

TradeWatch

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EY publishes Global trade management: how high performers are accelerating ahead

EY has just released the latest in its series of thought leadership reports on global trade.

For more than a decade, the EY Global Trade Symposium has been a forum for a select group of key executives from wide-ranging industries to examine leading practices and evolving strategies of global trade departments. This year's symposium topic allowed the executives to look beyond leading practices to provide their views on the characteristics common to high performance. The discussions and findings from the EY Global Trade Symposium are summarized in this report, which can be accessed [here](#).

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Spotlight on the European Union

European Parliament and Council adopt Union Customs Code



The European Parliament and the Council have jointly adopted Regulation no. 952/2013, laying down the Union Customs Code (UCC). The UCC is a recast of the Modernised Customs Code (MCC), which was adopted in 2008. The UCC seems to address some concerns of stakeholders. However, key issues, such as centralized clearance and customs valuation, still need to be outlined by the European Commission (Commission) by means of delegated and implementing acts. Hence, there is still quite a bit of uncertainty on the legislation, which will apply as of 2016, and the related consequences for business.

Below we highlight some of the signature topics.

Background

The MCC provided for the creation of a pan-European electronic customs environment with harmonized and simplified customs procedures to promote trade with a balance between trade facilitation and customs controls. The MCC was adopted in April 2008 as a regulation by co-decision (i.e., jointly by the European Parliament and the European Council). The MCC was to be applicable once its implementing provisions were in force, at the latest by mid-2013. According to the Commission, however, it was appropriate to proceed with a recast of the MCC.

The Commission has stressed the following considerations in this respect. First, with the deadline of June 2013 approaching, it became apparent to policymakers, including the Commission, that a very limited number or even no new IT systems could be introduced. Second, the MCC needed to be aligned with the Lisbon Treaty, according to which implementing provisions of the MCC have to be split between delegated acts and implementing acts. In addition, work on the implementing provisions revealed the need to adjust provisions that proved difficult to implement. Therefore, in February 2012 the Commission proposed a draft regulation laying down the UCC. The European Parliament and the European Council jointly adopted Regulation no. 952/2013, laying down the UCC in October 2013, following the Commission's proposal.

Trading companies have been anticipating the adoption of the UCC because the related changes in business processes require clearness and consistency in customs rules. The UCC entered into force 30 October 2013; however, most provisions will not apply before 1 June 2016. The articles referring to the delegated and implementing acts are applicable from the date of entry into force, which enables the Commission to work on them in view of the 1 June 2016 deadline. Furthermore, the MCC has been repealed by the UCC.

Centralized clearance

A key aspect of the MCC was the concept of centralized clearance, according to which it is possible for authorized EU traders to declare goods electronically and pay their customs duties at the place where their business is established, irrespective of the Member State where the goods are presented. The UCC introduces additional responsibilities for both the customs office at which the customs declaration is lodged and the customs office at which the goods are presented. Furthermore, the customs offices involved must exchange the information necessary for verification of the customs declaration and release of the goods. In this respect, we would like to highlight that the conditions for granting the authorization still have to be specified by the Commission, by means of delegated acts. Further, the Commission needs to identify the procedural rules concerning the relevant customs formalities and controls.

First sale for export

The first sale for export rules were a debated area during the drafting of the implementing provisions for the MCC. Currently, many traders that import merchandise subject to multiple sales prior to importation into the EU benefit from the first sale for export valuation strategy. The existing rules allow EU importers that meet certain requirements to declare the price paid in the earlier sale (i.e., the first sale) for customs purposes, resulting in a lower dutiable value and, thus, lower customs duty liability.



The proposed MCC implementing provisions specified that the last sale prior to the introduction of goods into the EU would qualify as the relevant transaction for the customs valuation basis. This change in the rules would result in a higher customs value and, thus, a higher tax burden for affected traders. It seems that the first sale for export rule is not precluded by the UCC. However, we note that the Commission still needs to specify the procedural rules for determining the customs value by means of implementing acts. Hence, at this point in time, businesses remain uncertain on the retention of the first sale for export rule.

Royalties and license fees

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

Under the proposed implementing provisions of the MCC, the condition of sale determination had been broadened so that royalties are much more easily included in the customs value, thus increasing the tax burden of affected traders. The add-on provisions in the UCC correspond to the provisions currently applicable in the Community Customs Code. On the other hand, as mentioned above, the Commission is still to specify the procedural rules for determining the customs value by means of implementing acts, which include the rules regarding the add-on elements, such as royalties and license fees. Thus, it is to be seen whether the condition of sale determination remains as is.

Miscellaneous items

Customs representation

In order to facilitate business, any person may appoint a customs representative, who can assist in dealings with the customs authorities, such as the submission of customs declarations. The MCC included the requirement that customs representatives had to be established in the EU. However, in the UCC this requirement is waived if the customs representative acts on behalf of persons who are not required to be established within the EU (customs territory), except where otherwise provided.

AEO program

In a way, the UCC seems to meet traders' wishes to link more advantages to the Authorised Economic Operator (AEO) program (considering the investment necessary to obtain AEO status). For instance, criteria that have been examined when granting the AEO status will not be re-examined according to the UCC. Further, the UCC specifically expresses that an AEO will "enjoy more favourable treatment than other economic operators in respect of customs controls according to the type of authorisation granted, including fewer physical and document-based controls." The above reflects the goodwill of the EU legislator. However, it is still an abstract obligation, which should be linked to concrete favorable treatments. These favorable treatments are to be outlined in delegated acts by the Commission.



Paperless environments

The use of information and communication technologies is a key element in ensuring trade facilitation and customs controls. Therefore, the MCC included a framework to implement the legal principle that all customs and trade transactions are to be handled electronically. However, the self-imposed deadline of June 2013 appeared to be too ambitious. Therefore, the UCC allows the use of non-electronic data processing techniques on a transitional basis, however not beyond 31 December 2020. The transitional measures for centralized clearance would consist of maintaining the procedure currently known as the “single authorisation for simplified procedures” until the necessary electronic systems are operational.

Takeaways

The UCC has been drafted for longevity and to address part of the concerns of various stakeholders. However, it remains to be seen whether these concerns have actually been addressed since the Commission is still to specify certain non-essential elements and procedural rules in delegated acts and implementing acts. Companies are anxiously awaiting these acts, which can turn out very positive or very negative. In any case, the UCC has committed the Commission to introduce the above acts well in advance of 1 June 2016.

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Cloud computing and export control challenges and considerations, including regulatory developments in the US and Japan



A company's desire to streamline operations, modernize, share services and facilitate communications internally and externally fuels the movement toward internet-based cloud computing models. As cloud computing has taken off as an enterprise concept, many organizations are still unclear of the regulatory risks, particularly considering the often borderless nature of this internet-based computing.

In many jurisdictions, export controls restrict the export, re-export or transfer of controlled goods, software, technology or technical data and apply equally to the exports of items through physical channels (e.g., shipment, freight courier) and virtual means (e.g., transfer of data from one server to another or remote access).

Regulatory agencies in a growing number of jurisdictions have begun to clarify how export control laws, largely formulated and written for a physical world, apply to new technologies such as the emergence of cloud computing. In this article, we provide an overview of the key challenges and considerations for cloud users that are subject to export controls and discuss some regulatory developments in the US and Japan.

Cloud computing generally

In a business context, cloud computing allows corporate users and subscribers the opportunity to utilize a vast array of computing resources (e.g., processing power, security, storage and infrastructure) through cloud-based hardware and shared global networks with their own selected devices.

Cloud computing service providers generally offer subscribers three types of service models:

1. Infrastructure as a service (IaaS): raw computing power, storage and network bandwidth
2. Platform as a service (PaaS): databases, development tools and other components required to support the delivery of custom applications

3. Software as a service (SaaS): applications both general, such as word processing, email and spreadsheet, and specialized, such as customer relationship management and enterprise resource management

Cloud computing can also be configured and deployed with varied levels of shared resources with potentially more scalability and cost savings from increased sharing, such as:

- ▶ Community cloud – exclusive use by a specific community of consumers from organizations that have shared concerns
- ▶ Private cloud – single organization, internal or external management
- ▶ Hybrid cloud – combination of community cloud, private and/or other types of deployment models

Cloud computing: specific export control challenges and considerations

The major export control compliance obstacle many companies face with regard to cloud computing is really one of mind-set. The non-physicality of cloud communication and data access can be challenging to control if not configured properly up-front to specifically address export controls.

The hyper-speed, ease and stealth with which data may be transferred in a cloud world does pose risks for inadvertent transfer or export of technology that may subject a company – the user of such technology – to violations of export and/or other applicable laws. Companies considering cloud computing should consider the following topics as part of the upfront planning process.



Physical location and security

The practice of outsourcing infrastructure (e.g., storage space) for controlled data may especially put a company at risk for unlawful exports that can occur when the cloud user is unaware of the location of the cloud provider's physical server. Often, due to cost-saving benefits of outsourcing, cloud servers are located in a foreign country and may be moved without any notice to a consumer of cloud services. Hybrid or community cloud models have additional export control risks, where the user may not have the same degree of control over community members' access and use as it would on its own private systems.

Administration and support access controls

As cloud services increase in number and diversity, the level of interaction between the service provider and its customers may become more or less intertwined – leading to other concerns for a customer, including the servicing and access to its technology and information by the service provider's personnel – foreign or otherwise. Even private cloud models are not without export risks. A user must identify its technology and data in advance of its migration to any cloud model and understand any risks associated with the even inadvertent export of such technology or data once it is placed in the cloud.

Identification and tagging of controlled technology

The process to identify (i.e., classification) and mark (i.e., tagging) a company's controlled technology is a critical compliance measure for a company subject to export controls. This process allows for the application of internal controls (sometimes automated) to physical and virtual exports to prevent unauthorized transfers. Identification and tagging improves a company's ability to control where and how data is transferred to or stored within a cloud.

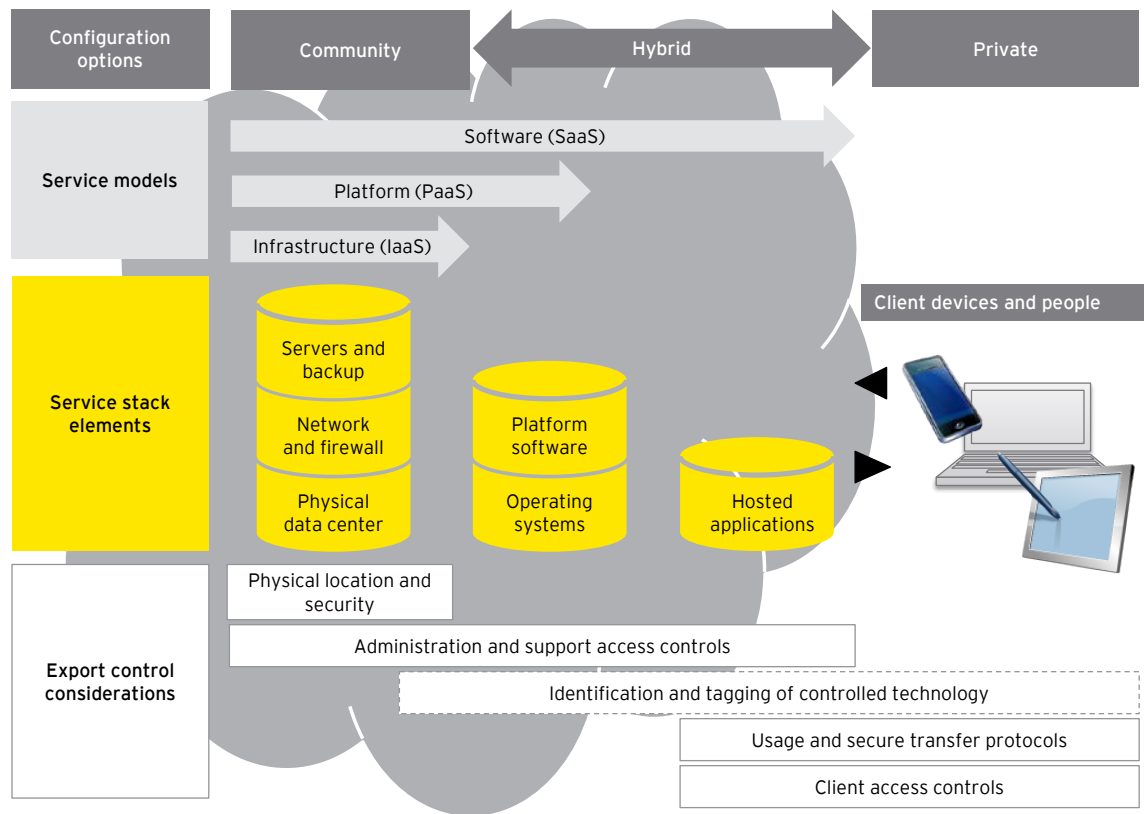
Usage and secure transfer protocols

Some companies with highly controlled technology opt to utilize a private cloud to store highly sensitive information, together with a community cloud for less restricted information. Cloud subscribers should clearly define internal controls around the storage, transfer and use of controlled data for cloud users. As an additional security measure, some companies have also opted to encrypt data transmitted to and stored within the cloud.

Client access controls

Cloud users must also master an understanding of how the cloud model they choose affects data and technology sharing with its own employees or users. Additionally, companies should weigh up-front cost benefits or savings against long-term compliance risks where a cloud model is either unstable or inflexible. For example, a public versus hybrid or community cloud model may require a number of additional access controls depending on the type of data or technology at issue and the type of access desired by the user. These models require the implementation of access controls for the user's own employees and controls for any parties (non-service providers) with access to such hybrid or community models.

Coupled with a failure to identify and then tag and/or properly manage the data and technology within the cloud infrastructure, unplanned access models create exponential opportunities for export compliance missteps. Simple changes to the user's employee identities, physical locations or access requirements may affect data or technology that can be shared in a cloud model. Cloud users should consider routine resource or structural changes (e.g., global movement of employees, merger or acquisition, joint venture) in the planning for any cloud computing structure. Cloud users should additionally consider the ability to audit such processes and measure the flexibility of the cloud model and underlying contract where future changes to the identity and character of its employee resources, data or technology may have an impact on the security or compliance integrity of the entire system.



US regulatory activity related to cloud computing

The three main concerns cloud computing users must be aware of are:

1. Transfers of data from the US to a prohibited foreign destination
2. Re-transfers of US-controlled data from an approved foreign location to a prohibited foreign location
3. Transfers of data in the US to prohibited parties in the US (i.e., deemed exports)

In the virtual context, transfers can occur through movement of data from one server to another or through remote access. In some cases, the mere ability of restricted persons to transfer or access information (in the US or abroad) and not the actual transfer or access of information can be viewed by the government as a transfer and therefore a violation.

Thus far, guidance from US agencies administering export controls has been rather limited in the area of cloud computing. We highlight below some key issues that have been touched on by various agencies, although more clarity is needed.

Responsibility for export controls

A key issue for businesses is an understanding of each party's responsibilities (i.e., the cloud user/subscriber and the cloud service provider) for export controls. The Bureau of Industry and Security (BIS) is the only agency to have formally commented in this area. In a 2009 Advisory Opinion letter confidentially requested by cloud computing service provider(s), BIS opined that, among other things, while the cloud service provider is generally not an exporter of such technology for purposes of the Export Administration Regulations (EAR), the cloud subscriber would be subject to US export control requirements – very much in the same way such users would be responsible for the transit of their own data when, for example, utilizing a third-party logistics carrier in the “physical” world.¹

¹“Application of EAR to Grid and Cloud Computing Services,” Bureau of Industry and Security, 13 January 2009.



In a 2011 Advisory Opinion, BIS had been asked whether cloud service providers would be responsible for obtaining deemed export licenses for foreign national IT personnel “who service and maintain their cloud computing systems.”² Somewhat counterintuitive to our general notions regarding deemed exports, the opinion seemed to state that where the service provider was not an “exporter” for purposes of the EAR (and instead, the user was the shipper or transferor of data or technology), no deemed export license would be required by the service provider. However, BIS seemed to state that the user would in fact be responsible for obtaining such licensing, further adding to the complexity of utilizing a cloud-based solution where a company regularly transmits or stores data subject to US export regulations.

We note that guidance from BIS cannot be used as an indication of the actions of the other regulatory agencies with jurisdiction over exports and transactions with non-US persons.

Additionally, we note that with respect to the International Traffic in Arms Regulations (ITAR), which controls the export and import of defense-related articles and services on the US Munitions List, the Defense Trade Advisory Group (DTAG) recently addressed the issue of clarity in its Cloud Computing Plenary Session. The DTAG has proposed some ideas to foster uniformity and unambiguous understanding of ITAR regarding the roles and responsibilities of cloud users and service providers and a uniform set of standards and licenses that would better inform parties of their risks. For more information on the Plenary Session, see www.pmdtdc.state.gov/DTAG/.

Encryption use

Another issue is the impact, if any, of the use of encryption to prevent inadvertent transfers of controlled data. In the May 2013 Plenary Session, the DTAG pushed for cloud-specific regulatory changes that included a proposal to eliminate encrypted data from the definition of an ITAR export, based on the proposition that encrypted data appears only as cipher text to both human and computer readers. The DTAG offered the argument that where data is transferred without a cipher key, even those who possess such data would not be able to read or compute the data contained in encrypted format, thus eliminating risk of even inadvertent transmission where there was no access to the decryption materials. For now, persons subject to US regulations should continue to assume that the Directorate of Defense Trade Controls will strictly enforce the ITAR with regard to activities conducted in the cloud until the ITAR is amended.

OFAC has not addressed cloud computing

Another US regulatory agency involved in export controls is the Office of Foreign Assets Control (OFAC), which administers and enforces economic and trade sanctions against targeted foreign countries and specially designated nationals. OFAC regulations concern the restriction or prohibition of services, items and benefits to the restricted parties or countries.

²“Cloud Computing and Deemed Exports,” Bureau of Industry and Security, 11 January 2011.



OFAC has not directly addressed how the sanctions it administers affect cloud computing. Thus, both users and service providers should ensure that their cloud models prevent the receipt of cloud services, data or technology in the cloud (or benefits from cloud services financially or otherwise therefrom) to any restricted party or to restricted destinations.

Japan regulatory activity related to cloud computing

In response to increasing demand from industry, the Ministry of Economy, Trade and Industry (METI) published new guidance, effective 1 September 2013, which clarifies the application of Japanese export control regulations to cloud computing.

Under Japanese export control regulations, an export license is required where:

- ▶ A Japanese resident or nonresident seeks to conduct a transaction with the aim of providing certain controlled technology in certain foreign countries.
- Or
- ▶ A Japanese resident seeks to conduct a transaction with the aim of providing certain controlled technology to nonresidents of certain foreign countries.

Previously, formal guidance was not available on the application of this provision to cloud computing services, resulting in uncertainty regarding the level of controls required by providers and users of this relatively new technology/service.

IaaS

With regard to IaaS models, there was previously uncertainty as to whether a Japanese resident's mere upload of data to a server in a foreign country or a server accessible by nonresidents of certain foreign countries, wherever located, would carry the requisite "aim" (i.e., intent or knowledge) to provide technology to prohibited persons or countries, in that the Japanese resident could be held responsible without such "knowledge" or "intent." In its clarification, the METI infers that such "aim" exists where the Japanese resident user knows (or later discovers and does not take action within a reasonable time to correct) that the service provider (or any other nonresident third party) is able to view, obtain or use the technology. In such cases, a license would be required for the upload. However, where only the Japanese resident user can view, obtain or use the technology, a license is not required.

SaaS

With regard to SaaS, there was previously uncertainty in a service provider's responsibilities in making certain software available for use only where the underlying software or technology would not be made available for download.

The new guidance clarified that an export license is required to make controlled software available through SaaS. When determining the export classification of SaaS, it is only necessary to consider the technology of the application software itself and not the operating system, middleware, load balancer, etc. that is used to deliver the application. Additionally, if the program qualifies for the license exemption for programs available for retail sale, then an export license will not be required.



Next steps for navigation and planning for the cloud

While we expect more clarity and guidance from the various jurisdictions on the application of export controls for cloud computing, cloud users have the ultimate compliance responsibility for their controlled technology. While the service providers are not necessarily without risk, the users, particularly in global organizations, must determine how to capitalize on the benefits of cloud computing while complying with global export control requirements.

The transnational, fluid character of each of the cloud computing models may peacefully coexist with compliance requirements for the management of a company's controlled technology. However, a company will want to address planning for its export compliance obligations at the earliest outset of its larger IT infrastructure enhancements in order to ensure a smooth transition to the cloud.

Advance planning and the ability of a company to identify risks, classify technology subject to the regulations and properly manage its technology based on the risk profile derived from the identification and classification steps will result in managed compliance risk and the potential for cost savings where planning will prevent "emergency" action – that is, corrective action based on necessity or the possibility of a violation, which can be costly, time dependent, and detrimental to a company's reputation and ultimate business goals (including having the potential to slow or stop entirely the flow of technology or physical goods and services).

Consider the following questions:

- ▶ Have you examined your data and technology to identify controlled items and classified the items subject to controls?
- ▶ Does your current export controls program address the transition to a cloud computing model now or in the future?
- ▶ Do you know where your controlled data is stored, what IT models are presently being used, where servers are located and what support models/persons are used?
- ▶ Do you have a written global trade compliance program and a technology control plan covering physical and IT security and technology/data management protocols?
- ▶ Are you especially at risk because of a recent or upcoming transition (e.g., IT transition, merger or acquisition, joint venture or partnership, change in product or service line, international expansion)?

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Free trade agreement developments

Canada-European Union: the Comprehensive Economic and Trade Agreement Agenda



The apparent successful conclusion of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) was announced on 18 October 2013. This long-term effort (since 2008) toward trade liberalization with Europe will create a number of new trade and supply chain opportunities for importers and exporters of goods (as well as for labor mobility and market access for professional services) and will protect investors and facilitate international trade in services. With CETA and the North American Free Trade Agreement (NAFTA), Canada will be one of the few developed countries to have preferential access to the world's two largest economies.

It will take a few years for CETA to come into force, as the Canadian Provinces and every EU Member State will have to ratify the agreement. However, staged reductions in tariffs and other provisional liberalization measures may come into force earlier when Canada and the EU conduct the annual revision of their respective customs tariffs.

The finalization of CETA has yet to come as the legal text is yet to be drafted. Nevertheless, the parties have started to announce the framework of the changes expected to occur once the agreement is ratified and entered into force. Based on the limited official announcements to date and the "Opening New Markets in Europe" action plan (a 52-page document just recently released on the Canadian Department of Foreign Affairs, Trade and Development website (www.international.gc.ca) and the most detailed information yet available), the expected benefits to trade are:

- ▶ **Tariff and non-tariff barriers elimination and quota adjustments** – Almost all (98%) of EU and Canadian tariff lines will become duty-free the day CETA comes into force, with the remainder staged in. Additionally, a significant number of non-tariff barriers (e.g., burdens of regulatory certifications and technical standards that often exceed tariff rates in terms of their impact) will be eliminated by reciprocal harmonization; for example, import quota volumes on European cheese and on Canadian pork and beef products will see a significant increase in market access levels.

- ▶ **Rules of origin** – To determine whether goods qualify as originating in Canada or the EU, rules of origin will come into force alongside any preferential tariff measures. In determining what regional value content must originate in Canada, it is expected that the rules will not stifle Canada's trade and supply chain relationships with the US. The CETA regional value content requirement for automobiles will accommodate existing cross-border manufacturing supply chains.
- ▶ **Notable sectors** – Benefiting sectors of the economy include the industrial sector, the agricultural sector, the pharmaceutical and life sciences sector, and the automotive sector. Industrial sector advantages will particularly benefit Canada's oil and gas and mining sectors. For example, Canada is a leading nation in mineral exploration and mining. Exports of metals and mineral products are worth over CA\$20 million annually to the EU. Tariffs on metals, minerals and mining technology equipment will be virtually eliminated on CETA coming into force (or even earlier). However, the shipbuilding sector, where the 25% rates on imported commercial vessels are among the highest for Canada's non-preferential tariff rates, will not likely be impacted in the near future.
- ▶ **Procurement** – Subnational to the provincial- or state- and municipal-level procurement, rights will be granted for nationals of the EU or Canada. This is a significant difference from NAFTA. Canada's contracting firms will have preferential access to the EU government procurement market (worth CA\$2.7 trillion annually).
- ▶ **Temporary entry for business and high-skills workers** – Canadian professionals and businesses will have access to simplified temporary entry of professional

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European Union and Central America Association Agreement enters into force



The trade pillar of the Association Agreement between the EU and Central America (i.e., Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica and Panama) signed in June 2012 (the Agreement) is now in force for El Salvador, Costa Rica and Guatemala.

The Agreement comprises three interdependent and fundamental pillars: political dialogue, cooperation and trade.

The Agreement's trade pillar establishes a free trade area among both regions. The key benefits of the Agreement include:

- ▶ Reduction or elimination of customs tariffs and non-tariff barriers to trade
- ▶ Facilitation of trade in goods
- ▶ Liberalization of trade in services
- ▶ Promotion of economic regional integration regarding customs procedures
- ▶ Effective, reciprocal and gradual opening of government procurement markets
- ▶ Adequate and effective protection of intellectual property rights
- ▶ Promotion of free and undistorted competition
- ▶ Establishment of an effective, fair and predictable dispute settlement mechanism
- ▶ Promotion of international trade and investment between the parties

While the Agreement was ratified by the Salvadoran and the Costa Rican Congresses in July 2013, the entry into force of the trade pillar for these two countries was delayed due to a dispute with Italy, which has been resolved.

As a result, the trade pillar of the Agreement is now in force for the whole region (Honduras, Nicaragua and Panama since 1 August 2013; Costa Rica and El Salvador since 1 October 2013; and Guatemala since 1 December 2013).

The political dialogue and cooperation pillars will enter into force when national parliaments of all 28 member states of the EU ratify the Agreement.

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Trans-Pacific Partnership: an update

The Trans-Pacific Partnership (TPP), which has been more than three years in the making, now boasts 12 members that account for one-third of world trade. The comprehensive free trade agreement currently involves Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam with expectations that more will join in the future.

The TPP, touted as a 21st-century comprehensive and high-standard Free Trade Agreement (FTA), includes 29 chapters that cover trade in goods, services, labor standards, investment, competition policy, environment, intellectual property and state-owned enterprises, among other areas. The TPP aims to liberalize trade in nearly all goods and services and includes commitments beyond those currently established under the World Trade Organization.

Similar to most FTAs, the rules of origin will likely be product-specific and may be based on a particular rule or a combination of rules (e.g., wholly obtained, change in tariff classification, value added and process-specific rules).

The TPP will add to the mix of FTAs that already exist between some partner countries. For instance, with the TPP, New Zealand and Singapore will have four FTAs in common (i.e., the bilateral FTA, the “Pacific 4” Partnership Agreement and the ASEAN-Australia-New Zealand FTA). Accordingly, the exporter will need to make an informed decision as to which FTA is most beneficial, as the rules of origin, tariff concessions and procedural requirements for the product may differ among the respective FTAs.

A major advantage of the TPP is the sheer size of the grouping, which provides an expansive area for regional sourcing as the FTA allows raw materials and inputs to be treated as “local” materials to help the manufacturer meet the rules of origin for the product.

Overall, the TPP is expected to make a significant impact on trade among the partner countries, and expectations are that membership will grow, particularly with countries that are members of the Asia-Pacific Economic Cooperation (APEC)³ and the Association of Southeast Asian Nations (ASEAN).⁴

Given the US presence in the TPP, the likelihood of ASEAN joining as a bloc is of interest to many traders in the region. Singapore is the only ASEAN member that currently has an FTA with the US. Accordingly, the TPP is particularly advantageous for the additional ASEAN members participating in the TPP (Brunei, Malaysia and Vietnam), which gain preferential access to the US market. As a bloc, however, there are no signs that ASEAN will join the TPP at this time, given the uneven levels of economic development and diverse legal and political systems of the individual member countries. Additionally, with the high standards of the TPP, ASEAN is unlikely to accept the progressive commitments in areas such as the environment, intellectual property and labor in the near future.

At the same time, under the US-ASEAN Expanded Economic Engagement (E3), the countries are working together to identify specific cooperative activities to facilitate US-ASEAN trade and investment and increase efficiency and competitiveness of trade flows and supply chains throughout ASEAN. In doing so, cooperation on E3 activities will help lay out the groundwork for additional ASEAN countries to join high-standard trade agreements, such as the TPP.

³ APEC membership includes Australia, Brunei, Canada, Chile, China, Hong Kong (China), Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Chinese Taipei, Thailand, the United States and Vietnam.

⁴ ASEAN membership includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.



China and India are also interesting prospects to join the TPP due to the size of their markets; however, there are no formal indications that these countries are actively considering membership at this time.

For now, traders planning to take advantage of the TPP are anxiously awaiting details on the agreement, which have been closely guarded by negotiators. Watch for more developments on the TPP in future issues of *TradeWatch*.

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Gulf Cooperation Council and Singapore free trade agreement enters into force



A free trade agreement referred to as the GSFTA entered into force 1 September 2013 between the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Saudi Arabia and the United Arab Emirates) and Singapore. The GSFTA is a comprehensive agreement that covers trade in goods and services, government procurement and other areas of cooperation. Major industry sectors that are expected to benefit include telecommunications, electrical and electronic equipment, petrochemicals, jewelry, machinery, and iron- and steel-related industries.

Important aspects of the GSFTA

- ▶ Initially, 95% of tariffs for Singapore exports to the GCC are eliminated; an additional 2.7% of tariff lines gain duty-free status by 2018.
- ▶ Foreign equity limits are relaxed for Singapore businesses operating in the GCC.
- ▶ Specific reliefs are provided for Singapore financial service institutions operating in Qatar and Bahrain.
- ▶ Singapore will grant zero tariff treatment to all imports from the GCC.
- ▶ To benefit from preferential tariff treatment under GSFTA, the product must meet the agreement's rule of origin, and an authorized certificate of origin from the relevant authority is required for values from US\$1,000; direct shipment requirements also apply.

Singapore is the first country outside the Middle East to enter into a trade agreement with the GCC. Accordingly, Singapore exporters will gain a significant competitive cost advantage over other foreign exporters from the preferential tariff preferences. On the other hand, the GSFTA will offer limited new tariff benefits for GCC exporters to Singapore, as the majority of these products already enjoy zero-duty rates under Singapore's most favored nation (MFN) tariffs.

Singapore businesses doing business in the GCC will also benefit as GCC foreign equity limits will be relaxed. However, the relaxation of the GCC equity requirements may need further legislative changes in the respective GCC states. Therefore, these benefits may not be immediately available to Singapore investors.

In addition, the procedural requirements for claiming preferential tariff treatment are still not finalized, and Singapore exporters should seek prior advice before seeking to claim preferential tariff treatment under the agreement.

Rules of origin

Rules of origin determine the nationality of a product for customs purposes. In the GSFTA, the rules ensure that only products that are sufficiently worked or produced in Singapore or the GCC qualify for the tariff concession in the agreement. Under the GSFTA, a product can qualify for preferential treatment if at least 35% of the ex-works price (value-added percentage) can be attributed to manufacturing and other operations in the originating country. However, we note that there are 10 products where the origin criteria are based on a change in tariff classification.

To determine the value-added percentage, the following formula applies, which takes into consideration the ex-works price and the non-originating materials (NOM):

$$\frac{\text{Ex-works price} - \text{NOM}}{\text{Ex-works price}} \times 100\% \geq 35\%$$

The ex-works price is the price paid for the product ex-works to the manufacturer in the GCC or Singapore. Related expenses after the production of the goods, including transportation, insurance and local taxes, are excluded.

Originating materials from the GCC used in the production of a good in Singapore are considered to originate in Singapore and vice versa when determining origin. This accumulation rule should aid in the development of increased trade between the GCC and Singapore.

The GSFTA also sets out seven insufficient operations that shall not be considered as sufficient production to confer origin to the product. They include operations to preserve goods; simple operations such as the removal of dust, changes in packing, the breaking up and assembly of consignments, placement of product in bottles, simple cutting, placement of marks or labels on goods or their packaging, the slaughter of animals; and any combination of the above.



In general, to benefit from the preferential tariff treatment under the GSFTA, there must be direct shipment of product from the GCC to Singapore and vice versa although transshipment through third countries may be allowed provided certain conditions are met.

Customs procedures

The agreement provides for certain customs procedures to aid the free movement of goods between the GCC and Singapore, including:

- ▶ Advance rulings on the eligibility of originating goods for preferential treatment and tariff classification
- ▶ Waiver of the certificate of origin requirement for low-value originating goods
- ▶ Risk management approach to focus on high-risk goods and to facilitate the clearance of low-risk consignments

Trade in services

The GSFTA will provide Singapore service providers with enhanced market opportunities into the GCC. Some GCC countries will relax the foreign equity limits in certain key sectors of interest to Singapore, including construction services, distribution services and hospital services, while other GCC countries will relax the foreign equity limit across the board for all sectors between 70% and 100%.

Government procurement

The GCC and Singapore have committed to maintaining an open and transparent system of procurement to give competitive opportunities to the suppliers of both sides to penetrate each other's markets. Singapore suppliers are also given the same price preference of 10% that is given to a GCC domestic supplier for the use of any goods or services that are produced in a GCC state for the procurement of goods and services.

Conclusion

With increased trade between Singapore and the GCC, the GSFTA presents opportunities for businesses to significantly reduce costs in their supply chains. However, the term "free trade" should more accurately be termed "conditional trade" because in order to obtain the preferential treatment, businesses must comply with the specific rules of origin to determine whether a product actually qualifies. The GSFTA rules are complex, and full compliance with the terms is essential to obtain the benefits under the agreement and to avoid the risk of incorrectly claiming benefits.

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Brazil

Inovar-Maquina regime: tax incentives for capital goods



The Brazilian Government is considering a new tax regime for the capital goods (e.g., machinery and equipment) sector called Inovar-Maquina, a Portuguese expression for machinery innovation. Expectations are that the new regime, which generally aims to develop the domestic industry through innovation and protect against harmful imports, could be approved by the end of the year 2013.

Inovar-Maquina is based on the Inovar-Auto regime, which was released last year. The regime would impose import quotas and implement a strict traceability system to prove that local content requirements are met. Non-originating capital goods imported in excess of the quota limitations would be subject to federal value-added tax (VAT) (Imposto sobre Produtos Industrializados or IPI) by up to 30 percentage points more than that applied to Brazil-originating capital goods.

The project is supported by the Brazilian Association of Machinery and Equipment (Associação Brasileira da Indústria de Máquinas e Equipamentos or Abimaq) and the National Association of Vehicle Manufacturers (Associação Nacional dos Fabricantes de Veículos Automotores or Anfavea). Additionally, the project has received the endorsement of the Brazilian Development Bank (BNDES).

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

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Inovar-Peças regime: tax incentives for automotive parts and components



The Brazilian Government is preparing to announce the Inovar-Peças regime, which is a package of tax incentives aimed at developing the local industry of components and parts for the automotive sector. The regime aims to complement the Inovar-Auto regime, which established tax incentives based on quota limitations and local content requirements for automakers. In practice, however, Inovar-Auto did not effectively influence the supply chain to promote more local production of automotive parts and components. Inovar-Peças thus aims to better address the issues confronting automotive parts and component suppliers with respect to foreign competition.

The details of Inovar-Peças are being discussed by the Brazilian Government along with the National Trade Union of the Industry of Components for Automotive Vehicles (Sindipeças) and Anfavea. Under consideration are the following:

- ▶ The reduction of IPI by up to 30 percentage points for companies that meet certain production requirements in Brazil and use parts manufactured in MERCOSUR countries
- ▶ The creation of a traceability system for components to assess the origin of the finished product
- ▶ The financing of the modernization of the sector and the support of engineering products through BNDES and the Brazilian Innovation Agency (Financiadora de Estudos e Projectos or FINEP)
- ▶ The implementation of local production arrangements for auto parts and components in some Brazilian states (such as São Paulo, Rio Grande do Sul, Paraná, Minas Gerais, Rio de Janeiro, Santa Catarina and Goiás), which will constitute centers of research supported by domestic automakers in the region
- ▶ The participation of the National Institute of Metrology, Quality and Technology (INMETRO) in developing the covered parts and components

The system for the traceability of parts, which links Inovar-Peças and Inovar-Auto, is a complex issue for both the regimes. The burden falls primarily on the original equipment manufacturers, which will be responsible for compliance with the traceability system. The Brazilian Agency for Industrial Development (Agência Brasileira de Desenvolvimento Industrial or ABDI) will likely manage the system and regulate the information provided by automakers.

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

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Reduction of the PIS/COFINS import tax basis



The tax basis for determining the amount of PIS/COFINS (i.e., social contributions) that is levied on imported goods has been reduced. Pursuant to Law no. 12,865/2013 (published in the *Diário Oficial da União* on 10 October 2013), ICMS (i.e., state VAT), PIS and COFINS are excluded from the tax basis in the so-called grossed-up method. Accordingly, the customs value is now the basis for assessing PIS/COFINS on imported goods, as reflected in Article 7 of Law no. 10,865 (amended by Article 26 of Law no. 12,865).

This significant change is the result of a recent Supreme Court ruling that found the tax basis for PIS/COFINS, which involved the gross-up calculation of customs value, ICMS, PIS and COFINS, to be unconstitutional.

For importers that operate under the non-cumulative regime for PIS and COFINS, the reduction in the import tax basis provides some cash flow relief. Under the non-cumulative regime, the taxpayer is entitled to tax credits to offset PIS/COFINS debt. However, any right of recovery for past import transactions would depend on the effective reversal of the portion of credits recorded in the past. In practice, this determination presents administrative and bureaucratic obstacles.

For importers that operate under the cumulative regime (i.e., not entitled to credits for contributions paid on imports), the reduction of the PIS/COFINS import tax basis means direct savings through a reduction in import costs. At the same time, there may be an opportunity for such importers to seek refunds for overpaid taxes over the last five years (i.e., the statute of limitations). Any refund request would require that the importer rectify the past import declarations individually (i.e., paper-based). Depending on the potential refund amount, the administrative exercise may be worthwhile.

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Canada

Canada seeks to capitalize on its foreign trade zone advantage



In the 2013 federal budget, Canada reconfirmed its commitment to the ongoing reform of foreign trade zone (FTZ)-like policies, originally announced in 2011. The Minister of State (for Finance), Kevin Sorenson, recently announced important new measures aimed at benefiting importers and attracting foreign direct investment:⁴

- ▶ Elimination of the annual registration fee for the Customs Bonded Warehouse Program (a scaled fee of up to CA\$5,000 per year)
- ▶ Simplification of the application process to access Canada's FTZ-like programs
- ▶ Introduction of service standards for application processing times
- ▶ Acceptance of requests for new FTZ Point single windows to enhance delivery of FTZ-like programs at strategic locations in Canada
- ▶ Launch of a five-year, CA\$5 million program to market Canada's FTZ advantage

Canada does not have a site-specific FTZ program as such, like those found south of the border. There are, however, general relief programs administered by the Canada Border Services Agency (CBSA), with Canada Revenue Agency (CRA) collaboration, that provide

benefits comparable to those found in FTZs elsewhere in the world (see Figure 1). Importers/manufacturers may benefit from these programs regardless of the geographic location of their site within Canada.

While Canada's programs may offer more flexibility, they sometimes suffer from a lack of recognition of the programs or from difficulty in accessing them in one place. Built on the success of the CentrePort Canada pilot program near Winnipeg, Manitoba,⁵ the new FTZ Point program is intended as a remedy to perceived access and recognition issues. Through the legal incorporation of strategically located public-private partnerships, the FTZ Point program aims to provide operators with administrative and financial support in exploiting the existing relief programs, as well as labor and infrastructure programs at all levels of government.

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Figure 1

Relief programs	Customs bonded warehouse (CBSA)	Duty deferral (CBSA)	Duty drawback (CBSA)
Duty relief	Yes	Yes	Yes
GST/HST relief	Yes	Conditional (CRA approval required)	No
Relief for storage and export distribution operations	Yes	Yes	Yes
Relief for export processing and production operations	Limited	Yes	Yes

⁴ See "Harper Government's Improvements to Foreign Trade Zones Helping Canadian Businesses Compete Globally" at <http://news.gc.ca>.

⁵ See The CentrePort Canada Act (C.C.S.M. c. C44), for the apparent template legislation. Also see "Backgrounder: Canada's Foreign Trade Zone Programming" at <http://www.fin.gc.ca> for more information on what can be expected from future FTZ Points, as well as current relief programs.

Mexico

Mexican tax reform to have significant impact on foreign trade operations



On 31 October 2013, the Mexican Congress approved important amendments to the Mexican customs, VAT and excise tax laws, which will have a significant impact on customs and foreign trade operations. While most of the amendments will enter into force on 1 January 2014, some will be deferred until additional regulations are issued.

We are including below an explanation of the most relevant changes and the potential impact that companies may face under the new legislation.

VAT and excise tax to be paid on temporary imports (i.e., IMMEX program) and other customs regimes

Under article 25, section I of the VAT Law, temporary importations of goods and fixed assets were not subject to the payment of VAT. This exemption benefited temporary and in-bond import regimes for manufacture, transformation or repair, such as the IMMEX⁶ (previously known as maquila) program, bonded warehouse for transformation (such as the one for the automotive industry) and strategic bonded warehouse.

In accordance with the amendments to the VAT Law, an import VAT at the general 16% rate will have to be paid on temporary or in-bond importations. While the VAT paid upon importation may be recovered through a credit or refund when the finished products incorporating the imported goods are exported or transferred via virtual operations, the recovery process may take significant time and effort.

Additionally, the provision exempting temporary or in-bond importations of goods from the excise tax was also eliminated. As such, temporary or in-bond importations of goods subject to payment of the excise tax will be subject to the corresponding excise tax when imported under an IMMEX program or destined to a bonded warehouse for transformation or a strategic bonded warehouse. Affected goods include beverages with alcohol content, beer, cigarettes, gasoline and diesel (and with the recent amendments to the Excise Tax Law junk food with caloric density of 275 kilocalories or more per 100 grams, such as snacks, confectionery products, chocolate and other cocoa-based products, among others).

Relief through certification

The amendments do provide an opportunity for relief through a certification program conducted by the Tax Administration Service. Under this program, importers that demonstrate compliance with requirements related to adequate controls of their temporary or in-bond importations can apply a tax credit against the VAT and any applicable excise tax that has to be paid for the temporary or in-bond importation of goods. This certification remains valid for one year with renewals required 30 days prior to its expiration date. The formal requirements for the certification process have not yet been clarified by the Mexican authorities.

Another option for importers who choose not to obtain the certification is to file a bond, issued by an authorized institution, before the customs authorities guaranteeing the VAT and any applicable excise tax payments for those goods that are not exported or returned abroad after their temporary importation period expires.

⁶ The Decree to Promote Manufacturing, Maquila and Export Services Companies.



It is important to note that the obligation to pay the VAT and excise tax upon the temporary or in-bond importation of goods will become effective one year after the Tax Administration Service issues the regulations governing the certification process and the mechanism through which the tax credit will be applied.

The amendments to the VAT and excise tax laws provide important new considerations for affected companies that will face the new obligation to pay the VAT and excise tax (or cover this obligation through guarantees), or endure the certification process with the Tax Administration Service. Additionally, companies need to consider the increasing potential for audit in this area.

Maquila use may decrease

Adding to these considerations for companies that operate under a “maquila” structure, significant amendments were also enacted that eliminate certain tax benefits that were available for companies that qualified as maquila operations for income tax purposes. Further, the amendments provide for more stringent requirements to qualify as a maquila operation (e.g., all income from productive activities should originate exclusively from the company’s maquila operation).

For some companies, given the amendments to the VAT and excise tax laws and the amendments that increase the complexity of operating under a maquila structure, it may no longer be feasible to remain in these programs. Instead, affected companies, particularly those that currently use the IMMEX program and other temporary import regimes only for customs purposes, should explore other options, such as taking full advantage of preferential duty rates under special programs, such as the sectoral promotion programs (PROSEC), as well as the vast network of free trade agreements implemented by Mexico.

The use of a customs broker to file import and export operations is no longer mandatory

In order to file import and export operations in Mexico, companies were required to engage a customs broker who was responsible for the preparation of documentation, validation of information, and filing of import and export entries, or “pedimentos.” The customs broker was jointly liable with the importer for certain omitted duties and taxes due from the import of goods. The General Customs Administration could also authorize an individual employed by a company to act as an in-house broker responsible for filing import and export pedimentos.

Under the amendments to article 40 of the Mexican Customs Law, the customs clearance filings may be performed by the importers or exporters on their own behalf, and it is no longer mandatory to engage the services of a customs broker to perform such filings. The amendment does not eliminate the customs broker’s role from the customs clearance process because it continues to allow importers to perform the customs clearance filings through a customs broker acting as their representative.

As such, while importers and exporters may opt to continue using a customs broker to perform the customs clearance filings, they may also choose to perform such procedures on their own behalf by designating their legal representative as the company’s customs representative who will be responsible for preparing and filing import and export pedimentos.



Only Mexican nationals can be designated as “customs representatives” as long as they meet certain requirements, such as proving that they are up to date with all tax obligations; show that they have a working relationship with the importer or exporter; and demonstrate knowledge and expertise regarding foreign trade issues. Also, note that the “customs representative” will be jointly liable with the importer or exporter for the payment of duties and other taxes due upon the importation or exportation of goods.

The Mexican tax authorities will establish the mechanisms to be used by importers and exporters performing the customs clearance procedures on their own behalf through additional regulations no later than one year after the amendments are published. Until such regulations are issued, imports and exports will still have to be filed through the customs broker.

This amendment may be seen as a positive development since it will allow companies to set up their own procedures related to tariff classification, customs valuation and other topics that were usually handled by the customs broker, thus giving more control to companies regarding the customs and trade function.

While additional processes may have to be established to ensure that compliance with local requirements and regulations is still met, companies should assess whether they could benefit from performing the import and export customs clearance of goods through their own “customs representative.”

Other significant amendments

- ▶ The establishment of a strategic bonded warehouse (similar regime to a US foreign trade zone) anywhere in the country is now allowed. Under the previous legislation, the strategic bonded warehouse was limited to facilities adjoining a customs office. Nevertheless, the VAT and excise tax will apply on imports destined to the strategic bonded warehouse regime, which may greatly reduce the benefits of operating under such regime.
- ▶ The former “single window” platform will be merged into a new electronic customs system through which all filings required for the customs clearance process will be performed electronically and through digital documentation, including the supporting documentation accompanying pedimentos (e.g., commercial invoice, bill of lading, certificates of origin). As part of the new electronic customs system, importers will have to transmit an electronic declaration with information on the value of imported goods. A new fine of US\$1,500 and up to US\$2,500 may be imposed on importers declaring inexact or false data in the electronic value declaration.
- ▶ The Mexican Customs Law limited the ability to amend pedimentos for post-entry adjustments. For example, when adjusting the value, an importer could only correct the information on pedimentos up to two times when no tax payment was generated with the adjustments. In addition, some fields in the pedimentos, such as the country of origin or the description of the goods, could not be modified. The amended Customs Law will allow changes to be made regarding the information contained in the pedimento at any time and as many times as needed. Exceptions will be determined via a prior authorization issued by the Tax Administration Service. However, the cases in which this authorization will be required are still to be determined.
- ▶ The regularization procedure allows importers to create the corresponding import documentation paying the applicable duties and VAT. While the current Customs Law did not allow expired temporary imports to be brought into compliance through this “regularization” procedure, an alternative mechanism that applied to expired temporary imports through “virtual” documentation was available under Mexico’s General Foreign Trade Rules. The amended Customs Law now expressly allows importers to apply the “regularization” on expired temporary imports. This change will help importers by limiting their exposure to the payment of omitted duties, if any, and VAT.



- ▶ The VAT Law includes an exemption through which sales conducted between non-Mexican residents or between non-Mexican residents and Mexican residents of temporarily imported goods (e.g., those imported under the IMMEX Program) were not subject to the applicable sales VAT. Under the amendments to the VAT Law, the exemption for sales performed between non-Mexican residents and Mexican residents of imported goods under IMMEX and other customs regimes is eliminated. Accordingly, such sale will be subject to the general 16% VAT rate, which may have a significant cash-flow impact on the Mexican resident as it will be the party obliged to withhold and remit the payment to the tax authorities. On the positive side, the VAT exemption on sales performed between non-Mexican residents of temporarily imported goods was not eliminated.
- ▶ The special VAT rate that had applied to importations and sales in Mexico's border region of 11% is eliminated and the 16% VAT rate will be in force as of 1 January 2014 across the country.

While the amendments to the Customs Law may provide a more efficient process giving companies more control over the customs and trade function, the payment of VAT and excise tax on temporary and in-bond imports may significantly impact companies' cash flow. Importers need to analyze the potential implications on their individual operations and determine the best course of action to reduce any negative impact.

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Australia

Recent case law highlights requirements for tariff concession orders



A number of recent Administrative Appeals Tribunal (AAT) cases highlight the importance of properly preparing and using tariff concession orders (TCOs) in accordance with the legislative requirements under the Customs Act 1901 (Customs Act).

Broadly, a TCO is a tariff-based concession that reduces the rate of customs duty to zero for imported goods where there is no Australian producer or manufacturer of substitutable goods. TCOs are product-specific and provide a public concession meaning that, once approved, they can be used by any importer whose goods fall within the terms of that TCO.

Importantly, on the date that the TCO application is made, the applicant must:

- ▶ Have reasonable grounds to have established a belief that there are no Australian producers or manufacturers of substitutable goods
- ▶ Include a full description of the goods and a statement of the tariff classification that applies to the goods

Belief that there are no Australian producers or manufacturers of substitutable goods

Vestas - Australian Wind Technology Pty Limited [2013] AATA 721 (Vestas) involved wind turbine gearboxes and addressed the extent of inquiry necessary to support a belief that no Australian producers or manufacturers of substitutable goods exist. The Chief Executive Officer of Customs (CEO) argued that the applicant had not sufficiently inquired as to whether locally produced substitutable goods existed at the time of the application. The CEO stated that local producers of substitutable goods existed at the time of application and referred to the contents of a website of a potential local manufacturer. We note that this potential producer had been contacted by the applicant, but the applicant's inquiry had not been replied to. Additionally, the CEO argued that the applicant did not use the term "manufacture" in its search terms, despite the directions of an Australian Customs Notice (ACN) 2010/03.

The AAT held that the ACN was not a binding document and the existence of a website of a potential local producer was insufficient proof to discredit the applicant's belief; rather, the CEO had to actually prove that the goods were in fact substitutable. The AAT concluded that the applicant had made the necessary inquiries to establish reasonable grounds for belief there were no Australian producers or manufacturers of substitutable goods.

For TCO applicants, Vestas is a reminder that making assumptions in a TCO application leaves room for the CEO to dispute its validity. Applicants should be thorough in searches to ensure that all relevant inquiries have been made with respect to local manufacturers. If potential Australian manufacturers are identified, they should be contacted to determine whether they are in fact capable of producing or manufacturing substitutable goods, and such contact should be documented.

Full description of the goods

H.A.G. Import Corporation (Australia) Pty Ltd and Chief Executive Officer of Customs [2013] AATA 599 addressed the importance of adequately describing the goods in the TCO application. The case involved goods broadly described as a range of kitchenware, tableware and toilet articles made from porcelain, china and ceramic materials for sale in major department and retail stores. The CEO announced in the Tariff Concessions Gazette the intention to revoke a total of 12 TCOs (of which five were subject to this case) on the basis that they did not contain a full description of the goods. During the appeal, the CEO also indicated that he had become aware of local manufacturers of substitutable goods.



The Customs Act states that the process of revocation can commence if a TCO is in force on a particular day and the CEO has a belief that if it were not in force, and an application for the TCO was made, such application would not be accepted. In this case, the AAT confirmed that the TCOs did not include a full description to identify the goods with confidence. Basically, the goods were too broadly described. For example, a cup, saucer, butter plate or salt and pepper shaker would have been more specific.

We note that the AAT made an important conclusion in disregarding the CEO's argument that local manufacturers of substitutable goods exist because such statement was only made during the appeal. The AAT clarified that his "belief" on this matter was not formed on the day in which the revocation notice was published in the Tariff Concessions Gazette, but at a later time.

This case highlights the importance of providing an accurate and full description of the goods in a TCO application. The description should be able to clearly identify exactly what the goods are, including design and operation where appropriate, and not be limited to the materials from which they are made from.

Woolworths Limited and Chief Executive Officer of Customs [2013] AATA 730 (Woolworths) also addressed the description of the goods in a TCO, but in this case the more specific description in the TCO limited its application to similar goods. Woolworths involved goods described as "ripsticks," and the issue was whether such goods fell under existing TCOs for "skateboards" or "snakeboards." The AAT held that the goods were not skateboards or snakeboards, but were "casterboards," and therefore did not fit the description of the TCOs. In reaching the decision, the AAT stated that "while there are similarities between skateboards, snakeboards and ripsticks, there are significant differences in look, design and operation such that considered objectively, and in terms of the intention underpinning the two TCOs, a ripstick should be separately classified." Further, the AAT also noted the existence of an individual TCO for skateboards and snakeboards as relevant in determining that a ripstick should therefore be examined on its specific differences.

Importers utilizing existing TCOs should consider whether the terms of those TCOs are in fact met. Relying on the fact that a particular good is similar to that of an existing TCO is not sufficient. Rather, applying for a new TCO may be required. We recommend that importers seek guidance should the TCO's coverage be unclear.

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Streamlined anti-dumping system to strengthen compliance



The overhaul of Australia's anti-dumping system has resulted in the introduction of a newly formed Anti-Dumping Commission and legislative amendments that are already showing signs of increased compliance activity to combat dumping. Australian businesses injured by low-cost imports now have a more effective system of trade remedies.

Broadly, dumping occurs when goods are exported at a price below their normal value in the exporter's domestic market. This may also occur where an exporter is provided with a subsidy or financial assistance by its government. Anti-dumping and countervailing duties are remedial measures applied to imported goods to give a level of protection to Australian industry where it has suffered "material injury" as a result of dumped or subsidized goods.

In June 2013, amendments to Australia's anti-dumping system became operative. These changes are consistent with the federal Government's policy initiative released in June 2011, "Streamlining Australia's anti-dumping system - An effective anti-dumping and countervailing system for Australia." The amendments include:

- ▶ The establishment of a new anti-dumping review panel appeals process
- ▶ Changes to the provisions dealing with countervailable subsidies
- ▶ The establishment of a new anti-circumvention framework

Importantly, the anti-circumvention framework introduces a new inquiry process designed to prevent exporters of goods subject to dumping measures on certain imports into Australia from circumventing the payment of applicable anti-dumping and countervailing duties.

Circumvention activities are not necessarily illegal, and thus the framework serves to strengthen compliance by expanding the coverage of an existing anti-dumping notice to include such activities based on an inquiry. Circumvention activities can include the assembly in Australia or a third country of exported parts of goods subject to a dumping notice by the exporter subject to the notice, exportation of affected goods through a third country and exportation through another exporter that is subject to a lesser duty rate.

These legislative amendments provide better mechanisms for the Anti-Dumping Commission, which commenced operations from 1 July 2013, to administer the system and improve compliance. The Anti-Dumping Commission has taken over responsibility for the anti-dumping system from the Australian Customs and Border Protection Service (Australian Customs), which continues to assist with enforcement. Having a specialized body administering the system is expected to provide greater transparency and rigor for dumping inquiries.

The Anti-Dumping Commission and Australian Customs have already shown that they are increasing compliance activities. On 19 August 2013, Australian Customs released a statement advising that it had executed search warrants across Victoria, New South Wales and Queensland in relation to the alleged circumvention of dumping and countervailing duties on importations of aluminum road wheels from China. The affected importers and exporters are suspected of evading the additional duties by importing the goods through a third country rather than direct shipment from China.



Further strengthening of Australia's anti-dumping system in the near future is likely. As part of its election platform, the Coalition party, which won September's federal election, announced that it would improve the speed of anti-dumping investigations and would consider further legislative changes. A significant change discussed is a reversal of the onus of proof in anti-dumping investigations, which would require foreign businesses accused of dumping to prove their innocence.

These latest developments are welcome news for Australian businesses affected by low-cost imports. With an agency focused on administering the anti-dumping system and more effective compliance mechanisms, particularly through the anti-circumvention framework, we anticipate that anti-dumping inquiries and compliance activities will significantly increase in Australia.

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Changes in approach to Australian trade policy under new Coalition Government



On 7 September 2013, the Coalition, an alliance of center-right political parties, won the 2013 Australian federal election, defeating the former Labor government that had held power since 2007. Since being sworn, Prime Minister Tony Abbott and his ministers have made numerous public statements regarding the Coalition's trade policy, emphasizing a willingness to conclude long-running free trade agreements and reach fast, pragmatic bilateral agreements with Australia's trading partners.

At the recent Asia-Pacific Economic Cooperation (APEC) summit held in Bali, the Prime Minister announced that the Coalition would conclude the China-Australia free trade agreement (FTA) within 12 months and compromise, if necessary, to meet this deadline. The Coalition's pragmatic approach to international trade represents a key shift from that of the former government, which focused on obtaining more comprehensive multilateral trade deals.

In addition to the China-Australia FTA, the Coalition has promised to fast-track bilateral agreements with China, Indonesia, Japan, India, South Korea and the Gulf Cooperation Council. Further, the feasibility of entering into new free trade negotiations with other key Australian trading partners, including the EU, Brazil, Hong Kong, Papua New Guinea, South Africa and Taiwan will be explored.

Pre-election policy announcements made by the Coalition also suggest the party will adopt a more pragmatic approach in relation to the use of investor-state dispute settlement (ISDS) clauses in FTAs. ISDS clauses allow foreign businesses to initiate proceedings against the governments of FTA signatory countries where obligations under an FTA have been contravened. While the Coalition is generally against the use of these clauses, it has stated that it is willing to consider their inclusion on a case-by-case basis. However, the Coalition has stated it will not agree to the inclusion of ISDS provisions in the Trans-Pacific Partnership, a proposed multilateral FTA currently under negotiation, which comprises several major Australian trading partners, including the United States, Singapore and Japan.

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China

Shanghai Pilot Free Trade Zone



In September 2013, the State Council approved the establishment of a pilot free trade zone in Shanghai (SHFTZ), which marks a milestone in another wave of economic reforms. The SHFTZ is designed to promote trade and investment (particularly in the financial sector), as provided in the “General Plan for China (Shanghai) Free Trade Zone” (the Plan), published in Guofa [2013] No. 38 (27 September 2013).

Although most of the measures focus on opening up the finance and banking industries in China, China Customs is aiming to introduce a new set of supervision measures for managing the activities in the pilot SHFTZ through “simplifying the import supervision to promote frontier opening and strictly enforcing second-tier effective and efficient control.” Thus, it is expected that there shall be some advantageous tax and customs benefits that will appeal to traders and manufacturers.

As a free trade zone, the designated geographical area, which covers approximately 28.78 square kilometers around Shanghai, is a consolidation of the current Waigaoqiao Bonded Zone, Waigaoqiao Logistic Park, Yangshan Port Area and Pudong Airport Comprehensive Bonded Zone. These areas are considered outside the customs territory, and goods that enter the zone are not subject to import duties and taxes unless the goods enter the domestic market.

Goods entering the zone are not subject to the usual customs controls. To expedite the import process of goods entering the SHFTZ, Customs is expected to further relax their supervision compared to existing bonded zones in China. For instance, the prevailing policy applied in current customs bonded zones is “entering after customs declaration.” For the SHFTZ, the imported goods will be allowed to enter into the zone prior to being declared to the customs authorities. Relevant procedures for importation and exportation of goods related to international transit shipment and freight deconsolidation are streamlined accordingly. Although limited to certain conditions, the SHFTZ would permit a trading platform for designated areas, which means a direct trading manner on bonded goods would be possible within the zone.

Goods manufactured in the zone that enter the domestic market benefit from an optional tariff treatment. That is, business will be allowed to elect

the duty settlement based on either imported material input or finished goods upon the finish goods manufactured in the SHFTZ into the domestic market. Additionally, manufacturing companies and production-related service companies located in the SHFTZ can benefit from the duty-free import of machinery and equipment (some exceptions apply, particularly for the automotive industry). These preferential treatments for manufacturing operations have been confirmed by the document CaiGuanShui [2013] No.75 (15 October 2013), but the actual implementation is still subject to further observation.

In addition to the above beneficial treatment to manufacturing operations, there are also discussions that the SHFTZ may consider allowing more flexibility in other areas. These areas could include cross-border e-business, inbound and outbound repair operations, warehouse receipt pledge, bonded future transactions, international ship registration and commodity inspection/quarantine.

Some experts contend that the SHFTZ is one way for China to compete with the upcoming major new free trade agreements under negotiation, of which China is not participating. These include the Trans-Pacific Partnership (see article, “Trans-Pacific Partnership: an update”) and the Transatlantic Trade and Investment Partnership (bilateral agreement between the United States and the EU).

For information on additional measures related to finance and investment promotion measures, see the EY China Tax and Investment News (Issue No. 2013005, 30 September 2013), “A milestone for China’s new wave of economic reform: Shanghai Pilot Free Trade Zone.”

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Japan

Amendments to Japan's Generalized System of Preferences program



Generalized System of Preferences (GSP) is a trade program that aims to assist the economic development of developing countries by providing preferential access to Japanese markets through the application of reduced duty rates on certain products from such developing countries.

In applying the criteria for product exclusion, the following changes to the GSP program are planned.

Certain excluded products originating in China to become eligible

The following articles originating in China were excluded from the GSP program for the period 1 April 2011 to 31 March 2014 because they were deemed as highly competitive in the Japanese market. However, these articles will be reinstated and will be eligible for GSP treatment from 1 April 2014.

HS code	Description	MFN rate Until 31 Mar 2013	GSP rate From 1 Apr 2014
0306.14-1	Crabs (frozen) (smoked)	9.6%	7.2%
0306.24-2	Crabs (not frozen) (smoked)	9.6%	7.2%
0910.12-2-(2) ex	Ginger (crushed or ground) (not provisionally preserved in brine, in sulfur water or in other preservative solutions nor put up in containers for retail sale) (fresh)	2.5%	Free
0910.12-2-(2) ex	Ginger (crushed or ground) (not provisionally preserved in brine, in sulfur water or in other preservative solutions nor put up in containers for retail sale) (other than fresh)	2.5%	Free
1605.51 ex	Oysters (prepared or preserved) (not in air-tight containers)	9.6%	7.2%
1605.53 ex	Mussels (prepared or preserved) (not in air-tight containers)	9.6%	7.2%
1605.58 ex	Snails, other than sea snails (prepared or preserved) (not in air-tight containers)	9.6%	7.2%
2206.00-2-(2)-B(b)	Other fermented beverages (classified under "Other")	42.40 yen/ℓ	30.80 yen/ℓ
28.43	Inorganic or organic compounds of precious metals	2.5%	Free
55.13	Woven fabrics of synthetic staple fibers, containing less than 85% by weight of such fibers, mixed mainly with cotton, of a weight not exceeding 170 g/m ²	6.6%-10%	5.28%-8%
62.14	Shawls, scarves, mufflers and the like (woven fabric)	4.4%-9.1%	Free
71.16	Articles of pearl and precious stones	2.5%-5.2%	Free
81.10	Antimony and articles thereof	0-8.80 yen/kg	Free
82.15	Kitchen or tableware, such as spoons (of base metal)	3.9%-4.6%	Free
85.44	Insulated wire, cable and other insulated electric conductors	0%-4.8%	Free
94.05	Lighting fittings and parts thereof	0%-3.9%	Free
95.06	Articles for sport	0%-3.2%	Free
96.13	Cigarette lighters and other lighters, and parts thereof	0%-5.1%	Free



It would be prudent for importers to check the latest list to determine whether there are new opportunities to benefit from GSP from 1 April 2014.

Exclusion of certain products originating in China

The following products originating from China are currently eligible for GSP treatment but will be excluded from the GSP program as of 1 April 2014 because they have been deemed as highly competitive in the Japanese market. Importers currently utilizing the GSP program to import the goods below from China will see an increase in landed cost due to the higher duty rate.

For a complete list of products to be excluded from Japan's GSP program, please see the following link (Japanese only): <http://www.customs.go.jp/shiryo/tokkeikanzei/hinmoku-jogai.pdf>.

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HS code	Description	MFN rate Until 31 Mar 2013	GSP rate From 1 Apr 2014
1212.99-2ex	Fruit stones, kernels and other vegetable products of a kind used primarily for human consumption (classified under "Others," other than those of apricot, peach (incl. nectarine) or plum)	0%	3%
1604.32ex	Caviar substitutes other than Ikura	4.8%	6.4%
27.01	Coal, briquettes, ovoids and similar solid fuels manufactured from coal	0%	0%-3.9%
29.03	Halogenated derivatives of hydrocarbons	0%	0%-3.9%

New Zealand

Review of the low-value import threshold



Similar to many jurisdictions, New Zealand is currently trying to address the difficult issue of the indirect taxation of low-value imports, particularly in light of the explosion of online shopping and digital products from overseas suppliers. With a formal review under way and non-compliance in the spotlight, New Zealand appears ready to make changes.

Current indirect tax treatment of low-value imports

New Zealand adopts a unique approach by using an amount of duty method for determining the low-value import threshold, rather than using a consignment value. The current threshold is NZ\$60 of duty (including goods and services tax (GST)). If the duty is less than the threshold amount, the goods can be imported into New Zealand free of any charges from New Zealand Customs. If the duty is equal to or above the NZ\$60 threshold amount, then duty, GST and an import entry transaction fee will be imposed on the importer.

In practice, this means that duty-free goods with a consignment value of up to NZ\$399 in value (including freight and any associated insurance) can be imported free of any charges (given the current GST rate of 15%). If the goods are subject to duty, then the de minimis threshold will apply at a lower consignment value (based on the product's applicable rate of duty). The difficulties in making this calculation led New Zealand Customs to launch an online tool (www.whatsmyduty.org.nz) to assist consumers buying goods online.

Digital products (e.g., music downloads and digital books) are generally regarded as services for GST purposes and are taxed through the reverse charge mechanism. This mechanism only applies to end consumers in New Zealand that import more than NZ\$60,000 of digital products per year, which is the level that requires GST registration. As such, the reverse charge often has very limited practical effect in the context of online shopping of digital products.

Review of the low-value import threshold

In 2011, New Zealand Customs reviewed the low-value import threshold. No changes were made as a result of the review, except to increase the threshold amount to take into account the increase in the standard GST rate from 12.5% to 15%.

However, the low-value import threshold is already under review again by New Zealand Customs, Treasury and Inland Revenue. A Government Decision Document is expected to be released shortly. This review appears to be as a consequence of the significant increase in online shopping, lobbying by the local retail industry, and the debate concerning base erosion and profit shifting and indirect taxation. In this respect, the current review includes an assessment of the indirect tax treatment of products that can be downloaded from the Internet and the cross-border sale of goods.

Some of the options widely covered in the media debate on online shopping include:

- ▶ Abolishing or reducing the low-value import threshold and requiring consumers to pay indirect taxes at a point of collection of the goods from New Zealand Customs or New Zealand Post
- ▶ Imposing requirements on credit card companies and payment solution providers to charge and collect indirect taxes on Internet transactions
- ▶ Requiring overseas suppliers to register for GST by changing the place of supply rules in New Zealand



Notwithstanding the conclusions of the current review, it is clear that New Zealand Customs is getting ready for potential changes. The Border Processing (Trade Single Window and Duties) Bill was introduced to Parliament on 1 July 2013 and contains a proposed amendment that will empower the Comptroller of Customs to prescribe a valuation method (i.e., not necessarily based on an amount of duty) and a low-value threshold amount below which duty and GST need not be collected.

Non-compliance by overseas suppliers in the spotlight

New Zealand Customs recently completed an operation to examine consignments cleared through the use of Electronic Cargo Information, which is designed for low-value imports. Out of 2,562 consignments, Customs identified 733 (i.e., almost 30%) that were incorrectly declared as low-value imports.

The Minister of Customs stated in a media release issued on 9 September 2013, "If this operation is anything to go by, the loss of revenue adds up to millions of dollars a year. This is an unacceptable abuse of the express pathway."

Customs has increased the monitoring of goods being processed through the Electronic Cargo Interchange, and we anticipate that the agency will seek to use their full power in cases of non-compliance. In this respect, it may be difficult for reputable overseas suppliers to distinguish genuine mistakes from cases at the other end of the spectrum involving fraud. This provides a timely reminder for overseas suppliers to regularly review their processes and communications concerning the sale of goods through the Internet and the way in which these goods are declared for customs purposes.

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Europe, Middle East, India and Africa

European Union and Gulf Cooperation Council

GCC oil, gas and petrochemical industries impacted by reform of EU's Generalised Scheme of Preferences



Effective 1 January 2014, products from the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) will no longer benefit from preferential tariffs granted under the EU's Generalised Scheme of Preferences (GSP). GCC oil, gas and petrochemical industries exporting to the EU will face increased duty costs unless alternative customs planning opportunities can be identified and implemented.

EU GSP reform

The EU GSP program supports developing countries by granting preferential (i.e., zero or reduced) customs duty rates on imports of their products into the EU. As reported in the September 2013 issue of TradeWatch, reforms to the GSP program, which take effect 1 January 2014 will reduce the number of beneficiary countries. Kuwait, Saudi Arabia, Bahrain, Qatar, the United Arab Emirates and Oman will be excluded from the program because they have been classified as "high-income" countries by the World Bank for three consecutive years.

As a result, exports from GCC countries will be subject to duty at most favored nation (MFN) rates and, thus, no longer benefit from preferential access to the EU markets.

Implications on GCC oil, gas and petrochemical industries

The financial impact of the loss of GSP preferential customs duty rates for sales to the EU could be significant considering competition from Norway and South Korea, which both have free trade agreements with the EU. While the importation of crude oil from the GCC into the EU will continue to be duty-free, other important GCC exports to the EU will become subject to higher customs duty rates. Table 1 provides a comparison of EU customs duty treatment for various products with and without GSP preferences and rates under the EU-Korea free trade agreement (FTA).

Table 1: Comparison of EU customs duty treatment

Product category	Sub-product category	Duty rate under GSP	MFN duty rate	Duty rate under the EU-Korea FTA
Oil and gas products	Jet fuel	0.00%	4.70% (*)	0.00%
	Gas oil (high sulfur)	0.00%	3.50%	0.00%
	Base oil	0.00%	3.70%	0.00%
Petrochemicals	Low-density polyethylene (LDPE)	3.00%	6.50%	0.00%
	Linear low-density polyethylene (LLDPE)	3.00%	6.50%	0.00%
Chemicals	Methanol	2.00%	5.50%	0.00%
Aluminum	Aluminum bars (not alloyed)	4.00%	7.50%	0.00%

(*) Potentially 0% if a proposed tariff suspension is accepted by the EU Commission



The MFN duty rates assessed on certain GCC products as of 1 January 2014 will increase the landed cost of many GCC exports to the EU, particularly compared to other countries that enjoy preferential access to the EU market. In the current environment, there are limited opportunities for GCC producers to recover the increased customs duty cost from customers at current market prices. Accordingly, it is important that affected businesses consider customs strategies to mitigate the financial impact.

EU customs planning opportunities

Depending on the company's supply chain, various customs regimes may help to reduce import costs into the EU. We provide a few examples as follows:

- ▶ Inward processing relief allows products to be imported into the EU without the imposition of customs duty if the product is processed and subsequently exported outside the EU. Various processing operations, such as blending within the oil and gas industry, may be considered in this respect.
- ▶ Processing under custom control allows raw materials to be imported under suspension of duties to be processed under customs supervision into a finished product. The finished product may then be imported at a lower duty rate.
- ▶ Bonded warehouse allows products to be stored under suspension of EU customs duties. If re-exported to a non-EU destination, this regime will prevent EU customs duties becoming due.

We also note that EU trade and regulatory agreements should also be considered. For instance, in the case of jet fuel, EY has had several conversations with the EU customs authorities and the European Commission to discuss possible solutions for the import of jet fuel from the GCC. The EU and individual Member States have entered into binding air transport agreements, which include provisions exempting jet fuel from duties and taxes, irrespective of origin. The European Commission has proposed a tariff suspension for jet fuel imported after 1 January 2014 (however, this proposal has not been accepted yet).

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Russia

Russia to resume use of TIR Carnets



After months of delays and uncertainty for transit operations, Russia will be extending the use of Transport Internationaux Routiers (TIR Carnets) at least until 1 July 2014.

Starting from July 2013, the Russian Federal Customs Service (FCS) started placing restrictions on the use of TIR Carnets (i.e., the guarantee that covers duties and taxes for goods transiting through Russia) in certain regions of Russia. According to FCS, TIR Carnets were no longer sufficient; rather, customs transit had to be secured by alternate measures, as set forth in the customs legislation of the Customs Union (e.g., bank guarantee). The FCS' actions were based on the mounting debt of the Association of International Road Transport Carrier's (ASMAP) in securing commitments under TIR Carnets.

The restrictions against the use of TIR Carnets were controversial considering that Russia is a contracting member under the Customs Convention on the International Transport of Goods Under Cover of TIR Carnets (1975). Additionally, the Supreme Arbitration Court of the Russian Federation had ruled in October 2013 in favor of ASMAP, finding that the new restrictions were not in compliance with the customs legislation. Even so, FCS announced that as of 1 December 2013, the use of TIR Carnets would be restricted in all regions of Russia. Expectations were that the restrictions on TIR carnets would spread to the other members of the Customs Union (Belarus and Kazakhstan) as well.

As a result, international customs transit operations through certain regions of Russia have been experiencing costly delays, and it seemed the FCS would follow through with plans to stop accepting TIR Carnets. However, on 30 November 2013, the FCS announced an agreement with ASMAP that would allow an extension of TIR Carnets until 1 July 2014.

While this latest announcement is welcome news for traders and transit operations throughout Russia and the Customs Union, we emphasize that the situation is not yet stable. The FCS has clarified that from 1 December 2013, TIR Carnets can be used only in Vyborgskaya, Murmanskaya and Karelskaya. For now, other regions should secure transit using alternative measures.

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Global Trade

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