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Quarterly update

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. Above the 'Y' is a yellow chevron shape pointing to the right.

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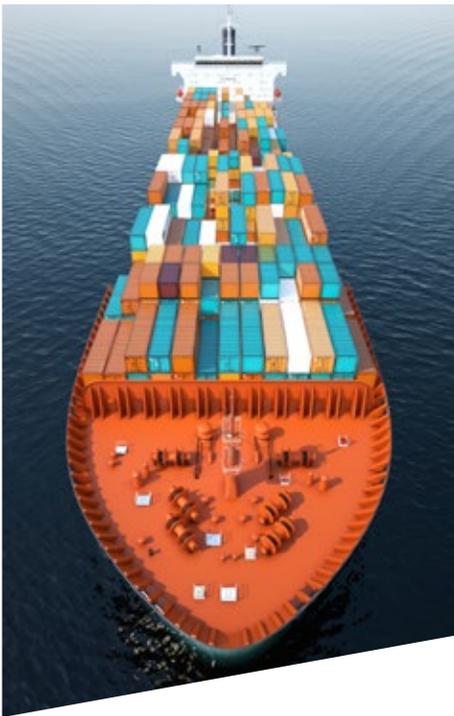
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Trans-Pacific Partnership countries reach agreement on trade agreement terms



On 4 October 2015, the ministers of the 12 Trans-Pacific Partnership (TPP) countries announced that they had reached agreement on terms. TPP is the most expansive trade agreement undertaken by the US; an Office of the United States Trade Representative (USTR) press release describes it as a “high-standard, ambitious, comprehensive, and balanced agreement that will promote economic growth; support the creation and retention of jobs; enhance innovation, productivity and competitiveness; raise living standards; reduce poverty in our countries; and promote transparency, good governance, and enhanced labor and environmental protections.”¹

The proposed TPP impacts many trade areas, including customs procedures, e-commerce, the environment, financial services, government procurement, intellectual property, investment, labor standards, sanitary and phytosanitary requirements, telecommunications and the participation of state-owned enterprises in international trade and investment.

The TPP will eliminate or reduce tariffs on qualifying goods made in TPP territories in trade among the members. The current TPP participants include Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States and Vietnam. The formal text of the proposed trade agreement was released on 5 November 2015.²

The TPP contains alternative effective date provisions. If all 12 TPP countries ratify the agreement within two years, the TPP is effective 60 days following notification of the final ratification. If all 12 countries have not ratified within two years, but at least 6 countries have ratified it, and the ratifying countries represent 85% of the 2013 GDP of the 12 TPP countries (which effectively requires ratification by both the US and Japan), then the TPP becomes effective as to those signatories 60 days following the expiration of the two-year period. If neither event happens within two years, then the agreement will be effective at the time that at least six countries have ratified, and the 85% of GDP threshold is met. If TPP becomes effective with less than all 12 countries, other countries will be added as they complete the ratification process.

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- 1 "Summary of the Trans-Pacific Partnership Agreement," *Office of the United States Trade Representative website*, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/summary-trans-pacific-partnership>, 4 October 2015.
 - 2 The full text of the TPP is available at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text>.



In the US, the President was given renewed “fast track”³ authority whereby ratification follows a truncated process requiring only a simple majority vote in both chambers of Congress, rather than the 60-vote supermajority needed to overcome a filibuster in the Senate. That vote must take place within 90 days from submission of the implementing bill by the administration, which will not occur until mid-February at the earliest. Based on the varying ratification requirements of the 12 countries, the earliest TPP could go into effect is in the third quarter of 2016 – of course, it could take much longer.

Even with the effective date months away, business trading in the area will want to closely review the full text of the TPP to identify opportunities. Each TPP country has set forth a preferential tariff schedule that sets forth how it will reduce tariffs, which can vary by originating country (e.g., US imports from Vietnam may have a different phase-in schedule than do imports from Japan.) The US has 38 separate phases in designations alone. Moreover, the TPP is meant to coexist with other free trade agreements already in place, rather than supersede them. The US, for example, has existing free trade agreements with six of the TPP countries (Australia, Canada, Chile, Mexico, Peru and Singapore), and the TPP will allow business to elect whether it applies the TPP rule of origin or the rule set forth in one of the existing agreements. The environment will be very complex, and how a business may take advantage of expanded opportunities will be very fact-specific.

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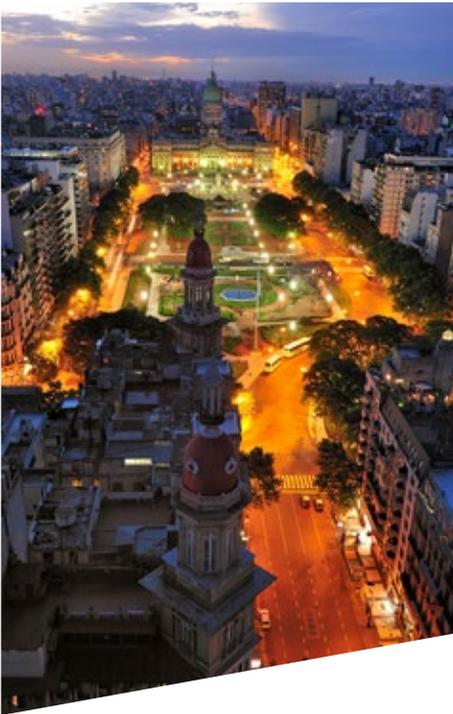
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3 “Fast track” authority was provided by the Bipartisan Congressional Trade Priorities and Accountability Act of 2015, part of the Defending Public Safety Employees’ Retirement Act, Public Law No. 114-26 (29 June 2015). As discussed in the June 2015 issue of *TradeWatch*, the fast track authority establishes a set of Congressional objectives to be pursued when trade agreements are negotiated by the President. When those objectives are met in negotiations, Congress will vote “yea-or-nay” (i.e., either approve or disapprove, but not amend or filibuster) on agreements presented to it.

Argentina

New measures to benefit the Patagonia region



An important benefit, in the form of an additional rebate that was provided three decades ago, has been restored for exports channeled through Patagonian ports and customs.

To stimulate the economy of the Patagonia region, in 1983, the Argentine legislature adopted Law No. 23,018 (the Law), which introduced a preferential system intended to boost settlement in this area and offset existing asymmetries created by the distance between consumption centers and remote Argentine regions.

The Law also provided for an additional rebate for exports utilizing certain Patagonian ports and customs. The rebate provisions went into effect starting on 1 January 1984 and were subsequently renewed and then reduced gradually to zero by 31 December 2011.

Having recognized that the discontinuation of this rebate in 2012 has since hindered commercial competitiveness and has caused serious damage to the activities of the Patagonia region, Argentina's President issued a Presidential Decree on 2 November 2015⁴ to reinstate the rebate.

The rebate is applicable to exports for consumption of goods originating from the region located to the south of the Colorado River and channeled through Patagonian regional ports and customs, as established under the original provisions of the Law.

The applicable rate is the same as the rate that was effective from 1 January 1984, which ranges between 8% and 13%, depending on the shipment port. The rebate rate applies to the FOB (free on board) value of the exported goods and will be effective for five years from 11 November 2015, the effective date of the Presidential Decree.

To receive the benefit, exporters are required to prove the origin of the product to be exported by presenting a certificate of origin.

Furthermore, products of the sea captured by Argentine-flagged vessels and by foreign-flagged vessels chartered by Argentine companies, also qualify for the additional rebate.

⁴ *Decreto 2229/2015, Modificación de Ley No. 23.018, 2/11/2015* (Decree 2229/2015 amending Law No. 23.018, 2 November 2015).

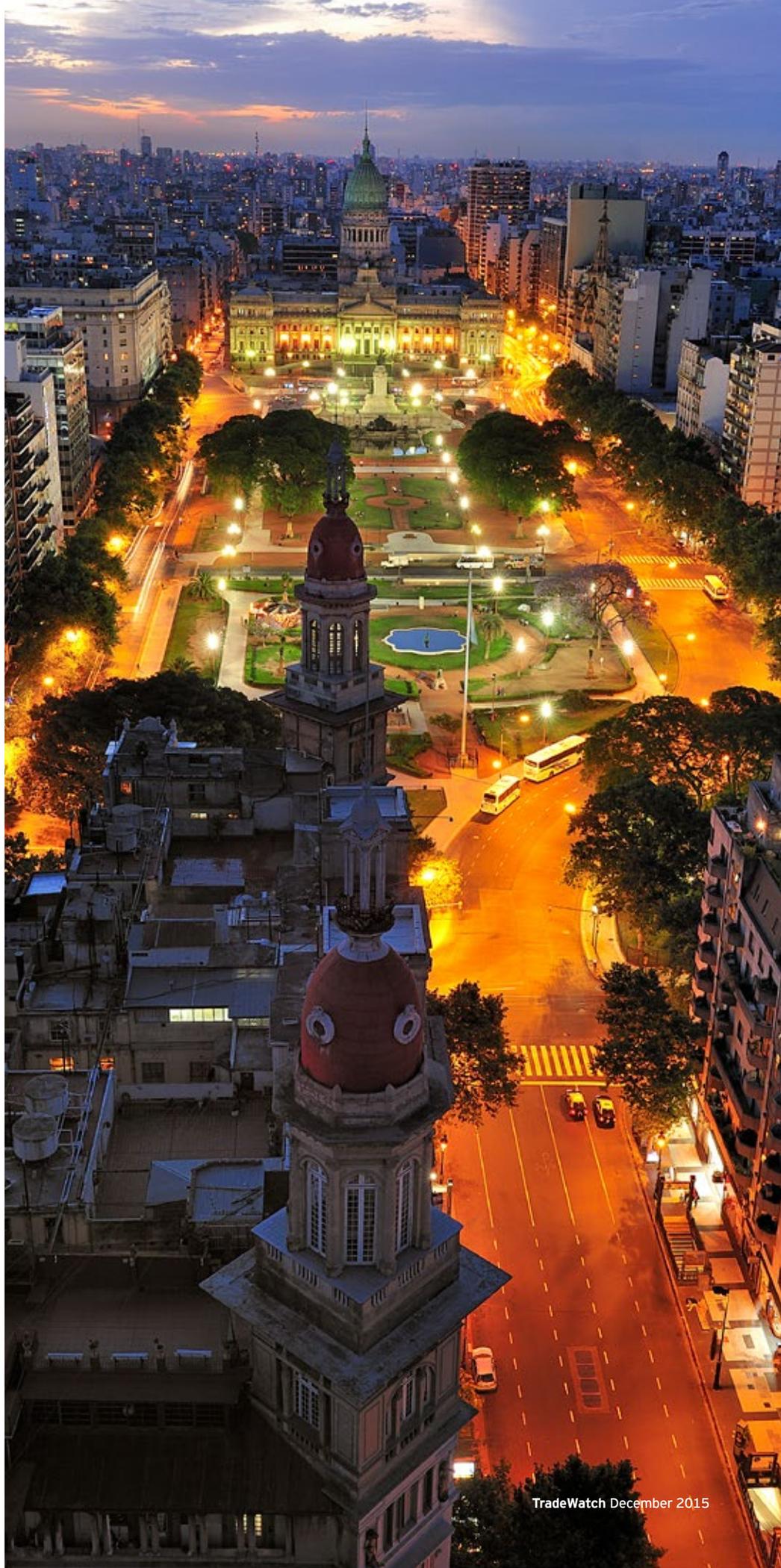
Companies that do business in Argentina, and especially in the Patagonia region, should determine whether the additional rebate could apply to their operations and put in place procedures to secure the required origin substantiation for any qualifying goods.

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Canada

CBSA releases revised customs Memorandum on Transaction Value Method for Related Persons



Background

The Canada Border Services Agency (CBSA) has removed a long-standing barrier to filing import duty refund claims pursuant to downward transfer pricing (TP) adjustments. The initial announcement was made by the CBSA in the form of Customs Notice 15-001 (Customs Notice) on 19 January 2015. In the March 2015 issue of *TradeWatch*, we discussed the background and history that led to the release of the Customs Notice. We outlined the general requirements under the new policy as well as the implications of the new policy on importers.

While the Customs Notice advised importers that there was a change in policy and, therefore, new refund claims opportunities for companies that pay import duties and have the required documentary support, the notice also outlined and reaffirmed the agency's directives on which periodic TP adjustments an importer is obligated to report. As we underscored earlier, the change in policy is a welcome change, although it will raise compliance burdens for related-party TP customs valuation purposes.

In September 2015, the CBSA released the long-awaited update to D-Memorandum D13-4-5 (D-Memo), Transaction Value Method for Related Persons.⁵ The revised D-Memo continues to provide importers with specific administrative guidance and detailed information on the use of international transfer prices in the value for duty calculation. It now also incorporates policy updates that were communicated in the earlier Customs Notice. The D-Memo guidelines are in line with what importers expected as it contains no significant changes that were not outlined in the Customs Notice.

In this article, we focus on the additional details provided in the D-Memo, the guidelines that importers should follow when filing a refund claim as well as when exactly an importer must report an adjustment to the CBSA. Additionally, we outline the various agreements that the CBSA may accept as proof that the price between related parties was set at arm's length, and that an agreement was in place prior to importation.

⁵ D-Memorandum D13-4-5 (D-Memo), Transaction Value Method for Related Persons, available at www.cbsa-asfc.gc.ca/publications/dm-md/d13/d13-4-5-eng.pdf.



Guidelines for importers

The primary method of valuation for imported goods is the transaction value method, the price paid or payable for imported goods. This method, however, may not be used when the price paid or payable is influenced by the relationship between the vendor and the purchaser. The D-Memo provides important administrative guidance regarding valuation provisions in the Customs Act⁶ with regard to related-party transactions. To support a claim that the relationship did not influence the price, importers may show that the value for duty is acceptable by either examining the circumstances surrounding the sale, or by demonstrating that the price closely approximates a specific “test value.” Additionally, the CBSA will accept a price paid or payable that is derived from one of the methods set out by the Organisation for Economic Co-operation and Development (OECD) guidelines or through a transfer price agreement (TPA).

Transfer price adjustments requirements under the new policy

In many cases, importers must voluntarily report periodic TP adjustments (e.g., year-end adjustments that are made so that the Canadian entity may reach an overall profitability target) to the CBSA. The D-Memo outlines specifically when an importer must report a TP adjustment to the CBSA.

Upward TP adjustments

Customs adjustments that result in duties and taxes being owed due to an increase in the price of the goods, trigger an obligation to report to the CBSA within 90 days of the importer having “reason to believe” that

such corrections are required. The reason to believe criteria are met at the point when an importer believes that its declarations were incorrect.⁷

Revenue-neutral TP adjustments

Similarly, customs adjustments that are revenue neutral also trigger an obligation to report to the CBSA, regardless of whether the result was due to an upward or downward TP adjustment. A revenue-neutral downward TP adjustment must be declared by way of voluntary amendment to self-correct the original declaration.

Revenue-neutral TP adjustments (for either an upward or downward adjustment) must be reported within 90 days from the time the importer has reason to believe that such corrections are required because the original declarations were incorrect. This obligation presents additional compliance burdens, which, if not met, can result in penalties to the importer. The CBSA is likely to conduct more valuation audits (verifications) to ensure compliance and to offset revenue losses from duty refunds.

Downward TP adjustments

If the adjustment results in excess duties and taxes that have been already paid, the importer, although not required, may file for a refund with the CBSA up to four years from the date of the importation. This is a major change, as prior to the release of the Customs Notice and the D-Memo, the CBSA typically refused refund claim requests based on downward TP adjustments because such downward adjustments were considered post-import rebates.

⁶ Customs Act, R.S.C., 1985, c. 1 (2nd Supp.) *as amended*.

⁷ Memorandum D11-6-6, “Reason to Believe” and Self-Adjustments to Declarations of Origin, Tariff Classification, and Value for Duty, available at www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-6-6-eng.pdf.



Agreements

The release of the updated D-Memo has provided some clarity on what documentary evidence is acceptable as support for a refund claim based on a downward TP adjustment. The D-Memo outlines that there are various agreements that the CBSA may accept as valid factual evidence that a relationship between the vendor and the purchaser did not affect the price, and also that the price paid or payable determined at time of importation may be subject to adjustments at a later date (i.e., post-importation adjustments).

Typical documentary support for establishing the related-party price includes: TPAs, transfer pricing studies, transfer pricing benchmarking reports and advance pricing arrangements (APAs), provided that the agreements or the studies were in effect at the time of importation, and that the value for duty was based on the agreement on record.

There are various types of APAs, categorized by the number of parties involved (unilateral, bilateral or multilateral). The Canada Revenue Agency (CRA) has an APA program to help taxpayers determine appropriate transfer pricing methodologies (TPMs) for transactions or arrangements they participate in with nonresident persons with whom they do not deal at arm's length in a manner consistent with the Income Tax Act (ITA) and the OECD guidelines.

Any payments or adjustments made post-importation must be declared to CBSA in order for the price to be considered uninfluenced by the relationship. Should the transfer price have been set through an APA, CBSA may require that a correction to the value for duty be made if compensating adjustments are made to the transfer price.

These agreement requirements, outlined in the D-Memo, do not come as a surprise for the importing community. The contents of the revised D-Memo are in line with importers' expectations following the release of the Customs Notice. The D-Memo simply reaffirms the guidelines and obligations under the new policy. As emphasized previously, it is critical for refund claim purposes that the TP be documented and supported from a customs valuation perspective and have been the subject of a legally binding agreement.

Implications for importers

Importers that purchase goods from related parties outside Canada and pay import duties should welcome this detailed update to the D-Memo. The revised D-Memo is likely to help interested parties to determine whether refund claims are possible, or if the interim upward and downward adjustments in the same period can be "netted" to help reduce the magnitude of upward adjustments that the company may need to report. The CBSA's administrative guidance should also help to clarify that the voluntary amendments to be made on revenue-positive or revenue-neutral TP adjustments are, in fact, mandatory.

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Colombia

Colombia amends Authorized Economic Operator regulations



Colombia has recently aligned its existing Authorized Economic Operator (AEO) program with international standards under the World Customs Organization (WCO) SAFE Framework of Standards to Secure and Facilitate Global Trade.⁸

The National Tax and Customs Authority (*Dirección de Impuestos y Aduanas Nacionales, DIAN*) grants AEO status to individuals or legal entities in Colombia that, as part of the international supply chain, comply with the minimum security conditions established by the Government and, therefore, guarantee safe and reliable foreign trade. Currently, qualification as an authorized trader is contemplated for exporters of any economic sector.

Exporters that obtain qualification as an AEO may have, among others, the following benefits:

- ▶ Recognition as a safe and reliable trader by the authorities
- ▶ Fewer audits, physical inspections and documentation requirements
- ▶ Open communications with the customs authorities

- ▶ Use of special simplified procedures during audit or inspection
- ▶ Fewer financial guarantee requirements
- ▶ Access to training provided by the authorities
- ▶ Consolidation of customs duty payments
- ▶ On-site customs clearance for exports

The AEO program in Colombia was created and is regulated according to the Ministry of Treasury and Public Credit Decree 3568 of 2011, which was recently amended by Decree 1894 of 2015.⁹

One of the primary changes introduced by Decree 1894 was the creation of two AEO categories as follows:

- ▶ Security and facilitation
- ▶ Health safety and facilitation

Exporters may apply to the DIAN for either or both of these categories.

Another change was to simplify the conditions enumerated in Decree 3568 of 2011 for qualifying and maintaining AEO status.

⁸ The WCO SAFE Framework of Standards to Secure and Facilitate Global Trade 2015 edition is available at www.wcoomd.org/en/topics/facilitation/instrument-and-tools/tools/safe_package.aspx.

⁹ *Decreto No. 1894 de 22 septiembre 2015 por el cual se modifica parcialmente y se adiciona el Decreto 3568 de 2011* (Decree No. 1894 of 22 September 2015 partially amending Decree 3568 of 2011).

Additionally, the Decree 1894 allows AEOs to file a formal administrative appeal internally with the Customs Authority, in the case an adverse assessment has been issued by the DIAN under its Risk Management System.

Given the fact that until now only 13 Colombian export companies have been granted AEO status, companies that determine whether AEO benefits apply to them and then proceed to structure their processes accordingly to qualify under the EAO rules will secure a competitive advantage.

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Mexico

Argentina and Brazil implement restrictive rules of origin on imports of automotive parts from Mexico under preferential duty treatment



In the June 2015 issue of *TradeWatch*, we discussed Argentina, Brazil and Mexico's agreement to extend until March 2019 the quota system for Mexican automotive vehicles and auto parts imported into Argentina and Brazil. Following is a brief update on the agreement's background, developments and current status.

The MERCOSUR (*Mercado Común del Sur*, Argentina, Brazil, Paraguay and Uruguay, and since 2012, Venezuela) countries signed the Economic Complementation Agreement No. 55 (ECA No. 55) with Mexico, under the framework of the Latin American Integration Association (*Asociación Latinoamericana de Integración*, ALADI) in 2002. The ECA No. 55 provides for preferential duty treatment to imported automotive vehicles and parts originating in member countries.

In 2012, the Brazilian authorities claimed there was an automotive vehicles trade deficit with Mexico. The ECA No. 55 was then amended to establish a quota system for Mexican imports into Brazil and to provide for more stringent regional value content requirements.

Afterwards, Argentina claimed that the amendments introduced by Brazil modified the trade flow of automotive vehicles, which was likely to affect negatively the development of current and future investments. As a result, on 26 June 2012, Argentina unilaterally suspended the application of the ECA No. 55 for a three-year term,¹⁰ during which Mexican automotive vehicles and parts could no longer be imported duty-free.

Mexico and Argentina then negotiated further amendments to the ECA No. 55 that reactivated the preferential duty treatment under a new quota system and stricter regional value content requirements, similar to those under the amended agreement with Brazil.

In March 2015, Argentina, Brazil and Mexico negotiated new amendments to the ECA No. 55. The amended agreement extended the quota system (originally set to expire on 15 March 2015) until March 2019 and increased the regional value content requirement for automotive vehicles originating in Mexico to 35% starting in March 2015 through March 2019 and 40% starting in April 2019 for imports into Argentina and Brazil.

¹⁰ Decreto No. 969/2012 de 22/6/2012, B.O. 26/6/2012, Argentina, (Decree No. 969/2012 dated 22 June 2012, O.J. 26 June 2012, Argentina).



The new amendments to the ECA No. 55 also introduced changes to the rules of origin for automotive parts used in the manufacture of vehicles.

Under the previous rules of origin, a simple tariff shift at the heading level was required for many automotive parts to be considered as originating in Mexico. If the tariff shift requirement was not met, the parts could still be considered originating as long as the value of the non-originating materials did not exceed 50% of the value of the goods.

The amendment to the rules of origin eliminated the tariff shift rule and instead introduced a minimum regional value content requirement of 35% until 18 March 2019, and a possible increase to 40% thereafter.

This amendment has had a significant impact on Mexican automotive parts manufacturers whose products qualified as originating under the tariff shift criteria whereby qualification mainly relied on processes conducted in Mexico from non-originating materials.

The Mexican Ministry of Economy is currently undertaking several measures intended to provide some alternatives to companies affected by these changes. These measures include a request to the Brazilian authorities to reduce the regional value content requirement for a limited number of products. Another measure involves adjusting the regional value content calculation formula to allow Mexican manufacturers to use a higher number of non-originating materials in the Mexican production process.

It is important for companies to be aware of these changes, assess how the changes affect their operations and take proactive measures to ensure that their products qualify under the new rules of origin.

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New requirements to support customs valuation of imported goods into Mexico



Under the Mexican Customs Law (the Law), the importer has the obligation to file an affidavit (i.e., a customs value statement) that provides sufficient information to allow for the determination of the customs value of imported goods.¹¹ The importer must also keep a copy of the statement along with a file of information, documentation and other evidence, which demonstrates that the declared value has been determined in accordance with the customs valuation provisions of the Law. Upon request, the importer must submit any such evidence to the customs authorities.

As a result of certain major amendments introduced in the Law in 2014, Mexico amended its Customs Law Regulations (the Regulations)¹² on 20 April 2015, to include necessary adjustments to certain provisions.

Namely, Article 81 was added in the Regulations. It includes a long list of documents that will need to be submitted at the time of importation attached to the customs value statement, as follows:

- ▶ Commercial invoice
- ▶ Bill of lading, packing list, airway bill or other transport documents
- ▶ Documents demonstrating country of origin, when applicable
- ▶ Documents demonstrating payment for the goods, such as electronic transfers or letters of credit
- ▶ Documents related to transport, insurance and costs related to the operation
- ▶ Contracts related to the transaction of the imported goods
- ▶ Documents supporting any additions to value that must be included in the customs value of the goods
- ▶ Any other information and documentation necessary to determine the customs value of the goods

¹¹ *Ley Aduanera, artículo 59, fracción III* (Customs Law, Art. 59, para III).

¹² *Reglamento de la Ley Aduanera, 20 de abril de 2015* (Regulation under the Customs Law, 20 April 2015).

These new documentary requirements are broad and could cause significant administrative burden for importers that will now be required to compile new detailed documentary files for each import operation.

The authorities have recognized that these provisions are unclear and have postponed the entry into force of the new requirements until 15 January 2016, so that additional guidelines on the specific documentation that must be provided to comply with the new requirements may be issued. The authorities have involved various Mexican associations and trade chambers in the discussions to obtain appropriate feedback from stakeholders.

Accordingly, the additional guidelines are expected to clarify the extent of documentation that needs to be provided. In the meantime, importers should take proactive steps to ensure that, by 15 January 2016, they have compiled accurate and sufficient information to support the customs value of their imported goods.

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Peru

Amendments to Peru's General Customs Law



Peru has introduced updated international customs practices to improve the security and control of international operations and provide for trade facilitation. On 26 September 2015, Legislative Decree No. 1235¹³ was published in the Official Daily Gazette El Peruano. The Decree amends Peru's General Customs Law (adopted by Legislative Decree No. 1053).

The most relevant changes related to security and control of international operations are as follows:

Definitions

The definition of "cargo manifest" has been modified by adding information regarding the general description of the goods, and the name and identification number of its owner or consignee. Moreover, the definitions of "tally note" and "detailed tally" have been removed from the law.

Customs obligations

Additional obligations for all foreign trade operators have been included, such as:

- ▶ Requirements to implement security measures provided by the customs authorities, by other foreign trade operators or by managers and concessionaires of international ports, airports or bus terminals

- ▶ Requirements to transport goods between authorized primary zones on vehicles with a control system and wireless monitoring that transmits continuously information about the vehicle's location

Certain obligations for managers and concessionaires of international ports, airports or bus terminals have also been included to provide for mechanisms that ensure customs operations security.

Penalties

Noncompliance with the aforementioned obligations is subject to fines. The amounts of such fines will be detailed in future regulations (a supreme decree, yet to be adopted, is expected to amend Supreme Decree No. 031-2009-E).

In addition, certain violations that were previously penalized with suspension or cancellation of operations (applied to customs brokers, customs warehouse, postal service companies and express delivery service companies) are now subject only to fines. These include, among others:

- ▶ Not maintaining or adapting operations in accordance with the requirements and conditions to operate, such as the location's infrastructure, valid financial guarantees and others

¹³ Decreto Legislativo No. 1235, 26 de setiembre de 2015 (Legislative Decree No. 1235, 26 September 2015).



- ▶ Modifying or relocating zones and premises without authorization from the customs authorities
- ▶ Releasing or disposing of goods prior to customs clearance

Changes related to trade facilitation

Authorized Economic Operator

The amendments establish specific authorized economic operator (AEO) certification requirements as follows:

- ▶ History of compliance with local regulations in force
- ▶ Adequate accounting and logistics system registries enabling operation traceability
- ▶ Duly supported financial solvency
- ▶ Proper level of security

However, AEO certification may now be subject to suspension or cancellation, for which regulations and guidelines are yet to be issued.

In addition, the amendments to the General Customs Law provide for customs control facilitation and simplification for AEOs, including:

- ▶ The possibility to submit a single customs declaration that covers customs processing for various shipments over a specific period of time to be defined by the Customs Administration
- ▶ The option to submit minimal declaration for the clearance of goods, and then complete the missing information at a later time
- ▶ Reduced financial guarantees or exemption from filing
- ▶ Other facilitations that the Customs Administration may establish

It is worth mentioning that the AEO program currently only applies to exporters, customs brokers and customs warehouses that comply with all the specific requirements.

Customs clearance

Legislative Decree No. 1235 provides for the following changes:

Before	As amended
"Advance clearance": within 15 days prior to arrival	"Advance clearance": within 30 days prior to arrival
"Exceptional clearance": up to 30 days after arrival	"Deferred clearance": up to 15 days after arrival
"Urgent clearance": within 15 days prior to arrival and up to 7 days after arrival	"Urgent clearance": Time limit to be established by customs regulation

Additionally, the Customs Administration will compile a report regarding the advisability of making advance clearance mandatory.



Errors not subject to penalty

Under Legislative Decree No. 1235, errors not subject to penalty include: system failures or non-implementation of computer systems (attributable to the Customs Administration), force majeure and certain fortuitous events.

Legal abandonment

An owner or consignee may recover his or her goods in legal abandonment before the disposal of goods is rendered effective by the Customs Administration by:

- ▶ Complying with any legal formalities of the customs regime that may be applicable

Or

- ▶ Paying the customs tax debt and other corresponding expenses when importing for consumption

An important change is that goods in legal abandonment may also be assigned for re-exportation.

Effective dates

Legislative Decree No. 1235 is not fully in force yet; some articles will go into effect after the expected supreme decree to amend the Regulations under the General Customs Law enters into force. Considering that any amendments to the Regulations of the General Customs Law and Sanctions Table must be approved within 120 calendar days after the publication of Legislative Decree No. 1235, the amending supreme decree is likely to be issued by January 2016.

AEO regulations will become effective after the enactment of another supreme decree to furnish guidelines.

Look for updates on the expected amendments to the Regulations under the Customs Law and other provisions related to amendments introduced by Legislative Decree No. 1235 in future issues of *TradeWatch*.

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Peruvian Tax Court mandatory customs ruling eliminates the double standard for customs tariff classification



A recent ruling by Peru's Tax Court has established that a change of classification standard does not subject importers to penalties and interest for classification under the previous standard for the period before the new standard was adopted, and this applies to all importers of goods so classified.

Background

Until recently, the Peruvian Customs Administration could challenge the tariff classification declared at importation and require payment of unpaid duties and taxes (in addition to a fine equivalent to twice the amount of unpaid duties and taxes) years after a company had declared a classification code on imported goods. In fact, even a physical inspection or documentary review by customs at the time of importation would not constitute validation of the declared tariff code absent an advance Customs Administration classification ruling.

However, according to the Peruvian Tax Code, a change of classification standard introduced by the Customs Administration does not invalidate any prior declaration made under the previous standard and does not subject the importer to penalties or interest for the period of time when the previous standard was valid.¹⁴

Notwithstanding, according to the Customs Administration's interpretation, the aforementioned Tax Code provision applies only to the importer whose tariff classification was changed as a result of a physical inspection or documentary review. It would not apply to other importers who may have imported the same goods under the same tariff code at the same time, and these importers could later be subjected to penalties and interest.

¹⁴ *Código Tributario, Art. 170, numeral 2* (Tax Code, Art. 170, para 2).



Mandatory Tax Court ruling

The Peruvian Tax Court has issued a mandatory ruling in September 2015,¹⁵ which is expected to eliminate the double standard described above. The ruling provides that validation by the Customs Administration of a declared tariff classification at the time of physical inspection constitutes adoption of a classification standard for the imported goods, which applies to all importers of the same type of goods.

Thus, the Tax Court has recognized that a physical inspection or documentary review as well as an official classification ruling by the Customs Administration establishes a tariff classification standard, which applies to all importers of goods that are identical for tariff classification purposes. Furthermore, in these cases, under the Tax Code provision, importers may not be held liable for unpaid duties, taxes and penalties for goods classified according to a standard that was valid at the time the goods were imported.

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¹⁵ *Resolución del Tribunal Fiscal No. 07957-A-2015, 3 de setiembre de 2015.* (Tax Court Resolution No. 07957-A-2015, 3 September 2015).

United States

FTZ Board: proposed changes to production scope of authority



At the NAFTAZ's (National Association of Foreign-Trade Zones) most recent annual conference, the Foreign Trade Zones Board (the Board) announced two proposed changes to the way it approaches granting "production" authority. Importantly, the Board has reached out to both industry and the trade community seeking feedback on the potential ramifications, feasibility and desirability of such measures.

Background

In the 2012 regulatory changes,¹⁶ the Board created the term "production" to replace and encompass both "manufacturing" and "processing" activity. Production describes activity involving the substantial transformation of a foreign article or other activity that causes a tariff classification change of the article, or affects its eligibility for entry for consumption.

In its current state, production activity within authorized zones may not be conducted without prior authorization from the Board. Upon approval, such activities are then limited to the scope of authority granted, with strict limitations on the specific foreign-status components/inputs used in production and the specific finished products described in the participant's notification or application.

Proposed adjustments to the Board's approach

1. Shift from commercial description to HTS-based production scope

The Board proposed adjustments to descriptions of foreign-status inputs and subsequent outputs within the company's scope of production authority as an effort to provide additional structure to the production notification process. Current practice requires a physical or commercial description of the item followed by a six-digit HTSUS (Harmonized Tariff Schedule of the United States) subheading. Under the proposed adjustment, a potential Foreign-Trade Zone (FTZ) production participant may frame its requested scope of production authority in terms of the eight-digit HTSUS numbers associated with its articles, accompanied by the corresponding HTSUS description, and omit the commercial description entirely.

¹⁶ Foreign-Trade Zones in the United States, Final Rule, 77 Fed. Reg. 12112, 28 February 2012.



From the industry's perspective, this proposed adjustment greatly facilitates scope determination and may be utilized by operators and FTZ users to systematically determine whether a given activity is within scope or not. Future use of HTS numbers in the production authority notification procedures will lead to potential automation of the entire process. Alternatively, current description practices provide a higher degree of flexibility to FTZ users, many of whom are concerned that HTSUS integration may lead to increased enforcement and more effective oversight by the Board and U.S. Customs and Border Protection (CBP). Also, providing production notification lists to the Board at the eight-digit level, rather than at the six-digit level, will likely lead to requests containing much larger lists of inputs.

2. Allowance for retrospective production notification

As previously noted, the Board must authorize all production activity prior to commencement of operations. This proposed change will now allow for retrospective notifications for additional foreign-status inputs for previously approved production operations and authorized finished products. As proposed, submission of the retrospective notification would be required within 90 days of commencement of use of new foreign-status inputs and will be subject to certain limitations. For example, inputs subject to antidumping or countervailing duties (AD/CVD), or quota, will still require prior Board authorization. Also, new foreign-status inputs would be restricted to Privileged Foreign (PF) status during the 90-day period prior to notification submission as well as for the duration of the typical 120-day production notification review period (unless interim authority is granted).

Retrospective notification would provide flexibility for FTZ operators by allowing expedited use of most new inputs in the production process. However, strong material controls would need to remain in place to monitor the timing of foreign admissions and zone status election to ensure that either PF is elected for unapproved inputs, or that Non-Privileged Foreign (NPF) status articles are not used in production prior to completion of the review period. Automation through the Automated Commercial Environment (ACE) deployment will play a key role in helping companies monitor the scope of authority compliance.

Next steps

These proposed regulatory amendments will likely roll out in a voluntary pilot program for further testing and to gauge the changes' anticipated (and unanticipated) effects on FTZ activity. Communication from the Board to date has indicated that operators with existing scopes of authority may be "grandfathered" and, therefore, potentially not subject to the new scope of authority methodology. However, all new potential FTZ production applicants would be subject to the new methodology procedures upon adoption by the Board.

Companies with existing FTZ operations are well-advised to review their current scope of production authority to determine the level of impact such measures could have on their FTZ operations.

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China

Customs to promote the implementation of Collective Duty Settlement Program



Background

On 24 July 2015, China's General Administration of Customs (Customs) issued Circular 33 to promote the implementation of the Collective Duty Settlement Program throughout the country.

This announcement is part of the efforts by Customs to extend the scope of the previous pilot program that was limited to certain major locations (e.g., Beijing, Tianjin, Shanghai, Guangzhou). It is also consistent with the pilot programs rolled out in the Shanghai Free Trade Zone to facilitate the import and export clearance process.

The Collective Duty Settlement Program allows a qualified importer to collectively settle the applicable duty and import taxes with Customs on a periodic basis (e.g., monthly). The requirements of this program stress the creditability of the qualified importer; for example, the importer must be rated as a General Authorized Enterprise or higher and a guarantee must be provided to secure the potential import tax liability, as approved by Customs.

The program operates as follows:

- ▶ With a valid guarantee, the import shipment can be released in advance and the applicable import taxes may be settled afterwards. That is, a one-month deferral period is permitted in Circular 33, whereby the deferred tax payment from each month must be settled by the fifth day of the following month.
- ▶ However, in principle, deferral from one calendar year to the next is not permitted.

Observations

Different from traditional import clearance procedures (settlement prior to release), the advantages of the Collective Duty Settlement Program include, but are not limited to, the following:

1. Goods can be cleared before settlement of custom duties, which decreases time and costs of customs clearance.
2. The importer can collectively settle the import tax payments within a specified period of time after receiving the goods, which decreases the frequency of tax payments and mitigates the cash flow burden.
3. Guaranteed amounts can be recovered automatically after payment of taxes, reducing the finance and administrative burden on the importer.



Customs will accept a guarantee provided in the form of either cash deposit or guarantee letter. The differences are summarized in the following table:

Cash deposit	Guarantee letter
Cash deposited into the account designated by Customs	Guarantee letter must be issued by a bank or qualified financial institute acceptable to Customs
Deposit is still a cash flow burden on the importer	Reduced cash flow burden, but the importer should have good financial credit and will have to pay a fee

The cash flow burden resulting from import tax payments can be different depending on the industry and type of business (e.g., manufacturing, distribution). The new Collective Duty Settlement Program does provide an opportunity for certain businesses to optimize their import operations, but it will require good planning to achieve the benefit.

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Expansion of the pilot program for customs clearances with a paperless automatic import license



Background

On 29 July 2015, China's General Administration of Customs (Customs) issued Announcement on Further Expanding the Pilot Program for Customs Clearance with Paperless Automatic Import Licenses (Circular 35). The purpose of Circular 35 is to expand the scope of the pilot program for customs clearances with a paperless automatic import license from the Shanghai Free Trade Zone to include Tianjin, Shanghai, Nanjing, Ningbo, Fuzhou, Xiamen, Shenzhen, Gongbei and Huangpu Customs.

Paperless clearance is one of the major reform areas for Customs in recent years. Based on the positive experience from the previous pilot program, Customs issued Announcement on Expanding the Paperless Customs Clearance Reform (Circular 25) in April 2014 for the purpose of expanding the pilot scope nationwide. However, according to this announcement, the paperless program does not apply to situations where the clearance involves a licensing control and the license cannot be verified electronically through the network. Circular 35 serves to supplement Circular 25; that is, a business that satisfies all of the prescribed requirements can submit the license electronically to Customs through a paperless declaration and then Customs will verify the license through the automatic license data network.

Observations

The positive impacts of Circular 35 in accelerating the customs clearance process for certain goods using paperless automatic import licenses include, but are not limited to, the following:

1. An importer can now avoid submitting automatic import licenses in paper format, which will save time and costs.
2. Clearance efficiency will be enhanced when Customs can verify the license through the automatic license data network instead of verifying the paper license.

Products falling within the scope of Circular 35 are subject to automatic licensing, which is favorable news to both manufacturers and trade enterprises of such in-scope products; however, the application of the current program is limited to situations where the import license is matched to a shipment on a one-to-one basis, although occasionally for certain products, the import license may be issued for multiple shipments. Companies that familiarize themselves with such operational details will be able to benefit from the program and secure an important competitive advantage.

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Japan

TPP agreement: tariff elimination in Japan



The full text of the Trans-Pacific Partnership (TPP) agreement – a provisional edition that is still subject to legal review – was released on 5 November 2015 to the public by the TPP parties. In Japan, however, the Cabinet Secretariat has released only the basic summary and outline to serve as a guideline for the future tariff elimination of covered products.

Because the schedule for signing is different among the 12 countries, and for a number of other reasons, it is yet unclear whether the signed TPP agreement can be submitted for ratification to the National Diet by next January. But assuming that all 12 countries submit their signed agreement by spring, the earliest ratification date in Japan that can be estimated is June 2016.

It is expected that the TPP will surpass any economic partnership agreement (EPA) that Japan has ratified until now in terms of tariff elimination acceleration as well as the scope of products likely to benefit. Tariffs on most industrial goods will be eliminated immediately, and even though tariffs on some goods, such as rice, pork, beef, dairy products and others, may remain to a certain extent, they will be reduced significantly. In comparison to past EPAs, importers using TPP will most likely enjoy greater access to Japan's market.

Pork imports

The tariff rates for certain agricultural goods are scheduled for long-term reduction. In the case of pork, the current gate price system and differential tariff will be maintained.

Under the gate price system, customs duty for imported pork (imported as pork cuts rather than whole carcasses) is calculated on the basis of ad valorem duty, specific duty or differential tariff. Where the value per kilogram of the imported pork equals or exceeds the administratively set gate price (currently JPY524/kg), ad valorem duty (currently 4.3%) applies. Where the value of the imported pork per kilogram is below another administratively set amount – the minimum price (currently JPY64.53/kg) – specific duty applies (currently JPY482/kg). When the value of the imported pork per kilogram is lower than the gate price, but higher than the minimum price, the differential tariff applies. In that case, the importer pays the difference between the gate price and the import value per kilogram (the differential tariff) in addition to 4.3% ad valorem duty using the gate price to calculate the dutiable value of the imported pork.



For pork, the ad valorem duty will be reduced from the 4.3% before TPP implementation to 2.2% within the first year, and eventually to 0% over the course of 10 years. The current specific duty rate of JPY482/kg will be reduced to JPY70/kg within 5 years, then reduced to JPY50 per kg by the 10th year.

Tariff structure for pork (imported as pork cuts)

Currently in effect	After TPP
Above JPY524/kg (gate price) → 4.3%	Above JPY524/kg (gate price) → Free (10th year)
Below JPY64.53/kg (minimum price) → JPY482/kg	Below JPY474/kg (minimum price) → JPY50/kg (10th year)
Above JPY64.53/kg and below JPY524/kg → difference between the gate price and import value/kg (differential tariff) + 4.3% ad valorem rate at JPY524/kg	Above JPY474/kg and below JPY524/kg → difference between the gate price and import value/kg (differential tariff) + 4.3% ad valorem rate at JPY524/kg

Other imports

Tariff rates of industrial goods, such as oil, chemicals, textiles and jewelry, will be eliminated immediately upon implementation of the TPP, as indicated in the chart below.

Articles	Specifics	Summary
Industrial goods		
Oil	▶ Diesel, fuel oil, kerosene, etc.	▶ Immediately eliminated (0%~3.9% → 0%)
Chemicals	▶ Plastics, organic and inorganic chemicals	▶ Immediately eliminated (0%~17% → 0%)
Textiles	▶ Textiles and most apparel	▶ Immediately eliminated (5%~13.4% → 0%)
Jewelry		▶ Immediately eliminated (0%~10% → 0%)
Agricultural products		
Rice		▶ Maintain the existing government control over trade and the tax rate of JPY341/kg for imports in excess of the quota limit ▶ Set a separate framework under the simultaneous-buy-sell (SBS) system with the US and Australia
Beef		▶ Gradually eliminate customs duty over the course of 16 years ▶ Final rate will be 9%
Pork		▶ Eliminate ad valorem duty in 10th year ▶ Gradually decrease specific duty over 10 years ▶ Maintain differential tariff and gate price
Wheat		▶ Maintain the existing government control over trade and the tax rate of JPY55/kg for imports in excess of the quota limit ▶ Reduce import margin by 45% by the ninth year
Sugar		▶ Maintain the basic framework, yet exempt from duty and cut back adjustment price in response to demand for raw sugar



The TPP also includes the possibility for accelerated tariff elimination in some cases. Section 8(a) of TPP, Schedule of Japan, provides:

“Upon request from Australia, Canada, Chile, New Zealand or the United States, Japan and the requesting Party shall consult to consider Japan’s commitments to the requesting Party regarding treatment of originating goods related to the application of customs duties, tariff rate quotas, and safeguards in Schedule of Japan no sooner than seven years after the date of entry into force of this Agreement for Japan, with a view to increasing market access.”

This suggests that tariffs for goods with a long-term tariff reduction schedule (e.g., beef at 16 years) may be adjusted accordingly for accelerated elimination.

Implications for importers

Multiple benefits for goods imported into Japan are expected after TPP is implemented. Tariffs on most industrial products will be eliminated, and tariffs on agricultural products will also be significantly reduced with the addition of readjustment schedules (on tariff, quota, and safeguards) after seven years. Moreover, similar to the Japan-Australia EPA, TPP allows importers and exporters to utilize the self-certification system to voluntarily declare the eligibility of their imported goods. As long as the importer meets the TPP Rules of Origin requirements, the self-certification process can significantly expedite trade operations.

Therefore, it is crucial for importers and exporters to correctly assess the value and the origin of their goods, and to keep proper records to prevent any miscalculations or errors. Companies that pay close attention to compliance management are in a better position to take advantage of the benefits made possible under the TPP and, at the same time, avoid unnecessary scrutiny from customs.

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Customs annual report on post-entry audits shows a new trend



On 4 November 2015, Japan's Ministry of Finance published a report on the results of post-entry audits conducted by Japan Customs for the period from July 2014 to June 2015. A total of 3,545 importers were audited and 2,363 importers were found to have submitted incorrect import declarations that resulted in duty/tax shortfall. Although the rate of noncompliant importers was 66.7% (0.5% less than the previous year), the total amount of under-declared value of all audited companies was approximately JPY108.2 billion, an increase of 21.9% from the previous year. The total amount of customs duty and tax additionally levied was JPY11.8 billion and the additional tax reached JPY748 million, resulting in a huge increase of 40% and 26%, respectively.

In comparison with the prior year, the total number of audited importers has decreased by 1.9%. This is possibly due to the fact that instead of auditing broadly

across industries, Customs audit resources were focused on the meat industry, where substantial duty shortfall had been suspected for some time, specifically for pork imports.

Nevertheless, other industries should also be mindful to ensure that their import operations are in compliance with Customs rules and relevant laws. In recent years, Customs clearance procedures have become much simpler in line with efforts toward trade facilitation. As a result, Customs is able to spend more hours on post-entry audits to thoroughly check whether import declarations have been made appropriately. Therefore, not only the targeted industry, but also all other industries engaging in import to Japan should pay attention to this trend.

The top five product categories with high duty/tax shortfall were as follows:

Items and Harmonized Schedule (HS) code	Duty/tax shortfall
1. Meat (Chapter 02)	JPY2,786 million
2. Electrical equipment (Chapter 85)	JPY1,528 million
3. Machinery (Chapter 84)	JPY1,336 million
4. Pharmaceutical products (Chapter 30)	JPY691 million
5. Footwear (Chapter 64)	JPY624 million



According to the Ministry of Finance's published report, customs identified the following major cases of incorrect declaration:

- ▶ **Case 1: Development fees paid by importer (other than invoice amount) not included in declared value** – An importer of auto parts paid development fees related to the imported goods to an exporter in the US separately from the invoice amount for the auto parts. The importer improperly failed to add the payment for the development fees to the customs value.
- ▶ **Case 2: Intentionally adjusted price declaration of frozen pork – abuse of the gate price system¹⁷** – An importer of frozen pork from the US declared a value higher than the actual transaction value. The declared value was approximately JPY524/kg, a value that subjects the imported pork to the lowest duty rate under the gate price system. As a result, the difference between the incorrect declared value and the actual transaction value was levied as a duty, and the imported pork was also subjected to an additional tax.
- ▶ **Case 3: Value of materials provided by importer free of charge not included in declared value** – An importer of jewelry from Thailand had provided materials to the exporter free of charge for the manufacture of the imported jewelry. The importer improperly failed to include the cost of the materials in the declared value.
- ▶ **Case 4: Non-declaration of royalty fee related to imported goods** – An importer of bags from China had made trademark royalty payments related to the imported bags to the exporter's parent company. The importer should have added the royalty fee to the declared import value, but failed to do so.
- ▶ **Case 5: Application of preferential treatment by falsifying documents subject to heavy additional tax** – An importer of cookies from Cambodia improperly declared the cookies as goods of Cambodian origin in order to claim preferential duty treatment. Even though the cookies did not meet the applicable origin criteria, the importer altered evidentiary documents to show a false origin for the product's ingredients.

Focus on compliance with preferential treatment rules

Traditionally, Japan Customs focuses its efforts primarily to confirm whether the declared customs value is appropriate, i.e., whether the value was determined in accordance with customs valuation rules and whether all necessary additions to the transaction value were made at the time of import declaration. However, as in Case 5 above, Customs also verified whether the importer complied with preferential duty rules of the applicable regime when a claim for preferential duty treatment was made.

17 For a detailed description of the gate price system, see article on "TPP: tariff elimination in Japan" in this issue of *TradeWatch*.

Importers claiming preferential duty treatment are advised to establish a compliance system to accurately analyze the circumstances surrounding their trade operations to ensure that the goods meet the origin criteria for each applicable regime.

Furthermore, there may be cases where two or more regimes may apply to the goods at the same time, e.g., Japan-ASEAN Economic Partnership Agreement (EPA) and Japan-Thailand EPA. Since the rules of origin and tariff reduction schedules are different under each agreement, it is possible for goods that do not qualify as originating under one agreement to qualify under the other. It is important for importers to analyze the best applicable regime so that they may optimize their operations to qualify for preferential treatment.

Customs continues to focus attention on abuse of the gate price system for imported pork and the required addition of payments made to the seller

As discussed in the March 2015 issue of *TradeWatch*, additional Customs auditor resources have been allocated to target key importers of pork under the gate price system. The amount of duty/tax shortfall for meat imports was the highest – as compared to other goods – for two consecutive years. Furthermore, the shortfall amount for the 2014-15 period was JPY2,786 million, which is almost twice the amount of the previous year.

In cases where the importer intentionally declared incorrect information (e.g., price, country of origin) at the time of import declaration, Customs imposes a substantial additional duty of 35% on the duty shortfall. It is likely that Customs will continue to pay special attention to pork imports.

Finally, businesses should continually pay attention to aspects of customs valuation where payments other than the invoice price are made to the seller for various fees, such as royalty fees, development fees and assists. According to customs valuation rules, if the importer paid fees for engineering, development, artwork, design work and plans, and other goods or services that are necessary for the production of the imported goods in a place other than in the country of importation, and where such payments were not included in the invoice price, then these payments must be included in the customs value. As Japanese companies are increasingly shifting operations, such as R&D and engineering, offshore, it is apparent that Japanese importers may not be fully aware of the requirement to add such payments to the customs value. Furthermore, such payments are also often overlooked because usually the company departments handling the payments are different from the department in charge of customs clearance procedures. Again, an internal trade compliance system is essential for businesses to ensure adequate cross-department communication in order to compile all information needed to accurately process import declarations.

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European Union

Union Customs Code: update on the delegated and implementing acts; Implementing Act to be officially published by the end of December 2015



In the September 2015 issue of *TradeWatch*, we provided a status update of the delegated and implementing acts under the Union Customs Code (UCC). At the time, the European Commission adopted the Delegated Act on 28 July 2015, and because no objection has been expressed by the European Parliament or the Council, the text of this draft is now final.

The Implementing Act was adopted on 24 November 2015 and official publication is expected before the end of December 2015. This approval was the last hurdle to be cleared before the formal application of the UCC as of May 2016.

Below we give a brief update on some notable items, such as the changes in the field of customs valuation and the definition of “exporter.”

Background

The European Parliament and Council adopted the UCC in October 2013 with most provisions scheduled to go into force on 1 May 2016. Thereafter, the Community Customs Code – which currently still applies – will be repealed. Meanwhile, the European Commission is committed to ensure that the delegated and implementing acts, which deal with key issues, such as customs valuation, enter into force sufficiently in advance to allow EU Member States to implement the UCC in a timely manner.

Title II, Chapter 3, Implementing Act: customs valuation provisions

Title II, Chapter 3 (Value of goods for customs purposes) of the Implementing Act remains unchanged from the previous draft. As we discussed in the September 2015 *TradeWatch* issue, the existing “first sale for export” rules will be significantly limited. Royalties and license fees are to be included in the customs value more frequently than under the present rules, and trademark royalties, which are presently excluded under certain conditions, will be subject to the same analysis as all other royalties, and will in many instances be included in the customs value under the UCC.

Definition of exporter

The definition of exporter is relevant to determine the specific customs office where the export declaration must be submitted and to determine who is responsible for compliance with the export formalities.

The implementing provisions of the currently applicable Community Customs Code refer to the following definition:

“The exporter [...] shall be considered to be the person on whose behalf the export declaration is made and who is the owner of the goods or has a similar right of disposal over them at the time when the declaration is accepted.



“Where ownership or a similar right of disposal over the goods belongs to a person established outside the Community pursuant to the contract on which the export is based, the exporter shall be considered to be the contracting party established in the Community.”

The above definition poses a number of difficulties in practice. For instance, where a non-EU- based company transfers its own goods from the EU to a third country, it is difficult to identify any responsible party. Moreover, when goods are supplied on an “ex-works” basis by an EU based supplier, in spite the fact that the goods are supplied ex-works the supplier could be unwillingly involved in the export formalities.

The Delegated Act to the UCC includes the following new definition of exporter:

“the person established in the customs territory of the Union who, at the time when the declaration is accepted, holds the contract with the consignee in the third country and has the power for determining that the goods are to be brought to a destination outside the customs territory of the Union.”

“the private individual carrying the goods to be exported where these goods are contained in the private individual’s personal baggage.”

“in other cases, the person established in the customs territory of the Union who has the power for determining that the goods are to be brought to a destination outside the customs territory of the Union.”

This new definition also emphasizes that the exporter needs to be established in the customs territory of the European Union and, hence, established within the jurisdiction and subject to its laws. However, the phrase “who has the power for determining that the goods are to be brought to a destination outside the customs territory” seems to have a broader scope than “contracting party established in the Community.” It remains to be seen whether this will provide any practical improvement for businesses, as the provision still does not give a clear solution for situations where the exporter is not established in the EU. It is unclear, for example, whether using a customs agent to perform export formalities for a non-EU established business wishing to export offers a solution. It is, furthermore, questionable whether a customs agent can be regarded as having “the power for determining that the goods are to be brought to a destination outside the customs territory.” It thus remains to be seen whether the new definition is an improvement of the current definition.

Final comments

It is expected that the Implementing Act will be published in the Official Journal by the end of December 2015.

Watch for further updates on the UCC in our Global Trade Alerts and future issues of *TradeWatch*.

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Shortages during movement of excise goods under suspension: have the challenges for businesses been eliminated?



The European Commission has recently issued a provisional recommendation to clarify certain terms of the Excise Duty Directive¹⁸ in an attempt to prevent double excise taxation by EU Member States. This, however, may lead to certain additional challenges for companies doing business in the EU.

Background

The general arrangements and principles concerning excise duty in the EU are provided in Council Directive 2008/118/EC of 16 December 2008 (Excise Duty Directive). Among others, the Excise Duty Directive aims to provide clear instructions when excise duties are due, who is liable to pay the excise duties and which EU Member State is responsible for collecting them.

Excise goods that are yet to be taxed (excise duty suspended arrangement), can be produced, stored and moved from one place to another within the EU as long as there are appropriate excise duty authorizations in place. Excise duties become due when the goods are removed from the excise duty suspended arrangement, or when a shortage or other irregularity arises.

Excise duties resulting from irregularities during a movement of goods under excise duty suspension, as a general rule, become due in the EU Member State where the irregularity was committed. If it is not possible to establish where the irregularity was committed, the excise duties become due in the EU Member State where the irregularity was detected. However, the Excise Duty Directive also provides that in the event excise goods do not arrive at their destination and no irregularity has been detected, that an irregularity is deemed to have occurred in the EU Member State of dispatch and the excise duties become due in that EU Member State.

These provisions have led to ongoing discussions in the EU because of a difference in interpretation of the Excise Duty Directive provisions relating to shortages that are identified upon arrival at the premises of the consignee in the EU Member State of destination. Some EU Member States treat such shortages as “irregularities,” while other EU Member States treat these shortages as “goods which did not arrive.”

¹⁸ Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, O.J. (L 9)12, 14 January 2009 (Excise Duty Directive).



As a result, certain EU Member States levy the excise duties on the basis of the “irregularities” provisions in the EU Member State of arrival, while other EU Member States levy the excise duties as “goods which did not arrive” in the EU Member State of dispatch. This potentially leads to double excise taxation on a single shipment of excisable goods – i.e., in the country of dispatch as well as in the country of destination.

Provisional recommendation

The European Commission's recommendation clarifies that the provision for “goods which did not arrive” only applies in situations where the whole shipment is not delivered. This means that mere shortages detected during the movement need to be treated as “irregularities.”

Based on this recommendation, excise duties resulting from shortages that were identified during the movement, but it was not clear where the irregularity was committed, become due in the EU Member State where the irregularity was identified. This eliminates the aforementioned difference in interpretation between the EU Member State of dispatch and EU Member State of destination and reduces the possibility of double excise taxation.

New challenges

The European Commission's provisional recommendation, however, introduces additional practical challenges. Because shortages are most likely to be identified and notified to the authorities at the point where the warehouse keeper/consignee takes delivery of the excise goods in the EU Member State of destination, any resulting excise duties will in all probability be due in the EU Member State of destination. The EU Member State of destination will then issue an assessment for excise duties to persons in the EU Member State of dispatch. Certain practical challenges are likely to occur as tax assessment decisions are issued on the basis of the excise duty domestic legislation, legal procedures and language of the EU Member State of destination to an entity in the EU Member State of dispatch, which will then have to appeal the tax assessment according to foreign appeal procedures (those of the EU Member State of destination). For example, the Dutch authorities may issue a tax assessment in Dutch, under Dutch legislation and procedures to a company in Hungary who will then have to respond according to Dutch appeal procedures.

Companies that trade in excise goods in the EU will need to plan accordingly to be able to manage proactively these practical challenges in the event the provisional recommendation is officially implemented, as a similar situation could conceivably arise in any combination of EU Member States.

Look for updates in future issues of *TradeWatch*.

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Gabon

Gabon to adopt use of container scanners during customs inspections



To improve the collection of customs duties and guarantee port security, Gabon's Government signed in September 2012 an agreement to procure and implement use of container scanning equipment in the Owendo and Port-Gentil ports.

Accordingly, Decree 0009/MEPIP/CAB/DGDDI (the Decree), dated 7 April 2015, was adopted to regulate the use of container scanners during customs inspections.

Below is an overview of the Decree along with clarifications provided by the Gabonese Managerial Confederation (GMC) in a circular notice dated 1 October 2015.

The use of container scanners during customs inspections in Gabon reinforces the security of the supply chain. It also simplifies customs clearance procedures and modernizes Gabonese customs capabilities.

Scan Gabon, a Gabonese company, has been incorporated to supervise the installation, operation and maintenance of the scanners.

Installation and operation of scanners will lead to additional costs, which according to the Decree, Section 3, will be borne by the owners of the inspected goods or their representatives, by way of a scanning license (SL) fee. The SL fee will be collected upon the importation of sea containers, the exportation of containers transporting timber or any other exportation of containers as designed by the Customs Head Office.

The SL fee will amount to XAF81,500 (approximately USD133 at time of publication), excluding taxes, per TEU (twenty-foot equivalent unit). The SL fee is payable by the owner of goods, or his or her representative, at the customs office.

The GMC circular notice further indicates that the following goods are exempted from the SL fee payment:

- ▶ Goods imported for foreign diplomatic representation (diplomatic pouch) or similar organizations
- ▶ Goods imported by nongovernmental organizations (NGOs) or religious communities
- ▶ Goods benefiting from the exemption regime and the "stabilized" regime,¹⁹ specifically, equipment used for oil exploration or exploitation, mining or forestry

¹⁹ A favorable regime specifically granted by the Government for the import of equipment used by certain industries at a lower rate.



Further details are pending, and it is unclear at this time when this measure will come into force and how it will operate in practice.

Look for updates in future issues of *TradeWatch*.

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Eurasian Economic Union

Kazakhstan joins the WTO



On 12 October 2015, Kazakhstan ratified the Protocol on Kazakhstan's accession to the World Trade Organization (WTO). As of 15 December 2015, Kazakhstan is the 162nd member of the WTO.

WTO accession requires Kazakhstan's legislation to be brought into conformity with the provisions of international trade law, including WTO rules. To that effect, the President of Kazakhstan has already signed the relevant law to introduce amendments into a number of legislative acts.

Below we provide certain conditions for Kazakhstan's accession to the WTO that triggered changes to local legislation as well as the reservations that Kazakhstan has negotiated for its transition period.

Import duties

Currently, Kazakhstan imposes import duties according to the Common Customs Tariff (CCT) of the Eurasian Economic Union (EAEU), the common external customs tariff applied to goods imported into any of the Member States of the EAEU (Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia) from outside of the EAEU. Within five years after accession to the WTO, Kazakhstan is expected to decrease import duties on certain commodities to the level determined by its WTO accession obligations (Kazakhstan's bound tariff rates).

In effect, upon accession, Kazakhstan's duty rates will be lower than the rates contemplated by the CCT of the EAEU.

According to Kazakhstan's schedule of concessions, import customs duties of nearly 3,500 items will be decreased by 2-5% or reduced to 0%, depending on the type of goods.

In this regard, the EAEU has adopted a list of goods (the Withdrawal List), that are subject to lower import customs duty rates than those set out by the CCT of the EAEU. The Withdrawal List currently contains 1,347 items, including pharmaceuticals, agricultural products, precious stones and metals, textiles, transportation goods and others.

In line with its EAEU obligations, Kazakhstan has undertaken commitments not to allow goods on the Withdrawal List that are imported at lower customs duty rates from other WTO members to be exported to other EAEU Member States.

In practice, goods on the Withdrawal List imported into Kazakhstan should be entered either at Kazakhstan's bound tariff rates without the right of export to other EAEU Member States, or at the CCT of the EAEU rates, if the goods will be further exported to other EAEU Member States.



Export duties

Kazakhstan has reserved the right to continue to impose export duties on certain goods that are currently subject to export duty in Kazakhstan (petroleum and petroleum products, remnants and scrap of ferrous and non-ferrous metals, elements of locomotive rolling stock, wool and domestic animal hide, and others).

However, upon WTO accession, Kazakhstan will start calculating export duties for petroleum and petroleum products according to a formula that is currently used by the Russian Federation. This will increase Kazakhstan's export duty rate for crude oil from the current USD60 per metric ton to Russia's level of USD91.5 per metric ton.

State subsidies

Upon WTO accession, Kazakhstan is required to discontinue all subsidies, such as financial assistance, grants, state loans, guarantees on loans, tax and customs exemptions or other benefits intended to promote export and import substitution activities.

Kazakhstan may continue to grant state subsidies to a particular industry, or a particular project or a group of projects, that are unrelated to export or import substitution. Such subsidy funding, however, is to be discontinued or restricted if it causes proven injury to an industry of another WTO member.

On the other hand, Kazakhstan is entitled to grant unrestricted subsidies to the following categories and activities:

- ▶ Socially and economically disadvantaged groups and regions
- ▶ State sectors
- ▶ Research and development
- ▶ National culture and history promotion

Value-added tax (VAT) exemptions of up to 70% for agricultural producers and agricultural processing businesses will be effective until 1 January 2018.

Customs duty and VAT exemptions for participants in special economic zones (SEZ) and owners of free warehouses (FW) who export goods outside the SEZs and FWs territory will be effective until 1 January 2017.

Customs duty and VAT exemptions for assembly of vehicles from imported parts under special regimes will be effective until 1 July 2018.

Existing state assistance measures for small and medium-sized businesses will remain in force, as they are not contrary to WTO rules.

Reservations in favor of domestic producers, suppliers and service providers

In accordance with the WTO's most favored nation (MFN) rules, suppliers from the WTO members must be subject to equal treatment as domestic suppliers.

Kazakhstan has negotiated certain reservations to the MFN rule, as follows:

- ▶ Local content requirements for goods procured under subsoil use contracts concluded before 1 January 2015 will be effective until 1 January 2021. This requirement will be waived in future contracts concluded after 1 January 2015.
- ▶ Kazakhstan has also reserved the right to require up to 50% of services related to subsoil use operations to be procured from Kazakhstani legal entities.



For purposes of procurement of services, the local content ratio with regard to human resources will be gradually decreased to allow more Kazakhstani legal entities to qualify for a certain conditional 20% discount. A conditional 20% discount is applied to tender bids of Kazakhstani manufacturers and service providers, to help them win tenders. Under existing requirements, to be considered a Kazakhstani manufacturer or service provider and to qualify for the conditional 20% discount, 95% of the employees of a Kazakhstani legal entity must be Kazakhstan nationals. This percentage will be decreased to 75% upon Kazakhstan's accession to the WTO, and to 50% by 2021.

The local content requirements of the National Welfare Fund "Samruk-Kazyna"²⁰ procurement procedures will be abolished after Kazakhstan's accession to the WTO.

Most existing government procurement requirements will remain in effect after Kazakhstan's WTO accession. However, within four years, Kazakhstan plans to negotiate the conditions for accession to the WTO Government Procurement Agreement.

Implications for importers

Importers should be aware of the following requirements that are effective starting December 2015:

- ▶ Goods imported into Kazakhstan at the lower rates on the Withdrawal List are prohibited for export and circulation to other EAEU Member States.
- ▶ Goods imported into Kazakhstan at the CCT of the EAEU rates that are on the Withdrawal List must be accompanied by a copy of the customs declaration and an electronic invoice confirming customs clearance of the goods at the CCT of the EAEU rates before the goods may be exported to other EAEU Member States.

- ▶ Goods on the Withdrawal List that are produced in Kazakhstan may be exported to EAEU Member States so long as they are accompanied by a Form CT-1 certificate confirming the origin of the goods.

Companies that import goods into Kazakhstan at Kazakhstan's bound rates and then export them to other EAEU Member States will be liable under the legislation of the respective EAEU Member State. In this regard, a transportation agent may refuse to transport any goods destined for export to other EAEU Member States that are not supported by the required shipment documents.

In addition to the above, as other accession implementation measures continue to be introduced, Kazakhstani companies as well as companies exporting to Kazakhstan and the EAEU need to assess the implications of Kazakhstan's WTO accession as a wide range of products and industry sectors will be affected.

Look for updates in future editions of *TradeWatch*.

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²⁰ The National Welfare Fund "Samruk-Kazyna" (Самрық-Қазына ұлттық әл-ауқат қоры Акционерлік Қоғамы) is a state-owned sovereign wealth fund and joint stock company.

Kenya

Kenya enacts the Special Economic Zones Act



In the spirit of promoting foreign direct investment and positioning Kenya as a prominent business hub in the region, the President of Kenya on 11 September 2015 approved the Special Economic Zones Act, 2015 (SEZA). SEZA, in force as of 15 December 2015, provides for the establishment of special economic zones (SEZs). Entities licensed under the SEZA are entitled to various benefits, such as exemptions from value-added tax (VAT), income tax, customs and excise duties, stamp duty and work permit quotas.

Declaration of SEZs

By notice in the *Kenya Gazette*, the Cabinet Secretary of Industrialization and Enterprise Development is empowered to declare any area as a SEZ upon recommendation by the SEZ Authority (the Authority). Such declaration defines the limits of the zone and remains in force until revoked by an order by the Cabinet Secretary (upon recommendation by the Authority) published in the *Kenya Gazette*.

The Authority is a corporate body with perpetual succession and a common seal. It is administered by a board of directors whose chairperson is appointed by the President. The Authority helps to implement the Government's SEZ policies and programs and is responsible for the SEZs' establishment, operation and regulation.

The SEZA will focus on both exports and local consumption. Note that Kenya currently has export processing zones in place that are managed by the Export Processing Zone Authority, and these will remain valid and implemented alongside the SEZs and the SEZA.

Types of SEZs

Types of SEZs will include, inter alia:

- ▶ Business service parks
- ▶ Free port zones
- ▶ Free trade zones
- ▶ Industrial parks
- ▶ Information communication technology parks
- ▶ Regional headquarters, science and technology parks
- ▶ Tourist and recreation centers



Benefits under the SEZA

Tax benefits

Under SEZA, all licensed SEZ enterprises, developers and operators are exempt from all taxes and duties payable under all domestic tax legislation, including the East African Community Customs Management Act. The benefits apply to all SEZ transactions.

However, the Finance Act 2015, which was adopted on the same day as the SEZA, appears to limit tax incentives by amending the Income Tax Act and the VAT provisions as follows:

- ▶ SEZ enterprises, developers and operators will be subjected to reduced corporate rates of 10% for the first 10 years of operation and 15% for the next 10 years.
- ▶ Dividends received by licensed SEZ enterprises, developers and operators are exempt.
- ▶ Withholding tax on professional services and interest (other than dividends) by a SEZ enterprise, developer and operator to nonresidents will apply at 10%.
- ▶ The supply of taxable goods to SEZ enterprises, developers and operators licensed under the SEZA are exempt from VAT.

In effect, some of the above amendments appear to be inconsistent with SEZA, which offers unmitigated exemptions on all taxes. It remains to be seen whether this important inconsistency will be addressed before any licenses are issued under SEZA.

Work permits

The licensed SEZ enterprises, developers and operators are entitled to work permits for up to 20% of their full-time employees. Upon recommendation by the Authority, additional work permits may be obtained for specialized sectors.

Other exemptions

Licensed SEZ enterprises, developers and operators are granted the following exemptions from:

- ▶ Stamp duty on the execution of any instrument relating to the business activities of SEZ enterprises, developers and operators
- ▶ Certificate for approved enterprise under the Foreign Investments and Protection Act fees
- ▶ Provisions under the Statistics Act
- ▶ Advertisement fees and business service permit fees levied by the respective county governments' finance acts
- ▶ General liquor license and hotel liquor license under the Alcoholic Drinks Control Act, 2010
- ▶ Manufacturing license under the Tea Act
- ▶ License to trade in unwrought precious metal under the Trading in Unwrought Precious Metals Act
- ▶ Filming license under the Films and Stage Plays Act
- ▶ Rent or tenancy controls under the Landlord and Tenant (shops, hotels and catering establishments) Act
- ▶ Any other exemption as may be granted under the SEZA in consultation with the Cabinet Secretary, by notice in the Kenya Gazette



Regulatory provisions

A person intending to conduct business as a SEZ developer, operator or enterprise needs to apply to the Authority by submitting a duly completed license application form along with supporting documentation and a prescribed fee. The Authority, upon recommendation by the Commissioner of Customs, will issue a license within 30 days of receipt.

Within 180 days of SEZA's effective date, the Cabinet Secretary will publish regulations on the SEZ license application, issuance, suspension, revocation and appeal processes. The Cabinet Secretary will also publish in the Kenya Gazette all approved applications to establish a SEZ.

A developer under SEZA needs to meet the following requirements, among others:

- ▶ Be a company incorporated in Kenya for the purpose of undertaking SEZ activities
- ▶ Have financial capacity, technical and managerial capacity, and an associated track record of relevant development or operational projects required for developing or operating the SEZ
- ▶ Own or lease land, or premises within the SEZ as stipulated under the SEZ (Land Use) Regulations that are to be enacted within 180 days of SEZA's effective date

Impact

As one of the flagship projects under the economic pillar of Vision 2030 (Kenya's development program), SEZA's enactment creates an enabling environment for both global and local investors and reaffirms that Kenya is still footed on the right trajectory toward Vision 2030.

Look for more insight into the SEZA developments in future issues of *TradeWatch*.

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South Africa

Metamorphosis of the customs legislative framework in South Africa



Catalysts, such as international conventions, best practice, globalization, business, technology and the like, have driven Southern African Revenue Services' customs legislation framework into a metamorphosis. In response to the new customs legislation, all customs clients, including importers and service providers, should be aware of changes in terms of systems, process and policy.

The current legislative framework governing South Africa's customs and excise is provided by the 51-year-old Customs and Excise Act 91 of 1964, which is now being overhauled by a much-needed transformation into three new customs and excise acts.

The objective of the new acts is to establish a world-class customs control system that speaks to international standards, best practice, business and technology. The proposed customs and excise acts are benchmarked with the revised Kyoto convention and the World Customs Organization's Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework).

The proposed acts provide end-to-end supply chain visibility for Southern African Revenue Services (SARS), as a result of advance cargo reporting, improved seal provisions and mandatory electronic communications and notifications.

The current customs legislation is to be replaced by the following three acts, noted in the table below.

Proposed customs acts	Purpose	Projected effective date
Customs Control Act No. 31 of 2014 (CCA) and applicable regulations	Provides customs control of all vessels, aircraft, trains, vehicles, goods and persons entering or leaving South Africa, and prescribes the operational aspects of the system	These two acts will be implemented together, possibly in the SARS 2016-17 financial year.
Customs Duty Act 30 of 2014 (CDA) and applicable regulations	Provides for the importation assessment payment and recovery of customs duties on goods imported or exported from South Africa, and others	
Excise Duty Act No 32 of 2014 (EDA) and applicable regulations	Provides for the imposition, assessment and collection of excise duties	This will likely become effective after the CCA and CDA.



The new proposed customs acts' objective is to provide the following benefits:

- ▶ Simplified customs administration and a speedier process
- ▶ Terminology that is clear in plain language and can be easily understood consistent with global terminology
- ▶ A logical and systematic arrangement with topic-specific chapters that can be easily followed
- ▶ Flexible warehousing and manufacturing options that will attract multinational companies to South Africa as a distribution hub and stimulate industrialization
- ▶ Support of the National Development Plan to promote exports and business competitiveness, stimulate domestic manufacturing and support small and medium-sized enterprises

Selected aspects that have early impact on all customs stakeholders

Re-registrations

The proposed customs acts will require all importers, exporters and any special manufacturing warehouses (original equipment manufacturers, or OEMs) to re-register on or before and within 30 days of the CCA's effective date. Existing excise registrations or licenses are not affected by the enactment of the CCA, however, failure to re-register within the 30 days will result in the lapse of existing customs registrations. SARS will be planning its capacity and service channel offerings to ensure optimal efficiency during this time. It remains to be seen how this will develop in practice.

Permissible warehousing

The proposed CCA differentiates between "public storage warehouses" and "private storage warehouses."

In terms of the new warehousing regimes, important changes include, among others, the following areas:

- ▶ Application for new licenses
- ▶ New receipt and delivery notification requirements by public and private warehouse licensees and licensed carriers
- ▶ Storage of free circulation goods with goods not in free circulation
- ▶ Electronic inventory management system
- ▶ Periodic goods accounting reporting
- ▶ Permissible operations in a warehouse

General clearance and release processes

The proposed customs acts have changed the timing of certain clearance procedures, subjecting them to strict time constraints. There are separate import and export activities for various customs procedures with designated legislation applicable to each activity, e.g., home use processing, inward processing, outward processing, temporary admission procedures and warehousing procedures.

Examples include:

- ▶ The period for submission of import clearance declarations is reduced from seven days to three days after arrival due to improvements in the electronic environment.
- ▶ A clearance declaration is now required for transit instead of a manifest/transport document.



Movements within SACU are now “imports and exports”

The new legislation will change the treatment of the movement of goods within the Southern African Customs Union (SACU), the oldest customs union in the world. Movements within SACU will now be defined as imports and exports. This is contrary to the current customs legislation.

Other important considerations

There will also be new compliance measures and changes regarding the penalties regime, voluntary disclosure process, reporting requirements and heightened responsibility and accountability of customs stakeholders.

The new legislation shifts the burden of accountability and compliance to customs clients. It is, therefore, the responsibility of importers and exporters as well as service providers in the supply chain to take responsibility for their actions and that of their agents.

The complexity of the new customs legislation makes it important for importers and exporters to stay abreast of developments in this ever-changing landscape. Look for updates of the proposed South African customs legislation in future issues of *TradeWatch*.

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Romania

Romania's customs territory and exclusive economic zone: challenges for the oil and gas industry



Continuing developments of offshore activities in the oil and gas sector are triggering many controversies regarding the fiscal and customs treatment of operations performed within the exclusive economic zone (EEZ) of Romania, as a growing part of the world's oil and gas production comes from offshore developments, and technological progress allows for ever deeper offshore drilling. This article discusses one such controversy that began when the Romanian authorities introduced a new customs regime, which in effect places the EEZ within the EU customs territory.

Background

The United Nations Convention on the Law of the Sea²¹ defines the concept of EEZ²² as an area beyond and adjacent to the territorial waters within the sea area (exceeding 12 nautical miles up to 200 nautical miles from shore) over which the coastal state has special rights.²³ These rights include exploration and use of the marine resources.

Romania's Law 17/1990 (republished in 2014)²⁴ defines the EEZ as "the marine space of the Romanian Black Sea shore, located beyond and adjacent to the territorial sea waters, where Romania exercises sovereign rights and jurisdiction over the natural resources of the seabed, its subsoil and water column above as well as over various activities related to their exploration, exploitation, protection, conservation and management."²⁵

From a customs point a view, the EU customs territory includes, in addition to the customs territory of each EU Member State, the territorial waters, the inland maritime waters and the airspace of each EU Member State, with certain exceptions.

Romanian national law provides that "the state border of Romania separates the territory of the Romanian state from the territory of each of the neighboring countries and the territorial waters of Romania from the contiguous zone."

21 United Nations Convention on the Law of the Sea (UNCLS), 1833 UNTS 3; 21 ILM 1261 (1982), available at http://www.un.org/depts/los/convention_agreements/texts/unclos/unclos_e.pdf.

22 Ibid., Art. 55.

23 Ibid., Art. 56.

24 *Legea nr. 17/1990; republicata Monitorul Oficial nr. 252 din 8 aprilie 2014* (Law 17/1990; republished in Official Gazette No. 252, 8 April 2015).

25 Ibid., Art. 9(1).



Law 17/1990 defines Romania's contiguous zone as the area adjacent to the territorial waters, extending from the outer edge of the territorial waters to up to 24 nautical miles.²⁶ Therefore, on the basis of the foregoing, the territorial waters area is part of the territory of Romania, while the contiguous zone is not part of Romania's territory.

Accordingly, in line with the aforementioned EU customs provisions and relevant national law, neither the contiguous zone, nor the Romanian EEZ was considered part of the EU (including Romanian) customs territory until the end of 2013.

At that time, after lengthy discussions regarding the Romanian customs territory concept, the Romanian customs authorities decided to change the customs regime for operations performed within the Romanian EEZ, even though Romanian and EU relevant law remained unchanged. Specifically, the Romanian customs authorities considered that the transport of goods from EU territory (including Romania) to the Romanian EEZ as well as the transport of goods from the EEZ to EU customs territory would no longer be considered export or import operations, while goods having non-community status introduced into the Romanian EEZ would be considered imports and be subject to customs formalities.

Impact on EEZ oil and gas offshore drilling activities

Considering the increasing oil and gas exploration activities in the Black Sea, the Romanian customs authorities' decision has had significant impact on Romanian EEZ activities. Under the new regime, specific equipment for oil and gas exploration needs to be imported and released for free circulation. Although customs duty rates for such equipment are low (even zero), these imports are subject to Romanian value-added tax (VAT), which currently amounts to 24%²⁷ of the customs value of the imported equipment.

Notwithstanding, the practical impact of the 24% Romanian VAT on imported rigs and certain related equipment was initially low as in most cases rigs were considered seagoing vessels, which are VAT-exempt. Under Romanian national law governing vessels and the Customs Combined Nomenclature and Harmonized System, floating constructions that (under normal circumstances) are not destined for movement, such as drilling rigs, are deemed seagoing vessels.

²⁶ Ibid., Art. 7.

²⁷ Starting in 2016, the standard VAT rate is reduced to 20%, while starting in 2017, the standard rate will be 19%.



However, recently, the Romanian Central Fiscal Commission²⁸ issued an official decision,²⁹ which provides that the VAT exemption available under Romanian VAT law and applicable to seagoing vessels is conditioned on specific criteria, including whether or not the seagoing vessel is effectively and predominantly used for navigation on the high seas. Therefore, because offshore drilling rigs are not primarily used for navigation, the Central Fiscal Commission's decision implies that offshore drilling rigs are not seagoing vessels for purposes of VAT exemption under Romanian VAT law.

Conclusion

Although there is a lot of confusion and uncertainty with regard to the Romanian authorities' current customs regime in the EEZ, and there is still ample room for interpretation in the Central Fiscal Commission's official decision regarding VAT exemption for seagoing vessels, EEZ operators are likely to face new challenges that impact directly their cash flow and, in certain situations where the 24% import VAT applies, even increase the cost of their Black Sea operations.

Look for updates in future issues of *TradeWatch*.

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28 A body within the Romanian Ministry of Public Finances in charge with, inter alia, the resolution of sensitive tax issues for which a unitary approach is required in order to eliminate subjective views on the specific issue.

29 *Decizia Comisiei fiscale centrale nr. 3/2015* (Decision 3 / 2015 of the Romanian Central Fiscal Commission) in effect as of 27 August 2015.

Russia

New environmental duty to be paid in Russia as of 2015



In the March 2015 issue of *TradeWatch*, we discussed a draft resolution that imposed environmental duties on certain goods imported into Russia as well as on certain locally produced goods subject to recycling after loss of their consumer properties (reuse value).

Russia's Government has since adopted a modified version of the aforementioned draft resolution, along with several other regulations, to provide a list of goods subject to recycling. These new regulatory measures also define the procedure and terms of payment, and name the executive agency responsible for environmental duty collection.

The list of finished goods and packing materials subject to recycling includes textiles, such as carpeting and various specified types of apparel; millwork building materials; stationery; tires and tire covers; computers and peripheral equipment; household appliances; packing materials; and others. In the case where the packing materials are subject to recycling, but the goods packed in these materials are not included on the list, the environmental duty applies only to the packing materials.

The environmental duty is calculated as the product of the environmental duty rate, the weight of the finished product (or the number of units of the finished product) subject to recycling released for free circulation on Russia's territory, or the weight of the packing materials used during the manufacture of such product, taking into consideration the applicable recycling norm.

The Government, however, has yet to specify the environmental duty rates.

The executive agency responsible for environmental duty collection is the Federal Supervisory Natural Resources Management Service. It also has the responsibility to provide the form that needs to be completed when calculating the amount of environmental duties to be paid.

According to the adopted government resolution, environmental duties for 2015 are to be paid by 15 October 2015 for the first nine months of the year. October, November and December 2015 duties must be paid by February 2016. Starting in 2017, the environmental duties for the previous year must be paid annually by 15 April of each year.

However, the Ministry of Natural Resources and Environment has clarified that the environmental duty does not have to be paid for the year 2015, since no recycling norms have been issued for this reporting period.

Currently, importers and local manufacturers of goods subject to environmental duty need to monitor when the required calculation form is published. The first calculation of duty must be made and submitted on the form during the reporting period in which the form is introduced.

As a final point, note that importers and manufacturers can be exempted from environmental duty payments if they perform on their own the management of waste derived from their imported or locally produced goods. This can be done by creating the necessary infrastructure or by resorting to waste management service providers.

Look for updates in future issues of *TradeWatch*.

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Turkey

Customs value and the direct selling model



The General Directorate of Customs has issued Circular 2015/17 dated 9 July 2015,³⁰ which constitutes the “Customs Agenda” of companies that operate in Turkey under the direct selling marketing model. This regulation provides that payments transferred abroad and paid directly or indirectly to the seller as “bonus” (or under similar names) in addition to the invoice price of the goods imported for sale under the direct selling method must be included in the customs value of the imported goods. This requirement impacts a broad group of products that are sold under a direct selling model, such as household appliances, cosmetics, personal care products, household care products and nutritional products.

Customs value

Turkey has adopted the World Trade Organization (WTO) Valuation Agreement,³¹ which provides that the preferred method of valuation is transaction value, the price actually paid or payable in the sale of goods for export to Turkey. However, the customs value does not necessarily consist only of the invoice amount. It also includes amounts paid to the seller that are for the product and that are not reflected on the

invoice as well as certain required additions to value. For example, if part of the revenue generated from the use or disposal of the goods through resale by the purchaser, or by any other means, is directly or indirectly transferred to the seller, that part should be added to the price actually paid or payable for the imported goods. Furthermore, the payment does not have to be made to the seller to serve as a basis for the customs value. All payments that are or will be made to the seller or to a third party by the seller to meet a liability, especially where such payments are a condition for the sale, are to be included in the customs value.

Relationship between the direct selling model and customs value

“Direct selling” refers to the marketing system where sales representatives, distributors and those acting under similar titles, who may or may not be employed by a company, offer goods or services to consumers under single or multilevel sales methods at places, such as consumers’ homes or workplaces rather than at retail establishments.

³⁰ *Doğrudan satış ve gümrük kıymeti, Genelge (2015/17), Gümrükler Genel Müdürlüğü, 9/7/2015* (Direct Sales and Customs Value, Circular (2015/17), General Directorate of Customs, 9 July 2015).

³¹ Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (GATT) 1994. Text available at www.wto.org/english/docs_e/legal_e/20-val_01_e.htm.



Each sales representative may recruit other sales representatives and also earn an income from their sales.

A common direct selling model would involve a corporate parent direct selling exporter selling product to a related local subsidiary direct selling importer, who would in turn resell the product to an independent distributor. It is common for the local direct sales company (the importer of the product) to collect the bonus or commission amounts to be paid to others in the direct sales network as part of the price it charges to the distributor for the product, and then remit the bonus payments to the appropriate parties. When the bonuses are to be paid to foreign distributors, the bonuses are often remitted to the exporting parent company, or another related company, for redistribution. In this regard, the customs authority states that where part of the total sales revenue is transferred to the seller, or persons related to the seller abroad, as a requirement of the direct selling arrangement, an equivalent amount should be added to the customs value declared for the imported goods. Where a known part of the sales revenue of the goods imported by the purchaser will be transferred abroad under certain conditions to the seller, and where unit prices are determined accordingly, the conditions required for the addition of payments to the customs value are met.

Implications for importers

According to the regulation, the customs authority takes the position that goods imported for direct selling are being undervalued. The new customs regulation aims to prevent undervaluation by linking the imported goods and post-importation payments as described above. Nevertheless, this approach raises a number of issues as follows:

- ▶ To add a payment to the customs value, its relation to the imported product should be demonstrated clearly. However, the payments made to persons abroad in the scope of direct selling are not necessarily related to the imported product, but are rather made in return for a marketing activity that is independent from the import transaction.
- ▶ The regulation states that the amounts equal to the payments made should be added to the price of the imported goods. In other words, the regulation indicates that the imported goods are undervalued, resulting in the payment of lower customs duty. However, the person employing the direct selling method and the importer are completely different persons; import transactions of the products subject to direct selling are conducted by the company offering this marketing model, and even if there is a discount, this discount is applied to the domestic selling price of the imported goods.

- ▶ The price of the imported goods can be paid to the seller or a third party for the fulfillment of a liability assumed by the seller (e.g., payment of the seller's debt to a third party). However, in the direct selling system, there is no such liability relation between the seller and the sales representatives. The amounts paid to the sales representatives are determined according to orders placed by other sales representatives down the line that have been recruited. Even if the first sales representative is based abroad, as noted above, the payment made to this person is the price of the marketing activity under the direct selling system rather than the fulfillment of a liability assumed by the seller.

In conclusion, the addition of the payments made to foreign direct sales representatives to the customs value of the imported goods depends on clearly demonstrating, under the applicable customs rules, the relation between the seller and the sales representative, the imported goods and the amount paid.

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Ukraine

Ukraine introduces test customs values



Effective as of 23 September 2015, Ukraine's Government has introduced test customs values for imported goods released for free circulation.³² According to the authorities, such values would be used in the risk management system maintained by customs for ensuring a uniform approach to verifying the truth and accuracy of the imported goods' declared customs value.

The test values are determined on the basis of average customs values of imported goods, depending on tariff code and country of origin, and calculated for the past six months. The test values do not apply to military and dual-use goods, and goods traded on commodity exchanges. The test values are used only in internal customs databases and are not publicly available.

The test values will be revised monthly. Officially, the test values do not represent minimum customs values that are prohibited by both WTO norms and Ukrainian customs legislation. However, deviation from the test value may trigger risk of a customs valuation dispute.

The governmental resolution does not provide for any clear procedure on how customs officers are to use the test values. Therefore, as practice demonstrates in many cases, the customs authorities challenge the declared customs value of imported goods on the sole ground that the invoice value of the goods is lower than the test value. This may lead to delays of customs clearance, and the customs authorities may increase the customs value, which burdens importers with payment of excessive import duty and value-added tax (VAT).

In case of any deficiencies in the basic documents (invoice, contract, transport documents, etc.), customs may reject the declared value under the transaction value method and proceed with customs valuation using other methods, taking into account the test values. Therefore, importers must ensure they have adequate supportive documentation.

³² Кабінет Міністрів України, Постанова "Про використання у системі управління ризиками орієнтовних показників митної вартості товарів" від 16 вересня 2015 р. № 724. (Resolution of the Cabinet of Ministers of Ukraine "On Use of Test Customs Values in Risk Management System" No. 724, 16 September 2015).

In the worst-case scenario, the importer may request release of the goods under financial guarantees and be able to delay the final customs value determination. The importer will thus have 80 days to submit additional documentation and present arguments to support the declared value. If the customs authorities agree with the declared value, the guarantees will be refunded.

In every case, importers need to pay close attention to the documentary support of the declared customs value to be able to manage effectively the increased risk of customs valuation scrutiny.

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