



## FEDERAL TAX OMBUDSMAN SECRETARIAT

C.No.0016/OM/2020

Dated: 09-09-2021

To,

The Advisor Media & Awareness,  
FTO, Secretariat,  
Islamabad.

Copy of Findings/Recommendations in C.No.0016/OM/2020 is enclosed herewith for Publication.

  
(Arshad Mahmood Cheema)

Registrar  
Federal Tax Ombudsman Secretariat  
Islamabad  
051-9214348

Encl: As above  
Copy to:

1. ✓ MIS Manager, FTO, Secretariat, Islamabad.
2. Secretary to FTO.
3. Office copy.



**BEFORE  
THE FEDERAL TAX OMBUDSMAN  
ISLAMABAD**

**0016/OM/2020**

Dated: 20.08.2020 R.O. Karachi

The Secretary,  
Revenue Division,  
Islamabad

... Respondent

Dealing Officer

: Mr. Shahid Ahmad, Advisor

Departmental Representatives

: Mr. Shoukat Ali, Secretary (Valuation),  
Federal Board of Revenue  
Mr. Shafique Ahmed, Latki, Director  
(Customs Valuation)  
Mr. Shoaib Anwar Hashmi, Dy. Director  
Directorate of Post Clearance Audit

**FINDINGS/RECOMMENDATIONS**

7 This is an Own Motion (OM) investigation initiated through exercise of jurisdiction, conferred under Section 9(1) of the Federal Tax Ombudsman Ordinance, 2000 (FTO Ordinance) based on a news item published in the Daily Jang dated 07.08.2020, regarding persistent "under-invoicing of imported goods". The news reported a specific case of under-invoicing in the import of Tang powder by declaring value as \$0.4 per Kg, as against the value of \$2.39 per Kg. This fact revealed from the actual export documents, obtained from UAE Customs Authorities. Preliminary investigation revealed that certain importers established shell corporations in Dubai to manage under-invoicing of imported goods leading to revenue leakage as well as having adverse implication for the viability of domestic industry.

2. The Customs valuation is the main pillar in the determination of Customs Duty liability. Section 25 of the Customs Act, 1969 (the Act), provides a methodology for establishing a Customs Valuation system that primarily bases the customs value on the transaction value of

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\* Date of registration in FTO Secretariat



imported goods. Section 25A of the Act, empowers the Directorate of Customs Valuation to determine Customs value of any goods imported into or exported out of Pakistan. The Directorate currently issues Valuation Rulings (VR) in respect of selected items or on a reference received from the Collectorates. The Collectorate while finalizing assessment either consult the VR, if applicable or compare the National database in respect of identical goods for the last 90 days. The phenomenon of under-reporting of value appears to be a systemic issue of tax maladministration within the FBR and its field formations.

3. Comments were requisitioned from the Secretary, Revenue Division, in terms of Section 10(4) of the FTO Ordinance, read with Section 9(1) of the Federal Ombudsmen Institutional Reforms Act, 2013. In response thereto, the Secretary (Valuation & Audit), FBR, Islamabad submitted comments vide letter dated 02.10.2020. It was contended that Section 25 of the Customs Act, 1969 (the Act), provides the legislation for determination of value of imported and exported goods on the basis of Transaction Value (TV). However, in case the goods could not be assessed on the basis of TV, the law provides various alternative methods for determining the fair value of goods for purpose of levy of Customs duties and other taxes. Under the provisions of Section 25A of the Act, the Customs authorities can determine the Customs value of the goods through issuance of a VR, while Section 25C ibid provides that in case, where declared value of the imported goods is not considered to be actual transactional value, the Collector of Customs may, after approval from FBR, entertain offer by any other person to buy such goods at a substantially higher value than the declared customs Value, subject to fulfilment of certain procedure. Section 25AA of the Act, allows the use of information received through data exchange for the purpose of determination of

customs value. This was the legal basis for operationalizing the Pakistan-China Electronic Data Exchange Agreement (EDEA), whereas, Sections 26A and 26B of the Act, empower officers of Customs to conduct audit of declarations and determine liability of any person regarding payment of duties & taxes. These powers provide the basis for undertaking post-clearance audit (PCA) of both importers and exporters, which is a critical pillar of modern Customs administration. Chapter IX of Customs Rules, 2001 (SRO 450(I)/2001 dated 18<sup>th</sup> June 2001) contains detailed procedure relating to valuation of goods by Customs. A significant part of Pakistan's imports comprises commodities/items that have published price mechanisms which is a transparent way of determining prevailing prices.

4. In order to curb under-invoicing of imports in certain cases, the Directorate of Customs Valuation fixes the minimum value of imported items through issuance of VR. Moreover, VRs had also been issued in order to provide uniform guidelines for assessments such as for freight, packaging etc. There are a large number of items which are considered low risk for various reasons. In the case of such items/categories, the Deptt either accepts the declared value or assesses based on established yardsticks of valuation.

7. 5. The valuation controls are mostly exercised at import stage where the transaction value is not known. Determination of value under Section 25(1) of the Act, requires several documents for ascertaining the correct value of imported goods. However, if detailed documentary checks and verifications are exercised in real-time at import stage at the ports, this will result in delay in clearance, port congestion, incurring of demurrages etc. Therefore, the Deptt had to rely upon documents submitted by the importers which, in case of informal sector, are often either manipulated or not genuine. Majority



of Pakistan's Informal sectors, particularly the wholesale and retail, import goods through a network of middlemen, brokers and agents. Some of these middlemen resort to various malpractices to maximize their margins of profit and it is one of the main issues relating to under-invoicing in imports of goods. Sometimes, some unscrupulous traders, in order to avoid proper valuation of imported goods, submit vague declaration of quantity (e.g fabric in meters instead of kilograms), description and classification. Although, the Customs officials are alert to such misdeclarations, yet the volume and load of work often result in improper assessment of goods.

6. The FBR had elaborated following measures to address the problem of under-invoicing/reporting of value at import stage:

- i. **In-depth study of valuation system.**
- ii. **Review of Customs Valuation.**
- iii. **Reference Prices.**
- iv. **Withdrawal of Outdated VR.**
- v. **Focus on sensitive dutiable imports.**
- vi. **Mirror Analysis.**

7. The Directorate General of Customs Valuation, after analysis of Pak-China import data, identified major sectors where under-invoicing was rampant. The VR of these sectors were taken up for revision. It is averred that the extent of under-invoicing in imports was on the decline in Pakistan, For example, the trade gap between Pakistan and China (being the largest exporter of consumer goods to Pakistan) was reduced from 33% in the year 2015 to 9% up to June 2020.

8. The Directorate General of PCA, Karachi vide letter dated 14.07.2020, contended that during scrutiny of import data of 'TANG' about period 2016-17 to 2018-19, it was observed that various unscrupulous commercial importers were importing 'TANG' brand drinking powder manufactured in Bahrain via Dubai port which was

released at the declared value of \$ 0.40 per Kg. The same item was imported by M/s Mondelez Pakistan Limited, Karachi directly from the manufacturer at a higher value and the average value was \$ 1.40 per Kg as against the declared value of \$ 0.40 per Kg by commercial importers. It was evident that the values being declared by the commercial importers for the same product were fictitious, concocted and managed through "group under-invoicing" resulting in huge loss to the government exchequer. The evidence obtained from Dubai Customs Authorities in respect of GD No.KAPE-HC-135025 dated 19.02.2019, indicated that value declared before Dubai Customs Authorities was \$ 2.3 per Kg. The evidence was examined and compared with the declaration of the importer and it was discovered that Export Document filed before Dubai Customs Authorities pertained to "M/s Mijwad General Trading LLC" and the invoice and packing list were issued in the name of "Imtiaz Provision Store". However, examination of documents filed by M/s Imtiaz Provision Stores, revealed that the declared value was different than the value declared at the time of export. It was found that payments were made through LC issued by Mashriq Bank to the supplier, NAHLA ABDULLA GEN. TRADING CO. LLC, Dubai and the import value declared and paid was \$0.40/kg. It was apparent that importer had established a 'shell company' in Dubai, through which amount mentioned in GD was transmitted through LC, while the rest of the amount might have been transferred through other means. Consequently, the Directorate framed audit observations/contravention cases against the importers who mis-declared the value of this item involving duty/taxes of Rs.248.000 million. During investigation, it was informed that Rs.47.200 million, were recovered while the Hon'ble Sindh High Court in Special Customs Reference vide judgment No.543 to 596/2020 dated 08.04.2021, remanded the cases back to the Customs



Appellate Tribunal to decide upon the law points involved in the instant cases. However, all the importers cases have preferred appeals before the Hon'ble Supreme Court of Pakistan and matter is subjudice.

9. Averments perused and arguments of the DRs considered.

10. It is observed that historically the government maintained very high tariff to protect domestic industries from imported goods, which becomes a major cause of under-invoicing. It was estimated that annual average net revenue loss due to under-reporting of value was almost equivalent to around 11% (percent) of total revenue generated from Customs tariff. Analysis of import from UAE, conducted by the Pakistan Business Council, revealed that major import value discrepancies and estimated annual loss of about Rs.150 billion. The under-invoicing of imported goods is a serious and complex problem that negatively impacts the economy in several ways. This also leads to an uneven playing field, unfair competition and is disadvantageous to locally manufactured goods. Although, the general perception that reduction in rates of taxes will have a positive impact on the under-invoicing, however, with the gradual reduction in the customs duties no major decline in the instances of under-invoicing had been observed. It is largely attempted by the traders but the manufacturers are also not far behind.

11. The review of customs valuation system conducted by the FBR established that several factors had contributed to the current state of affairs. These include issues relating to existing business process which is focused at clearance stage, a weak Risk Management System (RMS), an ineffective PCA Organization, trading practices resulting from a large informal undocumented economy, as well as issues of integrity and poor accountability within the Department. The



Action Plan as a result of review recognizes the need to modernize customs valuation control mechanism and processes, including WCO recommended technique of “mirror analysis” to investigate cases of misdeclaration of value in imports from major trading parties.

12. With the increase in volume of international trade and the need for trade facilitation has necessitated the adoption of risk management and audit-based controls. PCA is one of the most important means/tools used and has become a major challenge for Customs administration who are required to facilitate trade while at the same time ensure effective control in compliance of law. However, PCA implementation is not a standalone process, it needs to be embedded into clearance system by incorporating transaction-based controls for low and medium-risk transactions as well as adopting compliance-based PCA for high-risk transactions. The Revised Kyoto Convention (General Annex- Chapter 6, 6.6 Standard) recommended reliance on audit-based controls by using traders’ commercial systems. Standard 6.6 of the General Annex to the Revised Kyoto Convention describes the principle of audit-based control, while the Guidelines in Chapter 6 include details of the post-clearance audit.

13. It is apparent that FBR has failed to put in place an effective “post-clearance audit organization” to deal with the issue of rampant under-invoicing, especially in respect of GDs cleared under Green Channel.

#### **FINDINGS:**

14. Failure to put in place audit-based controls, recognize vulnerabilities in RMS and ineffective PCA to deal with the problem of undervaluation, besides developing a comprehensive monitoring mechanism for verification of the correctness of trade-related declarations and adopting timely corrective measures, is tantamount

to systemic maladministration in terms of Section 2(3)(ii) of the FTO Ordinance.

**RECOMMENDATIONS:**

15. (a) **CASE SPECIFIC:**

FBR to –

- (i) direct the Directorate General of Post Clearance Audit (PCA) to pursue cases pending before various adjudicating fora and ensure recovery of legitimate revenue from the unscrupulous importers; and
- (ii) pass on information pertaining to the commercial importers dealing in these items to IRS to cross-match the data with sales tax and income tax returns filed by the importers.

(b) **INSTITUTIONAL AND SYSTEMIC REFORMS.**

FBR to –

- (i) Develop Dynamic Risk Management Framework
  - a) which should be able to intervene for high-risk transactions, post-entry verification for lower risk and investigative capability to detect fraud.
  - b) review the existing RMS for identification of valuation related checks and control for improvement and integration in the WeBOC system.
- (ii) Strengthening of Post Clearance Audit
  - a) make effective the Directorate of Post Clearance Audit Organization to perform in the light of responsibilities assigned as per Customs General Order No. 03 of 2009, dated 13.06.2009, through checking the accuracy and authenticity of declarations filed by the importers through the examination of relevant books, accounting records and commercial data held by the importers to verify that the amount of revenue legally due has been identified and paid in compliance with customs requirements.
  - b) provide trained human resource in adequate numbers so as to make PCA a vibrant



organization based on international best practices.


(iii) Use of National Database

- a) national valuation database may be used as a risk assessment tool along with other risk tools to assess potential risk regarding the accuracy of the declared Customs value for imported goods. The information in the database should be recent data reflecting the Customs value and other pertinent information for previously imported goods. The values may not be used to determine the Customs value for imported goods, as a substitute value for imported goods, or as a mechanism to establish minimum values.
- b) establishment of monitoring mechanism to ensure that the valuation database is being used as a risk assessment tool and that the information stored in the database is updated on a regular basis.

(iv) Exchange of Information


request valuation-related information from the Customs administration in the country of exportation to verify the accuracy of the Customs value declared by the importer where fraud is suspected. The requested information may include the value of the goods stated in the export declaration/entry presented to the Customs administration of the exporting country. For this purpose, provisions of Section 219A of the Customs Act, 1969 may be invoked for entering into bilateral or multilateral administrative assistance agreements on customs matters; and

(v) report compliance within 45 days

  
(Mushtaq Ahmad Sukhera)  
Federal Tax Ombudsman

Dated: 24/8/2021  
z.a/HUK/Satti

Certified to be True Copy



Deputy Registrar  
FTO Secretariat  
Islamabad

