

# TradeWatch



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## EY Global Trade

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## TCCV approves advisory opinion on royalty withholding taxes, declines to issue an instrument on exclusive distribution rights



The Technical Committee on Customs Valuation (TCCV) approved a new advisory opinion at its May meeting confirming that withholding tax obligations of an importer do not impact the dutiable value of goods. Following approval by the World Customs Organization Council, it is expected to be released as Advisory Opinion 4.16. At the same meeting, the TCCV concluded its assessment of a case study involving exclusive distribution rights, but decided not to issue an instrument.

The TCCV is a committee of customs authorities created by the WTO Valuation Agreement and tasked with providing interpretation and guidance on the Valuation Agreement and is administered by the World Customs Organization. While its guidance is not binding on any jurisdiction, its pronouncements are regularly cited by customs authorities worldwide.

Domestic tax law in the country of import, Country I, imposes a 25% withholding tax on the royalty – the importer must withhold 25% of the amount due the licensor, CU 25, and remit it to the Country I tax administration. While the obligation to withhold is on the importer, the tax is an income tax on the income earned by the licensor from exploitation of royalty in Country I. The Advisory Opinion makes clear that the gross amount of the royalty, the entire CU 100, is considered an addition to transaction value under Article 8.1(c) of the WTO Valuation Agreement. The addition to transaction value is determined by the amount of the importer's royalty obligation, not the amount received by the licensor net of the withholding tax.

The Advisory Opinion provides no analysis of the royalty payment itself, but instead assumes that the payment is an addition to value.

### Advisory Opinion 4.16

Advisory Opinion 4.16 deals with a common situation in which an importer must pay a trademark royalty based on a percentage of the importer's sales income. In the case presented, the royalty is set at 5% of the net proceeds of sale, with sales during the period at issue totaling currency units (CU) 2,000, making the royalty CU 100.



## Exclusive distribution rights

As reported in a previous issue of *TradeWatch* (March 2014), the TCCV has been reviewing a case study involving a payment made by an importer of automobiles for the right to be the exclusive distributor for the brand of vehicles. While the right to resell a product is inherent in the authorized purchase of that product, the right to be the exclusive reseller for that product is not automatically conveyed with the product purchase. Conceptually, the right to be an exclusive distributor of a product is more valuable than the right to be only a distributor; exclusivity rights provide greater business certainty in building brand value and customer awareness in the marketplace without concern that the efforts will instead benefit a competitor who is also a distributor of the same products. In HQ 242894 (4 December 2013) U.S. Customs and Border Protection issued a ruling on a similar fact pattern determining that the payment for the distribution rights should not be considered part of, or an addition to, the transaction value for imported vehicles. The US ruling contained a detailed analysis of the contracts, as well as a study prepared by Ernst & Young LLP determining the value of the exclusive distribution rights.

The TCCV discussed the case study at length, but concluded that the complexity of the issues and required analysis made it inadvisable to issue an instrument providing general guidance. The implication is that a properly structured fee for exclusive distribution rights may be excluded from the dutiable value of imported products. As is apparent from the analysis given in the US ruling, careful definition of the rights conveyed, appropriate segregation of those rights and thorough support for the value of the rights are critical to excluding the rights from the dutiable value of imported product.

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## Argentina

### Argentina's Supreme Court of Justice upholds legality of export duties within MERCOSUR



On 11 December 2014 Argentina's Supreme Court of Justice ruled<sup>1</sup> that imposing export duties on goods destined for a MERCOSUR member country is not incompatible with the principles of the Treaty of Asunción, MERCOSUR's founding charter.

Argentina imposes export duties on all exports at varying rates. Export duties were introduced during Argentina's economic crisis of 2002 by the Ministry of the Economy and Public Finance Resolution 11/2002 (under authority of Law No. 25,561). Although intended as a temporary measure, export duties continue to be an important source of public revenue in Argentina.

Over the years, exporters have argued that export duties imposed on goods exported to other MERCOSUR member countries are in conflict with the Treaty of Asunción's established principle of free circulation of goods and services between member countries, and that such free circulation can only be achieved through the elimination of customs duties, non-tariff restrictions and other equivalent measures. The case that finally reached Argentina's Supreme Court used this argument, but it nonetheless did not persuade the Court.

The Supreme Court noted that “we have to consider the countries' intention to establish a common market progressively under the principles of gradualness, flexibility and balance listed in the preamble of the treaty.” In essence, the Supreme Court suggested that although the Treaty sets the objectives, it does not define clearly the methods to be used to achieve them.

The Court also added that even if the economic integration system is ultimately aimed at eliminating export duties – as a means to promote the free circulation of goods between member countries – it does not follow that the Treaty of Asunción specifically prevents member states from imposing such duties in the interim.

The Supreme Court then compared the Treaty of Asunción with the Treaty establishing the European Economic Community (Treaty of Rome, 1957), which expressly prohibited member countries from imposing “quantitative restrictions on exports and equivalent measures” and also required that existing restrictions be eliminated “by the end of the first stage” (Article 34). The Court pointed out that such provisions were not included in the Treaty of Asunción.

1 Whirlpool Puntana SA v. General Directorate of Customs, SCJ 61/2008 (44-w), Supreme Court of Justice of the Nation, 11 Dec. 2014 (available in Spanish at the Supreme Court of the Nations' website: <http://servicios.csjn.gov.ar/confal/ConsultaCompletaFallos.do?method=verDocumentos&id=717646> )

2 *Mercado Común del Sur*, Southern Common Market: Argentina, Brazil, Paraguay and Uruguay, and since 2012, Venezuela.



Along the same lines, the Supreme Court also noted that the MERCOSUR Customs Code of 2010 (the Code) does not address the issue of export duties and, therefore, the laws that existed on this matter within each member state's respective customs territory before the Code was adopted would apply. Furthermore, as the Common Market is *"based on the reciprocity of rights and duties among the member states"* it would be improper to infer that any member state would be required not to impose or, as in the case of Argentina, to repeal its export duties.

On the basis of the foregoing reasoning, the Argentine Supreme Court upheld the legality of export duties having ruled that Resolution 11/2002 does not conflict with the principles of the Treaty of Asunción. Notwithstanding, it remains to be seen how this ruling will play out in the other MERCOSUR member states (none of which imposes export duties) as well as in the global marketplace where export duties are considered an important barrier to trade.

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# Brazil

## Authorized Economic Operator in Brazil to incorporate Blue Line regime



The recently introduced Authorized Economic Operator (AEO) program is expected to incorporate Brazil's Blue Line regime by December 2015. All Blue Line companies will be authorized for an automatic migration to AEO according to a procedure to be determined in the near future.

### AEO

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.

Brazil introduced its AEO program with the publication of the Normative Instruction IN RFB 1.521/2014 regulations that provide for program eligibility, minimum requirements, benefits for the certified companies, certification process and other details as well as the types of certification and monitoring procedures the Brazilian Government is to implement after certification.

The following entities are eligible for AEO in addition to importers and exporters: bonded warehouses, port and airport administrations, customs brokers and freight forwarders.

There are three types of certification:

1. AEO-S (Security and Safety): the AEO-S certification focuses on supply chain security and safety of foreign trade transactions
2. AEO-C (Compliance): the AEO-C certification focuses on the analysis of tax and customs obligations compliance
3. AEO-P (full scope): this certification combines both AEO-S and AEO-C

The Brazilian Government's objective with the implementation of AEO is to enter into agreements of bilateral recognition with countries already working with AEO and thus provide a faster customs clearance process. As more companies in Brazil qualify for AEO certification, more benefits can be negotiated with other countries

The Brazilian Government expects to provide the following benefits to AEOs: enhanced procedures that will guarantee better oversight and control of internal workflows, recognition of the AEO as a reliable company abroad, open communication with the customs authorities in Brazil and the possibility for simpler and faster customs processing.





Companies must meet certain minimum requirements, such as be established in Brazil for at least 24 months and be up to date with their tax and financial obligations, among others.

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.

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

After the questionnaire analysis, AEO authorities conduct a physical inspection on the company's premises to validate facts and assess potential risks and matters of concern. Certification is granted or denied on the basis of the level of internal controls that the company has and monitoring frequency will be planned based on the level of risk that is assessed.

## Blue Line regime

The implementation of AEO in Brazil has raised some questions regarding the Blue Line regime, a similar certification program that grants to companies credentials of having reliable internal controls and provides for express release of goods upon importation, exportation and customs transit within Brazil.

The Blue Line regime was introduced in Brazil in May 2001 under Normative Instruction IN SRF 47/2001, which was replaced in 2004 by the currently in force Normative Instruction IN SRF 476. At this time there are approximately 50 Blue Line certified companies, with a number of companies still waiting for Blue Line approval from the customs authorities. Under the present rules, Blue Line companies are required to present monitoring audit reports on a biannual basis.

The customs authorities introduced in April 2015 two main changes in the Blue Line regime requirements. One change concerns the size of eligible companies and the other reduces the frequency for presenting the monitoring audit report from every two years to every three years.

As a result, Blue Line companies that were to present their audit reports during 2015 will now submit them in 2016. With this new rule, companies will have more time to work on their transition from Blue Line to AEO and the customs authorities will have more time for managing transition details and issuing decisions.

One decision has already been issued: the Blue Line regime will be incorporated into AEO by December 2015. All Blue Line companies will automatically transition to AEO and will be required to submit the aforementioned questionnaire after a period of time yet to be determined.

## Final thoughts

The transition from Blue Line to AEO will change the focus of participating companies from audit and certification to content of internal controls and details of the monitoring and testing program. Companies looking to benefit from the AEO program are well advised to map and assess their current processes, and monitoring programs.

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# Mexico

## Update: Pharmaceuticals are the new focus of the Mexican FTA audit program



The Mexican tax authorities (Servicio de Administración Tributaria or SAT) have subjected an increasing number of companies over the last few years to Free Trade Agreement (FTA) audits by using new sampling methodologies to verify FTA origin qualification (as reported in the December 2014 issue of *TradeWatch*). The SAT has also broadened the FTA audit scope to focus on new areas, such as compliance with direct shipment requirements and duty deferral restrictions (i.e., Article 303 of the North American Free Trade Agreement, NAFTA).

SAT's latest efforts appear to be industry-focused with particular attention to the pharmaceutical industry. Under the NAFTA, pharmaceutical products classified under Chapter 30 of the Harmonized Tariff Schedule are usually subject to strict rules of origin that require, for example, compliance with tariff shift requirements, or regional value content of not less than 60% under the transaction value method, or 50% under the net cost method.

Importers of pharmaceutical products into Mexico need to be prepared to support their origin qualifications or risk significant consequences, including payment of omitted duties and fines. Similarly, manufacturers and exporters of pharmaceutical products, especially from the United States and Canada, where the Mexican authorities have extraterritorial audit rights under the NAFTA, should have efficient processes in place to support origin determination and to manage effectively origin verification audits.

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## Argentina and Brazil renew import quotas for Mexican automotive vehicles and parts



Argentina, Brazil and Mexico have agreed to extend until March 2019 the quota system for Mexican automotive vehicles and auto parts imported into Argentina and Brazil.

As background, on September 27, 2002 the MERCOSUR (Mercado Común del Sur, Argentina, Brazil, Paraguay and Uruguay, and since 2012, Venezuela) countries signed the Economic Complementation Agreement No. 55 (ECA No. 55) with Mexico, under the framework of the Latin American Integration Association (Asociación Latinoamericana de Integración, ALADI). The ECA No. 55 provides for preferential duty treatment on the importation of automotive vehicles and auto parts originating in the member countries.

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

In addition, on 26 June 2012, Argentina unilaterally suspended the application of the ECA No. 55 through Decree No. 969/2012 for a three-year term, during which Mexican automotive vehicles and parts could no longer be imported duty-free. Argentina claimed that the negotiations with Brazil had not been performed in accordance with the provisions of the ECA No. 55 and the amendments introduced by Brazil modified the trade flow of automotive vehicles to a degree where the restrictions imposed by the quota between Brazil and Mexico would increase imports into the rest of the signatory parties to the ECA No. 55 (i.e., Argentina, Paraguay and Uruguay). This increase would represent a grave and imminent threat to Argentine manufacturers of automotive vehicles and would affect negatively the development of current and future investments.

Mexico and Argentina resolved their trade dispute by negotiating further amendments to the ECA No. 55 that terminated the suspension of the agreement by Argentina and reactivated the preferential duty treatment under a new quota system and stricter regional value content requirements. The quota system limits the number of Mexican imports of automotive vehicles in a manner similar to the amended agreement with Brazil.





In March 2015, Argentina, Brazil and Mexico renegotiated new amendments to the ECA No. 55 that extend the quota system (originally set to expire on 15 March 2015), until March 2019, as outlined below:

### Imports into Brazil

The amended agreement establishes a quota system that limits the value of Mexican automotive vehicles and parts that can be imported into Brazil duty-free as follows:

- ▶ USD1,560,000,000 until March 2016
- ▶ USD1,606,800,000 until March 2017
- ▶ USD1,655,004,000 until March 2018
- ▶ USD1,704,654,000 until March 2019

The amended agreement also includes changes to the regional value content requirements for automotive vehicles and auto parts originating in Mexico and imported into Brazil. From March 2015 through March 2019, the minimum regional value content requirement will be 35%. Starting April 2019, the regional value content requirement will increase to 40%.

### Imports into Argentina

The amended agreement establishes a quota system that limits the value of Mexican automotive vehicles and parts that can be imported into Argentina duty-free as follows:

- ▶ USD575,000,000 until March 2016
- ▶ USD595,250,000 until March 2017
- ▶ USD612,978,750 until March 2018
- ▶ USD637,497,900 until March 2019

From March 2015 through March 2019, the minimum regional value content requirement for automotive vehicles and auto parts originating in Mexico imported into Argentina will be 35%. Starting April 2019, the regional value content requirement will increase to 40%.

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# United States

## Newly introduced legislative bills present expanded drawback opportunities



With trade issues at the top of the agendas of both the White House and Congressional leaders, the trade community has had a number of issues worth monitoring during 2015's first legislative session. Of particular note are bills introduced in both the Senate and House of Representatives that include significant amendments to current drawback regime that will provide new avenues of recovery while allowing claimants to streamline drawback operations.

The proposed changes include the following:

- 1) **Substitution based on classification under the Harmonized Tariff Schedule of United States (HTSUS) or Schedule B** – Currently, manufacturing drawback under 19 USC §1313(b) and unused merchandise drawback under §1313(j)(2) permit claims to be filed on amounts paid upon importation of merchandise when different, or “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.

The pending bills simplify 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 allows for expanded substitution opportunities beyond the limitations that result from the need for products to be commercially interchangeable.

The bills also allow for substitution in §1313(j)(2) claims to be based on correspondence of the first eight digits of an article's Schedule B number to its HTS classification, regardless of whether the Schedule B number corresponds to an HTS subheading with more than eight digits. This is a novel form of drawback substitution, and has the potential to significantly increase substitution opportunities.

The bills contain certain limitations on the application of this HTSUS-based substitution for § 1313(j)(2) drawback where the HTSUS provision product description begins with “other.” While this limitation 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** – Currently, 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. The pending bills expand this window to within five years from the date of importation.

3) **Taxes and fees included in manufacturing drawback claims** – Under current rules, manufacturing drawback claims, including those for substitution manufacturing drawback, are limited to 99% of the duties paid on the imported merchandise. Additional “taxes and fees” recoverable under other types of drawback are not available for manufacturing claims.

The proposed legislation would expand the recovery permitted under manufacturing claims to include recovery of 99% of duties, taxes and fees paid with respect to the imported merchandise. By way of example, importers who are subject to excise taxes on certain raw materials inputs are currently unable to file manufacturing drawback claims on those taxes. The new bills would permit recovery of those excise taxes.

4) **Relaxation of transfer documentation requirements** – Under certain circumstances, current drawback rules require a certificate of delivery to be provided when an importer transfers merchandise to a manufacturer or claimant who will ultimately rely on the merchandise in submitting a drawback claim. Claimants are required to submit these certificates as part of their claims.

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

The pending bills currently state that their provisions become effective upon enactment with the exception that claimants will not be able to actually file claims under the new provisions until two years after enactment. 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 and claimants can begin filing drawback claims in ACE, it is expected that claimants will still be able to take advantage of the expanded time frame above, and look back five years from the effective date for eligible imports and exports.

While the legislation introduced by Congress provides opportunities for expanded claims and simplified operations, the general compliance requirements - and risks - related to filing drawback claims will remain high. Accordingly, it will be worth monitoring the bills to maintain familiarity with the requirements ultimately passed into law. While a definite deadline cannot be set for such passage, relevant Committee Chairs and Ranking Members from the House and the Senate release a joint statement on 18 May 2015 expressing their hope that the bills could be reconciled and sent to the President by the end of June.

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## Trade bills to provide increased opportunities and compliance requirements for importers



As members of the trade community have undoubtedly noticed, this spring has been a very active time for customs and trade issues in Washington, DC. There are several trade-related bills currently working their way through Congress, and keeping track of them can prove difficult and time-consuming. It is worth monitoring this progress, however, because these bills may provide importers increased savings opportunities or create requirements for heightened compliance. A summary of some of the highlights follows:

### Trade Promotion Authority

The Trade Promotion Authority (TPA) bill<sup>3</sup> may be the most high-profile bill being considered. TPA establishes a set of Congressional objectives to be pursued when trade agreements are negotiated by the President. Trade objectives range from overall goals such as establishing more open, equitable and reciprocal markets, to a series of more specific, or “principal” objectives related to trade in goods and services; agricultural trade; protecting foreign investment through equal treatment and fair dispute resolution; and labor and environmental concerns.

When those objectives are met in negotiations, Congress will vote “yea-or-nay” (i.e. either approve or disapprove, but not amend or filibuster) on agreements presented to it.

The TPA plays a unique role for customs professionals because it will not directly create new requirements or opportunities for importers. Nevertheless, it remains important for a few reasons.

First, the TPA is widely considered important, if not essential, to the completion of negotiations on the Trans-Pacific Partnership (TPP) trade agreement. TPP, currently being negotiated by the US and 11 other Pacific Rim nations<sup>4</sup>, is expected to provide significant opportunities for companies engaged in trade in that region. While the objectives set forth in TPA are not limited to TPP negotiations, many believe TPP negotiations will be difficult to conclude without the assurance of a simple yes or no vote that TPA provides.

Second, TPA has been prioritized by legislators so that consideration of other bills may be held up if TPA is not passed. While the other measures discussed here are not part of the TPA bill, there are indications that progress will be slow if TPA progress stalls.

3 The Bipartisan Congressional Trade Priorities and Accountability Act of 2015, H.R. 1314, 114th Cong. (2015).

4 Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, in addition to the United States.





The Senate passed TPA on 22 May 2015. On 12 June 2015 the House of Representatives voted by a narrow margin to pass TPA. However, on the same day the House rejected a Trade Adjustment Assistance (TAA) bill to which the TPA bill was tied. Because these bills have been packaged together, the TAA rejection will prevent TPA from advancing unless additional support can be garnered. The House is likely to bring these bills up for another vote in the near future.

## Trade Facilitation and Trade Enforcement Act

The Trade Facilitation and Trade Enforcement Act of 2015 is a wide-ranging bill encompassing many trade-related topics that have been under discussion for years. First, the bill identifies a number of priorities related to customs modernization, and trade facilitation and enforcement, for which U.S. Customs and Border Protection (CBP) plans to work with Congress to establish priorities and performance standards. These include the Centers of Excellence and Expertise, transactions related to merchandise imported in bond, collection of countervailing and antidumping duties, and the Automated Commercial Environment (ACE), for which the bill appropriates not less than \$153,736,000.<sup>5</sup> The topics are treated to a varying extent throughout the rest of the bill.

Of particular note, the Trade Facilitation Act grants CBP new enforcement authority to investigate allegations that an importer has evaded payment of antidumping or countervailing duties upon import. CBP is authorized to investigate the targets of these allegations and issue a determination regarding whether evasion occurred. In conducting this investigation, CBP is authorized to make adverse inferences if a party fails to cooperate. Upon a determination that evasion occurred, CBP is authorized to take steps such as suspending liquidation of unliquidated entries, requiring cash deposits to cover the amount evaded, and initiating penalty proceedings under 19 USC §§ 1592 and 1595a.

The Senate passed the Trade Facilitation Act on 14 May 2015 and the House of Representatives passed an amended bill on 12 June 2015.

## AGOA/GSP renewal

The AGOA Extension and Enhancement Act of 2015 will renew the African Growth and Opportunity Act, which is set to expire on 30 September 2015 as well as the Generalized System of Preferences (GSP), which expired in July of 2013. Together, these programs provide development assistance to Sub-Saharan Africa and other developing economies. They also include duty reduction or elimination provisions for imports into the US. In its current form, the bill makes duty relief under GSP retroactive to cover claims made since the program's expiration.

Versions of the bill passed in both the House and Senate, and on 11 June 2015 the House passed amendments to be deliberated by the Senate.

## Conclusion

This article provides just an overview of a few measures pending in Congress. The trade and customs community should monitor developments on these and other bills in the coming months to stay abreast of possible compliance implication and opportunities that may become available.

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<sup>5</sup> The bill also cites drawback as a priority and the proposed amendments to the drawback rules are discussed in a separate article in this issue of Trade Watch.

# Venezuela

## Distortions on VAT created by foreign exchange controls in Venezuela



Importers in Venezuela who cannot do business except with foreign currency face numerous challenges from the complex foreign currency exchange controls. This article focuses on import VAT (value-added tax) distortions created by the multiple exchange rates currently in place in Venezuela.

### Background

Venezuela has had highly restrictive foreign currency exchange controls since 23 January 2003. Under the existing regime, there are three official systems, all controlled by the Central Bank of Venezuela (Banco Central de Venezuela, BCV), by which foreign currency may be legally obtained:

- ▶ CENCOEX or *Centro Nacional de Comercio Exterior* (National Center for Foreign Trade)
- ▶ SICAD and SICAD II or *Sistema Cambiario Alternativo de Divisas* (Alternative Foreign Currency Exchange System)
- ▶ SIMADI or *Sistema Marginal de Divisas* (Marginal Currency System)

Each of these three systems uses a different exchange rate. As a result, the following different exchange rates coexist under the current exchange control regime:

- ▶ **A fixed exchange rate**, which is only applicable to preferred goods (mostly medicines and food). This exchange rate is managed by CENCOEX and is currently set at VEB6.30 per USD.
- ▶ **The SICAD rate**, which is applicable to certain operations as set forth in Exchange Agreement No. 25 (royalties, technical assistance and international investments, i.e., dividends, among others). The exchange rate is approximately VEB12 per USD.
- ▶ **The SICAD II rate**, which is applicable to certain operations as set forth in Exchange Agreement No. 28. Note that SICAD II was eliminated as a system in February 2015 and as a result some of the articles of Exchange Agreement No. 28 were repealed. However, the rate itself remains in force for certain items, such as incoming international investments. The applicable exchange rate in this case would be the one obtained at the latest auction conducted within this system and posted on the BCV website, effective until a new exchange rate is set and posted. Currently the rate is VEB52 per USD. Nevertheless, it is worth noting that new regulations in this regard are expected, which could result in the complete elimination of SICAD II rate.





- **The SIMADI rate**, which is applicable to the items set forth in Exchange Agreement No. 33, such as tax obligations derived from customs operations. This system was introduced recently after the SICAD II system was suspended. The exchange rate is approximately VEB199 per USD.

## VAT distortions

From a Venezuelan tax perspective, operations in foreign currency should be analyzed on a case-by-case basis to determine which exchange rate applies.

As there are several different exchanges rates, the exchange rate applicable for tax purposes is determined according to the regulations set forth by the Exchange Agreements that is currently in force.

The exchange rate for all operations or items that have not been explicitly assigned a specific exchange rate (i.e., SICAD, SICAD II or SIMADI) is the fixed exchange rate of VEB6.30 per USD according to Exchange Agreement No. 14. It is noteworthy that the Venezuelan Government maintains the fixed exchange rate of VEB6.30 per USD as the official exchange rate (even though the others rates mentioned above are as just as official and legitimate) because the Government has not adopted an official currency devaluation, but rather has assigned specific exchange rates to specific transactions.

In this sense, the nature of the transaction determines the foreign currency exchange rate applicable to a specific item.

In the case of imports, Exchange Agreement No. 33 provides that the conversion rate for purposes of determining the taxable base of tax obligations for customs operations is to be made at the same exchange rate used initially to acquire the foreign currency corresponding to these operations.

The above means that if the importer obtains foreign currency through any one of the official mechanisms available (i.e., CENCOEX, SICAD or SIMADI) to carry out its operations, then the same exchange rate should be used to determine the taxable base of tax obligations derived from imports, such as customs duties and VAT.

Where an importer uses its own foreign currency funds for import operations, the exchange rate to determine customs duties and VAT is SIMADI's according to Exchange Agreement No. 33 (VEB199 per USD).

If the import operation is subject to different exchange rates, then the importer must file and pay customs duties and VAT for each item separately at the applicable exchange rate.

Thus, VAT generated from import operations (input) could be either settled at the fixed rate of VEB6.30, SICAD (VEB12) or SIMADI (VEB199).

In the case of VAT derived from local sales, the VAT Law provides that if the taxable base is denominated in foreign currency, it shall be converted into VEB at the current market exchange rate on the day when the taxable event occurs.

Naturally, this rule is not adapted to the current foreign exchange regulations, as there is more than one exchange rate. Thus, the "current market exchange rate" in this case is the fixed exchange rate of

VEB6.30 per USD, as there is no Exchange Agreement that establishes another specific exchange rate (SICAD, SICAD II or SIMADI).

As a result, when imported products are sold locally, the exchange rate for purposes of determining the taxable base for VAT from sales (output) would be VEB6.30 per USD.

Therefore, an importer in Venezuela would be potentially facing VAT from imports (input) at different rates of up to VEB199 and, VAT from local sales (output) at VEB6.30 per USD, creating a significant distortion between VAT inputs from import operations (VAT paid) and VAT outputs from local sales (VAT collected), in the case where the currency exchange for the import was not obtained through CENCOEX at VEB6.30. Ultimately, this will represent a greater cost for the importer, which is not recoverable as it is determined through the VAT mechanism (input-output offset).

Given the distortions the exchange control regime in force could trigger for companies conducting business in Venezuela, it is important to proactively manage each transaction to find an optimum balance among the options that could help mitigate any adverse tax effects.

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## China

### China to cut import tariff on certain consumer goods



#### Background

The recent growth of the Chinese economy has created an increased number of middle-class shoppers wishing to purchase foreign consumer luxury products. At the same time, the prices of these products in China, due to a combination of high operating costs, duties and other indirect taxes on imported consumer goods, are higher when compared to other countries, which means Chinese consumers have to pay more if they buy locally. As a result, consumer tourism (i.e., shopping trips overseas) and cross-border B2C (i.e., online overseas purchases), both of which enable Chinese consumers to buy goods overseas more cheaply than buying locally, has increased dramatically and impeded local consumption in the domestic market.

In light of the above, Premier Li Keqiang's has recently stressed the importance of implementing policies that are designed to boost the China domestic market for consumer goods. Soon thereafter, the Tariff Commission of the State Council responded by announcing a pilot program to reduce import tariffs on selected daily consumer products. The duty reduction is on average 50% of the goods falling within the scope of the announcement and is in effect as of Monday, 1 June 2015. The full scope of consumer goods covered by the announcement and the corresponding tariff reductions are outlined in the schedule on the next page.





## Adjustment of interim import duty rates for certain consumer goods

| No. | Ex* | HS code  | Description   | 2015 MFN rate (%) | Current interim rate (%) | Interim rate effective June 1 (%) |
|-----|-----|----------|---|-------------------|--------------------------|-----------------------------------|
| 1   | ex  | 33049900 | Preparations for the care of the skin   | 6.5               | 5                        | 2                                 |
| 2   |     | 43031010 | Articles of apparel of fur  | 23                |                          | 10                                |
| 3   |     | 61101200 | Jerseys, pullovers and similar articles, knitted or crocheted, of Kashmir (cashmere) goats  | 14                |                          | 7                                 |
| 4   |     | 62011100 | Men's or boys' overcoats, cloaks and similar articles, of wool or fine animal hair  | 16                |                          | 8                                 |
| 5   |     | 62021100 | Women's or girls' overcoats, cloaks and similar articles, of wool or fine animal hair   | 16                |                          | 8                                 |
| 6   |     | 62031100 | Men's or boys' suits of wool or fine animal hair  | 17.5              |                          | 10                                |
| 7   |     | 62041100 | Women's or girls' suits of wool or fine animal hair   | 17.5              |                          | 10                                |
| 8   |     | 64029100 | Other footwear, covering the ankle, of rubber or plastics   | 24                |                          | 12                                |
| 9   |     | 64029910 | Other footwear with uppers of rubber or plastics  | 24                |                          | 12                                |
| 10  |     | 64041100 | Sports footwear with uppers of textile materials  | 24                |                          | 12                                |
| 11  |     | 64051010 | Other footwear with uppers of leather or composition leather and with outer soles of rubber, plastics, leather or composition leather | 24                |                          | 12                                |
| 12  |     | 64051090 | Other footwear with uppers of leather or composition leather and with outer soles of other materials                                  | 24                |                          | 12                                |
| 13  |     | 64052000 | Other footwear with uppers of textile materials   | 22                |                          | 12                                |
| 14  |     | 96190010 | Diaper and napkins  | 7.5               |                          | 2                                 |

Note: \*Commodities marked with "ex" would be applicable to the interim duty rates only if the commodities are within the scope of the listed HS code and the nature of the commodities is consistent with the detailed description.

## Observations

### 1. Scope

Overall, this announcement is a very positive and clear message by the Chinese Government to encourage domestic spending and attract Chinese consumers back to the domestic market. That said, it should be noted that the scope of goods currently covered in the announcement is only limited to 14 kinds of daily

consumer goods and does not currently address the large demand by Chinese consumers for expensive, high-tariff luxury items (e.g., cosmetics, watches and leather goods) in China.

While those expensive luxury items, which are the main driving force behind consumer tourism and cross-border B2C transactions, are not currently included in the tariff reduction pilot, the message from Premier Li Keqiang's is that this announcement appears to be



only the first wave of duty reductions for consumer goods covered under the pilot program. Depending on the results of the pilot duty reduction, it is expected that the Chinese Government will likely introduce tariff reductions on additional consumer products. However, will future tariff reductions, apply to, and result in increasing domestic purchases, of the luxury items mentioned above?

## 2. Rate reduction

As mentioned above, tariffs will be reduced by 50% on average for the daily consumer goods falling within the scope of the announcement. However, the import taxes applicable to the imported consumer goods will also include import VAT and possibly consumption tax (if any) that when consumer goods are imported. As such, a 50% average tariff reduction may only contribute to a fractional reduction of the costs associated with importing these particular daily consumer goods.

Moreover, the high retail prices of imported consumer goods can also be attributable to the high operational and overhead expenses that come with maintaining a distribution network in China. Therefore, it is worth asking the following question: If the reduced tariff rates decrease the landed cost at the import level, will the price reduction be absorbed through the distribution network rather than being passed onto the final consumer?

## 3. Consumption tax

At this point in time, it is unclear how the consumption tax reform in China will affect domestic spending on certain consumer goods. Currently, consumption tax in China is applied when goods are imported. However, if under the consumption tax reform, the application of the consumption tax is moved to the retail level and the consumption tax rate remains unchanged, the tax base will increase and potentially offset the benefits of a tariff reduction. Thus, if the pilot reduction is further expanded to include consumer goods subject to consumption tax, it will be challenging for the Government to pursue a balanced outcome between the consumption tax reform and the tariff reduction.

## 4. Postage tax

Chinese consumers who buy goods overseas or through cross-border B2C channels are subject to postage tax, which is applied to the individual purchase price. The postage tax rates are relatively low, which raises the question of whether the tariff reduction is sufficient enough to persuade the Chinese consumers to purchase locally instead of buying overseas or through cross-border B2C channels.

It will also be interesting to ask whether the Government will consider increasing the postage tax to reverse the current trend of overseas purchasing and help retain Chinese consumers for more spending in the local market.

## 5. Brand strategy

The objective of the tariff reduction is to lower the retail price to attract the consumers of luxury goods back to the local market. It is typical in the luxury industry that brands may want to maintain the increasing trend of their retail price in order to protect the prestige of their brand names. With that in mind, will the brands be willing to reduce the retail price for their products, which may be in contrast to their traditional brand strategy?

## Conclusion

The recent announcement for the limited tariff reduction pilot program is likely only the first step in the Chinese Government's attempt to attract the Chinese consumers back from overseas consumer tourism and cross-border B2C channels to domestic consumption. While it will take time to see the results of the tariff reduction pilot program, it is likely that further efforts will be required in the future to accomplish their goal. As outlined above, various factors such as expanded scope, rate reduction, consumption tax, postage tax, brand strategy, etc., could affect the outcome of this program and therefore should be subject to further observation.

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## South Korea

### Use of Advance Customs Valuation Arrangements on the rise as South Korea customs increases scrutiny of transfer pricing issues



South Korea Customs Service (KCS) has recently increased the frequency of investigations of whether transfer prices (TP) are appropriately used by multinational companies as transaction value for customs purposes. Over the past five years, the total penalties imposed on trading companies in South Korea as a result of KCS' aggressive investigations on TP issues amount to approximately KRW1,145 billion.

Transfer prices refer to values used by multinational companies when importing or exporting goods between affiliates or related parties. One instance of such transaction would be importing/exporting between a company's headquarters in South Korea and a subsidiary located in a different country.

Confusion arises when a TP is deemed acceptable for national tax (corporate income tax) purposes but, at the same time, is determined as inappropriate for customs valuation purposes. This can happen because the national tax authority (National Tax Service, NTS) and the customs authority (KCS) in South Korea use different rules in assessing whether a TP or import price is appropriate or not.

Most importantly, KCS would review the individual import prices on an item by item basis, whereas NTS would look at the taxpayer's operating income for the entire accounting year. Also, while KCS would challenge import prices that appear to be "under-reported," NTS would try to find any "over-valued" import prices which could lead to less reported income and thus reduced income tax in South Korea.

As a result, under these contrasting points of view, a taxpayer may be left in a situation where he or she is forced to pay a penalty imposed by KCS for inappropriate use of the TP as transaction value, even though the TP has been assessed as appropriate value by NTS. In other words, even if the TP had been calculated as normal price in accordance with the arm's length principle under the Organisation for Economic Co-operation and Development (OECD) guidelines, the same TP value may be questioned and evaluated again according to the World Trade Organization (WTO) Customs Valuation Agreement. After all, it is well known that KCS and NTS do not interact or share information with one another.



Companies that wish to mitigate such risks and penalties resulting from the two tax authorities' different perspectives may apply for an Advance Customs Valuation Arrangement (ACVA), a measure that allows KCS to review and confirm the value of a good prior to importation into South Korea.<sup>6</sup>

It is notable that the number of applications for ACVA has risen significantly in recent years as customs audits conducted by KCS have become increasingly aggressive and many companies seek measures to reduce customs-related risks arising from their cross-border intercompany transactions.

Some of the recognized benefits of ACVA include:

- ▶ By having their import prices "pre-approved" by the customs authority, the taxpayers will be able to secure a stable pricing policy based on a more accurate estimation of tax payments.
- ▶ Time and costs can be saved as import prices will not be subject to customs audit for three years after approval.

- ▶ The taxpayer's corporate image will be improved as ACVA approval means that the company has satisfied specific criteria and is compliant as required by KCS, including with the filing of accurate annual reports. Additionally, stakeholders tend to perceive the company's ACVA-approved import prices as more reliable.

Until the result of the ACVA application is confirmed by the customs authority, the applicant can make changes to the initial contents of the application, or withdraw the application. Furthermore, once the result of ACVA is notified, under Chapter 7 of the Notification on Determination of Dutiable Value of Imported Goods in South Korea, the applicant may choose whether or not to accept the result.

More importantly, once a taxpayer files an application for ACVA, he or she becomes entitled to use the provisional declaration system whereby the taxpayer first declares imports at a provisional import price and subsequently adjusts the final import price when the result of the ACVA (i.e., a confirmation of appropriate import prices for the relevant goods) is notified to the taxpayer.

There are no penalties or fines for discrepancies between the provisional and final adjusted (ACVA-approved) import prices declared for the relevant goods.

Companies that import goods into South Korea from related parties and would like to benefit from an ACVA approval should review their transfer pricing practices and supporting documentation from a customs valuation perspective prior to applying for ACVA.

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<sup>6</sup> ACVA as originally introduced in South Korea was reported in the December 2007 issue of *TradeWatch*



# New Zealand

## Taxing online shopping



The New Zealand Government is facing pressure from domestic retailers to close a tax loophole where goods below the low-value import threshold purchased online from a foreign seller may be imported into New Zealand without being subjected to customs duty and GST (goods and services tax, New Zealand's value-added tax). Similar goods purchased within New Zealand would incur a 15% GST, which domestic sellers claim puts them at a competitive disadvantage. The Government is now facing the task of finding a practical and cost-effective way to enforce a GST collection requirement on foreign entities for numerous low-value imports.

Taxing online shopping in New Zealand is complicated by the fact that New Zealand currently adopts a unique approach of using a low-value import threshold based on the amount of revenue to be collected on importation, rather than the threshold being based on the consignment value of the goods. The threshold is NZD60 of revenue (customs duty and GST), which means that goods with a consignment value of less than NZD400 can be imported free of taxes assuming the imported goods are only subject to GST and not customs duty.

In this article we explore a possible solution to the problem of taxing online shopping in New Zealand.

### A simple approach

According to Prime Minister John Key, adding GST to online purchases is "inevitable." Retail NZ and Booksellers NZ's current campaign is calling for urgent action to close this tax loophole.

But there is no agreement as to how this might be done and, as Key noted, different countries have different views around the best solution.

New Zealand needs to find a workable system it can implement relatively quickly if it wants to tax internet shopping.

### Slow and expensive

Asking banks or credit companies to collect tax on internet shopping has been touted as an efficient solution, making it hard for people to avoid the tax.

But there are major deficiencies with current online payment mechanisms. They do not contain the detailed breakdown of a transaction that would be needed for tax purposes. Although information collection technology is developing at a fast rate, a technology solution is unlikely to emerge in the next 12 months. Nor would it be cheap.



## Boost duty free limit?

It may sound counter intuitive, but increasing the duty free limit could simplify matters and increase tax revenue. Duty, close to the heart of customs specialists, means complex reporting. Variable rates of duty are determined by the origin of the goods, strict classification rules, valuation rules, tariff concessions and the impact of free trade agreements (FTAs), to name but a few.

If the duty free limit is increased and the GST threshold reduced, this could pave the way to a simple method of taxing online shopping and boosting tax revenue.

The most critical factor is the value of the goods. From GST point of view it's not necessary to distinguish between a T-shirt and a book because GST applies at 15%, regardless. But for duty purposes, it does matter whether you are importing into New Zealand a T-shirt (subject to 10% duty) in contrast to a book (imported duty free).

Although the New Zealand Government misses out on the collection of duty with standard rates of 5% and 10% (before the impact of FTAs), GST can be collected at a flat rate of 15% on more transactions.

This approach is already in place overseas. The UK does not impose customs duty if the value of the goods does not exceed GBP135. However, VAT is imposed if the value of the goods is GBP15 or more.

## Simplify declarations

A normal import entry for goods worth NZD1,000 or more requires more than 50 fields of information to be completed.

Import entries processed by Customs' new Joint Border Management System require much more information. A simplified import entry for goods costing less than NZD1,000 isn't particularly simple to complete as it removes only the need for the importer (including individual online shoppers) to have a client code (a registration number with Customs). Only goods below the current low value import threshold of NZD400 (assuming duty is not applicable) and postal items are exempt from these requirements.

To tax online shopping, a simple mechanism of reporting is needed. With an increase to the duty free limit, the complexities could be removed with an import entry format for internet shopping focusing on the value of the imported goods.

## Difficulty with downloads

This still leaves the difficult issue of taxing imports of intangibles (such as music downloads, e-books, downloads of games and software) that currently can't be taxed at the border by customs.

The best bet at this stage is for Inland Revenue to adopt the Organisation for Economic Co-operation and Development (OECD) proposals of requiring non-residents to register for GST and charge GST to their customers – similar to the approach adopted in South Africa for e-services.

While this approach is not perfect, it represents a start in the right direction.

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## European Union

### Union Customs Code: update on the delegated and implementing acts and AEO – Customs Simplifications status



In the March 2015 edition of *TradeWatch*, we discussed the consolidated preliminary drafts of the delegated and implementing acts under the Union Customs Code (UCC) issued by the European Commission in December 2014. In this article we provide a status update of the delegated and implementing acts and discuss briefly the Authorized Economic Operator (AEO) – Customs Simplifications status under the UCC.

#### Update on the delegated and implementing acts

The Commission issued a final draft of the delegated and implementing acts on 4 March 2015 and was expected to adopt and publish the acts (with minor changes) in May 2015, but is yet to do so. As discussions among representatives of Member States on the valuation provisions continue, it is uncertain at this time when the delegated and implementing acts will be adopted. This is of concern, as market operators do not have legal certainty regarding provisions that will affect their day-to-day operations and finances.

#### Customs simplifications reserved for AEOs

An AEO holder may receive the following types of authorizations:

- a) AEO – Customs Simplifications, which enables the holder to benefit from certain simplifications under the customs legislation.
- b) AEO – Security and Safety, which entitles the holder to certain customs controls facilitations relating to security and safety.

Under the UCC, certain simplifications will be reserved exclusively for AEO – Customs Simplifications status holders.

One such simplification is the centralized clearance authorization that allows companies to submit a customs declaration at a local customs office where they are established for goods that are physically imported through another customs office. For example, a Dutch company can file import declarations centrally in the Netherlands, for goods imported into France or Germany or Belgium. Under the UCC, the centralized clearance authorization will only be granted to AEO – Customs Simplifications status holders.



Under the UCC, the customs authorities may, upon application, authorize market operators to lodge customs declarations, including simplified declarations in the form of an entry in their records. In this context, the customs authorities may waive the obligation for the goods to be presented. In that case, the goods will be deemed to have been released into the EU customs territory at the moment of entry in the declarant's records. The above corresponds to the provisions of the current Community Customs Code (CCC) and is referred to as the local clearance procedure. Under the UCC, the waiver to present the goods to the customs authorities may only be granted under certain conditions, one of which is the AEO - Customs Simplification status.

The above constitutes a key change compared to the currently applicable CCC where generally market operators are only required to fulfill certain AEO conditions and criteria in order to be authorized for a customs simplification.

## Final note

Businesses should carefully review their current and future supply chains (and possibly involve third-party logistics as well) to determine whether they will be affected by the above changes.

It remains to be seen whether the delegated and implementing acts will be adopted and published sufficiently in advance of 1 May 2016 for the sake of legal certainty. Nevertheless, the Commission has already outlined the future provisions of the delegated and implementing acts through earlier drafts. Thus, economic operators should not hesitate to assess the UCC's implications and to map out possible alternatives, if necessary.

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# New restrictions on private use of non-EU company cars in the EU



## Background

Employers located outside the European Union (EU) who provide their cross-border employees residing in the EU with a non-EU company vehicle for business as well as for private use may be subject to import duties and import VAT in addition to possible penalties depending on the type of “private use” that is allowed by the company.

Until recently, a company vehicle provided under the employment agreement for business and private use could be imported into the EU under the temporary importation regime and be granted total relief from import duties. Accordingly, employment contracts and company vehicle policies allow employees living in the EU to use their company cars for a variety of personal activities in addition to company business.

A recent amendment to the Customs Code implementing regulations, however, has narrowed the definition of “private use” of a company vehicle for purposes of duty-free temporary importation to cover only the commute between the workplace outside the EU and the employee’s home in the EU. Any other private use would subject the imported vehicle to customs duty and other taxes.

## Limiting private use

The amendment to the Customs Code implementing regulations was in part triggered by a recent judgment of the European Court of Justice (EUGH), 7 March 2013, 2013 (C-182/12) that addressed the issue of non-EU company cars used by employees living in the EU. The Court ruled that total relief from import duties for company vehicles used privately can be obtained only where such use is expressly provided for in the employment contract.

The judgment raised a number of questions among the EU national authorities, such as: Who should be allowed to use vehicles that are imported temporarily duty free into the EU and to what extent? Should the foreign employer be subject to VAT in the EU on company cars provided to its employees for private use? Not surprisingly, the national authorities, for example, in Italy, France, Germany and Austria, each have different answers to these questions with regard to company cars imported temporarily from Switzerland.





To ensure uniform customs treatment in these cases and to prevent misuse, the European Commission issued Implementing Regulation 2015/234 dated 13 February 2015, which applies as of 1 May 2015. This regulation amends the Customs Code implementing regulations and provides that total relief from European import duties is possible only if the company car is driven by the employee personally within the EU for commercial or for private purposes, which consist of the commute between the employee's home and the respective workplace, and travel necessary to accomplish business tasks specifically included in the employment agreement. Furthermore, the regulation requires the employee to present a copy of the employment agreement upon request by the customs authorities. This implies that relief from import duties will no longer be possible if the company car is used for any other private activities, such as shopping or vacation trips.

The new rule is likely to have extensive consequences for Swiss companies and traffic between Switzerland and its neighboring EU countries. Similarly, the rule will affect traffic between Sweden and Norway, Croatia and Serbia, and others.

## Reactions of the national customs administrations in Germany and Austria

### Germany

Until recently, the German customs administration allowed EU citizens living in the EU customs area, but working in Switzerland, to use their Swiss-registered company car for private purposes as long as the company vehicle policy contained a respective clause. On 10 March 2015 the German customs administration commented for the first time on the new regulations. Due to the aforementioned amendment, private use of the company car will now only be allowed for travel between the workplace and residence of the employee, or for tasks necessary to fulfill the employment agreement. Notwithstanding, the German customs authorities have noted that an interruption of the commute, to pick up groceries on the way home, for example, would not be considered significant.

Private use that is outside the narrow definition subjects the employer to 10% customs duties and 19% import VAT. Some EU Member States also impose additional taxes on vehicles, but there are even more drastic consequences. An improper private use of a company vehicle (e.g., vacation trips or shopping trips outside the commute) could constitute withdrawal from customs supervision with

immediate incurrence of import duty debt. This would make both the employer and employee liable for a variety of penalties, especially if the violation is found to be an administrative offense or tax fraud. In such cases the EU customs authority may impound the vehicle.

### Austria

The Austrian Federal Ministry of Finance issued an official notice on 18 March 2015 that it has also tightened restrictions. Previously in Austria, employees were allowed to use the company vehicle as "a family car" in certain cases and other workers, such as contractors, were allowed to use company cars for their commute home. Now such use would make the car subject to customs duty in the EU.

Illegal use of company cars in Austria subjects the employer to 10% customs duties and 20% import VAT. Other taxes may apply, such as duty on consumption (*Normverbrauchsabgabe*) as well as other VAT-related implications, such as input-VAT related to purchasing, renting or driving a motor vehicle, which is in principle not deductible. Finally, the employer may also be prosecuted under the financial law.



## Switzerland

In an official notice issued in April 2015, the Federal Customs Administration stated that the tightened regulations in the EU would not affect Swiss customs regulations.

Generally, a foreign-registered car may be temporarily exempt from duties inside the Swiss customs territory if brought into Switzerland by a foreign employee of a Swiss company who resides outside Switzerland and uses the car for commuting purposes only. If, however, the car is also used for business travel within Switzerland on behalf of the employer, the Swiss customs authorities currently take the view that the car must be entered into free circulation in Switzerland subject to import duties and registration with Swiss license plates.

## Implications for affected companies

Companies should review all cases of cross-border use of company cars. Different situations may require different solutions to allow companies to continue operations and at the same time meet the legal requirements in each specific case.

## Some possible solutions include:

- A. The company may have to adapt its employment agreements and company car policy to incorporate the amended regulations and to prohibit private use of company vehicles within the EU customs territory, except for travel between the workplace and residence.
- B. The company may consider revising the employment contract and offer financial compensation instead of a company car to employees.
- C. Company vehicles may be cleared for free circulation in the EU after paying customs duties. These cars, or other newly procured cars, can then be licensed by an EU established company (e.g., an affiliate) and provided to the employee.

In this respect, it may also be possible to register cars in both the third country (e.g., Switzerland) and an EU Member State (e.g., Germany). Depending on the specific case, contractual agreements may be set up with all relevant parties. This is likely to require prior discussions with the competent authorities.

D. Employees may drive their own private cars, for example, to the EU-Swiss border, park their private car there and then change to another car from a fleet of Swiss company cars parked on the other side of the border.

To avoid unfavorable consequences, all situations and implications of customs duty; import VAT; domestic VAT; payroll taxes; social security contributions; vehicle tax; car insurance requirements; transfer pricing; current lease contracts amendments or cancellations; and other similar concerns need to be carefully evaluated. Each of the alternatives listed above should be assessed individually with regard to the various taxes and related consequences in light of the respective guidelines of any EU Member State that may be involved.

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# Re-importation of vehicles into the EU: what the German Federal Finance Court's recent decision means for EU car manufacturers



In a recent judgment (Case VII R 21/12 dated 11 November 2014) the Federal Finance Court (Germany's court of last resort in tax and customs matters) ruled that customs authorities may not compel the original car manufacturers to provide information in cases where a car has been exported outside the EU and then reimported and declared as returned goods for the purpose of relief from import duties.

Goods originating in the EU that are exported to a non-EU country and are then returned to the EU may be exempt from import duties under certain conditions at the request of the importer (the so-called "returned goods relief"). In practice, the main challenge of the returned goods relief procedure in general is proving that the conditions are met. One of these conditions is that the returned goods either originate or have previously been imported and released for free circulation in the EU. However, motor vehicles that have originally been manufactured in the EU under inward processing relief often include installed components sourced from non-EU countries.

In these cases, the components remain non-Community goods during the manufacturing process. Because these components never become Community goods (unlike other vehicle components that have been released for free circulation or originate in the EU), such installed components cannot be treated as returned goods when the exported vehicles are returned to the EU. The value of these components, therefore, needs to be deducted when applying for returned goods relief.

In the case at hand, the Federal Finance Court had to decide whether the original exporter of the vehicles (the car manufacturer) is required to cooperate and open its books to the customs authorities when information regarding the origin of the vehicles and their components needs to be assessed upon re-importation of the returned vehicles.

The Federal Finance Court ruled that there is no such obligation for the manufacturer because the latter is not even indirectly involved in the re-importation procedure. Under Article 6 of the Community Customs Code, the burden to supply all information and documents required by the authorities is on the applicant. Consequently, according to the judgment, parties not involved in the import procedures may not be compelled to produce evidence. On the contrary, all information needed to apply for returned goods relief must be supplied by the applicant (the importer).



Importers should bear in mind that the preconditions for applying for returned goods relief are rather strict. The latest decision of the highest finance court in Germany is likely to make the proof that the preconditions are met even more difficult as information regarding individual vehicle components might often be unavailable to importers who are not related to the original manufacturer.

However, importers are advised to recall decision C-56/02 of the European Court of Justice, which ruled that – even though the obligation to produce evidence may not exist for third parties – the customs authorities may use all information that is already available. In the aforementioned cases the authorities may already have had sufficient information on the origin of the goods from, e.g., existing authorizations for inward processing relief as the vehicles, at least in Germany, will most likely have been assembled under customs supervision.

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# Gabon

## Update: Decree on special restrictions for the import of secondhand vehicles finalized



In previous issues of *TradeWatch* we have reported on Gabon's restrictive measures regarding the importation of secondhand vehicles into the Gabonese Republic and more recently, the outlook for possible easing of some of the restrictions after a draft decree was introduced on 23 December 2014.

On 12 January 2015 the Council of Ministers adopted the draft decree (Decree 00051/PR/MT) into law and repealed all previous contrary provisions found in Order No. 002707 of 27 September 2013.

This article will analyze the scope, rules of enforcement and penalties provided in the new decree.

### Scope of the new decree

#### Definitions

Article 2 of Decree 00051/PR/MT provides definitions for "secondhand vehicle" and "importer."

"Secondhand vehicle" means any motor car, moped or tricycle<sup>7</sup> that is at least six months old from the date of first circulation abroad and having an odometer reading of at least 6,000 kilometers.

As such, the decree adds another condition regarding the number of kilometers traveled.

### Targeted vehicles

Order 002707 of 27 December 2013 prohibited the importation of cars that have been in use for more than three years.

The new decree now distinguishes among various categories of cars and fixes the number of years a vehicle can be used and still be imported into Gabon.

Category A, B and D vehicles may not be imported if they have been in use longer than three years.

Category C and E vehicles, on the other hand, may be imported if they have been in use for up to six years.

### Exceptions

Decree 00051/PR/MT dated 12 January 2015 excludes the following vehicles:

- A. Vehicles with special engines used in public works, maintenance, agriculture and forestry
- B. Vintage cars
- C. Secondhand cars imported for use by religious groups as approved by the Gabon Government
- D. Secondhand cars imported for private use by Gabonese citizens living abroad when they return to Gabon, (limited to one car per person)

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<sup>7</sup> Industrial or transportation trikes; does not include children's tricycles.





- E. Vehicles for private use by diplomats and the administrative and technical staff of embassies, consulates and international organizations operating in Gabon
- F. Specially equipped vehicles for private use by disabled people (limited to one car per person)

The aforementioned vehicles may not be sold for two years after importation and use in Gabon, except the cars mentioned in (A) and (B) above.

### Administrative control

Customs can now use an expert to determine the condition and real age of the imported car in case of doubt.

In the event fraud is proved, the fees for the expert's assessment will be charged to the importer and the car will be considered as having been imported in violation of the aforementioned decree.

In addition, imported cars will also be subject to antipollution control when entering the Gabonese territory.

### Penalties

Any imported car found to be in violation may be destroyed or re-exported at the importer's expense.

### Transitional provisions

Owners of secondhand cars imported in violation of former and no longer effective legal provisions will have three months to clear customs under the new rules.

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# Kenya

## Integrating the African continent: the significance of the WTO 10th Ministerial Conference to be held in Nairobi



Kenya has won the competitive bid to host the 10th Ministerial Conference of the World Trade Organization (WTO) scheduled to take place 15-18 December 2015. The Ministerial Conference is the chief decision-making body of the WTO, an organization whose main objective is to establish an orderly and transparent framework where trade barriers are gradually reduced. It is the first time that this conference is being held in Sub-Saharan Africa, and more specifically, in Kenya. It is worth noting that some countries such as Turkey dropped their bid in favor of Kenya signifying the confidence that Kenya is equally capable.

As a founding member of the WTO, Kenya has made commendable progress in WTO matters and has been able to build the structures necessary for the implementation of the WTO agreements. Kenya has participated in all major WTO trade talks and has maintained a strong negotiating team in Geneva. Kenya has also prepared position papers on a number of issues and has even taken the lead at the regional level in a number of cases.

The Ministry of Foreign Affairs, which lobbied to host the event is expected to ensure all preparatory and other related logistical measures are in place to make the stay in Kenya a memorable experience. A strong National Preparatory Committee (NPC) that includes all stakeholders is planned to work round the clock to ensure the Ministerial Conference's success in terms of both substance and logistics.

### Significance

The conference marks a milestone honor to all of Africa as it is the first time that the conference will take place on African soil. It is a manifestation of the commitment of the WTO membership and the international community at large to integrate the African continent into the Multilateral Trading System (MTS). The integration into MTS will augment and compliment Africa's regional and continental efforts toward increased intra-Africa trade that will make the vision of the continent's Free Trade Area (FTA) a reality.

It sends a strong signal that the entire world has realized the social economic and sustainable development potential that the continent has to offer. (This is further evidenced by the Third International Conference on Financing for Development to be held in Addis Ababa, Ethiopia.)

In addition, it is an indicator that Kenya, as a founding member of WTO and the largest economy in both East and Central Africa, continues to enjoy a cordial relationship with the WTO. The time has come for Kenya to intensify its efforts to attain a comprehensive reduction of poverty and sustainable economic growth in the near future.





## Expectations

The Ministerial Conference will be more meaningful and memorable if the outcome delivers on the development aspirations of developing countries. It should provide an opportunity for members and relevant stakeholders to exchange views on how to optimally exploit diverse global resources for the welfare of mankind in a predictable rule-based environment.

It should also provide an opportunity for members to restore confidence into the MTS by reaching an agreement on a work plan to conclude the Doha Round negotiations and deliver the originally envisioned development. The Doha Round focused on agriculture, non-agriculture market access, intellectual property rights, trade and development, trade facilitation and dispute settlement. If successfully concluded, it will not only boost trade and investment, but will also create employment and ultimately help to eradicate poverty.

In the face of the ongoing integration of the world economy, the Ministerial Conference is expected to emphasize on the institutional, economic and legal interrelationships between foreign direct investments (FDI) and world trade. FDI has a great potential of stimulating economic growth in many of the world's developing countries. It is a major source of much needed capital, new technology as well as other intangibles, such as managerial and organizational skills and marketing networks. Most of the developing countries, Kenya included, have already felt the positive impact of FDI. With more than 6,000 delegates from WTO members expected to attend the event, Kenya is anticipated to reap enormous advantage for the tourism industry, which has suffered the impact of terror threats and attacks that have recently frightened and driven away international visitors and investors.

In conclusion, as the 10th Ministerial Conference approaches, multinational corporations should take advantage of the clear signal exhibited by the global community in regard to the great potential of the continent. Representatives of the African countries are expected to take the lead and contribute greatly to the conclusion of the Doha Round that is focused on issues affecting developing countries, the majority of which are in Africa.

The Ministerial Conference is expected to open trade within and outside Africa that will result in a favorable business environment. Overall, achieving reduced barriers to trade and a favorable business environment are the best way of ensuring the growth of multinational corporations.

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# Kenya releases guidelines on import duty exemption for industrial spare parts



Registered manufacturers in Kenya are now eligible for import duty exemption for industrial spare parts of machinery used in the manufacturing process. In the past, manufacturers in Kenya had not been in a position to benefit from such import duty exemption, even though the exemption was provided for by the East African Community Customs Management Act (EACCMA), 2004. This was largely due to lack of clear guidelines on the administration of the exemption. However, this is no longer the case after Kenya's Commissioner of Customs Services issued in December 2014 guidelines on the importation of industrial spare parts. Below is a synopsis of the guidelines:

## The guidelines

- i. **Spare parts must be for machinery classified under chapters 84 and 85.** Under the guidelines, manufacturers are required to apply to the Commissioner of Customs Services (the Commissioner) for importation of industrial spare parts exclusively for machinery classified under chapters 84 and 85 of the East African Community (EAC) Common External Tariff (CET). It is important to note that parts for general use, as defined under note 2 of Section XV of the EAC CET, do not qualify for exemption.
- ii. **The spares must be strictly for the manufacturers' own use in replacement of worn out and obsolete parts.** Spare parts may not be imported under the exemption regime for resale or any other commercial purpose. Furthermore, a manufacturer may not import spares under the exemption regime on behalf of another manufacturer.
- iii. **Manufacturers need to apply to the Commissioner prior to importation.** Manufacturers who are eligible for the exemption must submit a formal application. Applications will be vetted by a committee appointed by the Commissioner and once approved, registered manufacturers will be allowed to import spare parts under the exemption regime.
- iv. **The Commissioner must authorize the disposal of used parts.** Disposal of the replaced spare parts, i.e., waste or scrap and unusable parts must be authorized by the Commissioner. The manufacturer need not account for parts that are consumed completely by the wear and tear process. Note that replaced parts that were originally imported under the exemption regime may become subject to duty when disposed in certain ways, for example, if sold to persons or entities who do not qualify for the exemption.



- v. **Normal exemption process.** Customs entries for spare parts imported under the exemption regime are subjected to the normal exemption entry process whereby customs agents will use the Exemptions Customs Procedure Code (CPC) to clear such consignments.
  - vi. **Document retention.** All manufacturers are required to maintain proper records of imported spare parts under the exemptions regime for verification by the Commissioner at all times.
  - vii. **Registration period.** The registration period is for three calendar years.
- ▶ Lower production costs by the manufacturers are likely to trickle down to the population in terms of reduced prices of consumer goods. This is likely to result in either increased spending or saving, which in turn will lead to a general increase in the national output and growth of the economy.
  - ▶ Manufacturers with lower costs are likely to stay in business for the foreseeable future, thereby continuing to offer jobs and valuable knowledge transfer to the people, which will help to improve living standards.
  - ▶ Manufactures with significant cost reductions are likely to continue to pay taxes to the government, which also contributes toward improving the economy.

## Implication of the guidelines

Successful implementation of the guidelines is likely to benefit both manufacturers and the nation. The expected benefits are as follows:

- ▶ Registered manufacturers will benefit from reduced import duty costs of industrial spare parts. Hence, the manufacturers will only bear the import duty costs for the spares that do not qualify for exemption. This is likely to result in an overall reduction of production costs.

## Closing thoughts

Manufacturers need to ascertain whether they qualify for the exemption under the guidelines by first determining whether their machinery is classifiable under chapters 84 and 85 of the CET. Eligible manufacturers should then apply to the Commissioner to be allowed to import their industrial spares under the exemptions regime. Thus, it is important for manufacturers to seek appropriate tax advice to determine whether they are eligible for the exemption and if so, to obtain assistance with regard to completing and submitting the formal application to the revenue authority.

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# Nigeria

## Update: ECOWAS Common External Tariff takes effect in Nigeria



In the September 2014 issue of *TradeWatch*, we announced that the Economic Community of West African States' Common External Tariff (ECOWAS CET) is to enter into force as of 1 January 2015. Additionally, we highlighted that ECOWAS Member States have been given some margin to maintain higher national rates compared to the CET for a number of years (up to five years after the CET implementation date) by means of two supplementary protection measures: the Import Adjustment Tax and the Complementary Protection Tax. Few months after the official entry into force, the actual implementation process is now taking place across the region.

In this context, Nigeria, ECOWAS' largest and most industrialized economy, has formally adopted the CET on 11 April jointly with its own supplementary protection measures – applicable until 2019. The Circular from the Federal Ministry of Finance, approving the CET, also includes the 2015 national Fiscal Policy Measures. As a result, all imports arriving into Nigeria are subject to the rates contained in the 2015-2019 CET and 2015 Fiscal Measures. Nigeria further maintains an Import Prohibition List applicable to certain goods originating from third countries, i.e., from outside the ECOWAS region.

In practice, the Nigerian Customs Service (NCS) is yet to commence implementation of the ECOWAS CET 2015-2019 as the new rates have not yet been incorporated into their system. Awaiting the operational readiness of the system, the NCS continues to apply the old rates. A probable effective implementation date has not been established yet. There is possibility, however, that the new CET – when it becomes operational – would be applied retrospectively subject to the commencement date mentioned in the Circular.

### Import Adjustment Tax

A more detailed analysis of the Circular and its Annexes shows that Nigeria has opted to apply only one of the two allowed supplementary protection measures, notably the Import Adjustment Tax (IAT). Consequently, additional taxes will be imposed on 177 tariff lines of the ECOWAS CET. Commodities of various chapters of the Harmonized Systems are affected (selected lines are provided in the table below) including sugar, alcohol, tobacco, paper, plastics, certain textiles, iron and steel products and electrical transformers.



## Future headline IATs in Nigeria (extract)

| Description  | HS 2012 subheading | 2008-2012 CET | 2015-2019 CET Duty | IAT | Total |
|--|--------------------|---------------|--------------------|-----|-------|
| Cane or beet sugar: in powder, crystal or granule form   | 1701.91            | 95%           | 20%                | 50% | 70%   |
| Whiskies   | 2208.20            | 50%           | 20%                | 50% | 70%   |
| Cigarettes containing tobacco  | 2402.20            | 120%          | 20%                | 50% | 70%   |
| Printed paper or paperboard labels of all kinds, whether or not printed  | 4821.10            | 20%           | 10%                | 20% | 30%   |
| Other plates, sheets, films, foil and strip, of plastic, non-cellular and not reinforced, laminated, supported or similarly combined with other materials of polymers of ethylene, not printed | 3920.10            | 5%            | 10%                | 20% | 30%   |
| Woven fabrics of cotton, containing less than 85% by weight of cotton, weighing not more than 200 g/m2 – obtained by wax-based printing process  | 5208.51            | 5%            | 35%                | 10% | 45%   |
| Hot rolled iron/steel bars and rods, in coils, cont. deformations produced by rolling  | 7213.10            | 45%           | 20%                | 25% | 45%   |
| Electrical transformers, static converters and inductors – having a power-handling capacity exceeding 16kVA but not exceeding 500 kVA  | 8504.21            | 5%            | 5%                 | 35% | 40%   |

The above selection of products subject to IAT demonstrates that the new total duty rate may be considerably higher than the current one (e.g., whisky, particular textiles, paper, plastics, electrical transformers). For other products, the duty burden is significantly lower (e.g., sugar, tobacco), and yet others have remained unchanged (e.g., iron/steel bars).

## Fiscal policy measures

In addition, the circular also covers a National List of goods whose import duty rates have been reviewed/lowered to encourage the development in strategic sectors of the Nigerian economy. These goods involve mainly raw materials, which have limited availability on the domestic market and are thus a valuable boost for the Nigerian manufacturing industry.





## Products covered by the National List in Nigeria (extract)

| Description   | HS subheading | 2015-2019 CET | Duty rate recommended for implementation |
|---|---------------|---------------|--|
| Malt extract: malted beverage powder/liquid in bulk not less than 25kg  | 1901.90       | 10%           | 5%                                       |
| Petroleum oils and oils obtained from bituminous minerals, other than crude: meant to be mixed further                      | 2710.19       | 10%           | 5%                                       |
| Articles for the conveyance or packaging of goods; of plastics; stoppers, lids, caps and other closures, of plastic - other | 3923.90       | 20%           | 10%                                      |
| Yarn of jute or of other textile base fibers of heading 53.03: multiple (folded) or cabled                                  | 5307.20       | 10%           | 5%                                       |
| Unwrought aluminum: aluminum not alloyed  | 7601.10       | 5%            | 0%                                       |

Given the large number of tariff lines that will be affected by the Import Adjustment Tax or the National List, many industry sectors will be impacted. Therefore, any importer or trader in Nigeria should carefully assess the risks and opportunities related to the new tariff structure as well as the possible retroactive implementation. The list of products subject to the IAT should be carefully evaluated to understand the new applicable total import duty rate compared to the current duty burden. For the manufacturing industry in Nigeria, the national fiscal measures may create opportunities to lower the cost of raw materials for processing.

If such products manufactured in Nigeria qualify under the ECOWAS Trade Liberalisation Scheme, the competitive position of Nigeria as production hub for the wider West Africa region will likely be strengthened.

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# Russia

## Antirecessionary measures in Russia



Under the burden of various unfavorable economic and political events, Russia has been moving toward recession in recent months. In an attempt to counteract this trend, the Russian Government has either adopted, or is in the process of reviewing, various antirecessionary measures, some of them controversial, aimed at reducing prices and protecting certain local and regional industries. Two such measures concern the importation of pharmaceuticals and government procurement of medical devices and equipment.

### Parallel importation may become legal in Russia

To reduce the price of branded goods the Government may eliminate the ban on parallel imports. In fact, according to information available from the media, parallel importation of pharmaceuticals, medical equipment as well as auto parts and accessories may become legal on 1 January 2016. This means that unauthorized distributors may be allowed to import patented or trademarked goods without the consent of the respective intellectual property owners.

Currently, Russia applies the principle of national exhaustion and patent or trademark holders are able to prevent their goods from being released for free circulation unless the importer is an authorized dealer. This may soon change.

Several years ago the Russian Federal Antimonopoly Service started a debate on whether the restrictions on parallel importation should be eliminated. The Federal Customs Service initially opposed this initiative, but has recently expressed willingness to take part in a pilot project to study the effect of parallel importation of pharmaceuticals. The plan is to examine extensively the importation into Russia of medicinal goods at specialized customs posts and to keep a register of all importers. After the project is completed, the authorities will decide whether parallel importation should also be allowed for other types of products.

It remains to be seen when changes of the legislation currently in force, if any, will take place as there is evidence that representatives of the pharmaceutical industry oppose the initiative.



## Restrictions on government procurement of foreign medical devices and equipment

A Resolution of the Russian Government, in force as of 14 February 2015, provides a list of medical devices and equipment that may not be procured for state and municipal use if originating from foreign countries. There is an exception for cases where fewer than two bids have been received for the supply of similar medical devices and equipment originating from countries of the Eurasian Economic Union (Armenia, Belarus, Kazakhstan and Russia).

The list includes medical devices and equipment, such as medical garments; sets of reagents; medical freezers; surgical sutures; microsurgical forceps and micro scissors; individual blood glucose monitoring devices; hearing aids; blood transfusion devices; electrocardiographs; photofluorographs; and bedside portable X-ray machines.

As noted above, the purpose of the resolution is to protect local manufacturers of medical devices and equipment. Similar protectionist measures have been previously introduced with regard to other products, such as construction machinery, and possibly others are forthcoming.

Follow updates in future issues of *TradeWatch*.

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# South Africa

## Compulsory tariff determinations for the alcoholic beverage industry



South Africa has amended, effective as of 1 April 2015, the Customs and Excise Act 91 of 1964 (the Customs Act) to require importers and local producers of alcoholic beverages (spirits, beers, wines, coolers, ciders and other fermented beverages, i.e., products of chapter 22 of the Harmonized Customs Tariff) to apply for tariff determination prior to the importation or removal from an excise manufacturing warehouse of such goods. The classification of imported or locally produced goods is necessary to determine the amount of customs or excise duties applicable and payable to the South African Revenue Service (SARS).

The change in legislation emanates from a review conducted by the National Treasury department on the taxation of alcoholic beverages in South Africa. According to a discussion document issued by the Treasury in May 2014, the South African Government is introducing compulsory tariff determinations as one of the interventions aimed at reducing the harm associated with alcohol abuse.

The Government determined that the legislation governing the alcohol industry (e.g., the Customs Act and the Liquor Products Act) needed to be aligned as discrepancies between the legislative acts resulted in uncertainties and led to potential anomalies in the alcoholic beverages market.

The discrepancies and anomalies, in turn, negatively impacted effective enforcement and led to disputes regarding the tariff classification for excise purposes of such goods. It is unclear at the present time whether similar measures will be rolled out to other industries that the South African Government wishes to regulate for community health reasons.

Time frames for compulsory tariff determinations for tariff determinations issued prior to 1 April 2015 are outlined below:

- ▶ Prior to 1 April 2013: companies need to apply for a new tariff determinations during the period 1 April 2018 and 31 March 2019
- ▶ 1 April 2013 to 31 March 2015: companies need to apply for new tariff determinations during the period 1 April 2019 to 31 March 2020)

Interestingly, no new application for tariff determination is required with respect to an existing determination for any change in the alcoholic strength or vintage of beverages classified under any subheading of headings 22.04 or 22.05, provided the alcoholic strength remains within the range specified in the subheading of the existing tariff determination.





If no tariff determination was issued prior to 1 April 2015, importers and manufacturers need to apply for new tariff determinations during the periods listed below:

## Order and periods for submission Under Rule 47.03 of the Customs and Excise Act 91 of 1964

| Tariff heading  | Period   |
|---|--|
| 2208.90   | Within a period of 6 months from 1 April 2015 (by 30 September 2015) |
| 2206.00.90  | 1 October 2015-31 March 2016   |
| 2208.70<br>2206.00.83<br>2206.00.84<br>2206.00.87                     | 1 April-30 September 2016  |
| 2203.00.90  | 1 October 2016-31 March 2017   |
| 2206.00.81  | 1 October 2016-31 March 2017   |
| 2206.00.82  | 1 October 2016-31 March 2017   |
| 2206.00.85  | 1 October 2016-31 March 2017   |
| All other classes or kinds of alcoholic beverages not mentioned above | 1 April 2017-31 March 2018   |

The introduction of compulsory tariff determination dispensation is phased over a five-year period to reduce the administrative burden both on SARS and the alcoholic beverage industry. However, the phased nature of the dispensation leaves ample room for non-compliance, which could potentially lead to penalties. Therefore, it is advisable for importers and local manufacturers of affected alcoholic beverages to take the appropriate steps to:

- ▶ Identify products affected by the amendment
- ▶ Put in place submission time frames
- ▶ Assign responsibility for ensuring compliance with the new requirements

Companies that ensure compliance with the new requirements will benefit from reduced exposure to penalty risk.

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# Tanzania

## New VAT Act to abolish special relief for certain imports



The Tanzanian Parliament recently approved The Value Added Tax Bill 2014 (the new VAT Act), which is awaiting presidential assent for enactment. It is currently not known when the new VAT Act will become effective. One of the objectives of the new VAT Act is to minimize VAT exemptions and special relief, and retain exemptions that are economically productive, spur socioeconomic development and help ensure fairness. The new VAT Act proposes several changes, some of which will have direct impact on imported goods. Some of these changes include:

### 1. Special VAT relief on imported capital goods abolished

Currently, special economic schemes grant VAT relief on raw materials and capital goods directly related to manufacturing in the Export Processing Zones (EPZs) and Special Economic Zones (SEZs). Eligible capital goods include ambulances, firefighting vehicles and equipment. Additionally, investors registered under the Tanzania Investment Act, 1997 (TIC) who have a certificate of incentives currently enjoy full relief on “deemed capital goods,” granted upon importation. Under the new VAT Act, companies will no longer receive VAT relief under these special economic schemes.

### 2. VAT exemption for certain imported petroleum products abolished

The new VAT Act excludes certain petroleum products, such as heavy furnace oil (HFO), industrial diesel oil (IDO) and aviation gas (AVGAS) from the exempted list. While this measure is intended to broaden the tax base, it will impact some taxpayers' cash flow given that VAT will have to be paid upon importation and then claimed later in VAT returns.

### 3. Special VAT relief on goods and services used in oil, gas and mineral explorations or prospecting abolished

Currently, licensed explorers or prospectors receive 100% special VAT relief on goods and services used exclusively for oil, gas and mineral exploration or prospecting activities. Under the new VAT Act, such special VAT relief will be abolished. Nevertheless, persons who are registered and licensed as explorers or prospectors will be exempted from VAT on certain imported goods, if such goods are for the exclusive use in oil, gas or mineral explorations or prospecting activities and at the same time are eligible for relief from customs duties under the East African Community Customs Management Act, (EACCOMA) 2004.



Persons who have concluded a binding agreement with the Government of Tanzania for mineral, oil and gas exploration and prospecting before the effective date of the new VAT Act will continue to be entitled to any relief/exemptions provided for in the respective agreement. This concession will also continue to apply to investors who were licensed under the EPZs and SEZs schemes prior to the commencement of the new VAT Act.

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# Turkey

## Opportunity for importation on credit



The Resource Utilization Support Fund (RUSF) surcharge, which was levied at 6% upon the importation of certain investment and intermediate goods on foreign currency credit (with loan term of less than one year), has been reduced to 0% under Council of Ministers Decree No. 2015/7511, promulgated in the *Official Gazette* and in force as of 10 April 2015. This regulation, which concerns many industrialists, applies to certain listed goods.

RUSF was established in 1988 by Decree on RUSF 88/12944. Pursuant to this Decree, a contribution to RUSF is collected on the CIF (Cost-Insurance-Freight) value of imported goods according to one of the following payment methods:

- Cash against goods
- Letter of acceptance
- Deferred payment letter of credit

An amount equal to the value of the imported goods must be transferred to the exporter bank account before or on the registration date of the declaration for release for free circulation regardless of the date on the *pro forma* invoice or the final sales invoice. The declarant is required to show that such deposit has been made before or on the date of registration by submitting the transfer notification form/ bank letter (which contains the details of the transfer) to the customs authorities so that they can determine whether a contribution to RUSF is applicable by assessing the timing of the transfer of the importation

amount. If the importer can submit evidence of the full transfer on, or prior to, the importation date, no RUSF surcharge will be due. In case such documentation cannot be presented, a RUSF deduction will be made.

Additionally, where the price of the imported goods is paid in partial installments, so long as the sum of the importation amount is transferred before the importation date, no RUSF surcharge will be applied. Where only part of the price is transferred before importation, while the rest is paid afterwards, then only the amount paid after the importation would be subject the RUSF surcharge.

As the RUSF surcharge rate has been reduced to 0% (from the previous 6%), local and foreign businesses are offered a finance advantage on the importation of certain listed goods (see table below) as these goods are no longer subject to the RUSF surcharge and are no longer required to make advance payments. Thus, Turkish companies and companies exporting to Turkey need to assess whether their goods qualify to ensure they avail themselves of this important advantage.





## Goods with zero RUSF surcharge rate

| HTS Chapter/<br>subheading | Definition  |
|----------------------------|---|
| 27                         | Mineral fuels, mineral oils and products derived from the distillation of the foregoing; bituminous substances; mineral waxes   |
| 32                         | Extracts used in painting or tanning; tannins and derivatives; paints, pigments and other paint substances; preparation paints and varnishes, glazing putty and other putties; inks (except 3210.00.10, 3212.90.00 and 3213.90.00)  |
| 33.02                      | Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages   |
| 34.03                      | Lubricating preparations (including cutting-oil preparations, bolt or nut release preparations, antirust or anticorrosion preparations and mold-release preparations, based on lubricants) and preparations of a kind used for the oil or grease treatment of textile materials, leather, fur, skin or other materials (but excluding preparations containing, as basic constituents, 70 % or more by weight of petroleum oils or of oils derived from bituminous minerals) |
| 3701.10.00                 | Films for X-rays  |
| 3702.10.00                 | Films for X-rays (in rolls; empty)  |
| 38                         | Miscellaneous chemicals (except 3808, 3820 and 3824.90.58)  |
| 39                         | Plastics and products thereof (except 39.18, 39.22, 3923.10, 3923.21, 3923.29, 3923.30, 3923.50, 3923.90, 39.24, 3925.30.00, 3926.10.00, 3926.20.00, 3926.40.00, 3926.90.50, 3926.90.92 and 3926.90.97 )  |
| 40                         | Rubber and rubber products (except 4011.10, 4011.40, 4011.50, 4012.11, 4012.20, 4012.90, 4013, 4014, 4015, 4016.10, 4016.91, 4016.92 and 4016.95)   |
| 41                         | Raw fur, skin (except furs) and patent leather  |
| 49                         | Print industry products such as printed book, newspaper, pictures, etc., manuscripts  |
| 68.13                      | Friction material and articles thereof (for example, sheets, rolls, strips, segments, discs, washers, pads), not mounted, for brakes, for clutches or the like, with a basis of asbestos, of other mineral substances or of cellulose, whether or not combined with textile or other materials  |
| 70                         | Glass and glassware   |
| 72                         | Iron and steel  |
| 73                         | Goods manufactured from iron or steel (except 73.15)  |
| 74                         | Copper and copperware (except 74.19)  |



| HTS Chapter/<br>subheading | Definition   |
|----------------------------|--|
| 75                         | Nickel and nickel products   |
| 76                         | Aluminum and aluminum products   |
| 78                         | Lead and lead products   |
| 79                         | Zinc and zinc products   |
| 80                         | Tin and tin products   |
| 81                         | Other ordinary metals; cermet; and products thereof  |
| 84                         | Machinery, mechanical devices and instruments; parts and components thereof (except 84.15, 8419.11, 8433.11, 8433.19, 84.71)   |
| 85                         | Electrical machinery and devices and parts and components thereof; devices for recording sounds and reproducing recorded sounds (Except 85.04, 8506.10, 8506.30, 8506.40, 8506.50, 8506.60, 8506.80, 8507.10, 8507.20, 8508.11, 8508.19, 8508.60, 8509.40, 8509.80, 8510.10, 8510.20, 8510.30, 8513.10, 8515.31, 8515.39, 8516.10, 8516.21, 8516.29, 8516.31, 8516.32, 8516.33, 8516.40, 8516.50, 8516.60, 8516.71, 8516.72, 8516.79, 8516.80, 8517, 8518, 8519, 8521, 8522, 8523, 8527, 8528, 8531, 8539.10, 8539.21, 8539.22, 8539.29, 8539.31, 8539.32, 8539.39, 8539.41, 8539.49, 8543.10, 8543.20, 8543.30, 8543.70, 8544, 8546, 8547, 8548 ) |
| 87.05                      | Special purpose motor vehicles, other than those principally designed for the transport of persons or goods (for example, breakdown lorries, crane lorries, fire fighting vehicles, concrete-mixer lorries, road sweeper lorries, spraying lorries, mobile workshops, mobile radiological units) (except 8705.40 and 8705.90.30)   |
| 87.06                      | Chassis fitted with engines, for the motor vehicles in headings 87.01 to 87.05   |
| 87.08                      | Parts, components and accessories of motor vehicles in headings 87.01 to 87.05 (except 8708.30, 8708.70, 8708.80, 8708.91, 8708.92, 8708.93 and 8708.99)   |

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# Uganda

## Free zones in Uganda



The Government of Uganda is optimistic that the recently introduced free zones will attract foreign and domestic direct investments that will accelerate export-led industrialization, increase employment, increase commodity processing from raw materials to finished goods and contribute significantly to economic growth.

While the East African Community Customs Management Act, 2004 has always provided for export processing zones and free ports operations, Uganda had never implemented any of these provisions until the Free Zones Act, 2014 (the Act) took effect on 1 August 2014. The Act provides for the establishment, development, management, marketing, maintenance, supervision and control of free zones. Additionally, the Act establishes the Uganda Free Zones Authority (UFZA) to oversee all matters pertaining to free zones in Uganda.

### What is a free zone?

The Free Zones Act, 2014 defines a “free zone” as “a designated area where goods introduced into the designated area are generally regarded, so far as import duties are concerned, as being outside the customs territory and includes exports processing zones or free port zones.”

Accordingly, goods that are brought into the designated area, or are manufactured and re-exported to countries outside the East African Community (i.e., Uganda, Kenya, Tanzania, Rwanda and Burundi) are not subject to customs duties. Companies operating within the free zones are also exempt from various other requirements (discussed below) that normally apply to companies operating in Uganda.

### Operations within a free zone

To operate within a free zone a business needs first to be licensed as a business enterprise and then needs to obtain an operator’s license from the UFZA. These licenses are issued in consultation with the Commissioner General, Uganda Revenue Authority who ultimately supervises all activities carried out in the free zone.

The UFZA approves all projects to be undertaken within the free zone. Project approval implies agreement that the operator’s primary activity will be export outside the East Africa region. Notwithstanding, manufacturing and services export projects may be approved with up to 20% of sales going to the domestic market.



While the law allows free zone enterprises to sell a portion of their products on the Ugandan and East African market, such local sales will trigger VAT and import duty obligations. Once released into the local market the goods are considered imports and are subject to all relevant taxes, duties and levies as applicable in the customs territory of Uganda.

## Project and operator license approvals

The procedure to obtain project approval and a free zone operator's license is as follows:

- ▶ The investor contacts the UFZA with its initial project proposal and discusses it in some detail to see whether the intended activities are suitable for the free zone scheme.
- ▶ The UFZA provides the investor with the appropriate application forms; the investor completes these and returns them to the UFZA with the specified application fee.
- ▶ The following information is provided in the application: intended company name; product description; list of shareholders; production flow chart; machinery requirements; production costs; intended markets; sources of technological know-how; project cost; sources of finance; number of jobs to be created; utility requirements; and intended location.
- ▶ The company must have been registered or incorporated in Uganda and its articles of association and memoranda must reflect only free zone-related activities.
- ▶ A feasibility study must accompany the application form when submitted and provide the following:
  - Project description
  - Market survey
  - Funding proposals
  - Five-year financial projections
  - Environmental impact assessment
- ▶ After receipt of the completed application, the UFZA will notify the investor within 30 days of its decision to accept, reject or accept with modifications the proposed investment project.
- ▶ The new firm is then issued a letter of approval which will enable it to commence activities in an officially established free zone.
- ▶ The approval letter may include certain terms and conditions, such as:
  - Permitted activities
  - Permitted volume of sales to the Ugandan market
  - Date by which the firm must have commenced exports



- ▶ Free zone benefits for investors
- ▶ Businesses who operate in a free zone receive certain benefits including:
  - ▶ Exemption from payment of custom duties and VAT on imported raw materials, intermediates, capital equipment, spare parts and construction materials
  - ▶ Exemption from payment of stamp duty on documents relating to the business
  - ▶ Exemption from withholding taxes
  - ▶ One-stop-customs clearance within the free zone for both incoming and outgoing materials and goods
  - ▶ No customs clearance required at the port of entry or the port of departure because goods move under transit bond
  - ▶ Unrestricted access to foreign borrowing and capital
  - ▶ Exemption from certain licensing requirements including:
    - Licenses under the Trade Licensing Act
    - Export licenses
    - Investment license from the Uganda Investment Authority

- ▶ Extensive storage opportunities available within the free zone
- ▶ Increased security and safety of goods
- ▶ Top-of-the-line operating facilities within the free zone

## Final comments

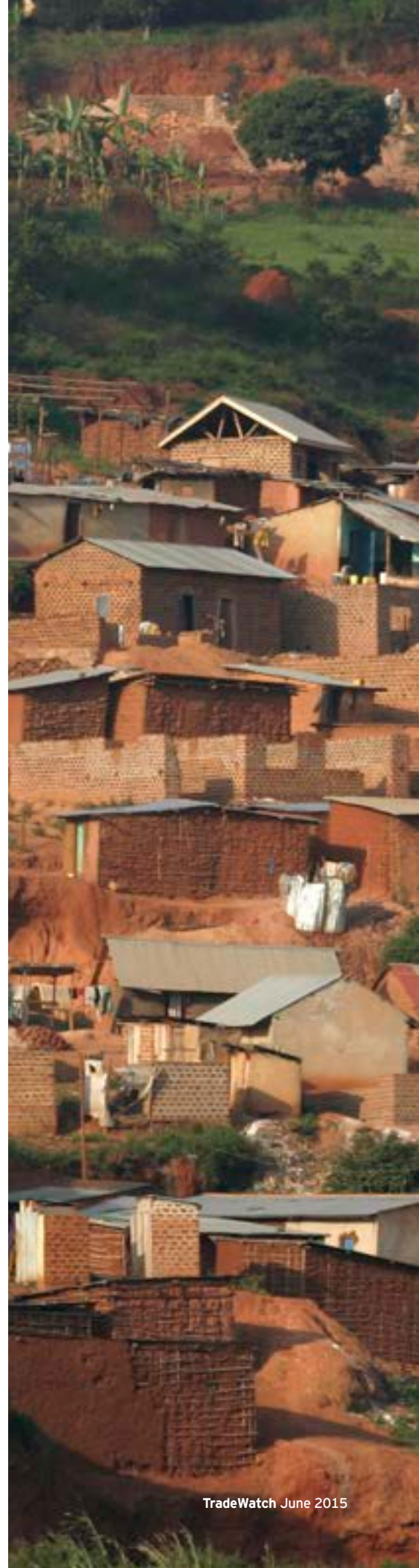
Uganda's free trade zone regime is an initiative that is expected to benefit both the Government and investors. Businesses are attracted to investment-friendly environments where they can increase profitability by producing larger quantities of goods at relatively lower costs than they would have done outside the free zone. Those businesses that can effectively make the most of the benefits provided by Uganda's free zone regime will secure a competitive advantage. In turn, the Government of Uganda will accomplish its goal of export-led industrialization of the country while creating new jobs, increasing manufacturing operations and stimulating significant economic growth.

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# Ukraine

## Ukraine reduces import duties and fees



Ukraine has reduced a number of duties and fees that will result in lower costs for importers. We highlight below some important recent changes.

### Safeguard duty on imported new cars

On 14 April 2015, Ukraine decreased for the second time the safeguard duty on imported new passenger cars with 1-1.5-liter petrol engines from 4.31% to 2.15%, and cars with 1.5-2.2-liter petrol engines from 8.63% to 4.32%.

Ukraine's Interagency Commission on International Trade introduced in 2013 safeguard measures in the form of a special ad valorem duty on imported new passenger cars as a result of an investigation initiated by the Zaporizhia Automobile Building Plant and Bogdan Corporation, Ukraine's two largest car manufacturers. Initially, the duty was 6.46% for new passenger cars with 1-1.5-liter petrol engines and 12.95% for 1.5-2.2-liter petrol engines.

Under the trade liberalization regime<sup>8</sup> introduced in 2014, the special duty is subject to an annual reduction of one-third. The third and final reduction will take place in March 2016.

### Tare and package utilization fee cancelled

Until recently, packaged goods imported into Ukraine were subject to a special tare and package utilization fee collected by the Ukrekoresursy State Agency<sup>9</sup> as part of the customs clearance of imported goods. Ukrekoresursy was a de facto waste management monopoly for almost 14-years.

On 18 March 2015, the Cabinet of Ministers of Ukraine issued a resolution<sup>10</sup>, in force as of 26 March 2015, that divested Ukrekoresursy of its monopoly status and repealed Ukrekoresursy's legal basis for requiring businesses to pay recycling fees. However, companies, including importers, must continue to comply with existing requirements to recycle packaging waste.

8 *Decision of the Interagency Commission on International Trade "On Liberalization of Safeguard Measures for Importation of Passenger Cars in Ukraine Irrespective of the Country of Origin and Exportation" No. СП-306/2014/4423-06, 12 February 2014.* (available in Ukrainian at: <http://www.ukurier.gov.ua/uk/articles/mizhvidomcha-komisiya-z-mizhnarodnoyi-torgivli-opr/>)

9 The Ukrekoresursy State Agency was created by Resolution of the Cabinet of Ministers of Ukraine No.915, 11 July 2007 as amended by Resolution of the Cabinet of Ministers of Ukraine No.508, 26 July 2001 to provide waste management in Ukraine.

10 *Resolution of the Cabinet of Ministers of Ukraine No. 128, 18 March 2015.* (available in Ukrainian at: <http://zakon4.rada.gov.ua/laws/show/128-2015-%D0%BF>)





## VAT rate for medicinal products imported for clinical trial studies

In April 2014, the Ukrainian Parliament<sup>11</sup> reduced the VAT rate from 20% to 7% applicable to medicinal products, including imported goods, intended for use in clinical trials. However, VAT at the reduced 7% rate has not been applied in practice. In particular, the customs authorities have claimed that a special permit for clinical trials is required in order to apply a 7% VAT rate upon customs clearance. Importers have not been allowed to use the expert conclusion issued by the State Ministry of Healthcare Expert Center that provides for the registration of clinical trial medicinal products and permits clinical trials to be conducted in Ukraine.

To solve the problem, the Ministry of Healthcare issued a clarification on 20 April 2015, which provides that unregistered medicinal products may be imported for clinical trial purposes only after the clinical trial has been approved by Resolution of the Ministry. For clinical studies registered prior to the clarification notice, the preferential VAT rate should apply based on the expert conclusion of the Ministry of Healthcare Expert Center.

Subsequently, the Ukrainian State Financial Service also issued instructions to the local tax and customs authorities directing them to accept the health care authorities' documents as sufficient basis for applying the 7% VAT rate.

The new approach of the State Financial Service, however, is still ambiguous and may be interpreted in different ways by local customs offices. It is advisable that importers seek appropriate advice to understand the complexities of clinical trial operations in Ukraine and to be able to take advantage of any import VAT reduction, to which they may be entitled.

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<sup>11</sup> "On Amendments to the Tax Code of Ukraine and some other legislative acts of Ukraine regarding the elimination of individual inconsistencies of the legislation," 2 Aug. 2014. (available in Ukrainian at <http://zakon1.rada.gov.ua/laws/show/1200-18>)

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ED None

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