

TradeWatch

In this issue

Spotlight on Argentina

New early import declaration system adopted in Argentina	2
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Global

Export controls – Wassenaar Arrangement issues best practice guidance for internal control programs for exporters	4
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Americas

Brazil – 2014 FIFA World Cup and 2016 Olympic Games in Brazil: Value-added tax and customs duty saving opportunities	6
Canada – Canada Border Services Agency's latest list of national trade compliance priorities	8
Mexico – Mexico's new Authorized Economic Operator program	10
New value-added tax rules for IMMEX "virtual operations" now in force with new invoice requirements	12
New free trade agreements signed by Mexico	14
Peru – Seven new free trade agreements to be implemented by Peru in 2012	15
United States – U.S. Customs proposes new policy accepting transfer pricing adjustments	17
The California Transparency in Supply Chains Act attracts broad attention	18
New legislation clarifies applicability of US countervailing duty law to non-market economies	19

Asia-Pacific

Australia – Australia free trade agreement developments	20
Prepare for increased assessments and penalties issued by Australian Customs	23
China – Changes to China's Foreign Investment Catalogue to impact certain industry benefits	24
Japan – Extension of customs assessment period	26
Republic of Korea – Korea-US free trade agreement takes effect	29
Thailand – Thailand's Supreme Court decision on trademark royalty payments (Case No. 962/2011)	30

Europe, Middle East, India and Africa

European Union – European Parliament issues resolution with pro-business stance on key outstanding issues for implementation of the Modernised Customs Code	31
European Court of Justice annuls anti-dumping duties for certain Chinese shoe manufacturers	34
Russia – Russia's accession to the WTO and its impact on foreign trade regulation	35
Ukraine – President vetoes new version of the Customs Code	37
Ukraine trade developments: import and export duty reductions, excise duty increases and canceled quotas	38
New financial sanctions for certain customs-related offenses	40

Spotlight on Argentina

New early import declaration system adopted in Argentina



On 1 February 2012, the Argentine Federal Tax Authorities (AFIP) implemented a new early import declaration system, Declaración Jurada Anticipada de Importación (DJAI), which requires advance reporting and approval prior to importation. This new system is radically changing the way trade is conducted with Argentina as importers scramble to comply.

Pursuant to the AFIP's General Resolutions 3252 and 3255 (published in the *Official Gazette* on 10 January and 23 January 2012, respectively), under the new DJAI, importers have to file with the tax authorities certain information related to their importations prior to the issuance of the purchase order (or similar document) to the foreign supplier. The required data includes the importer's Tax ID, currency, free on board (FOB) value, tariff code, quantity, country of origin and country of export, among other information.

Additionally, the DJAI declaration must be approved by the government organizations involved in international trade matters that participate in the program. These organizations, which are given access to the information submitted in the DJAI declaration, have the ability to approve or reject each early declaration within 72 hours, although such term can be extended up to 10 calendar days and potentially longer.

Without approval, the importer cannot file the actual import declaration upon importation as it will not be accepted by the Customs IT system. Thus, rejection by a governmental organization will have to be remediated directly with the corresponding government organization before the importation can occur. On the other hand, if the 72-hour term lapses and no observations are made, it would be possible to proceed with the import operation.

The DJAI requirements apply to definitive imports for consumption, including the import of goods from free trade zones and the special customs territory of Tierra del Fuego. Certain exceptions apply to imports of samples and donations, and imports performed under the courier system, among other exceptions. As per the rules issued to date, temporary imports are not subject to the DJAI system.

The AFIP issued General Resolution 3256 (published in the *Official Gazette* on 27 January 2012) that established the procedure through which the different government organizations will confirm their participation.

The Secretary of Commerce was the first to participate in the DJAI system, but with the stipulation that responses to each DJAI declaration would be provided within 15 working days (instead of the 10 calendar days established by AFIP). There is some uncertainty regarding the Secretary of Commerce's involvement in DJAI because the entity is already asking importers informally to provide essentially the same DJAI information (available via the Customs IT system) directly to an email address specified by the Secretary. In other words, importers currently may need to provide the same information twice, which adds to the administrative burden.

Over the last month, several additional government organizations have confirmed their participation in the DJAI. These organizations include the National Service of Health and Quality for the Food and Agriculture Sector (SENASA), the National Authority for Medicines, Food and Medical Technology (ANMAT), the Secretary of Planning for the Prevention of Drug Addiction and Action Against Drug Trafficking (SEDRONAR) and the National Wine-Growing Institute (INV).



As a separate matter, the Federal Tax Authorities have also created a new “Early Declaration System for Services” (Declaración Jurada Anticipada de Servicios or DJAS), which will enter into force on 1 April 2012. DJAS will require Argentine tax residents to disclose the provision of services by foreign residents to local residents and those services rendered by Argentine residents to foreign parties. The services to be reported include royalties for the license of trademarks, patents and technical assistance. From a customs standpoint, it is important to bear in mind that this new declaration system may be utilized by the Argentine customs authorities to track resident companies that make payments for services or licenses abroad, in order to analyze whether such payments should be considered for customs valuation of imports.

As the DJAI system is new and controversial, we expect more guidance and changes to come. For now, Argentine importers need to assess the impact of the new regulations on their operations given the increased risk of customs clearance delays for import shipments. Additionally, it is essential that companies update and implement the necessary changes to their policies and procedures to adequately align and comply with the new advance reporting obligations. Finally, be prepared for more changes and closely monitor future developments.

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Export controls

Wassenaar Arrangement issues best practice guidance for internal control programs for exporters



The 13-14 December 2011 plenary session of the Wassenaar Arrangement (Wassenaar) in Vienna produced a number of long-awaited changes and updates to the control lists. However, an equally interesting development applicable to all exporters is the publishing of “Best Practice” guidelines for internal control programs (ICP) for exporters.

Large multinational exporters who developed compliance programs based on guidance published by regulatory bodies, such as the United States’ “How to Develop an Effective Export Management and Compliance Program and Manual” (Bureau of Industry and Security), Germany’s “The Handbook of German Export Controls” (Federal Office of Economics and Export Controls) or Japan’s “Internal Compliance Program” (Ministry of Economy, Trade and Industry), will not find much new in the Wassenaar guidance. The new guidelines are, however, intended to provide an internationally accepted framework for examining the adequacy of export compliance programs. The global standardization of internal compliance programs for export controls is comparable to similar efforts in the area of supply chain security (e.g., World Customs Organization SAFE protocol, ISO/PAS 28000).

Basic elements of an internal control program

Wassenaar’s best practice guidelines for internal control programs include the following eight themes:

1. **Commitment to compliance** – Issue a written statement by a senior representative, such as the CEO, that the exporter is aware of all domestic export control laws and regulations and will comply with them. Make all employees and officers aware of the statement.
2. **Structure and responsibility** – Establish an internal export control organization headed by a Chief Export Control Officer (CECO). Additionally, export control operations can be managed by an Export Control Manager (ECM) reporting to the CECO and supported by Export Control Officers (ECO) within each business unit, where appropriate. The export organization should be responsible for: development and revision of the ICP; development and revision of operation procedures; staying up-to-date with changes to relevant regulations and with any directions or guidance issued by the competent authorities; classification, license determination, and transaction screening; general export control management, assignment of personnel in charge of auditing; and training. The guidelines additionally recommend that the compliance organization be independent from the sales department or any other export oriented units.
3. **Export screening procedures** – Establish procedures that include export control classification, license determination, end-use and end-user screening, transaction-specific screening procedures and licensing.
4. **Shipment controls** – Promulgate controls to ensure classification, licensing and transaction screenings are completed prior to shipment and to verify that the goods and/or technologies and their quantities correspond to the descriptions set out in export instruction documents and/or export licenses.
5. **Performance review** – Establish a regular performance review system to confirm that the export control operation is implemented appropriately according to the ICP and the operational procedures and is compliant with all relevant domestic laws and regulations. The guidelines recommend that these reviews be performed annually by a unit separate from sales or an outside specialist, as the structure, size and other circumstances of the exporter permit.



6. **Training** – Provide training and education of officers and employees to ensure that personnel are aware of all domestic export control laws, regulations, policies and control lists and all amendments to them as soon as they are made public. Regular training and continued education should be carried out for employees at all levels, especially new staff, persons who work in sales, export-related units or are involved in technology transfer. Maintain internal training records, including staff participation in external events.
7. **Record-keeping** – Archive export-related documents for an appropriate period according to the requirements of domestic export control regulations. Export-related documents may include export licenses, end-use assurances, commercial invoices, clearance documents, product classification sheets and records of electronic transfers. Records should be maintained in a manner that permits traceability.
8. **Reporting and corrective action** – Procedures should include a mechanism for prompt reporting to the CECO or ECM of any known or suspected violations of export control regulations or ICP procedures. The guidelines recommend a prompt report to the competent authorities if the CECO or ECM confirms a violation of export control laws and regulations has occurred. The CECO or ECM should take corrective actions to prevent similar violations in the future.

The guidelines acknowledge that the method in which ICPs are developed and implemented will depend on the size, organizational structure and other circumstances of individual exporters. In any event, the guidelines underscore that documented and auditable policies and procedures are a key component of any export compliance program.

Conclusion

The best practice ICP guidance issued by Wassenaar is welcome guidance for the exporting community. While it does not include as much detail as guidance issued by individual countries (e.g., US Bureau of Industry and Security guidance is more than 200 pages while the Wassenaar guidelines are 5 pages) and is not itself operative law, it does provide an internationally recognized framework by which exporters may examine adequacy of internal controls. Exporting companies should review their existing export compliance programs, and perhaps those of their trading partners, to ensure that they meet the new internationally recognized standards.

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Brazil

2014 FIFA World Cup and 2016 Olympic Games in Brazil: Value-added tax and customs duty saving opportunities



As Brazil prepares to host major sporting events, the Fédération Internationale de Football Association (FIFA) World Cup in 2014 and the Olympic Games in Rio de Janeiro in 2016, the level of competition is increasing – and we're not referring to the athletes. Foreign companies are racing to invest in Brazil at a rapid pace in order to take advantage of the growth and economic stimulus expected from these events. The country's economic outlook is also lifted by the government's measures to enhance the country's infrastructure, including expanding the capacity and comfort of Brazilian ports and airports, in preparation for the events. Against this backdrop, Brazil offers a variety of attractive investment opportunities.

Both the federal and state governments are creating fiscal incentives for the private sector to support new Brazilian investment. Specifically, special programs designed to reduce the indirect tax burden have already been established. In this article, we discuss some of the tax incentive programs available, which should be considered prior to implementing an investment project related to the upcoming major sporting events in Brazil.

Indirect tax incentives for the 2014 FIFA World Cup

Considering that the 2014 FIFA World Cup matches will take place in 12 (out of 27) Brazilian states, the federal government rapidly instituted a special tax relief program named RECOPA (Regime Especial de Tributação para Construção, Ampliação, Reforma ou Modernização de Estádios de Futebol). This special regime, published in October 2010, aims to promote investment projects for the construction and modernization of Brazilian football stadiums in preparation of the FIFA 2013 Confederations Cup and 2014 World Cup events by reducing the tax burden of such projects.

Specifically, the regime provides for the suspension of federal taxes (customs import duties, federal value-added tax (VAT) and social contributions, PIS/COFINS) levied on imported or locally acquired machinery and materials for construction projects related to Brazil's stadiums. However, the suspension of import duty for such materials is only granted provided that such goods cannot be locally sourced in Brazil (i.e., there is no similar, local production of the subject goods). We also note that the suspension of PIS/COFINS can also apply to imported and locally provided services.

After the use or incorporation of the goods into the stadium project, the suspension of taxes will be converted into a tax rate reduction to 0%, effectively canceling any tax burden. However, if the subject goods are not used or incorporated into the stadium project, the suspended taxes will be charged along with applicable late fines and interest.

Interested parties must apply to the Brazilian Federal Revenue for approval under RECOPA. Approvals must be granted by 31 December 2012 to participate in the program. RECOPA benefits end on 30 June 2014.

Under RECOPA, FIFA can also designate companies as direct service providers. These companies benefit from additional tax incentives, such as exemption from import duties and additional fees (e.g., SISCOMEX, AFRMM, CIDE) related to the importation of non-durable and durable goods, provided certain requirements are met. Additionally, these companies benefit from an exemption from corporate income tax and contribution, among other direct and turnover taxes related to the development of activities directly related to the FIFA events.

Regarding state VAT (ICMS), the Brazilian states have signed ICMS Agreement No. 108/2008, which authorizes the states to exempt sales transactions of goods to be used in the construction and modernization of Brazilian football stadiums for the 2014 FIFA World Cup. In this respect, the exemption from ICMS on imports only applies to goods that cannot be sourced locally (i.e., there is no similar, local production), given that such goods are also exempt from the federal import duties.



Another ICMS Agreement, No. 39/2009, authorizes the states to exempt from ICMS transactions performed under the Temporary Admission special regime that relate to operations performed by or associated with FIFA, given that federal import duties are also exempted.

Companies planning investment projects should also explore tax relief programs provided by the municipalities hosting FIFA World Cup matches.

Indirect tax incentives for the 2016 Olympic Games

To date, the federal government has not yet created any tax relief mechanisms directly related to the Olympic events. Nevertheless, the Brazilian states are already aligned to exempt state ICMS on transactions involving qualifying goods and services that would benefit under a federal tax relief program. This development indicates that a federal program will be forthcoming, likely after the effects of the incentives established for the FIFA events are known.

As Rio de Janeiro is host city of the Olympic Games, ICMS Agreement No. 90/2011 has extended the ICMS suspension to apply to the acquisition of power energy and the use of inter-municipal and interstate transport and communication services by the Olympic and Paralympic Games organizer committees.

Final considerations

The FIFA 2014 World Cup and the 2016 Olympic Games are major sporting events expected to attract companies from all over the world to do business in Brazil, a country eager for foreign investment. Preparations for these events are already under way, and now is the time to initiate tax planning associated with related investment projects. Proactive planning can identify opportunities to reduce Brazil's heavy tax burden and ensure proper implementation to promote compliance with the stringent requirements and regulations tied to the tax incentives.

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Canada

Canada Border Services Agency's latest list of national trade compliance priorities



In January 2012, the Canada Border Services Agency (CBSA) released its latest list of national trade compliance priorities (NPs). NPs are determined on a periodic basis (generally, every six months) through a risk-based approach and constitute areas of specific interest above and beyond the more general areas of customs compliance CBSA generally monitors through random verifications.

NP audit targets

CBSA has identified the following product categories and corresponding compliance area emphasis as NP audit targets:

Tariff Classification	HS number(s)
Spent fowl (new)	Various goods under Headings 02.07, 16.01 and 16.02
Specially defined mixtures (new)	1602.31.11.10, 1602.31.11.90, and 1602.32.92.10
Pet toys (new)	9503.00.90
Seaweed (new)	1212.20.00
Steel T-posts (new)	7308.40.00.90
Fresh cut flowers (new)	0603.19.00.00
Safety headgear (new)	6506.10.10.90
Valuation	HS number(s)
Motor car, bus and lorry tire industry	Various goods under Heading 40.11
Video recording apparatus (2nd round)	8521.90.90.00
Pumps for liquids	8413.11.10, 8413.19.10, 8413.70.99
Jewelry	Various goods under Heading 71.13
Fresh cut flowers (new)	0603.19.00.00
Origin	HS number(s)
Vegetable fats and oils (2nd round)	1516.20.90.41, 1517.90.99.00
Pumps for liquids	8413.11.10, 8413.19.10, 8413.70.99
Cocoa powder	1805.00.00, 1806.10.10, 1806.10.90

Companies that import NP products should be prepared for additional customs scrutiny, whether in the form of post-entry inquiries or notification of a pending audit. At the same time, importers that deal in goods or industries not listed as current NPs should not adopt a false sense of security. We commonly see CBSA verifications in sectors identified as NPs as well as sectors that are not listed as NPs.



CBSA trade compliance audits – what to expect

Over the last several years, CBSA, much like customs authorities in many other jurisdictions around the world, has moved toward a periodic review system based on customs risk assessments. Previously, customs authorities typically reviewed imports on an entry-by-entry basis. This was mainly carried out through random “spot checks.” However, faced with increased global trade and restricted funding, CBSA, like other agencies, has been forced to move away from transaction-based reviews and has turned its attention to identify high-risk industries, market segments and importers, which it then targets for audits, as identified by the NP list.

On-site reviews with multidisciplinary audit teams are now commonplace. Auditors examine books and records, reconciled with import declarations, to determine the level of compliance with customs legislation and regulations. Furthermore, internal reporting systems, which include purchasing, receiving and accounting data, are closely scrutinized to determine how information is disseminated within the organization.

Consequently, such audits, which are viewed by many as invasive, can be time-consuming and costly for importers and especially for those who are unprepared. Essentially, companies are ultimately being evaluated as to whether or not they are carrying out importing and/or exporting activities with due diligence and reasonable care. Importers must ensure that compliance measurement plans, reliable procedures and reasonable care programs are in place to avoid possible penalty actions, which in some instances can be quite severe.

For companies that take a proactive approach to customs compliance, CBSA established the Customs Self-Assessment Program, which is similar to the US Importer Self-Assessment Program. Through this program, companies that have effective compliance programs in place may be able to submit summary reports (i.e., accounting for goods on a monthly basis) and obtain pre-release privileges among other benefits. Naturally, CBSA retains the right to examine goods at the border or carry out on-site verifications. However, companies willing to invest the time and money in compliance by implementing and maintaining adequate systems under the Customs Self-Assessment Program benefit from their efforts in ways that can secure a competitive advantage over other importers (e.g., faster border clearance). Additionally, these companies generally have their processes and systems in good shape in the event of an audit.

In summary, on-site audits are the new enforcement norm for the CBSA. Such audits are costly and cannot be avoided. It is highly recommended that companies have in place robust compliance programs to help mitigate the audit's impact. Companies whose products are listed as an NP have been put on notice of an increased risk of customs verification; however, all importers should prepare accordingly.

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Mexico

Mexico's new Authorized Economic Operator program



Mexico has reorganized its certified company program (Empresa Certificada) to create a new Authorized Economic Operator (AEO) program, known as Nuevo Esquema de Empresa Certificada (NEEC). NEEC was established by amendment under rule 3.8.1 of the General Foreign Trade Rules (GFTR), effective 2 January 2012.

The NEEC adds a supply chain security element to the certified company program, which is consistent with the World Customs Organization's SAFE Framework of Standards to Secure and Facilitate Trade and is similar to the US Customs-Trade Partnership Against Terrorism (C-TPAT), Canada's Partners in Protection (PIP) and other AEO programs across the globe.

Under this new program, special customs benefits are reserved only for NEEC companies that meet more stringent supply chain security and customs compliance requirements. Accordingly, NEEC's AEO certification provides a higher "trusted trader" status than the basic certification.

More stringent requirements for AEO certification

The NEEC's AEO program entails more stringent requirements that cover compliance as well as security-related obligations, as provided by section "L" of rule 3.8.1. In this respect, companies must continue to meet the basic certified company requirements, such as obtaining a favorable opinion on the status of their tax obligations and filing a written request before the Central Regulatory Administration (CRA) of the General Customs Administration.

For the NEEC AEO certification, companies must also meet the following obligations (among others):

- ▶ Obtain a favorable ruling from the Central Administration of International Affairs (CAIA)
- ▶ Have performed foreign trade operations for at least five years before applying
- ▶ Comply with a specific security and customs-related "Company Profile," among other requirements

The Company Profile must be accurate and include information on the company's standard operating procedures and documented processes regarding supply chain security planning, internal audits, physical security of the facilities, physical access controls, criteria for selecting commercial partners and logistical process mapping, among others. Companies must designate a contact who will act as a liaison between the General Customs Administration and the company.

The CAIA may take up to 100 business days to issue a response to the ruling request and, once this response is obtained, the CRA may take an additional 40 business days to issue the final authorization to participate under the NEEC AEO program.

Primary benefits now limited to NEEC AEO-certified companies

As a significant change, some of the primary benefits that previously were accessible by all certified companies are now only available to NEEC companies operating under the AEO program. These benefits include (but are not limited to):

- ▶ Regularization of goods after an audit has been initiated
- ▶ Use of "express" lanes for customs clearance
- ▶ Use of PROSEC preferential duty rates upon change of regime
- ▶ Virtual transfers of goods to Mexican residents (applicable to IMMEX operations)



Implications for companies with IMMEX operations

For IMMEX companies, perhaps the most significant benefit lost (or gained for AEO-certified companies) is the mechanism that allows the virtual transfer of goods to Mexican residents. Prior to the implementation of the NEEC, rule 3.8.4, section VI of the GFTR allowed all certified companies with an IMMEX program to transfer temporarily imported goods or finished products to Mexican residents for their permanent importation. This operation was performed through a “virtual” export and import process that allowed the goods to be physically delivered in Mexico without having to perform their physical exportation.

From a customs perspective, the virtual transfer of goods to Mexican residents allows the IMMEX entity to defer and potentially waive the payment of duties. We note that the value-added tax treatment has been modified (see the article “New value-added tax rules for IMMEX ‘virtual operations’ now in force with new invoice requirements” in this issue of *TradeWatch*).

Also, the virtual transfer of goods was the mechanism through which Mexican residents could permanently import goods manufactured by a IMMEX company applying the preferential duty rate under any FTA with Mexico, thus reducing the import duty impact for the Mexican resident (i.e., trade parity for goods manufactured in Mexico under an IMMEX program).¹

With the entry into force of the NEEC program, only those NEEC companies operating under the AEO program are allowed to perform the virtual transfer of goods to a Mexican resident, thereby limiting what has become a very common process for IMMEX companies. For affected operations, participation in the new program will be essential to maintain current benefits which would be costly to lose.

Implications for existing Empresa Certificada companies

For certified companies authorized prior to 2 January 2012, their authorization is generally valid for one year and may be renewed for the same period of time. Thus, existing certified companies may still exercise all benefits under their existing Empresa Certificada program until their current authorization expires. However, when requesting the renewal, such companies will have to comply with the new additional requirements to participate under the NEEC AEO program to maintain all current benefits.

Accordingly, companies operating in Mexico will need to pay close attention to the expiration of their certified company authorization and be prepared to comply with more stringent requirements for renewal.

Closing thoughts

Mexico's NEEC program with AEO certification offers Mexican importers and exporters that meet the more stringent program requirements with a significant competitive advantage considering the higher level of customs benefits. Additionally, as Mexico works toward mutual recognition with other AEO programs, such as C-TPAT, additional advantages will extend along the supply chain and promote opportunities with business partners that also set high standards of supply chain security and customs compliance.

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¹Rule 3.2.29 of the Ministry of Economy's General Trade Rules

New value-added tax rules for IMMEX “virtual operations” now in force with new invoice requirements



After a provisional postponement, new value-added tax (VAT) rules for “virtual operations” by certified IMMEX companies have entered into force. As a result, sales by foreign residents of goods assembled by the certified IMMEX company to the Mexican market through the virtual export mechanism no longer benefit from the 0% VAT treatment provided for exports. Given that these transactions are now subject to VAT on both the sale and the permanent importation, there are important new invoice requirements that should be fulfilled in order to ensure recovery of paid VAT by the Mexican purchaser of the goods.

Background

One of the tax incentives exclusively enjoyed by IMMEX companies certified under the Empresa Certificada program (now the Nuevo Esquema de Empresa Certificado, which also requires that the company meets AEO standards²) is the foreign trade mechanism known as “virtual exportation.” Through the virtual export mechanism, a foreign resident is able to sell goods temporarily imported by its IMMEX company in Mexico to a final customer resident in Mexico that has no customs program (i.e., not an IMMEX or certified company).

Prior to last year’s amendments to the General Foreign Trade Rules (GFTR), this sale of goods produced by the IMMEX to a Mexican customer was deemed an export, thus giving it the same VAT treatment that applied to export sales. In other words, the 0% rate of VAT applied to these transactions, which would have otherwise been subject to the standard Mexican VAT rate of 16% applied to domestic sales.

As we reported in the September 2011 issue of *TradeWatch*, recent amendments to the GFTR included provisions that changed the VAT treatment for sales by foreign residents of goods assembled by the certified IMMEX company to the domestic market so that such transactions were treated as a sale for VAT purposes, rather than an exportation. As a result, the amendment effectively eliminated the beneficial VAT export treatment.

Double VAT taxation issues

Under the new rules, the Mexican customer must withhold the corresponding VAT, given that the foreign resident (seller) is not registered in Mexico as a taxpayer. Consequently, the sale is effectively subject to a double VAT taxation considering that VAT is assessed on both the permanent importation of the goods into Mexico and on the sale of the goods in the Mexican territory.

In principle, the Mexican purchaser of the goods should be able to recover both VAT payments through the credit and/or refund mechanism. The primary concern was the significant cash flow effects as well as the increased administrative burden for the Mexican acquirer of the goods.

In practice, however, the Mexican purchaser’s ability to recover the VAT triggered by the sale was limited. In many cases the invoices issued by the foreign resident were not considered valid because they did not fulfill the formalities required under the Mexican Tax Code.

As a result, the implementation of the new rules was postponed so that, pursuant to an amendment to the Mexican Tax Code (Código Fiscal de la Federación), the Mexican tax authorities could enact rules that establish the documentation requirements for virtual IMMEX transfers.

²See the article “Mexico’s new Authorized Economic Operator program” in this issue of *TradeWatch*.



New invoice requirements

Effective 1 January 2012, Rule I.2.8.3.1.5 of the Temporary Regulations to the Mexican Tax Code (Resolución Miscelánea Fiscal) establishes the minimum requirements that an invoice issued by a foreign resident must contain in order to be used by a Mexican resident for purposes of a VAT credit or deduction. Therefore, invoices issued by foreign residents for the sale of goods assembled by their certified IMMEX company to a Mexican customer must now include the following information, as applicable, in order to be deemed valid for Mexican tax purposes:

- ▶ Corporate name, address and taxpayer identification number (or its equivalent) of the foreign issuer of the invoice
- ▶ Place and date of issuance
- ▶ Mexican taxpayer identification number (Registro Federal del Contribuyente) of the Mexican resident to which the invoice is issued
- ▶ Quantity, unit of measurement and description of the nature of the goods transferred by means of the transaction documented by the invoice
- ▶ Per-unit price set forth numerically and the total price written with numbers or letters
- ▶ Specification as to whether the total price agreed for the transaction shall be paid in one or several payments
- ▶ As applicable, specification that total price is payable in several installments, including total price of transaction as well as the issuance of an invoice per installment meeting aforementioned requirements

- ▶ Indication of whether the respective price was paid in cash through an electronic fund transfer, check, debit or credit card, specifying at least the last four digits of the corresponding account or card number

We emphasize that it is the responsibility of the Mexican purchaser to verify that the required information is contained in the invoice in order to validly sustain the corresponding VAT recovery request. In this respect, the Mexican purchaser should work closely with the foreign resident to ensure the invoice requirements are fulfilled.

In closing, the application of the new VAT rules to virtual operations is a disappointing development for certified IMMEX companies (particularly considering the stricter AEO standards now required for certification). The virtual export mechanism continues to provide a competitive advantage for certified IMMEX companies over non-certified IMMEX companies considering that only these IMMEX operations have the ability to sell to the domestic market. At the same time, it remains to be seen how the Mexican purchaser's new administrative burden and cash flow implications will affect these sales.

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New free trade agreements signed by Mexico

On 9 January 2012, the Mexican government published two decrees ratifying new free trade agreements (FTAs). These latest additions to Mexico's preferential trade network serve to expand opportunities in Peru and Central America.

Commercial Integration Agreement with Peru

The Commercial Integration Agreement between Mexico and Peru extends the Economic Complementation Agreement No. 8, previously enacted by both countries. The new agreement grants preferential duties to a much larger universe of products and includes trade in services clauses, dispute settlement mechanisms and an innovative regional origin accumulation mechanism, among other relevant provisions. This agreement, which had been signed on 6 April 2011 by Mexico and Peru, was finally ratified by Mexico on 15 December 2011 and entered into force on 1 February 2012.

(See also the article, "Seven new free trade agreements implemented by Peru in 2012" in this issue of *TradeWatch*.)

Mexico-Central America Free Trade Agreement

The Mexico-Central America FTA is a consolidation of existing FTAs entered into separately by (i) Mexico and Costa Rica, (ii) Mexico and Nicaragua, and (iii) Mexico and the Northern Triangle (Honduras, Guatemala and El Salvador). Technical negotiations were concluded on 20 October 2011 with the agreement signed a month later. The FTA is significant in that it provides for a single regulatory framework among the six countries to facilitate trade in goods, services and investments. The Mexican government ratified the FTA in mid-December of last year, as published in the recent decree. The FTA will enter into force once the Central American countries ratify the agreement and exchange the appropriate diplomatic notes to that effect.

As companies assess potential tariff reduction opportunities these new Mexican FTAs can offer to their supply chain, it is important to also consider each FTA's specific requirements (e.g., rules of origin) that must be complied with to access the cost savings.

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Peru

Seven new free trade agreements to be implemented by Peru in 2012



During 2012, seven new free trade agreements (FTAs) with Peru will go into effect. These new FTAs further expand Peru's growing number of bilateral and regional trade agreements, thus providing extensive duty planning opportunities for businesses looking to gain preferential access to a wide variety of global markets.

Peru's growing FTA network

This latest round of new FTAs reach a variety of global markets, which include Thailand, Mexico, Japan, the European Union, Panama, Costa Rica and Guatemala. These new FTAs join Peru's already extensive network of preferential trade agreements, including a Trade Promotion Agreement with the US and FTAs with countries/customs territories such as Chile, China, Canada, the European Free Trade Area (EFTA)³, Singapore and South Korea. Additionally, Peru enjoys economic cooperation agreements with MERCOSUR (Argentina, Brazil, Uruguay and Paraguay) and Cuba, and is a member of the Andean Community customs union.

Additionally, FTA negotiations are currently under way with Honduras, El Salvador, Venezuela (which has extended the term of the tariff benefits under the Andean Community), the Trans-Pacific Partnership Agreement (involving Australia, Brunei Darussalam, Chile, the US, Malaysia, New Zealand, Peru, Singapore and Vietnam). There are also negotiations as part of the Doha Round under the World Trade Organization multilateral trade liberalization.

Overview of new FTAs

The following chart provides a high-level overview of the new FTAs. We note that most of these FTAs focus not only on trade in goods, but also cover customs cooperation, investments, services, intellectual property issues and other areas.

Direct shipment requirements, formal requirements for certificates of origin, rules of origin and other specific provisions vary according to the specific FTA. These requirements must be met prior to the importation of the goods into Peru or such goods cannot benefit from preferential treatment. Further, if non-compliance is detected post-importation (e.g., post-importation audit), the importer in Peru is subject to the differential of duties and taxes, as well as interest and fines of 200% of the unpaid duties and taxes.

Peru already has established measures that address specific topics of the FTAs, such as advanced rulings on customs valuation and tariff classification, cross-border measures, and other trade facilitation measures implemented by Peru pursuant to the country's initial FTA with the United States. These measures are already applicable to all imports into Peru as provided for under the Peruvian Customs Law and corresponding regulations.

At the same time, we point out that never before has Peru enforced seven new FTAs in one year. Therefore, we would recommend observing additional caution when applying for these preferential trade benefits to ensure that origin qualification and other FTA-specific requirements are met prior to importation.

³ An FTA with Norway, the only country missing from the framework of the FTA, with the EFTA should also come into force this year.



Overview of new FTAs

FTA	Implementation date	High-level tariff benefits	Primary exports
PE – Thailand	31 December 2011	70% of tariff codes become duty-free within 5 years	<ul style="list-style-type: none"> ▶ Thai cars and appliances ▶ Peruvian agricultural goods, fishery products and minerals
PE – Mexico	1 February 2012	12,000 Peruvian Tariff codes become duty-free within 10 years	<ul style="list-style-type: none"> ▶ Mexican consumer goods and technology ▶ Peruvian textiles and apparel, agricultural goods, fishery products and wine
PE – Japan	1 March 2012	Specific Peruvian tariff codes (almost all of actually traded goods) become duty-free within 17 years	<ul style="list-style-type: none"> ▶ Japanese cars, mobile phones, computers, televisions and electronic devices ▶ Peruvian agricultural goods, fisheries and minerals
PE – European Union	First half 2012 (estimated)	Specific tariff codes become duty-free within 11 years	<ul style="list-style-type: none"> ▶ EU consumer goods and technology ▶ Peruvian textiles and apparel, and agricultural products (special regulations apply to bananas and fishery products)
PE – Costa Rica	First half 2012 (estimated)	80% of goods traded between the countries become duty free within 5 years	<ul style="list-style-type: none"> ▶ Costa Rican medicines and electrical devices (e.g. switches, junction devices and conductors) ▶ Peruvian agricultural and fishery products
PE – Panama	First half 2012 (estimated)	More than 90% of the goods traded between the countries become duty-free within 5 years	<ul style="list-style-type: none"> ▶ Panamanian crude oil, medicines, jewelry and books ▶ Peruvian agricultural products
PE – Guatemala	First half 2012 (estimated)	More than 81% of the goods traded between the countries become duty-free within 5 years	<ul style="list-style-type: none"> ▶ Guatemalan ornamental fish, chemicals, veterinary medicines, varnishes, dyes, inks, fuels, and jewelry ▶ Peruvian agricultural products, insecticides, detergents, clothing and apparel

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United States

U.S. Customs proposes new policy accepting transfer pricing adjustments



U.S. Customs and Border Protection (CBP) has moved a step closer to adopting a policy first proposed in September 2011, which will accept transfer pricing adjustments provided that specified conditions are met.

Last September, CBP issued an advance notice inviting public comment on a proposed policy change to broaden CBP's interpretation of what constitutes a formula for purposes of using "transaction value." Specifically, CBP's proposal would consider the transfer pricing policy as an objective formula. Moreover, downward price adjustments pursuant to the transfer pricing policy could be eligible for a refund of overpaid customs duty. The notice outlined specific criteria that must be met. (See the December 2011 issue of *TradeWatch*.)

CBP has now proposed to adopt the policy change by revoking a prior CBP ruling and replacing it with a new ruling that allows post-importation customs value adjustments made pursuant to a transfer pricing policy, provided that the transfer pricing policy can be shown to demonstrate arm's-length pricing under customs-specific tests. CBP notes that the initial comments on the proposed change were favorable. If adopted, the revised policy will provide greater flexibility to importers who make periodic adjustments to transfer prices after importation.

Implications for importers

Importers into the US that purchase products from related parties quite often base their transfer pricing on targeted profit margins. To the extent the financial results for a period (often the fiscal year) are within the targeted range, no additional action is taken. When profits are outside the targeted range, a retroactive adjustment to the purchase is made to bring the profits into the range. This action by CBP provides a path forward for importers using this approach, allowing them to treat the purchase price, as it may be adjusted, as the transaction value, and to report any adjustments, up or down, through the CBP Reconciliation Program.

Importers that may benefit from the new CBP position should consider taking three specific actions:

1. Prepare customs-specific supporting documentation. CBP's proposal deals only with reporting adjustments made pursuant to transfer prices that are otherwise acceptable for customs purposes. It does not mean that CBP will accept transfer pricing studies as support for customs value. Because the proposed policy will make adjustments easier to make, including adjustments that would result in customs refunds to taxpayers, it is more important than ever that taxpayers supplement transfer pricing studies with customs-specific supporting documentation. CBP has made it clear that transfer pricing studies by themselves are unlikely to satisfy customs valuation rules.
2. Apply for the Reconciliation Program. CBP specifies that the new proposal is intended to apply to importers using the CBP Reconciliation Program. Reconciliation allows an importer to declare a provisional value at import and adjust to the final value up to 21 months following import. Importers must be approved to use the Reconciliation Program in advance of the imports whose value may be later adjusted. All importers contemplating transfer pricing adjustments should apply for reconciliation in order to benefit from the new policy.
3. Supplement transfer pricing policies. CBP's proposed ruling adopting the new policy notes five specific criteria that were demonstrated by the importer. Several of these criteria (e.g., specifying products subject to customs adjustments) may not be clearly present in current transfer pricing policies. Importers may find it advantageous to conform transfer pricing policies to clearly meet the customs criteria.

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The California Transparency in Supply Chains Act attracts broad attention



The California Transparency in Supply Chains Act (CTSC Act), which went into effect on 1 January 2012, has been attracting attention well outside of California. The CTSC Act intends to promote fair trade practices with respect to the prevention of human trafficking and slavery in the product supply chain. The CTSC Act basically requires large California retailers and manufacturers (with annual worldwide gross earnings of over US\$100 million) to disclose their prevention efforts to consumers via their corporate website.

Disclosure requirements

Specifically, a company subject to the CTSC Act must indicate the extent to which it does the following:

- ▶ Audits suppliers for trafficking and slavery
- ▶ Engages in verification of product supply chains to evaluate and address risks of human trafficking
- ▶ Maintains internal accountability standards
- ▶ Provides training on human trafficking and slavery (i.e., mitigating risks within the product's supply chain) to company employees and management who have direct responsibility for supply chain management
- ▶ Certifies that materials used in its products comply with human trafficking laws in the countries where business is conducted

Consequences for non-compliance

The exclusive penalty contained in the CTSC Act for non-compliance is an action brought by the California state attorney general for injunctive relief, whereby an equitable remedy in the form of a court order would require the company to do or refrain from doing specific acts. Perhaps of more significance for many companies is the reputation risk of non-compliance. The loss of business from any bad publicity resulting from non-compliance with the Act could be the most detrimental potential impact.

More to come?

Whether conducting business in California or not, US companies that are making efforts now to address the risks of human trafficking and slavery in the supply chain may be one step ahead. Federal legislation was introduced in August 2011 (HR 2759) to require disclosures similar to those required by the California Act by any company registered with the U.S. Securities and Exchange Commission (SEC). As introduced, the bill would require publicly traded companies to include in their annual reports to the SEC a disclosure describing any measures the company has taken during the year to identify and address conditions of forced labor, slavery, human trafficking and the worst forms of child labor within the company's supply chain. In some respects, the proposed legislation's disclosure requirements go even further than the California law.

Closing thoughts

Regardless of whether they're subject to the CTSC Act, many global companies have posted information on their website regarding responsible supply chain practices in their sustainability stewardship and/or supplier responsibility. In addition to disclosure on company websites, some companies have gone further as to directly provide customers with a statement disclosing collaboration with industry associations to maintain overall supply chain sustainability and responsibility in their engagement with suppliers across the globe. Some companies are expanding efforts under their existing Customs-Trade Partnership Against Terrorism (C-TPAT), the U.S. Customs and Border Protection's supply chain security program, to also cover certain aspects of the CTSC Act requirements. We expect more activity in this area, whether imposed or voluntary, and business may be well served to consider how CTSC requirements can be integrated with other supply chain compliance efforts.

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New legislation clarifies applicability of US countervailing duty law to non-market economies



New legislation, signed into law by the President on 13 March 2012, clarifies that the countervailing duty provisions of the Tariff Act of 1930 apply to non-market economy countries (NMEs), thereby effectively overturning a recent decision by the U.S. Court of Appeals for the Federal Circuit (CAFC).

In the 19 December 2012 decision, GPX International Tire Corp. (GPX) v. United States (2011-1107-09), the CAFC ruled that the countervailing duty law does not apply to NMEs, such as China. The GPX case involved the appeal of a U.S. Department of Commerce (DOC) decision in 2007 to impose antidumping and countervailing duties on off-the-road tires imported from China.

The GPX decision had significant implications beyond the Chinese tires at issue. Basically, the decision meant that the DOC did not have legal authority to impose countervailing duties on any imports from any NME. In addition to tires, there is a range of Chinese goods that have been subject to the countervailing duty law as well as certain imports from Vietnam (another NME).

However, the outcome of the GPX case has become a moot point. The new legislation ensures that the DOC can continue to apply the countervailing duty law to NMEs and has retroactive effect to cover proceedings initiated on or after 20 November 2006.

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Australia

Australia free trade agreement developments



Australian importers and exporters have reason to be optimistic about the likelihood of new opportunities to decrease customs duty costs and increase market access, despite rising fears of protectionist tariff measures in some global markets and the continued stalling of the WTO Doha round of negotiations.

Australia has been heavily involved in negotiating both regional and bilateral trade agreements, with the most significant being the Trans-Pacific Partnership (TPP). While the TPP is getting the most attention at the moment, Australian traders should also be aware of new opportunities with Indonesia and the status of free trade agreement (FTA) negotiations with South Korea. Each of these developments is discussed below.

Trans-Pacific Partnership

The Australian government has stated that the Trans-Pacific Partnership (TPP) is its highest regional trade priority. The TPP is a proposed comprehensive regional trade agreement whose negotiating members are currently Australia, Brunei, Chile, New Zealand, Singapore, Peru, the US, Vietnam and Malaysia. Of those members, Peru is the only country with which Australia has not already entered into an FTA. This demonstrates an emerging trend that tariff reduction is not necessarily the primary consideration for countries entering into FTAs. Rather, non-tariff measures such as market access for services, foreign investment, intellectual property, non-tariff barriers to trade and competition conditions are just as, if not more, relevant than tariff levels.

However, from a tariff reduction perspective, it is of great importance to Australia that Japan, Canada and Mexico have recently expressed interest in joining the TPP negotiations. Japan is Australia's second largest trading partner and a country with which Australia has been in FTA negotiations for five years. Japan's inclusion in the TPP would confirm the TPP's status as Australia's most important regional or bilateral trade agreement.

While Japan has expressed an interest in joining TPP negotiations, it has not yet requested to become a negotiating member. If it makes that decision, the current negotiating members will have to decide whether to accept Japan. Australian officials have stated that in considering allowing countries to join negotiations, the main concerns are whether the country can meet the high standards of the TPP and whether their joining will slow negotiations. For Japan, major issues will include convincing countries, such as the United States and Australia that it is prepared to open up its agriculture and automotive industries.

Similarly, it is unlikely that Canada will be permitted to join the TPP negotiations if it is not willing to open up its dairy and poultry markets. This would require a major change in policy for Canada, which has sought high levels of protection for these markets under the North American FTA (i.e., NAFTA).

In respect of countries with whom Australia has already entered into an FTA, the TPP promises the following additional benefits:

- ▶ Regional rules of origin, which will help facilitate regional supply chains
- ▶ Increased removal of restrictions on investment and financial services
- ▶ Improving access for cross-border service providers
- ▶ Greater removal of behind the border impediments to trade
- ▶ Comprehensive chapters dealing with issues, such as intellectual property, labor conditions, competition and consumer protection, e-commerce, the environment and government procurement



Following a meeting in Honolulu in December last year, the leaders of nine TPP negotiating states set a goal of concluding negotiations by the end of 2012. The countries have exchanged offers in respect of the key areas of goods, services and government procurement. However, negotiations in other areas are slow with the difficulty of negotiating with nine different countries being realized. The latest round took place in Melbourne earlier this month with negotiations continuing to make progress.

Indonesia

On 10 January 2012, Indonesia enacted the ASEAN-Australian-New Zealand Free Trade Agreement (AANZ FTA) meaning that the AANZ FTA has now been fully enacted by all 12 member countries (Australia, Brunei, Myanmar, Cambodia, Indonesia, Laos, Malaysia, New Zealand, the Philippines, Singapore, Thailand and Vietnam).

Indonesia is the largest economy in ASEAN and Australia's 12th largest trading partner. The entry into force of the AANZ FTA for Indonesia provides Australian exports duty-free entry into Indonesia in respect of 80% of tariff lines, up from the current level of 11%. This figure will increase to 92% by 2015. For Indonesian exporters, more than 96% of tariff lines are duty-free from 10 January 2012.

As Australian importers from other ASEAN countries may already be aware, the AANZ FTA contains regional rules of origin. This helps facilitate concessional entry into Australia of goods imported from one ASEAN country, say Thailand, where those goods were produced using materials from Indonesia. This will be important in respect of the import of manufactured goods where Australian importers can now more strongly view ASEAN as part of a regional supply chain.

However, it is important for ASEAN exporters and Australian importers to appreciate the certificates of origin requirements under the ASEAN FTA. Unlike Australia's FTAs with New Zealand and the United States, an importer seeking preferential entry under the ASEAN FTA must hold a certificate of origin for the goods. Further, the AANZ FTA requires that certificates of origin be issued no later than three days after the date of export. Only in the case of involuntary error or other valid cause can a certificate of origin be issued retrospectively. Even then, the retrospective certificate of origin must be issued within 12 months of the date of export. It is therefore crucial that Indonesia producers of goods are obtaining certificates of origin prior to exportation.

Despite these administrative burdens, the entry into force of the AANZ FTA for Indonesia represents significant opportunities for Australian importers to reduce the amount of duty paid on Indonesian goods. As discussed, proactive steps – particularly with respect to certificates of origin – should be taken now to ensure that the full benefits of the AANZ FTA are realized.



Republic of Korea

Currently, Australia's most advanced bilateral FTA negotiations are with the Republic of Korea. As late as November 2011, politicians from Australia and Korea were pushing for a trade deal to be completed by the end of 2011. Unfortunately, that goal was not realized and the potential for a trade agreement to be finalized in the near future appears slim. The three main reasons for this pessimism are:

1. Korean parliamentary elections taking place in April 2012 with the opposition party strongly opposing FTAs that weaken protection for Korean farmers
2. Strong Korean domestic opposition to the removal of protection for Korea's agricultural sector (as demonstrated by the domestic response to Korea's FTA with the US)
3. The change in leadership in North Korea having the potential to divert attention away from trade negotiations

Recently, Australia's Prime Minister conceded that the political and domestic opposition in Korea against the Korea-US FTA has slowed negotiations regarding a deal with Australia. However, an FTA with Korea is said to remain a top priority of the Australian government. As the FTA between the US and Korea has now been implemented, Australian exporters consider that it is crucial that an Australia-Korea FTA be finalized in the near future. Particularly concerned is the Australia beef industry. Australian beef supplies almost 50% of the Korean market but is subject to a 40% tariff. That same tariff will be reduced to zero over 15 years for US beef pursuant to the Korea-US FTA.

We have been advised that agreement on the actual text of the agreement is very close, with the main issues being agriculture and the automotive industry. However, it seems that the outcome of the Korean elections is likely to have the biggest influence on the outcome of the FTA negotiations.

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Prepare for increased assessments and penalties issued by Australian Customs



The Australian Customs and Border Protection Service (Australian Customs) looks set to increase assessments and penalties issued to non-compliant importers in response to a recent performance review that criticized its risk management processes and revenue generation.

In December 2011, the Australian National Audit Office (ANAO) released *Audit Report No.15 2011-12 Performance Audit Risk Management in the Processing of Sea and Air Cargo Imports*, its independent review of the Australian Customs' risk management processes. As a result of its review, the ANAO issued the following three recommendations to Australian Customs.

1. To improve its estimation of revenue leakage:
 - ▶ Adopt a revenue estimation methodology that estimates leakage across all sections of the import population
 - ▶ Accurately report the results and methodology applied
2. To improve the usefulness of the Infringement Notice Scheme (INS), its penalty mechanism when there is no direct revenue impact, in encouraging compliance and discouraging noncompliance:
 - ▶ Review the operation of the INS to identify the impediments to its wider use and whether these impediments can be rectified
 - ▶ Seek any necessary administrative or legislative changes to the INS to improve its effectiveness (as required)
3. To better assess and manage the risks presented by Cargo Report Self Assessed Clearances, undertake a review of its processing arrangements for Self Assessed Clearances

Australian Customs subsequently agreed to undertake actions to internally review all three recommendations.

In support of its recommendations, the ANAO's research into the revenue generated from the INS was particularly revealing. The ANAO found that Australian Customs personnel viewed the process of issuing INS penalties as too complex and cumbersome, and as a result, in the four year period between 1 July 2007-30 June 2010, issued only 228 INS penalties, amounting to AU\$273,877. In its report, the ANAO profiled Canada to compare the use of the INS with the revenue generated by a similar scheme in comparable trade. In the same four-year period, the Canadian authorities issued 23,810 penalty notices for a total penalty amount of AU\$27,687,100, which is more than 100 times the utilization of the INS.

Given the stark difference between the application of the two regimes, and the ANAO Report recommendations, there is expected to be an increase in the use of the INS and, more generally, penalties issued by Australian Customs. This means that importers and exporters must be ever more vigilant to ensure they are accurately reporting all shipments, even where there is no duty incidence.

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China

Changes to China's Foreign Investment Catalogue to impact certain industry benefits



China maintains a Foreign Investment Industrial Guidance Catalogue (Catalogue) that divides industries into categories of Encouraged, Restricted and Prohibited that seek to guide and promote/limit investment behavior. The Encouraged List provides certain benefits to covered industries. One of the most important encouraged industry benefits is the customs duty exemption permitted on qualifying imported equipment for these encouraged industries. While this benefit used to be available for a wider range of industries, in recent years the list has been shrinking as certain industries or types of projects have been removed from the Catalogue. The changes to the Catalogue can impact how a foreign company invests in China and their costs for doing so.

The Catalogue has once again been updated (effective 30 January 2012) for the fifth time since it was first published in 1995. The revisions have focused on two areas: relaxation of certain restrictions and emphasis on quality rather than quantity for foreign investment projects. Overall, the latest Catalogue encourages foreign investment in high-end manufacturing, high-end and new technology industries, modern service industries, and new energy and energy-efficient industries that are environmentally-friendly. The following table provides a snapshot of the latest changes to the Catalogue:

2012 Changes to the Catalogue

Encouraged list	Added	Nine modern service industry items (e.g., intangible property (IP) services, venture investment enterprises and motor vehicle charging stations)
		Equipment and construction for the recycling business (e.g., waste tires, waste textile and water-pollution control)
		Removal of the restriction on the percentage of foreign investment in areas such as new energy power generating equipment
		For textile industry: functional, green/environmental protective and special clothing production
	Removed*	Manufacturing of whole cars
		Production of large chemical products using coal as raw materials
		Polycrystalline silicon
		Manufacturing of X-ray stereotactic radiation therapy systems
		Production of Bacille Calmette-Guerin and poliomyelitis vaccines
		Production of sequential fiberglass original silk felt, fiberglass surface felt, micro-electronics fiberglass cloth and thin felt
		Production of coherent fiber bundle and laser medical optic fiber
		Development and manufacturing of fluid pressure rubber sealing; manufacturing of high binding spares of 12.9 level or more; manufacturing of casting and forging work blanks for cars and motorcycles
		Manufacture of high-performance, single-lens reflex with more than 6 million pixels
		High-tech green battery manufacture: e.g., dynamic zinc and nickel storage cell, zinc and silver storage cell, lithium-ion batteries, high-capability, air-proof and repair-free lead-acid battery, solar battery, fuel battery, column-shaped zinc-air battery, etc.
		Manufacture of Asynchronous Transfer Mode (ATM) and IP digital communications system

**NOTE: a number of items were removed from the Encouraged list and not all can be included here; rather, below is an excerpt of some affected industries or projects:*



2012 Changes to the Catalogue

Restricted list	Added	Small scale or the use of outdated technologies for sulfuric acid, nitric acid, potash production
		City gas, heat supply and drainage network construction for urban population of more than 500,000 (Chinese party shall hold a dominant position)
		Canola oil, peanut oil, cottonseed oil, tea seed oil, sunflower oil, palm oil and other edible oils and fats processing (Chinese party shall hold a relatively dominant position); rice, flour processing
		Other
	Removed	Rubber products-renovation of old tires and low-performance industrial rubber parts production
Prohibited list	Added	Medical institutions, financial leasing companies
		Domestic express courier services for letters
		Construction and operation of villas
		Alkaline button batteries containing mercury
		Other
	Removed	Video-screening companies
		Master issuing and importing of books, newspapers and periodicals
		Importing of audio and visual products and electronic publications

For foreign companies wishing to invest in China, it is important to understand whether the industry or project may fall under one of the Catalogue lists. The benefits for an encouraged industry project can be significant while the restrictions levied on those covered in the Restricted or Prohibited lists could present a challenge to investment.

Many companies had relied on the duty exemption for qualified imported equipment to manage costs of an encouraged project. However, as this list has continued to change and projects have been removed, a number of companies stand to lose this privilege and should plan accordingly.

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Japan

Extension of customs assessment period



Recent changes to Japan's 2011 tax reform law relating to corporate income tax, tax environment and administrative matters, generally known as the Re-Revised Bill,⁴ came into force on 2 December 2011. The bill included provisions that have extended the customs assessment period from three to five years. Considering the current customs audit trends in Japan (which we discuss below), the five-year customs assessment period could make customs non-compliance even more costly.

New five-year customs assessment period

In principle, all goods entering Japan on or after 2 December 2011 are subject to the extended customs assessment period. We note that for goods imported under special customs procedures, the effective date to determine when the five-year assessment period applies may be a date other than the entry date. For instance, for goods imported under the Authorized Importer Program, it's the special declaration date, and for goods imported using Before Permit (BP) clearance procedures, it's the BP approval date that must be on or after 2 December 2011 for the transaction to be subject to the extended assessment period.

The extended assessment period means that the customs authorities have a longer period to assess the importer's compliance and collect underpayments of customs duties, import consumption taxes and applicable penalties. On the other hand, the importer has a longer period to request a correction and collect refunds for any overpayments of customs duties. While this could present an opportunity for some importers, the extension is most concerning for importers in the event of an audit considering that systemic mistakes (e.g., incorrect tariff classifications, failure to include required additions to the price paid or payable, such as royalties and assists) made over a five-year period could quickly add up to significant assessments of additional customs duty, import consumption taxes and penalties owed.

Japan customs audit trends

The risk of exposure to customs assessments stemming from a customs audit is very real. The most recent data available from the Ministry of Finance covering the period from 2006 to 2010 illustrates the thoroughness of customs audits undertaken by Japan Customs. According to the data, approximately 70% of companies subject to an audit each year are assessed additional customs duties and/or import consumption tax along with applicable penalties for incorrect declarations. The amount of customs collections from these assessments totaled ¥13.5 billion in 2010 alone (see Table 1). While this is a significant amount, it only takes into account a three-year assessment period for the importer. One wonders how much higher this amount would be under the new five-year assessment period.

⁴Reform bill for partial revision of income tax law, etc. in response to the changing economic structure



Table 1: Japan customs audit statistics

	2010	2009	2008	2007	2006
Number of audit	6,031	6,204	6,080	5,865	5,548
Number of deficit declaration	4,226	4,356	4,188	4,099	3,836
Ratio of deficit declaration	70.1%	70.2%	68.9%	69.9%	69.1%
Customs value related to the deficit declaration	¥193.3b	¥198.0b	¥198.4b	¥161.7b	¥155.4b
Additional Assessment					
▶ Customs duty	¥3.2b	¥3.6b	¥2.1b	¥2.5b	¥2.7b
▶ Import consumption tax	¥10.3b	¥10.9b	¥10.9b	¥8.7b	¥8.4b
▶ Total	¥13.5b	¥14.5b	¥13.0b	¥11.2b	¥11.1b

Information compiled by the Ministry of Finance

Moreover, even importers of duty-free items are being subject to additional assessments. According to the Ministry of Finance, electronic equipment, optical equipment and machinery, which are mostly duty-free items, rank as the top three assessed items. While import consumption tax is creditable, penalties apply at the rate of 10% to 15% of the tax owed. So importers of duty-free items are not without risks.

In terms of areas often assessed by Japan Customs (other than those related to additions to the price actually paid or payable, such as assists and royalties), the following are cited as main causes for assessments.

Failure to reflect an end-of-year transfer pricing adjustment in the customs value of affected imports

As discussed in the December 2011 issue of *TradeWatch*, Japan Customs recently issued a ruling on the customs treatment of retroactive transfer pricing adjustments that highlighted Customs' expectations with respect to the applicability of transaction value and circumstances that require the importer to file amended returns when such retroactive adjustments are made. With the issuance of such a ruling, it can be expected that transfer pricing adjustments will continue to attract close scrutiny by Japan Customs in future audits.



Inappropriate use of preferential tariff programs

With the increase in imports claiming tariff preferences under Japan's Economic Partnership Agreements (EPA) and Generalized Systems of Preferences (GSP), incorrect use of such programs are also being identified by Japan Customs during the audits. As more EPAs are employing self-declaration measures (i.e., self-certification of the EPA eligibility status by the exporter), importers should expect Japan Customs to be more stringent in future audits when assessing EPA imports that employ such self-declaration measures. These include the Japan-Switzerland EPA, Japan-Mexico EPA and newly effected Japan-Peru EPA (which entered into force on 1 March 2012).

A more robust compliance program will not only reduce customs exposure for importers, but will also often lead to a more efficient import process. At the same time, by taking a close look at import operations, importers may identify duty savings opportunities, such as from customs valuation planning, special customs programs or preferential trade agreements. Additionally, refund opportunities may exist for identified errors that resulted in the overpayment of duty, in which case the extended customs assessment period could actually (in the future) be beneficial.

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Implications for the importers

The extension of the customs assessment period means an increased risk of exposure to additional customs duties, import consumption tax and penalty exposure. This is particularly the case in the event of a customs audit when Japan Customs is closely scrutinizing importer declarations and records. Accordingly, it is important that importers take the time now to review their existing import processes, procedures and internal controls and close any compliance gaps. Otherwise, today's errors could prove costly for the company up to five years from now.

Republic of Korea

Korea-US free trade agreement takes effect



As an update to our report in the December issue of *TradeWatch*, the Korea-US trade agreement (KORUS) takes effect on 15 March 2012.

According to the United States Trade Representative, on this date, almost 80% of US exports of industrial products to Korea will become duty-free, including aerospace equipment, agricultural equipment, auto parts, building products, chemicals, consumer goods, electrical equipment, environmental goods, all footwear and travel goods, paper products, scientific equipment, and shipping and transportation equipment. Additionally, almost two-thirds of US exports of agricultural products to Korea will become duty-free.

According to Korea's Ministry of Foreign Affairs and Trade, the duty reduction schedule calls for US tariffs to be eliminated on nearly 78% of South Korean exports upon implementation. Within five years after implementation, 93% of South Korean exports will have duty-free access to the United States – including many textiles and agricultural products as well as auto parts, passenger cars, LCD monitors, camcorders and television sets, among many other items.

The agreement also includes a number of significant commitments related to non-tariff measures, including obligations related to motor vehicle safety and environmental standards, enhanced regulatory transparency, standard-setting, technology neutrality and customs administration as well as strengthened protections for intellectual property rights and commitments opening up the services market.

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Thailand

Thailand's Supreme Court decision on trademark royalty payments (Case No. 962/2011)



In late 2011, the Supreme Court of Thailand ruled that royalty payments made by Nike Thailand (importer/licensee) to Nike International (licensor) for the use of the Nike trademark and trade name are not required to be added to the customs value of the imported goods (Case No. 962/2011). The goods at issue were golf balls affixed with the Nike trademark at the time of import, which it purchased from Bridgestone (an unrelated supplier).

In determining that the trademark royalties paid were not subject to import duties, the Supreme Court's decision (reached at the general meeting of all the judges at the Supreme Court) was based on the independent relationship of the US supplier (Bridgestone) and Nike Thailand (customer and importer), while the royalty was paid by Nike Thailand to Nike International. The Supreme Court laid down the following reasons for its decision:

- ▶ No royalty payment was made to Bridgestone (the US manufacturer/seller).
- ▶ The royalty payment was made by Nike Thailand to Nike International (not the manufacturer/seller).
- ▶ There was no relationship between Nike International and Bridgestone.
- ▶ Bridgestone manufactured golf balls for various customers, including Nike Thailand and the price charged to all customers (with or without trademark) was of the same range.
- ▶ The royalty payment was a separate act and not related to the sale of goods to Nike Thailand by Bridgestone.

The Supreme Court's favorable dicta appears to be at variance with the way Thai Customs – and indeed many other customs authorities – have historically interpreted on the issue of trademark royalty. The transcript of the Court's decision notes that the royalties are not production-related costs and that Bridgestone did not produce the golf balls under a license (but simply applied a trademark on the instruction of the purchaser). The transcript, however, does not mention any evidence being presented to the Court about whether Bridgestone was authorized by Nike International (the owner of the intellectual property rights) to apply its trademarks and under what conditions (if any).

While this decision sets a favorable precedent for importers, it is more likely that, at best, the Thai customs authorities will restrict the interpretation to cases that exactly match the circumstances of Nike Thailand's case.

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Europe, Middle East, India and Africa

European Union

European Parliament issues resolution with pro-business stance on key outstanding issues for implementation of the Modernised Customs Code



The European Parliament (Parliament) has adopted a resolution (2011/2083(INI)) that resonates as a call to action for the European Commission and the EU Member States to deliver progress with the implementation of the EU Modernised Customs Code (MCC). In doing so, the Parliament gives its stance on the need to extend the current deadline and addresses some of the controversial provisions of the draft MCC Implementing Provisions (MCCIP) with a pro-business attitude that could be a good sign for European importers.

Background

The MCC provides for the creation of a pan-European electronic customs environment with harmonized and simplified customs procedures to promote trade with a balance between trade facilitation and customs controls. The MCC was adopted in 2008 in the form of a regulation by co-decision (jointly by the Parliament and the European Council). Ever since, stakeholders have been anxiously watching the development of the MCCIP, which are currently being drafted by the European Commission in collaboration with the EU member states.

Pursuant to the MCC, the MCCIP (a prerequisite to the implementation of the MCC) would take effect in one to five years (i.e., by 2013). However, key issues remain, particularly with respect to the development of the necessary IT system to support the new customs procedures, and it has become clear that the above deadline was too ambitious. The Commission is currently considering an amendment to the MCC to postpone the current deadline beyond 2013. (See also the article "Further delays and controversy expected for implementation of the EU Modernised Customs Code" in the June 2011 issue of *TradeWatch*).

The resolution, dated 1 December 2011, is a legislative procedure that provides the Parliament's point of view on some of the current issues that are stalling the MCC implementation. The resolution is formally addressed to the European Council and the European Commission, and, while non-binding, it does carry considerable political weight. Below we highlight some of the controversial issues of MCC implementation addressed by Parliament.

Proposed extension of MCC implementation deadline to 2016

A primary concern with respect to the current 2013 deadline to implement the MCC is that the majority of new customs procedures depend on properly developed and advanced IT systems. In this respect, many strategic decisions with regard to the IT architecture have not yet been taken by the Commission and EU member states. Further, business will need access to the new IT specifications and time to develop and implement their own IT applications. Taking the above into consideration, the Parliament resolution emphasizes the need to postpone MCC implementation and calls on the Commission and the EU member states to extend the deadline to 2016 to provide sufficient time to meet these objectives.

Centralized customs clearance

A principal aspect of the MCC is the concept of centralised customs clearance, according to which it is possible for authorized EU traders to declare goods electronically and pay their customs duties and value-added tax (VAT) at the place where their business is established, irrespective of the member state where the goods are presented. The Parliament states that this concept utterly depends on the development of IT systems and regrets the lack of progress in the implementation of this concept.



Another key concern is the slow pace of development with respect to the harmonization of VAT and excise rules by the member states. It appears that many member states wish to retain control over the collection of VAT and excise duties, despite the call for a harmonized, centralized clearance system.

Further to the collection of VAT, under the present rules of the VAT directive 2006/112/EC, the importers, even using centralized clearance, would still be subject to VAT obligations in each member state of physical arrival and destination of goods. Where the VAT rules remain unchanged, the simplification objective of the MCC is clearly thwarted. Furthermore, the administrative burden on traders is not reduced in this way.

In relation to the above, the Parliament calls on the member states to commit themselves fully to the concept of centralized clearance, as only “truly harmonized customs rules, information exchange systems and data formats can ensure its successful implementation.”

Key outstanding issues

The Parliament also airs its opinion on a number of issues for which there is no agreement between the Commission and the member states.

EU AEO program

The Parliament voices its concerns on the considerable investment necessary to obtain AEO status, which might be a serious obstacle for traders. Therefore, the Parliament calls on the Commission to consider simplifying the procedures for applying for AEO status and to propose additional concrete benefits granted to AEO-certified traders. Based on the above, it seems that the Parliament is urging the Commission and the member states to meet the wishes of traders, who would like to see more advantages for AEOs.

“First sale for export” customs valuation

As the Commission drafts the rules for customs valuation, a controversial area is the “first sale for export” rules. Currently, many traders that import merchandise subject to multiple sales prior to EU importation benefit from the “first sale for export” valuation strategy. The existing rules allow EU importers that meet certain requirements to declare the price paid in the earlier sale (i.e., the first sale) for customs purposes, resulting in a lower dutiable value and, thus, lower customs duty liability.

However, the MCCIP proposal specifies that the last sale prior to the introduction of goods into the EU qualifies as the relevant transaction for the customs valuation basis. This change in the rules would result in a higher customs value and, thus, a higher tax burden for affected traders. On this point, Parliament seems to side with traders, calling for the Commission to maintain the current “first sale for export” rules so not to increase the tax burden.

Customs treatment of royalties and license fees

Another controversial issue involves the customs treatment of royalties and license fees. Royalties are to be added to the transaction value (i.e., customs value) of imported goods only if they are related to the goods being valued and payable as a condition of sale of those goods for export to the EU. Under existing rules, royalties can generally be excluded from the customs value where certain conditions are met.



Under the proposed MCCIP, the “condition of sale” determination has been broadened so that royalties are much more easily included in the customs value, thus increasing the tax burden of affected traders. In the resolution, Parliament appears to again take a pro-business stance, calling for maintenance of the existing provisions so not to increase the tax burden of traders.

Final thoughts

Overall, the Parliament’s pro-business stance on some of the pressing MCCIP issues facing traders is welcome news. However, it remains to be seen what impact the resolution will have on the position of the Commission and EU member states. Most likely, the MCC implementation will be postponed. The extent of the postponement remains uncertain, although surely 2016 as a possible date is under discussion as a result of the resolution.

Assuming this timeframe is adopted, traders have additional assurances that existing customs strategies – particularly with respect to “first sale for export” and the customs treatment of royalty payments – can continue in the foreseeable future. In this respect, the resolution provides some hope that these strategies may – in the end – continue under the MCCIP without a detrimental effect to the trader’s tax burden.

Only time will tell. As before (i.e., since the MCC was adopted in 2008), stakeholders must continue to anxiously watch the development of the MCCIP. It has been a rollercoaster ride, and judging by the Parliament’s resolution, the concerns of business are being heard. Accordingly, it is crucial that continue involved in EU trade business to actively participate in the process where possible to provide input and make their voices heard. The MCC will change the way trade is conducted with and within the EU, and it is important that the MCCIP stays true to the original intent of the MCC.

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European Court of Justice annuls anti-dumping duties for certain Chinese shoe manufacturers



On 2 February 2012, the European Court of Justice (ECJ) issued a decision annulling anti-dumping duties imposed by the European Union on certain Chinese shoe manufacturers. The significance of the ECJ decision could be far-reaching, potentially impacting a number of current anti-dumping measures and future anti-dumping investigations.

The case at hand, *Brosmann Footwear (HK) and Others v. Council* (C-249/10 P) involved four manufacturers of Chinese shoes involved in an anti-dumping proceeding. Considering the large number of exporters involved, sampling was applied to ascertain whether there had been dumping with approximately 154 manufacturers coming forward to be included in the sample.

The appellants, which were not selected to be included in the sample, had submitted to the European Commission (Commission) the information required in order to be granted Market Economy Treatment (MET), i.e., that they operate under market economy conditions without government influence. MET is beneficial in that it allows the exporter to use sale prices on the Chinese market as the basis for determining the level of anti-dumping duties, which are generally lower than prices otherwise applied, which are generally based on a comparable third country market economy.

The Commission did not examine each individual MET claim due to the substantial number of requests as it would be “administratively impossible” to review all claims within the required time. Instead, the Commission applied equally a weighted average margin resulting from the sample. As a result, the appellants were assessed anti-dumping duties at the rate of 16.5%. By comparison, the only Chinese trader in the sample that obtained MET was assessed anti-dumping duty at the rate of 9.7%.

The ECJ concluded that the Commission erred in law as it did not examine the individual MET requests from a trader from a non-market economy country. Accordingly, Regulation (EC) No. 1472/2006, which imposed the anti-dumping duty on footwear originating in China and Vietnam, was annulled with respect to the four exporters involved in the case.

Possible implications

The ECJ decision has potential implications for other Chinese and Vietnamese exporters to the EU affected by the regulation. Those exporters that were denied an individual assessment of a MET request and subjected to anti-dumping duties based on the third-country market economy price or constructed value could potentially seek refunds considering the precedent set in the *Brosmann Footwear* case.

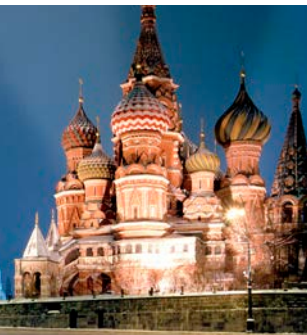
Furthermore, the impact of the ECJ decision could be even more far-reaching. Essentially, the ECJ has established that exporters requesting MET status for anti-dumping assessments should be entitled to receive an individual analysis. Accordingly, exporters from non-market economies subject to anti-dumping proceedings in the EU under similar circumstances may also consider pursuing claims against the Commission.

For future anti-dumping investigations, there is now more incentive to put forth the effort to pursue and support the case for MET, knowing that the Commission is required to review the individual MET claims. If successful, such an effort can potentially serve to reduce the amount of anti-dumping duties.

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Russia

Russia's accession to the WTO and its impact on foreign trade regulation



The final protocol on Russia's accession to the World Trade Organization (WTO) was adopted by the WTO ministers on 16 December 2011. Russia will become a full-fledged member of the WTO after the internal ratification procedures are completed, which should occur this summer.

According to the WTO, Russia has concluded over 100 bilateral agreements on market access for goods and services. These agreements include a wide range of commitments that aim to reduce customs tariffs and non-tariff barriers while also opening up Russia's investment environment through various foreign trade regulation measures. The final protocol is available on the website of the Russian Ministry of Economic Development.⁵ We highlight some of Russia's WTO commitments below.

Customs tariff reductions

The weighted average rate of import customs duty is to be reduced from the current level of 10% to 7.8%. In this respect, the weighted average rate for agricultural products will be reduced from the current level of 13.2% to 10.8%, and for industrial goods from 9.5% to 7.3%.

The final bound rate will be implemented on the date of accession for more than one-third of national tariff lines with another quarter of the tariff cuts to be put in place three years later. The longest implementation period is eight years for pork, followed by seven years for motor cars, helicopters and civil aircraft.

Customs duties will be reduced gradually until 2020. For instance, the customs duty on motor cars will be reduced from 30% to 25% at the time of Russia's accession to the WTO (i.e., expected by mid-2012), and then these rates will be gradually reduced to 15% over the following seven years.

The average import duty rates for certain groups of goods will be reduced as follows:

- ▶ Dairy products, to 14.9% (currently, 19.8%)
- ▶ Cereals, to 10.0% (currently, 15.1%)
- ▶ Chemicals, to 5.2% (currently, 6.5%)
- ▶ Electric equipment, to 6.2% (currently, 8.4%)
- ▶ Articles made of wood and paper, to 8.0% (currently, 13.4%)

At the end of the transition period, zero customs duty rates are to be established for cotton articles and high-tech goods.

Additionally, export duty rates have been fixed for more than 700 types of goods, including oil, metals, fish products, rawhides, wood, cellulose and paper, among others.

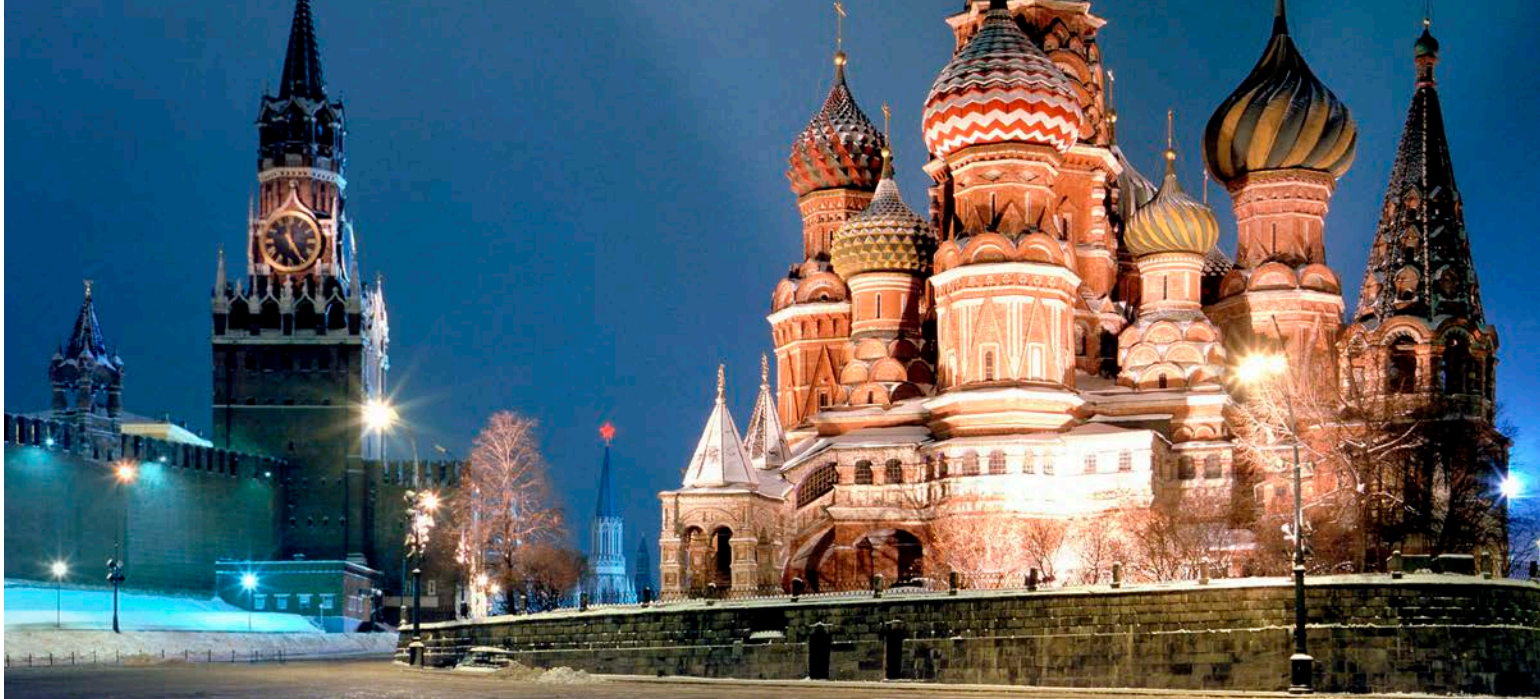
Reduction of non-tariff barriers (quotas, import licenses)

Import tariff quotas will remain for beef, pork and domestic fowl. The quota regime will be effective for pork until 31 December 2019, while the term for beef and poultry has not been determined yet. The customs duty rates for those types of products will be established as follows:

- ▶ Beef, 15% (55% outside the quota)
- ▶ Pork, 0% (65% outside the quota, a reduction to 25% by 2020)
- ▶ Domestic fowl, 25% (80% outside the quota)

The current system of licensing the import of goods (except for the transition to automatic licensing for the import of alcohol) and the system of notification for goods with a cryptographic component will remain within the WTO framework.

⁵http://www.economy.gov.ru/wps/wcm/connect/b5169000497225038c9aae5f9eae86bc/russia_protocol.pdf?MOD=AJPERES&CACHEID=b5169000497225038c9aae5f9eae86bc



Other foreign trade regulation measures

A transition period will be established for investors in special economic zones in the Kaliningrad and Magadan regions. During that period, they will continue to use the benefits provided by Russian legislation, thereby allowing them to fully implement the investment projects on the terms agreed upon earlier.

In term of some key sectors, the following changes are expected:

- ▶ **Car industry:** The "Industrial Assembly regime" for motor vehicles, key parts and integral units, and respective benefits (reduced customs duty rates on automotive components imported for manufacturing purposes) could be applied until 2018. As the end date for the majority of agreements for the Industry Assembly regime is 2020, the Russian Ministry of Economic Development is to develop a special toll allowing car manufacturers to finalize their programs in accordance with WTO principles.
- ▶ **Aviation:** foreign-made aircraft will qualify for the same leasing benefits as Russian-made ones.
- ▶ **Telecoms:** limit of 49% for foreign equity ownership will be scrapped four years after accession.
- ▶ **Banking:** foreign banks will be allowed to operate in Russia, but with an overall limit on foreign-bank control of the banking market set at 50%.
- ▶ **Insurance:** nine years after the date of accession, foreign insurance companies will be able to open fully owned branches.

Implications for the Customs Union

Pursuant to the agreements under the Customs Union with the Belarus Republic, Kazakhstan and Russia, all commitments assigned by a country that is first among the member states to enter the WTO, become a part of the legislation of the Customs Union. At the same time, Russia will, upon accession to the WTO, publish the draft legislative acts of the Customs Union well in advance so as to allow the WTO members to send their comments to the relevant bodies of the Customs Union.

Concluding thoughts

Russia's accession to the WTO has been a long time coming (i.e., since 1993, when Russia first applied to the WTO). Now traders can expect many changes in a short period of time. We have highlighted only a portion of the upcoming changes to the foreign trade regulations. These changes are expected to bring new opportunities for foreign investment and trade expansion. In this respect, Russia will undergo significant reforms to conform with WTO rules and commitments. While these reforms will lower trade barriers, they will also mean new laws, processes and procedures for businesses to adapt to.

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Ukraine

President vetoes new version of the Customs Code



In the previous issue of the *TradeWatch* (December 2011), we reported that on 3 November 2011, the Verkhovna Rada adopted the draft Law of Ukraine “On Amendments to the Customs Code of Ukraine and Certain Other Legislative Acts of Ukraine” (registration No. 8130-d) (the Law). The Law established a new version of the Customs Code.

The Law was submitted to the President for signature. The new Customs Code would have come into force on 1 January 2012 if signed by the President. However, the President vetoed the Law.

Stated reasons for the veto include:

- ▶ It breaches obligations undertaken by Ukraine within the WTO framework, i.e. the customs value determination mechanism according to the Agreement on the Implementation of Article VII GATT of 1994.
- ▶ It creates the risk of tax evasion, in particular evasion of payment of special customs duties or underpayment of customs duties.
- ▶ It restricts the right to judicial review of customs authorities' decisions related to the implementation of control and check measures.
- ▶ It causes additional corruption risks and risks of infringement of constitutional guarantees of equity before the law by granting to customs officials the right to evaluate the reliability of the evidence at their discretion.
- ▶ It creates an imperfect mechanism for holding parties responsible for violations of the customs rules; there is a lack of balance between the responsibilities of business agents and customs bodies.
- ▶ There is a contradiction between the Law and some other legal acts, including the Tax Code.
- ▶ It violates the constitutional right to business activity on the provision of customs brokerage services and limitation of competition in this sphere.

Taking the above into account, the President returned the Law to the Verkhovna Rada for reconsideration and proposed to postpone its enforcement date under 1 January 2013. There are some expectations that this could occur sooner considering that the government is already actively working to complete the necessary amendments. Watch for further developments in future issues of *TradeWatch*.

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Ukraine trade developments: import and export duty reductions, excise duty increases and canceled quotas



Import duty reductions

Effective 1 January 2012, Most-Favored Nation duty rates for goods imported into Ukraine were further reduced on certain vehicles. The duty reductions are being made in according to the schedule of tariff commitments of Ukraine under the Protocol on Ukraine's accession to the World Trade Organization (WTO). The Law of Ukraine "On Making Amendments to the Customs Tariff of Ukraine and Certain Laws of Ukraine in Regard to Description and Rates of Import Duties on Certain Goods," No. 4235-VI, provides for the duty reduction from 7% to 6% on the following tariff codes:

- ▶ 8703 23 11 10 – motor homes of a cylinder capacity exceeding 1,500 cc, but not exceeding 2,200 cc
- ▶ 8703 23 11 30 – motor homes of a cylinder capacity exceeding 2,200 cc, but not exceeding 3,000 cc
- ▶ 8703 24 10 00 – vehicles of a cylinder capacity exceeding 3,000 cc

Also, Ukraine reduced import duty from 8.5% to 8% on certain seagoing motorboats, other than outboard motorboats (tariff code 8903 92 10 00).

Export duty reductions

Effective 1 January 2012, Ukraine reduced its export duties on oilseeds, live cattle, animal skins, ferrous and non-ferrous particles. The tariff cuts are being made according to the schedule of tariff commitments of Ukraine under the Protocol on Ukraine's accession to the WTO.

Specifically, the Law provides for the following export duty reductions:

- ▶ Certain live bovine animals and live sheep – from 35% to 30%
- ▶ Raw hides and skins of bovine or equine animals – from 27% to 26%
- ▶ Raw skins of sheep or lambs – from 27% to 26%
- ▶ Certain other raw hides and skins – from 27% to 26%
- ▶ Certain oilseeds (flaxseed, sunflower seeds, rye seeds) – from 11% to 10%
- ▶ Certain ferrous waste and scrap products – from €14.8 per ton to €13.2 per ton
- ▶ Certain ferrous and non-ferrous products – from 24% to 21%.

Excise duties increase

Effective 1 January 2012, the Law "On Making Amendments to the Tax Code of Ukraine and Certain Laws of Ukraine in Regard to Taxation," No. 4235-VI, provides for an excise duty increase on certain products, due to the indexation of fixed excise duty rates (based on the calculated inflation rate). According to the Law, Ukraine increased, by approximately 9% on average, excise duty rates applied to alcohol and tobacco products, motor spirits (petroleum), vehicles and car bodies. Specifically, the excise duty increases are as follows:

- ▶ Motor spirits (A72 - A98) increased by approximately 9% on average.
- ▶ Light and heavy oils for undergoing a specific process or other chemical transformation, and white spirit increased by 10.7 times; heavy oils for undergoing a specific process or other chemical transformation increased by 6.5 times.
- ▶ New vehicles classified under 8703 of the UFEACC are subject to increased excise duty levels that range from €0.05 per 1 cc to €1.09 per 1 cc (by approximately 9% on average), depending on the good's classification.



- ▶ New car bodies (completed and uncompleted) increased from €100 to €109 per 1 piece (by approximately 9% on average).
- ▶ Cigarettes with and without filter, smoking tobacco, chewing and sniffing tobacco increased by approximately 9% on average.

Moreover, the Law provides that excise duty on certain alcohol products (e.g., beer, undenatured ethyl alcohol, ethyl alcohol, denatured, of any strength, spirits, liqueurs and other spirituous beverages) will be increased by approximately 9% as of 1 April 2012.

Quotas on Uzbek passenger vehicles cancelled

In the September 2011 issue of *TradeWatch*, we reported new import quotas on certain passenger vehicles imported from Uzbekistan. The quotas were established for a three-year period as follows:

- ▶ Vehicles classified under 8703 21 10 00 UFEACC – one vehicle per year
- ▶ Vehicles classified under 8703 22 10 00 UFEACC – one vehicle per year
- ▶ Vehicles classified under 8703 23 19 10 UFEACC – one vehicle per year

These quotas were the result of an investigation of discriminatory taxation on Ukrainian cars in Uzbekistan. In January 2012, Uzbekistan canceled the discriminatory excise duties applied to Ukrainian vehicles.

In turn, on 27 January 2011, Ukraine has canceled the quotas on Uzbek vehicles pursuant to the decision of the Interdepartmental Commission for International Trade.

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New financial sanctions for certain customs-related offenses



On 17 January 2012, the Law of Ukraine “On Amendment of Certain Legislative Acts of Ukraine on Humanization of Liability for Violations in the Sphere of Economic Activity” (the Law) took effect. The Law amends the Criminal Code of Ukraine, the Customs Code of Ukraine and other legislative acts to harmonize the treatment of certain customs-related criminal offenses committed in the course of business activity. We highlight below the new sanctions for smuggling violations and tax evasion, which can involve customs-related offenses.

New sanctions for smuggling violations

The Law includes provisions for commodity smuggling (i.e., contraband) that significantly increase the financial sanctions for violations and abolish the existing criminal sanctions (with certain exceptions). The Law redefines contraband as the transfer of cultural valuables, poison and explosive substances, strong remedies, radioactive materials, weapons, ammunition and special devices for collecting information informally, through the Ukrainian border beyond or concealed from customs control.

Significant financial sanctions

According to the amended Customs Code, the transportation of contraband beyond customs control and the submission of unauthentic/unreliable documents for customs clearance purposes are subject to a fine of 100% of the goods' value, plus their mandatory confiscation. For repeated violations, the penalty increases to 200% of the goods' value. Furthermore, the Law clearly provides for confiscation of the transport vehicles that were directly used to transport contraband.

Under the previous versions of the Criminal Code, the smuggling of commodities valued at more than UAH536,500 (approximately US\$67,000) was subject to criminal prosecution with penalties and imprisonment for three to seven years and forfeiture of the commodities in question.

The Ukrainian government believes that the new focus on financial sanctions to deal with smuggling violations will be a better deterrent for such crimes. The new legal regime should also significantly cut down on the time and effort that the customs authorities spend on investigations and formalizing documents for criminal cases related to smuggling, while also boosting the state budget as a result of the collection of fines and the disposition of confiscated commodities and vehicles.

Implications for logistics operators and transport companies

While the overall impact of the Law remains to be seen, the amendments to the Customs Code are concerning for logistics operators and transport companies. The Ukrainian authorities have initiated a large-scale campaign to confiscate trucks used to transport contraband across the Ukrainian border. Despite the fact that the law took effect just recently, there have been several cases of truck arrests by the customs authorities, often based on the submission of false information about the contraband discovered in the truck.

Under the legal changes, the burden of responsibility for compliance rests, to a considerable extent, on carriers and transporters. But truck drivers are frequently unfamiliar with the features and quantities of the commodities they are transporting. Nevertheless, if the customs authorities discover discrepancies between the commodities transported and the documents submitted for them, the carrier could be subject to vehicle seizure.

In view of the above, we highly recommend that carriers and transporters take a proactive approach to carefully verify the nomenclature and quantity of commodities they are transporting and reconcile with the supporting documentation. Additionally, it is important to check the integrity of the packaging. These actions will significantly lessen the risk of unexpected complexities at the Ukrainian border that could result in vehicle seizure.



New sanctions for tax evasion (including customs-related offenses)

In the case of tax evasion, which can include customs-related offenses (i.e., crimes resulting in the underpayment of import duties and VAT), the new Law also significantly increases related fines. In this respect, the maximum penalty has increased from approximately UAH34,000 (US\$4,300) to UAH425,000 (US\$53,000). Although the Law has abandoned imprisonment as a sanction for tax evasion, it remains a criminal offense.

For instance, post-clearance audits conducted by the Ukraine customs authorities have frequently resulted in the reassessment of the importer's tax liabilities, including fines and penalties (e.g., when the customs authorities identify royalties that were not included as part of the customs value of imported goods). In some cases, the customs authorities may also initiate criminal proceedings against the importer to investigate whether tax evasion led to customs duty underpayment.

In this respect, the State Customs Service of Ukraine (SCSU) recently issued a special clarification to unify the actions of customs offices with respect to customs audit results. SCSU has mandated that should a customs audit reveal import duty and tax underpayment, and the reassessment of the importer's tax liabilities exceeds UAH536,000 (approximately US\$67,000), the customs authorities must notify the law enforcement bodies (e.g., tax militia) within five business days from the tax reassessment's date and pass the relevant documents along to them. Under this scenario, the tax militia typically opens a criminal case against the importer.

In sum, where high customs duty and tax amounts are involved, a customs audit can quickly turn into a tax evasion case. Although in a criminal case a court has to establish that a person intended not to pay taxes due, the mere fact of criminal proceedings and potential imprisonment is a daunting prospect. Large importers, in particular, need to be aware of these additional customs risks, which intensify the importance of customs compliance and due diligence with respect to trade transactions.

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