

TradeWatch

Volume 15, Issue 1

March 2016

EY Global Trade

Quarterly update



EY

Building a better
working world

In this issue

Spotlight on the European Union

Union Customs Code becomes fully applicable as of 1 May 2016..... 1

Global

WTO Nairobi Package provides preferential origin guidelines for exports
from least developed countries..... 7

Americas

Argentina issues new measures on foreign trade and foreign exchange matters 10

Brazil – Authorized Economic Operator in Brazil: Full Scope launched..... 13

Mexico – Is Mexico ready to implement the Trade Facilitation Agreement? 16

United States – Trade Facilitation and Trade Enforcement Act of 2015 expands
drawback opportunities..... 20

The Trade Facilitation and Trade Enforcement Act of 2015: highlights
and potential impacts..... 23

Potential Merchandise Processing Fee implications of the Trans-Pacific
Partnership and the Fix America's Surface Transportation Act..... 27

Doing business with Iran: highlights of the Iran deal nuclear-related sanctions..... 29

Asia-Pacific

Hong Kong Customs introduces Free Trade Agreement Transshipment
Facilitation Scheme..... 33

India – Customs valuation for related-party transactions: key changes in
investigation procedure..... 37

Indonesia – New regulation on Bonded Logistics Centers 40

Thailand – Free Zone or Export Processing Zone: changes to duty
privilege treatment and qualifying criteria..... 42

Customs amnesty 2016: Voluntary Audit Program 45

Europe, Middle East and Africa

Eurasian Economic Union – Restrictions imposed on goods imported into Kazakhstan 47

European Union – Recent European Court of Justice case brings further
clarification regarding treatment of shortages during movement of excise
goods under suspension 49

Italy – Customs Guidelines on transfer pricing and customs valuation 51

Russia – Restrictions imposed on imports from Turkey..... 54
Russia-Ukraine mutual economic sanctions 56



Union Customs Code becomes fully applicable as of 1 May 2016



The Union Customs Code (UCC),¹ which replaces the currently applicable Community Customs Code (CCC),² is expected to provide for a new, streamlined and codified framework of customs legislation that is up-to-date with recent developments. Implementation of the UCC will start gradually from 1 May 2016, its effective date, and is expected to last until the end of 2020.

The new customs legislation will bring about substantial reform that is likely to affect the cost of importing goods into the EU and impact business operations, processes, reporting and information technology (IT) systems.

The most substantial changes likely to cause considerable financial consequences for companies that import goods into the European Union, relate to customs valuation. The UCC abolishes the “first sale for export” and introduces the “last sale for export” rules. Additionally, the UCC requires royalties and license fees to be included in the customs value in more instances than under current legislation.

The other remarkable feature of the new customs legislation is that it strongly encourages companies to acquire “Authorised Economic Operator” (AEO) status and reserves the more sophisticated customs facilitations exclusively for AEO-accredited companies. For many companies, AEO accreditation will no longer be something that is “nice to have” but rather something that a company “must have.”

The new legislation also offers opportunities for improvement, such as the restoration of a comprehensive guarantee covering several customs procedures at one time, the possibility to reduce the amount of such guarantee in function of certain compliance standards, the facilitation of more simplified and flexible means to declare goods to customs, the use of customs warehousing for internet sales, the movement of goods between temporary storage facilities, and others.

In this article we focus on the main changes introduced by the UCC and the challenges that businesses may face.

¹ Regulation (EU) No 952/2013 Of The European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast), OJ L 369, 10 October 2013, p. 1.

² Regulation (EC) No 450/2008 of the European Parliament and of the Council of 23 April 2008 laying down the Community Customs Code, OJ L 145, 4 June 2008, p. 1.



UCC implementation

Delegated and Implementing Acts

The Delegated Acts (DA)³ and Implementing Acts (IA)⁴ are required to make the UCC work: the IA ensure uniform application of the UCC, and the DA supplement or amend certain (less-essential) elements of the UCC. Both were published 29 December 2015 in the Official Journal of the European Union.

The Transitional Delegated Act

At this moment, the Transitional Delegated Act (TDA) is still pending. The TDA contains specific IT-related transitional measures that allow customs authorities to continue using any existing IT system and/or paper-based system until the new IT systems that are required by the UCC are implemented. On 17 December 2015, the EU Commission approved the text of the TDA, giving the EU Parliament and EU Council two months to raise any objections. If no objections are made, the TDA will be finalized and published shortly thereafter. With this final step, the UCC legislative framework will be complete, consisting of four Acts: the UCC itself, the DA, the IA and the TDA.

Changes in customs valuation

The last sale for export

Under current EU legislation, importers may base the transaction value on the so-called "first sale for export" for the appraisal of their imports. In other words, they may use the value of an earlier sale in the supply chain as a basis for determining the customs value, provided that certain conditions are met.

Under the UCC, importers must use the value of the sale "occurring immediately before the goods are brought into the customs territory of the Union." This rule is better known as the "last sale for export" rule.

In multiple-party supply chains, the guiding principle will be the sale in the supply chain occurring immediately before the goods physically enter the customs territory of the EU (the "last" sale). If an importer has already sold the products to a customer before the goods physically enter the EU, the sale price of that transaction may have to be used as the customs value. Needless to say, what is to be understood as a "sale" will become decisive in determining whether the sale price received by the importer must be used for the customs value.

³ Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code, OJ L 343, 29 December 2015, p. 1.

⁴ Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code, OJ L 343, 29 December 2015, p. 558.



For example, last sale for export valuation may occur in cases of back-to-back ordering where importers receive purchase orders from their EU customers. If such a purchase order is in place when the goods are exported to the EU, according to some interpretations of the UCC, the importer should use its price to the EU customer as basis for the customs value of the imported goods. In this case, the term “sale” is interpreted broadly, where any obligation to supply goods against consideration constitutes a sale. While it remains to be seen whether such a broad interpretation will be acceptable, some EU customs authorities seem to favor this approach. Further guidance on this important issue for businesses by the EU Commission is anxiously awaited.

The IA contain a grandfather clause that allows use of first sale for export until the end of 2017 on the condition that a binding contract was in place before 18 January 2016, the date the IA entered into force.

It is not clear what constitutes a binding contract. In the United Kingdom, customs authorities give some clarification.⁵ According to UK Customs, “there must be a contract in place clearly specifying a start date but they need not specify the value of each expected shipment or consignment.” This may be interpreted to mean that more generic contracts, or addenda to existing contracts, will be sufficient to qualify as a binding contract under the grandfather clause. The Dutch and Irish customs authorities also take a flexible approach. Furthermore, some customs authorities may find that a ruling issued in the past confirming first sale valuation is sufficient to apply the grandfather clause. That being said, views on what constitutes a binding contract may differ from Member State to Member State.

Royalties and license fees

Another area of customs valuation where substantial changes are expected to occur is royalties and license fees. Royalties and license fees are only dutiable to the extent that:

- ▶ The buyer is the payer, directly or indirectly.
- ▶ The payments relate to the goods being valued.
- ▶ The payments are a condition of sale of the goods being valued.

The IA includes one consolidated article about the definition of royalties and license fees, which elaborates on the applicable test criteria, i.e., when the payments are “related to the goods being valued” and when these are considered as “a condition of sale.” The IA stipulate the following three situations in which the “condition of sale” is assumed to be met:

1. The seller, or person related to the seller, requires the buyer to make this payment.
2. The payment by the buyer is made to satisfy an obligation of the seller, in accordance with contractual obligations.
3. The goods cannot be sold to or purchased by the buyer without payment of the royalties or license fees to a licensor.

The third condition seems to include many situations and leaves room for interpretation. For instance, in a scenario where the buyer, the seller and the licensor are all unrelated, a royalty or a license fee could still become dutiable. Moreover, the rule focuses on the obligations of the buyer, rather than the requirements of the seller.

⁵ Customs Information Paper 41 (2015): transitional arrangements for the withdrawal of the “earlier sale” facility under the Union Customs Code, HM Revenue & Customs, 3 November 2015.



Put differently, a licensor in many cases cannot block a (non-related) seller from selling the product to a buyer (even if related to the licensor), but it can block the purchase of the product if the royalty is not paid by the buyer (especially where the buyer is related to the licensor). Consequently, the royalty would become dutiable in many more situations than under the current legislation. This view has been confirmed by both the UK and Dutch customs authorities.

Under the current legislation, trademark royalties are treated differently from other royalties and license fees. When the importer of the goods is free to obtain the goods from other sellers that are unrelated to the licensor, the trademark royalty paid for the goods is not dutiable. This exception will be withdrawn under the UCC. Consequently, any business currently importing products for which trademark royalties are paid will be affected by this change. Under the new legislation, trademark royalties will be subject to the same general rules for other royalties and license fees.

The above rule is an apparent attempt to increase the taxable base, as royalties and license fees are much more likely to be included in the customs value than under current legislation. Affected businesses could investigate whether it is possible to bifurcate the royalty into non-dutiable (activities usually not subject to duties, such as marketing and advertising) and dutiable parts.

AEO: practical standards of competence

Companies granted AEO authorization under the current legislation may benefit from certain customs simplifications, or they are entitled to facilitations relating to security and safety. To be granted AEO status under current rules, operators have to meet certain criteria, including:

- ▶ An appropriate record of compliance with customs requirements
- ▶ A satisfactory system of managing commercial and, where appropriate, transport records, which allows appropriate customs controls
- ▶ Where appropriate, proven financial solvency
- ▶ Where applicable, appropriate security and safety standards

The above criteria are more or less transposed – albeit in different words – to the UCC. The criteria for granting an AEO authorization are further specified in the IA.

One notable change affects the first criterion (record of compliance): the UCC refers to the “absence of any serious infringement or repeated infringements of customs legislation and taxation rules.” This phrase leaves room for interpretation among the Member States, especially since the enforcement of customs rules has not been harmonized in the EU, and compliance with customs rules and the lawful imposition of penalties are within the ambit of each Member State’s national law.



Perhaps the most prominent change is a new criterion for the granting of AEO-Customs Simplifications status, where the UCC and its implementing legislation include specific provisions on professional qualifications or practical experience requirements that create a new significant restriction for granting the authorization.

Special procedures

One of the key features of the UCC modernization and simplification is the grouping together and alignment of the former suspension procedures (i.e., external transit, customs warehousing, inward processing suspension system, processing under customs control, temporary importation with internal transit, temporary storage, free zones, inward processing drawback system, outward processing and end-use) within four special procedures:

- ▶ Transit
- ▶ Storage
- ▶ Specific use
- ▶ Processing

The UCC introduces rules for the special procedures to make it simple for the operator to choose the right procedure, to avoid errors, and to reduce the number of post-release recoveries and repayments.

The basic principle is that goods placed under a special procedure, or the products made from them, are assessed at the time when the customs debt is incurred. However, it is also possible to assess the goods at the time when they were placed under a special procedure, where economically justified.

Processing comprises inward and outward processing. Given that the intention of re-export is no longer necessary, the inward processing suspension procedure will be merged with processing under customs control, and the inward processing drawback procedure will be abandoned.

The use of the inward or outward processing procedure, the temporary admission procedure, the end-use procedure and the operation of storage facilities for the customs warehousing of goods are subject to authorization, for which the applicant must provide the “necessary assurance of the proper conduct of the operations.” Companies granted AEO authorization for customs simplifications are deemed to fulfill this condition, insofar as the activity pertaining to the special procedure concerned is taken into account in their AEO authorization. This again illustrates that the concept of AEO will become much more prevalent under the UCC, given that the CCC does not require companies to be AEO compliant to be granted authorization to use a customs procedure, such as inward processing.

Binding information

The CCC allows economic operators to obtain legal certainty on the correct tariff classification for goods they intend to import or export, through Binding Tariff Information (BTI). BTI is issued on request to economic operators by the customs authorities of the Member States. It is valid throughout the EU, regardless of which Member State issued it. There is a similar tool available in matters of origin: Binding Origin Information (BOI).

The UCC will bring along notable changes in the field of binding information. BTIs and BOIs will be valid for a period of three years under the UCC, whereas BTIs and BOIs are currently valid for six years and three years, respectively.

BTIs and BOIs are currently binding on the customs authorities as against the holder. However, under the UCC, BTIs and BOIs will also be binding on the holder of the decision as against the customs authorities. Thus, the use of binding information is no longer at the discretion of the holders, and businesses are required to make a thorough analysis before they consider an application.



In this respect, the IA include the requirement to indicate the BTI decision reference number in the customs declaration when customs formalities are carried out by, or on behalf of, the holder of a BTI decision with respect of goods covered by the BTI decision. Therefore, companies that have import and export operations in the EU are advised to look up all BTIs issued in their name well in advance of 1 May 2016. Timely communication of BTIs to the third-party service providers, such as customs brokers, is of the essence. The same goes for the timely adjustment of import processes.

Non-EU based companies will continue to be able to obtain a BTI or BOI. The Dutch customs authorities have endorsed this practice for years. However, the applicant/holder will need to be registered with the customs authorities, which implies a limitation as compared to the current rules.

Definition of “exporter”

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

In the existing customs rules, the term exporter predominantly follows the ownership (or a similar right of disposal) over the goods at the time when the customs declaration is accepted. The CCC definition poses a number of difficulties in practice. For instance, where a non-EU based company transfers its own goods from the EU to a third country, it is difficult to identify any responsible party. Moreover, when goods are supplied on an “ex-works” basis by an EU-based supplier, despite the fact that the goods are supplied ex-works, the supplier could be unwittingly involved in the export formalities.

The new definition introduces a phrase that the exporter is someone “who has the power for determining that the goods are to be brought to a destination outside the customs territory,” which seems to have a broader scope than the current “contracting party established in the Community.” It remains to be seen whether this will provide any practical improvement for businesses, as the provision still does not give a clear solution for situations where the exporter is not established in the EU. The impact will depend on the guidance provided by the Commission and interpretation adopted by the customs authorities.

Final comments

The UCC will bring along major changes that will affect many companies with supply chains in the EU. It is crucial to become familiar with the new rules and assess which areas of operations, financials and IT systems will be affected. Because certain currently existing concepts, authorizations and facilitations will either disappear or change in the future, businesses need to reconsider their supply chain structures, distribution strategies and operational procedures; identify possible impacts; and take timely action where necessary.

For additional information, contact:

Ernst & Young Belastingadviseurs LLP (the Netherlands)

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

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

WTO Nairobi Package provides preferential origin guidelines for exports from least developed countries



Background

Rules of origin are required to determine the source of products in a consistent and predictable manner. They are important because they are used in the assessment of preferential import duty rates and other trade aspects such as antidumping and countervailing duties and country of origin marking. In practice, governments take a varied approach on rules of origin, which often creates trade barriers. In an effort to reduce such trade barriers, The World Trade Organization (WTO) has been working toward harmonizing the rules of origin. The least developed countries (LDCs),⁶ in particular, have been advocates for rules of origin harmonization.

LDCs cite the shifting patterns of trade as rationale for some of the changes they advocate. Specifically, the LDCs point out that manufacturing processes are becoming increasingly multi-step processes with

products crossing borders often many times before the final product is completed. This multi-country process increases costs related to transportation and insurance, and it complicates the qualification process with incremental values being added in a variety of countries. As such, one area of change that LDCs advocate is a more cumulative approach to rules of origin to the extent multiple LDCs are involved in the manufacturing process.

The WTO's Tenth Ministerial Conference was held in Nairobi, Kenya, in December 2015. As a result of the meetings, the "Nairobi Package," which contains a series of six Ministerial Decisions, was issued. One of the decisions relates to preferential treatment for LDCs and the criteria for determining whether exports from LDCs may benefit from trade preferences under non-reciprocal preferential trade arrangements.⁷

⁶ The WTO does not define the terms "developed country," "developing country" and "least developed country"; instead, it uses the United Nation's definition and generally allows WTO Members to self-select LDC status. Currently, there are 34 LDCs that are WTO Members: Angola, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Democratic Republic of the Congo, Djibouti, Gambia, Guinea, Guinea Bissau, Haiti, Lao People's Democratic Republic, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Senegal, Sierra Leone, Solomon Islands, Tanzania, Togo, Uganda, Vanuatu, Yemen and Zambia. Additionally, Afghanistan, Bhutan, Comoros, Equatorial Guinea, Ethiopia, Liberia, Sao Tomé & Príncipe and Sudan are currently in the process of negotiations to join the WTO. See www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm.

⁷ Preferential Rules of Origin for Least-Developed Countries - Ministerial Decision - WT/MIN(15)/47 WT/L/917/Add.1, 19 December 2015, Ministerial Conference Tenth Session Nairobi, 15-18 December 2015.



The Nairobi Package Decision (the Nairobi Decision) expands on an earlier 2013 Bali Ministerial Decision (Bali Decision).⁸ The Bali Decision established for the first time a set of multilaterally agreed guidelines aimed at increasing transparency and simplifying the rules that qualify LDC exports for preferential market access. The Nairobi Decision includes specific recommendations related to the broader guidelines that had been articulated in the Bali Decision.

The updated guidelines

The Nairobi Decision on preferential origin for LDCs first sets forth considerations related to application of an *ad valorem* percentage criterion to be used when determining substantial transformation. Preference-granting WTO members are encouraged to develop calculation methods based on the value of non-originating materials. In applying these rules, members are encouraged to permit preferential treatment of goods having non-originating materials of up to 75% of the goods' value. Additionally, the Nairobi Decision states that members should consider allowing the deduction of transportation and insurance costs from other countries in calculating costs incurred outside the LDC.

The Nairobi Decision also sets forth considerations related to the development of tariff shift rules by preference-granting members. The Nairobi Decision encourages members, as a general principle, to allow simple changes in tariff heading or sub-heading as the basis of origin determinations and to eliminate exclusions or restrictions from the tariff shift rules. The Nairobi Decision states that, in developing these rules, members should introduce tolerances allowing for the use of different inputs from the same tariff heading or subheading.

Next, the Nairobi Decision includes factors to be considered when members develop LDC-related preferential origin rules based on distinct manufacturing or processing operations. Specifically, the Nairobi Decision states that rules should be developed under which the following processes would confer origin:

- ▶ The assembling of fabrics into finished products (where the finished product is clothing described in Chapters 61 and 62 of the Harmonized System nomenclature)
- ▶ Chemical reactions that form a new chemical identity
- ▶ The transformation of raw agricultural products into processed agricultural goods
- ▶ The assembly of parts into finished machinery and electronics, as long as the assembly of parts goes beyond "simple assembly"

⁸ Preferential Rules of Origin for Least-Developed Countries - Ministerial Decision - WT/MIN(13)/42 - WT/L/917, 7 December 2013, Ministerial Conference, Ninth Session, Bali, 3-6 December, 2013.



In line with the earlier Bali Decision, the Nairobi Decision encourages members to expand opportunities for LDCs to use cumulation when analyzing origin. Specifically, the Nairobi Decision states that members may consider origin calculating opportunities using cumulation for products of the LDC and those of (1) the preference-granting member, (2) other LDCs, (3) GSP beneficiaries of the respective preference granting member and (4) developing countries that are part of a regional group with the LDC, as defined by the preference-granting member. Finally, the Nairobi Decision encourages members to reduce the administrative burden that results from documentary or procedural requirements and specifically mentions eradication of certificate of non-manipulation requirements.

Impact and next steps

To the extent the provisions outlined in the Nairobi Decision are implemented, importers would benefit from simplified rules of origin and the likelihood that additional products will meet preferential rules of origin requirements. For example, the Generalized System of Preferences (GSP) in the United States currently affords preferential treatment to goods having at least 35% local content. If the United States adopts the Nairobi Decision, this requirement would be reduced by 10%.

Additionally, GSP does not currently include special origin-conferring processing rules, such as the chemical reaction rule. Adoption of these guidelines would increase the opportunities for manufacturers in LDCs to have their goods deemed originating in an LDC and given preferential duty treatment under the GSP.

Preference-granting members are directed to inform the WTO's Committee on Rules of Origin of the steps they will take to implement the provisions of the Nairobi Decision by 31 December 2016. Accordingly, companies that import from LDCs and use the accompanying duty benefits extended under these preferential regimes should monitor indications over the next year as to whether the provisions of the Nairobi Decision are being pursued in their jurisdiction. Depending on the jurisdiction, consideration and implementation of the Nairobi Decision provisions may involve periods of notice and comment, and importers may find it beneficial to participate in these processes.

For additional information, contact:

Ernst & Young LLP (United States)

Seamus Flaherty, *New York*
+1 212 773 2527
seamus.flaherty@ey.com

Sharon Martin, *New York*
+1 212 773 0273
sharon.martin1@ey.com

Argentina

Argentina issues new measures on foreign trade and foreign exchange matters



The new Argentine Government, which took office 10 December 2015, has recently announced important measures dealing with foreign trade and currency exchange matters. Several of these measures are outlined below.

Export duties

In the June 2015 issue of *TradeWatch*, we noted that Argentina imposes export duties on all exports at varying rates. Export duties were introduced during Argentina's economic crisis of 2002 and were originally intended as a temporary measure.

One of the first decisions of the new Government was to abolish export duties for farm products (except for soybeans and soybean byproducts, where the rate was reduced from 35% to 27%-30%). Furthermore, the Government has also eliminated export duties for most industrial products. Export duties, however, remain in place for products from the oil and gas industry.

DJAI procedure repealed

The new Government also repealed the Advance Sworn Import Declaration procedure (*Declaración Jurada Anticipada de Importación*, DJAI). In the September 2015 issue of *TradeWatch*, we discussed the DJAI procedure, which required certain advance reporting and approval prior to importation since it was introduced in 2012. The DJAI procedure was challenged as a trade barrier under the dispute settlement mechanism of the World Trade Organization (WTO) and was found inconsistent with WTO law.⁹ As expected, Argentina's new Government eliminated the DJAI procedure effective as of 23 December 2015.¹⁰

Integrated System of Import Monitoring

The same Resolution that repealed DJAI implemented a new Integrated System of Import Monitoring (*Sistema Integral de Monitoreo de Importaciones*, SIMI), which is expected to be much more efficient than the DJAI procedure.

⁹ Disputes DS438, DS444, DS445: Argentina – Measures Affecting the Importation of Goods; Appellate Body report, AB-2014-9, 15 January 2015 available at www.wto.org/english/tratop_e/dispu_e/cases_e/ds438_e.htm.

¹⁰ General Resolution of the Federal Public Revenue Administration, AFIP, N° 3823/2015, 21 December 2015.

Importers must file a declaration through SIMI for every definitive import registered as of 23 December 2015. The government agencies that already participate, or will participate, in the system approve submitted declarations according to their authority. The agencies must respond within 10 days after a declaration is filed. Once approved, a declaration is effective for 180 days. If the declaration is not approved, the importer may need to provide additional information and clear any objections before the corresponding agency may grant approval.

As a practical consideration, DJAI declarations that were registered before the effective day of Resolution No. 3823 will remain valid for the prescribed period of time.

Import licenses

In addition to the newly implemented SIMI, a system of prior automatic import licenses (*Licencia Automática Previa de Importación*) and prior non-automatic import licenses (*Licencia no automática*) has been introduced. Definitive imports are subject to approval in the form of prior automatic or non-automatic import licenses, depending on the type of goods involved.

The new regulations¹¹ enumerate the documents and information that must be submitted through SIMI to obtain an import license, and they provide lists of goods according to the Mercosur Common Nomenclature that are subject to their respective licensing requirements prior to importation.

Foreign exchange control system

In line with the new Argentine Government's policy, the Central Bank of Argentina (*Banco Central de la República Argentina, BCRA*) has implemented new regulations¹² aimed at relaxing the control measures on foreign exchange.

Some of these measures include:

- ▶ Payments abroad for imports of goods and services can now be made on the foreign exchange market without any limit. This provision applies to new payables. A schedule has been established for payment of existing debts related to the importation of goods and services.
- ▶ Individuals and companies may purchase foreign currency up to USD2 million per month.
- ▶ Before 17 December 2015, nonresidents needed the BCRA's approval to repatriate investments. Beginning 17 December 2015, the regulations allow nonresidents to repatriate new direct investments without BCRA's prior consent, to the extent the investments either enter the Argentine exchange market and are converted into Argentine pesos or are used to purchase direct investment assets in the country.
- ▶ The mandatory deposit requirement of 30% on incoming currency into Argentina applicable to loans granted by foreign parties as well as other transaction has been reduced to 0%.

¹¹ Ministry of Production Resolution No. 5/2015 as amended by the Commerce Secretariat Resolution No. 2/2016, Filing for Automatic and/or Non-Automatic Import Licenses.

¹² BCRA Comunicado "A" No. 5850, 17 December 2015, as amended by BCRA Comunicado "A" No. 5899, 4 February 2016.





Final thoughts

With these new regulations, the new Argentine Government aims to eliminate or relax existing restrictions and barriers to the free circulation of funds and goods, as well as attract new investment and capital into the country.

Argentine companies as well as companies exporting to the Argentine market need to assess the implications of these ongoing changes as a wide range of products and industry sectors will be affected.

Look for updates in future issues of *TradeWatch*.

For additional information, contact:

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

Gustavo Scravaglieri, *Buenos Aires*

+54 11 4510 2224

gustavo.scravaglieri@ar.ey.com

Sergio I. Stepanenko, *Buenos Aires*

+54 11 4318 1648

sergio.stepanenko@ar.ey.com

Brazil

Authorized Economic Operator in Brazil: Full Scope launched



Brazil has officially launched the Authorized Economic Operator (AEO) program with the AEO-C (Compliance) and AEO-P (Full Scope) certification options in December 2015. The AEO-S (Security and Safety) option was launched in 2014.

As discussed in the June 2015 issue of *TradeWatch*, AEO is a program based on standards set out in the World Customs Organization (WCO) Standards to Secure and Facilitate Global Trade (SAFE Framework), whereby customs administrations of countries that have adopted the program certify companies who meet certain criteria designed to enhance the security of supply chains and foreign trade transactions. In return, certified companies enjoy a number of trade facilitation benefits.

Normative Instruction IN RFB, 1.598 published 11 December 2015 by the Federal Revenue of Brazil (*Receita Federal do Brasil*, or RFB), clarified the benefits and provided the procedures on how to qualify for each type of certification.

AEO benefits

General

All certifications (AEO-S, AEO-C levels 1 and 2, and AEO-P) provide the following benefits:

- ▶ The company's logo and name as AEO published on the RFB's website, upon request
- ▶ Use of AEO stamps on company documents
- ▶ Free communication channel with RFB and improved relationship with the customs authorities
- ▶ Priority migration from the current certification to another certification
- ▶ Mutual Recognition Agreements with other countries that have an AEO program
- ▶ Effective participation and discussions with RFB on introducing changes in the law
- ▶ Facilitated admittance to special trade regimes
- ▶ Effective participation in seminars and trainings sessions



Specific benefits for AEO-S

In addition to general benefits, the AEO-S certification provides the following benefits:

- ▶ Reduced number of physical and documentary inspections for export transactions
- ▶ Immediate designation of inspection channel for export transactions
- ▶ Priority treatment during the customs clearance process in cases where export transactions are under physical and documentary inspection

Specific benefits for AEO-C, level 1

In addition to general benefits, AEO-C (Compliance) level 1 certification grants the following benefits:

- ▶ Administrative rulings on tariff classification issued within 40 days of request
- ▶ No need for monetary guarantee for temporary admission for economic use (applicable to temporary importation of manufacturing equipment)

Specific benefits for AEO-C level 2

In addition to the general benefits and the specific benefits for AEO-C level 1, AEO-C level 2 grants the following benefits:

- ▶ Reduced number of physical and documentary inspection of import transactions
- ▶ Immediate designation of inspection channel for import transactions
- ▶ Priority treatment during the customs clearance process when import transactions are selected for physical and documentary inspection
- ▶ For ocean freight, importers will be able to register the Import Declaration before the goods' arrival
- ▶ Facilitated temporary admission using the green channel without documentary and physical inspection

AEO-P benefits

The AEO-P benefits combine those of AEO-S and AEO-C level 2.

Procedures

As in other countries, companies apply for AEO certification by conducting a self-evaluation based on a questionnaire. The results of this self-evaluation are then submitted to the AEO authorities along with supporting documentation.

Special procedure is required for AEO-C level 2 and AEO-P. A Complementary Report of Evaluation must be conducted by a third-party auditor, who reviews, evaluates and reports the quality of the company's internal controls. This report must be sent to AEO authorities together with the self-evaluation questionnaire.

For AEO-S certification, the company must provide information on internal controls for employees; access to restricted areas; training; security systems; and history of customs and tax controls, violations and penalties.

For AEO-C certification, the company must provide information on internal controls for foreign trade procedures, such as rules of origin, customs valuation, internal procedure for tariff code definition, quality of description of goods, compliance of cross-document information and others.

For AEO-C, level 2 and AEO-P, the Complementary Report of Evaluation will include the audit of a sample of transactions, which will be registered on Excel spreadsheets and enclosed with the support documentation of the certification request.

Certification renewal will be required every three or five years, depending on the company's risk level as determined by the AEO authorities. High-risk companies need to renew every three years, and low-risk companies need to renew every five years.



Blue Line regime

As discussed in the June 2015 issue of *TradeWatch*, Blue Line will be fully incorporated into the AEO program when all Blue Line companies adjust their audit reports to AEO models. The transition is expected to be completed by 2018. Blue Line companies are required to present a statement of intent to become AEO companies by 1 March 2016. After that date, companies in transition will be committed to submit their AEO reports six months before the expiration date of their last Blue Line reports.

Final thoughts

The ongoing AEO program implementation and transition from Blue Line involves complex assessment of current processes, implementation of AEO standards and compliance with certification requirements. Companies who commit to these standards will benefit from greater business certainty and competitive advantages.

For additional information, contact:

Ernst & Young Serviços Tributários S.P. Ltda. (Brazil)

Vanessa Grespan Baroni, *São Paulo*

+55 11 2573 6965

vanessa.baroni@br.ey.com

Mexico

Is Mexico ready to implement the Trade Facilitation Agreement?



Negotiations on the Trade Facilitation Agreement (TFA),¹³ the first multilateral agreement concluded at the World Trade Organization (WTO) since the WTO was established 20 years ago, were completed in December 2013 at the Bali Ministerial Conference. The TFA contains provisions for expediting customs processes, such as the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other authorities on trade facilitation and customs compliance issues.

WTO's efforts to promote international trade have so far been focused on the reduction of both tariff and non-tariff restrictions and barriers to trade. These efforts have paid off, and low import duties are generally a given. Additionally, agreements such as the Sanitary and Phytosanitary (SPS) Agreement and the Technical Barriers to Trade (TBT) Agreement, together with extensive case law derived from the WTO's dispute resolution mechanism, contribute toward reducing tariff and non-tariff trade barriers.

However, there are still barriers to trade other than import duties and sanitary or technical measures. Some of the focal obstacles to trade integration of developing countries today are transportation costs, customs processes, regulatory transparency, transportation infrastructure and supply chain rule of law.¹⁴

In this article we focus on the main challenges facing Mexico with respect to TFA implementation.

Current situation in Mexico

The World Economic Forum ranks Mexico in 61st place out of 138 countries in the Trade Facilitation Index.¹⁵ It ranks below some other Latin American countries, such as Chile, Costa Rica, Peru, Panama and Uruguay. Experts in the field do not believe this represents good performance considering Mexico is the 15th largest economy in the world.

¹³ Agreement on Trade Facilitation (TFA), Ministerial Decision – WT/MIN(13)/36 – WT/L/911, 7 December 2013, Ministerial Conference, Ninth Session, Bali, 3-6 December, 2013. The TFA is binding on all WTO members. It is not self-executing; therefore, once it goes into force, WTO members will have to pass legislation to implement the measures of the TFA where such measures are not already in place.

¹⁴ *World Trade Report 2014*, World Trade Organization, pp. 8 and 127, available at www.oec.org/spanish/res_s/booksp_s/world_trade_report14_s.pdf.

¹⁵ *Global Enabling Trade Report 2014*, World Economic Forum (WEF), pp. 19 and 33.



According to the World Bank, it takes four documents and 11 days to process an import or export operation in Mexico.¹⁶ Mexico is closely behind Panama¹⁷ in these statistics ranking countries according to import/export operations efficiency in Latin America. However, Mexico is also behind other countries in Latin America, such as Chile, Costa Rica and Peru, in other trade facilitation indicators, including appeal procedures, fees and charges, information availability and involvement of the trade community.¹⁸

Availability of information

Information availability is the publication of trade information, including on the internet and enquiry points. Since 2014, the Organisation for Economic Co-operation and Development (OECD) has recommended Mexico improve the quality of the research/help function of the customs website and make it more user-friendly.¹⁹ According to the OECD, Mexico needs to:

- ▶ Improve the availability of information on import and export procedures, advance rulings, applicable legislation, penalties and appeal procedures
- ▶ Improve the operation of customs hotlines
- ▶ Provide access to examples of customs classification and judicial decisions²⁰

While Mexico has several electronic platforms that contain items on the list of minimum information required, it is questionable whether these items are presented in a non-discriminatory and easily accessible manner. Essential information, such as practical import and export guidelines, is difficult to find, and the guidelines that are published occasionally cannot be described as “practical” or “comprehensive.”

In fact, even Mexican foreign trade and customs professionals find it difficult to gather and interpret the information. The challenge can be even greater for foreign governments, traders and other interested parties.

Customs hotlines

To make information more accessible, the OECD also recommends Mexico improve customs hotline operations, which serve as enquiry points to obtain responses to reasonable questions and to request the required forms and documents within a reasonable time.

Mexico has yet to address the difficulties users face when calling customs hotlines. Currently, staff can respond only to the most basic inquiries. When specialized assistance is required, it is difficult to find a person who is able (or willing) to provide the necessary information.

¹⁶ *Doing Business, Ranking of Economies*, World Bank Group available at www.doingbusiness.org/rankings.

¹⁷ In Panama it takes three documents for importing and exporting, 10 days for exporting and nine days for importing.

¹⁸ *Trade Facilitation Indicators, Country Note - Mexico*, available at www.oecd.org/trade/facilitation/indicators.htm.

¹⁹ *Trade Facilitation Indicators for Mexico*, OECD Trade Facilitation Indicators - Mexico, available at www.oecd.org/trade/facilitation/mexico-oecd-trade-facilitation-indicators-april-2014.pdf.

²⁰ *Compare Your Country. Review*, available at www.compareyourcountry.org/pdf.



Advance rulings

Mexican customs law provides for advance ruling mechanisms for tariff classification and customs valuation. Nevertheless, importers and exporters rarely request such advance rulings. Similarly, importers and exporters do not regularly use the general interest examples of customs tariff classification and responses to consultations on customs valuation published in the Mexican Federal Official Gazette (*Diario Oficial de la Federación*, DOF).

Fees and charges

In addition to import duties, imports are subjected to a number of fees and taxes, such as customs fees (*Derecho de Trámite Aduanero*, DTA), storage fees, value-added tax, excise tax (certain goods only), new car tax (*Impuesto Sobre Automóviles Nuevos*, ISAN) and others. Mexico does not have a webpage dedicated to fees and charges on the customs website that is easily accessible. Basic information, such as the full amounts of fees and charges, are not comprehensively displayed in the SIICEX (*Sistema Integral de Información de Comercio Exterior*, Integrated System for Foreign Trade Information) platform. Importers need to research the various laws and regulations repeatedly to determine the amounts of fees and charges applicable to their goods. For example, to determine the excise tax rate for goods that are subjected to excise tax upon importation, an importer would have to research the Mexican Excise Law and determine which rate is applicable in each individual case. To determine the amount of DTA due, an importer needs to research the Law on Mexican Federal Government Fees.

Formalities and procedures

The Mexican Government has made various attempts to simplify customs and trade procedures. A Decree that grants administrative facilitation in customs and foreign trade matters was enacted in 2008.²¹ It includes provisions for the simplification, automation and enhancement of customs and foreign trade processes through electronic customs clearance, control measures reduction and others.

Additionally, the Mexican Customs Law was amended in 2013²² to include provisions on formalities simplification (procedure, automation and documentation). For instance, secondary inspection for customs clearance was replaced with a non-intrusive examination that is part of the customs inspection process. Risk analysis tools were formally introduced in addition to non-intrusive inspection technologies that enable the authorities to be more efficient and assertive in their reviews. This contributes to reduced clearance time and lower incidence of physical inspections. However, it is difficult to assess the results of these provisions as consistent periodic publication of the average clearance time for the principal customs offices, as per OECD's recommendation, has yet to take place.

²¹ *Decreto por el que se otorgan facilidades administrativas en materia aduanera y de comercio exterior* (Decree that grants administrative facilitation in customs and foreign trade matters), DOF 31 March 2008.

²² *Ley Aduanera* (Customs Law), DOF 15 December 1995; as amended, DOF 9 December 2013.



TFA implementation challenges

Developing countries may accept TFA provisions under different categories. Each country self-designates as Category A, B, or C.

- ▶ Category A: the country agrees to implement TFA measures upon its entry into force.
- ▶ Category B: the country may defer the implementation of certain provisions.
- ▶ Category C: the country may defer implementation of TFA measures until it has acquired the capacity to implement them and must notify need for assistance.

Mexico has submitted Category A notification, which means that once the TFA is in effect, Mexico must comply with all the provisions and requirements found in the TFA.

Although Mexico already has in place many of the TFA trade facilitation measures and, according to its notification to the WTO, the Information Center is the only outstanding obligation in TFA yet to be implemented, some Mexican customs experts question whether compliance exists with regard the other measures noted above, such as readily accessible information on fees and charges, appeal procedures guidelines, advance rulings and others.

The TFA may provide an incentive for Mexico to work on pending issues, as other international commitments have done in the past. For example, the North American Free Trade Agreement (NAFTA) triggered the improvement of Mexico's trade facilitation policies and led to the enactment of a new Mexican Customs Law in 1995, which included many of the trade facilitation measures that are now found in the TFA.

Notwithstanding and contrary to official statements that Mexico is already in compliance with TFA requirements, unfulfilled obligations still exist, and Mexico may face the risk of disputes at the WTO if Mexican authorities do not address deficiencies in a timely manner before Mexico ratifies the TFA.

Look for further insight into Mexico's TFA implementation process in future issues of *TradeWatch*.

For additional information, contact:

Mancera, S.C. (México)

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

United States

Trade Facilitation and Trade Enforcement Act of 2015 expands drawback opportunities



On 11 February 2016, the United States Congress passed HR 644, the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA). TFTEA includes a broad slate of customs and trade-related reforms. Of particular note are drawback simplification and expansion provisions that will provide significant new financial benefits to US importers and exporters. The US President signed the bill into law on 24 February 2016.

Drawback is a mechanism to recover duty, taxes or fees paid with respect to imported merchandise when the imported merchandise, a product manufactured with the imported merchandise, or substituted “like-kind” merchandise is subsequently exported. Benefits and rules vary based on the kind of drawback. Highlights of the new rules include:

- 1) **Substitution based on Harmonized Tariff Schedule of the United States (HTSUS) or Department of Commerce Schedule B Statistical Classification (Schedule B)** – Under current law, manufacturing drawback and unused merchandise drawback claims can be filed on amounts paid upon importation when substituted merchandise “of the same kind or quality” is used in a manufacturing process, exported or destroyed. This “same kind or quality” analysis focuses on whether the imported merchandise and the merchandise used in the manufacturing process, exported or destroyed are commercially interchangeable.

TFTEA simplifies this analysis by allowing substitution between articles having the same eight-digit HTSUS classification. This form of substitution is similar to that already in effect for petroleum product drawback under 19 USC §1313(p). Experience with §1313(p) drawback has shown that HTSUS-based substitution not only simplifies the drawback claim process, but it also allows for expanded substitution opportunities beyond the limitations that result from the need for products to be commercially interchangeable.



TFTEA also allows for substitution under §1313(j)(2) where the first eight digits of an article's Schedule B number correspond to its HTSUS classification, regardless of whether the Schedule B number corresponds to more than one HTSUS eight-digit subheading. This is a novel form of drawback substitution and has the potential to provide even more opportunities than would arise from HTSUS-based substitution.

TFTEA does not limit HTSUS-based substitution only to certain tariff classifications, as has been the case under §1313(p) drawback. It does, however, contain certain limitations on the application of this HTSUS-based substitution for §1313(j)(2) drawback where the HTSUS product description begins with "other." TFTEA also includes an anti-abuse provision, under which claims are limited to the lesser of the actual duties, fees and taxes paid on import, or the duties, fees and taxes that would have been paid if the exported article were imported. This means that when claimants import high-value items and export low-value items with the same HTSUS classification, recovery will be limited by the lower-value item.

While these provisions may limit some claims, the move to HTSUS-based substitutions will likely bring a net gain of opportunities for prospective claimants while simplifying the claim process.

- 2) **Expanded time frame** – Under current drawback provisions, an imported or substituted product must be used in a manufacturing process, exported or destroyed within three years from the date of importation in order to support a manufacturing or unused merchandise drawback claim. TFTEA expands this window for all drawback claims to five years from the date of importation.

- 3) **Taxes and fees included in manufacturing drawback claims** – Under current drawback rules, manufacturing drawback claims limit recovery to 99% of only the duties paid on the imported merchandise. Additional "taxes and fees" recoverable under §1313(j)(2) drawback were not available for manufacturing claims. TFTEA provides uniformity in authorizing drawback for 99% of duties, fees and taxes paid for all types of drawback.

- 4) **Relaxation of transfer documentation requirements** – Drawback rules currently in effect require a certificate of delivery to be provided when an importer transfers merchandise to a manufacturer or claimant who ultimately relied on the merchandise in submitting a drawback claim. Claimants were required to submit these certificates as part of their claims.

TFTEA removes this certificate requirement, stating that business records kept in the normal course of business will be sufficient evidence of a transfer.

The provisions of TFTEA become effective upon its enactment with a notable caveat: claimants will not be able to file claims under the new provisions until 24 February 2018. This delay is to allow for the development of the ability to file drawback claims within the Automated Commercial Environment (ACE). However, when this delay period passes, claimants will be able to take advantage of the expanded time frame described above and file drawback claims on imports that occurred up to five years before the date upon which claims may be filed. In other words, claimants will be able to file claims on imports going all the way back to 24 February 2013. Congress considered a delay provision that would have applied if ACE was not ready for drawback claim filing, but such delay provision was not included in TFTEA's final text. Accordingly, the 24 February 2018 filing date is most likely firm and will not change.

Implications

The opportunities presented by these reforms to companies having the right profile may be significant. Any company importing products on which it pays duties or excise taxes while exporting similar products may benefit from a review of its product profile under the new law. Some specific profiles that may see benefits under the new rules include:

- ▶ Manufacturers of similar products under different brands in the United States and foreign locations – Under previous law, the different brands were likely not viewed as commercially interchangeable, while under the new rules the “like kind” determination is made under objective HTSUS standards. To the extent one branded product is imported and another exported under the same HTSUS, these products will be substitutable for drawback. Importers and exporters of products subject to excise tax
- ▶ Commodities traders with international operations

While TFTEA promises opportunities for expanded claims and simplified operations, it will be important to structure the transactions – and create and retain suitable documentation – to maximize drawback benefits while preserving optimal operational, distributional and taxation structures. Accordingly, companies wishing to take advantage of the opportunities presented by TFTEA should take steps to understand the full scope of the changes – both statutory and practically – and how they impact each aspect of the drawback claim process and their business. As imports before the effective date will be eligible for drawback under the new rules, businesses that may benefit are well-advised to address the structural and operational requirements immediately.

For additional information, contact:

Ernst & Young LLP (United States)

Seamus Flaherty, *New York*
+1 212 773 2527
seamus.flaherty@ey.com

Bill Methenitis, *Dallas*
+1 713 750 8272
william.methenitis@ey.com

Bryan Schillinger, *Houston*
+1 713 750 5209
bryan.schillinger@ey.com



The Trade Facilitation and Trade Enforcement Act of 2015: highlights and potential impacts



The Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA) became law after the US President signed the final version of HR 644 on 24 February 2016. This sweeping law is designed to ensure that US Customs and Border Protection (Customs) programs are working efficiently to facilitate trade and produce tangible results. It mandates Customs to improve its enforcement efforts with a focus on priority trade issues (PTIs). Importers should be aware that certain goods and trade programs will receive increased scrutiny based on these PTIs. This article details the key TFTEA highlights to help importers prepare for these upcoming changes.

Improving trade partnership programs

Customs is required to evaluate and improve its trade partnership programs, such as Customs Trade Partnership Against Terrorism (C-TPAT), to determine program effectiveness and participant benefits. This involves consulting with the private sector and federal agencies to make sure participants are receiving tangible trade benefits, including preclearance of goods for certain participants.

Customs will coordinate with Immigration and Customs Enforcement (ICE) and other federal agencies with similar partnership programs and admissibility (detain and release) functions to enhance program benefits, allocate resources and provide for streamlining merchandise release. The private sector can provide input about how to improve programs and increase participation.

Automated Commercial Environment

Congress appropriated no less than USD153,736,000 for fiscal years 2016 through 2018 to implement and develop the Automated Commercial Environment (ACE) system. ACE facilitates trade by processing import and export data through a single window system. By the end of 2016, Customs must submit a report to Congress on the implementation's progress.



Centers of Excellence and Expertise

Customs continues to establish industry-based knowledge centers, known as Centers of Excellence and Expertise (CEEs), designed to level the playing field and facilitate trade through consistent application of the Customs laws at every port. Four of the 10 current CEEs are fully implemented²³ and managing entry matters, according to their assigned industries, for all importers, not just those participating in programs, such as C-TPAT and the Importer-Self Assessment (ISA). The CEEs adjust their entry scrutiny and importer review process based on the importer's level of involvement and participation in these and other programs. The TFTEA bolsters the CEEs' ability to oversee importers and focus on PTIs.

Customs must annually evaluate the performance of programs, such as CEEs, ACE, drawback and collection of countervailing and antidumping duties.

Trade enforcement activities

The Government Accountability Office will report on the effectiveness of trade enforcement activities by detailing what resources Customs is dedicating and what actions it is taking to address, e.g., undervaluation, transshipment, verifying right to make entry, protecting revenues, fraud and penalties, as well as priority trade issues:

- ▶ Agriculture programs
- ▶ Antidumping and countervailing duties
- ▶ Import safety
- ▶ Intellectual property rights
- ▶ Revenue
- ▶ Textiles and wearing apparel
- ▶ Trade agreements and preference programs

National Targeting Center

The TFTEA requires that the National Targeting Center (NTC) and Office of International Trade set criteria and methods for evaluating whether goods on their way to the United States violate the Customs laws, particularly those involving PTIs. The NTC already targets imports for additional examinations and importers for focused assessment. However, the NTC will now target importers and issue trade alerts to ports based on public information and data gathered from ACE data, the Automated Export System, the International Trade Data System (bolstered by the TFTEA²⁴) and others. The NTC will also use allegations from the private sector in its assessments. The NTC must pass along allegations involving PTIs to the appropriate Customs office and notify the person making the allegation of any violations and any criminal or civil actions Customs or another agency takes.

²³ These CEEs are: (1) petroleum, natural gas and minerals; (2) pharmaceuticals, health and chemicals; (3) electronics; and (4) apparel, footwear and textiles.

²⁴ The International Trade Data System is strengthened by requiring participating agencies to: (1) implement the proper information technology infrastructure (that provides for electronic submission of data), (2) agree to share information with Customs and (3) provide their admissibility criteria (that will be incorporated into ACE) to assist Customs with releasing merchandise.



Importer of Record and Importer Risk Assessment programs

The TFTEA mandates that Customs increase its scrutiny and management of US importers. As a result, Customs will develop and implement an Importer of Record (IOR) program which assigns and keeps track of importer of record numbers. New and foreign importers should anticipate providing Customs with more detailed information about the entity as well as related entities so that Customs can further vet and keep track of importers. Customs maintains the numbers and importer information in a central database. Customs will likely use this information to assess the risk associated with new and foreign importers in determining bond amounts as part of its Importer Risk Assessment Program. One exception to Customs' increased oversight of new and foreign importers is for Tier 2 or 3 C-TPAT participants.

Similarly, Customs will impose additional requirements on Customs brokers regarding the information they must collect and maintain to verify importer identity. Brokers are subject to penalties and even license revocation for violations.

Duty drawback reform

Congress amended the duty drawback rules so they allow for a broader application and simplification for traders. Notably, the time period for making drawback claims is increased from three years to five years, and substitution is permitted at the 8-digit tariff level. A detailed discussion of these changes is provided in the article "Trade Facilitation and Trade Enforcement Act of 2015 expands drawback opportunities," found in this issue of *TradeWatch*.

Evasion of antidumping and countervailing duty orders

The TFTEA establishes the Trade Remedy Law Enforcement Division under the Customs Office of International Trade to target the evasion of antidumping duties and countervailing duties (AD/CV duties). This includes policies to ensure that bonds adequately provide for the collection of AD/CV duties according to risk.

Based on allegations, Customs will investigate and determine whether importers entered merchandise by a material false statement or omission that results in the underpayment of AD/CV duties. Customs can issue importers a questionnaire to collect additional information about the imports. If the importer fails to comply or adequately respond, Customs may draw an adverse inference against the importer. If Customs determines that the merchandise is covered by an AD/CV duty order, this will result in suspending entry liquidations and extending the period for liquidation, as needed. Duties will be assessed at the applicable AD/CV rates. If no rate is currently available, the importer must post the applicable cash deposit or other security.

Intellectual property rights protection

Intellectual property rights (IPR) protection remains a priority trade issue for Customs. To combat counterfeiting and piracy, Customs will provide information to rights holders, including photographs of unredacted packaging and labels, as well as samples, for use with infringement determinations. Rights holders that record their trademarks or copyrights with Customs stand to benefit from this further involvement in the determination process.

ICE will implement a National Intellectual Property Rights Coordination Center to increase information sharing between law enforcement and federal agencies (including Customs) and target those that produce, smuggle or distribute IPR-violating merchandise. This center increases communication between Customs and importers suffering from IPR-infringing imports.

The TFTEA includes provisions to ensure sufficient resources and training for targeting IPR violations. Some training will come from the private sector, and entities can donate technology (software, hardware, etc.) for Customs' use in identifying infringing merchandise.



Import health and safety

The TFTEA creates an Interagency Import Safety Working Group that consists of various departments, including the Department of Homeland Security (DHS). The working group must develop an import safety rapid response plan by 31 December 2016. This is designed to coordinate federal responses with respect to imports that threaten the health or safety of consumers. The working group will look at the responsibilities of foreign governments, manufacturers and private entities to ensure the safety of goods imported into the United States. Importers can expect increased accountability for ensuring supply chain security and inspections of foreign manufacturers and imported goods.

Additional notable provisions

- ▶ Requiring further education of Customs staff (with the help of the private sector) about proper classification and appraisalment of merchandise
- ▶ Customs, ICE and other federal agencies creating a strategic plan devoted to improving trade enforcement and trade facilitation
- ▶ Amending 19 USC §1501 so that the deadline for re-liquidations stems from the date of the original liquidation
- ▶ Amending US Note 3 involving articles repaired, altered, processed or otherwise changed in condition abroad so that for Subheadings 9802.00.40 and 9802.00.50, HTSUS (Harmonized Tariff Schedule of the United States), fungible articles exported from the US: (1) may be commingled and (2) the origin, value and classification of such articles may be accounted for using an inventory management method

- ▶ Providing preferential treatment for certain goods from Nepal until the end of 2025
- ▶ Requiring the Secretary of DHS to consult with the international trade business community (including the Commercial Operations Advisory Committee, or COAC) at least 30 days before proposing and at least 30 days before finalizing DHS measures that impact international trade and Customs revenue

Implications for importers

Overall, the TFTEA offers importers means for improving partnership program benefits and efficiencies by working with Customs. However, the focus on enforcement is likely to lead to more regulation, assessments, penalties and audits, especially for PTIs. At the same time, increased enforcement provides partnering and training opportunities for importers to help Customs detect infringing merchandise.

For additional information, contact:

Ernst & Young LLP (United States)

Mandy Edwards, *Los Angeles*
+1 213 240 7552
mandy.edwards@ey.com

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

Potential Merchandise Processing Fee implications of the Trans-Pacific Partnership and the Fix America's Surface Transportation Act



Provisions in the proposed Trans-Pacific Partnership (TPP) that specifically bar parties from levying import processing fees on an *ad valorem* basis could signal impending changes in the way US Customs and Border Protection (Customs) calculates the Merchandise Processing Fee (MPF). Recent legislation that calls for adjustments for inflation to customs fees, including MPF, may complicate matters even further.

MPF is an *ad valorem* fee. It is the primary user fee charged on importations into the United States, paid at the time an entry is presented to Customs. For formal entries, MPF is calculated as a percentage (0.3464%) of customs value, with a USD485 cap and USD25 floor applied to the amount charged. MPF is based on the transaction value of the merchandise.

As noted in the December 2015 edition of *TradeWatch*, the formal text of the proposed TPP was made available on 5 November 2015. The TPP is yet to be ratified through one of several possible scenarios before it enters into force for any of the parties, including the United States. Article 2.15, Paragraph 1 of the TPP invokes a principle from the 1994 General Agreement on Tariffs and Trade that fees and charges levied in connection with imports or exports “are limited in amount to the approximate cost of services rendered and do not serve as barriers to trade.”

Paragraph 4 of Article 2.15 of the TPP goes on to state that no party “shall levy fees and charges on, or in connection with, importation or exportation on an *ad valorem* basis.” Taken together, the current text of the TPP seems to provide for a flat fee structure to guarantee that administrative fees represent the actual cost incurred by customs agencies to process imports. A footnote expressly identifies MPF as the only US fee to which Paragraph 4 applies three years after the proposed agreement’s entry into force. This suggests that other *ad valorem* fees assessed by Customs, such as the Harbor Maintenance Fee, are exempt from the Paragraph 4 requirement.

Discussions to date appear to have focused on a tiered structure for the determination of MPF payments on formal entries, based on the value of an entry. One example suggests the following value ranges and corresponding: USD2,500 (minimum for a formal entry) to USD20,000 - MPF of USD30; USD20,001 to USD55,000 - MPF of USD120; USD55,001 to USD130,000 - MPF of USD260, and; USD130,001 and above - MPF of USD500. Merchandise entered informally is already subject to a tiered structure: USD2 if the entry is automated and not prepared by Customs, USD6 if the entry is manual and not prepared by Customs, or USD9 if Customs prepares the entry regardless of whether the entry is automated.²⁵

²⁵ 19 CFR §24.23 (b)(2).



Practices for charging customs processing fees differ per country. Japan charges fixed-amount customs brokerage fees for various customs clearance procedures, generally between JPY4,000 and JPY10,000 (approximately USD36 to USD90). Australia has a tiered fixed fee for customs processing based on whether goods are imported via air or sea, and whether the customs value of the goods is greater or less than AUD10,000 (approximately USD7,200). On the other hand, Mexico charges the *Derecho de Trámite Aduanero* (Customs Processing Fee), a 0.8% *ad valorem* fee similar to MPF that is charged on the customs value. Mexico's fee structure is also likely to require changes if TPP is adopted.

Should TPP enter into force, the United States Congress could approve an exemption of MPF for goods determined as originating in a TPP country. Such exemptions exist for most – but not all – US free trade agreements currently in force. For example, NAFTA (North American Free Trade Agreement) Annex 310.1 eliminated MPF for goods qualified to be marked as originating in Canada or Mexico as of 1999. Similarly, CAFTA-DR (Dominican Republic-Central America FTA) Article 3.10, US-Singapore FTA Article 2.8 and a number of other agreements²⁶ provide exemptions of MPF for qualifying goods.

Further complicating the future of the MPF is a provision within the Fix America's Surface Transportation Act (FAST Act), which the US President signed on 4 December 2015. Section 32201 of the FAST Act calls for certain customs service fees, including the MPF, and the limitations on such fees (both cap and floor) to be adjusted for inflation beginning in 2016.²⁷ Specifically, this section of the FAST Act adds text to the end of 19 USC §58c, stating that "on 1 April 2016, and at the beginning of each fiscal year thereafter" the Secretary of the Treasury will adjust such customs fees and the limitations on such fees "to reflect the percentage (if any) of the increase in the average of the Consumer Price Index for the preceding 12-month period compared to the Consumer Price Index for fiscal year 2014."²⁸

To calculate this adjustment, the Secretary of the Treasury: "(A) shall round the amount of any increase in the Consumer Price Index to the nearest dollar; and (B) may ignore any such increase of less than 1 percent."²⁹

Under this provision, the current USD25 floor and USD485 cap of the MPF are likely to be adjusted in the future. Any increase to these amounts in April 2016 is dependent on inflation figures, which have not yet been released by the Bureau of Labor Statistics. It is worth mentioning that the year-over-year increase to the Consumer Price Index for December 2015 was 0.7%, which is below the 1% inflation threshold cited in the FAST Act. Depending on TPP's potential impact on the MPF calculation method, it remains to be seen how an inflation adjustment – as called for in the FAST Act – may affect MPF payments beyond increases to the applicable ceiling and floor.

Importers wishing to take advantage of possible duty savings under the TPP once the agreement goes into force should continue to monitor news related to the MPF. Additionally, importers who regularly pay the MPF should remain aware of inflation-based adjustments to the maximum and minimum MPF amounts, as well as to the calculation method of the amount to be charged.

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

For additional information, contact:

Ernst & Young LLP (United States)

Tim Heyse, *Dallas*
+1 214 969 0652
tim.heyse@ey.com

²⁶ The Harmonized Tariff Schedule of the United States (HTSUS), General Statistical Note 1(c) provides a list of FTAs, under which qualifying goods are MPF-exempt subject to certain conditions.

²⁷ Fix America's Surface Transportation Act, Pub. L. No. 114-94, §32201, 129 Stat. 1312, 1892 (2015).

²⁸ *Id.* §32201 (a)(1)(1).

²⁹ *Id.* §32201 (a)(1)(2).

Doing business with Iran: highlights of the Iran deal nuclear-related sanctions



The years-long negotiations between Iran and the P5+1 countries³⁰ resulted in the Joint Comprehensive Plan of Action (JCPOA), which details Iran's commitments to scale back its nuclear infrastructure as well as the sanctions to be lifted once those commitments are met. Following confirmation from the International Atomic Energy Agency (IAEA) that Iran had met its initial preparation requirements to comply with the agreed-upon commitments, the parties' JCPOA activities have begun. The lifting of nuclear-related sanctions that took place beginning on 16 January 2016, or "Implementation Day," also signals a time for Iran to begin receiving relief from such sanctions and contemplate normalization of business, trade and political relationships. The changes in the Iran sanctions are nuanced, which can create risks for businesses in their international transactions and supply chains.

Overview

In accordance with the JCPOA, the United States has lifted certain sanctions; carved out of specific, authorized activities for US persons³¹ and US-owned or US-controlled foreign entities; and provided for changes to its licensing policy with respect to certain activities with Iran.³²

The United States has removed more than 400 individuals and entities from the Office of Foreign Assets Control (OFAC) proscribed party lists, including the Specially Designated Nationals (SDN), Non-SDN Iranian Sanctions Act and Foreign Sanctions Evaders lists. However, US secondary sanctions remain in place that target dealings by non-US persons with Iranian persons and entities remaining on the SDN list (e.g., the Iranian Revolutionary Guard Corps).

³⁰ P5 + 1 countries include China, France, Germany, Russia, the United Kingdom and the United States.

³¹ The term "United States person" or "US person" means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States. See 31 C.F.R. § 560.314.

³² Office of Foreign Assets Control, Department of the Treasury, Iran Transactions and Sanctions Regulations, General License H: Authorizing Certain Transactions Relating to Foreign Entities Owned or Controlled by a United States Person, 16 January 2016.



Additional parallel authorities remain in place aimed at countering Iran's other activities related to terrorism, proliferation of weapons of mass destruction, support for persons involved in human rights abuses in both Iran and in Syria,³³ and support for persons threatening the peace and stability of Yemen.³⁴ Thus, policy changes associated with the JCPOA do not substantially affect compliance required of US persons with the broader Iran trade embargo still in effect, and they still carry compliance risks for non-US persons.

US-owned or US-controlled foreign entities: authorized engagement with Iran

As of 16 January 2016, the Department of the Treasury's OFAC issued General License H (GL-H) that authorizes direct or indirect engagement by such US-owned or US-controlled foreign entities³⁵ with "the Government of Iran or any person subject to the jurisdiction of the Government of Iran" that would otherwise be prohibited under current US laws. US persons, unless specially authorized, will still generally be prohibited from engaging in any of these transactions directly.

US regulations also forbid US persons from directly engaging in, or facilitating³⁶ others to engage in, prohibited dealings with Iran; the Government of Iran, including government-owned or -controlled entities; individuals; and legal entities. GL-H specifically carves out two types of permitted activities for US persons that directly address the element of facilitation: establishing or altering corporate policies and procedures and making certain "automated" and "globally integrated" business support systems available to US-owned or US-controlled foreign entities "to the extent they are necessary" in order to allow the foreign entity to engage in transactions authorized by GL-H.

Anecdotally, OFAC has traditionally used a broad brush approach with regard to activities it considers "facilitation." In the absence of historical example to guide compliance with these newly permitted activities, US persons utilizing GL-H should continue to document compliance and exercise care in pursuing activities in furtherance of such transactions with its foreign entities where the regulations do not permit management, oversight, or day-to-day operational support of resultant transactions or activities with the foreign entity.

³³ Iran Threat Reduction and Syria Human Rights Act of 2012, Pub. L. No. 112-158, 126 Stat. 1214 (2012).

³⁴ Exec. Order No. 13611, 77 Fed. Reg. 29,533 (18 May 2012).

³⁵ "... an entity is 'owned or controlled' by a United States person if the United States person: (1) holds a 50 percent or greater equity interest by vote or value in the entity; (2) holds a majority of seats on the board of directors of the entity; or (3) otherwise controls the actions, policies, or personnel decisions of the entity." *Id.*

³⁶ Facilitation can be described as a kind of enablement. Examples of facilitation activities include making referrals; changing practices or procedures to allow others to engage in prohibited transactions; providing business, legal planning or other support (e.g., advice, payroll, IT, logistics or other operational support); or granting approvals (tacit or overt). Facilitation is also viewed as foreign persons that "cause" a US person to violate US law.

Other authorized activities

The US has implemented a favorable licensing policy, according to which OFAC will issue specific licenses on a case-by-case basis that will authorize US persons and certain non-US persons (who are not on the SDN and Denied Persons lists) to engage in activities associated with the export or re-export of commercial passenger aircraft as well as related parts and services.

OFAC has issued a general license (effective 21 January 2016³⁷) for specific activities involving the importation of carpets and certain Iranian-made textiles and foodstuffs. The license provides specific requirements for financing and brokering the importation of these items from Iran.

Sector-specific effects

Secondary US sanctions, subject to exclusions and other conditions, were lifted across the following areas: finance and banking; petrochemical and energy; shipping, shipbuilding and port operations; trade in gold, precious metals, graphite and raw or semi-finished metals; provision of insurance, reinsurance and underwriting; and trade with Iran in the automotive sector as well as for services associated with these areas. Some of these provisions are highlighted in greater detail below.

Petrochemical and energy

Non-US persons are now free to participate in the Iranian crude oil market and invest in Iran's oil, gas and petrochemical sectors, provided the transactions do not involve persons on the SDN list. US persons, however, continue to be prohibited from engaging in activities related to Iran's energy sector, and US financial institutions are still prohibited from processing payments related to Iranian oil. Iran's oil production and exports, which had been subject to an EU embargo, are expected to increase due to the sanctions relief.

Technology and personal mobile communications

While separately enacted from the Implementation Day licensing and policies described above, General License D-1 (GL-D1), issued 7 February 2014, amending and replacing General License D, provides that authorized activities may be enhanced by policy changes affecting non-US persons and transactions involving US-owned or US-controlled foreign entities.

GL-D1 currently allows US persons to export to Iran certain specifically enumerated fee-based hardware, software and services incidental to personal communications (e.g., smartphones, mobile phone accessories, mobile applications and computers). GL-D1 further authorizes US persons, wherever located, and US-owned or US-controlled foreign entities to engage in certain specified export transactions.

The provisions of GL-H may provide additional pathways for the use of GL-D1 licensing provisions, as US-owned or US-controlled foreign entities may now engage in permitted Iranian transactions (and US persons may engage in necessary limited activities in furtherance of such transactions). The removal of parties from SDN lists may support these activities as well, where dealings with such persons or entities are now authorized.

Automotive sector

Secondary sanctions covering non-US persons were also lifted in connection with the sale, supply, or transfer of goods and services used in Iran's automotive industry. US automakers are still prohibited from exporting or re-exporting, selling or supplying – directly or indirectly from the US – any goods, technology or services to Iran's automotive industry.



³⁷ 31 C.F.R. §560 and Appendix A to Chapter V, 81 Fed. Reg. 3330 (21 January 2016).

Finance

Iran's financial markets are now open for investment to non-US persons, who can engage in activities related to the Iranian rial (IRR), provide US bank notes to the Iranian Government, purchase Iranian sovereign debt and provide financial messaging services to certain Iranian financial institutions. The United States has removed bilateral trade limitations on the Central Bank of Iran revenues held abroad, allowing financial institutions to conduct transactions with funds that were previously restricted. Prohibitions still remain on US persons with regard to these activities, including processing or receiving funds or any transfer of funds to, from or through a US depository institution, or a US-registered broker or dealer in securities.

What to expect going forward

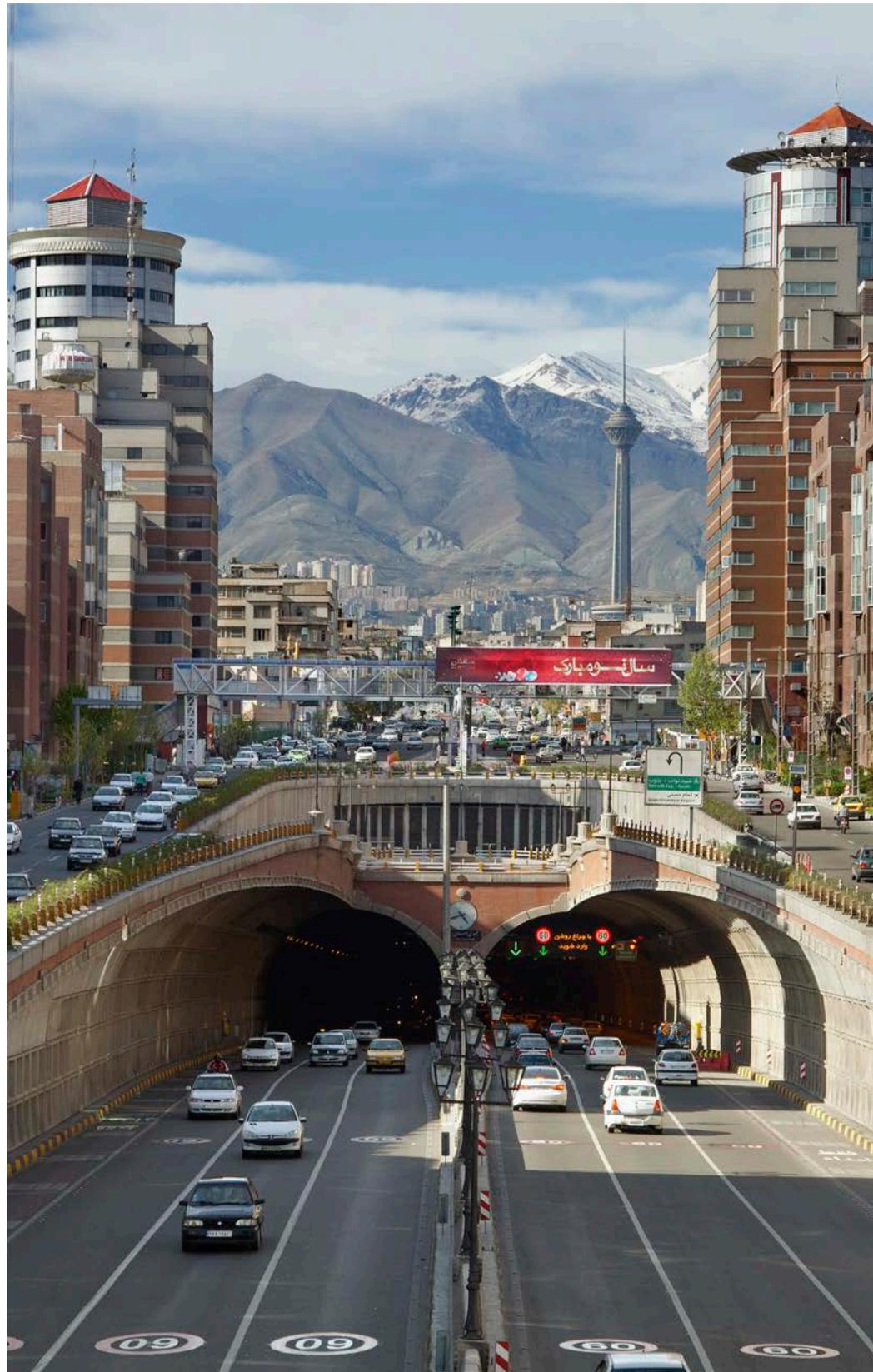
Changed circumstances, political uncertainty, and the possibility that new or more restrictive sanctions may be enacted at any time should serve as a constant warning for companies engaged in any permitted activities with Iran, directly or indirectly. A company should continue to maintain vigilance in its compliance structures, evaluate the sufficiency of existing corporate systems (e.g., whether sufficient firewalls are in place to protect US persons from authorized activities of US-owned or US-controlled foreign entities), and consider any future contracts and supply chain security issues, as well as comprehensive internal reporting and escalation policies, to ensure risk mitigation.

For additional information, contact:

Ernst & Young LLP (United States)

Angelica Tsakiridis, *San Francisco*
+1 415 894 4922
angelica.tsakiridis@ey.com

Katie Gustafson, *Dallas*
+1 214 754 3231
katie.gustafson@ey.com



Hong Kong

Hong Kong Customs introduces Free Trade Agreement Transshipment Facilitation Scheme



Transshipping goods through Hong Kong has often been problematic for companies that expect their goods to qualify under various free trade agreements (FTAs). To address this concern, the Hong Kong Customs & Excise Department (Hong Kong Customs) has recently rolled out the Free Trade Agreement Transshipment Facilitation Scheme (FTA Scheme). The FTA Scheme, which went live from 20 December 2015, will facilitate qualifying consignments passing through Hong Kong to enjoy preferential duty rates under the FTAs signed by Mainland China and to streamline the transport of goods under the Economic Cooperation Framework Agreement between Mainland China and Taiwan (ECFA).

Most FTAs have strict rules of origin, and preferential treatment is usually only granted for goods that meet each FTA's rules of origin. In broad terms, under direct consignment rules, goods transhipped through an intermediate country lose their FTA benefits entitlement if the intermediate country is not a party to the FTA and the goods do not remain under customs control.

Due to its status as a duty-free port, Hong Kong has traditionally not been a party to many of the FTAs in the region, and with the exception of certain dutiable commodities,³⁸ Hong Kong does not provide bonded warehousing facilities to meet the transshipment requirements. Consequently, preferential origin claims for goods without a single through bill of lading that have been transhipped through Hong Kong have been denied.

To strengthen Hong Kong's position as a logistics hub, the FTA Scheme provides a facilitation service and issues a certificate of non-manipulation (CNM) for certain goods passing through Hong Kong that may qualify for preferential treatment under 13 FTAs to which Mainland China is a party. Upon receiving a trader's application, Hong Kong Customs may issue a CNM after vetting the application or selecting the shipment for inspection. Cargo consolidation, vanning, devanning or repacking in Hong Kong must be done under Hong Kong Customs supervision.

³⁸ There are four categories of dutiable commodities: alcoholic beverages, tobacco, methyl alcohol and hydrocarbon oils.



The FTA Scheme covers transshipment cargo in Hong Kong heading for Mainland China under the following agreements:

- ▶ Economic Cooperation Framework Agreement between the Mainland and Taiwan
- ▶ China-Korea Free Trade Agreement
- ▶ China-Australia Free Trade Agreement
- ▶ Framework Agreement on Comprehensive Economic Co-operation between the Association of South East Asian Nations and the People's Republic of China
- ▶ China-Pakistan Free Trade Agreement
- ▶ China-Singapore Free Trade Agreement
- ▶ China-Iceland Free Trade Agreement
- ▶ China-Switzerland Free Trade Agreement
- ▶ China-Chile Free Trade Agreement
- ▶ China-Costa Rica Free Trade Agreement
- ▶ China-Peru Free Trade Agreement
- ▶ China-New Zealand Free Trade Agreement
- ▶ Asia-Pacific Trade Agreement

The FTA Scheme also covers transshipment cargo in Hong Kong heading for Taiwan, Korea and Australia under the following agreements:

- ▶ Economic Cooperation Framework Agreement between the Mainland and Taiwan
- ▶ China-Korea Free Trade Agreement
- ▶ China-Australia Free Trade Agreement

CNM visas

In the past, the visa department of the China Inspection Company Limited (CIC), an organization established in Hong Kong by the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and the Certification and Accreditation Administration of China (CNCA), was authorized to issue CNM visas to be affixed to a certificate of origin for goods transited via Hong Kong. However, acceptance of CNM visas issued by the CIC was mostly limited to cargo bound for Mainland China under a handful of prescribed FTAs.

The extended FTA coverage announced by Hong Kong Customs for both Mainland China in-bound and out-bound cargo under the FTA Scheme should greatly benefit importers as it is an official endorsement by Hong Kong Customs that the goods did not undergo any operations and the condition of the goods remains the same as at the origin of export.

According to Hong Kong Customs, the CIC is likely to continue to be the issuing authority for transshipment cargo concerning aquatic animals, animal fur, fruits and ornamental fish.

Limitations on the applicability of the CNM for China outbound shipments

In light of the above, the CNM coverage for outbound goods from the Mainland under the respective FTAs appears to be somewhat limited at present. Only 3 of the 13 FTAs with Mainland China are listed under Hong Kong Customs' FTA Scheme announcement for outbound goods, namely with Taiwan, Korea and Australia.

The Australian Government has also recently clarified that goods transhipped through a third party into Australia, including Hong Kong and Singapore, will not require any specific additional documentation to grant preferential duty treatment under the China-Australia Free Trade Agreement (ChAFTA). However, this does not relieve the importer of the obligation to ensure that goods transiting, transshipping and warehousing through Hong Kong do not undergo any operation other than unloading, reloading, repacking or relabeling for the purpose of satisfying the requirements of Australia, or splitting up of the goods for further transport, temporary storage or any other operation that is necessary to preserve the goods in good condition. The Australian



authorities may request documentary evidence from importers to prove that the goods meet the foregoing requirements.

Comparison with Singapore

Like Hong Kong, Singapore is also a major transshipment port, and many shipping lines use Singapore as a transit hub to transport their goods to the country of final destination. To assist traders, Singapore Customs issues CNM as documentary evidence that the goods have not undergone any manipulation and have not been switched during transit.

To qualify for CNM, the goods must not have undergone any processing other than what is necessary to keep them in good condition, and they must have been kept under Singapore Customs surveillance, i.e., the goods should have been stored in a Zero-GST (goods and services tax) warehouse, a licensed warehouse or in a free trade zone during the period of transit in Singapore.

The table below shows some key comparisons between the Hong Kong Customs' FTA Scheme and Singapore Customs' CNM.

Description	Hong Kong Customs' FTA Scheme	Singapore Customs' CNM
Scope of service	Covers inbound shipment to Mainland China under 13 FTAs and outbound shipments from Mainland China to Taiwan, Korea and Australia ³⁹	Not restricted to any FTAs
Applicant	The relevant local shipment agent or freight forwarder with a letter of authorization from the owner of the goods	The relevant local shipment agent or freight forwarder who acts as agent on behalf of the overseas principal
Storage of goods	Goods are stored in Hong Kong	Goods are stored in free trade zone, Zero-GST warehouse or licensed warehouse in Singapore
Fees payable	Basic fee is HKD155 (approximately USD19.9) per application. Other charges may apply for cargo consolidation (vanning, devanning, repacking or others)	SGD4 (approximately USD2.9) per application
Maximum period of stay	The maximum period that goods are allowed to remain in Hong Kong is 2 to 12 months for some of the specified FTAs. Note that the total time period for the storage and final leg shipment may not exceed the validity period of the preferential certificate of origin.	Not specified. Note that the total time period for the storage and final leg shipment may not exceed the validity period of the preferential certificate of origin.
Acceptance by the importing country	Applicable to the countries/ FTAs listed above	Subject to acceptance by the importing country

³⁹ Australia Customs does not require CNM from Hong Kong Customs when granting preferential tariff treatment under China-Australia FTA.

Future outlook for Hong Kong

The FTA Scheme announced by Hong Kong Customs should benefit importers who wish to claim preferential duty benefits for goods transhipped or warehoused in Hong Kong under the various FTAs, which in the past could not meet the rules of origin requirements if transhipped through Hong Kong.

The FTA Scheme is positioned to set a positive precedent for discussions with the customs authorities on other FTAs (FTAs to which Mainland China is not a party) to support the eligibility for preferential treatment of goods transhipped or warehoused in Hong Kong.

Look for updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young Tax Services Ltd (Hong Kong)

Joanna Chow, *Hong Kong*
+852 2629 3438
joanna.chow@hk.ey.com

Ernst & Young Solutions LLP (Singapore)

Juan Fook Tan, *Singapore*
+65 6309 8061
juan-fook.tan@sg.ey.com



India

Customs valuation for related-party transactions: key changes in investigation procedure



India's Central Board of Excise and Customs (Customs) has issued Circular No 4/2016 and Circular No 5/2016, both dated 9 February 2016,⁴⁰ to completely revamp the Special Valuation Branch (SVB) procedure for investigating related-party import transactions and to address traders' concerns with a number of issues, such as delays in finalizing investigations, continued imposition of Extra Duty Deposits (EDD), arbitrary assessments and difficulties with renewing SVB orders. These changes take into consideration the *World Customs Organization Guide to Customs Valuation and Transfer Pricing* published in June 2015.⁴¹

Related-party transactions are investigated by the SVB (a specialized division of Customs) to ensure that the relationship between the overseas supplier and the importer has not influenced the declared value of imported goods. Following investigation, SVB issues an order that confirms whether the related parties' relationship has affected the import prices. If SVB finds that the relationship has influenced prices, SVB quantifies the extent of the influence and recommends a "loading" (increase) of the declared value as a percentage of the import price.

The SVB order is valid for three years, after which importers must approach the authority for renewal.

A unique feature of the SVB process is the "gatekeeper" concept where the importer is required to make an EDD for every related-party import transaction until the SVB order is issued. While the EDD amount is refundable, given the backlog of cases to be resolved, the funds can be tied up for a long time, which causes unfair hardship to importers.

Additionally, challenges at the operational and administrative levels result in delays in finalizing the SVB investigations and, in certain cases, exposure to arbitrary loading of the declared import value of goods sourced from related parties.

Changes in the procedure for investigation of related party imports are outlined below.

⁴⁰ Customs Circulars have the legal effect of guidelines.

⁴¹ For additional information, see "World Customs Organization publishes guide to customs valuation and transfer pricing" in the September 2015 issue of *TradeWatch*.



Key features of Circular No. 4/2016 applicable to pending SVB cases as of 9 February 2016

Cases where the SVB order is pending renewal

Importers need to submit a declaration using the forms provided in either Annexure 1 or Annexure 2, as applicable, to the SVB by 31 May 2016.

- ▶ Annexure 1 – One-time declaration that there is no change in:
 - ▶ The circumstances of the sale
 - ▶ Terms and conditions of agreement
 - ▶ Related supplier
 - ▶ Royalty/license arrangements
 - ▶ Post-importation price adjustments

In the case of Annexure 1 declaration, there is no requirement for the renewal process; EDD is immediately discontinued and all pending provisional assessments are finalized.

- ▶ Annexure 2 – One-time declaration where any of the above changes exist.

In the case of Annexure 2 declaration, the SVB enquiries will be initiated according to the procedure laid out in Circular 5/2016 with the objective to close the investigations as soon as possible.

Cases pending SVB investigation where a first order has not been issued

- ▶ If the importer has submitted all the required information, then EDD is discontinued.
- ▶ In cases where the EDD has been increased from 1% to 5% (in cases where the documentation provided is incomplete), the SVB office will call for the relevant documents to complete the investigation and issue directions to discontinue the EDD.

It is likely that in practice EDD will be discontinued after the investigation is complete; however, the statement in the Circular can also be interpreted that once the complete information is submitted, EED would be discontinued. In any case, the Government's decision to stop levy of EDD upon completed submission of information and documents is a welcome change. It remains to be seen whether, and to what extent, SVB offices will adhere to these guidelines.

Key features of Circular No. 5/2016 – SVB Procedure for new cases of related-party imports

Phase 1: Selection of cases for SVB investigation

Every importer is required to file a completed questionnaire as provided in Annexure A to Circular 5/2016 at the time of filing the corresponding bill of entry. Annexure A lists a number of documents to be submitted, such as Advance Pricing Agreements, transfer pricing reports, pricelists and others.

- ▶ Within three days, the customs officer at the port of entry must determine whether:
 - ▶ To clear the goods on provisional assessment basis and refer the matter to SVB for investigation
- Or
- ▶ Whether the assessment can be finalized by conducting enquiries in terms of Rule 4 to 9 of the Customs Valuation Rules, 2007 (transaction value of identical goods, transaction value of similar goods, deductive value, computed value, or residual (fallback) method)
- Or
- ▶ Whether the assessment can be finalized under Rule 3 of the Customs Valuation Rules, 2007 (transaction value)

Phase 2: Clearance of goods

- ▶ In case the related-party transaction is referred to SVB, SVB will clear the imported goods by making a provisional assessment of the corresponding Bill of Entry, and the importer will be required to furnish additional information according to the questionnaire in Annexure B.
- ▶ In that case, the importer will not be required to pay 1% EDD for new SVB cases immediately upon importation of the goods into India. However, if the importer does not submit the required information listed in Annexure B within 60 days, then a security deposit amounting to 5% of the declared import value will be required to be paid for all goods imported from related parties over a period of three months. Importers can make the security deposit by way of either a cash deposit or a bank guarantee.

The above represents an important change whereby, going forward, EDD will not be charged upon importation and importers will be given time to comply with the documents and information request. Also for the first time, importers have the option to provide the security deposit either in cash or by bank guarantee.

Phase 3: SVB investigation

- ▶ The SVB commences its investigation upon receipt of the information and documents from the customs officer. The SVB office then submits an Investigation Report (IR) to the concerned customs officer at the port of import.

This is a significant change. Going forward, the SVB office will no longer issue to the importer an SVB order accepting or rejecting the value of imported goods. Instead, the SVB office will issue an IR to the customs officer at the port of import.

Phase 4: Assessment finalization

- ▶ If the declared value conforms to Rule 3 of CVR 2007 (transaction value may be used), then all provisional assessments are finalized immediately.
- ▶ If the SVB determines that the declared value is influenced by the related-party relationship, then the customs officer will issue a “show cause notice” to the importer within 15 days after the IR is received. The customs officer at the port of import will issue an order quantifying the extent of influence on the declared value.
- ▶ The previous provision where the SVB order was valid for a period of three years and then the importer was required to renew the order has been abolished. Existing SVB orders remain valid until there is a change in the facts of the related-party import transactions.

The above clarifications are positive steps addressing the challenges faced by importers while also balancing the Government’s interests.

Look for updates in future issues of *TradeWatch*

For additional information, contact:

Ernst & Young LLP (India)

Suresh Nair, *Mumbai*
+91 22 6192 0000
suresh.nair@in.ey.com

Sarika Goel, *Gurgaon*
+919650702224
sarika.goel@in.ey.com

Harishanker Subramaniam, *Gurgaon*
+91 124 6714103
harishanker1.subramaniam@in.ey.com



Indonesia

New regulation on Bonded Logistics Centers



The Government of Indonesia recently issued a new regulation⁴² on Bonded Logistics Centers (BLCs) in Indonesia. BLCs provide greater flexibility and efficiency in the logistics of importing and exporting goods. They are an extension of the bonded warehouse concept whereby an offshore entity may store imported goods without paying import duty and taxes.

However, there is an important distinction between a BLC and a bonded warehouse. In the case of a BLC, at the time the goods leave the BLC for the domestic Indonesian market, the importer of record need not be the BLC operator and may be the Indonesian entity receiving the goods (the Indonesian customer). The Indonesian customer may act as the importer of record and hence may use its import privileges when receiving deliveries from the BLC. These privileges include the Master List (a list of goods that are granted import duty exemption and, in some circumstances, additional tax exemptions) for capital investment in Indonesia or the oil and gas industry or taking advantage of preferential tariffs under a free trade agreement, such as Association of Southeast Asian Nations (ASEAN)-China Free Trade Agreement, and others.

Other features of the BLC include:

- ▶ Goods can be stored in the BLC for a maximum of three years with an option for extension.
- ▶ A greater number of simple operations may be carried out in the BLC, such as consolidation, repairing, blending, reassembling and the like, as compared to bonded warehouse.
- ▶ The BLC operator must be an Indonesian legal entity, consistent with the requirements for a bonded warehouse. However, the BLC entrepreneur may be an offshore entity that has a permanent establishment in Indonesia with the necessary governmental licenses and tax registration.
- ▶ The regulation stipulates that title of the goods may be retained by a foreign supplier.
- ▶ Goods stored in the BLC may be sourced from imports, other bonded storage, free zones and economic zones. Under certain circumstances, BLC may also receive goods from the domestic market to be used to support the BLC entrepreneur's activities or for export. We expect further regulations to clarify what types of goods may be received from the domestic market.

⁴² Minister of Finance Regulation no. 272/PMK.04/2015.



Potential benefits of the BLC

- ▶ BLCs allow subcontractors of oil and gas companies that work under a production sharing contract (PSC companies) to procure imported material and store it in the BLC. When the materials are shipped out from the BLC, PSC companies act as the importer of record and are eligible to use their import privileges (e.g., the PSC Master List). For tax purposes, subcontractors may now use the customs declaration upon importation into a BLC to support the sale of the imported materials to the PSC companies.
- ▶ The regulation specifically outlines the potential for movement of exempted goods under the PSC Master List. PSC companies may return excess material to the BLC without the risk of being subjected to import duty and tax clawback and the payment of value-added tax (VAT) and luxury goods sales tax (LGST).
- ▶ It is possible for foreign suppliers to store goods in Indonesia in a BLC. This will shorten the delivery time and help deal with potential commercial issues surrounding the issuance of letters of credits. However, the Indonesian tax consequences for storing goods in Indonesia will need to be considered.

To take advantage of the aforementioned benefits, companies who do business in Indonesia are advised to review whether they meet the requirements under the BLC rules and, if so, file an application with the Indonesian Customs Authority.

For additional information, contact:

Ernst & Young (Indonesia)

Ary Untung Sutoto, *Jakarta*

+62 21 5289 5000

ary.untung@id.ey.com

Thailand

Free Zone or Export Processing Zone: changes to duty privilege treatment and qualifying criteria



On 17 December 2015, the Ministry of Finance issued *Notification of Ministry of Finance regarding Exemption and Reduction of Customs Duty Rates Schedule under Section 12 of the Customs Tariff Decree B.E. 2530, No. 13* (2015 Notification). The purpose of the 2015 Notification is twofold:

1. To repeal and replace Clause 2 (7) (7.2) of an existing Ministry of Finance Notification dated 6 January 2012 (2012 Notification), which relates to the duty privilege treatment and corresponding qualifying criteria that apply to goods produced in a Free Zone (FZ) or Export Processing Zone (EPZ), which are subsequently sold or consumed domestically
2. To add a new clause (Clause 4/1) to the 2012 Notification to clarify the duty privilege treatment for goods imported into Thailand and brought into an FZ or EPZ for subsequent resale or consumption domestically

The 2015 Notification comes into effect on 20 June 2016, 180 days from the date of its publication on 22 December 2015.

If FZ or EPZ operators have already been granted duty reduction or duty exemption under Clause 2 (7) (7.2) of the existing 2012 Notification, or are awaiting the Thai Customs Department's decision on their

duty reduction or exemption application, their goods will continue to enjoy such duty exemption or duty reduction provided under the existing 2012 Notification for up to two years after the effective date of the 2015 Notification.

Key changes to Clause 2 (7) (7.2)

The purpose of the Clause 2 (7) (7.2) revision is to simplify the duty privilege regime and implement stricter eligibility requirements. The key changes are summarized below.

1. Simpler duty privilege treatment

Under the 2012 Notification, the applicable duty privilege rate varies depending on which regional or bilateral free trade agreement (FTA) rate the FZ or EPZ operator elects to apply and whether the goods meet the value test threshold under the respective FTA.

Under the 2015 Notification, the applicable duty privilege rate on goods produced in an FZ or EPZ that are subsequently sold or consumed domestically is set at 0%, subject to certain qualifying criteria.



2. Stricter qualifying criteria on goods produced by FZ or EPZ operator

To qualify for 0% duty, the FZ or EPZ operator must ensure that the goods meet both a value test threshold and a process test criteria, as outlined below.

Value test threshold: the goods must meet any one of the following thresholds:

- ▶ The total value of raw materials originating in Thailand, labor costs and other production costs actually incurred in Thailand in production of the goods, including profit, is not less than 40% of the ex-factory price of the goods.
- ▶ The total value of raw materials originating in Association of Southeast Asian Nations (ASEAN) countries, labor costs, and other production costs actually incurred in Thailand in production of the goods, including profit, is not less than 40% of the ex-factory price of the goods.
- ▶ The total value of the raw material content originating in Thailand and ASEAN countries, labor costs and other production costs actually incurred in Thailand in production of the goods, including profit, is not less than 40% of the ex-factory price of the goods.

With this change in the value test criterion, an FZ or EPZ operator will only be allowed to include raw materials that originate in Thailand and other ASEAN countries in their calculation of qualifying material costs of goods produced in FZ or EPZ and destined for sale or consumption domestically. The costs of raw materials originating from Thailand's other major FTA trading partners such as China, Japan and South Korea will be treated as non-originating materials in the value test threshold calculation.

Moreover, under the 2015 Notification, for the purposes of the value test threshold calculation, the value of raw materials transferred from another FZ or EPZ is defined as the FOB (free on board) price at the time the materials are brought into the FZ or EPZ (as opposed to the ex-factory price base applied under the 2012 Notification).

Process test

This is a new criterion which basically requires that the goods produced undergo an essential operation process in an FZ or EPZ.

Further details of the process test will be included in notifications to be issued by the Office of Industrial Economics or other governmental agencies with authority to control such goods.

3. Stricter qualifying criteria for locally procured materials sourced by an FZ or EPZ operator

Certain key definitions relevant to the qualifying criteria for locally procured materials have been expanded:

- ▶ The definition of "raw materials originating in Thailand" covers "raw materials produced in Thailand, including within an FZ or EPZ, where such raw materials are certified as being derived from an essential production process in the manufacture of the raw materials and not a minimal operation process."
- ▶ The definition of "minimal operation process" is expanded to include "assembly of parts of goods into a complete article, simple disassembly of goods into parts, or simple assembly or forming of parts into a complete item."



Customs formalities, as prescribed by Thai Customs, apply to the certification process described above. Details of the formalities are yet to be released.

The 2015 Notification also specifically provides that the prescribed formalities do not preclude Thai Customs from investigating any production processes carried out within Thailand.

4. Other key definitions

- ▶ “Ex-factory price” is defined as the “total value of costs of raw materials originating in Thailand, costs of raw materials originating from ASEAN countries, costs of raw materials imported from other countries or costs of raw material of which the origin cannot be identified, as well as labor costs and other production costs actually incurred in Thailand to produce the goods plus profit.”
- ▶ “Production costs” are defined as the “total value of costs of Thai raw materials, costs of raw materials imported from ASEAN countries, costs of raw materials imported from other countries or costs of raw materials of which the origin cannot be identified, as well as labor costs and other production costs actually incurred in Thailand to produce the goods.”
- ▶ “Profit” is defined as the “ex-factory price after deduction of production costs, with generally accepted accounting principles to be applied.”

Definitions of “production costs” and “profit” were not included in the 2012 Notification. For purposes of Clause 2 (7) (7.2), it is apparent that these definitions have been included to clarify the implied requirement that the ex-factory price base should include profit.

5. Additional eligibility requirements

To be eligible to apply the 0% duty rate treatment under the 2015 Notification:

- ▶ The importer of the goods must be able to prove that the goods meet the value test threshold and the process test criteria.

- ▶ The goods must not be subject to any notification issued by the Director General of Customs (DGC) that prohibits such goods from being brought into or moved out of an FZ or EPZ.
- ▶ The DGC has authority to approve or reject the application on the basis of the criteria and conditions stipulated in the 2015 Notification.

New Clause 4/1 on goods imported into Thailand and brought into an FZ or EPZ for domestic resale or consumption

Often goods that are eligible for customs duty privileges under any bilateral or regional FTAs are imported into Thailand and brought into an FZ or EPZ for purposes of distribution, sorting, picking, packaging, fixing labels or other marks, repackaging, quality testing, performance testing, sterilizing, or other commercial operations that do not result in a change of the customs classification and do not include any part of other goods from the FZ or EPZ. When such goods are offered for sale or domestic consumption, the applicable duty rate is determined according to the corresponding FTA preferential duty rate at the time of the goods’ importation into Thailand.

For additional information, contact:

Ernst & Young Corporate Services Limited (Thailand)

William Chea, *Bangkok*
+66 2264 9090 ext. 77056
william.chea@th.ey.com

Aschara Toopsuwan, *Bangkok*
+66 2264 9090 ext. 21046
aschara.toopsuwan@th.ey.com

Sireeras Janjarasskul, *Bangkok*
+66 2264 9090 ext. 21093
sireeras.janjarasskul@th.ey.com

Customs amnesty 2016: Voluntary Audit Program



The Thai Customs Department (Customs) has recently announced the latest round of the amnesty process as part of its policy and efforts to foster good working relationships with importers and exporters and to facilitate settlement of any past outstanding duty and indirect tax liabilities. The current Voluntary Audit Program (VAP) process is open from 1 January 2016 to 31 December 2016.

Similar to the last amnesty process in 2014, under the current VAP process, Customs sends selective invitations to trusted taxpayers suspected to have unintentionally underpaid duty and taxes to undertake a self-audit and report their findings for review by Customs. Depending on the outcome of the review, any outstanding liabilities may be settled with Customs without penalties.

Importers and exporters who have not been invited to participate but are interested in doing so may approach Customs and apply for an invitation.

However, the VAP process does not apply under any of the following circumstances:

- ▶ Imports smuggled into Thailand or imports with clear evidence of fraudulent intent to avoid duty payment
- ▶ Imports of prohibited or restricted goods, or goods that violate intellectual property rights

- ▶ Importers and exporters who are subject to an ongoing post-clearance audit process or investigation, or who are being prosecuted for customs violations by relevant government authorities, such as the Department of Special Investigations
- ▶ Repeat disclosure of the same issue(s) subject to a past VAP amnesty

VAP participants are required to provide documents or evidence relating to the issues disclosed to Customs within 30 days from the date the invitation letter is received. An extension may be requested, but the request must be made in writing and is subject to approval by Customs.

If a VAP participant fails to report, or hinders the reporting of his or her self-audit review results within the required timeframe, Customs may decide to launch a post-clearance audit at the participant's premises.

Key benefits of VAP participation:

- ▶ Waiver of penalties (penalties usually amount to 200% for duties, 100% for excise tax and 100% for VAT shortages)
- ▶ Waiver of the 1% per month duty surcharge (uncapped)
- ▶ Single point disclosure to the Customs Post-Clearance Audit team at Customs headquarters (this eliminates the need to disclose at each port of entry)

- ▶ Self-audit by importer or exporter with minimal or no disruption by Customs to day-to-day business operations

Companies looking to benefit from the 2016 Customs amnesty program are well-advised to review their current practices and consider participating in the VAP process.

For additional information, contact:

**Ernst & Young Corporate Services Limited
(Thailand)**

William Chea, *Bangkok*
+66 2264 9090 ext. 77056
william.chea@th.ey.com

Aschara Toopsuwan, *Bangkok*
+66 2264 9090 ext. 21046
aschara.toopsuwan@th.ey.com

Sireeras Janjarasskul, *Bangkok*
+66 2264 9090 ext. 21093
sireeras.janjarasskul@th.ey.com



Eurasian Economic Union Restrictions imposed on goods imported into Kazakhstan



In the December 2015 issue of *TradeWatch*, we discussed Kazakhstan's accession to the World Trade Organization (WTO) and certain legislative changes that Kazakhstan must implement as a result. Some of these changes, however, are caused by Kazakhstan's need to balance its WTO obligations with those of the Eurasian Economic Union (EAEU),⁴⁴ of which Kazakhstan is also a Member State.

In line with its WTO schedule of concessions, Kazakhstan is expected to reduce or eliminate the import duty rates of nearly 3,500 items within five years after accession to the WTO. Many of these duty rates (Kazakhstan's bound tariff rates) will, in fact, be lower than the duty rates of the same goods under the Common Customs Tariff (CCT) of the EAEU.

To prevent a situation whereby goods imported at the lower rates into Kazakhstan are later exported duty-free to other EAEU Member States, the Eurasian Economic Commission Council adopted Decision No. 59 dated 14 October 2015 and in force as of 11 January 2016 (the Decision). The Decision provides a list of 1,347 subheadings that will be subjected to lower duty rates than those set out by the CCT of the EAEU.

The Decision prohibits goods that are on the list (listed goods) and imported into Kazakhstan at Kazakhstan's bound tariff rates from being exported to other EAEU Member States. Alternatively, an importer may choose to pay the higher CCT rates upon importation into Kazakhstan for listed goods, in which case these goods may later be exported to other EAEU Member States.

For purposes of monitoring the movement of listed goods, the EAEU has also introduced changes in the rules for executing customs declarations. Importers must submit a separate customs declaration when importing listed goods if these goods are imported subject to Kazakhstan's bound tariff rates. However, if the importer chooses to pay CCT rates for any of the listed goods, then these goods may be declared on the same customs declaration as goods that are not on the list.

Additionally, for the purpose of monitoring the trade in listed goods, importers are required to issue an electronic invoice in the following cases:

- ▶ In the event of a sale of listed goods that are imported into Kazakhstan from outside of the EAEU
- ▶ In the event of a sale of listed goods that are imported into Kazakhstan from other EAEU Member States

⁴⁴ Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia.

- ▶ In the event of a sale of listed goods that are produced in Kazakhstan
- ▶ In the event listed goods are exported from Kazakhstan to other EAEU Member States for the purpose of moving them between branches of the same legal entity, where the listed goods have been:
 - ▶ Imported into Kazakhstan from outside of the EAEU
 - ▶ Imported into Kazakhstan from EAEU Member States

Companies that export listed goods from Kazakhstan to other EAEU Member States are required to issue electronic invoices and shipping documents that are authorized by the government revenue agencies.

Importers and exporters who fail to comply with the above requirements may be subjected to administrative penalties and may also be prohibited from exporting listed goods to other EAEU Member States.

Look for updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young Kazakhstan LLP

Dinara Tanasheva, *Almaty*
+7 727 258 5960, ext. 1220
dinara.s.tanasheva@kz.ey.com

Borys Lobovyk, *Almaty*
+7 727 258 5960, ext. 1250
borys.lobovyk@kz.ey.com

Samat Karmys, *Astana*
+7 7172 58 04 00, ext. 1743
samat.karmys@kz.ey.com

Dauren Rakhymgozhin, *Astana*
+7 7172 58 04 00, ext. 1748
dauren.rakhymgozhin@kz.ey.com



European Union

Recent European Court of Justice case brings further clarification regarding treatment of shortages during movement of excise goods under suspension



In the December 2015 edition of *TradeWatch*, we reported on the European Commission's provisional recommendation regarding the excise duty liability arising where a shortage has been detected as a result of a movement of goods under excise duty suspension.

Recently, the Court of Justice of the European Union (ECJ) released its ruling in Case C-64/15, *BP Europa SE v. Hauptzollamt Hamburg-Stadt*, 28 January 2016, concerning the excise duty treatment of shortages identified by consignees and warehouse keepers at delivery. The ECJ brings further clarity regarding the treatment of shortages in the event that the excise goods moved under duty suspension do not arrive at their destination.

Excise duties resulting from irregularities (total or partial loss) during a movement of excise goods under excise duty suspension usually become due in the Member State where the irregularity arose. If it is not possible to establish where the irregularity arose, the duties become due in the Member State where the irregularity was detected. However, EU excise duty legislation also provides that if excise goods do not arrive at their destination but no irregularity has been detected in transit, an irregularity is deemed to have occurred in the Member State of dispatch, and the excise duties become due there.

These provisions have led to differences in interpretation among EU Member States relating to shortages that are identified only upon arrival at the premises of the consignee or warehouse keeper in the Member State of destination. Some Member States treat such shortages as "irregularities," while others treat them as "goods which did not arrive."

Overview of the facts and findings

BP Europa had dispatched excise goods (gas oil) to a tax warehouse in Germany. The owner of the tax warehouse found a discrepancy between the volume of oil received and the original dispatch volume stated on the commercial documentation.

The German tax authorities levied excise duty on the missing volume because it exceeded the tolerance threshold generally allowed in Germany. They considered that the irregularity was committed (and therefore the excise duty should be levied) in the Member State where it was detected (i.e., Germany). BP initiated a court case, and the German court lodged preliminary questions to the ECJ.



First, the ECJ clarified when the movement of excise goods under a duty suspension arrangement ends, as the chargeability of the excise duty, in respect of goods under a duty suspension arrangement, is linked to the departure from that arrangement. The ECJ has ruled that the movement ends when the consignee of those goods has found, after unloading in full from the means of transport carrying the goods in question, that there were shortages of the goods in comparison with the amount which should have been delivered to him or her.

This is particularly relevant because excise goods are deemed not to have arrived if no "irregularity" has been detected during their movement. The excise duties are then to be levied by the EU Member State of dispatch. But if a shortage is detected during the movement, it will qualify as an "irregularity," and excise duty will be levied in the EU Member State of destination (or in the EU Member State where the shortage was first detected).

Considering the different interpretation across the EU with regard to treatment of shortages as "irregularities" or "goods which did not arrive," the German court asked the ECJ whether the excise duty provisions regarding the "goods which did not arrive" can be applied in situation where only some – but not all – of the consignment arrives at the destination. Tax authorities across the EU had typically taken the practical approach that the provisions are applicable only where none of the consignment is delivered. In contrast, the ECJ found that these provisions also apply where only part of it fails to arrive.

Interpreting the ECJ ruling

While the ECJ ruling in the *BP Europa* case clarifies when an excise duty suspended movement of goods ends and how the term "taking delivery" should be interpreted (i.e., the unloading in full at point of destination), some practical challenges in relation to the treatment of shortages and irregularities will continue to exist.

Since shortages are most likely to be identified when the warehouse keeper or consignee takes delivery, any resulting excise duties will in all probability be due in the Member State of destination.

However, companies that trade in or transport excise goods will need to stay aware of the continued challenges of the conflicting views between the ECJ and national tax authorities. They will need to plan accordingly to proactively manage these practical challenges since a similar scenario to the one in this case could arise in any of the EU Member States.

As a result, the issue is under ongoing discussion by the European Commission. Look for updates and analysis on the outcomes of those discussions in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young LLP (United Kingdom)

Marius Cosnita, *London*
+44 20 7197 9221
mcosnita@uk.ey.com

Arjen Odems, *London*
+44 20 7951 1446
aodems@uk.ey.com

Ernst & Young Belastingadviseurs LLP (the Netherlands)

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

Italy

Customs Guidelines on transfer pricing and customs valuation



Assessment of the customs value using transfer pricing documentation has been the focus of numerous discussions and disputes between operators and the Italian customs authorities.

The non-harmonization of rules regarding the valuation of goods subject to inter-company transactions for income tax and customs purposes as well as the conflicting interests of the tax and customs authorities may lead to a difference between the value of transactions determined according to transfer pricing policy and the value of goods declared to customs.

In the current economic environment and due to difficulties with the forecasting of operating margins, the treatment of the transfer price adjustments by both the tax and customs authorities is a sensitive issue for multinational enterprises (MNEs).

For these reasons, the Italian Customs and the Italian Revenue agencies have signed a protocol to define the treatment of transfer pricing adjustments for customs valuation purposes. The main goal of the protocol is to offer businesses the proper tools that are shared by both the tax and customs authorities in order to correctly handle transfer pricing adjustments from a customs perspective.

In November 2015, the Italian Customs Agency published administrative guidelines⁴⁵ (the Guidelines) concerning customs value assessment carried out in accordance with the transfer pricing policy adopted by MNEs.

The Guidelines note that, in principle, both income tax and customs laws require that the valuation of goods in international transactions between related parties should not be affected by the existing relationship between them.

In this respect, the Guidelines identify a connection between the tax and customs laws, analyze the common aspects and propose technical solutions to solve implementation problems.

The topics of immediate interest to MNEs covered by the Guidelines are:

- ▶ Relevance of transfer pricing policy for customs purposes
- ▶ Impact of transfer pricing adjustments on customs value, when the adjustment constitutes a change of the imported or exported goods' price or of the amount of royalties due

⁴⁵ Circolare N. 16/D, Roma, 6 novembre 2015 (Circular No. 16/D, Rome, 6 November 2015).



The Guidelines, after a brief review of the basic rules on customs valuation provided by Articles 29 and 30 of the Community Customs Code as per Council Regulation (EEC) no. 2913/92 (CCC),⁴⁶ analyze the transfer pricing methods provided by the Organisation for Economic Co-operation and Development (OECD):⁴⁷

- ▶ Comparable Uncontrolled Price Method (CUP)
- ▶ Resale Price Method (RPM)
- ▶ Cost Plus Method (CPM)
- ▶ Transactional Net Margin Method (TNMM)
- ▶ Profit Split Method (PSM)

Italian Customs considers these methods acceptable for customs valuation purposes, although with varying reliability and some limitations. Notably, the TNMM, a method typically related to income (i.e., profit-based), can rarely be used for customs valuation of specific goods.

The Guidelines then address post-transaction transfer pricing adjustments and propose the following two alternative procedures to manage such adjustments:

1. Incomplete declaration
2. Advance lump sum of the customs value

These procedures may be used only after authorization by Italian Customs and are effective only for future transactions (i.e., for the operations carried out after the authorization is issued and until its expiration date).

Both procedures are in line with provisions in the *World Customs Organization Guide to Customs Valuation and Transfer Pricing* published in June 2015.⁴⁸

Incomplete declaration procedure

The incomplete declaration is a simplified procedure provided by Article 76 (1) (a) of CCC and Article 254 of the implementing provisions of the CCC, as per Commission Regulation (EEC) 2454/93, Implementing Provisions of the Community Customs Code (IPCC). This procedure may be used to amend the customs value for both exports and imports.

According to this procedure, importers or exporters may submit customs declarations providing only part of the required information and/or submit only part of the mandatory documents.

The incomplete declaration does not relieve the importer or exporter from eventually providing complete information or filing all documents, but rather allows for an extension of time limits.

However, the benefit of adopting this procedure as compared to the one described below, where applicable, depends on the number of customs declarations to be filed. If the customs operations are numerous, the incomplete declaration procedure may be inconvenient because importers or exporters will have to perform operations twice.

⁴⁶ The Community Customs Code (CCC) will be replaced for the most part, effective on 1 May 2016, by the Union Customs Code (UCC), but it introduces no substantive changes to the rules covered by the Guidelines. For additional information on the UCC implementation, see “Union Customs Code becomes fully applicable as of 1 May 2016” in this issue of *TradeWatch*.

⁴⁷ Organisation for Economic Co-operation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, Edition 2010.

⁴⁸ For additional information, see “World Customs Organization publishes guide to customs valuation and transfer pricing” in the September 2015 issue of *TradeWatch*.



Estimated advance lump sum procedure

The estimated advance lump sum of the customs value is a procedure supported by Article 156a of IPCC. It applies only to imports.

The procedure allows importers to establish an estimated lump-sum value of some elements to be added to, or deducted from, the price of the goods that cannot be quantified at the time of customs clearance, and it allows the operator to provide the exact amount of these elements at a later stage.

In this case, the customs value is not determined as a provisional value to be amended later, but as a definitive one. This means that the importer is not required to modify the customs declarations already submitted because the estimated lump-sum value is considered as definitive in accordance with the transfer pricing adjustments.

However, the Guidelines highlight that importers must supervise the consistency of adjustments to avoid turning the simplification into an unfair advantage.

The clarifications provided by the Guidelines about the use of the incomplete declaration and the estimated advance lump sum for customs valuation purposes offer new opportunities for MNEs to properly determine customs duties and avoid the risk of corrections and the related penalties by Italian Customs.

For additional information, contact:

Ernst & Young – Studio Legale Tributario (Italy)

Andrea Primerano, *Rome*
+39 334 6581483
andrea.primerano@it.ey.com

Russia

Restrictions imposed on imports from Turkey



In the aftermath of the shooting down of a Russian Su-24 bomber aircraft by a Turkish Air Force F-16 fighter jet and the worsening of bilateral relations between Russia and Turkey, Russia's President issued Presidential Decree *On measures for safeguarding national security of the Russian Federation and protecting Russian citizens from criminal and other unlawful acts and on application of special economic measures against the Republic of Turkey* (the Decree) on 28 November 2015. It imposes a temporary ban on the importation of certain goods originating in Turkey according to a government list in effect as of 1 January 2016. The list of goods includes fresh-cut carnations; table salt; seawater; chewing gum; parts of carcasses and byproducts of frozen chickens and turkeys; and fresh, refrigerated or dried fruits and vegetables.

The purpose of these measures is to prevent Turkish origin products from the aforementioned list to be imported for sale in Russia. Accordingly, the Government is conducting large-scale inspections of stores and markets, and has already impounded and destroyed considerable quantities of food products originating in Turkey.

The Decree also suspends meetings of the Intergovernmental Russian-Turkish Commission on Trade and Economic Cooperation as well as the negotiations with Turkey on the draft Agreement on Trade in Services and Investment, and the Medium-term Program of trade-economic, scientific-technical and cultural cooperation for 2016-19.

In practice, the time it takes to clear customs for goods imported into Russia from Turkey has increased significantly. According to media news reports, several engineering companies that use Turkish automotive components and tobacco companies that use oriental tobacco imported from Turkey are facing the risk of production suspension.

At the same time, a draft resolution introduced by the Ministry of Economic Development in January 2016 provides an opportunity to import goods from the sanctioned list where such goods cannot be procured from Russian suppliers or where procurement from Russian suppliers leads to disproportionately high expenses. This resolution has not yet been adopted.

According to information available in the media, the Governmental Commission on Economic Development may decide to add certain contracts for the importation of goods to a list of exceptions. Contracts deemed to affect Russia's security or the interests of a significant number of Russian consumers may be included in the list of exceptions. Likewise, contracts required for the implementation of state economic, technical, financial and innovative programs may also be placed on the list. Companies that wish to apply to have their contracts included in the list of exceptions need to provide a written justification and supporting documents.

For additional information, contact:

Ernst & Young (CIS) B.V.

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

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



Russia-Ukraine mutual economic sanctions



Strained bilateral relations between Russia and Ukraine have resulted in mutual imposition of economic sanctions.

Russia has suspended the free trade zone agreement signed by Commonwealth of Independent States (CIS) countries in October 2011 with regard to Ukraine as of 1 January 2016. Russia will instead apply the most favored nation principle to goods from Ukraine, and a federal law to that effect came into force on 30 December 2015. These measures were undertaken to protect the Russian market from duty-free import of goods originating in EU countries after the economic portion of the Ukraine-European Union Association Agreement came into force on 1 January 2016.

Subsequently, the Ukrainian Government adopted a resolution that abolishes the free trade regime with Russia and sets certain customs duty rates applicable to Russian goods. The resolution will be in force until 31 December 2016.

Russia then extended to Ukraine an import ban on agricultural products, raw materials and food previously imposed on goods originating in the United States, the EU countries, Canada, Australia, Norway, Albania, Montenegro and Liechtenstein. The ban applies to Ukraine as of 1 January 2016.

The list of goods that may not be imported into Russia from Ukraine includes meat, fish, vegetables, milk and dairy products, fruits and nuts, sausages, and others. The ban was introduced after Ukraine supported anti-Russian sanctions imposed by the countries listed above.

In turn, the President of Ukraine signed the law *On Foreign Economic Activity* on 30 December 2015, authorizing the Ukrainian Government to impose economic sanctions on Russia. Accordingly, Ukraine imposed a ban on the import of certain food products originating in Russia, such as meat, fish, coffee, black tea, beer, vodka, pastry, bakery products, filter cigarettes, baby food, locomotives, equipment for railways and others. This legislation went into effect on 10 January 2016 and will remain in force until 5 August 2016 or until Russia lifts its ban on Ukrainian goods.

This list was further extended by *Resolution of the Ukrainian Government No. 28 of 20 January 2016* to include onions, green tea, white chocolate, ketchup, soy sauce and others.

It is noteworthy that trade volume between Russia and Ukraine in 2015 was reduced by more than half as compared to 2014. The imposed mutual sanctions are likely to further worsen the situation, and trade volume is expected to decrease by an additional 10%-15% in the foreseeable future.



Look for updates in future issues of *TradeWatch*.

For additional information, contact:

Ernst & Young (CIS) B.V.

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

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

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY's Global Trade practices

We bring you a global perspective on Global Trade. Our Global Trade professionals can help you develop strategies to manage your costs, speed your supply chain and reduce the risks of Global Trade. We can help to increase trade compliance, improve import and export operations, reduce customs and excise duties and enhance supply chain security. We help you to address the challenges of doing business in today's global environment to help your business achieve its potential. It's how EY makes a difference.

TradeWatch is a quarterly newsletter prepared by EY's Global Trade groups. For additional information, please contact your local Global Trade professional.

© 2016 EYGM Limited.
All Rights Reserved.

EYG no. YY3832
BSC no. 1602-1845527 NE

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

Americas

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

Asia-Pacific

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

Europe, Middle East and Africa

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

TradeWatch Editor

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