



Brussels, 13 September 2017

CUSTOMS-TAX COOPERATION

o Draft Guidance on Customs' role in the collection of indirect taxes

(Item XIII on the Agenda)

I. Background

1. At its April 2017 sessions, the PTC discussed the topic of Customs-Tax cooperation including a preliminary research on joint approaches/activities between Customs and Tax authorities and provided suggestions on future work in this domain, including a more detailed study of Members' practices (in particular revenue authorities).
2. Following that, further work has been conducted with regard to the sharing of data between Customs and Tax authorities through inter-operable systems/databases or common database, as well as joint activities/initiatives (e.g. joint audit, joint risk management). Members' (including revenue authorities) experiences (positives and negatives) and associated challenges have also been analysed from various perspectives.

II. Discussions at the Policy Commission and the Council

3. In July 2017, the Policy Commission discussed the topic of Customs-Tax Cooperation and examined additional cooperation opportunities between the two authorities in terms of the exchange of information and joint approaches towards revenue collection, risk management, audit, and financial crimes.
4. In addition, the Policy Commission discussed a concept paper on Customs' role in the collection of indirect taxes (appended as Annex I to this document) and tasked the PTC to develop a Guidance, taking into account the indicated broad outline and key areas (set out in Annex II to this document)
5. At the July sessions of the Council, there was a clear interest among Members regarding the topic of Customs-Tax cooperation. While sharing their national experiences, Members underlined the need for exchanging best practices as well as outlining benefits of cooperation for both Customs and Tax authorities.

III. Customs' Role in the Collection of Indirect Taxes

6. Customs administrations are primarily responsible for the assessment and collection of Customs duties. However, in many countries Customs also collects indirect taxes on imported goods. This area provides several opportunities for further cooperation between Customs and Tax authorities, not only in ensuring fair and efficient collection of revenue (duties and taxes) on imported goods, but also in assisting Tax authorities with the collection of leviable taxes on further sales and processing of those goods through a robust data exchange mechanism.
7. Over the years, with declining share of Customs duties, the share of indirect taxes in the overall revenue collection by Customs has significantly increased in many countries around the world. Following are the some examples¹:

Country	Customs Duties as % of Tax Revenue	Total % of Tax revenue collected by the Customs agency
China	3.6	21.3
France	0.7	24.4
Germany	0.8	8.7
Japan	1.7	14.3
Korea (Republic of)	3.3	21.8
Singapore	<0.1	14.8
South Africa	4.3	18.8
Switzerland	1.8	35.2

8. Furthermore, the contribution of Customs to tax revenue in respect of 'OECD/High-Income Economies (HIE)' and 'Others' is outlined below :

OECD/HIE (<u>33</u> Members): <u>28</u> valid responses	Others (<u>149</u> Members): <u>74</u> valid responses								
Contribution of Customs to tax revenue (%)	Contribution of Customs to tax revenue (%)								
18.0	34.1								
<table border="1" style="width: 100%;"> <tr> <td>Customs duties on imports/exports</td> <td style="text-align: right;">1.2</td> </tr> <tr> <td>Other duties/taxes on imports (VAT, excise etc.)</td> <td style="text-align: right;">13.8</td> </tr> </table>	Customs duties on imports/exports	1.2	Other duties/taxes on imports (VAT, excise etc.)	13.8	<table border="1" style="width: 100%;"> <tr> <td>Customs duties on imports/exports</td> <td style="text-align: right;">8.4</td> </tr> <tr> <td>Other duties/taxes on imports (VAT, excise etc.)</td> <td style="text-align: right;">22.8</td> </tr> </table>	Customs duties on imports/exports	8.4	Other duties/taxes on imports (VAT, excise etc.)	22.8
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9. With growing globalization and inter-connectedness of economic activities as well as the emergence of new channels of trade, it is becoming increasingly important for Customs and Tax authorities to enhance coordination and harmonization so that their policy directions and effects are mutually coherent. Such measures aimed at greater facilitation and effective enforcement could potentially enhance authorities' revenue streams and other national benefits associated with overall economic competitiveness.

¹ WCO Annual Report 2016-2107

10. Modern 'technological and institutional tools' and 'formalized cooperation between Customs and Tax authorities' can make it easier for both authorities to collect revenue in a more fair and efficient manner than before. A coordinated approach on revenue collection along with the exchange of information can assist both authorities in curbing revenue frauds when seeking to prevent or resolve non-compliance issues.
11. In the growing E-Commerce environment, Customs, through its risk-based approach and the use of information and communication technologies, can improve the efficiency of processing imports of low-value small shipments and collecting VAT/GST/Excise duties on such imports. This too requires closer cooperation between Customs and Tax authorities that may include, inter alia, the examination and implementation of alternate models of revenue collection (e.g., vendor collection and intermediary collection).
12. The proliferation of 'Special Customs Zones' (e.g., Free Trade Zones, Special Economic Zones) have contributed to foreign direct investment (FDI), employment and trade volumes in many countries. However, there are increasing concerns with regard to the misuse of these special zones for illegal activities including evasion of duties and taxes. This issue can be addressed to a certain extent through robust collaborative arrangements between Customs and Tax authorities.

IV. Development of a Guidance on Customs' Role in the Collection of Indirect Taxes

13. As requested by the July 2017 Policy Commission, the PTC is expected to develop a Guidance on Customs' Role in the Collection of Indirect Taxes.
14. The objective of this Guidance is to provide assistance to Customs and Tax authorities in enhancing their understanding of Customs' role in the collection of indirect taxes on imported goods; implementing associated processes; and exploiting potential opportunities for cooperation between both authorities in this area.
15. Based on the broad outline (Annex II), preliminary work for the development of the draft Guidance has been initiated. Further work involves detailed discussions, research, and analysis as well as collection and study of Members' practices.

V. Action Requested

16. The PTC is invited to :
- discuss and provide suggestions (including those relating to the structure and potential content) for advancing the work on the development of the Guidance;
 - consider and, if appropriate, establish a group of interested Members and other stakeholders for carrying out further work; and
 - encourage Members and stakeholders to share related resource materials and practices.

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Concept Paper on Customs' Role in the Collection of Indirect Taxes on Imported Goods

Introduction

1. There are various types of indirect taxes, for example Value Added Tax (VAT), Goods and Service Tax (GST), Sales Tax, Excise duty. These taxes are normally levied on domestic manufacture and/or sale/supply of goods and services.
2. Excise duties² are one of the oldest indirect taxes on the manufacture, sale or use of specified goods. Over the last half-century, VAT and GST have been spreading; limited to fewer than ten countries in the late 1960s, it has now been implemented by about 136 countries, with some other countries actively considering introducing it.
3. Based on the economic imperatives and policy considerations in each country/jurisdiction, these indirect taxes, equivalent to the rate levied on such goods on domestic manufacturing/sales, are applied to imported goods to provide a level playing field between imported goods and domestic goods.
4. In connection with international trade, exports are normally zero-rated (from domestic indirect taxes) and imports are generally taxed on the same basis and at the same rate as local production/sale. Customs administrations play an important role at both ends (export and import), allowing legitimate reimbursement of taxes/drawback claims on exported goods as well as charging taxes as applicable in the destination country.

Customs' role

5. In many countries, aside from Customs duties, Customs administrations are also responsible for the collection of indirect taxes such as VAT/Sales Tax and GST as well as Excise duties on goods at import.
6. The 2015 WCO survey, to which 72 Members responded, indicates that Customs administrations are responsible for the collection of a wide range of duties and taxes, primarily on imports but in a few cases even on domestically manufactured/traded goods. Besides the collection of Customs duties by 70 Member Customs administrations (99 %), 67 (94 %) also collect Excise duties on certain goods (for example, alcohol, tobacco, petroleum products, mineral oils, energy and electricity).
7. 57 respondents (80 %) indicated that they are also responsible for the collection of Value Added Tax/Sales Tax on imported goods. Likewise, 11 (15 %) indicated that they collect GST on imported goods. 33 Members (46 %) are also responsible for the collection of various other duties and taxes such as provincial sales tax, road tax, environment/green tax, national building tax, social security contribution, veterinary control tax and special levies/charges.
8. Given their wider mandate in the international supply chain, Customs administrations fulfill multiple responsibilities, including for example : fair and efficient

² The etymology of the word *Excise* is derived from the Dutch *accijns*, which is presumed to come from the Latin *accensare*, meaning simply "to tax".

revenue collection; community protection and security; and trade facilitation and modernization. Customs administrations receive and process information concerning cross-border flows of goods, money, people and means of transport, as well as details of individuals and businesses. Thus, they have a comprehensive view and understanding of the dynamics and business models of supply chains, via different modes.

9. Customs collects, with no additional cost or nominal cost, indirect taxes (including VAT/GST/Excise duties) on goods crossing the border. Generally, Customs uses the same assessment and collection mechanisms as for Customs duties, which are typically based on (i) the description and classification of goods, (ii) the value of the goods, (iii) the characteristics or origin of the goods, and (iv) the nature of business model and means of transport. This makes Customs a very cost-effective agency for such collections.
10. Customs has the domain expertise to determine the correct value and other aspects relevant to the collection of duties and taxes based on extant legal provisions and associated parameters, by adopting a risk-based approach. Customs plays an important role not only in collecting legally due taxes on imported goods, but also in obviating any potential distortionary impact on domestic sales. This assumes a greater significance in the growing E-Commerce environment, with a phenomenal increase in low-value and small shipments.
11. Customs valuation ensures the “integrity” of downstream value addition activities for business and taxation purposes. Indirect taxes (e.g. VAT/GST/Excise duties³) on imported goods are normally charged and calculated on the Customs value of the item plus certain post-importation charges and costs (e.g. Customs duty, freight, and insurance). It is in this sense that the correct assessment of taxes on imported goods, and downstream valuation and taxation by competent authorities, can be said to be based on the valuation carried out by the Customs authorities. This process also ensures the seamless flow of correct tax credit from one economic operator to another.
12. Being the leading border agency, Customs usually have the first interface with new products and trade flows. They may also have much better cooperation arrangements with their cross-border counterparts through bilateral/regional/plurilateral Customs-to-Customs cooperation arrangements than other government agencies, and thus have a better access to product identification and associated commercial information on a transactional basis. Given this, Customs can effectively collect indirect taxes on new products that may not even be domestically produced/manufactured and share respective information with Tax authorities to assist them in dealing with such products downstream.
13. Furthermore, Customs can establish a taxable event for charging taxes on imported goods, like duties. At the same time, Customs is well placed and sometimes legally obliged to apply exemptions and special arrangements concerning VAT/GST/Excise duties in order to meet specific policy objectives.

³ Excise duties are also levied on specific rate basis (based on quantity).

Cooperation opportunities

14. Customs administrations being/becoming responsible for levying and collecting indirect taxes at the border, they need to have close cooperation with the authorities responsible for levying such taxes in domestic situations, for example Tax authorities, GST authorities, and Excise authorities. Good working cooperation and the effective exchange of information between the two authorities would make cross-border trade processes more predictable and less burdensome for traders, thus fostering cross-border trade and economic development.
15. Enhanced cooperation between Customs and Tax authorities in the area of indirect tax collections would lead to the fair and efficient collection of leviable VAT/GST/Excise duties. The exchange of information and a coordinated approach by the two authorities, through leveraging the synergies between them, will result in financial and efficiency gains. It would also increase their capabilities to access additional sources of information that can be used to ensure tax compliance and identify potential non-compliance by providing the missing link in the information “ecosystem”.
16. Furthermore, mutual cooperation between two authorities would help in efficient implementation of the WTO Agreement on Trade Facilitation (TFA), thus creating a more effective and facilitative tax-payer environment. Some of the trade facilitation measures in terms of trusted trader programmes (e.g., SAFE Authorized Economic Operator programme, TFA Authorized Operators scheme); e-payments; separation of release from final determination of Customs duties, taxes, fees and charges; deferred payments subject to specified criteria, and post-clearance audit can equally be applied by Customs in coordination with the Tax authorities, when collecting indirect taxes at importation.
17. In the growing E-Commerce environment, Customs, through its risk-based approach and the use of information and communication technologies, can improve the efficiency of processing imports of low-value small shipments and collecting VAT/GST/Excise duties on such imports. This requires enhanced and closer cooperation between Customs and Tax authorities that may include, inter alia, the examination and implementation of alternate models of revenue collection (e.g., vendor collection and intermediary collection).
18. Some Tax authorities are exploring alternate models of tax collection (e.g., vendor collection and intermediary collection) for cross-border low-value shipments, potentially reducing or eliminating de minimis for VAT/GST purposes. Since alternate models of collection of VAT/GST would primarily be dependent on voluntary compliance by overseas vendors/intermediaries, there would be a need to establish a fallback mechanism, where Customs could provide support in addressing risks of inadvertent/deliberate undervaluation and misdeclaration, including the risk of fraud associated with refunds.
19. In some Customs Unions (e.g., the EU), where VAT/GST on imports is charged based on the destination principle by the importing Member State, goods are released at the first point of importation for their onwards movement to the destination Member State, subject to specified criteria. VAT payment is deferred, with collection to be carried out by the destination Member State. This calls for closer cooperation between the Customs and Tax authorities in terms of the collection of taxes and fraud prevention, through improved exchange of information between them and more coordinated supervision from the point of importation through to the final destination.
20. Furthermore, in order for Tax authorities to levy indirect taxes on domestic transactions, Customs administrations could share the relevant information deriving from

the goods concerned (i.e., the importer/consignee), which could lead to the identification of subsequent domestic sales and processing/value addition.

Where Tax authorities find it difficult to identify the fraudulent refund of taxes/wrong drawback claims, they could potentially benefit from cooperation with Customs administrations, including requests for on-site inspection of exports, and the sharing of information in relation to, for example, fraudulent exports, export over-valuation and import under-valuation. This cooperation and sharing of information should be more than mere credit linkage; for instance, the classification for Customs purposes may also apply to VAT/GST, as is already the case in some Members' administrations.

21. Information shared by Customs, relating to the import of goods including taxes levied and collected, can help Tax authorities to verify tax compliance when returns are submitted in which the import VAT/GST is declared. Harmonization of VAT/GST and Customs processes could be another area for closer cooperation.
22. Customs can also ensure overall compliance management with regard to indirect taxes on importation. However, this requires constant interaction with the Tax authorities in terms of enhanced understanding of taxation concepts and underlying requirements, as well as mutual sharing of risk indicators.
23. Underpinning to sustainable cooperation and exchange of information mechanisms between Customs and Tax authorities is a robust legal framework. Legislative enablers and safeguards need to be put in place to allow for the exchange of information. It should also ensure the confidentiality of information exchanged and limit its use to mutually agreed purposes.
24. A preliminary draft outline of the "Guidance on Customs' Role in the Collection of Indirect Taxes" is appended to this document.

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Draft Outline of Guidance on Customs' Role in the Collection of Indirect Taxes

Preface

Chapter I : Introduction

- a. Indirect Taxes
- b. Global Developments
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- d. E-Commerce

Chapter II : Customs and Tax

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Chapter III : Collection of Indirect Taxes on Imported Goods

- a. Core Principles
- b. Customs' Role
 - i. Classification and Valuation
 - ii. Compliance Management
 - iii. Facilitation

Chapter IV : Enablers

- a. Legal and Policy Frameworks
- b. Working Mechanisms and Processes
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Chapter V : Cooperation

- a. Exchange of Information
- b. Administrative Assistance
- c. Knowledge Management
- d. Cooperation Frameworks

Chapter VI : Case Studies and Best Practices
