Customs & Trade in Israel

A Legal Newsletter

Adv. Gill Nadel, Chair of the Import, Export and International Trade Law Practice, Tax Department

Obtaining a Waiver of Short Paid Customs Duty Even When the Customs Authority Is Ostensibly Right

Adv. Gill Nadel, Adv. Moran Oz

Section 3 of the Indirect Taxes Law (Overpaid Tax or Underpaid Tax), 1968 enables a taxpayer to obtain a waiver of short paid customs duty even when Customs is ostensibly right in its position. Customs is not thrilled with the section, interpreting it as narrowly as possible and in general gives taxpayers attempting to benefit from it a hard time. Below we will present a few tips that may assist in obtaining the waiver, if need be.

The short paid customs duty relates to past events, and requires an importer to pay for previous releases of goods. In some cases, particularly in relation to classification cases, there is also a forward-looking component to the dispute with Customs, as the position which led to the Customs demand will lead to demand further custom duty to be paid on future releases. Even so, the importer is often willing to pay the future custom duty, focusing instead on efforts to evade retroactive Custom demands. The logic is simple – custom duty to be paid on future releases will be rolled over to consumers, decreasing the direct damage to the importer. On the other hand, past sales did not include the custom duty component, as the importer was unaware of the required customs, resulting with the importer being forced to cover the custom costs himself.

Section 3 of the Indirect Taxes Law

The legislature was aware of the importer's predicament in case of a retroactive custom, and therefore established a mechanism that enables an importer to receive a waiver from payment of underpaid tax under certain circumstances. We refer to Section 3 of the Indirect Taxes Law (Overpaid Tax or Underpaid Tax), 1968. Under this section, the importer will be exempt from payment of underpaid custom if: (1) the customs deficit is not the result of an inaccurate or missing account by the importer; (2) the importer did not know or shouldn't have known of the tax deficit; (3) the importer did not roll the custom over to the consumers.

As the Supreme Court clarified in one of the cases, the heart of the matter is good faith. An importer who acted in good faith upon the assumption that the goods are exempt from import duties, pricing the goods accordingly, will receive a waiver of underpayment. On the other hand, an importer who should have suspected that the goods are dutiable but chose to ignore the signs and not clarify the facts, thus avoiding payment of taxes, cannot benefit from the exemption.

Case Study: Classification Dispute

As an example we may review a case in which there is a dispute between the importer and Customs regarding the classification of a specific product: Customs is arguing that the product is classified as

dutiable, while the importer argues that the product is classified as exempt from tax. In order to obtain a waiver of underpayment the importer must display that he acted in good faith. First of all, he will be required to prove that he submitted all required information to Customs, and did not offer any false presentations regarding the goods. In addition, he must display that he did not believe the goods are classified under a dutiable article, and that an average importer would not have thought so either. Finally, the importer must display that he did not roll the costs over to the consumers.

Customs **Dislikes Section 3 of the Indirect Taxes Law**

Section 3 of the Indirect Taxes Law is like a bone stuck in the Tax Authority's throat. If we are correct in our position - why should we waive the underpaid tax? Why should the public fund the importer's oversight?

But the law is the law, and Customs must uphold the law. To overcome this contradiction, Customs narrowly interprets the law, minimizing the cases in which Customs waives an importer's short paid customs duty . According to expert estimates, only a small percentage of the requests for waiver of short paid customs duty under Section 3 receive a positive reply.

The second condition to set by Section 3 of the law is the greatest barrier for importers to overcome, and Customs often argues that an importer knew or should have known of the custom deficit. This is a regular occurrence in classification disputes. Customs bases its arguments on the second condition, claiming that the importer knew or should have known that the goods should have been classified under a dutiable article. In order to make things even more difficult, Customs position is that the importer's customs agents' knowledge should be attributed to the importer, as he is the importer's representative, and therefore the question should be whether the customs agent knew or should have known that the goods should be classified as dutiable. This position is supported by the wording of the law and rulings by the Jerusalem Magistrate Court, Israel's lowest level court.

In disputes related to the disqualification of origin certificates, Customs usually bases it arguments upon the first condition, arguing that a disqualified certificate of origin is considered inaccurate information supplied by the importer. Customs ignores the fact that upon the release of the goods the certificate was valid, and that the importer relied upon it in good faith. The test is completely objective, argues Customs, and a disqualified certificate is considered inaccurate information. This position is puzzling, at least with regard to EU certificates of origin, which are issued and signed by European customs authorities. If the basis of the exemption is good faith, why should an importer be "punished" for relying upon a certificate produced by an official customs authority? Is it expected that an importer will verify the facts behind an official certificate? Does the Israeli Customs expect its own certificates to receive similar treatment?

Despite the many questions surrounding this position, it was upheld by Israeli courts, including the Supreme Court.

The third condition of the section - not rolling tax expenses upon consumers - does not usually constitute a great challenge for the importer in the case of a short paid customs duty , unlike the corresponding case of custom overpayment.

How Can One Still Meet the Conditions of Section 3 of the Indirect Taxes Law?

Despite the above, there were cases in which the courts accepted the importer's position and exempt him from payment of a tax deficit under Section 3 of the Indirect Taxes Law. Below are a few tips

for meeting the second condition (the importer did not know or shouldn't have known of the tax deficit).

1. It is recommended to move forward only after obtaining an approval / opinion from the customs agent regarding the classification of the goods (or their valuation for customs purposes). It is important to present all relevant information to the customs agent, and receive a clear opinion from him, so that you may later support your claim that you did not and should not have known of the tax deficit, nor was your customs agent aware of it.

   If the case appears problematic - do not gamble on section 3. It is preferable to request early information from Customs, and if necessary, in cases in which Customs decided that the goods are dutiable, to pay the duties under protest, and later demand custom returns.
2. It is highly recommended to check whether there is a Customs guideline that applies to your case. In several cases the "did not know or shouldn't have known" argument was dropped due to the existence of a Customs guideline.

3. Following the activity of competitors is recommended. The price set by the competitors can attest to the custom rates paid by them, and their classification. In one case the court was willing to accept such information as supporting evidence.

4. Feigned innocence and turning a blind eye will not help! In one case, the Tel Aviv Magistrate Court summarily ruled against an importer (and a customs agent) once it became known that they did not examine the classification of the goods for over a decade.

5. At times, additional government entities are involved in the goods release process: the Economy Ministry, the Health Ministry (Department of Pharmacy, Food Service), the Agriculture Ministry, the Standards Institute and others. It is important to check what the position of these entities is, as they often correspond to the importer's position rather than to the Tax Authority's position.

   In one case, an importer imported raisins and classified them as blueberries (which have a lower custom rate). The importer was issued a short paid customs duty, and the importer argued in his defense that he did not know that he imported raisins, he believed them to be blueberries. While the importer did in fact import blueberries, the underpaid tax was waived, as it was proved before the court that the Agriculture Ministry representatives made the same mistake regarding the goods, and could not determine whether they were raisins or blueberries.

Most importantly - follow the process of release of your goods. Released goods that were subject to comprehensive physical examination and then approved by Customs may save you the trouble. In several cases, the existence of an approval by Customs was sufficient to negate Customs argument that the importer "knew or should have known of the deficit".

As we mentioned before, Customs position is not holy scripture, and is subject to judicial review. There were cases in which the courts rejected Customs position and determined that the importer met the criteria set by Section 3 of the Indirect Taxes Law, and subsequently voided the tax deficit notices.

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

For more information, please contact Adv. Gill Nadel, Chair of the Import, Export and Trade Law Practice.

Email: Gill.Nadel@goldfarb.com Phone: 03-6089979.