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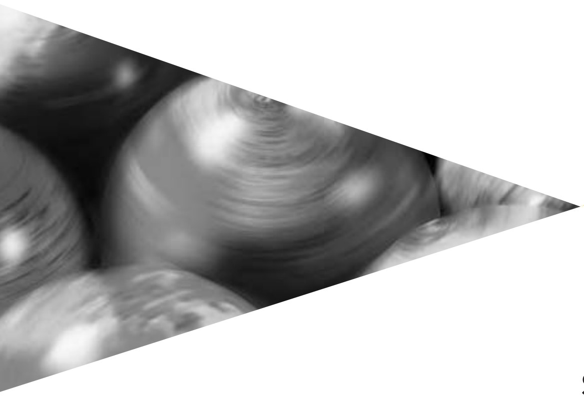

In this issue

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Spotlight on

Whether and how transaction value, the preferred method for customs valuation, can be used for related party sales in which the parties set prices based on income tax transfer pricing methodologies is a topic of increasing importance to both importers and customs authorities worldwide.

Despite the shared ideal of an arm's length price on transactions between related parties, the tax and customs rules are derived from completely separate statutory schemes enforced by different agencies. As a result, an acceptable arm's length price for transfer pricing purposes may not be acceptable for customs purposes. Accordingly, businesses must actively plan to meet both sets of rules, or risk being required to report different prices for income tax and customs purposes.

This issue of *TradeWatch* spotlights developments in the US, Australia, and South Africa, which illustrate the complexity and differences of approaches by customs authorities over the topic. Our spotlight includes articles on US Customs and Border Protection providing guidance for how to make a connection between a profits based transfer pricing method and transaction value; Australian Customs proposing a stricter approach to the administration of transfer pricing adjustments; and the South African Revenue Service increasing scrutiny on related party pricing in an environment that restricts the use of transaction value when transfer pricing adjustments are present.

Customs valuation and related party pricing

United States — New guidance

A recent ruling from US Customs and Border Protection (CBP) provides significant guidance for US importers in the complicated area of related party pricing.

HQ H219515, issued on 11 October 2012 is quite notable in several respects:

- It is a rare advance ruling, one given on the acceptability of related party prices under a proposed pricing methodology. All other recent related party pricing rulings from CBP Headquarters have been in the form of an Internal Advice, responding to an inquiry from a CBP official in the field questioning the existing pricing practice of an importer.
- The ruling was issued to an importer whose related party pricing was previously the subject of an Internal Advice 15 months earlier (HQ H065024, 28 July 2011), which held that the importer was unable to demonstrate that its related party prices were acceptable for transaction value. Without changing the way in which prices were set, the importer proposed to CBP that it could support the related party pricing using a different approach, and CBP agreed.
- The ruling is the first issued by CBP since dealing with the new policy on making transfer pricing adjustments to customs value, as reported in the June 2012 issue of *TradeWatch*.

Background

Transaction value, the price paid or payable between a buyer and a seller, is the primary method of customs valuation. Transaction value is acceptable for related party sales if either (1) an examination of the circumstances of the sale indicates that the relationship between the parties does not influence the price actually paid or payable, or (2) the transaction value of imported merchandise closely approximates a test value. Test values must have been previously accepted as liquidated customs values. Frequently, no test values exist; consequently an examination of the circumstances of sale is necessary to determine the acceptability of transaction value.

There is no prescribed approach to meet the circumstances of sale test. CBP regulations provide three illustrative examples of ways in which an importer may establish that the relationship of the parties did not influence the price: (1) if it can be shown that prices are settled in a manner consistent with the normal pricing practices of the industry; (2) if it can be shown that prices are settled in the same way the seller settles prices for sales to unrelated buyers; or (3) if it can be shown that the prices are adequate to ensure recovery of all costs plus a profit which is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class or kind.

The Analytical Instruments ruling — linking the "least relevant method"

HQ H219515 was issued to an unnamed company that imports analytical instruments from a related party manufacturer. Transfer prices are set in accordance with the comparable profits method (CPM). CPM compares the profits earned by the importer with the profits earned by other US distributors which purchase products from unrelated parties, but share a common function and risk profile with the importer. If the profits of the importer are within a statistically determined range of profit of the benchmarked companies, the prices are viewed as arm's length. If the profit is outside the established range, the prices must be adjusted to bring profit within the range.

While CPM is very commonly used by a wide variety of industries, CBP refers to CPM as "the least relevant method for customs purposes." This ruling, successfully linking CPM to transaction value, gives insight into the current views of CBP Headquarters.

Originally, for the 2011 Internal Advice, the importer tried to argue that it met the circumstances of sale test using the "all costs plus a profit" example from the regulations. While the importer could demonstrate that it recovered all costs, and made a profit, it failed to show that the profits were "equivalent to the firm's overall profit." In our view, attempts to support a CPM based price with the all costs plus a profit test are inherently dangerous. CPM (when applied to an importer/ distributor's profits) is designed to provide the importer with a steady profit, and push back all of the entrepreneurial risk, and accompanying profit or loss, to the manufacturer. Unless the environment is stable and predictable, it is difficult to count on equivalence of profits.

The importer proposed a different approach in its request for the 2012 ruling, utilizing both qualitative and quantitative factors which, in the aggregate, satisfied CBP that the circumstances of sale test was met. First, focusing on the "normal pricing practices of the industry" example, the importer commissioned Ernst & Young LLP to prepare an independent study of the analytical instruments industry to determine whether or not there is a consistent industry approach to setting prices. The study identified leading companies in the industry, and identified commonalities in structure, trends, risks, and business approach which resulted in a similar approach to pricing. This industry approach to pricing was shown to follow the same underlying economic rationale as to the importer's approach for establishing prices using the CPM transfer pricing methodology, providing a routine return to the US distributor and pushing the balance of the profit to the manufacturer.

The importer then supplemented the qualitative study with quantitative data, comparing the enterprise profit margins of significant industry participants to further reinforce the stability in the industry. Finally, the importer provided a transfer pricing study for the most recent fiscal year, further reinforcing the commonality with the industry practice.

CBP concluded that the information provided did not fall strictly under any of the illustrative examples provided in the CBP regulations. Nevertheless, "based on the totality of the information considered and our review and examination of all relevant aspects of the transaction," CBP concluded that the circumstances of sale test was met. The conclusion reinforces the importance of reviewing the underlying economic rationale for the transfer pricing method chosen, and explaining how that rationale demonstrates that the pricing between the parties has not been influenced by the relationship. Rather than being a single direct connection between the transfer pricing method and transaction value, there may be several touch points which in the aggregate can create a sufficient link.

Meeting the new policy on adjustments

CBP announced its new policy on transfer pricing adjustments on 30 May 2012. This ruling also provides some guidance on how CBP views the five factors required to make adjustments. The five factors are:

"1 A written "Intercompany Transfer Pricing Determination Policy" is in place prior to importation and the policy is prepared taking IRS code section 482 into account

2 The US taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return

3 The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted

4 The company maintains and provides accounting details for its books and/or financial statements to support the claimed adjustments in the United States

5 No other conditions exist that may affect the acceptance of the transfer price by CBP."

CBP noted that the transfer pricing study reviewed stated that it was prepared in accordance with Section 482 of the Internal Revenue Code, and the importer stated that it would use the study in filing its income tax return and report any adjustments. The importer satisfied the third factor by demonstrating that the transfer pricing study covers all of the importer's products, and stating that it would make adjustments proportionately across all products in a product category subject to adjustment. As the adjustments will be booked as costs of goods sold, this further demonstrates that the adjustments impact the price paid and relate directly to transaction value. CPB addressed the fifth factor only by stating that based on the documents reviewed no other conditions that may affect transaction value were identified. CBP conditioned the ruling on ongoing compliance with the fourth factor, keeping appropriate books and records.

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Australia — Stricter approach

Australian Customs has recently announced proposed changes to its administration of customs transfer pricing issues. The proposed changes signal a stricter approach that could make the customs valuation treatment of related party sales even more challenging for multinationals importing into Australia.

The customs valuation challenge

There is a constant tension between the income tax and customs treatment of related party transactions. This tension stems in part from different approaches: customs authorities are required to assess arm's length pricing on an import-by-import basis, while revenue authorities have the flexibility to review overall profitability without direct reference to underlying transactions. From a revenue perspective, tension also arises from the fact that a lower price of goods will increase profits and income tax; however, that lower price will result in decreased customs duty.

The challenge for business is highlighted in the case of a transfer pricing adjustment to the cost of goods sold which often does not refer to a specific transaction, and is made retroactively (i.e., post importation of the relevant goods). Such an increase in the cost of goods, without a corresponding customs adjustment, can result in payment of the incorrect amount of duty and the breach of strict liability customs offenses.

The gap is likely to be widened in Australia with amendments to income tax legislation that favor a profits-based approach, which increases the potential for retroactive price adjustments. Additionally, this approach to transfer pricing allows the revenue authority to make adjustments without reference to a specific underlying transaction, which makes it difficult to identify the imports affected by a corresponding customs adjustment.

Australian Customs approach

Adding to this changing transfer pricing environment, Australian Customs has recently released proposed amendments to its Transfer Pricing Practice Statement No. PS2009/21, "Applying for a Valuation Advice relating to Transfer Pricing." This 2009 practice statement set out the customs procedure for providing importers binding rulings in respect of the valuation of related party transactions and managing the effects of post-importation transfer pricing adjustments. The practice statement reflected the difficulties of applying customs legislation to pricing driven by income tax considerations, but balanced this by acknowledging the role of advanced pricing agreements and transfer pricing studies in considering customs issues. The practice statement was also complemented by a business friendly and efficient method of processing the customs implications of post-importation transfer pricing adjustments.

The proposed amendments to the practice statement are subtle, but significant. In particular, the changes:

1. Place a greater reference to, and emphasis on, the application of customs valuation methodologies, such as the often highly impractical identical and similar goods methods (while still acknowledging the role of transfer pricing documentation)
2. Emphasize the need for line-by-line import entry adjustments following a post-importation transfer pricing adjustment (as opposed to the bulk amendment process currently adopted)
3. Apply a stricter approach to the situation where a transfer pricing adjustment alters the customs value of duty-free goods, or results in a refund
4. Make the provision of a long list of documents mandatory, whereas previously Australian Customs merely detailed the types of documents it has found useful in considering transfer pricing issues

The proposed amendments are open to public consultation and no doubt Australian Customs will receive responses highlighting the potential practical difficulties of the proposed new approach. Given the upcoming changes in the transfer pricing legislation, the only way to help importers juggle the two taxation regimes is for Australian Customs to administer the law in a way that is practical and provides certainty to importers, while at the same time not putting customs revenue at risk.

While the environment is difficult, engaging with Australian Customs can provide importers certainty as to their valuation methodology and the customs effect of a transfer pricing adjustment. It is also our experience that importers that are proactive in dealing with customs transfer pricing issues are more likely to receive a business friendly response from Australian Customs.

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South Africa — Increased scrutiny

The South African Revenue Service (SARS), clearly on a compliance mission, has been sending out requests for verification of compliance to taxpayers for a wide range of tax issues. In recent weeks, we have noted an increase in requests for taxpayers to confirm whether an appropriate adjustment to the customs value for imports was made following retroactive transfer pricing adjustments.

Importers into South Africa that purchase product from related parties need to realize that this is a loaded question with implications. Specifically, this question has the potential to dive deep into the complex issues surrounding customs valuation for related party sales. Accordingly, this letter from SARS needs to be carefully responded to.

SARS approach

Like the United States and Australia, South Africa's customs valuation rules are based on the World Trade Organization's Valuation Agreement, which provides that transaction value (the price paid or payable for the imported merchandise) is the preferred method of valuation. Transaction value is allowed for related party transactions provided that it can be demonstrated that the price was not influenced by the relationship between the parties. The single biggest challenge for companies in supporting customs valuation for related party sales is demonstrating that the sales price was unaffected by the relationship.

The customs rules and guidance in South Africa in this area have generally been elusive. Some countries, such as the United States, have made progress in allowing importers to treat the purchase price subject to adjustments under a transfer pricing policy as the transaction value subject to certain factors (as discussed previously). In South Africa, however, the existence of a transfer pricing policy that can lead to adjustments makes the argument that the relationship between the seller and the buyer has not influenced the price paid or payable unlikely to be defendable under the transaction value method.

Consistent with the WTO Valuation Agreement, South Africa's customs legislation provides for additional valuation methods to be applied (in hierarchical order) where the price actually paid or payable is influenced by the relationship between the buyer and the seller (or for other reasons). These valuation methods are:

- Transaction value of identical goods imported by non-related parties at the same commercial level, in the same quantities and at the same time as the subject goods
- Transaction value of similar goods for sale for export to South Africa, at the same commercial level, in the same quantities and at the same times as the subject goods
- Deductive value based on the unit price of the goods when sold in South Africa to unrelated parties, provided in the same condition as at the time of importation, but subject to certain deductions (e.g., commissions, profits, etc.)
- Computed value based on the price supplied by the producer, including specified cost factors (e.g., costs of manufacturing process, profit and general expenses, etc.)

Should none of the above provide a relevant method for arriving at an appropriate customs value, the importer may request an advanced ruling, known as a "value determination (VDN) from the Commissioner for the SARS to determine the proper method, which may be based on a combination of the above methods (i.e., the fall back method). The transfer pricing policy applied will influence the development of the customs "fall back" valuation method.

Implications for business

Companies that face retroactive transfer pricing adjustments that have not sought a VDN may be particularly vulnerable to customs scrutiny over their customs valuation declarations. Keep in mind that most transfer pricing methods reference a profit margin and thus commonly have the potential for retroactive price adjustments.

Another potential area of exposure is the basic requirement to declare the status of the buyer's (i.e., importer's) relationship to the seller and the valuation method applied on the customs clearance documentation (SAD500) for customs duty and VAT purposes. In our experience, this requirement is not always diligently complied with and comprises a risk for the imposition of penalties.

Closing thoughts

Awareness of the issues surrounding the interaction between transfer pricing and customs valuation has been growing among customs administrations worldwide, and clearly SARS has taken an interest. However, we find that for South African businesses, this issue is commonly overlooked. It is important that importers that purchase from related parties take a proactive approach to managing their transfer pricing and customs valuation policies in a coordinated manner. Particularly for businesses that have received the letter from SARS, we recommend that you review your compliance with the customs valuation rules and be prepared to address any issues of exposure with SARS.

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Signs of momentum — Information Technology Agreement expansion

Negotiations to expand the products covered under the WTO Information Technology Agreement (ITA) are progressing with more insight into what additional information and communications technology (ICT) products could soon enjoy duty-free treatment.

ITA expansion

The ITA is adhered to by over 70 WTO participants, representing 97% of global trade in ICT products listed under the agreement. The ITA commits participating members to eliminate duties on ICT products covered by the agreement. The main products currently covered include:

- Computers
- Semiconductors
- Semiconductor manufacturing equipment
- Telecommunication apparatus
- Instruments and apparatus
- Data storage media and software
- Parts and accessories (of the above categories)

However, the rapid pace of technological change and increasing functions for ICT products over the last 15 years since the ITA was implemented has given rise to disputes regarding whether certain products are covered under the ITA. Additionally, with new technologies, new ICT products have entered the market without an effective mechanism to modify the ITA to take into account the latest innovations. Accordingly, negotiations are underway with 17 WTO participants, including Asia Pacific countries, the United States, Canada and the EU, among others, working to expand the ITA.

The current draft list of ITA expansion products includes 130 product codes (or 439 product descriptions) under the Harmonized System that cover a broad range of products, some of which are not normally considered as an ICT product (e.g., certain household appliances). To highlight just a few of the products under consideration, the list includes printing ink, multi-function printers, laser machine tools, various machinery (e.g., to manufacture semiconductor devices and flat panel displays), optical media, smart cards, various media/storage devices (including smart cards), monitors, multi-chip integrated circuits, coaxial cables, various medical apparatus, and a wide range of parts and accessories to ICT products that are not currently covered.

The participating countries are currently reviewing the proposed list and the implications on local industry to identify any import sensitive items. Additionally, there is likely to be a debate as to what qualifies as an ICT product, given the broad range of candidates.

Import sensitive items — US perspective

The U.S. International Trade Commission has released a draft report providing its preliminary information and advice with respect to the products included in the draft product expansion list.[1] The report looks at the purposes of these products (i.e., ICT and non-ICT) and summarizes input from interested parties (i.e., local industry).

[1]The Information Technology Agreement, Advice and Information on the Proposed Expansion: Part 1, USITC Publication 4355, October 2012.

The report identifies the following nine products that may be "import sensitive" from a US industry perspective.

HS Code	Description
321511	Printing ink, black
321511ex	Printing ink (black) packaged in the ink jet cartridge
321519	Printing ink, other than black
321519ex	Printing ink (other than black) packaged in the ink jet cartridge
321590	Inks, other than printing ink
370790	Other (chemical preparation for photographic uses, put up in measured portions or put up for retail sale in a form ready for use)
690911ex	Ceramic wares of a kind used for the production or processing of semiconductor boules or wafers, semiconductor devices, electronic integrated circuits, or flat panel displays
690919ex	Ceramic wares of a kind used for the production or processing of semiconductor boules or wafers, semiconductor devices, electronic integrated circuits, or flat panel displays
741011ex	Copper foil of refined copper not backed of thickness not exceeding 0.15 mm designed for printed circuits
741021ex	Copper clad laminates backed with paper, paperboard, plastics, or similar backing materials of a thickness (excluding any backing) not exceeding 0.15 mm
900110	Optical fibers, optical fiber bundles and cables

The "ex" marking flags proposed products that do not correspond to the entire HS 6-digit subheading, but rather comprise only a portion of, or a particular product within, the coverage of the 6-digit category.

This short list of US "import sensitive" items provides insight into what products may have an uphill battle for inclusion in the ITA expansion. The full list of proposed products currently being considered in the ITA expansion negotiations can be found in the U.S. ITC report.

More soon

According to the WTO, a revised consolidated list of products proposed for inclusion in the ITA expansion will be circulated to participating countries later this month that will serve as a basis for the next round of negotiations in January 2013.

In addition to the issue of product coverage, divergences in classification for certain ICT products are also expected to be addressed as well as non-tariff barriers that are limiting the effectiveness of the ITA in some countries.

Another issue will be increasing participation from other WTO members. The tariff commitments under the ITA are made on a most-favored nation basis, meaning participants must extend their duty-free treatment to all WTO members, even those that have not joined the ITA and in this case, those that do not participate in an ITA expansion.

The coming months may provide further insight into product coverage and any road blocks that could delay an ITA expansion agreement. For now, negotiations appear to be moving forward with momentum. Watch for more developments in future issues of *TradeWatch*.

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"Expanded cumulation" provisions in Latin American FTAs provide new benefits for producers

Manufacturers in Latin America are benefitting not only from the expanding network of free trade agreements (FTAs) throughout the region, but also from the expanded cumulation rules that are more frequently part of these FTAs.

First generation cumulation rules

FTAs are conditioned on meeting the rule of origin established to ensure that preferential duty rates are provided to products made in the territory of one of the parties to the FTA. The cumulation rules in "first generation" FTAs generally provided that the originating materials from one or more of the parties which are incorporated into a finished good in the territory of another party will be considered as originating in the territory of that other party.

For example, under the cumulation provision of the Dominican Republic — Central America — United States FTA (DR-CAFTA) a producer in El Salvador may incorporate materials originating from the Dominican Republic when manufacturing a finished good in El Salvador and those materials would be considered as originating in El Salvador when the manufacturer performed the origin qualification analysis of the finished good for export to the United States or any other country party to DR-CAFTA.

The flexibility on the rules of origin through the use of the cumulation provision under DR -CAFTA is evident, allowing manufacturers to source materials from any of the member countries thereby expanding the manufacturers' sourcing options. This expansion on sourcing options could lead to cost reductions for the manufacturer without negatively impacting the origin qualification of the finished good and preferential treatment upon importation.

Another effect of the cumulation provisions is that they encourage true integration between the members of a FTA or a preferential trade area as far as trade in goods is concerned, by using these provisions in expanding regional supply chains and at the same time reducing the duty impact of imported materials.

Expanded cumulation provision

Many of the latest generation FTAs, some of which are still under negotiation and others which are already in force, include an "expanded cumulation" provision which allows manufacturers to consider as originating those materials or components that are sourced from a third country with which both the exporting and importing parties have a valid FTA in force.

For example, under the expanded cumulation provision established in the Mexico — Central America FTA[2], a manufacturer in Costa Rica may incorporate materials originating from Chile, who is not a party to the Mexico — Central America FTA, when manufacturing a finished good in Costa Rica and those materials would be considered as originating in Costa Rica when the manufacturer performs the origin qualification analysis of the finished good for export to Mexico since both Costa Rica and Mexico have entered into separate FTAs with Chile[3].

In order to apply this expanded cumulation provision, the materials from the third party must meet the applicable rules of origin under the FTA between the exporting and importing countries. In our example, the materials originating from Chile would have to meet the rules of origin established under the Mexico — Central America FTA in order to be considered as originating in Costa Rica. Additionally, the same treatment would have to be granted to the third party if it enacted a similar expanded cumulation provision. Therefore, reciprocity between countries is a vital element for the implementation of the expanded cumulation provisions.

[2]Including Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

[3]Mexico — Chile FTA, in force since July 1999 and Chile — Central America FTA, in force since October 1999.

Specific details will vary according to each FTA. For example, some may require that the goods from the third party comply with the rules of origin of the FTA in force between the exporting and importing countries while others may require that such goods comply with the rules of origin in force between the third party and the importing country.

Overall, the expanded cumulation provision offers even more benefits for manufacturers with wider sourcing possibilities than under first generation cumulation rules. This flexibility can provide more efficiencies for manufacturing operations and thus, more competitive products. Moreover, expanded cumulation provisions may lead to the creation of true regional blocs since the availability of sourcing options will be greatly expanded not only by the specific FTA entered into by the manufacturing country, but also through all other FTA partners shared by the exporting and importing countries.

Some FTAs that are in advance stages of negotiation, such as the EU — Central America FTA and the EU — Peru and Colombia FTA, may even take advantage of common origin certification requirements (i.e., EUR.1 certificate of origin or "invoice declaration") to implement the expanded cumulation provisions. Implementation for other FTA's that are already in force, such as the Chile — Ecuador FTA, the Canada — Colombia FTA and the Canada — Peru FTA, among others, may not be so straightforward, but the benefits of implementation may be considerable.

Benefits and regional integration

With the adoption of expanded cumulation provisions in the latest generation FTAs, manufacturers may be greatly benefitted by an expansion of their sourcing options without limiting or impacting the originating status of their finished goods. Regional trade in Latin American might also be benefitted by more efficient supply chains which may take advantage of the expanded cumulation provisions and operate on a duty free basis as long as the appropriate rules of origin are complied with.

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Brazil

Brazil lowers state VAT rate to 4% for interstate sales of imported goods

Effective 1 January 2013, Senate Resolution 13/2012 establishes a unified state value-added tax (Imposto sobre a Circulação de Mercadorias e Serviços — ICMS) rate of 4% for interstate sales involving imported goods. The 4% rate is significantly lower than the current rates, which range from 7 — 12%. While a reduction in tax rates is usually a positive development for taxpayers, in this case importers may be adversely impacted. Because the general rate of ICMS rate on imports is 18%, the reduction may cause ICMS credit balances to increase for some importers, hindering cash flow. Additionally, this measure may negatively impact importers that benefit from state ICMS tax incentives.

The resolution aims to level the playing field among the Brazilian states that compete with each other for foreign investment by lowering their state ICMS rate. Additionally, the resolution may discourage imports and stimulate local manufacturers considering that similar imported goods lose special tax benefits that are attributable to unfair competition between imported and domestically-produced goods.

The unified tax rate will apply to imported goods and commodities that, after customs clearance, have not undergone industrial processing or, if subject to industrial processing, the final product incorporates import content exceeding 40%. Rules that define the criteria and procedures for the import content certification will be forthcoming.

The unified tax rate does not apply to imported goods listed as without similar domestic production, as determined by the Council of Ministers of Foreign Trade Chamber (CAMEX). Also excepted from the unified rate are goods manufactured in the Manaus free trade zone and natural gas from foreign sources.

According to the resolution, each state will continue to set the applicable rate for the calculation and payment of ICMS on imported goods at customs clearance. In this regard, the new legislation does not restrict the credit of ICMS paid at customs clearance. However, this aspect of the resolution will result in significant ICMS credit balances, considering the 18% rate of ICMS generally applied to imports compared to the low unified rate for interstate sales of the imported goods.

It should be noted that the issue of import content can affect other ICMS-related incentives beyond the interstate transactions. Companies whose processes do not add much value (e.g., assembly, repackaging, etc.) can also be reached by the unified rate, which may affect state granted ICMS incentives related to presumed credit or financing of the tax, among others.

Affected importers should assess the implications of the new rules to unify the interstate ICMS rate on their Brazilian operations and tax position.

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More on Brazil's indirect tax relief opportunities for FIFA World Cup and Olympic Games preparations

The upcoming 2014 FIFA World Cup and 2016 Olympic and Paralympic Games are bringing significant new foreign investment projects to Brazil as the country builds and modernizes sports venues, improves infrastructure and makes preparations to host the events. In the March 2012 issue of TradeWatch, we highlighted some new indirect tax relief programs established for the events to help alleviate the high tax burden. As expected, Brazil has recently established more indirect tax relief opportunities and guidance for companies supplying goods and services to these major sporting events.

New tax relief package for 2016 Olympic and Paralympic Games

The recently published Provisional Measure #584 of 10 October 2012 establishes a tax relief package especially for the 2016 Olympic and Paralympic Games. The benefits include exemption from import duty, federal VAT, social contributions (PIS/COFINS), Contribution of Intervention on Economic Domain (CIDE) and other fees related to customs clearance of foreign goods. The goods that benefit under this measure are limited to goods for use or consumption exclusively in the Olympic and Paralympic events, such as trophies, medals, promotional materials, printed and other non-durable goods that last up to one year.

The incentives do not apply to goods, such as sports equipment, recording and transmission equipment, medical equipment and office equipment unless such goods are donated to certain charities, government and non-profit entities after their usage in the event. Alternatively, these goods can benefit, although to a lesser degree, from tax relief under Brazil's Temporary Admission Regime.

Additionally, the tax relief package is limited to specific entities and organizations. These include the International Olympic Committee (Comité International Olympique – CIO), National Olympic Committees, companies that will be rendering services to the CIO, the organizing committee, international sports federations, the World Anti-doping Agency, the Court of Arbitration for Sport, media companies and sponsors of the 2016 Olympic and Paralympics Games. The CIO and international companies related to the CIO also benefit from certain direct tax incentives.

In addition to the federal package of incentives, the host city, Rio de Janeiro, under ICMS Agreement #90/91, has extended the ICMS suspension for the acquisition of power energy and use of inter-municipal and interstate transport and communication services by the Olympic and Paralympic Games organizer committees.

More RECOPA guidance for FIFA 2013 Confederation Cup and 2014 World Cup events

Earlier this year, we highlighted some indirect tax relief programs established for the construction and modernization of football stadiums in Brazil for the upcoming FIFA Confederation Cup and World Cup (see the March 2012 TradeWatch). In particular, RECOPA (Regime Especial de Tributação para Construção, Ampliação, Reforma ou Modernização de Estádios de Futebol) provides for the suspension of federal taxes and duties upon the importation of machinery and materials.

A recently published regulation establishes the process by which interested companies must apply to participate in the RECOPA program. On specific forms provided by the Brazilian Federal Revenue Department, the company provides basic corporate and individual data, such as name, address, contact numbers, etc., that support a relationship with FIFA and its affiliates. The company's approval to RECOPA is based in part on the requirement that FIFA and its affiliates have declared the applicant as a supplier. Once approved, the company's RECOPA authorization will be published in the Federal Daily Official. We note that certain small companies (e.g., SIMPLES NACIONAL) are not allowed to enter the program.

Accordingly, it is important that interested companies are diligent in filing their application and ensuring that FIFA and its affiliates also fulfill their filing obligations to ensure timely approval.

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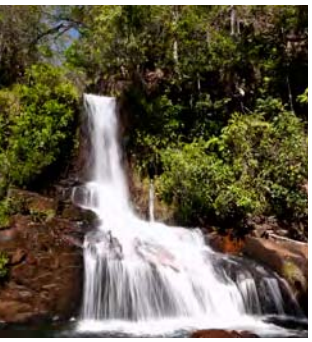
Colombia

Authorized Economic Operator program opens to all exporters



In Resolution 091, Colombia's National Tax & Customs Authority (DIAN) established the possibility that all exporters of any sector of the economy may enter the Authorized Economic Operator (OEA by its Spanish acronym) program.

The OEA was established by Decree 3568 of 2011, which allows the DIAN to grant OEA status to individuals or legal entities in Colombia that, being part of the international supply chain, meet minimum security conditions established by the Government. Resolution 011434 of 2011 provided for a gradual implementation, which would start with the four principal traditional exports and the two principal non-traditional exports (oil, coal, coffee, fuel oil, flowers and bananas). Now all approved exporters that meet the OEA security and customs compliance requirements can benefit under the program.

Companies with OEA status may receive the following benefits, among others:

- Recognition as a secure and reliable operator for the border authorities
- Decrease in the number of documentation reviews and physical inspections
- Assignment of an operations official by each border authority to provide support for the OEA's trade operations
- Possibility to file declarations directly with the customs authority (i.e., without a customs broker)
- Training provided by the border authorities
- Use of special and simplified procedures for the development of recognition or inspection efforts
- Use of special channels and mechanisms to carry out foreign trade operations
- 20% reduction in global guarantees with the DIAN on the final amount resulting from the calculation of setting up or renewing the guarantee
- Authorization to perform the inspection of goods subject to exportation ordered by the DIAN and Agricultural Institute at the exporter's premises and enabled deposit, when applicable
- Participation in the Congress for OEA

The OEA program may eventually be expanded gradually by the DIAN to other users that are part of the international supply chain, such as importers, ports, transporters, customs agencies, etc.

OEA is an opportunity to generate alliances between the public and private sectors to ensure a strict compliance with security schemes and offer advantages and facilitated conditions for foreign trade operations. These benefits will increase substantially when OEA's mutual recognition agreements are subscribed with other countries, as foreseen within the medium term.

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United States

CBP expands the Importer Self-Assessment program

Customs and Border Protection (CBP) is giving importers more reasons to join the Importer Self Assessment (ISA) program, or you could say, fewer reasons not to join. CBP recently announced additional benefits and the opportunity for qualified importers that complete a Focused Assessment (FA) audit to join the program without further review.

The primary objective of the ISA program is to maintain a high level of trade compliance through the collaborative partnership efforts of the importer and CBP. Importers may apply to join the program at any time upon establishing and demonstrating the existence of the requisite internal controls necessary to achieve the highest level of compliance with customs laws and regulations. Essentially, ISA allows companies to assess their own compliance with the customs laws and regulations rather than undergoing comprehensive CBP audits.

More benefits

Some of the primary benefits for participation in ISA already include:

- Removal from the FA audit pool (including drawback and foreign-trade zones if included in the ISA application)
- Assignment of a CBP national account manager
- Quarterly receipt of CBP Importer Trade Activity (ITRAC) data
- Special prior disclosure privileges
- Potential mitigation of civil or liquidated damages due to participation in the program
- Expedited cargo release

This list has been expanded by new benefits that include internal advice/consultation from CBP's Regulations and Rulings division. This benefit serves to decrease the time it takes to resolve compliance issues and supports a proactive approach to customs compliance.

Additionally, ISA members now receive priority consideration for applications to participate in CBP's new Centers of Expertise and Excellence test programs. This initiative centralizes CBP industry expertise in one location, serving as a single point of processing for participants, which gain increased uniformity and transparency of practices specific to their industry. For more information on benefits associated with the new CBP Centers of Expertise and Excellence, see the June 2012 issue of TradeWatch.

Successful FA can transition to ISA

Importers that have not joined ISA may be subject to an FA audit. FA audits entail a comprehensive and rigorous audit process conducted by CBP's Regulatory Audit division to determine whether a company's import activities represent an acceptable risk through an assessment of the company's organizational structure and internal controls over compliance with applicable customs laws and regulations.

CBP has now expanded the ISA program to permit a qualified importer who has completed an FA to apply for ISA privileges within 12 months of FA conclusion. In this respect, this benefit is open to US or Canadian resident importers that are members of the Customs-Trade Partnership against Terrorism (C-TPAT). Expedited application review is provided for those not already C-TPAT members.

The importer will need to agree to the requirements under the ISA Memorandum of Understanding, which establishes the roles and responsibilities of the ISA member and CBP for participation in ISA. Additionally, the importer will need to submit a written, risk-based self-testing plan that provides details of the importer's risk assessment methodology, testing methodology, frequency of self-testing activities, and an overview of the sampling plan contemplated to be followed by the importer.

Upon acceptance of this information by CBP, the importer will be notified of ISA approval without having to first participate in the formal Application Review Meeting (ARM) process traditionally required of ISA participants. Post-ISA requirements include compliance with the ISA Handbook, including submission of an annual notification letter which advises CBP of the importer's continued participation in the ISA program requirements. The letter also must provide details of the importer's testing results and findings from the most recent completed year.

Closing thoughts

Overall, the offer for importers of a successful FA to transition to ISA is a natural fit considering that CBP now requires that in order for an importer to successfully pass the FA, it must develop internal controls and procedures similar to those required of ISA importers.

This change in ISA policy presents an important consideration for the pool of importers that could potentially be subject to an FA (i.e., non-ISA members). Basically, the importer can choose to take a proactive approach to meet the ISA standards, working collaboratively with CBP and gaining benefits provided under the ISA program. Alternatively, the importer can take a reactive approach to meet the ISA standards while under a comprehensive and rigorous FA audit conducted by Regulatory Audit whereby the importer has little control over the process and risks duty and penalty exposure for any noncompliance discovered. Clearly, CBP is doing its best to make the decision to join ISA an easy one.

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Australia

New export controls for intangible technology

The Defence Trade Controls Act (Act), enacted 13 November 2012, strengthens Australia's export control regime and implements the Defense Trade Cooperation Treaty between Australia and the United States (AS-US DTC). With significant changes and expanded coverage, including new export controls on intangible technology, the Act means new compliance obligations and challenges for Australian companies that export controlled goods and intangible technology.

The Act imposes export controls on the following additional activities not previously covered:

1. Intangible transfers of technology
2. Provision of services relating to defense and strategic goods and technology
3. Brokering of the supply of controlled goods, technology and related services

Under the Australian export controls regime, export permits and licenses issued by Australia's Department of Defence are required to export goods listed on the Defence and Strategic Goods List (DSGL). The DSGL is split into two categories of goods, namely dual-use goods and munitions. The exportation of controlled technology is also listed as an item on the DSGL, which requires a license or export permit. The exportation of controlled technology is defined as "the export of technology which is required for the development, production or use of dual-use goods listed in the DSGL." Controlled technology for munitions is defined as either "technical assistance" or "technical data" for munitions.

Previously, the export controls regime only regulated tangible technology related to defense and strategic goods, i.e., information contained on a computer disc or hard drive. The Act goes one step further and imposes export controls on the exportation of intangible technology related to defense and strategic goods. The intangible transfer of technology may be facilitated through a variety of means, including email, some voice conversations, fax, software and services.

In practical terms, it may become necessary to obtain permits from the Minister of Defence (Minister) for seemingly routine activities, such as sending emails, holding international teleconferences, and some international file sharing (e.g., servers or cloud computing). The Minister will issue a permit "if the Minister is satisfied that the activity would not prejudice the security, defense or international relations of Australia." The compliance burden incurred in obtaining an export permit for these additional activities has sparked wide debate and extensive consultation between the Government and various industries, particularly research and educational institutions.

The Act attempts to curtail the challenges faced by exporters by introducing a two-year trial period. During this trial period, exporters will need to adhere to the new export controls, but they will be excluded from the offense provisions, or from obtaining permits. A "Strengthened Export Controls Steering Group" will be established to assist the exporters in effectively implementing the new export controls. The Steering Group will also provide regular reports detailing any inadequacies present in the new legislation.

In accordance with the AS-US DTC, the Act establishes an "approved community" whereby permits or licenses will not be required for the trading of specific defense articles between Australian and US members of the approved community. While being a member of the approved community attracts exemptions from licensing and permit requirements, members will have a separate set of reporting obligations and compliance costs.

Overall, the Act creates increased compliance obligations and costs for exporters by imposing export controls on an expanded scope of activities that were not previously controlled. After the two-year transition period, failing to have a permit for the export of technology listed under the DSGL will attract a maximum penalty of AU$275,000, or 10 years imprisonment, or both. Given the scale of these penalties, it is critical for exporters to undertake a holistic review of their export activities to identify which activities would be captured under these strengthened export controls. Exporters should have special regard to items listed on the DSGL and whether they provide or propose to provide any global communication or services concerning these items. Importantly, exporters need to ensure they have export control compliance procedures and internal controls in place, and resources available to comply with the record keeping and reporting obligations imposed by the Act.

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Australian anti-dumping update

Anti-dumping measures in Australia continue to attract increased attention as Australian industry seeks increased protection. A new initiative underway could mean changes to Australia's anti-dumping policies and procedures to improve their effectiveness for companies injured by low cost imports.

Broadly, dumping occurs when goods are exported at a price below their normal value in the exporter's domestic market. This may also occur where an exporter is provided with a subsidy or financial assistance by its government.

Anti-dumping and countervailing duties are remedial measures applied to imported goods to give a level of protection to Australian industry where it has suffered 'material injury' as a result of dumped or subsidized goods. This assistance is achieved by applying additional import duty, known as "dumping duty" or "countervailing duty," to goods subject to the measures to elevate import prices to a price that is determined to be non-injurious to Australian industry.

In order to bring anti-dumping or countervailing measures against imported goods, the applicant must prove its industry has suffered "material injury," or is likely to be caused injury as a result of the dumped or subsidized goods. "Material injury"' would include, among other things, loss of sales or reduced profits.

In Australia, anti-dumping investigations and determinations are administered by the Australian Customs and Border Protection Service (Customs) and recommendations are referred to the Minister for Home Affairs and Justice for decisions. Recently, the Australian Government has moved to streamline its anti-dumping policies in an attempt to make the measures more effective. An anti-dumping review, led by former Victorian State Premier John Brumby, was recently conducted to consider the feasibility of establishing a stand-alone Commonwealth agency to manage anti-dumping.

The report, released on 27 November 2012, found that the number of anti-dumping investigations almost tripled in Australia over the last 12 months and is likely to continue to increase. One of the central recommendations in the report is that a new anti-dumping authority, agency or commission be established under legislation.

Currently, dumping measures are reported via Australian Customs Dumping Notices (ACDN), which are published on the Customs website and contain details of current investigations, reviews, enquiries, findings and monthly status reports. To date, there are a number of investigations and measures in place on a variety of imported goods such as biodiesel, pineapples and clear float glass. Steel products continue to attract significant attention from Australian industry and this has resulted in the following recent activity:

- Anti-dumping measures implemented on "hollow structural sections" from China (as well as countervailing), Korea, Malaysia, Taiwan and Thailand
- An investigation and interim dumping duty on "hot rolled coil steel" from Japan, Korea, Malaysia and Taiwan
- An investigation on "zinc coated (galvanised) steel and aluminium zinc coated steel' from China, Korea and Taiwan

Dumping duties and countervailing duties are only applicable to tariff classifications that are subject to current measures or investigations. Therefore, if imported goods fall outside of the specific tariff classifications subject to anti-dumping measures, then dumping or countervailing duty is not payable.

Given the apparent focus on anti-dumping and countervailing measures by Australian industry, importers in particular should consider whether contractual arrangements appropriately deal with the implications arising from the potential imposition of anti-dumping or countervailing duties on imported goods.

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Regional Comprehensive Economic Partnership agreement announced

On 20 November 2012, leaders from the Association of South East Asian Nations (ASEAN) (including Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam), Australia, China, India, Japan, New Zealand, and South Korea formally announced that negotiations on a Regional Comprehensive Economic Partnership agreement (the Agreement) would commence in 2013.

With an aim of concluding negotiations by 2015, the proposed Agreement will cover trade in goods and services, investment, intellectual property, economic and technical cooperation and dispute settlement.

According to the Australian Trade Minister, Craig Emerson, the Agreement between the 16 countries will cover approximately 60% of Australia's two-way trade and provide access to countries with a combined gross domestic product of US$20 trillion.

Once concluded, this Agreement will provide opportunities for Australian companies to gain greater access to China, India, Japan and South Korea, as despite on-going negotiations, no free trade agreements currently exist with these countries. We will keep you updated on the negotiation process in future editions of TradeWatch.

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New Zealand

New Zealand exports to China — are you paying too much duty?

The New Zealand — China Free Trade Agreement (FTA), which entered into effect in October 2008, has been repeatedly reported as a success; however, trade statistics suggest that New Zealand exporters of goods to China are significantly underutilizing the agreement's preferential tariff opportunities.

2010 figures obtained by the Ministry of Foreign Affairs and Trade show that:

- Less than 40% of all exports of goods to China were fully utilizing available preferential rates of duty
- Approximately 13% of exports were partially using available tariff preferences
- Approximately 25% of exports were underutilizing available tariff preferences
- Over 20% of exports were not using available tariff preference at all

New Zealand's Trade Minister, Tim Groser, has stated that local businesses have overpaid over NZ$90 million in duties by not taking advantage of the FTA.

In particular, the fishing; textile and apparel; and minerals and metals industries have been identified as underutilizing preferential duty opportunities. The following table illustrates the duty savings offered by the FTA for a sample of exported product in these and other industry sectors:

Product type	Normal duty rate	Preferential duty rate
Fresh, chilled or frozen fish & fish fillets	10% - 12%	0%
Bottled wine	14%	0%
Minerals (excluding fuels, oils, etc.)	3% - 5%	0%
Clothing	14% to 25%	0% to 4%
Iron and steel	1% to 10%	0%
Iron and steel products	3% to 30%	0% to 4%
Aluminium and related products	1.5% -30%	0% to 4%
Mechanical and electrical equipment	1% to 35%	0% to 4%

Note that the actual preferential duty rate applied depends on the specific product's Harmonized System tariff code. Accordingly, FTA preferential rates may differ within a product category.

While the trade statistics are surprising, there are a number of challenges for business that may have attributed to the underutilization of the FTA tariff preferences. For example, the sometimes complex rules of origin can be a stumbling block for some products. Evidencing that the product meets the regional value content requirements and/or tariff shift requirement can require extensive documentary support and be subject to interpretation by China Customs.

The non-manipulation rules for goods that transit a third country can also prevent eligible goods from gaining the tariff preferences. For instance, there may be challenges in obtaining a certificate of non-manipulation from the third country upon request by China Customs.

Particularly in complex supply chain structures, goods sold for export to China may undergo multiple related party sales transactions prior to importation. In this scenario, China Customs may reject claims for FTA preferences where the documentation does not clearly support FTA qualification.

The certificate of origin requirement can also be a deterrent to using the FTA. Although certificates of origin are not required for goods imported into New Zealand from China, exports of goods to China require the certificate of origin to claim the FTA preference. China Customs is likely to deny FTA qualification where the original certificate of origin is not provided upon request. The burden of obtaining the certificate of origin is on the New Zealand exporter. Depending on the sales arrangement, the exporter may have less incentive to take on the certificate of origin and FTA obligations when the benefit goes to someone else.

Despite these challenges, FTA strategies can be effectively employed. Considering that almost all goods exported under the FTA will reduce to zero in 2013, it may be worthwhile for companies that are not utilizing FTAs to reconsider. An FTA feasibility analysis may uncover eligible goods and significant duty that is being unnecessarily overpaid. FTA considerations in supply chain restructuring activities can lead to cost savings opportunities. Internal trade processes, procedures and internal controls can be put in place to safeguard FTA benefits. In other words, there are a number of ways that businesses can effectively utilize and manage FTA preference opportunities to ensure that you are not paying too much.

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European Union

European Court of Justice takes strict position on compliance with customs procedures for duty suspension arrangements

Customs procedures for duty suspension arrangements, such as inward processing relief and customs warehousing, allow goods to be imported without the payment of customs duties and value added tax (VAT) provided they are subsequently exported. The timely export is critical; moreover, recent judgments by the European Court of Justice (ECJ) make clear that compliance with the technical formalities required under the regulations to support the procedure are just as important. As established in the two cases discussed below, the customs authorities can impose a customs debt (i.e., the imposition of duty on subject exports) on companies that do not strictly comply with the procedure's obligations.

"Döhler" case (C-262/10) — inward processing relief

Döhler Neuenkirchen Gmbh (Döhler), a trader in fruit juices, placed non-Community concentrated fruit juice under the inward processing relief (IPR) suspension regime. Under IPR, non-Community goods intended for re-export can be used in processing operations within the EU customs territory without being subject to import duties or commercial policy measures. The IPR customs procedure must be discharged (i.e., concluded) within a predetermined period by exporting the processed goods and fulfilling certain customs obligations, such as supplying a bill of discharge within 30 days of the expiration period.

Although Döhler exported a portion of the processed goods within the IPR time period, the German customs authorities imposed customs duties on all goods placed under the IPR procedures because the bill of discharge was supplied two and a half months late. The ECJ affirmed the position of the German customs authorities, finding that a customs debt had incurred through the non-fulfillment of one of the obligations arising from the use of the customs procedure, pursuant to Article 204 of the Community Customs Code (CCC).

"Eurogate" case (C-28/11) — customs warehousing

Eurogate Distribution GmbH (Eurogate) operated a private customs warehouse to store customers' non-Community goods intended for export under the suspension of customs duties. Pursuant to Eurogate's customs warehouse license, the company had to keep stock records of the goods placed under the customs warehousing procedure. The company exported the goods; however, the German customs authorities imposed customs duties on the removals because the company had not timely entered the removals in their stock records (performed from 11 to 126 days late). The ECJ affirmed the position of the German customs authorities. The delayed stock entries qualified as non-fulfillment of the obligations arising from the use of the customs warehousing procedure, pursuant to Article 204 of the CCC.

Implications for business

The ECJ's judgments support strict compliance with the formal obligations for the use of a customs procedure. Clearly, there is no distinction between "principal" obligations and "secondary" obligations. While the principal obligations (e.g., the timely export of the goods subject to the duty suspension) may be met, a relaxed approach to secondary obligations (e.g., timely stock entries or the timely supply of a bill of discharge) can be costly.

We note that Article 204 includes the provision that a customs debt upon importation will not be incurred when it is established that the non-compliance has no significant effect on the correct operation of the customs procedure in question. For this purpose, Article 859 of the CCC Implementing Regulation provides a restrictive list of allowable omissions (e.g., time extension request made).

Businesses that utilize these and other types of customs procedures (e.g., transit, processing under customs control and temporary admission) can expect more scrutiny by the customs authorities throughout the EU. Affected businesses should assess their compliance with the customs procedures' formal obligations, rectify any gaps in procedures and internal controls, and address any issues of duty exposure.

Businesses should also consider the potential VAT implications of any customs procedure non-compliance. Based on the VAT Directive, VAT shall become chargeable when goods cease to be covered by a customs procedure. It is questionable whether the goods are no longer covered by a customs procedure when a customs debt based on Article 204 CCC is established. This question has already been raised by the Dutch Supreme Court and is currently pending at the ECJ. The outcome will be particularly important for logistics providers that transport or store goods owned by customers under customs procedures. These types of companies may not be able to recover the import VAT due (21% in the Netherlands).

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Ukraine

Ukraine's controversial request to the WTO to increase tariffs

Ukraine's controversial request to the World Trade Organization (WTO) to increase tariffs on more than 350 products could have significant implications beyond the industries directly affected.

Under the provisions of Article XXVIII of the General Agreement on Tariffs and Trade (GATT), contracting parties may modify or withdraw a tariff concession through negotiation and agreement with other WTO members. The negotiations generally entail ensuring that compensatory concessions (i.e., reduced duty rates) are provided for other products in a comparable amount. These provisions have generally been used for minor technical changes, not the widespread tariff increases requested by Ukraine.

Further, given the vast number of products for which Ukraine intends to increase tariffs and the country's relatively small range of exports, it is doubtful that tariff rates may be comparatively reduced for other industries. The tariff increases at issue affect products, such as meat, flowers, fruit, vegetables, refrigerators, washing machines, vehicles, certain agricultural machinery and certain medical products. Notably, some of these product categories focus on key industry sectors for bilateral trade between Ukraine and the EU, such as tractors, cars and other vehicles as well as household devices and agricultural machinery.

Ukraine's position is based on statistical trade data that shows continuing growth of imports for the affected goods that are limiting the development of domestic production. Nevertheless, Ukraine may face an uphill battle at the WTO, given the unprecedented number of tariff lines affected. Concern and objections from various WTO member countries have been made clear as 23 WTO countries issued a joint statement urging Ukraine to withdraw their request to renegotiate tariffs. At a press conference in Oslo, Ukraine responded that it is acting in strict accordance with the WTO statute, indicating that it will not withdraw the request. Accordingly, WTO negotiations are likely to be long and intense.

The implications of Ukraine's request to the WTO could be significant. If Ukraine is able to increase such a wide range of tariffs under WTO rules, then the move sets a dangerous precedent for other countries that may also consider using the Article XXVIII provision to make drastic tariff increases.

Should Ukraine unilaterally increase the tariffs without WTO permission, the country could face retaliatory measures by other WTO member countries, such as the withdrawal of concessions affecting Ukraine exports.

Other considerations include the implications for Ukraine's commitment to EU integration and negotiations on the creation of a free trade zone with the EU. Ukraine's actions could potentially signal a redirection of trade focus more to the East, including the possibility of joining the customs union of Russia, Belarus and Kazakhstan, and further integration in the Eurasian Economic Community. The geopolitical fallout of any widespread tariff increases and the implications for mutual trade between WTO members is difficult to predict.

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Central Africa — CEMAC area

Increasing post-importation customs controls in Central Africa (CEMAC area)

The customs reform movement in Central Africa is placing more customs resources on post-importation controls to verify the information contained in the customs declaration. This shift means more emphasis on documentation trails and on-site verification visits by the customs authorities. As a result, customs compliance is becoming a bigger issue for businesses, considering that the information declared to the customs authorities can be scrutinized years after the goods have been imported.

Gabon, a member country of the Central African Customs and Economic Union (CEMAC), which also includes Cameroon, Equatorial Guinea, Congo, Chad and the Central African Republic, recently implemented the CEMAC Customs Code's customs control procedures to detect offenses. The primary customs controls are referred to as "immediate," "deferred," and "a *posteriori*."

The "immediate" control is conducted by the central customs office prior to or during customs clearance. During the inspection, the goods remain under customs control. Customs agents inspect declarations in detail; however, the control cannot exceed 48 hours.

The "deferred" control occurs after the release of the goods and is the sole responsibility of the Regional Directorate. This control involves the inspection of documents submitted with the customs declaration to verify the proper assessment of customs duties and compliance with the customs rules.

The "a *posteriori*" control is an on-site inspection conducted by the Directorate of Customs Fraud Prevention and Litigation at the company headquarters or place of business. This control involves the examination of sales and accounting records to better understand the nature of certain transactions and trade activities.

Based on their findings, the respective customs agency will issue a "report on irregular procedure," which identifies any customs offenses (e.g., errors or involuntary omissions in declarations) or misdemeanors (e.g., smuggling) identified during the control and any additional customs assessment that applies. In case of fraud, the customs agency may issue a "report on the seizure of goods," which allows any enforcement officer to seize all items subject to confiscation and retain shipments and documents relating to the goods at issue.

The implications of customs non-compliance can be severe. Consider that for systemic errors (e.g., consistently applying an incorrect tariff classification), the calculation for the duty assessment may cover a multi-year period. For instance, in Gabon, the customs authorities can go back 30 years in reviewing customs declarations. Additionally, customs penalties of 10% or higher may be applied to the additional assessment. Certain customs violations (e.g., smuggling) are punishable by three years of imprisonment, or longer in the case of fraud.

The customs rules provide various options of recourse through the court system. Alternatively, the company can negotiate a customs settlement directly with the customs administration, subject to established limits and conditions as provided in the customs rules. This procedure allows for the mitigation of the severe nature of the customs legislation and helps relieve bottlenecks in the court system.

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East Africa — Kenya

Kenya ends controversial cash bond requirement for transit goods but concerns remain

Kenya's Mombasa port is an important gateway for imported goods to reach many landlocked countries in East Africa and beyond. The normal practice for goods transiting through Kenya has been for traders to issue a non-cash insurance bond which is cancelled once the goods exit the Kenyan territory.

In mid-August 2012, the Kenya Revenue Authority (KRA) unilaterally directed that all transiting sugar and imported vehicles of engine capacity of over 2000cc through Kenya must pay a cash bond or issue a bank guarantee equivalent to the value of the imported goods before leaving the port of Mombasa. It was not clear when the cash would be refunded once the transit cargo was cleared.

The key motivation behind the directive was to regulate trade and prevent dumping of sugar and motor vehicles (both highly taxed goods in the region) in Kenya under the premise that such goods were destined to neighboring countries. The government therefore needed to be sure that taxes have been collected in case the goods remained in Kenya.

The directive was heavily opposed by Kenya's trading partners, particularly fellow member states of the East African Community (EAC) that argued the unilateral move contravened agreements under the EAC Customs Union. Further, this directive threatened the momentum for EAC integration into a bigger market free trade area with COMESA and the rest of Africa.

The stalemate continued for a period of more than one month when KRA gave into pressure from regional trade partners, especially Uganda. Uganda threatened a retaliatory measure against imports to Uganda from Kenya if the cash bond requirement was not withdrawn.

Transit trade through Kenya has generally returned to normal. However, traders are still feeling uncertainty and concern after the ill effects of the trade dispute on their business in terms of cashflow challenges and high demurrage charges due to the delays in clearing cargo. There is currently a push by many EAC member countries to have the ports of Mombasa and Dar-es-salaam become regionally managed assets to address this uncertainty as well as reduce costs emanating from inefficiencies of the current transit procedures. In the short-term, however, the heightened attention on goods transiting Kenya is likely to remain.

KRA is expected to closely scrutinize transit goods to determine whether additional measures are necessary. Accordingly, the following actions should be employed by companies dealing in imports that transit through Kenya:

- Ensure proper and timely reconciliations of transit goods through Kenya
- Ensure transit bonds for all transit goods are cancelled within the required timelines
- Should a similar directive be implemented in the future, prove track record and make an application for special permission not to pay a cash bond

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