

Customs & Trade in Israel

A Legal Newsletter

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Tax Positions Related to Customs for 2017-2018

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Background:

As part of the State Budget Law 2016-2017 (the Arrangements Law), the Customs Authority was first bestowed the power to demand that importers report to it when they act contrary to the tax position of the Customs Authority (in certain cases).

In this capacity, the Customs Ordinance was amended and section 231E was added, with sub-section C of the amendment stating that:

"An individual which holds a (tax) position which requires reporting shall report it in a form determined by the Director, within 60 days from the end of the tax year in which he held the position which requires reporting."

Under the amendment, the Customs Authority was required to publish a list of "tax positions which requires reporting" on its website, and the reporting requirement applies only in cases in which the tax benefit derived from the position is greater than 2 million ILS per year, or 5 million ILS over a four year period.

Similar sections already exist regarding income tax and VAT.

A taxpayer which fails to report a position contrary to a position published by the Customs Authority not only to civil enforcement proceedings and tax demands, but may be exposed to criminal charges as well.

The Customs Authority recently published three tax positions which requires reporting for 2017 in relation to the valuation of goods, which we will review in the following article. These are in addition to the 16 tax positions published by the Customs Authority for 2016, which still apply and require reporting in 2018 as well.

As noted above, the reporting requirement is retroactive, so taxpayers who acted contrary to these tax positions in 2017 and gained tax benefits amounting to a sum beyond that detailed above, are required to report the fact to the Tax Authority by 1.3.2018.

Tax Position 17/2017

Under this tax position, the importer is required to add to the valuation of the goods for customs purposes all the costs of moulds and similar items which were used in the manufacturing process of the goods, were supplied by the importer either directly or indirectly for free or for a reduced rate, and were not included in the sales accounts provided to the importer.

This position is based upon section 133A(2) of the Customs Ordinance, which states that the relative value of manufacturing tools provided by the importer should be added to the transaction value in relation to the manufacture, sale and export of goods:

"(A) materials, components, parts and similar items included within the goods; (B) tools, moulds and similar items which were used in the production the goods; (C) materials used and consumed in the production of the goods."

This section of the Customs Ordinance is based on section 8(1)(b) of the General Agreement on Tariffs and Trade (GATT), an international trade agreement, which states that the value of the following should be added to the goods valuation:

"(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;"

A typical example of such a case can be found in the World Customs Organization's (WCO) case study 5.1. In this case, importer A acquired 10 cars in a certain country for their full price, and supplied the cars for free to a different supplier in the same country which armored the cars. The armored cars were then imported to the importer's country. The WCO ruled that for customs valuation purposes the cost of the cars supplied to the supplier by importer A for free should be included, under a section similar to section 133A(2)(a), as the unarmored cars are considered "materials / components" supplied by the importer at no cost for the production of the goods.

Another example of the implementation of these sections is a case in which the importer supplies the supplier with moulds for the production of the goods, either for free or at a reduced rate. The underlying assumption is that in such a case, the importer is reducing production costs for the supplier, for if the moulds were not supplied by the importer, the supplier would have been required to purchase them himself, resulting in an increase in the goods' price.

It should be noted that the condition for the application of this section is that the tools were supplied by the importer to the supplier for free or at a reduced rate. In other words, if the tools were sold to the supplier for their full price, the costs of the tools should not be included in the transaction value for custom purposes under this section. This is due to the assumption that in such a case the supplier will not reduce the price of the supplied goods, as he received no discount on the tools.

Tax Position 18/2017

Under this tax position, the importer is required to include in the value of the transaction the payments made by him to the supplier or a related entity for "advertising expenses" or "global advertising", which are usually comprised of a certain percentage of either sales of acquisitions.

The position states that when the payment percentage is calculated according to acquisitions, it should be included in the transaction value under section 132 of the Customs Ordinance which refers to the "transaction price". On the other hand, when the payment percentage is calculated according to sales, it should be included in the transaction value under section 133A(4) of the Customs Ordinance, which refers to "any part which may be attributed to the seller, directly or indirectly, in expected income from any sale or use of the goods performed after their sale for export to Israel."

To our understanding, this position is based upon the Central District Court ruling in the Gottex case (September 2016), where the court ruled that when the importer is obligated by contract to acquire external services from the seller (such as inventory management services, advertising, and interior design services for stores), these services are dutiable.

It should be noted that the Gottex ruling determined that these payments are considered royalties related to the goods, and a precondition for the import of the goods, under section 133A(3) of the Customs Ordinance. On the other hand, the tax position refers not to royalties but to a part of the transaction value, under section 132 of the Customs Ordinance, or payments the seller is entitled to, value under section 133A(4) of the Customs Ordinance.

We respectfully feel that the ruling in the Gottex case was far reaching and wrongly interpreted the Customs Ordinance in a manner contrary to the ruling of the Supreme Court in the Mariodex case (November 2016).

Furthermore, we would like to note that our firm has submitted an appeal on the District Court ruling in the Gottex case (our firm did not represent parties in the District Court proceeding), and the matter is currently being deliberated by the Supreme Court. We therefore feel it would have been prudent if the Customs Authority would have waited for the ruling of the Supreme Court on the matter prior to publishing its position.

Tax Position 19/2017

Under this tax position, the value for customs purposes should include any payments to a party related to the seller, under section 133A(4) of the Customs Ordinance, which refers to: "any part which may be attributed to the seller, directly or indirectly, in expected income from any sale or use of the goods performed after their sale for export to Israel."

An example was given of an importer who signs a franchising contract, purchases fashion products from a subsidiary, and pays the company itself a franchisee fee of 3%. In such a case, the franchisee fee should be included under section 133A(4) of the Customs Ordinance.

We believe that since section 133A(4) of the Customs Ordinance uses a broad description, referring to any part that may be attributed to the seller "directly or indirectly", any payment to a company related to the seller would anyway fall under the same broad category as an "indirect" payment to the seller.

Tax Positions Published In 2016

As noted above, the Customs Authority published 16 tax positions which require reporting for 2016, six relating to valuation for customs purposes and ten relating to goods classification, all of which still apply for 2017, in addition to the new tax positions. The tax positions published in 2016 relating to valuation for customs purposes included a wide variety of topics, including returns for advertising expenses, the inclusion of distribution costs, liability, discounts, transportation components, and the inclusion of royalties and services.

External Links:

[Tax positions which require reporting for 2016-2017](#) (in Hebrew)

[Tax positions which require reporting for 2017](#) (in Hebrew)

**The above review is a summary. The information presented is for informative purposes only,
and does not constitute legal advice.**

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