Goldfarb Seligman
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Issue 3

Customs & Trade in Israel

A Legal Newsletter

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A Dispute Regarding Classification of Smoke Detectors is Decided in Favor of the Importer

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In the following article, we will review the Magistrate Court in Rishon LeZion's ruling in the case of a dispute on the proper classification of smoke detectors for customs purposes.

The importer of the smoke detectors claimed that they should be classified under Customs Heading 90.27, exempt from customs duty. The Customs Authority contradicted his claim, classifying the detectors under Customs Heading 85.31-9010, which is liable to a 12% customs duty.

The court ruled in favor of the importer's classification, exempting the smoke detectors from customs duty.

The importer's monetary claim was only partially recognized, due to failure to substantiate the claim of not passing on the duty.

Case Facts and Detailed Arguments:

The differing sides disputed on the proper classification of merchandise.

The importer claimed that the smoke detectors should be classified under Customs Heading 90.27, a classification which includes measurement devices and tools, such as gas or smoke analyzation devices, due to the detectors traits and definition. The Customs Authority, on the other hand, claimed the smoke detectors should be classified under Customs Heading 85.31-9010, a classification which includes electric visual or auditory signaling devices- detectors.

There was no real dispute between the two sides, for according to the manufacturer's instructions and testimonies provided by the importer, the data gathered by the detectors is sent to a switch box that reports the smoke level detected by the device.

It was proven that the switch box's report is accessible and can be viewed, leading the importer to claim the detectors allow for a measurement process, as well as analyzation and constant scrutiny of changing smoke levels by the switch box, and should therefore be classified as a Customs Heading 90.27 - measurement device. Moreover, the importer claimed the detectors themselves are not equipped with, and cannot produce any type of visual or auditory signal, and therefore cannot be classified under Customs Heading 85.31-9010.

Alternately, the importer asked to be absolved from payment of a 130,000 ILS tax deficit due to his meeting the criteria of the Indirect Tax law (Over Paid or Short Paid Tax), 1968.

The Customs Authority claimed that if the detectors cannot operate independently, but only as part of a detection system in which the server receives the measurement data, it should not be classified under Customs Heading 90.27 - measurement device. Moreover, the Customs Authority claimed that the detectors themselves provide no visual indication of smoke levels, and in accordance with the explanatory notes of the Harmonized System, the detectors cannot be classified under Customs Heading 90.27.

The Customs Authority also argued that in 2008, a specific Customs Heading regarding detectors that are part of fire alarm systems was added to the Customs Tariff Order (85.31-9010). The addition occurred following a ruling in a different case, and since then there is no dispute regarding the classification of these detectors as a dutiable Customs Heading 85.31-9010.

The Court's Ruling:

The Classification Tools Available to the Court:

The court reviewed the laws relevant to classification. The court noted that the Harmonized System is a secondary tool down the road if the available tools prove insufficient to reach a clear conclusion. The court also noted that the rulings of other courts are an additional interpretation tool, as are classifications of Customs Authorities in other countries which adhere to the Harmonized System. It was additionally noted that the purpose of the legislation will also be considered in the court's final classification decision. Regarding the purpose of the legislation, the court specifically mentioned that the purpose of customs duty is usually to protect local production, of which it was proven there is none in the case of detectors.

Specific Classification of the Detectors:

The court ruled according to the evidence presented to it that the detectors do in fact measure smoke levels in a way that falls under Customs Heading 90.27 classification. The court rejected the Customs Authority's claim, based on explanatory notes of the Harmonized System, that the detectors lack a visual indicator and therefore cannot be classified under Customs Heading 90.27. The court ruled that the wording of the Customs Tariff Order does not imply the visual indicator must be on the detector in order to be classified under Customs Heading 90.27, for there is no mention of the word "indicator" regarding the detector itself.

The court rejected the Customs Authority's suggested classification because although the description of Customs Heading 85.31-90 includes the word "detector", the 85.31 category refers to devices with visual or auditory signals, while the aforementioned detectors have neither.

The court accepted the importer's claim that foreign classifications may be referenced when discussing international merchandise classification, and noted that the Customs Authority itself relies on foreign classifications in some instances.

Parenthetically, the court rejected the Customs Authority reliance on the OPTEX ruling, which led to the amendment of the Customs Tariff Order adding Customs Heading 85.31-9010, "detectors".

Therefore, the court ruled that the more appropriate classification would be Customs Heading 90.27, as suggested by the importer.

Criticism of the Customs Authority Regarding its Classification Justification:

The court criticized the Customs Authority for presenting only one justification (no visual indicator on the detector) to the importer in the pre-trial disapproval of the detector's classification under Customs Heading 90.27. Later, while presenting its case to the court, the Customs Authority added an additional justification (claiming the detector does not perform measurements as described by the 90.27 classification), a previously undisclosed argument.

The court ruled that the proper policy for the Customs Authority should be to present the importer with the full array of justifications upon which it based its decision before filing a lawsuit, thus allowing the importer to operate with certainty, trusting in the transparency of the Customs Authority.

Regarding Proof of not Passing on the Duty- Does the Import of Detectors and Sale of Systems Absolve from the Burden of Proof?

The importer relied on the **Holis ruling** of the Supreme Court, which states that if the imported goods are raw material, and sold in Israel as a different, finished product, the importer will be entitled to custom tax returns on over duty paid by him, without the burden of proof that the duty was not passed on to the customer.

The court rejected this claim, differentiating the Holis ruling by determining detectors cannot be viewed as "raw materials", even though the importer proved they are only a component of a complete system designed to operate as one, unified fire detection and alarm system. The court ruled that even though the alarm system requires multiple components, such as a switch box, alarms, detectors etc., it is still considered a product in its own right, as is evident in its inherent detection ability, as well as in the fact that it can be transferred from one system to another. In the Holis case, it was proven that the importer imported varying lengths of wooden bars in order to create "venetian" shutters. In other words, the court ruled that the imported goods being a component of a larger system is not enough to exempt an importer from the burden of proof of not passing on the duty.

Did the Importer Pass on the Duty?

The CFO of the importer claimed that the additional duty was not passed on, and no changes were made regarding the pricing of the aforementioned items. Therefore, the amount mentioned in the duty deficit and the duty later over paid were not included in the price paid by consumers. The Customs Authority claimed that the importer failed to prove his claim since he provided only consumer purchase information, and not information on his selling price.

The court differentiated between two time periods concerning this matter: the period before October 2009, and the period after October 2009. The importer refrained from providing evidence on the price of the detectors or the complete system beyond October 2009, and therefore his claim was rejected due to lack of proof. Even so, it was proved that the Customs Authority agreed to classify the detectors imported by the importer as a Customs Heading 90.27 in 2004, and that this state of affairs continued until October 2009, when new guidelines were published by the Customs Authority. The court therefore ruled that the importer is entitled to tax returns on the taxes paid up to October 2009, in accordance with the Indirect Tax law.

Due to the mixed conclusion reached by the court, partially accepting the plaintiff's claim, no cost order was given.

[TA (Rishon LeZion Magistrate Court) 25694-05-10 **Hashmira- Defense Technology (1971) Ltd. Vs. Ministry of Finance\Customs and VAT**, ruling from 16.4.15 presiding judge Helit Silash]

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