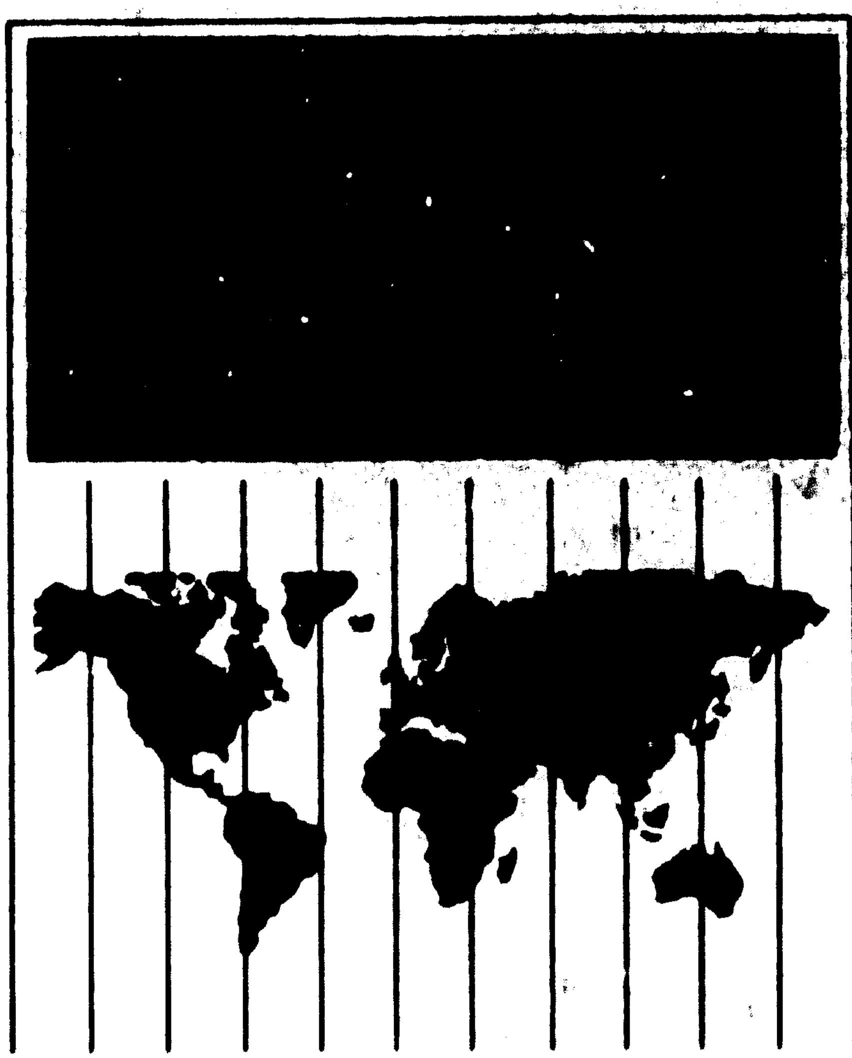
UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE INSPECTOR GENERAL



Regional Inspector General for Audit
CAIRO

PDAAN 497

MEMORANDUM REPORT ON PAYMENT OF CUSTOMS DUTIES ON LOCALLY PROCURED PROJECT EQUIPMENT IN EGYPT

Audit Report No. 6-263-83-9

September 29, 1983

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UNITED STATES GOVERNMENT

memorandum

DATE: September 29, 1983

REPLY TO ATTN OF: Harold R. Gill, RIG/A/Cairo

SUBJECT: Memorandum Audit Report No. 6-263-83-9 dated September 29, 1983
Payment Of Customs Duties On Locally Procured Project Equipment
In Egypt

TO: Mr. Michael P. W. Stone, Director USAID/Egypt

We found during the subject review that USAID/Egypt routinely reimburses AID financed contractors and Government of Egypt (GOE) entities for customs duties paid on locally procured imported items. We concluded that the practice is wasteful because in most cases the amount of the duty can be identified prior to reimbursement by AID and thus avoided. In comments on a draft of this report USAID/Egypt disagreed, noting that existing AID policy allows for payment of duty on shelf items. Our conclusions and the USAID response to the draft report clearly identify a conflict between two AID policies. Accordingly we are suggesting that the AID Bureau for Management take the lead in reconciling the two policies.

Issues: The policies in conflict are on the one hand a long standing overall policy that the United States as a donor should not have to pay tax or duty to the donee. This principle is supported by the need to conserve AID's scarce resources. On the other hand, USAID's position is that there is no requirement under existing AID policy to seek relief from the payment of customs duties incorporated in the price of shelf items, even though said duties are easily identifiable.

Background: The bilateral agreement and specific project and grant agreements between the governments of the United States and Egypt specify that project procurement of commodities will be free from any taxes and duties. Our prior audit work found, however, that USAID/E reimburses contractors and GOE entities for the cost of locally procured, imported shelf items.

Our report on the Urban Health Delivery Systems Project (6-263-81-9), issued in March 1981 showed that customs duties were being paid on AID-financed contractors' local procurement. We conducted a survey in October 1981 to determine if further audit work on the payment of customs duties on local procurement should be scheduled. As a result of the survey, an audit was included in the FY 1983 audit plan.

The USAID, in response to our prior audits, supported its position on payment of customs duties with an AID General Counsel legal opinion issued in April 1982 which stated in part that:

> "Under existing AID policy, no requirement exists to seek reimbursement from a host country for taxes or customs duties which might have been previously paid by a local supplier as part of his cost of obtaining goods later sold as shelf items in a subsequent AID-financed transaction. However, should a purchaser of AID-financed commodities pay an identifiable duty or tax as part of the specific AID-financed transaction, then AID's policy is that refund or reimbursement may be sought by AID from the host country in accordance with the governing agreements."

USAID/E issued Mission Order No. 1-3 on July 13, 1982 citing the above opinion as an Agency policy and setting forth guidelines concerning the financing of taxes and customs duties under AID-financed local procurement. The Mission Order included a description of the taxes and duties for which the USAID would not seek relief from the GOE:

> "Customs and taxes incorporated into the price of shelf items even where the amount of such tax or customs duties is shown on the retail invoice. These would be considered "prior included" taxes and customs duties which were charged in prior transactions which were not themselves AID-financed. Since only transactions 'financed by AID' are subject to tax and customs duties relief, such transactions are not subject to the tax relief provisions of AID agreements with the GOE."

Our survey work indicated that substantial amounts of AID project funds were being spent on local procurement, including imported shelf items. We therefore decided to carry out a functional audit of this aspect of local procurement for AID-financed projects.

<u>Purpose and Scope</u>: The purpose of this audit was to estimate the amount of customs duties paid on locally procured shelf items and to determine if reimbursement by AID of the duties could be reasonably and cost effectively avoided.

The audit was made in accordance with prescribed standards for government audits and included review of AID records, reimbursement procedures and criteria, and visits to vendors, contractors and GOE entities.

The results of the audit were discussed with USAID/E officials whose comments were considered in the preparation of this report. The USAID's response to a draft of this report is included herein as Appendix I.

FINDINGS AND CONCLUSIONS

We identified total local procurement of about $3.1 million on 30 active USAID/E projects. From the 30 projects, we selected four for detailed testing. Of the 190 items locally procured under these four projects, we found that the USAID had reimbursed import duty on 108, or 57 percent of the items in the test sample. The total cost of the local procurement reimbursed by AID was LE 441,742 and included identifiable import duty of at least LE 35,541 (equivalent to $42,820) or eight percent of the total. All of the vendors we contacted told us that customs duties could be separately identified on their invoices. Thus, it would not be difficult for AID to avoid payment of duties as provided in the governing agreements.

The four projects selected for detailed review were:

Project Title and Number	Items Tested	Cost
Major Cereals Improvement (263-0070)	57	LE 111,988
Irrigation Management Systems (263-0132)	61	172,463
Agricultural Development Systems (263-0041)	40	59,654
Development Industrial Bank II (263-0045)	32	97,637
Total	190	LE 441,742

The 190 items reviewed in detail were purchased from 35 local vendors during the period December 1980 to April 1983. The 190 items did not include items costing less than LE 500 and did not include vehicles.

The customs duties on the 190 items were at least LE 35,541 ($42,820) based on verified percentage rates of duty.

Vendors told us that they would have no problems in providing pro forma invoices showing customs duties as separate amounts. Most of the vendors also told us that they would be able to procure items duty free if payments were made in dollars by opening a letter of credit.

Audit Conclusion

We believe it would be a simple matter to avoid payment of duties when AID finances the local procurement of project equipment. The AID agreements provide for duty free procurement and vendors are willing to identify the duty on their invoices. Procedurally, it is our understanding that USAID approves shelf item purchases in advance. USAID could therefore easily arrange with the GOE counterpart Agencies to provide, in advance of approval, pro forma invoices which show the amount of duty as a separate item. USAID's advance approval could then be for the financing of purchases net of duty. This would avoid payment of duty, eliminating any need to subsequently seek reimbursement from the GOE.

We fully agree with AID's basic policy of not paying duty to recipients on AID-provided assistance. This long standing policy has its origins in 1952 tax relief agreements with NATO countries. At that time the policy was: "...that those taxes whose incidence could be and clearly had shifted to the expenditures of the United States were to be the primary object of tax relief. Taxes of the sales tax type clearly fell within this category as would gross income taxes, if any."

USAID/Egypt in the response to our draft report cited another long standing AID policy that, at the bilateral level for an item to be exempt from local taxes it must,at the time of the tax,be associated with or identified with the assistance activity involved. Thus USAID's position is that duties are not payable by AID on shelf items because the duties are not assessed at the time of AID financing.

We believe the policies are in conflict in situations where the amount of duty is readily identifiable in advance of AID's financing the purchase. One policy says we don't pay, the other policy says we do.

Our detailed audit found that USAID routinely paid for shelf items, the prices of which included duties of 15 to 40 percent. Given the significant levels of AID-financed local procurement, $3.1 million identified during our review, we believe the policy of paying duties on shelf items should be modified. The modification should provide that payment of duties on shelf items is the responsibility of the host government and that duties will be paid by AID only in those cases where the amount is <u>de minimus</u>.

We strongly suggest that the Bureau for Management's Offices of Procurement and Contract Management review AID's policy on the routine payment of duties on shelf items. In light of AID's general policy of not paying duties to donees, we believe the policy on shelf items needs modification.

UNITED STATES GOVERNMENT

memorandum

DATE: September 14, 1983

REPLY TO ATTN OF: Gerald H. Zarr, Acting Director GHZ/

SUBJECT: Draft Memorandum Audit Report on Payment of Custom Duties on Locally Procured Project Equipment in Egypt

TO: Harold Gill, RIG/A/Cairo

SEP 21 REC'D

Background: The subject draft Audit Report recommends that USAID "require GOE project officials and project contractors to obtain proforma invoices from local vendors identifying customs duties in the invoice price and to exclude these amounts from their billings to USAID/E." The auditors (RIG/A) base their recommendation on a view that local procurements financed by AID funds are exempted under the Bilateral and Project Grant Agreements from customs duties, including whatever identifiable duties may be contained in the cost of locally purchased imported shelf items. A recent RIG/A survey shows that prices paid on such locally purchased items do often include customs duties owed or paid by the importer and that the amounts can be identified.

The Mission, as RIG/A correctly points out, has taken the approach that it will not seek relief from customs duties incorporated into the price of shelf items, even where they are identifiable. This policy is reflected in Mission Order No. 1-3, dated July 13, 1982.

Issue: Is Mission in violation of AID policy in failing to seek relief from identifiable customs duties incorporated into the price of shelf items?

Dicussion: In its draft report, RIG/A focuses on the identifiability of customs fees. On this point, it cites the following portion of an AID Legal Opinion responding to an Urban Health Audit Report, from Theodore B. Carter, GC/NE to Edward Vinson, AA/NE/PMC, dated April 28, 1982:

> Under existing A.I.D. policy, no requirement exists to seek reimbursement from a host country for taxes or customs duties which might have been previously paid by a local supplier as part of his cost of obtaining goods later sold as shelf items in a subsequent A.I.D. financed transaction. However, should a purchaser of A.I.D.-financed commodities pay an identifiable duty or tax as part of the specific A.I.D.-financed transaction, then A.I.D.'s policy is that refund or reimbursement must be sought by AID from the host country in accordance with governing agreements.

RIG/A maintains that the Mission, by failing to seek relief from payment of identifiable customs on shelf items, is acting contrary to the Carter opinion. I disagree.

By focusing on identifiability, perhaps RIG/A was misled from the central argument of the Carter opinion, which deals with the definition of an "AID-financed transaction" for purposes of customs exemption under the Standard Grant Provisions. The Carter opinion does not say that A.I.D.'s policy is to avoid payment of any identifiable amount traceable to a tax or customs charge. Rather it states that AID will not reimburse an identifiable duty or tax which is paid "as part of the specific A.I.D.-financed transaction." The amounts discussed in the draft report are certainly identifiable, but they are not, according to Carter's argument, part of a specific AID-financed transaction.

As Carter points out, it is important first to be clear on the facts surrounding the transactions at issue. RIG/A has surveyed the type of transaction where AID funds are used to purchase imported shelf items, i.e., goods imported and kept in stock to meet general demand in country for the item. (AID Handbook 1, section 18A4) They are not goods imported specifically for an A.I.D. project and AID is not involved in the importation process. The custom charges at issue in such instances are levied at the time of importation and the transaction giving rise to these charges is the importer's normal importation transaction by which he acquires his stock of goods. Carter forcefully argues in the following passage that there is no exemption from customs duties for such transactions:

> A commodity procurement transaction is financed under this grant (and any other grant featuring local cost financing) when dollars or local currency provided under the grant are spent to acquire the commodity for the assistance purpose; such a transaction is entitled under the agreement to relief from tax or duty. It is not a commodity transaction financed under the grant when a dealer with his own resources imports or buys items to put on his shelves. The transaction in which the dealer acquires his stock is not one financed under the grant and, consequently, not a transaction as to which the two governments have agreed that there shall be tax relief.

The "A.I.D.-financed transaction" in the instances surveyed by RIG/A is that transaction in which AID funds are used to purchase goods previously imported and now in stock in country. Carter states that if the GOE had laws which taxed this specific transaction, AID would have a right to relief. However, he adds:

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> . . . . we are informed that Egypt does not have a sales tax or a value added tax which applies to sales transactions and, thus, it is apparent that A.I.D.-financed transactions under the local cost financing mode are not burdened with any Egyptian impost which would trigger a claim for reimbursement.

What should be clear from the above is that when AID pays a price for commodities purchased locally which includes amounts to cover the customs duties paid by the importer, it is not paying duties levied on that transaction. The duties have been previously levied and paid as part of a transaction to which AID was a stranger. Even if these charges are identifiable, they are not subject to exemption or relief under U.S./G.O.E. agreements. Although Carter, apparently wrongly, assumes that such prior-included taxes are not readily identifiable, he is explicit in stating that identifiability is an issue separate from whether AID is financing a transaction taxed by the GOE.

Carter states that "should an AID-financed purchaser pay an identifiable duty or tax as part of the specific A.I.D.-financed transaction, then A.I.D.'s policy is that refund or reimbursement must be sought in accordance with governing agreements." To apply this rule we must first determine whether an "A.I.D.-financed transaction" has been taxed and only then whether such tax is identifiable.

Conclusion: USAID is implementing an Agency policy requiring it to seek refund or reimbursement of custom charges levied on "A.I.D-financed transactions." A tax or customs duty previously paid by an importer as part of his cost of obtaining goods later sold as shelf items, although identifiable, is not a tax levied or paid as part of an "A.I.D.-financed transaction." There is no requirement to avoid or seek reimbursement for these previously paid amounts. Thus, the Mission is not in violation of A.I.D. policy in failing to seek such reimbursement.

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