CHAPTER 5
CUSTOMS DUTIES

5.1 INTRODUCTION
This chapter presents the compliance issues in Customs duties in which the focus is given to the strategies that have been implemented by the Customs to combat the smuggling of cigarettes as a result of increment of import duty on such commodity with effect from 19 October 2001.

5.2 OVERVIEW OF CUSTOMS DUTIES
The original customs legislation for the Federated Malay States was enacted in 1936 with the primary purpose of catering to functions of the Customs and Excise Department namely the collection of duties on goods imported and exported. The Customs Enactment of 1936 was first replaced by the Customs Ordinance of 1952 and 15 years later by the Customs Act 1967 which is in force today. The Customs Act is important because it has harmonised and replaced the Customs laws that were operating in the various Malaysian states from colonial days.

In the 1995 Budget, the definition of Customs duty has been amended and expanded in which under section 2(1), Customs duty refers to any import duty, export duty, surcharge or cess imposed by or under the Countervailing and Anti-Dumping Duties Act 1993 and includes any royalty payable in lieu of an export duty under any written law, or a contract, lease or agreement to which the Federal Government has consented.

The concept of customs control envisages that goods may be imported or exported by land, sea or air only at prescribed places. The powers for officers of customs to enforce the department's functions are provided for in the following legislations:
I. Customs Act 1967
II. Customs Regulations 1977
III. Customs (Prohibition of Exports) Order 1988
IV. Customs (Prohibition of Imports) Order 1988
V. Customs Duties Order 1996
VI. Customs (Rules of Valuation) Regulation 1999
VII. Other related legislation such as the Sales Tax Act 1972.

5.3 THE REVENUE POTENTIAL OF CUSTOMS DUTIES
Due (1988) outlined a number of factors that affect the ability of a country to raise revenue from custom duties. First factor is the openness of the economy. Openness is related to size, in which small countries are more likely to have limited types of resources and are unable to attain the advantages of specialisation and large-scale production. Typically what many goods consumers want simply cannot be produced in the country, thus increasing imports.

A second determinant of customs revenue is per capita income, the higher the income, the greater the diversity of what consumers want and the smaller the possibility that production in the country can supply them. Third factor is an elasticity of consumers demand for imported products. Optimal revenue tariffs dictate relatively high rates on commodities with inelastic demands and lower rates on those with elastic demands.

Fourth, the avoidance of the use of tariffs for protection will positively affect revenue. The more protective a tariff is, the less revenue it will raise while a completely protective tariff raises no revenue. Fifth, the potential for export and the orientation of the economy towards exports plays an important role. Some countries have very little potential for export and thus total foreign trade potential and customs revenue are limited.
A sixth consideration affecting customs revenue is the ability to enforce customs duties. It is important for the Customs to curb non-compliance activities like smuggling in order to protect the revenue for the country. Finally, participation in a common market will also reduce potential customs revenue to the extent that trade with common market partners is a substantial portion of the total. Joining a common market with external tariffs that are lower than the country's existing tariffs will reduce customs revenue. For example, in the Caribbean, the formation of CARICOM, with no internal tariffs and a common external tariff, forced several countries to increase use of domestic indirect taxes to preserve revenue.

5.4 TAX COMPLIANCE UNDER THE CUSTOMS ACT 1967 AND THE CUSTOMS REGULATIONS 1977- IMPORT AND EXPORT
Sections 23 to 30 of Customs Act deals with the place and time of import or export that the goods for import or export must be at a competent customs office, at legal landing places or prescribed places of import or export and on such days during such times as may be prescribed, unless permission has been granted by authorised Customs officers to land goods on other days and during other times.

It is a duty of every importer or exporter to declare a full and true account of the goods imported or exported in the respective prescribed forms. (Section 58 and section 78 of Customs Act). All declarations should indicate a full and true account of the number and description of goods and packages, value, weight, measurement or quantity, and country of origin or the final destination. (Section 79, section 80 and section 87 of Customs Act)
Classification of goods is one of the most important functions of the Royal Customs Malaysia. All goods imported or exported must be classified under the correct tariff code in accordance with the rules of classification in the Customs Duties Order 1996. The classification system used by Malaysia is the Harmonised Commodity Description and Coding System under the World Customs Organisation. The Customs Duties Order 1996 is used in conjunction with the explanatory notes of the World Customs Organisation. The classification of goods assist the clients of the Royal Customs Malaysia in the following ways:

I. Payment of the relevant Customs duties
II. Carrying out the trade of import or export; and
III. Compiling of information and trade statistics.

The Minister of Finance has power to fix and exempt the customs duties to be levied on any goods imported into or exported from Malaysia and to be paid by the importer or exporter. (Section 11(I) and section 14 of Customs Act). The value of imported goods must be the “Transaction value” that is the price actually paid or payable for the goods when sold for export to the country of importation. The valuation system used by Malaysia is the WTO valuation system.

5.5 NON-COMPLIANCE UNDER THE CUSTOMS ACT 1967 AND CUSTOMS REGULATIONS 1977.
Escape from payment of required duties arises in several ways and the person involved shall be convicted of an offence against the Customs Act 1967. The offences related to the Customs Act could be broadly classified under 2 categories namely, offences related to Customs documents and smuggling offences.
Offences related to Customs documents include falsifying or altering Customs declaration or supporting documents, submitting an application, which is untrue, or fraudulently altering a document required by Customs. Smuggling offences involve attempts or actions of persons leading to the evasion of Customs duties or the breach of import or export prohibition on goods.

The penalty imposed on the offences related to Customs documents, the person shall be liable to a fine not exceeding RM500,000 or to imprisonment for a term not exceeding 5 years or to both. In the case of smuggling offences, the minimum penalty imposed is to a fine not less than 10 times of the amount of customs duty or RM50,000 whichever is the lesser while the maximum penalty is to a fine not more than 20 times of the customs duty or RM100,000 whichever is the greater, or to imprisonment for a term not exceeding three years or to both.

5.6 SMUGGLING ISSUES

From the days of the first customs duties, smuggling in a great variety of forms has been the primary form of escape. Goods may be smuggled across unguarded borders by sea, land or air or may pass through control points concealed from customs officers. There is no fixed definition for the smuggling as different person gives different definition. The Immigration Department may define smuggling differently from the Customs or other enforcement agencies. Suraj Gupta (1992) defines smuggling as:

“Smuggling refers to the illegal import or export of goods. Only when there is complete free trade in goods of all kinds (including narcotics, arms and ammunition) is smuggling, by definition, completely eliminated”.

Even though the definition of smuggling is not given under the Customs Act 1967, the Royal Customs Malaysia has broadly classified smuggling into two types:
1. Direct smuggling
2. Indirect smuggling

Direct smuggling is any activity to import or bring goods into Malaysia through illegal landing places (not prescribed in the Customs Act) or at legal landing places but without making any declaration. While indirect smuggling is any activity to import or bring goods into Malaysia through legal landing places but the declaration made is incorrect.

In line with the government's health objective, the 2002 Budget has proposed that import duty on cigarettes and tobacco products be increased from RM180.00 per kg. to RM 216.00 per kg. and that excise duty be increased from RM 40 per kg. to RM 48 per kg. The increase in import duty and excise duty is a measure to combat social ills due to smoking and to curb the spread of the smoking habit among school children. It is also an effort to increase public awareness of the hazards of smoking.

High tax levels can play an important role in reducing overall tobacco consumption. High tobacco prices have been highlighted by the Department of Health as a deterrent to children tempted to take up smoking. A report from the World Bank (1999) found that:

"Evidence from countries of all income levels shows that price increases on cigarettes are highly effective in reducing demand. Higher taxes induce some smokers to quit and prevent other individuals from starting. They also reduce the number of ex smokers who return to cigarettes and reduce consumptions among continuing smokers. Children and adolescents are more responsive to price rises than older adults, so this intervention would have a significant effect on them."

However another implication of such measure that should be paid attention by the government is that higher import duty will encourage the smuggling of
cigarettes into the country. As in Canada in the early 1990s, when tobacco prices increased drastically, cigarette smuggling became a larger problem. However many experts claimed that correlation between high prices and high levels of smuggling does not exist in western Europe as the countries like Norway and Sweden with expensive cigarettes do not have smuggling problem whereas countries in the south of Europe do. They argued that cigarette smuggling is mainly caused by fraud, by the illegal evasion of import duty.

Besides evasion of import duty, there are also other factors that influence the smuggling of cigarettes:
   a) Higher demand of cigarettes in the market – illegal cigarette can be sold at cheaper price
   b) Instant profit for the smugglers.
   c) Tariff imposed by the government. It is difficult and involves lengthy process to get the licence for importation of tobacco product.

Joosens and Raw (1998) suggest that informal distribution networks, nonexistent or weak policies concerning cigarette smuggling, and their lack of enforcement can be or more important determinants of smuggling than price differentials.

Table 5.1 below shows the statistics of smuggling for the major commodities in the year 2002. From the table, it shows that cigarettes and tobacco products contribute the highest revenue loss to the government (RM 97,251,458.03). Table 5.2 shows the statistics of smuggling of cigarette from the year 1994 to the year 2001. Refers to the Chart 5.3, it seems that the number of cigarettes that have been smuggled increased drastically in the year 2002. It can be said that the rise in the number of smuggling of cigarettes might be due to an increment of import duty imposed to cigarettes and tobacco products.
Since the report is based on the seizures made by the Customs, it also can be said the higher numbers of cigarettes that have being seized might be due to an effective and strategic approaches that have been taken by the Customs to curb this smuggling activity.

**TABLE 5.1: STATISTICS OF SMUGGLING OF MAJOR COMMODITIES IN THE YEAR 2002.**

<table>
<thead>
<tr>
<th>No</th>
<th>Commodity</th>
<th>Quantity</th>
<th>Value (RM)</th>
<th>Tax (RM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cigarettes and tobacco products</td>
<td>430,322.23 kg</td>
<td>30,547,855.44</td>
<td>97,251,458.03</td>
</tr>
<tr>
<td>2</td>
<td>Liquors</td>
<td>93,029.41 lit</td>
<td>4,115,299.41</td>
<td>2,456,832.52</td>
</tr>
<tr>
<td>3</td>
<td>Beers</td>
<td>744,945.33 lit</td>
<td>3,075,852.26</td>
<td>6,161,736.57</td>
</tr>
<tr>
<td>4</td>
<td>Textiles</td>
<td>527,373</td>
<td>2,402,656.70</td>
<td>625,694.98</td>
</tr>
<tr>
<td>5</td>
<td>Vehicles</td>
<td>1,664 unit</td>
<td>41,250,097.68</td>
<td>81,741,715.21</td>
</tr>
<tr>
<td>6</td>
<td>Multimedia disc</td>
<td>1,705,305 pcs</td>
<td>2,317,928.00</td>
<td>891,594.20</td>
</tr>
<tr>
<td>7</td>
<td>Electrical goods</td>
<td>342,794</td>
<td>39,198,681.74</td>
<td>9,456,317.76</td>
</tr>
<tr>
<td>8</td>
<td>Telecommunication equipment</td>
<td>49,584</td>
<td>14,212,323.53</td>
<td>2,062,366.44</td>
</tr>
<tr>
<td>9</td>
<td>Tyre</td>
<td>6,250</td>
<td>573,330.09</td>
<td>308,423.12</td>
</tr>
<tr>
<td>10</td>
<td>Rice</td>
<td>3,114,330.50</td>
<td>3,589,591.22</td>
<td>-</td>
</tr>
<tr>
<td>11</td>
<td>Other commodities</td>
<td>9,372,235.49</td>
<td>186,038,543.91</td>
<td>29,783,008.07</td>
</tr>
</tbody>
</table>

Source: Royal Customs Malaysia

**TABLE 5.2: STATISTICS OF SMUGGLING OF CIGARETTE FROM THE YEAR 1994-2001**

<table>
<thead>
<tr>
<th>Year</th>
<th>Quantity (kg)</th>
<th>Value (RM)</th>
<th>Tax (RM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>233,911.63</td>
<td>11,459,157.10</td>
<td>45,296,610.78</td>
</tr>
<tr>
<td>1995</td>
<td>279,812.57</td>
<td>14,128,528.57</td>
<td>54,248,362.94</td>
</tr>
<tr>
<td>1996</td>
<td>184,900.09</td>
<td>9,584,222.75</td>
<td>32,158,520.18</td>
</tr>
<tr>
<td>1997</td>
<td>231,213.80</td>
<td>13,287,641.70</td>
<td>44,884,187.86</td>
</tr>
<tr>
<td>1998</td>
<td>214,031.90</td>
<td>13,086,889.26</td>
<td>41,863,829.48</td>
</tr>
<tr>
<td>1999</td>
<td>256,081.60</td>
<td>15,342,744.98</td>
<td>51,056,484.92</td>
</tr>
<tr>
<td>2000</td>
<td>228,060.59</td>
<td>14,860,896.68</td>
<td>49,645,029.86</td>
</tr>
<tr>
<td>2001</td>
<td>136,792.89</td>
<td>9,288,851.10</td>
<td>32,775,636.03</td>
</tr>
</tbody>
</table>

Source: Royal Customs Malaysia
A survey done by Royal Customs Malaysia shows about 20% of cigarettes in the market are illegal cigarettes (refers Table 5.4). There are two types of cigarettes that have been smuggled into the country namely white cigarette (eg. Malboro and Dunhill) and krettek cigarette (eg. Gudang Garam). Normally the krettek cigarette has been smuggled by the sea to the coastal area of Selat Melaka. While the white cigarette has been smuggled indirectly that is by giving an incorrect or wrong declaration at the ports. The statistics in Table 5.3 shows there is an increment of illegal cigarette (white cigarette, 12%) in the market in year 2001 and 2002.
TABLE 5.4: COMPARISON BETWEEN LEGAL CIGARETTES AND ILLEGAL CIGARETTES IN THE MARKET

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Type of cigarette</th>
<th>Legal cigarettes</th>
<th>Illegal cigarettes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>White Cigarette</td>
<td>Kretak</td>
<td>White Cigarette</td>
</tr>
<tr>
<td>1997</td>
<td>80%</td>
<td>5%</td>
<td>8%</td>
</tr>
<tr>
<td>1998</td>
<td>80%</td>
<td>5%</td>
<td>8%</td>
</tr>
<tr>
<td>1999</td>
<td>77%</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>2000</td>
<td>79%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>2001</td>
<td>73%</td>
<td>6%</td>
<td>12%</td>
</tr>
<tr>
<td>2002</td>
<td>73%</td>
<td>6%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Royal Customs Malaysia

5.7 STRATEGIES TO CURB SMUGGLING

There are the objectives of the Royal Customs Malaysia to curb the smuggling of cigarettes as well as to ensure all the importers and local tobacco manufacturers comply with the requirements under the Customs Act. Among the strategies that have been taken by the Customs to overcome the smuggling cases are:

1. Intensive courses and training have been given to the Customs officers in detection, investigation and lawsuit cases. Training has been given in computerisation technique especially in computer forensic.

2. Organising and monitoring of human resources, financial and logistic equipment in an efficient and effective way.

3. Purchase of high technology and modern equipment like x-ray scanners. The Customs has invested about RM 67 million in purchasing of x-ray scanners to be located at the major airports and ports in Malaysia.
Currently, there are 12 units of x-ray scanners and the other 2 units will be received from China in this year. This equipment will enhance the vigour and scope of enforcement effort and achieve the step change in interception rates necessary to make tobacco smuggling an economically unattractive proposition.

4. Collaboration with other enforcement and state agencies like Angkatan Tentera Malaysia, Polis Diraja Malaysia, JPJ, SIRIM, BERNAS, Immigration Department, Inland Revenue Board and MITI (Ministry of International Trade and Industry)

5. Raise public awareness of the negative aspects of smuggling like the dangerous of smuggling and effects to the country.

6. Enhance cooperation with international agencies like Interpol; RILO (Regional Intelligent Liaison Office) between Asia Pacific, Eastern Europe and Western Europe; WCO (World Customs Organisation), WIPO (World Intellectual Property Organisation), JICA (Japanese International Corporation), ILEA (International Law Enforcement Agencies); DEA (Drug Enforcement Agencies) and all Customs administrations designated under the Kyoto Convention.

7. To make an amendment to the Customs Act so that higher and tougher penalty can be imposed to the smugglers and more power will be given to the Customs officers during the investigation. Among the prevention activities are patrol, incursion, inspection, road block, investigation, compound and lawsuit.

8. The government also proposed in the Budget 2003 to affix special sticker on each packet of cigarettes to indicate that tax has been paid
and to protect consumers from purchasing counterfeit goods. This sticker can help the Customs to identify smuggled cigarettes more readily.

5.8 PROBLEMS TO COMBAT SMUGGLING

Even though the Customs has come up with the various strategies to combat smuggling, there are still problems faced by the Customs to curb this activity. Among the problems faced by the Customs are:

1. Geographical factor.
   Malaysia has long coastlines and land borders with many isolated crossings that cannot be guarded economically and are particularly vulnerable to smuggling since it is impossible in practice to patrol an entire border intensively at all times.

2. Volume of border traffic
   Increasing international trade will increase the volume of border traffic. When the number of persons crossing the borders is very large, control becomes more expensive and more difficult especially in times of peak travel. Inspection of persons, baggage and small parcels entering the country becomes uneconomic if extended very far and is a source of strong public complaints and interferes with tourist travel. People do not like to be physically searched, and detailed inspection of all baggage is very time consuming.

3. Ability to provide or invest in high technology and sophisticated equipment to overcome the smuggling activities. Smugglers (large scale smuggling) are more aggressive and use high technology equipment in their activities.

4. Lack of enforcement due to the lack of manpower and the professionals in the Customs organisation. In the year 2002, there were only 1251 staff in the enforcement unit throughout Malaysia.

5. Lack of cooperation from the public to give information regarding the smuggling.
6. Ignorance of responsibility to the country among the public. They are not aware of the importance of paying tax to the country and assume that tax is a burden on them.

7. Attitudes of certain Customs officers who involve either in bribery or misuse of power.

5.9 RECOMMENDATIONS

Cigarette smuggling can be reduced but action is needed at the national, regional and global level. The government should pay more attention to the problems faced by the Customs in terms of the number of manpower and the logistic equipments. All this problems should be overcome in order to have an effective control of smuggling. The government's commitment to tackling smuggling of cigarettes is important to protect the revenue as well as to maintain a fair tax system. Besides all those objectives the government also can protect

- honest businesses from unfair and criminal competition;
- society from scourge of organised crime; and
- local communities from debilitating effects of criminal supply chains.

Besides all the strategies that have been implemented, the government should give consideration to adopt the strategies proposed in WHO Framework Convention on Tobacco Control and the strategies recommended to the UK government. Among the proposed strategies are:

1. Monitoring at national, regional and international level is needed to provide high quality data on smuggling, tax free imports and cross border trade of tobacco.

2. Demand record keeping and tracking systems that place the onus on manufacturers to prove that cigarettes arrive legally in their intended markets. Hold up the major cigarette companies strictly liable for any of the cigarette they export ending up as smuggled contraband.
3. Greater number of Customs officers needed both at the key points and inland.

4. Increase penalties. Cigarette smuggling continue because the benefits outweigh the risks. New offences and penalties for those caught handling or selling unmarked tobacco products and a tougher penalty regime for owners of premises where smuggled goods are sold. These new offences will deter both individuals and retailers from selling unmarked product and will deter proprietors of establishments such as pubs and clubs from allowing sales on their premises.

5. Advertising to explain the serious criminal nature of smuggling and the consequences of being caught engaged in this illegal trade. This can be done by printed notices on tickets sold and displays on board ferries and terminal shops.

6.0. CONCLUSION

This chapter discusses the strategies and problems faced by the Customs in order to prevent smuggling activities. Some recommendations are made to the relevant authorities to overcome the stated problems. The next chapter provides the conclusion and recommendation for future research.