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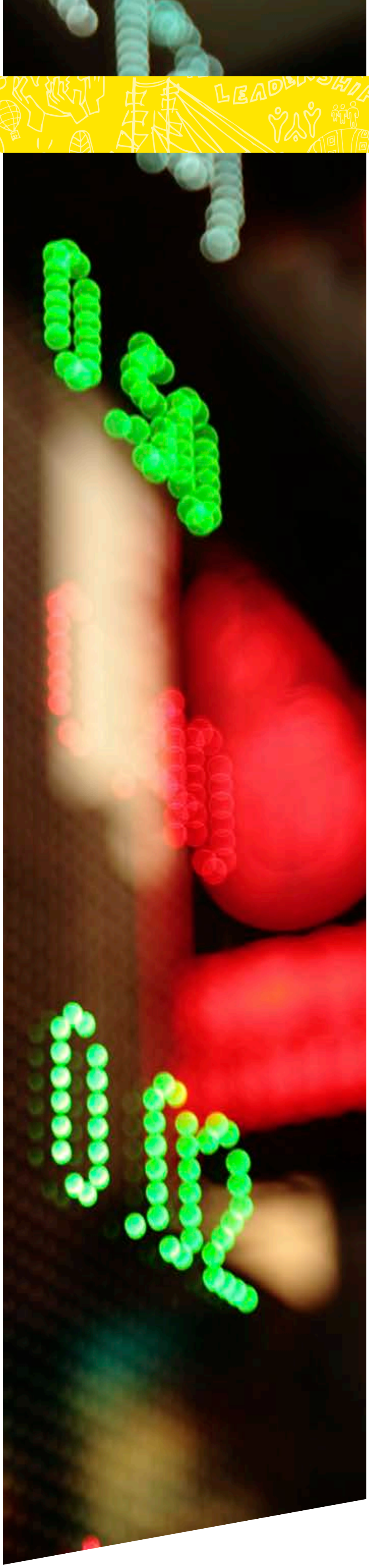

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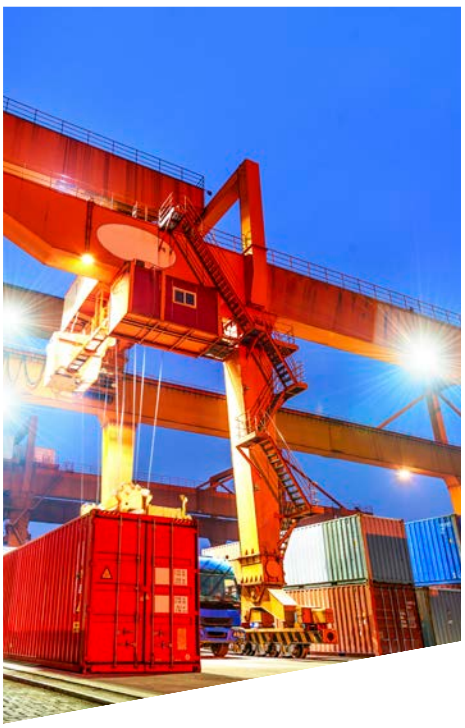
World Customs Organization publishes guide to customs valuation and transfer pricing



On 24 June 2015, the World Customs Organization (WCO) published the *WCO Guide to Customs Valuation and Transfer Pricing* (the Guide). Although the Guide is primarily designed to assist customs officials who are responsible for undertaking customs valuations or conducting customs audits on multinational enterprises (MNEs), it is also a recommended reference for multinational business and tax administrations. The Guide represents a significant step forward in efforts to better align related-party pricing for income tax and customs purposes.

Background

The dynamic between transfer pricing and customs valuation has long been an issue that has been faced by MNEs, tax administrations and customs authorities. In general, the recent focus on transfer pricing together with an increase in customs authorities' scrutiny of related-party transactions, has led to increased pressure on MNEs to have a coordinated and aligned approach to transfer pricing and customs valuation. It has also led to challenges for tax administrations and customs authorities who often operate with a disconnect between the two disciplines.

The WCO is an intergovernmental organization representing 180 customs administrations around the world that currently process 98% of world trade. The WCO, working closely with the Organisation for Economic Co-operation and Development (OECD) and the World Bank, has been active in promoting dialogue among customs administrations, tax administrations and business to provide a better understanding of the rules that govern related-party pricing. The introduction to the guide states: "Greater understanding of this issue and sharing of ideas and solutions will provide more certainty for governments and business and will lead to a more consistent approach and accurate determination of duty liabilities. Burdens on business can also be reduced ... ."

Key areas

As noted in the Guide, the WCO Valuation Agreement requires customs authorities to establish that the price of goods sold to an importer by a related seller has not been influenced by the relationship between the buyer and seller. Tax administrations also focus on the relationship between taxpayers in establishing that the conditions surrounding a particular transaction are consistent with the arm's length principle as further detailed in the OECD transfer pricing guidelines.[1]

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[1] Organisation for Economic Co-operation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* Edition 2010.

As such, the Guide aims to highlight the similarities between transfer pricing and customs valuation as well as the potential benefit of customs officials using transfer pricing documentation when examining related party transactions for customs valuation purposes. The Guide also emphasizes the need for alignment between the two disciplines given the ever-increasing volume of trade between related parties. The Guide confirms transaction value as the starting point for customs valuation, and emphasizes that even in related-party transactions the transaction value may still be accepted, provided that the relationship did not influence the price. For this reason, the Guide encourages customs officials to consider transfer pricing studies and documentation when examining related-party transactions, highlighting the usefulness when examining the circumstances of sale.

Highlights of the Guide include:

- A discussion of the International Chamber of Commerce (ICC) Policy Statement on Transfer Pricing and Customs Valuation updated earlier this year, which provides a very pragmatic approach to utilizing transfer pricing documentation to support customs value.
- Examples of how transfer pricing data may be presented by business and analyzed by customs administrations to support transaction value for customs purposes using the "circumstances of sale" test, with special emphasis on the transactional net margin method (TNMM) and the comparable profits method (CPM), the most frequently used transfer pricing approaches.
- An explanation of how transfer pricing adjustments should be evaluated for customs purposes, noting that adjustments made pursuant to a transfer pricing policy in place prior to importation, and impacting the actual price for the imported products (as opposed to an adjustment made for tax purposes only) may property be considered by a customs administration as a component of transaction value.
- Conversely, the Guide notes that an adjustment for income tax purposes only calls into question the use of transaction value for importations during the period covered by the adjustment.
- A list of "good practices" for customs administrations, including "Customs administrations are encouraged to consider information derived from transfer pricing studies" when examining related-party transactions.
- A list of "good practices for business," including:
  - Coordination among tax and customs departments and advisors on transfer prices
  - Consider the needs of customs authorities when preparing transfer pricing documentation or developing APAs
  - With appropriate consideration of local requirements, provide customs administrations with advance notification that post-importation adjustments may occur
  - Work with customs authorities to provide interpretation into a customs framework of transfer pricing analyses and data

Implications

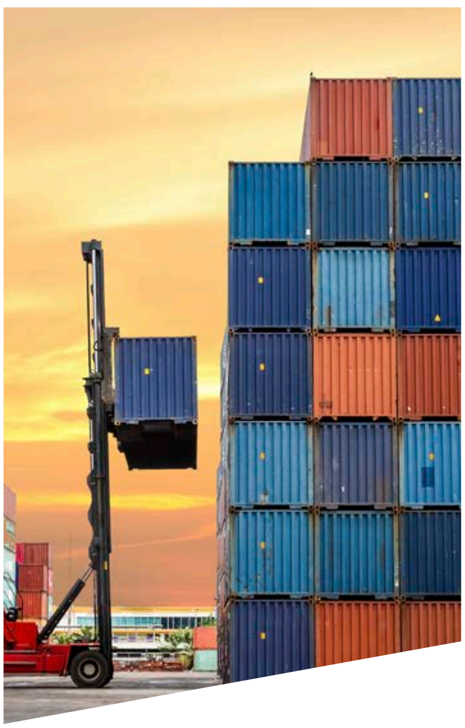
Businesses have long recognized the potential benefits of satisfying both income tax and customs requirements from a single approach to establishing related-party prices. The Guide provides what many businesses believe has been missing: a thorough examination of the subject from a global organization with the stated mission of enhancing the effectiveness and efficiency of customs administrations. For MNEs, the Guide illustrates the importance of having an aligned strategy for both customs and transfer pricing and the benefits that can potentially be achieved by approaching these areas proactively. As many businesses will be focused on refreshing transfer pricing documentation in light of the OECD Base Erosion and Profit Shifting (BEPS) initiative, timing is ideal to address customs valuation simultaneously.

For additional information, contact:

Ernst & Young LLP (United States)

Bill Methenitis, *Dallas*
+1 214 969 8585
william.methenitis@ey.com

WTO Information Technology Agreement finally expanded to eliminate tariffs on 201 additional products



The World Trade Organization (WTO) has finally completed the highly anticipated Information Technology Agreement (ITA) expansion, representing the first tariff eliminating deal at the WTO in 18 years. The ITA was originally concluded in December 1996, and provides for the elimination of duties on information technology products that are covered by the ITA. Despite vast changes to information technology products and global expansion of the industry, the ITA's list of covered products has not been updated since 1997.

Beginning in June 2012, 54 WTO members participated in 17 rounds of ITA product coverage expansion negotiations. On 24 July 2015, nearly all participants, including the US, agreed to reduce and ultimately eliminate tariffs on 201 additional information technology products. The WTO recently published a Declaration outlining the planned expansion of covered products, including two attachments listing the additional products as well as other agreed upon actions and the significant dates of the planned implementation.[2] Implementation is expected by December 2015.

Agreement benefits

Global trade in the additional 201 covered products is valued at more than USD1.3 trillion annually and currently equals approximately 7% of total global trade. All WTO members may accept the Declaration. Even members who do not accept the deal may benefit from the increased global efficiency and competitiveness, as the tariff reduction and ultimate elimination will apply on a Most Favored Nation (MFN) basis.

Covered products

The Declaration includes two attachments. Attachment A lists the Harmonized System 2007 subheadings or parts thereof that are covered by the Declaration. Attachment B lists specific products that are covered by the Declaration, wherever they are classified in the Harmonized System 2007.

All parties of the expanded agreement will remove global tariffs for the added products, which include certain touch screens, new-generation semiconductors, global positioning system (GPS) navigation systems, tools used in the manufacturing of printed circuit, telecommunication satellites and medical equipment.

2 See WTO publication, WT/L/956 (28 July 2015).

Planned implementation

Parties must submit draft schedules by 30 October 2015 detailing how the country will eliminate tariffs on the covered products. Parties will implement the changes once all of the approved country-specific schedules represent approximately 90% of global trade in the covered products, which is expected to occur by December 2015.

Customs duties will be eliminated in four equal duty rate reductions, with complete tariff elimination effective by 1 July 2019. The four deadlines are as follows: 1 July 2016; 1 July 2017; 1 July 2018; and 1 July 2019. Elimination of other duties and charges must be completed by 1 July 2016.

For additional information, contact:

Ernst & Young LLP (United States)

Lynlee Brown, *San Diego*
+1 858 535 7357
lynlee.brown@ey.com

Sara Schoenfeld, *New York*
+1 212 773 9685
sara.schoenfeld@ey.com

The Eurasian Economic Union and Vietnam sign a free trade agreement

A free trade agreement (FTA) was signed between the Socialist Republic of Vietnam and the Eurasian Economic Union (EEU: Armenia, Belarus, Kazakhstan, Russia) on 29 May 2015 in Kazakhstan. It is the first FTA signed between the EEU and an outside trade partner.

The main purpose of this FTA is to develop economic ties between Vietnam and the EEU member states and to boost trade. It also regulates other important issues, such as intellectual property rights protection, development of e-commerce and government procurement regulation. It is expected that EEU's trade turnover with Vietnam (currently at approximately USD4 billion) will at least double in five years. Professionals in the field note that this agreement will also help to involve EEU members in the integration processes of the Asia-Pacific region.

The FTA provides for a stage-by-stage reduction of import customs duty rates on goods originating from the EEU countries and Vietnam during a transition period expected to last 5 to 10 years depending on the type of goods. Import customs duties will be reduced to various levels, including 0%. For example, Vietnam's import duty rates for passenger cars originating in the EEU are projected to fall from the current 50% to 70% to 0% by the year 2026. Duty rates for certain special goods, such as tea and coffee from Vietnam, however, will be preserved.

The FTA will come into force 60 days after it is ratified by the contracting parties. Professionals in the field expect the parties will complete the ratification process by the end of the year.

Vietnam is not the only country looking to bolster trade with the EEU. According to information available from the media, at least 40 countries have recently expressed intent to broaden trade relations with the EEU, including China, India and Turkey.

Companies with trade flows between the EEU and Vietnam should assess whether any benefits potentially apply to their operations, and if so, consider appropriate FTA planning to help ensure that specific requirements are met.

For additional information, contact:

Ernst & Young (CIS) B.V.

Anastasia Chizhova, *Moscow*
+7 495 755 9700 ext. 7004
anastasia.chizhova@ru.ey.com

Alexandra Kiseleva, *Moscow*
+7 495 755 9700 ext. 4191
alexandra.kiseleva@ru.ey.com

The European Union and Vietnam agree on a free trade and investment agreement

After three years of negotiations, the European Union (EU) and Vietnam have agreed in principle to conclude a comprehensive free trade and investment agreement. This is the second free trade agreement (FTA) (the first was with Singapore) that the EU will be concluding with a member state of ASEAN (Association of Southeast Asian Nations) in line with the EU's ultimate objective toward comprehensive EU-ASEAN FTA.

Some the key elements of the EU-Vietnam FTA relevant to trade in goods, as outlined in the memorandum of the European Commission dated 4 August 2015,[3] are listed below:

Customs duties

The agreement will eliminate nearly all duties, except for a small number of tariff lines, for which the EU and Vietnam agreed on partial liberalization through zero-duty tariff rate quotas (TRQs):

- Vietnam will eliminate 65% of import duties on EU exports to Vietnam at entry into force, while the remainder of duties will be gradually eliminated over a 10-year period. For example, almost all machinery and appliances, roughly half of all pharmaceuticals and all textiles fabric exports from the EU will be duty free when the FTA goes into effect.
- EU will eliminate all duties on imports from Vietnam over a seven-year period with longer staging periods and strict rules of origin for certain products, such as textiles, garments and footwear. Certain agricultural products will not be liberalized, but will be allowed access to the EU market via TRQs such as rice, sweet corn, garlic, mushrooms, sugar and high-sugar-containing products, manioc starch, surimi and canned tuna.
- Vietnam has agreed to eliminate most of its export duties (and not to increase any remaining export duties) with regard to EU trade.

Non-tariff barriers to trade

The EU and Vietnam have agreed to practices consistent with the WTO Technical Barriers to Trade (TBT) Agreement, such as use of international standards in drafting regulations, licensing and customs procedures, plant and animal products, and others.

Vietnam will accept the "Made in EU" marking of origin for non-agricultural products. Member State-specific markings of origin will also be accepted, especially for products that are regulated at the national level, such as pharmaceuticals.

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[3] *EU and Vietnam reach agreement on free trade deal, Memo, European Commission,* 4 Aug. 2015 available at: trade.ec.europa.eu/doclib/docs/2015/august/tradoc_153674.pdf.

Vietnam and the EU have also agreed to protect each other's geographical indications, such as for example, champagne, Rioja wine and Scotch whiskey from the EU, and Mc Châu tea or Buôn Ma Thut coffee from Vietnam, among others.

Government procurement

EU companies will gain access to bid on a variety of public projects in Vietnam, such as public hospitals, roads, ports, railroads and others.

Dispute resolution

The FTA provides mechanisms for formal consultations, establishment of a panel as needed, or alternatively, for mediation.

The European Commission stresses that the legal text of the agreement will be completed pending technical discussions. However, most commentators expect that the process could be finalized in a few months' time and most likely before the end of 2015.

This agreement is first of its kind that the EU will be concluding with a developing country since it includes a far-reaching, fully symmetrical tariff elimination. Companies should be well aware of the potential benefits that this FTA offers and the variety of opportunities for FTA planning that are possible to take advantage of these benefits.

For additional information, contact:

Ernst & Young Belastingadviseurs LLP (the Netherlands)

Walter de Wit, *Amsterdam*
+31 88 407 1390
walter.de.wit@nl.ey.com

Othleo Gemin, *Amsterdam*
+31 88 407 1909
othleo.gemin@nl.ey.com

Argentina

Argentina to eliminate the Advance Sworn Import Declaration procedure

In the March 2012 issue of *TradeWatch*, we described the implementation of a new and controversial Advance Sworn Import Declaration procedure (*Declaración Jurada Anticipada de Importación*[4], *DJAI*) in Argentina, which requires certain advance reporting and approval prior to importation. The DJAI procedure (along with a number of other trade-related requirements that are not addressed in this article) was challenged under the World Trade Organization's (WTO) dispute settlement procedure and was recently found inconsistent with WTO law.[5] As a result, Argentina plans to eliminate the DJAI procedure by 31 December 2015.

According to the DJAI procedure, importers in Argentina are required to file with the tax authorities certain information related to their importations before they issue a purchase order or another similar document to the foreign supplier. The information contained in such declarations is made available to participating Argentine government agencies involved in international trade matters.

These government agencies must grant approval or provide observations on each advance declaration and goods that receive observations cannot be imported until the observations are lifted. Importers must meet certain requirements set at the discretion of the respective government agency before the agency may lift the observations and grant approval for import.

On 25 May 2012, the European Union (EU) requested consultations with Argentina through the WTO on the DJAI procedure and certain other trade-related requirements adopted by Argentina on the importation of goods. The United States and Japan also requested consultations. These consultations took place between July 2012 and September 2012. The parties reached no mutually satisfying decision and subsequently submitted a request to the WTO Dispute Settlement Body to establish a Panel. Fourteen other countries[6] later joined as third participants in addition to the EU, Japan and the United States (US).

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4 The DJAI procedure was introduced by *Resolución General AFIP Nº 3252/2012, 05 de enero de 2012* (General Resolution of the Federal Public Revenue Administration, AFIP, No. 3252/2012, 5 Jan. 2012) available in Spanish at biblioteca.afip.gob.ar/dcp/REAG01003252_2012_01_05.

5 Disputes DS438, DS444, DS445: Argentina — Measures Affecting the Importation of Goods; Appellate Body report, AB-2014-9, 15 Jan. 2015 available at docs.wto.org/.

6 Australia, Canada, China, Ecuador, Guatemala, India, Israel, South Korea, Norway, Saudi Arabia, Switzerland, Taiwan, Thailand and Turkey.

The EU, Japan and the US claimed that Argentina's DJAI procedure is inconsistent with a number of provisions under the GATT 1994[7] and the Import Licensing Agreement,[8] but most importantly, with Article XI:1 of the GATT 1994 (prohibition of import or export quantitative restrictions).

Argentina's position, in broad terms, was that the DJAI procedure is a customs or import formality subject to Article VIII, GATT 1994 (fees and formalities relating to the importing and exporting of goods) and therefore, not subject to Article XI:1 of the GATT 1994.

The Panel found that Articles VIII and XI are not mutually exclusive and that Article XI:1 obligations must be met regardless. Further, the Panel also found that the DJAI procedure is not a mere customs formality, but "a highly discretionary and non-transparent procedure" to determine the right to import, which constitutes a restriction on the importation of goods that is inconsistent with Article XI:1 of the GATT 1994. Having established inconsistency with Article XI:1, the Panel found it unnecessary to address the DJAI procedure under the Import Licensing Agreement.

Argentina appealed and on 15 January 2015 the Appellate Body affirmed the Panel report.

On 23 February 2015, Argentina informed that it will implement the Dispute Settlement Body's recommendations and rulings in line with Argentina's WTO obligations and agreed to eliminate the DJAI procedure by 31 December 2015.

For additional information, contact:

Pistrelli Henry Martin y Asociados S.R.L. (Argentina)

Sabrina Maiorano, *Buenos Aires*
+54 11 4318 1600
sabrina.maiorano@ar.ey.com

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7 General Agreement on Tariffs and Trade 1994, 1867 U.N.T.S. 187 (1994) (GATT-1994).

8 Agreement on Import Licensing Procedures, 1868 UNTS 436 (signed 15 April 1995, entered into force 1 January 1995).

Brazil

New RECOF rules to simplify qualification requirements

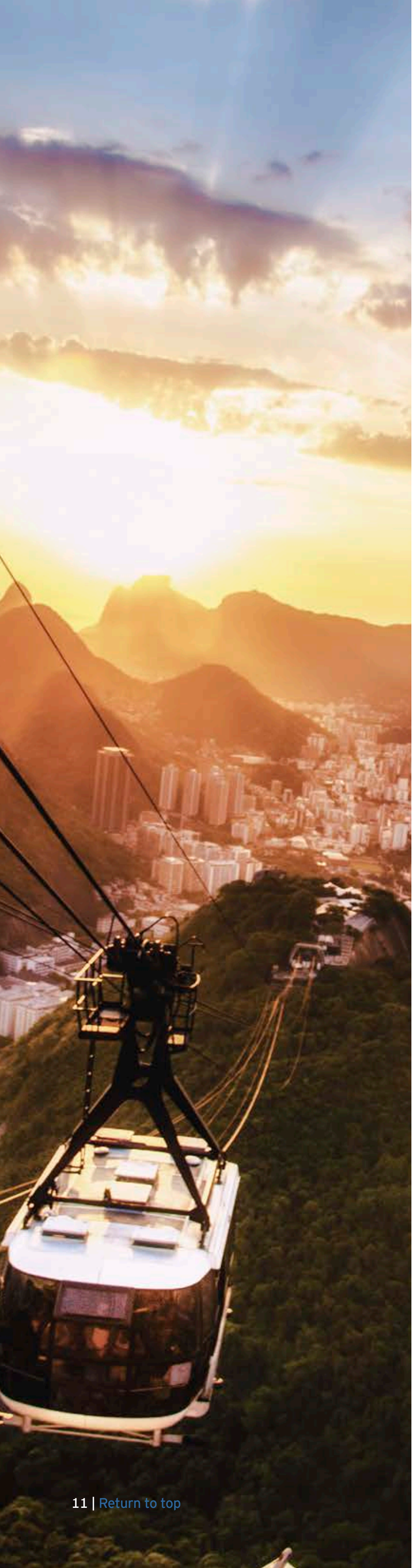
The Brazilian Government is stepping up efforts to increase Brazil's global trade competitiveness by implementing tax incentives and other cost-reducing strategies for companies. Accordingly, the Secretariat of Federal Revenue of Brazil has issued a Normative Instruction (IN RFB 1.559/2015)[9] that introduces new and simplified requirements aimed at enabling more companies to participate in Brazil's Special Regime of Industrial Warehouse under Automated System Control (*Regime de Entreposto Industrial sob Controle Aduaneiro Informatizado,* RECOF).

RECOF, created in 1997, is a special bonded warehouse regime, according to which participating companies can import or obtain domestically raw materials for the manufacture of certain goods for export or, to a certain extent, for the domestic market, without paying any import or other taxes and duties while in the bonded warehouse (tax suspension). Goods that are exported become tax exempt, while import and other taxes and duties for goods that are entered for domestic consumption become due, but without any penalties or interest.

The regime grants tax suspension for a period of 12 months, with option for an additional 12-month extension, for the following taxes:

II –	*(Imposto de Importação)* import duty
IPI –	*(Imposto sobre Produtos Industrializados)* – manufactured goods tax, Brazil's federal value-added tax (VAT)
PIS –	*(Programa de Integração Social)* – social integration program tax
COFINS –	*(Contribuição para o Financiamento da Seguridade Social)* – social security finance tax
AFRMM –	(*Adicional de Frete para Renovação da Marinha)* – additional freight for the renovation of the merchant marine
Airport fees –	50% discount on certain airport storage fees *(Empresa Brasileira de Infraestrutura Aeroportuária, INFRAERO)*
ICMS –	*(Imposto sobre a Circulação de Mercadorias e prestação de Serviços)* state (certain states only) VAT

9 *Instrução Normativa RFB Nº 1559, de 14 de Abril de 2015,* DOU 15 Apr. 2015, sec. 1, p 12 available in Portuguese at normas.receita.fazenda.gov.br.



To become RECOF-certified, a company must meet the following requirements, among others:

- Submit an official request to the customs and tax authorities supported by financial and accounting documents
- Submit a business plan
- Be dedicated to one or more of the following activities: manufacture or assembly of goods or parts used to manufacture other goods; repair and assembly of spare parts; other alterations and repair; maintenance or repair of aircraft and aircraft parts, equipment and tools
- Have minimum net equity of BRL10 million (approximately USD2.9 million)
- Assure minimum exports of USD5 million per year after certification
- Assure use of 70% to 80% of raw materials for the manufacturing process of finished goods (the range varies depending on the projected quantity of exports)
- Have an integrated system that meets the approval of, and grants access to, the tax and customs authorities

The new Normative Instruction introduces two important changes in these requirements:

1. Companies no longer have to be Blue Line certified[10] to apply for RECOF certification.
2. Certain system audits are no longer required.

Companies may already have measures in place that meet some of these requirements. The computerized system for inventory controls, SPED (*Sistema Público de Escrituração Digital*) is already a requirement that all companies must meet by January 2016. The same type of controls are required for RECOF certification.

RECOF certification offers a number of benefits in addition to the tax suspension described above. Benefits include:

- Suspended taxes related to inputs used in finished goods destined for export become exempt.
- Suspended taxes related to inputs used in finished goods destined for the domestic market become due, without any penalty or interest, on the 10th day of the month after the product sale (which is intended to positively impact cash flow).
- There is no requirement to segregate goods under the regime physically; only documentary control required.
- Import license is not required for admission under RECOF.
- Third-party toll manufacturing is allowed, even when ordered by companies that are not RECOF-certified.
- The customs authorities recognize the company's controls as reliable.

As noted above, RECOF certification offers a number of important benefits. Companies that conduct a feasibility study to assess whether such benefits would apply to them, and then accordingly proceed to structure their processes to apply for, implement and maintain RECOF certification, will secure a competitive advantage, especially given the fact that at present fewer than 20 companies in Brazil are RECOF-certified.

For additional information; contact:

Ernst & Young Serviços Tributários S.P. Ltda.

Diego Bassan, *Campinas*
+55 19 3322 0518
diego.bassan@br.ey.com

[10] The Blue Line regime was discussed in the June 2015 issue of *TradeWatch*. It is a certification program that grants to companies credentials of having reliable internal controls and provides for express release of goods upon importation, exportation and custom transit within Brazil.

Mexico

Mexico's Energy Reform: NAFTA implications

Mexico's energy reform is one of its most radical legal reforms of the past 70 years. During the last two years, Mexico has amended its Constitution, enacted more than 10 new laws and administrative regulations, amended 12 federal laws and created four new government agencies.

Although Mexico's Government has retained exclusive mineral rights to any subsoil hydrocarbon assets, the energy reform has opened the country's hydrocarbon resources to private investment, both domestic and foreign.

Energy reform was and still is a heated and polarized issue in Mexico and many unanswered questions remain: Will it deliver the investment and economic development promised by its supporters? Is it sustainable and safe for the environment? And especially, are there any unforeseen consequences?

In the December 2014 issue of *TradeWatch* we highlighted certain customs considerations of the reform and the importance of proactively identifying customs strategies that can reduce the duty impact of import operations. This article will focus on some possible North American Free Trade Agreement (NAFTA)[11] implications of Mexico's oil and gas industry reforms.

Background

Before the reform, the Mexican Government had a monopoly over the energy sector. To protect and retain such monopoly, reservations (exceptions to general obligations under international treaties) were negotiated in the free trade agreements and bilateral investment treaties, to which Mexico became a party.

The reservations that Mexico negotiated for the energy sector within the NAFTA were mainly to Chapter VI: "Energy and Basic Petrochemicals" and Chapter XI: "Investment."

Chapter XI provides investment protection obligations, including national treatment, under Article 1102 and the prohibition of performance requirements under Article 1106. Prohibited performance requirements include, among others, requirements for minimum domestic content and requirements to give preference to domestic goods or services.

The reservations to Chapter XI that Mexico obtained are included in Articles 1108, Annex I and Annex III.

[11] North American Free Trade Agreement, 32 I.L.M. 289 and 605 (1993) (NAFTA). Text available at www.sice.oas.org/trade/nafta/naftatce.asp.

Article 1108 provides that Articles 1102 (national treatment) and 1106 (prohibition of performance requirements) do not apply to any existing non-conforming measure as set out in Mexico's Schedule to Annex I or III.

Mexico obtained a reservation to Article 1102 (national treatment) for its nonconforming measures, including Articles 25, 27 and 28 of the Mexican Constitution,[12] the Regulatory Law of Constitutional Article 27 in the Petroleum Sector[13] and the Mexican Petroleum (PEMEX) Law.[14] As the Mexican Government had reserved the right to perform exclusively in oil and gas activities (that is, no foreign investment was allowed at all), there was no need — at the time — to negotiate a reservation to Article 1106 (the performance requirements prohibition).

Energy reform provisions

Presently, the energy reform is being implemented progressively. Starting December 2014, three bidding procedures of the so-called Round 1 were introduced and are currently in progress.

What has caught the attention of some international investment professionals is that these bidding procedures have requirements for minimum domestic content, preference for domestic goods and services, and minimum investment commitments.

Another controversial provision of the bidding requirements is a clause in production sharing contracts, which requires, in addition to preference for domestic goods and services, the training and hiring of Mexican nationals for technical and management positions.[15]

These requirements are in line with the newly adopted measures as part of the energy reform. According to Mexico's Hydrocarbons Law of 2014,[16] contracts for the exploration and extraction "... shall, at least, contain provisions on ... domestic content minimum percentage."[17] In fact, the domestic content minimum provisions for bids on government contracts are part of the government's overall economic policy to promote the Mexican energy industry.[18]

The minimum domestic content requirements of the first bidding process that started in December 2014 are as follows: 13% at the exploration phase, 25% during the first year of the development phase, and an increase each year until it reaches at least 35% for year 2025. For the second bidding process, which started in February 2015, the minimum domestic content rate for the extraction phase begins at 17%. For the third bidding process, the domestic content minimums are higher: 22% for the evaluation period (two years) and 27% for the first year of development up to 38% in 2025.

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12 *Constitución Política de los Estados Unidos Mexicanos, que Reforma la de 5 de Febrero de 1857* (Political Constitution of the United Mexican States, which amends the previous of 5 February 1857). Diario Oficial de la Federación (D.O.F.) 5 Feb. 1917, Art. 25, 27 and 28.

13 *Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo* (Regulatory Law of Constitutional Article 27 in the Petroleum Sector of 1958), as amended, D.O.F. 29 Nov. 1958. Repealed 11 Aug. 2014.

14 *Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios* (PEMEX Law), D.O.F., 16 Jul. 1992 (Mex.), as amended. Repealed 28 Nov. 2008.

15 Bidding guidelines for the award of production sharing contracts for the exploration and extraction of hydrocarbons in shallow waters – first invitation to bid. Text in English available at: ronda1.gob.mx/English/pdf/PDF-L-01/R01L01_Bidding-Guidelines_20141211.pdf.

16 *Decreto por el que se expide la Ley de Hidrocarburos y se reforman diversas disposiciones de la Ley de Inversión Extranjera; Ley Minera, y Ley de Asociaciones Público Privadas* (Decree implementing the Hydrocarbons Law and amending various provisions of the Law on Foreign Investment; Mining Law and the Law on Quasi-Public Corporations), D.O.F. 11 Aug. 2014 (Hydrocarbons Law).

17 Hydrocarbons Law, Art. 19 and 46.

18 Hydrocarbons Law, Art. 125.

The domestic content percentage is subject to verification by the Secretariat of Economy annually and contractors may be assessed liquidated damages in cases of noncompliance.

NAFTA implications

The World Trade Organization (WTO) Agreements[19] and most free trade agreement and bilateral investment treaty models prohibit performance requirements provisions as discriminatory trade and investment practices, except where reservations are made in justified circumstances. As noted above, the NAFTA is no exception.

It is important to reiterate here that even though Mexico negotiated reservations for the energy sector in the NAFTA to maintain its state monopoly, the reservations were made according to the legal framework in effect at that time. This framework has now been changed. Articles 25, 27 and 28 of the Mexican Constitution have been amended[20] and both the Regulatory Law of Constitutional Article 27 in the Petroleum Sector and the PEMEX Law have been repealed.[21]

Since the non-conforming measures have been either amended or repealed, a possible consequence is that the reservations that were negotiated are no longer in effect and the national treatment (Article 1102) requirements, among others, under Chapters VI and XI now apply fully to the oil and gas sector.

Additionally, the performance requirements prohibition under Article 1106, which did not apply in the absence of foreign investment, would now conceivably apply to any foreign investment in the oil and gas sector.

Because Mexico never obtained a reservation to Article 1106, under the NAFTA, Mexico may be precluded from implementing measures that require minimum domestic content and preference for domestic goods and services. Therefore, the performance requirements that are currently in effect for participating in the hydrocarbon exploration and extraction bidding processes are potentially in violation of the NAFTA.

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19 Agreement on Trade-Related Investment Measures (TRIMs), Apr. 15, 1994, 1868 U.N.T.S. 186 (1994).

20 *Decreto por el que se reforman y adicionan diversas disposiciones de la Constitución Política de los Estados Unidos Mexicanos, en Materia de Energía,* (Decree amending Various Energy Provisions of the Political Constitution of the United Mexican States), D.O.F. 20 Dec. 2013.

21 The Regulatory Law of Constitutional Article 27 in the Petroleum Sector was repealed on 11 Aug. 2014. The PEMEX Law was repealed on 28 Nov. 2008.

As possible consequence of NAFTA violations, investors may take legal action against the Mexican Government for requiring them to meet domestic content minimums, and to give preference to domestic goods and services, under the dispute settlement mechanism in Chapter XI, Section B. Damages awarded to investors by the panel of three arbitrators can be substantial and the decision cannot be appealed. Furthermore, some international law professionals are of the opinion that investment arbitrations of this kind tend to favor private investors more often than governments.

Notwithstanding, the Mexican Government holds the position that performance requirements are a valid and legal economic public policy designed to promote the new Mexican energy industry and to attract investment. Similar policies have been successfully implemented in Mexico in the past. For instance, applicable reservations were included in the NAFTA for the development and modernization of the Mexican automotive industry. A schedule with progressive reduction of the minimum domestic content requirement that ended in 2004 was part of the reservation.

Possible outcomes

To avoid violations, it is possible to amend the NAFTA to introduce a reservation to Article 1106 in Annex I, according to the procedure provided in the Mexican Schedule of Annex III, Section B, Subsection 2: "Deregulation of Activities Reserved to the State." The process for amending the NAFTA (where all three parties must agree), however, is a difficult and time-consuming task.

On the other hand, even though there may technically be a violation of NAFTA provisions, it may not necessarily be an issue in practice if the domestic content requirement can be met easily. This, however, appears unlikely. Perhaps it is too soon to tell, but some subject matter professionals have forecasted that meeting these requirements may be a challenge as currently there is no real policy for the development of domestic oil and gas industry suppliers.

Nonetheless, the National Hydrocarbons Commission and the Secretariat of Economy are empowered to change the domestic content minimum percentages as they see fit and may possibly lower the percentages if the first bidding processes show that the requirements are difficult to meet.

Finally, it is worth noting that the situation may be even more complex as similar reservations have been negotiated in most of the FTAs and bilateral investment treaties, to which Mexico is a party, and the implications and challenges of the energy reform are likely to be similar.

Look for further insight into Mexico's energy reform developments in future issues of *TradeWatch*.

For additional information, contact:

Mancera, S.C. (México)

Perla Martínez, *Monterrey*
+52 (81) 8152 1822
perla.martinez@mx.ey.com

Pacific Alliance

The Pacific Alliance Framework Agreement now in force

As an update to our report in the December 2014 issue of TradeWatch, the Framework Agreement of the Pacific Alliance between the Republic of Colombia, the Republic of Chile, the United Mexican States and the Republic of Peru, signed in Antofagasta, Chile on 6 June 2012, is now in effect as of 20 July 2015.

The last hurdle in the ratification process was overcome when Colombia's Constitutional Court issued Decision C-163 dated 15 April 2015 to uphold the constitutionality of Law 1721 of 2014, by which Colombia's Congress had ratified the Framework Agreement. Once the Court's decision was notified, Colombia deposited the ratification documents on 21 May 2015. Under the relevant clause, the agreement entered into force 60 days later on 20 July 2015.[22]

The Pacific Alliance — composed by Chile, Mexico, Peru and Colombia — aims for free trade and economic regional integration by facilitating the cross-border movement of originating goods, services, capital and people between member countries, and for opening member countries' markets to global trade.

Chile, Colombia, Mexico and Peru held the first summit of the Pacific Alliance in Lima, Peru on 28 April 2011, where they signed the Declaration of Lima as the first step toward the formation of the Pacific Alliance. At the second summit on 4 December 2011, the presidents of the four countries met in Merida, Mexico where they signed the agreement to form the Pacific Alliance.

Most recently, at the 10th summit of the Pacific Alliance held on 3 July 2015, in Paracas, Peru, the presidents of Chile, Colombia, Mexico and Peru signed the Declaration of Paracas, by which they agreed to further economic integration and emphasized the significant progress made on the Additional Protocol and the Agreement to establish the Cooperation Fund.

The presidents also pledged to move forward on the plan for deeper integration by strengthening human capital, science, technology and infrastructure, and by increasing the involvement of small and mid-sized companies (*Pequeña y Mediana Empresa* or PyMEs by their acronym in Spanish) in international markets. The presidents indicated that their efforts should be directed toward diversification and participation of member countries and companies in global value chains.

[22] Website of the Ministry of Foreign Relations of the Republic of Colombia July 22, 2015 available at: cancilleria.gov.co/sites/default/files/alianza-del-pacifico/acuerdo_marco.pdf.

Companies that are able to take advantage of any benefits offered under this continuously evolving trade agreement will secure a competitive advantage in both domestic and global markets.

For additional information, contact:

Ernst & Young Ltda (Colombia)

Gustavo Lorenzo, *Bogotá*
+57 1 484 7225
gustavo.lorenzo@co.ey.com

Ana Maria Vega, *Bogotá*
+57 1 484 7391
ana.maria.vega@co.ey.com

United States

US Generalized System of Preferences reauthorization: details importers should know regarding scope and application, changes and procedures for refunds

The Generalized System of Preferences was reauthorized on 29 June 2015

Long awaited by many importers, the Trade Preferences Extension Act of 2015 (the Act)[23] renewed the US Generalized System of Preferences (GSP) on 29 June 2015. Effective 29 July 2015, GSP is now in force through 31 December 2017.

GSP was originally established by the Trade Act of 1974[24] to support the economic growth of developing countries by providing duty-free treatment to certain "covered articles" imported from designated beneficiary countries. US importers rely on GSP's duty savings to remain competitive, as it reduces the costs of imports used in subsequent manufacturing in the US.

The program has expired on a number of occasions in the past. For each of these occasions Congress reinstated the program with retroactive effect from the date it had expired. GSP most recently expired on 31 July 2013. Since then, importers have been required to pay "normal trade relations" duties for covered products imported from GSP-qualifying countries.

As expected, the Act that renewed GSP contains a retroactive clause for eligible goods entered after 31 July 2013 and before 29 July 2015. The importers of such goods may file a claim before 28 December 2015 to obtain a refund of duties paid.

Changes to the GSP program and how to claim benefits on future entries

The renewed GSP is substantially similar to the previous GSP program with the following key differences:

1. The Act authorizes the President to grant eligibility to certain products, including certain luggage and travel products for all GSP beneficiary countries and certain cotton articles for least developed countries only. Importers of these items should watch for updates to the list of covered products in case their imports become eligible for duty refunds.
2. Certain countries have lost their GSP eligibility:
   - Bangladesh lost GSP status effective September 2013 due to its failure to meet statutory eligibility requirements related to worker rights.

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[23] Pub. L. No. 114-27, 129 Stat 362.

[24] 19 U.S.C. 2465 (2014).

- Russia lost its GSP eligibility effective on 3 October 2014 as a result of economic sanctions imposed on Russia.

GSP-eligible goods entered into US commerce on or after 29 July 2015 may be imported duty-free for the duration of the program.

GSP applies retroactively: How can importers claim benefits for past entries?

U.S. Customs and Border Protection (CBP) has issued guidance to help importers with their retroactive GSP claims. Claims must be received on or before 28 December 2015. Refunds are expected to be paid without interest no later than 90 days after liquidation or reliquidation. The retroactive clause does not apply to goods originating from countries that lost eligibility at any time during the lapse period (Bangladesh and Russia).

Before the program expired, CBP issued a Cargo Systems Messaging Service (CSMS) message dated 12 July 2013[25] to advise importers of GSP-eligible goods who make entries through the Automated Commercial Environment (ACE) Automated Broker Interface (ABI) to pay the normal trade relations (column 1) duty rate once the program expired, but to continue to flag GSP-eligible importations with the applicable Special Program Indicator (SPI) A, A+ or A*. Now that the program has been reinstated, CBP will automatically process refunds for entries filed through ABI with the A, A+ or A* SPI. No additional action is required by these importers to obtain refunds, if due. CBP has stated that retroactive claims for unliquidated ACE entry summaries that did not contain a GSP SPI must be made via post-summary correction (PSC) where both the 270-day PSC filing requirement as well as the 28 December 2015 deadline can be met.

Importers who filed entries outside of the ACE ABI system and paid duty must submit a GSP claim by 28 December 2015 to obtain a refund. CBP's requirements for such claims depend on how the entry was filed, whether the entry is liquidated or unliquidated, and whether the SPI was indicated. These claims (including ABI entries that did not use the SPI) must be filed by requesting liquidation or reliquidation and providing sufficient information for US CBP to locate the entry, or to reconstruct the entry if it cannot be found. To that end, CBP has advised importers to include at a minimum the entry number, line number and requested refund amount in written requests for refunds. Importers should expect longer processing time for these claims.

Importers should act quickly to claim benefits

Importers should confirm that they are using the appropriate SPI for GSP-eligible goods imported after 29 July 2015 to obtain preferential treatment. Further, importers should determine whether any of their past entries are eligible for refunds, and where automatic processing does not apply, submit a claim before the 28 December 2015 deadline.

For additional information, contact:

Ernst & Young LLP (United States)

Michael Leightman, *Houston*
+1 713 750 1335
michael.leightman@ey.com

Sara Schoenfeld, *New York*
+1 212 773 9685
sara.schoenfeld@ey.com

[25] Cargo Systems Messaging Service (CSMS) # 13-000348 of 12 July 2013.

China

Chinese customs issues first administrative classification ruling

China's customs authorities have published the first administrative classification ruling[26] in line with the Government's policy to standardize nationwide classification determinations with binding force.

As background, China's General Administration of Customs (GAC) issued the "Interim Measures on the Administration of the Administrative Rulings of Customs"[27] in 2001 to specify the relevant provisions of a customs administrative ruling. In 2007, the GAC issued the "Provisions of the Customs of the People's Republic of China about the Administration of the Commodity Classification of Import and Export Goods"[28] to further standardize import and export commodity tariff classification.

However, due to various reasons, the GAC has not issued any formal classification administrative rulings in the past 10 years. Although preclassification determinations by third-party service providers were allowed by certain other government programs, these had limited effect because such determinations are not binding on the GAC. Companies needed effective solutions to practical problems and demanded greater certainty and less controversy.

Consequently, GAC announced that administrative rulings will be issued to support the development of the Shanghai Free Trade Zone (FTZ). The recently issued first nationwide-effective administrative classification ruling is a milestone in the formal implementation of the customs classification rulings system, which provides companies with an effective solution to manage tariff classification issues.

Specifically, classification rulings:

- Are equally binding on both the import/export enterprises and the GAC
- enable import/export enterprises to classify goods in advance and help to avoid classification disputes during the import/export clearance process
- Facilitate cost accounting, clarify regulatory requirements and increase trade predictability
- Reduce lead time and improve customs clearance efficiency

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[26] Announcement No. 28 of 2015 (Announcement on the publication of the administrative rulings of commodity classification), 3 Jun. 2015, General Administration of Customs (GAC).

[27] Order of the GAC No.92, 2001.

[28] Order of the GAC No.158, 2007.

The procedure for obtaining a GAC classification ruling is as follows: the importer would normally need to file the application three months before the importation is to take place. The application must include basic information about the importer as well as all necessary information about the goods in question (e.g., product specifications, pictures, samples, analysis report). It may take one or two weeks for officials to decide whether they would agree to accept the ruling request. If the request is accepted, GAC will make a determination and issue the ruling to the importer within 60 days.

At this time, the administrative classification rulings system applies only to companies registered within the Shanghai FTZ and to specific commodities under certain chapters of China's Import and Export Tariff guidebook. Nevertheless, the GAC is expected to expand the commodity scope to all import and export goods, and replicate the system nationwide in the foreseeable future.

Implementation of the classification ruling system will enable companies with operations in China to better manage tariff classification uncertainty, which traditionally is a high-risk area for customs controversy in China.

Watch for further updates in future issues of *TradeWatch*.

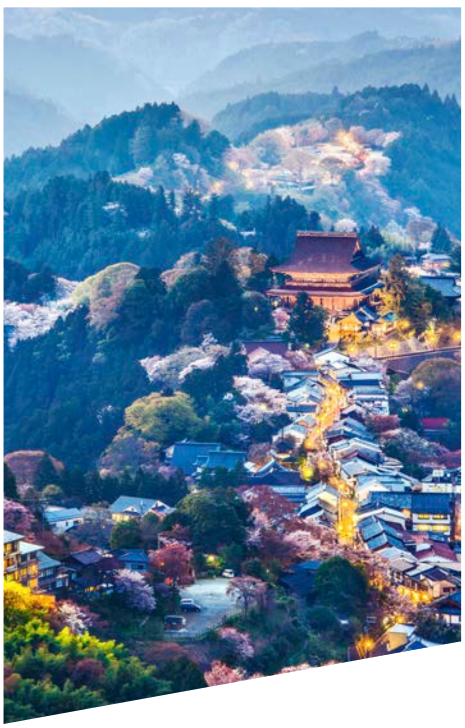
For additional information, contact:

Ernst & Young (China) Advisory Limited

Bryan Tang, *Shanghai*
+86 21 2228 2294
bryan.tang@cn.ey.com

Japan

Trend toward liberalization of the customs declarations policy



A legislative proposal is underway in Japan which will grant authorized economic operators (AEOs) flexible customs declaration options, whereby AEOs will be able to declare their imported/exported goods at customs offices other than the designated customs office where the goods are physically stored. Following the report of the Council on Customs, Tariff, Foreign Exchange and Other Transactions of the Ministry of Finance (MOF) issued on 30 December 2014 on this topic, the Working Group on Liberalization of Declaration Offices and Customs Brokerage commissioned by the Bureau of Customs recently issued a more detailed report on the flexible customs declaration framework in light of its projected implementation by 2017. At this time, the report is open for public comment and further developments are expected in the following months.

Current policy on customs declaration at the customs office where the goods are stored

As a general rule, under the Japanese Customs Act,[29] customs declarations must be made at the regional customs offices where the imported/exported goods are physically stored. The rationale is that such measure lowers the risk of cargo switching and allows customs officials to respond promptly upon suspicion of illegal activity by conducting cargo inspections and issuing licenses through a single process at the bonded area approved by the Director General of Customs. According to current practice, when goods are exported/imported throughout the country at different locations managed by different customs offices, importers/exporters need to make a separate declaration and register different brokers at each office.

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[29] Customs Act, Art. 67-2, Sec. 1.

The liberalized customs declaration policy

Liberalization of the customs declaration policy is likely to help achieve Customs' long-held goals of facilitating trade, provided that such measures do not substantially limit the security and adequacy of customs procedure. Liberalization will serve the following two purposes:

1. Consolidate the work of customs brokers: By allowing customs brokers to directly file declarations at customs offices other than where the goods are stored, importers/exporters will no longer need to employ multiple brokers, but instead will work with fewer brokers. This will contribute to administrative efficiency and cost reduction.
2. Consolidate declarations in fewer customs offices: By allowing customs brokers located at the place of import/export to declare goods at a specific customs office other than where the goods are stored, the importers/exporters will be able to use fewer customs offices to file import/export declarations. This will contribute to administrative efficiency and cost reduction as importers and exporters will need to deal with fewer, or even only a single customs office.

The new proposal aims to take a restrictive approach and grant the aforementioned benefits only to AEOs. The proposal makes clear that there is no intent at this time to extend the benefits to non-AEO operators. Thus, it is crucial for importers/exporters who would like to benefit from the liberalization policy to apply for AEO certification and ensure full compliance with AEO approval requirements.

Closing thoughts

Although the details of the liberalized customs declaration policy are yet to be fully defined, AEOs will be granted the flexibility to make customs declarations at a customs office other than where the goods are stored, while the current practice of making customs declaration at the customs office where the goods are stored will continue for all other importers/exporters. This is in line with customs' plan to ensure enhanced convenience and trade facilitation for AEOs. For this reason, companies looking to benefit from the liberalized customs declaration policy are advised to be well informed of upcoming changes and consider applying for AEO certification.

For additional information, contact:

Ernst & Young Tax Co. (Japan)

Yoichi Ohira, *Tokyo*
+81 3 3506 2678
yoichi.ohira@jp.ey.com

Advance customs rulings on duty reduction/exemption programs

Overview

Japan's Ministry has announced[30] that Japan Customs will start issuing advance customs rulings on the use of duty reduction/exemption programs from 1 October 2015. While the advance ruling system already exists for tariff classification, customs valuation and country of origin, it did not previously cover duty reduction/exemption programs, even though it is well known that these programs are complex and eligibility for them is difficult to ascertain. Advance rulings will allow importers to confirm eligibility for any duty reduction/exemption programs prior to importation.

Duty reduction/exemption programs

The duty reduction/exemption programs in Japan are defined in the Customs Tariff Law and the Temporary Tariff Measures Law. As shown in the table below, there are multiple types of duty exemption/reduction programs and in most cases they consist of restrictions on the type and use of eligible goods and various requirements for importers and exporters to follow certain strict procedures. Unfortunately, the lack of Customs guidance on the specific operational issues makes it difficult for importers to determine with certainty whether their goods will qualify for the programs.

For the aforementioned reasons and because duties are rather low in Japan on most industrial goods, some companies do not aggressively pursue the use of duty exemption/reduction programs and thus voluntarily waive the opportunity to reduce duty costs.

[30] Revision in part of Basic Circular to Customs Law (Notice No. 702) dated 30 June 2015.

Main duty reduction/exemption schemes under the Customs Tariff Law

Type of duty reduction/ exemption	Overview of conditions
Unconditional exemption (Art. 14)	▸ Applied to the importation of certain specific goods, samples for soliciting orders, or goods with extremely small value, etc.
Reduction on goods re-imported after repair or processing, (Art. 11)	▸ Must be goods exported from Japan for processing or repair, and subsequently imported into Japan within one year from the date of their export permission. ▸ With regard to goods exported for processing, they are limited to processing recognized as "difficult" in Japan.
Re-import exemption (Para. 10 Art. 14)	▸ Goods exported from Japan and subsequently imported into Japan in the same condition in which they were permitted to be exported.
Re-export exemption (Art. 17)	▸ Goods for further processing*, goods to be repaired or goods for testing purposes are subject to the exemption, although there are further restrictions on the type and the use of the goods. ▸ Importer must notify Customs of its intention to re-export the imported goods at the time of import declaration. *It should be noted that according to Cabinet Order, goods to be used as materials for processing are limited to those imported goods used for processing of certain specific goods.
Re-export reduction (Art. 18)	▸ With respect to goods, as may be specified by Cabinet Order, which are imported into Japan for temporary use, in accordance with a certain contract (lease contract or work contract), customs duty to be levied thereon may be reduced, provided that they are exported within two years (or under certain conditions, five years) from the date of their import permission.
Reduction/exemption for raw materials for use in manufacture (Art. 13)	▸ Goods to the program are specified as raw materials for manufacture of feed or groundnut oil. ▸ Processing of the imported goods must be completed within one year from the date of their import permission and the processing must be conducted at a factory approved by the Director-General of Customs.
Reduction/exemption on raw materials for manufacture of export goods (Art. 19)	▸ Imported raw materials which are used for manufacturing export products are limited to a certain primary commodities such as wheat flour, potato starch, cotton seed oil and others.

Benefits of applying for advance customs rulings

The major benefit of applying for an advance customs ruling is that the ruling result will be binding on customs for a maximum of three years from the date of issue. This provides certainty to the importers whether their goods are eligible for duty exemptions/reductions prior to importation and contributes to expedite customs processing as customs officers will not question an official ruling.

Implications for importers and exporters

Due to the complexity and, to a certain degree, ambiguity of Japan's duty reduction/exemption programs, it has been difficult in the past for importers and exporters in Japan to determine whether they are eligible for benefits under these programs. The customs advance ruling system specific to duty reduction/exemption programs is welcome news to importers/exporters looking to benefit from the programs. Because of the certain ambiguity in the programs, importers and exporters are advised to submit carefully formulated technical arguments in support of their case to increase chances of obtaining a favorable ruling.

For additional information, contact:

Ernst & Young Tax Co. (Japan)

Yoichi Ohira, *Tokyo*
+81 3 3506 2678
yoichi.ohira@jp.ey.com

East African Community

East African Community 2015/16 budget review: implications for importers and exporters

On 11 June 2015 the Kenyan, Ugandan, Tanzanian and Rwanda governments had their budget readings in their respective countries. The following paragraphs highlight the implications of some of the budget proposals to importers and exporters across Kenya, Uganda, Tanzania and Rwanda.

Kenya

Increase in Common External Tariff (CET) rates – Certain goods continue to be affected by trade measures aimed at protecting upcoming local industries:

- **Sugar** – The specific duty rate of sugar was increased from USD200 per metric ton to USD460 per metric ton. The current rates are USD460 per metric ton or 100%, whichever is higher. Importers of industrial sugar under the duty remission scheme will not be affected by this measure since the duty is remitted to 10% or 0% for producers for domestic consumption and export respectively.
- **Plastic tubes for packing cosmetics and toothpaste** – Manufacturers of these products exist in Kenya; therefore, the CET rate has been increased from 10% to 25%. This same measure was also announced by Tanzania.
- **Gas cylinders** – At the EAC (East African Community: Burundi, Kenya, Rwanda, Tanzania and Uganda) level the Council of Ministers proposed to remove gas cylinders from the list of exempt items and attach a 0% CET rate on these imports. Imports of gas cylinders into Kenya will attract 25% import duty to protect local manufacturers, while similar goods will be imported into Tanzania, Rwanda and Uganda duty-free.
- **Aluminum milk cans and iron and steel products** – Import duty has been increased from 10% to 25% and duty rate for selected products has been increased from 10% to 25%.

Stay of CET application – The EAC Council of Ministers have agreed on applicable duty rates or levies that will apply to all or some of the countries. Depending on geographical location, economy, need, etc., a country may request to "stay the application" of certain measures as follows:

- **Paper and paper products** – Kenya has been allowed to stay the application of 10% duty rate and apply 25% on specified types of paper (four types under tariff heading 4805) which may be locally available. Other paper and paper products when imported into Kenya will attract 10% CET rate.

- **Made-up fishing nets** — Import duty will be 25% instead of 10% to protect local industries.
- **Aluminum alloy in sheets** — Kenya will stay the application of the CET rate of 25% and apply a lower rate of 10% to help local manufacturers who use these sheets as raw materials.

Duty remission scheme — Section 140 of the EAC Customs Management Act gives mandate to member states to remit duty on goods that are to be used as raw materials in manufacture of goods for subsequent export or domestic consumption. It is granted upon request by the company and once the application is approved qualifying companies are gazetted for a period of 12 months:

- **Nylon yarn and synthetic twine** — Raw materials for the manufacture of fishing nets are to be granted duty remission at a rate of 0% instead of 10%.
- **Semolina (groats and wheat meal)** — Raw material for the manufacture of pasta and spaghetti are granted duty remission at a rate of 0% instead of 25%. This measure was also announced by Tanzania.

Other changes affecting importers in Kenya:

Import Declaration Fee (IDF) — The draft Miscellaneous Fee and Charges Bill proposes to reduce the current IDF rate from 2.25% to 2% of the CIF (Cost-Insurance-Freight) value of the imported goods. This reduction is aimed at harmonizing the IDF rates within the region. Kenya's new proposed rate of 2% is still higher than the rate in the other EAC countries. This will be a relief to importers who have been paying the fee regardless of the type of goods imported. There is a further proposal for importers of goods under the duty remission scheme to pay a flat rate of KES10,000 (about USD100) as opposed to the 2% of the CIF value of the goods.

Tax reforms and modernization — The Cabinet Secretary has tabled the tax procedures bill and excise duty bill 2015 and the Miscellaneous Fee and Charges bill. Key changes that appear in the excise duty bill 2015 are as follows:

- **Change from use of both *ad valorem* and specific duty rates to use of specific duty rates** — The new bill proposes to generally apply specific duty rates (rates based on KES per unit quantity) on all excisable goods. Only food supplements will continue to attract an *ad valorem* rate of 10% (from 7% currently); other excisable goods will attract specific duty rates.

  The overall excise duty on low value/priced items, such as soft drinks and juices, previously subject to 7% excise duty will attract KES10 per liter upon enactment of the Excise Duty bill 2015. The specific rates will be adjusted for inflation at the beginning of every fiscal year.

- **Changes in the list of excisable goods** — The proposed Excise Duty bill 2015 does not include certain goods implying that these will no longer be excisable once the bill is enacted into law. These products include perfumes and toilet waters; lip and eye makeup preparations; manicure or pedicure preparations; shampoos; other beauty or makeup preparations and preparations for the care of the skin (other than medicaments), including sunscreen or sun tan preparations; preparations for permanent waving or straightening of hair; hair lacquers; other preparations for use on hair; personal deodorants and antiperspirants; pre-shave or after shaves; perfumed baths salts; deodorizers; and petroleum jelly.

  Notably, bottled water is still on the list of excisable goods even though the Cabinet Secretary announced during his budget speech that bottled water will no longer be excisable. This is likely to have a serious negative impact as bottled water is a basic necessity in developing countries that do not have readily available clean water supply throughout their territories.

Uganda

Import duty rates reduction — For yet another year the duty rates on imports of certain types of motor vehicles have been reduced as follows: road tractors for semi-trailers from 10% to 0%; motor vehicles of 5 to 20 metric tons from 25% to 10%; motor vehicles exceeding 20 metric tons, from 25% to 0%; and buses for transportation of more than 25 persons, from 25% to 10%.

Rwanda has also announced similar reductions on imports of certain motor vehicles. This is a welcome measure for importers in Uganda and Rwanda, but it could have a ripple effect on assemblers of similar products in Kenya, as Uganda, Tanzania and Rwanda do not allow similar goods originating in Kenya to be imported duty-free. If motor vehicles assembled in Kenya attract 25% duty rate on importation into Uganda, Tanzania or Rwanda against 0% or 10% duty rate charged on imports from outside Kenya, the Kenyan-assembled vehicles will have a higher cost than those from outside EAC.

Environmental levy of used motor vehicles more than eight years old (excluding goods vehicles) was increased from 20% to 50%. This is aimed at discouraging imports of older cars that will negatively affect the environment.

Introduction of excise duty on confectioneries, furniture and motor vehicle lubricants — Imports of sweets and chewing gum, and furniture will attract excise duty at 10% whereas motor vehicle lubricants will attract 5% duty.

Tanzania

Import duty rate of 50% on 100,000 metric tons of sugar from April to June — This is a measure intended to alleviate the sugar shortage in Tanzania. Like Kenya and Uganda, imports of sugar would attract USD460 per metric ton or 100%, whichever is higher, if no application for duty remission is granted.

Railway development levy at 1.5% — Last year, the EAC introduced a 1.5% infrastructure levy applicable as of 1 July 2014 to all EAC states. This was already applied by Kenya effective 1 July 2013 as railway development levy. Tanzania stayed application of the levy for one year. It has been reintroduced this year with a change in name from infrastructure levy to railway development levy specifically to fund construction of the Standard Gauge Railway. Rwanda has also introduced an infrastructure levy at 1.5% this year.

Rwanda

Import duty on ICT (information and communications technology) equipment — To further enhance development of ICT in the country, equipment used by telecommunications firms will be imported duty-free into Rwanda for one year. This would include items such as electric resistors; filaments and insulators; self-adhesive plates of plastic; towers and lattice masts; unrecorded magnetic and optical media; monitors; and others.

Closing comments

The financial budgets and demands by the EAC states grow every year increasing the need for greater tax revenue from the respective revenue authorities. These tax revenues can be achievable if compliance is enhanced, the tax base is widened and all taxes due are collected. Therefore, it is important for taxpayers to stay abreast of their responsibilities in a fair, simple and equitable manner.

Watch for updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young (Kenya)

Hadijah Nannyomo, *Nairobi*
+254 20 27 15300
hadijah.nannyomo@ke.ey.com

The new Tripartite Free Trade Area: opportunities and risks for businesses in the East African Community

A coalition of three regional economic communities (RECs) was launched to form the Tripartite Free Trade Area (TFTA) on 10 June 2015. The three RECs include the Southern African Development Community (SADC[31]), the East African Community (EAC[32]), and the Common Market for Eastern and Southern Africa (COMESA[33]).

These three RECS cover 27 countries in Africa, all of which are now eligible to enjoy the benefits of membership in the new TFTA.

Among them, the TFTA countries account for half of the membership of the African Union (AU[34]) with a Gross Domestic Product (GDP) of USD1.3 trillion, which is about 58% of the continent's GDP; a combined landmass of 17 million square kilometers and a population of more than 600 million.

The TFTA aims at promoting development through increased economic integration of North, East and South Africa. TFTA is set to eliminate or reduce tariff and non-tariff barriers and other restrictions on commerce and thereby facilitate trade within the expanded market.

Opportunities and risks for EAC businesses

Over the years the EAC regional integration process has made tremendous progress having formed the East African Customs Union in 2005 and the Common Market in 2010. The Protocol for the establishment of the East African Monetary Union was signed by the Heads of States in November 2013 and implementation is underway. The EAC has now joined hands with the COMESA and SADCA and launched TFTA. As a result, the opportunities and risks posed by further economic integration to businesses within the EAC Region are expected to increase.

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31 Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

32 Burundi, Kenya, Rwanda, Tanzania and Uganda.

33 Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, South Sudan, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

34 All United Nations member states based in Africa and African waters, except for Morocco (withdrew unilaterally) and the Central Africa Republic (suspended).

Increased intraregional trade with other businesses in Africa

Currently, the multiple regional integration arrangements have created incompatible preferential trade regimes that facilitate trade, but only within the different RECs. The main goal of the new TFTA is to establish a FTA on a tariff-free, quota-free and exemption-free basis by building on the existing COMESA, EAC and SADC FTAs. Whether EAC businesses gain or lose from the resultant increase in volume of intraregional trade will depend on their level and position of participation in the trade and whether they will be sellers/producers/exporters or merely buyers/consumers/importers.

Going forward, EAC businesses are expected to increase their levels of production and intraregional exports if they are to benefit from the harmonized preferential trade regimes. Deliberate efforts at value-addition to raw materials from EAC countries will ensure that competitive semi-finished and finished goods are exported to the expanded TFTA market resulting in increased revenues for businesses and the EAC countries.

Enlarged market across Africa

In terms of both population and GDP per capita, the TFTA is expected to create a large market through the creation of a single economic space that is larger than what is currently enjoyed by EAC businesses within the EAC region. The EAC industrialists, for example, will enjoy increased market opportunities for trade in manufactured goods and services in a larger market. However, EAC businesses will face stiff competition penetrating the COMESA and SADCA regions from the dominant players in those regions. In preparation for these envisaged challenges, local firms should therefore strive to produce low-cost, high-quality goods that are sold at competitive prices for maximum market penetration.

Opportunity for increased foreign direct investment (FDI)

The TFTA is expected to act as a pull factor for investment in the whole region and thus attract new investors in fields such as agriculture, energy, financial services, manufacturing, mining and telecommunications, which are crucial for economic growth and development. The enlarged market is expected to attract investors into these and other areas thereby boosting the region's export earnings.

The EAC entities involved in several economic sectors would benefit from increased foreign direct investment once they position themselves as the right investment "targets" through share subscription, mergers and acquisitions. EAC businesses will need to improve their corporate governance, among other standards, in order to attract increased foreign direct investments.

Conclusion

The TFTA will enhance economic integration across the African continent and help assure benefits to businesses within the East Africa Community. However, the EAC businesses will need to be well prepared if they are to compete favorably with their counterparts in the SADC and COMESA regions.

For additional information, contact:

Ernst & Young (Uganda)

Edward Balaba, *Kampala*
+256 414 343520
edward.balaba@ug.ey.com

Tanzania implements phase II pilot stage of the East African Community Single Customs Territory

Starting 12 June 2015, Tanzania has rolled out the phase II pilot stage of the East African Community Single Customs Territory (EAC-SCT: Burundi, Kenya, Rwanda, Tanzania and Uganda), making it easier to clear greater quantities of goods in transit via the Dar es Salaam port to other member states. The move aims ultimately at unifying the EAC customs territories and eliminating most customs duties and other non-tariff barriers to trade.

A Single Customs Territory (SCT) is a stage toward the full attainment of the Customs Union. It consists of the removal of restrictive regulations and internal border controls with the ultimate goal of free circulation of goods.

Kenya, Uganda and Rwanda started implementing SCT in August 2013. While Tanzania did not start implementation until June 2014, it has already completed phase I and is well on its way toward implementing phase II.

Goods covered under phase I

Phase I covered the following imports into Tanzania: rice, maize, sugar, cigarettes and edible oil. Additional products under the SCT include: wheat and petroleum products imported through Dar es Salaam and destined for Rwanda; wheat and all brewery imports including beer, malt, phosphoric acid and silicon dioxide destined for Burundi; cement, salt and cosmetics from Tanzania to Burundi.

Targeted goods under phase II

Under phase II, the system will be used to clear petroleum products; rice; cotton seeds; detergents; maize flour; household and industrial plastics; bottled water, spices; and fertilizers imported through the Dar es Salaam port into Uganda. Additionally, soap, cooking oil, steel and steel products from Kenya imported into Tanzania will also be under SCT.

Expected benefits:

- Reduced cost of doing business
- Single customs declarations at first point of entry
- Elimination of multiple entries
- Elimination of multiple bonds (Single Regional Bond)
- Single verification of goods at source (for goods subject to verification)
- Elimination of non-tariff barriers to trade
- Elimination of customs bond for duty-paid goods
- Improved transportation turnaround time

Challenges pending full implementation of SCT

At their meeting in May 2015 in Arusha, the EAC ministers adopted a six-month road map on the full clearance of products under the different customs regimes in preparation of the projected full rollout of the EAC-SCT in June 2016. However, there are still pending issues to be resolved. For instance, member states need to integrate Electronic Cargo Tracking Systems across borders, enhance port agencies' systems to support exchange of information needed for SCT operations and implement regional bond to facilitate the movement of goods across the region.

Another issue that needs to be resolved is the lack of uniform mechanism for granting systems access to clearing agents and customs officers from other revenue authorities. According to the SCT system, the EAC partners are expected to train personnel on the use of the Automated System for Customs Data (ASYCUDA) Customs clearance system. However, while Uganda and Rwanda already use ASYCUDA, Kenya still uses the Simba customs software and Tanzania uses Tanzania Customs Integrated System (TANCIS).

Achievements of the SCT

A recent Northern Corridor report on the SCT showed that since Kenya, Uganda and Rwanda launched SCT last year clearance time for cargo from the Mombasa port destined for Kampala has dropped from 18 days to 4 days, and for cargo destined for Kigali, from 21 days to 6 days.

According to the report, the cost of clearing a container destined for Kampala was reduced from USD3,375 before the launch of the SCT to USD1,731. Similarly, the cost of clearing a container destined for Rwanda was reduced from USD4,990 to USD3,387.

The new system is also likely to reduce the amount of time needed to make customs declarations for goods/cargo (both in transit and for domestic consumption) as the new system requires a single declaration compared to multiple declarations under the previous system. All of these developments are expected to reduce the cost of doing business in the region.

Watch for further developments in future issues of *TradeWatch*.

For additional information contact:

Ernst & Young (Tanzania)

Silke Mattern, *Dar es Salaam*
+255 782 065 040
silke.mattern@tz.ey.com

Hadijah Nannyomo, *Nairobi*
+254 729 847 195
hadijah.nannyomo@ke.ey.com

Anthony Baasha, *Dar es Salaam*
+255 22 266 6853
anthony.baasha@tz.ey.com

Chuma John, *Dar es Salaam*
+255 22 266 7227
chuma.john@tz.ey.com

European Union

Union Customs Code: update on latest draft of the delegated and implementing acts

In the June 2015 issue of *TradeWatch* we provided a status update of the delegated and implementing acts under the Union Customs Code[35] (UCC). At the time, the EU Member States were still discussing various provisions of the European Commission's draft issued in March 2015 and it was unclear when the Commission will adopt the delegated and implementing acts.

On 1 July 2015, the Commission shared its latest drafts. The Commission's legal service and legal revisers have edited both drafts to improve the legal drafting and overall quality of the texts, and to ensure compliance with legal requirements. As a result, while the wording had been altered in a number of places, the substantive changes are few. The Commission adopted the delegated acts on 28 July 2015 and the Customs Code Committee's vote is pending on the implementing acts. Below we briefly discuss some notable items.

Background

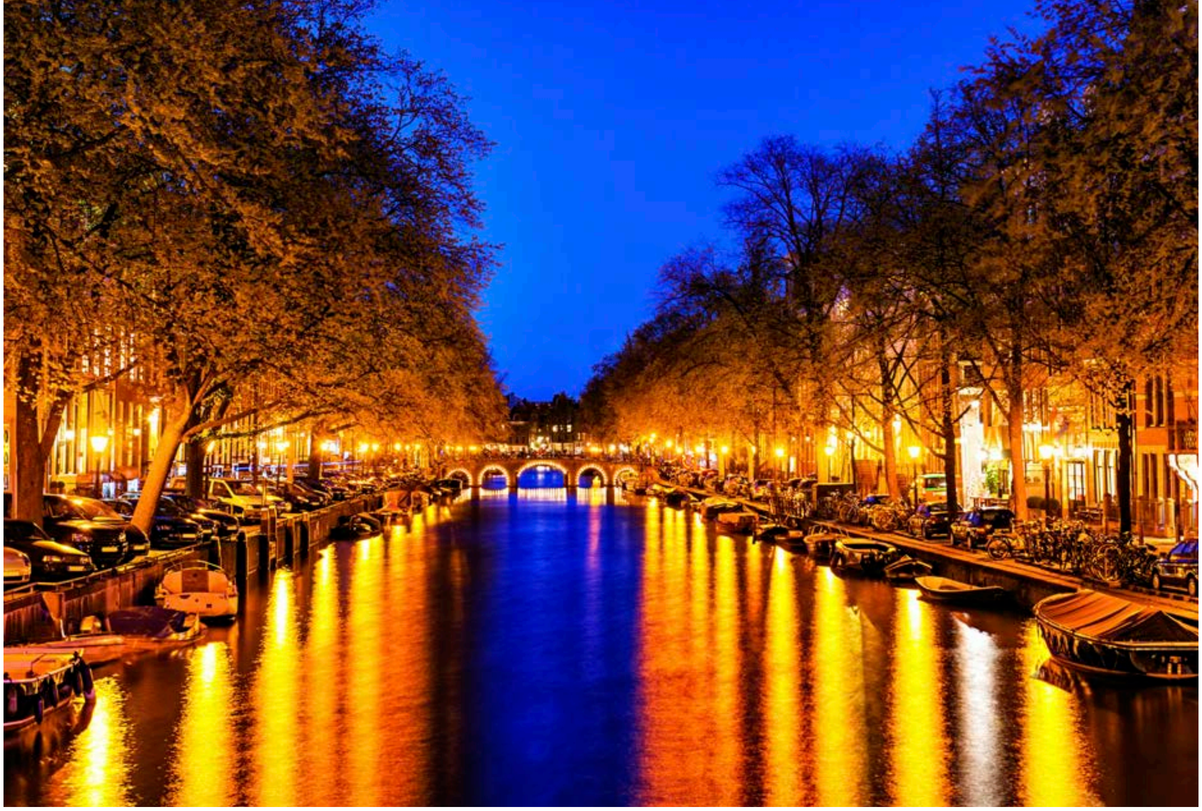
The European Parliament and Council adopted the UCC in October 2013 with most provisions scheduled to go into force on 1 May 2016. Thereafter, the Community Customs Code — which currently still applies — will be repealed.

Meanwhile, the European Commission is committed to ensure that the delegated and implementing acts, which deal with key issues, like 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: Customs valuation provisions

Title II, Chapter 3 (Value of goods for customs purposes) remains for the most part unchanged from the previous draft. As we discussed in the March 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 much more frequently than under the present rules, and trademark royalties, which are presently excluded under certain conditions, will no longer be subject to a special exemption, resulting in many more trademark royalties being included in the customs value under the UCC.

35 Regulation (EU) No 952/2013 Of The European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast), OJ L 369, 10.10.2013, p. 1 available at: eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0952&rid=1.



Title IX: Final provisions

The text of Title IX (Final provisions) of both drafts has been revised in line with legal requirements. Title IX will affect companies to whom the customs authorities have granted authorizations and decisions that will still be force on 1 May 2016. For instance, Binding Tariff Information (BTI) decisions will remain valid for the period set out in each BTI. However, valid BTI decisions, which currently are binding only on the customs authorities of all Member States, will be binding on both the customs authorities and the holder of the BTI starting on 1 May 2016.

Furthermore, all authorizations without a limited period of validity that have been granted on the basis of the Community Customs Code, or its implementing provisions, and that are valid on 1 May 2016, will be reassessed.

Title IX of the implementing acts also includes a number of transitional provisions. First sale valuation will be allowed until 31 December 2017 provided that a contract was in place before the new regulations were adopted. Similarly, a transitional period will apply to goods that were placed in a type D customs warehouse before 1 May 2016. Until 1 January 2019, these goods may be released in accordance with the Community Customs Code.

Final comments

The European Commission adopted the UCC Delegated Act and its Annex (Part 1, Part 2 and Part 3)[36] on 28 July 2015. It has now been sent to the European Parliament and the Council who may raise objections. If no objections are raised, the UCC Delegated Act will go in force. The implementing acts will first have to be voted by the Customs Code Committee composed by representatives from the Member States before they can be adopted by the Commission. However, when this will take place is still unclear and there is a lot of uncertainty in the market since key provisions still leave room for interpretation.

Watch for further updates on the UCC in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young Belastingadviseurs LLP (the Netherlands)

Walter de Wit, *Amsterdam*
+31 88 407 1390
walter.de.wit@nl.ey.com

Othleo Gemin, *Amsterdam*
+ 31 88 407 1909
othleo.gemin@nl.ey.com

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[36] Commission Delegated Regulation (EU) .../... of 28.7.2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council with regard to detailed rules of specifying some of the provisions of the Union Customs Code, links available at: ec.europa.eu/taxation_customs/customs/customs_code/union_customs_code/index_en.htm

Russia

New restrictions on government procurement of industrial goods

Russia has adopted new measures aimed at supporting and promoting Russian industry in an attempt to improve the local economy. A new Federal Law № 488-FZ "On Industrial Policy in Russia" came into force on 30 June 2015.[37] It provides for financial and consultative support to legal entities and individual entrepreneurs operating in Russia as well as the elaboration of special investment contracts. Additionally, under the new law, state and municipal bodies and certain state corporations must give priority in government procurement contracts to industrial goods made in Russia over similar goods manufactured in foreign countries.

Currently there is no specific definition of what constitutes "goods made in Russia." The Federal law does not provide a definition, but delegates the task to the executive branch of the government. Accordingly, the recently adopted Governmental Resolution № 719, in force as of 1 October 2015,[38] provides criteria for identifying "industrial products made in the territory of Russia."

The Government Resolution details criteria for a number of industries, such as machine-tool construction, automotive and special automotive manufacturing, photonics and light engineering, electrical and power engineering as well as heavy industrial engineering. The criteria are complex and product-specific, and include, for example, performance of a certain number of particular production operations in Russia, limits on the number of imported components and raw materials used in the manufacture of certain goods, whether maintenance and repair services are available in the Eurasian Economic Union countries for certain manufactured industrial products, and others.

In the case of special investment contracts, industrial goods are considered to be made in Russia when they meet the criteria established by the terms of the specific investment contract.

If there is no investment contract and no special criteria are established by the Governmental Resolution, industrial goods are considered to be made in Russia if they meet standard country of origin criteria.

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[37] *Федеральный закон №488-ФЗ от 31 декабря 2014 года "О промышленной политике в Российской Федерации,"* available in Russian at: publication.pravo.gov.ru/Document/GetFile/0001201412310017?type=pdf.

[38] *Постановление от 17 июля 2015 №719* available in Russian at: publication.pravo.gov.ru/Document/GetFile/0001201507210008?type=pdf.

Companies that are currently importing industrial products into Russia may consider moving or restructuring their production operations to take advantage of the recently implemented preferential treatment of industrial goods made in Russia.

For additional information, contact:

Ernst & Young (CIS) B.V.

Anastasia Chizhova, *Moscow*
+7 495 755 9700 ext. 7004
anastasia.chizhova@ru.ey.com

Alexandra Kiseleva, *Moscow*
+7 495 755 9700 ext. 4191
alexandra.kiseleva@ru.ey.com

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Americas

Bill Methenitis, *Dallas*
Ernst & Young LLP (United States of America)
+1 214 969 8585
william.methenitis@ey.com

Asia-Pacific

Adrian Ball, *Singapore*
Ernst & Young Solutions LLP (Singapore)
+65 6309 8787
adrian.ball@sg.ey.com

Europe, Middle East and Africa

Neil Byrne, *Dublin*
Ernst & Young (Ireland)
+353 1 221 2370
neil.byrne@ie.ey.com

TradeWatch Editor

Azalea Rosholt, *Abu Dhabi*
Ernst & Young Middle East (United Arab Emirates)
+971 2 417 4400, ext. 216
azalea.rosholt@ae.ey.com