

## Special Valuation Branch Customs - Role, Operational Challenges and Reforms

### Introduction

The Special Valuation Branch (“SVB”) is a unit of the Indian custom authorities that investigates valuation of goods during imports between related parties. A special relationship between an Indian importer and a foreign supplier may impact the transaction price of the import and thereby affect the customs duty imposed on such transaction. SVB’s function is precisely to examine the impact of such relationship on the invoice value of the imported goods.

This newsletter discusses the framework of SVBs, the erstwhile procedure for investigation previously followed by SVBs, the related practical issues faced by Indian importers and the new framework introduced by the government along with its proposed impact.

#### 1. Purpose and constitution of SVB

Under Section 14 of the Customs Act, 1962, customs duty is imposed on the value of the imported goods. If the Indian buyer and foreign supplier are related say as holding and subsidiary the goods may be imported at a discounted price that could be lower than the normal market price. Accordingly, the customs duty imposed will be lower leading to a potential loss in revenue accruing to the authorities. The SVBs have been constituted to monitor the valuation of goods in such cases in accordance with circulars issued by the Central Board of Excise and Customs (“CBEC”) from time to time. At present, only four (4) SVB offices are in operation at Chennai, Calcutta, New Delhi and Mumbai respectively. Each SVB is headed by a Deputy Commissioner of Customs and assisted by one appraising officer and the necessary ministerial staff. Before February 9, 2016, the working of SVBs was governed by CBEC Circular No. 11/2001 dated February 23, 2001 (“**2001 Circular**”). However, two weeks ago CBEC has revamped the assessment procedure to be followed by SVBs through issuance of Circular No.4/2016 (“**Circular 4**”) and Circular No. 5/2016 (“**Circular 5**”) effective February 9, 2016. Consequently, the 2001 Circular stands repealed from this date.

#### 2. Related party criteria and erstwhile procedure followed by SVB

The Customs Valuation (Determination of Value of Imported Goods), Rules, 2007 (“**Rules**”) require every importer to furnish information to the custom authorities in a bill of entry on the basis of which the customs duty is assessed. The importer and exporter are considered as related if they satisfy any of the criteria laid down in Rule 2(2). This rule considers parties to be related in 8 different situations. These are (i) officers or directors of one another’s business, (ii) business partners, (iii) employer-employee, (iv) if one person owns, directly or indirectly, 5% or more stock or shares of both parties in aggregate, (v) either party directly or indirectly controls the other<sup>1</sup>, (vi) both parties are, directly or indirectly, controlled by a third person, (vii) both parties together control a third person; and (viii) they are members of same

<sup>1</sup> The interpretative notes forming part of the Rules define “control” as a position, in a legal or operational capacity, that enables a party to exercise restraint or direction over another.

family. All related importers must provide details of their relationship in a declaration form along with the bill of entry. Rule 3(3)(a) provides that for assessing the applicable customs duty in case of related parties, the transaction value shall be taken to be the value of the imported goods only if the circumstances of the sale indicate that the special relationship between the importer and exporter did not influence the transaction value. The importer is required to give documentary evidence to this effect and if it is unable to do so, the concerned authorities refer the case to SVB for investigation.<sup>2</sup>

Under the 2001 Circular, the concerned SVB office, upon receiving a reference, registered a case to initiate investigation into the valuation of the concerned import through issuance of a PD circular for provisional assessment.<sup>3</sup> At this point, the importer had to execute a PD bond containing a 1% extra duty deposit (“**EDD**”) on the assessable value of the goods.<sup>4</sup> Simultaneously, a questionnaire was issued to the importer requiring submission of relevant information and documents within thirty (30) days of its receipt failing which the EDD increased from 1% to 5% of the assessable value. Upon receiving the reply, the SVB could seek further information and give a personal hearing to the importer to explain its case regarding the valuation adopted in context of the imported goods. Thereafter, the SVB passed an order finalizing the importer’s case and the EDD was adjusted accordingly. The maximum time limit to pass the order was four (4) months after receiving the reply to the questionnaire beyond which the EDD must be discontinued. In practice, the time period is not really respected. Each SVB order was applicable for 3 years and for imports continuing beyond this period, the importer had to apply for renewal at least 3 months before the order’s expiry. All orders were appealable to the concerned Commissioner of Customs (Appeals).

The foregoing process is plagued with several practical difficulties for the importers. Right from the point of reference to SVB, liaising with the department is not an easy task. Importers often seek assistance from intermediaries who may have varied interests. In many cases, the questionnaire does not reach the importers within time resulting in an unjustified increase of EDD. Further, the SVB generally does not accept the transaction value and pricing methodology applied by the importer. To this end, importers are often quizzed with various superfluous questions which sometimes may have no legal basis. For instance, the department may ask for the pricing adopted by the foreign supplier while exporting goods to other countries. Importers are also sometimes asked to provide costing details of all products imported in India which is difficult, time-consuming and gives rise to confidentiality issues.

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<sup>2</sup> Rule 3(3)(b) provides that the importer must be permitted to demonstrate that value of goods declared in the bill of entry closely approximates to transaction value of similar or identical goods sold to unrelated buyers in India or the deductive or computed value for identical or similar goods ascertained at or about the same time.

<sup>3</sup> Under Section 18 of the Customs Act, the concerned customs officer can make a provisional assessment of customs duty if (a) the importer is unable to furnish complete information required to make a final assessment or (b) the officer needs to subject the import goods to chemical or any other kind of test or (c) the importer has furnished all necessary information but the officer deems it necessary to make an enquiry before making a final assessment.

<sup>4</sup> The customs officer gets a bond executed of such amount that he feels will cover the difference between customs duty provisionally assessed and the duty arrived at post final assessment. If the bond amount exceeds the difference, a refund is given to the importer but if it falls short, the importer is required to make further payment of the shortage amount.

Some other issues identified by stakeholders in context of SVBs are as follows. In practice, the EDD is not discontinued even after expiry of the stipulated four (4) months period. Consequently, the importers often have to resort to litigation and even when a case gets decided in their favour, the department is reluctant to refund the EDD.<sup>5</sup> Then, there is a huge pendency of cases before the SVB extending upto 3-4 years due to which the importers' money remains locked for a long period as EDD.<sup>6</sup> A common problem is that orders issued by SVB offices are often arbitrary and do not adequately deal with the critical issues associated with the case. They have an extremely low success rate when tested in appeal.<sup>7</sup> Another challenge is that the SVB offices lack adequate personnel with the required level of training necessary to handle complicated custom valuation issues. Finally, since the transaction occurs between related parties, the importer has to justify the import price to the transfer pricing authorities to prove that the transaction was undertaken on an arm's length basis. Due to a difference in approaches followed by the SVB and transfer pricing authorities, the importer struggles in arriving at an import price acceptable to both.<sup>8</sup>

### 3. Assessment under the new circulars

The plight of the importers associated with the prevalent practices led to passing of Circular 4 and Circular 5. Briefly, the process for investigation by SVBs prescribed under Circular 5 is as follows:

(a) At the time of filing the bill of entry the importer shall provide information outlined in Annexure A of the circular to the concerned customs officer who shall thereafter proceed to determine the need for investigation by SVBs. Within 3 days of receiving the information, he shall submit preliminary findings to the concerned Commissioner of Customs ("**Commissioner**").

(b) After assessment of the preliminary findings, the Commissioner can direct either reference of the case for investigation by SVB along with a provisional assessment of goods, in parallel, or finalization of the customs duty assessment or assessment in terms of Rule 3 of the Rules by the concerned officer without any SVB investigation;

(c) Reference to SVB shall not be made for import of samples and prototypes, exempted goods (*where no duty is charged or charged at nil rates*) and goods whose value does not exceed INR 100,000 (*USD 1,471*)<sup>9</sup>. Additionally, SVB investigation is mandatory for transactions involving payments towards royalty and license fee or where proceeds of a subsequent resale, disposal or use of the imported goods accrue to the seller or if the condition of sale involves future payments to the buyer.

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<sup>5</sup> Chapter VI.11 of the First Report of the Tax Administration Reforms Committee dated May 30, 2014 available at [http://www.finmin.nic.in/the\\_ministry/dept\\_revenue\\_/First\\_report\\_TARC.pdf](http://www.finmin.nic.in/the_ministry/dept_revenue_/First_report_TARC.pdf), last accessed on February 12, 2016.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Santosh Dalvi, *Special Valuation Branch Cell – Operational Issues and Challenges*, The Chamber's Journal – September 2013, available at: [http://ctconline.org/pdf/chamber-journal/CJ\\_September\\_2013/CJ\\_September\\_2013\\_14.pdf](http://ctconline.org/pdf/chamber-journal/CJ_September_2013/CJ_September_2013_14.pdf), last accessed on February 12, 2016.

<sup>9</sup> 1 USD = INR 68.

(d) For cases where SVB investigation has been directed, the concerned customs officer shall seek relevant information and documents from the importer in a questionnaire (Annexure B of the circular) while continuing with the provisional assessment of the imported goods;

(e) The importer must furnish its reply to the concerned SVB within sixty (60) days from the receipt of questionnaire. Upon failure to do so, the importer is granted a further period of sixty (60) days to reply and while no EDD is levied, a security deposit at the rate of 5% of the assessable value is imposed. The security deposit, which can be given through cash deposit or a bank guarantee, is applicable for three (3) months and must necessarily be discontinued thereafter. After expiry of this period, the SVB can only resort to the Customs Act to obtain necessary replies from the importer.

(f) After receiving the importer's reply, the SVB shall commence inquiry and may seek further information as needed. The investigation must be completed within 2 months of receiving the importer's reply or, after obtaining an extension from the Commissioner, within 4 months thereof;

(g) Upon completion of its investigation, the SVB shall submit its findings to the Commissioner for approval. After the approval has been granted, the SVB shall send an investigation report to the concerned customs officer for finalizing the provisional assessment. The report must contain relevant facts, importer's submissions, investigative findings, grounds for acceptance/rejection of the transaction value declared by the importer and extent of the influence of the importer's relationship with the foreign supplier on the value;

(h) If the findings of the report indicate that the transaction value conforms to Rule 3 of the Rules, the provisional assessment must be finalized accordingly. However, if the value is found to have been influenced by circumstances surrounding the sale, a show cause notice is sent to the importer and an adjudicating authority is appointed; and

(i) The adjudicating authority shall pass an order quantifying the extent of influence of the declared transaction value and the provisional assessment shall be finalized accordingly. The said order, unlike previously, shall remain applicable till change, as maybe declared by the importer, in the terms and conditions of the import in case of which a fresh reference shall be made to the SVB for investigation. Thus, no renewal is necessary under the new law.

Considering the wait for transition to the new regime, Circular 4 provides for treatment of pending cases till such time. It provides that in all pending SVB investigations, EDD is to be discontinued after receipt of the necessary information and documents from the importer or with immediate effect if they have already been provided. Further, for all matters pending renewal, importers are required to provide further information indicating whether or not there is a change in the terms and conditions of the imports. In case there are changes, SVB shall initiate fresh inquiries in terms of Circular 5 and if not, then EDD is to be discontinued immediately and concerned authorities must finalize the ongoing provisional assessment.

#### **4. Proposed impact**

On the whole, the reforms introduced by CBEC are laudable efforts towards making the process simpler for importers from a procedural standpoint. They provide much needed

clarity on what does or does not require investigation by SVB considering the existing tendency of the department to intervene even when not needed. Exclusion of certain transactions from the ambit of SVBs shall not only provide greater ease to the importers in doing business but also reduce the administrative burden on the department. Measures such as dispensing EDD and doing away with the need for renewal would work towards reducing the pendency of cases and lower compliance costs for the importers. Further, furnishing of deposit through bank guarantee shall allow the importer to avoid blockage of funds with the department. To avoid any risks, most importers would probably want to follow this method as opposed to making a cash deposit. However, effectiveness of the new regime would be contingent on a smooth transition of SVBs to the new norms.

### **Conclusion**

The current operational methods of the SVBs are not favourable to importers and hamper the growth of an environment conducive for business. They act as in-country barriers to trade related activities undertaken by group companies. An over-inquisitive approach tends to adversely impact completely genuine import transactions. Hopefully, the SVBs take speedy measures to implement the new norms which would facilitate trade and thereby act as a further step towards transforming the government's "Make in India" vision into a reality.

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