arbitrarily set by the importer and the exporter to achieve a lower duty. Where doubt occurs, Customs may ask the importer to submit all documents or other relevant evidence in order to show that the goods would sell at the price without the royalty.

Since details on the issue of royalties or licence fees laid down in the Code and the Interpretative Notes are very limited[149], some countries add certain provisions in the area of royalties in their customs legislation. For example, under the EU customs law, many situations relating to royalties and licence fees are adopted. These include, for example, methods of calculation of the amount of royalties and licence fees[150]; treatments of royalties and licence fees in relation to (i) ingredients and components of the goods manufactured in the country of importation, or (ii) importations of unassembled or unfinished goods[151]; and

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[148] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 2 to Article 8.1(c).
[149] Apart from Article 8.1(c) of the Code, there are only two provisions found in the Interpretative Notes. See *supra* notes 145, 148.
[150] See Commission Regulation (EEC) No. 2454/93, Article 161.
[151] See Commission Regulation (EEC) No. 2454/93, Article 158.

treatments of royalties or licence fees paid to a third party who is not related to the seller.[152]

- Benefits of Subsequent Resale or Use of the Imported Goods

Article 8.1(d) of the Code provides specifically for the inclusion in the customs value of any part of the proceeds of subsequent resale, disposal or use of the imported goods by the buyer that accrues directly or indirectly to the seller. This provision is designed mainly to prevent the sale at a low base price, with the buyer required to pass on a percentage to the seller after the goods are resold.

Article 8.1(d) is linked to Articles 1.1(c) and 8.1(c) of the Code. Article 1.1(c) concerns with the rejection of the transaction value method where the value of the proceeds payment under Article 8.1(d) cannot be adjusted. Reading Article 1.1(c) and Article 8.1(d) together, the proceeds payment to the seller for the imported goods is dutiable and can be added to the price actually paid or payable if an adjustment is made. Where a proceeds adjustment cannot be made, no transaction value under Article 1 is to be applied.

The royalty provision under Article 8.1(c), discussed above, also plays an important part in the proceeds provision under Article 8.1(d). This means that any royalty that is not dutiable under the provision expressly dealing with royalties should not become dutiable under the proceeds provision merely because it is calculated as a percentage of resale price. In other words, royalties which are expressed as a portion of resale proceeds can be added to the transaction value

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[152] See Commission Regulation (EEC) No. 2454/93, Article 160.

under Article 8.1(d) only if or to the extent that two conditions of royalties and licence fees, discussed earlier, are met. However, one should bear in mind that failure to make an addition for proceeds accruing to the seller where no addition is called for by Articles 8.1(c) and (d) cannot reject the transaction value.[153]

Let us assume that S manufactures lamps in Singapore. He imports identical lamps made by P in Malaysia, paying $70 a dozen. P owns the trademark under which S markets the lamps in Singapore. S pays a trademark royalty of 10 per cent of his net sales, regardless of where the lamps are manufactured.

As one can see, the royalty in the foregoing example is not dutiable under Article 8.1(c) because it is independent of the purchase of the imported product and not a condition of sale. In this respect, an addition should not be required under Article 8.1(d), even though 10 per cent of the proceeds of resale accrue to the seller (in the form of a non-dutiable royalty). However, the transaction value of $70 a dozen should not be rejected under Article 1.1(c).[154]

It is worth noting that the treatment of the flows of proceeds under Article 8.1(d) does not extend to cover the flows of dividends or other payments from the importer to the exporter if those flows *do not relate to the imported transaction.* [155]An example of the latter is dividends paid by a company of a group to another company of the group, when the first company purchases goods from the latter.

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[153] See *supra* note 116, p. 184.
[154] See note 171 below.

Conversely, if the flows of dividends arise from a *direct* relationship between payment of dividends and the imported goods, such flows will then be part of the customs value.

1.3.1.4 Cost of Associated with the Transport

Apart from elements related to the production and sale of the goods, which always result in an addition being made, the Code also refers to several elements that are particularly connected with transport. This category of the Code, obviously, undermines the aim of uniformity in customs valuation because the Code leaves open the option between a c.i.f. and f.o.b. value.[156] This is due to the difference concerning the basis of valuation existing between the US and the EEC as well as other countries at the time the Code was completed.[157] The US and some countries (e.g. Australia, Canada, etc.) have traditionally applied the f.o.b. basis, while most countries use a c.i.f. price.[158]

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[155] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 4 to Article 1.

[156] Article 8.2 of the Code states that 'in framing its legislation, each party shall provide for the inclusion or the exclusion from the customs value, in whole or in part, of...(a) the cost of transport and insurance 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 place of importation; and (c) the cost of insurance'.

The reference to 'unloading' costs in the Code may cause many doubts. Normally, imported goods are unloaded after the goods have arrived in the country of importation, or after the goods have been cleared (such as in case of transport by truck or railway). In this situation, the costs of unloading are not 'associated with the transport of the imported goods to the port or place of importation.' Thus, they are not to be added to the price. From this point, it can be assumed that the term 'unloading' in Article 8.2 can only mean the 'unloading in case of a change of carrier before the arrival at the place of importation'. Any charge of unloading before the goods are arrived at the country of importation has to be included in the transaction value. See *supra* note 116, p. 165. Notably, the term 'unloading' does not exist in customs legislation of some countries (e.g. the EU). See Council Regulation (EEC) No. 2913/92, Article 32(1)(e).

[157] See *supra* note 92, p. 29.

[158] See *supra* note 49, p. 45. It is interesting to note that the main reason for adopting the f.o.b. basis in the US is to avoid discrimination between various states. The US Tariff Commission stated: "On a c.i.f. basis, however identical goods from the same source could be valued differently, depending upon the location of the US port of entry. f.o.b. valuation, therefore, does not favour one state over another or one port over another, since, whatever the valuation may be, it is assessed uniformly throughout the United States." See the US Tariff Commission, Customs

Regarding the c.i.f. valuation basis, the costs of transport refer to all the costs, whether they are main or incidental costs, incurred 'directly' to the movement of the goods from the place of first loading in the country of exportation to the place of importation[159] (e.g. freight surcharges; harbour or airport fees; costs of interim warehousing when carrier is changed; etc.) In this regard, if a delay in 'loading' is occurred in the country of exportation, the demurrage costs should be included in the price actually paid or payable for the imported goods, since they are 'directly' connected with the transport of goods.[160]

As mentioned earlier, only the cost of transport and related charges up to the point of importation which is payable by the importer has to be included in the customs value. The problem may arise when the price of imported goods includes costs of transport as well as insurance in the country of importation. In this regard, such costs have to be apportioned, and only the amount of the portion of transport and insurance costs up to the place of importation is to be added to the customs value.

Notably, the Code and the Interpretative Notes, again, do not give any guidance on the issue of the determination of the freight charge of imports which is covered the whole journey (i.e. to the inland place of destination). This will depend on the customs legislation of each member country. The EU, for example, holds this situation that:

Valuation, Report to Senate Comm. on Finance, 93d Cong., 1st Sess. 83-86 (Comm. Print 1973), quoted in John H. Jackson and William J. Davey, *Legal Problems of International Economic Relations*, 2nd ed., West Publishing Co., USA, 1986, p. 384.

[159] See *supra* note 156.

- Where goods are carried by the same mode of transport to a point beyond the place of introduction into the customs territory of the Community, the transport costs must be assessed in proportion to the distance covered outside and inside the customs territory of the Community, unless evidence is produced to the customs authorities to show the costs that would have been incurred under a general compulsory schedule of freight rates for the carriage of the goods to the place of introduction into the customs territory of the Community. [161]

- If several means of transport are used and if, therefore, different schedules of freight rates have been applied, there is no longer any direct relationship between the proportion of the total distance represented by the journey outside the Community and the proportion of the costs relating thereto. In such cases, the cost of transport must be calculated, either by deducting the costs of transport within the customs territory of the Community, determined on the basis of the schedule of freight rates normally applied, from the price actually paid or payable, or by determining the costs of transport to the place of introduction into the customs territory of the Community on the basis of the rates normally applied.[162]

- If goods are invoiced at a uniform free domicile price which corresponds to the price at the place of introduction, transport costs

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[160] See Case C-11/89, *Uifert Handels GmbH* v. *Hauptzollamt Munster* [1990] ECR1-2275.
[161] See Commission Regulation (EEC) No. 2454/93, Article 164(a).
[162] See Case C-17/89, *Hauptzollamt Frankfurt am Main-Ost v. Deutsch Olivetti GmbH,* [1990] ECR I-2301, paragraph 2.

within the Community will not be deducted from the price.[163] However, such deduction will be allowed if evidence is produced to the customs authorities that the free-frontier price would be lower than the uniform domicile price.[164]

Another problematic issue is the treatment of a free transport or transport provided by the buyer. Again both the Code and the Interpretative Notes are silent on this matter. However, the amount of transport costs which are free or provided by the buyer should be added to the price in arriving at the transaction value in a c.i.f. country. The total amount of the transport costs in question should be calculated by applying the 'freight rates' tariff depending on the type of transport used. For example, the UK uses IATA rates for air transport costs, conference rates for sea, etc. [165]

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[163] See Commission Regulation (EEC) No. 2454/93, Article 164(b). A uniform price implies a price which is uniform for every place of destination within the area where it is applied and includes in general a fixed amount intended to cover the average costs of transport of the goods from the place of dispatch to the various places of destination. The concept of uniform free domicile price must be interpreted as meaning that the price in question is not necessarily uniform for all destinations within the customs territory of the Community. See Case 84/79, *Richard Meyer-Uetze HG v. Hauptzollamt Bad Reichenhall,* [1980] ECR 291, paragraph 8-9.

[164] This exception must be interpreted as meaning that it is not necessary to prove that the same supplier has in fact sold the goods at a free frontier invoice price. Instead, it is necessary to determine the price which a prospective purchaser would have had to pay for a free frontier purchase of the goods which have been assessed, all other conditions of the sale being identical, in the event of importation through the same place of introduction. See Case 84/79, *Richard Meyer-Uetze HG v. Hauptzollamt Bad Reichenhall,* [1980] ECR 291, paragraph 12.

[165] See HM Customs and Excise, *Valuation of Imported Goods for Customs Purposes, VAT and Trade Statistics,* Notice 252, HM Customs and Excise, UK, 1996, p. 35.

1.3.2 Excludable Costs

The Interpretative Note to Article 1 of the Code allows the importer to deduct the costs undertaken *after* the goods have been imported from the transaction value method. To achieve the international uniformity in the valuation of goods for duty, the Note lists a number of costs which are not included in the customs value, provided that they are distinguished from the price actually paid.

These excludable costs are:

(1) charges for construction, erection, assembly, maintenance or technical assistance undertaken after importation;

(2) the cost of post-import transportation;

(3) duties and taxes of the country of importation.[166]

In accordance with the Decision of the GATT Customs Valuation Committee[167], interest charges under a financing arrangement are also not part of the customs value. These charges normally incur in the case where payments for buying the imported goods are deferred. Payments for such charges, whether to the seller or to a third party, are viewed as the cost of money and not the cost the goods being valued.

However, exclusions from customs value of the interest or financing charges can only be made when: (i) the charges are distinguished from the price

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[166] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 3 to Article 1.

[167] See Decision of the Technical Committee on Customs Valuation (on 26 April 1984), in *supra* note 116, pp. 274-275. It should be noted that the EU includes this Technical Committee's decision in its customs law. See Council Regulation (EEC) No. 2913/92, Article 33.

actually paid or payable; (ii) the financing arrangement has been made in writing; and (iii), where required, the buyer can demonstrate that such goods are actually sold at the price declared as the price actually paid or payable, and the claimed rate of interest does not exceed the level for such transactions prevailing in the country where, and at the time when, the finance was provided.

It is apparent that a fictitious increase in the interest paid to the seller under the financing arrangement relating to the purchase of goods is not easy to make. In practice, Customs may ask the importer to furnish evidence or documents in support of any claim to exclude the amount for interest charges from customs value. This evidence can be for example a copy of the finance agreement; or a copy of contract of sale of the goods if it contains the financing clause. However, in some cases, Customs may have to check on the interest rate in the country of exportation. In verification, the interest rate shown in the agreement should be accepted if it falls within the range of rates known to be appropriate in the country of exportation at the relevant time. Further inquiries would be needed when interest rates appear to exceed the appropriate upper limits.[168]

1.4 Restrictions or Conditions to the Transaction Value Method

While the transaction value is commonly applied, the Code recognises that the transaction valuation is not appropriate where the goods are not sold under fully competitive conditions. Accordingly, Article 1 stipulates that customs value is to be based on the actual price paid for imported goods unless one of the

following restrictions or conditions is present: (i) where there are restrictions on the buyer's disposition or use of the goods[169]; (ii) where the sale or price is "subject to some condition or consideration for which a value cannot be determined" [170]; (iii) where some "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." [171]

1.4.1 Relationship Between the Buyer and Seller

In addition to the above restrictions or conditions, the transaction value may also be rejected where the buyer and seller are related.[172] The impact of the

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[168] See *supra* note 116, pp. 96-97

[169] A restriction on the disposition or use of the imported goods will prevent their valuation under Article 1 unless the restriction (a) is imposed or required by law or by the public authorities in the country of importation; (ii) limits the geographical area in which the goods may be resold; or (iii) does not substantially affect the value of the goods. See Article 1.1(a) of the Code. "An example of a restriction which does not substantially affect the value of the goods would be the case where a seller requires a buyer of automobiles not to sell or exhibit them prior to a fixed date which represents the beginning of a model year". See WTO Customs Valuation Agreement, Annex I, Interpretative Note to Article 1.1(a)(iii).

[170]See WTO Customs Valuation Agreement, Article 1.1(b). An example could be where the seller establishes the price of the imported goods on condition that the buyer will also buy other goods in specified quantities. See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 1.1(b). However, "conditions or considerations" related to the production or marketing of the goods, e.g. the furnishing of engineering plans by the buyer, do not cause the rejection of the transaction value standard for Article 1 purposes. See WTO Customs Valuation Agreement, Interpretative Note 2 to Article 1.1(b).

It is worth noting that the Code and the Notes are silent on the situation where the acquisition or use of the imported goods is subject to a condition or consideration for which the value of the goods concerned can be determined. However, this matter has been included in the Implementing Regulation of the EU. It states that:

'If it is established that the sale or price of the imported goods is subject to a condition or consideration the value of which can be determined with respect to the goods being valued, such value will be considered as an indirect payment by the buyer to the seller and part of the price actually paid or payable provided that the condition or consideration does not relate either other activities, including marketing activities, undertaken by the buyer on his own account; or a factor in respect of which an addition is to be made to the price actually paid or payable under Article 32 of the Customs Community Code.'

See Commission Regulation (EEC) No. 2454/93, Article 148.

[171] See WTO Customs Valuation Agreement, Article 1.1(c). See also section IV.B:1.3.1.3.

[172] See WTO Customs Valuation Agreement, Article 1.1(d). Two persons are deemed to be related only if:

relationship of parties on the price of goods and their declared customs value is becoming increasingly important in international trade. The most common relationship is that of a parent and subsidiary. Intraorganisation transfers are often conducted with prices that are not truly reflective of arm's length prices, in order to reduce the amount of duties payable. In the economic sense, such manipulated prices result in the major distortion to free competitiveness in the world market.

Because of the unique nature of related buyers and sellers, separate provisions apply, subjecting related-parties pricing to scrutiny to determine case by case whether or not the invoice price is acceptable as the basis for a transaction value.[173]To ascertain whether the price is distorted or whether the price is

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(a) they are officers or directors of one another's businesses;
(b) they are legally recognised partners in business;
(c) they are employer and employee;
(d) any person directly or indirectly owns, controls or holds five per cent or more of the outstanding voting stock or shares of both of them;
(e) one of them directly or indirectly controls the other;
(f) both of them are directly or indirectly controlled by a third person;
(g) together they are directly or indirectly control a third person; or
(h) they are members of the same family.

See WTO Customs Valuation Agreement, Article 15.4. See also WTO Customs Valuation Agreement, Article 15.5 where it provides that 'persons who are associated in business with one another in that one is the sole agent, sole distributor or sole concessionaire, however described, of the other shall be deemed to be related for the purposes of this Agreement if they fall within the criteria of paragraph 4 of this Article.'

It is interesting to note that rules of the related party transaction are broadly provided under the BDV system. Annex I, Article II(2) stipulates that:

'Two persons shall be deemed to be associated in business with one another if, whether directly or indirectly, either of them has any interest in the business or property of the other or both have a common interest in any business or property, or some third person has an interest in the business or property of both of them.'

From both systems of valuation, it appears that the Code is more specific regarding the conditions under which persons shall be deemed to be related and to this extent, the Code is more restricted although not in all instances. For example, regardless of a common shareholding of less than 5 per cent, the Code provides that a sole agent, sole distributorship or sole concessionaire does not of itself constitute a relationship whereas under the BDV, it undoubtedly would be considered as such. On the other hand, the Code provides that members of the same family are deemed to be related for the purposes of the Code whereas under the BDV a family relationship is not in itself a relevant factor. See *supra* note 104.

[173] See WTO Customs Valuation Agreement, Article 1. 2.

influenced by the relationship, two tests are required. These demonstrate the arm's length of the price.

The first test is a circumstances-of-the-sale test. The Code requires Customs to examine from the circumstances surrounding the sale, by means of data supplied by the importer.[174] There is no definition of the phase 'circumstances of the sale' in the Code. However, as provided in the Interpretative Note[175], the examination should include the build-up of the price and all relevant aspects of the transaction, including the way in which the trade-relation is organised by the buyer and seller.

The Code lists several elements which may show the relationship between the parties has had no influence on the price, and that the buyer and seller act as though unrelated. Examples are:

(i) the price has been settled in a manner consistent with the normal pricing practices of the industry in question;

(ii) the price has been settled in consistent with sales to buyers who are not related;

(iii) the price is sufficient to ensure recovery of all costs plus a profit which is representative of the firm's overall profit realised over a representative period of time (e.g. on an annual basis).[176]

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[174] See WTO Customs Valuation Agreement, Article 1.2(a).
[175] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 1.2(a), paragraph 2(2).

The second test is a test value. The price between related persons is acceptable if the importer can demonstrate that the declared value "closely approximates" one of the following, taken at or about the same time:

(a) the transaction value in sales to unrelated parties in the same country of importation of identical or similar goods;

(b) the customs value of identical or similar goods as determined under the deductive value method; or

(c) the customs value of identical or similar goods under the computed value method.[177] All of these methods will be discussed below.

In applying the foregoing tests, certain differences with respect to the sales involved will be taken into account if the differences are based on sufficient information supplied by the buyer otherwise available to Customs.[178]

Notably, the test values are to be used at the request of the importer and only for comparison purposes to determine whether the transaction value is relevant despite the relationship between the buyer and seller. Accordingly, Customs may neither reject a transaction value because the test values do not fit nor use a test value to establish a substitute value.[179]

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[176] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 1.2(a), paragraph 2(3).

[177] See WTO Customs Valuation Agreement, Article 1.2(b).

[178] Article 1.2(b) of the Code states: 'the differences must be related to commercial levels, quantity levels, packing costs, selling commissions, value of assists, royalties or licence fees, any proceeds of resale that accrue to the seller, and costs incurred by the seller in sales where the seller and buyer are not related that are not incurred by the seller in sales in which the seller and buyer are related.'

[179] See WTO Customs Valuation Agreement, Article 1.2(c).

Two observations should be made in relation to the test value. First, the test value is difficult to apply in the complex circumstances, e.g. when a sole manufacturer sells a patented product only to one related importer. In this respect, the circumstances-of-sale approach may be used in a flexible manner. For example, the reasonableness of either importer's markup or the manufacturer's markup should validate the transaction value.[180] Second, there is no clear standard on the time element required in the test value. The Code only states that the transaction used for comparison must have occurred 'at or about the same time'. In this connection, it is not clear whether the two transactions must have been entered into or the two exportations or importations must have occurred 'at or about the same time'. This depends on the customs law of each individual country. For example, the US focuses on the date of exportation.[181]

2. The Transaction Value of Identical or Similar Goods (Method 2 or 3)

Where the transaction value cannot be accepted or defined under the first method (e.g. because the relationship between the parties influences the price actually paid or payable), the value is to be determined by taking the transaction value of identical goods (Article 2), and failing this, similar goods (Article 3).

These two Articles seek to base valuation on another transaction which previously qualified under the transaction value (Article 1). The rules which are applied in order to establish the customs value of both Articles are in all other

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[180] See *supra* note 106, p. 144.

[181] See 19USC s. 140a(b)(2)(B). It provides that '...the test values used for comparison must relate to merchandise that was exported to the United States at or about the same time as the imported merchandise'.

respects the same, except that Article 3 computes "the transaction value of similar goods to the goods being valued. In this regard, it is worth examining both Articles together.

Customs value can be determined under Articles 2 and 3 only if a transaction value of appropriately similar or identical goods can be discovered. To decide if the goods are identical or similar, one must consider from the definition provided in the Code, not from the tariff headings. For customs valuation purposes, 'identical goods' are defined as goods which are the same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance do not disqualify goods from falling within the intent of this definition.[182] 'Similar goods' means goods produced in the same country as the goods being valued and which, although not alike in all respects, have like characteristics and component materials which enable them to perform the same functions and which are commercially interchangeable. Quality, reputation and the existence of trademarks all have to be taken into account in determining whether the goods are similar. [183]

To satisfy Article 2 or 3, the imports to be compared must be similar in several important respects. They must be produced in and imported to the same country at or about the same time, the date of exportation must be at or about the

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[182] See WTO Customs Valuation Agreement, Article 15.2(a). A transaction value for goods produced by a different person will be taken into account only when no transaction value can be found for identical or similar goods produced by the same person as the goods being valued. See WTO Customs Valuation Agreement, Article 15.2(e).

[183] See WTO Customs Valuation Agreement, Article 15.2(b). As to similar goods produced by a different person, see WTO Customs Valuation Agreement, Article 15.2(e).

same, and the quantity of the goods and the commercial level at which the sale is made must be compared. If there is no sale at the same commercial level or in the same quantity as the goods being valued, the comparison value is to be adjusted for differences in quantities, commercial level or transportation costs and related charges involved in the two transactions.[184] The adjustments, whether leading to an increase or decrease in the value, must be based on evidence which clearly establishes the reasonableness and accuracy.[185] If more than one applicable transaction value is found under Article 2 or 3, the lowest such value shall be applied to determine the customs value for the imported goods. Where the adjustments cannot be made, valuation may not be based on Article 2 or 3.

One major problem in applying these two methods of the Code is in finding identical or similar goods. It is difficult in practice to find the identical goods which are similar in all respects and have been exported at or about the same time as the goods being valued. Even in the case of the similar goods, the degree of likeness required is still high. The requirement of 'commercially interchangeable' shows that the differences of the two things being compared, if they are to qualify as 'similar', are not important to buyers, sellers or users. Otherwise expressed, the imported goods and the comparable goods, even though

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[184]See WTO Customs Valuation Agreement, Article 2.2. However, goods are not considered as 'identical' or 'similar' if they include the costs of any design, engineering, development, sketches etc., which undertaken in the country of importation and are supplied by the buyer to the seller free of charge or at reduced cost. See WTO Customs Valuation Agreement, Article 15.2(c).

[185] See WTO Customs Valuation Agreement, Articles 2.1(b) and 3.1(b). An example of a suitable adjustment is where the goods being valued consist of a shipment of 10 units and a transaction value exists for similar or identical goods in a shipment of 500 units. If the seller of 500 units used a quantity discount, the required adjustment may be made by referring to the seller's price list and using the price that would apply to a sale of 10 units. See WTO Customs Valuation Agreement, Annex I, Interpretative Note 5 to Articles 2 and 3.

not identical, must be equivalent (i.e. equal in value), or very close to each other in all meaningful respects, both physical and commercial.[186]

Apart from a degree of identity or similarity, a trademark is one, among many others, factor which can prevent the two Articles from being 'similar'.[187] For example, the wallets of the same size are imported from two different manufacturers, both established in the same country. While each manufacturer uses a different trademark, the wallets made by both are the same standard, are of the same quality, have equivalent reputations. In this case, the wallets cannot be treated as being identical because they are not the same in all respects. However, as the goods in question are made to the same standard, are of the same quality, and have equivalent reputations and carry trademarks, they should be considered 'similar', although they bear different trademarks. However, if the goods being compared bear different trademarks which are not equal in value (e.g. the differences in reputation), they will not be qualified as similar goods.

The transaction value of identical or similar goods may be unfavourable to importers because it entirely relies on the discretion of customs authorities in each member country, for example, in determining which goods have the same

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[186] A Commentary of the Technical Committee of the Customs Valuation illustrates an example with regard to the concept of 'similarity and commercial interchangeability':
'The special grade of sodium peroxide is manufactured by a process using very pure raw material in dust form; it is thus much more expensive than the normal grade. The normal grade sodium peroxide cannot be used in place of the special grade because the normal grade is not pure enough to meet analytical specifications and neither is it clearly soluble nor in dust form. Since the goods are not the same in all respects they are not identical. With respect to similarity, the special grade would not be used for bleaching purposes, or for the large scale production of chemicals, as the price of the special grade is prohibitive for these applications. While both kinds of sodium peroxide certainly have like characteristics and like component materials, they are not commercially interchangeable since the normal grade could not be used for analytical purposes.'

characteristics, quality and reputation as the goods being valued. In this respect, it is difficult for importers to predict the price of the goods which will actually be applied to their imported goods.

In addition, since applications of the transaction value of identical or similar goods are based on the transaction value of another importer, the importer may know who else is importing identical or similar goods from the same country – or that no one else is. More importantly, he may know the price of the goods or other commercial information of his competitors.

3. The Deductive Value (Method 4)

This method is applied when the above transaction valuation does not lead to a determination acceptable to Customs.[188] However, at the importer's request, the computed value discussed below will be used in place of the deductive value. If the computed value was chosen and subsequently determined not to exist for customs valuation purposes, then the basis of appraisement reverts to the deductive value.[189]

The starting–point for the deductive value is the unit price for which the goods being valued (or comparable imported goods, i.e. identical or similar imported goods) *are sold in the country of importation*, to persons who are not

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See Technical Committee of Customs Valuation Commentary, in *supra* 116, p. 299.
[187] See *supra* note 116, pp. 201-202.
[188] See WTO Customs Valuation Agreement, Article 4.
[189] See WTO Customs Valuation Agreement, General Introductory Commentary, paragraph 3. See also *supra*.

related to the sellers of the goods.[190] The unit price must relate to sales in the greatest aggregate quantity at or about the same time of importation of the goods to be valued.[191]

Where there is no sale at or about the time of importation, the deductive value is the unit price at which the goods concerned are sold in the greatest aggregate quantity, but within 90 days after importation.[192] Where the goods being valued or identical or similar goods are neither sold in the condition as imported nor within 90 days after importation, the unit price at which the goods are sold, after further processing, may be taken as a basis, subject to conditions provided by the Code.[193]

If none of these deductive methods apply, which also means the transaction value was first ruled inapplicable, the next test to apply will be the computed value method.

Once the price per unit has been found, a number of items can be deducted from the unit price. They include commissions, additions for profit and general

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[190] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 5. One should not confuse on the unrelated party transaction required in the deductive method and the transaction value method under Article 1.1(d) and (2), as mentioned above. The deductive method focuses on the relationship between the two persons in the country of importation. This means that the first buyer must not be related to the seller. The transaction value method, on the other hand, considers on the transaction between the exporter and the importer.

[191] See WTO Customs Valuation Agreement, Article 5(a). The concept of the greatest aggregate quantity is introduced to deal with sale at varying prices. For example, if 1000 units are imported and 500 are sold at 40 currency units each, 300 are sold at 60 currency units each, and 200 at 100 currency units, then the greatest number of units sold at a particular price is 500. Therefore, the unit price in the greatest aggregate quantity is 40.

[192] See WTO Customs Valuation Agreement, Article 5(b).

[193] See WTO Customs Valuation Agreement, Article 5(c).

expenses (e.g. the direct and indirect costs of marketing)[194], inland transport and related costs, customs duties and any internal taxes payable in the country of importation, and where the third option of deductive value (i.e. sales after further processing of the goods) is applied, the costs of additional processing (see Method 4 flow chart in Appendix II:4).[195]

The deductive value method is attractive to importers who sell to many customers in small quantities but who have enough sales to big buyers (at a lesser price) to result in a lower valuation. The low deductive value may also be found in the case where the imported goods being valued have not been resold at or about the time of importation. In this respect, customs authorities will use the resale prices for comparable goods on the first commercial level after importation in calculating the deductive value. The figures of profit and general expenses based on other imports of goods of the same class and kind may yield a higher deduction than the importer's actual profit and general expenses. (The result is however different if the low markup for goods of the same class and kind is taken into account). The goal of certainty is thus difficult to achieve under the deductive value method.

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[194] For the purpose of this Article, Interpretation Notes 6 and 9 to Article 5 provide that 'profit and general expenses' should be taken as a whole. The figures for the purposes of this deduction should be determined on the basis of information supplied by the importer unless his figures are inconsistent with those obtaining in sales in the country of importation of the imported goods of the same class or kind. Where the importer's figures are inconsistent with such figures, the amount of profit and general expenses may be based upon relevant information other than that supplied by the importer.

[195] See WTO Customs Valuation Agreement, Article 5(a)(i)-(iv).

4. The Computed Value (Method 5)

The computed value is complicated and rarely used in practice (see Table 2.1) mainly because it is based on the costs of production of the goods. In reality, it is not possible for importers to provide the very detailed breakdown of their suppliers' costings that the method requires. Accordingly, this method can only be applied in cases where foreign suppliers and importers are related (since unrelated suppliers are unlikely to supply details of their overheads).[196] Due to the difficulty and the complication, developing countries may defer the application of this method for up to three years after they put the other provisions of the Code into effect.[197]

It is relatively essential to mention elements contained in the computed value. As the name suggests, this method relies on a computed value of the sum of:

(i) the cost or value of materials and fabrication or other processing incurred in producing the imported goods[198];

(ii) an amount for profit and general expenses (e.g. marketing expenses) equal to the amount usually reflected in sales of goods of the same class or kind as the goods being valued[199] which are

[196] The Interpretative Note 1 to Article 6 recognises that the computed value method is "limited to those cases where the buyer and seller are related, and [where] the producer is prepared to supply to the authorities of the country of importation the necessary costings..."
[197] See WTO Customs Valuation Agreement, Article 20(2).
[198] See WTO Customs Valuation Agreement, Article 6(a).
[199] It is important to emphasise that 'goods of the same class or kind' under the computed value method (Article 6) is limited only to goods imported from the same country as the goods being valued. However, under the deductive value method (Article 5), 'goods of the same class or kind' includes goods imported from other countries besides the country from which the goods being valued was imported.

made by producers in the country of exportation for export to the country of importation[200];

(iii) the cost of transport and associated costs up to the port of entry (if the country of importation does its valuation on a c.i.f. basis)[201];

(iv) the costs of containers and packing[202]; and

(v) ancillary goods and services insofar as supplied by the buyer free of charge or at a reduced cost[203].

Two major observations should be made in relation to the application of the computed value. First, since this method of valuation is based on costs of and not on proceeds to the manufacturer, royalties or licence fees paid by the importer (the buyer) to the producer are therefore not included.[204] However, if royalties or licence fees paid by the manufacturer to a third party or the buyer for furnishing production rights and production know-how, such royalties or licence fees are regarded as part of 'cost of fabrication'. Royalties or licence fees paid by the manufacturer for trademark rights will be included in the 'general expenses', if it

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[200] See WTO Customs Valuation Agreement, Article 6(b). Some further explanations provided in the Interpretative Note relating to this category should be mentioned. Firstly, the necessary data supplied by the producer must be based on the producer's commercial accounts. These accounts must be consistent with the generally accepted accounting principles of the country of production. Secondly, the amount for profit and general expenses has to be taken as a whole. (This is the same treatment as occurs in the deductive value method noted before.) Only the total has to be in accordance with what is 'usual'. Basically, the producer's profit could be low whereas his general expenses could be high (for example, new products), the total amount being consistent with what is usually reflected in sales of goods of the same class or kind. In such a situation, a producer's actual profit figures, even if low, will be used, provided that he has valid commercial reasons to justify them and his pricing policy reflects usual pricing policies in the industry concerned. This application reflects the 'positive' concept of valuation, as opposed to a 'notional' concept. See WTO Customs Valuation Agreement, Annex I, Interpretative Note 5 to Article 6. See also *supra* note 92, p. 43.

[201] See WTO Customs Valuation Agreement, Article 6(c).

[202] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 3 to Article 6.

[203] See *supra*. See also Method 5 flow chart in Appendix II:5.

[204] See *supra* note 116, p. 229.

is clear that the payment is related to the exported goods and not to like goods sold in the home market. (The costs of design and development incurred by the producer may also be treated as part of general expenses).

Second, as one might observe the concept 'profit and general expenses' found in the deductive value method has again been contained in the computed value method. Unlike the deductive value, the amount for profit and general expenses in the computed value is supplied by or on behalf of the producer. Basically, customs authorities should accept the producer's data if they are consistent with the generally accepted accounting principles in the country of production and are in line with that usually reflected in sales of goods of the same class or kind.

5. The Flexible Valuation Method (Method 6)

The final method for calculating customs value is derived from one of the five methods enumerated above. Perhaps an idea for having this method is to prevent the member countries free to apply any rules of customs valuation.[205] Having that freedom might create a temptation for a member country which wanted to revert to one of its old valuation methods outlawed by the Code.

Under the flexible valuation method, the customs value is computed using 'reasonable means', which are consistent with the underlying principles and general provisions of the Code. In order for Customs to consider an importer's argument regarding appraisement, the information upon which the argument is

based must be made available to Customs, whether it was generated by a foreign or domestic source.[206] However, certain methods have been explicitly ruled out [207], i.e. (i) the selling price in the country of importation of goods produced in such country[208]; (ii) a system which provides for the acceptance for customs purposes of the higher of two alternative values; (iii) the price of goods on the domestic market of the country of exportation[209]; (iv) the cost of production, other than computed values which have been determined for identical or similar goods; (v) prices for export to a country other than the country of importation; (vi) minimum customs values[210]; or (vii) arbitrary or fictitious values.[211]

The reference to the 'reasonable means' is significance. The Interpretative Note to Article 7 clarifies this vague wording by indicating that the customs value so determined "*should be based, to the greatest extent possible, on previously*

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[205] See *supra* note 116, p. 235.
[206] See WTO Customs Valuation Agreement, Article 7.1.
[207] See WTO Customs Valuation Agreement, Article 7.2.
[208] The notorious American Selling Price (ASP) was an example of this proscribed method. The ASP was unrealistic because it ignored differences in the cost of producing a similar item domestically and abroad. In other words, the value of the import was measured by the price of the domestic competitor (usually very high). The ASP was applied to a select group of imports, obviously for the purpose of protecting the industries that produced those import items domestically. The prime targets for the ASP were the European producers of benezoid chemicals and products. ASPs also applied to knit wool and gloves and glove linings, canned clams, and some types of plastic and rubber footwear. See *supra* note 106, p. 123.
[209] Canada, for example, used this proscribed method until the Code became effective in January 1985. See *supra* note 108. In addition to the prohibition under Article 7, it has been found that Canada's former system of valuation is also contrary to the spirit of the declaration in the Preamble to the Code that 'valuation procedures should not be used to combat dumping'. Dumping is basically defined as 'selling for export at less than is charged in the home market (plus injury to industry in the country of importation) and valuation based on the home market price is usually directed at increasing duties in situation where the price for export is lower'. See *supra* note 116, p. 239.
[210] The major objective of this prohibited provision is to prevent signatory governments the use of customs valuation as an instrument of protectionist policy or as a means of raising fiscal revenue. See *supra* note 116, p. 240.
[211] An example of an arbitrary value is the value assigned to an import item by a government agency or official and not subject to appeal, rather than by invoice or fair market value. See *supra* note 108.

determined customs values"[212] and that the methods used should be those in the hierarchical order determined in a reasonably flexible manner.[213] Apparently, valuation under Article 7 is to be derived on a case-by-case basis from methods specified elsewhere in the Code. In this respect, customs authorities could accept the values of identical (or similar) goods although they come from a different country, or although exported earlier or later than the goods being valued.[214]

Application of the flexible valuation method might be of particular importance in the case where an exporter refused to disclose figures on which to base a computed value. However, there is a broader problem in this area: If customs authorities alter the methods adapted under this final provision, the temptation to resort to it frequently might prove irresistible to some customs services. This potentially could result in deterioration of the Code's most basic concept – the reciprocal commitment among countries as to how they will value imports.

V. Evaluation of the Code: Observations and Final Remarks

1. As we have demonstrated above, the Code has received wide acceptance since its establishment. The rules are more specific than Article VII of the GATT-1947 and the BDV. They offer greater certainty for importers with respect to the value that will be assigned

[212] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 1 to Article 7.
[213] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 2 to Article 7.

to their goods and the duties that are to be paid. It seems that the goal of certainty does not create any problem where the transaction value is used, particularly in the routine cases in which invoice price equals transaction value, and thus duty value. Nevertheless, when there are some challenges to the transaction value, the problem then occurs. Importers are hardly to know in advance which alternative methods of valuation will actually be applied to their goods.

In addition, from developing countries' point of view, methods of customs valuation other than the transaction value are complicated and difficult to apply. In this respect, a total of duty for imported goods may be underpaid or overpaid to Customs by traders who fail to understand the complexity of various methods of customs valuation. Accordingly, traders should constantly review the rules and principles of customs valuation. On the other hand, Customs should also have sufficient training regarding customs valuation methodology so as to ensure the customs valuation system's effectiveness.

2. Although items, which are to be included and excluded in the invoice price, are listed in the Code and the Interpretative Notes, customs authorities have to carefully consider types and amounts of additional and excludable costs. With regard to additions, for example, importers may deliberately not declare and include additional costs in order to reduce the burden of customs duties unduly and therefore to make possible the fixing of lower sale prices. Alternatively, they may include the high costs of addition in the price. The result of making

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[214] See WTO Customs Valuation Agreement, Annex I, Interpretative Note 3 to Article 7.

artificially high additional costs may bring undue profits to importers; in particular, when the overvaluation permits them to show an artificially small margin of profit and thus to escape fiscal burdens that may bear more heavily than the higher customs duties.

3. Reversal of the order of application of methods 4 (the deductive value) and 5 (the computed value) may benefit some importers. This is true where the figures required by the two provisions of the Code are available from both the importer and the producer of the goods in question. In this regard, the importer may prefer the computed value to the deductive value because the latter would be based on a high price of the greatest aggregate quantity or a low markup for profit and general expenses. The low markup would be based on other imports of goods of the same class or kind (regardless of the country of origin). For example, imports from France dominate the market and have a low markup. Imports of the same class or kind of goods from the UK have a high markup, but their deductive value would be calculated by deducting the 'usual' markup on the French imports, thus resulting in a deductive value higher than the invoice price of the UK imports. An importer from the UK would very likely be better off under the computed value valuation.

4. It appears that the Code and the Interpretative Notes fail to cope with certain complex situations. This can be seen, for example, in case where the deductive value method is used to determine the customs value of goods imported by sole agents, or sole distributors. Since the price under this method is reduced by profit margin and other costs,

provided by the Code, it is difficult for customs authorities to examine reference data of profit and general selling expenses declared by the sole agents or distributors. Accordingly, such data will be deductible in calculating the deductive value. Taking into consideration the expertise and manpower required for such investigations of market references in developing countries, they are far from easy.

In the next chapter, Thailand's experience of customs valuation and the operation of the BDV system will be analysed. This will help us to answer a question of whether the Code is the only one which can meet the standards of fairness, uniformity, and neutrality.

CHAPTER 3

The Existing Customs Valuation Methods and Procedures in Thailand

From the beginning of the 20th century, the Thai government has developed and enforced a set of rules in order to determine the value of imported goods for customs purposes. One of the major concerns is that Thailand still applies its own national rules for determining customs valuation on importation, which depart from the Code. The customs valuation system of Thailand is largely based upon the 'notional concept' of market value under the BDV system.[215] Basically, the customs authorities have the rights to access value of market price of the goods at the port of entry if the declared value differs from the market price (i.e. the price at which, in assumed conditions, for example, of independence between buyer and seller, the goods to be valued would be sold). This system has been severely criticised by a number of traders because of its arbitrariness, complexity, and uncertainty.

Undoubtedly, the major reason for the implementation of the customs valuation rules in this way is to raise revenue to finance government spending without violating the tariff bindings under Article II of the GATT 1994 (e.g. the

[215] See Chapter 2.

increase of tariffs). It should be noted that the basic level of tariffs[216] in Thailand, ranging from 0 to 30 per cent,[217] is strictly based on the GATT tariff bindings.

From the year 2000, nevertheless, the system of customs valuation in Thailand will be changed dramatically. The current system of customs valuation in Thailand will be at last addressed on 31 December 1999. The new national system of customs valuation, following the Code, will be introduced on 1 January 2000. The major reason for such a radical change is because the start of the year 2000 signals the end of period in favour of developing countries under Article 20 of the Code, which allowed Thailand to delay application of the Code's provisions for five years.

Therefore, it would be interesting to observe whether or not the implementation of new customs valuation system in accordance with the Code could provide Thailand with a better system. In order to answer this question, it is worth analysing in this chapter the existing system of customs valuation in Thailand as well as stating any relevant problems of customs administration which can, in practice, be found between the Thai customs authorities and importers.

This chapter will accordingly be divided into four sections. In the first section, it is a general introduction to the legal system and the present role of

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[216] These exclude tariffs on certain products under the Common Effective Preferential Tariff (CEPT) Scheme for AFTA. The issue of the CEPT Scheme will be discussed in Chapter 5.
[217] These exclude duties on imported cars, ranging from 32 to 68.5 per cent. See BOI, *Costs of Doing Business in Thailand*, BOI, Bangkok, August 1998.

customs duties on importation in Thailand. In section 2, a comparison between the concept of **'market value'** under the Thai customs laws and that of the BDV will then be made. To some extent, our analysis also involves the implications of tax incentive schemes that aim to encourage international trade flows to Thailand. In section 3, the time has come to assemble the available empirical data in relation to administrative problems on customs valuation. Finally, section 4 provides the concluding remarks that will be the major data available to our discussions in the final chapter of this thesis.

I. Introduction

Basically, Thailand has a codified system of law as a result of reforms instituted by King Chulalongkorn (King Rama V), at the turn of the century. The supreme law of Thailand is the Constitution. Under the present Constitution, promulgated in 1998, the executive powers of the King are exercised by the Prime Minister and the Council of Ministers. This is supplemented by the major Codes [218] (i.e. the Civil and Commercial, Penal, Civil Procedure, Criminal Procedure, Revenue Code and Land Code), Acts of the Legislature, Royal Decrees, Emergency Decrees, Ministerial Regulations, Ministerial Notifications, other governmental notifications and local government regulations.[219]

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[218] It should be noted that the contents of such Codes were drawn from the laws of some developed countries having codified systems (e.g. France, Switzerland and Germany), from countries with common law systems (e.g. the United Kingdom) and from the traditional laws of Thailand.

[219] Thai laws are normally drafted in broad terms, especially laws regulating commercial activities. Broad powers are delegated to the relevant government ministry or organization, which is empowered to issue notifications or regulations.

Notably, Thailand's principal taxes under the Revenue Code[220] include income tax, VAT, specific business tax, and the stamp duty. Other taxes of specific revenue-collecting statues include excise taxes, customs duties, property and land taxes. In this respect, tax collections are administered by the Ministry of Finance through three departments:

(1) *the Customs Department*, which is responsible for the collection of import and export duties;

(2) *the Revenue Department*, which attends to the collection of income tax, value-added tax, specific business tax, and stamp duty; and

(3) *the Excise Department*, which is in charge of the collection of excise taxes imposed on certain commodities.

The local governments are also the recipients of the property taxes.

A. Development of Customs Law in Thailand

In general, the customs laws in Thailand are governed by statutes, departmental regulations as well as decisions of the court. The basic legislation which lays down customs procedures is **the Customs Act B.E. 2469 (1926)** as amended by subsequent Acts. Duties are collected on both imports and selected exports.[221] The classification of goods for customs purposes is based upon the internationally adopted Harmonised Commodity Description and Coding System

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[220] Taxation on income earned from petroleum operations is however not included in the Revenue Code.

[221] At present, export duties are imposed on rice, scrap iron, raw silk, rawhide, wood, and powdered fish.

(usually known as the Harmonised System or HS) of the Customs Co-operation Council.[222]

Historically, customs duties have been levied in the Kingdom of Siam[223] for more than 150 years. At the beginning of the 19th century, the Royal Thai government[224] was not responsible for duties imposed on the movement of goods into, and from its territory. Customs duties were, instead, administered and collected by private agents appointed by the government (named in Thai as '*Jao Pasee*').[225] The Royal Thai government was the recipient of the fixed lump sum every year. Private agents could only earn their profits from the rest. At that period, customs duties were not the largest source of government revenues in Thailand. As one might observe, the rates of import duties were substantively low, ranging from 0 to 3 per cent.

In 1890, the Royal Thai government set the goal of reforming its customs law system in order to form part of central government revenue. Accordingly, the old system of tax collection (i.e. Jao Pasee) was abolished. In this regard, foreign trade taxes (i.e. both import and export duties) have directly been administered

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[222]See the Customs Tariff Decree B.E. 2530 (1987) as amended. Customs duties in Thailand are levied on an *ad valorem* or a specific rate basis, whichever is greater. Generally, the value is based on c.i.f. for imports and f.o.b. for exports. The Customs Department has the right to assess the value at the market price of the goods at the port of entry or exit if the declared value differs from the market value.

[223]Notably, the name 'the Kingdom of Siam' was replaced by 'Thailand' after the end of World War II.

[224] Thailand's government is a constitutional monarchy that dates back to 1932 when King Rama VII abolished an absolute monarchy. Since then the country has had a series of Constitutions that have refined the concept of a constitutional government with the King as the Head of State.

[225] See Chuchart Asavaroj, *Customs Law* (Thai Version), Winyuchon Publishers, Bangkok, 1998, p. 29.

and collected by the newly governmental tax department, so-called the 'Customs Department'.

At the beginning of the 20th century, the state revenue needs became increasingly significant with the growth of welfare spending and military. The Royal Thai government then realised the importance of tax revenue, in particular customs tariffs and direct taxation on income. Accordingly, in 1909, the 'Draft on Trade and Customs Regulation for the Kingdom of Siam, which was largely based on the UK Customs Consolidation Act 1876, was proposed for the first time. However, it was not successfully implemented as the new customs law in the Kingdom of Siam mainly because the draft legislation provided a complex tariff structure with high rates on many categories of imports. As a result, the maximum *ad valorem* rate of 3 per cent under the old system was restricted and it had been applied until the first customs law of Thailand, i.e. **the Customs Act 1926 (B.E. 2469).** Remarkably, this Act is still in force.[226]

B. Revenue Importance of Import Duties

In 1930 - 1975, import duties had been used as the major source of revenue in Thailand. In other words, the purpose for collecting import duties in Thailand during that period was mainly revenue, not protection. Evidence in 1963, for example, showed that the main sources of revenue from customs duties

[226] It should also be noted that, since 1926 the Thai Customs Act has been amended in some specific areas by the Customs Law Amendment Acts as well as the Royal Decrees. For example, in 1978, the Thai Customs Act was amended by the Customs Tariff Decree, in order to conform to the Harmonised System.

were petroleum products (21 per cent), vehicles (15.5 per cent), and textiles and clothing (13 per cent) respectively.

The changes over time are significant, reflecting changes in economic structure and industrialisation strategy of Thailand. In 1968, rates began to be changed (mostly raised) on over 150 items. Moreover, in accordance with the Third National Economic and Social Development Plan (1971-76), attempts were made by the Royal Thai government to exempt exporting industries from tariffs and business taxes on imported inputs, while at the same time import tariffs on manufactured goods were also adjusted upwards to protect domestic industries.[227] Apparently, revenues from import duties on intermediate goods, especially chemicals and machinery have declined, whereas revenues from import duties on manufactured goods have substantively increased.[228]

These policies resulted in a complex tariff structure with high rates on many categories of imports. Nevertheless, since the late 1970s the tariff structure of import duties in Thailand has been reformed in accordance with the harmonised system of the CCC and the tariff bindings (Article II) of the GATT. As a result, it has been a shift from foreign trade taxes to direct income-based and consumption taxation under the structure of Thailand's tax revenue from the past two decades. Revenues from import duties have thus become less important. On

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[227] See Narongchai Akrasanee, 'Import Substitution, Export Expansion and Sources of Industrial Growth in Thailand 1960 – 72', in Prateep Sondysuvan, *Finance, Trade and Economic Development in Thailand*, Sompong Press, Bangkok, 1975, p. 203.
[228] See Mugul G. Asher and Anne Booth, *Indirect Taxation in ASEAN*, Institute of Southeast Asia Studies, Singapore University Press, Singapore, 1983, p. 90.

the other hand, revenues from direct taxes as well as sales and excise taxes have formed major parts of the Royal Thai government revenue.

As Table 3.1 shows, Thailand is no longer a country with a very high degree of reliance on customs duties (in particular export duties have almost been abolished).

Table 3.1 Government Revenue by Source: Fiscal Years 1990 - 1992 (Thousand Baht)[229]

Source	1990	1991	1992
Total Revenue	**411,652**	**426,608**	**511,455**
Taxation	385,742	427,214	456,572
Income Taxes	101,940	126,960	138,683
Personal	41,524	49,200	50,109
Corporation	58,658	74,934	85,586
Petroleum	1,758	2,826	2,988
Indirect Taxes	283,802	300,254	317,889
Import Duties	**93,218**	**82,809**	**89,769**
Export Duties	**69**	**9**	**13**
Business Taxes	90,157	101,789	12,037
Selective Sales Tax	72,210	89,413	106,135
Fiscal Monopolies	5,224	5,975	7,334
Royalties	2,934	3,478	3,736
Licences and Fees	5,454	5,818	6,000
Other Taxes	14,536	10,963	11,815
Sales and Charges	4,761	4,889	15,139
State Enterprises	12,031	18,626	25,455
Others	9,118	11,879	14,289

II. The BDV and the Thai Customs Valuation Systems

The Thai customs valuation system is a notional standard in that the dutiable value of a product is the price at which goods would be sold under specific conditions. In this regard, **Article 2 of the Thai Customs Act**[230] provides that:

> "True Market Value" or "Value" of any goods shall mean the wholesale cash price (exclusive of duty in the case of imports), for which goods of the like kind and quality would be sold without loss at the time and place of importation or exportation, as the case may be, without any deduction or abatement."

Although the notional concept inherent in Article 2 of the Thai Customs Act is based on the BDV[231], the Thai customs valuation system departs from the BDV as regards the adjustments, which are made by the Thai customs authorities, and these will be analysed in this section.

A. The Defects of the Thai Customs Valuation System

Apart from the obligation under the GATT/WTO, there are many persuasive reasons why Thailand needs to replace its existing system of customs valuation with the Code. At present, based on the BDV, the valuation system in

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[229]**Source**: The Customs Department and the Comptroller-General's Department, Ministry of Finance (1993).

[230] See Department of Customs, *Thai Customs Act* (English Version), Bangkok, Thailand, 1985.

[231] The BDV is currently used in a number of the WTO member countries, in particular developing countries. As was seen in Chapter 2, this system basically derives import price from a notional concept of value as the normal price of goods. Article I (1) of the Convention states that: 'For the purposes of levying ad valorem duties of customs the value of any goods imported for home use shall be taken into the normal price, that is to say, the price which they would fetch at the time the duty becomes payable on a sale in the open market between a buyer and a seller independent of each other.'

Thailand is arbitrary and complicated. These constitute a significant barrier to international trade flows. The problems can be summarised as follows:

(a) the author observes that the customs valuation system of Thailand provides a high level of protection for local industries. As will be discussed below, the basic requirement of the import value under Article 2 refers to the 'price would be sold without loss'. In this respect, the value of the imported goods for duty assessment is often greater than the invoice price. Undoubtedly, from the foreign traders' point of view, this has an indirect effect as an increased tariff. It gives the Thai customs authorities the ability to protect domestic products as needed by allowing inflation of the value for duty. Implicitly, it can be claimed that the Thai valuation system does not promote the kind of trade liberalisation that parties to the GATT had originally intended.

(b) The current valuation system of Thailand provides the meaning of 'market value' in a very narrow and unrealistic approach. A number of methods for determining customs valuation under the Thai Customs laws are practically based on the ground of the highest declared price found in similar products during a certain period (i.e. within one or three months). In practice, the Thai customs authorities are generally uplifts the actual value of the goods to be valued if such a declared price is considerably lower than the price of similar imported goods. These matters will be discussed again below.

(c) The absence of 'certainty' can also be found under the existing system for determining customs valuation in Thailand. Similar to other Thai

laws, the Thai Customs Act is drafted in broad terms. Thus. procedures and practice relating to the determination of the term 'market value' under Article 2 of the Thai Customs Act are generally gained from a consideration of the Customs Department in the form of the departmental instructions or notifications. The main concern is that the departmental instructions or notifications can be changed at anytime. Our observation is that the importer might not be better informed about changes in advance. It seems to be that the introduction of the WTO customs valuation system in the year 2000 would eliminate this problem. Accordingly, the new customs valuation laws will be clearly drafted and well defined, and the Customs Department will have to keep the rules simple and certain to all importers.

(d) In addition, there is the lack of transparency under the existing valuation system, caused by the so-called 'bureaucratic secrecy'. For example, importers will be informed the highest price, declared by the Customs Department, only at the time when the duty assessment of imported goods is made. Criticism can thus be made from the point of view of the importer that this system is very difficult to comply with. In fact, all importers should know the highest declared price in advance so that they can prepare their arguments (if their import prices are lower than the highest declared price of Customs).

B. Advantages of the Thai Customs Valuation System

Although the introduction of new legislation on customs valuation procedures in Thailand by the beginning of the year 2000, which is based on the Code, seems to be a significant reform, there are a number of major advantages of the present system that should be mentioned here.

The Customs Department of Thailand always argues that the current valuation system is still effective in providing the substantive amount of revenue collection[232]; preventing tax evasion[233] or anti-dumping (e.g. declaring the low price in order to pay the low tax); and encouraging fair competition among importers in the local market.[234] The implementation of the provisions of the Code would result in the loss of government revenues.[235] In this respect, the Customs Department of Thailand estimates that the amount of revenue loss after the year 2000 would be up to US$ 300 million approximately, or equal to 8.74 to 11.21 per cent of the total revenue collected in 1997. Clearly the effects of such revenue loss will be of significance to Thailand, especially in the situation of economic turmoil.

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[232]Customs Department of Thailand, *GATT Valuation and Thailand: An Official Report* (Thai Version), Bangkok, Thailand, 1998.

[233] Based on the personal interview with Mr. Santi Krongsitidaj, the Director of Customs Valuation Division, the Customs Department of Thailand (Bangkok, Thailand, December 1999). He argued that the adoption of the new system would lead to the increasing number of frauds and evasion.

[234] See Esara Santi, *Customs Valuation Procedures - Trade Distortions: The Report,* Development Research Institute Foundation, Bangkok, Thailand, 1997, p. 47.

[235]See Satit Limpongpan, *Thailand and International Customs Valuation Systems* (Thai Version), Customs Journal of Thailand, Customs Department Press, Bangkok, Thailand, 1991, pp. 9 - 12.

C. Methods for Determining the Value of Imported Goods: A Structural Analysis

Customs valuation in Thailand is an extremely wide and complex topic. Basically, the applicable customs law is not only Article 2 of the Thai Customs Act that sets forth the basic elements of a 'market price' valuation standard,[236] but also **Article 9 of the Customs Tariff Decree B.E. 2530 (1987)**[237] which permits the Director-General of the Customs Department (hereafter referred to as 'the Customs Director-General') to notify the so-called 'average market value' for certain categories of goods. In this respect, the customs authorities must rely on the average market value, irrespective of the actual price of the goods, in arriving at the customs value of the imported goods. At present, there are only two items (i.e. lumbers and logs) subject to the average market value.[238]

There are many factors to be taken into account in considering the market price of goods in accordance with Article 2. These include, for example, the country of production, component materials, quality or reputation of the goods.

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[236] Criticisms had been made by importers that the meaning of 'market price' under Article 2 was not clearly drafted, well defined, and easily understood. As a result, in accordance with some key words under Article 2, the Thai Customs Department then issued the 'Departmental Instruction on the Interpretation of 'Market Price' in 1975. See Departmental Instruction, No. 17/B.E. 2518 (1975)

[237] Article 9 stipulates that:

'For goods subject to ad valorem rate of duty, the Director-General of Customs may, from time to time, notify the 'average market value' for any category of goods. Such value shall be deemed the value for assessment of duty on the notified category of goods instead of the actual market value as from the date of notification until cancelled or modified by subsequent notification.

The notification, the cancellation or the modification of notification as referred in the first paragraph, shall be published in the Government Gazette.'

[238] See Paradon Pongsuwan, *The GATT Customs Valuation and the Thai Customs Department*, Chulalongkon University, Bangkok, Thailand, 1997, p. 30. Application of Article 9 of the Customs Tariff Decree has largely been criticised by a number of importers. This is because the law requires that all the Customs Director-General's notifications have to be published in the

Thus, similar kinds of imported goods that have differences in sizes, brand names or trademarks might reflect differences in prices. In practice, unless importers can prove that their invoice prices meet Article 2's requirements, the Customs Department of Thailand thus continues to employ its own valuation methods for determining the value of imported goods, which are:

(a) Minimum values

Minimum values are established to protect certain local industries and to value products whose normal value is difficult to determine. At present, there are a small number of products subject to minimum values. These include, for example, wood, rubber and plastic products, and chemicals.

(b) Price list

According to the general commercial practice of international trade, some foreign sellers may provide a 'price list' of the goods to their importers, and promise to charge the goods in accordance with the list within one period (e.g. 3 or 6 months) or until the new price list is given. [239] In this respect, the prices of the goods, approved by the Thai Customs Department, are regarded as actual import values for customs valuation purposes. Products usually subject to the price list are, e.g., cars, and motor vehicle parts.

Government Gazette. It is therefore not convenient for importers to update or check the average market value in the Government Gazette.

[239] In practice, the importer has to update his price list to the Customs Department each December, or as soon as the price of the goods is changed.

(c) The highest price of goods

Where none of the preceding methods is found to be applicable, then the customs value is based on the highest price. Under this approach, as noted above, Customs uses the highest price of similar goods imported into Thailand within the same day as the goods to be valued to establish the customs value. Where there is no similar good imported within the same day, the value may be based on the highest price of similar imported goods within a thirty-day (or ninety-day) period.

It should be noted that, this method is used in the vast majority of cases. It is established mainly for protective purposes. However, it appears that the protective feature inherent in this method creates problems for importers. In practice, the Thai customs authorities may disregard actual invoiced values in favour of the highest price of similar goods. It is very difficult for importers to predict the customs value of their imports. For example, the highest price of similar goods that are equivalent in standards or reputation as the goods to be valued may be accepted although they are different in brand names[240]or are produced by a different person.[241] For goods imported from a country other than the country of origin, the customs authorities may use the highest price of similar goods which are

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[240] See *Ramafour Import Limited* v. *the Customs Department,* the Supreme Court, Case No. 4268/B.E.2530, where the value of photographic papers imported from Japan under the trade name of 'sakura' was applied to the case of appellant, who imported the same goods from the same country under the trade name of 'sinsug'.

[241] See *Wiwonsirikul* v. *the Customs Department,* the Supreme Court, Case No. 1722/B.E.2532, where the invoice price of the 'monosodium glutamate' imported from the 'Cho' company in Singapore was used to determine the value of the similar imported goods which the appellant bought from a company, named 'Makin', in Singapore.

imported from either the country of origin or the country of shipment, whichever is greater.[242]

Lastly, the Thai customs valuation system can be summarised as follows:

Table 3.2 : The Thai Customs Valuation System

1. Major Objectives - to safeguard revenues; - to raise revenues. **2. Concept of the value of goods** The definition of 'market value' in Article 2 of the Customs Act can be gathered up into one concept by the notional use of **'would'**. The price at which goods 'would' be sold permits the customs authorities to adjust the declared value of the goods in order to conform to the concept. Therefore, upward adjustments, or 'uplifts', are commonly found. **3. Methods of valuation** The valuation methods used by the Thai Customs Department are as follows: (a) The 'average market value' declared by the Customs Director-General; (b) The minimum values; (c) The price list; or (d) The highest declared price.

D. The Definitions of the 'Market Value' under Article 2 and the BDV: A Comparison

As was mentioned, Article 2 of the Thai Customs Act basically provides that the market value means the wholesale cash price (exclusive of duty in the case of imports), for which goods of the like kind and quality would be sold without loss at the time and place of importation or exportation, as the case may be, without any deduction or abatement.[243] In this regard, there are many important conditions on the term 'market price' stated under Article 2, which merit consideration. Thus, the purpose of this part is to identify the similarities and differences between the BDV and the Thai valuation systems.

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[242] This is contrary to Articles 2.3 and 3.3 of the Code. They provide that if several transaction values of identical (or similar) goods are available, the lowest will be used to establish the value of the imported goods. See full details in Chapter 2.

1. Price

According to the BDV, the market price must be the price of goods that would fetch on the open market at the time of the valuation. In practice, when imported goods are the subject of a bona fide sale, the price paid or payable on that sale can generally be considered as a valid indication of the market price. In Thailand, on the other hand, Article 2 of the Thai Customs Act defines 'the market price' as the 'whole sale cash price' for which goods of the like kind and quality would be sold without loss. The Thai Customs Act, however, is silent on the definition of the term 'wholesale cash price', nor does the Departmental Instruction issued in 1975.[244]

In the general commercial level, it may be assumed that the wholesale cash price could refer to the total amount of 'cost price'[245] plus profits for the sale (in cash only) of bulk goods, which are mostly inputs to production (rather than finished commodities). In practice, it should be noted that, in determining the customs value of the imported goods the Thai customs authorities do not pay close attention to the words 'wholesale' or 'cash' stated in Article 2. Therefore, payment for a small number of imported goods purchased between a retailer in a foreign country and a buyer in Thailand could be regarded as the wholesale cash price, depending on the fact whether the price concerned can be acceptable to the Thai customs authorities. In addition, payment in advance or deferred payment of

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[243] *Cf.* Article 1 (1) of the Convention, *supra* note 231.
[244] See Departmental Instruction, *supra* note 236.
[245] Notably, the term 'cost price' in this respect includes fixed or overhead costs, and variable costs. Fixed costs must be incurred if any output is produced (e.g. management payments, rents, etc). Variable costs, on the other hand, depend on the level of output. Generally these include, for example, the cost of labour, fuel, and materials.

imported goods can also be acceptable[246] even though it is, in fact, not the 'cash' price. It should be noted that the term 'wholesale cash price' must exclude import duties in order to avoid the problem of double taxation.[247]

Another important point is that there is also no clear definition of the phase 'the like kind and quality' in the Thai Customs Act. At a glance, the word 'like' is not very different from the word 'similar', so that it should be regarded as 'similarity', rather than the same identity, between two or more imported goods (i.e. these goods must be equivalent even though not identical). However, this perception is inaccurate. The 1975 Departmental Instruction interprets in a very narrow sense that the 'like kind and quality' means the 'identical goods' (i.e. the same identity between the two or more things). In this respect, the term 'like' for the purpose of Article 2 is equivalent to the term 'identical goods' stated under Article 15.2 (a) of the Code, which provides that goods must be the same in all respects, including physical characteristics, quality and reputation[248] (although minor differences in appearance, such as colour, may be ignored).

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[246] See Manit Vitayatem, *Customs Laws in Thailand*, Chulalongkorn University, Bangkok, 1993, pp. 215-216.

[247] This implies that the value of imported goods must be the c.i.f. value (i.e. cost, insurance and freight). This is because the c.i.f. value, as noted in Chapter 1, is the value of goods when they reach the port of entry to their country of destination: it includes their purchase price in the country of origin, and freight and insurance costs of shipping them to a foreign port. Importantly, it does not include import duties or costs of transport within Thailand.

[248] For discussion of identical goods, see Chapter 2. See also *F.E. Sillic Co. Ltd. v the Customs Department of Thailand*, the Supreme Court, Case No. 4798/B.E. 2533. In this case, the Supreme Court rejected the claim of the Customs Department that imported motor vehicle parts under the brand name of 'BOSCH' should have the same market value as imported motor vehicle parts under the brand names of 'BMW' and 'MERCEDESBENZ'. Taking into account the Thai commercial practice that the BOSCH vehicle parts have a lower reputation as compared with 'BMW' and 'MERCEDESBENZ', the Supreme Court held that they were not equal in value and the Customs Department was wrong to adjust the values of the goods to the same level.

It can be observed further that the 1975 Departmental Instruction does not apply the principle of 'similar goods' as an alternative method for determining the market value of imported goods.[249] Accordingly, the market values of two or more similar imported goods, which have like characteristics and component materials, perform the same functions, and be commercially interchangeable, are not comparable.[250]

In practice, it is not easy for the Thai customs authorities to find '*identical*' goods which are similar in all respects and imported at or about the same time as the goods being valued. Instances of '*identical*' imported goods, especially physical as well as commercial characteristics (e.g. the same trademark, or the same packaging) are likely to be rare. In the absence of a comparable 'identical' imported good, the determination of market value therefore varies. Mostly it depends upon so-called 'case-by-case' decision made by the Thai Customs authorities, which is, from the importer's point of view, arbitrary.

The market price under Article 2 must also be the price at which the goods would be sold without loss. Interestingly, the words in this Article clearly state as

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[249] This is obviously contrary to the WTO customs valuation system. See Article 15.2 (b) of the Code, *supra* note 183.

[250] See *the Customs Department* v. *Sri Esara Limited Partnership,* the Supreme Court, Case No. 184/B.E. 2531. In this case, Sri Esara Limited Partnership, the plaintiff, argued that the market value of imported product (i.e. Saccharin) could be determined in comparison with another like imported product (i.e. Sodium Soluble Saccharin), which was equivalent in characteristics. More specifically, both products were exported from the same exporter located in Singapore. The Customs Department of Thailand, the defendant, claimed that these two imported products were not 'identical' because of differences in names and 'mesh sizes'. Accordingly, the Supreme Court held in favour of the Thai Customs Department that similar characteristics between two imported

'would be sold', rather than 'is sold'. As mentioned earlier, the term 'would be' under Article 2 is obviously similar to the BDV's notional concept. As being applied the word 'is', the Code calls for the ascertainment of that market value as a question of fact, and no other values are relevant to it. Under the Thai Customs law, on the other hand, the market value can be established for any goods even though they may not be the subject of a sale or of a sale on the terms specified.

For example, if a particular consignment of goods which has to be valued is the subject of a sale on the terms specified, the price at which it 'would' be sold will usually be the price at which it has in fact been sold. If it is not the subject of a sale, or of such a sale, there will usually be sufficient factual information for establishing the price at which, on the terms specified, it could be expected to be sold, or, having regard to such factors as the past history of the goods and their probably future, the price at which, on the terms specified, it would be likely to be sold.[251]

An important point in this respect is concerned with the term 'without loss' in connection with the term 'would be sold' under Article 2. Remarkably, the phase 'without loss' does not exist in any provisions of the BDV as well as the Code. However, the Departmental Instruction (1975) briefly states that 'foreign wholesale prices which are less than those for similar merchandise should not be acceptable as the market value under Article 2 although the prices of the imported

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goods were not sufficient to prove that these goods were 'of the like kind and quality' under Article 2. The market values of these two imported products thus were not comparable.

goods concerned are established in the ordinary course of trade under fully competitive conditions'.[252] It is apparent that this requirement does not conform to commercial realities. The use of 'without loss' thus limits the scope of 'market value' under Article 2.

The determination of 'would be sold without loss' has long been a controversial issue in the field of customs valuation because it involves the degree of discretion. Recently, the Thai Supreme Court has made decisions on a number of cases in favour of the Customs Department. In *Siam Konlakarn Co. Ltd.* v. *the Customs Department*[253], for example, the Supreme Court held that the very low price of the imported goods, which was presumed to be under the level of goods' ordinary costs, could not be regarded as the market value under Article 2. Apparently, the Court made the decision disregarding the fact that the goods were the subject of a *bona fide* sale. The defendant, the Siam Kornlakarn Company, argued that the low price was offered by the seller in order to promote the sale of the goods in question in Thailand. Again, in *Mitsui & Go Co. Ltd.* v. *the Customs Department*[254], the decision of the Supreme Court still remained the same.

To sum up, the major weakness in applying the term 'would be sold without loss' is the administrative difficulty for the Thai Customs Department. In

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[251] See Customs Co-operation Council, *Explanatory Notes: Valuation of Goods for Customs Purposes under the Brussels Definition (Convention of December 15th, 1950)*, Brussels, Belgium, 1960, p. 45.
[252] See Departmental Instruction, *supra* note 236.
[253] The Supreme Court of Thailand, Case No. 1860/B.E. 2535.
[254] The Supreme Court of Thailand, Case No. 52/B.E.2539.

determining whether the value is sold without loss, the Thai customs authorities have to value the goods on the assumption that all costs, charges and expenses incidental to the sale and delivery to Thailand are included. The most arguable issue seems to be the question of how to determine profits of the imported goods. It is, in practice, very difficult to do so and the determination often leads to a dispute between the Thai Customs Department and the importer.

2. Time and Place

According to the BDV, the goods are to be valued when they enter the country of importation. However, as some time usually passes between the conclusion of the contract and the introduction into the importing country a degree of tolerance is accorded in respect of this time element.[255] This tolerance was formalised in the Council Recommendation of 16 June 1981 which provides that when goods are valued on the basis of the price actually paid or payable, that price should not be adjusted to take account of price fluctuations occurring between the date of the contract of sale and the time of valuation, provided that the contract is executed within a period consistent with normal practice in the trade concerned.[256]

In addition to the element of time, the BDV also concerns with the place element. It provides that the place of importation must be the place for delivery of the goods to the buyer at 'the port or place of introduction into country of importation'. In this connection, Article I (2) of the Convention makes it clear that

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[255] See Interpretative Note 5 to Article I of the Convention
[256] See *supra* note 104, pp.5-6.

in valuing any goods they are to be treated as being so delivered (Article I (2)(a)), the costs, charges and expenses incidental to such delivery being included in the value (Article I (2)(b)), but duties and taxes applicable in the country of importation being excluded (Article I (2)(c)).

Article 41 of the Thai Customs Act also provides in the same way, i.e. the market value must be determined when the goods are physically imported into Thailand.[257] As discussed earlier, in determining the market price, all costs, charges, and expenses incidental to the sale and to the delivery of the goods at the port or place of importation must be included. As stated in the **Departmental Instruction B.E. 2530 (1987),**[258] costs and charges that must be added to the market price are: (1) commissions and brokerage; (2) handing charges; (3) interests[259]; (4) licence fees; (5) royalties; and (6) freight charges. This instruction corresponds to the c.i.f. value.

However, neither Article 2 nor the Departmental Instruction defines the term 'place of importation'. In this respect, an interesting question is whether it means 'when the goods are physically imported to the *customs* territory of Thailand'. The author observes that the customs territory in this respect is

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[257] Article 41of the Customs Act provides:
"If it is still be necessary for any purpose relating to the Customs to determine the precise time at which the importation of any goods shall be deemed to have brought to effect, such time shall be deemed to be the time at which the ship importing such goods actually came within the limits of the port of discharge or consignment."
[258] Part VI, Section I, No. 18/B.E. 2530.
[259] The Customs Department of Thailand has issued the guidelines in relation to the interest charges for deferred payments: 'charges for interest under a financing arrangement relating to the purchase of imported goods are treated as part of the customs value if payments are made within 90 days'. This means the 'market value' under Article 2 may sometimes include 'interests' for the

narrower than the 'Thai' territory. For example, the goods that are directly delivered from abroad to a customs bonded warehouse, an export processing zone, a foreign trade zone and a free-port in Thailand[260] are not treated as imports although they are actually delivered to the territory of Thailand.

3. Discounts and Price Reductions

Another condition for determining the 'market value' under Article 2 of the Thai Customs Act is that the price of imported goods must be the price charged without any deduction or abatement. According to the 1975 Departmental Instruction, the term 'without any deduction or abatement' refers to the prohibition of discounts or price reductions that are available only to the buyer of the imported goods under the special relationship or arrangement between the buyer and the foreign seller. This means that any discounts or other reductions in price that are generally available to all buyers in the trade concerned are acceptable.[261] This practice is notably in line with the BDV principle: where discounts and other price reductions that are freely available to any buyers in the open market do not ordinarily call for any adjustment (Interpretative Note 5 to Article I of the Convention).

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customs purposes. See the Report of the Special Committee on Determination 'Market Value', the Customs Department, issued in 1978 (No. 10/B.E. 2521).

[260]See *supra* note 225, pp. 73-75. Like most developing countries, Thailand provides a wide range of tax incentives to promoted investment, both domestic and foreign. Tax incentives include 3-8 years tax holiday, exemption/deduction from import duty on machinery and reduction from import duties on raw or essential materials. See the Investment Promotion Act B.E. 2520 (1977), as amended by the Investment Promotion Act B.E. 2538 (1995). For details, see section E below.

[261] However, it is important to mention that the price of imported goods which is relatively low because of discounts or price reductions offered by sellers in foreign countries could be subject to re-adjustment by the Thai customs authorities.

Again the Thai Court has made a number of decisions in favour of the 1975 Departmental Instruction. For example, in *Siam Konlakarn & Nissan Thailand Co.Ltd..*v. *the Customs Department*,[262] the Supreme Court held that the market value under Article 2 could not be reduced by privileged or abnormal discounts. A reduction available to the Siam Konlakarn & Nissan Thailand Company in this case was not made from the ordinary competitive price. Rather, the reduction was given from the seller, the Nissan Japan Company, in favour of the sole concessionaire (i.e. the importer) in Thailand. Thus, the discount given to the importer had to be added back for customs purposes.

4. Royalties and Licence Fees

Under Article III of the Convention, the value of goods manufactured in accordance with any patented invention or imported under a foreign trademark is established under the assumption that the value of the right to use the patent, design, or trademark in respect of goods should be included.

In Thailand, prior to 1980 a question of whether royalties and licence fees should be included in the value of imported goods was controversial. The Thai customs authorities claimed that, in accordance with the departmental notification, No. 2/B.E. 2514 (1971) on the matter of contents of the customs invoice, all importers were obliged to declare any important details of imported goods, e.g. quantity, weight, price, and other relevant details. The term 'other relevant details' implied that royalties and licence fees whether they were paid

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[262] The Supreme Court of Thailand, Case No. 771-772/B.E. 2532. See also a number of similar decisions such as Case No. 902/B.E.2535; No. 1587/B.E. 2534.

directly or indirectly to foreign sellers were included in the customs value. The importers, however, disagreed with the interpretation of Customs. They argued that this notification was not clearly drafted. Thus, in order to solve all problems caused by such a notification, the Customs Department then issued its new departmental notification, No. 24/B.E. 2529 (1986), specifying that the payment of a royalty or licence fee must be added to the price in determining customs value. Notably, this notification has been used as the applicable law in Thailand up to now.

Before considering the next section, it is worth summarising the differences between the Thai customs valuation system, based on the BDV, and the WTO customs valuation system, as discussed in Chapter 2 (see Table 3.3).

Table: 3.3 Differences between the Thai Customs Valuation/the BDV and the Code Systems: A Summary

The Thai Customs Valuation/ The BDV	The Code
1. Notional concept (a normal price)	1. Positive concept (an invoice price)
2. The normal price is to be based on c.i.f. price of imported goods.	2. The price can be either c.i.f. or f.o.b.
3. The value of warranty, advertising, etc. is part of dutiable value.	3. The value of warranty, advertising, etc. undertaken by the importers in the importing country is not included in the customs value.
4. Discounts and other price reductions are tested by a comparison with whatever is customary in the line of business concerned, e.g. reduction on account of the level at which the transaction is made, or the quantity purchased.	4. Discounts or other price reductions are acceptable as long as these have not been influenced by a relation between the buyer and seller
5. Goods subject to a patent or protected design or to a foreign trademark are to be valued on the assumption that the importer has the right to use it.	5. A royalty or licence fee is added to the invoice price of goods in determining the duty value only when this payment is related to the goods being valued, and constitutes a condition of sale of the goods in question.

6. The price influenced by a commercial, financial or any other special relationship between the buyer and seller is not accepted for determining the customs value.	6. The price influenced by a commercial, financial or any other special relationship between the buyer and seller is accepted, subject to conditions provided by the law

E. Exemption or Reduction of Import Duties under Incentive Schemes

In general, all goods imported into Thailand are subject to customs duties. However, they can sometimes be eliminated or reduced by various incentive schemes offered under specific governmental legislation, i.e. the Investment Promotion Act, the Industrial Estate Authority of Thailand Act, and the Customs Department's Import and Export Promotion Measures.

Why does Thailand provide fiscal incentives? In the mid-1950s, the Royal Thai government began to realise that international trade and investment flows could promote economic growth and development at the domestic level. To some extent, since the late 1970s, the role of foreign direct investment (FDI), production of industrial goods, and manufacturing technology have become of great importance to Thailand. From the Thai government's point of view, becoming more competitive in the global market under the 'export-led growth' policy could be expected to expand local industrialisation. In other words, Thailand aims to transform itself from an agricultural-based economy to a country whose GDP and exports contain a large share of industrial production, i.e. the newly industrial country (NIC). Therefore, the development of Thai industrialisation has been boosted by the so-called 'outward-oriented development

strategies', focusing specifically on the promotion of exports as well as foreign direct investment.

In this respect, various incentives, e.g. exemptions of corporate income tax, customs duties and VAT, have been introduced under the **Investment Promotion Act B.E. 2520 (1977), as amended.** The Board of Investment (BOI) was also established in the same year (i.e. 1977). The BOI is the government agency responsible for providing incentives to stimulate investment in Thailand (see Table 3.4). Thus, the main tasks of the BOI are not only to promote foreign investment and manufacturing technology transfer, but also to strengthen local resource development. Basically, the BOI has encouraged industrial projects to locate in the provinces and away from Bangkok – the capital of Thailand, by providing special incentives for promoted enterprises located in 'Investment Promotion Zones'.[263]

In addition to the Investment Promotion Act, taxation and customs duty incentives may also be offered under the **Industrial Estate Authority of Thailand Act B.E. 2522 (1979).** Such incentives are in particular given to industries located in General Industrial Estates[264] or Export Processing Zones

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[263]The BOI has divided investment location into 3 zones for the purpose of granting tax privileges. Zone 1 comprises Bangkok and five neighbouring provinces (i.e. Samut Prakan, Samut Sakhon, Nakon Pratom, Nontha Buri and Pathum Thani). Zone 2 includes many provinces within a two-hour drive of Bangkok such as Ratburi and Chonburi. Zone 3 (Investment Promotion Zones) comprises the remaining 57 provinces including Laem Chabang Industrial Estate. See Office of the Board of Investment, *A Business Guide to Thailand,* Office of the Prime Minister - Royal Thai Government, September 1997.

[264]General Industrial Estates are areas designated for industrial activities or other activities beneficial to or connected with industrial activities.

(EPZs)[265]. These industries are supervised by the Industrial Estate Authority of Thailand (IEAT).

The IEAT is fundamentally a state enterprise attached to the Ministry of Industry. It is aimed to be an operational agency to pursue industrial development plans and to decentralise industrial development into regional areas. Although location in an industrial estate often appears as a requirement by the BOI, the IEAT has its own privilege and incentive schemes which industries operating in an industrial estate can enjoy without having to apply for BOI promotion. Incentives provided by the IEAT are similar to those offered by the BOI, including the right for a foreigner to own land in an industrial estate; permission to bring in skilled workers, experts and family into Thailand; and reassurance of bringing in and remittance of foreign currency (see Table 3.5). For industries operating in EPZs, additional incentives such as exemption from import duty, export duty and value-added tax on machinery, equipment and supplies which are used or essential for production are provided (Table 3.6). Up to present, 29 industrial estates have been established, as solely or jointly managed by the IEAT.

Apart from the BOI and IEAT, there are also additional incentives that are provided by the Customs Department of Thailand, namely the **Customs Department's Import and Export Promotion Measures** (Table 3.7). For example, the Customs Department can refund import duties on materials imported for the production of goods that are then exported. These measures obviously

[265]Export Processing Zones are areas designated for industrial or other related activities for export.

improve efficiency on export promotion in response to the government's policy on the enhancement of export productivity in Thailand.

Table 3.4: Tax Incentives under the Investment Promotion Act: A Summary

Income Taxation	Import Duties
In general, tax incentives are granted only if an incentive project is located in an industrial estate or exports at least 80 per cent of its product. - Zone I - 3 years for 100% tax holidays; - Zone II - 7 years for 100% tax holidays; - Zone III - 8 years for 100 % tax holidays plus reduction of 50 % for another 5 years.	The basic rules for granting import duty exemptions on the import of machinery and raw materials by 'promoted companies' are outlined below. In addition, certain machinery and raw materials for use in manufacturing and export by a person with investment promotional privileges may be imported free of VAT, provided that various regulations are complied with. - Zone I - 50 per cent import duty reduction on machinery (provided that at least 80 per cent of total sales is to be exported or factories must be located in an industrial estate or promoted industrial zone), and the exemption of import duty on raw or essential materials used in export products for a period of one year (provided that at least 30 per cent of total sales is to be exported); - Zone II - 50 per cent import duty reduction on machinery and the exemption of import duty on raw or essential materials for a period of one year (provided that at least 30 per cent of total sales is to be exported); - Zone III - 50 per cent import duty reduction on machinery and the exemption of import duty for raw or essential materials for a period of five years (provided that at least 30 per cent of total sales is to be exported).

Table 3.5: Tax Incentives under the Industrial Estate Authority of Thailand Act

1. **General Industrial Estates/General Industrial Zones (GIZs)**	Currently, there are General Industrial Estates in the Bangkok vicinity, northern Thailand, and southeast of Bangkok. As mentioned earlier, location in an Industrial Estate often appears as a requirement for promotion by the BOI. The BOI promoted industries located in Industrial Estates (whether privately owned or not) are eligible for preferential treatment which includes: - Foreign investors are able to own the freehold interest in land within the IEAT approved estates without any restriction; - Investors in approved industrial estates may employ additional numbers of foreign nationals in

	Thailand, who are skilled workers or experts, over the quota normally allowed under the immigration and labour laws; - There are no restrictions on the remittance of foreign currency from Thailand for investors whose domicile is overseas. Notably, industrialists locating in government-sponsored estates also receive a set of incentives irrespective of whether or not they are eligible for BOI promotion.
2. Export Processing Zones (EPZs)	Some of the Industrial Estates also include Export Processing Zones. The IEAT can grant certain tax privileges to non-BOI promoted foreign or Thai investors, which establish commercial operations in an approved EPZ. The privileges include an exemption of import and export duties as well as value-added tax on machinery, equipment, tools and supplies which are essential for production and goods imported for use in production, similar to those provided to promoted enterprises by the BOI.

Table 3.6: Joint Incentives from IEAT and BOI

BOI Zone 1	**BOI Zone II**	**BOI Zone III**
(A) Corporate Income Tax		
General Industrial Zone (GIZ) / Export Processing Zone (EPZ)		
100 % Exemption for 3 years	100 % Exemption for 7 years	100 % Exemption for 8 years plus reduction of 50 % for another 5 years
(B) Duties on Capital Goods (Machinery, parts, accessories etc.)		
General Industrial Zone (GIZ)		
Pay 50 %	Pay 50 %	Free
Export Processing Zone (EPZ) - Incentives by IEAT		
Free	Free	Free
(C) Duties on Imported Raw Materials		
General Industrial Zone (GIZ)		
Exemption for 1 year if export at least 30 %	Exemption for 1 year if export at least 30 %	Exemption for 5 years if export at least 30 % and pay 25 % for 5 years for domestic sales
Export Processing Zone (EPZ) - Incentives by IEAT		
Free	Free	Free
(D) VAT, Excise Tax, Surcharge (BOI), Import and Export Duty (IEAT)		
General Industrial Zone (GIZ)		
Normal Rates	Normal Rates	Normal Rates
Export Processing Zone (EPZ) – Incentives by IEAT		
Free	Free	Free
(E) Transportation, Electricity and Water Supply		
Double Deduction from the cost from Taxable Income		
General Industrial Zone (GIZ)/ Export Processing Zone (EPZ)		
Not Applicable	Not Applicable	For 10 Years
(F) Infrastructure Facilities		
Deduction from the cost from Taxable Income		
General Industrial Zone (GIZ)/ Export Processing Zone (EPZ)		
Not Applicable	Not Applicable	25%

Table 3.7: Tax Incentives from the Customs Department of Thailand

1. Customs Free Zone (CFZ)	**Details:** Free trade zone is an export promotion measure under the bonded warehouse scheme by being the hub of bonded manufacturing warehouses and other types of bonded warehouses with the exception of bonded warehouses of the duty-free shop type, thereby assisting in export promotion and international trade besides supporting the development of specific areas for undertaking production activities and other activities associated with cyclic production without bearing a tax and duty burden to minimise production costs and to be internationally competitive. This measure is aimed at supporting the following five main industrial types as stipulated by the Ministry of Industry: - electronic industry; - automobile manufacturing and assembly industry; - jewelry, ornaments and valuable inventions industry; - high-quality, expertise-oriented industry; - agricultural food and non-food produce transformation industry. **Benefits:** 1. Entrepreneurs can carry out multi-facet undertakings, both using raw materials from overseas and domestic sources to be produced, mixed or assembled as other goods for re-export and engaging in other activities, for example custody of imports from overseas, packing or re-packing, cargo transshipment, fairs and exhibitions, maintenance and engineering work, research and development or other similar work or activities approved by the Customs Director-General; 2. Entrepreneurs are exempted from the submission of bank guarantees; 3. Entrepreneurs will be provided with one-step service to reduce costs and save time; 4. The goods kept in bonded warehouses can be stored therein for 2 years, and will be exempt from the payment of import and export duties upon their exportation out of Thailand.
2. Inward Processing Relief: Duty Drawback Procedure under Article 19bis	The Customs Department has stipulated some measures to expedite drawback and provided various benefits to reduce the problems and burdens of entrepreneurs as well as to promote export trade. Article 19bis of the Customs Act (No. 9) B.E. 2482 provides: 'If any goods have been exported to a foreign port or as stores for use on board a ship proceeding to a foreign port, and proved to the satisfaction of the Director-General or the person designated by him to be produced from, mixed, assembled or packed with imported goods, the import duty already paid on such imported goods shall be repaid as drawback to the importer, subject to the following rules and conditions: (a) the drawback on such imported goods are not prohibited by a Ministerial Regulation; (b) the quantity of imported goods used in producing, mixing, assembling or packing exported goods shall be in accordance with the rules approved or specified by the Director-General; (c) the goods are exported through a port or place for the exportation of goods on drawback; (d) the goods are exported within one year from the date of importation of the goods used in producing, mixing, assembling or packing exported goods; and

	(e) a claim for drawback must be made within six months from the date of exportation of the goods, provided that the Director-General may extend this time limit as he deems fit. The Director-General has the power to issue regulations with respect to identification and re-exportation of the goods, preparation and production of documents, calculation of drawback allowable and other procedures concerning claim for this type of drawback. It should be noted that at present there is no **outward processing relief** scheme in Thailand. However, in case of re-importation of goods that have been exported for repair outside Thailand, the importer can obtain total relief from import duties. This relief is subject to the conditions that the goods are sent for repair free of charge under a guarantee or warranty and re-imported within one year (Royal Decree on Customs Tariffs (B.E. 2530), Part IV).
3. Bonded Manufacturing Warehouses	Manufacturing and processing products for exportation in a bonded manufacturing warehouse are probably the widest and simplest option available to be free from import VAT and duties. Article 8 bis of the Customs Act provides: The Director-General is empowered to: ..(2) approve the establishment and lay down the regulation for the operation of a bonded warehouse of manufacturing type where the goods imported and stored therein shall be used in the process of producing, mixing or assembling. In this respect, import VAT and duties are suspended while imported goods remain in the bonded warehouse, as well as when the imported goods are processing in the warehouse regime. Duty and VAT exemption will be granted after the manufactured products are wholly exported. However, when it occurs that the products manufactured in the bonded manufacturing warehouse have partly, or wholly, been sold in Thailand, rather than totally been exported. In that event, import VAT and duties are no longer suspended for imported goods. The payment of both import VAT and duties must be made in accordance with quantities of products made from various imported raw materials (i.e. the rate of yield), which are expressed as so many of each imported item to one product. Notably, entrepreneurs have to deposit a security worth 10 per cent of the duty value of the imported raw materials remaining in stock during each accounting period but not exceed THB10 million (GBP 160,000) (the Customs Department's Declaration No.14/B.E. 2537).

One further point needs to be mentioned. As far as tax incentives (e.g. import duty, VAT as well as profits tax exemption) in Thailand have been made in order to promote exportation, these may lead to the unsustainable growth of

local industries, and provide a severely distorted and ineffective fiscal system in Thailand.

From the author's point of view, the major concerns about tax incentives in Thailand have to be seen in the context of revenue loss[266] as well as the administratively complicated character of national tax system. Another concern is that, under the related Thai investment laws, the project of 'promoted enterprises' qualified for tax incentives (especially tax holidays in a given period) in Thailand must be a large-scale investment project which is, in most cases, carried on by foreign companies from developed nations rather than local businesses.[267] As we can see, creating specific 'tax-free' areas for foreign enterprises, in order to attract

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[266]For example, the figures below clearly show the amount of revenue loss resulted from the inward processing relief (i.e. duty drawback procedure under Article 19bis of the Thai Customs Act) and the exemption of import VAT and duties under bonded manufacturing warehouses, between 1992 and 1993 (**Source:** the Customs Department of Thailand, 1994):

Months	1992	1993	Increased (Decreased)	In Percentages
October	1,327.30	2,092.05	764.75	57.67
November	1,154.91	1,583.79	428.88	37.14
December	1,423.12	1,583.29	160.17	11.25
January	1,258.04	1,307.55	49.51	3.94
February	1,148.83	1,553.29	404.46	35.21
March	1,311.45	1,803.27	491.82	37.50
April	2,200.93	1,545.02	(655.91)	(29.80)
May	1,460.83	1,703.66	242.83	16.62
June	1,699.12	1,809.79	110.67	6.51
July	1,867.85	1,913.41	45.56	2.44
August	1,531.94	1,626.72	94.78	6.19
September	1,762.03	1,660.71	101.32	5.75
Total Revenue Loss	**18,146.35**	**20,182.55**	**2,036.20**	**11.22**

[267]Small and medium-sized enterprises often find themselves disqualified for applying tax incentives. This is due to the requirements for being 'promoted enterprises' of the investment legislation. For example, the Investment Promotion Act provides that an investment project must account no less than THB 200 million (GBP 3.2 million). Interestingly, the status of Thai nationality for being 'promoted enterprises' is not required so that all foreign enterprises can be

capital inflows and to increase the growth of exportation, establish an onshore 'tax haven' with accompanying pressures and strains on local industries. No matter how far benefits of tax incentives are considered, it is less likely to conclude that the rise of exportation under tax exemption schemes would ensure the long-term development of Thai industries. Therefore, Thailand will be well-advised to avoid tax exemption policy.

III. The Right to Appeal : Problems

An assessment relating to customs duty is currently another major area of conflicts between the importer and the Customs Department of Thailand. The basic principle of the right to appeal against a decision of customs authorities on the matter of customs valuation is found in paragraph 3, Article 112 bis of the Customs Act. It states:

> "The importer...**may**... lodge an appeal to the Director-General or the person designated by him against the assessment ...within thirty days after the date of receiving the notice of assessment..."

It is clear from the word 'may' that an appeal against the assessment of Customs can be made to the Customs Director-General (or the person designated by him) and/or to the Tax Court. This means the right to lodge the appeal is also allowed even if the importer has already been on the process of appeal with the

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qualified if they have enough funds. See the Notification of Board of Investment No. 50/2534 (1991)

Customs Director-General, and the decision of dispute has not yet been concluded.

An interesting question is that why the law is so flexible in this matter. The reason for this involves the procedure of the Departmental review and the time limit for lodging an appeal to the Tax Court. In Thailand, the Departmental review process on the matter of valuation is long and complicated. Since there is no system of local review of a decision given by a valuation officer, an application for the review must be made direct to the Customs Review Commission, chaired by the Customs Director-General, at the Customs Headquarters. In this respect, the Commission may affirm, reverse or amend the determination of the valuation officer. The Commission's decision, approved by the Customs Director-General, will then be given, in writing, to the appellant. The appellant, who is not satisfied with a decision of the Departmental review, can take the matter up to the Tax Court, and then on to the Supreme Court in the usual way. The Supreme Court's decision is final and conclusive.[268]

In every year, the number of appeals coming to the stage of the Departmental review is so great that inevitably there is a period, which varies

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[268] For the commercial and civil cases, there is a three-tiered judicial system composed of the Supreme Court, the Court of Appeal and the Courts of First Instance. However, as Thailand applies the dual system of Courts, there are also separate Juvenile, Intellectual Property, Labour and Tax Courts. Therefore, any tax case is considered different in nature from the commercial and civil cases. The Tax Court Establishment and Procedure Act B.E. 2527 (1985) provides special and accelerated procedures for tax litigation. Accordingly, acting as the Courts of First Instance in the commercial and civil cases, the Thai Tax Court has authority to judge the following five cases, i.e. (1) Appeal against the decision of the tax officers or committees; (2) Disputes over the claims of the state tax obligations; (3) Disputes over tax refunds; (4) Disputes over rights or obligations concerning tax collection obligations; (5) Other cases made subject to the Act as prescribed by other laws. There is still a major difference between commercial and civil cases and tax cases:

from five months to five years, between lodging the appeals and giving the decisions. Problems normally arise when the process has been taken longer than two years. This is because the time limit for lodging an appeal against a claim for a refund of duty paid in excess to the Tax Court is short, i.e. two years from the date of importation (paragraph 5, Article 10 of the Customs Act). This time limit is strictly enforced. In practice, the Thai Supreme Court generally dismisses the appeal if facts show that the appellant failed to comply with the time limit. In this respect, the Customs Director-General's decision will become final and be binding on the appellant. The amount of excess duty paid at the time of importation will not be refundable.[269] Accordingly, the prohibition of lodging an appeal to the Tax Court, while the administrative review stage is not complete, seems unfair to the appellant (the importer).

A. Clearance of Imported Goods In Case of Disputes on the Value of Goods

Basically, the customs authorities will not release the imported goods until all charges have been paid. Delay in obtaining clearance for the goods may be

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decisions of the Tax Court must be appealed directly to the Supreme Court; the Court of Appeal is not included in the system of tax litigation.

[269] See, for example, *Fai-fa (2521) Co.Ltd.* v. *the Customs Department*, the Supreme Court, Case No. 1401/B.E. 2530. In this case, the appellant imported 50,033 yards of fabrics made from the 'polyester georgette' from a company located in Korea. The customs value of the goods in question was THB 659,414.90, which was THB 140,000 different from the appellant's import entry. In order to remove the goods in question from the customs custody, the appellant agreed to pay the full amount of duty determined by the customs authorities plus the cash deposit of THB 30,000, and made a notice of a claim for a refund of duty paid in excess to the customs authorities before the release of the goods (paragraph 5, Article 10 of the Customs Act B.E. 2469). The Supreme Court held that although the detailed conditions of making the notice were fulfilled, the appellant did not lodge his appeal to the Court within a two- year period. Therefore, the duty paid in excess was not refundable. The same decision has been found in a number of cases, such as *Chanatipol Co.Ltd.* v. *the Customs Department*, the Supreme Court, Case No. 2758/B.E. 2532; *Fajeep Co.Ltd.* v. *the Customs Department*, the Supreme Court, Case No. 220/B.E. 2534.

costly in terms of a variety of commercial charges, including container rentals for the importer. However, the importer can immediately remove the disputed goods from the customs custody, if one of the following actions has been taken.

1. The importer agrees to pay the amount of duty declared in his import entry plus an additional sum of money covering the maximum duty payable on the goods as a guarantee.[270] In practice, import duties (and other taxes) can be paid by cash, cheque or 'customs card'.[271] Additionally, the guarantee given by the Ministry of Finance or a bank in lieu of such additional money may also be acceptable if the Customs Director-General approves.[272]

Example 1

P.S. Co. Ltd., a Thai company, bought 10,000 televisions from a Japanese company, namely Kyoto Co. Ltd. On 16th January 1999, the goods in question arrived in Thailand. The value of the goods in question determined by the Thai customs authorities at the time of importation was THB 200,000, which was THB 50,000 different from the amount of duty declared in the import entry of the importer. In order to release the imported goods from the customs custody, the P.S. Co. Ltd. agreed to pay THB 150,000 together with THB 50,000 as a guarantee to the customs authorities.

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[270] See Article 112 of the Thai Customs Act (B.E. 2469).

[271] A card issued by the Customs Department, namely the 'customs card', has three different values (i.e. THB 100,000, THB 10,000, and THB 1,000). Each card lasts three years starting from the date of issue. However, it can be extended up to twice. A three-year period is given each time. To obtain this card, a person has to register with the Customs Department together with the documents required by the Customs Director-General. Subject to certain conditions, the registered person may transfer the right of using his customs cards to other persons. See Articles 18-23 of Tax Compensation for Exports Act (B.E. 2524), the Customs Department of Thailand, Bangkok, Thailand.

[272] See *supra* note 270.

In practice, where this course is taken, the customs authorities will notify the importer, in writing, the amount of duty which in their opinion is payable.[273] If the additional duty, given as a guarantee, is not sufficient to cover the amount specified in the notice of assessment, the importer concerned has to pay the shortfall in the duty within thirty days after the date of receiving the notice. [274]

Example 2

Assume further that on 17th February 1999 the customs authorities notified, in writing, the actual amount of duty to the P.S. Co.Ltd., which was THB 200,000. The customs authorities then brought the amount of cash guarantee given at the time of importation (i.e. THB 50,000) to account. In this respect, the P.S. Co.Ltd. was automatically deemed to pay the notified amount of duty within the time limit. However, if the notified amount of duty was, (say) THB 300,000, the P.S. Co.Ltd. had to pay an extra amount of THB 100,000 to the Customs Department within 30 days after the date of receiving the notice of assessment, i.e. before 17th March 1999.

It should be noted that in case of the notified amount paid out of time, the Customs Director-General (or the person designated by him) *may* levy a surcharge not exceeding 20 per cent of the amount of additional duty payable.[275] The surcharge period runs from the date of default until the date of payment.[276] Since the rate of surcharge is not a flat rate, equal treatment between importers is not possible.

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[273] It should be noted that the importer cannot make any appeal against an assessment of customs authorities until he receives the notice specified the amount of duty. When the notice of assessment is given, the importer who is dissatisfied with the decision of the customs authorities can make an appeal to the Customs Director-General (or the person designated by him) and/or to the Tax Court. See *S.K.W. Steel Production Limited* v. *the Customs Department,* the Supreme Court, Case No. 509/B.E.2532.

[274] See paragraph 1, Article 112 bis of the Thai Customs Act (B.E. 2469).

[275] The additional duty payable is calculated from the difference between the actual amount of duty payable at the time of importation and the notified amount paid. See section 2(1), *Departmental Notification on Customs Clearance Procedures* (No. 2/B.E.2518).

In addition to the above surcharge, the importer is also liable to a surcharge at the rate of 1% per month (or 12% per annum) on the sum of additional duty payable, whether or not the notified amount of duty is paid within the time limit.[277] The surcharge is calculated from the date of the release of the imported goods to the date of payment.[278]

This surcharge aims to penalise any importer who does not agree with the assessment of the customs authorities at the time of importation. This is clearly unfair, particularly, for the importer who agrees to pay the notified amount within the time limit. In addition, delay in giving the notice specifying the amount of duty payable causes the importer a real disadvantage. This is because the period for calculating the surcharge in this case runs from the date of the release of the imported goods to the date of payment. In this regard, the longer the notice is delayed, the greater the amount of the surcharge payable.

2. The importer agrees to pay the full amount of duty assessed by the customs authorities at the time of importation, and makes a notice of a claim for a refund of the duty paid in excess to Customs before the goods have been released.[279]

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[276] Article 112 ter of the Thai Customs Act, B.E.2469.
[277] See paragraph 1, Article 112 quarter of the Thai Customs Act (B.E. 2469).
[278] See *supra*.
[279] See paragraph 5, Article 10 of the Thai Customs Act (B.E. 2469).

Example 3

Instead of using the method of payment the duty in the first example above, the P.S. Co.Ltd., decided to pay the full amount of duty (i.e. THB 200,000) assessed by the customs authorities at the time of importation, and made the notice of a claim for a refund of the duty paid in excess before the goods had been delivered.

The effect of making such a notice is fundamental and conclusive. In recent years, there have been a number of cases relating to the claim for a refund of the excess duty paid coming to the Court.[280] Unfortunately, because the appellant failed to make the notice before the release of the imported goods, the Court held in favour of the Customs Department (although in fact the appellant had considerable evidence to dispute against the assessment of customs authorities).

It is worth noting that, apart from making the notice of the claim for the refund of the duty paid in excess, the appellant should also be aware of the time limit for lodging the appeal to the Tax Court (i.e. within two years from the date of importation).[281]

B. Which Method Is Good for Importers?

It is widely accepted that payments of the duty for the release of disputed goods in both methods mentioned above result in a substantial cash-flow loss to the importers concerned, particularly when there is a large amount of duties paid

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[280] See, for example, *Jaidee Impac Co.Ltd.*, v. *the Customs Department*, the Supreme Court, Case No. 2859/2530 B.E.; B.K.L. Asia Trading v. *the Customs Department*, the Supreme Court, Case No. 3761/2532 B.E.; Pattanakonlakarn Co.Ltd., v. *the Customs Department*, the Supreme Court, Case No. 1010/2537 B.E.

in excess. However, from the importer's point of view, the second method (i.e. paying the maximum rate of duty and reserving the right to settle the dispute at a later time) gives the importer a better position as compared with the first method (i.e. paying the amount of duty declared with an additional amount covering the maximum payable duty as a guarantee). The reasons are made as follows:

Burden of surcharges: As was mentioned, where the first method is applied, importers are bound to pay the surcharge at the rate of 1%. In addition, they are liable to the surcharge at the maximum rate of 20 per cent if they fail to pay the notified amount within the time limit. Taking into account the two kinds of surcharge, this means a substantial high burden which the importer would suffer (see Tables 3.8).

Unlike the first method, the importer under the second method is not liable to any surcharge (see Table 3.9). Instead, if the final decision of the appeal against a claim for a refund of a duty paid in excess is in the importer's favour, the Customs Department must refund the amount of the duty paid in excess together with the interest at the rate of 0.625% per month (or 7.5% per annum). The amount of interest is calculated from the date of payment of the duty to the date of approval of the refund.[282]

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[281] See *supra* note 269.
[282] See paragraph 4, Article 112 quarter of the Thai Customs Act (B.E. 2469).

Table 3.8 Illustration of surcharge tax burden under Method 1		Table 3.9 Illustration of surcharge tax burden under Method 2	
	THB		**THB**
On 1st March 1997			
Import duty	1,000	Import duty	1,000
Duty paid by Mr. X (at the time of importation)	600	Duty paid by Mr. X (at the time of importation)	1,000
Deposited additional money	400		
On 1st March 1998			
Notified total amount of the duty to the importer	2,000		
On 1st April 1998			
Notified amount of duty due			
On 1st June 1998			
Paid the notified amount of duty			
Surcharge		**Surcharge**	0
(a) 1% of additional-paid value (calculated from the date of importation to the date of payment)			
(1% X 1,000 X 455)	4,550		
(b) Payment of duty out of time limit 20% of additional-paid value (calculated from the date of the notified amount due to the date of payment)			
(20% X 1000 X 60)	12,000		
Total import duty chargeable	**2,000**	**Total import duty chargeable**	**1,000**
Total surcharge	**16,550**	**Total surcharge**	**0**
Net import duty paid	**18,550**	**Net import duty paid**	**1,000**

Differences in the net amount of import duty paid between the two methods are significant. The situation could be even worse for the importer who chooses the first method since the total amount of import duty would then be used as the basis for calculation of other import taxes, e.g. excise duties, VAT, etc.

Guarantee: The use of a bank or the Ministry of Finance guarantee allowed under the first method is convenient, but the importer has to pay the bank

or the Ministry of Finance a sum of additional charge for providing such a guarantee.

It appears that problems of guarantee costs do not exist under the second method because the purpose of paragraph 5, Article 10 of the Customs Act, as noted above, is to refund the amount of duty paid in excess. Accordingly, a guarantee from an approved bank, insurance company, or the Ministry of Finance is not acceptable under this method.[283]

IV. Concluding Remarks

The above survey clearly illustrates that the existing laws and procedures of customs valuation in Thailand are unrealistic and arbitrary. The laws leave too much discretion to Customs to adjust the declared value of the product, as well as to impose a rate of surcharge (up to 20 per cent) when the importer pays the notified amount out of time. From an economic point of view, such situations undermine the notions of effectiveness and fairness, and accordingly, create a significant barrier to international trade flows to Thailand.

In accordance with the WTO obligations, the Royal Thai government aims to replace its existing system with a transparent, simple, and predictable customs valuation system by the year 2000. Nevertheless, it is doubtful whether the new system suggested by the Code would help Thailand to overcome all the existing problems. Moreover, in applying the new system, the Customs Department of

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[283] See *supra* note 225, pp. 106-107

Thailand should be aware of the issues of tax evasion that might increasingly occur.[284] In this respect, the new system for determining the value of imported goods under the Code could be undermined by the faking of invoices that show the lower price than the actual value of imported goods. Such practices are often used by a multinational group of corporations as a mechanism to channel profits and capital from the high tax jurisdiction to reduce the tax liability of the seller, i.e. abusive transfer pricing.[285] From the point of view of Customs, the major concern is a question of how to obtain the information abroad. Without exchange of information between related countries, the prices shown on the invoices of the imported goods cannot be examined effectively.

Together with the reform of the custom valuation system, it is also important for the Thai government to reform appeal procedures against an assessment of duties. The issue of reform will be discussed in the final chapter.

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[284] See *supra* note 233.

[285] For example, if a commodity with a normal price of $100 is subject to a 60 per cent *ad valorem* import duty in Thailand, it is possible for MNEs to lower the value declared on the transaction to $70, as the import duty bill would be reduced by $18. Assuming there will also be indirect effects both in Thailand and the country of exportation, says the US, and on the subsidiaries located in these two countries. Since Thailand currently has a lower tax rate (i.e. a flat rate of 30 per cent), taxable profits in Thailand for income tax purposes will be increased and those in the US will achieve the minimisation of both profits tax and import duties.

Chapter 4

National VAT Procedures on Importation: Thailand and the UK

As we have already seen in Chapter 3, different systems of customs valuation between countries can distort the flows of international trade in goods, and thus undermine the objective of trade liberalisation proposed by the GATT/WTO. Another key concern in this thesis is whether or not domestic procedures of VAT on importation may result in double imposition and non-neutrality at the international level. When such situations occur, these, undoubtedly, create significant barriers to international trade flows.

Up to present, there has been little research done on the matter of VAT in developing countries. As regards developing world, interestingly, few in either private sectors or tax officers seem to be aware that their national aspects of VAT could have impacts on international trade practice. This chapter then devotes itself to analyse and compare VAT laws on importation in Thailand, a developing country, and the UK, a developed country. A comparable discussion in this chapter will be analytically drawn, to consider whether Thailand has shortcomings in its applicable VAT laws in terms both of competitiveness and neutrality. The outcome may afford a model for the improvement of national VAT procedures in other developing countries. In this regard, a proposal for reforming VAT on importation will be discussed in the final chapter.

I. VAT SYSTEMS IN THAILAND AND THE UK

A. Legal Bases

The legal basis for imposing VAT in Thailand is basically contained in the Revenue Code as well as subsequent Royal Decrees. Similar to some countries (e.g. Poland, Portugal, Spain, etc.)[286], VAT in Thailand is administered by the Inland Revenue Department. However, as regards importation, the Customs Department is responsible for the collection of VAT on behalf of the Revenue Department. Involving more than one department results in a complex system of VAT administration poorly suited for securing efficiency and equity objectives.[287]

On the other hand, when the UK became an EC Member State in 1973, it was required by Article 1 of the First VAT Directive (Directive 67/227) to replace its existing tax systems (i.e. Purchase Tax and Selective Employment Tax (SET)) with the common VAT system. The UK VAT system was initially implemented by the Finance Act 1972.[288] The Act was substantially amended to comply with the EC harmonising provisions, the Second Directive (Directive 67/228), effective from 1 January 1978.[289] It was consolidated by the Value Added Tax Act 1983 (VATA 1983) (effective from 26 October 1983). The VAT legislation [290] was subsequently amended by the **Value Added Tax Act 1994 (VATA 1994)** with effect from 1 September 1994,[291] when the Second Directive was replaced

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[286] See *supra* note 78, pp. 227, 245, 381.
[287] This problem will be discussed in section III below.
[288] FA 1972, Part I and Schs 1-5 (repealed).
[289] FA 1977, s. 14, Sch. 16.
[290] F (No. 2) A 1992, s. 14, Sch. 13.
[291] See John Tiley, *UK Tax Guide 1995-96*, Butterworths, London, 1995, p. 2354.

by the Sixth Directive (Directive 77/388).[292] The UK VAT legislation broadly conforms to the EEC Sixth Directive.

Notably, most parts of the UK VAT legislation are contained in the VATA 1994. But there are many detailed rules in Statutory Instruments. These are either orders issued by the Treasury, or regulations made by Customs and Excise (C&E).[293] Basically, the administration of VAT within the UK is the responsibility of Her Majesty's Customs & Excise Department, whilst the area of direct taxation such as corporation tax, income tax, etc. is administered by the Inland Revenue Department.

B. Revenue Reliance of VAT

It is important to emphasise that VAT has played a relatively important role in revenue structure in developing countries. Historically, evidence clearly shows that governments in developing countries have depended on indirect taxation, rather than direct taxation (e.g. income taxes), as their major source of tax revenue.[294] This is due to the low level of per capita income in those countries.[295] In particular since the 1970s, VAT has been recognised by many developing countries as the best substitute for their existing domestic sales taxes. For example, in 1976 saw the Republic of Korea became the first country in the

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[292] O.J. No. L. 145 of 13 June 1977. See also note 314 below.

[293] See HM Customs and Excise, *The VAT Guide: A Guide to the Main VAT Rules and Procedures*, Notice 700, Customs and Excise, UK, 1996, paragraph 1.7.

[294] See United Nations, *Economic and Social Survey of Asia and the Pacific 1993*, United Nations, New York, 1994, p. 70.

[295] For example, in the ASEAN member countries, in 1991, the share of indirect taxation was distinctly high, accounting for between 50-70 per cent. However, major exceptions were Indonesia and Singapore where the share was about one third. It should be noted that the exceptions are due

East Asian region that replaced the sales tax by the VAT. Singapore is the latest country in the region that introduced the VAT system in the form of a goods and services tax (GST) in 1994.

The widespread introduction of VAT around the world during the past two decades is one of the most significant events in the evolution of global tax structures. The fact that the yield of VAT can be much the same as other forms of sales taxes is obviously one of major advantages. In this regard, VAT is as an exceptionally stable and flexible source of government revenues. But a major reason why a number of countries have adopted VAT is that VAT would not distort domestic production and distribution.[296] Interestingly, in accordance with the 1994 UN report[297], many developing countries introducing VAT have still kept using the excise duty for selective application to generate additional revenue or greater progressivity in their tax systems. This event, however, results from the reduction of tariff rates in those countries. Also, specific duty rates have notably been converted into *ad-valorem* rates in many cases.

1. Thailand

Like other developing countries, VAT has become an increasingly important source of revenue for the Thai government since it was introduced in

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to an oil factor in Indonesia and near non-existence of an agriculture sector in Singapore. See *supra*. See also note 443 below.

[296] From the point of view of economists, VAT has been expected to provide least distortions in terms of a unified system with a simplified rate structure. VAT reduces a multiplicity of bases and rates under other forms of sales taxation that results in greatly differentiated degrees of high and often unintended protection of different sectors of the economy as well as misallocation of resources. Moreover, it appears that the multiplicity of points of levy and taxes on both inputs and final products often causes a pyramiding of tax effects, high production costs and a consequent distortion in the prices of domestic products.

1992. The share of VAT in total tax revenues increased from 12.2 per cent in 1992 to 19.3 per cent in 1996 (Table 4.1). The revenue importance of VAT is of significance because of the broad base and the low uniform rate. When VAT was originally introduced into Thailand, it was set at a rate of 7 per cent, and increased to 10 per cent in August 1997.[298] As from 1 April 1999, the uniform rate has been reduced to 7% principally in order to allow a higher level of people's spending and to encourage the growth of business locally.[299]

Table 4.1: VAT as a Percentage of Total Taxation in Thailand, 1992-1996

		1992	1993	1994	1995	1996
Total national tax revenues	(A)	425,761.3	485,802.3	573,658.9	671,809.2	761,680.9
Total revenues from indirect taxes	(B)	288,029.3	326,700.1	374,424.5	431,375.5	483,900.8
	(B/A)	(67.7%)	(67.3%)	(65.3%)	(64.3%)	(63.5%)
Revenue from VAT	(C)	52,086.5	73,765.8	93,309.9	113,701.5	147,618.3
	(C/B)	(18.0%)	(22.5%)	(24.9%)	(26.3%)	(30.5%)
	(C/A)	(12.2%)	(15.1%)	(16.2%)	(16.9%)	(19.3%)

Note: These numerical illustrations are developed from the data of Ministry of Finance, *The Comptroller-General's Department.*

2. The UK

Since the 1980s, there has been a trend among major industrial countries towards switching from the highest reliance ratio of direct taxation to indirect taxation.[300] A typical example was observed in the UK tax reform of 1979 in

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[297] See *supra* note 294, p. 71.

[298] With the recession of the economy in Thailand in 1997, by the suggestion of the IMF, the Thai government decided to increase the uniform rate of VAT to 10 per cent. See Royal Decree No. 309, *dated* 12 August, 1997.

[299] See Royal Decree No. 353, *dated* 31 March, 1999.

[300] For example, in France in 1990 direct taxes accounted for 40 per cent of the total national tax revenues as against indirect taxes of 60 per cent. See Torao Aoki, 'Recent Developments Concerning Japan's Consumption Tax', 4 *VAT Monitor,* 5, July-August 1994, p. 197. Notably, in countries with no broad-based indirect taxation, such as Japan, VAT was introduced. And in the EU where VAT had already been adopted by all Member States, a number of governments raised the rate of VAT to offset part of the revenue loss from income tax charges. For example, in Denmark VAT was introduced in 1967 with a standard rate of 10 per cent. It was increased to 22 per cent in 1988, and then to 25 per cent in 1992. See *supra* note 85, p. 40. See also Coopers & Lybrand, *A Guide to VAT in the EU*, Hartnolls Ltd, Cornwall, 1997, p. 313.

which the government's fiscal policies pledged to shift the balance of taxation from income to indirect taxes, and obviously VAT remained the most important source of tax revenue over other forms of UK indirect taxes. In 1979, the UK Conservative government declared a Budget in which income tax rates were significantly lowered and the VAT rate was raised to 15 per cent.[301] This means the standard rate of VAT increased from 8 to 15 per cent in place of reducing income taxes with equal revenues.[302] At present, the standard rate of VAT in UK is 17.5 per cent.

The overall picture of indirect taxation revenues in the UK is stated in Table 4.2 below. It is thus clear that the UK government has relied heavily on the VAT.

Table 4.2: Revenues from Indirect Taxes (including VAT) in the UK, 1982-1991 (Millions of Pounds)[303]

Types	Beer	Wine	Spirits	Tobacco	Hydrocarbons	Road Licences	VAT	Customs Duties
1982/83	1,525	453	965	3,447	5,239	1,864	**13,815**	1,028
1983/84	1,679	614	1,099	3,806	5,605	2,045	**15,218**	1,139
1984/85	1,826	600	1,240	4,140	6,201	2,168	**18,534**	1,326
1985/86	1,957	632	1,504	4,459	6,395	2,467	**19,329**	1,239
1986/87	1,975	661	1,469	4,769	7,507	2,563	**21,428**	1,306
1987/88	1,972	706	1,553	4,767	7,810	2,684	**24,067**	1,487
1988/89	2,105	784	1,576	4,990	8,679	2,785	**27,328**	1,673
1989/90	2,074	791	1,513	5,035	8,728	2,993	**29,483**	1,814
1990/91	2,229	855	1,703	5,636	9,628	2,965	**31,006**	1,684

It should be borne in mind that, as one of the EU Member States, a portion of total VAT revenue collected by the UK government has become part of Community own resources, i.e. each Member State is obliged to contribute to the

[301] See Simon James and Christopher Nobes, *The Economics of Taxation*, 4th ed., Prentice Hall, UK, 1992, p. 201.

community's budget. Fundamentally, the Council Decision 88/376[304] stipulates that own resources are constituted by the revenue from: (a) agricultural and sugar levies; (b) customs duties; (c) 'the application of a uniform rate [..] to the VAT assessment base which is determined in a uniform manner for Member States; and, (d) the application of a rate to the total Community GNP (usually called the "fourth resource").[305]

With regard to the VAT own resource, it is levied by applying the agreed percentage call-in rate to the VAT assessment base for the Member States.[306] Notably, the call-in rate has varied over time. In 1970, the Luxembourg Council concluded that revenue from the VAT could be obtained by applying a rate not exceeding 1 per cent to the basis of assessment. This 1 per cent was increased to 1.4 per cent in 1984 at the Fontainebleau Council. However, the European Council in 1994 agreed to reduce the VAT call-in rate from 1.4 to 1 per cent between 1995-1999.[307]

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[302] See Dora Hancock, *Taxation Policy and Practice,* 6th ed., International Thmonson Business Press, Oxford, 1999.

[303] **Source**: Financial Statistics, HMSO, July 1987.

[304]Of 24 June 1988 (1988 OJ L 185). The Community own resources were initially introduced in 1970 by the Council Decision 70/243 of 21 April 1970 (1970 OJ L94/1). One objective was to gradually enhance the Community's financial independence from Member States' transfers. The 1970 Decision stood until being replaced by a similar Decision in 1985 and a further Decision in 1988. The most recent Decision is Decision 94/728 of 31 October 1994 (1994 OJ l293/9).

[305]See the 1994 Own Resources Decision, Article 2, paragraph 1(d). Notably, the "fourth resource" was created, in 1988, to supplement the VAT. The revenue it provides is a function of the combined GNP of all Member States. The rate applied to the GNP is determined every year as part of the budget process. Essentially, the rate is calculated so as to make up the shortfall between other revenue collections and planned budget outlays. See *supra* note 79, p. 94.

[306]As stated by Terra and Kajus (1992), in order to make a fair share of the 'tax burden' (based on the 'own resources decision') among Member States, it is necessary that a scope of VAT should be as uniform as possible. If, for example, the UK taxes only one half of the supplies of goods and services as compared to France, it is clear that France will contribute to the Community's resources, in proportion, twice as much. See Ben Terra and Julia Kajus, *Introduction to Value Added Tax in the EC After 1992,* Kluwer Law and Publishers, Deventer, 1992, p. 9.

[307] See the 1994 Own Resources Decision Article 2, paragraph 4 (a). Perhaps the major reasons for increasing the ceiling on the Community VAT rate to 1.4 per cent were to raise the

In addition to the ceiling on VAT, the role of the VAT own resource is also limited by capping the size of the assessment base. The main objective is to reduce the effects of the regressive character of the resource. At present, the cap is restricted to 50 per cent of gross national product (GNP) of the Member State.[308]

Even though the call-in rate of the VAT own resource is small, it represents a significant figure throughout the Community. Table 4.3 below shows that own resources arising from VAT have been the main own resource for the European Community since VAT first contributed to the Community's common revenue in 1980.[309]

Table 4.3: VAT in the Community and in the Member States - Community Own Resources by Source of Revenue (in Percentages)[310]

Community Revenue	1980	1990	1991	1992	1993	1994
Agricultural Levies	12.4	4.9	4.4	3.3	2.9	2.9
Customs Duties	37.0	24.3	20.4	18.9	16.8	18
VAT Own Resources	**44.7**	**60.4**	**53.8**	**58**	**52.5**	**51.3**
Fourth Resource (GNP)	0	4.2	13.2	13.9	25.2	27
Miscellaneous	5.9	6.2	8.1	5.8	2.6	0.7

Community revenues and to solve the problem of the UK, complaining that its contribution to the budget was excessive as compared with the expenditure on the UK. See *supra* note 43, p. 45. It is worth noting that the maximum call-in rate for the VAT resource, currently at 1 per cent, will be reduced to 0.75 per cent in 2003, and to 0.50 per cent from 2004 onwards. See EC Commission, *Proposal for a Council Decision on the System of the European Union's Own Resources,* COM (1999), 333 final.

[308] See the 1994 Own Resources Decision Article 2, paragraph 1 (c).

[309] Ideally, there are many reasons why the choice in favour of VAT should be placed as a resource of the community. First, most Member States now tend to rely more heavily on VAT. And second, VAT is a more robust form of consumption tax than others. It disperses the collection process over the whole of industry and commerce, resulting in revenue yield of a broad base with few exceptions. Since consumption as a share of GDP fluctuates little under the national level, by implication VAT represents a stable revenue for the community's budget.

[310] **Source**: EC Commission, *Second Article 12 Report (Regulation (EEC/Euratom) No 1553/89): VAT Collection and Control Procedures Applied in Member States,* Office for Official Publications of the European Commission, Luxembourg, Brussels, 1995; and McLennan, *supra* note 79, p. 90.

C. Why VAT? Developed and Developing Countries' Experience

1. Thailand

VAT was introduced in Thailand 1992. The major reason was to replace the system of sales taxation, so-called 'business taxation', which had a number of significant defects. (The business tax's structure is given in Appendix III). It should be noted that the following disadvantages of the business tax system became of great concerns to the Thai government in the late 1980s.[311]

First, the structure of the business tax was imposed at every stage of manufacture and distribution. Therefore, if goods went through various stages of production, each manufacturer had to pay tax again and again. Generally, taxes would be added up the costs of the products, and became finally a heavy burden on the consumer. Thus, the problems of cascading effects as well as artificial inducements to vertical integration were significant.

Second, the business tax system created unpopularity with firms. The rates of business tax varied from 1.5 per cent to 44 per cent and in between there were about 20 rates. This caused frequent disputes between Revenue officials and

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[311] The new VAT, which was to replace the business tax, was approved by the Parliament in 1989, but the Thai Royal government decided to postpone it. This was because there was politically a strong opposition from most traders who wanted to stick to the old system, since it was easier for them to pay and evade the tax. Moreover, they were also afraid that the new VAT system would not work or became too complicated. However, the idea of introducing VAT was reconsidered in 1991, and finally the law became effective on 1 January 1992. In this regard, the former system of business taxation was repealed and replaced by two kinds of taxes on goods and services: the VAT and the Specific Business Tax. Briefly, the Specific Business Tax (SBT) applies to business activities that are not subject to VAT (the Revenue Code, s. 77/3). It is generally levied on gross turnover and no tax credit is allowed for taxes paid on business inputs. At present, there are four categories of businesses subject to the SBT: (1) banking and like businesses; (2) insurance; (3) pawn brokerage business; and (4) trading in immovable property. The SBT rates for these businesses range from 2.5 to 3.0 per cent. See the Revenue Code, secs.91/5 and 91/6. See also

firms: the Revenue Department tried to impose the highest rate while firms argued for the lowest rate. This potentially bred corruption among government tax assessors.

Third, with regard to the international business context, the business tax system affected local investors. Applying the mark-up rates (i.e. the standard rate of profits) to the import price might result in the gross receipt being different from the amount on which the business tax applied for similar domestic products. Consequently, the burden of tax on imports and domestic products might not be the same, despite the same business tax rate being applied to both these products. [312]

Fourth, the business tax was collected many times on a piece of exported goods that had to go through several production stages before the goods were delivered to foreign countries. Because there was no systematic removal of taxes from exports, the price of exports went unrealistically high, and could not compete with merchandise exports from countries apply the destination-based VAT system.

Lastly, it created an opportunity for traders to evade the tax. As was mentioned, the business tax was collected on the manufacturer, and all subsequent traders, either wholesaler, retailer or exporter, were excluded. Therefore, many producers set up shops and disappeared from the tax collection system.[313] In

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Petcharat Supanimitkulkit, 'Tax Treatment of Services in Thailand: Value Added Tax and Specific Business Tax', 9*VAT Monitor,* 3, May-June 1998, pp. 62-66.

[312] See GATT, *Trade Policy Review in Thailand,* GATT, 1991, Vol. 1, p. 104.

[313]See Suvan Valeisathern, *New Thai Taxation*, Nititham Publcation, Bangkok, 1993, pp. 105-106

addition, businesses claimed that they were not manufacturers so that they did not have a liability to pay the business tax. Billions of bahts in business taxation were lost due to evasion by the manufacturers.

2. The UK

When comparing historical background of Thailand's VAT with that of the UK, surprisingly, we found the UK story is somewhat different. The reasons for introducing the VAT in the UK are based on two factors. The first, similar to Thailand, lies in the defects of its old tax systems, i.e. Purchase Tax and SET (see details in Appendix IV). The second is that the switch to VAT is a necessary condition for joining the EC common market. In this regard, Article 99 of the Treaty of Rome, as amended, mandates the EC Council to 'adopt provisions for the harmonisation of legislation', principally concerning all forms of indirect taxation within the EC (e.g. turnover taxes and excise duties).

It should be noted that, before the UK became a Member State of the Community in 1973, VAT was already in force in many EC Member States, such as France (1954), Denmark (1967), Germany (1968), and the Netherlands (1969). At that time, the First and Second VAT Directives, as an obligatory element of the tax systems of Member States, were applied.[314]

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[314] As regards turnover taxes, the principles of the EC VAT were initially laid down in 1967 by the First VAT Directive (27/227/EEC). More details were added by a Second Directive. The Second Directive was revoked in 1977 and finally replaced by the Sixth VAT Directive (77/388/EEC). In its embellished version, as being amended and extended considerably since 1977, the Sixth Directive forms the present system of the VAT law in the EU. Notably, the Sixth Directive, which replaced the Second Directive in 1978, gave a further harmonisation on the various national VAT laws. It continues the more precise common definitions of terms begun in the Second Directive. These terms include: "taxable person" (Article 4 of the Directive

In 1963, the first official body to examine the possibility of a VAT in the UK was the report of Richardson Committee. The Committee was appointed to consider "*the practical effects of the introduction of a form of turnover tax, either in addition to existing taxation or in substitution either for the purchase or the profits tax or both*". The Committee concluded that VAT was the only form of turnover tax worth considering.

However, the Committee decided that there was no advantage in replacing the single-stage sales tax system (i.e. Purchase Tax) by the multi-stage sales tax system (i.e. VAT).[315] It argued that the multi-stage collection which characterised VAT would require the creation of an extensive administrative machinery; that VAT could not readily be made to differentiate between goods; and that the case for VAT as a means of promoting exports had been overstated.[316] All turnover and sales taxes, it held, are aimed ultimately at consumer expenditure, and hence arguments for one method or another must rest largely on collection methods and flexibility, and VAT is intrinsically much more cumbersome (than Purchase Tax) as a means of consumer taxation.

The report of National Economic Development Office (NEDO) in 1969, however, placed a comment against the report of Richardson Committee. It viewed that VAT was imposed at the point of sale, and retailers could recover

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77/388/EEC); "taxable transactions" (Articles 5-6); "chargeable event" (Article 10); "taxable amount" (Article 11); "rates" (Article 12); and "exemptions" (Article 12).

[315]See HMSO, *The Richardson Committee": Report of the Committee on Turnover Taxation*, HMSO, UK, 1964.

[316]The VAT could not completely free exports of tax. One of the most significant distortions arose when registered exporters had inputs of exempt services such as banking, insurance. To the extent

input tax. Therefore, VAT removed the major disadvantage of Purchase Tax that retailers had to carry tax paid stocks. In addition, because retailers had to impose VAT on their final selling price, there was a competitive incentive to keep retail prices low, which did not exist with Purchase Tax levied at the wholesale stage.[317]

The UK government tended to favour the NEDO Report, and stated in the Green Paper (1971)[318] that:

> '*the existing pattern of indirect taxation in this country is open to the objection that it is selective and is based on too narrow a range of expenditure. Selective taxation gives rise to distortion of trade and of personal consumption patterns, and can lead to the inefficient allocation of resources*'.

From the government's point of view, therefore, VAT is a system that would reduce the distortion of consumer choice because it is a broad-based tax, and services are subject to tax on exactly the same basis as goods. In addition, with regard to the international level, Purchase Tax and SET were charged on some inputs to exports, like stationery and office equipment. These created a disadvantage in relation to the market competitiveness. Undoubtedly, such problems would be eliminated under VAT.[319]

Remarkably, during the early period of applying VAT, problems of administrative costs, as predicted by the Richardson Committee, arose. This is because the administration of VAT in the UK has not been integrated with that of

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that the non-creditable tax on inputs of these service sectors entered the prices they charged for their services to business firms, exports thus were not entirely freed of tax.

[317] See C.T. Sandford, M.R. Godwin, P. Hardwick and M.I. Butterworth, *Costs and Benefits of VAT*, Heinemann, London, 1982, pp. 2-5.

[318] Cmnd. 462, HMSO, London, 1971.

direct taxation. To administer VAT, new machinery had to be created. Computers were used from the outset to keep VAT records and to check the credibility of traders' returns. This was in contrast to the administration of direct taxes where the Inland Revenue had not found it possible to use computers to ease its workload.[320]

In addition to the need to establish new administrative machinery, an increase in a number of registrations for VAT over those for Purchase Tax was another factor that might increase administrative costs. Evidence shown that between 1975 and 1979, administrative costs of VAT in the UK were about 2 per cent of the revenue collected, compared with 0.75 per cent under Purchase Tax. The number of traders increased from 70,000 under Purchase Tax to 1,400,000 under VAT and the number of tax collectors increased from 2,000 to 12,500.[321] Notably, since the VAT is a self-assessed tax – a form must be completed and tax paid or refunds claimed by the taxpayer himself, subject to routine checks by control officials, total compliance costs were put by Sandford *et al.* (1981) at 10 per cent of the revenue collected.[322]

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[319] See *supra* note 317.
[320] See J.A. Kay and M.A. King, *The British Tax System*, 4th ed., Oxford University Press, Oxford, 1986, p. 134.
[321] See *supra*.
[322] See *supra* note 317, p. 9.

D. International Systems of VAT

1. Basic Concepts

In general, taxes on commodities entering interjurisdictional trade may be levied according to the destination or the origin principle. A VAT can be imposed on either of the two principles. Under the destination principle, commodities are taxed in the country where they are consumed, regardless of where they are produced. To achieve this, exports must leave the exporting jurisdiction free of tax, and a compensatory tax is required on imports so that they can compete on an equal footing with domestically produced goods. Obviously, application of the destination principle requires border tax adjustments. This means the revenue from VAT on internationally traded goods accrues to the importing country. At present, the destination principle has been operated in almost all countries, including Thailand and the UK.[323]

In contrast, under the origin principle, commodities are taxed on the basis of their place of production or origin, that is, in the jurisdiction in which they are produced. Unlike the former, no border tax adjustments are necessary under the origin principle: imports are not taxed and no rebate is given with respect to exports. In this respect, the tax revenue accrues to the exporting country. The distinction between the two principles can be made in accordance with the *location* of production and consumption, rather than the *type* of products being produced or consumed (Table 4.4).

Table 4.4: Comparison of the Differences between the Origin and Destination Principles[324]

	Origin	Destination
(a) rate of tax finally applied	that of exporting country	that of importing country
(b) which country finally gets the revenue	exporting country	importing country
(c) where tax is levied	in exporting country	in importing country

2. The Destination or Origin Principle?

From an economic point of view, it makes no difference to allocative efficiency, whether the destination principle or the origin principle is applied. The equivalence theorem postulates that the substitution of one principle for another will have no effect on relative prices and trade in real terms, provided that domestic prices and exchange rates are perfectly flexible.[325]

Nevertheless, it might well be asked: what would happen if the perfect situation did not exist? Interestingly, Hufbauer (1977)[326] considers that the destination-based VAT system would then place the effects of tax-induced distortions in the product market because the structure of world prices facing producers remains unchanged. On the other hand, the origin-based VAT system would shift tax-induced distortions to the factor market because the structure of world prices facing consumers remains unchanged. In this regard, since there is a presumption that rigidities in factor markets are more severe than those in product markets, the destination principle is preferable.

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[323] Most countries, such as Member States of the EU, China, Japan, etc., apply the destination principle, while few countries such as Russia and states within the Commonwealth of Independent States adopt the rules of origin. See Williams, *supra* note 76, p. 172.

[324] **Source:** Ken Messere, *International Consumption Tax Rules,* IBFD Bulletin, December 1994.

[325] Nevertheless, it can be argued that the condition of price and exchange rate flexibility is so far from being met in practice. Moreover, it is not possible to impose a uniform rate of sales taxation on all goods and services. See Cnossen, *supra* note 72, p. 44.

In order to answer why the destination principle is mostly applied in a number of countries, let us suppose that good X produced in State I and State I will when exported have the 10 per cent VAT remitted. It would thus be exported to State II free of the tax and State II would apply its own VAT at the rate of 20 per cent. Obviously, good X produced in State I and good X produced in State II would be treated equally, in terms of the VAT imposed on them, when sold in State II. In other words, differences in VAT statutory rates in two jurisdictions, i.e. States I and II, would not lead to distortions of competition between the two States.

Another observation should also be made. Generally, a conflict would not happen, if all countries had the same VAT principle (either origin or destination). However, when two jurisdictions apply different principles, a country with the origin principle is in a less advantageous position than a country using the destination principle. First, products sold within the internal market of the country applies the origin-based tax system could be affected by untaxed imports (i.e. non-taxation).[327] And, second, its exports trade will be subject to tax in the country of destination where imports are taxed (i.e. the double taxation)[328] For example, assuming State A applies an origin-based VAT and State B applies a

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[326] See G.C. Hufbauer, 'Border Tax Adjustments: A Challenging Issue for the Carter Administration', quoted in Cnossen, *supra* note 72, p. 44.

[327] Assuming product X is manufactured in State I and State I applies the VAT, which amounts to 10 per cent on the cost of producing a product. Accordingly, if product X is exported to State II, it retains the 10 per cent and is thus delivered to consumers in State II with the VAT applied. Assuming further that State II applies a 20 per cent VAT to product X which it produces itself then, other things being equal, product X coming from State I has an artificial competitive advantage. Indeed, unlike the destination principle, if producers of product X in States I and II are equally efficient then producers in State II will find their sales falling as they are undersold by State I producers.

destination-based VAT. Exports from State A to State B will be subject to tax twice, i.e. in State A on exportation, and then in State B on importation. As a result, goods from State A will be too expensive to be competitive within the local market in State B.[329]

3. Debates in Europe: The Origin Principle?

Although it is obvious that the destination principle would be the most preferred choice in the economic literature, it is also interesting to observe the sentiment favouring the origin principle in the Single European Market.

Historically, attempts to achieve a common market in Europe by removing the fiscal and other controls at the borders between Member States were completed in 1993. Thus, from 1 January 1993, the concepts of 'imports' and 'exports' of goods apply only to transactions with countries outside the Member States.[330] For intra-EC movements of goods, the terms 'acquisitions from other Member States' and 'supplies to other Member States' are used.[331] As a general rule, supplies of goods by taxable persons to taxable persons in another Member State are treated as exempt with refund of input tax/zero-rated. A condition of exemption is that the acquirer's VAT registration number must be quoted on the supplier's invoice. As a direct counterpart of supplies of goods, the corresponding

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[328]See Loyens Lefebvre Raler, *VAT: The 1993 Experience,* IBFD Publications BV, Amsterdam, The Netherlands, 1994, p. 8.

[329] To avoid the problem of double taxation, it would suggest that State B should remove exports from the charge of VAT. Conversely, it should exempt imports where exports are taxed.

[330] See Directive 77/388/EEC, Article 7(1).

[331] Directive 77/388/EEC, Article 5(a)(1) defines an "intra-Community acquisition of goods" as:

intra-Community acquisition of these goods by a taxable person is taxable in the country of destination at the rate of VAT applicable there. (The VAT due on the acquisition is deductible in so far as the goods are used for activities for which a right to deduction exists).[332]

With the vision of a real free internal market without the nuisance of border controls in the EU, the European Commission proposed to use the destination principle for the intra-Community transactions by the end of December 1996, and the new system, i.e. the origin principle, was supposed to apply in January 1997.[333] However, up to present (1999), the origin system has not been put in force. One major reason, among others, is because the rates of VAT between Member States are somewhat different, ranging from 15% to 25% for the standard rate, and from 6% to 16% for the reduced rate.[334] Some view[335] that the origin principle could not work properly if all Member States would not agree to apply a uniform rate of VAT, in order to prevent the cross-border shopping and trade distortion. For example, Member State A might be selling

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'acquisition of the right to dispose as owner of movable tangible property dispatched or transported to the person acquiring the goods by or on behalf of the vendor or the person acquiring the goods to a Member State other than that from which the goods are dispatched or transported'.

[332] See *supra* note 306, p. 44.

[333] See 'Completing the Internal Market', White Paper from the Commission to the European Council, 29 June 1985, COM (85) 301 final. The objective of the origin system set by the European Commission (usually known as the 'definitive system of VAT') is to permit taxpayers to fulfil their VAT obligations on intra-Community transactions the same way as for domestic transactions, i.e. by billing their customers from other Member States at the domestic tax rate for the goods or services sold. See F. Vanistendael, 'A Proposal for a Definitive VAT System Taxation in the Country of Origin at the Rate of the Country of Destination, without Clearing', *EC Tax Law Review,* 1, 1995, p. 45.

[334] See Coopers & Lybrand *supra* note 300. See also Directive 77/388/EEC, Article 12(3)(a).

[335] See, for example, Sijbren Cnossen and Carl S. Shop, 'Co-ordination of Value-Added Taxes', in S. Cnossen (ed.), *Tax Co-ordination in the European Community,* Kluwer Law and Taxation Publishers, USA, 1987, p. 68.

goods bearing only a 15 percent tax on VAT to consumers in Member State B where the VAT rate was 25 percent.

4. The Destination Principle in Practice

From Thailand's point of view, the destination principle is apparently the preferred choice because it is committed to fiscal neutrality. With respect to international trade, goods can leave Thailand free of tax, while imports can be taxed on exactly the same footing as domestically produced commodities.[336] Implicitly, the rebate of VAT on exports makes the Thai exports attractive in the foreign markets.

It appears that the destination principle is pertinent to present development policies, i.e. export-led growth policies, of Thailand. With the low flat rate of the VAT as compared with some countries, it is likely to be an artificial export aid. In addition, the border tax adjustments under the VAT agree with the tax provisions of the GATT/WTO.[337]

Interestingly, the question of whether the origin-based VAT system is necessary in the context of regional trade integration (which the EU now faces) does not arise for Thailand. It should be noted that the harmonisation of VAT procedures and rates within the ASEAN region might not be feasible in the very near future. This issue will again be mentioned in Chapter 5.

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[336] See the Revenue Code, s. 80 where it provides that a product imported into Thailand is subject to the VAT at the same rate as the product supplied in the home market. This is done so even if the legal or natural person who imports the goods is not registered for VAT purposes or if the transaction is not carried out as a commercial activity. See also the Revenue Code, ss. 77/2 and 82.

II. PROCEDURES OF VAT ON IMPORTATION

It can be observed that the implementation of VAT does not automatically remove all tax barriers affecting international trade flows. Differences in applications of VAT between countries could lead to the distortion of international competition. As compared with the UK, for example, VAT procedures in Thailand are somewhat different, e.g. rules for determining the base of VAT on importation. Problems of this kind may derive from the administration of the tax as much as from the substantive rules.

A. The VAT and Customs Law: Definitions of the 'Importer'

Basically, VAT on importation is payable at the same time as custom duty arising.[338] A person who acts as an importer of goods is the person on whom VAT and any duty due is levied.[339] In practice, import clearance can be undertaken either by an importer or his agent. One interesting question is whether the 'importer' in the customs law is necessarily 'at one' with the VAT law. Consideration is therefore important in identifying the term 'importer' for customs and VAT purposes.

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[337] For details of border tax adjustments and VAT, see Chapter 1.
[338] See VATA 1994, s. 1(4). See also the Revenue Code, s. 82/14.

With regard to the UK, **Customs and Excise Management Act** (CEMA 1979 s.1(1)) defines an 'importer' as someone who:

> 'in relation to any goods at any time between their importation and the time when they are delivered out of charge, includes any owner or other person for the time being possessed of or beneficially interested in the goods...'

The UK VAT law is however silent on the meaning of the 'importer'. In the view of scholars, a person who can act as 'importer' of goods in the customs law (CEMA, s.1(1)) may not be the same person as in the VAT law.[340] A focus is on the phase 'beneficially interested in the goods'. For customs purposes, on the one hand, it means any persons *other* than the owner of the goods. On the other hand, for VAT purposes it seems to be restricted only to those who are importing goods 'for the purpose of their business'.[341] In this regard, it is impossible for certain persons, particularly an import agent who lodges customs entries and pays VAT and duty due on his principal's behalf, to be treated as importer for VAT purposes. This is because the goods concerned are not imported for the purpose of his business. Thus, he cannot reclaim the VAT paid on importation as input tax. He can only recover the VAT from his principal by treating it as a disbursement.

Similar to the UK customs law, Article 2 of the Thai Customs Act states:

> 'Importer' shall mean, include and apply to any owner or other person for the time being possessed of or beneficially interested in any goods at and from the time of the importation thereof until the same are duly delivered out of the charge of the Officers of Customs...'

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[339] See VATA 1994, s. 15(2)(b). See also the Revenue Code, s. 82(2).

[340] See for example John Feltham and Alan Cooke, 'Customs Planning', in A.J. Shipwright, *Strategic Tax Planning*, Volume II, Sweet & Maxwell, the UK, 1993, section 7.

[341] Section 24(1) of VATA 1994 only permits credit for input tax where the person claiming is a taxable person and the goods concerned are imported 'for the purpose of a business carried on by him'. See, for example, *Cavenco Ltd.*, LON/93/540A, January 1994 (11700); *Angela Walker*, LON/92/1339A, July 1994 (912421).

For the purposes of VAT in Thailand, the importer means 'a supplier or *any* other person who imports'.[342] This wide definition is keeping with the characteristic of VAT as a general tax on consumption and is within the scope of the 'importer' under Article 2 of the Thai Customs Act.

The Thai VAT law requires that a VAT registered importer can recover input tax paid on imported goods if he holds documents required by the law, and the input tax is 'directly connected with the business' carried on by him.[343] The phrase 'directly connected with the business' is fundamental. According to paragraph 4 of the Notification of the Director-General of Revenue on Value Added Tax (No. 17/B.E. 2534), it means 'an input tax that is qualified as expenses paid for seeking profits or paid out exclusively for the purpose of business'. In this respect, the import agent, who acts on behalf of his principal, is not entitled to deduct the VAT paid on importation as input tax, subject to the normal rules.[344]

To sum up, the definitions of 'importer' offered by customs legislation in both countries are inclusive. These provide great flexibility to Customs in many of its areas of operation. Customs officers are free to pick and choose anyone who falls within the definition to pay import duties and other taxes. However, as indicated above, only certain importers are entitled to recover VAT paid on

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[342] See the Revenue Code, s. 77/1(11). The Revenue Code, s. 77/1(5) defines the 'supplier' as 'a person who sells goods or provides a commercial professional service, whether in doing so he receives any benefit or consideration, and whether or not he is recorded for value added tax registration'.
[343] See the Revenue Code, ss. 77/1(18), 82, and 82/5(3)
[344] See the Revenue Code, s. 77/1(18)(a).

importation as input tax. It can thus be said that the scope of 'importer' for VAT purposes is narrower than that for customs purposes.

B. The Base of VAT

The issue of tax base of VAT on imported goods under the Revenue Code is problematic because it is different from that of the UK law. In the UK, the value of goods imported from a country outside the EU is generally determined according to the rules for Community Customs Code (whether or not the goods in question are subject to customs duties). In addition to the customs value, the value for VAT must include, if not already taken into account, the following:

1. Any EU customs duty or levy payable on importation whether at the UK boundary or at that of another EU country.[345] The latter occurs when the goods were originally imported from the country outside the EU and were entered for customs duty purposes in another Member State, say, in France and then redirected to the UK. The amount of customs charges payable in France is included in so far as they do not already form part of the price;
2. A deduction for any discount for prompt payment earned under a contract (but no deduction is permitted for payment by instalments[346]);[347]
3. All incidental expenses, such as commission, packing, transport[348] and insurance costs, up to the 'first destination' of the goods in the UK.[349] The

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[345] See VATA 1994, s. 21(2)(a).
[346] See Directive 77/388/EEC, Article 11(A)(3)(a).
[347] See VATA 1994, s. 21(3)(b). See also Richard Pincher, *UK Taxes and Duties in the Internal Market*, Sweet & Maxwell, London, 1993, p. 85.
[348] Transport costs include handling, loading and storage charges.
[349] See VATA 1994, s. 21(2)(b)

phase 'first destination' in this context means the place mentioned on the consignment note or other importation document by means of which the goods are imported. In the absence of such documentation it means the place of the first transfer of cargo in the UK;

4. All such incidental costs where they result from transport to a further place of destination in the EU if that place is known at the time of importation;[350]
5. Any excise duty and other charges payable on importation into the UK (except the VAT itself).[351]

It is worth emphasising that the value determined for customs purposes and that required for VAT are not necessarily the same. For example, as discussed in the Chapter 2, the transaction value method for customs purposes requires inclusion in the value of royalties and licence fees to the extent that they are related to the goods being valued, and payment of them is a condition of the sale for export to the country of importation. However, such royalties or licence fees are not required to the VAT value as they are taxable under the reverse charge/international service arrangements.[352] The discussion on services is, however, outside the scope of this study.

In accordance with the Thai Revenue Code, the tax base for imported goods for VAT purposes includes the following:

(1) An amount equal to the price payable for the goods.

(2) Any customs duty payable on the goods.

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[350] See VATA 1994, s. 21(2)(c).
[351] See *supra* note 345.

(3) All commission, packing, transport and insurance costs incurred up to the place entry into Thailand.

(4) Excise duties[353] *and* other charges (i.e. special surcharge under the law governing promotion of investment, and other taxes and fees as prescribed in the Royal Decree, such as local government surcharges).[354]

Considering the elements contained in the tax bases of imported goods in the VAT laws of both countries, the base of VAT on importation in Thailand may obstruct the flows of international trade. The term 'other charges' in the Thai VAT law is broadly interpreted. In the UK, on the other hand, there is no clear definition of 'other charges' in the context of section 21 of VATA 1994. Because this term follows the words "taxes" and "duties", the 'other charges' for the purpose of this provision could be charges which are in the nature of taxes and duties only.[355] However, the 'other charges' contained in section 79/2 of the Revenue Code in Thailand, noted above, could be any charges, e.g. special surcharge under the law governing promotion of investment. As one might observe, various surcharges included in the tax base for calculating VAT on importation of goods in Thailand inevitably increase the tax burden for importers, although the goods are subject to VAT at the same rate as domestic goods. We return to the tax base of the Thai VAT on importation in Chapter 6.

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[352] See Colin Miles, *VAT and Imports & Exports*, CCH Editions Limited, Bicester, 1986, p. 41

[353] As to the Revenue Code, s. 77/1(19), 'excise tax' means 'liquor tax, tobacco, stamp, playing-cards stamping fee, and any other tax or fee of a similar nature as designated by a royal decree.'

[354] See the Revenue Code, s. 79/2.

[355] See *supra* note 352, p. 40.

An example for calculating VAT on importation in Thailand can be illustrated as follows:

Assuming a Thai car manufacturer, THV Co.Ltd, imports tyres from AA Co.Ltd., located in the UK. Assuming further that the total c.i.f. value of goods is THB200. The basic rate of customs duty is 60%. Also, they are subject to the special charge of THB 10, a levy under a Royal Decree of THB 50, excise tax rate of 30%, VAT of 7%.

A. Customs duty

= (c.i.f. value x Tariff) + special surcharge under the law governing promotion of investment

= (200 x 60%) + 10

= 120 + 10

= 130.00

B. Royal Decree levy

= 50.00

C. Excise Tax formula

$$= (\text{c.i.f. value} + \text{Tariff} + \text{Royal Decree levy}) \times \frac{\text{Excise Tax Rate}}{[1 - (1.1 \times \text{Excise Tax Rate})]}$$

$$= (200 + 130 + 50) \times \frac{30\%}{[1 - (1.1 \times 30\%)]}$$

= 380 x 0.44776

= 170.00

D. Local government surcharge

= Excise Tax x 10%

= 170 x 10%

= 17.00

E.VAT calculation

= c.i.f. value + Customs Duties + Royal Decree levy + Excise Tax + local government surcharge

= 200 + 130 + 50 + 170 + 17

= 567.00

F. VAT liability

= VAT base x VAT Rate

= 567 x 7% = 39.69

The total amount of tax THV has to pay to the Customs Department is:

= (A) + (B) + (C) + (D) + (F)

= 130 + 50 + 170 + 17 + 39.69

= THB 406.69

C. Reliefs from Charging Import VAT: The Zero Rate

Generally, reliefs granted for customs duty purposes are available against VAT, so as to avoid unnecessary inconsistencies. These cover a wide variety of circumstances, e.g. the importation of personal effects by an individual on change of residence, goods imported for trade promotion purposes, goods for testing, and awards. And vice versa, reliefs from VAT charge on importation can also be available if those imported goods are similarly exempt from tax when produced locally. Such reliefs are intended to ensure a fair competitiveness between the domestic and similar imported goods.

Some countries, e.g. the UK, allow certain internal supplies to be zero-rated.[356] The UK contains categories of zero rates in Schedule 8 to the VATA

[356] For VAT purposes, the zero-rating (sometimes known as exemption with credit) is different from the exemption. The zero-rating supplies are technically taxable supplies: a supplier applies a rate of zero to the sales of the preferentially taxed goods. However, he remains entitled to claim

1994. At present, this Schedule is divided into 16 groups. These are, for example. Group 1 (food), Group 3 (books), and Group 16 (children's clothes). The reason for allowing the zero-rating in the UK is because those forms of supplies were. historically, exempt from the UK Purchase Tax that preceded VAT. However. the European law did not allow the exemption of those supplies in the new tax.[357] Thus, the UK treats these selected supplies more favourably, by zero-rating them.

The European Commission has long made it clear that, in its view, the existing zero rates in the UK are contrary to the basic philosophy of Community VAT. A zero rate on a final good effectively allows intermediate goods and services connected with the sale of non-taxed goods to go untaxed, thereby eroding the tax base, which the Sixth Directive attempted to make uniform for all members of the EU. Furthermore, zero-rating amounts to a tax subsidy of activity which is zero-rated, and thus can lead to distortion of competition within the Community. In this regard, the zero rates can only be tolerated as a transitional concession.[358]

Nevertheless, at present zero rating of internal supplies remains in the UK VAT system, although the government agreed to move several previously zero-

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any input tax incurred in making that supply and is therefore entitled to a refund of that input tax if there is no output tax against which to offset the input tax.
By contrast, an exemption supply is not taxable supplies. This means that an exempt supplier has to pay VAT on his inputs, which he is unable to claim as an offset to his VAT liability, because he cannot impose a VAT on his exempt sales. In this respect, he may pass the irrecoverable VAT suffered on to his customers or absorb it by himself. If his customer is another trader who registers for VAT, this hidden irrecoverable VAT is a distorting burden on his business. However, the exemption is not always a disadvantage. It is useful when it applies at the final stage in the VAT chain which is on supplies to the final consumer. In this regard, the exemption results in a reduction of tax burden.

[357] See Directive 77/388/EEC, Article 13.

rated supplies, e.g. electricity, water and sewage services, to a reduced rate.[359] It was evident that 16 per cent of UK consumer expenditure for 1994 was on zero–rated supplies. There would be a very substantial increase in VAT net receipts if these were reduced or standard rated.[360] Apart from the loss of revenue, another major problem in applying the zero rates in the UK is an interpretation of what is or is not, say, a food item. Difficulties have arisen particularly with restaurant meals and in other areas such as confectionery.

Most zero-rated goods, contained in the Schedule 8 to VATA 1994, are not taxed on import.[361] However, that general application is further subject to specific terms of the provisions concerned. In this regard, goods zero-rated by Groups 8 (construction of buildings, etc)[362], 10 (gold)[363] and 12 (drugs)[364]are subject to a standard rate if they are imported.

In Thailand, the application of zero rating is limited only to exports, not imports.[365] At the domestic level, most supplies of goods and services are subject to the standard rate of 7 per cent, but, for social and political reasons, certain supplies of goods are exempt from VAT in Thailand. They are agricultural products, unprocessed food, animal foodstuffs, drugs and chemical products for

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[358] See *supra* note 79, p. 82. See also *supra* note 85, p. 54.
[359] See *EC Commission* v. *United Kingdom,* [1988] STC 456.
[360] See Roger Cockfield, 'A VAT Suspension Regime', 8 *VAT Monitor*, 3 May-June 1997, IBFD, p. 112.
[361]See VATA 1994, s. 30(3).
[362] See note 24 to Group 5 of VATA1994 , Sch. 8.
[363] See note 2 to Group 10 of VATA 1994, Sch. 8.
[364] See note 1 to Group 12 of VATA 1994, Sch. 8.
[365] See the Revenue Code, s. 81(3).

plants and animals, fertilizer, and newspapers, magazine or textbooks.[366] For ensuring neutrality, these goods are also exempt from VAT when they are imported into Thailand.[367] In order to comply with the customs legislation, exemption from import VAT also allows to goods listed in the part on the goods exempted from duty under the law governing customs tariff.[368]

Is the zero-rating necessary? From an economic point of view, an application of a zero or reduced rate on food and other basic necessities of life would alleviate the regressivity of VAT. Needless to say, VAT is basically regressive because it is applied to all goods and services at a standard rate, therefore, making low-income consumers pay a higher proportion of their disposable incomes on VAT than high-income consumers. However, one might object that solving the problem of regressivity with zero rating does not provide a benefit directly to low-income groups.[369] The regressivity of VAT may be easily offset by providing refundable income tax credits to compensate low-income families for any VAT paid on food and other necessities. This system would specifically target low-income earners as groups warranting preferential treatment under the law.[370]

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[366] See the Revenue Code, s. 81(1)-(2)(a).
[367] See *supra.*
[368] See the Revenue Code, s. 81(2)(c). Goods relieved from customs duty are divided into 18 categories. These include, for example, goods imported into Thailand for processing and subsequent export; personal property permanently imported; goods for testing; goods imported by diplomats; exhibition goods. See Part IV of the Customs Tariff Decree, *dated* 23 December, 1988.
[369] Zodrow, for example, notes that 'some analysts oppose zero-ratings for necessities because they benefit all groups, not just low-income earners'. See Zodrow, 'A Direct Consumption Tax As An "Add-On" Tax', 38*Tax Notes*, 1988, p. 1399.
[370] See *supra.*

D. Reclaiming VAT Paid on Imported Goods: Problems Stated in Thailand

A significant advantage of the VAT destination-based system in Thailand is that it allows reclaim of input tax paid for imported goods. However, to achieve this benefit, the Thai Revenue Code requires, as discussed above, that importers or other persons (e.g. an individual, a corporate) who import the goods have to be registered persons, and the goods concerned are 'directly connected with their business'.[371] Basically, a trader is required to register for VAT in Thailand, if the total taxable transactions of that trader exceed set levels of turnover (THB 1,200,000 or GBP 20,000).[372] Notably, this registration threshold has been used

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[371] See *supra* note 343.

[372] See the Revenue Code, s. 81/1. See also Royal Decree (No. 237), *dated* 25 December 1992, as amended by Royal Decree (No. 354), *dated* 31 March 1999.

It is interesting to note that prior to 1999 a small trader in Thailand who had his annual gross receipts between THB 600,000 (GBP 10,000) and 1,200,000 (GBP 20,000) was obliged to register for VAT at a special rate of 1.5%. Unlike the ordinary registered trader, the small trader was levied at a rate of 1.5% on the gross sales. However, the trader had no right to charge VAT, or anything purporting to be VAT, on supplies made by him. In addition, he was not entitled to issue VAT invoices, or to claim any input tax credit. The small trader had to keep adequate records, file a monthly VAT return, and pay the tax due to the Revenue Office by the 15th day of the following month.

An advantage of registered small traders lay in the simplicity of VAT calculation, which was similar to the former business tax. However, there were three main disadvantages inherent in the system of small traders in Thailand.

- First, the small trader had to bear unduly high compliance costs with the requirements of the VAT law (e.g. preparing and keeping the adequate records).
- Second, because the small trader was not allowed to issue the VAT invoice, ordinary registered suppliers would be reluctant to do business on this basis. Generally, when the ordinary registered supplier sells goods or provides services to customers, they would require a VAT invoice from the supplier to enable the purchaser to claim deductions for the VAT paid. In this regard, businesses prefer to deal with the registered supplier who can give them the invoice since they can pass on VAT liability to their own customers who, in turn, deduct it from their output. Businesses who dealt with the small trader did not have the channel for shifting their VAT forward.
- Lastly, the small trader was not subject to VAT on his sales; nor did he receive credits for taxes paid on purchases. Thus, purchases of goods or services from this trader carried a hidden tax element.

For the foregoing reasons, in April 1999 the Royal Thai government decided to remove small businesses from the coverage of the tax. (The Royal Decree (No. 354), *dated* 31 March, 1999; and the Revenue Code, ss. 82/17 and 82/18).

since the adoption of VAT in 1992. Once a trader is registered, VAT has to be charged on output, and input tax can be recovered.

With regard to foreign investors doing businesses in Thailand, the Revenue Code, section 85/3 provides that a foreign VAT payer who makes taxable transaction in Thailand is required to register for VAT if he has a permanent establishment (e.g. a branch) in Thailand, and his taxable supplies are in excess the registration limit.[373] However, for any foreign business making taxable supplies in Thailand *without* having a permanent establishment, registration for VAT purposes can be made in two alternative ways.

First, like other countries, a VAT representative may be appointed to act on behalf of foreign traders in respect of all rights granted and all obligations imposed by the Thai VAT law.[374] Second, the foreign trader may apply for a temporary value added tax registration in Thailand if conditions provided by the law are fulfilled[375], and applications prescribed by the Director-General are made to the Revenue Department. On approval of the application, a certificate, showing a temporary VAT registration number, a date of expiration, etc., is issued to the

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[373] Interestingly, no definition of a permanent establishment is stated under the Revenue Code. But this term in practice can be interpreted in accordance with the meanings stated under the Model Double Taxation Agreements.

[374] See the Revenue Code, s. 85.

[375] 1. Foreign businesses are temporarily carrying on business in Thailand for a period exceeding 1 year but not exceeding 3 years; 2. they must not have any permanent establishment in Thailand; 3 the other party in a contract must be a juristic person; 4. a contract for selling goods or providing services must be made in writing and must be delivered to the Revenue Department at the time of applying for value added tax registration. See Notification of the Director-General of Revenue on Value Added Tax (No. 43), *dated* 29 January, 1993.).

trader.[376] The objective of the temporary VAT registration is mainly to promote foreign trade and investment in Thailand.

It is important to emphasise that there are a number of problems under the Thai VAT laws regarding the reclaim of input tax paid on imported goods. For example, considering the repayment period of VAT, the problem of cash flow loss is significant. In general, the importer has to submit a monthly VAT return together with the VAT payment due, if any, on the 15th day of the month following the month of importation[377], and the repayment will usually be made by the Revenue Department within four to eight weeks.[378] This, obviously, benefits the government, i.e. the revenue is immediate and the risk of evasion is reduced. From the importer's point of view, however, this leads to the situation of a substantial cash flow loss (at least thirty days), and also discourages trade inflows to Thailand.

Perhaps Thailand could learn from the UK experience. The basic rules for payment of VAT on importation in the UK are similar to Thailand, i.e. payment of VAT is due at the time of importation (or removal from customs warehouses). VAT paid on the importation of goods can be recovered as input tax in accordance with normal rules.[379]

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[376]See the Revenue Code, s. 82/13.
[377] See the Revenue Code, s. 83.
[378] See 'VAT around the World', 8*VAT Monitor*, 3, May-June 1997, pp. 140-141.
[379]See Robert Wareham and Alan Dolton, *Tolley's Value Added Tax 1997-98*, Tolley Publishing Company Limited, 1997, p. 370.

Apart from the general procedures, the UK also operates the VAT deferment scheme that is currently not allowed in Thailand. This scheme is widely used after the withdrawal of the 'postponed accounting system' in 1984.[380] Under the deferment scheme, the total amount of VAT on importation of goods is paid to C&E by direct debit on the 15th of the month following importation. This means that a registered trader could put off paying the charges for, on average, 30 days. The amount of import VAT paid can thus be recovered as input tax in the next VAT return. Returns are generally due quarterly, however the trader is allowed to make monthly returns (SI 1995/2518, s.25(1)).

To use this deferment scheme, the trader must provide security to Customs to cover all amounts of deferrable charges (VAT, customs duty, etc.) in each calendar month. This is normally in the form of a bank guarantee. In practice, the guarantee amounts to twice the estimated monthly amount of VAT and duty charges incurred on importation. This is because the trader can defer up to the guarantee limit in one month, and then again in the next month before the trader has paid for the first month.[381]

After having the guarantee, the trader has to apply Customs for a 'Deferment Approval Number' (DAN). This number may then be quoted by the trader (the importer) when the entry is made, and provided that the guarantee is

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[380] The 'postponed accounting system' allowed registered traders to bring goods into the UK without actually paying the VAT assessed up import. They simply declared the tax on their VAT returns showing it as both output and input tax so that the figures cancelled each other. This was therefore merely a statistical exercise in most cases, though partially exempt traders could of course suffer some restriction of the input tax. See *Croner's Reference Book for Importers*, Croner Publication Ltd, Surrey, 1989, p. 104c.

not exceeded the goods will be released.[382] Companies, which are members of the same group registration for VAT purposes, can apply for group approval, and the guarantee can cover all companies.[383] Alternatively, it is possible to seek deferment approval separately for each company within a group. In this respect, the guarantee has to be separated as well.[384]

When the import agent is used to clear the goods from the customs custody on behalf of the importer, the import agent can defer payment of duties and VAT on importation by using his own DAN or his importer's DAN. The former seems to be convenient for the importer but the agent may charge the importer for use of his deferment facility. The latter can only be used when the agent is authorised through the forms provided by C&E.[385] However, in case of emergencies (e.g. when goods are diverted to another port at short notice), it is possible for the importer to provide a telex authority to a new agent for the agent to pass to the local Customs Office.

Notably, the UK deferred payment scheme is popular among importers as compared to the payment at the time of importation. This is because, under the

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[381]See HM Customs and Exices, *Deferring Duty, VAT and Other Charges,* Notice 101, Customs and Excise, June 1995, paragraph. 5.1

[382] See Peter Hewitt, 'VAT Consequences of Importing Goods', *The Tax Journal*, July 1990, p. 16.

[383] See *supra* note 379, p. 367.

[384] See *supra* note 352, p. 9.

[385] There are two alternative forms of the authority for the importer to choose and to be completed: (1) Form C1207N. This is a standing authority allowing the agent to use the importer's approval number whenever or wherever entering goods. The importer must complete the form and sent it to C&E (Deferment Section, Southend-on-Sea). It takes normally about three working days from receipt to process it. When the importer wants to cancel to use this authority, he must inform in writing to C&E. (2) Form C1207S. This is a 'one-off' authority in respect of a specific consignment or removal of goods and obtainable from local C&E offices. See *supra* note 379, p. 368.

deferment, the goods after importation are cleared by Customs quickly without paying charges. Apparently, importers would gain the cash flow advantage, since the payment will be due, as was mentioned, by direct debit on the 15th day of the month following importation. The cash flow advantage will be furthermore improved if importers make monthly instead of quarterly VAT returns.

For example, X, an importer in the UK, imports goods which regularly attract £200,000 VAT liability per quarter and whose inland trade provides output tax of £100,000 and input tax of £80,000. X can choose to make a quarterly or monthly VAT return.

Quarterly return	
Output tax	£100,000
Input tax (£80,000 + £200,000)	£280,000
Repayment due	£180,000

Under the deferment scheme, X has to make at least two monthly payments under the direct debit system before this repayment can be received.[386] A period of repayment from Customs normally takes about two weeks after submission of the return. Obviously, a substantial cash flow loss can be incurred. However, if X opts to make a monthly return, then the figures become:

Monthly return	
Output tax (£100,000 / 3 Months)	£33,333
Input tax (£280,000 / 3 Months)	£93,333
Repayment due	£60,000

It should be borne in mind that payment of VAT on importation can be deferred to the 15th day of the month following importation. If X submits a monthly VAT return within seven days following the end of the month, he will receive the repayment from Customs around the 21st day of that month. Therefore, not only is repayment accelerated by the use of monthly returns but the period of cash flow loss can be reduced to as little as six days.

There are notably some disadvantages of the deferment scheme. First, according to a requirement of a bank or insurance company guarantee, it is inevitably for traders to pay the bank or insurance company a sum of additional charge for providing the guarantee. This burden, however, does not exist in case of the payment at the time of importation. Second, traders have to ensure that the level of the guarantee is appropriate in each case. This is because Customs can refuse the deferment of traders, if the guarantee limit for the calendar month has been exceeded or if the amount of the guarantee left for the calendar month is insufficient to fully cover the deferment requested. If this happens, the clearance could be delayed, and other charges, such as a port or container rental charge, might be additionally incurred.[387]

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[386] See *supra* note 352, p.15.
[387] See *supra* note 381, paragraph 7.3.

III. Two Administrative Bodies – One VAT: Thailand's Problems

Apart from the discussion of VAT procedures in both countries, it is necessary to stress one of the major administrative problems found in Thailand. As mentioned earlier, the collection of VAT on importation is the responsibility of the Thai Customs Department[388], whilst policies and appeals of VAT are governed by the Inland Revenue Department. Thus, traders may find it difficult to deal with two different departments, particularly when they disagree with a decision given by customs authorities and appeal for re-adjusting the value of imported goods.

As discussed above, the base of VAT in relation to importation includes an amount equal to the price payable for goods (i.e. product's price) plus customs duties imposed on the imported goods. From the traders' point of view, if the valuation of imported goods goes wrong, this means the net amount of VAT chargeable on imports must also be incorrect. In this regard, traders must lodge their appeals to the Customs Department (for customs duties) and, again, the Inland Revenue (for VAT) separately.[389] This means appeals must accordingly be made to the Customs Director-General (or the person designated by him) if importers disagree with the customs value[390] and, in addition, to the Board of Appeals if they disagree with the value for VAT of goods at import.[391] Dealing

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[388] See the Revenue Code, s. 83/10(1).
[389] See the Revenue Code, s. 30.
[390] See Chapter 3.
[391] See the Revenue Code, s. 30 (1)(a).

with separate departments is unnecessarily time-consuming. Moreover, this situation creates complexity in the tax laws in Thailand, and, unavoidably, increases the costs of compliance to importers.

In practice, it is found that horizontal communication between the Customs and Inland Revenue Departments is still lacking in relation to VAT on importation. Both of them are reluctant to co-operate or provide a one-stop centre for importers on this matter. The Supreme Court of Thailand, in addition, has ruled in a number of cases that taxpayers (importers) are obliged to make their appeals separately to each department.[392] In view of these factors, it may be advisable for the Royal Thai government to reform such complicated procedures of the appeals. Undoubtedly, doing this is, however, far from easy.

IV. Conclusion

As the world moves increasingly towards trade liberalisation, simplicity and certainty of VAT procedures on importation in each country is necessary. As discussed above, the destination-based VAT and the tax credit method applied in Thailand are in line with international practice. The single tax rate with few exemptions on importation also makes the tax system and administration simple and transparent. It, in effect, serves the interest of both customs authorities and traders by making it unnecessary to adopt systems of classifying goods into different categories which are prone to dispute. Taxing imported goods at the

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[392]See, for example, *Wittaya Co.Ltd* v. *the Revenue Department*, the Supreme Court, Case Number 3748/B.E.2529, *Masara* v. *the Revenue Department*, the Supreme Court, Case Number

same rate as the domestic goods not only ensures neutrality but also encourages fair competition between domestic and foreign goods in the local market.

According to our studies, it is found that procedures of VAT on importation in Thailand are different from those of the UK system. For example, the Thai VAT does not have provisions of the deferred payment and of the zero-rated supplies on certain categories of imported goods while the UK VAT covers these provisions. These two schemes generally benefit traders. For reasons of revenue and administrative costs, it can nevertheless be observed that they would be unattractive for a developing country like Thailand.

Finally, some problems inherent in the Thai VAT system, e.g. the tax base of VAT on importation, and different administrative departments in considering appeals on import VAT and customs duties, remain significant. Reform would therefore be needed in order to ensure efficiency and to encourage the flows of trade and investment. The issue of reform will be made in Chapter 6.

3425/2530. See also Punprasit Litruksa, *Thai Tax Cases*, Winyuchon Publications, Bangkok, 1992, p. 15.

CHAPTER 5

TRADE REGIONALISM – AN APPROPRIATE SOLUTION?

In the previous chapters, special emphasis has been laid, from the perspectives of selected countries, on the inherent defects of the customs valuation laws as well as VAT on importation. In this regard, the author observes that there are two particular inducements at the international level that could cause such defects in each individual country:

- First, the issues of consumption taxation (e.g. VAT or other forms of sales taxes) in relation to cross-border trade activities are not parts of any WTO's efforts. The exceptions of consumption tax issues to the very comprehensive WTO rules undoubtedly attach serious consequences to the objective of free trade, making it difficult in practice.
- Second, the basic concept of the Code is ineffective and far from easy to implement in case of developing countries. This issue will be discussed in chapter 6.

Apart from the WTO, it is believed that the formation of regional trade integration can be an alternative basis for reducing defects of the customs valuation laws and VAT on importation. Increased attention is being given to trade regionalism in many parts of the world. Traditional analysis generally

concludes that trade regionalism would lead to more rapid expansion of trade and investment amongst the member countries. This has been reflected, especially the mid-1980s, in large increases in the ratio of international trade to GDP and even more rapid increases in the ratio of international trade to total investment in many regions. The pace of economic and political development in each member country can no longer be looked at individually, but needs to be considered in the perspective of the increasing interdependence of each country within its own region. The growth of trade regionalism is likely to have powerful effects on world trade patterns as well as related international fiscal laws. In this regard, the harmonisation of taxation has generally been part of those arrangements. The achievements of the European Union provide a very good example, in particular in relation to the issues of consumption taxation.

In order to investigate whether the reform of customs valuation law and VAT on importation in Thailand should rather be made under the regional basis, it is thus necessary to provide an analytical description of the so-called Association of Southeast Asia Nations (ASEAN). These include the development of economic and trade co-operation in the ASEAN, and the emergence of the free trade area by the year 2003. In this regard, attempts to identify factors underlying current ASEAN trade policies in relation to Thailand then shall also be made. Finally, we discuss the opportunity for harmonising customs valuation laws and VAT on importation, as the basis of indirect tax reform, in the ASEAN region.

I. The ASEAN Perspectives

The ASEAN, comprising of all developing countries in the Southeast Asia region, has developed by the dynamics of trade and investment linkages. The emergence of the ASEAN free trade area (AFTA) in which the free movement of goods would be ensured by 2003 would be relevant to reform indirect tax laws in Thailand. Undoubtedly, the harmonisation of VAT and customs valuation laws within the ASEAN is the key measure to promote the objectives of simplification and standardisation of intra-trade regulations.[393] Of course, this idea can also be applicable to other regions.

A. Introduction to the Basic Framework of ASEAN

When ASEAN was established by *the Bangkok Declaration* on 8 August 1967, its objectives are mainly to promote cultural and economic co-operation. The Bangkok Declaration basically sets forth the guiding principles for the association in five brief statements or 'declarations'. The second of these declarations delineates seven purposes of ASEAN: (i) accelerating economic growth, social progress, and cultural development; (ii) promoting regional peace and stability through abiding respect for justice and rule of law in the relationship amongst countries of the region and adherence to the principles of the United Nations Charter; (iii) promoting active collaboration and mutual assistance on matters of common interest in the economic, social, technical, scientific and

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[393]In this regard, ASEAN Customs Code of Conduct (1995) aims:

> "(a) to facilitate intra-ASEAN trade by simplifying and harmonising trade procedures so as to support the implementation and acceleration of CEPT for ASEAN Free Trade Area;...(d) to endeavour to harmonise tariff nomenclature, customs valuation and procedures in ASEAN."

administrative fields; (iv) providing assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres; (v) collaborating more effectively for the greater utilisation of agriculture and industries; (vi) promoting regional studies; and (vii) maintaining close and beneficial co-operation with existing regional and international organisations with similar aims and purposes.

It should be noted that the Bangkok Declaration, which established the institutional framework for regional co-operation and was signed by the Foreign Ministers of the five founding member countries in 1967 (i.e. **Indonesia, Malaysia, the Philippines, Singapore, and Thailand**) was not a treaty with legal obligations.[394] More specifically, the Bangkok Declaration is clearly different from the Treaty of Rome, which established the EEC in 1958. The structure of ASEAN is therefore based on the mutual assistance and co-operation, rather than mutual obligations of its member countries. In this respect, the Bangkok Declaration creates the ASEAN administrative structure, including the Annual Meeting of Foreign Ministers, a Standing Committee composed of representatives from each member country, and a National Secretariat in each member country.

In addition to the five founding ASEAN member countries, **Brunei** became the sixth member of ASEAN in January 1984. Eleven years later, in July 1995, **Vietnam** joined as a new ASEAN member country, and followed by **Laos**

See ASEAN Customs Code of Conduct, *done* 18 July 1995, available in *http://www/aseansec.org*. See also note 438 below.

[394] See Vinita Sukrasep, *ASEAN in International Relations*, Institute of Security and International Studies, Chulalongkorn University Press, Bangkok, 1989, p. 5.

and **Burma** in the same month. Finally, **Cambodia** became the last ASEAN member country in April 1999, completing the aim of ASEAN to gather all ten countries in the Southeast Asia region as so-called the *'ASEAN Ten'*.

B. The Failure of Economic Co-operation before 1992

The most ambitious objective of the Bangkok Declaration of 1967 was notably to develop a kind of regional solidarity among neighbours, especially for the purpose of regional peace and stability. In other words, the formation of ASEAN was the result of political motives.[395] The founding ASEAN member countries began to realise that the attempt to develop their countries alone might not be so successful as joined forces, enabling them, as a group, to increase their economic and political bargaining power. Nevertheless, the ASEAN itself seems to omit mentioning intensified political co-operation or collective defence, which may encourage disputes between the member countries. It should be noted that, according to the Bangkok Declaration's appendix, the word 'politics' does not appear at all.

For the first nine years of its existence, nothing was achieved by way of ASEAN economic co-operation. During that period, the objective of ASEAN was political and, at some levels, anti-Communist. The end of the Vietnam War

[395] The political motives or factors were the common attitude of the five founding ASEAN member countries to oppose all types of imperialism from the Great Powers and their attempts to avoid being involved in the latter's rivalries by emphasizing an independent and self-reliant foreign policy. Notably, the ASEAN member countries share quite a number of common historical experiences. All of them (except Thailand) had once been the colonies of the Western Powers and just gained their independence at the end of World War II. Politically, the formation of ASEAN in 1967 means the founding member countries tried to build up their economic and political stability lest they would be colonised again.

collapsed its political objective, and the ASEAN's main focus then shifted to the economic arena.

A programme of ASEAN economic co-operation had been first discussed at the first ASEAN summit meeting in Bali in 1976, at which the Declaration of the ASEAN Concord was agreed upon. The Declaration provided for the adoption of a series of political, economic[396], social, cultural and information, security, and administrative programmes. It is worth noting that most aspects of the economic programme[397] embodied in the Declaration were drawn from the report of a United Nations Study Team on Economic Co-operation (so-call the 'Kansu Report') submitted to the ASEAN governments in 1972.[398]

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[396] The ASEAN does not represent the first attempt of regional co-operation in Southeast Asia. Before 1967, there were two former organisations which failed to achieve the expected aims, due to the conflicts among member countries in the region. First, it was a conflict between Malaysia and the Philippines about the so-called 'Sabah Questions' in mid-1962 that stagnated the operation of the Association of South East Asia (ASA), formed by Malaysia, the Philippines and Thailand in 1961. Second, Maphilindo was an organisation established by Indonesia, Malaya (then Malaysia) and the Philippines in 1963. However, conflicts erupted between Indonesia and Malaysia, when Malaya established itself as the Republic of Malaysia which included Sabah (already in conflict with the Philippines), Sawak, and Singapore, again stagnated Maphilindo's activities. It should be noted that the conflict between Indonesia and Malaysia was restored to a normal climate with the change of Indonesia's President in 1965. Relations between Malaysia and the Philippines also improved, aided by Thailand. These factors encouraged the leaders of the five countries to form ASEAN in 1967. See *supra* note 394.

[397]Economic programmes between the ASEAN member countries included (i) co-operation in the production and supply of basic commodities (such as food and energy); (ii) co-operation in the establishment of large scale industrial plants; and (iii) co-operation in trade including the encouragement of preferential trading arrangements. See the Declaration of ASEAN Concord, Part B.

[398] The Kansu Report or the Report on Economic Co-operation for ASEAN was the product of a study conducted by a United Nations Study Team from March 1970 to April 1972. The study team's major emphasis was on how the five ASEAN member countries could co-operate in trade and industrialisation. It recommended three major techniques for trade and industrial co-operation: (i) selective trade liberalisation through negotiations at the office level, aimed at promoting intra-ASEAN trade and greater specialisation between countries; (ii) industrial complementary agreements through negotiations among the ASEAN private sectors, so as to enable private industrialists to promote specialisation and exchange of products and components of selected industries; and, (iii) package deal agreements for the allocation of large scale industrial plants to be negotiated at the official level to enable ASEAN to establish certain large scale industrial projects to serve the regional market. Furthermore, the Report also suggested other areas for co-operation including research, co-ordination of national economic plans, provision of services in finance and clearing arrangements, and financing development and insurance facilities. See

One might observe that the Declaration of the ASEAN Concord fell short of any commitments to a free trade area, even as a medium or long term objective. It might be further noted that the five founding ASEAN member countries, in that period, were not yet ready to accept very close and complete integration in the form of a free trade area, a customs union or a common market.

Throughout the late 1970s and much of the 1980s, three principal areas of ASEAN co-operation had been implemented, i.e. the ASEAN Preferential Trading Arrangement (1977), the ASEAN Industrial Complementation scheme (1981), and the ASEAN Industrial Joint Venture (1983). However, none of the last two industrial co-operation schemes was particularly successful.

Apart from tariff reductions under the ASEAN Preferential Trading Arrangement, which will be discussed below, prior to 1992 progress on intra-ASEAN economic co-operation was very slow because the ASEAN member countries were seen to be competitors for similar developed country markets. In addition, there were the differences in philosophies and strategies among the member countries, particularly during the first decade after the ASEAN formation. Besides Singapore, whose trade regime has always pursued an outward-oriented trade strategy, the ASEAN member countries followed highly protective, import-substituting strategies until the mid-1980.[399] In this regard, the

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Economic Co-operation in the ASEAN: Report of a United Nations Team (headed by G. Kansu), monograph, 1974; also published in the *Journal of Development Planning*, 1974.

[399] See Sherry M. Stephenson, 'ASEAN and the Multilateral Trading System', 25*Law and Policy in International Business,* 1, 1994, p. 442. It should be noted that despite protectionist trade structure, the ASEAN countries have witnessed remarkable high export growth rates. In Thailand, for example, exports grew at an average annual rate of almost 20 per cent over 1988-1993 period.

four ASEAN member countries (i.e. Indonesia, Malaysia, the Philippines, and Thailand) adopted tariff policies to protect their domestic industries.

C. The First Step in Regional Trade Liberalisation – The ASEAN Preferential Trading Arrangement (PTA)

Although some areas of ASEAN economic co-operation, e.g. industrial co-operation, had little progress, there was however the rapid pace of exchange of trade preferences between the ASEAN member countries.

The most important initial step for ASEAN co-operation in trade was remarkably the establishment of ASEAN Preferential Trading Arrangement (PTA) in February 1977.[400] Its aim was the reductions of trade barriers on selected products essentially a series of PTAs for different products, but not necessarily the same products for all ASEAN member countries.

The products to be included in the PTA, the predecessor of AFTA, were selected on two bases. The first method was known as the matrix approach, whereby a member country made a request to the other member countries in

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See Andrew Maule, 'Some Implications of AFTA for Thailand: A Revealed Comparative Advantage Approach',13*ASEAN Economic Bulletin*, 1, July 1996, p. 14.

[400] The Agreement on the ASEAN PTA was drafted by the Trade Preference Negotiating Group, under the supervision of the Committee on Trade and Tourism (COTT), during 1976 in accord to the Declaration of ASEAN Concord where it stated that 'member states shall progress towards the establishment of preferential trading arrangements a long-term objective on a basis deemed to be at any particular time appropriate through rounds of negotiations subject to unanimous agreement of member states'. See Saw Swee-Hock, 'Asean Preferential Trading Arrangements', in Saw Swee-Hock and Hong Hai (eds.), *Growth and Direction of Asean Trade,* Singapore University Press, Singapore, 1982, p. 138.

respect of products for which it wanted to accord tariff preferences. If the other member countries responded positively, the products were included in the PTA.

The second method was the voluntary approach, whereby each ASEAN member country voluntarily offered a list of products for tariff reductions to all countries. The voluntary approach had found more effective than the matrix approach because it was difficult in finding two products deserving tariff reductions on a quid pro quo basis under the matrix approach. Initial progress was, however, slow. Only a limited number of products were approved for preferential tariff reductions.[401] After 1980, tariff preferences were complemented by across-the-board tariff reductions for imports of certain values.[402] The adoption of across-the-board tariff cuts was accompanied, however, by the introduction of exclusion lists of 'sensitive items' to protect certain industries.[403]

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[401] The first batch of tariff preferences consisted of only 71 product items implemented in January 1978.Concessions in PTA were mostly in the form of tariff cuts and the margin of preference on existing rates of duty ranged from 10 to 33 per cent. The 71 items included manufactured goods such as ball bearings, sanitary towels, portable typewriters, and insecticides as well as primary products such as maize, rice, vegetables, soda ash, and sawn timber. By and large, items offered in this initial list were rather insignificant in mutual trade, and a mere 10 per cent reduction in tariff rates in most cases did not help much in intra-regional trade. The total value of intra-regional trade in the 71 agreed products was estimated at US$150 million, constituting about 2.6 per cent of the total intra-Asean trade in 1975. See *supra* p. 142.

[402] Initially, all items with an annual import value of less than US$50,000 in 1978 trade statistics qualified for tariff reductions of 20 per cent across-the-board. Later, the cut-off ceiling was raised to US$500,000 in May 1991 and to US$1 million in January 1992. In November 1992 the ceiling was further raised to US$ 10 million. See Tin Guat Ooi, 'ASEAN Preferential Trading Arrangements: An Assessment', in Noordin Sopiee, Chew Lay See, and Lim Siang Jin (eds), *ASEAN at the Crossroads: Obstacles, Options & Opportunities in Economic Co-operation*, Institute of Strategic and International Studies, Malaysia, 1987, p. 57.

[403] Indonesia and Thailand excluded 54 per cent and 53 per cent respectively of their total items from the across-the-board tariff cuts. The figure for Malaysia was 37 per cent, the Philippines 25 per cent, and Singapore 2 per cent. See Tin Guat Ooi, *ASEAN Preferential Trading Arrangements (PTA): An Analysis of Potential Effects on Intra-ASEAN Trade*, Institute of Southeast Asian Studies, Research Notes and Discussion Paper, no. 26, Singapore, 1981.

It appears that exclusion lists weakened efforts to expand the coverage of items.[404]

In addition, there were several implementation problems found in the PTA scheme. These include: inclusion of irrelevant or untraded (e.g. snow ploughs, nuclear reactors) items; tariff preferences on zero tariff items; non-automatic acceptance of product based on proof of origin and ASEAN content of the product; and lack of dissemination of information on the PTA.[405]

At the Third ASEAN Summit in Manila in 1987, several measures to improve the PTA were accepted.[406] However, the changes did not appear to have had an effect on the PTA's contribution to intra-ASEAN trade. ASEAN policy makers had not paid the necessary attention required to make ASEAN's PTA work more effective. Tariff cuts were working slowly and still not substantial enough to encourage the flow of intra-ASEAN trade. Member countries were also hesitant to bring the items on their exclusion lists into the ASEAN PTA.

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[404] By March 1987, a total of 18,907 items had been placed under the PTA. See Suthiphand Chirathivat, 'ASEAN Economic Integration with the world through AFTA', in Joseph L.H. Tan (ed.), *AFTA in the Changing International Economy*, Institute of Southeast Asian Studies, Singapore, 1996, p. 39.

[405] See Hadi Soesastro, *ASEAN in a Changed Regional and International Political Economy*, Centre for strategic and International Studies, Indonesia, 1995, p. 48.

[406] For example, each ASEAN member country should reduce the items on its exclusion list such that by the end of 1992, the items did not amount to more than 10 per cent of the number of items traded by each nation and the value should not exceed 50 per cent of intra-ASEAN trade. See *supra* note 403.

II. The AFTA Perspectives

Many economists (e.g. Maule, 1996[407]) view that the formation of a free trade area within the ASEAN will assist exporters by reducing their input costs while simultaneously opening up ASEAN markets. On the other hand, producers of import-competing goods will be harmed by import liberalisation process resulting from the AFTA. At the same time, they may gain some benefits from liberalisation in as much as the cost of their intermediate inputs is reduced when local suppliers are forced to compete with imports.

A. Introduction to the Basic Framework of AFTA

The AFTA is the product from the Fourth ASEAN Summit and the Singapore Declaration of 1967. At the Singapore Summit of January 27-28, 1992, the heads of the six ASEAN member countries developed a legal framework to promote economic co-operation in their region.[408] The system is developed through a series of three documents: the Singapore Declaration of 1992[409], the Framework Agreement of Enhancing the ASEAN Economic Co-operation[410] and

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[407] See Maule, *supra* note 399, p. 15.

[408] A spokesperson for the Thai Chamber of Commerce pointed out that a truly integrated relationship among the countries of Southeast Asia would create a formidable market of 330 million people. See Surya Gangadharan, *South-East Asia: Business Cautious about ASEAN Free Trade Idea,* Inter Press Service, January 1992. See also Peter Kenevan and Andrew Winden, 'Flexible Free Trade: the ASEAN Free Trade Area', 34 *Harvard International Law Journal*, 1993, p. 224.

[409]See Singapore Declaration of 1992, January 28 1992, 31 I.L.M. 498. This Declaration summarises the agreements reached by the ASEAN heads of government in a variety of fields including politics and external relations as well as economic integration, and outlines a broad-based programme for economic integration adaptable enough to encompass the needs of the various ASEAN countries.

[410] See Framework Agreement on Enhancing ASEAN Economic Co-operation, January 28 1992, 31 I.L.M. 506, 507 (hereafter referred to as the 'Framework Agreement'). This Agreement provides a set of principles and goals for the development of ASEAN economic co-operation,

the Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area.[411] The ASEAN member countries recognised and agreed to accomplish the full establishment and functioning of AFTA within fifteen years by means of the Common Effective Preferential Tariff (CEPT) Scheme.[412]

It is worth noting that after over a year of implementation there were two major economic developments which prompted the ASEAN to speed up the AFTA process and extent its coverage. The first was the conclusion of the Uruguay round negotiations in 1994, which resulted in the reduction of tariffs and non-tariff barriers for all agricultural products. The other was the decision by the APEC Summit in Bogor, Indonesia, in 1994 to liberalise trade and investment in APEC by 2020.[413]

In September 1994, the ASEAN Economic Ministers (AEM) Meeting decided that the execution of the AFTA scheme had to be accelerated, and would

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outlining broad areas of concurrence while leaving the specifics of integration to further subsidiary agreements such as the Agreement on the CEPT Scheme for ASEAN Free Trade Area.

[411] See the Agreement on the CEPT Scheme for ASEAN Free Trade Area, January 28, 1992, 31 I.L.M. 513 (hereafter referred to as the 'CEPT-AFTA Agreement').

[412]See the CEPT-AFTA Agreement, Article 2, paragraph 1.

[413]See Apirada Tantraporn, *ASEAN and Regional Economic Co-operation,* in OECD, Regionalism and Its Place in the Multilateral Trading System, OECD, 1996, p. 51. The Asia-Pacific Economic Co-operation (APEC), founded at Canberra, Austria, in 1989, is a loosely organised group of Pacific nations formed to promote regional economic co-operation. Australia, Canada, Hong Kong, Japan, New Zealand, People's Republic of China, South Korea, Taiwan, the United States, and the countries of ASEAN are APEC members. See Andrew A Faye, 'APEC and the New Regionalism: GATT Compliance and Prescriptions for the WTO', 28*Law and Policy in International Business,* 1996, p. 177.

now take place from 1993-2003. This shortened the CEPT implementation scheme from 15 to 10 years.[414]

Basically, the ultimate objective of the AFTA is to "*increase ASEAN's competitive edge as a production base geared for the world market*" It is hoped that the elimination of tariff and non-tariff barriers "*will have the effect of making ASEAN's manufacturing sectors more efficient and competitive in the global market. At the same time, consumers will source goods from the more efficient products in ASEAN, thus creating intra-ASEAN trade*".[415]

B. Factors Leading to AFTA

There are, at least, three important factors led to the creation of ASEAN free trade area in 1992.

First, in the late 1980s and early 1990s, the ASEAN member countries, which all adopted unilateral liberalisation policies and outward-oriented policies, seemed ready to take more concrete measures. It was obvious that tariff structures among ASEAN member countries had been reformed,[416] creating an atmosphere more conductive to co-operation.

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[414] See Protocol to Amend the Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area, signed in Thailand in December 1995 (hereafter referred to as 'Protocol to Amend the Agreement on the CEPT Scheme for AFTA').

[415] See ASEAN Secretariat, *AFTA Reader*, Volume 1, Jakarta, November 1993.

[416] Indonesia, for example, implemented major tariff reforms in 1989 by reducing the average tariff level from 37 per cent to 22 per cent. So did the Philippines by cutting the average tariffs from 28 per cent to 19 per cent in 1990, and Thailand (cut to 11.1 per cent average tariffs). Singapore eliminated tariffs on sugar products and refrigerators. See Rolf J. Langhammer, 'AFTA – A Step Towards Intensified Economic Integration?', in Wolfgang Moellers and Rohana Mahmood (eds.), *ASEAN: Future Economic and Political Co-operation*, Institute of Strategic and International Studies, Malaysia, 1993, p. 46.

Second, the stalling and probable failure of the Uruguay round of multilateral trade negotiations under the GATT, in that period, was also a major rationale for the formation of the AFTA. In this respect, the idea of regional free trade areas was increasingly looked upon as a new engine of growth if the GATT failed.

Third, following the second, growing regionalist tendencies in North America and Europe, and the rapid increase of investment into China at the time made the ASEAN member countries worry about the unfavourable diversion of trade and the redirection of investment flows away from their region. Therefore, the fear of being excluded from major free trade areas forced the ASEAN to form its own.

C. The Key Element of AFTA: the Common Effective Preferential Tariff (CEPT) Scheme

The Common Effective Preferential Tariff (CEPT) Scheme, described in the preamble to the CEPT-AFTA Agreement as the primary vehicle for implementation of the free trade agreement, provides a schedule for the reduction of intra-ASEAN tariffs on all manufactured goods in the ASEAN countries.[417] The comprehensive nature of the CEPT Scheme is evidenced by the inclusion of both capital goods and processed agricultural products within the schedule for

[417] It should be noted that the CEPT Scheme differs from the previous PTA in that its approach is essentially sectoral, making it more comprehensive and less cumbersome than item-by-item approach of the PTA.

tariff reductions.[418] Raw materials and other agricultural products are however not covered by these original agreements.[419] The matter of expanding the coverage of the CEPT Scheme had been considered, among others, at the ASEAN Economic Ministers (AEM) Meeting in 1994. The AEM eventually agreed to include raw or unprocessed agricultural products, which were excluded from the original CEPT Scheme, into the CEPT list.[420] With this, the whole agricultural sector is automatically included in the CEPT Scheme.[421]

Under the CEPT, ASEAN member countries set out comprehensive timetables for the gradual reduction of intra-ASEAN tariffs on nominated goods.

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[418] See CEPT-AFTA Agreement, Article 2, paragraph 5.

[419] See CEPT-AFTA Agreement, Article 3. Unprocessed agricultural products are defined in Article 7 of the CEPT-AFTA Agreement as:

(a) agricultural raw materials/ unprocessed products under Chapters 1-24 of the Harmonised System (HS), and similar agricultural raw materials/ unprocessed products in other related HS Headings; and
(b) products which have undergone simple processing with minimal changes in form the original products.

Evidence shown that by December 1993, there were a total of 1,823 tariff lines in the list of unprocessed agricultural products submitted by member countries. This accounted for about 4 per cent of the total number of tariff lines in ASEAN. Fish (Chapter 3), edible vegetable (Chapter 7), edible fruits (Chapter 8) were the three biggest chapters in terms of number of tariff lines. Apart from HS Chapters 1-24, other HS Chapters where unprocessed agricultural products in the sense of definitions (a) and (b) could be found were Chapter 40 (rubber), Chapter 41 (rawhides) and Chapter 44 (wood). See ASEAN Secretariat, *AFTA Reader,* Vol. 11, Jakarta, March 1995, available in *http:www//aseansec.org.*

[420] See Protocol to Amend the Agreement on the CEPT Scheme for AFTA, Article 2. Moreover, to eliminate the temporary exclusion list and to expand the number of products in the tariff reduction programme, the AEM Meeting in 1994 agreed to move products in the temporary list into the inclusion list. The temporary exclusion list was reviewed in 1996, and 20 per cent of the items on the exclusion list was transferred to the inclusion list annually. The review of products from the temporary exclusion list should be completed in five years, at which time a reduction scheme aimed at lowering tariffs to below 5 per cent by the year 2003 will begin. This decision was then included in the Protocol to Amend the Agreement on the CEPT Scheme for AFTA, Article 1.

[421] Unprocessed agricultural products, phased into the CEPT Scheme, are divided into three separate lists, as follows:

(a) immediate inclusion list - to be phased into the CEPT Scheme beginning 1996-2003;
(b) temporary exclusion list – to be phased into the CEPT Scheme beginning 1997-2003;
(c) sensitive list – to be phased into the CEPT Scheme beginning 2001-2203 and ending 2010.

See the ASEAN Secretariat, *AFTA Reader*, Volume 4, Jakarta, September 1996, available in *http://www.aseansec.org.*

Goods can be placed on 'fast track'[422] or 'normal track' timetables.[423] In addition to the two-track tariff reduction plan, each member country is permitted to exclude certain products from the tariff reduction schedule temporarily.[424] The temporary exclusion list comprises items that are deemed "sensitive" by each member country. These sensitive products cannot enjoy the CEPT tariffs from other ASEAN member countries that have included the goods in the CEPT schedule.[425]

Interestingly, the CEPT does not provide any criteria for a member country in determining of a product's sensitivity. Neither do any yardsticks exist which could be used to measure the reasonability, or unreasonability as the case may be, of a country's determination that an excluded product is indeed sensitive. The definition of "sensitive" products therefore rests solely on the unilateral decision and discretion of a member country. Based on member country

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[422] The fast track schedule for reduction applies in the first instance to the fifteen product groups agreed at the Fourth ASEAN Summit for accelerated tariff reductions. The fast track aims at reducing tariffs on items currently above 20 per cent to 5 per cent or less within seven years (by 2000) and those currently at or below 20 per cent to 5 per cent or less within five years (by 1998). The products on the fast track scheme are: vegetable oils, cement, chemicals, pharmaceuticals, fertiliser, plastics, rubber products, leather products, pulp, textiles, ceramic glass products, copper cathodes, electronics, wooden and rattan furniture. See Singapore Declaration of 1992, *supra* note 409.

[423] The normal track schedule applies to all remaining manufactured goods. Normal-track products that are currently above 20 per cent will face tariff reductions in two steps: first, to 20 per cent by 1998 and, subsequently to 0-5 per cent by 2003 (the last year of the CEPT). Normal-track tariffs already at or below 20 per cent will be reduced to 5 per cent or less by the year 2000. See CEPT-AFTA Agreement, Article 4.

[424] Apart from the temporary exclusion list, members are allowed to exclude goods from the CEPT permanently if they think that it is necessary for the protection of national security, public morals, human, animal or plant life and health, and articles of artistic, historic and archaeological value. See CEPT-AFTA Agreement, Article 9. This article is similar to Articles XX (General Exceptions) and XXI (Security Exceptions) of the GATT 1994. Regarding Article XXI however, national security exceptions are narrowly defined to cover situations relating to arms and nuclear materials traffic and international emergencies such as war. That the ASEAN article does not have similar restrictions on the definition of "national security" suggests that there is the potential for abuse of this provision. See Kenevan and Winden, *supra* note 408, p. 231.

[425] See CEPT-AFTA Agreement, Article 2, paragraph 3.

submissions to the ASEAN Secretariat, as of December 1993, there were a total of 3,321 tariff lines for temporary exclusion from the CEPT. This accounted for less than 8 per cent of total tariff lines committed under the CEPT Scheme.[426]

The ASEAN Secretariat (1996) observes that for the current tariff reduction schedules of products in the CEPT Scheme, about 87.76 per cent of total tariff lines in the inclusion list will be in the 0-5 per cent category by 2000. In terms of trade value, these products account for US$ 40.35 billion or 97.83 per cent of total intra-ASEAN imports. In other words, almost all imports among the ASEAN member countries would be subjected to no more than 5 per cent import tariffs.[427] Again, the current tariff reduction schedules show that 40.91 per cent of total tariff lines will be at 0 per cent in the ending year 2003. However, in terms of trade value, these products account for a large proportion of intra-ASEAN trade, i.e. US$ 32.46 billion or 78.67 per cent of total intra-ASEAN imports. Therefore, nearly 80 per cent of intra-ASEAN imports in the year 2003 will have their tariffs completely eliminated.[428]

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[426]The number of exclusions submitted in each member country varied as follows: Indonesia (1,624 items), the Philippines (714 items), Malaysia (627 items), Brunei D. (208 items), Thailand (118 items) and Singapore (0 item). See *supra* note 415. The bulk of submissions in the temporary exclusion list was in the chemicals, plastics and vehicles sectors. Together these three sectors accounted for a little over 45% of the temporary exclusion list. See Bhanoji Rao, *ASEAN Economic Cooperation and the ASEAN Free Trade Area (AFTA): A Primer,* Institute Kajian Dasar, Malaysia, 1996, p. 16.

[427] The remaining of US$ 897 million (or 2.17 per cent) of intra-ASEAN imports are dominated by a few products particularly in the Machinery and Electrical Appliances (US$ 302 million), Base Metal and Metal Articles (US$ 141 million) and Plastics (US$ 95 million) sectors. See *supra* note 421.

[428] Major sectors which will have minimal tariff rates (5 per cent or less) in the year 2003 are Machinery and Electrical Appliances (US$ 4,002 million or 9.7 per cent of total import value), Chemicals (US$ 1,358 million or 3.3 per cent of total import value), and Base Metal and Metal Articles (US$ 706 million or 1.7 per cent of total import value). See *supra* note 421.

D. Rules of Origin

Liberalisation of trade in goods among the ASEAN member countries, through the formation of AFTA, requires rules to identify the goods that are entitled to the benefits of the liberalisation. These rules are called rules of origin that provide the legal basis for determining the 'nationality' of a product, i.e. what products 'originate' in the territory of its member country.

Implicitly, the rules of origin aim to prevent third country exporters from using a lower-tariff country as a back door through which enters the high tariff country. This is so-called 'trade deflection'. In the ASEAN, trade deflection can commonly occur because national import tariffs in the ASEAN member countries vary significantly. Among the fifteen product groups in the fast track programme,[429] tariff rates range from zero per cent in Singapore to as high as 60 per cent for apparel and leather products in Thailand.[430] These disparities mean that strict rules of origin have to be enforced.

With regard to Article 2(4) of the CEPT-AFTA Agreement, a product is regarded as an ASEAN good and qualified for the CEPT Scheme if 40 per cent of its content originates in an ASEAN member country. As compared with other free trade areas, the 40 per cent limit is low[431], and thus encourages the high trade linkages among the ASEAN member countries.

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[429] See *supra* note 422.
[430] See Narongchai Akrasanee and David Stifel, 'The political Economy of the ASEAN Free Trade Area', in Pearl Imada and Seiji Naya (eds.), *AFTA the Way Ahead,* Institute of Southeast Asian Studies, Singapore, 1992, p. 39.
[431] For example, in European Free Trade Association (EFTA) and the Australia-New Zealand agreement, at least 50 per cent of the export price of goods must represent value added in the area.

However, the main problem in relation to the rules of origin in AFTA is the meaning of local content. It is not clear whether the CEPT-AFTA Agreement specifies 40 per cent 'national' or ASEAN 'cumulative' content. Without further interpretation, it is almost impossible to implement the local content rule, as all the ASEAN member countries are net importers of most of industrial raw materials and other inputs even for the fast track products. For example, none of the ASEAN member countries produces natural and man-made fibres for textiles. Another controversial issue is found in the electronic sectors. Because nearly all of the production of electronics in ASEAN is of assembly type, only small quantities of unimportant components of electronics are produced in this region.[432]

E. The AFTA and Thailand

A number of observations in relation to the implications of AFTA on national trade policies in Thailand should be made as follows:

1. The establishment of AFTA is considerably less important for Thailand. The volume of Thai exports to the ASEAN is relatively low: over the past few years, it has been running at about 11 per cent; and the important share of that

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In Mercosur, the Treaty of Asuncion, establishing the Mercosur among Argentina, Brazil, Paraguay and Uruguay, provides basically for change in tariff heading based upon the nomenclature of the Latin American Integration Association, supplemented with a 50 per cent value added test for processing operations. See David Palmeter, 'Pacific Regional Trade Liberalisation and Rules of Origin', *Journal of World Trade,* Vol. 27, October 1993, p. 57. See also Seiji Naya and Pearl Imada, 'The Long and Winding Road ahead for AFTA', in Imada and Naya (eds.) *supra* note 430, p. 65.

[432] See *supra* note 405, p. 103.

has been with Singapore.[433]The major sources of Thailand's exports depend on the industrial countries, particularly the United States and the EU.

2. To implement its commitment made under the AFTA, Thailand has brought 14 of 15 product groups into the fast track scheme.[434] Detailed examination of Thailand's CEPT trade at a broad level of definition for the items in each product group indicates that the value of intra-ASEAN trade in certain sectors is limited. For example, in 1991, total exports of pulp products from Thailand to the ASEAN member countries were US$128 million while imports of those products amounted to US$6,617 million (see Table 5.1 below). On an overall basis, Table 5.1 also shows that Thailand's trade on all 14 product sectors is mainly with countries outside the Southeast Asian region. Exports of those product sectors to region outside of the ASEAN made up to 42.4 per cent of total exports from Thailand while imports accounted for 36.3 per cent. Important import and export items are textiles, electronics and jewellery. It is worth noting that Thailand generally imports those products in the form of raw materials or intermediate goods for processing, and then re-exports them in the form of consumer or finished goods.

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[433] '70 per cent of Thai exports to ASEAN still go to Singapore, traditionally Thailand's biggest trading partner in the ASEAN'. See *No 'dynamic effect' from AFTA*, THE NATION, 13 August 1997, p. 1.

[434] The copper cathode product sector is excluded from the fast track scheme.

Table 5.1: Thailand's Trade of Fast Track Commodities with ASEAN, 1991 (Unit: 1000 US$)

Industry	Thailand Trade with World			Thailand Trade with ASEAN		
	Export	Import	Balance	Export	Import	Balance
1. Electronics	3,747,480.0	5,072,575.0	1,325,095.0	803,300.0	721,927.0	81,373.0
2. Furniture	412,234.0	21,079.0	391,155.0	6,358.0	983.0	5,375.0
3. Vegetable oils	5,454.0	11,864.0	6,410.0	518.0	6,875.0	6,357.0
4. Leather Products	264,850.0	211,136.0	53,714.0	13,552.0	1,345.0	12,207.0
5. Fertilisers	78.0	404,220.0	404,142.0	0.0	70,964.0	70,964.0
6. Pharmaceuticals	35,718.0	238,665.0	202,947.0	8,597.0	6,407.0	2,190.0
7.Pulp	11,460.0	195,181.0	183,721.0	128.0	6,617.0	6,489.0
8. Jewellery	1,501,489.0	1,870,890.0	369,401.0	55,376.0	24,676.0	30,700.0
9. Ceramics and Glass Products	307,741.0	268,849.0	38,892.0	43,124.0	21,365.0	21,759.0
10. Cement	4,196.0	375,758.0	371,565.0	748.0	28,274.0	27,526.0
11. Chemicals	475,402.0	3,014,457.0	2,539,055.0	86,003.0	289,508.0	203,505.0
12. Plastic Products	216,038.0	740,224.0	524,206.0	51,139.0	61,510.0	13,071.0
13.Rubber Products	198,187.0	131,266.0	66,921.0	12,534.0	7,872.0	4,662.0
14. Textiles	4,829,423.0	1,037,622.0	3,791,801.0	211,021.0	19,301.0	191,720.0
Total 1-14	12,009,750.0	13,593,806.0	1,584,056.0	1,292,398.0	1,267,624.0	24,774.0
Total Trade	28,354,456.0	37,498,845.0	9,144,389.0	3,357,996.0	4,674,177.0	1,316,181.0
Fast track/Total Trade (%)	**42.4**	**36.3**		**38.5**	**27.1**	

Source: UN Statistics Office (1992)

3 In order to protect domestic products, in 1993 Thailand submitted a total of 118 tariff lines in the temporary exclusion list. These includes, for example, petrochemicals, plastic products and televisions. In this regard, these products are subject to high import tariffs, compared with other member countries where the similar products are included in the CEPT Scheme.[435] Thailand would, therefore, not be an attractive market for foreign investors.

4 As compared with other ASEAN member countries participating in the free trade area scheme, Thailand delayed the process of reducing tariffs under the normal track programme (Table 5.2). The existing tariff rates of Thailand (above 20 per cent) started to reduce to 20 per cent in 1996, while the rest of AFTA member countries began in 1993. Delay in cutting tariffs would make costs of certain products exported from Thailand higher than those of other AFTA member countries, and thus could undermine Thailand's

competitiveness in the global market. Also, with regard to intra-ASEAN trade, Thailand was unable to claim the tariff concessions on those products, for at least three years, from the importing country with tariff rates reduced to 20 per cent or below. Conversely, the importing country could impose the previous CEPT rate of above 20 per cent for those products coming from Thailand.[436]

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[435] See *supra* note 415.
[436] See CEPT-AFTA Agreement, Article 4(2).

Table 5.2: General Formulae of Programmes for Tariff Reduction

Normal Track												
Products with tariffs 20% and below												10 Years
Country		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Brunei Darussalam	Existing tariff rate (%)											
	20	20	20	20	15	15	15	10	10	10	0-5	
	15	15	15	15	10	10	10	5	5	5	0-5	
	10	10	10	10	5	5	5	5	5	5	0-5	
Indonesia	Existing tariff rate (%)											
	20	20	20	20	15	15	15	10	10	5	5	0-5
	15	15	15	15	10	10	10	5	5	5	5	0-5
	10	10	10	10	5	5	5	5	5	5	5	0-5
Malaysia	Existing tariff rate (%)											
	20	18.5	17	15.5	14	12.5	11	9.5	8.0	6.5	5	
	10	9.5	9	8.5	8	7.5	7	6.5	6	5.5	5	
Philippines	Asean duty (%)											
	16-20				15	15	15	15	10	10	10	0-5
	11-15				10	10	10	10	10	10	0-5	0-5
	6-10				0-5	0-5	0-5	0-5	0-5			
	0-5	0-5	0-5	0-5	0-5	0-5	0-5	0-5				
Singapore	Asean duty (%)											
	0-2.5	0	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Thailand	Existing tariff rates (%)											
	20				20	20	20	15	15	10	10	0-5
	15-19							15	15	10	10	0-5
	10-14							10	10	5		
	5-9							0-5				
	5 or below	0-5										

Source: Third AFTA Ministerial Council Meeting (December, 1992)

III. Towards A Greater Degree of Uniformity in Customs Valuation and VAT Laws on Importation

A. Substantial Development of Customs Co-operation in ASEAN after 1992

The AFTA has as its ultimate goal, the desire to increase ASEAN competitive edge as a production base through the liberalisation of trade in the region. This involves, as mentioned above, schemes aimed at reducing intra-regional tariffs as well as elimination of non-tariff barriers. This implies that the existence of AFTA will inevitably place pressures on its member countries' customs infrastructures, i.e. co-operative activities in the area of customs. The year 1995 then saw the **Customs Code of Conduct** (hereafter referred to as 'the 1995 Code') agreed by all the ASEAN member countries.[437] The four major objectives of the 1995 Code are:

(a) to facilitate intra-ASEAN trade by simplifying and harmonising trade procedures so as to support the implementation and acceleration of the CEPT for AFTA;

(b) to enhance ASEAN co-operation in customs so as to complement economic co-operation activities in ASEAN;

[437] The first ASEAN Customs Code of Conduct was signed in March 1983 at Jakarta, Indonesia. The latest version was concluded and signed by the nine ASEAN member countries (i.e. Brunei, Burma, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam) in July 1995.

(c) to promote the salient principles in the conduct of customs matters in ASEAN, as per the principles of this Code[438];

(d) to endeavour to harmonise tariff nomenclature, customs valuation methods and procedures, and customs procedures in ASEAN.

After signing the Code of Conduct, in March 1997 the ASEAN member countries signed **the ASEAN Customs Agreement.** This Agreement is seen as a significant step in the field of customs co-operation within the region. As stated clearly in the objectives of both the 1995 Code and the ASEAN Customs Agreement[439], the issues of customs valuation methods and procedures are one of the three main areas of ASEAN co-operation, i.e. tariff nomenclature, customs valuation methods and procedures, and customs procedures.

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[438] The five principles stated in the 1995 Code are: (i) *transparency* ('Member countries will make all laws, regulations, administrative guidelines and policies pertaining to Customs administration in their economies publicly available in a prompt, transparent and readily accessible manner); (ii) *consistency* ('Member countries will ensure the consistent application of Customs determinations to different traders, and in different cities, regions or states of ASEAN'); (iii) *efficiency* ('Member countries will ensure the efficient administration and expeditious clearance of goods to facilitate intra-ASEAN trade subject to the proper enforcement of the Customs barrier and the applicable CEPT tariff rate'); (iv) *simplicity* ('Member countries will strive to ensure the simplification and harmonisation of trade transactions and customs procedures within ASEAN'); (v) *mutual assistance and co-operation* ('Member countries will ensure the utmost co-operation and mutual assistance between Customs Authorities in complementarity with the various Declarations and Agreements on enhancing economic co-operation in ASEAN'). See *supra* note 393.

[439] The aims of the ASEAN Agreement on Customs are:

(a) to simplify and harmonise customs valuation, tariff nomenclature and customs procedures;
(b) to ensure consistency, transparency and fair application of customs laws and regulations, procedures and other administrative guidelines within each ASEAN member country;
(c) to ensure efficient administration and expeditious clearance of goods to facilitate intra-regional trade and investments;
(d) to explore other appropriate intra-ASEAN co-operation arrangements in the filed of customs, particularly in the prevention and repression of all forms of smuggling and other customs frauds.

See ASEAN Agreement on Customs, *signed* in March 1997, available in *http://www.aseansec.org/economic/custom.*

B. Customs Valuation in AFTA

The AFTA member countries believe that the harmonisation of customs valuation systems within the ASEAN region would bring about a greater degree of uniformity in their customs laws. This would, at least in theory, reduce barriers to intra-trade flows. The traders in ASEAN would be better informed about valuation practices and hence, the degree of compliance would be much higher. More specifically, the harmonisation of customs valuation systems means the ASEAN member countries would support the main objective of the WTO Customs Valuation Agreement that aims to achieve international standardisation and simplification on customs valuation procedures between countries.

However, in practice problems of uniformity the systems of customs valuation among the ASEAN member countries arise. In this regard, the following discussion of the failure of customs valuation harmonisation is of some importance.

1. The Lack of Political Commitment

The 1995 Code was significantly the indicator of intensified integration in the area of customs valuation. Annex I (1) - (2) of the Code provides that "Member countries, being signatories to GATT, shall implement the GATT Valuation Code as per Article VII of the General Agreement on Tariffs and Trade and the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 of the Final Act of the Uruguay Round. Member countries shall, where possible, endeavour to use a common interpretation of the

GATT Valuation Code"; ***and*** "Member countries, under Article 20 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, may delay application of the provisions of this Agreement for a period not exceeding five years from the date of entry into force of the WTO Agreement for such Members. This, however, shall not prevent member countries from implementing Article VII on an accelerated schedule".

It can nevertheless be observed that the goal of harmonising customs valuation systems in the ASEAN is difficult to achieve under the 1995 Code. This is because the wording stated in Annex I (1)-(2), noted above, refers to the implementation of the WTO customs valuation system by the ASEAN member countries which are 'signatories to GATT', but remains silent on the treatment of the ASEAN member countries which are not the WTO members (such as Vietnam, Laos, etc.).

However, significant progress had been made in ASEAN to harmonise customs valuation systems. For example, at the Seventh AFTA Council Meeting in Brunei Darussalam in September 1995, the ASEAN member countries agreed to accelerate the target implementation of the WTO valuation system in the ASEAN region to the year 1997. Obviously, the date for implementing the customs valuation within the ASEAN region provided in the 1995 Code, i.e. a period not exceeding five years from the date of entry into force of the WTO Agreement for such members, differs from what the Seventh AFTA Council Meeting agreed upon, i.e. by the end of 1997.

Based on the Seventh AFTA Council Meeting, the harmonisation of ASEAN customs valuation systems in accordance with the WTO Valuation Agreement would remarkably be divided into two major steps. The first step referred to the decisions to implement the provisions of the WTO Valuation Agreement. Accordingly, the ASEAN member countries had to make preparations for implementing the WTO Valuation Agreement in accordance with the accelerated deadline. Paragraphs (2) and (3) of Article 5 of the 1997 ASEAN Customs Agreement[440] clearly state that *all* the ASEAN member countries have to implement the provisions of the WTO Valuation Agreement, whether or not they are member countries of the WTO.

The second, and following the first, was administrative co-operation and assistance relating to the determination of value under the WTO Valuation Agreement between the ASEAN member countries. In this regard, for effective implementation of the ASEAN customs valuation system, the Seventh AFTA Council Meeting of 1995 considered that the ASEAN member countries should enter into a multilateral arrangement on 'Mutual Administrative Assistance' on the line of WCO model.

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[440] Paragraph 2 provides: 'Member States shall implement the GATT Valuation Agreement, as per the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, on an accelerated schedule.'

To sum up, details of these two issues can thus be summarised as follows:

A. **Decisions in relation to legislative aspects for implementing the Code**	B. **Co-operation in administrative procedures**
- Application of minimum or reference values - Paragraph 2 of Annex III of the Code - Option in Article 4 of the Code concerning the order of application of 'deductive value' method and computed value method – Paragraph 3 of Annex III - Option in Article 5, paragraph 2: (deductive value method) – Paragraph 4 of Annex III - reservations under Article 20.2 of the Code	- choice of a basis for determining value - whether c.i.f. or f.o.b. – whether to include loading and handling charges - choice of critical date for currency conversion - adoption of a uniform of declaration form if the same is considerably necessary, e.g. the format of invoices, time-frame for preservation of records - evolving a uniform procedure for verification of declared value, including valuation database and information sharing

Unfortunately, the objective of implementing a single customs valuation system in ASEAN by the end of 1997 was unsuccessful. There were only two ASEAN member countries, i.e. Indonesia[441] and Singapore[442], implemented the WTO customs valuation system within the required period. Other ASEAN member countries, on the other hand, apply varying valuation systems, such as the BDV (e.g. Thailand, Brunei Darussalam, and Malaysia), or the valuation based on the Home Consumption Value of the exporting country (e.g. the Philippines). However, these member countries, which are signatories to the Final Act of the Uruguay round, are obligated to implement the WTO Customs Valuation Agreement based provisions by the year 2000. It is important to note

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In addition, Paragraph 3 states: 'Member States shall adopt a common interpretation of the GATT Valuation Agreement and standardise the systems used to operationalise the Agreement.'

[441] Indonesia introduced the provisions of the WTO customs valuation into its Customs Law in 1995. See Article 15 of Indonesia Customs Law, No. 10/1995.

[442] Singapore implemented the WTO Customs Valuation Agreement in October 1997. The provisions of the WTO Valuation Agreement are stipulated either in the Customs (Amendment) Act or in the Customs (Valuation)(Import Duty) Regulation. See *http:/ www.gov.sg Customs.*

that no progress in the area of administrative co-operation on technical issues of customs valuation has been achieved at the regional level.

2. Will the Harmonisation of Customs Valuation Systems within the ASEAN Region still be Necessary after the Year 2000?

Although attempts had been made, and failed, during the 1990s, the desired ideal of harmonising customs valuation methods and procedures within the ASEAN region remain important. It is appropriate to state the following reasons for the introduction of harmonising customs valuation in the ASEAN:

1. At present, there are four ASEAN member countries that are not signatories to the WTO (i.e. Burma, Laos, Vietnam and Cambodia). This means that these member countries are not obligated to implement the WTO Customs Valuation Agreement by the year 2000. In this regard, the customs valuation methods and procedures among the ASEAN member countries will remain different after 2000. Needless to say, differences in valuation methods and customs procedures between the ASEAN member countries can be expected to induce anti-competitive behaviour by any one of those four member countries which has as its objects or effect the prevention, restriction or distortion of competition. This situation would become the major obstacle to the ASEAN objective for enhancing intra-trade flows within its region.

2. The harmonisation of the customs valuation methods and procedures will be necessary for achieving a greater degree of administrative co-operation between the ASEAN member countries, e.g. mutual administrative assistance. It is undeniable that co-operation of administrations generally sets the regional standard regarding customs collections and enforcement. Yet, from the author's point of view, it might be too soon to expect a positive result of ASEAN administrative co-operation. In this context, it can be observed that ASEAN efforts to co-operate their administrative matters may be undermined by a number of the underlying problems like the differences in the level of development of the member countries[443], or the financial and economic crisis started in 1997.

C. Harmonisation of VAT

Unlike the issue of customs valuation, the harmonisation or co-ordination of general sales taxation has not been part of any ASEAN economic planning. The author observes that each ASEAN member country consciously tends to be independent in controlling its fiscal policies. Perhaps the major reasons are the divergence of systems of general sales taxation applicable within the ASEAN

[443]For example, there are a large number of people with a per capita income below US$500, especially in Laos, Cambodia and Vietnam. At the other extreme, there is a small population with a per capita income of well over US$ 7,500, as in Singapore and Brunei. There are also the middle-income countries such as Indonesia, Malaysia, the Philippines and Thailand. See Kao Kim Hour, and Sarah Kanter, *ASEAN Free Trade Agreement: Implications and Future Direction*, ASEAN Acadamic Press, London, 1997, p.19.

region, and concerns about the erosion of national tax revenue.[444] At present, there are only five ASEAN member countries apply the destination-based VAT system, i.e. Indonesia, the Philippines, Singapore, Vietnam and Thailand. More importantly, it should be emphasised that the rates of VAT as well as the thresholds for VAT registration in such member countries are somewhat different (see Table 5.3).

Table 5.3: Year of Introduction of VAT, Percentage VAT Rates, and Thresholds for VAT Registration in the ASEAN Member Countries

	Date VAT Introduced	Sales Taxes Mainly Replaced	V A T Rates	Thresholds for VAT Registration
Indonesia	Apr. 1985	Manufacturer sales tax	10*	Rp24 million
Philippines	Jan. 1988	Manufacturer sales tax	10	P550,000
Singapore	Apr. 1994	No sales tax	3	S$ 1 million
Thailand	Jan. 1992	Manufacturer sales tax	7	THB1,200,000
Vietnam	Jan. 1999	Turnover tax	10	VDong 50 million

Source: Tait (1988) and various country reports.
*Indonesia also has a luxury sales tax ranging from 10-35 per cent.

No VAT is imposed in other ASEAN member countries. Malaysia, for example, currently applies an *ad valorem* single-stage tax. The tax is equally imposed at 10 per cent on both imports and locally manufactured goods, either at the time of importation or at the time the goods are sold or otherwise disposed by the manufacturer. However, although exports are exempt from sales taxation, the trade effects on products' prices from Malaysia remain significant. This is because there is no systematic removal of taxes from exports in Malaysia. Thus, the hidden burden of local sales tax on exportation places Malaysian traders at a competitive disadvantage. This situation is obviously unnecessary costs of doing

[444] For example, in Indonesia VAT accounted for 22.5 percent of total national tax revenues in fiscal year 1996. See International Monetary Fund, *Government Finance Statistics Yearbook*, IMF, USA, 1997.

trade. It is accordingly not possible for Malaysian traders to operate with a minimum of distortions in the ASEAN.

Apart from the harmonisation of the systems of general sales taxation, there is also another important issue, i.e. harmonisation of the tax base. In this regard, one should be aware that trade flows within the ASEAN are affected by the divergence of the bases of sales tax on importation. As a group of developing countries, there are apparently a number of tax rules and incentive schemes dealing differently with various types of imports in each ASEAN member country. However, these matters are beyond the scope of this work.

At this stage, it can only be observed that the achievement of VAT harmonisation in the ASEAN could be possible if the high level of regional integration such as the single market or the customs union was achieved. As noted earlier, the formation of AFTA concentrates on the cross-border exchanges of raw materials and manufactured goods, in particular medium-technology capital and intermediate goods. The direction of AFTA is to support investment in each member country, and leaves out efforts in others areas of fiscal integration. This implies that the harmonisation of VAT within the ASEAN, at present, sounds very unrealistic at the level of a free trade area.[445]

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[445] It may not be feasible for the ASEAN member countries to establish the customs union or a single market in the very near future like the EU did in the 1980s and 1990s. The harmonisation of VAT also means that the ASEAN member countries have to pursue the uniform VAT rate, identical rules in determining VAT bases, and the same principle (either the destination or origin principle) throughout the region. This requires strong political commitments from all member countries.

The last explanation is the limitation of the ASEAN constitutional framework itself. As compared with other regions, the EU, for example, was established in 1958 by an international agreement, i.e. the Treaty of Rome, and the idea of a united Europe is its initial main objective. The Bangkok Declaration, on the other hand, is not regarded as a treaty. Each ASEAN member country reserves exclusive control over its own jurisdiction, and pursues its own fiscal as well as economic policies independently.[446]

From the forgoing discussions, it appears that the only available option for VAT reform in the ASEAN has to be undertaken at the level of each individual country. In this regard, reform of VAT in Thailand will be discussed in the next chapter.

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[446] See *supra* note 394.

CHAPTER 6

CONCLUDING REMARKS AND GUIDELINES FOR REFORM

Introduction

The major objective of this chapter is to assess the feasibility and desirability of 'alternative' approaches for VAT and customs valuation procedures in the context of trade globalisation. Accordingly, attempts will be made to draw conclusions as the guidelines for reform. These guidelines will be, from the macro economic point of view, essential to facilitate and ensure the growth of global trade. It will also be of interest to carriers, end users of imported goods, as well as local manufacturers who sell their goods abroad. Fundamentally, the guidelines will be placed in accordance with four following objectives:

1. supporting global interdependence and free trade development (i.e. international trade liberalisation);
2. promoting the stability and long-term growth for national markets in transition (i.e. market economy development);
3. ensuring economic efficiency in the context of indirect taxation on international trade flows; and
4. improving fair competitiveness between developing and developed countries.

This chapter is divided into three sections. Based on different levels of economic development between developing and developed countries[447]. the first section discusses the impact of trade globalisation on customs valuation systems. The draft customs valuation legislation and regulation to implement the provisions of the Code in Thailand as well as problems of manipulated transfer pricing in developing countries are also analysed in this section.

The second section provides a discussion of VAT in the context of trade globalisation. It also examines problems of unnecessary charges and the base of VAT on importation in Thailand. The last section suggests alternative approaches for determining the value of goods for customs purposes, and then proposes reform of VAT on importation in Thailand. In practice, a major argument in favour of such alternatives is that the existing customs valuation systems, both the BDV and the Code, do not work well in developing countries.

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[447] In general, per capita income has been the traditional measure in ranking different levels of economies. But interestingly the World Bank has recalculated wealth to identify so-called 'good economy', including national resources; machinery, buildings, highways and other 'produced assets'; human resources; and so-called social capital - the value added by families and communities. The World Bank's formula changes the rankings:

Top 10 ranked by per capita income:		**Top 10 ranked by 'estimated wealth'**	
1. Luxembourg	$ 36,650	1. Australia	$ 835,000
2. Switzerland	$ 36,330	2. Canada	$ 704,000
3. Japan	$ 29,770	3. Luxembourg	$ 658,000
4. Sweden	$ 29,770	4. Switzerland	$ 642,000
5. Denmark	$ 26,470	5. Japan	$ 583,000
6. Norway	$ 25,510	6. Sweden	$ 491,000
7. Iceland	$ 24,550	7. Iceland	$ 486,000
8. Austria	$ 23,330	8. Qatar	$ 472,000
9. USA	$ 23,280	9. U.A.E.	$ 468,000
10. France	$ 22,880	10. Denmark	$ 461,000

Source: World Bank, 1995.

I. The Impact of Trade Globalisation on Customs Valuation: An Analytical Review

As the multinational trading system is unfortunately not governed by one set of rules by which the movement of goods between countries is to be conducted, the idea of trade liberalisation is weak in practice. Since the end of World War II, there have been growing concerns about competitiveness and performances of nation-states and their business enterprises. In fact, trade between countries is not simply drawn from their respective comparative advantages; rather, advantages from trade seem to be drawn from differentiation, economies of scale, and so forth.

The long-run consequence would be that countries tend to put into place a number of tax policies and laws for the purposes of protection. These include, for example, Thailand's existing methods for determining the value of imported goods.

As also mentioned in the previous chapters, two international customs valuation systems, i.e. the BDV and the Code, co-exist. To ensure the right direction of moving towards liberalisation of trade policy, a single international system of customs valuation is thus required. It is interesting to see whether the Code can bring a needed measure of uniformity, transparency, and fairness to customs valuation procedure in an expanded number of countries.

A. The BDV System and Developing Countries

Based on Chapters 2 and 3, the BDV system itself contains both advantages and disadvantages, which can be summarised as follows:

Advantages	Disadvantages
1. Effective in combating fraud; 2. Not complex, easy to understand and apply by local customs administrations; 3. Useful in protecting domestic infant industries in developing countries; 4. Ensured the high amount of revenue.	1. Uncertainty and, sometimes, alleged arbitrariness; 2. Possibility of discrimination and unfair treatment in the case of goods imported from some countries; 3. With artificial markups, providing unnecessarily excessive tax burdens for honest importers.

There is a perception that the notional concept inherent in the BDV system leaves too much discretion to national customs officials, generating uncertainty in application. Apparently the outcome stated in our studies considering Thailand's experience confirms this perception (see Chapter 3). Since adjustments depend on the assessment of customs officials, there have been an increasing number of cases involving appeals against customs valuation each year. The Customs Co-operation Council alleged the BDV system as[448]: *'The BDV is therefore outmoded ..., and thus is losing touch with commercial reality'*. But one question remains: do these facts tell us the full story?

As we might observe, all arguments against the BDV are made on the basis that it does not facilitate cross-border trade flows, i.e. the objective of trade liberalisation. However, the author is aware that such arguments overlook the

actual position of global trading system that is currently dominated by multinational firms (i.e. MNEs) of industrialised countries.[449] The MNEs generally establish a number of affiliates in developing countries, so strengthening their global business networks around the world. In this regard, one might be aware that the achievements of trade liberalisation would result in optimal benefits for both developed countries and MNEs which have controlled the local markets in developing countries.

Obviously, widening trade deficits in many developing countries reveal unresolved fundamental problems. The author is aware that developing countries have not been properly brought into the bargaining process under the forum of the WTO. Moreover, they have to accept heavier responsibilities[450] as they are not yet in a position to compete freely. In other words, it thus may not be possible for

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[448] See *supra* note 251.
[449] See Table 1.1
[450] This represents the dilemma in most developing countries because the amount of revenue gains and the growth of local industries are particularly critical in enhancing national competitiveness. In the long run, it is obvious that reductions in the rates of duties and the removal of barriers to trade in goods and services under the operation of the WTO would inevitably affect the amount of revenue gains in developing countries. Although world interests in theory recommend that no barriers to cross-border trade flows should exist, the revenue loss in the context of economics of development are however very much sensitive issues, and should not be overlooked.
As a result, developing countries struggle to adjust their fiscal structures for raising revenue without breaking the WTO rules. This means, to meet the long-run growth of government expenditure, they are going to rely on compensating sizeable amounts of revenue loss by extending the bases of taxation as well as adjusting procedures of consumption-based taxes. An example can be drawn from Thailand's experience when the rates of import duties for certain goods were increased in 1997. As one might observe, Thailand currently suffers badly from the economic turmoil. Accordingly, the major objective of increasing customs tariffs is to meet the economic criteria imposed by the IMF.
With effect from 14 October 1997, the following new customs duties apply:

Fully built automobiles	Old rate: 42% - 68.5%	New Rate: 80%
Perfume and Cosmetics	Old rate: 20%	New Rate: 30%
Leather bags and bells	Old rate: 20%	New Rate: 30%
Leather and canvas shoes	Old rate: 20%	New Rate: 30%
Crystal, glassware and jewellery	Old rate: 20%	New Rate: 30%
Eye glasses, frames and lenses	Old rate: 5%	New Rate: 30%
Cameras, watches and lighters	Old rate: 5%	New Rate: 30%

See Paul Carter, 'Thailand: Recent Developments', *Asia Pacific Tax Bulletin*, January 1998, p. 44.

developing countries to compete equally with developed countries under the conditions of free trade.

One further question is whether trade liberalisation could bring a more efficient allocation of scarce resources with beneficial effects on the rates of economic growth in developing countries. Needless to say, low level of development is presently linked to low productivity, which results from poor capital base and saving, inadequate infrastructure and unskilled labour force. This of course begs the question of how the idea of trade liberalisation can promote the degree of trade mobility and macro-economic interdependence between developed and developing countries.

In addition, rapid technological advances are likely to foster conflicts and become major impediments in achieving trade liberalisation. Developing countries are concerned with the advanced technology which is incorporated into many services and equipment which are imported from developed countries and used in production. This issue has surfaced in international trade discussions. Developed countries would see advanced technologies as advantages of competitiveness. Yet developing countries often complain about human factors (e.g. unskilled labour force). This will be of increasing concern because of the inability of people in the workforce to cope with these new technologies.

Hence, it is easy to understand why developing countries are generally in favour of the BDV system. In Thailand and other ASEAN member countries, for

example, it is apparent that a degree of protection becomes much more necessary alongside their export-oriented policies, which can be mentioned as follows:

1. the development of local labour-intensive technologies, consistent with the developing countries' factor endowments and comparative advantages, to produce competitive exports;
2. greater direct employment creation associated with the use of labour-intensive technologies;
3. a more equitable size distribution of income, in part resulting from the creation of greater employment opportunities.

Unfortunately, developing countries have to accept that they exist in a world where power is not distributed equally. And because of lower level of political power, freedom of developing countries to protect their own resources as well as local markets could possibly be limited. The implementation of 'positive concept' under the Code, which will be discussed below, is not an easy job for developing country governments vis-à-vis the subsidiaries of powerful multinational enterprises of developed countries.

B. Introducing the Code in Thailand

1. Overview of the Thai Economy

Before considering the new Thai customs valuation system, it is important to note the Thai economic situation. By the year 2000, prospects for Thai economy are expected to be a lot brighter as exports increase, the industrial sector recovers and the Royal Thai government maintains an expansionary budget. The

Ministry of Commerce and the Ministry of Finance have revised the export growth forecast to 6.08 per cent for the year 1999, up from the earlier official target of 4 per cent. Based on such significant figures, the Royal Thai government then plans to revise upward its gross domestic product growth forecast for both 1999 and 2000, originally predicted to be 3 to 4 per cent this year and 3 per cent next year. The Asian Development Bank (ADB) has recently forecast that Thailand's economy will grow by 4 per cent in 1999 and 5 per cent for the year 2000.

Interestingly, the IMF also forecasts that GDP growth of Thailand should reach 6 per cent by 2002.[451] In particular, the import-export sectors would benefit from greater world economic expansion, mainly from the European side as well as East Asia.

2. New Customs Valuation System

2.1 Planning for Implementation of WTO Customs Valuation Agreement

Briefly, the Thai Customs Department started the preparation programme for implementing the WTO Customs Valuation Agreement in June 1995, i.e. two months after signing the Final Act establishing the WTO. Unfortunately, the working programme was not successful due to the lack of expert officers in the Code and inadequate training facilities. At the time of writing (December 1999), the Royal Thai government has issued the draft customs valuation legislation and regulation (see details below) to implement the WTO Customs Valuation

[451] See Thailand Update (A Publication of the Royal Thai Government), Vol. 7 No. 12 December 1999, pp. 1-2.

Agreement. There is no sign when the Thai Parliament will approve the draft legislation and regulation. In this regard, it seems not to be possible for Thailand to implement and apply the Code within the permissible timeframe (i.e. by 1 January 2000). Such a delay would become a serious obstacle to the Customs Department in preparing the effective implementation of the new provisions, training the officers, refashioning their administrative arrangements, and, more importantly, educating the traders. Also, it would not be possible to arrange a public debate, which is necessary concomitant of improved compliance. In fact, these matters would be helpful in solving several practical problems for both customs officers and importers.

2.2 Legislation and Regulation

The draft legislation and regulation to implement the provisions of the Code and Interpretative Notes are:

1. The draft amendment to the Customs Act of Thailand number X year 1999, regulating matters about Customs including Customs Value. This draft adopts the principles of the Code which consists of six methods of valuation;
2. The draft amendment to a Ministerial Regulation (MR) on customs valuation, regulating detailed methods of valuation provided in the Code and Interpretative Notes. Also included in this draft are rules on transaction value, conditions to use the transaction value, adjustments to price actually paid or payable, identical and similar goods, deductive method, computed value method and flexible value method.

3. The draft amendment to the Customs Tariff Decree of 1978, regulating the powers of the Director-General of Customs Department.

It is interesting at this point to compare the definitions of the term 'market value' stated under Article 2 of the existing Thai Customs Act (discussed in Chapter 3) with that provided in the draft amendment to the Customs Act.

Existing Thai Customs Act	**Draft Amendment to the Customs Act**
"true market value" or "value" of any goods shall mean the wholesale cash price (exclusive of duty in the case of imports), for which goods of the like kind and quality would be sold without loss at the time and place of importation or exportation, as the case may be, without any deduction or abatement"	"The term 'the customs value' or 'value' shall mean 1. In the case of exportation, this term shall mean the wholesale cash price for which goods of the like kind and quality would be sold without loss at the time and place of exportation, as the case may be, without any deduction or abatement 2. In the case of importation, this term shall mean the customs value determined in accordance with one of the following methods: - the transaction value; - the transaction value of identical goods; - the transaction value of similar goods; - the deductive value; - the computed value; - the flexible value."

Obviously the new format of Article 2 acknowledges the primacy of the concept of transaction value in determining the value of imported goods for

customs purposes. Notably, the Royal Thai government seems to be unaware of the application of term 'wholesale cash price' in the case of exportation of goods. Implicitly, this means Customs has the right to make systematic adjustments irrespective of the price actually charged for the exported goods. This might cause unnecessary tax burdens on products exported from Thailand to foreign countries. It can be observed that the Thai customs law would affect Thai industries' competitiveness in the global market.

2.3 Arbitrariness and Uncertainty in the New Customs Valuation Legislation

2.3.1 Treatment of freight, insurance and handling charges

As mentioned in Chapter 2, Article 8.2 of the Code allows each member country of the WTO to include in or exclude from the customs value of imported goods, in whole or in part the cost of transport to the place or port of importation. In this respect, Article 11 of the draft amendment to the Customs Act bases the customs value on the c.i.f option. However, the draft legislation does not address any detailed rules on this subject, except the treatment of free transport. In this connection, paragraph 2 of Article 11 states that 'where transport is free, the costs of transport and associated expenses up to the port or place of importation, *specified by the Customs Director-General*, shall be included in the customs value.

The wording of this draft provision is vague and leaves too much discretion to the Customs Director-General. It is also not clear what criteria the Customs Director-General will use to determine the cost of transport (and other

related charges) for the purpose of this provision. Non-transparency of proceedings and unpredictability of application are obviously contrary to the basic objective of the Code.

2.3.2 'Declared Fair Market Value'

As discussed in Chapter 3, Article 9 of the Customs Tariff Decree is one of major concerns to the existing system of customs valuation in Thailand. Surprisingly, this provision still remains in the draft amendment to the Customs Tariff Decree of 1978, with few changes.[452] The new text of Article 9 states that:

> 'For goods subject to ad valorem rate of duty, the Director-General of Customs may, from time to time, notify the fair market value for any category of goods. Such value shall be the value for assessment of duty on the notified category of goods instead of the price actually paid or payable as from the date of notification until cancelled or modified by subsequent notification.
>
> The notification, the cancellation or the modification of notification as referred in the first paragraph, shall be published in the Government Gazette.'

Needless to say, the clause '... the Director-General of Customs may ... notify the fair market value for any category of goods...' is not consistent with commercial practice. As the Preamble to the Code 'precludes the use of arbitrary or fictitious customs values', it is no doubt that the notional approach under this draft provision violates the Code. It is, accordingly, necessary for the Royal Thai government to amend or remove this draft provision before the implementation of the Code.

2.4 Other Remaining Problems: Appeal Procedures

Surprisingly, there is no amendment or reform to improve rules in relation to appeal against the determination of customs authorities in respect of the value

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[452] See *supra* note 237.

of imported goods in Thailand. This means that any specific problems, as noted in Chapter 3, will continue. Such problems can be summarised as follows:

(1) Delay making a decision on a request for administrative review of the valuation officer's decision;

(2) A maximum of 20 per cent surcharge imposed on importers who fail to pay the full amount of duty within the time limit (Article 112 ter of the Thai Customs Act); and

(3) The time limit for lodging an appeal on the matter of customs valuation to the Thai Tax Court, i.e. within two years from the date of importation (Paragraph 5, Article 10 of the Thai Customs Act).

Admittedly, the appeal procedure on valuation is an important factor that influences the decision of foreign investors. As discussed in Chapter 3, customs appeal procedures in Thailand are complex, and obstruct trade inflows. It is therefore necessary for the Royal Thai government to review the provisions of customs appeals and other related rules. Some suggestions can be made as follows:

- A decision on a request for administrative review should be made within the time limit, e.g. 45 days from the filing date of the request concerned;
- To avoid the problem of unequal treatment among importers, the rate of surcharge should be a single rate; and
- The time limit for lodging the appeal on the matter of valuation to the Tax Court should be reduced from 2 years to 45 days from the date of receiving the notice of assessment. Nevertheless, an extension of the appeal period should be allowed if an application is made with the reason for the delay.

3. Special Treatment

A novel feature of the Code is that it prescribes special and differential treatment for developing countries, notably in deferring application of the Code and in permitting certain reservations. This is designed to help developing countries with particular problems in applying the Code.

According to the Official Report of the WTO (1996)[453]. Thailand had invoked the following application and reservations allowed by the Code:

- Article 20.2 of the Code (delayed application of the computed value method (Article 6) for a period of three years);
- Annex III, paragraph 3 of the Code (reservation concerning reversal of sequential order of Articles 5 and 6);
- Annex III, paragraph 4 of the Code (reservation concerning application of the deductive value method (Article 5) whether or not the importer so requests); and
- Annex III, paragraph 2 of the Code (reservation concerning application of minimum values).

One consideration should be made in relation to minimum values. As mentioned in Chapter 3, the minimum value system currently applied in Thailand is aimed to protect local industries. It appears that Annex III, paragraph 2 of the Code allows Thailand to pursue the protective policy for a transitional period of three years (i.e. by the end of 2003). Although the use of minimum values will be

applicable solely to imports with a declared value manifestly below the reference value, and only a small number of imports (30 categories of products) will be affected by this reservation[454], the system neither conforms to commercial realities nor promotes trade liberalisation. It is advisable that the Royal Thai government should remove the application of minimum prices before reaching the agreed deadline.

4. Recommendations for the Successful Implementation of the Code in Thailand

As was seen in Chapter 2, the Code is a complicated piece of legislation and it is seen, from developing countries' point of view, as working in favour of importers. This attitude has widely developed because the view is held that in the normal course of daily Customs business there is a little chance of proving the importer wrong even if the suspicion is that the declared value is not correct. From the administrative perspective, in order to appreciate the Code, knowledge of international business practice becomes more and more important especially for those who are required to deal with the national legislation. Therefore, customs departments in developing countries should prepare skilled valuation officers because the commercial world is looking to ways of reducing their import taxes and duties. It is also important that customs officials in charge of valuation should be trained to give the best advice knowing that their decisions are likely to be challenged by the legal profession in court.

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[453]WTO, *First Annual Review of the Implementation and Operation of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994*, G/VAL 6, 10 January 1996, p.1.

[454] See Official Report of the Thai Customs Department (unpublished), No. 46/B.E. 2537.

In addition, for effective implementation of the Code some developing countries, in particular Thailand, need to develop the computerised database system for valuation purposes. The database should record the price observed from time to time for various commodities and the customs officers who are engaged in the checking and verification of the valuation aspects should have the facility to look at past precedents and also draw information from the system which could contain the price information obtained from published sources as well. Having created such a database it would then be possible for Customs to go in for procedures generally known as post-entry audit and verification. Such a system could be adopted gradually, replacing the present transaction by transaction verification at least for identified importers. As the volume of trade grows, the move towards post-entry audit or verification could become an operational necessity.

As important as the creation of database is the need to have a special declaration form for customs purposes. This new document, called a 'Declaration of Customs Value', would help Customs to cope with the problem of related party transactions. Regardless of administrative and compliance costs, all importers should submit this document for customs clearance in addition to the basic documents (e.g. import entry, invoices, etc.) required by Customs. This document should contain a question on whether the buyer and the seller (in a given cross-border transaction) are related. If a relationship is declared, a statement should be made as to whether the relationship has influenced the price of the goods and, if not, whether the customs value of the imported goods is very close to their

transaction value. It should be noted that importers should be subject to legal penalties if they make 'untrue' statements in customs documents.

The introduction of new valuation rules has clearly meant a significant change to the present system of customs valuation in Thailand. One primary concern in relation to the operation of the transaction value method in Thailand is how Customs will handle with some complex situations, in particular successive sales before valuation. It appears that the draft legislation on customs valuation in Thailand remains silent on this matter. It would therefore be necessary for the Thai Customs to learn from the experience of countries, which have successfully implemented the Code. The experience of EU member countries would be particularly instructive in this regard.

Among the alternative methods of customs valuation under the Code, the author considers that the deductive value method could be used with advantage in Thailand. The requirement that the goods must have been sold in the condition as imported (Article 5 of the Code) could be flexible interpreted; the 90-day requirement could be administered flexibly in the case of developing countries. However, application of the so-called 'computed value' could pose difficulties for the Thai Customs, for example, in obtaining and examining the data supplied by the producer of the goods. Although Article 6.2 of the Code allows Customs to verify such data in other countries with the permission of the person who supplied those data and the government of the country concerned, the foreign government in practice may object to the request of Customs. Accordingly, this method is one for which the Thai customs administration will be well-advised to support

technical training for its officials, so that they may acquire the in-depth knowledge needed.

Finally, the Thai Customs Department should prepare guidelines on "objective and quantifiable data" and on accounting standards. As mentioned in Chapter 2, the Code's preferred use of the actual transaction value method is conditional on the availability of "objective and quantifiable data" from the importer in order to substantiate additions required to be made under Article 8 of the Code.[455] This means that even if an importer has truthfully declared the actual value of imported goods, the declared value will not be acceptable to customs authorities because no data have been submitted to substantiate additions to the price included in the declared value.

In this connection, however, the Code provides no concrete and specific definition of the term "objective and quantifiable data". To ensure fairness and uniformity in administration, customs authorities need to be furnished with a guideline that sets out a practical definition on which they can rely in decision-making. One approach to defining "objective and quantifiable data" is to treat this expression as meaning information sufficient to demonstrate the truth and accuracy of the value declared by the importer. Even though an importer submits information which tends to substantiate the basis for the declared value, however, a calculation of value will not be acceptable to the customs administration under

[455] "[W]here objective and quantifiable data do not exist with regard to the additions required to be made under the provisions of Article 8, the transaction value cannot be determined under the provisions of Article 1". See WTO Customs Valuation Agreement, Annex I, Interpretative Note to Article 8, paragraph 3.

the actual transaction value method if the data were not prepared in a manner consistent with generally accepted accounting principles in the country of importation.

This implies that even if the declared value corresponds to "objective and quantifiable data" evidence, it may nevertheless be regarded as 'untrue' or 'inaccurate' value, unless the data in question conform to generally accepted accounting principles, by which is meant rules and interpretations of accounting established by recognised consensus of the accounting profession within the country of importation at that particular time.[456]

C. Problems of Manipulated Transfer Pricing in Developing Countries: The Weakness of the Code

The importance of MNEs has been growing considerably. UNCTAD data show that total revenue for MNEs in the industrial sector amounted in 1992 to $4.5 trillion. To be precise, about 50 per cent of total international trade have been carried about between related parties.[457] Their shares are likely to rise substantially with increased trade globalisation.

It is worth stressing that issues currently being encountered by developing countries, i.e. cross-border trade activities by MNEs, are completely new. At present, international trade practice encompasses all factors of production.

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[456] See *supra* note 114.
[457] See UNCTAD, *Transnational Corporations and Integrated International Production*, World Investment Report, UN, New York, 1993.

breaking down barriers and creating new ways of conducting businesses by multinational firms. National tax authorities brought in to these matters may find that they have to cope with the high complexity and sophistication of modern trade arrangements. In Thailand, for example, the Director of the Bureau of Legal Affairs, the Revenue Department, accepts that the majority of customs and tax officials are not capable of dealing effectively with the current practice of traders at the international level.

A unique feature of MNEs is their abilities to view the world as a single economic unit and consequently to plan, manage and organise their activities on a global scale. Thus, a question is of what are the major effects of MNEs in relation to international fiscal matters? As mentioned in Chapter 2, the MNEs may, as far as possible, attempt to minimise the amount of taxes and duties payable. One of the serious problems that many governments currently face is the issue of 'manipulated transfer pricing' placed by MNEs. In the context of international trade, as the name suggests, the terminology 'transfer pricing' refers to the price for the internal sale of a good or service in intra-firm trade, i.e. in trade between branches or affiliates of a single business enterprise located in different countries. In practice, the setting of transfer prices will affect the global tax burdens of MNEs because both import duties and corporate tax of enterprises are based on input and output prices, and effective tax rates vary greatly among countries.

The temptation to undervalue imported goods for the purposes of shifting profits and capital via manipulated transfer pricing between members of MNEs is strong in the case of goods exported to 'tax holiday' countries. Because of the

absence of income tax, those countries, including Thailand, provide major advantages for the MNEs to operate their transfer pricing strategies in order to accumulate profits from the high tax jurisdiction. This implies the loss of tax revenue in those developing countries. The Code itself suggests nothing about the question of how to cope effectively with a false declaration of undervalue lodged by affiliated companies. A major concern is that it may not be easy for Customs in developing countries to obtain the information abroad so that the prices shown on the invoices cannot be examined correctly. It can thus be observed that the effects of 'tax holidays' are significant in the contexts of both transfer pricing as well as customs valuation.

Moreover, it has to be admitted that transactions between related parties rarely involve a single item of goods. They extend to a range of goods, services and related arrangements (e.g. licensing agreements), which may be difficult to distinguish as individual benefits or considerations within the total relationship. As regards the Code, the author observes in Chapter 2 that the Code might increase the possibility for manipulation of the value of imports under the intra-firm transactions. This is because the Code concentrates the valuation process on goods. Therefore, the parent company may isolate much of the service and intangible value from the contract for the exchange of goods, effectively reducing the overall transaction value and the resulting duty liability. For example, royalties and licence fees are, under certain conditions, legitimate deductions from the customs value, while service payments for management, administration and research and development may not relate to the imported goods and therefore are not included in determining the transaction value.

As a direct consequence, this situation causes most concerns to traders who do not engage in related party trade. The service and other intangible components of their merchandise imports cannot be separated through a structured relationship with a sympathetic trading partner so that high customs value would be imposed. Hence, the price of goods imported by non-related parties might not correspond to competitive prices with goods imported by MNEs. This event is seen as a loophole through which large traders might influence the market price by arranging a low actual price paid or payable resulting in low custom valuation.

It can be observed further that methodologies for evaluating transfer prices among MNEs addressed by the OECD are, in nature, similar to those valuation methods provided in the Code. The OECD has formulated and published principles and guidelines to assist firms and tax authorities to arrive at an acceptable methodology for assessing transfer pricing.[458] Historically, the OECD first published a detailed report on transfer pricing in 1979 which was followed

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[458] The OECD Report examines the considerations which need to be taken into account in arriving at arm's length prices in general and, specifically, in the context of sales of goods, the provision of intra-group services, the transfer of technology and rights to use trademarks within a group, and the provision of intra-group loans. The OECD Report considers the four general methods of ascertaining arm's length prices briefly listed below:

(1) **The Comparable Uncontrolled Price Method (CUP).** This method uses the uncontrolled market price for the same or similar goods, or the prices of the same or similar goods to independent third parties;
(2) **The Resale Price Method.** This method starts with the price at which the goods are sold by the connected purchaser to independent customers and works back to the arm's length price by deducting a markup;
(3) **The Cost Plus Method.** This method adds an appropriate markup to the vendor's cost;
(4) **Other Methods (or the 'Fourth Method').** These generally involve some form of analysis, which attempts to identify the rewards, risks and responsibilities shared between the entities in an inter-company transaction chain and allocate a reasonable return to each entity. The so-called 'functional analysis' approach seeks to identify the various roles and contributions by entities participating in the transaction flow

by additional reports in 1984 and 1987. On 27 June 1995, the Committee on Fiscal Affairs approved of new Transfer Pricing Guidelines which were published with the unanimous consent of the OECD Council on 13 July 1995. The first edition of the OECD guidelines, in particular, comprised of five chapters discussing the arm's length principle, traditional transaction based methods, other methods based on profit elements, administrative rules and documentation. The latest supplement, issued in 1999, deals with the issues of so-called advanced pricing agreements (APAs).

It is however apparent that the Code concentrates on transactions based trade arrangements, thereby failing to address comprehensively the overall relationships and issues in the same manner as the OECD guidelines. Thus, the valuation methods outlined in the Code do not necessarily produce the same result as the arm's length principle required for income tax purposes. The problem is mainly that the Code ignores the complexity of the service trade, related party transactions and managed arrangements in the forms and volumes that exist as fact today.

What should we do in practice to cope with such problems? In many countries, including Thailand, there is no substantive link between the issues of transfer pricing for income tax purposes and valuation standards for customs duties. As relationships of one form or another comprise a significant portion of world trade and appear to be growing, it is advisable that co-operation between

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and then find a comparable form from which to derive a transfer price which allocates an appropriate reward to each party.

the customs and tax authorities should become more and more intensive in each country. The Customs Department should be empowered to pass information to the Revenue Department and vice versa.

It is important to note that the OECD transfer pricing guidelines support the use of information exchange between income tax and customs administrations. Paragraph 1.66 of the guidelines states that: '*customs valuations, because they may occur at or about the same time the transfer takes place, may be useful to tax administrations in evaluating the arm's length character of a controlled transaction transfer price.*' Paragraph 1.67 further states that: '*co-operation between income tax and customs administrations within a country in evaluating transfer prices is becoming more common and this should help to reduce the number of cases where customs valuations are found unacceptable for tax purposes or vice versa.*'

II. VAT and Trade Globalisation

In addition to Chapter 4, there are two important issues of VAT that need to be in particular analysed in this chapter. This is because those issues are closely related to the context of trade globalisation, i.e. transfer pricing problems, and the extensive base of VAT on importation in Thailand.

A. Transfer Pricing Problems

In theory, given a destination-based VAT in Thailand or other EU Member States, transfer prices arranged by MNEs do not create problems as long

as the chain of transactions is properly traced under the VAT net. Tax jurisdictions share revenue solely on the basis of *situs* of final consumption. This means that the relative increase or decrease of cash flow for businesses, as a result of distortive transfer prices, is irrelevant in determining the division of revenue among different tax jurisdictions. From the country of importation's point of view, there would generally be no incentive for the importer to manipulate the value of imported goods.[459]

Notably, the only exception would be the case where the importer has an exempt status with regard to domestic transactions under the VAT system of the country of importation. In such a situation the importer may be induced to push down the import price in order to reduce the VAT amount on import which cannot be credited. Such a problem is, however, a result of the break of the VAT chain due to the exemption status of the importer, rather than the general structure of the destination-based VAT.

Turning to an origin-based VAT, on the other hand, a different result can be found. Transfer prices would create problems that are similar to those that arise under income tax. Under this principle, the jurisdiction to tax is determined by the origin of value added by each business.[460] As one might observe, the country of exportation can impose its VAT on the portion of value added within its jurisdiction. The country of importation, by the same token, may also tax on the value added by the importer after the goods are imported.

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[459] See *supra* note 45.

The choice between these two systems, as already discussed in Chapter 4, raises one important issue that lies inside the scope of this thesis. Can it be said that the destination-based VAT will become increasingly significant for the WTO members that implement the Code? In accordance with both theoretical and practical grounds, this primary suggestion seems to be, however, contradictory. Some countries, in particular a group of countries within the regional trade integration, such as the EU, might prefer to implement the origin-based VAT since there still remains the issues of dividing the tax revenue among the countries involved. Given that the VAT rates among countries converge, there can clearly be no huge incentive for businesses to create artificial transfer prices.

B. Unnecessary Charges and the Base of VAT on Importation: Thailand

Ideally, from an economic point of view taxes should not distort the flows of goods between countries, so that taxation would be neutral as regards the choice between domestic and imported goods.

The VAT in Thailand, imposed at a flat rate of 7 per cent with few exemptions, seems to be one of the simplest types of VAT which has been adopted. Nevertheless, in Chapter 4, the author found that the existing VAT law in Thailand does not apply equally between domestic and imported goods. There is no doubt that attempts to extend the tax base of VAT, by imposing tax on the

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[460] In this situation, transfer prices across the border between exporting and importing countries determine the division of revenues between the two countries.

price of imported goods plus import duties, excise taxes, fees and other charges. mean that the total amount of VAT liability on imports is higher than that on domestic goods. It is therefore obvious that, under the Revenue Code, domestic goods have been placed in more favourable position than imported products. As one might observe, excessive burdens of VAT could make imported goods unattractive in the local market of Thailand, although it has been argued that importers might shift tax burdens to local consumers (i.e. Thai buyers).

Under the Revenue Code, two sections apply differently for determining VAT base on sales of goods: first is section 79 of the Revenue Code which basically applies in general terms for all goods supplied in Thailand[461]; second is section79/2 which imposes a special tax base for imported goods.[462]

Table 6.1 below illustrates the difference between the total amount of VAT payable on imported goods and domestic goods sold within Thailand. Let us assume, in accordance with the first and second columns, that the intermediate distributor will add profits to the price when he supplies the goods to consumers in Thailand. It should be noted that imported goods are exported from a country that applies the VAT destination principle so that the imported goods are exempt

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[461] Section 79 provides:

"The tax base for sale of goods or provision of a service means total value received or receivable by a supplier from such or provision inclusive of excise tax as defined in Section 77/1 (19), if any.

Value of the tax base refers to money, property, compensation, consideration for services, or any benefits ascertainable in terms of money."

[462] Section 79/2 provides:

"The tax base for import of goods, shall be governed by the following rules:

(1) The tax base for import of goods of all kinds shall be the value of the imported goods

from tax in that country. As a result, those imported goods will only be taxable when they are imported to Thailand.

Table 6.1: Comparison of the Total Burden of VAT between Imported and Local Goods

	Exporters	Importers	Local Consumers	Net VAT Liability
Imported Goods	**100** Baht (Excluding VAT)	**128.40** Baht[463]	**244.38**Baht[464]	**24.38** Baht
	Manufacturers	**Retailers**	**Local Consumers**	**Net VAT Liability**
Domestic Goods	**100** Baht	**107** Baht	**221.49** Baht[465]	**21.49** Baht

Obviously, the increased amount of VAT in the case of imported goods is relevant to the amount of additional charges that are made by the Thai customs authorities. It should thus be emphasised that unnecessary charges or fees that are added to the base of VAT on importation would distort the flows of international trade as well as consumer choices in the local market.

III. Moving Towards Changes

A. Customs Valuation

Before the 'alternative' approaches are proposed, some problems relating to customs valuation should be summarised.

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determined by reference to c.i.f. plus import duty, excise tax defined under Section 77/1 (19), special surcharge under the law governing promotion of investment, as well as other taxes and fees listed by a Royal Decree."

[463] The c.i.f. price of imported goods of 100 + import duties and excise taxes of 12 + Other fees of 8 = 120 plus VAT of 7 per cent (8.40) = 128.40

[464] The price of imported goods of 128.40 + mark-up profits of 100 = 228.40 + VAT of 7 per cent (15.98) = 244.38

[465] The price of goods (including VAT) = 107 + mark-up profits of 100 = 207 + VAT of 7 per cent (14.49) = 221.49.

- One of the most difficult matters of the Code, as was mentioned, is how to appraise the customs value made under the transaction between related parties involving a subsidiary in the country of importation and its parent corporation abroad.

- Tax holidays in importing-capital countries can influence the value of imports. It enables the MNEs to manipulate the value of imports.

- Fluctuation of currency in developing countries can affect the determination of the value of imported goods;

- The Code becomes the basis of appraisement on imported goods for VAT purposes. Thus, adjustments of the price actually paid or payable, such as selling commissions, assists, costs associated with the transport, etc. require verification.

Based upon analytical data established above, it clearly poses challenges to the basis of transaction value in the Code that might be problematic in the case of developing countries. Nevertheless, like most researches, this study has been limited by the fact that, in the real world, there are overwhelming demands for implementing the Code. At present, 49 member countries have adopted the Code, and next year (i.e. January 2000), 29 of 53 developing member countries of the WTO[466], which had invoked the delayed application of the provisions of the Code, will follow. This situation entails that developing countries have no input

[466]For the rest of 24 developing WTO member countries, 19 countries will implement the provisions of the Code by the end of the year 2000, and another 5 countries will apply them by the end of the year 2001. See *the Report of the Committee on Customs Valuation*, G/VAL M9, 28 January 1999, p.7.

into the philosophical or technical considerations attendant upon the implementation of the Code.

Fortunately, as studied in Chapter 5, recent developments in trade liberalisation within the ASEAN region have offered an opportunity to pursue the objective of improving the existing customs valuation systems in developing countries. The formation of the regional group of countries, such as a free trade area, provides rapid easily accessible ways for exchange of information. More specifically, for co-ordination in customs valuation at the regional level, it would be helpful to maintain and analyse the records demonstrating factors concerning differences of commercial level, quantities and the cost of transport among them. It also enables the member countries (of that regional group) to cope effectively with importers who have close relationships with their suppliers/sellers. In this respect, a valid and complete database at the regional level is needed in order to ensure the effective applications of their customs valuation laws, particularly for basis of selecting traders to be post audited. These cover information about importers and their suppliers or related parties, criteria of relationship, branch offices.

Co-ordination in customs valuation within the ASEAN is thus considered in respect of following aspects:

(1) Application of minimum or reference values;

(2) A uniform approach of certain terms and expressions that are not specifically defined or explained in the Code, e.g. place of importation;

(3) The choice of the basis for determining value – whether c.i.f. or f.o.b. It is advisable that the member countries should agree on the c.i.f. basis that includes loading and handling charges;

(4) The issue of currency conversion throughout the region for the purposes of stability;

(5) Adoption of a uniform approach to the declaration process, the submission of supporting documents, including the commercial invoice and the preservation time-frame for documentary retention which could be kept at 10 years;

(6) The appeal procedure placing less burden on the trade;

(7) The creation of a standardised database for checking value declarations and providing precedents for future assessments;

(8) Mutual Administrative Assistance. The establishing arrangement of mutual administrative assistance should also come up with suitable measures to deal with manipulated transfer pricing. In addition, the ASEAN member countries should establish a committee on customs valuation that could meet periodically in order to consider and decide on important valuation issues as well as to monitor the implementation of the Code in each individual member country.

In order to cope with trading activities of MNEs, it is therefore appropriate to propose the application of 'minimum values' for regional trade integration that is a group of developing countries. In this regard, the customs valuation system applicable in the ASEAN would be divided into two different levels (i.e. the so-called dual system) as follows:

(1) in case of extra-regional trade, i.e. goods imported from non-ASEAN member countries, and in case of goods trading within the region between non-related parties, the basis for determining the value of imported goods would be the transaction value of the goods concerned, i.e. the application and operation of the Code. This in addition would help promote the WTO objective of world-wide uniformity because some ASEAN member countries that are not the WTO member countries, would have to implement the Code as well;

(2) in case of goods trading within the region between related parties where those goods fall within the free trade area schemes (i.e. internal trade flows), the regional 'minimum values' would be the basis for determining the value of the imported goods concerned. Such minimum values would be the minimum prices of goods declared by the ASEAN Committee's Ministries of Commerce (or the Committee of Customs Valuation) from time to time. The minimum values should be applied when the ASEAN Customs in the destination country of importation has reasons to doubt the truth or accuracy of the price of goods, or there exists a reason to suspect that the relationship influenced the price. It is thus advisable that the list of minimum values for certain imports would authorise the member country to remedy the defects of the Code. Although the Code expressly prohibits the minimum value system in general[467], such arrangements could be possible since these might be agreed by the member

[467] See *supra* note 210.

countries of the ASEAN group and applicable to internal trade flows only. Obviously, the major argument in favour of such dual approach is that the majority of trade flows within the ASEAN are made under the transactions of MNEs. In addition, to obtain the benefits of the AFTA, most prices declared to the customs authorities tend to be lower than the actual price. This means Customs sometimes cannot rely on the price written on the invoice because it is made at the choice of the importer (in other words a related party) who may attempt to reduce his tax liabilities, e.g. VAT on importation, income taxes.

B. VAT Reform

VAT in the context of cross-border trade flows has been dominated in recent years by the debate between the destination-based and origin-based systems. Each side of debate, as mentioned in Chapter 4, has claimed its ability to facilitate international trade. The author found that the origin-based VAT system tends to be preferable, at least in theory, for regional trade integration. Nevertheless, the tax system, which may be appropriate in one environmental context, e.g. the EU, might not be appropriate in another, e.g. the ASEAN free trade area. Therefore, our studies in Chapter 5 implicitly suggest that the ASEAN at this stage should apply the destination-based VAT system. This accordingly means that the goods imported to this region would be subject to VAT at the border of each country.

In this regard, two observations need to be taken into account. First, reform of national VAT laws in relation to importation can only be made by the ASEAN member countries on the unilateral basis. This is due to, as stated in Chapter 5, the lack of advanced economic integration as well as political commitments amongst the ASEAN member countries. However, confronted with demands that there should be the formation of a free trade area in the very near future, each ASEAN member country should be asked to introduce the equal flat rate of VAT, or general sales taxes if any, on importation. The equalisation of tax rates as well as giving exemption in the case of exportation would be satisfied to support the objective of trade liberalisation. There might however be some difficulties in doing so. Nevertheless, the author observes that the introduction of a flat rate of VAT on importation might be politically possible. This is because differences in VAT rates are not great, varying between 3 - 10 per cent. In particular, as compared with other countries, the rates of 3 and 7 per cent in Singapore and Thailand respectively are considered low. Therefore, the majority of applicable rates in the ASEAN region suggest that these two countries should adjust their rates up to the standard practice of 10 per cent.

Second, and following the first, such reform should be made in line with equity, simplicity, certainty and efficiency. In particular in Thailand, specific tax bases in computing VAT on importation, e.g. unnecessary charges or fees like the BOI fees, should be excluded in determining the amount of VAT on those imported goods. The base of VAT on imported goods should be, on the other hand, made in accordance with the international practice. Again, co-operation in

this matter between the ASEAN member countries would be of practical assistance.

There are also a number of suggestions that should be made to Thailand as follows:

- Exemptions from VAT with regard to domestic transactions would undermine the operation of destination-based VAT system. Therefore, it is advisable that the Royal Thai government should not provide specific treatments such as tax-reduced and exempt items under its VAT laws. In particular, the Royal Thai government should limit the exemption of VAT on importation under the incentive schemes to raw materials only. Otherwise, it would induce the MNEs to undervalue the price of imports in order to compensate irrecoverable VAT on those imported goods;
- To facilitate trade, appeals concerning the valuation for VAT of imported goods should be made, at the first stage, to the Customs Department, rather than to the Inland Revenue. If the appellants would not be satisfied with the decision of the Customs Department, they should appeal to the tax court and to the Supreme Court, respectively. It should be noted that, however, if the appeal relates to the question of whether an importation is subject to VAT at a standard rate (or exempt from import VAT), traders should appeal this matter direct to the Inland Revenue.

Finally, although considerable efforts were taken to ensure the full range of analysis in this study, care must be taken when generalising from our suggestions. This is because, sometimes, the important issues identified in this study may or may not be important in other countries, or even other regions. The present form of the EU, for example, now goes beyond the scope of this study, and therefore cannot compare the EU to the AFTA. Further research can investigate whether the same issues appear to be important in other countries as well.

Appendix I:1

Illustration of Computing the Cascading Tax and VAT

- Cascading Taxes

A tax is imposed at 10 per cent on manufacturers, wholesalers and retailers of televisions. 'A' manufactures televisions, and sells all televisions made to 'B'. 'B' wholesalers them to small regional wholesalers, of whom 'C' is one. 'C' wholesales televisions to 'D' who sells them to the public. A, B, C and D each makes a profit of 100 on the sale. How much tax is paid by a customer 'E'?

'A' sells to 'B' 100 plus tax at 10%, charging 110.

'B' sells to 'C' at 210 (110 plus profit) plus tax at 10%, charging 231.

'C' sells to 'D' at 331 (231 plus profit) plus tax at 10%, charging 364.

'D' sells to 'E' at 426 (364 plus profit) plus tax at 10%, charging 510.

'E' therefore pays 510, of which 110 is tax.

- Value-Added Tax

A value-added tax is imposed at 25 per cent on all levels of production and distribution of goods and services. As in the previous example, 'A' is the manufacturer of televisions, 'B' and 'C' are wholesalers, and 'D' is a retailer who sells to 'E'. A, B, C and D each makes a profit of 100 on the sale. How much tax is paid by the customer 'E'?

'A' sells to 'B' at 100, plus tax of 25%, charging 125.

'B' sells to 'C' at 200, charging tax on the value added at this stage. This is done by imposing tax on the sale to 'C' at 25%, producing tax of 50, but allowing 'B' to deduct from that 50 the tax paid by 'B' to 'A', which was 25. Therefore, 'C' pays 'B' 250, and 'B' has collected tax of 50 of which 25 refunds the tax paid by 'B' to 'A'.

'C' then sells to 'D' at 300, plus tax at 25%, a total of 375. 'C' uses 50 of that 75 tax to recover the 50 paid to 'B', holding only the additional 25 as tax owed to the state. This is 25% of the 100 value added by 'C'.

'D' likewise sells on to 'E' at 400 plus tax at 25%, a total of 500. Of the 100 tax 'E' pays, again 'D' keeps 75 to recover the tax paid to 'C' with 25 going to the state.

'E' therefore pays 500 of which 100 is tax.

Source: Williams (1992)

Appendix I:2

Illustration of VAT and RST Collection Mechanism and Revenue Flows to the Government

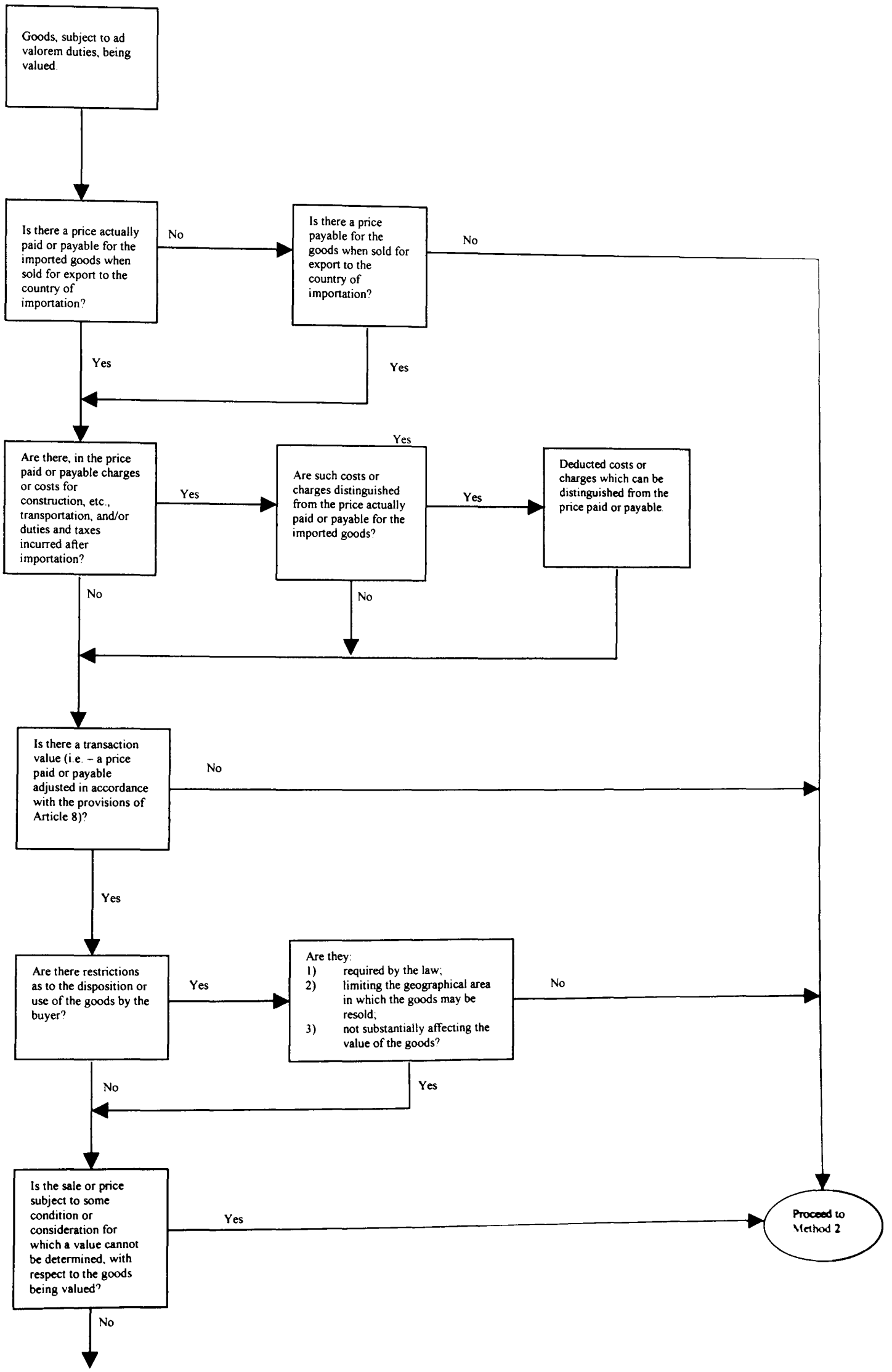
VAT (at rate of 10 per cent)		RST (at rate of 10 per cent)	
Period 1: $ 100 sale from primary producer to Manufacturer		**Period 1**: $ 100 sale from primary producer to Manufacturer	
Taxable payable on sale	10	Taxable payable on sale	0
Tax credit claimed on purchase	-10	Tax credit claimed on purchase	0
Net revenue to government	0	Net revenue to government	0
Period 2: $200 sale from manufacturer to retailer		**Period 2**: $200 sale from manufacturer to retailer	
Taxable payable on sale	20	Taxable payable on sale	0
Tax credit claimed on purchase	-20	Tax credit claimed on purchase	0
Net revenue to government	0	Net revenue to government	0
Period 3: $300 sale from retailer to consumer		**Period 3**: $300 sale from retailer to consumer	
Taxable payable on sale	30	Taxable payable on sale	30
Tax credit claimed on purchase	0	Tax credit claimed on purchase	0
Net revenue to government	30	Net revenue to government	30

Net tax calculations at each stage of production				Net tax calculations at each stage of production			
	Primary producer	Manufac-turer	Retail trade		Primary producer	Manufac-turer	Retail trade
Sales excluding tax	100	200	300	Sales excluding tax	100	200	300
Purchase excluding tax	0	100	200	Purchase excluding tax	0	100	200
Tax on sales	10	20	30	Tax on sales	0	0	30
Tax on purchases	0	10	20	Tax on purchases	0	0	0
Net Tax	**10**	**10**	**10**	**Net Tax**	**0**	**0**	**30**

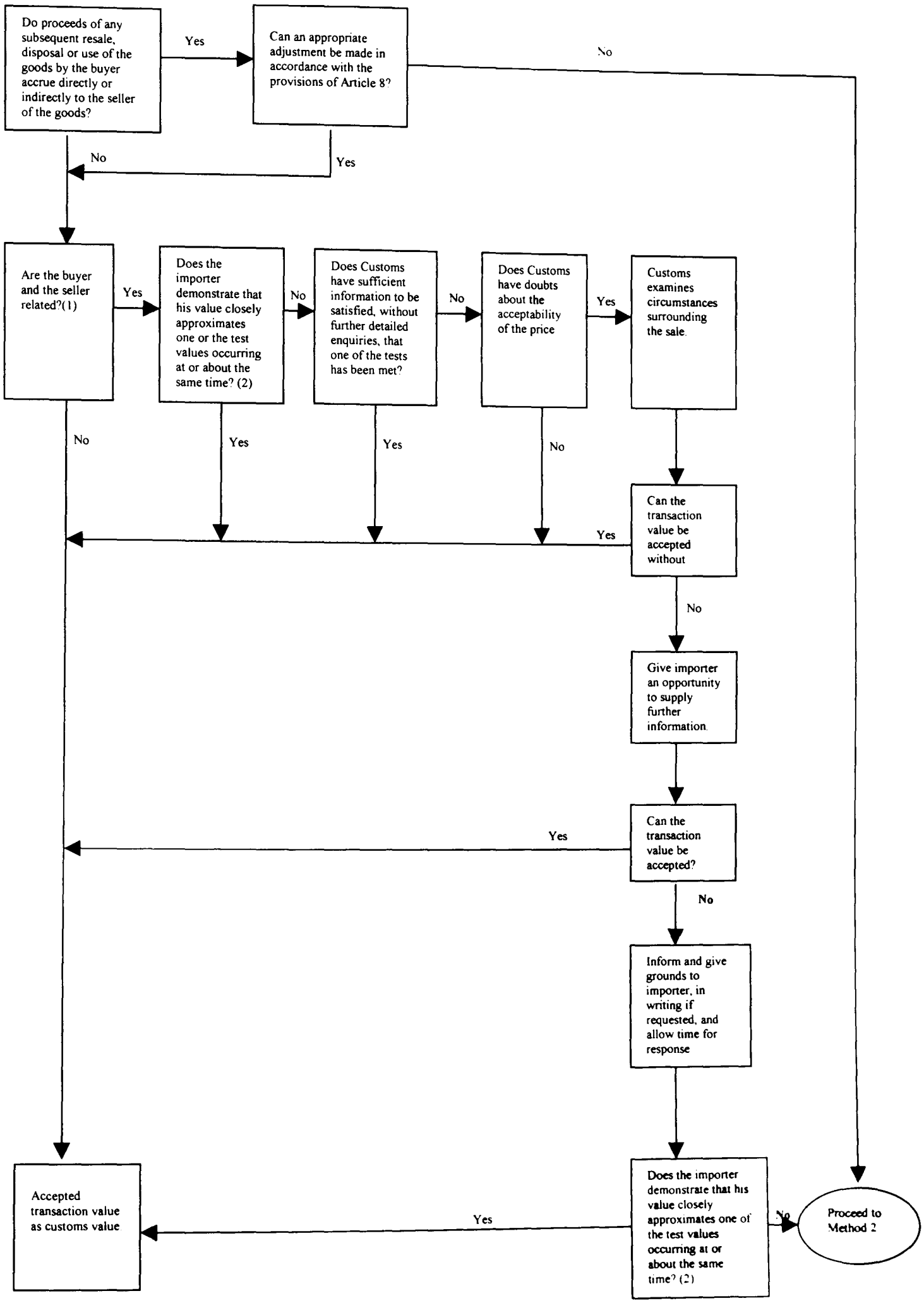
Source: McMorran (1995)

Appendix II:1

Method 1 flow chart:



Method 1 (continued)



Footnotes

(1) Persons shall be deemed to be related only if :

(a) they are officers or directors of one another's businesses;

(b) they are legally recognised partners in business;

(c) they are employer and employee;

(d) any person directly or indirectly owns, controls, or holds 5% or more of the outstanding voting stock or shares of both of them;

(e) one of them directly or indirectly controls the other;

(f) both of them are directly or indirectly controlled by a third person;

(g) together they directly or indirectly control a third person; or

(h) they are members of the same family.

(2) Tests

Transaction value must closely approximate one of the following occurring at or about the same time:

(a) the transaction value in sales to unrelated buyers of identical or similar goods for export to the same country of importation;

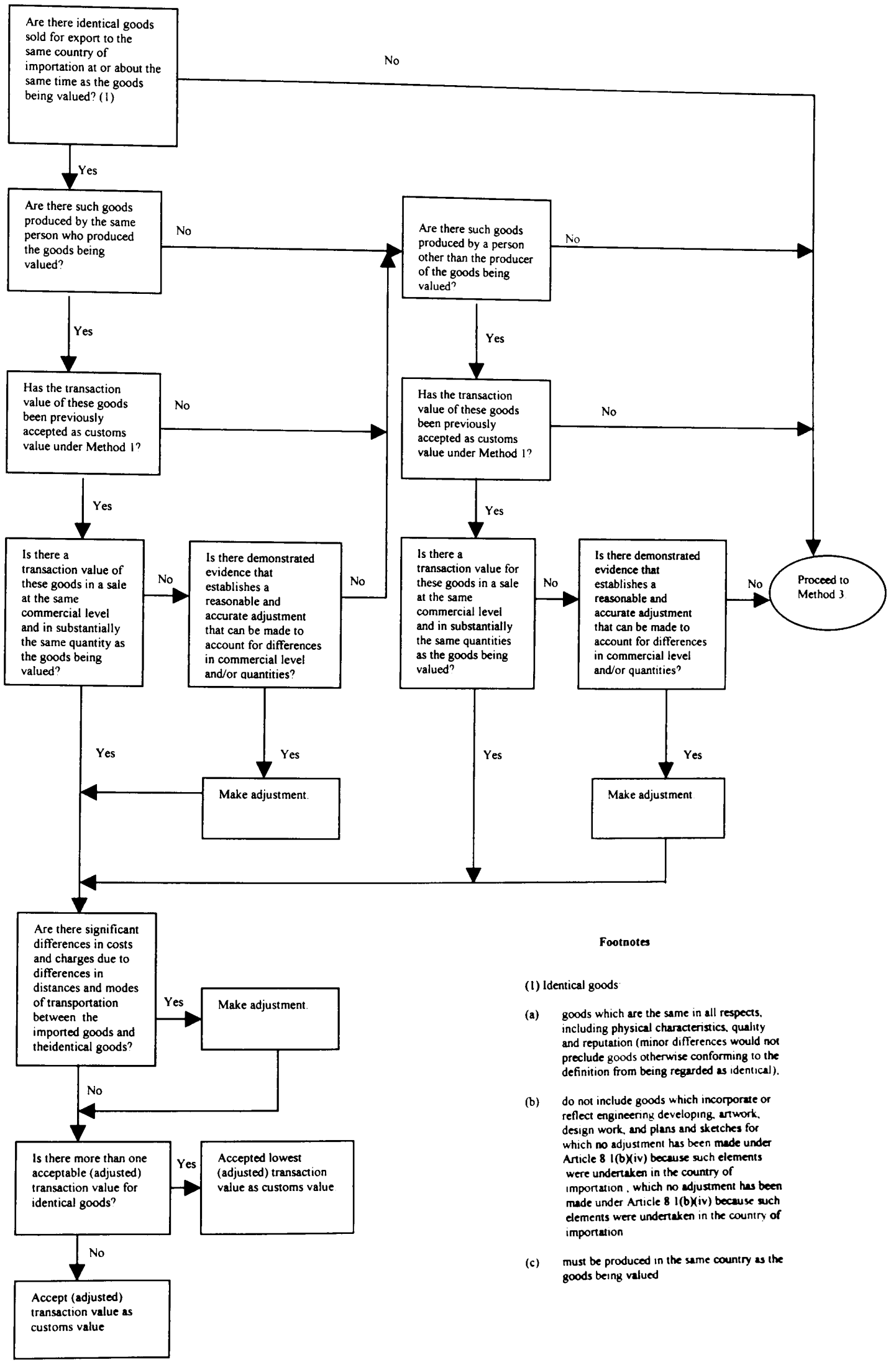
(b) the customs value of identical or similar goods as determined under the provisions of Article 5;

(c) the customs value of identical or similar goods as determined under the provisions of Article 6;

(d) the transaction value in sales to unrelated buyers for export to the same country of importation of goods which would be identical to the imported goods except for having a different country of production provided that the sellers in any two transactions being compared are not related.

Appendix II:2

Method 2 flow chart:



Footnotes

(1) Identical goods

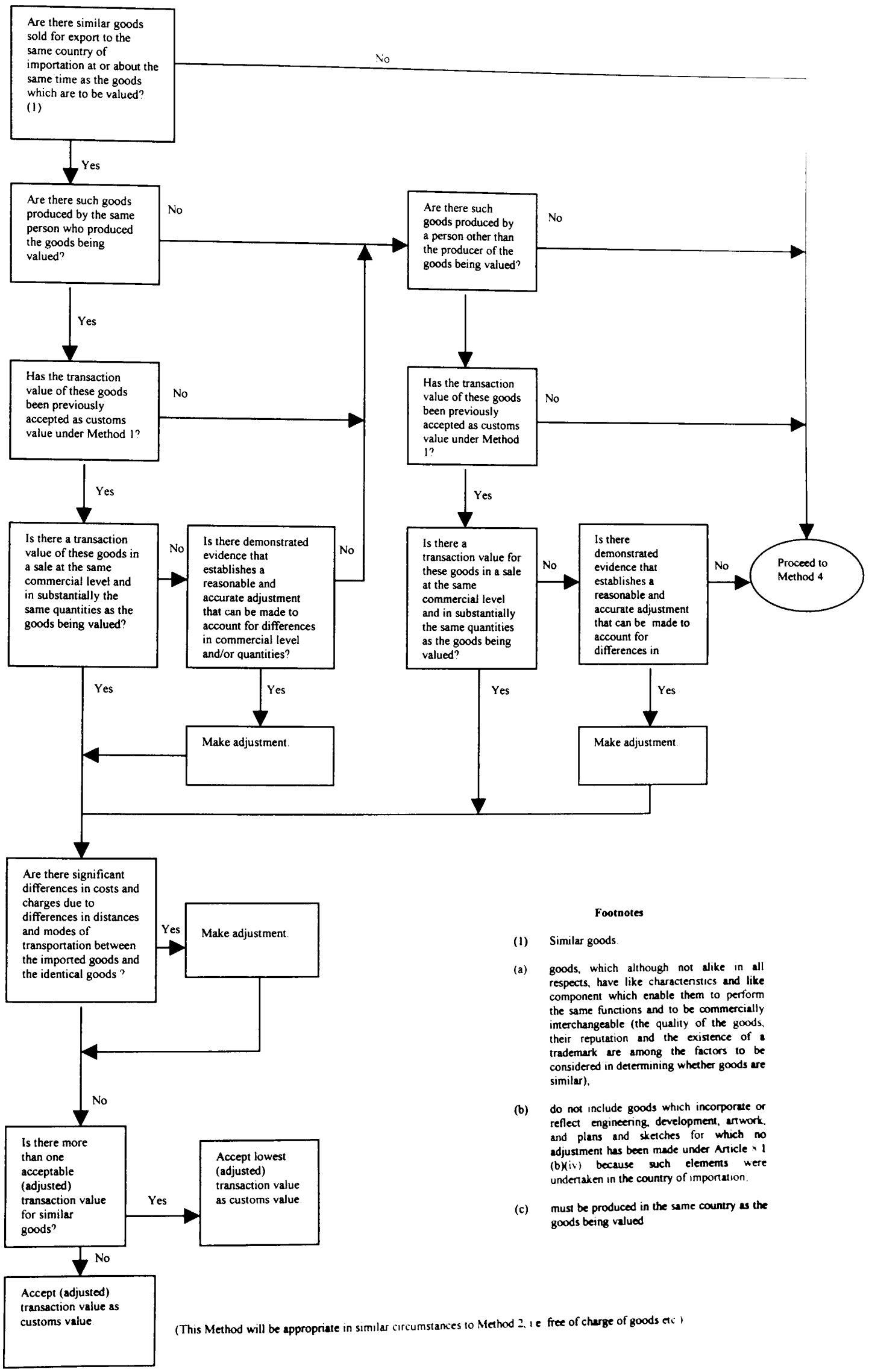
(a) goods which are the same in all respects, including physical characteristics, quality and reputation (minor differences would not preclude goods otherwise conforming to the definition from being regarded as identical),

(b) do not include goods which incorporate or reflect engineering developing, artwork, design work, and plans and sketches for which no adjustment has been made under Article 8 1(b)(iv) because such elements were undertaken in the country of importation , which no adjustment has been made under Article 8 1(b)(iv) because such elements were undertaken in the country of importation

(c) must be produced in the same country as the goods being valued

Appendix II:3

Method 3 flow chart:



Footnotes

(1) Similar goods.

(a) goods, which although not alike in all respects, have like characteristics and like component which enable them to perform the same functions and to be commercially interchangeable (the quality of the goods, their reputation and the existence of a trademark are among the factors to be considered in determining whether goods are similar),

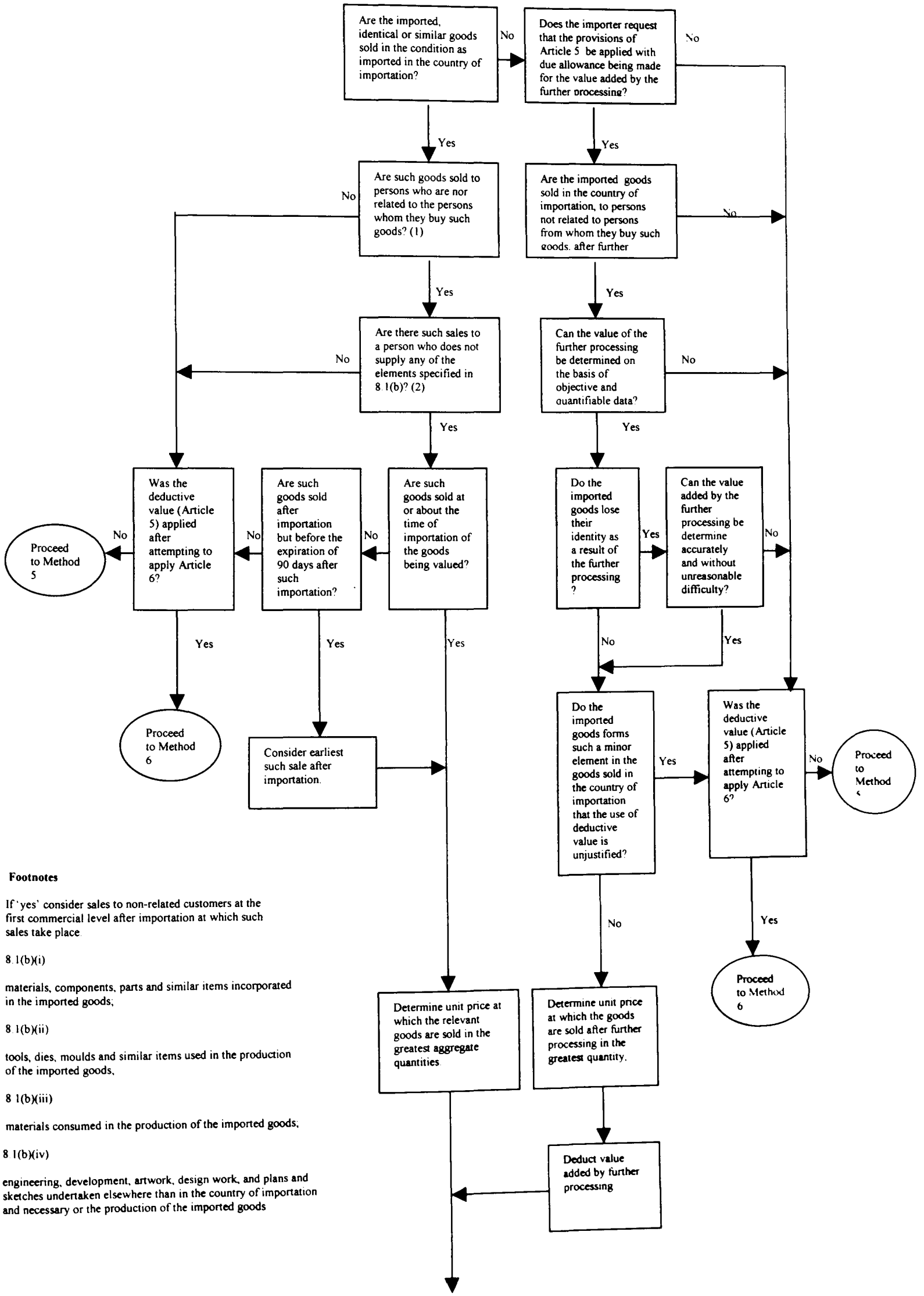
(b) do not include goods which incorporate or reflect engineering, development, artwork, and plans and sketches for which no adjustment has been made under Article 8.1 (b)(iv) because such elements were undertaken in the country of importation,

(c) must be produced in the same country as the goods being valued

(This Method will be appropriate in similar circumstances to Method 2, i.e. free of charge of goods etc.)

Appendix II:4

Method 4 flow chart:



Footnotes

(1) If 'yes' consider sales to non-related customers at the first commercial level after importation at which such sales take place.

(2) 8.1(b)(i)

materials, components, parts and similar items incorporated in the imported goods;

8.1(b)(ii)

tools, dies, moulds and similar items used in the production of the imported goods,

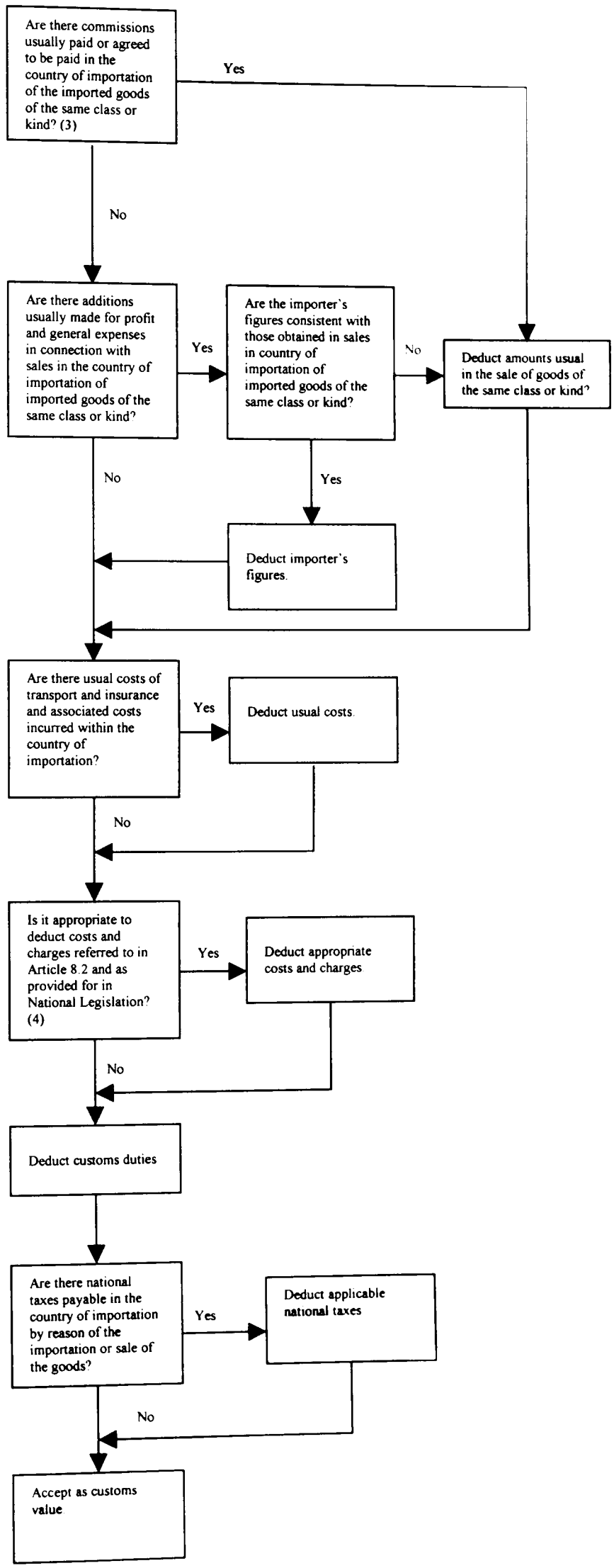
8.1(b)(iii)

materials consumed in the production of the imported goods;

8.1(b)(iv)

engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary or the production of the imported goods

Method 4 (continued)



Footnotes (continued)

(3) for the purposes of Article 5 "goods of the same class or kind" include goods imported from the same country as the goods being valued as well as goods imported from other countries.

(4) 3 2 Elements:

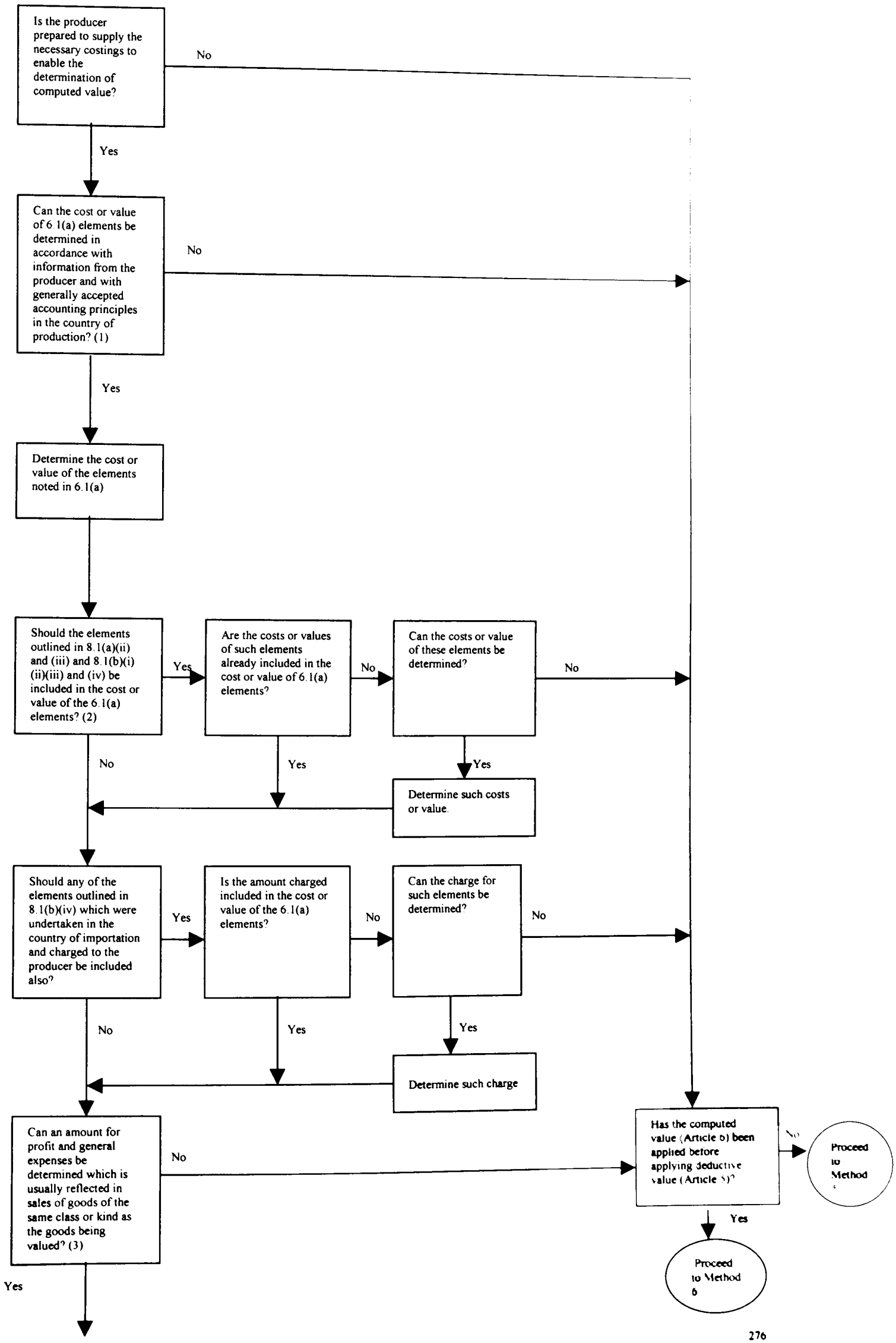
(a) cost of transport of the imported goods to the port or place of importation;

(b) loading, unloading and handing charges associated with the transport of the imported goods to the port or place of importation;

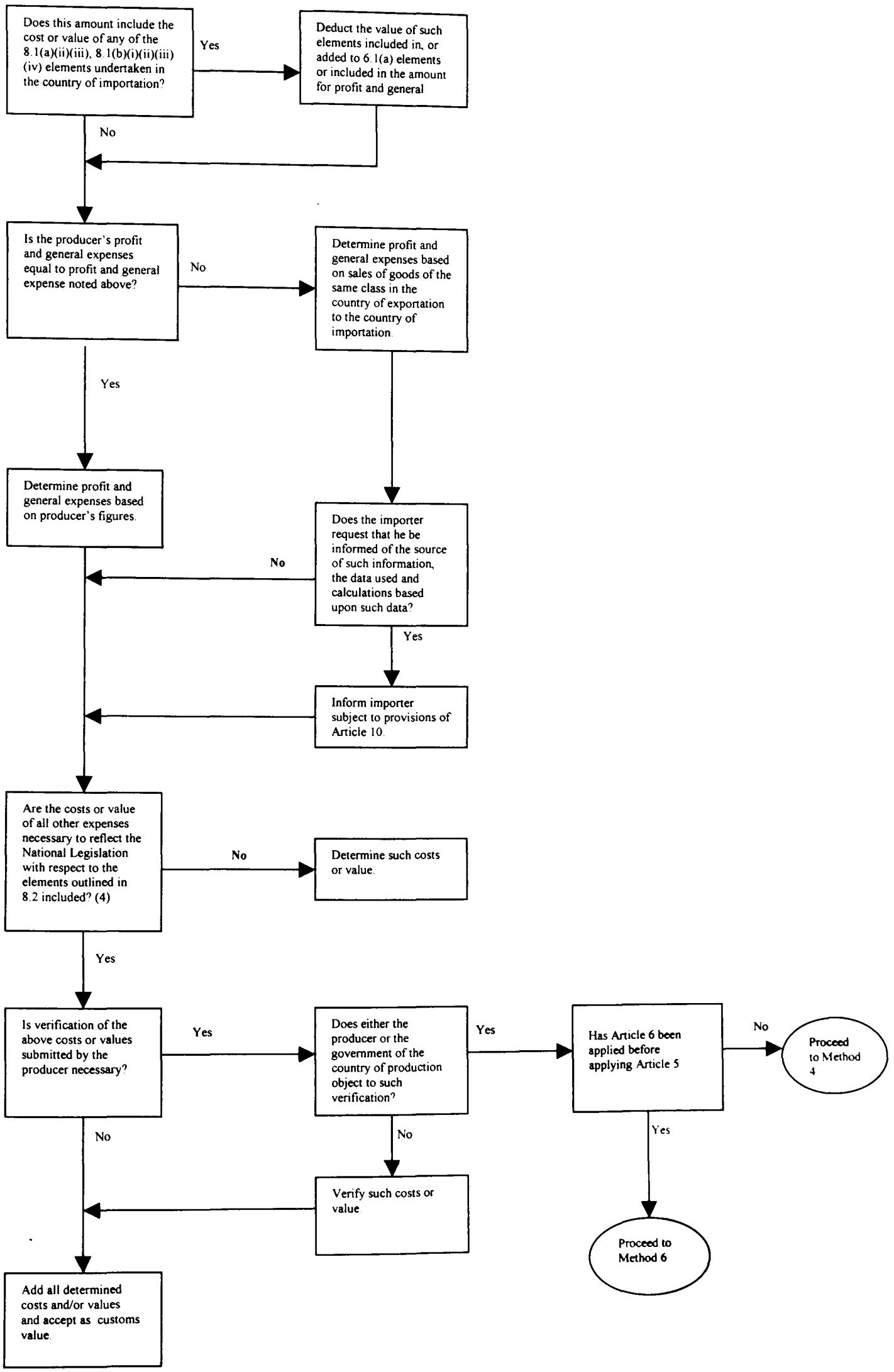
(c) cost of insurance.

Appendix II:5

Method 5 flow chart:



Method 5 (continued)



Footnotes

(1) 6.1(a) elements

the cost of value of materials and fabrication or other processing employed in producing the imported goods.

(2) 8.1(a)(iii) elements

cost of containers which are treated as being one for customs purposes with the goods in question.

8.1(a)(iii)

the cost of packing whether for labour or materials.

8.1(b)(i)

materials, components, parts, and similar items incorporated in the imported goods.

8.1(b)(ii)

tools, dies, moulds and similar items used in production of the imported goods.

8.1(b)(iii)

materials consumed in the production of the imported goods.

8.1(b)(iv)

engineering, development, art work, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary for the production of the imported goods.

(3) Goods of the same class or kind must be produced in the country of export of the goods being valued for export to the country of importation

(4) 8.2 elements

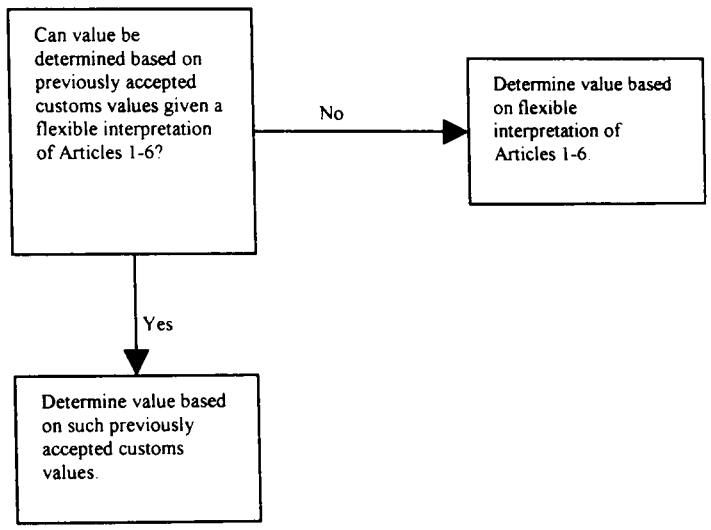
(a) the cost of transport of the imported goods to the port or place of importation;

(b) loading, unloading and handling charges associated with the transport of the imported goods to the port or place of importation;

(c) the cost of insurance.

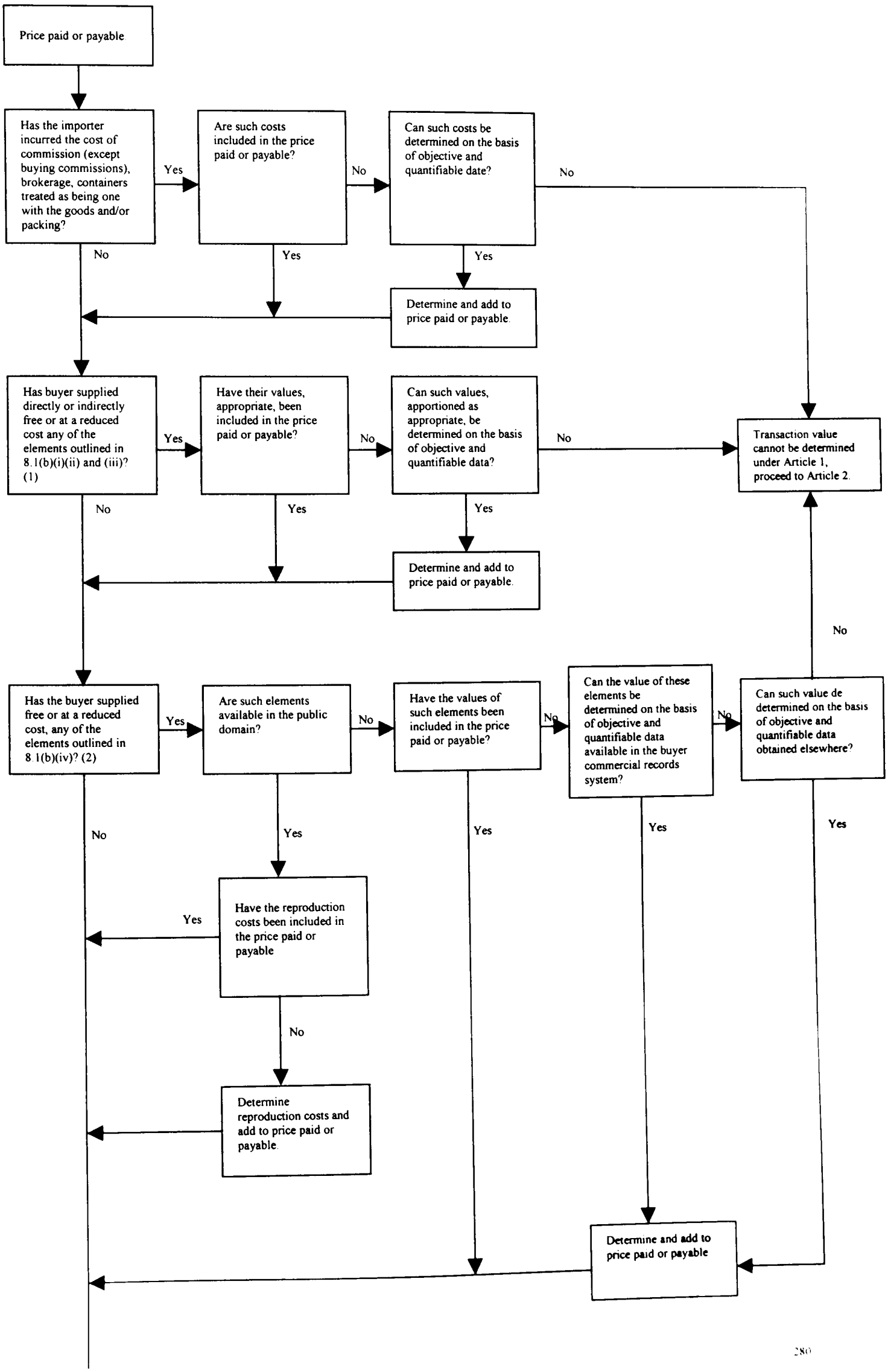
Appendix II:6

Method 6 flow chart:

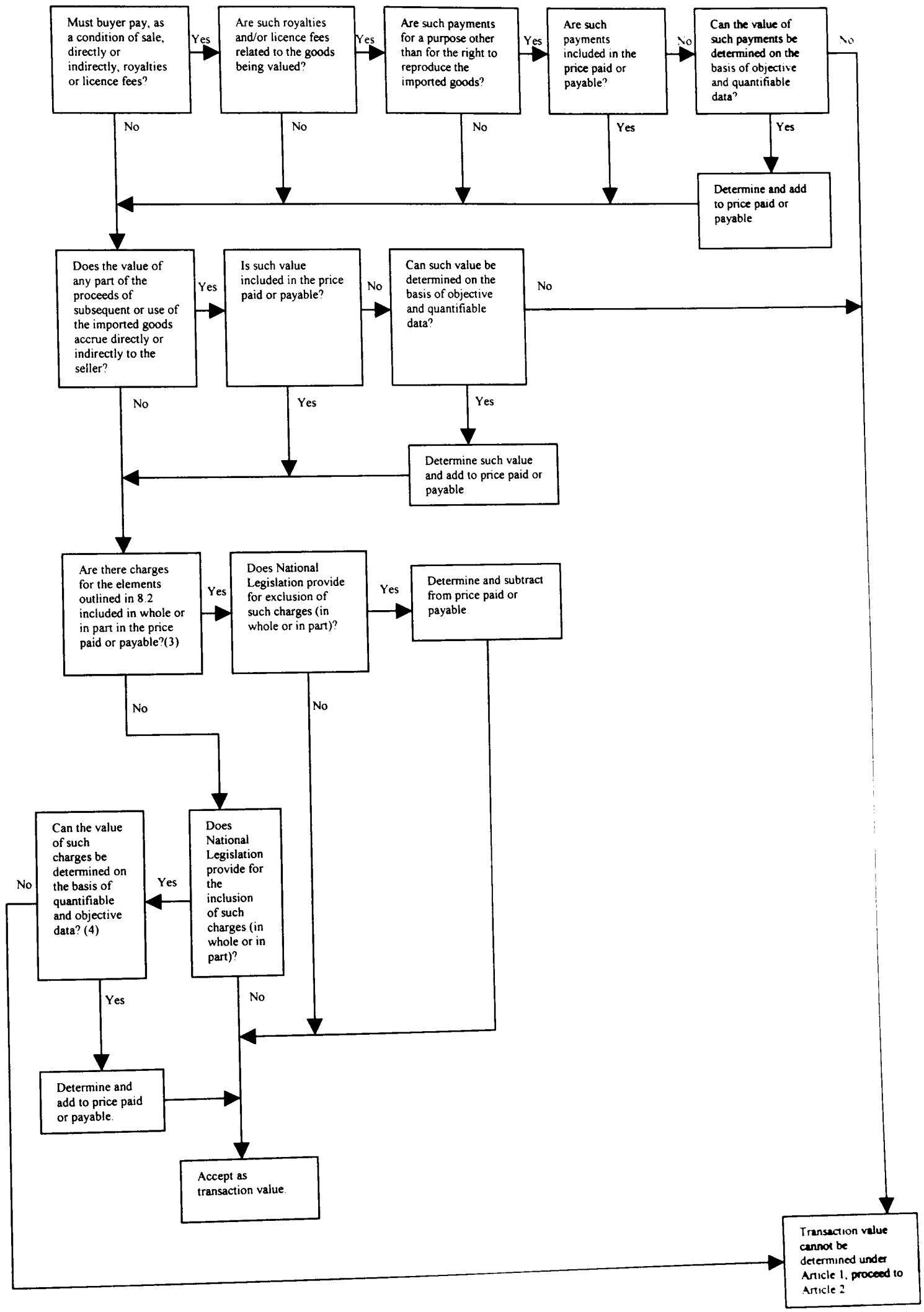


Appendix II:7

Article 8:



Article 8 (continued)



Footnotes

(1) 8.1(b)

(i) materials, components, parts and similar items incorporated in the imported goods.

(ii) tools, dies, moulds and similar items used in the production of the imported goods.

(iii) Materials consumed in the production of the imported goods.

(2) 8.1(b)(iv)

engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the country of importation and necessary for the production of the imported goods.

(3) 8.2

(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.

(c) Cost of insurance.

(4) "No" answers leading to this step require a "no" answer to the decision point in Article 1 dealing with price paid or payable adjusted under Article 8. A "no" to that decision point leads to Article 2.

Appendix III

Business Taxation in Thailand (1932-1991)

The business taxation was first introduced in 1932 as a cumulative dual stage tax covering the wholesaler and retailer with a different tax rate (8% and 6% respectively). The reason for adopting this tax was mainly to raise needed revenues. However, the tax was applied to a limit number of transactions[a], and because of the lack of good accounting records kept by businesses, the base of tax was accounted on rental value of business premises and other similar criteria, rather than gross sales.[b]

The 1932 Act was withdrawn in 1938 and was replaced by the Revenue Code. The 1938 Revenue Code brought together all major taxes levied at that period (e.g. income tax, stamp tax, and business tax). This Code had been amended several times. However, with regard to the business tax, the Code did not alter the nature and structure of the original business tax, particularly the base of tax and the system of levying a tax.

Until 1953, the Revenue Code Amendment Act of 1953 was announced. According to this Act, the base of business tax was changed from the rental value to the total gross sales or turnover of a business. Also, the form of levying a tax was converted into an all-stage cumulative cascade system. There were 23 business activities subject to the new business tax, ranging from production and distribution of goods to various services such as banking, advertising, and utilities. While the rates ranged from 0.5 per cent for transport to 10 per cent for hotels, the rate of one per cent was the most common. Nevertheless, at that period, certain

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[a] There were only eight activities subject to the business tax. These included, for example, sales of goods, hotels, hire of work, etc.
[b] See Annan Lewchalermwong, *Taxation and Tax Reform in Thailand*, Kurusapha Ladprao Press, Bangkok, 1975, p. 70.

domestically produced and imported luxury items were subject to a separate imposition under the commodities tax.[c]

However, the structure of the tax gave rise to cascading effects. A study by Thailand Development Research Institution Foundation in 1987 observes that the business taxation created economic distortions to industries in Thailand. The major problems were that it encouraged vertical integration because the reduction of inter-firm sales reduced total tax liability; it penalised specialisation for the same reason; and finally it induced businesses to import finished goods from abroad, rather than purchased them within the country.[d]

Because of dissatisfaction with the system, the government, again, amended the basic nature and structure of the business tax in 1961, and set out in the Revenue Code Amendment Act. Several changes had been found in this law. First, the basic structure of business tax was changed to a broad-based general sales tax at the manufacturing-importer level (i.e. the manufacturer, importer, exporter, or first seller of goods and services). Second, the commodities tax was abolished and goods subject to this tax were incorporated in the business tax schedule. Third, the number of separate categories subject to tax was reduced from 23 to 13 accordingly. Four years later, one of the 13 categories, that of public utilities, was exempted from the business tax.

Under the new structure, the taxable base for goods was gross receipts with some exemptions.[e] In the case of exports subject to the business tax[f], the export duty was not included in the taxable base. Such the imposition on some export goods clearly suggests that the business tax itself did not provide an incentive to

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[c] The rates of commodities tax varied from 5 to 20 per cent.
[d] See Thailand Development Research Institute Foundation, *General Sales Tax in Thailand: The Impacts on the Industrial Sectors,* Bangkok, 1987, p.15.
[e] The major exceptions occurred in the case of cars and motor-cycles for which the retail price was taken as the base, and for certain petroleum products and cement for which the average wholesale price was taken as the base. See Suvan Valaisathien, *New Thai Taxation*, Finance One Public Company Limited, Thailand, 1993, p. 65.
[f] There were, for example, rice, raw silk, lentils, jute, raw cotton, and certain metallic ores.

promote exports in Thailand.[g] However, Asher and Booth (1983) view that it was necessary for the Thai government to levy additionally the business tax on exports because the revenue importance of exports was not likely to be significant (Table A1).

Table A1: Tax Reliance Ratios for the Business Tax, Excise, and International Trade Taxes in Thailand between 1970 – 76 Average[h]

The Business Tax	Excise Tax	Import Duties	Export Duties	Total
22.9	20	27.3	5	75.2

It should be noted that manufacturers[i], whose gross monthly receipts were less than THB 2,000, were exempt from the business tax in that month.[j] Small manufactures, whose gross monthly receipts were less than THB 10,000 per month, might pay a fixed sum rather than had their business tax liability varied with gross receipts. From an administrative point of view, a low exemption implied that many small traders were liable to the business tax, and thus increased the complexity of the system.

The rate structure of the business tax for goods was much more differentiated, ranging from 1.5 per cent to 44 per cent.[k] However, the rates of raw materials and intermediate products were lower than those for finished goods. In order to avoid cascading effects, there were a number of exemptions granted to certain goods. Generally exemptions of the business tax were given to certain raw materials and intermediate products. Moreover, for essential daily necessities or

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[g] An exception was the exemption from import duty and the business tax of essential raw materials, which were imported for producing goods meant for export. See Department of Customs, *Customs Tariff of Thailand*, Bangkok, 1976.

[h] Source: Mukul G. Asher and Anne Booth, *Indirect Taxation in ASEAN*, Singapore University Press, Singapore, 1983, p. 45.

[i] The law defines the term 'a manufacturer' as: 'a trader who engages in agriculture, extracts, or exploits natural resources, assembles, processes, or transforms goods, or does any act in order to bring into existence any kinds of goods by whatever method.' See the Revenue Code, s.77 of as amended by the Revenue Code Amendment Act (No. 19) of 1965.

[j] THB60 = 1 GBP (At 1999).

[k] For the case of services, the business tax was levied at an *ad valorem* rate ranging from 0.1 per cent to 10.5 per cent of gross receipts on a wide variety of services provided to both businesses and final consumers. Since no deduction was allowed for business tax paid on services purchased by traders liable to sale taxes, multiple taxation, cascading effects, and disincentive for specialisation in services were likely to result. See *supra* note, g

social reasons, extensive exemptions also provided to foodstuffs, a wide variety of educational, charitable, and religious institutions.

In particular, business tax exemptions were also granted under the Tabacco Act of 1969, the Petroleum Act of 1971, and other laws relating to investment promotion. Undoubtedly, such differentiations caused a complex system of tax administration as well as introduced a discriminatory element.

At a glance, the rate structure of the import business tax was generally similar to that of the domestic business tax. The valuation of the base, however, differed. For business tax purposes, the import duty was taken as the taxable base. For certain goods[l] like various petroleum products, motor cars and motor cycles, beer, tobacco products, and cements, the base was in some cases wholesale price and in other retail price. In other types of goods, the business tax liability was determined by the following formula[m]:

$$\text{Business Tax Liability} = \frac{(\text{c.i.f. price} + \text{import duty}) \times (100 + P) \times T}{100 \times 100}$$

(Where: T = rate of business tax; and P = rate of standard profit[n])

In the manner in which the taxable base for imported goods was defined, the fact that some imported goods[o] bear the higher rates than for their domestic counterparts suggests that the business structure was partly used to provide protection for domestic industries. In particular, some goods were subject to the business tax only if imported (e.g. food, textiles, and clothing).[p]

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[l] The Revenue Code, s. 79 (8) of as amended by the Revenue Code Amendment Act (No. 19) of 1965.

[m] It should be noted that those imported goods, which were exempt from customs duties, were also exempt from the business tax. See the Revenue Code, s. 79 (10) of as amended by the Revenue Code Amendment Act (No. 19) of 1965.

[n] The rate of standard profit varies from 3.5 per cent to 31 per cent of CIF price plus import duty, with a wide variety of rates in between, thus adding to the administrative complexity of the tax. See *supra* note h, p. 47.

[o] For example, imported automobiles were subject to the business tax at the rate of 40% whereas 30% rate was applied if they were locally manufactured.

[p] See Priboon. Limprapat and Pichart. Svetarundra, 'Fiscal System and Practices in Thailand', in Asher M. G (ed.), *Fiscal Systems and Practices in ASEAN: Trends, Impact and Evaluation*, Institute of Southeast Asian Studies, Singapore, 1989, p. 78.

Appendix IV

The UK: Purchase Tax and Selective Employment Tax

- Purchase Tax

The purchase tax was introduced in the UK in 1940, in order to help raise revenue for the war effort. The UK government levied purchase tax only at the wholesale stage with different rates. By 1947, the rates of purchase tax went up dramatically high, ranging between 33.5% to 125%. However, the tax base was narrow, excluding food, fuel, and services. By 1970, there were four different rates of tax, varying from 13% to 55%. The rates of tax were classified according to the nature of goods, i.e. the more 'luxurious' the goods the higher the rate. One objection to the tax was the arbitrariness of this classification (especially as, with the passage of time, the luxuries of yesterday became the necessities of today): another was the view that such discrimination between goods distorted production patterns and consumer's preferences.[a]

In addition, it was found that some goods used for business and industry purposes were nonetheless free from tax but subject to tax if they were used for domestic or office use, or for personal or domestic purposes. For example, refrigerators of capacity of less than 12 cubic feet were taxed because they were presumed to be used for domestic purposes while those above that capacity were not so regarded and were not taxes.[b] This, therefore, resulted inevitably in tax distortions and anomalies.

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[a] See C.T. Sandford, M.R. Godwin, P. Hardwick and M.I. Butterworth, *Costs and Benefits of VAT*, Heinemann, London, 1982, p. 1.
[b] See D.J. Willson, H.H. Mainprice, E.L. Gomeche, *Willson & Mainprice on Value Added Tax*, VAT Planning and Publications Ltd., London, 1973, p. 7.

- **Selective Employment Tax (SET)**

In 1966, a sale tax on services, namely selective employment tax (SET), was introduced, in order to improve the 'fiscal balance' of taxation and to help raise the revenue of government. Basically, the SET required every employer to pay a weekly sum for each employee in addition to the National Insurance contribution to the Minister of Social Security. The SET, however, was not required in the case of self-employed.

The refund mechanism was also allowed to employers under the SET, depending on the selected types of activities. For example, employers in manufacturing activities received a refund of payments, plus a premium. A second group of industries consisting mainly of agriculture, transport, mining, quarrying and fishing received a refund but no premium. The third group, comprising construction, distribution and service industries, received no refund.

During that period, the SET had not been operating successfully, and a number of disadvantages were found instead. Firstly, since the SET was paid as a fixed sum per worker (in each category), the burden of tax was proportionately heavier for the low paid than for the high paid. Thus, the SET was strongly criticised for falling to achieve the fair tax system. Secondly, exemption of the self-employment encouraged the artificial development of self-employment, especially in building industries. Thirdly, as a tax on a factor of production, the SET had a disadvantage that it entered into production costs and therefore export prices, both of invisible exports and of the exports of goods insofar as the manufacturers had bought in services such as financial or consultancy advice. Undoubtedly, the SET was finally abolished at the same time as Purchase Tax on the introduction of VAT in 1973.

List of Legislation

COUNCIL REGULATIONS

Council Regulation 803/68, OJ 1968 L148

Council Regulation 1224/80, OJ 1980 L134

Council Regulation 2913/92, OJ 1992 L302 (establishing the Community Customs Code)

COMMISSION REGULATIONS

Commission Regulation 2454/93, OJ 1993 L253 (laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code)

Commission Regulation 1762/95, OJ 1995 L171

COUNCIL DIRECTIVES

Council Directive 67/277, OJ 1967

Council Directive 68/297, OJ 1968

Council Directive 77/388, OJ 1977 L 145

Council Directive 92/111, OJ 1992 L 384

Council Directive 92/77, OJ 1992 L 316

DECLARATIONS

Bangkok Declaration (1967)

Declaration of the ASEAN Concord (1976)

Singapore Declaration (1992)

CODE OF CONDUCTS

ASEAN Customs Code of Conduct (1995)

AGREEMENTS

Agreement on Implementation of Article VII of the GATT 1979.

Agreement on Import Licensing Procedures (1980)

Agreement on the Common Effective Preferential Tariffs (CEPT) Scheme for ASEAN Free Trade Area (1992)

ASEAN Agreement on Customs (1997)

Framework Agreement on Enhancing ASEAN Economic Cooperation (1992)

General Agreement on Tariffs and Trade (GATT) (1947)

General Agreement on Tariffs and Trade (GATT) (1969)

General Agreement on Tariffs and Trade (GATT) (1994)

NATIONAL LEGISLATION

THAILAND

Board of Investment's Notification No. 50/2534 (1991)

Customs Act (No. 9) B.E. 2482 (1939)

Customs Act B.E. 2469 (1926)

Customs Department's Declaration No. 14/94 of 2537

Customs Tariff Decree B.E. 2503 (1960)

Departmental Instruction No. 17/75 of 2518

Departmental Instruction No. 18/87 of 2530

Departmental Notification No. 2/75 of 2518

Departmental Notification No.2/71 of 2514

Director-General's Notification on Value Added Tax No. 43/93 of 29 January 1993

Industrial Estate Authority of Thailand Act B.E. 2522 (1979)

Investment Act B.E. 2534 (1991)

Royal Decree No. 309/97 of 12 August 1997

Tax Compensation for Exports Act B.E. 2524 (1981)

The Civil and Commercial Code B.E. 2468 (1925)

The Revenue Code Amendment Act (No. 19) B.E. 2508 (1965)

The Revenue Code Amendment Act B.E. 2534 (1992)

UK

Customs and Excise (Personal Reliefs for Goods) Order 1992 (SI 1992/3193)

Customs and Excise (Personal Reliefs for Special Visitors) Order 1992 (SI 1992/3156)

Customs and Excise Duties (General Reliefs) Act 1979

Customs and Excise Duties (Goods Permanently Imported) Order 1992 (SI 1992/3193)

Inward Processing Relief Regulation 1977 (SI 1977/910)

Value Added Tax Act 1983

Value Added Tax Act 1994

Value Added Tax Regulation 1985 (SI 1985/866)

Value Added Tax Regulation 1995 (SI 1995/2518)

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